Statement of

The Honorable Steve Bartlett

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The Financial Services Roundtable

Before the

House Financial Services Subcommittee on

Capital Markets, Insurance, and Government Sponsored Enterprises

U.S. House of Representatives

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Chairman Kanjorski, Ranking Member Garrett, and members of the Committee, I am Steve Bartlett, the President and CEO of the Financial Services Roundtable (Roundtable). The Roundtable is a national trade association composed of the nation's largest banking, securities and insurance firms. Our members provide a full range of financial products and services to consumers and businesses, accounting directly for $85.5 trillion in managed assets, $965 billion in revenue, and 2.3 million jobs.

I would like to begin my remarks by commending you and all the members of this Committee for your efforts to restore stability and liquidity to the markets. Equally important to restoring stability and liquidity is implementing policy reforms to prevent a recurrence of these events.

The financial crisis exposed critical gaps in financial regulation, as well as the absence of a method for comprehensive oversight of our financial system. Consider our current regulatory structure which was created in piecemeal fashion beginning in 1912 and through a series of incremental changes through 1999; these changes didn't build upon one another logically, but often added another regulatory structure or feature that would sometimes conflict with the existing structure. This system seemed to withstand time – but over the last two years, at the onset of the current crisis, the system got pulled down by the weight of hundreds of federal and state agencies that regulate the U.S. financial services industry today, often in an ad hoc way. To say the financial regulatory system is fragmented or uncoordinated would be an understatement.

Webster's Dictionary defines "systemic" as "of, relating to, or common to a system." I've been asked to provide the Roundtable's view of a systemic risk regulator, which the Roundtable refers to as a market stability regulator. In light of the regulatory gaps and "weight," it is important first to look at how that regulator fits into broader financial reform, because, by definition, to consider regulation that simply "bolts" a new regulator onto the existing chassis may not result in a reduction of risk that is "systemic" in nature.

My testimony is divided into three parts. First, I will outline how a market stability regulator should fit within our larger financial regulatory structure. Second, I will discuss the need for a market stability regulator to identify systemic risk. Third, I will propose a definition of a systemic risk and discuss the role and structure of a market stability regulator.

## I. Market Stability and Our Financial Regulatory Structure

The creation of a market stability regulator is just one piece of the bigger puzzle – the need for better, more effective financial regulation that can evolve with global financial markets. In recent testimony, Federal Reserve Chairman Ben Bernanke identifies the need for better regulation stating, "As we look at regulatory reform, we need to ask the question, are all sectors of the economy that need oversight – are they being watched by somebody and/or are there major gaps where there's no effective oversight where there needs to be? That's. . . a very basic aspect of the reform that Congress needs to address."[1] As such, the Roundtable recommends that Congress consider the market stability regulator's role within the broader need for sweeping reform of our regulatory architecture.

Like others in the financial services industry, the members of the Roundtable have been engaged in a dialogue over how to reform our current financial regulatory system. While our internal discussions continue, we have developed a set of proposals, including a "Financial Regulatory Architecture Proposal" that is intended to close the gaps in our existing system.

