Regulatory Reform in the Real World

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Introductory Note

This Wednesday, June 17th, President Obama is expected to unveil a White Paper outlining his Administration's proposal for reforming financial regulation in the United States. The proposal is likely to touch upon a number of topics that I have addressed in my academic writing over the past two decades and most centrally with the issue of regulatory reform and consolidation.[1] To give a flavor of my views on regulatory reform, I'm attaching with this introductory note, two recent drafts offering perspectives on regulatory reform. The first, titled "Learning from Eddy: A Meditation on Organizational Reform of Financial Supervision in Europe," explores the potential benefits of

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[1] My earliest academic writing focused on the problems in devising effective capital requirements for financial conglomerates. See, e.g., Howell E. Jackson, The Expanding Obligations of Financial Holding Companies, 107 HARVARD LAW REVIEW 507 (January 1994); Howell E. Jackson, Consolidated "Capital Regulation for Financial Conglomerates," in CAPITAL ADEQUACY BEYOND BASEL:BANKING, SECURITIES AND INSURANCE, 123- 45 (2005, Hal S. Scott, ed.) (Oxford University Press). In the late 1990's, drawing in part on work I did for the Clinton Administration's Treasury Department leading up to the Gramm-Leach-Bliley Act, I focused the complexity of maintaining fragmented regulatory system in a modern economy where conglomerates increasing operated across the traditional sectors of banking, insurance, and securities and where lawyers were increasingly adept at recharacterizing financial products to fall within the jurisdiction of a more accommodating regulator or to escape regulation altogether. Howell E. Jackson, Regulation of a Multisectored Financial Services Industry: An Exploratory Essay, 77 WASH. U.L.Q. 319 (1999) (avail. at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=166651). Later, I undertook a series of comparative regulatory projects comparing the costs of financial regulation across a range of advanced economies and exploring the benefits of more consolidated forms of regulation that most other advanced countries have adopted in the past decade or two. Howell E. Jackson, An American Perspective on the FSA: Politics, Goals & Regulatory Intensity, in REGULATORY REFORMS IN THE AGE OF FINANCIAL CONSOLIDATION: THE EMERGING MARKET ECONOMY AND ADVANCED COUNTRIES 39 (2006) (Lee-Jay Cho & Joonkyung Kim, eds.); Howell E. Jackson, *Variation in the Intensity of Financial Regulation: Preliminary Evidence and Potential Implications*, 24 YALE J. REGULATION 253 (2007) (avail. at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=839250). Most recently, I have focused on more practical questions of how the United States might reform and rationalize its system of financial supervision.

regulatory consolidation for the United States. The second piece is testimony I gave before a Senate hearing in January of this year on weaknesses in current U.S. regulatory structures, focusing on the relationship between the fragmented structure of our system of financial regulation and the ongoing financial crisis.

My current research project is to extend these writings through an analysis of the Obama Administration's reform proposal and its evolution as it wends its way through Congress and perhaps into legislation. As the next few months are likely to illustrate, political pressures and vested interests will greatly influence the content of legislated reform in this area. Constituent groups are well organized and well financed, and both congressional committee chairs and well entrenched bureaucracies have strong views on structural changes. The resulting legislation, if indeed there is legislation, will almost certainly not conform to the idealized forms of regulatory reorganization that academic writing (including my own) tends to analyze.[2] Rather any reform bill will be a compromise of policy prescriptions and practical politics. The goal inn this project is explore how the inevitable political promised might be negotiated so as to achieve as many as possible of the benefits of consolidated regulatory oversight while mitigating the theoretical weaknesses of our current regulatory structure.[3] I'm also hope go explore the extent to which the year's reform legislation might include components that will encourage further rationalization of our regulatory system in the years to come.

This introductory note includes a short summary of what's likely to be included in the Obama Administration reform plan. You can probably get a more complete and accurate presentation in Thursday morning's papers. I then outline what I think will be the most interesting design issues in implementing the proposal.

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[2] My own proposal for regulatory reform is available at Howell E. Jackson, A Pragmatic Approach to the Phased Consolidation of Financial Regulation in the United States (Nov. 12, 2008) (avail. at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1300431).

[3] Conversely, one might also hope to minimize the weaknesses of the elements of consolidation built into the reforms while maintain the virtues of our existing system of fragmented oversight. As a proponent of consolidation, however, I believe the factors identified in the main text are the more important.

Summary of Expected Contours of the Obama Administration Proposal

While the details of the Obama Administration White Paper are not yet public, press accounts suggest the general contours. In terms of regulatory consolidation, the Administration is apparently going to abstain, for the most part, from recommending sectoral consolidation of banking agencies (like the Comptroller of the Currency, the FDIC and the Federal Reserve Board's bank supervision operations) or securities/futures regulators (the SEC and CFTC) and almost certainly not endorse the creation of a consolidated, cross-sectoral agency such as the British Financial Services Authority. At most, the Office of Thrift Supervision may be merged into the Office of the Comptroller of the Currency, both already located within the Treasury Department. The Administration has however signaled that it will support the expansion of Federal Reserve Board oversight of systemically important institutions and also, it seems, the creation of a new consumer financial protection agency along the lines that my colleague Elizabeth Warren has been advocating for several years. The Administration also envisions the creation of a new council of regulators with as-yet unspecified powers and responsibilities. Rounding out the reform program, the Administration has already voiced support for expanded federal powers to resolve the failure of large conglomerates, like AIG or Lehman, and has endorsed expanded federal oversight of OTC derivatives and associated trading markets. Other pieces of pending and recently enacted legislation deal with other areas of financial regulation, like credit rating agencies, credit cards, and home foreclosures, but do not directly bear on regulatory structure.

The Administration's apparent regulatory choice represents a unique hybrid of existing organizational archetypes. Generally speaking, policy analysts divide financial regulatory structures into three basic groups: sectoral regulation, in which a separate regulatory governs banking, insurance, and securities; consolidated supervision, where a unified agency oversees the entire financial sector; and then "multi-peaked" systems where two or more agencies are charged with specific and unique regulatory functions, like consumer protection or prudential regulation. The United States has historically been characterized as an extreme form of the first category with sectoral authority fragmented at the federal level and then further delegated in part to state authorities. The Obama Administration is apparently choosing to retain our existing highly fragmented system of sectoral regulation but simultaneously to super-impose a "twin peak" approach with the Federal Reserve Board gaining a systemic risk oversight function (sometimes called macro-prudential oversight) and the new Consumer Financial Products Commission getting what appears likely to be a narrowly constrained consumer protection mandate. In pushing for expanded federal authority over the failure of financial conglomerate, the proposal creates another new statutory structure, which will need to be integrated with existing bodies, such as the FDIC, SIPC, and state insurance resolution funds, that operate only sectoral lines as well as with the federal bankruptcy system that deals with corporate insolvencies.

Key Issues of Implementation

1. Defining the Jurisdiction and Mandate of New Functional Units

Important initial questions concern the jurisdictional scope and statutory mission to be given to the new functional units that the Obama proposal contemplates: The Federal Reserve Board's new systemic risk powers and the Consumer Financial Product Commission's consumer protection powers. The issues concern not just the powers granted to these new bodies but the interaction of those powers with existing regulatory agencies that will retain day-to-day supervisory responsibilities over most of the financial services industry.[4]

A. Federal Reserve Board's Systemic Risk Powers

Starting with the Fed's systemic risk authority, I see two key design issues. The first concerns whether the Board's jurisdiction will be limited to a discrete group of clearly identified systemically important financial institutions, including for example the largest insurance companies like AIG and perhaps major hedge funds and derivatives traders, or whether the Board will have more of a roving mandate to investigate whichever elements of our financial markets it suspects may generate the potential for systemic risks?[5] Second, whatever firms do fall within the Federal Reserve

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[4] The new financial conglomerate resolution authority raises somewhat similar issues of interaction with existing resolution bodies for financial institutions and the bankruptcy system. Though I hope to address this topic eventually, I do not do so in this introductory note.

[5] The concept of system risk is not always well defined. When I use the term, I mean the possibility that the failure of an institution will have consequences for other entities that are not in direct contractual privity of the failed institution. There are several channels through which systemic risk can

Board's systemic risk oversight responsibilities, will that authority be exclusive and plenary or will it somehow be shared with existing regulatory bodies, like the Comptroller of the Currency, the SEC and state insurance commissions.

The decision is complex for several reasons. At the Fed, there is a tradition of maintaining plenary supervisory authority over certain entities (bank holding companies and state-chartered member banks) on the grounds that it gives the organization a better feel for market conditions. For that reason, the Board is likely to lean towards having some front-line regulatory oversight of some firms in the key sectors of the financial service industry and may well want exclusive or lead responsibility for a handful of key firms and some sort of residual oversight of other areas if its systemic risk mandate goes beyond a discrete set of firms.[6] On the other hand, the chief benefit of functional regulation is that it allows each regulatory body to specialize in one regulatory objective. In the case of a systemic risk regulator, that speciality is macro-prudential risk, and expanding the Federal Reserve Board's mandate to entail front-line supervision may tend to lessen its regulatory focus, as more mundane supervisory considerations come into play. A pure systemic risk supervisor would have no front line responsibilities, but simply look over the shoulder of front line regulators and, in essence, offer an independent and impartial judgment as to whether industry and firm practices posed potential sufficient system risks to warrant intervention.

