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Introduction

Chairman Frank, Ranking Member Bachus, thank you for the opportunity to participate in today's hearing and to share the Financial Services Forum's views regarding the Administration's proposal to reform and modernize our nation's framework of financial supervision.

As you may know, the Forum is a nonpartisan financial and economic policy organization comprised of the chief executives of 17 of the largest and most diversified financial institutions with business operations in the United States. The purpose of the Forum is to promote policies that enhance savings and investment and that ensure an open, competitive, and sound global financial services marketplace.

Reform and modernization of our nation's framework of financial supervision is overdue and needed. As you know, our current framework is an outdated and ineffective Depression-era patchwork of regulatory fiefdoms with overlapping jurisdictions, varying statutory responsibilities and powers and, too often, inconsistent supervisory postures, priorities, and methodologies. For years, these circumstances have led to duplication, confusion, regulatory arbitrage, structural imbalances, inefficiency, and waste. Worse, the balkanized nature of the current framework undermines regulators' ability to ensure institutional and systemic safety and soundness – helping to create the opportunity for, and exacerbating, the current financial crisis.

To reclaim its position of financial and economic leadership, the United States needs a 21st century supervisory framework that is effective and efficient, ensures institutional safety and soundness and systemic stability, promotes the competitive and innovative capacity of the U.S. capital markets, and protects the interests of depositors, investors, and policyholders. With this imperative in mind, the Financial Services Forum applauds the Administration's focus on reform and modernization, and the ongoing work of this Committee.

The Administration's Reform Plan

The Forum agrees with the Administration's diagnosis of the deficiencies of our current framework, and applauds the conceptual direction and many of the details of the Administration's reform proposal. Let me briefly address the major elements of the plan:

Systemic Risk Supervisor

Perhaps the most significant deficiency of our current supervisory framework is that it is highly balkanized, with agencies focused on specific industry sectors – commercial banking, securities firms, and insurance companies. This stove-piped structure has led to at least two major problems that created the opportunity for, and exacerbated, the current financial crisis: 1) gaps in oversight naturally develop between the silos of sector-specific regulation; and, 2) no agency is currently charged with assessing risks to the financial system as a whole – the big picture.

A more seamless, consistent, and holistic approach to supervision is necessary to ensure systemic stability and the safety and soundness of all financial entities. The cornerstone of such a modern framework is a systemic risk supervisor.

"Systemic risk" refers to any threat to the stable and efficient functioning of the financial system. It is important to emphasize that such threats can stem from many sources:

- deterioration of a large, interconnected entity;
- problems effecting a collection of smaller institutions;
- rapidly increasing exposures to a particular asset class, like real estate;
- unexpected volatility in key markets;
- pervasive deficiencies in risk management methodologies; or,
- difficulties in the financial system's clearing and settlement infrastructure.

A systemic supervisor should perform three essential tasks: First, looking out over the entire financial system, the supervisor would continuously monitor, assess, and, if necessary, take steps to address any risk that might threaten the stability of the system. In his comments announcing the reform plan a few weeks ago, President Obama aptly described this role of the systemic supervisor as focusing on the "forest," complementing the functional regulators' focus on the "trees."

Importantly, all three aspects of this role – monitoring, assessing, and addressing systemic risk – would require continuous interaction and cooperation with the functional regulators. Indeed, to avoid unnecessary supervisory duplication and confusion, and to avail itself of their sector-specific expertise, the Forum is of the view that the systemic supervisor – in supervising financial firms whose combination of size, leverage, and interconnectedness could pose a threat to the financial system – should rely on the functional regulators for day-to-day regulatory responsibility, examination reports, and other relevant regulator information regarding such firms, except under extreme emergency circumstances. As part of that continuous interaction, the systemic supervisor would perform a second critical task – helping to coordinate the functional regulators, close regulatory gaps, and promote more unified, consistent, and coherent supervision.

Third, the systemic supervisor would lead crisis-fighting efforts. Given the fast-moving and intensely psychological nature of modern financial crises, restoring public confidence and financial stability requires that the systemic supervisor have the capacity and authority to act swiftly and decisively. For this reason, the systemic supervisor cannot be comprised of a council of regulatory authorities, as some have suggested. A single entity is required – with the authority, resources, and tools to effectively combat financial instability.

We do believe that a Risk Council of functional regulators does have an important role to play in a modern supervisory framework, as a complement to the systemic supervisor. I'll have more to say about the Council in a few moments.