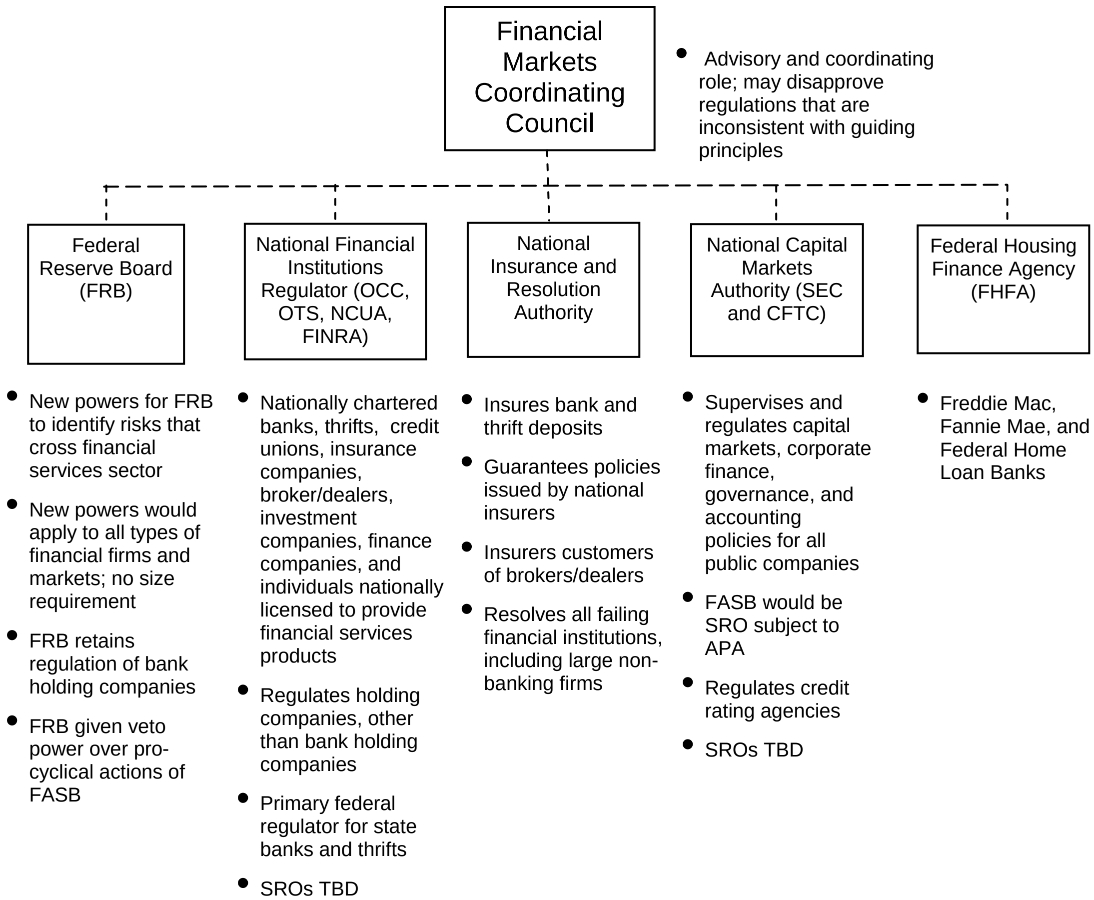
Specifically, the Roundtable's proposals for regulatory reform are:

- **New Architecture.** *Our financial regulatory system should be better aligned with modern market conditions and developing global standards.*

The key features of our proposed regulatory architecture are explained below, and are illustrated in the following chart.

[1] Testimony of Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System, before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, Feb. 24, 2009.

**FINANCIAL REGULATORY ARCHITECTURE PROPOSAL**




*Financial Markets Coordinating Council*

To enhance coordination and cooperation among the various financial regulatory agencies, we propose to expand membership of the President's Working Group on Financial Markets (PWG) and rename it the Financial Markets Coordinating Council (FMCC). We believe that this Council should be established by law, in contrast to the existing PWG, which has operated under a Presidential Executive Order since 1988, thereby permitting this Committee and the Congress to oversee the Council's activities on a regular and ongoing basis. We also believe that the

Council should include representatives from all major federal financial agencies, as well as individuals who can represent state banking, insurance, and securities regulation.

This Council should serve as a forum for national and state financial regulators to meet and discuss regulatory and supervisory policies, share information, and develop early warning detections. In other words, it should help to better coordinate policies within our fragmented regulatory system.

We do not believe that the Council should have independent regulatory or supervisory powers. However, it might be appropriate for the Council to have some ability to review the goals and objectives of the regulations and policies of federal and state financial agencies, and thereby ensure that they are consistent.

### *Federal Reserve Board*

As I will discuss below in more detail, to address systemic risk, the Federal Reserve should be authorized to act as a market stability regulator. As a market stability regulator, the Federal Reserve should be responsible for looking across the entire financial services sector to identify interconnections that could pose a risk to our financial system and to perform the functions that I describe below.

*National Financial Institutions Regulator*

To reduce regulatory gaps and arbitrage, we propose the consolidation of several existing federal agencies into a single, National Financial Institutions Regulator (NFIR). This new agency would be a consolidated prudential and consumer protection agency for three broad sectors of the financial services industry: banking, securities, and insurance.

More specifically, this new agency would charter, regulate, and supervise: (1) banks, thrifts, and credit unions, currently supervised by the Office of Thrift Supervision (OTS), the Office of the Comptroller of the Currency (OCC), and the National Credit Union Administration; (2) licensed broker/dealers, investment advisors, investment companies, futures commission merchants, commodity pool operators, and other similar intermediaries currently supervised by the Securities and Exchange Commission (SEC) or the Commodities Futures Trading Commission (CFTC); and (3) insurance companies and insurance producers that select a federal charter. The AIG case illustrates the need for the federal government to have the capacity to supervise insurance companies. A federal insurance regulator also is needed to work with the Federal Reserve in its capacity as a market stability regulator.