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spread to these third parties. A firm's failure can impose losses on creditors that will then fail and impose losses on other third parties, as was arguably the case with respect the many counter-parties on AIG's credit default swaps Or, a firm's failure can compromise complex networks that implicate many other parties, as was the case in Lehman's failure with respect to various OTC derivative markets. Or the failure of a firm can precipitate downward pressure on asset prices and a resulting liquidity crisis, as accompanied several of the prominent failures of the past year. Or the elimination of a particular firm can reduce the flow of credit to a particular sector as to have significant negative externalities, as the closure of Fannie Mae might have done last summer. Broadly speaking, one might understand the Federal Reserve Board's new responsibilities as preventing the failure of any financial firm that poses these kinds of risks to our financial system.

[6] A roving mandate of some sort of likely the better approach for two reasons: First, as the current crisis reveals, systemic risk can come from unexpected places and it would be unwise to expect that we can know the source of future systemic risks with any clarity. Second, the moral hazard problems of precisely defining systemically important institutions is considerable as the market may well conclude these institutions are too big to fail and so the Federal will have reason to try to keep the number of firms clearly within its systemic risk oversight to a minimum.

To the extent that at least a portion of the Federal Reserve Board's systemic risk mandate will extend to portions of the financial services industry not under its direct supervisory mandate, a number of challenging issues of shared jurisdiction will arise. To begin with, there is a question as to the Board's authority to superimpose regulatory requirements and instituted supervisory actions on these other institutions. Within policy circles, it is widely assumed that the Federal Reserve Board will be charged with setting capital standards and perhaps liquidity standards across much of the financial services industry, and these regulatory requirements are a key bulwark against firm insolvency and systemic risks. But many other regulatory requirements can mitigate systemic risk: diversification requirements, limitations on firm size, and regulation of clearing and settlement arrangements are prominent examples. Even lax consumer protection, as the subprime crisis reveals, can have systemic implications in extreme cases. The authority of the Board to superimpose regulatory requirements across the full breadth of the financial services industry is thus an important question that legislative drafters will need to address.

A related question is how the Board will educate itself about sectors of the financial services industry where it traditionally has not had supervisory expertise. Other jurisdictions secund employees from the central bank to front line regulatory agencies or have policies to encourage cross-agency promotions into to distribute front-line supervisory expertise. Mechanisms for staff rotations are less common in the United States, but may be needed if the Board is to develop genuine expertise throughout the financial services industry.

B. Consumer Financial Products Commission

As a newly formed agency, the Consumer Financial Products Commission is being devised from whole cloth and so the scope of its responsibilities is less clear. Indeed, we don't yet know whether the Commission will be built around the consumer finance division of the Federal Reserve Board staff, which oversees the Truth in Lending Act and a few other federal statutes covering some aspects of mortgage lending and fair credit or whether a completely new staff will be hired. The underlying logic of the proposal is, however, straightforward. Traditional sectoral regulators tend to focus on preserving the solvency of regulated firms and therefore short-change consumer protection requirements. A single purpose consumer protection commission, in contrast, would maintain its focus on the consumer and be a more effective advocate of fair dealing.

In my view, there are several key policy issues about the new Consumer Financial Products Commission. First is the scope of its responsibilities. Draft legislation already pending in Congress contemplates a relatively narrow mandate, including credit cards, mortgages, and savings accounts (closely tracking areas where the Federal Reserve Board staff currently has expertise) but not including investment products, mutual funds, retirement savings, or insurance products (areas currently within the jurisdiction of the SEC, Department of Labor, and state insurance commissions). While there is some logic in limiting the responsibilities of a new organization, this narrow approach is likely to create discontinuities of regulation (fostering regulatory arbitrage) and also inhibits the Commission from addressing cross-cutting issues of personal financial planning and financial literacy.

Another open question about the Commission is the mode of regulatory intervention it will utilize. In some formulations, the Commission would exercise FDA-like prior approval authority for all consumer financial products; others envision a Consumer-Product-Safety-Commission model that issues ex poste orders against unsafe products. The behavioral economists have suggested the Commission should establish default products, like thirty-year fixed mortgages, as to which consumers would permitted to opt out under receipt of appropriate disclosures and counseling. In the draft Senate bill, the Commission would have all these powers and also more traditional latitude to establish disclosure requirements and enforce more open ended fiduciary obligations on firms selling covered financial products to consumers. Among other things, legislation will have to define the precise scope of Commission powers and the standards under which those powers will be exercises. In all likelihood, the Commission's powers will be fulsome, its arsenal formidable.[7]

[7] As I am focused primarily on jurisdictional issues here, I put to the side the tremendously important and difficult question of which supervisory approaches most effectively advance the goal of consumer protection. Suffice it to say, there are many ways to skin this particular cat and historically we have employed dramatically different methods in substantially similar contexts across the financial services industry. See, e.g., Howell E. Jackson, "The Trilateral Dilemma in Financial Regulation," in IMPROVING THE EFFECTIVENESS OF FINANCIAL EDUCATION AND SAVINGS PROGRAMS (Anna Maria Lusardi, ed.) (University of Chicago Press 2008) (avail. at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1300419).

But the expected scope of the Commission's powers will present another set of design issues. How will the expansive Commission authority interact with power of existing sectoral agencies. The draft Senate bill contemplates overlapping authorities with consumer protection jurisdiction for both the Commission and the front-line regulator of the firm in question. In cases of conflicting requirements, the more stringent rule governs. And presumably, in the case of overlapping enforcement actions, the more aggressive agency prevails. At a minimum, such overlapping jurisdiction will require the development of supervisory protocols to ensure an efficient allocation of supervisory resources and the minimization of unnecessary conflicts. In addition, there are some nice questions as to how these overlapping sources of federal consumer protection authority will interact with state consumer protection law. A much litigated issue in recent years has been the extent to which federal banking law preempts consumer protection laws.[8] What is unclearly is whether the creation of a Consumer Financial Product Commission, based on overlapping state authority, would and should change the preemptive effect of other kinds of federal financial regulation. Again this is an important topic that enabling legislation could profitably address.

C. Common Problems of Expertise, Morale and Compensation

In the academic literature on regulatory reorganization, one of the often cited advantages of a consolidated regulatory body or a system of multiple-peaked functional regulation is that consolidated agencies tend to attract better qualified and more committed personnel. Partially this is a function of the fact that new agencies often have higher salaries and dedicated funding sources, but proponents of regulatory consolidation also argue that personnel prefer the broader jurisdictions of consolidated supervisory agencies, which tend to have more opportunities for professional advancement and a broader field of operation. Problems of regulatory capture are also said to be less acute with consolidate agencies that are not beholden to a single sector of the industry and so less prone to facilitate regulatory arbitrage.

To the extent that the Federal Reserve Board's systemic risk division and the new Consumer

[8] See Howell E. Jackson & Stacy A. Anderson, Can States Tax National Banks to Educate Consumers About Predatory Lending Practices?, 30 HARV.J.LAW &PUB.POL'Y 831 (2007) (avail. at http://www.law.harvard.edu/students/orgs/jlpp/Vol30_No3_Jacksononline.pdf).

Financial Product Commission share these attributes, one might expect their creation to have potentially adverse consequences on existing regulatory bodies. In all likelihood, the new agencies will be perceived to be the more prestigious entities in the federal regulatory pantheon and will most likely offer more attractive compensation packages and opportunities for professional development. To the extent that our fragmented sectoral agencies have had difficulty retaining top flight talent in the recent past, these difficulties could become more acute and could require some sort of mitigation efforts.

2. Resolving Jurisdictional Gaps and Preventing Regulatory Arbitrage

One of the most commonly voiced criticism of sectoral supervision is its inability to resolve jurisdictional gaps and to ensure comparable treatment of functionally similar products. Industry participants are quick to exploit these weakness through regulatory arbitrage and the creation of new products that fall between agency jurisdictions. In the United States, where agencies often have narrowly defined jurisdictional mandates and courts have often been sympathetic to industry litigants, these problems have been rampant.

The Obama proposal appears to address this problem in several ways. To begin with, Obama proposal also includes a number of specific initiatives to address areas where the current financial crisis has reveal major regulatory. Previously endorsed legislation to clarify the division of SEC and CFTC authority of over OTC derivative markets is one example, as is an expected proposal to extend regulatory coverage to hedge funds and other large under-regulated pools of investment capital.

Going forward, the major gap-filling plank of the Obama plan is expected to be the creation of a new inter-agency regulatory council, modeled on the existing President's Working Group on Financial Markets. The role of this new council is as-yet unclear, but it is expected to be charged with identifying regulatory gaps and emerging problems in regulatory design. For example, will the council have the power to adjust the jurisdictional boundaries of other regulatory agencies or insist on consistent supervisory requirements across sectors of the financial services industry or merely to make recommendations on such matters. In addition, there are important questions as to how council will relate to the Federal Reserve Board's new systemic risk responsibilities. Both will entities will be charged with identifying emerging risks and it remains to be seen how these roles will mesh.

3. Enhancing the Likelihood of Future Regulatory Consolidation

A final challenging question of regulatory design is the extent to which the Obama Proposal will include mechanisms that will enhance the likelihood of further regulatory consolidation over the next few years. Immediate press commentary will undoubtedly focus on the failure of the initiative to recommend immediate consolidation of regulatory structure, and many aspects of this introductory note emphasize the complexity of operating a regulatory system that combines functional agencies (macro prudential and consumer protection units) with our traditional sectoral units. But the proposal may also contain the seeds of a more streamlined structure.

