Testimony of Gregory P. Wilson
to the Commission on the Regulation of U.S. Capital Markets in the 21st Century
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The Importance of Financial Market Regulation
for the Competitiveness of the U.S. Economy

EXECUTIVE SUMMARY

Members of the Commission, thank you for the opportunity to share my views at this town hall meeting as you examine the current and future regulation of the U.S. capital markets. The views I present today are based on more than 30 years of experience in the financial services policy and regulatory arena, serving in both the legislative and executive branches of the U.S. government early in my career and most recently as a partner with McKinsey & Company until July 1 of this year when I left to form my own consulting firm. In the past decade I have served policy officials, financial regulators, trade associations, and financial institutions in more than 20 countries – in the United States and other developed and emerging markets – on issues of crisis management, capital market and financial sector development, and regulatory risk management. I appear today to share my own personal views as an independent management consultant; I am not here to represent the views of any client.

In response to the questions posed by the Working Group, my testimony today is divided into three parts. First, I believe that the position currently enjoyed by the United States as the dominant global financial hub is coming under increasing competitive pressure, which in turn has long-term implications for our economy. Second, while our combined financial sector policy and regulatory environment in the past may have been a major contributing factor to our present competitive advantage, it is more likely to be a source of our competitive disadvantage in the future. This is due not just to the increasing complexity and cost of our regulatory system. More importantly, it stems from a strategic problem that our country faces today: namely, the lack of a shared vision, actionable strategy, and unified regulatory structure for our financial services sector. Finally, I recommend three major actions that the President's Working Group on Financial Markets can take to address the important issues that arise from the timely debate that this Commission and others have initiated.

Specifically:

1. Revitalize the Working Group to give it a forward-looking mandate to assess the competitiveness of the U.S. financial services sector and our financial markets
2. Require the Working Group to develop a common vision and action-oriented strategy for our financial sector that is broadly accepted throughout the government and the private sector
3. Charge the Working Group with making recommendations to the President and Congress for a new, optional financial services charter and regulatory regime for those companies – domestic or international – that want to serve their customers better and more efficiently by operating from a truly national or international platform.

THE CURRENT SETTING

While the United States continues to benefit from its position as the world's dominant financial hub, that position is under increasing pressure. Any erosion from this preferred position, in my view, has long-term implications for our national economic self-interest.

The forces at work today on financial markets are well known, and we can do little to change them. They include a number of factors: rapidly advancing technology; changing customer needs at all levels across a diversified range of products and services; an increasing number of countries – including current competitors and potential competitors – that fully understand the link between financial sector development and their own economic growth; changing regulatory environments to support financial sector development to capture the economic growth potential; and the falling importance of artificial political boundaries vis-à-vis national, regional, and global financial markets. We cannot escape the fact that we live in an increasingly globalizing financial world where prices are set by market forces that operate freely across time zones and geo-political boundaries. Today, market participants collectively wield more financial power than governments.

Capital markets are important

Most financial market observers agree that the ability to access deep and vibrant capital markets has a major impact in supporting sustained economic growth and development. While the causal relationship is difficult to prove conclusively, the evidence and logic are compelling: open, fair, and competitive financial markets are an engine for more productive economic growth, especially if they have the right standards, a resilient infrastructure, and solid intermediary skills that bring companies and investors together in an efficient marketplace.

Countries benefit from efficient and well-regulated capital markets for three primary reasons:

- **Capital markets provide fuel for economic growth.** Not only do they provide access to cheaper and longer-term capital, but they also open access to a larger set of corporates in search of financing and help to ensure a better allocation of capital to the most productive needs. They also help to ensure a higher return for more diversified domestic savings and promote the development of the private sector as a vital alternative to government investment companies and development institutions.

- **Capital markets provide greater financial stability.** They enhance risk management in general through better price discovery, greater transparency, faster and less costly market corrections, and the ability to hedge and benchmark performance. They help diversify a national economy and lower the concentration of risk in a financial system that typically is too heavily weighted toward bank lending.

- **Capital markets provide an efficient link to integrate the global financial market.** They are less volatile to portfolio flows compared to bank lending, they attract greater foreign expertise and experience, and simultaneously force domestic institutions to become more competitive to serve their customers faster, better, and more economically than before.