With the exception of holding companies for banks, the NFIR would be the regulator for all companies that control broker/dealers or nationally chartered insurance companies.

The NFIR would reduce regulatory gaps by establishing comparable prudential standards for all of these nationally chartered or licensed entities. For example, national banks, federal thrifts and federally licensed brokers/dealers that are engaged in comparable activities should be subject to comparable capital and liquidity standards. Similarly, all federally chartered insurers would be subject to the same prudential and market conduct standards.

In the area of mortgage origination, we believe that the NFIR's prudential and consumer protection standards should apply to both national and state lenders. Mortgage lenders, regardless of how they are organized, should be required to retain some of the risk for the loans they originate. Likewise, mortgage borrowers, regardless of where they live or who their lender is, should be protected by the same safety and soundness and consumer standards.

We believe that is it important for this agency to combine both safety and soundness (prudential) regulation and consumer protection regulation. Both functions can be informed, and enhanced, by the other. Prudential regulation can identify practices that could harm consumers, and can ensure that a firm can continue to provide products and services to consumers.

*National Capital Markets Agency*

To focus greater attention on the stability and integrity of financial markets, we propose the creation of a National Capital Markets Agency (NCMA) through the merger of the SEC and the CFTC, preserving the best features of each agency. The NCMA would regulate and supervise capital markets and exchanges. As noted above, the existing regulatory and supervisory authority of the SEC and CFTC over firms and individuals that serve as intermediaries between markets and customers, such as broker/dealers, investment companies, investment advisors, futures commission merchants, and other intermediaries would be transferred to the NFIR. The NCMA also should be responsible for establishing standards for accounting, corporate finance, and corporate governance for all public companies.

*National Insurance and Resolution Authority*

To protect depositors, policyholders, and investors, we propose the National Insurance and Resolution Authority (NIRA) to manage insurance mechanisms for depository institutions, federally chartered insurance companies, and federally licensed broker/dealers. These three insurance systems should be legally and functionally separated. Additionally, this agency should be authorized to act as the receiver for large non-bank financial services firms. The failure of Lehman Brothers illustrated the need for such a better system to address the failure of large non-banking firms.

*Federal Housing Finance Agency*

Finally, to supervise the Federal Home Loan Banks and to oversee the emergence and future restructuring of Fannie Mae and Freddie Mac from conservatorship we propose that the Federal Housing Finance Agency remain in place, pending a thorough review of the role and structure of the housing Government Sponsored Enterprises (GSEs) in our economy.

The Roundtable's other proposals on regulatory reform include:

- **Common Prudential and Consumer and Investor Protection Standards.** *Financial services firms engaged in offering comparable products and services should be subject to comparable prudential, consumer, and investor protection standards. In the event of multiple oversight authorities, uniform standards should apply nationwide.*

- **Balanced and Effective Regulation.** *Financial regulation should be focused on outcomes, not inputs, and should seek a balance between the stability and integrity of financial services firms and markets, consumer protection, innovation, and global competitiveness.*

- **International Cooperation and National Treatment.** *U.S. financial regulators should coordinate and harmonize regulatory and supervisory policies with international financial regulatory authorities, and should* *continue to treat financial services firms doing business in the United States as they treat U.S. financial services firms. The United States should continue to play a leadership role in the current G-20 process to develop new international norms for financial regulation across markets.*

- **Accounting Standards.** *U.S. financial regulators should adjust current accounting standards to account for the pro-cyclical effects of the use of fair value accounting in an illiquid market. Additionally, U.S. and International financial regulators should coordinate and harmonize regulatory policies to develop accounting standards that achieve the goals of transparency, understandability and comparability.*

## II. Why We Need a "Market Stability and Systemic Risk" Regulator

The on-going crisis in our nation's financial markets demonstrates the need for some federal agency or authority to act as a market stability regulator. This crisis is not the result of any single action, but the result of multiple, unconnected actions taken across industry sectors. Yet, throughout the run-up to this crisis, no single agency was monitoring the connections between different market participants across the nation's financial markets.

The creation of an agency that was charged with monitoring activities and practices across all markets may not have been able to prevent this crisis but may have been able to put the pieces together sooner and propose corrective actions before this crisis occurred, rather than after.

