TESTIMONY

OF THE HONORABLE STEVE BARTLETT

PRESIDENT AND CHIEF EXECUTIVE OFFICER

OF

THE FINANCIAL SERVICES ROUNDTABLE

ON

BANKING INDUSTRY PERSPECTIVES ON THE

OBAMA ADMINISTRATION'S FINANCIAL REGULATORY REFORM PROPOSALS

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

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Executive Summary

- The Financial Services Roundtable ("Roundtable") supports bold, comprehensive financial regulatory reform to strengthen the ability of our financial markets to serve consumers and support the economy.
- The Obama Administration's New Foundation is a thoughtful starting point for discussion; we agree with many aspects and believe there are ways to improve upon other parts of it in the legislative process.
- Any reform legislation should include clear objectives and guiding principles for our financial markets and their direct linkage to serving consumers and supporting the economy.
- Specifically, the Roundtable:
    - *Consumer protection* – supports strong and improved consumer protection and comprehensive, uniform national standards for consumer protection to be achieved through enhanced and explicit regulation for the prudential regulators; we strongly oppose the creation of a new agency to achieve better outcomes for consumers
    - *Financial literacy* – supports increased efforts to promote greater financial literacy in a nationwide educational program
    - *Executive compensation* – supports linking executive compensation to long-term performance by adhering to Roundtable supporting principles
    - *OTC derivatives* - supports a regulatory framework for standardized and customized over-the-counter ("OTC") derivatives that maintains these products' usefulness and protects consumers
    - *Systemic risk* – supports the designation of the Federal Reserve as a market stability oversight authority, but opposes drawing a "bright line" around systemically important financial institutions and defining them publicly as Tier 1 FHCs and making the Federal Reserve an "uber-regulator"
    - *National resolution authority* – supports the creation of a new regime for the orderly resolution of failing nonbank financial institutions that may pose systemic risk but recommends such authority be designated to the prudential regulator and that current funding systems for each sector be preserved
    - *Insurance* – supports the creation of the Office of National Insurance within Treasury, but also supports H.R. 1880 to create a national insurance charter with its own national insurance supervisor
    - *National Bank Supervisor* – supports the creation of the NBS but also include federal oversight of state member and non-member banks
    - *Financial Services Coordinating Council* – supports the legislative creation of a new Council with some additional amendments
    - *Accounting* – supports improving accounting for financial institutions and international harmonization of accounting standards, while specifically requiring the FASB to become subject to the Administrative Procedures Act ("APA") under the Securities and Exchange Commission ("SEC")
    - *Retirement security* - supports a comprehensive set of policies to improve American retirement readiness, including the Roundtable's own proposals to enhance retirement security
    - *Payments* - supports regulatory improvements that ensure the integrity, security and availability of these payments systems but opposes any action that inhibits the ability of the private sector to sponsor and operate various payments systems
    - *Housing* - supports simplified, uniform, coordinated mortgage disclosures for consumers; supports the Administration's proposal to assign appropriate levels of risk retention by mortgage originators on loans, provided regulators retain sufficient discretion in establishing risk retention; and supports the prohibition of yield spread premiums for mortgage loans.
    - *Global harmonization* - supports the U.S. playing a more visible leadership role in the new G20 forum and Financial Stability Board while ensuring that these new structures develop new international standards that are enforced consistently, recognize the benefits of globally competitive markets, and do not put U.S. financial firms at a competitive disadvantage.
    - *Credit Rating Agencies* – supports the maintaining the independence of the credit rating process, enhancing transparency within this process, and addressing conflicts of interest through enhanced supervision by the SEC

Chairman Frank, Ranking Member Baucus, and Members of the Committee, my name is Steve Bartlett, and I am President and CEO of the Financial Services Roundtable (the "Roundtable"). I appreciate the opportunity to testify on our perspective of the Obama Administration's Financial Regulatory Reform Proposals and most importantly, on the need for comprehensive financial regulatory reform.

The Roundtable is a national trade association composed of the nation's largest diversified banking, securities, and insurance companies. Our members provide the full range of financial products and services to every kind of consumer and business. Roundtable member companies provide fuel for America's economic engine, accounting directly for $85.5 trillion in managed assets, $965 billion in revenue, and 2.3 million jobs.

I. The Roundtable Supports Bold and Comprehensive Regulatory Reform

The Roundtable supports bold and comprehensive regulatory reform that will strengthen the ability of our financial system to serve the needs of consumers and ensure the stability and integrity of our financial system. Although there is specific legislation that has been introduced on the Consumer Financial Protection Agency (which I will address in a minute), it is important to emphasize that this is just one important component of regulatory reform that should move forward as part of the comprehensive regulatory reform package and not in lieu of such reform.

We need to be mindful of lessons learned from the financial crisis. Yet, we also need to be forward-looking and rebuild our financial regulation system to ensure that U.S. financial markets and firms remain competitive and innovative. Financial services firms must be well positioned to meet the needs of their customers, support sustained economic recovery and steady growth, and provide a robust foundation to create jobs.

Today, I will provide the Roundtable's views on the Administration's comprehensive financial regulatory reform proposals, as set forth in the recently released paper entitled "Financial Regulatory Reform: A New Foundation." There are many features of the proposal that we favor. There are also some features that we do not support as proposed, and we would hope to work with this Committee to modify those features. Throughout this discussion, I will highlight aspects of the Roundtable's proposed financial regulatory architecture that are consistent with the Administration's proposal and at times, bolder than the Administration's proposal[1] and outline three basic reforms that we believe should be part of any financial regulatory reform package. These reforms are (1) the enactment of common principles to guide all financial regulators; (2) the enactment of a coordinating council for financial regulators; and (3) the enactment of incentives for financial regulators to employ a prudential approach to supervision.

II. The Administration's New Foundation for Financial Regulation

The Administration has proposed a thoughtful plan for financial regulatory reform. There are many elements of the plan that the Roundtable supports. There are also parts that we respectfully disagree with, and should be modified. Let me turn now to the Roundtable's position on various elements of the Administration's plan or on the subsequent legislation. For each element, I will provide our analysis and, where appropriate, offer specific recommendations.

A. Consumer Financial Protection Agency

Consumer protection should be significantly strengthened. It is fundamental to our financial system. The status quo – with its regulatory gaps and lack of uniform, national standards to ensure equal protection under U.S. law – is unacceptable. Consumers must have confidence in the firms they deal

[1] Starting in early 2008, the Roundtable developed our own proposed "Financial Regulatory Architecture" to address the flaws in our current system and meet the needs of consumers and our globally linked economy in the 21st century. This architecture can be found on our website at: www.fsround.org.

with, and the financial firms must treat consumers fairly. Therefore, we endorse the spirit of the Chairman’s legislation, HR 3126, the Consumer Financial Protection Agency Act of 2009, to ensure sound protections and better disclosures for consumers. However, **we strongly oppose the creation of a separate, free-standing Consumer Financial Protection Agency, but we support elevating the importance of consumer protection within prudential regulators and requiring them to promulgate rules to greatly strengthen consumer protections while considering the implications for safety and soundness.**

The Roundtable is not advocating for the status quo. Rather, we recommend that stronger, more explicit consumer protections be provided to regulators to close the regulatory gaps and provide for uniform national standards. **We are concerned that, in its current form, the legislation will have some negative consequences for consumers, for sound financial institutions, and for our financial system.**

1. *Consumer Protection and Safety and Soundness Should Not Be Separated*

We are most concerned about the separation of consumer protection and safety and soundness regulation. Consumer protection and safety and soundness regulation go hand in hand. Standards that ensure that only qualified borrowers obtain a loan help ensure that a lender gets repaid and remains solvent to serve other consumers in the future. Likewise, consumer protection is at the core of safety and soundness regulation. Consumers are protected when they deal with a firm that is in a stable strong position to provide competitive products and services. Sound mortgage underwriting standards, for example, protect both the interests of consumers and the solvency of lenders. These functions should not be separated.

We recognize that many members of this Committee and many consumer groups believe that consumers have not been adequately protected under the current system. Clearly, consumers have been harmed by the recent financial crisis. However, the harm was primarily due to gaps and lapses in regulation, including a lack of regulation of certain types of mortgage originators; inappropriate underwriting standards for mortgage lenders; insufficient capital standards; and insufficient liquidity requirements.

One of the key flaws revealed in this current crisis was there were no uniform standards of consumer protection and there was inadequate supervision over certain players in the financial markets. Many of the firms and individuals involved in the origination of mortgage were not subject to supervision or regulation by any prudential regulator. No single regulator was held accountable for identifying and recommending corrective actions across the activity known as mortgage lending to consumers. Many mortgage bankers and brokers were organized under state law, and operated outside of the regulated banking industry. Their incentives were linked to volume, not the quality of the product or the best interests of consumers. They had no contractual or fiduciary obligations to brokers who referred loans to them. Likewise, many brokers were not subject to any licensing qualifications and had no continuing obligations to individual borrowers. Most were not supervised in a prudential manner like depository institutions engaged in the same business line.

The solution to these problems is to close the gaps and to put consumer protection on par with safety and soundness regulations, not to add another layer of regulation to our already fragmented system of financial regulation. In fact, improved regulation of mortgage brokers and stronger underwriting standards for all mortgage lenders has already begun through regulation and legislation, much of it initiated by this Committee. This experience also demonstrates the nexus between consumer protection and safety and soundness regulation. We believe Congress must go further and mandate that prudential regulators treat consumer protection as a fundamental obligation equal to their responsibility to ensure safety and soundness.

The legislation itself illustrates the difficulty in separating consumer protection and safety and soundness. It provides for each of the federal banking agencies to transfer consumer financial protection functions to the new agency. Such functions are defined to mean "research, rulemaking, issuance of orders or guidance, supervision, examination, and enforcement activities, powers, and duties relating to the provision of consumer financial products or services."[2] This appears to apply to underwriting standards, loan limits, and even anti-money laundering requirements. Clearly, such requirements should protect both consumers and safety and soundness

2. All Consumers Deserve to Be Treated the Same

One of the central goals of HR 3126 is the establishment of more consistent regulation of similar products and services. In its report on financial regulatory reform, the Administration notes that this new agency would "reduce gaps in federal supervision and enforcement; improve coordination with the states; set higher standards for financial intermediaries; and promote *consistent* regulation of similar products."[3] Yet, as drafted, the Consumer Financial Protection Agency Act of 2009 would frustrate the goal of consistent consumer protection standards.