As the new coordinating council will likely be supported by a staff housed in the Treasury, that Department will have an increasingly important role in regulatory oversight, as it also contains a major consolidated banking regulator (the combined OCC and OTS) plus the TARP operation. Depending on how closely these units work together, the Treasury could become something of a proto-consolidated supervisory agency, setting the stage for the kind of "three-peak" regulatory model that the Bush Treasury Department recommended as optimal in a report issued in the Spring of 2007.[9] Whether that actually comes to pass depends heavily on the precise powers the new coordinating council is given and how the council exercises that authority in the years ahead. Of critical importance will be the amount of direct control the council can exercise over other regulators. Also important will be the manner in which the Council interacts with Congress. If, for example, Council reform proposals were entitled to fast track legislative authority, that could dramatically improve its chances of avoiding many of the political impediments to regulatory reform that the Obama Administration now faces. But even without such procedural advantages, the Council could influence future policy simply by providing a single, authoritative voice on regulatory policy rather than discordant chorus that has typically characterized public discourse on reform

[9] I advocated the creation of this sort of council in Howell E. Jackson, A Pragmatic Approach to the Phased Consolidation of Financial Regulation in the United States (Nov. 12, 2008) (avail. at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1300431).

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Learning from Eddy: A Meditation Upon Organizational Reform of Financial Supervision in Europe

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Learning from Eddy: A Meditation Upon Organizational Reform of Financial Supervision in Europe

by

Howell E. Jackson*

January 9, 2009

Abstract

In this essay written in honor of the retirement of Eddy Wymeersch, Professor Howell Jackson explores the manner in which European nations have moved towards more consolidated systems of financial regulation and discusses the implications of the European experience for the United States. While U.S. policy debates over regulatory reform often reduce to theoretical claims regarding the benefits and pitfalls of consolidation, the consolidation of oversight within the members states of the European Union offers many concrete examples of how consolidated supervision actually works. European experience demonstrates that there are many different ways in which to implement consolidated regulation, and often times the process of consolidation occurs gradually over a number of years. In addition to the expected advantages of increased efficiency and the elimination of regulatory gaps, European experience suggests that consolidated regulatory agencies often attract higher quality personnel and do a better job maintaining consistency across different sectors of the financial services industry. In addition, European reforms have devised a number of mechanisms to ensure that consolidated agencies remain politically accountable and resolve policy conflicts in an efficient and timely manner.

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Learning from Eddy: A Meditation Upon Organizational Reform of Financial Supervision in Europe

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Howell E. Jackson*

January 9, 2009

With the March 2008 release of the U.S. Treasury Department's Blueprint for a Modernized Financial Regulatory Structure, the reorganization of financial regulation in the United States is, once again, an issue of public debate in American policy circles. Fortunately, this is also a subject which Eddy Wymeersch recently addressed in *The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors*. Like much of Professor Wymeersch's academic writing, this article offers American readers a unique and illuminating view into European regulatory practice, combining the theoretical sophistication of an accomplished academic with the pragmatic insights of a senior regulatory official. My goal in this essay is to meditate upon Professor Wymeersch's description of the evolving supervisory practices in Europe and draw out potentially useful implications for policy issues raised in the Treasury Department's *Blueprint* and how regulatory reform might be implemented in the United States.

At the outset I should acknowledge the envy with which I regard my academic and

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regulatory counterparts working in other jurisdictions. While the United States prides itself in having a dynamic economy that fosters innovation and invention, the country's capacity to reform the structure of its regulatory institutions pales in comparison to the ability of member states of the European Union – or other developed countries such as Japan and Australia – to modernize their regulatory bodies. As has often been noted, the American system of financial regulation is a product of nearly two centuries of bureaucratic accretions, dating back to the free banking statutes of the 1830s. Over the generations, numerous oversight bodies have been added and few eliminated with the resulting maze of supervisory bodies incomprehensible to those familiar with the supervisory systems of other leading economies and a source of extraordinary cost and unnecessary complexity for regulated firms and practicing attorneys in the United States.

With effort and patience, one can come to understand how and why the American regulatory structure has evolved in the way it has and a large portion of any academic course on financial regulation in the United States is typically dedicated to unpacking the mysteries of regulatory jurisdiction in this country. (Jackson and Symons 1999) A national taste for federalism explains why we have overlapping systems of state oversight in banking and securities. Anachronistic and long abandoned interpretations of the Commerce Clause of the U.S. Constitution allowed insurance regulation to develop exclusively at the state level in the late 19th and early 20th centuries. An aversion to concentrated sources of governmental power has lead American politicians to retain sectoral division of supervisory agencies – that is, separate regulatory bodies for banking, insurance and securities – and also our even more fragmented oversight of depository institutions (Federal Deposit Insurance Corporation (FDIC), Comptroller of the Currency (OCC), Office of Thrift

Supervision (OTS), and Federal Reserve Board), securities/futures (Securities and Exchange Commission (SEC) plus the Commodities Future Trading Commission(CFTC)), and insurance (distinguishing freestanding insurance companies regulated at the state level from employer-provided pensions and health insurance covered by the Employee Retirement Income Security Act of 1974 at the federal level). On top of these latent political preferences and historical accidents, the political impediments inherent in our divided and increasingly partisan political system make it difficult to effect financial reform, at least as compared to the parliamentary systems of government found in most other developed nations. Finally, add in a national predilection to review any idiosyncratic aspect of governmental structure as a manifestation of American exceptionalism, and one can develop a relatively rich though not always inspiring explanation of why the American system of financial regulation has strayed so far from the models of supervisory oversight upon which the rest of the world is converging.

But whatever the explanation of the Rube Goldberg complexity of regulatory oversight in the United States, there is still much to learn from the experience of other countries in reforming their own supervisory systems. My purpose in reflecting upon Professor Wymeersch's article is to consider how the regulatory reforms with European members states over the past decade might inform our understanding of the Treasury Department's recent proposal and, more specifically, to consider how that experience can help us evaluate the many conflicting arguments that have been made for and against more radical proposals to consolidate financial regulation in this country.

I.

In modern debates over regulatory reform, the issue is typically framed in terms of a question of the degree to which and the manner in which traditional sectoral agencies should be consolidated into a smaller number of regulatory bodies. There are two basic approaches to consolidation. The first and simpler approach is to combine two or more sectors of the financial services industry under a consolidated regulatory body, such as the British Financial Services Authority. (Jackson 2006) Alternatively, existing agencies can be reconstituted into new and specialized organizational units designed to advance specific regulatory objectives, like ensuring the fairness and transparency of interactions between financial firms and their customers (sometimes called market conduct) or safeguarding the safety and soundness of financial institutions (often denominated prudential supervision). Adopting terminology coined by Michael Taylor, this second approach is often labeled a "twin peak" or "multi-peaked" model, depending on how many different regulatory objectives are specified and assigned to separate agencies. (Taylor 1995) The Treasury Department's recent *Blueprint* contains elements of both approaches. In terms of combinations, the Department recommends in the relatively near future the merger of the SEC and CFTC as well as the consolidation of banking supervisory bodies, including its proposed merger the Office of Thrift Supervision with the Comptroller of the Currency and also its more obliquely recommended combination of the currently divided FDIC and Federal Reserve oversight of state banks. (United States Department of the Treasury 2008, pp. 89-100) Over the longer run, the proposal envisions the creation of multi-peaked objective-oriented agencies, focusing on prudential regulation, market conduct, and market stability, an objective centered on minimizing systemic risks. As the Treasury also envisions the creation of two smaller regulatory units – one for oversight of corporate issuers and the other to contain government guarantee funds – the Blueprint's long-term recommendations might best be labeled a "Three Peak, Two Foothill" model of regulation. (United States Department of the Treasury 2008, pp. 137-180)

Within policy circles, the debates over the reform of financial regulatory systems have been well-rehearsed at this point, and the basic trade-offs are fairly well understood.[1] The combination of single-sector agencies offers the promise of greater efficiency and efficacy, as consolidated agencies enjoy economies of both scale and scope. The advantages are, it is argued, capable of simultaneously improving the quality and lowering the cost of financial supervision, while also benefitting regulated firms by offering a single point of supervisory contact and eliminating sources of regulatory duplication and inconsistency. The on-going consolidation of the financial services industry is often cited as further justification for the combination of supervisory functions, as an integrated regulatory supervisor is said to be better equipped to oversee conglomerates that offer a full spectrum of financial products and manage their own risks on an organization-wide basis. The growing dominance of financial conglomerates in global markets also raises the costs of single-sector supervision, as consolidated firms are thought to be more capable of exploiting opportunities for regulatory arbitrage – that is, instances in which different regulators establish different substantive rules to deal with functionally similar products or activities – which single-sector agencies have difficulty identifying and correcting. Relatedly, consolidated agencies are thought to be better equipped to identifying regulatory gaps, that is, pockets of economic activity that fall outside the remit of traditional financial sectors, with hedge funds and perhaps sub-prime mortgage

[1] For more extensive treatments of the subject, see Herring and Carmassi (2008); United States Government Accountability Office (2007); Brown (2005); Llewellyn (2004); Masciandaro and Porta (2004); Briault (2002); Di Giorgio and Di Noia (2001); Abrams and Taylor (2000); Schooner (1998).

lending activities and securitization activities being prominent examples in recent times.

The case against regulatory consolidation is also multi-faceted. To begin with, there is the absence of irrefutable evidence that consolidated agencies are any more efficient than their single-sector predecessors, at least in terms of total regulatory costs.[2] More substantively, critics of consolidated supervisory argue that the goals of supervision differ across industry sectors and that a combination of regulatory functions may actually dilute the quality of supervision by imposing a standardized model of oversight on all sectors of the industry. Combined oversight may also diminish market discipline as government guarantees traditionally limited to certain sectors, like banking, may be assumed to extend more broadly in a country where all sectors have a common supervisory agency. In addition, there is concern that regulatory consolidation produces a governmental monopoly, less likely to respond to changing market conditions and potentially more prone to wholesale regulatory capture or at least a supervisory posture tilted in favor of large conglomerates at the expense of smaller more specialized firms.

