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I have a great deal of respect for the New York Society of Securities Analysts. For over 70 years your organization has been a key player in financial markets, affecting trends and helping shape the investment industry. There is no doubt that securities analysts play a vital role in our capital markets, and the innovative and experienced leadership of NYSSA members is an important reason why.

The NYSSA has also served an important role in educating and informing investment professionals through countless seminars and forums such as this. Given current market conditions, this educational role is more important now than ever. Your organization can play crucial role in key areas like investor awareness of risk.

Let me congratulate you on organizing an especially timely conference. Your program today is excellent and you are focused on the right set of issues. Topics like hedge funds, GSEs and rating agencies are topics we think about every day at the Treasury Department. You have an exciting day in front of you.

My remarks this morning will focus on Treasury's work on a new regulatory blueprint for U.S. financial services regulation. I will begin by giving a bit of perspective about financial regulation and U.S. competitiveness in the global capital markets. I will then discuss challenges with our current regulatory system, and what principles we at the Treasury believe are essential to include in a modernized regulatory framework. I will conclude with some brief comments on current conditions in the markets and the broader economy.

Capital Markets Competitiveness

Maintaining and enhancing the competitiveness of U.S. capital markets has been one of Secretary Paulson's primary goals since arriving at the Treasury.

Our markets are the strongest in the world, but maintaining this leadership requires having the confidence to continually self-assess our position and when appropriate, make changes or adjustments. Secretary Paulson's capital markets competitiveness initiative is about using recent trends like globalization as an opportunity to leverage our competitiveness and bring even greater benefits to our economy and citizens.

Secretary Paulson kicked off these efforts in the fall of 2006 in here New York with a speech which served to frame the issues. After that address, an enriching period of public discourse followed, highlighted by the release of four separate and independent reports: one from Mayor Bloomberg and Senator Schumer, one from the U.S. Chamber of Commerce, one from the Financial Services Roundtable and one from a highly-regarded study group called the Committee on Capital Markets Competitiveness.

Last spring, Secretary Paulson hosted a conference on capital markets competitiveness at Georgetown University. We heard from key policymakers, consumer advocates, business representatives and academics, each with different perspectives on ways to keep U.S. capital markets the strongest and most innovative in the world.

Following that conference, Secretary Paulson announced a series of initiatives aimed at maintaining the competitiveness of U.S. markets. In June, Secretary Paulson announced that Treasury would publish a "regulatory blueprint study," that will consider ways to rationalize the current regulatory structure in an effort to maintain a dynamic U.S. market for financial services while improving oversight.

Limitations of our Current Structure

If we were starting from scratch, no one would choose to design today's system. Nor is it a system we would design in order to ensure that the United States remains the global leader in financial services.

Our current regulatory framework has been largely knit together over the last 75 years – with act on top of act, initiative on top of initiative – each a reaction to various crises or innovations in the financial services industry. Today we have a series of individual regulations, each
designed in response to specific circumstances and lacking an overarching set of guiding principles. Our system has multiple federal and state regulators with unclear and sometimes overlapping boundaries.

Let me provide some more specific examples of the limitations of our current regulatory system, and how these affect depository institutions, securities and futures markets and the insurance industry.

Within our existing regulatory structure, the regulation of depository institutions may choose from one of three federal charters or a state charter. For institutions that are subject to federal oversight, there are five distinct regulators, which have primary regulatory responsibility based on various characteristics of the institution and its membership within the Federal Reserve System. Sound oversight and consumer protections should not be a matter of choice.

Given multiple regulators with overlapping responsibility in many cases, it is difficult to ensure that standards are consistently applied across all types of depository institutions. This system also exposes us to the potential for “regulatory arbitrage.” If a company perceives a discrepancy between two jurisdictions, it might go ‘regulator shopping’ to find the friendliest regime in which to do business. Furthermore, no single regulator is able to take an overarching perspective and observe the broader market. This limits regulators’ ability to detect trends or early warning signs across financial markets. The flip side of this argument is that multiple charters encourage regulatory competition, which can lead to more effective regulation.

Securities and futures markets have a different structure, one where regulation is determined on a product basis. Here jurisdiction between the Securities and Exchange Commission and the Commodity Futures Trading Commission over products is determined by whether a product falls within the definition of a “security” under the federal securities laws or a “future” under futures law.

But markets do not respect the historic distinctions between securities and futures. In recent years we have seen not only substantial product convergence within these two markets, but also convergence among market participants – investors, intermediaries and trading platforms.

