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Chairman Frank, Ranking Member Bachus, and members of the Financial Services Committee, thank you for the opportunity to testify before you today about the Administration's plan for financial regulatory reform.

On June 17, President Obama unveiled a sweeping set of regulatory reforms to lay the foundation for a safer, more stable financial system; one that properly delivers the benefits of market-driven financial innovation while safeguarding against the dangers of market-driven excess.

The President's plan focuses on the essential reforms. It addresses the core causes of the current economic crisis. It addresses the areas critical to confronting future vulnerabilities. And, in pursuing what amounts to the most extensive overhaul of our financial regulatory regime in decades, it makes clear to the American people that their government, at an early stage in this new Administration, is intent on fixing the basic regulatory flaws that caused extensive damage to families and businesses.

Over the past five weeks, in Congress and in the press, among legislators and business leaders, academics and advocates, the Administration's proposals have spurred an important and sometimes heated debate about how best to reform the financial regulatory system. That debate is to be expected, and is welcome. While crafting our plan, the Administration sought input from all points of view, considered all options and heard many of the opinions being expressed today.

We understand that on any issue this complex and this important there will be areas where parties genuinely disagree, and we look forward to refining our recommendations through the legislative process.

But there should be no disagreement on the need to act.

Over the past two years, we have faced the most severe financial crisis since the Great Depression. The damage has been indiscriminate and unforgiving. Millions of Americans have lost their jobs; families have lost their homes; small businesses have shut down; students have deferred college educations; and seniors have shelved retirement plans. Some of our largest financial institutions failed; others came under extraordinary pressure; and many of the securities markets that are critical to the flow of credit broke down.

As a country, we now know that our financial system failed in its most basic responsibility to be stable and resilient enough to provide credit while protecting consumers and investors.

We now know that our regulatory regime permitted an excessive build-up of leverage, both outside the banking system and within the banking system; that the shock absorbers critical to preserving the stability of the financial system – capital, margin, and liquidity cushions in particular – were inadequate to withstand the force of the global recession; and that they left the system too weak to withstand the failure of major financial institutions.

We now know that millions of Americans were left without adequate protection against financial predation, especially in the mortgage and consumer finance areas; and that many were unable to evaluate the risks associated with borrowing to support the purchase of a home, a car, or an education.

And, we know that the United States entered this crisis without an adequate set of tools to contain the risk of broader damage to the economy and to manage the failure of large, complex financial institutions.

As a result, American families have made essential changes and they expect their government to do the same. There exists today a national mandate, not seen in years, to reform our outdated and ineffective regulatory system.

Still, despite that reality, there are some who suggest we are trying to do too much too soon, and that we should wait until the crisis has definitively receded. Others say we do not need comprehensive change or that it will destroy innovation. And with respect to consumer protection in financial services, there are even those who contend we should leave things as they are.

That is not surprising. Every financial crisis of the last generation has sparked some effort at reform, but past attempts began too late, after the will to act had subsided.

That cannot happen this time.

The reforms proposed by the President are necessary. They would substantially alter the ability of financial institutions to escape regulation, to choose which regulator suits them best, to shape the content of future regulation and to continue the financial practices that were lucrative for parts of the industry for a time, but that ultimately proved so damaging. That is why we have to act, and why we need to deliver real, meaningful change.

The Administration welcomes the commitment of this Committee and your counterparts in the Senate, as well as other key committees and the Congressional leadership, to pass legislation this year. And the Administration is moving aggressively to help advance the overall process.

In the weeks following the President's announcement, we have delivered detailed legislative language to Congress on virtually all of our proposals: on the enhanced regulation of our largest, most interconnected financial firms; on the supervision and regulation of federal depository institutions; on new resolution authority; on payments and settlement systems; on investor protection; on private fund registration; on executive compensation; on securitization and credit rating agencies; and on the proposed new Financial Services Oversight Council and Consumer Financial Protection Agency (CFPA).

We are also working to put in place reforms that do not require legislation. We have used the President's Working Group on Financial Markets to pull together all government agencies that oversee elements of the financial system to formulate more detailed proposals for implementing the comprehensive reforms outlined by the President.

By now the details of our plan are widely known and so I would like to provide some additional context by explaining our key priorities for reform.

Consumer Protection

Let me begin with a pressing concern for this Committee – building strong protections for consumers, and ensuring they can understand the risks and rewards associated with the products sold to them. I know you will soon be marking up legislation on this issue.