These statements are not just platitudes. Research by my former firm, McKinsey & Company,[1] the IMF, the World Bank, and others shows that capital markets do in fact provide real economic benefits: cheaper financing; lower financial volatility; and higher growth. Moreover, there is a correlation between deep capital markets as measured by bonds and equities and development as measured by per capita GDP. So for any country looking for proof, the case is convincing. Capital markets

[1] See, for example, Ralph Heidrich, Alan Morgan, and Gregory Wilson, *Building High-Performing Capital Markets,* McKinsey & Company confidential working paper, April 2005.

and a country's economy are intertwined – successfully developing capital markets can lead to good things from the perspective of both policy makers and market participants.

Financial trends are disturbing

If we agree that capital markets are important to national economies, then some of the trends we see today are disturbing from a U.S. perspective.

The good news is that the global financial stock is large and growing. Recent estimates by the McKinsey Global Institute (MGI) put it at roughly $188 trillion in 2005, with the potential to exceed $200 trillion by 2010. More good news is the fact that the U.S. share of the global financial stock is roughly 37 percent. While this gives the United States a leading position, the bad news is that we are increasingly challenged by Europe, emerging markets like China and India, and the Arabian Gulf countries.

In fact, based on some of my recent work, I can assure you that the Gulf countries and others have been working hard in the past few years – witness the creation of the Dubai International Financial Center and the new Capital Market Authority in Saudi Arabia. The Gulf countries are developing their own domestic capital markets, not only to channel their significant wealth into more domestic investment, but also to repatriate Gulf investors' capital back from the United States and Europe.[2] In the future, especially in a post-9/11 environment, we can expect to see more of this capital either remain in the Gulf countries given their own investment needs to build infrastructure and privatize state-owned enterprises, or alternatively move east. Based on recent research, some former colleagues and I estimate that over the next 5 years as much as $250 billion in capital – a significant amount of which otherwise would have found its way in the past to the United States – is now headed east for investments in China, India, and the rest of Asia.[3] A new, financial "Silk Road" is rapidly emerging that could have long-term implications for our economy.

A recent editorial in the *Financial Times* by the chief executive of the London Stock Exchange (LSE) highlights some of these trends at the micro-economic level. While the United States may have a comfortable lead today when it comes to the depth of the equities markets, or M&A transactions, or secondary market trading,

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[2] McKinsey Global Institute, *$118 Trillion and Counting: Taking Stock of the World's Capital Markets*, McKinsey & Company, April 2005 (MGI).

[3] Dominic Barton, Kito de Boer, and Gregory Wilson, "The New Silk Road: Opportunities for Asia and the Gulf," *The McKinsey Quarterly*, July 2006.

over the past 18 months the LSE has attracted roughly three times more listings of international companies than the combined total of the NYSE and Nasdaq: 152 to 54. Moreover, a recent joint study by the LSE and the City of London found that initial public offerings (IPO) underwriting fees in London are typically 3 percent to 4 percent of funding proceeds, compared to 6.5 to 7 percent here.[4] Statistics like these, and the potential warning signs they imply for future growth, cannot be ignored.

A final set of numbers needs to be considered: 12 percent of U.S. equities, 25 percent of domestic corporate bonds, and 44 percent of U.S. Treasury bonds are held by international investors.[5] While I am not a trained economist, I know enough about economics to assert that any abrupt or significant shift in these numbers for whatever reasons will have a potentially negative impact on our economy over time. I have worked extensively in markets in financial crisis throughout Asia and Latin America in recent years, and I know how quickly psychology and perceptions can change compared to facts and reality, how quickly capital can shift when it has to, how drastically the values of assets and liabilities can fall during a currency crisis, and how radically a financial landscape can be altered from relative calm to sheer panic in a matter of days and weeks. Whether you like it or not, our capital markets are linked inextricably to the global economy.

In my opinion, therefore, it is in our national interest to ensure strong and well-supervised financial markets – including our leading position in the global capital markets – to provide the foundation for a competitive and steadily growing economy in the future. Part of that belief means having a robust regulatory regime that complements financial sector development by supervising *with* – rather than against – basic market forces.

THE CHALLENGE GOING FORWARD

While the current U.S. legal and regulatory environment may have been part of our competitive advantage in financial markets in the past and helped get us to where we are today, it is just as likely to be a source of our potential competitive *disadvantage* within this same global marketplace in the future.

