STATEMENT OF

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THE FINANCIAL SERVICES ROUNDTABLE

On

CONSUMER PROTECTION IN FNANCIAL SERVICES:

PAST PROBLEMS AND FUTURE SOLUTIONS

Before the

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

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Chairman Dodd, Ranking Member Shelby and Members of the Senate Banking Committee. I am Steve Bartlett, President and Chief Executive Officer of the Financial Services Roundtable. The Roundtable is a national trade association composed of the nation's largest banking, securities, and insurance companies. Our members provide a full range of financial products and services to consumers and businesses. Roundtable member companies provide fuel for America's economic engine, accounting directly for $85.5 trillion in managed assets, $965 billion in revenue, and 2.3 million jobs.

On behalf of the members of the Roundtable, I wish to thank you for the opportunity to participate in this hearing on the role of consumer protection regulation in the on-going financial crisis. Many consumers have been harmed by this crisis, especially mortgage borrowers and investors. Yet, the scope and depth of this crisis is not simply a failure of consumer protection regulation. As I will explain in a moment, the root causes of this crisis are found in basic failures in many, but not all financial services firms, and the failure of our fragmented financial regulatory system.

I also believe that this crisis illustrates the nexus between consumer protection regulation and safety and soundness regulation. Consumer protection and safety and soundness are intertwined. Prudential regulation and supervision of financial institutions is the first line of defense for protecting the interests of all consumers of financial products and services. For example, mortgage underwriting standards not only help to ensure that loans are made to qualified borrowers, but they also help to ensure that the lender gets repaid and can remain solvent.

Given the nexus between the goals of consumer protection and safety and soundness, we do not support proposals to separate consumer protection regulation and safety and soundness regulation. Instead, we believe that the appropriate response to this crisis is the establishment of a better balance between these two goals within a reformed and more modern financial regulatory structure.

Moreover, I would like to take this opportunity to express the Roundtable's concerns with the provision in the Omnibus Appropriations bill that would give State attorneys generals the authority to enforce compliance with the Truth-in-Lending Act (TILA) and would direct the Federal Trade Commission to write regulations related to mortgage lending. As I will explain further, we believe that one of the fundamental problems with our existing financial regulatory system is its fragmented structure. This provision goes in the opposite direction. It creates overlap and the potential for conflict between the federal banking agencies, which already enforce compliance with TILA, and state AGs. It also creates overlap and the potential conflict between the federal banking agencies, which are responsible for mortgage lending activities, and the Federal Trade Commission. While it may be argued that more "cops on the beat" can enhance compliance, more "cops" that are not required to act in any coordinated fashion will simply exacerbate the regulatory structural problems that contributed to the current crisis.

My testimony is divided into three parts. First, I address "What Went Wrong." Second, I address "How to Fix the Problem." Finally, I take this opportunity to comment on the lending activities of TARP-assisted firms, and the Roundtable's continuing concerns over the impact of fair value accounting.

What Went Wrong

The proximate cause of the current financial crisis was the nation-wide collapse of housing values, and the impact of that collapse on individual homeowners and the holders of mortgage-backed securities. The crisis has since been exacerbated by a serious recession.

The root causes of the crisis are twofold. The first was a clear breakdown in policies, practices, and processes at many, but not all, financial services firms. Poor loan underwriting standards and credit practices, excessive leverage, misaligned incentives, less than robust risk management and corporate governance are now well known and fully documented. Corrective actions are well underway in the private sector as underwriting standards are upgraded, credit practices reviewed and recalibrated, leverage is reduced as firms rebuild capital, incentives are being realigned, and some management teams have been replaced, while whole institutions have been intervened by supervisors or merged into other institutions. So needed corrective actions are being taken by the firms themselves.

More immediately, we need to correct the failures that the crisis exposed in our complex and fragmented financial regulatory structure. Crises have a way of revealing structural flaws in regulation, supervision, and our regulatory architecture that have long-existed, but were little noticed until the crisis exposed the underlying weaknesses and fatal gaps in regulation and supervision. This one is no different. It has revealed significant gaps in the financial regulatory system. It also revealed that the system does not provide for sufficient coordination and cooperation among regulators, and that it does not adequately monitor the potential for market failures, high-risk activities, or vulnerable interconnections between firms and markets that can create systemic risk and result in panics like we saw last year and the crisis that lingers today.