While it is often assumed that some combination of the U.S. Treasury Department (Treasury) and the Federal Reserve Board (Federal Reserve) are responsible for broad financial market stability, neither the Treasury nor the Federal Reserve has the explicit mandate and the full arsenal of regulatory powers to promote market stability and prevent systemic risk across different company charters and products.

Prior to 2008, the only authority the Secretary of the Treasury (Secretary) had to look at the financial markets as a whole was the authority delegated to the Secretary by the President (through an Executive Order) in 1988 to chair and convene the PWG. The PWG could only ask regulators to cooperate on key issues and issue occasional reports. In 1991, the Congress gave the Secretary a pivotal role in the implementation of the systemic risk exception to the Federal Deposit Insurance Corporation's (FDIC) least-cost resolution process. Under that process, the Secretary, in consultation with the President, must agree that paying uninsured depositors or creditors "would have serious adverse effects on economic conditions or financial stability" and as such, the FDIC would have the power to intervene in the market to address systemic risk.[2] Yet, the *FDIC Improvement Act* did not give the Secretary any additional responsibilities, either

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[2] 12 U.S.C. § 1823(c)(4)(G)(I)(i).

to determine what constitutes systemic risk, to more closely monitor systemically relevant institutions, or to make any detailed reports about its analysis when this exemption is invoked.

The Federal Reserve plays multiple roles in financial markets, yet does not have an explicit market stability mandate or clearly defined role to identify and prevent systemic risk to U.S. financial markets. As the nation's central bank, it has broad monetary policy tools to promote price stability and full employment in the U.S. economy. It oversees part of the U.S. payments system, but not all. It regulates and supervises state-member banks at the national level, but not national banks, which are regulated by the OCC or state nonmember banks, which are regulated by the FDIC. It regulates and supervises all bank and financial holding companies, but not thrift holding companies, which are regulated and supervised by the OTS, or investment bank holding companies, which are supervised by the SEC. It lends to financial institutions through normal discount window operations. Starting in 2008 during the current crisis, the Federal Reserve greatly expanded its emergency lending to financial institutions and others using its authority to lend in Section 13(3) during "unusual and exigent circumstances."[3] But even in these roles, the Federal Reserve's market stability activities are confined mainly confined to *reactive* actions and financing vehicles under its unique lending powers.

The missing link is a single federal authority with the mandate, responsibility, and expertise to oversee the nation's entire financial system, not just its individual parts, and to promote market

[3] 12 U.S.C. § 342.

stability while preventing systemic risk for firms that operate in this global marketplace. This would resolve the regulatory redundancy that currently creates the gaps in oversight.

## III. "Systemic Risk" and the Role and Structure of a Market Stability Regulator

Systemic risk could be related to the size of an institution, counterparty risks, accounting treatment of investment vehicles or the diversity of customer relationships. We do not believe that this risk should be associated with any single factor, especially the size of an institution. In our view, systemic risk is a significant, industry-wide threat or vulnerability based on market interconnections and regulatory gaps across the financial services industry as a whole (including products, markets, and firms), which, if left unaddressed, could have material and adverse effects on either our financial markets or the U.S. economy.

In other words, systemic risk is not an isolated risk posed by a single institution or a solitary practice. It is a risk that crosses market segments as well as whole markets, domestic and globally, in addition to firms.

Several respected authorities have suggested that systemic risk regulation should be focused on the nation's largest financial services firms. We do not support this approach. While large firms can create large risks, systemic risks can arise from the collective actions of many firms, both small and large. Moreover, the classification of large firms as "systemic" not only would create a competitive imbalance between those and other firms, but it also would give rise to a "moral hazard" as systemic firms were perceived as "too big to fail."

In hindsight, we now can identify some of the practices and activities from the current crisis that, collectively, created a "systemic risk" to the economy. These include underwriting standards based on short-term adjustable rates, not rates over the term of a loan; securitizations based only upon a credit rating, with little due diligence by investors; and pro-cyclical capital standards that promoted the development of off-balance sheet vehicles. Individually these actions did not give rise to systemic risk, but collectively they did.

One of the challenges in identifying systemic risk is not to discourage innovation. Indeed, innovation is important to economic growth and development. Therefore, in the design of a market stability regulator, Congress should explicitly instruct the regulation to balance market stability with innovation.

Within the Roundtable's proposed architecture, which I described above, we believe the Federal Reserve should be authorized to act as a market stability regulator.