Much of this potential disadvantage, in my view, is driven directly by the complexity and cost of U.S. financial regulation today. The good news here is that many of the problems in our regulatory system are things that we can control

[4] Clara Furse, "SOX is not to blame – London is just a better market," *Financial Times*, 2006.
[5] MGI, op. cit.

directly. At this point in our financial history, we would be well advised to think long and hard before some of these trends overwhelm us. We need to be proactive and take certain initiatives from the position of relative strength that we enjoy today, rather than being forced to react from a position of parity, or worse, relative weakness in the future.

Regulatory complexity is real

The complexity and inefficiency of our current regulatory structure is well known, evolving in the past 200 years from a largely state-dominated system onto which a national system has been grafted at various intervals for a variety of reasons. Some of the most far-reaching regulatory changes in our financial history came during times of crisis – the creation of the national banking system during the Civil War; the establishment of the Federal Reserve System after a series of financial panics at the turn of the 20th century; and the creation of the Federal Deposit Insurance Corporation (FDIC) and the Securities and Exchange Commission (SEC) during the Great Depression. The Office of Thrift Supervision (OTS) was added as a new bureau in the Treasury Department in the wake of the S&L crisis in the 1980s. The President's Working Group on Financial Markets was created in 1988, when I was still at the Treasury Department, to attempt better government-wide coordination in response to financial crises – in this case the 1987 stock market crash. It is time, however, to step back and ask whether collectively we have the right regulatory structure that national and international companies require across our financial markets to meet the needs of their customers in today's world. My working hypothesis is that our current system – without significant reform – is one of the biggest threats to both the current and future competitiveness of our financial system.

The issues are well known to you, but let me touch on them briefly. There is no single, comprehensive, accountable regulator looking across the financial services industry in the United States today. At least three separate regulators exist for different types of financial holding companies – the Federal Reserve, the OTS, and the SEC – and each has a different mandate, a different regulatory philosophy, and a different approach to regulation. To my knowledge, there is no formal mechanism for these agencies to interact in a coordinated way to address issues of mutual concern; hopefully, they do so in an ad hoc, informal manner when needed.

Multiple state and federal regulators exist at the industry-silo level for banking, securities, insurance, credit unions, and other forms of finance. There are full federal preemptions for some things (branching by thrifts), but not for others (branching by commercial banks). We have dual, overlapping state and national regulation for both banks and securities. Regulation at the state and federal levels can be inconsistent for companies, the products they offer, and the customers they serve. Insurance regulation by the 50 states is arcane and clearly out of sync with national insurance providers and their international market competitiveness; many states still impose rate (price) and form regulation before consumer products can be offered. As you know, prices in all other parts of the U.S. financial sector – and most of the developed world – were deregulated decades ago. Moreover, through highly publicized enforcement actions, states' attorneys general and even municipal prosecutors are preempting knowledgeable regulators (who should be the first responders when problems arise) and are assuming de facto regulatory roles that largely did not exist a decade ago.

Excessive regulation has a cost

There is a real need in today's global marketplace for prudent financial regulation in line with basic market principles at three oversight levels: at the corporate level, by boards of directors and senior management; at the market level, by rating agencies, analysts, a free business press and others; and, finally, at the government level, by national and global financial regulators.

The increasingly negative impact of regulation, however, is seen as a top strategic issue by most CEOs, including those who attended the 2006 World Economic Forum in Davos. And it has been featured in many recent economic and banking surveys. The "remorseless rise in regulation" dominated executives' opinions in both of the 2005 and 2006 U.K.-based *Banana Skins* survey of risks facing banks in 54 countries: respondents said that too much regulation leads to higher prices for end users, stifles innovation, and discourages new and smaller entrants who provide financial services to the public.[6]

Other research confirms these views. Going back to 1991, McKinsey & Company conducted an in-depth diagnostic of large U.S. regional banks, and determined that their excess regulatory costs – above and beyond what senior managers thought were prudent banking practices – were anywhere from 10 percent to 12 percent of the banks' noninterest expense (NIE).[7] All unnecessary regulatory costs are passed ultimately to a company's investors, employees, or customers.

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[6] Center for the Study of Financial Innovation/PricewaterhouseCoopers, *Banana Skins 2005: The CSFI's annual survey of the risks facing banks* (United Kingdom: Heron, Dawson, & Sawyer, 2005).

[7] Gregory Elliehausen, "The Cost of Bank Regulation: A Review of the Evidence," *Federal Reserve Bulletin*, April 1998, and staff paper; U.S. General Accounting Office, *Regulatory Burdens: Recent Studies, Industry Issues, and Agency Initiatives* (Washington, D.C.: GAO/GGD-94-28, December 1993).