In a section of the legislation that is entitled, "Preservation of State Law," every state is permitted to enact its own set of consumer protection regulations that would be in addition to the regulations developed by the new agency. In other words, a financial services company would have to comply with different state rules, and compliance with the national regulations will not be sufficient. This is like saying that different truck safety features can be mandated by each state, and the trucking company must change its equipment at state borders to travel across state lines. Such a system would not be good for American commerce, and the imposition of different state requirements on identical or similar financial products would likewise have a negative impact on consumers.

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[2] Section 161 of HR 3126.
[3] "Financial Regulatory Reform: A New Foundation, (http://www.financialstability.gov/docs/regs/FinalReport_web.pdf), page 55 (emphasis added).

It also is important to note that in writing consumer protection regulations, the states would not be subject to the same principles as the new agency. The legislation directs the new agency to take a balanced approach in its regulatory efforts: weigh the potential benefits and costs to consumers and providers, consider the potential reduction of consumer access to financial products and services, and consult with the prudential regulators to assess the consistency of a proposed regulation with the safety and soundness of financial services providers, market impacts, and systemic risks.[4] The creation of a stand-alone Agency that merely "consults with" prudential regulators does not create a system of consistent standards.

The states are not required to consider any of these factors. They would be free to take actions that are not balanced. So long as a state action is not in conflict with the regulations of the new agency the action will apply, even if it may have a detrimental impact on safety and soundness, systemic risk, or the efficient functioning of our financial markets in a globally linked economy.

The provision preserving state law in the legislation is patterned after provisions in several existing federal consumer protection laws, such as the Real Estate Settlement Procedures Act, the Fair Debt Collection Practices Act, the Equal Credit Opportunity Act, and the privacy provisions in the Gramm-Leach-Bliley Act. However, the authority for state action in these laws is relatively narrow. In this case, the proposal would authorize the states to regulate all aspects of a consumer financial transaction.

Under the proposed legislation, a state could adopt rules prohibiting "unfair, deceptive, or abusive" acts or practices in connection with any transaction with a consumer for a financial product or service. States could impose different disclosure requirements and communication standards between financial services firms and consumers, as well as new fiduciary duties, including the duty of fair dealing. Such requirements may result in actually confusing consumers to the extent they are

[4] Section 122(b)(2) of HR 3126.

overwhelmed with new information, using non-standard terminology. The costs of complying with all of these rules, multiplied by the number of states adopting different requirements, will eventually be passed on to consumers and to the economy. Additionally, the creation of new fiduciary or suitability requirements, over and above the standards adopted by the new agency, will expose financial services companies to litigation costs and risks that will also be passed on to consumers. Further, to the extent that the states supplement the new agency's requirements to provide a standard or "plain vanilla" product, financial services firms will be required to offer several of these "plain vanilla" options, negating the concept that consumers would have one product to use as a base when considering alternatives. In sum, the authority for states to adopt "stronger" standards in all of these areas could result in a multiplicity of different standards that frustrate the goal of consistent consumer protection.

Multiple and different state consumer protection standards also would impact product opportunities for consumers. Today, many financial products and services are national in scope. However, if states exercise the authority granted in this proposal, financial services firms will be required to develop different products for consumers in different states. For example, an adjustable rate mortgage permissible in one state may not be deemed acceptable in another state. Likewise, a credit card that meets the standards set by the new agency may not be offered in a state that imposes different standards. This will create inconveniences for consumers, especially as they move from state to state, and adds to regulatory costs that may not be beneficial to consumers.

Administration officials and some consumer advocates suggested that if the new agency sets high minimum consumer protection standards, the states may not feel compelled to adopt different standards. Nonetheless, the Administration argues that the authority of the states to set different standards is necessary to ensure optimal protection for consumers. The Roundtable disagrees; creating such a system would only encourage even less coordination amongst the regulators. Rather, we believe consumer protection rules that are clear and applied equally regardless of where a consumer resides should be the rule.

3. The Dual Banking System Should Be Preserved

The current legislation also would significantly alter the regulation of national banks and federal thrifts. It would do so by permitting individual states to regulate the lending, deposit-taking and other basic banking activities of national banks and federal thrifts. While this proposal is intended to benefit consumers, it will have just the opposite effect.

Currently, national banks and federal thrifts must comply with a variety of state laws, including state contract, criminal, debt collection, real property, tax, tort and zoning laws. However, under a long-standing policy, national banks and federal thrifts have not been required to comply with state laws that impact their lending, deposit-taking, and other authorized activities. This legal structure is the foundation of the dual banking system. It has permitted the development of two parallel systems of banking in the United States: a system of national banks that may engage in banking activities under a single set of rules on a national basis, and a separate system of state banks, which operate under state law. This structure has been in place since 1863. The political and intellectual force behind the system was President Lincoln, who saw a need for a system of national banks to finance the development of the nation. Congress subsequently extended this same legal structure to federal thrifts and to federally chartered credit unions.

The proposed Consumer Financial Protection Agency Act of 2009 would alter this legal structure by expanding the category of state laws that apply to national banks and federal thrifts to include "state consumer protection laws." The Act defines such state laws broadly to include any state law that "accords rights to or protects the rights of its citizens in *financial transactions* concerning the negotiation, sale, solicitation, disclosure, terms and conditions, advice and remedies…" (emphasis added).[5] The Act does not define "financial transactions", but presumably this term would include the deposit-taking, lending, and other basic banking activities of national banks and federal thrifts.

While intended to benefit consumers, this legislation will actually limit product opportunities for consumers and increase the cost of banking products and services for consumers. For example, national banks and federal thrifts will no longer be able to design and offer the same mortgage or credit card products to all consumers, regardless of where the consumers may live. Separate products will need to be designed to conform to standards set by individual states. This will increase the cost of products, and create confusion for consumers especially when they move from one state to another.

4. The U.S. is Unique

Some may argue that we should create a separate consumer protection agency because other G20 countries – Canada or Australia, for example – have them. While that is true, we should not forget the differences between the U.S. and those countries. Canada and Australia only have two basic financial regulators – prudential and consumer - not the hundreds that we have across financial services at both the national and state levels, so these really are not fair comparisons or good examples. We must remember that one of the lessons we have learned from the financial crisis is that we have numerous regulatory gaps among too many regulators. There is a strong consensus that we need fewer regulators and regulatory consolidation, not an expansion of regulators, more diffuse authority, and more open questions about which regulator is ultimately accountable for the kind of regulatory outcomes we all desire – treating consumers fairly.

5. The Better Answer is Uniform, National Consumer Protection Standards

A better approach to protecting consumers, and one more in line with the Administration's stated goal of consistent regulation, would be to establish federal standards that apply to all consumers,

[5] See sections 143 and 146 of the Act.

regardless of where they live or what type of institution provides the particular financial product or service. If these standards are sufficiently robust, there is no need to reserve any additional power to the states and impose the costs and confusion on consumers that will result from multiple, and different consumer protection standards.

Rather than create a new agency and bifurcate consumer protection from safety and soundness regulation, we recommend that the Congress enact strong, national consumer protection standards for all consumers. This would ensure that all Americans are accorded the same consumer protections regardless of where they live or what institution provides the product or service.

6. Financial Literacy

Financial literacy is a key component of consumer protection. Therefore, we also support the need to strengthen financial education for consumers. We do not, however, believe that the creation of a separate consumer protection agency is the solution.

The financial preparedness of our nation is essential to not only consumers' well-being but of vital importance to our economic future. Consumers make better decisions if they are better informed and, in essence, the whole economy benefits. Roundtable member companies offer financial literacy opportunities to consumers in a variety of ways, including online curriculums, workshops and seminars, and free-of-charge tips and advice booklets.

The Roundtable recommends the creation of a specific K-12 and post-secondary level financial literacy curriculum for the nation's school system so all children learn to manage their financial affairs as they grow up and become responsible adults.

B. Compensation

The topic of compensation in the context of promoting better corporate governance has been the subject of much public scrutiny and debate. This is not just a U.S. debate; the Group of Twenty (G20) has addressed this issue as well. Consequently, any actions we take must be consistent internationally, otherwise we risk unintended competitive effects as talent and skills seek the best opportunities either outside U.S. financial markets or outside the United State entirely.

Should the Committee include compensation in the larger Regulatory Restructuring package, we believe the Committee should focus on the following Roundtable principles: 1) the Board of Directors should oversee the executive compensation system's design and practices; 2) the Board of Directors or Board Committee should consult with the firm's risk management personnel and/or outside experts regarding the risk components of the firm's executive compensation programs; 3) executive incentive compensation should be based on performance and aligned with shareholder interests and long-term, sustainable, firm-wide success; 4) executive compensation mix and payout schedules should be sensitive to the time horizon of risks; and 5) termination of benefits provided to executives, including severance, should be consistent with good corporate governance. We would be happy to work with you and your staff to provide more details on these principles.

C. OTC Derivatives

The use of over-the-counter ("OTC") derivatives has been a central part of the debate about the causes of the crisis. Issues ranging from transparency to risk management of the broader securitization process to the necessary capital cushions are rightly being debated. Restoration of the securitization process, albeit at a different level than the recent past and under new supervisory norms, is essential to

U.S. economic growth in the future. Properly regulated and supervised derivatives markets need to play an integral part of our nation's return to economic growth.

The Roundtable supports a regulatory framework for standardized and customized OTC derivatives that maintains these products' usefulness and protects consumers. OTC derivatives are a key tool for American corporations to manage their risks and finances. It is important to strike an appropriate balance between effective oversight of OTC derivatives trading and their risk-managing benefits. The Roundtable supports a strong regulatory framework for OTC derivatives that promotes the stability and transparency of the financial markets and meets the other goals laid out by the Administration, including the prevention of market manipulation and fraud, and ensuring that derivatives are not marketed inappropriately.

