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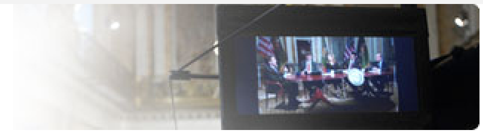

Treasury Under Secretary for International Affairs Lael Brainard Remarks As Prepared for Delivery at the Peterson Institute for International Economics

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Thank you, Fred, for that kind introduction. It is a pleasure to be at the Peterson Institute.

Today, I'd like to discuss the U.S. policy response to the global financial crisis and what we have learned. Let me make three observations.

Global Shocks Require Global Responses

First, in response to the most globally synchronized recession the world has seen, we have mounted the most globally coordinated response the world has attempted.

In April 2009, with the global economy contracting at an annualized rate of 6 percent, huge numbers of people facing the catastrophic loss of jobs and savings, and trade in free fall, President Obama and other G-20 leaders together committed to undertake an unprecedented fiscal expansion amounting to $5 trillion and raising global output by 4 percent.

This action, coupled with coordinated efforts by central banks and the international financial institutions, constituted the largest and the most comprehensive recovery program in history. This action helped pull the world back from the precipice. It stabilized markets. It restarted the trading system. And it established a path to growth.

A year later, in Toronto, President Obama again joined with G-20 leaders. This time, they agreed to maintain stimulus until the recovery is assured while charting a common path to fiscal sustainability. They committed to halve deficits by 2013. And they committed to at least stabilize government debt-to-GDP ratios by 2016. This provided financial markets with reassurance of credible, medium-term commitments to fiscal consolidation. And it provided the private sector with the support needed to continue recovering and growing.

Of course, different countries need to make judgments about how steeply to pull back stimulus based on national circumstances as well as global conditions. And that provides ample fodder for talk of division and divergence.

But think about it. Think back to past economic challenges and ask yourself, when in history have 20 countries, representing 85 percent of global GDP, emerging economies alongside advanced economies, joined hands and agreed to mount as significant a common response to a common challenge. Of course, the road ahead won't be easy but we have forged a clear path.

Decisive Financial Repair and Reform are Key to Growth

A second observation is governments must move decisively and rapidly on financial repair and reform in the wake of financial crisis.

The historic enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act lays the foundations for a sounder and more resilient financial system. It will be a system less prone to destabilizing bubbles and panics, and one that is more open to a stronger and more competitive real economy, where investment flows to the most productive uses.

The challenge before us now is to ensure that the world's standards are every bit as strong as America's standards. Financial firms, markets, and transactions are more interconnected than ever before, and the breadth and depth of these linkages require us to coordinate across borders if we are to protect America's economic and financial wellbeing.

But while global convergence will be critical in areas such as capital and derivatives, our efforts in other areas may be better served by setting common principles to guide different approaches. These approaches will reflect deeply rooted differences in national institutions and business models.

The financial crisis demonstrated clearly that some financial firms are so large, leveraged, and interconnected that their failure could pose a threat to overall financial stability. It revealed the profound inadequacies in the existing framework for constraining the risk of large, interconnected firms. And it revealed the inadequacies of our toolkit for managing their failure.

That is why our reform efforts are tackling head on the moral hazard problem associated with firms perceived to be "too big to fail." They do so by increasing the incentives of these firms and their shareholders, creditors, and counterparties to manage and discipline their risk taking and by reducing the threat they pose to the system. They also do so by expanding the supervision of these firms to include protecting the stability of the financial system as a whole--not just the solvency of individual firms.

We are also addressing this problem by setting new standards for capital and liquidity. More and higher quality capital must be at the core of our efforts to ensure a more resilient financial system. And the new standards on capital must be harmonized internationally to be effective domestically.

That is why in Toronto the G-20 agreed that financial institutions must hold enough common equity to enable them to withstand--without government intervention--stresses of the magnitude we experienced in the crisis. We are working through the Financial Stability Board (FSB) and the Basel Committee to reach agreement by the end of the year.

We are doing so by addressing derivatives. The web of bilateral derivates trades between major financial firms was a major source of contagion during the crisis. The Dodd-Frank legislation reduces these risks by requiring the central clearing and exchange of standardized OTC derivatives, and by supervising and regulating all derivatives and major market participants. The same goals have been embraced by the G-20. And the FSB is now overseeing their implementation, including in Europe, where we are working to ensure a common approach.