As the market stability regulator, the Federal Reserve should have the ability to monitor broad market trends to discover potential vulnerabilities and significant risks to the financial system and our economy at the earliest possible stage. It should have the authority to collect information on all types of financial services firms, including depository institutions, broker/dealers, insurance companies, hedge funds, private equity firms, industrial loan companies, credit unions, and any other financial services firms that facilitate financial flows (e.g., transactions, savings, investments, credit, and financial protection) in our economy.

Like the National Weather Service, a market stability regulator should be able to monitor and study the financial "weather," analyze and report on developing conditions and trends, and issue public alerts as necessary when there is hurricane forming or a winter storm heading our way. In other words, the market stability regulator should have the authority to establish an activities-based surveillance system to detect early crisis warning signs and vulnerabilities, develop scenario planning, conduct contingency planning with other financial regulators across all financial markets, and, in exceptional cases, examine individual financial services firms in conjunction with the prudential regulator for a firm.

This next point is critical: the market stability regulator must be in a position to work <u>with</u> other regulators to enforce the proper corrective action to identify, prevent and address systemic risks, regardless of whether that action is taken against a set of institutions that are deemed to be systemically relevant or against a particular activity that spans a range of institutions with different types of charters or business licenses. In other words, the market stability regulator should not be a "super regulator." This ensures a solid working relationship between the market stability regulator and prudential regulators and ensures that individual prudential regulators are sensitive to larger systemic risks. Today we spend more than $5 billion for the direct cost of financial supervision, not counting the cost of compliance, and not a single agency adequately saw the crisis coming or took any precautionary actions until it was too late. We can no longer afford a financial regulatory system in which individual regulators remain in a "silo." It also warrants a system in which no company will be subject to two regulators with conflicting regulations.

This brings me to a related issue. As the market stability regulator interacts with prudential regulators, there is an evident need to create a national insurance regulator for the insurance industry. Insurance is a national and global business and yet, it lacks a national insurance prudential regulator. In response to a direct question posed at last week's full committee hearing, Federal Reserve Chairman Bernanke further emphasized this point when he said that he thought "it would be a useful idea to create a federal option for insurance companies," particularly "systemically important ones."[4] Effective systemic risk regulation should include a strong national insurance regulator with the authority to charter companies and to establish uniform national standards for market conduct and consumer protection activities. Only through coordination with a national insurance regulator, will a market stability regulator have the ability to both detect, and to act upon, risky market activity and business practices in a timely, uniform, and comprehensive fashion. Asking the market stability regulator to coordinate actions by

[4] Testimony of Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System, before the Committee on Financial Services, U.S. House of Representatives, Feb. 25, 2009.

multiple state insurance regulators is not an option that will effectively address systemic risk due to the different state and territorial insurance regulators, with varying legal and budget authority, and varying levels of expertise.

A national insurance regulator should have the authority to charter insurance companies, establish and enforce uniform national standards for all factors material to the solvency of nationally chartered insurance companies and the protection of consumers, and represent the U.S. internationally on behalf of federally chartered institutions. The national insurance regulator's authority should be an independent bureau within a federal agency headed by a Presidential appointee.

Some may say that creating a national insurance regulator creates regulatory redundancy. The Roundtable does not believe this is accurate. Just as the state/federal banking system works well for the industry and the economy – so too can a similar insurance system. It would provide companies the ability to decide which system works best to serve their customers, a state or a national system. Regardless, there should be common principles in the national and state insurance systems. We commend Congresswoman Melissa Bean and Congressman Ed Royce for their tireless work on this specific issue, and we look forward to working with this Subcommittee toward the creation of the national insurance regulator to enhance stability in our national insurance markets and reduce systemic risk in the future.

The only time we would recommend that the market stability regulator intervene and effectively preempt the primary regulator would be in a significant, systemic market emergency, when it needs to react swiftly to market developments that pose an <u>immediate and equally significant risk to our economy</u>. After such immediate risk, the market stability regulator will return to a normal course of action and work in conjunction with the primary prudential regulator, as I previously described. In any event, the Roundtable would still recommend that emergency actions should be approved by a super-majority of the Federal Reserve and agreed to by the Secretary of the Treasury, following consultation with the President. Such emergency actions should be reported immediately to the public.

Some have suggested that granting the Federal Reserve the authority to act as a market stability regulator would create conflicts due to the Federal Reserve's current mandates. However, we believe it's just the opposite. In layman's terms, the Federal Reserve's charter gives it the authority to protect the economy. While looking at "systemic risk" as the market stability regulator – the risk posed to the industry as a whole and the economy – the Federal Reserve will be doing just that – protecting the economy.