The regulation of mortgage finance illustrates these structural flaws in both regulation and supervision. Many of the firms and individuals involved in the origination of mortgage were not subject to supervision or regulation by any prudential regulator. No single regulator was held accountable for identifying and recommending corrective actions across the activity known as mortgage lending to consumers. Many mortgage brokers are organized under state law, and operated outside of the regulated banking industry. They had no contractual or fiduciary obligations to brokers who referred loans to them. Likewise, many brokers were not subject to any licensing qualifications and had no continuing obligations to individual borrowers. Most were not supervised in a prudential manner like depository institutions engaged in the same business line.

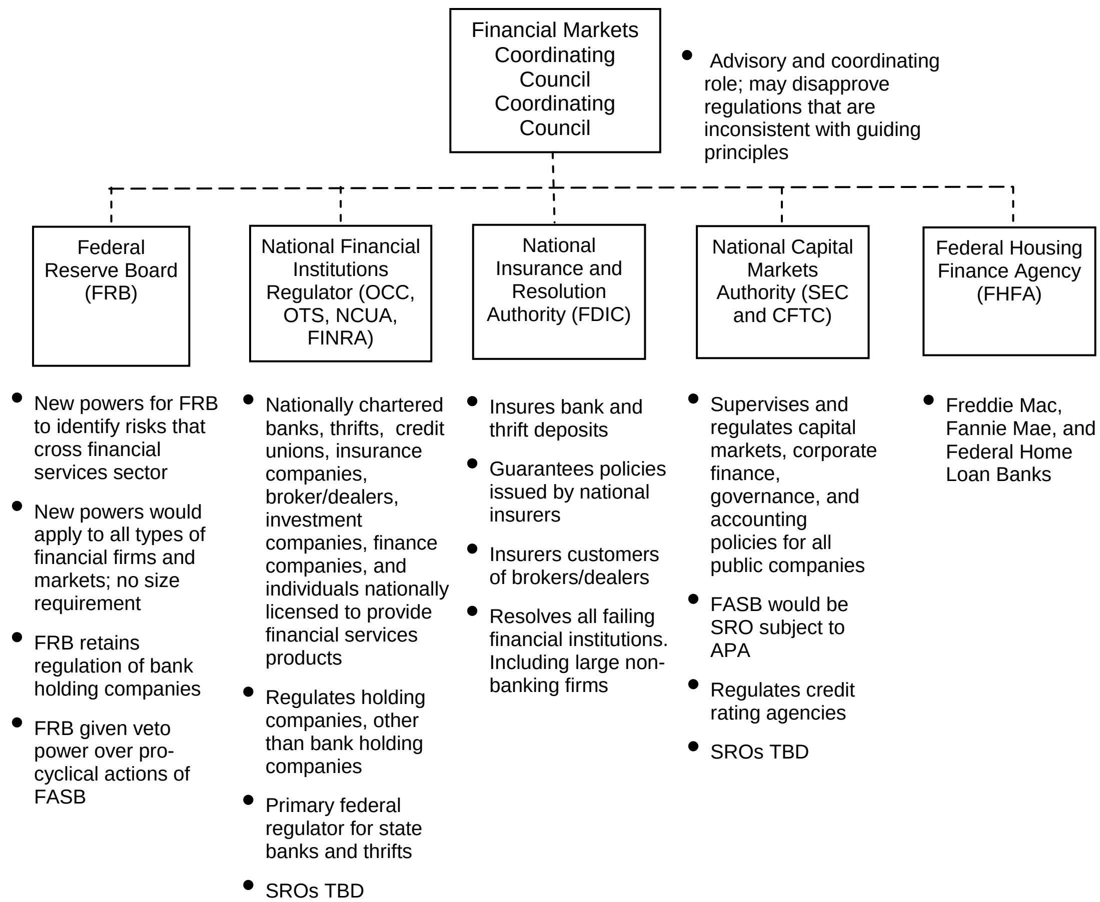
The federal banking regulators recognized many of these problems and took actions – belatedly – to address the institutions within their jurisdiction, but they lacked to power to reach all lenders. Eventually, the Federal Reserve Board's HOEPA regulations did extend some consumer protections to a broader range of lenders, but the Board does not have the authority to ensure that those lenders are engaged in safe and sound underwriting practices or risk management.

The process of securitization suffered from a similar lack of systemic oversight and prudential regulation. No one was responsible for addressing the over-reliance investors placed upon the credit rating agencies to rate mortgage-backed securities, or the risks posed to the entire financial system by the development of instruments to transfer that risk world-wide.