The Roundtable recommends that standardized derivatives are cleared through a regulated clearinghouse to provide more transparency and to reduce systemic risk within the industry. However, clearing sophisticated, customized derivatives should not be required because they allow flexibility for institutions to meet their customers' needs. Additionally, we support recordkeeping and reporting requirements of end-of day pricing of these instruments to a central reporting entity for dealers of OTC derivatives, regardless of whether or not the derivatives are standardized or customized.

D. Systemic Risk Regulator and Tier 1 FHCs

The creation of a systemic risk authority is an essential part of regulatory reform legislation. Today, no single agency has the specific mandate, the necessary surveillance purview, or the accountability to detect and mitigate the risks of financial stress and future financial crises. Realistically, we cannot expect any single agency to prevent each and every financial panic or crisis;

like it or not, financial bubbles are part of a competitive market economy. Yet, we can do a better job of anticipating trouble spots, issuing the necessary public warnings about brewing hot spots, and then taking prompt corrective action when needed in a timely manner.

We express our strong support for the designation of the Federal Reserve Board ("the Board") as a systemic risk oversight authority that can collect data on the financial services industry and identify potential systemic risks. The Roundtable actually recommended the Federal Reserve Board in this role in our own proposed architecture. We must emphasize, however, that the Board should not be an additional super-regulator. Rather, it should work with the prudential regulator in non-emergencies to address potential systemic risks. Moreover, the Board also should not publicly identify systemically significant institutions ("Tier 1 FHCs"), as proposed by the Administration; it should focus its priorities and focus on activities and practices across the entire financial system, not individual institutions. In retrospect, the activities of relatively small, state-licensed mortgage brokers created significant systemic risk, but they would not fall into the Administration's Tier 1 FHC category. Institutions designated as Tier 1 FHCs could be viewed as "too-big-to-fail." This designation also could have the unintended consequence of encouraging such institutions to take excessive risk (i.e., create even more of a moral hazard) and/or create a competitive imbalance in the market as customers choose to do business with "too-big-to-fail" institutions.

Further, requiring each Tier 1 FHC to comply with the nonfinancial activity restrictions of the Bank Holding Company Act does not address a cause of the current credit crisis or threat to the safety and soundness of the financial system. Commercial ownership of financial services has been a source of strength and capital to the nation's economy, and restricting it would reduce the total amount of credit available to consumers and businesses. Forcing unnecessary divestitures, when there are no safety and soundness issues, does not make any sense and can impede our much needed economic recovery and dampen economic growth in the future.

Since the Roundtable submitted a statement for the record on this topic just last week to the Domestic Monetary Policy and Technology Subcommittee, I will not repeat the need for a new market stability oversight authority and better regulatory coordination here. I have attached our as an appendix to my testimony (See Attachment A).

E. National Resolution Authority

The recent financial crisis demonstrated the urgent need for an explicit and definitive resolution regime for nonbank financial institutions, especially those that had the potential to increase or exacerbate systemic risk. As such, **the Roundtable supports and has advocated for the establishment of a resolution regime for insolvent nonbank financial institutions that pose a systemic risk to U.S. financial markets and the economy during financial emergencies.** From our perspective, such a regime should achieve several clear objectives: (1) respect the rule of law and contracts; (2) be objective and fact-based; (3) be transparent; (4) impose resolution costs on the segment of the industry most affected by a resolution; and (5) never impose an obligation on the FDIC to act as a receiver or conservator for nonbank financial institutions or jeopardize the integrity of the federal deposit insurance fund.

While we support the general concept of an orderly failure resolution regime for systemically significant nonbank financial institutions during financial emergencies, we have significant reservations with the Administration's draft proposal and will reserve final judgment until we see the final legislation that is introduced and considered by Congress. The Administration's legislative draft, for example, relies too heavily upon the FDIC to act as a receiver or conservator for such institutions, and thereby runs the risk of jeopardizing the integrity of the deposit insurance fund. **We would recommend that the Treasury Department have the authority to appoint the appropriate prudential regulator for an institution upon a determination that such authority is necessary. We also oppose funding such an authority with assessments of all systemically significant institutions. Furthermore, the FDIC's Deposit Insurance Fund, the Securities Investor Protection Corporation, and the state insurance guarantee funds should be retained and protected for their original intended uses. Additionally, in normal times, the Roundtable supports the use of current bankruptcy proceedings to resolve these failing firms.**

We are currently discussing bankruptcy reforms with our members as an additional tool to resolve troubled firms. We would be happy to provide our solutions for such reforms with you and your staff at a later date.

F. Insurance

The Roundtable strongly supports the adoption of a federal insurance charter for national insurers, reinsurers, and producers under the supervision of a national regulator. It is essential that this piece be included in the larger regulatory reform legislation. In our financial architecture, the Roundtable recommends that such authority be housed in a single prudential regulator, which I will discuss in a minute.

Insurance is a national and international business, and we need to recognize it as such, at least for those insurance companies that choose to serve their customers' needs with a nationwide or global strategy. We are the only member country of the G20 that does not have a national insurance regulator, and we have been singled out as running counter to international best practices in numerous official reports (e.g., the most recent Group of Thirty Report) for our deficiencies and inconsistencies at the international level. We need to modernize our statutes and provide the ability for companies to serve their customers under a national charter, with uniform national principles and rules, and under the supervision of a single, accountable national supervisor.

In addition to a new national insurance charter and regulator, the Roundtable also supports the establishment of an Office of National Insurance ("ONI"), as outlined in the Administration's proposal, and the proposal's six principles for insurance regulation: (1) effective systemic risk regulation; (2) strong capital standards; (3) meaningful and consistent consumer protection; (4) comprehensive and consolidated regulation of insurance companies and affiliates; (5) international coordination; and (6) increased national uniformity.

However, history has proven that these principles can only be accomplished by giving the ONI the authority to charter and exclusively regulate national insurers and reinsurers. The Administration proposal recognizes that "our current insurance regulatory system remains highly fragmented, inconsistent, and inefficient" and "has led to a lack of uniformity and reduced competition across state and international boundaries, resulting in inefficiency, reduced product innovation, and higher costs to consumers."[6] Strong, uniform federal regulation and supervision of insurance companies, producers, and holding companies would reduce risks to consumers and the economy. Consequently, **we strongly support enactment of H.R. 1880, the National Insurance Consumer Protection Act, sponsored by Congresswoman Melissa Bean and Congressman Ed Royce and urge that the Committee consider this bill as part of the comprehensive regulatory restructuring legislation.**

<u>G. National Bank Supervisor</u>

Correcting clear regulatory failures and closing equally clear regulatory gaps is one of the most urgent priorities for Congress and the Administration to address. We need comprehensive reform, a

[6] Financial Regulatory Reform: A New Foundation, page 40.

simple, more rational regulatory architecture, and fewer regulatory agencies that have overlapping missions. Rationalizing our financial regulatory architecture will also help to increase regulatory accountability and more uniform treatment of financial activities, practices, and products as we move away from having different supervisors for different legal entities.

The Roundtable supports the merger of the Office of the Comptroller of the Currency and the Office of Thrift Supervision to create the new National Bank Supervisor ("NBS"). Creating a single bank supervisor will enhance the prudential regulation between such a supervisor and the entities under its authority. To further enhance prudential supervision, the Roundtable also recommends that the state bank regulation and supervision responsibilities of the Federal Reserve and the FDIC move into the NBS.

The Roundtable's proposed financial architecture goes a bit further than the Administration's proposal and proposes 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.

Regardless of how many agencies are consolidated into this single regulator, the Roundtable does not view the various financial charters that exist today as a "gap" in regulation. Institutions have been free to choose the charter that best serves their competitive strategy to serve their customers and are fully regulated at the state and national level. The choice of a national or state bank charter will still be possible even if the Administration's plan is adopted as proposed. Therefore, **the Roundtable supports grandfathering existing charters (such as ILCs and thrift charters).** Placing even greater restrictions on affiliations between commercial and financial firms would force unnecessary separations of finance companies from their parent institutions, often a source of strength for the finance company, and in some cases, would cause their outright divestiture. ILCs and nonbank finance companies have been a vital source of affordable credit for consumers and small businesses at a time when many other sources of credit have all but dried up. **The Roundtable supports increased regulatory oversight of the financial affiliates of commercial companies to assure that such finance companies continue to provide this much needed credit in a safe and sound manner, but cautions against proposals that eliminate or severely restrict the activities of such institutions.**

H. Financial Services Oversight Council

As part of the Roundtable's 2007 *Blueprint for U.S. Financial Competitiveness,* we fully endorsed better regulatory coordination and cooperation as an imperative for any financial reform. At that time, we recommended formally expanding and enhancing the authority of the President's Working Group on Financial Markets ("PWG") and enacting it into statute instead of just relying on an Executive Order that only covered some of the financial regulators but not all of them. We also thought it should have a more forward-looking agenda, not one exclusively focused on the last financial crisis. Therefore, **the Roundtable supports the creation of a new Financial Services Oversight Council ("Council") described in the Administration's proposal, but with additional suggestions.**

1. Additional Seats on the Council

Consistent with our views on the need for a national insurance regulator and a national charter, the national insurance regulator should also have a seat on the new Coordinating Council.

2. Develop a set of Guiding Principles

As part of a more forward-looking mandate, t**he Council should monitor the adherence to basic principles that Congress legislates to guide future financial regulation and preferred regulatory outcomes for regulators and regulated firms.** Today, our federal financial regulators have different and sometimes conflicting missions. The enactment of a set of principles to guide all financial regulators and financial firms would help to ensure a more uniform and consistent approach to financial regulation. The enactment of a set of principles also would help to eliminate any existing confusion over regulatory missions, including the relationship between safety and soundness and consumer protection.

The Roundtable has its own set of six "Guiding Principles." We recognize that these may not be the only or the best principles. However, we believe that a common set of principles to guide financial regulators and financial firms would promote more consistent and better regulation. We urge this Committee to include this concept in its package of financial regulatory reforms.

