

OVERCOMING INERTIA: PUTTING FINANCIAL REFORM INTO ACTION

Steve Bartlett
Remarks at American Enterprise Institute
January 28, 2008

Thank you, Peter. It is a pleasure to be here today at the American Enterprise Institute. Since its inception in the early '40's, AEI has become a recognized resource for policymakers on a wide range of matters. The Financial Services Roundtable and its members particularly appreciate the work AEI is doing in the field of financial services regulation under the leadership of Peter Wallison.

I had the pleasure of working with Peter when I was in Congress and Peter was at the Treasury Department and then the White House. Peter Wallison is one of America's thought leaders regarding financial services. Peter was a member of the Roundtable's Commission on Enhancing Competitiveness, which issued our Blueprint for U.S. Financial Competitiveness. He contributed significantly to the breadth and depth of the blueprint.

Almost one year ago today, President George W. Bush addressed the importance of our financial system in a speech at Federal Hall in New York City. He noted that "America's economic leadership rests on strong and flexible capital markets" and that "To keep America's economic leadership, America must be the best place in the world to invest capital and do business."

The Roundtable's Blueprint for U.S. Financial Competitiveness is based upon that challenge. It is a call to action for legal and regulatory reform so U.S. financial markets and firms can remain competitive in global financial markets.

U.S. financial markets and firms are facing unprecedented competitive challenges from foreign firms and foreign regulatory regimes.

How we respond to these challenges reminds me of the old story of "draining the swamp." If you recall that story, everyone knows it is time to drain the swamp, but no one is able to do so, giving the excuse that they are "up to their armpits in alligators." So, the swamp never gets drained and the alligators get meaner and more numerous every year.

As the mortgage market crisis continues to unfold, we are all indeed up to our armpits in alligators – and some have pretty sharp teeth. It's time to recognize, however, that those alligators will just keep getting meaner and bigger until we do something about the swamp.

Perhaps we could not have totally avoided the current turmoil if we had adopted the reforms. I do believe, however, that if those reforms had been in effect there would be fewer alligators around today, and even fewer next year.

Fortunately, there is a growing consensus for the reforms set forth in our Blueprint. That consensus is reflected in the two volumes I have here before me. These two volumes contain all of the letters submitted to the Treasury Department in response to its request for public comment on the structure and role of our financial regulatory system.

My goal today is to outline how we can turn this emerging consensus and the current inertia into action.

Inertia is a strong force. The laws of physics state that, under the force of inertia a body at rest will stay at rest, and a body in motion will remain in motion.

It is time to overcome inertia and put financial regulatory reform in motion.

WHY REGULATORY REFORM IS NEEDED

First, allow me to expand on why financial regulatory reform is urgently needed.

We live in a global marketplace, where the United States can no longer presume a leadership position as a matter of “divine right”.

We face growing competition for business, finance, and jobs from firms and countries located around the globe. And that’s good, assuming we choose to compete.

The Bloomberg-Schumer Report documented a number of external factors that challenge us: faster growing overseas markets, continued business expansion away from the U.S., and better regulatory regimes such as in the U.K.

We cannot control these external challenges, but we can respond with our own competitive challenge.

The fact is that the U.S. financial services sector is the third largest sector of our domestic economy – after manufacturing and real estate. Financial services account directly for 8 percent of the nation’s GDP.

The financial services sector also is among the three fastest growing sectors of our domestic economy, with an average growth rate of over 5 percent. This compares to 3.2 percent average for the economy as a whole.

Financial services account directly for 5 percent of all employment in the U.S. More importantly, virtually all other jobs are indirectly dependant on a vibrant and competitive financial services industry.

These indirect effects are compelling. Financial markets and firms provide consumers, businesses, investors, and governments with the means to invest, save, borrow, finance and exchange funds. Secretary Paulson called the financial services sector the “lifeblood of our economy.” If you build it, live in it, work at it, eat it, or drive it; someone had to finance it.

THE ROUNDTABLE’S BLUEPRINT

The Roundtable’s Blueprint is the work product of a 62-member Blue Ribbon Commission. These Commission members are among the most respected executives of the financial services industry in America today.