Regulation by objective, the third multi-peaked model of regulatory organization, is a bit of a hybrid approach and thus shares some of the advantages and disadvantages of the two other models. (Kremers, Schoenmaker and Wierts (2003)). By reducing the number of supervisory units, regulation by objective offers potential efficiency advantages over traditional sectoral regulation, and it also addresses concerns of regulatory arbitrage as functionally similar products and services are under the jurisdiction of the same supervisory body. But, like fully consolidated oversight,

[2] See Ćihák and R. Podpiera (2006) (finding evidence of quality improvements not cost savings from consolidated supervision).

regulation by objective risks imposing one-size-fits-everyone rules, which discount unique characteristics of traditional sectors and subsectors. Moreover, multi-peaked models generate new problems of coordination, duplication and gaps, as the lines between functions such as market conduct, prudential regulation, and market stability are not clear, and many regulatory structures, like disclosure or even capital requirements, advance all three objectives. With regard to concerns over governmental monopolies and supervisory rigidity, multi-peaked models again constitute an intermediate case, less centralized than fully consolidated operations but less attuned to sectoral differences than traditional sectoral oversight.

Another much discussed dimension of regulatory consolidation is the appropriate supervisory role of central banks. Often times, reorganization entails the movement of bank supervision away from the central bank, as happened in the United Kingdom when the supervisory powers of the Bank of England were transferred to the new Financial Services Authority in the late 1990's. Less frequently, but occasionally, the central bank itself becomes the consolidated regulatory, thereby expanding its jurisdiction as a result of reorganization. Finally, in certain multi-peaked models, including perhaps the Treasury Department's *Blueprint*, the central bank may itself be designated the "peak" responsible for market stability. The often voiced concern about this aspect of regulatory reorganization is the possibility that moving direct supervisory oversight out of a central bank diminishes the bank's ability to effect appropriate monetary policy and maintain financial stability.

Like many important issues of public policy, the debates over regulatory reorganization rests on a numerous, conflicting claims regarding the consequences of various kinds of reforms. Seldom do policy analysts have unambiguous empirical evidence to validate their intuitions. But, in the case of the financial regulation, we do have the benefit of looking to the experiences of the dozens of European jurisdictions which have engaged in regulatory reorganizations over the past two decades, as well as Professor Wymeersch's very helpful synthesis of what we might learn.

II.

In many respects, Professor Wymeersch's portrayal of European regulatory consolidation covers familiar arguments for and against regulatory consolidation, with the growth of financial conglomerates pushing supervisors towards sectoral consolidation and the creation of amalgamated agencies posing concerns over the homogenization and dilution of supervisory oversight. But where Professor Wymeersch's analysis covers new territory is in its explication of how the process of financial consolidation has actually occurred in the twenty-five members EU member states his article surveys.

A.

Consider, for example, Professor Wymeersch's description of modern regulation within the traditional sectors. Typically, one discusses sectoral oversight in terms of the regulatory structure applicable to the core lines of business: banking, securities and insurance. But a recurring theme of Professor Wymeersch's article is the accretion of numerous cross-sectoral regulatory regimes that are already in place in most industrialized countries – money laundering rules, privacy requirements, anti-terrorism measures, and measures to police tax avoidance. (Wymeersch (2007), at pp. 245-246). As is true in the United States, regulations addressing these over-arching issues of public policy tend to be imposed uniformly across the financial services industry – that is, on a consolidated basis – and then implemented on a sector by sector basis. Thus, in even the most fragmented of modern supervisory systems (that is, in the United States), we observe many elements of consolidated regulation, albeit implemented in a haphazard, diffuse and likely inefficient manner.

Another theme of Professor Wymeersch's description of European practices is the incremental and variegated manners in which members states have transitioned to consolidated financial services oversight. While foreign observers tend to focus on the fact that a substantial majority of EU member states now maintain consolidated supervisors, Professor Wymeersch's front line reporting reveals that many countries have made the transition only haltingly and often have only gone partway down the path. Moreover, if one looks closely at the organizational structure within the regulatory apparatus of different EU member states, one can often observe that old sectoral models of oversight have not disappeared even within jurisdictions that maintain a single financial services agency.

Consider first the initial stages of financial reform. In many jurisdictions, reform has often been a gradual process. The front end of regulatory consolidation is sometimes accompanied by ad hoc efforts to coordinate sectoral bodies, such as the creation of a coordinating council in the Netherlands and several other jurisdictions or the use of memoranda of understanding to coordinate existing bodies in Germany and the United Kingdom. (Wymeersch (2007), at p. 262) While Professor Wymeersch reports that these preliminary efforts typically lack sufficient strength to effect significant changes in regulatory practices, they often serve as the first step in a complex supervisory quadrille that ultimately results in legislated reforms enacted through parliamentary procedures. If true, then perhaps the much publicized memorandum of understanding between the SEC and CFTC in the Spring of 2008 will someday come to be marked as the opening movement of this process in the United States as would be subsequent efforts to achieve written agreements between the SEC and Federal Reserve Board

Also of potential interest to US observers is Professor Wymeersch's discussion of the role of industry conglomeration in regulatory consolidation. Within the United States, the merger of banking and securities firms – facilitated by the passage of the Gramm-Leach-Bliley Act in 1999 – has longed been recognized as a reason to develop better coordination between banking and securities regulators. And the decision of the Federal Reserve Board to extend credit to Bear Stearns and its subsequent actions with respect to AIG have only reinforced the need for coordination. Within parts of the EU, one sees similar developments, particularly in the London markets, where the lines between major banks and securities firms have long been blurred. But what is interesting about Professor Wymeersch's account of industry consolidation is his emphasis on the combination of banks and insurance companies in many continental European jurisdiction and his assertion that the regulatory objectives in these two areas are actually quite closely aligned, focused as they are on prudential oversight and thus highly likely to benefit from integrated supervision. For American financial analysts, less attuned to insurance regulation which is largely regulated to state bodies, the notion that there are serious benefits to be gained from combining banking and insurance regulation is eye-opening, but upon reflection not wholly implausible.

Perhaps the greatest lesson to be learned from Professor Wymeersch's survey of regulatory practices in Europe is the array of organizational arrangements currently in place within the EU.

Putting aside the several countries that have not yet combined all three core sectors into one body, one still sees ample variation in approaches. On the one hand, many jurisdictions maintain separate sectoral divisions for front line oversight within integrated regulatory structures. This practice is quite common in the Nordic states but exists elsewhere around the world, most notably Japan. In contrast, other consolidated agencies, such as the British FSA, organized their chief supervisory units into retail and wholesale markets (sort of a mini twin peaks approach within integrated agencies) but also have something of a sectoral matrix approach that maintains expertise along traditional lines but with a special unit for complex organizations. Perhaps not surprisingly, integrated supervision does not in practice consist of an undifferentiated blob of civil servants loosed upon the financial service industry. Rather, in many jurisdictions, operations are divided into supervisory units that would be readily intelligible to one versed only in traditional sectoral oversight.

B.

A commonly cited, but as yet not well documented virtue of consolidated financial oversight is cost savings in government payrolls. Although Professor Wymeersch alludes to these financial savings, as well as even greater savings accruing to regulated firms that need only deal with one supervising body (Wymeersch (2007), at p. 263), his emphasis is on the qualitative improvements that consolidated supervisory agencies provide, an aspect of integrated supervision that has been explored elsewhere but not with nearly as much institutional detail as Professor Wymeersch is able to offer.[3]

[3] For supporting views, see Taylor and Fleming (1999); Ćihák and Podpiera (2006).

To begin with the most mundane, many administrative functions are common to all regulatory bodies: personnel offices, information technology departments, various support personnel at all levels, and even top positions such as the executive director or governing board. (Wymeersch (2007), at p. 260) Aside from the elimination of redundant offices, consolidated departments have inherently larger mandates, which are apt to attract more experienced and senior personnel. Often times, expanded scope will afford increased flexibility, allowing examiners or enforcement staff to be transferred from one sector to another depending on changing conditions.

In terms of substantive expertise, there are to begin with the mounting number of topics – money laundering, tax avoiding, privacy, and financial education – that in many jurisdictions apply to all sectors of the financial services industry and must be staffed repeatedly and inefficiently under traditional sectoral regulation. (Wymeersch (2007), at pp. 245-56, 248-49) With integrated agencies, policy making can be combined and streamlined. But if one looks inside the substance of traditional sectoral regulation, there are many more instances of highly comparable matters of substantive expertise: fitness qualifications for new owners or controlling shareholders; suitability standards for investment products (and exemptions for qualified parties); limitations on transactions with affiliated parties; diversification requirements; disclosure obligations of various sorts; and licensing procedures for new firms. (Wymeersch (2007), at pp. 270-71) Most modern systems of financial regulation share these same core elements. While the technical requirements (and even terminology) often differs from sector to sector, the differences are often more the product of historical happenstance than major distinctions in substantive policy. Attorneys, economists, and other policy analysts trained up to deal with these matters in one sector could quite easily apply their expertise in other sectors. Very plausibly, they would do their jobs better and make life substantially easier for regulated parties if they had the broader remit afforded under a consolidated supervisor. (Wymeersch (2007), at p. 275)

An excellent example of the benefits or a cross-sectoral purview is capital requirements. Much attention has focused on the reform of bank capital requirements under the Basel II process, which has attracted the attention of some of the world's most talented financial economists and been supported by literally hundreds of working papers and dozens and dozens of academic conferences and symposia. Many of the issues that have been explored in the Basel II process – value at risk models, internal ratings, back-testing procedures – are potentially applicable to other types of financial institutions, such as securities firms and insurance companies. Within the more integrated European system, these connections are more easily drawn. In fact, securities firms in Europe are subject to the Basel II capital requirements (and not the different SEC net capital rules applicable to broker dealers in the United States). As Professor Wymeersch explains, even the new insurance Solvency II directive is heavily informed by the Basel II capital rules. (Wymeersch (2007), at p. 269). Thus the oversight of insurance companies in Europe indirectly draw on the expertise of the Basel process in a way that would be difficult to imagine in the United States, where insurance capital rules fall within the bailiwick of the NAIC and state insurance commissions, which have few formal connections to banking regulators and the large number of highly trained economists housed in the Federal Reserve regional banks.