We are also making the system safe for failure. The U.S. government now has special resolution authority at times of crisis when a major firm's failure could pose a threat to the broader system. We have worked within the G-20 and FSB to secure a commitment to robust resolution systems within nations coupled with better crisis management mechanisms across borders.

And we have committed that the financial sector, not taxpayers, will bear the burden of risks imposed on the system as a whole. We have accomplished this both in our financial reform legislation and in the G-20.

Now, the opponents of the financial reforms that were just signed into law would have us believe that reforms will stifle growth. But history suggests otherwise: governments that move quickly to recapitalize and reform their financial systems lay the foundations for steadier, and more certain growth.

Opponents would have us believe financial reforms will stifle competitiveness. But by addressing the weaknesses in our financial system, we are strengthening the competitiveness of our overall economy. And by securing global commitment to our reform agenda through the new G-20 and the FSB mechanisms, we are working to level the playing field and avoid regulatory arbitrage.

By addressing the moral hazard associated with too big to fail and strengthening the market infrastructure to reduce contagion, we will ensure financial resources flow to the most productive investments. Those investments will lay the foundations for more durable growth for future generations.

Financial Markets Need Clarity

The third observation I'll share is that financial markets need clarity to function effectively.

Transparency is critical to enable market discipline to constrain risk taking by large, interconnected financial firms.

We learned from the crisis that stress tests can provide invaluable information to help assess sources of significant risk and the resilience of individual firms. The Supervisory Capital Assessment Program (SCAP) we undertook in the spring of last year marked a turning point in global financial markets. It helped reduce uncertainty and restore confidence. Following the tests, U.S. banks raised more than $150 billion in high-quality capital.

Last Friday in Europe, the Committee of European Banking Supervisors released bank-by-bank stress test results for the large cross-border European banking groups as well as for a number of smaller banks. We welcomed the release of the European stress tests. We believe that with this undertaking, the EU has made a significant effort to increase disclosure on the conditions of individual European financial institutions and enhance market stability.

Similarly, we learned from the crisis that we had to bring all firms, products, and institutions that could pose significant risks to the system out of the shadows in order to strengthen market transparency and stability. The parallel or "shadow" banking system had none of the government-provided shock absorbers that protect the banking system--for example, protections such as deposit insurance, a lender of last resort, or guaranteed payment systems.

In turn, the traditional banking system had important exposures to the shadow banking system with its risks of asset bubbles, runs, and collapse. Banks provided credit and payment, clearing, and settlement services to the parallel banking system. Banks also and engaged in large amounts of over-the-counter derivative transactions with it.

In significant part because of these exposures, the collapse of the non-bank financial sector during the crisis threatened the safety and soundness of the banking system itself. That is why financial reform extends the perimeter of legislation--such that all firms, products, and institutions that could pose significant risks to the system are regulated.

That is also why we incorporated stronger oversight of hedge funds into the U.S. legislation. Our approach requires advisers to register and report so that supervisors can assess whether any fund poses a threat to overall financial stability. If so, they now have the ability to impose heightened prudential standards on entities that do. And as the EU works to establish similar requirements under their Alternative Investment Fund Managers Directive, we are working to ensure U.S. managers and funds retain non-discriminatory access to their market.

We need only think back to February 2009, to remember the doubt and uncertainty that surrounded the SCAP program. Far from adding to the volatility, the SCAP program, in conjunction with a strong capital backstop, dampened it. It was essential to financial stability and essential to our recovery effort. And heightened transparency and discipline, along with expanded oversight and supervision, will be hallmarks of financial reforms here and among the G-20 more broadly.

Conclusion

In conclusion, this crisis, which was unprecedented in its scope, severity and synchronicity, has prompted policy innovation that is equally unprecedented.

We have been most effective in responding to the crisis when we have moved swiftly and decisively to bring greater clarity to market expectations, undertaken decisive financial repair and reform, and mounted a common response with the world's largest economies.

Going forward, the challenge will be to continue to work through the new architecture of the G-20 and the FSB to raise international standards and level the international playing field, and to coordinate our policies to support growth both at home and around the world.

Thank you.

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