They—together with more than 150 industry, legal, and regulatory experts—formed various working groups and subgroups that met in 30 formal sessions over the course of six months.

We deliberately labeled the Commission's report a Blueprint. It is a plan for action, not simply another report to be studied.

Our Blueprint is based on the excellent work of three prior reports and Commissions:

- The Committee on Capital Markets Regulation;
- The Bloomberg-Schumer Report; and
- The Commission on the Regulation of U.S. Capital Markets, organized by the U.S. Chamber of Commerce.

We did not duplicate those reports. Rather, our Commission took those reports and developed concrete steps to achieve the goals.

Our Blueprint contains 68 specific recommendations for action in real time, including recommendations for a more principles-based approach to financial regulation, litigation reform, and reforms to regulatory policies such as our anti-money laundering rules, capital and accounting rules.

These reforms are not a call for deregulation. They are in whole, and in part, a call for better regulation.

HOW TO MOVE FORWARD WITH NEEDED POLICY REFORMS

As I mentioned at the start of my remarks, there is a growing consensus for financial reform. That consensus is apparent in the comment letters filed with the Treasury Department as part of Secretary Paulson's review of our financial markets and financial regulatory system.

The challenge we face is how to put this consensus into action.

I would urge the Congress and the Treasury Department to address this challenge by being bold, comprehensive, and pragmatic.

We need to be bold because the challenge is great. Many features of our existing financial regulatory system have not been seriously reviewed for years. The McCarran-Ferguson Act, for example, was passed in the '40's. Investment companies were not in existence in 1940.

We need to be comprehensive because the challenges we face cut across markets and geographic borders. We live and work in a global economy. Boise is connected to Birmingham and Boston; and also to Belgrade, Beijing, and Belfast.

We need to be pragmatic. We face a situation like the fellow that invited to eat an elephant. He naturally asked "How do you eat an elephant? It is too big." His host answered "one bite at a time."

One approach is for policymakers to start on three discreet and achievable reforms – what I would call the "low hanging fruit". Each of these reforms can be achieved in 2008, although they would be not be easy.

The three reforms are: (1) principles-based regulation; (2) prudential supervision; and (3) optional national insurance charter. These same reforms, as well as others listed in the Blueprint, are among the Roundtable's 2008 Legislative Priorities, which I will publicly announce tomorrow.

Principles-based regulation

The need for principles-based financial regulation was first identified by the Bloomberg-Schumer Report. In March 2007, Treasury Secretary Paulson issued his challenge to consider whether principles-based regulation was appropriate for the U.S. In our Blueprint, we went a step further and identified six Guiding Principles.

Those six principles are: (1) fair treatment for consumers; (2) competitive and innovative financial markets; (3) proportionate, risk-based regulation; (4) prudential supervision and enforcement; (5) options for serving consumers; and (6) management responsibilities.

Support for principles-based regulation is broad and solid with opposition only from the inertia of an object at rest. Major trade associations - representing financial services, business, and end users of financial services – signed a joint letter to Secretary Paulson endorsing principles-based regulation.

This joint letter was signed by the Business Roundtable, the U.S. Chamber, the Financial Services Forum, SIFMA, and ICI, and the Financial Services Roundtable.

Individual companies as diverse as State Street, Swiss Re, and Deutschebank also have endorsed it.

Principles-based regulation has even been endorsed at the state level by the New York State Banking Superintendent and the New York State Insurance Commissioner.

Let me cite from just a few of the 25 letters of support filed with Treasury.

The Chamber's Center for Capital Markets Competitiveness said: "it is critical that the U.S. move away from its prescriptive, rules-based and 'gotcha' approach to regulation and enforcement, and adopt a more principles-based and prudential approach."

The Managed Funds Association (MFA) stated: "This flexible approach [principles-based regulation] fosters the development of a cooperative, not combative, regulatory relationship for businesses and their regulators, and avoids the problems a rigid, one-size-fits-all approach imposes . . ."

Acknowledging that principles must also include "outcome-based rules", SIFMA concluded that: "a more principles-based approach should provide firms with the flexibility to respond appropriately to new market developments and innovations, without compromising investor protection."