How to Fix the Problem

How do we fix this problem? Like others in the financial services industry, the members of the Financial Services Roundtable have been engaged in a lively debate over how to better protect consumers by addressing the structural flaws in our current financial regulatory system. While our internal deliberations continue, we have developed a set of guiding principles and a “Draft Financial Regulatory Architecture” that is intended to close the gaps in our existing financial regulatory system. We are pleased that the set of regulatory reform principles that President Obama announced last week are broadly consistent and compatible with the Roundtable’s principles for much needed reforms. Our first principle in our 2007 *Blueprint for U.S. Financial Modernization* was to “treat consumers fairly.” Our current principles for regulatory reform this year build on that guiding principle and call for: 1) a new regulatory architecture; 2) common prudential and consumer and investor protection standards; 3) balanced and effective regulation; 4) international cooperation and national treatment; 5) failure resolution; and 6) accounting standards. Our plan also seeks to encourage greater coordination and cooperation among financial regulators, and to identify systemic risks before they materialize. We also seek to rationalize and simplify the existing regulatory architecture in ways that make more sense in our modern, global economy. The key features of our proposed regulatory architecture are as follows.

DRAFT FINANCIAL REGULATORY ARCHITECTURE



Financial Markets Coordinating Council

To enhance coordination and cooperation among the many and various financial regulatory agencies, we propose to expand membership of the President's Working Group on Financial Markets (PWG) and rename it as the Financial Markets Coordinating Council (FMCC). We believe that this Council should be established by law, in contrast to the existing PWG, which has operated under a Presidential Executive Order since 1988. This would permit Congress to oversee the Council's activities on a regular and ongoing basis. We also believe that the Council should include representatives from all major federal financial agencies, as well as individuals who can represent state banking, insurance, and securities regulation.

This Council could serve as a forum for national and state financial regulators to meet and discuss regulatory and supervisory policies, share information, and develop early warning detections. In other words, it could help to better coordinate policies within our still fragmented regulatory system.

We do not believe that the Council should have independent regulatory or supervisory powers. However, it might be appropriate for the Council to have some ability to review the goals and objectives of the regulations and policies of federal and state financial agencies, and thereby ensure that they are consistent.

Federal Reserve Board

To address systemic risk, we believe the Federal Reserve Board (Board) should be authorized to act as a market stability regulator. As a market stability regulator, the Board should be responsible for looking across the entire financial services sector to identify interconnections that could pose a risk to our financial system. To perform this function, the Board should be empowered to collect information on financial markets and financial services firms, to participate in joint examinations with other regulators, and to recommend actions to other regulators that address practices that pose a significant risk to the stability and integrity of the U.S. financial services system.

The Board's authority to collection information should apply not only to depository institutions, but also to all types of financial services firms, including broker/dealers, insurance companies, hedge funds, private equity firms, industrial loan companies, credit unions, and any other financial services firms that facilitate financial flows (e.g., transactions, savings, investments, credit, and financial protection) in our economy. Also, this authority should not be based upon the size of an institution. It is possible that a number of smaller institutions could be engaged in activities that collectively pose a systemic risk.

National Financial Institutions Regulator

To reduce gaps in regulation, we propose the consolidation of several existing federal agencies into a single, National Financial Institutions Regulator (NFIR). This new agency would be a consolidated prudential and consumer protection agency for banking, securities and insurance.

More specifically, it would charter, regulate and supervise (i) banks, thrifts, and credit unions, currently supervised by the Office of the Thrift Supervision, the Office of the Comptroller of the Currency, and the National Credit Union Administration; (ii) licensed broker/dealers, investment advisors, investment companies, futures commission merchants, commodity pool operators, and other similar intermediaries currently supervised by the Securities and Exchange Commission or the Commodities Futures Trading Commission; and (iii) insurance companies and insurance producers that select a federal charter. The AIG case illustrates the need for the federal government to have the capacity to supervise insurance companies. Also, with the exception of holding companies for banks, the NFIR would be the regulator for all companies that control broker/dealers or national chartered insurance companies.

The NFIR would reduce regulatory gaps by establishing comparable prudential standards for all of these of nationally chartered or licensed entities. For example, national banks, federal thrifts and federally licensed brokers/dealers that are engaged in comparable activities should be subject to comparable capital and liquidity standards. Similarly, all federally chartered insurers would be subject to the same prudential and market conduct standards.