## <u>**Conclusion**</u>

Mr. Chairman, I again commend this Committee for discussing an important issue that must be addressed – the need for a market stability regulator is a necessary first step in broader reform of our financial regulatory architecture. We must be able to explain with confidence how our financial markets will be strengthened and what a new regulator would do differently to prevent this kind of turmoil in the future. The crisis, while devastating, does afford us the opportunity to build a state-of-the-art regulatory apparatus, and that apparatus should be carefully considered.

While looking at the role of a market stability regulator, you should not lose sight of the forest through the trees — and examine the role of this regulator in the larger regulatory reform that is required. Broader regulatory reform is important not only to ensure that financial institutions continue to meet the needs of all consumers, but also to restart economic growth and much needed job creation. We need a financial system that provides market stability and integrity, yet encourages innovation and competition to serve consumers and meet the needs of a vibrant and growing economy, a modern financial regulatory system unrivaled anywhere in the world.

As President Lincoln said in his first inaugural address, “The dogmas of the quiet past are inadequate to the stormy present. The occasion is piled high with difficulty, and we must rise -- with the occasion. As our case is new, so we must think anew, and act anew.” The Roundtable is poised and ready to work with you – to think anew and act anew - on these initiatives, starting with the creation of a market stability regulator and regulatory restructuring of our financial industry.

# FINANCIAL REGULATORY ARCHITECTURE PROPOSAL

## Financial Markets Coordinating Council

- Advisory and coordinating role; may disapprove regulations that are inconsistent with guiding principles

## Federal Reserve Board (FRB)

- New powers for FRB to identify risks that cross financial services sector
- New powers would apply to all types of financial firms and markets; no size requirement
- FRB retains regulation of bank holding companies
- FRB given veto power over pro-cyclical actions of FASB

## National Financial Institutions Regulator (OCC, OTS, NCUA, FINRA)

- Nationally chartered banks, thrifts, credit unions, insurance companies, broker/dealers, investment companies, finance companies, and individuals nationally licensed to provide financial services products
- Regulates holding companies, other than bank holding companies
- Primary federal regulator for state banks and thrifts
- SROs TBD

## National Insurance and Resolution Authority

- Insures bank and thrift deposits
- Guarantees policies issued by national insurers
- Insurers customers of brokers/dealers
- Resolves all failing financial institutions including large non-banking firms

## National Capital Markets Authority (SEC and CFTC)

- Supervises and regulates capital markets, corporate finance, governance, and accounting policies for all public companies
- FASB would be SRO subject to APA
- Regulates credit rating agencies
- SROs TBD

## Federal Housing Finance Agency (FHFA)

- Freddie Mac, Fannie Mae, and Federal Home Loan Banks

# THE FINANCIAL SERVICES ROUNDTABLE

# PROPOSAL FOR FINANCIAL REGULATORY REFORM

In anticipation of the most sweeping financial regulatory reforms since the Great Depression, the Financial Services Roundtable's Executive Advisory Council on Regulatory Restructuring has developed six proposals for financial regulatory reform. The first proposal addresses the need for a modern financial regulatory architecture, and the remaining proposals address new regulatory standards to guide the behavior of all financial services firms and regulators.

## Six Proposals for Financial Regulatory Reform

**1. New Architecture.** *Our financial regulatory system should be better aligned with modern market conditions and developing global standards.*

**2. Consumer and Investor Protection Standards.** *Financial services firms engaged in offering comparable products and services should be subject to comparable prudential, consumer, and investor protection standards. In the event of multiple oversight authorities, uniform standards should apply nationwide.*

**3. Balanced and Effective Regulation.** *Financial regulation should be focused on outcomes, not inputs, and should seek a balance between the stability and integrity of financial services firms and markets, consumer protection, innovation, and global competitiveness.*

**4. International Cooperation and National Treatment.** *U.S. financial regulators should coordinate and harmonize regulatory and supervisory policies with international financial regulatory authorities, and should continue to treat financial services firms doing business in the United States as they treat U.S. financial services firms. The United States should continue to play a leadership role in the current G-20 process to develop new international norms for financial regulation across markets.*

**5. Failure Resolution.** *Financial regulation should provide for the orderly resolution of failing financial services firms to minimize systemic risk.*

**6. Accounting Standards.** *U.S. financial regulators should adjust current accounting standards to account for the pro-cyclical effects of the use of fair value accounting in an illiquid market. Additionally, U.S. and International financial regulators should coordinate and harmonize regulatory policies to develop accounting standards that achieve the goals of transparency, understandability and comparability.*