The Financial Services Roundtable has drafted a bill that would establish Guiding Principles for U.S. financial regulators, markets and firms. The consensus is there; and action is needed.

Prudential supervision

Prudential supervision goes hand in hand principles-based financial regulation.

Prudential supervision encourages constructive and ongoing engagement between firms and their regulators to ensure compliance with both principles and rules.

Firms and regulators can address and correct issues in a timely and effective manner to achieve common objectives.

Prudential supervision also can encourage regulated firms to bring matters of concern to supervisors. Rather than resort to immediate enforcement actions, prudential supervision contemplates that regulators would correct practices.

Prudential supervision is the norm in banking regulation, but it is just taking root in securities regulation through the SEC's Consolidated Supervisory Entity (CSE) program for the five largest securities firms. Typically, prudential supervision is not in use at all in the state-based insurance world.

Prudential and principles-based supervision has been endorsed by SIFMA, the Chamber, ICI, and the Institute of International Bankers (IIB). The IIB summarized it best by noting that "The balance between prudential oversight . . . and the enforcement of regulatory norms . . . should be recalibrated."

The Financial Services Roundtable has also drafted legislation to implement prudential supervision. We will share the draft with all other interested parties, and then move to get it introduced on the Hill together.

New optional charters

Finally, let me talk about the need for new, optional charters for serving consumers better in the future. Our Blueprint advocates three new financial charters, a new national insurance charter, a new national securities charter, and a new universal financial services charter.

Of these, the optional federal insurance charter is furthest along. The comment letters to the Treasury indicate a strong base of support for this proposal. The proposals for a universal financial services charter and a new national securities charter deserve attention, but need more time to develop.

The arguments in favor of an OFC can be boiled down to two basic ones.

First, the current state-based system is uncompetitive, as the Bloomberg-Schumer Report concluded: "An optional national insurance charter would benefit the competitiveness of both domestic and international firms. A single charter would give U.S. companies a uniform regulatory platform from which to operate and serve their customers nationwide as well as globally."

The second argument goes to the heart of serving all consumers – one of the key principles outlined in the Roundtable's Blueprint. As the OFC Coalition noted: "Today's balkanized regulatory system results in significant delays in bringing products to market and stifles innovation that would assist consumers' financial and retirement needs."

The OFC was endorsed by the Bloomberg-Schumer Report and the U.S. Chamber report.

One of the letters filed with the Treasury Department in support of OFC was signed by a coalition of multiple trades: The Financial Services Roundtable, Agents for Change, ABA, ABA Insurance Association, the ACLI, AIA, Council of Insurance Agents and Brokers, the Financial Services Forum, the Life Insurance Council, the National Association of Independent Life Brokerage Agencies, and the Reinsurance Association of America.

One letter in support of OFC caught my eye. It was filed by an independent agent in Ohio who holds multiple state insurance and securities licenses. He noted that "every state has a different set of rules that seldom makes sense."

This agent then stated that the obvious: "A federal charter that sets the same standards for everyone would mostly benefit consumers. They would have better products and an assurance that reasonable enforcement keeps agents honest."

OFC reform bills have been introduced in the Congress by Senators Johnson and Sununu and Representatives Bean and Royce in the House. Treasury should place an optional federal insurance charter at a high priority for early action by Congress.

CONCLUSION

In closing, I urge the Treasury Department and the Congress to let the force of inertia work for us with action, rather than against us with inaction. The industry has spoken in agreement - in support of principles based regulation, prudential supervision, and optional federal insurance charter. These reforms can be achieved in the near term.

At the outset of my remarks I quoted President Bush on the need for competitive financial markets. In the spirit of bipartisanship, let me close by quoting another President. Even though he was not addressing the same financial market issues, his words of admonition apply equally today to these competitive issues.

President John F. Kennedy said: “Things do not happen, they are made to happen.”

He also said: “There are risks and costs to action, but they are far less than the long range risk of comfortable inaction.”

Ladies and gentlemen, let me suggest that we can overcome inertia and make things happen to improve the regulation of our financial markets in the name of serving consumers better and maintaining our competitiveness in an increasingly global economy.

Let me also suggest that we can not afford “comfortable inaction,” as JFK acknowledged.

Thank you.