There is broad agreement that consumer protection needs to be stronger. Achieving this objective requires mission focus, market-wide coverage, and consolidated authority, none of which exist in today's system.

That is why we are proposing one agency for one market place with one mission – protecting consumers.

The case for the Consumer Financial Protection Agency is clear.

First, non-banks such as mortgage brokers and large independent mortgage companies, consumer credit companies and pay-day loan operations, currently operate under no federal supervision. No federal agency sends consumer protection examiners into these institutions to review their files or interview their salespeople. No federal regulator collects information from them, except for limited mortgage data.

In the years before the crisis, capital flowed heavily to these unsupervised non-banks in large measure because they enjoyed the advantage of weak consumer oversight. Banks were left with the untenable choice of lowering their standards to compete or giving up market share.

The proposed CFPA would fix this problem and ensure a level playing field by extending the reach of federal oversight to all financial firms, no matter whether they are banks or non-banks.

Second, even where federal oversight exists, standards are weakened by the ability of banks and thrifts to choose the regulator that will have the least restrictive oversight of consumer protection, something we also saw in the years leading up to the current crisis.

The President's proposal would correct this by consolidating responsibility for consumer protection into one agency, meaning financial institutions would no longer be able to shop for the weakest regulator and pursue a race to the regulatory bottom.

Third, the banking agencies responsible for implementing and enforcing consumer protection have higher priorities. The agencies' primary focus is the safety and soundness of the institutions they oversee. As a matter of mission and internal organization, they are focused on the effect of a bank's products and practices on the bank itself, rather than the effect on consumers. That is why the CFPA would have as its sole mission examining how a product or practice affects consumers.

Importantly, nothing in the CFPA's mission or authority would conflict with or undermine the safety and soundness of banking institutions. Our proposal ensures cooperation with prudential regulators by placing one of them on the board of directors and requiring examiners to exchange examination reports.

Making banks act fairly and transparently with their customers only enhances their safety and soundness. Market-wide jurisdiction of the CFPA will ensure that banks are not forced to choose between lowering their standards and giving up market share.

Finally, the government agencies that have responsibility for consumer financial protection are limited in their ability to do something about the problems they encounter because they have only one set of authorities available to them, instead of the full range, from rule-writing to supervision to enforcement. This leads to inertia and finger-pointing in place of action. And it makes any action taken less likely to be effective.

For example, when it comes to credit cards, the Federal Reserve has substantial power to write rules but has little authority to enforce them outside of bank holding companies, while the Office of the Comptroller of the Currency has little authority to write rules but wide power to enforce them. As concerns about fairness and transparency emerged, each agency looked to the other to act and, in the end, not enough was done.

Even in cases where agencies have what, in principle, should be the more flexible authority to issue regulatory guidance to institutions, they are hampered by the fact that several agencies have similar authority.

In the case of subprime mortgages, it took the federal banking agencies until June 2007 to reach final consensus on supervisory guidance imposing even general standards on subprime mortgages. By then it was too late.

Our consumer protection proposal would put an end to this problem by giving the CFPA consolidated authority to write rules, supervise compliance and take enforcement action when there are violations.

It is time for a level playing field for financial services competition based on strong rules, not based on exploiting consumer confusion. Our proposal achieves that by ensuring consumer choice, preserving innovation, strengthening depository institutions, reducing regulatory costs, and increasing national regulatory uniformity and accountability.

Financial Stability

Our second priority was creating a more stable financial system by strengthening supervision and regulation of financial firms.

That necessarily begins with higher capital requirements. The most important thing to lowering risk in the financial system is stronger capital cushions.

The Committee is well aware that in the years leading up to this crisis, as rising asset prices, particularly in housing, concealed a sharp deterioration of some of the underwriting standards for loans, risks built up substantially while capital cushions did not. The nation's largest financial firms, already highly leveraged, became increasingly dependent on unstable sources of short-term funding.

These firms did not plan for the potential demands on their liquidity during a crisis. And when asset prices started to fall and market liquidity froze, they were forced to pull back from lending, limiting credit for households and businesses.

Looking back it is clear that regulators did not require firms to hold sufficient capital to cover risks from their trading assets, high-risk loans, and off-balance sheet commitments.

Under our plan, that will change. Financial firms will be required to follow the example of millions of families across the country that are saving more money as a precaution against bad times. They will be required to keep more capital and liquid assets on hand and, importantly, the biggest, most interconnected firms will be required to keep even bigger cushions.

Now, higher capital requirements are an important step towards longer-term stability, but they are only the first step.