Our proposed Guiding Principles are intended to ensure that the regulation of financial services and markets is more balanced, consistent, and predictable for consumers and firms. They would guide the supervisory and regulatory policies and practices of all financial regulators, as well as the policies and practices of financial services firms. They are not intended as a complete substitute for rules, but should guide both the development of new rules and the review of existing rules.

Our six Guiding Principles are as follows:

1. Fair treatment for consumers (customers, investors, and issuers). Consumers should be treated fairly and, at a minimum, should have access to competitive pricing; fair, full, and easily understood disclosure of key terms and conditions; privacy; secure and efficient delivery of products and services; timely resolution of disputes; and appropriate guidance.
2. Competitive and innovative financial markets. Financial regulation should promote open, competitive, and innovative financial markets domestically and internationally. Financial regulation also must support the integrity, stability, and security of financial markets.

3. Proportionate, risk-based regulation. The costs and burdens of financial regulation, which ultimately are borne by consumers, should be proportionate to the benefits to consumers. Financial regulation also should be risk-based, aimed primarily at the material risks for firms and consumers.
4. Prudential supervision and enforcement. Prudential guidance, examination, supervision, and enforcement should be based upon a constructive and cooperative dialogue between regulators and the management of financial services firms that promotes the establishment of best practices that benefit all consumers.
5. Options for serving consumers. Providers of financial services should have a wide choice of charters and organizational options for serving consumers, including the option to select a single national charter and a single national regulator. Uniform national standards should apply to each charter.
6. Management responsibilities. Management should have policies and effective practices in place to enable a financial services firm to operate successfully and maintain the trust of consumers. These responsibilities include adequate financial resources, skilled personnel, ethical conduct, effective risk management, adequate infrastructure, complete and cooperative supervisory compliance as well as respect for basic tenets of safety, soundness, and financial stability, and appropriate conflict of interest management**.**

3. Require Comprehensive Regulatory Action Plans from each Regulatory Agency

The Roundtable proposes that each regulatory agency at the table should develop comprehensive regulatory action plans to review the costs and benefits of each regulation under an agency's purview on a continuous basis. These action plans would be regularly presented and reviewed by the Council to ensure regulations are effective and efficient in serving their intended purpose while adapting to changes in consumer needs and competitive market conditions.

The proposed Regulatory Action Plans are intended to ensure that each financial regulator adheres to the principles enacted by Congress. Each financial regulator would be required to develop its own Regulatory Action Plan to implement the principles. We propose that all financial regulatory agencies at the table design a multi-year plan to review of all regulations that affect the ability of financial services firms to serve consumers' financial needs and compete in the marketplace. Our goal is that this review process will lead to regulations that are consistent with the principles, agency policy objectives, and desired regulatory outcomes.

The Council would serve as the U.S. Government's review panel to monitor and measure the progress of each agency in implementing these principles. It would rely upon a system of public reporting and transparency to ensure the implementation of the principles. The Council would be required to submit the results of its evaluation of the Regulatory Action Plans in its annual or interim reports to the Congress and the President. Those evaluations could be performed by Treasury Department personnel in cooperation with relevant agency personnel. The reports would identify regulations deemed to be inconsistent with the principles and recommend actions that should be taken to bring regulations into compliance with the principles by the regulators and Congress.

It is not our desire to have the Council intrude on the statutory mission of individual regulators or become an impediment to other needed regulatory reforms. To the contrary, because we do not have one single financial regulator, we expect the Council to provide greater focus, accountability, and transparency to regulatory issues across the financial services industry that affect broader national policy concerns.

4. Prudential Supervision

The Roundtable also recommends the adoption of a "prudential" approach to supervision by all financial regulators. Prudential supervision is a form of supervision in which regulators and regulated entities maintain a constructive engagement to ensure an effective level of compliance with applicable laws and regulations. Prudential supervision relies upon regular and open communications between firms and regulators to discuss and address issues of mutual concern as soon as possible. Prudential supervision encourages regulated entities to bring matters of concern to the attention of regulators early and voluntarily. Prudential supervision promotes and acknowledges self-identification and self-correction of control weaknesses, thereby reinforcing continued focus and attention on sound internal controls. We recommend that financial reform include incentives for financial regulators to adhere to a prudential approach to supervision.

At the end of my statement, I have included a draft bill to implement a set of common principles, expand and empower the Council, and encourage all regulators to adhere to prudential supervision (Appendix B). I urge you to incorporate these three concepts into the larger, financial reform legislation you are developing. We believe these three basic reforms should be part of any financial regulatory reform package.

I. Accounting Standards

The Roundtable has been a consistent advocate of improving the quality of financial reporting information. **We support accounting standards that provide transparent information, but not ones that drive economic activity.** While we believe that Congress should not legislate accounting standards, **we propose that Congress subject the Financial Accounting Standards Board ("FASB") to the Administrative Procedures Act ("APA") by placing FASB under the jurisdiction of the Securities and Exchange Commission ("SEC"). Let me be clear --- making FASB subject to the APA should in no way allow Congress to legislate accounting standards; rather, it will provide a new and fair standard of due process for public comment to current FASB accounting standard setting procedures. The Roundtable supports efforts to review current accounting standards to improve and streamline financial reporting, with an emphasis on accelerating convergence and harmonization internationally. The Roundtable supports modifications of procyclical accounting standards, including loan loss reserves, fair value accounting, and purchase accounting.**

J. Retirement Security

The Administration appropriately included essential items on retirement security in their proposal – enacting voluntary automatic IRAs administered by the private sector and strengthening the Saver's credit to give low-income households greater incentives to save. **The Roundtable strongly supports these proposals.** The time is now that retirement security needs to be address. This economic crisis has significantly affected the retirement security of all Americans.

The Roundtable believes that the list of reforms to address retirement security can also be expanded to include**: 1) creating incentives for lifetime income options in defined contribution ("DC") plans; 2) developing clear and meaningful disclosure for plan participants and plan sponsors; 3) creating mechanisms to reduce leakage from DC and defined benefits ("DB") systems by increasing the cash-out distribution balance for auto rollovers to IRAs to $10,000; 4) temporarily doubling the cap on annual dollar deferral contributions to retirement accounts for the next five years to allow for the recent market downturn; and 5) eliminating the current 10% auto escalation cap and providing employers the option to apply an initial default rate between 3% and 6%, with a maximum escalation to 15%.**

K. Payment Systems

Payment systems are an integral part of our nation's financial system. They are the conduit for funds to flow between and among domestic and international businesses, consumers and government agencies.

The Roundtable supports regulatory improvements that ensure the integrity, security and availability of these payments systems. The Roundtable believes that the Congress and regulators should not inhibit the ability of the private sector to sponsor and operate various payments systems. The

Roundtable encourages the U.S. financial regulatory agencies to engage other federal agencies with oversight of telecommunications providers and consumer protection responsibilities to address safety and soundness and consumer protection concerns with emerging mobile financial services products.

L. Housing

The Roundtable supports simplified, uniform, coordinated mortgage disclosures for consumers. A single prudential regulator could be given authority and direction to ensure development of uniform and understandable disclosures for mortgages for consumers under RESPA and TILA. This is best done by providing enhanced authority to an existing prudential regulator rather than by creating a new separate agency. We are supportive of the Administration's proposal to assign appropriate levels of risk retention by mortgage originators on loans, provided regulators retain sufficient discretion in establishing risk retention. **The Roundtable supports the prohibition of yield spread premiums for mortgage loans and for providing simpler, more understandable disclosures for mortgage products. However, mandating the offering of some type of "plain vanilla" mortgage product would have the impact of reducing consumer choice and increasing costs for consumers. A better approach would be to continue to improve and clarify the current effort to ensure strong underwriting by ensuring the ability to repay a loan by prospective consumers. Strengthening underwriting is a more effective approach than attempting to proscribe specific products for consumers.**

M. Global Harmonization

The recent G20 Leaders Summit stressed the need for new and harmonized international regulatory standards and supervisory procedures. The G20 leaders also reaffirmed their support for open and competitive global markets that are well regulated and supervised as a precondition for sustained, stable economic growth. They also endorsed better coordination and cooperation at the international level, and opposed regulatory fragmentation among individual countries. Significant differences in regulatory regimes can undermine the safety and soundness of the financial system and produce competitive disparities across countries that will impede international trade, finance, and investment.

From the Roundtable's perspective, it is essential that the Administration play a more visible leadership role in the G20 and the new Financial Stability Board ("FSB"). Specifically, the U.S. Government needs to ensure that the proper structures and frameworks are implemented to achieve internationally consistent standards as well as the consistent enforcement of those standards. Moreover, the Treasury Department needs to ensure that U.S. firms are not disadvantaged when competing globally under any new international regulatory structures or standards. New international regulatory standards for supervision, capital, liquidity, and risk management should not only be balanced, effective, and risk-based, but also recognize the benefits of globally competitive financial markets. Any change in U.S. financial laws and regulations must be consistent with these evolving new international norms, and regulatory fragmentation among nations should be opposed as a matter of U.S. Government policy.

N. Credit Rating Agencies

Credit ratings are an integral part of the financial system. As such, ratings should be independent, reliable, clear, and unbiased. The credit ratings process should be made more transparent so investors can make a more informed analysis of the relevance of specific ratings. Toward that end, **the SEC should publish, on a regular basis, audits of credit rating agencies that include the following**

information: (i) an analysis of the credit rating agency's compliance with its own internal policies and procedures; (ii) a comparison of the agency's ratings for individual securities with the actual experience of the rated securities, and (iii) the time periods used by the agency in estimating probability of default. Credit rating agencies should address conflicts of interest within their published processes and policies that include the separation of the fee discussion from the ratings process. The SEC should continue to permit the issuer-paid model with adequate disclosure and firewalls. Moreover, the SEC should examine how to manage inherit conflicts of interest in general and then issue a report to Congress in 6 months on its findings and recommendations.

O. Merger of the SEC and CFTC

One issue that was not included within the Administration's proposal was the merger of the SEC and the Commodities Futures Trading Commission ("CFTC"). **To focus greater attention on the stability and integrity of financial markets, the Roundtable proposes in its financial architecture 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. The NCMA also should be responsible for establishing standards for accounting, corporate finance, and corporate governance for all public companies.

