Principles on Financial Reform

A Bipartisan Policy Statement

December 2009

(The Task Force recommendations reflect the views of the signatories. The Pew Charitable Trusts takes no position on any of these recommendations.)

Forward

In the years leading up to the financial crisis of 2008, shortcomings in financial regulation contributed significantly to a near-collapse of the U.S. financial system, which triggered a deep world-wide recession. In response the Administration, Congress and several groups have developed proposals for reform. The Pew Charitable Trusts launched its Financial Reform Project in March 2009. The Task Force was formed in May.

The Task Force is a group of prominent scholars and financial market experts with disparate views and philosophies. It has been working to build bipartisan consensus on the major federal financial reform issues. This document is a statement of the principal recommendations of the Task Force signatories:

Martin Baily, Senior Fellow, Economic Studies at the Brookings Institution*
Charles Calomiris, Professor of Finance and Economics, and International at Columbia University
Morris Goldstein, Senior Fellow at the Peterson Institute for International Economics
Richard Herring, Professor of Finance, University of Pennsylvania
Robert Litan, Vice President, Research & Policy at the Kaufmann Foundation and Senior Fellow Economic Studies at the Brookings Institution
Paul Mahoney, Dean of the Law School at University of Virginia
Avinash Persaud, Chairman of Intelligence Capital Limited
Alice Rivlin, Senior Fellow at the Brookings Institution and Visiting Professor at Georgetown University
Robert Steel, former CEO of Wachovia Corporation and US Treasury Undersecretary for Domestic Finance
Benn Steil, Senior Fellow and Director of International Economics at the Council on Foreign Relations
Peter Wallison, Senior Fellow at the American Enterprise Institute*

* Task Force Co-Chairs

While the Task Force was not able to address all aspects of financial regulation and some signatories would have preferred different approaches with respect to certain individual recommendations, the signatories believe strongly that this entire package will, if adopted, represent a substantial step toward creating a sound financial regulatory system for the United States in the decades ahead.

Introduction

The financial crisis had multiple, reinforcing causes, which in combination produced an economic and financial "perfect storm": lax lending standards on the part of the government-sponsored enterprises; mortgage lenders and other consumer lenders; excessive government subsidization of mortgages; low interest rates; imprudent consumer borrowing; the widespread perception that U.S. housing prices would not fall; the explosion of securitization; the creation of complex, unregulated and badly understood financial products; the continuous heavy inflow of savings from abroad; excessive leverage and inadequate risk management at many financial institutions; irresponsible behavior by rating agencies and, in general, the mispricing of risk. While the blame for the near collapse of the financial system and its devastating consequences must be widely shared and cannot all be laid at the door of inadequate regulation only, the crisis highlighted serious weaknesses in the U.S. financial regulatory structure. Regulation cannot and should not attempt to eliminate ups and downs in financial markets or the real economy, but improved regulation will reduce both the frequency and severity of future crises.

This statement is organized in two sections. The first summarizes the recommendations; the second provides context, rationale and more detail.

Summary

1. Systemic Risk and Macro-Prudential Regulation

A new Financial Services Oversight Council (FSOC) should oversee policy on systemic stability. That policy should be developed in consultation with the Federal Reserve (Fed). If signs of stress emerge, the FSOC should initiate action, based on consideration of specific responses recommended by the Fed. Once approved by the FSOC, interventions should be implemented by the relevant federal financial regulatory agencies. The Fed should retain observer status on specific examinations, and the authority to collect any information directly from financial institutions and markets relevant to monitoring systemic risk that was not available from their primary supervisors.

2. Large Complex Financial Institutions

The larger and more complex an institution, the higher the standards for capital, liquidity and leverage to which it should be held. Large institutions should maintain regulator-approved wind-up plans and, if they cannot, they should shrink. No institutions, however large or complex, should be "too big to fail." Depository institution failures should continue to be handled by the FDIC. A hybrid solution should be adopted for non-depository financial institutions comprising a strengthened bankruptcy process as the default approach and a backstop administrative resolution process, available in exceptional circumstances after strong safeguards have been met. In all circumstances, shareholders in a failing institution should lose their investment, senior management responsible for the institutional failure should lose their jobs, and creditors should face a haircut.