Finally, within the insurance industry we encounter yet a third regulatory framework, one that is managed almost exclusively by the states. Within this market, insurers must be licensed with the states — there is no federal charter available. Although the state commissioners created the National Association of Insurance Commissioners more than 135 years ago to assist with the monitoring, administration and coordination of insurance regulation, actual regulatory authority is still vested in the individual states.

As a result, both the compliance process and the approval of structures or pricing within the insurance industry are inconsistent. Furthermore, with a network of over fifty separate regulators there is no single regulator with a comprehensive view of the insurance market. There is also no single national regulator to address international insurance issues.

Recent challenges within the mortgage market highlight the risks of this regulatory patchwork and the vital need for a modernized regulatory structure. Yet using the mortgage market as an example, the overlapping layers of regulation for national banks, savings association, thrift holding companies, bank holding companies, state-chartered mortgage finance companies and other institutions highlight the challenges that regulators face not only as they respond to a crisis, but also in their everyday work. However, let me be clear: our regulatory framework did not cause these market disruptions – they were created by other forces, as I will discuss in bit.

Goals of Regulation

When undertaking the task of writing a new regulatory blueprint, it is important to first articulate what the philosophy and goals of financial regulation should be – who should be protected, which participants should be regulated, and how should that regulation be developed and applied.

As I have discussed before, markets serve as a bridge, connecting suppliers of capital with users of capital. They connect those who have resources to invest with those who could use this capital to turn ideas into new businesses or expand existing businesses, thereby generating jobs and contributing to a growing economy.

Considering the goals of regulation in this context, we are reminded that the most effective bridges allow participants and their capital to cross from one side to the other with as little friction as possible. Effective bridges facilitate a safe, open, and transparent flow of information.

An effective bridge must also be built on a sound, predictable foundation, and it must have strong pillars of investor and consumer protection, market integrity and risk mitigation.

We must recognize that not all participants travel at the same speed on this bridge and so a continuum of protection in this open-market environment is appropriate. At one end, retail consumers might need government-sponsored insurance to protect their savings or the confidence to know that they are not disadvantaged when dealing with a more experienced market participant. At the other end of this continuum we find large, sophisticated investors who understand market risks and do not need the same regulatory protections as they interact with peer organizations. Treasury is creating a blueprint with this understanding, to give the consumers and institutions on differing sides of the continuum the appropriate protections.
As we in the Treasury Department develop a blueprint for a more optimal regulatory structure, we must balance policies that allow for efficient movement of capital while also promoting a safe and stable environment. A regulatory structure that meets all of these conditions will invite capital by inspiring confidence among market participants.

**Toward a Modernized Regulatory Approach**

We need a new, modernized approach to regulation – one that is risk-based, globally oriented and flexible in scope.

As we progress with our analysis, we are guided and comforted by the fact that other countries have conducted similar exercises as how to best regulate financial market activity in the modern era.

For example, as you well know, the United Kingdom closely analyzed its regulatory structure just over a decade ago and made fundamental changes such as separating bank supervision and monetary policy and consolidating financial services supervision from nine regulatory bodies to a single regulator. The tripartite, comprised of the Financial Services Authority, the Bank of England and Her Majesty's Treasury, operates under a memorandum of understanding which delineates areas of responsibility, supports the exchange of information, and identifies roles in a financial or operational crisis.

Issues related to the collapse of Northern Rock have raised some concerns about how the revamped regulatory structure in United Kingdom performed in a crisis. In particular, issues associated with information and coordination agreements between government agencies, as well as the role of the Bank of England in bank supervision will likely be re-evaluated. Also fundamental issues, such as the nature of the deposit insurance regime in the United Kingdom have also been noted as contributing to the recent problems with Northern Rock.

There are other macro-level regulatory structures from which we can learn, such as the "Twin Peaks" model adopted in Australia and the Netherlands. In general the "Twin Peaks" focuses on regulation by objective, which results in the establishment of two distinct regulatory bodies – one responsible for prudential financial regulation of entities where such regulation is necessary, and one responsible for conduct of business regulation related to financial products being offered to consumers and investors.

Many in the United States view these alternative approaches around the world as opportunities to learn about how our regulatory system might be enhanced. Some of the overarching reasons for looking at alternative structures is a better balance between principles and rules, and a better analysis of benefits and burdens of regulation. Of course, an optimal construct should balance both rules and principles.

We believe that regulation should be guided by principles at an overarching level. But in many cases some type of rules-based regulation is necessary. In particular, regulation at the retail level will require some focus on rules, particularly to protect less sophisticated market participants. Too often, however, discussions about ideal regulatory philosophy and structure have been reduced to a black and white debate of rules versus principles. This oversimplification undermines the complexity of these issues, and is not constructive.