The Federal Reserve as Systemic Risk Supervisor

It is the Forum's firm view that the Federal Reserve might be best suited to serve the role of systemic supervisor. Indeed, Congress created the Fed in 1913 in response to another financial crisis, the Panic of 1907. As the monetary authority and lender-of-last-resort, the Fed has unique tools and powers that enable it to reach into financial markets and alter fundamental conditions. And by way of its enormous balance sheet, the Fed can also, if necessary, become the buyer-of-last-resort for various classes of short-term debt instruments critical to the continued operation of businesses, such as commercial paper and asset-backed securities. It is for these important reasons that the Federal Reserve is the agency to which all financial institutions and market participants look in times of crisis. No other agency has the necessary tools. The Federal Reserve is the fire department, with the trucks and hoses needed to put out fast-moving blazes that can threaten major aspects of, or even the entire, financial system.

Moreover, by way of its role as the monetary authority – altering the supply of money by way of open market operations – the Fed has nearly 100 years of institutional experience in the capital markets. No other agency has capital markets experience.

The Fed also brings tremendous institutional experience to bear as the systemic supervisor. It has supervised bank holding companies since 1956. Since the passage of the Gramm-Leach-Bliley Act of 1999 (GLBA), the Fed has served as the "umbrella supervisor" of financial conglomerates that include banking, securities, and insurance entities. Moreover, in recent months a number of major non-bank financial institutions – Goldman Sachs, Morgan Stanley, American Express, and even GMAC – have become bank holding companies and submitted to consolidated oversight by the Federal Reserve.

Streamlining of Federal Supervision of Financial Entities

The Forum also supports the Administration's proposal to streamline Federal banking regulation. There are presently four Federal banking agencies – the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the Federal Deposit Insurance Corporation (FDIC), and the Federal Reserve. Meanwhile, there is only one Federal regulator of broker/dealers – the Securities and Exchange Commission (SEC) – and, of course, no Federal regulator of insurance.

Merging the OCC and OTS to create the National Bank Supervisor (NBS) is entirely sensible – it is the lowest of the low-hanging fruit when it comes to agency streamlining. Both agencies are bureaus of the Treasury Department and have similar cultures. Moreover, very few, if any, meaningful differences remain between banks and thrifts – both take deposits and make loans. Merging the two agencies would reduce the number of Federal banking agencies by one and would generate significant efficiencies and cost savings, to the benefit of the industry and the American taxpayer.

There is another important opportunity to realize very significant additional streamlining efficiencies and costs savings, one regrettably not contemplated by the Administration's proposal – requiring the FDIC and the Federal Reserve to rely on the NBS and state banking departments for on-site examination reports and other relevant regulatory information.

There is no question that the FDIC needs access to detailed information about the activity and condition of banks in order to effectively perform its role as the administrator of the Deposit Insurance Fund. Similarly, the Federal Reserve requires detailed information about commercial banks to effectively perform its role as the monetary authority and lender-of-last-resort. But there is no reason, in the Forum's view, why the FDIC and Fed should need to conduct duplicative on-site examinations themselves to harvest such information. Both agencies can confidently rely on the examination reports and other relevant regulatory information produced by the NBS and the state banking department – particularly if both agencies participate in the pre-examination planning process, as they commonly do.

We know they can because the Fed has relied on the functional regulators of the subsidiaries of financial holding companies since the passage of GLBA. The Act repealed the "Glass-Steagall" provisions of the Banking Act of 1933, permitting well-managed and well-capitalized financial institutions to become "financial holding companies" (FHCs) and to engage in a diversified range of financially related activities. GLBA also created a new regulatory arrangement for the effective supervision of FHCs – designating the Federal Reserve as their "umbrella" supervisor, with the OCC, the 50 state banking departments, the SEC, and the 50 state insurance authorities serving as the "functional regulators" of the banking, securities, and insurance subsidiaries of the Fed-supervised FHCs.

GLBA specifically prohibits the Fed from conducting on-site examinations of the non-bank subsidiaries of FHCs, except under extreme circumstances. Rather, GLBA stipulates that the Fed must rely "to the fullest extent possible" on examination reports and other relevant information provided by the functional regulators, which is a sensible approach.

Because the on-site examination is perhaps the most onerous and costly aspect of official oversight (for regulated entities as well as the taxpayer), the consolidation of on-site examination power within the NBS – thereby eliminating the duplication of multiple on-site examinations of the same institutions by multiple regulators – would achieve tremendous additional rationalization of the current supervisory framework.