The Administration prefers to maintain two separate agencies to oversee our capital markets, making the U.S. the odd man out with all other developed countries, which have a single securities regulator with the exception of Canada, which regulates securities at the provincial level.

P. 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. This was another issue that was not discussed in the Administration's proposal but we expect that this will be a priority issue for the industry and policymakers in 2010.

IV. Conclusion

The Roundtable favors comprehensive reform now, but recommends a number of practical and important improvements to the Administration's initial proposal and Chairman Frank's legislation on consumer protection to achieve a common objective: a strong and resilient financial system that not only complements full economic recovery in the short-run, but also sustained and stable economic growth in the future. Broader regulatory reform – starting from some clearly articulated common objectives and guiding principles - is important not only to ensure that financial institutions continue to meet the needs of all consumers but to restart economic growth and much needed job creation.

The Roundtable believes that the reforms to our financial regulatory system we have proposed and highlighted above would substantially improve the protection of consumers by reducing existing gaps in regulation, enhancing coordination and cooperation among regulators, ensuring greater regulatory accountability for commonly desired regulatory outcomes, and identifying systemic risks.

Financial reform and ending the recession soon are inextricably linked – we need both. 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. We need better, more effective regulation and a modern financial regulatory system that is unrivaled anywhere in the world. We deserve no less. The Roundtable stands ready to work closely with the Congress and the Administration to achieve our common goals to help all consumers of financial services and provide a stronger financial market foundation for our economy.

APPENDIX A

STATEMENT OF
THE FINANCIAL SERVICES ROUNDTABLE
On
REGULATORY RESTRUCTURING: BALANCING THE INDEPENDENCE OF THE FEDERAL RESERVE IN MONETARY POLICY WITH SYSTEMIC RISK REGULATION
Before the
SUBCOMMITTEE ON DOMESTIC MONETARY POLICY AND TECHNOLOGY
FINANCIAL SERVICES COMMITTEE
UNITED STATES HOUSE OF REPRESENTATIVES
JULY 9, 2009

Chairman Watt, Ranking Member Paul, and Members of the Subcommittee on Domestic Monetary Policy and Technology, the Financial Services Roundtable appreciates this opportunity to submit this statement for the record. The Roundtable is a national trade association composed of the nation's largest diversified banking, securities, and insurance companies. Our members provide the full range of financial products and services to every kind of consumer and business.

The Roundtable supports the urgent need for bold and comprehensive regulatory reform of financial services. We need to be mindful of lessons learned from the worst financial crisis in our lifetime, but we also need to be forward-looking and rebuild our financial regulation and regulatory architecture to ensure in the longer term that U.S. financial markets and firms are the most competitive and innovative in the world consistent with high standards for risk management and good governance. Financial services firms must be well positioned to meet the needs of their customers, support sustained economic recovery and growth, and provide a foundation to create new jobs. Any reforms enacted by Congress and signed by the President must be mindful of this simple economic imperative.

The Obama Administration has put forward a thoughtful proposal for regulatory reform, its New Foundation. The Treasury Department's white paper released on June 17, 2007, is a positive contribution to the current public policy debate. Specifically, we support the creation of a new Financial Services Coordinating Council (Council) and designating the Federal Reserve as what we prefer to call a market stability oversight authority (authority); in both cases, we recommend several changes to strengthen the Administration's proposal.

The Roundtable has testified numerous times in 2008 and 2009 on both the market and regulatory failures exposed by the financial crisis; this statement, therefore, will dispense with reciting that testimony again today. Instead, this statement will focus on three points that are directly relevant to your inquiry: 1) the Roundtable's detailed position on the need for better oversight and surveillance of systemic risk by the U.S. Government as one important part of regulatory reform; 2) the need for clear objectives and principles for our financial system to support our economy as a starting point for regulatory reform; and 3) the need for a new regulatory architecture for our financial system that fully supports stable economic growth and serves consumers. Since we only have analyzed the Treasury's white paper, we reserve the right to provide additional testimony when the detailed draft legislation on systemic risk is sent to Congress.

1. THE NEED TO LIMIT AND MITIGATE SYSTEMIC RISK

As a practical matter, we believe that "systemic risk" should be defined as an activity or practice that crosses financial markets or financial services firms, and which, if left unaddressed, would have a significant, material adverse effect on financial services firms, financial markets, or the U.S. economy. Risk is inherent in all competitive financial markets – banking, insurance, and securities. It is part of the intermediation process between providers and users of all financial services. It needs to be managed first at the institution level as well as at the systemic level to the extent possible, recognizing that no Government will be able to fully protect open and competitive markets from all financial stress and even occasional panic in the future.

After a brief review of why the Roundtable believes a market stability oversight authority is necessary, we analyze two important parts of the Administration's New Foundation: the creation of a permanent Financial Services Coordinating Council and the designation of the Federal Reserve as the market stability oversight authority.

Why do we need a systemic risk regulator?

The activities and practices of U.S. financial markets are interconnected, nationally and internationally. Banks, broker-dealers, insurance companies, finance companies, hedge funds, and other regulated and unregulated financial services firms are continuously and mutually engaged in a variety of lending, investment, trading, and other financial transactions. Yet, under our existing financial regulatory structure, no single agency has the authority to look across all sectors of the financial services industry and all markets to evaluate risks posed by these interconnections.

While often it is 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 supervisory authorities to promote market stability and prevent systemic risk across different company charters and products. Different regulators are responsible for the different silos they oversee; no single agency looks at the entire financial system serving consumers and our economy.

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 President's Working Group on Financial Markets (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 FDIC's 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. Yet, the FDIC Improvement Act did not give the Secretary any additional responsibilities, either 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, but also 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 supervised 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 lending in Section 13(3) during "unusual and exigent circumstances." But even in these roles, the Federal Reserve's market stability activities are confined mainly 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 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.

Why the Federal Reserve as a market stability oversight authority?

From the Roundtable's perspective, the U.S. financial system does not need another layer of regulation and a new bureaucracy on top of the current structure. What we do need, however, is better surveillance of interconnected activities and practices among all providers of financial services across the financial system, not another super-regulator of individual institutions. As such, we support and prefer the nuanced designation of a new Market Stability Oversight Authority that is the Federal Reserve, without making the Federal Reserve a super-regulator and without drawing a "bright line" around a set of providers publically designated as "systemically important". This nuance is explained in greater detail below.

Designating the Federal Reserve is a natural complement to the Board's existing role as the nation's central bank and lender of last resort. However, we recognize that this new role would require the Board to expand its staff to include experts in all types of financial activities, practices, and markets. Also, if the Board is given this new authority, it would need to establish a clear and transparent governance structure internally to minimize any potential conflicts with its existing responsibilities. Rigorous Congressional oversight of this new role will be critical.

Furthermore, we would recommend that the Board establish an Advisory Council on Market Stability to review activities and practices that may pose a systemic risk, balanced against the need for continuing market innovation and competitiveness. The Advisory Council should include representatives of domestic and international financial services firms doing business in the United States as well as representatives of consumers of financial services.

What is the role of a market stability oversight authority?

The purpose of a market stability oversight authority should be to promote the long-term stability and integrity of the nation's financial markets and financial services firms by identifying and addressing significant risks to the financial system as a whole.

This new authority should be authorized to oversee all types of all financial markets and all financial services firms, whether regulated or unregulated. However, a market stability authority should **not** focus on financial services firms based upon size. The designation of "systemically significant financial services firms" would have unintended competitive consequences and increase moral hazard as these firms would be deemed too big to fail.

The authority should **not** be just another layer of regulation added to the existing system; it should **not** be a "super-regulator". Absent an immediate, systemic threat, it should be required to work with and through other financial regulators, including a national insurance regulator. Also, a national insurance regulator is needed to give the federal government a better understanding and role in the supervision of this key part of our nation's financial services sector.

Congress, by statute, should require this new authority to balance the identification of activities or practices that pose a systemic risk against the need for continuing market innovation and competitiveness. This new responsibility should <u>not</u> stifle innovation, or preclude isolated failures. Failures in a market-based economic system are a fact of life and should be resolved in an orderly manner across all financial services. Innovation is a key to economic growth and new job creation.

Congress also should direct this new authority to focus attention on factors that present the greatest potential for systemic risk, such as excessive concentrations of assets or liabilities, rapid growth in assets or liabilities, high leverage, a mismatch between long-term assets and short-term liabilities, currency mismatch, and regulatory gaps. This authority should **not** focus attention on products or practices that pose little or no systemic risk.

How would this new authority function?

The authority should identify, prevent, and mitigate systemic risk by –

- Collecting and analyzing data from other financial regulators and individual financial services firms to understand potential or existing systemic risks in the financial system. Data on individual firms should be treated as confidential supervisory information;
- Establishing a surveillance system for activities and practices to detect early crisis warning signs and vulnerabilities, conduct scenario planning, and develop contingency planning with other prudential financial regulators across all financial markets;
- Examining individual financial services firms when a systemic risk is apparent. If a firm is engaged in activities and practices that are a threat to market stability and regulated by another national or state financial regulator, such examinations should be limited and coordinated with such regulator. Examination results should be treated as confidential supervisory information;
- Issuing, as necessary, reports and public notices on activities or practices that may pose a systemic risk;

- Working closely with other international authorities to ensure a global perspective on financial markets and potential systemic risk; and
- Taking corrective actions to prevent or address systemic risk.

To help prevent this authority from becoming a "super-regulator", we would recommend that, absent an emergency situation, the market stability regulator should take actions through other primary regulators. In other words, in non-emergency times, the market stability authority should be authorized to make recommendations to other regulators, the new Coordinating Council, and/or Congress to address activities and practices that could pose a potential systemic risk, but do not pose an immediate systemic threat to markets or the economy.

Whenever this new authority identifies a practice or activity that could pose a systemic risk and such practice or activity is within the jurisdiction of another national or state financial regulator, then it should issue a finding and recommend appropriate preventive actions to the other regulator. It also should submit any such findings and recommendations to the Administration's new Council and/or to the Congress. If another regulator disagrees with the authority's finding and recommendation, then the regulator can submit its own findings and recommendations to the new Council or this Congress.