A 2006 regulatory cost study commissioned by the United Kingdom's Financial Services Authority (FSA)[8] found that its regulatory costs across corporate finance, institutional funds management, and investment/pension advice were 10 percent to 15 percent higher than necessary; that is, what is considered good business practice.[9] What is striking about this report is not so much the actual finding, but the fact that an independent report would be commissioned by a financial regulator and then published, a practice I highly commend. I would expect that the FSA will not only take this report seriously but also take the appropriate steps to bring its regulatory costs more in line with good practices in these areas in the future.

Here at home, another 2006 study by the Securities Industry Administration (SIA) found that the average cost of compliance per firm in 2005 was 13 percent of net revenue.[10] While the cost and benefits of regulating the securities industry were not calculated from the survey, even being able to reclaim 10 percent to 15 percent of that figure through better, more effective regulation could be significant for firms and their investing customers.

While parts of our financial regulatory system are becoming more market-oriented and more performanced-based, there is much room for continuing refinements and improvement. This is an area where industry input from both end users and intermediaries can be helpful. First, groups of like-minded executives have established dialogues with policy makers and regulators from time to time, and have found ways to agree on an agenda of specific initiatives that meet common objectives.[11] Changes to old ways of regulating – where too often "one size fits all" regardless of supervisory standing – also need to be considered in favor of more performance-based regimes going forward. Such a move would include explicit and transparent incentives in place for companies that are good corporate citizens and perform well across multiple regulatory dimensions, and equally clear disincentives for bad behavior and poor performance.[12] While there have been some successes along these lines, more needs to be accomplished.

Unfortunately, regulatory complexity in the financial services world is increasing along with costs, a fact that ultimately affects all stakeholders not just financial institutions. Peter Wuffli, Group CEO of UBS AG in Switzerland, summed it up in

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[8] Deloitte & Touche, *The Cost of Regulation Study*, commissioned by the U.K. Financial Services Authority, June 2006.

[9] *Financial Adviser*, "Regulation costs break FSA good practice rules," July 6, 2006.

[10] "The Costs of Compliance in the U.S. Securities Industry – Survey Report," Securities Industry Association, February 22, 2006.

[11] See, for example, The Bankers Roundtable, *Market-Incentive Regulation and Supervision: A Paradigm for the Future* (Washington, D.C., April 1998).

[12] See also: Bank Administration Institute and McKinsey & Company, *Building Better Banks: The Case for Performance-based Regulation* (Chicago, 1996).

a recent observation: "Partly as a result of the rapid globalization and evolution of the financial sector, regulatory requirements have become highly complicated. There is a need to ensure that regulations are developed in a way that they are able to keep pace with the rapid change in the market and accurately reflect the global character of the financial services business."[13]

Excessive regulation, inefficient regulation, regulation that is not performance-based, and regulation that has lost touch with market realities all have a cost for companies, their shareholders, and their customers. As a starting point, I don't think anyone today, including myself, would argue that we don't need good financial regulation at the company, market, and government levels. Given their role in a nation's economy, financial institutions are special. That said, there have to be ways to realize better, more effective regulation at lower cost in the future. If we want to remain competitive in financial services in the future, then collectively we need to find a practical way forward – now.

A PRACTICAL WAY FORWARD

Given the U.S. role in the global economy, there is an opportunity for fresh, creative, "clean-slate" thinking about a modern financial regulatory regime.

As a practicing management consultant, let me propose a practical way forward – one that has been tested successfully in other countries and one that, I would argue, can be applied here today.

Borrowing a framework from my consultant's toolkit, several things are clear to me. First, as a country generally, we are blessed with a multitude of good people with strong skills throughout the various regulatory agencies who do their best to carry out the mandates imposed on them by the decisions of the executive and legislative branches of our government at all levels. Second, we may or may not have all the right regulatory systems (rule making, administrative procedures, dispute resolution) and supervisory systems (on-site examinations, off-site monitoring, and consumer compliance) in place all the time, but we undoubtedly have systems that can be improved and made more efficient and more effective in the future. Third, we have regulators with different styles for getting things done and different methods of operating, which at times can work at cross purposes and present conflicts that could be avoided under a different regulatory regime.