Similarly, calls for a cost-benefit analysis are easy to articulate but difficult to implement. Of course, we reject calling for regulation just for regulation's sake, but costs are often easy to estimate, while benefits are less so. Many, I fear, use cost-benefit analysis as a blunt proxy to mask a general reservation about new regulations. While neither view is completely correct, a better, more disciplined view of evaluating the costs and benefits of regulation is important.

The issues surrounding rules versus principles or cost-benefit analysis are not unique to a particular regulatory structure. In addition to considering these types of overarching regulatory issues, our focus in developing the regulatory blueprint is to look broadly at long-term issues associated with the underlying structure of our regulatory system.

**Regulatory Blueprint**

To begin mapping out a plan for modernizing our regulatory structure, the Treasury Department has been working to examine the issues that I have discussed with you today in order to propose a more efficient structure while improving regulatory oversight.

This work has not proceeded in a vacuum; instead public input has been very important to our work. Following an October request for public comment in the Federal Register, the Treasury Department received hundreds of thoughtful and enlightening comments covering a wide range of topics associated with the regulation of securities and futures firms, depository institutions and insurance firms.

While our work is still ongoing and no final decisions have been made, we expect to release our regulatory blueprint within the first quarter of this year. One aspect of the blueprint is to propose some broad ideas for an optimal regulatory structure to match the ever changing nature of the financial services industry. You should not be surprised to hear that this optimal structure will be different from our current structure. This will be a newly-designed model for the U.S financial services industry that should meet the needs of today and be flexible enough to address issues that might come tomorrow. In developing this model, we are focusing on the key aspects of regulating financial institutions; prudential regulation for safety and soundness; consumer and investor protection regulations; and overall market stability regulation.

Of course, we recognize that there are many difficulties in obtaining wholesale changes to the current regulatory structure. There are many political and parochial concerns and some market participants are hesitant and generally opposed to change. We recognize this
fact. Therefore, our report will also recommend some less conceptual ideas that we believe will serve as intermediate steps to put us on the path towards the optimal structure of financial services regulation.

The success of this initiative will not and should not be tied to just short-term accomplishments. Some of the recommendations will be immediately relevant to legislative and regulatory policy issues. On these matters, our hope is that the Treasury Department’s report will spur near-term tangible results. Implementation of other, longer-term recommendations will be subject to outside factors but will be ready should support for these reforms develop. Finally, our hope is that some of the recommendations will shape future debates regarding regulatory structure issues.

Market Conditions

In conclusion, let me comment briefly on current conditions in the markets since that is something on all of our minds these days.

It is clear that challenges in the markets are having significant consequences. What began as a credit issue last summer, raised questions about market liquidity in the autumn, and today is causing uncertainty about the economy.

The flow of liquidity that fueled a boom in borrowing and leverage across asset classes – from mortgages to leveraged buyouts – has now been reduced. Short-term funding markets were stressed and inter-bank funding spreads rose to unprecedented levels. Mortgage origination and other asset securitization dropped markedly, adding to the challenges in the housing sector. Given the interconnectedness of our capital markets, other stresses emerged as financial institutions grappled with valuing assets and balance sheets came under pressure.

Of course, housing has been at the center of all these challenges. Housing corrections take time and we are currently experiencing a period of adjustment in the housing sector of our economy. After years of unsustainable home price appreciation and relaxed lending practices, a housing correction was inevitable and necessary.

Our economy is resilient and fundamentally strong, but the housing correction, credit market turmoil, and high oil prices are weighing on growth this year and short-term risks are to the downside. We at Treasury expect that our economy will continue to grow over the coming year, but at a slower rate than we have enjoyed for the past few years.

However, there is the risk of a downturn. And to address this short-term challenge, President Bush announced a bipartisan agreement with House of Representatives on a growth package to bolster the economy this year. The proposal will provide about $150 billion of tax relief for the economy, leading to the creation of over half a million additional jobs by the end of this year. The Administration and the American people await action in the Senate to produce a targeted package to send to the President. By passing this economic growth agreement quickly, we can protect the strength of our economy as we weather the housing downturn and other challenges.

Conclusion

Thank you for the opportunity to discuss our regulatory blueprint today. Opportunities to share our perspective with important market participants like you are always appreciated. We will look forward to keeping you informed as we near final recommendations.

If you have the time, it would be my pleasure to take a few questions.