If the new authority identifies an activity or practice that could pose a systemic risk, and such activity or practice is not subject to regulation or supervision by another regulator – a clear regulatory gap – then it should make a recommendation to Congress on how best to regulate and supervise such activity or practice in the future to close the regulatory gap.

The authority should be granted the ability to take unilateral actions only in the most limited situations to address significant activities or practices and only when the authority determines that they pose an immediate, systemic risk, which could not be addressed in a timely fashion if the authority were to recommend actions by any other regulator. Such unilateral actions would include the power to issue orders or regulations affecting activities or practices of individual firms or categories of firms. Such unilateral actions should only be approved by a super-majority of the members of the Federal Reserve Board, and should be agreed to by the Secretary of the Treasury, who must consult with the President. Such unilateral actions also should be reported immediately to Congress. This authority would be in addition to the Board's existing authority under section 13(3) of the Federal Reserve Act to make extend credit to financial or non-financial institutions in "unusual and exigent" circumstances. The Board should retain that authority, with full and timely public disclosure every time this authority is used.

If market stability oversight authority had been in place before this crisis, how would it have impacted the crisis?

We should not expect a market stability oversight authority to identify all potential systemic risks and eliminate the potential for any crisis in a competitive, market-based, global economy. In fact, some level of risk is inherent in all financial systems by definition. As noted earlier, any new authority should be required explicitly by Congress to balance risk mitigation and innovation to serve all consumers better in the future and meet all the financing needs of the economy.

That said, there are a couple of activities or practices that this new authority could have flagged, and, if such activities and practices had been adjusted, the current crisis should have been identified earlier and as a result could have been less severe. First, it is now clear that one of the practices that contributed to the current crisis was excessive leverage by large financial services firms, especially investment banks. This new authority as the Roundtable envisions could have identified this leverage as a potential warning sign sooner and urged the SEC to take corrective actions. Has the SEC not acted, the authority could have taken its case to the new Coordinating Council for a full inter-agency review and debate.

Another practice that contributed to the current crisis was growth in non-traditional mortgage instruments. A new oversight authority might have seen this and recognized the value of these innovations for certain consumers, as well as the risk to other consumers who were at risk from no documentation, no money down, adjustable rate loans. This new authority then could have recommended new uniform, national standards for such products long before the banking agencies acted on their own joint guidance.

Managing systemic risk better in the future

There are two major and inter-related components in the Administrations proposal that will help to prevent and mitigate systemic risk in the future, recognizing that no architectural design is a guarantee against all future financial crises. The first is the Administration's proposal to create a new Financial Services Oversight Council, which is modeled on the Roundtable's 2007 proposal. The second is making the Federal Reserve responsible for the promotion of market stability and the prevention of systemic risk. We support both of these improvements to the U.S, financial regulatory architecture with some further refinements to strengthen what has been proposed by the Administration. We reserve the right to recommend additional changes once the Administration sends Congress draft legislation.

Financial Services Oversight Council. The Roundtable has been a consistent advocate of better regulatory coordination and cooperation since our 2007 Blueprint on Financial Modernization. We called for the codification of an enhanced and expanded President's Working Group on Financial Markets (PWG) with all regulators having a seat at the table, including representatives of state regulated industries (banking, insurance, securities).

Therefore, we generally support the creation of a new Financial Services Oversight Council along the lines described in the Treasury's report, with four additional suggestions: 1) a new National Insurance Supervisor for all insurance companies opting or mandated by Congress to have a national insurance charter to serve their customers nationally or internationally should also have a seat on the new Council; a new national insurance regulator is needed to give the federal government a better understanding and role in the systemic supervision of a key part of our nation's financial services sector; 2) representatives of state banking, insurance, and securities regulators also should be included; 3) as part of a more forward looking mandate, the Council should also monitor the adherence to whatever principles Congress legislates to guide financial regulation and preferred regulatory outcomes in the future; and 4) each regulatory agency should develop comprehensive regulatory action plans to review the costs and benefits of each regulation under an agency's purview; in turn, these regulatory action plans would be presented and reviewed by the Council on an ongoing basis to ensure regulations are as effective and efficient as possible in serving their intended purpose.

Market Stability Oversight Authority. There clearly is a need for a market stability or systemic risk oversight authority to look across all financial markets and try to identify and then mitigate potential threats of systemic risk from activities and practices before they undermine market stability. The Roundtable supports the Administration's position that the Federal Reserve should play this role of greater market surveillance, leading the effort to set new standards for capital, liquidity, and risk management, and then working with other regulators to prevent a systemic collapse or another financial panic in the future. In this capacity, the Federal Reserve should focus primarily on the activities and practices by firms that may pose a risk to the economy across markets, while leaving the regulation and supervision of individual firms to their primary regulator under the new system. We also support the addition of a private-sector Advisory Council on Market Stability as noted above.

From our perspective, there is no need to create an artificial distinction of a Tier 1 Financial Holding Company (FHC), as proposed by the Administration, if the new standards we are setting for all financial institutions – capital, liquidity, risk management, and governance – are risk-based and focused on the desired regulatory behaviors and outcomes mandated by these reforms. Therefore, the Roundtable opposes drawing any bright line around an artificially determined class of institutions because of their size or business lines – which will vary constantly over time - especially since doing so will only increase moral hazard, have a destabilizing effect on competition and the pricing of products, services, and funding, and ultimately work to the disadvantage of the long-term competiveness of U.S. financial services firms and markets.

Consequently, the Roundtable also opposes any forced or unnecessary divestitures of ongoing businesses, especially during an anemic economic recovery. We support stronger capital and liquidity requirements as well as better risk management and supervision – including better consolidated supervision at the parent company level - based on underlying risk fundamentals, but we oppose the artificial and public designation of institutions as systemically important (Tier 1 FHCs) and therefore assumed by the public, potentially, as still "too big to fail," for the reasons noted above. No financial institution should be too big to fail, and, as an aside, the Roundtable fully supports a new orderly resolution process for nonbank financial institutions during times of economic emergencies. In other normal times, bankruptcy should be the preferred option for orderly resolution of failing nonbank financial firms, and it should be harmonized across the financial services industry over time.

2. THE NEED FOR CLEAR OBJECTIVES AND GUIDING PRINCIPLES

The starting for any regulatory reform effort should be common agreement on a few clear objectives for our financial system's role on the real economy – what we want to achieve – and then a companion set of some basic principles for both regulators and regulated firms - to guide how they achieve those objectives. The Administration has outlined five objectives for financial regulatory reform, which at their highest level are hard to oppose and in fact the Roundtable supports as well. We also would encourage the Congress to write into law a set of even higher objectives for our financial markets and their connection to serving consumers and the broader U.S. economy. The Roundtable's three simple objectives, to serve as a discussion starter in this evolving debate, are:

1. Enhance the competitiveness of financial services firms to meet the financial and related needs of all consumers;
2. Promote financial market stability and security; and

3. Support sustained economic growth and new job creation in a globally integrated economy.

If we can agree on some basic objectives about "what" we want our financial system to achieve for the benefit of society, then we need to agree on a set of principles that everyone can understand – regulators, regulated firms, and consumers – about "how" we will achieve those objectives. Guiding principles don't replace the need for more detailed rules especially at the retail level – it's not an either-or discussion - but they do inform desired behavior and outcomes, and they can act as a much needed compass for every stakeholder in our financial markets. Again, the Roundtable believes that Congress should develop a clear set of guiding principles in any reform legislation. To begin this aspect of the debate, our regulatory reform principles for Congress' consideration are:

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. Consumer protection should be part of prudential supervision.*
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.*

3. THE NEED FOR BOLD, COMPREHENSIVE REGULATORY REFORM

The latest financial crisis has shown us that the time is now for bold, comprehensive regulatory reform. The Roundtable has developed a proposed "Financial Regulatory Architecture" to address the flaws in our current system. Our proposed architecture is designed to:

- Create a better, more rational financial regulatory architecture to support the U.S. economy and meet all consumer financial needs;
- Limit and mitigate systemic risk;
- Reduce regulatory overlap and close critical gaps in regulation;
- Provide for greater coordination among all financial regulators;

- Promote uniform regulation and supervision; and
- Preserve state financial regulation.

Our proposed regulatory architecture can be found on our website at www.fsround.org.

Briefly, the six components of this proposed architecture are as follows. First, 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 Executive Order dating back to 1988. 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.

Second, to address systemic risk, we propose that the Federal Reserve Board (Board) should be authorized to act as a market stability oversight authority. If granted this new authority, the Board should be responsible for looking across the entire financial services sector to identify activities, practices, and interconnections that could pose a material systemic risk to the U.S. economy. The interaction of these two points is addressed in the last section of this statement.

Third, 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.

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.

Fourth, 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 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.

Fifth, to protect depositors, policyholders, and investors, we propose that the Federal Deposit Insurance Corporation (FDIC) would be renamed the National Insurance and Resolution Authority (NIRA), and that this agency act not only as an insurer of bank deposits, but also as 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. The failure of Lehman Brothers illustrated the need for such a better system to address the failure of large non-banking firms.

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 GSEs in our economy.

Conclusion

The Roundtable believes that the reforms to our financial regulatory system we have proposed would substantially improve the protection of consumers by reducing existing gaps in regulation, enhancing coordination and cooperation among regulators, ensuring greater regulatory accountability for commonly desired regulatory outcomes, and identifying systemic risks. Broader regulatory reform is important not only to ensure that financial institutions continue to meet the needs of all consumers but to restart economic growth and much needed job creation. We support the thrust of the Administration’s proposals for a new Council and designating the Federal Reserve as a new market stability oversight authority with the caveats noted above.

Financial reform and ending the recession soon are inextricably linked – we need both. 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. We need better, more effective regulation and a modern financial regulatory system that is unrivaled anywhere in the world. We deserve no less. The Roundtable stands ready to work closely with the Congress and the Administration to achieve our common goals to help all consumers of financial services and provide a stronger financial market foundation for our economy.

