EliScholar – A Digital Platform for Scholarly Publishing at Yale

YPFS Resource Library

7-22-2009

Deputy Treasury Secretary Neal Wolin Speech Before The American Bankers Association Washington, D.C.

Neal Wolin

https://elischolar.library.yale.edu/ypfs-documents/7211

This resource is brought to you for free and open access by the Yale Program on Financial Stability and EliScholar, a digital platform for scholarly publishing provided by Yale University Library. For more information, please contact ypfs@yale.edu.

U.S. DEPARTMENT OF THE TREASURY

Press Center

Deputy Treasury Secretary Neal Wolin Speech Before The American Bankers Association Washington, D.C.

7/22/2009

TG-224

As Prepared for Delivery

Steve, thank you for that very kind introduction. Ed Yingling and members of the ABA, thank you for the opportunity to speak with you this morning.

Almost a century and half ago in the wake of another financial crisis, prominent citizens from across the country gathered at Saratoga, N.Y. to consider methods for averting a repetition of the crisis. They founded a powerful group that – as its constitution said--was to "promote the general welfare and (the) usefulness of banks and banking institutions…"

That group was the American Bankers Association. And the purpose for which it was founded is as relevant today as it was in 1875.

The crisis of the past two years has exposed serious vulnerabilities in our financial system – vulnerabilities that brought down some of our largest financial institutions and have hurt millions of American families.

In the wake of this financial crisis, one thing is clear: We cannot go back to business as usual.

Let me begin by talking briefly about what we have already done to restore financial stability and put America back on the path to economic growth.

Faced with extraordinary challenges, this Administration and Congress responded with swift, bold action. We enacted an historic economic recovery plan, giving a tax cut to 95% of American working families.

We have taken action to stabilize our housing market and avoid foreclosures; to boost new consumer and business lending by re-starting the market for securities; and to create a market for old mortgage loans and securities that are keeping banks from lending by weighing down their balance sheets.

As you all know, we have also taken extraordinary action to help build the capital base of viable U.S. financial institutions through the Capital Purchase Program – enabling banks around the country to continue lending to businesses and consumers.

Recognizing the particular importance of small, community banks, Secretary Geithner announced in May an expansion of that program to benefit banks with assets under $500 million.

We have invested in 657 institutions across 48 states, including over 300 small and community banks. As Treasury's Lending and Intermediation Survey illustrates, banks have continued to lend, despite the significant headwinds posed by this crisis and recession.

More generally, we have seen signs of stabilization in the financial markets. The 3 month LIBOR-OIS spread has fallen from a high of 365 basis points in October to 33 basis points today. In recent weeks, we have seen other encouraging signs as well, including an uptick in housing starts.

We have a long way to go and we cannot be complacent; the history of major financial crises includes many false dawns and periods of optimism even in the midst of the worst downturns. But I hope you will agree that the sense of free-fall that we all felt earlier this year has now largely abated.

Even as we have worked to contain the fallout from the crisis, we have also begun the work of fundamentally reforming and modernizing our financial regulatory framework.

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

In the weeks since the President's announcement, we have acted aggressively to advance the Administration's proposals. Before Congress adjourns for the August recess, we will have delivered to the Hill legislative language on every element of our White Paper that requires legislative action.

We have already delivered draft legislation that would create a Consumer Financial Protection Agency; that would strengthen investor protections; that would require the registration of hedge funds and other private pools of capital; and that would help ensure that executives are compensated in a way that keeps their interests aligned with the interests of their shareholders.

Just yesterday, we delivered draft legislation that would increase transparency, tighten oversight, and reduce reliance on Credit Rating Agencies.

Today, we are sending up legislation on some of the most significant elements of our reform package. The legislation we are delivering today would create a Financial Services Oversight Council to coordinate regulatory policy, taking a system-wide perspective.

It would establish authority for the consolidated supervision of the largest, most interconnected financial firms.

It would strengthen securitization markets, which played such a central role in precipitating this crisis, by increasing transparency and ensuring that originators have some skin in the game.

It would strengthen the oversight of systemically important payment, clearing and settlement systems.

It would close gaps and loopholes in the bank regulatory system and reduce the opportunities for regulatory arbitrage.