3. Micro-prudential regulation and consolidation

A new National Financial Regulator (NFR) for safety and soundness regulation should be created by combining the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS) and the Federal Deposit Insurance Corporation (FDIC). It should take on all of the micro-prudential responsibilities of the Fed, the Securities and Exchange Commission (SEC), the Commodity Futures Trading Commission (CFTC) and the Federal Housing Finance Agency (FHFA). Within the NFR, the FDIC should retain distinct roles for resolution and the deposit insurance fund. Capital standards should be significantly increased. Banks should issue debt that converts to equity in times of stress. Strong liquidity standards should be introduced. Regulation should focus on risk governance and management as much as measurement. Examinations should be strengthened.

4. Strengthening Markets and Market Discipline

Over-the-counter (OTC) derivative transactions should be recorded with trade registries. Collateral in OTC transactions should be managed by third parties. The migration of OTC transactions onto clearing houses and exchanges should be encouraged through capital requirements assessed on OTC instruments that are not centrally cleared. A private Securitization Board should be created to establish best practices at every stage of securitization including credit ratings. Risks that arise from using inaccurate credit ratings in regulation should be addressed. Executive compensation should be aligned with risk in financial institutions. Banks should issue subordinated debt. Excessive subsidization of household mortgage risk should be addressed. The FHA and the GSEs should be reformed.

5. <u>Consumer Protection</u>

A new federal Consumer Financial Protection Agency (CFPA) should be created with the sole mandate of protecting consumers of financial products and services. The CFPA should have powers of rulemaking, enforcement and preemption of state rules. All the powers for consumer protection for financial products and services currently assigned to federal financial regulatory agencies should transfer to the CFPA. The other federal financial regulatory agencies should be represented on the CFPA Board to ensure balanced deliberation and coordination of policy.

Recommendations

1. Systemic Risk and Macro-Prudential Regulation

   A new Financial Services Oversight Council (FSOC) should oversee policy on systemic stability. That policy should be developed in consultation with the Federal Reserve (Fed). If signs of stress emerge, the FSOC should initiate action, based on consideration of specific responses recommended by the Fed. Once approved by the FSOC, interventions should be implemented by the relevant federal financial regulatory agencies. The Fed should retain observer status on specific examinations, and the authority to collect any information directly from financial institutions and markets relevant to monitoring systemic risk that was not available from their primary supervisors.

The crisis revealed both gaps in regulation and unanticipated interconnections among different types of financial institutions and markets. Yet no one was charged with understanding these interconnections, looking for gaps, detecting early signs of systemic threats and acting to mitigate them. During the years preceding the crisis, no regulator was tasked with monitoring and understanding the overall health of institutions and markets and the connections between them across the entire breadth of the financial system. Nor was any regulator charged with taking the lead in responding to any early signs of systemic risks. So, for example, several years ago there were widely recognized signs of unusual credit expansion and increases in leverage associated with an unprecedented rise in housing prices. These developments signaled the beginning of a bubble with the potential to destabilize the entire system. No action by any government agency was taken to address this.

A new Financial Services Oversight Council should approve and oversee policy on systemic stability. That policy should be developed in consultation with the Federal Reserve.

A new Financial Services Oversight Council should be created. It should comprise the Secretary of the Treasury, the Chairman of the Board of Governors of the Federal Reserve System, the Chairman of a newly created National Financial Regulator (NFR) and Federal Deposit Insurance Corporation (FDIC), the Director of the newly created Consumer Financial Protection Agency (CFPA), the Chairman of the Securities and Exchange Commission (SEC), and the Chairman of the Commodity Futures Trading Commission (CFTC). The FSOC should be supported by its own small permanent staff.

This Council should approve policy for monitoring and responding to systemic threats. That policy, which should cover monitoring the financial system and responding to signs of systemic stress, should be developed in consultation with the Fed.