THE FINANCIAL SERVICES ROUNDTABLE

PROPOSAL FOR FINANCIAL REGULATORY REFORM

**Discussion of Proposals**

The on-going crisis in world financial markets has revealed both market failures and fundamental weaknesses in the U.S. financial regulatory system. Our fragmented financial regulatory system has resulted in gaps in regulation, which allowed imprudent lending and investment practices by both regulated and unregulated financial firms. Our diverse national and state financial regulatory agencies do not share a common vision and approach to supervision. There is no coordinating body where all regulators can meet to identify problems, exchange information, and devise solutions. Our rules-based system of regulation makes it difficult for regulators and firms to adjust policies and practices in response to rapidly changing market developments.

The Roundtable's six proposals are intended to guide the reform of the financial regulatory system. The Proposals would not only enable regulators to focus on desired policy outcomes and material risks to markets, but also reduce the potential for consumers to fall through gaps between the national and state legal and regulatory systems.

**Proposal 1. New Architecture** — *Our financial regulatory system should be better aligned with modern market conditions and developing global standards.*

Proposal 1 calls for the existing financial regulatory system to be better aligned with modern market conditions. The "Draft Financial Regulatory Architecture" that is described below is one possible approach to meeting this proposal. The "Draft Financial Regulatory Architecture" is designed to: preserve state financial regulation; provide for greater coordination among all financial regulators; provide for national regulation for insurance companies and insurance producers; reduce regulatory overlap; promote uniform regulation and supervision; limit systemic risk; and create a failure resolution mechanism for non-banking financial firms.

*Financial Markets Coordinating Council*

To enhance coordination and cooperation among the many and various financial regulatory agencies, we propose to expand membership of the President's Working Group on Financial Markets (PWG) and rename it as the Financial Markets Coordinating Council (FMCC). This Council should be established by law, in contrast to the existing PWG which has operated under a Presidential Order. This would permit Congress to oversee its Council's activities. The Council should include representatives from all major federal financial agencies, as well as individuals who can represent state banking, insurance and securities regulation. The Council should serve as a forum for national and state financial regulators to meet and discuss regulatory and supervisory policies, share information, and develop early warning detections.

The Council should not have independent regulatory or supervisory powers. However, it might be appropriate for the Council to have some ability to review the goals and objectives of the regulations and policies of federal and state financial agencies, and thereby ensure that they are consistent.

*Federal Reserve Board*

To address systemic risk, the Federal Reserve Board (Board) should be authorized to act as a market stability regulator. As a market stability regulator, the Board should be responsible for looking across the entire financial services sector to identify interconnections that could pose a risk to the financial system. To perform this function, the Board should be empowered to collect information on financial markets and financial services firms, to participate in joint examinations with other regulators, and to recommend actions to other regulators that address practices that pose a significant risk to the stability and integrity of the U.S. financial services system. The Board's authority to collect information should apply not only to depository institutions, but also to all types of financial services firms. This authority should not be based upon the size of an institution. It is possible that a number of smaller institutions could be engaged in activities that collectively pose a systemic risk. As the market stability regulator, the Board must work in coordination with the primary regulators of the financial services firms.

*National Financial Institutions Regulator*

To reduce gaps in regulation, we propose the consolidation of several existing federal agencies into a single, National Financial Institutions Regulator (NFIR). This new agency would be a consolidated prudential and consumer protection agency for banking, securities and insurance. The NFIR would reduce regulatory gaps by establishing comparable prudential standards for all of these of nationally chartered or licensed entities. For example, national banks, federal thrifts and federally licensed brokers/dealers that are engaged in comparable activities should be subject to comparable capital and liquidity standards. Similarly, all federally chartered insurers would be subject to the same prudential and market conduct standards. Each industry would be legally and functionally separated within the NFIR.

In the area of mortgage origination, the NFIR's prudential and consumer protection standards should apply to both national and state lenders. Mortgage lenders, regardless of how they are organized, should be required to retain some of the risk for the loans they originate. Likewise, mortgage borrowers, regardless of where they live or who their lender is, should be protected by the same safety and soundness and consumer standards.

*National Capital Markets Agency*

To focus greater attention on the stability and integrity of financial markets, we propose the creation of a National Capital Markets Agency through the merger of the Securities and Exchange Commission (SEC) and the Commodities Futures Trading Commission (CFTC), preserving the best features of each agency. The NCMA would regulate and supervise capital markets and exchanges. As noted above, the existing regulatory and supervisory authority of the SEC and CFTC over firms and individuals that serve as intermediaries between markets and customers, such as broker/dealers, investment companies, investment advisors, and futures commission merchants, and other intermediaries would be transferred to the NFIR. The NCMA also should be responsible for establishing standards for accounting, corporate finance, and corporate governance for all public companies.