And it would give the government the tools it needs to respond swiftly and effectively in times of crisis, by establishing a workable resolution regime to prevent – in extraordinary circumstances – the disorderly failure of Bank Holding Companies.

Finally, next week, we will deliver draft legislation on the regulation of over-the-counter derivatives.

At the same time, we are pushing ahead on other fronts. We have mobilized the President's Working Group on Financial Markets to ensure that regulators make maximum use of their existing authority to implement those provisions of the plan that do not require legislative action.

In recent weeks, the debate over our proposals has intensified. It is a debate that we expected – and welcome. While crafting our plan, we sought input from all points of view and considered a wide range of options and perspectives. We have proposed a balanced, pragmatic plan to strengthen our financial system.

Today, I would like to focus on two key issues-- systemic risk and consumer protection.

Let me begin with the issue of systemic risk.

In one sense, our entire regulatory reform proposal is about systemic risk. Taken together, our proposals for strengthening prudential requirements, closing loopholes, limiting opportunities for regulatory arbitrage, bringing key markets and activities under the regulatory umbrella, and establishing an effective mechanism for the resolution of failing firms, all combine to make our financial system safer.

To put it another way, we do not propose to create a "systemic risk regulator." We propose to create a comprehensive approach to systemic risk regulation.

That said, as part of our approach to systemic risk regulation, there are two specific – and quite distinct – questions that our proposal seeks to answer.

The first is: whose job is it to keep an eye on and understand what's going on across the financial system – to coordinate policy among regulators; to identify gaps, weaknesses and sources of vulnerability; to help ensure that, in the future, we don't allow systemic risk to build up unrecognized?

The second is: how should we handle the regulation of institutions and systems that, by virtue of their importance or interconnectedness, present particular risks to the financial system.

In response to the first question, we have proposed establishing a Financial Services Oversight Council, made up of the heads of the federal financial regulatory agencies. The Council will have both the authority and the mandate to look across the financial system to identify sources of weakness and vulnerability. Collectively, it will have broad and deep insight into our financial system and will serve the important role of promoting coordination among the various regulators.

While the Council will be well-suited to identifying risks and coordinating regulatory policy, a Council is not the answer to the second question. The regulation of large, interconnected financial institutions and systems is a specialized task, requiring tremendous institutional capacity and organizational accountability. It simply cannot be done by a committee of independent bodies.

It is critical that, with respect to our largest and most interconnected institutions and systems, we leave no lack of clarity about exactly who is accountable for their safety and soundness.

Indeed, with respect to the regulation of what we have called Tier 1 Financial Holding Companies, the Federal Reserve is the only regulatory body with the experience and with the deep and broad understanding of the capital markets necessary to supervise Tier 1 Financial Holding Companies in a comprehensive way.

The Federal Reserve already supervises and regulates all major U.S. commercial and investment banks at the holding company level. Giving it the authority and responsibility to supervise Tier 1 Financial Holding Companies is an incremental step – albeit an important one.

We believe our proposal represents the most reasonable, effective approach to systemic risk regulation.

Now, let me turn to the establishment of a Consumer Financial Protection Agency.

In my view, the case for a Consumer Financial Protection Agency could not be clearer. The irrefutable fact is that the recent financial crisis was caused, in important measure, by the failure of our consumer protection regime.

The current approach to consumer protection fragments responsibility over numerous regulators. All of the federal financial services regulators have higher priorities than protecting customers. There are wide gaps, allowing non-banks to escape federal supervision almost entirely. The current approach invites regulatory arbitrage.

The result is a system defined by ineffective regulation, inertia, and uneven standards.

Consider the problem of subprime lending: It took the federal banking agencies until June 2007 to reach consensus on supervisory guidance to impose even general standards on the sale and underwriting of subprime mortgages – two years after evidence of declining underwriting standards emerged in a regulator's public survey of loan officers.

It took additional time for states to adopt parallel guidance for independent mortgage companies. And it took yet another year for the federal agencies to settle on a simple model disclosure of subprime mortgages – by which time we were deep in the throes of a financial crisis precipitated largely by subprime lending.

The ABA has taken a position in opposition to our proposal to establish an accountable, mission-focused, market-wide consumer protection agency. But let me state why I think that the CFPA is in both the consumers' interest and your interest.

