U.S. DEPARTMENT OF THE TREASURY

Press Center

Treasury Under Secretary for Domestic Finance Robert K. Steel Remarks before the Institute of International Finance

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Washington- Thank you. I appreciate the invitation to be here today. And to those of you who have traveled from abroad to be here, it is my privilege to welcome you to the United States. For 25 years, the Institute of International Finance has been committed to being an influential global association of financial institutions. Your research, analysis, and best practices are always taken seriously, and it is an honor to be here today. I feel especially honored to be included among such a distinguished group of panelists.

Introduction – Regulation in a Global Economy

As a former business person, I understand that the nature of business today is global and without boundaries. None of us view our business models as beginning or ending within the context of territoriality.

Regulation, on the other hand, has not historically taken that borderless perspective. Today's topic, regulation in a globalized economy, is something upon which Treasury is spending considerable energy analyzing. We are doing our best to examine ways of modernizing our regulatory approach to more accurately reflect business models in today's global financial system.

For example, recent action we have taken with regard to private pools of capital reflect a more global regulatory approach. In February, the President's Working Group on Financial Markets (PWG) released a comprehensive set of principles and guidelines to address the two main challenges that private pools of capital, which include hedge funds, private equity and venture capital, pose to our financial markets: systemic risk and investor protection.

This principles-based framework lays a strong foundation for how market participants- investors, asset managers, creditors, counterparties, and policymakers- should enhance their practices and fulfill their responsibilities.

More recently, on September 25, we created two private-sector committees to develop best practices for the hedge fund industry. Using our principles and guidelines as a framework, these two committees – one comprised of asset managers and the other comprised of investors - will develop best practices. In these efforts, we are collaborating with our British counterparts, to build upon their work underway.

Capital Markets Competitiveness

Making our regulatory structure more effective is one area we have been focusing on at Treasury under a broader rubric of maintaining and enhancing U.S. capital markets competitiveness. Last November, Secretary Paulson gave a major speech on capital markets competitiveness and identified three areas of priority: (1) our regulatory structure and philosophy, (2) our auditing and accounting profession, and (3) legal and corporate governance issues.

Secretary Paulson hosted a conference in March on capital markets competitiveness at Georgetown University. We heard from key policymakers, consumer advocates, business representatives and academics, each with different perspectives on ways to keep U.S. capital markets the strongest and most innovative in the world. Several initiatives have been launched as a result of what we heard at that conference:

- Advisory Committee on the Auditing Profession: The Treasury Department has chartered a non-partisan, public committee to develop recommendations to address the challenges facing the auditing profession, including industry concentration and competition, and employee recruitment and retention.
- Study on Financial Restatements: Treasury has commissioned an academic study to understand the reasons for the growing number of public company financial restatements over the past decade. The study will explore potential policy implications.
- Regulatory Blueprint: The Treasury Department is working on a comprehensive report that will examine the regulatory structure and philosophy of our financial services industry and the protections they offer to investors. We will produce a blueprint that will outline recommendations on how to modernize our regulatory regime to keep pace with a global market place and uphold the highest investor protection standards.

Regulatory Blueprint

Our review of the U.S. financial regulatory system is particularly relevant today, so I would like to discuss this more in-depth.

While our efforts to modernize regulation were contemplated well before we entered the current period of mortgage market stress, issues of regulation are particularly relevant today, as recent challenges in the credit and housing markets have highlighted the need to modernize and streamline the U.S. regulatory structure.

Our fragmented regulatory system has complicated an already difficult situation in the housing and credit markets. Existing federal laws address mortgage fraud, disclosure, fair lending, unfair and deceptive practices, and other aspects of the mortgage process. But regulatory enforcement authority varies across federal regulatory agencies.

Moreover, many states have enacted additional layers of regulation. These laws often apply exclusively to institutions that operate within a particular state, creating confusion and complexity. This creates a difficult environment for both regulators and those being regulated. Our patchwork regulatory structure needs to be streamlined and modernized.

We believe this issue is so important to our global competitiveness that Treasury Department undertook this report on our own initiative, unlike previous reports mandated by Congress. It has been 10 years since the Treasury Department undertook this type of review and the financial services industry has evolved considerably.

We will take a comprehensive approach as we examine our regulatory structure, taking into consideration the entire financial services industry, including insurance, securities and futures firms, and a topic that was the focus of most past Treasury Department studies- the depository institutions.

Our hope is that this regulatory paper would also have a long-lasting effect, helping to shape the debate about longer-term regulatory reform, as have previous Executive Branch works on financial services regulation. For example, Administration reports in 1984 and 1991 laid the foundation for the ideas that carried through in the Gramm-Leach-Bliley Act of 1999, such as functional regulation.

Such a project gives us the benefit of thinking about what the ideal regulatory structure should look like. If we were starting fresh and had a blank page, no one would choose to draw a regulatory structure that resembles our current picture. For this reason, we are seeking broad public comment on a series of ideas that affect our financial regulatory structure.

Too often discussions about ideal regulatory philosophy and structure have been reduced to a black and white debate of rules vs. principles. This oversimplification undermines the complexity of these issues, and is not constructive. The optimal construct should balance both rules and principles. A modernized approach recognizes that we should be guided by principles at an overarching level.

But regulation at the retail level will require some focus on rules, particularly to protect less sophisticated market participants, where investor protection must be a paramount focus.

A key element of a modernized approach is a benefit-burden analysis. Policymakers should reject calling for regulation just for regulation's sake. Instead, we should engage in rigorous cost-benefit analysis of proposed and current regulation.

Additionally, there must be engagement between regulators and the regulated. Policymakers must to facilitate a move for constructive dialogue between regulators and the entities they regulate. There should be a clear process for businesses to engage with their regulators when they have questions or need clarification.

Current Market Conditions

Let me conclude by spending just a minute discussing an announcement made earlier this week by private sector banks to create a potential market-based solution to improve liquidity in the asset-backed commercial paper (ABCP) markets.

As Secretary Paulson and I have said many times, the markets needed to reassess and reprice risk. In early August, uncertainty regarding the future prospects of mortgage-backed securities, particularly those with subprime exposure, caused investors to reassess the risk of these securities and subsequently readjust and reassess prices.

This uncertainty and subsequent illiquidity began to spread to the ABCP market, typically a very liquid and important market. After the initial repricing of risk, markets begin to adjust and in most cases began a steady but gradual process of improvement. The ABCP market, however, while showing some signs of improvement, seemed to be improving slower than other segments of the market. The particular risk of a disorderly unwinding of structured investment vehicles (SIVs) became a matter of focus for market participants and the Treasury Department.

As part of our effort to vigilantly monitor markets, we brought together market participants to speak about market conditions, particularly conditions in the credit markets. Throughout these discussions Treasury was in regular dialogue with appropriate US and international regulators. It became clear in discussions with investors across markets, that while there has been some improvement in the ABCP market, this improvement could be enhanced and complemented by market participants working together.

The structure they are developing is expected to be temporary and serve as a bridge, which will provide some time for participating SIVs to restructure in a more orderly fashion. The technical organization of this solution is complex. Initial progress is being made by the lead banks and participation is expected to broaden in the weeks ahead.

We believe that the effect of these complementary efforts should be to enhance the current rate of improvement, and give further investor confidence to the important ABCP market. This effort is focused on improving market conditions so as to benefit all market participants, and not a particular subset of the market.

As regularly indicated, it will take a while for markets to regain full confidence – even with this structure. But we are fortunate to have a backdrop of strong U.S. fundamentals and a growing global economy.

Thank you and I look forward to our discussion.