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[13] Institute of International Finance press release, "IIF to Review Critical Issues in Global Banking Regulation," March 30, 2006.

Finally, there are some glaring omissions. The four major missing elements are:

- A unified, coherent vision for the financial sector
- A comprehensive, forward-looking strategy for the sector and its regulation
- A set of shared values to support the vision and drive the strategy
- An efficient, unified regulatory structure that underpins the first three elements.

In my view, these missing policy and regulatory elements are what are most likely to lead to potential problems in the future. Any decline in the U.S. position today will not come from a lack of initiative, competitive spirit, and entrepreneurship from the private sector.

Let me illustrate my point as graphically as I can. I know for a fact that the National Association of Securities Dealers (NASD) has a strategy, a set of shared values, and a well-defined structure as a self-regulatory organization for the firms and brokers its regulates, but I have no idea if the NASD's strategy or shared values are aligned with those of the SEC, let alone those of the various state securities regulators. The NYSE, which has an inherent conflict as both an operator and regulator of a stock exchange, is not necessarily in sync at all times with the NASD or the SEC. The various federal bank regulators coordinate policies and procedures as best they can through the Federal Financial Institutions Examination Council (FFIEC), but this is no guarantee that they have a shared strategy and vision at any given time for the banks they regulate and supervise. There is no shared vision or aligned strategy between the national bank regulators and the state regulators, even though the Conference of State Bank Supervisors is an ex officio member of the FFIEC. It is not uncommon to find that a holding company regulator like the Federal Reserve may be at odds with both state and federal (Office of the Comptroller of the Currency and the FDIC) banking regulators on issues of competition (e.g., Walmart's pending application to charter an FDIC-insured, Utah-licensed industrial bank), risk management (e.g., new Basel II capital requirements), and customer service (e.g., changes in, and the pace of, approvals for new products and services to serve customers better). And forget about any real cohesion or coordination in terms of strategy, shared values, and structure throughout the antiquated, state-based insurance regulatory system – the efforts of the National Association of Insurance Commissioners (NAIC) notwithstanding.

The other thing I have learned from serving clients in both the public and private sectors around the world is that if we care about financial sector reform broadly defined, and what it can mean for customers at all income levels in all walks of life, and what it means potentially for economic growth and development over the long term, then there are several key success factors that need to be understood clearly. These key success factors include a common vision for the sector, the right leader (or set of leaders) with the right team to drive the strategy and needed change management program over at least a 3- to 5-year timeframe, and the right alignment of broader political will to support that sustained reform program.[14] These factors are often the difference between success and failure when it comes to any program of financial sector reform.

The United Kingdom appears to be getting this right on all fronts. Clearly, there is a shared vision and strategy between the City of London and the FSA on the importance of the financial sector to the U.K. economy, recognizing that each has a different responsibility as market participants and regulator, respectively, and that at times these roles may come into conflict. Nevertheless, there is a fundamental alignment. What is even more striking, as related in two separate articles in the same edition of the *Financial Times* last week, is that both the Labour and Conservative parties get it right when it comes to the importance of the financial sector to the U.K. economy: in one article, a senior Labour party official praised record bank profits and asked what more the government could be doing to help the industry's competitive position (in stark contrast to previous Labour party positions that favored price setting and opposed "excessive" profits); and in the other article, the shadow Chancellor of the Exchequer, George Osborne, asserted that the U.S. had taken a step backwards since enactment of the Sarbanes-Oxley Act and pledged to defend the London-based exchanges from "U.S. regulatory creep." While at times they may be opposed on particular issues, it is equally clear that the major political parties are agreed on helping the U.K. financial services industry flourish in the context of a rapidly globalizing world.[15]

For these reasons, I believe that the U.S. government should launch a program immediately to maintain and enhance the competitive position of U.S. financial institutions in the global economy. We need a concerted effort at the highest levels to transform the multiple, overlapping regulatory systems that have been cobbled together over time into a more modern regulatory regime that serves our nation's economic needs. We simply cannot afford minimal tinkering at the margin on top of what this Commission itself describes as a "patchwork of federal and state regulation . . . none of [which] was created with a comprehensive perspective on the

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[14] Ralph Heidrich, Alan Morgan, Gregory Wilson, "Building World-Class Capital Markets," *The McKinsey Quarterly*, July 2005. See also Chapters 8 and 9 in Dominic Barton, Roberto Newell, and Gregory Wilson, *Dangerous Markets: Managing in Financial Crises* (New York: John Wiley & Sons, 2003).