Under the current approach, non-banks operate almost entirely outside the scope of federal consumer protection oversight. In the years leading up to the crisis, capital flowed heavily to non-banks in part because they had the advantage of weak consumer oversight.

Banks with straightforward credit products were forced to compete with less scrupulous providers outside the banking system. Banks that were not willing to lower their standards lost market share and revenue.

Our proposed CFPA would fix this problem by extending federal oversight to all financial firms, banks and non-banks alike – including mortgage brokers and large independent mortgage companies, consumer credit companies and pay-day loan operations. It would level the playing field.

Some have argued that you cannot separate responsibility for consumer protection from the responsibility for safety and soundness – even claiming that an independent consumer protection agency would "contradict" the goals of safety and soundness. That argument simply does not hold water.

In the first place, we reject the notion that profits based on unfair practices can ever be considered sound. They may produce short term profits, but they lead to long term losses and – most importantly – a loss of trust. Mortgages and credit cards are cases in point.

In the second place, our proposal requires the flow of information between the CFPA and other regulators through the exchange of examination reports. Legislation should also make clear that agencies are required to coordinate examination schedules and exchange reports in draft for comment.

I'm hard pressed to think of a realistic example of a true conflict between the consumer protection agency and the prudential regulators. But for the rare case in which such a conflict might arise, we can put in place a framework that ensures their swift resolution.

Separating consumer protection examinations from safety and soundness examinations does not cause problems. What does cause problems is separating consumer protection rule-writing from enforcement and supervision, as we do today. That separation keeps rule-writers from being fully informed about the market, and it ties the hands of supervisors who witness the failures first hand. Our proposal fixes that problem.

Critics have also claimed that establishing a consumer protection agency will stifle innovation. If that means that the agency will make it harder to sell consumers products that they don't understand and cannot afford – that's correct.

But the agency will not limit consumers' ability to choose the products they want. Quite the contrary, our proposed legislation explicitly charges the CFPA with preventing abusive and unfair practices and, at the same time, promoting efficiency, innovation and consumer access to financial services. A statutory mandate to weigh these considerations will help ensure the CFPA's regulations are balanced.

We reject the false choice between consumer protection and innovation. We should have a financial system that both fosters innovation and provides strong consumer protections.

Let me be clear: with respect to banks, we are not proposing more burdensome regulation. Banks are currently subject to an extensive supervisory regime, and there's no lack of examination hours or paperwork requirements.

What we are proposing is better regulation. We're proposing a system that consolidates fragmented regulatory authority – and, in the process, probably reduces regulatory burdens in areas where current authorities overlap or conflict. And by treating non-banks much more like banks, we're proposing a system that applies equally – making it much less likely that banks will be tarred in the public's eyes as a result of non-banks unscrupulous activity.

As you know better than anyone, the banking industry is, in the end, built on trust. Strengthening consumers' confidence that their interests are being protected will, perhaps more than anything else, help ensure the strength of our banking sector.

Let me close with another reference to the history of your own organization. In 1893 the ABA gathered for its eighteenth convention in the wake of what the ABA's then President, William Rhawn, described as "a financial convulsion of wider extent and greater severity than has befallen the Country in twenty years, if ever."

At the meeting, Rhawn read from a petition to Congress which stated the organization's view that "restoration of confidence is absolutely necessary to avert further disaster, and that it is the duty of our legislators to do everything in their power to bring about such restoration of confidence."

Today, we find ourselves meeting soon after another financial convulsion. And, once again, it is critical – and urgent – that we work together to restore confidence in our financial system, and to regain the trust of people who rely upon it to buy a home, save for college, or start a business.

In recent years, many in the financial industry have, at least initially, opposed key elements of many major pieces of financial consumer protection legislation. This is the time to join together to modernize our financial regulations. We must work together to lay the foundation for a safer, more stable system – one that supports strong, sustainable economic growth; one that protects American consumers, even as it continues to promote innovation and expand consumers' choices; one that the American people can trust.

Over the coming months, as Congress considers our legislative proposals and as we move forward with the non-legislative elements of our reform effort, we look forward to continuing to work with you. If you have ideas for how our proposals can be improved, we welcome them. As the recent crisis has demonstrated, your institutions are vital to keeping the American economy strong and growing.

Thank you.

###