TESTIMONY OF
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PRESIDENT AND CEO OF THE
SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION
BEFORE THE
U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES

HEARING ON THE FUTURE OF FINANCIAL SERVICES REGULATION

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Introduction

Chairman Frank, Ranking Member Bachus, and members of the Committee:

My name is Tim Ryan and I am President and CEO of the Securities Industry and Financial Markets Association ("SIFMA").[1] Thank you for your invitation to testify at this important hearing.

While I am speaking on behalf of the securities industry today, from 1990 to 1993 I served as Director of the Office of Thrift Supervision, with responsibility for regulatory oversight of the nation's approximately 2,000 thrifts. During that time, I also was a principal manager of the clean-up effort following the savings and loan debacle of the 1980s. That experience gave me an acute appreciation for the

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[1] The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers locally and globally through offices in New York, Washington, DC, and London. Its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong. SIFMA's mission is to champion policies and practices that benefit investors and issuers, expand and perfect global capital markets, and foster the development of new products and services. Fundamental to achieving this mission is earning, inspiring and upholding the public's trust in the industry and the markets. (More information about SIFMA is available at http://www.sifma.org.)

importance of effective regulation and the challenges we face as we work through the current crisis.

As we all know, debt and equity markets across the globe have experienced severe dislocations in recent months. Congress aggressively responded to these challenges in the United States by passing the Emergency Economic Stabilization Act of 2008 (the "EESA"), legislation granting the Treasury Department extraordinary tools designed to promote confidence in the U.S. financial system. We fervently hope that the steps being taken will unfreeze the credit markets and restore calm to our equity markets. Congress has rightly recognized, however, that addressing the immediate crisis is only half the battle. Serious weaknesses exist in our current regulatory model for financial services, and without reform we risk repeating the errors of the recent past. Thus, I commend you, Mr. Chairman, and the Committee, for beginning the process of reexamining our regulatory structure with a view toward effecting meaningful improvements.

We also should recognize that financial markets are global in nature. Individual U.S. and non-U.S. securities firms operate in all major markets around the world.[2] As such, we need a global approach to financial regulatory reform. Close cooperation among policy makers on an international basis will play an important part in effectively addressing weaknesses in financial regulation. In this regard, we believe the October 18th announcement by President Bush that he plans

[2] For example, the two largest non-bank-affiliated broker-dealers at the end of 2007 each had offices in over 23 different countries.

to hold a summit meeting of world leaders to discuss the global financial crisis is a good start.

SIFMA stands ready to be a constructive voice in this critically important public policy dialogue—in the U.S. and abroad—to restore confidence in the global financial system. Our members understand the value that a well-designed and implemented regulatory system brings to our markets. We believe that an international effort is required to develop such a regulatory system with common principles that limits regulatory arbitrage between and among countries.

In our view, a sound regulatory regime must contain several key elements. First, it must be designed to minimize systemic risk to the financial system. Second, it must promote the safety and soundness of each regulated financial institution. Third, it must contain business conduct rules that promote fair dealing and investor protection. Fourth, it should be consistent from country to country. And finally, it is critical that the regulatory structure be as effective and efficient as possible. Regulation imposes meaningful costs on our financial system and over-regulation or inefficient regulation can diminish the competitiveness of markets vis-à-vis better regulated venues. Thus, well-crafted regulation—by which I mean regulation that achieves its goals and does so in a cost effective manner—is an important objective.

I. A Financial Markets Stability Regulator

As you know, our nation's financial regulatory structure dates back to the Great Depression. That regulatory structure assumed, and even mandated to some extent, a financial system where commercial banks, broker-dealers, insurance companies and other financial institutions engaged in separate businesses and offered separate products, largely within local or domestic borders. The intervening years have seen remarkable changes in the financial services industry, both in terms of consolidation within the banking, securities and insurance lines of business, and in terms of expansion in the scope of products and services being offered by individual firms. Financial institutions no longer operate in single product or business silos or in purely domestic or local markets. Instead, they compete across many lines of business and in markets that are largely global and competitive across borders.

But the financial regulatory structure remains largely siloed at both the state and federal levels, reflecting the siloed financial structure of yesteryear. This creates a gap between the regulatory structure overseeing financial markets and the modern structure of the financial markets themselves. While there may be good and sound reasons to continue regulating our financial markets based largely on banking, securities, insurance or other functions, no single regulator currently has access to sufficient information or the practical and legal tools and authority necessary to protect the financial system as a whole against systemic risk.

Accordingly, we believe Congress should consider the need for a financial markets stability regulator that has access to information about financial institutions of all kinds that might be systemically important, including banks, broker-dealers, insurance companies, hedge funds, private equity funds and others. This regulator should have authority to use the information it gathers to determine which financial institutions actually are "systemically important," meaning institutions that would likely have serious adverse effects on economic conditions or the financial stability of other entities if they were allowed to fail as a result of a "run on the bank" or other loss of short-term liquidity during a financial crisis. We believe this is a relatively small number of financial institutions. We think it is important that a stability regulator's information gathering be coordinated with other regulators to avoid duplication of oversight and unnecessary regulatory burden. Moreover, any confidential information gathered in this process should remain confidential, unless otherwise publicly disclosed.

