Viewpoint: Principles to Weigh in the Reg-Reform Debate

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Treasury Secretary Henry M. Paulson Jr. has initiated a national policy debate on the need for financial regulatory reform to ensure vibrant and competitive financial markets. An important part of the Treasury's anticipated plan is the likely call for a more principles-based approach to financial regulation.

As its contribution to this debate, the Financial Services Roundtable has developed The Blueprint for U.S. Financial Competitiveness. It proposes a set of six principles that can serve as a compass for all financial regulators at the national and state level: fair treatment for consumers; competitive and innovative financial markets; proportionate, risk-based regulation; prudential supervision and enforcement; organizational options for servicing consumers; and management responsibilities.

These are not intended to be a substitute for all regulations. However, in contrast to our current system in which financial regulators have overlapping and sometimes conflicting missions, the principles can give financial regulators a common basis to guide policies, standards, and regulations. No such common standard exists today.

Also, unlike prescriptive regulations, which typically have been adopted in response to yesterday's problems, guiding principles would give regulators the flexibility to adapt and respond more rapidly to changes in financial practices and financial markets that have a direct and meaningful impact on consumers.

We believe that if the United States had these principles in place the past several years, the current turmoil in the credit and mortgage markets could have been identified sooner and been less severe. The application of the very first principles, fair treatment for consumers, could have dampened some of the speculative lending excesses to borrowers. Other complementary principles address prudential supervision across all financial markets and more constructive engagement between firms and their regulators.

Significant practical and policy issues must be addressed if the U.S. is to move in the direction of principles-based regulation. Not the least of these issues is congressional support for this approach to financial regulation. Thus, our blueprint recommends that the guiding principles be enacted into law.

Our plan also recommends that the President's Working Group on Financial Markets be expanded and empowered to oversee the implementation of the principles. An enhanced working group would provide a joint forum for all financial regulators — national and state — across both the credit and capital markets to identify issues affecting the financial services industry and consumers nationwide. Today, only some regulators sit on the working group; many important regulators are missing.

Principles-based regulation cannot succeed if it results in regulatory uncertainty or greater legal risks. Therefore, the blueprint recommends that the guiding principles be enforced by financial regulators and individual consumers (not class actions). It also recommends that shareholders seek redress from the SEC before filing securities class actions, and that all financial regulatory agencies adopt a culture of "prudential supervision". Prudential supervision is defined as an open exchange between regulated firms and regulators that identifies industry trends before they become consumer problems or jeopardize the stability of financial markets.

There is a pressing need to start long-term reform. The enactment of principles-based reform legislation this year would ensure the improved financial regulation and regulatory coordination so critical to consumers and our economy.

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