The policy should specify how combinations of indicators of potential systemic distress such as the expansion of credit and prices of housing and other large asset classes should be identified, monitored, measured and analyzed. The policy should specify how and under what circumstances the various federal financial agencies should respond with measures -- such as varying premia above normal standards on their micro-prudential capital, reserves, margin and leverage requirements (including loan-to-value ratios for mortgages) across financial institutions and markets -- to encourage stabilizing behavior. Such counter-cyclical leverage tools are potentially more effective in controlling asset-price bubbles than interest rate policy alone.

If signs of stress emerge, the FSOC should initiate action, based on consideration of specific responses recommended by the Fed. Once approved by the FSOC, interventions should be implemented by the relevant federal financial regulatory agencies. The Fed should retain observer status on specific examinations, and the authority to collect any information from financial institutions and markets relevant to monitoring systemic risk that was not available from their primary supervisors.

While the Fed should no longer engage in any micro-prudential regulation as discussed below, it should retain observer status in exams, particularly for large complex financial institutions. The Fed should also have the authority and resources to collect and verify any information from financial institutions and markets itself that would not be available through inter-agency coordination and would be relevant to its systemic stability or lender-of-last-resort responsibilities. Its data and analysis should be reported regularly to the FSOC members as a whole.

As signs of systemic stress emerge, the Fed should recommend specific responses, either at the behest of other members of the FSOC or on its own initiative. These responses should be implemented by the relevant federal financial regulatory agencies once approved by the FSOC. The Fed should be responsible for research on systemic stability and for the improvement of macro-prudential regulation over time.

The FSOC should be accountable to the public and to Congress as well as the President through regularly published reports and testimony describing current challenges to maintaining or reviving the stability of the financial system, and what measures were in place or underway at its constituent bodies to maintain or revive it.

2. <u>Large Complex Financial Institutions</u>

The larger and more complex an institution, the higher the standards for capital, liquidity and leverage to which it should be held. Large institutions should maintain regulator-approved wind-up plans and, if they cannot, they should shrink. No institutions, however large or complex, should be "too big to fail." Depository institution failures should continue to be handled by the FDIC. A hybrid solution should be adopted for non-depository financial institutions comprising a strengthened bankruptcy process as the default approach and a backstop administrative resolution process, available in exceptional circumstances after strong safeguards have been met. In all circumstances, shareholders in a failing institution should lose their investment, senior management responsible for the institutional failure should lose their jobs, and creditors should face a haircut.

Despite being officially "well capitalized" by conventional measures, in fact many large complex financial institutions (LCFIs) in the United States were weak going into the crisis. Risk management had become ineffective (with some risks ostensibly moved "off balance sheet" only to return as the crisis unfolded), complexity had become well nigh unmanageable, leverage had become excessive, and liquidity and high quality capital were in short and uncertain supply. When the crisis hit, the federal authorities were unprepared to deal with their serial collapse. Confusion over which institutions would be allowed to fail without intervention, and what the consequences of disorderly failure might be simultaneously heightened moral hazard, the scale of the market disruption and the costs to the taxpayer.

The larger and more complex an institution, the higher the standards for capital, liquidity and leverage to which it should be held.

Capital, liquidity and leverage requirements should rise with the size and complexity of the institution.[1] Larger, more complex institutions pose greater risk to the system and these risks

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[1] There is a difference of view within the Task Force regarding the regulation of non-bank institutions. Some believe that non-bank financial institutions should not be subject to safety and soundness regulation like banks, and should be free to take any risk the marketplace will allow. Others believe that non-bank LCFIs in particular should be subject to bank-like regulation.

"LCFIs" is shorthand for the institutions that have a combination of size, complexity, interconnectedness, leverage, maturity mismatch, or dominant role in a major market or activity that would make their failure potentially particularly disruptive to the financial system.

should be internalized. Moreover, a more conservative capital structure should strengthen governance and provide a greater buffer in the event that the institution faces difficulties.

No sharp jumps or thresholds in the schedule of capital and liquidity requirements should divide institutions into classes for different regulatory treatment.