Congress should give thoughtful consideration to the additional powers that might be given to the financial markets stability regulator. Among other things, they could include the authority, alone or in coordination with the institution's functional or prudential regulator, to set consolidated capital requirements at the parent company level and to recommend capital requirements at any subsidiary level, to examine the parent company and any of its subsidiaries, and to bring enforcement actions. In short, its powers could correspond to those that the Federal Reserve currently has as the umbrella supervisor of bank holding companies, but we believe it would not be appropriate to include the authority to impose the kind of activity restrictions that apply to bank holding companies.

Further powers that Congress could consider giving to the financial markets stability regulator or some other more specialized federal agency would be "prompt corrective action" and resolution powers over systemically important financial institutions. These resolution powers could be similar to those that the FDIC has with respect to insured depository institutions, including the power to put the institution into conservatorship or receivership, and to create bridge institutions similar to bridge banks to facilitate an orderly disposition of a failed institution's assets and liabilities.

If Congress does take the approach of creating a financial markets stability regulator, it would be important to ensure that it has the appropriate stature, reputation, and tools to be effective. It also is important, however, that it not become an additional layer of regulation. Rather, Congress should consider the stability regulator in the context of the overall streamlining of our financial regulatory system.

II. Additional Steps to Improve the Efficiency and Effectiveness of Regulation

We believe there are other steps that Congress should consider in connection with a financial regulatory reform effort. While financial products and services, and the activities of financial firms generally, have become significantly more complex in recent years, financial services regulation has not kept up. Modernizing financial regulation should be a priority for regulatory reform by Congress. In general, financial regulations should encourage institutions to behave prudently and incentivize them to implement robust risk management programs.

Securities, banking, and insurance products often have very similar economic characteristics, yet they may be subject to very different rules—for example, with respect to capital, margin requirements, or customer protection. These differences distort economic decision making by businesses and their customers, and Congress and regulatory agencies should work to eliminate them wherever possible.

We also believe Congress should consider how financial regulation can be streamlined to be more effective. Duplicative federal and state regulation is one area for review. Another is the separate regulation of securities and futures. When the Commodity Futures Trading Commission was formed, the overwhelming majority of futures products were agricultural in nature. Today financial futures constitute the lion's share of the futures business and the similarities between many securities and futures products, as well as the links between those markets, are significant. The U.S. should merge these regulators in the interest of regulatory efficiency; combining their jurisdiction would be consistent with the approach taken in other financial markets around the world.

Congress also should consider merging the Office of Thrift Supervision into the Office of the Comptroller of the Currency in order to achieve greater efficiency in the operation of federal bank regulatory agencies. In addition, Congress should consider the creation of a federal insurance charter and federal insurance regulator.

III. International Cooperation and Coordination

Another lesson from the current financial crisis is that markets are global in nature and so are the risks of contagion. If financial regulation is to be effective, we believe that common regulatory standards should be applied consistently across markets. Accordingly, we urge that steps be taken to foster greater cooperation and coordination among regulators in major markets in the U.S., Europe, Asia, and elsewhere around the world. There are several international groups in which the U.S. participates that work to further regulatory cooperation and establish international standards, including IOSCO, the Joint Forum, the Basel Committee on Banking Supervision, and the Financial Stability Forum. Congress should support and encourage the efforts of these groups. Moreover, as it considers regulatory reform in the United States, Congress itself should be mindful of the importance of regulatory and legislative solutions that work on a global, cross-border basis.

IV. Structured Products and Derivatives

Innovation has generated many new financial products in recent decades that have the basic purpose of managing risk. Credit default swaps ("CDS") are an example and in recent years the CDS market has grown exponentially. CDSs are an important tool for managing credit risk, but they can also increase systemic risk if key counterparties fail to manage their own risk exposures properly. SIFMA recognizes the risks inherent in this market and will continue to work closely with the International Swaps and Derivatives Association, the Futures Industry Association, and other stakeholders in an effort to create a clearing facility for CDSs that will reduce operational and counterparty risk. Establishing a clearing facility also will enhance the ability of regulators to monitor activities in the CDS market.

We are particularly concerned about efforts to regulate these products at the state level. We believe state-by-state regulation is not appropriate and could result in the business moving off shore, thereby creating more risk. Implementation of a clearing facility is an effective and efficient way to address regulatory concerns.

V. Adequacy of Regulatory Resources

As Congress considers the future landscape of regulatory reform, it must ensure that appropriate resources are dedicated to the regulatory effort. Regulatory agencies need to be appropriately funded and staffed in order to successfully undertake their missions. They need the ability to hire high quality professionals, including economists, accountants, lawyers, sophisticated risk management experts, and other persons with relevant expertise. Greater sophistication in our regulatory agencies is necessary in order to effectively regulate large, sophisticated, globally interconnected firms.

Conclusion

Recent challenges have strained the notion that U.S. markets are the most efficient, liquid and well-regulated markets in the world. They have highlighted the necessity of a fundamental review of our regulatory system in order to identify and correct its weaknesses. SIFMA strongly supports these efforts and commits to be a constructive participant in the process. We also recognize that the Committee is likely to consider other pressing financial markets issues as part of this review, including, among others, regulation of mortgage lending and financing institutions and the types of products they offer; addressing the problems of homeowners who are at risk of foreclosure; implementing the EESA; Securities Investor Protection Corporation reform; the role and performance of credit rating agencies; and problems with securities settlement and payment systems. SIFMA stands ready to assist the Committee as it considers these and other important issues. We are confident that through our collective efforts, we have the capacity to emerge from this crisis with stronger and more modern regulatory oversight that will better prepare us for the challenges facing financial firms today and in the future.