[15] "Brown ally backs record bank profits," and George Osborne, "The way to prevent American regulatory creep," *Financial Times*, October 12, 2006.

size, complexity, and speed of our current markets – or their impact on the lives of everyday Americans." From my perspective, this approach not only is in our national economic self-interest, but also is consistent with our leadership position within the global financial community.

Building on my earlier point about the need for vision, leadership, and political will, in our system of government this effort would fall first and most naturally to the new U.S. Treasury Secretary, Henry Paulson, on behalf of the Administration. Next, this Commission, the U.S. Chamber more broadly as a representative of end users, and groups like the Financial Services Roundtable as representatives of financial intermediaries are equally well positioned to be leading voices for your constituencies as a reform agenda and an action program are put in place. You can achieve this by providing much needed input from the private sector as policy, legislative, and administrative changes are considered in the future. Finally, the Administration then can move forward by working closely with the bipartisan leadership from the financial services committees in the Congress.

Based on the numerous financial sector and capital market change programs I have had the privilege of helping to lead for clients over the past decade, let me suggest a practical process for reforming our regulatory system to meet the demands of the modern financial marketplace. I do not pretend to have answers today to all of the substantive issues that are implied by the challenges that lie ahead. I do, however, have an informed point of view on an actionable way forward that I want to share with you in closing.

To launch this effort, I would urge President Bush to revise the Presidential Executive Order that established the Working Group on Financial Markets.[16] Specifically, I recommend three major steps for the Working Group to start a much-needed financial sector regulatory overhaul in line with our national interest:

1. **New mandate.** Revitalize the President's Working Group under the chairmanship of the Secretary of the Treasury, and give it a new mandate to design a blueprint for a modern financial services policy and regulatory regime commensurate with the U.S. role as the leading power in a competitive, global economy. Much of what the Working Group has done in the past has been needed, but too reactive; it is time to be proactive and forward-looking. Among other things:

    - **Diagnostic.** Require the Working Group to conduct its own diagnostic and develop its own independent fact base upon which future policy

16 Presidential Executive Order 12631 – Working Group on Financial Markets, March 18, 1988.

changes can be made. Much of this knowledge obviously exists already within the agencies represented by the Working Group members, but it needs to be assembled quickly, analyzed carefully, and synthesized comprehensively to look across the entire financial services industry and gain a better understanding of where it is heading.

- **Private sector input.** Create a small Financial Markets Advisory Council to the Working Group drawn from leaders in the private sector. The Council's role would be to advise the Group on a formal, regular, and ongoing basis, much like the Federal Reserve's Advisory Council. This would be the start of a new national dialogue and dedicated public-private sector partnership. Presumably, many of the suggestions that will flow from the work of this Commission could be channeled to the Working Group either directly or indirectly through this new Council.

- **Deadlines.** Set a clear deadline for an initial action report to the President for his consideration of needed policy, legislative, and administrative changes (e.g., deliver the first preliminary report within 3 to 6 months). Subsequent and regular reports to the President and the Congress could be provided by the Secretary of the Treasury on behalf of the Working Group that focus on the state of the U.S. financial services industry and continuing regulatory issues in need of action.

- **Comprehensive approach.** Additional cabinet members could be added to the working group on an issue-specific basis when a comprehensive Administration view is required on key issues (e.g., Homeland Security for immigration issues related to the global war for talent in financial services and related technology and information fields); State Department for assistance in ensuring open financial markets in other countries (e.g., China, India) or regions (e.g., European Union, Association of South East Asian Nations, the Gulf Coordinating Council).

2. **Shared vision and strategy.** Require the Working Group to develop an explicit, shared vision for the financial sector and its regulation as well as a supporting, comprehensive financial sector strategy –- an action plan based on a portfolio of legislative, regulatory, and administrative initiatives over different time periods (next 6 months, next 12 months, next 2 to 3 years). Given the shifting and blurred lines between capital markets and the rest of the financial services world, this has to be a comprehensive review across all segments of the financial services world, not just capital markets.

