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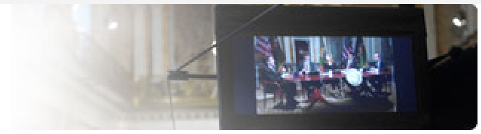

Geithner, Summers OP-ED: A New Financial Foundation

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WASHINGTON – In an op-ed piece appearing in tomorrow's Washington Post, Treasury Secretary Timothy F. Geithner and Director of the National Economic Council Lawrence Summers outline the case for financial regulatory reform and offer a brief preview of the proposals the Administration will put forward this week. To read the piece online: http://www.washingtonpost.com/wp-dyn/content/article/2009/06/14/AR2009061402443.html. The text of the piece follows:

A New Financial Foundation
By Timothy Geithner and Lawrence Summers

Over the past two years, we have faced the most severe financial crisis since the Great Depression. The financial system failed to perform its function as a reducer and distributor of risk. Instead, it magnified risks, precipitating an economic contraction that has hurt families and businesses around the world.

We have taken extraordinary measures to help put America on a path to recovery. But it is not enough to simply repair the damage. The economic pain felt by ordinary Americans is a daily reminder that, even as we labor toward recovery, we must begin today to build the foundation for a stronger and safer system.

This current financial crisis had many causes. It had its roots in the global imbalance in saving and consumption, in the widespread use of poorly understood financial instruments, in shortsightedness and excessive leverage at financial institutions. But it was also the product of basic failures in financial supervision and regulation.

Our framework for financial regulation is riddled with gaps, weaknesses and jurisdictional overlaps, and suffers from an outdated conception of financial risk. In recent years, the pace of innovation in the financial sector has outstripped the pace of regulatory modernization, leaving entire markets and market participants largely unregulated.

That is why, this week -- at the president's direction, and after months of consultation with Congress, regulators, business and consumer groups, academics and experts -- the administration will put forward a plan to modernize financial regulation and supervision. The goal is to create a more stable regulatory regime that is flexible and effective; that is able to secure the benefits of financial innovation while guarding the system against its own excess.

In developing its proposals, the administration has focused on five key problems in our existing regulatory regime -- problems that, we believe, played a direct role in producing or magnifying the current crisis.

First, existing regulation focuses on the safety and soundness of individual institutions but not the stability of the system as a whole. As a result, institutions were not required to maintain sufficient capital or liquidity to keep them safe in times of system-wide stress. In a world in which the troubles of a few large firms can put the entire system at risk, that approach is insufficient.

The administration's proposal will address that problem by raising capital and liquidity requirements for all institutions, with more stringent requirements for the largest and most interconnected firms. In addition, all large, interconnected firms whose failure could threaten the stability of the system will be subject to consolidated supervision by the Federal Reserve, and we will establish a council of regulators with broader coordinating responsibility across the financial system.

Second, the structure of the financial system has shifted, with dramatic growth in financial activity outside the traditional banking system, such as in the market for asset-backed securities. In theory, securitization should serve to reduce credit risk by spreading it more widely. But by breaking the direct link between borrowers and lenders, securitization led to an erosion of lending standards, resulting in a market failure that fed the housing boom and deepened the housing bust.

The administration's plan will impose robust reporting requirements on the issuers of asset-backed securities; reduce investors' and regulators' reliance on credit-rating agencies; and, perhaps most significant, require the originator, sponsor or broker of a securitization to retain a financial interest in its performance.

The plan also calls for harmonizing the regulation of futures and securities, and for more robust safeguards of payment and settlement systems and strong oversight of "over the counter" derivatives. All derivatives contracts will be subject to regulation, all derivatives dealers subject to supervision, and regulators will be empowered to enforce rules against manipulation and abuse.

Third, our current regulatory regime does not offer adequate protections to consumers and investors. Weak consumer protections against subprime mortgage lending bear significant responsibility for the financial crisis. The crisis, in turn, revealed the inadequacy of consumer protections across a wide range of financial products -- from credit cards to annuities.

Building on the recent measures taken to fight predatory lending and unfair practices in the credit card industry, the administration will offer a stronger framework for consumer and investor protection across the board.

Fourth, the federal government does not have the tools it needs to contain and manage financial crises. Relying on the Federal Reserve's lending authority to avert the disorderly failure of nonbank financial firms, while essential in this crisis, is not an appropriate or effective solution in the long term.

To address this problem, we will establish a resolution mechanism that allows for the orderly resolution of any financial holding company whose failure might threaten the stability of the financial system. This authority will be available only in extraordinary circumstances, but it will help ensure that the government is no longer forced to choose between bailouts and financial collapse.

Fifth, and finally, we live in a globalized world, and the actions we take here at home -- no matter how smart and sound -- will have little effect if we fail to raise international standards along with our own. We will lead the effort to improve regulation and supervision around the world.

The discussion here presents only a brief preview of the administration's forthcoming proposals. Some people will say that this is not the time to debate the future of financial regulation, that this debate should wait until the crisis is fully behind us. Such critics misunderstand the nature of the challenges we face. Like all financial crises, the current crisis is a crisis of confidence and trust. Reassuring the American people that our financial system will be better controlled is critical to our economic recovery.

By restoring the public's trust in our financial system, the administration's reforms will allow the financial system to play its most important function: transforming the earnings and savings of workers into the loans that help families buy homes and cars, help parents send kids to college, and help entrepreneurs build their businesses. Now is the time to act.

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