

Some Issues and Considerations Pertaining to U.S. Financial Regulatory Reform

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Introduction & Background

- Regulatory effectiveness in promoting safety and soundness of individual institutions and stability of the overall financial system
- Historical experience of other countries in reviewing and modifying their financial regulatory systems
- Impact of events over the last 2 years on financial regulatory systems globally
- Priority on crisis management, restoring health to banking systems and broader economics
- Domestic and international dimensions of financial developments
 - Public and private sector
 - Upcoming G-20 summit in April 2009
- Potential overhaul and reform of financial regulatory system
 - Lessons learned from recent events
 - Emerging consensus in U.S. and other jurisdictions
 - Range of views on actions, priorities and specifics

Contextual Considerations Regarding Regulatory Reform

- Evolution of U.S. regulatory system
 - Federal and state licensing
 - Belief in checks and balances
 - Reaction to past financial disruptions
 - Roots in the 1930's
- Past Proposals to reform U.S. system
- Institutional, cultural and political dimensions
- Characteristics of financial markets and products
 - Complexity, rapid innovation and leverage
 - Large, systemically important interconnected firms
 - Global financial system
- Importance of financial stability – domestic and international – to economic prosperity
- Importance of regulatory reform in facilitating financial stability
- Legislative and policy-makers' priorities and processes

High Level Priorities Relating to Financial Reform

- Effective regulation of systemic risk
- Mitigation of issue of “too big to fail”
- Strengthened financial infrastructure
- Reduction of procyclicality
- Enhanced regulatory rules and supervisory processes, including effective consolidated supervision
 - Safety and soundness of individual firms (microprudential supervision)
 - Consumer/investor protection
 - Stability of overall financial system (macroprudential supervision)
- Enhanced coordination domestically and globally

Some Principles and Goals Informing Financial Regulatory Reform

- Clear accountability, responsibility, and lines of authority in regulatory system
- Creation of systemic risk regulator
 - Determination of appropriate agency
 - Powers and authorities
 - Coverage: systemically important firms, activities, markets, and practices across financial system
 - Role of Federal Reserve
- Closing regulatory gaps and reducing opportunities for regulatory arbitrage
 - Prudential rules
 - Consumer/investor protection
 - Consolidated oversight of systemically important firms
 - Macroprudential dimension
- Streamlining, simplifying, and reducing overlap and inefficiencies where possible
 - Five federal depository agencies
 - Other possible overlaps and duplication

Some Principles and Goals Informing Financial Regulatory Reform (cont.)

- Consideration of need for new agencies, (e.g., Federal consumer or insurance agency)
- Oversight of rating agencies
- Facilitating coordination between regulatory authorities, Federal Reserve and U.S. Treasury
- Oversight of systemically important financial markets and infrastructure (e.g., credit default swap market and large dollar payments system, establishment of central counterparties and exchanges)
- Authority, funding, and legal framework for resolving/closing systemically important nonbank financial institutions – avoid disorderly failures
- Enhanced international coordination and strengthened international standards
 - Beyond rule-writing to application and implementation
 - Supervisory colleges
 - Governance reforms and expanded resources of key international organizations

Related Policy Enhancements or Areas Being Addressed

- Prudential requirements/expectations regarding quantity and quality of capital, liquidity, risk management, off-balance sheet activities, trading activities and structured credit products, concentrations, etc.
- Consumer and investor protection rules
- Transparency, disclosure and valuation practices
- Aspects of the “shadow or parallel” banking system, and the originate to distribute model
- Procyclicality in capital, reserving and other practices
- Principles for sound compensation practices
- Cross-border cooperation on crisis management
- Offshore tax havens

Some Potential Public & Private Sector Challenges Ahead

- More strict and intrusive supervision, higher standards, and more stringent oversight of risk-taking regarding both prudential matters and consumer/investor protection
- Increased reporting requirements
- Some areas of increased supervisory focus:
 - Business models
 - Compensation practices
 - Role/effectiveness of management and boards of directors
 - Involvement in key financial markets with systemic implications
- Effects on profitability and business strategies
 - Higher capital and liquidity cushions
 - More stable funding, less wholesale funding
 - Reduced maturity mismatches
 - Reduced concentrations
 - Constraints on risk-taking
 - Implications for profitability and volatility

Some Potential Public & Private Sector Challenges Ahead (cont.)

- Moving from capital market-centric to more bank-centric financial system
- High risk activities to lower risk utility banking
- Government exit strategies from role in financial system
- Long-term balance between government/societal interest in stability through rules and benefits of financial innovation through flexibility and reliance on market discipline



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