3. **Optional National Financial Services Charter proposal.** Last but not least, require the Working Group to provide recommendations to the President for

a new but optional and independent regulatory regime for those financial institutions that elect to serve customers nationally or internationally. This could start perhaps as an option for the top 50 to 100 financial institutions today by market capitalization, but should not be limited by size alone. It should be driven only by the choice by an institution of a national or international strategy as either a full line provider (e.g., a universal bank or financial holding company) or a niche market specialist (e.g., limited to a single product or customer segment). Elements of this optional national charter could include:

- **Objectives.** The objectives would be a world-class, prudential, efficient, and transparent regulatory regime based on equal treatment for all who opt in and elect to serve their customers from a national platform across some or all segments of the financial services industry.
- **Optionality**. This regime would be a new option for all domestic and international participants, not an additive layer of regulation. It would leave in place the current regulatory regime for those that choose to operate primarily within a segment of the industry (e.g., a small insurance company) or at a local/state-based level (e.g., a community bank or credit union).
- **Single regulator.** Those who opt in would have a single regulator across all financial services, a single point of contact to cut unnecessary red tape and make decisions that will help companies serve their customers better or more efficiently. Ultimately, there would be a single point of regulatory accountability as well. This new regulator would be open to all holding companies, financial institutions (e.g., universal banks not organized in a holding company structure), and insurance companies that choose to operate across some or all segments of the U.S. financial services industry – patterned on the FSA model.
- **Principles-based regulation.** Regulation would be primarily "principles-based" as opposed to "rules-based" with clearly demarcated lines for "prompt corrective action" by the new regulator.
- **Market orientation and efficiency.** This comprehensive regulatory regime would be derived largely from market principles for competition, conducting business, and serving customers, and subsequently supervised at three levels as they are today: self-governance and disclosure by the institution; market supervision through rating agencies, analysts, and other market participants, and, finally, the government on behalf of the entire financial system. An efficient regulatory system is necessary, but

this approach does not envision a race to the bottom to be the lowest-cost provider of regulatory oversight compared to other markets.

- **Performance-based supervisory standards and metrics.** World-class, prudential, performance-based standards would be set for admission and ongoing supervision – capital, governance, risk management, management "fit-and-proper" tests – in exchange for clear incentives and greater efficiency in regulatory processes including approvals, supervision, and enforcement. Examinations would be done only by the new regulator based on an institution's performance metrics.

- **Enforcement.** Enforcement would reside with the new national regulator as well, and would not be subject to review or action by the individual states; this could also include internal arbitration and dispute resolution. Both civil money penalties as well as criminal referrals to the Justice Department for action when needed would exist (i.e., federal court jurisdiction).

- **Preemption.** Full federal preemption of state laws would apply to all institutions electing this new regime. National standards would prevail. State regulation would continue for institutions that opt to remain chartered at the state or multi-state level.

- **Coordination.** The new, optional regulator would enter into memoranda of understanding (MOUs) with other stakeholders where necessary (e.g., Federal Reserve, FDIC, SEC, NYSE and other exchanges) for sharing of information and crisis management. This arrangement avoids potential conflicts of interest that exist today and the precedent is the MOU (treaty) between the FSA (regulator) and the Bank of England (central bank).

- **Conflict prevention.** This new regulator would be a regulator only. It would have a single objective – the prudential and efficient regulation of national and international financial providers – and would not have any additional objectives or mandates – e.g., the conduct of monetary policy, provision of deposit insurance, resolution of failing institutions, offering of products and services to regulated entities, operation of stock exchanges or market mechanisms that are better suited for self-governing organizations (standards setting boards, training organizations, professional trade associations).

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In summary, the current U.S. competitive position across financial markets, while healthy enough today, is at risk in the future given global realities and observable trends. Without fundamental change, our regulatory system, having served us well in the past, is a potential drag on our economy in the future. Vision, leadership, and political will are needed now to develop a shared vision, a set of shared values, a common strategy, and a modern regulatory structure for the 21st century. There is an urgent need to act now to maintain and enhance the U.S. competitive position by ensuring a world-class regulatory regime, not only for the sake of our domestic economy but also consistent with our leadership role in the international economy.

The President's Working Group on Financial Markets, under the new leadership of Treasury Secretary Paulson, can be the spark that is needed to ignite a new vision, a new financial sector strategy, and a modern financial regulatory structure that is second to none in the world. This will require bipartisan support of the Congress as well as continual input from the private sector – this Commission, the Chamber, and the Roundtable and other stakeholders – to create the kind of vibrant, supportive, and resilient financial sector and regulatory regime that our economy and our society deserve.

Thank you for your attention, and I would be happy to answer any questions.