In the area of mortgage origination, we believe that the NFIR's prudential and consumer protection standards should apply to both national and state lenders. Mortgage lenders, regardless of how they are organized, should be required to retain some of the risk for the loans they originate (keep some "skin-in-the-game"). Likewise, mortgage borrowers, regardless of where they live or who their lender is, should be protected by the same safety and soundness and consumer standards.

As noted above, we believe that is it important for this agency to combine both safety and soundness (prudential) regulation and consumer protection regulation. Both functions can be informed, and enhanced, by the other. Prudential regulation can identify practices that could harm consumers, and can ensure that a firm can continue to provide products and services to consumers. The key is not to separate the two, but to find an appropriate balance between the two.

National Capital Markets Agency

To focus greater attention on the stability and integrity of financial markets, we propose the creation of a National Capital Markets Agency through the merger of the Securities and Exchange Commission (SEC) and the Commodities Futures Trading

Commission (CFTC), preserving the best features of each agency. The NCMA would regulate and supervise capital markets and exchanges. As noted above, the existing regulatory and supervisory authority of the SEC and CFTC over firms and individuals that serve as intermediaries between markets and customers, such as broker/dealers, investment companies, investment advisors, and futures commission merchants, and other intermediaries would be transferred to the NFIR. The NCMA also should be responsible for establishing standards for accounting, corporate finance, and corporate governance for all public companies.

National Insurance Resolution Authority

To protect depositors, policyholders, and investors, we propose that the Federal Deposit Insurance Corporation (FDIC) would be renamed the National Insurance and Resolution Authority (NIRA), and that this agency act not only as an insurer of bank deposits, but also as the guarantor of retail insurance policies written by nationally chartered insurance companies, and a financial backstop for investors who have claims against broker/dealers. These three insurance systems would be legally and functionally separated. Additionally, this agency should be authorized to act as the receiver for large non-bank financial services firms. The failure of Lehman Brothers illustrated the need for such a better system to address the failure of large non-banking firms.

Federal Housing Finance Agency

Finally, to supervise the Federal Home Loan Banks and to oversee the emergence and future restructuring of Fannie Mae and Freddie Mac from conservatorship we propose that the Federal Housing Finance Agency remain in place, pending a thorough review of the role and structure of the housing GSEs in our economy.

TARP Lending and Fair Value Accounting

Before I close I would like to address two other issues of importance to policymakers and our financial services industry: lending by institutions that have received TARP funds, and the impact of fair value accounting in illiquid markets. Lending by institutions that have received TARP funds has become a concern, especially given the recessionary pressures facing the economy. I have attached to this statement a series of tables that the Roundtable has compiled on this issue. Those tables show the continued commitment of the nation's largest financial services firms to lending.

Fair value accounting also is a major concern for the members of the Roundtable. We continue to believe that the pro-cyclical effects of existing policies are unnecessarily exacerbating this crisis. We urge this Committee to direct financial regulators to adjust current accounting standards to reduce the pro-cyclical effects of fair value accounting in illiquid markets. We also urge the U.S. and international financial regulators coordinate and harmonize regulatory policies to development accounting standards that achieve the goals of transparency, understandability, and comparability.

Conclusion

Thank you again for the opportunity to appear today to address the connection between consumer protection regulation and this on-going financial crisis. The Roundtable believes that the reforms to our financial regulatory system we have developed would substantially improve the protection of consumers by reducing existing gaps in regulation, enhancing coordination and cooperation among regulators, and identifying systemic risks. We also call on Congress to address the continuing pro-cyclical effects of fair value accounting.

Broader regulatory reform is important not only to ensure that financial institutions continue to meet the needs of all consumers but to restart economic growth and much needed job creation. Financial reform and ending the recession soon are inextricably linked – we need both. We need a financial system that provides market stability and integrity, yet encourages innovation and competition to serve consumers and meet the needs of a vibrant and growing economy. We need better, more effective regulation and a modern financial regulatory system that is unrivaled anywhere in the world. We deserve no less.

At the Roundtable, we are poised and ready to work with you on these initiatives. As John F. Kennedy once cited French Marshall Lyautey, who asked his gardener to plant a tree. The gardener objected that the tree was slow growing and would not reach maturity for 100 years. The Marshall replied, "In that case, there is no time to lose; plant it this afternoon!" The same is true with regard to the future of the United States in global financial services - there is no time to lose; let's all start this afternoon.