It is difficult to know in advance of a crisis which institutions will pose the greatest risk. Institutions should not have an incentive to manipulate their size or scale to just (dis)qualify for “Too Big to Fail” status if that is seen as conferring commercial (dis)advantages. Moreover, to segregate institutions in advance is very likely to perpetuate the perception that some are “too big to fail” and consequently pose less risk to counterparties and creditors. Moral hazard is the likely result.

Large institutions should maintain regulator-approved wind-up plans and, if they cannot, they should shrink.

Institutions above a certain size should maintain a wind-up plan approved by the newly created National Financial Regulator (NFR). In addition to helping the authorities and the institution’s own management to cope in the event of a crisis, wind-up plans will serve as a litmus test for the danger from spillover effects in the event of failure, and the discipline of preparing them will help managers and directors restructure their institutions if necessary to reduce risk. If institutions find it difficult to produce adequate plans, their operational complexity could pose a risk to the system as a whole. Large, complex institutions whose plans are persistently weak should be required to divest businesses until their failure poses significantly less risk of spillovers.

No institutions, however large or complex, should be “too big to fail.”

It must be possible for all LCFIs to fail without unacceptably high costs to taxpayers or the rest of the financial system. Future arrangements for resolving non-depository LCFIs must be far more predictable to reduce moral hazard in advance and uncertainty when failure appears imminent. At the same time, future failures should not be allowed to cause contagion and threaten the stability of the system as a whole.

Depository institution failures should continue to be handled by the FDIC. A hybrid solution should be adopted for non-depository financial institutions comprising a strengthened bankruptcy process as the default approach and a backstop administrative resolution process, available in exceptional circumstances after strong safeguards have been met.

A new Federal Financial Institutions Bankruptcy Court (FFIBC) should be created and granted sole jurisdiction in the United States for the resolution of failing non-depository financial institutions. The bankruptcy code should be amended as necessary so that bankruptcy can be the default process for managing all failing non-depository financial institutions.

A new administrative resolution process should be created for failing non-depository financial institutions, for use only on those exceptional occasions when a bankruptcy poses unacceptable systemic risks. This process alone should be used and only after strong safeguards have been satisfied.[2] Once these are met, the Administration should have broad powers to manage failing non-depository financial institutions.

The newly created NFR should administer this regime. Like the process administered by the FDIC today for depository institutions, this would represent a last resort safety net. However it could be invoked only in the event of an extreme crisis and, while it should minimize taxpayer costs like the FDIC, it should minimize overall costs to the economy rather than protect depositors. A detailed and timely report on the causes and consequences of any administrative resolution should be submitted to Congress. Among other things, the report should cover any regulatory failures and document the reasons for the administrative resolution process.

In all circumstances, shareholders in a failing institution should lose their investment, senior management responsible for the institutional failure should lose their jobs and creditors should face a haircut.

Whatever the process, equity and subordinated debt holders should be wiped out, senior management whose decisions contributed to the failure of their institution should be fired and all unsecured debt-holders should suffer loss. A policy of no more "too big to fail" institutions will minimize moral hazard and public costs.

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[2] There is a difference of views within the Task Force regarding the safeguards that should be satisfied before such an administrative resolution process could be used for resolving a non-bank financial institution. Some want a more stringent test before a bankruptcy process can be converted into an administrative resolution process; others want a more lenient test that would make a resolution process easier to achieve.

Accordingly, some Task Force members would require consultation and formal agreement between the Treasury and the concerned federal financial regulatory agencies. This would permit prompt corrective action without waiting for a bankruptcy, and intervention on any scale that the Administration thought was necessary in the circumstances would then be possible.

Others would require that the Administration should apply for and receive a Congressional appropriation before a bankruptcy can be converted to an administrative process. In the interim, the firm in question would enter the bankruptcy process in the proposed special-purpose bankruptcy court. Congress would then have a limited and fixed number of days in which to make such an appropriation. A customary stay would apply, and the Fed could provide sufficient DIP financing against collateral under its 13(3) powers, to permit the firm to continue to operate while Congress deliberated. If Congress appropriated, then the estate of the firm could be transferred to the administrative procedure. If they did not, then the bankruptcy would proceed and the Fed would exercise its collateral once circumstances permitted.