While many of the financial firms at the center of this crisis were under some form of federal supervision and regulation, that oversight did not do enough. A patchwork of supervisory responsibility, loopholes that allowed some institutions to shop for the weakest regulator, and the rise of new financial institutions and instruments that were almost entirely outside the government's supervisory framework left regulators largely blind to emerging dangers and without the tools needed to address them.

That is why we propose evolving the Federal Reserve's authority to create a single point of accountability for the consolidated supervision of all large, interconnected firms whose failure could threaten the stability of the system, regardless of whether they own an insured depository institution. This is a role the Fed plays today, given its supervision and regulation of bank holding companies, including all major U.S. commercial and investment banks.

While our plan gives some new authority – along with necessary accountability – to the Fed, it also takes some away. That includes transferring the Fed's consumer protection responsibility to the CFPA and requiring the Fed to receive written approval from the Secretary of the Treasury before exercising its emergency lending authority.

Alongside the new role played by the Fed, there must also be a mechanism to look at the system as a whole for dangers, given that risk can emerge from almost any quarter.

That is why we are proposing a Financial Services Oversight Council to bring together the heads of all of the major federal financial regulatory agencies. This Council will improve coordination of policy and resolution of disputes among the agencies. It will have a significant consultative role to play in helping preserve financial stability. And, most importantly, it will have the power to gather information from any firm or market to help identify emerging risks.

Improving the supervision and regulation of financial firms broadly also requires reducing the ability of depository institutions to choose their regulator and regulatory framework. To address this problem, we have proposed eliminating the thrift and thrift holding company charter and removing other loopholes in the Bank Holding Company Act.

Market Oversight

The third priority that guided our decision making was establishing comprehensive regulation of financial markets.

The current financial crisis emerged after a long and remarkable period of growth and innovation. New instruments, such as over-the-counter (OTC) derivatives, allowed risks to be spread quickly and widely, enabling investors to diversify their portfolios in new ways and enabling banks and other companies to shed exposures that had once resided on their balance sheets.

However, the OTC derivatives markets, which were thought to efficiently promote dispersion of risk to those most able to bear it, instead became a major channel of contagion through the financial sector in the crisis. When fear spread that any institution could fail, the markets for risk transfer and liquidity froze – making it difficult for all financial institutions to maintain daily operations.

Two weeks ago, I testified at a joint hearing of this committee and the House Agriculture Committee on our comprehensive regulatory framework for the OTC derivatives markets. I outlined how our plan would provide strong regulation and transparency for all OTC derivatives regardless of whether the derivative is customized or standardized. In addition, I discussed how our plan will provide for strong supervision and regulation of all OTC derivative dealers and all other major participants in the OTC derivative markets.

We intend very soon to send up draft legislation on derivatives to implement our proposal.

Alongside reforms in the derivatives market, we also propose enhanced regulation of the securitization markets.

In the years preceding the crisis, mortgages and other loans were aggregated with similar loans and sold in tranches to a large and diverse pool of new investors with different risk profiles. Securitization, by breaking down the traditional relationship between borrowers and lenders, created various conflicts of interest that market discipline failed to correct.

Loan originators failed to require sufficient documentation of income and ability to pay. Securitizers failed to set high standards for the loans they were willing to buy, encouraging underwriting standards to sag. Investors were overly reliant on credit rating agencies, whose procedures proved no match for the complexity of the instruments they were rating. In each case, lack of transparency prevented market participants from understanding the full nature of the risks they were taking.

In response, the President's plan requires securitization sponsors to retain five percent of the credit risk of securitized exposures; it requires transparency of loan level data and standardization of data formats to better enable investor due diligence and market discipline; and, with respect to credit rating agencies, it ends the practice of allowing them to provide consulting services to the same companies they rate, requires these agencies differentiate between structure and other products, and requires disclosure of any "ratings shopping" by issuers.

Crisis Resolution

Our fourth priority was addressing the basic vulnerabilities in our capacity to manage future crises.

The United States came into the current crisis without an adequate set of tools to contain the risk of broader damage to the economy and to manage the failure of large, complex financial institutions. That left the government with extremely limited choices when faced with the failure of the largest insurance company in the world and one of the largest U.S. investment banks.

That is why, in addition to addressing the root causes of our current crisis, we must also act preemptively to provide the government better tools to manage future crises. To do that, we have proposed a new resolution authority for financial firms whose disorderly failure would threaten the stability of the financial system.