APPENDIX B

111th CONGRESS
2nd Session

H.R. XXXX

To protect consumers and promote economic growth through enhanced regulation and supervision of financial services firms and financial markets.

IN THE HOUSE OF REPRESENTATIVES

July ___, 2009

________ introduced the following bill; which was referred to the Committee on Financial Services.

A BILL

To protect consumers promote economic growth through enhanced regulation and supervision of financial services firms and financial markets.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Sec. 1. Short Title and Table of Contents.

(a) Short Title. – This Act may be cited as the "Financial Services Regulation Improvement Act of 2009."

(b) Table of Contents. – The table of contents for this Act is as follows:

TITLE II – PRINCIPLES-BASED REGULATION

TITLE III – PRUDENTIAL SUPERVISION

Sec. 2. Findings and Purposes.

(a) Congress finds that –

(1) Effective regulation of financial services firms and financial markets protects consumers and investors, and ensures the stability and integrity of financial services firms and financial markets;

(2) The existing system of financial regulation and supervision is fragmented, and different financial regulators often pursue different, and conflicting, missions;

(3) Given the dynamics of markets and consumer demands, financial regulators must have the flexibility to adjust policies to maintain consumer protection and the integrity of financial services firms and financial markets; and

(4) Early identification of practices that harm consumers or destabilize markets can help to better protect consumer and maintain the integrity of financial services firms and financial markets.

(b) Purposes. – The purposes of this Act are to –

(1) promote greater cooperation and coordination among all financial regulators by expanding the membership and mission of the President's Working Group on Financial Markets;

(2) enable financial regulators to adapt and respond more effectively to changes in markets and consumer protection through the adoption of a set of regulatory and supervisory objectives and principles; and

(3) encourage the early identification and resolution of potential supervisory risks by establishing a system of prudential supervision by financial regulators.

Sec. 3. Definitions.

In this Act, the following definitions shall apply –

(1) Financial regulator. – The term “financial regulator” means the Federal banking agencies (as defined in section 3(q) of the Federal Deposit Insurance Act), the National Credit Union Administration, the Financial Crimes Enforcement Network within the Treasury Department, the Securities and Exchange Commission, the Commodity Futures Trading Commission, the Financial Institutions Regulatory Authority, the Federal Housing Finance Board, the Office of Federal Housing Enterprise Oversight, and the Federal Trade Commission, with respect to its regulation and supervision of financial services firms.

(2) Financial services firm. – The term “financial services firm” means an individual or entity that engages primarily in one or more activities that are financial in nature, as that term is defined pursuant to section 4(k) of the Bank Holding Company Act of 1956, and is subject to the supervision or regulation of a financial regulator.

(3) Prudential supervision. – The term “prudential supervision” means a form of supervision that –

(a) is designed to ensure compliance by a financial services firm with applicable laws, regulations, and other supervisory requirements;

(b) is based upon an open and on-going engagement between a financial regulator and a financial services firm;

(c) encourages a financial services firm to establish and maintain sound internal controls;

(d) promotes and acknowledges self-identification and self-correction of compliance problems by a financial services firm;

(e) recognizes and distinguishes among financial services firms based upon their risk profile; and

(f) includes transparent regulatory incentives designed to promote compliance with laws, regulations, and other supervisory requirements by financial services firms.

TITLE I – REGULATORY COORDINATION

Sec. 101. Establishment and Composition of Working Group.

(a) Establishment. – There is established the Working Group on Financial Markets.

(b) Composition. – The Working Group shall be composed of –

(1) the Secretary of the Treasury;

(2) the Chairman of the Board of Governors of the Federal Reserve System;

(3) the Chairman of the Securities and Exchange Commission;

(4) the Chairman of the Commodities Futures Trading Commission;

(5) the Comptroller of the Currency;

(6) the Director of the Office of Thrift Supervision;

(7) the Chairman of the Federal Deposit Insurance Corporation;

(8) the Chairman of the National Credit Union Administration;

(9) the Director of the Office of Federal Housing Enterprise Oversight;

(10) the Chairman of the Federal Housing Finance Board;

(11) the Chairman of the Federal Trade Commission;

(12) the Chairman of the Financial Institutions Regulatory Authority;

(13) an individual, appointed by the President, by and with the advice and consent of the Senate, who is knowledgeable in State regulation of depository institutions and other State licensed lenders;

(14) an individual, appointed by the President, by and with the advice and consent of the Senate, who is knowledgeable in State regulation of the business of insurance;

(15) an individual, appointed by the President, by and with the advice and consent of the Senate, who is knowledgeable in State regulation of securities activities; and

(16) the Chairman of the Public Company Accounting Oversight Board.

(c) Conditions Applicable to Appointed Members of the Working Group. –

(1) Term and Vacancy. – Appointed members shall be appointed for a term of five years. If an appointed member resigns from the Working Group prior to the expiration of the member's term, or is otherwise unable to continue to serve as a member of the Working Group for any reason, another appointed member shall be selected in the manner established under subsection (b) and paragraph (1) of this subsection. The member appointed to fill the vacancy shall be appointed only for the remainder of the term of the preceding member.

(2) Compensation. –

(A) In General. – Appointed members shall receive compensation at the rate prescribed by law under section 5314 of title 5, United States Code, for positions at level III of the Executive Schedule.

(B) Technical Amendment. – Section 5312 of title 5, United States Code, is amended by inserting "Appointed Members of the Working Group on Financial Markets" as a new item after "Administrator, Pipeline and Hazardous Materials Safety Administration.".

(3) Prohibition on Financial Interests. – An appointed member may not have a direct financial interest in any financial services firm.

Sec. 102. Chairman and Meetings.

(a) Chairman. – The Secretary of the Treasury shall be the Chairman of the Working Group.

(b) Meetings. –

(1) In General. – The Working Group shall meet upon notice by the Chairman, but in no event shall the Working Group meet less frequently than once every 3 months.

(2) Special Meetings. – The Chairman may call a special meeting of all or some of the members of the Working Group.

(3) Designees. – Each member of the Working Group (other than the appointed members) may designate a senior policymaking official within the agency or an authority who may represent such member at a meeting of the Working Group, as necessary and appropriate.

Sec. 103. Purpose, Consultation, and Information Sharing.

(a) Purpose. – The Working Group shall –

(1) serve as a forum to identify and consider issues related to the regulation and supervision of financial services firms, including the stability and integrity of financial markets, investor and consumer protection, the efficiency and effectiveness of cross border regulation and

supervision, the implementation of Titles II and III of this Act, and other matters of mutual concern consistent with the purposes of this Act;

(2) recommend coordinated actions for financial regulators and financial services firms, especially in times of market stress or financial crisis;

(3) issue interpretations of the Guiding Principles established in section 202 of this Act, and guidelines for compliance with such Principles; and

(4) develop model supervisory policies on the matters specified in section 303 of this Act.

(b) Consultation. – The Working Group shall consult, as appropriate, with state regulators, major market participants, the various exchanges, clearinghouses, self-regulatory bodies, trade associations and others, and shall seek private sector solutions to issues whenever possible.

(c) Information Sharing. – The members of the Working Group shall, to the extent permitted by law, share information as may be necessary to meet the purposes and functions of the Working Group.

Sec. 104. Annual Report, Congressional Oversight, and Administrative Support.

(a) Annual Report. – Each year, no later than 3 months after the submission of the regulatory action plans, as required by section 206 of this Act, the Chairman of the Working Group shall –

(1) submit an annual report to the President, Congress and the governors and legislatures of each State that –

(A) describes –

(i) how the Working Group acted as a forum for the identification and discussion of regulatory and supervisory matters, during the preceding year, and

(ii) what coordinated actions, if any, the Group recommended to its members or financial services firms during the preceding year;

(B) summarizes the findings of the regulatory action plans submitted to the Working Group pursuant to section 206 of this Act;

(C) makes recommendations for changes in law to eliminate inconsistencies between existing regulatory and supervisory activities and the Guiding Principles established in section 201 of this Act; and

(D) addresses such other matters as the Working Group deems appropriate; and

(2) cause such annual report to be published in the Federal Register.

(b) Congressional Oversight. – Each year, following the submission of the annual report required by subsection (a), the Secretary of the Treasury, as Chairman of the Working Group, shall appear before the Committee on Financial Services of the U.S. House of Representatives and the Committee on Banking, Housing and Urban Affairs of the U.S. Senate regarding –

(1) the activities of the Working Group during the preceding year;

(2) the implementation of Titles II and III of this Act;

(3) any recommendations for changes in Federal or State law that would allow existing regulatory and supervisory activities to be made consistent with the Guiding Principles established in section 201 of this Act; and

(4) such other matters as the Secretary deems appropriate.

(c) Administrative Support. – The Secretary of the Treasury shall provide the Working Group with such administrative support services as may be necessary for the performance of its functions.

Sec. 105. Authorization. – There is authorized such funds as necessary to enable the Secretary of the Treasury to perform the duties required by this Title.

TITLE II – PRINCIPLES-BASED REGULATION.

Sec. 201. Guiding Principles.

(a) Financial Regulators. – The regulations, interpretations, guidelines, advisories, and other supervisory actions of a financial regulator shall be consistent with the Guiding Principles established in subsection (b).

(b) Guiding Principles. –

(1) Fair Treatment for Consumers. – Consumers shall receive fair treatment through uniform standards that ensure–

(A) protection from unfair or deceptive acts and practices;

(B) clearly written disclosure of key terms and conditions;

(C) protection of non-public personal information;

(D) secure and efficient delivery of financial products and services;

(E) timely and fair resolution of disputes;

(F) relevant guidance regarding financial products and services; and

(G) competitive pricing.

(2) Stability and Security. – Financial regulation and supervision shall support the integrity, stability, and security of U.S. financial markets and financial services firms.

(3) Competitive and Innovative Financial Markets. – Financial regulation and supervision shall support open, competitive and innovative financial markets, organizational options for financial services firms, including a single national charter and single national regulator.