Any taxpayer costs of resolution should be recovered from the industry once conditions permit. This will create an incentive among institutions to disseminate best practices on the one hand and, on the other, to argue against any administrative resolutions that might in fact be unnecessary.

3. Micro-prudential regulation and consolidation

A new National Financial Regulator (NFR) for safety and soundness regulation should be created by combining the OCC, the OTS and the FDIC. It should take on all of the micro-prudential responsibilities of the Fed, the SEC, the CFTC and the FHFA. Within the NFR, the FDIC should retain distinct roles for resolution and the deposit insurance fund. Capital standards should be significantly increased. Banks should issue debt that converts to equity in times of stress. Strong liquidity standards should be introduced. Regulation should focus on risk governance and management as much as measurement. Examinations should be strengthened.

The patchwork of federal financial regulatory agencies and their jurisdictions that long pre-dated the crisis allowed regulatory capture, charter shopping, inconsistent policies, gaps in coverage, inadequate resourcing and ineffective oversight. Future arrangements must allow for the evolution of the financial system while at the same time addressing all these weaknesses. Like institutions should be subject to like regulation. As an institution changes character, there should be no regulatory barriers to corresponding changes in the manner in which it is regulated.

A new National Financial Regulator (NFR) for safety and soundness regulation should be created by combining the OCC, the OTS and the FDIC. It should take on all of the micro-prudential responsibilities of the Fed, the SEC, the CFTC and the FHFA.

A new National Financial Regulator (NFR) should be created to provide prudential supervision and regulation of federally chartered or insured financial intermediaries including both commercial and investment banks and their holding companies. Such an agency would concentrate expertise, promote professionalism, eliminate gaps and inconsistencies, reduce regulatory burdens, prevent charter shopping, and might reduce the risk of regulatory capture and improve regulatory accommodation to future change. The new NFR would combine the OCC, the OTS and the FDIC and assume all the micro-prudential responsibilities of the Fed, the SEC, the CFTC and the FHFA. The Chairman of the NFR should be nominated by the President and confirmed by the Senate.

At the same time, the FDIC should retain a separate identity within the NFR. The fact that there were so few classic runs on depository institutions during this crisis is in part testimony to the value of the FDIC brand and that value should be maintained going forward.

The NFR should be organized into divisions to accommodate the different types of financial institutions from the smallest community bank to the largest international conglomerate. Still, as institutions change and classes of institution evolve, parallel changes in the organization of the NFR will be easier than would parallel changes in the charters of separate micro-prudential agencies.

Importantly, no institutions should be pre-designated as systemically significant or, on that basis, assigned for special oversight to another agency such as the Fed. Such an arrangement would entrench differences and potentially perpetuate moral hazard. Moreover, relinquishing micro-prudential regulation would insulate the Fed from any political pressures associated with supervision and regulation and allow it to focus on its central functions of ensuring monetary and systemic stability.

The NFR should set and enforce micro-prudential standards for capital, leverage and liquidity and should also enforce any premia set by the FSOC for macro-prudential reasons. The SEC and the CFTC should continue to jointly oversee securities and derivatives activities. They should enforce any market leverage premia proposed by the Fed and agreed by the FSOC for macro-prudential reasons.

Within the NFR, the FDIC should retain distinct roles for resolution and the deposit insurance fund.

The FDIC brand should be maintained. It should retain a distinct identity within the NFR. Administration of the Deposit Insurance Fund and resolution responsibilities of the FDIC should be assigned to a separate NFR division. Its board membership could perhaps be changed to be the same as the NFR board membership and the chairmanships of the NFR and the FDIC could be combined. The FDIC's examination and supervision functions should become a part of the larger examination and supervision functions of the NFR.

Capital standards should be significantly increased. Banks should issue debt that converts to equity in times of stress. Strong liquidity standards should be introduced.