C.

Another insight available in Professor Wymeersch's account concerns the persistence of jurisdictional and substantive conflicts within consolidated regulatory frameworks and the manner in which those conflicts are resolved. Regulatory reorganizations within the financial services industry do not so much eliminate the existence of conflicts, as they alter the dimension on which conflicts arise and change the locus of their resolutions.

Take the case of the classic form of twin peaks regulation, where market conduct is delegated to one agency and prudential oversight is given to another. While this division of authority works well in theory, in practice it entails considerable potential overlap in regulatory design. To begin with, market conduct rules can have prudential implications, as, for example, improper lending practices can give rise to private claims and enforcement actions, which in the extreme can threaten institutional solvency. On the other hand, ample capital reserves – the core of prudential regulation – can have market conduct implications, as well-capitalized concerns are more likely to police their own business activities in order to prevent reputational losses and diminution of franchise value. For these reasons, prudential regulators may have different views on market conduct issues that conflict with the views of the market conduct regulator and vice versa. Sometimes, a policy that advances market conduct regulation – say enhanced disclosure of financial weakness – can actually conflict with prudential considerations or even market stability. Thus one regulatory body may oppose additional disclosures whereas another opposes it, and the issue of the proper hierarchy of regulatory functions is called into question. (Wymeersch (2007), at pp. 245, 249) In the early years of twin-peak regulation in Australia, there were many examples of regulatory conflicts of this sort and it took a number of years (and several memoranda of understanding) to devise a practical system for implementing this form of divided regulatory authority. Professor Wymeersch suggests that similar problems have arisen in multi-peaked regulatory structures in the European context. (Wymeersch (2007), at pp. 247, 267)

With a fully consolidated regulatory structure, similar conflicts arise. If the agency is organized around traditional sectoral divisions, then the same inter-sectoral conflicts arise across divisions. For consolidated agencies organized around functional divisions – that is, replicated multi-peak models within a single agency – the same overlaps and potentially divergent views described above will arise in this context too. What is different about the consolidated agency, as Professor Wymeersch notes, is where these inevitable conflicts will be resolved, and that is within the agency itself, presumably at the highest level. (Wymeersch (2007), at p. 243; Kushmeider (2007), at p. 337) Conflict resolution in the United States and in other jurisdictions where regulatory jurisdictions is divided across numerous regulatory bodies is more complex. In some instances, cross-agency compromises, typically in the form of memoranda of understanding, can be used to reconcile disagreements. But, as Professor Wymeersch notes, these are complicated to negotiate and tend to leave important issues unresolved or unforeseen. (Wymeersch (2007), at pp. 267-68) The alternative is resolution in courts or through legislative intervention. (Wymeersch (2007), at pp. 281-82) But these solutions – as exemplified in the United States -- tend to be time-consuming and unreliable, with many inter-jurisdictional conflicts allowed to drag on for years. (Jackson (1999))

In this light, one of the less well understood virtues of consolidated regulatory structures is their built-in ability to resolve through internal mechanisms the inevitable conflicts that arise across industry sectors and regulatory functions. Of course, this advantage carries with it an amplification of one of the greatest potential problems with consolidation, the centralizatoin of excessive governmental authority within a single administrative body, a topic to which I now turn.

D.

Perhaps the most vexing questions surrounding the consolidation of financial regulatory functions concern issues of accountability and maintenance of appropriate regulatory focus. Especially in the United States, where concerns over aggregation of governmental authority have a special and historic salience, regulatory consolidation if often portrayed as almost un-American on the grounds that divided government is inherently better than centralized authority, at least in this hemisphere. On a more instrumental dimension, the benefits of regulatory competition among diverse and overlapping regulatory agencies are thought to prevent governmental stasis, to combat regulatory capture, and to ensure appropriate regulatory reforms in light of market and technological developments. European experience with consolidated supervision, as Professor Wymeersch recounts, offers a somewhat different perspective on all of these lines of argument.(Wymeersch (2007), at pp. 277-286)

To begin with, a number of European jurisdictions have attempted to hardwire political accountability into the enabling statutes for their consolidated regulatory bodies. The best example of this is the British FSA, for which Parliament set forth a clear set of regulatory goals and principles of good regulation to which the agency is expected to abide.[4] To ensure fidelity to these statutory guidelines, the FSA prepares annual reports, holds annual meetings, works with a larger number of advisory groups populated with different public constituencies, and – for at least it's first decade of

[4] For a more detailed discussion, see Taylor (2001). See also Hüpkes, Quintyn, and Taylor (2005); Briault (2002).

existence – seems to have honed fairly tightly to the guidelines that the British legislative process established. According to Professor Wymeersch's account, similar mechanisms of accountability are found in other European statutes. (Wymeersch (2007), at pp. 277-79, 81)

Another lesson of Professor Wymeersch's analysis is that domestic regulatory competition of the sort illustrated by SEC versus CFTC conflicts is not the sole source of competitive pressure on regulatory agencies.. Within an increasingly globalized economy, regulatory competition across international boundaries offers a quite plausible substitute for the kind of regulatory competition that once only existed within nation states. (Indeed, within the quite permeable national boundaries of the European Union, Professor Wymeersch seems to see an excessive amount of regulatory competition.) But the key point for policy analysts fearful of the aggregation of regulatory functions within a single national regulatory body is that cross-border regulatory competition is now an important dynamic, which will put a natural constraint on the ability of a domestic consolidate regulator to fall behind in regulatory innovations.[5] And, of course, in most jurisdictions, not all regulatory functions are moved into consolidated agencies, with central banks and Ministries of Finance (such as the U.S. Treasury) usually also retaining some market oversight role and offering a source of domestic checks on consolidated agencies.

Another and somewhat surprising insight from Professor Wymeersch's survey is the reportedly diminished role of regulatory capture with consolidated regulatory bodies. Among U.S. academics, one of the principal failings of administrative agencies is their tendency to fall under the

[5] In a similar vein, interaction with multilateral organizations, such as ISOCO or the Basel Committee on Banking Supervision, provides further check on any single countries regulator getting too far our of line of evolving international standards.

influence of the firms they oversee. (Macy 1994) A potential concern about consolidated supervision is that the dangers of regulatory capture could be multiplied as the jurisdiction of the regulatory agency is expanded. But what Professor Wymeersch reports from Europe is that the relative power of any sector of the financial services industry is diminished with respect to consolidated agencies and so the ability of any single sector to capture the agency is diminished. (Wymeersch (2007), at pp. 265, 278-79) To be sure, this portrayal does not ensure that a coordinated effort on the part of the entire financial services industry would not be successful in having undue influence on regulatory authorities. But it does suggest that in at least some instances consolidated agencies may be more resistant to regulatory capture than their single-sector predecessors.

E.

A final lesson to be drawn from Professor Wymeersch's description of current EU practices concerns the distinction between regulation – that is, the articulation of regulatory requirements – and supervision – the application of those legal requirements to various sectors of the financial services industry through oversight, examination and inspection, and both formal and informal enforcement activity. While financial supervision in Europe is increasingly implemented through consolidated agencies, financial regulation in the region is often still effected along traditional sectoral lines. The EU directives governing the financial sector are the best example of this phenomenon, structured as they are around securities sector (e.g., the prospectus directive, the transparency directive, or MIFID), the banking sector (e.g., the capital adequacy directive and the second banking directive), and insurance sector (the solvency directive).[6] (Wymeersch (2007), at p. 244). As Professor Wymeersch explains, this fragmented law making process produces many of the problems common in the United States. Functionally similar insurance and securities products are subject to different conduct of business rules, creating regulatory anomalies and opportunities for regulatory arbitrage. (Wymeersch (2007), at p. 254 & n. 37) Thus, while much attention has been focused of the supervisory consolidation within many EU member states, many of the benefits of this consolidation are not fully realized as long as regulatory standards are largely set on sectoral basis. Here seems to be an area where Brussels needs to catch up with the member states.

Another idiosyncracy of the EU regulatory structure is the dispersion of supervisory authority across member states, whether to consolidated regulatory units of the sort found in the United Kingdom or to more traditional sectoral bodies of France and Spain. This phenomenon raises serious questions as to whether regulatory policy established at the community level is being implemented and enforced consistently across the region, issues which the Lampfalussy process was designed to address, but which still has not been fully resolved, at least judging from Professor Wymeersch's account. (Wymeersch (2007), at p. 288) Perhaps ironically, the principal organizational mechanism being employed to monitor and correct uneven implementation or enforcement is sectoral-based coordinating councils, such as the Committee of European Securities Regulators (CESR), which Professor Wymeersch has chaired. Thus, the fully consolidated regulatory agencies, such as the British FSA or Wymeersch's own Belgium Banking, Finance and

[6] The financial conglomerate directive would be a counterexample (Wymeersch (2007), at p. 260), as would the privacy directive.