Our proposal is modeled on the existing FDIC resolution regime for banks. This exception allows the FDIC to depart from the least cost resolution standard only when financial stability is at risk. Similarly, our resolution authority would only be for extraordinary times and would be subject to very strict governance and control procedures.

Any costs to the taxpayer from the use of this authority would be recovered through ex post assessments on large financial firms. As such, it will reduce moral hazard by allowing the government to resolve failing large, interconnected financial institutions in a way that imposes costs on owners, creditors and counterparties, making them more vigilant and prudent.

No one should assume that the government will step in and bail them out if their firm fails.

In addition, we propose that the biggest firms prepare, continuously update, and periodically provide to regulators a credible plan for their rapid resolution in the event of severe financial distress. This would create incentives for firms to better monitor and simplify their organizational structure and would better prepare the government, as well as the firm's investors, creditors, and counterparties, for the possibility of a firm's collapse.

The key test of these reforms will be whether we make this system strong enough to withstand the stress of future recessions and the failure of large institutions.

Level Playing Field Internationally

The final priority of the Administration was working with our global partners to raise international regulatory standards and improve international cooperation.

As we have witnessed during this crisis, financial stress can spread easily and quickly across national boundaries. Yet, regulation is still set largely in a national context. Without consistent supervision and regulation, financial institutions will tend to move their activities to jurisdictions with looser standards, creating a race to the bottom and intensifying systemic risk for the entire global financial system.

The United States is playing a strong leadership role in efforts to coordinate international financial policy through the G-20, the Financial Stability Board, and the Basel Committee on Banking Supervision. Alongside our partners, we are proposing that the international banking regulators responsible for setting capital requirements take forward their work on reforming capital ratios to more effectively constrain leverage in the future. More broadly, we will call on the international banking regulators to develop proposals by the end of this year for countries to have the necessary tools to quickly resolve failures of cross-border financial firms.

Conclusion

Over the past six months, in responding to the current economic crisis, the Obama Administration has taken extraordinary action.

We moved quickly to restore confidence in the banking system. Without first stabilizing and repairing the financial system, broader economic recovery would not be possible. In doing so, we have increased transparency and disclosure, helping to bring billions of dollars of private capital into banks so they could safeguard against a deeper recession, and enabling some banks who took taxpayer funds to start paying back the government.

We worked to ease the housing crisis by helping to bring mortgage rates down to historic lows and establishing new programs to allow responsible homeowners to refinance into affordable mortgages or alter at-risk loans and help homeowners lower their monthly mortgage payments. Estimates indicate that up to 3 to 4 million homeowners will be offered trial loan modifications under the Administration's program.

We worked to offset the dramatic contraction in demand by working with Congress to put in place the most sweeping economic recovery package in our nation’s history – a comprehensive program of immediate tax incentives for businesses and households, support for state and local governments, and investments in critical economic priorities, from infrastructure and energy to health care and education. The Recovery Act was designed to provide a sustained boost to economic demand, concentrated over a two year period and, as designed, the largest effects on the spending side will come in the next six months.

Through the G-20 and G-8, we are working with the major economies of the world on a coordinated program of macroeconomic stimulus and financial stabilization, alongside regulatory reform. This has amounted to the most aggressive international response to any financial crisis in the last fifty years, implemented with unprecedented speed and breadth.

Because of these steps, in just six months, the Administration has substantially reduced the risk of a much deeper and more prolonged recession. We have begun stabilizing an economy that in January was in a free-fall. And we have seen improvements that have been more substantial and have come more quickly than expected when we were designing our response in December and January. Business and consumer confidence has started to improve, housing markets have begun to stabilize, the cost of credit has fallen significantly and credit markets are starting to open up.

But there is still a long way to go. We have a lot more work to do to lay the foundation for a more sustainable recovery, with the gains more broadly shared among all Americans, and central to that effort is passing comprehensive regulatory reform legislation by the end of the year.

We simply cannot afford inaction on this issue. We cannot afford a situation where we leave in place vulnerabilities that will sow the seeds for future crises, and prevent our financial system from functioning properly.

The United States is the world's most vibrant and flexible economy, in large measure because our financial markets and our institutions create a continuous flow of new products, services and capital. That makes it easier to turn a new idea into the next big company.

America's tradition of innovation has been vital to our prosperity. The reforms proposed in the Administration's plan are designed to strengthen our markets by restoring confidence and accountability, while preserving that tradition of innovation.

In the weeks and months ahead I look forward to working this Committee to help pass regulatory reform legislation and, in turn, build a stronger American economy.

Thank you.