*National Insurance Resolution Authority*

To protect depositors, policyholders, and investors, we propose the creation of the National Insurance and Resolution Authority (NIRA) to act as the insurer of bank deposits, the guarantor of retail insurance policies written by nationally chartered insurance companies, and a financial backstop for investors who have claims against broker/dealers. These three insurance systems would be legally and functionally separated. Additionally, this agency should be authorized to act as the receiver for large non-bank financial services firms. The failure of Lehman Brothers illustrated the need for such a better system to address the failure of large non-banking firms.

*Federal Housing Finance Agency*

To supervise the Federal Home Loan Banks and to oversee the emergence and future restructuring of Fannie Mae and Freddie Mac from conservatorship we propose that the Federal Housing Finance Agency remain in place, pending a thorough review of the role and structure of the housing GSEs in our economy.

**Proposal 2. Common Prudential and Consumer and Investor Protection Standards.** *Financial services firms engaged in offering comparable products and services should be subject to comparable prudential, consumer, and investor protection standards. In the event of multiple oversight authorities, uniform standards should apply nationwide.*

This proposal calls for comparable prudential standards (e.g., capital requirements and financial reporting) for financial services firms engaged in comparable activities. Such standards would reduce the potential for regulatory arbitrage and the potential for gaps in regulation. The proposal also calls for comparable consumer and investor protection standards for specific financial products and services. For example, residential mortgage loans should be subject to the same consumer protection standards regardless of what type of entity offers the loan. This would ensure that consumers are protected, regardless of where they live.

**Proposal 3. Balanced and Effective Regulation** — *Financial regulation should be focused on outcomes, not inputs, and should seek a balance between the stability and integrity of financial services firms and markets, consumer protection, innovation, and global competitiveness.*

Balanced, effective regulation requires: (i) greater reliance on principles-based regulations that are responsive to changes in market conditions and are focused on desired regulatory results; (ii) greater reliance on a system of prudential supervision that is based upon an on-going exchange of information between regulated firms and regulators that seeks to solve common problems before they pose a risk to consumers or the financial system; and (iii) a reduction in the pro-cyclical effects of accounting and capital requirements.

**Proposal 4. International Cooperation and National Treatment** — *U.S. financial regulators should coordinate and harmonize regulatory and supervisory policies with international financial regulatory authorities, and should continue to treat financial services firms doing business in the United States as they treat U.S. financial services firms. The United States should continue to play a leadership role in the current G-20 process to develop new international norms for financial regulation across markets.*

This proposal calls for the coordination of international financial regulations and the continuation of the national treatment for foreign firms doing business in the United States. The on-going financial crisis indicates that global financial markets require coordination and cooperation among financial regulatory authorities. Also, the benefits of national treatment for foreign firms operating in the U.S. are proven. National treatment promotes open, fair competition not only in the U.S., but abroad.

**Proposal 5. Failure Resolution** — *Financial regulation should provide for the orderly resolution of failing financial services firms to minimize systemic risk.*

This proposal calls for the establishment of orderly resolution procedures to apply to large non-banking firms. The failure of Lehman Brothers illustrated the limitations of existing receivership procedures. As discussed above, it is envisioned that the National Insurance Resolution Agency would perform this function.

**Proposal 6. Accounting Standards** — *U.S. financial regulators should adjust current accounting standards to account for the pro-cyclical effects of the use of fair value accounting in an illiquid market. Additionally, U.S. and International financial regulators should coordinate and harmonize regulatory policies to develop accounting standards that achieve the goals of transparency, understandability and comparability.*

This proposal calls for a review of the use of current accounting standards, such as fair value accounting and impairment accounting, when there is an illiquid market. Accounting requirements to write-down securities to observable prices encourages some companies to sell sooner than they otherwise would, further depressing prices in an illiquid market. Problematic pro-cyclical effects have created further problems in the areas of purchase accounting, accounting for annual pension expenses, mergers/acquisitions, adjustment of loan loss reserves, and auction rate securities. This proposal also recommends that the U.S. work with International Regulators to develop and harmonize accounting standards around the globe, providing both U.S. and foreign companies the opportunity to remain competitive in a global marketplace.