Insurance Commission (CBFA), find themselves operating under sectoral directives established at the EU level and then coordinating with the authorities of other members states through sectoral counsels such as CESR. It is apparently the fate of consolidated supervisors to have to operate, at least initially, in a world built upon sectoral structures.

While the institutional details of European regulatory organization reflect many conditions peculiar to the evolution of the European Union and larger issues of constitutional structure, certain aspects of European practice do, perhaps, have lessons for the United States and other jurisdictions. The distinction between regulation and supervision is an important one. Within the United States there is intense political resistance toward consolidation of traditional supervisory units, whether across sectoral lines, such as banking or securities, or even among depository institutions (such as banks, thrifts, and credit units) or functionally similar products such as securities or futures. But European practice reveals that it is possible to distinguish regulatory consolidation from supervisory consolidation. The United States might possibly proceed with regulatory consolidation – establishing uniform national standards across sectoral boundaries – and still retain supervision and enforcement within our traditional sectoral based oversight units, at least for a transitional period. In many areas, such as money laundering, privacy safeguards, and truth in lending, this is already the state of affairs although these rule-making functions are currently located in different administrative units. Recent initiatives to broadening the Federal Reserve Board's authority over issues of market stability could be seen as a continuation of this process. As I explore in greater detail elsewhere, one could easily imagine the creation of another industry-wide regulatory unit – perhaps built upon the current President's Working Group for Financial Markets – to develop consistent American regulation and associated policy making functions for other areas of financial regulation, including consumer protection, the mechanical aspects of regulation such as fitness standards or affiliated party transactions, and other rules common to all sectors of the financial services industry. In this way, the United States could begin to achieve many of the benefits of consolidated supervision, but without disrupting our traditional supervisory structure and taking on all of the quite formidable political challenges that consolidation of those units would entail.

If the United States were to head down this path, it would become the converse of the current European model. Whereas the EU system now largely depends on sectoral regulation at the EU directive level with mostly consolidated supervision and enforcement among member states, the path toward consolidation that I imagine for the United States would consist of moving towards consolidated regulation through congressional legislation as well as a newly devised regulatory agency to articulate most forms of financial regulation and perhaps the Federal Reserve Board for issues related to market stability, but could retain for some years sectoral supervision and enforcement along current lines. The United States and the European Union could then engage in a quite interesting form of regulatory competition over which form of financial regulatory consolidation works best.[7]

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For many years, financial regulation was a national affair, and regulatory structures evolved in response to national conditions and domestic constituencies, with little attention to developments

[7] One of the challenges of devising a more integrated form of financial regulation in the United States is dealing with the fact that the scale of the U.S. economy and its regulatory operations is so much greater than that of other jurisdictions. (Jackson (2006). For an argument that scale factors should not inhibit full consolidation of financial regulatory functions in the United States, see Brown (2005).

beyond national borders. Today, however, financial regulation is inherently a global undertaking, with an ever increasing volume of cross-border transactions and an ever escalating mobility of financial firms. Nowhere in the world can financial regulators proceed without attention to evolving supervisory practices in other jurisdictions. For a number of decades now, American legal academics have had the great good fortune to be able to look to the work of Professor Wymeersch for a lucid and insightful window into the European regulatory perspectives. All of us very much look forward to many more years of this most important and illuminating work.

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Testimony of
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Before the Senate Committee on Homeland Security and Governmental Affairs

Hearing on The Financial Crisis and the Breakdown of Financial Governance
Senate Homeland Security and Governmental Affairs Committee Hearing Room
SD-342 Dirksen Senate Office Building

January 21, 2009

Chairman Lieberman and Ranking Member Collins, I am delighted to have this opportunity to speak before your committee this afternoon and to participate in what I hope will be the beginning of a long overdue process leading to the transformation and modernization of financial regulation in the United States.

Let me begin by commending the staff of the Government Accountability Office in presenting a thorough and lucent overview of the shortcomings of the country's current system of financial regulation.[1] As the GAO study explains, our extraordinarily decentralized and fragmented system of financial regulation is poorly suited to supervise the financial services industry of the 21st Century. Jurisdictional divisions and subdivisions based on traditional financial sectors and subsectors create regulatory gaps and piecemeal, inconsistent solutions to common problems.[2] The result is a redundant and wasteful system of supervisory oversight, particularly ill-equipped to police a financial services industry in which financial conglomerates dominate. With the rest of the developed world having moved towards more consolidated financial oversight in recent years, our costly and inefficient regulatory system is a drag on American competitiveness.[3] Within academic and policy circles, the weaknesses documented in the GAO report are both well understood and

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[1] Financial Regulation: A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System (January 2009) (GAO-09-216).

[2] For an overview of problems associated with maintaining a fragmented regulatory system, see Howell E. Jackson, *Regulation of a Multisectored Financial Services Industry: An Exploratory Essay*, 77 WASH. U. L.Q. 319 (1999) (avail. at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=166651).

[3] See Howell E. Jackson, *Variation in the Intensity of Financial Regulation: Preliminary Evidence and Potential Implications*, 24 YALE J.REGULATION 253 (2007) (avail. at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=839250).

widely accepted to be a major shortcoming of our regulatory system. The GAO Report does an admirable job in documenting the existence and significance of these weaknesses. In my testimony today, I wanted to share with the committee my views on less well appreciated implications of the deficiencies identified in the GAO report.[4]

1. Oversight of systemic risk has been incomplete and inconsistent, based on anachronistic jurisdictional divisions and leaving no single governmental body with a comprehensive and informed view of all areas in which the financial services industry poses material risks to market stability.

A striking lesson of the current financial crisis is that no single regulatory body has a comprehensive view of all the sources of systemic risk within our financial system.[5] As lender of last resort, the Federal Reserve has traditionally been responsible for overseeing systemic risks, but its regulatory powers were largely defined more than half a century ago when the banking system was considered to be the primary source of systemic financial risks. In the mid Twentieth Century, jurisdiction over bank holding companies and state-chartered member banks may have provided the Board sufficient jurisdiction to police systemic risks. But the sources of systemic risk has long since expanded beyond the banking sector. Major investment banks, large insurance companies, hedge funds and other participants in the burgeoning OTC derivatives markets, government sponsored enterprises like Fannie Mae and Freddie Mac, all have proven to be major sources of systemic risk beyond the scope of the Board's current supervisory mandate or in-house expertise.

While the precise manner in the Federal Reserve Board could and should be transformed into an effective monitor of market stability is a subject of debate,[6] the weaknesses of the current

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[4] My remarks draw from two recent papers comparing US financial regulation to the more consolidated systems of financial supervision found in other developed countries, see Howell E. Jackson, Learning from Eddy: A Meditation Upon Organizational Reform of Financial Supervision in Europe, Conference Volume (Michel Tison, ed.) (Cambridge University Press forthcoming 2009) (avail. at . http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1325510), and proposing how the United States might approach the task of consolidation, see Howell E. Jackson, A Pragmatic Approach to the Phased Consolidation of Financial Regulation in the United States (Nov. 12, 2008) (avail. at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1300431 (forthcoming *Harvard Journal of Legislation* 2009).

[5] In a report released last Spring, the Treasury Department identified the need for a broadly empowered market stability regulator. See United States Department of the Treasury, *Blueprint for a Modernized Financial Regulatory Structure* (Mar. 2008) (avail. online at http://www.treas.gov/press/releases/reports/Blueprint.pdf) [hereinafter Treasury Blueprint].

[6] For a recent overview of several options for integrating market stability oversight with other aspects of financial regulation, see Committee on Capital Markets Regulation Releases Recommendations for Reorganization U.S. Regulatory Structure (Jan. 14, 2009) (avail. at. http://www.capmktsreg.org/pdfs/CCMR%20-%20Recommendations%20for%20Reorganizing%20the%20US%20Regulatory%20Structure.pdf).

regulatory system includes five major areas of market stability oversight where reform is needed. First, rather than having to depend on cramped jurisdictional provisions drafted decades ago, the Board should be given an open-ended mandate to monitor the entire financial services industry to identify and help rectify sources of systemic risk before the risks manifest themselves into real losses. Second, the scope of the Board's lender of last resort powers should be clarified and expanded so that the Board does not have to concern itself with operating at the boundaries of legal authority in times of crisis.[7] Third, the legal requirements for defraying the costs of systemic intervention should be made consistent throughout the financial service industry with at least a portion of those costs being imposed on the financial services industry itself both to promote responsible conduct and to limit the burden imposed on taxpayers and future generations.[8] Fourth, the Board needs to develop its expertise in financial areas, such as insurance companies and derivative markets, where it has traditionally lacked authority and deferred to the oversight of others. Fifth and finally, as the most effective and efficient responses to systemic risks consists of prudent regulatory interventions before problems arise, the Federal Reserve Board should be given clear authority to require other front-line regulators to take appropriate corrective actions when financial industry behavior threatens the stability of the broader economy.[9]

2. The manner in which Congress has designed the regulation of the financial services industry – devising legalistic divisions of authority and relying upon independent agencies to resolve inter-agency disputes – is ill-suited to a complex and dynamic financial services industry and contributed to the current financial crisis.