(4) Proportionate, Risk-Based Regulation. – Financial regulation and supervision shall be proportionate to the benefits and risks of the product or service offered. Proportionate financial regulation and supervision shall be risk-based, aimed primarily at the material risks applicable to financial services firms and consumers, and shall take into consideration the cost of such regulation and supervision to consumers, financial services firms, the economy, and U.S. competitiveness;

(5) Prudential Supervision and Enforcement. – The examination, supervision, and enforcement policies and procedures of a financial regulator shall be informed by an open and on-going engagement with the managers of financial services firms and shall seek to encourage all segments of the financial services industry to utilize the best practices to ensure the safety and soundness of financial services firms, consumer protection, and compliance with these Guiding Principles;

(6) Management Responsibilities. – The managers of a financial services firm shall adopt and implement policies and procedures that enable the firm to operate successfully and maintain the trust of consumers. Such policies and procedures shall require –

(A) the maintenance of adequate financial and managerial resources and skilled personnel;

(B) ethical conduct at all levels of the firm;

(C) effective risk management and controls;

(D) infrastructure that is adequate to ensure compliance with these Guiding Principles and other business requirements;

(E) complete and cooperative compliance with all applicable regulatory and supervisory mandates;

(F) respect for, and compliance with, the basic tenets of safety, soundness and financial stability; and

(G) appropriate conflict of interest management.

Sec. 202. Implementation of Guiding Principles.

(a) Five-Year Phase-in Period. – A financial regulator shall make its regulations, interpretations, guidelines, advisories and other supervisory actions consistent with the Guiding Principles as soon as practicable, but not later than five (5) years after the date of enactment of this Act.

(b) Interpretations and Compliance Guidance. – A financial services firm may seek interpretations of the Guiding Principles and compliance guidance from the Working Group for Financial Markets under the terms of section 103(a)(5) of this Act.

Sec. 203. Regulatory Action Plan.

(a) Process for Reviewing Regulations and Supervisory Activities. – A financial regulator shall establish a continuing process for assessing the consistency of its regulatory and supervisory activities with the Guiding Principles. Such process shall provide for –

(1) a continuous review of the consistency of its regulations, interpretations, guidelines, advisories, and other supervisory actions with the Guiding Principles;

(2) an opportunity for public comment on the consistency of such regulations, interpretations, guidelines, advisories, and other supervisory actions during the review described in paragraph (1); and

(3) the preparation of an annual regulatory action plan, as described in subsection (b).

(b) Annual Regulatory Action Plans. – Beginning one year after the date of enactment of this Act, and continuing annually thereafter, a financial regulator shall issue a regulatory action plan that –

(1)

(A) identifies the regulations, interpretations, guidelines, advisories and other supervisory actions reviewed by the regulator during the preceding year pursuant to the process required by subsection (a),

(B) summarizes any public comments received as part of that review, and

(C) explains whether or not such public comment should be adopted;

(2)

(A) describes how its regulations, interpretations, guidelines, advisories and supervisory actions are consistent or inconsistent with the Guiding Principles, and

(B) explains how the financial regulator plans to resolve any inconsistencies;

(3) makes, to the extent necessary, recommendations for changes in Federal or State law needed to allow the financial regulator to eliminate any inconsistencies between its regulations,

interpretations, guidelines, advisories and other supervisory actions and the Guiding Principles; and

(4) outlines a schedule for reviewing other regulations, interpretations, guidelines, advisories and other supervisory actions in order to comply with the five-year cycle required by subsection (a).

(c) Submission of Plans. – A financial regulator shall submit the regulatory action plan described in subsection (b) to –

(1) the Chairman of the Working Group on Financial Markets, who shall –

(A) provide a copy to all other members of the Working Group; and

(B) cause such plan to be published in the Federal Register; and

(2) the Speaker of the U.S. House of Representatives and the President Pro Tempore of the U.S. Senate, if the financial regulator is a Federal agency or authority; or

(3) the Governor and the leaders of the legislature of the State that created the financial regulator, if such regulator is a State agency or authority.

TITLE III – PRUDENTIAL SUPERVISION.

Sec. 301. Prudential Supervision.

(a) Required. – No later than three years following the date of enactment of this Act, each financial regulator shall apply prudential supervision in the exercise of its responsibilities with respect to financial services firms.

(b) Determination. – The Secretary of the Treasury shall determine if a financial regulator has complied with the requirement in subsection (a). The Secretary shall find that a financial regulator has complied with such requirement if the regulator has –

(1) adopted and implemented the policy statement specified in section 302 of this Act,

(2) taken the administrative actions specified in section 303 of this Act, and

(3) appointed the ombudsman required by section 304 of this Act.

Sec. 302. Policy Statement on Prudential Supervision.

(a) Policy Statement on Prudential Supervision Required. – Each financial regulator shall develop and publish a policy statement on prudential supervision.

(b) Contents of Policy Statement. – The policy statement required by subsection (a) shall address the following matters. –

(1) Internal Controls. – The policy statement shall encourage financial services firms to establish and implement internal risk control practices and procedures that are designed to detect and prevent violations of laws, regulations, and other supervisory requirements.

(2) Open and On-Going Engagement. – The policy statement shall encourage an open and on-going engagement with the financial services firms for which the regulator has regulatory or supervisory responsibility, and shall include transparent regulatory incentives for compliance with applicable law and regulations by financial services, as well as penalties for non-compliance, that are based upon the risk posed by, and performance of, a financial services firm.

(3) Self-Reporting. – The policy statement shall encourage financial services firms to self-report violations of applicable laws, regulations, or other supervisory requirements, and shall include appropriate incentives for a financial services firm to self-report an apparent violation of law, regulation, or other supervisory requirement.

(4) Self-Correction. – The policy statement shall encourage financial services firms to self-correct violations of applicable laws, regulations, or other supervisory requirements, and subject to such limitations as a regulator deems necessary to protect the safety and soundness of a financial services firm and the interests of consumers, the policy statement shall provide for the regulator to give a financial services firm a notice of the violation and an opportunity to take corrective action before the regulator decides to bring an enforcement action.

(5) Continuum of Actions. – The policy statement shall identify the range of enforcement actions the regulator may bring in response to a violation of law, regulation, or other supervisory requirement, and subject to such limitations as a regulator deems necessary to protect the safety and soundness of a financial services firm and the interests of consumers, the policy statement shall provide that a regulator shall impose enforcement actions in a continuum that begins with the least severe sanction or penalty and gradually escalates to the most severe sanction or penalty.

(6) Mitigating Factors. – The policy statement shall identify the factors the regulator will consider in determining whether to bring an enforcement action and in determining the type of action to be brought, including

(A) a firm’s good faith effort to self-identify the violation;

(B) a firm’s good faith effort to take self-corrective action;

(C) the gravity of the violation, including its impact on consumers;

(D) the firm’s history of previous violations; and

(E) such other matters as justice may require.

(7) Fair Notice. – The policy statement shall ensure that a financial services firm has sufficient prior notice of any law, regulation, or other supervisory requirement upon which an enforcement action may be based, and shall address the publication of applicable laws, regulations and other supervisory requirements by the regulator, or other State and Federal agencies and authorities, as appropriate.

(8) Investigations. – The policy statement shall specify the regulator's practices and procedures related to investigations, and shall require the regulator to notify a financial services firm within 10 days of completing an investigation, and to review the status of all open investigations on a semi-annual basis and determine if such matter should remain open or be closed.

(c) Public Comment. – A financial regulator shall seek public comment in developing the policy statement required by this section.

Sec. 303. Administrative Matters.

(a) Communications Between Divisions. – A financial regulator shall establish practices and procedures that encourage the enforcement and non-enforcement personnel of such regulator to communicate and coordinate actions so that financial services firms regulated or supervised by the regulator are encouraged to self-report violations of applicable laws, regulations, and other supervisory requirements and to self-correct those violations.

(b) Training and Incentives. – A financial regulator shall establish –

(1) a training program for enforcement and non-enforcement personnel that explains and promotes the application of prudential supervision by such personnel; and

(2) incentive programs for all personnel to apply prudential supervision in the exercise of their duties.

(c) Publication of Supervisory Policies and Procedures. –

(1) Requirement. – A financial regulator shall make its examination manual and other supervisory policies and procedures available to the public.

(2) Internet Access. – If a financial regulator maintains a web site on the Internet, the materials described in paragraph (1) shall be posted on such web site.

Sec. 304. Ombudsman for Prudential Supervision.

(a) Ombudsman. – A financial regulator shall appoint an Ombudsman for prudential supervision who shall report directly to the head or board of such regulator, as the case may be.

(b) Duties of Ombudsman. – The Ombudsman appointed under subsection (a) shall –

(1) ensure that the financial regulator has adopted practices and procedures that encourage financial firms supervised or regulated by such regulator to present compliance questions to the regulator and to self-identify and self-correct violations of laws, regulations or other supervisory requirements;

(2) advise and guide firms through the process of self-reporting violations of applicable laws, regulations or other supervisory requirements;

(3) act as a liaison between the financial regulator and a firm with respect to any problem the firm may have in dealing with the agency;

(4) ensure that financial services firms that engage in the self-reporting of violations of laws, regulations and other supervisory requirements are given due credit by non-enforcement and enforcement personnel;

(5) ensure that the regulator has adopted practices and procedures to train enforcement and non-enforcement personnel to apply prudential supervision in the exercise of their duties, and to provide incentives for doing so;

(6) ensure that the regulator has established practices and procedures that promote communications between the enforcement and non-enforcement personnel of the agency; and

(7) maintain the privilege of confidential communications between a financial services firm and the Ombudsman, unless such privilege is waived by the firm.

(c) Limitation. – In carrying out the duties under subsection (b), the Ombudsman shall utilize personnel of the financial regulator to the extent practicable, and nothing in this section is intended to replace, alter or diminish the activities of any other ombudsman or similar office that otherwise exists within a financial regulator.

(d) Report. – Each year, the Ombudsman for a financial regulator shall submit a report for inclusion in the annual report of such regulator. Such report shall –

(1) describe the activities of the Ombudsman during the preceding year; and

(2) include solicited comments and evaluations from financial services firms with respect to the effectiveness of the Ombudsman's activities.