Capital standards should be significantly increased. While it is true that capital can dissipate quickly, it remains the main buffer not only against individual institutional failure but also against contagion among institutions. While reported levels of capital based on historic valuations of assets and liabilities may have been high in some institutions that failed during the recent crisis, they proved to be misleading indicators of capital strength.
Moreover, larger banks and banking organizations that are capable of accessing the capital markets should issue a minimum amount of subordinated debt that converts to equity in times

of stress. In suitable amounts, the value of such “contingent capital” to the institution and to the financial system during a future crisis would justify any premium the market may demand relative to conventional debt.

New standards for liquidity management should be introduced. An institution that depends heavily on short-term borrowing is at risk compared to one with more stable sources of funding. Liquidity standards should require that a sufficient buffer be maintained over and above the immediate short-term obligations of an institution so that it can continue to operate even if its access to money markets is denied for a sustained period. Those standards should give most weight to cash and U.S. Treasury securities on the asset side because these assets proved to be liquid during the crisis. Beyond that, sources of liquidity should be sufficiently diversified to offer protection in times of distress of particular liquidity providers or money markets.

Regulation should focus on risk governance and management as much as measurement.

Examinations should be strengthened.

In the future, regulation should focus on risk governance and management as much as measurement. There is room for more useful discussion and understanding of the nature of different risks and their management both within boards and between senior management and regulators.

Examinations should be strengthened and their quality improved. There should be less focus on process and more on risk-taking and outcomes. Examinations must be more forward looking if they are to help as much as they should in guaranteeing the safety and soundness of the institutions involved. Something like the recent stress tests for the largest institutions should be implemented as a permanent feature of the regulatory and examination process.

Examination teams should be further professionalized through a combination of better selection, recruitment, training and compensation practices. Examiners should be held accountable for outcomes.

Higher standards should be required for risk management qualifications, governance, oversight and effectiveness in financial institutions.

4. Strengthening Markets and Market Discipline

Over-the-counter (OTC) derivative transactions should be recorded with trade registries. Collateral in OTC transactions should be managed by third parties. The migration of OTC transactions onto clearing houses and exchanges should be encouraged through capital requirements assessed on OTC instruments that are not centrally cleared. A private Securitization Board should be created to establish best practices at every stage of

> *securitization including credit ratings. Risks that arise from using inaccurate credit ratings in regulation should be addressed. Executive compensation should be aligned with risk in financial institutions. Banks should issue subordinated debt. Excessive subsidization of household mortgage risk should also be addressed. The FHA and the GSEs should be reformed.*

Over-the-counter (OTC) derivative transactions should be recorded with trade registries. Collateral in OTC transactions should be managed by third parties. The migration of OTC transactions onto clearing houses and exchanges should be encouraged through capital requirements.

The transparency of OTC derivatives transactions should be increased by the general use of trade registries. Operational predictability of OTC transactions should be increased by the general use of third party collateral managers. Regulation should strongly encourage transactions to migrate to exchanges and clearing houses by raising capital requirements for derivatives that are not centrally cleared.

A private Securitization Board should be created to establish best practices at every stage of securitization including credit ratings.

An independent Securitization Board outside of government should be established to develop and encourage adoption of voluntary operational standards that align the incentives of all parties involved in the securitization process -- including those of credit rating agencies -- with the interests of final investors.
The Securitization Board, which should be comprised primarily of representatives of final investors, should also include buy-side managers, originators, investment banks, credit rating agencies and other parties with an interest in raising and maintaining standards in the securitization process.

Credit rating agencies should shift from qualitative letter-grade ratings to quantitative default forecasts for debt issues as well as securitizations, and their performance over time should be tracked and published. Credit rating agencies should publish the information and assumptions they use to calculate their ratings.

The Securitization Board should establish and maintain a program to certify individual securitizations that meet their processing standards.

Risks that arise from using inaccurate credit ratings in regulation should be addressed.