Another important weakness in our current regulatory structure is the manner in which Congress has chosen to allocate federal jurisdiction over the financial services industry. The oversight of home financing is a good example. The Department of Housing and Urban Development has authority over mortgage closing documents, but the Federal Reserve Board is charged with policing disclosure of mortgage interest rates and subprime loans.[10] No less than five separate agencies have authority over the safety and soundness of the mortgage loans that federally insured depository institutions make, including the propriety of mortgage underwriting standards.

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[7] See Sue Kirchhoff and Barbara Hagenbaugh, *In Fed We Trust, But Can It Get Us Out of this Mess? Bernanke's Team Takes Unheard-of Actions,* USA TODAY, Mar. 18, 2008.

[8] See Howell E. Jackson, *Building a Better Bailout*, CHRISTIAN SCIENCE MONITOR, Sept. 25, 2008.

[9] In many areas, systemic risks are best addressed before problems arise through higher capital requirements, more stringent investment restrictions, or better control over complex payment and clearing systems.

[10] The inability of the Department of Housing and Urban Development to respond effectively to mounting evidence of customer abuse in mortgage originations is documented in Howell E. Jackson & Laurie Burlingame, *Kickbacks or Compensation: The Case of Yield Spread Premiums*, 12 STAN. J. LAW, BUS. & FIN. 289 (2007).

The SEC has been responsible for overseeing the disclosure documents and accounting treatment of the securitization process through which most American mortgages are financed, as well as over the credit rating agencies that have opined on the credit-worthiness of securitization transactions. In addition, the states have limited authority to establish fiduciary standards for mortgage brokers. On top of all of this, Congress this past year added a new federal entity to keep track of the licensing of mortgage brokers at the state level.[11] With this degree of fragmentation, it is no surprise that no one in the federal government foresaw the mortgage crisis coming and no one is being held accountable for the severe economic consequences that have resulted.

But fragmentation of responsibility is just part of the problem. In areas where federal agencies are given authority, the jurisdiction is often narrowly constrained and lacks the flexibility to allow agencies to intervene where they do see problems. The hedge fund industry is a good example. Earlier this decade, the Securities and Exchange Commission recognized the need to more carefully monitor the operations of hedge funds and proposed amendments to its regulation under the Investment Advisers Act to exert jurisdiction. Notwithstanding the strong policy arguments in favor of this reform, industry lawyers persuaded a divided panel of the District of Columbia Circuit that the initiative was beyond the Commission's statutory mandate and so the hedge fund industry was left largely beyond the SEC's supervisory control.[12] The federal reports abound with other examples of private parties challenging regulatory rulemaking, delaying reforms even when the courts reject the underlying claims.[13] Often, as was the case of the hedge fund litigation, the source of the problem was that the agency in question lacked broad a jurisdictional mandate and had to rely on narrowly defined jurisdictional authority devised decades ago for a much simpler financial system.

The problem of ill-defined jurisdictional boundaries is most acute where two or more agencies contest jurisdictional authority. The boundaries between banking, securities, and insurance are notoriously fuzzy, and industry participants are expert in playing one agency off against another, often choosing to operate under the oversight of the regulatory with the most lax regulatory requirements and sometimes exploiting jurisdictional uncertainty to operate in a twilight zone free from any effective oversight. Although the dangers of these jurisdictional gaps have been well understood for many years, Congress has failed to resolve the difficulties. The boundaries between SEC and CFTC oversight of the lines between securities and commodities is a notorious example of an instance in which Congress has failed to devise clear and sensible jurisdictional boundaries, with one consequence being that the credit default swap market was allowed to grow to gargantuan

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[11] The Secure and Fair Enforcement of Mortgage Licensing Act of 2008 was incorporated into the Housing and Economic Recovery Act of 2008, which President Bush signed into law on July 30, 2008.

[12] See Goldstein v. Securities and Exchange Commission, 451 F.3d 873 (D.C. Cir. 2006).

[13] See Jackson, *Regulation of a Multisectored Financial Services Industry*, *supra* note 2.

size without any effective oversight.[14] But one could just as easily point to divisions between securities and insurance or insurance and banking as posing similar problems. And even where Congress has acted, the response has often been provisional and equivocal. For example, for a number of the key jurisdictional questions addressed in the Gramm-Leach-Bliley Act of 1999, Congress declined to given clear authority to any single agency, but rather instructed the courts to resolve jurisdictional disputes without deference to the expertise of any supervisor.[15] In other cases, when faced with hard questions, Congress left it to the relevant agencies to work things out amongst themselves, in one case prompting a contested rulemaking process that stretch out over a decade, required an additional act of Congress to keep things moving, and resulted in promulgation of a byzantine regulation, which few can understand and with which no one is fully satisfied.[16]

The underlying problem here is that many financial products are functionally similar and well-advised financial services firms are capable of exploiting the legalistic boundaries of jurisdictional authority that characterize our system of financial regulation. Without broad jurisdictional mandates, our financial regulators will remain at a serious disadvantage in setting policy for new financial products and risks. Our reliance on multiple financial supervisors only exacerbates the problem. Each agency, after all, has its own bureaucratic imperatives – and a phalanx of lobbyists eager to defend those imperatives[17] – and can be expected to defend its turf against competing sources of authority. By allowing these agencies to operate under independent mandates and by failing to specify an unambiguous hierarchy of authority, Congress has perpetuated a supervisory system prone to paralysis and incapable of keeping pace with the modern financial services industry.

3. The Fragmentation of Financial Regulatory Structure Impairs the Quality and Flexibility of Supervisory Oversight in the United States

In addition to problems of jurisdictional gaps and a lack of comprehensive oversight, our

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[14] See U.S. General Accounting Office, CFTC and SEC: Issues Related to the Shad-Johnson Jurisdictional Accord (April 2000) (GAO/GGD-00-09). See also Christopher Cox, *Swapping Secrecy for Transparency*, N.Y. TIMES, Oct. 18, 2008 (discussing need for SEC oversight of credit default swaps).

[15] See, e.g., Gramm-Leach-Bliley Act, Pub L No 106-102, 113 Stat 1409 (1999), codified at 15 USC § 6714(e) (2000) (providing that in a dispute between federal and state insurance regulators over the preemptive effect of a federal statute, the court shall decide the issue "without unequal deference").

[16] This case involved the authority of the Securities and Exchange Commission to exercise jurisdiction over bank securities activities. See Regulation R: Definitions of Terms and Exemptions Relating to the "Broker" Exceptions for Banks, 72 Fed. Reg. 56,514 (Oct. 3, 2007) (codified at 12 C.F.R. § 218 and 17 C.F.R. §§ 240, 247).

[17] For a theoretical explanation of why lobbyists may sometimes oppose policy reforms that would actually advance their clients' interests, see Matthew C. Stephenson & Howell E. Jackson, Lobbyists as Imperfect Agents: Implications for Public Policy in a Pluralist System (Draft of Jan. 16, 2009).

fragmented regulatory structure impairs the quality and flexibility of financial supervision in the United States.[18] Agencies with narrow mandates have more difficulty attracting and retaining high quality personnel. With their limited jurisdictional scope, fragmented agencies offer less attractive career opportunities for their personnel with fewer possibilities for promotion and professional development. Moreover, since political appointees provide the top level of leadership within each fragmented agency, there are less opportunities for high ranking positions – and greater turnover with each new Administration – than exist in more consolidated supervisory systems.

Our extreme decentralization of regulatory jurisdiction also complicates allocation of supervisory resources. The Federal Reserve System, for example, employs many of the country's most talented economists and conducts a wide range of top flight research. But its research efforts tend to focus on matters within the Board's jurisdiction, like bank mergers and capital requirements. So other areas of financial regulation – notably securities markets that fall within the jurisdiction of the SEC, which hire many more lawyers than economists – have not been carefully studied and it is now clear that key aspects of the securities markets, such as the liquidity risks of repurchase agreements and counter-party risks from OTC derivatives, were not well understood.[19] The current financial crisis offers further examples of structural impediments of our regulatory system. When in late summer of 2008 the Federal Housing Finance Agency was confronted with the impending failure of Fannie Mae and Freddie Mac, the agency had to resort to borrowing personnel from federal banking agencies to examine the GSE's financial postures, lacking sufficient expertise on its own staff.[20] Similarly, when Bear Stearns encountered difficulties earlier in the same year, the SEC had to call on the Federal Reserve Bank of New York in order to come up to speed with the investment bank's deteriorating condition, and eventually had to rely on the Federal Reserve Board's lending authority to forestall financial crisis.[21] Even though the United States maintained the world's largest and best funded regulatory system – both in absolute and relative terms[22] – we lacked adequate analytical depth in sector after sector as the current financial crisis unfolded. A related problem concerns differential access to resources. The funding arrangements for federal supervisory agencies differ markedly. Some, like the Federal Reserve Board and the PCAOB, have a high degree of autonomy in setting budgets and gaining resources. But other agencies are more dependent on the annual appropriation process, and often find their access to resources fluctuating

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[18] For a discussion of the advantages of consolidated supervision on these issues, see Jackson, *Learning from Eddy*, *supra* note 2.

[19] See Testimony of Erik Sirri, Director, SEC Division of Trading and Markets, Concerning Oversight of Risk Management at Investment Banks Before the Subcommittee on Securities, Insurance and Investment of the Senate Committee on Banking, Housing and Urban Affairs (June 18, 2008).

[20] See Statement of James B. Lockhart (Sept. 7, 2008) (avail. at http://www.ofheo.gov/newsroom.aspx?ID=456&q1=1&q2=4).