Risk Council of Functional Regulators

Despite the compelling logic for designating the Federal Reserve as the single systemic supervisor, doing so also raises certain legitimate concerns – specifically: 1) concentration of power within the Fed; and, 2) the "single-point-of-failure" dilemma. Concern regarding the Fed's power would be significantly mitigated by the requirement that the Fed rely on the functional regulators for examination reports and other relevant information.

Creation of a "Risk Council" comprised of the functional regulators, as the Administration has proposed, would also significantly mitigate these concerns and help make the Fed a more effective systemic supervisor. The purpose of the Council is to provide input to the Fed regarding emerging risks in any area of the financial system, and how those risks can most effectively be addressed. Designation of the Fed as the systemic supervisor, coupled with creation of a Risk Council, achieves the significant advantages of a single systemic supervisor equipped with the powers and tools the role requires, while also achieving the value of bringing multiple perspectives to the evaluation of systemic risk.

Creation of an Office of National Insurance

The Forum's insurance industry members agree that it is essential that there be increased national uniformity in the regulation of insurance, and are supportive of the creation of an Office of National Insurance (ONI) within the Treasury Department. ONI will ensure that knowledge and expertise is established at the Federal level, which is critical to ensuring that insurance industry interests are represented in the context of international negotiations and regulatory harmonization efforts. The Forum's insurance industry members also agree with the Forum's broader membership that a systemic supervisor should have a role in the supervision of systemically relevant financial companies, and that the systemic supervisor, except under extreme emergency circumstances, should rely on functional regulators for day-to-day regulatory responsibility.

Resolution Authority for Non-Bank Conglomerates

Of the many unfortunate and objectionable aspects of the current financial crisis and the subsequent policy response, perhaps none is more regrettable and evoking of more passionate objections than "too-big-to-fail." Failure is an all-American concept because the discipline of potential failure is necessary to ensure truly fair and competitive markets. No institution should be considered too big to fail. A critical aspect of regulatory reform and modernization, therefore, must be to provide the statutory authority and procedural protocol for resolving, in a controlled way that preserves public confidence in systemic integrity, the failure of any financial entity – no matter how large or complex.

The Forum agrees with the Administration that the process stipulated by the Federal Deposit Insurance Act for dealing with failing banks, as well as the framework established for Fannie Mae and Freddie Mac by the Housing and Economic Recovery Act of 2008, provide a reasonable and sensible model for such authority. We also agree that the FDIC is the logical agency to serve as the principal coordinating agency for resolution authority, since it has acquired significant institutional experience as the resolution authority for banks; for insurance companies, we think the wind-down process should continue to be done at the state level, but in cooperation with the FDIC as the principal coordinating agency.

Consumer Financial Protection Agency

The Forum applauds the emphasis the Administration has placed on enhancing consumer protection. Of the many factors that have made the United States the world's premier capital marketplace for 80 years, our robust regime of consumer and investor protections is among the most important. The United States cannot have a world-class financial marketplace unless consumers and investors have full confidence in the safety and soundness of financial institutions, the integrity of the markets, the quality and suitability of financial products, and the basic fairness of the broader financial system. And there is no question that the essential confidence of investors and consumers has been profoundly damaged by the financial crisis.

Enhancement of consumer protection, therefore, must be part of any meaningful policy response to the current crisis. The Forum looks forward to working with Congress and the Administration to ensure that consumers, depositors, investors, and policyholders enjoy the world's most steadfast and effective protection of their interests.

Other Reform Ideas

Other reform and modernization ideas recommended by the Forum include:

- Because they entail potentially profound and pro-cyclical implications, accounting policies (i.e., FASB) should fall within the purview of the systemic supervisor.

- The systemic supervisor should conduct an ongoing review of the practices of the credit rating agencies to address conflicts of interest and to ensure independence and impartiality.

- The systemic supervisor should – in consultation with the Federal banking agencies, HUD, and FTC – develop national standards for mortgage origination, product features, securitization, and sale to ensure the proper and stable operation at every stage of this critical market and the protection of the rights and interests of mortgage consumers.

- Given the government rescue of Fannie and Freddie, the continuing role of the GSEs in the U.S. housing sector, and the large additional losses still anticipated, the systemic supervisor – in consultation with the FHFA – should study and provide guidance to Congress regarding the longer-term role and activities of the housing-related GSEs.

Again, thank you for the opportunity to appear before the Committee today. I'd be pleased to answer any questions you might have.