To prevent the use of inaccurate credit ratings by regulators, either credit rating agencies should no longer be awarded special official status -- the Nationally Recognized Statistical Rating Organization (NRSRO) designation -- and ratings would be removed from bank minimum capital and other regulatory standards, or NRSROs that egregiously and persistently underestimate default risk should be penalized accordingly.

Executive compensation should be aligned with risk in financial institutions.

The structure of compensation schemes for senior executives and other major risk-takers in financial institutions should not create incentives for excessive risk-taking. Very long-term restricted stock should be a significant component of compensation, emulating the remuneration schemes for partners in traditional financial partnerships. Compensation schemes should be seen as an integral part of the risk management of any financial firm and should be subject to risk management governance. Compensation structures that are persistently out of line with risk should have regulatory consequences, including potentially increases in capital requirements.

Banks should issue subordinated debt.

Larger banks and banking organizations that are able to access capital markets should be required to issue a minimum amount of subordinated debt. As noted above, this should convert to equity in times of stress. Its value will be to provide an additional signal of the financial health of institutions to markets and regulators.

Excessive subsidization of household mortgage risk should be addressed.

Public policy to promote housing has relied heavily on subsidizing mortgages. Preferential financing from the GSEs and non-recourse lending have encouraged households to take on much more risk than they otherwise would have done. Alternative policies, such as direct subsidies for first-time home buyers should be substituted. In effect, such a transparent means of subsidy would increase household equity and reduce household debt.

The FHA and the GSEs should be reformed.

In the long term, housing and related Government-Sponsored Enterprise (GSE) policies should be reformed to restructure or unwind the GSEs and reform the Federal Housing Authority (FHA). Once circumstances permit, Fannie Mae and Freddie Mac need to be transformed into either government agencies or purely private entities so that the toxic combination of public underwriting of risk and private capture of gain is dealt with once and for all. Given the current financial difficulties of the FHA (analogous to those already experienced by the housing GSEs), a restructuring is also required for FHA housing programs.

5. Consumer protection

A new federal Consumer Financial Protection Agency (CFPA) should be created with the sole mandate of protecting consumers of financial products and services. The CFPA should have powers of rulemaking, enforcement and preemption of state rules. All the powers for consumer protection for financial products and services currently assigned to federal financial regulatory agencies should transfer to the CFPA. The other federal financial regulatory agencies should be represented on the CFPA Board to ensure balanced deliberation and coordination of policy.

Unethical and deceptive practices in the sale and promotion of financial products and services became an issue in the run up to this crisis. Consumer protection was neglected even where it was mandated by statute: it was not given priority by the federal agencies that were primarily concerned with protecting the safety and soundness of the financial institutions under their supervision.

Ensuring that marketing and sales practices consistently and properly protect the interests of consumers is a separate mandate from micro-prudential regulation and will be performed better by a separate regulator.

A new federal Consumer Financial Protection Agency (CFPA) should be created with the sole mandate of protecting consumers of financial products and services. The CFPA should have powers of rulemaking, enforcement and preemption of state rules. All the powers for consumer protection for financial products and services currently assigned to federal financial regulatory agencies should transfer to the CFPA.

A new Consumer Financial Protection Agency should be created that combines within it all of the consumer protection powers of the existing federal financial regulatory agencies. To pursue this single broad mandate it should have all necessary rulemaking, enforcement and preemption powers needed to develop the necessary understanding and expertise, to support the development of a flexible national market for financial products and services and to protect consumers everywhere.

The CFPA's jurisdiction should extend to all consumer financial products and services and related providers with certain exclusions for products and services currently regulated by the

SEC and the CFTC, and for small service providers including those whose financial activities are only incidental to another business. The CFPA should set rules and enforce them and its regulation should preempt state regulation of financial products.

The other federal financial regulatory agencies should be represented on the CFPA Board to ensure balanced deliberation and coordination of policy.

The Chairman and the Board of the CFPA should be appointed by the President and confirmed by the Senate. The Chairman of the NFR should be a Board member, ex officio. To ensure that any unnecessary regulatory burdens and conflicts are avoided, the CFPA Board should include strong representation from the other federal financial regulatory agencies.