[21] See Stephan Labaton, *Testimony Offers Details of Bear Stearns Deal*, N.Y. TIMES, Apr. 4, 2008.

[22] See Jackson, *Variation in Regulation Intensity*, *supra* note 3.

with their political fortunes, creating further inconsistencies in supervisory practices.

Not only does our siloed approach to financial regulation produce an uneven regulatory structure, it makes individual agencies more vulnerable to regulatory capture.[23] When the sole task of a regulatory agency is to oversee a single subsector of the financial services industry, the agency is much more likely to interpret its mission as ensuring the survival and growth of the subsector it oversees. So, for example, the Pension Benefit Guarantee Corporation, which has as its sole mission to guarantee private defined benefit pension plans, has a strong incentive to relax the funding rules for these pension plans, even if this relaxation exposes the government to increased risks and encourages private employers to slough off obligations on the federal government. Similarly, in an effort to attract more depository institutions to federal charters, the Comptroller of the Currency and the Office of Thrift Supervision engaged over the past decade in what many regarded as the cavalier preemption of state consumer protection laws in order to provide national banks and federal thrifts a competitive advantage over their competitors with state charters.[24] In my view, the narrow jurisdictional mandates of these regulatory agencies contributed to an excessive degree of preemption, weakening protections for consumers and facilitating an explosion of ill-advised mortgage originations and excessive growth in consumer credit.

4. Our fragmented regulatory system also undermines the ability of regulators to protect consumers from financial fraud and to promote effective and comprehensive approaches to improving financial literacy.

A separate weakness of our fragmented regulatory system is the absence of a central locus for consumer protection and financial education. While many agencies have offices charged with some aspect of consumer protection, the overall result is a diffuse effort and one that often takes a back seat to prudential oversight and other matters.[25] Even the otherwise estimable Federal Reserve Board performed poorly with its consumer protection responsibilities over the past decade as its Division of Consumer and Community Affairs failed to appreciate the mounting risks of subprime credit and shied away from imposing meaningful constraints on non-prime credit until the housing crisis was well underway.[26] As mentioned earlier, the consumer protection efforts of the Comptroller of the Currency and the Office of Thrift Supervision were wholly inadequate, as were

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[23] See Jackson, *Learning from Eddy*, *supra* note 4.

[24] See Howell E. Jackson & Stacy A. Anderson, *Can States Tax National Banks to Educate Consumers About Predatory Lending Practices?*, 30 HARV.J.LAW &PUB.POL'Y 831 (2007) (avail. at http://www.law.harvard.edu/students/orgs/jlpp/Vol30_No3_Jacksononline.pdf).

[25] See Jackson, *A Pragmatic Approach to the Phased Consolidation of Financial Regulation*, *supra* note 4 (discussing importance of establishing clear mandate for consumer protection functions and not allowing them to become peripheral concerns for organizations focusing on other tasks).

[26] The Board ultimately adopted more stringent rules this past summer. See Final Rules Amending Home Mortgage Provisions of Regulation Z, 73 Fed. Reg. 44,523 (July 14, 2008).

those of the Department of Housing and Urban Development, which coddled mortgage brokers for years despite ample evidence that large segments of the mortgage broker industry were abusing the trust of their clients and promoting unsafe and unsustainable borrowing.[27]

But even if our regulatory agencies had genuinely wanted to promote consumer protection in recent years, the fragmented structure of our regulatory apparatus would have made that task difficult and costly. Effective consumer protection requires consistent regulation and comparable oversight for functionally similar products. With our divided regulatory structure, that consistency and comparability would be difficult to achieve. Money market mutual funds, regulated by the SEC, are functionally similar to bank deposits.[28] Equity index annuities, regulated by state insurance agencies, are substitutes for many securities products sold through SEC-registered broker-dealers.[29] In our current regulatory system, no government body has the ability to ensure that these functionally similar products are regulated and marketed in the same way. And regulatory agencies have little ability or inclination to coordinate amongst themselves to increase comparability and consistency. As a result, consumers do not get comparable disclosures about similar products and cannot be assured consistent legal protections for similar products across the financial services industry.

A further drawback of our federal regulatory system is its inability to promote financial literacy in a sensible manner.[30] While all financial regulatory agencies acknowledge the importance of financial literacy and many undertake some amount of financial education, the resulting patchwork of initiatives is inherently inadequate and ineffectual. The foundations of financial literacy include a basic understanding of compound interest, the relationship between risk and return, appropriate and inappropriate uses of credit, how to make a realistic life-time savings plan, the importance of comparing prices and services, and an appreciation of the conflicts that may compromise the recommendation of financial advisers. A sensible program of consumer education starts with these basics, and not the details of credit card terms or the closing terms of a home mortgage. Around the world, consolidated financial supervisors are gaining experience with national programs of financial education and the development of financial literacy teaching modules

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[27] See Jackson & Burlingame, *Kickbacks or Compensation*, *supra* note 10.

[28] The Treasury Department's emergency efforts to devise an ad hoc federal guarantee program for money market mutual funds, akin to longstanding FDIC insurance for banks, arises out of an inconsistency in federal guarantees for functionally similar products. See Treasury Announces Guarantee Program for Money Market Funds (Sept. 19, 2008) (avail. at http://www.ustreas.gov/press/releases/archives/200809.html).

[29] For a recent SEC proposal attempting to restate the division between securities and insurance, see Proposed Rule on Indexed Annuities and Certain Other Insurance Contracts, 73 Fed. Reg. 37,752 (July 1, 2008).

[30] For a collection of excellent writings on the importance of financial literacy, I recommend the work of Professor Annamaria Lusardi of Dartmouth College and the NBER. See http://www.dartmouth.edu/~alusardi/.

for use in primary and secondary schools.[31] In the United States, no such efforts are in evidence because no single government entity has the responsibility for promoting financial literacy.

5. Our fragmented regulatory system oversees an increasingly globalized financial services industry but is ill-equipped to coordinate with regulatory authorities in other jurisdictions and with the many multilateral organizations that coordinate regulatory affairs around the world.

A final and often overlooked weakness of our regulatory system is the difficulty it creates for coordinating with regulatory officials and organizations outside the United States. The absence of any federal authority responsible for overseeing American insurance companies is one obvious example of this deficiency,[32] but problems in international coordination exist for other sectors of the financial services industry as well. The divided authority over securities and futures in the United States – an allocation of supervision not found in any other major economy – is one example[33] but so too is the division of federal authority over depository institutions, a complexity that compromised the ability of the United States to participate effectively in the multi-lateral negotiations leading up to the Basel II capital reforms, as federal banking regulators routinely took conflicting positions with respect to negotiations, often squabbling in public setting and delaying and complicating the negotiation process. In major foreign capitals – where financial supervision in most countries has been consolidated into one or two overarching agencies – it is a commonly noted source of frustration that the United States cannot speak with one voice and that interactions with U.S. authorities are notoriously difficult and time-consuming to coordinate.

Aside from complicating international negotiations, the fragmentation of regulatory authority in the United States adds real costs and diminishes supervisory efficacy. All of the major supervisory units maintain their own international divisions, each of which must liaise with foreign counter-parts, negotiate memoranda of understandings to coordinate enforcement actions, and develop protocols for overseeing foreign firms and cross-border transactions.[34] All of the regulatory gaps and jurisdictional ambiguities that plague domestic oversight are replicated in the international

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31 The Bristish consolidated regulatory agency, the Financial Services Authority, has done particularly innovative work with comprehensive financial education initiatives. See, e.g., http://www.moneymadeclear.fsa.gov.uk/.

32 See Treasury Blueprint, *supra* note 5.

33 For a discussion of how this divided authority has led to inconsistent treatments of foreign securities and futures exchanges, see Howell E. Jackson, Mark Gurevich, & Andreas M, Fleckner, *The Controversy Over the Placement of Remote Trading Screens from Foreign Exchanges in the United States,* 1 CAPITAL M ARKETS L AW J OURNAL 54 (2006). (avail. at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=921435).

34 See Howell E. Jackson, *Toward a New Regulatory Paradigm for the Trans-Atlantic Financial Market and Beyond: Legal and Economic Perspectives,* __ EUROPEAN BUS. ORG. L REV. ___ (forthcoming 2009).

context, but the consequences can be even more severe. Especially where the U.S. imposes more stringent regulatory requirements, regulatory officials need to be in constant dialog with foreign authorities, otherwise transactions will simply move off-shore to escape US oversight. Moreover, the United States must speak with one consistent regulatory voice if it hopes to lead the world's economies in devising appropriately harmonized and efficiently integrated system of global financial oversight. Without effective and efficient international cooperation, US financial regulatory authorities are handicapped in preventing regulatory arbitrage across international boundaries and in maintaining the integrity of our financial markets.[35]

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We are today in the midst of a severe financial crisis that tests the wisdom of our political leaders, the ingenuity of our businesses, and the patience and endurance of the American people. For the most part, our country's task is to regain economic ground lost and personal wealth dissipated over the past few years. But with respect to financial regulation, the current crisis offers a unique opportunity to correct the errors of the past and devise a new system of financial regulation that will sustain the American economy and safeguard the wealth of the nation in the years ahead. This is a rare and precious chance. I would urge the members of this Committee and your colleagues in Congress to seize the moment.

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[35] One positive aspect of a dynamic global market is that other countries can now provide laboratories for regulatory innovation, as they have in the area of consolidated supervision. See Jackson,. *Learning from Eddy*, *supra* note 4. Whereas the dual banking system and the division of federal regulatory authority once may have been useful in providing this dynamism within the United States, the global financial market is now a better source of regulatory competition.