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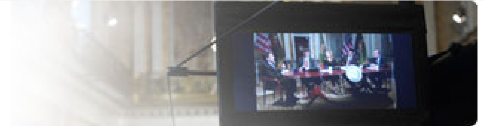

Assistant Secretary for International Markets and Development Marisa Lago Introductory Comments for Eurofi Panel Discussion of "Prospects of future G-20 discussions and Expected impacts for the EU"

9/30/2010

TG-879

As Prepared for Delivery

The G-20 agenda has been enormous. In the financial regulatory sphere alone, we produced a 47-point action plan in Washington, 148 pages of working group papers in London, and 23-page and 27-page communiqués in Pittsburgh and Toronto. The work by the Leaders and Finance Ministers has led, in turn, to dozens of working group reports by standard setters, the Financial Stability Board, and national authorities. The IMF published no less than 897 pages in its assessment of the U.S. financial system alone. The agenda is so large and complex that it has drawn more than 800 of us to this conference to dissect every feature of the G-20 agenda over four days.

In light of this, I was struck by Sir Howard Davies' recent article in the Financial Times calling for heightened clarity and focus on the core issues, or as he so eloquently phrased it, to move away from a sybaritic menu of foie gras and soufflé to "meat and two veggies" or as we Americans would say "meat and potatoes" -- core issues that are tough, but ultimately more nourishing.

Today, I'd like to discuss what U.S. Treasury sees as the "meat and potatoes" core issues of financial regulatory reform; the issues that the G-20 must prioritize going forward. Let me suggest four main ingredients: capital, systemically important financial institutions, resolution, and OTC derivatives markets.

Capital

First and foremost, the main course of our meal must be capital. In the lead-up to the recent crisis, major financial institutions around the world held too little loss-absorbing capital relative to risky assets; used excessive leverage to finance their operations; and relied too much on unstable, short-term funding. The resulting distress, failures, and government intervention imposed steep and unacceptable costs on households, workers, and businesses -- costs that are still being felt today. The lesson is clear: more and higher quality capital must be at the core of our efforts to ensure a more resilient financial system less prone to failure.

We welcome the Basel Committee's proposal as a critical step on the way to strong global financial reforms. We remain committed to reaching agreement by the time of the G-20 meeting in Seoul on a strong set of reforms that will reduce the costs of future financial crises, provide certainty to the markets, and establish a level playing field for global financial institutions. Finally, let me reiterate that the U.S. is implementing Basel II now and, as Secretary Geithner said before the U.S. Congress last week, the United States is committed to fully implement the Basel III capital reforms by the agreed deadlines.

Systemically Important Financial Institutions

The second key ingredient on the G-20's menu is our plan to address large, interconnected firms – a plan that we believe needs to have three facets.

First, we believe that each jurisdiction should have a clearly communicated policy about how it will address systemically important financial institutions (SIFIs). Second, we should also remain committed to ensuring that these national SIFI policies are internationally supportive, so that firms are not given conflicting direction by different regulators.

And third, we believe that there should be certain minimum policies that underpin an international SIFI strategy that is rigorous and provides a measure of global consistency. These minimum SIFI policies include: higher capital, stronger supervisory powers, and workable resolution regimes. In addition to these essential elements, there may be a variety of other tools that countries may chose to deploy --such as levies, activity restrictions (such as the U.S.' Volcker rule), or innovative capital structures. But we must stay focused on ensuring that the basic tools -- capital, supervision, and resolution -- are sturdy and meet international standards.

We are optimistic that the new institutions that are being put in place will help develop and promptly implement solid SIFI policies. In the U.S., the newly created Financial Stability Oversight Council is meeting for the first time this Friday. The FSOC has been given the

authority to identify firms for Federal Reserve supervision, so as to ensure that the most systemic firms are being supervised in a consistent manner, no matter what their legal form. In Europe, the new Systemic Risk Board will help address the same need by assessing systemic risks and vulnerabilities. Dialogue among the members of these two bodies is crucial.

Resolution

The third course of our nutritious meal is resolution. In the United States, we start from the basic view that no firm should be "too big to fail." To address the moral hazard created by governmental intervention in the crisis, each nation must develop robust resolution systems for banks and systemically important financial institutions so that markets see and believe that there is a credible threat of failure for any firm, regardless of size or interconnectedness.

At their most recent meeting this past summer, the G-20 Leaders committed to implement the Basel Committee's Recommendations on Cross-Border Resolution. This was not an easy commitment for many of us. In the U.S., one of the most contentious aspects of the landmark Dodd-Frank Act was the debate about how to plug our biggest resolution vulnerability – the absence of a mechanism for resolving non-bank financial institutions in an orderly manner. We are proud of the fact that we now have authority to resolve systemically important non-bank institutions in a manner that is as robust as the FDIC's time-tested bank resolution regime.

The G-20 Leaders agreed that all countries need to have effective national resolution systems. A national resolution tool box is a prerequisite for taking the next, harder step of dealing with cross-border resolutions. So, when reforming our national systems, we must consider how to address cross-border effects of national resolution measures. We must also create incentives for firms to reduce complexity and interconnectedness of group structures and operations; undertake advance planning for orderly resolution; and develop exit strategies for recent government intervention that promote market discipline and reduce moral hazard.

OTC derivatives

Our final key ingredient for a safer financial system is continued improvement in the regulation and supervision of over the counter derivatives markets. The build-up of risk in OTC derivatives markets became a major source of contagion during the crisis. To reduce risk from the web of bilateral derivatives trades between the major financial firms, U.S. financial reforms require clearing of standardized OTC derivatives through well-regulated central counterparties; exchange trading of standardized derivatives to promote transparency, price discovery and liquidity; and supervision of all derivatives dealers and major market participants. We now impose conservative capital and initial margin requirements on all non-centrally cleared derivatives. Moreover, trade repositories must provide regulators with information about both standardized and customized transactions so that they can assess the potential for derivatives trades to transmit shocks through the financial system.

G-20 Leaders recognized that the global nature of the OTC derivatives markets call for globally consistent reforms and coordination. For this reason, we are pleased to be working especially closely with the EU to make certain that critical OTC derivative market infrastructure is subject to oversight in line with the standards adopted by the Financial Stability Board at the behest of the G-20. A key element of our discussion with the EU is ensuring that we have appropriate cooperative oversight frameworks to address the information needs of supervisors. The recent EU proposal for OTC derivatives regulation demonstrates the efficacy of our cooperative efforts.

Conclusion

Our overarching objective remains unchanged: to raise financial regulatory standards globally to promote a level playing field. Without internationally consistent standards, large financial firms may be tempted to move their activities to jurisdictions where standards are looser and expectations of government support are stronger. This type of regulatory arbitrage can create a race to the bottom and intensify systemic risk throughout the entire global financial system.

But, while core standards must be global, financial regulation continues to be essentially a national activity – grounded in domestic laws, cultures, and history. We must work together to ensure that our national implementation doesn't lead to arbitrage opportunities and loopholes. We cannot be identical, but we must remain committed to similarly robust outcomes that strengthen the global financial system and reduce the likelihood of future crises.

We believe that if we focus on the "meat and potatoes" issues that I've just outlined -- capital, SIFIs, resolution, and derivatives -- we will all be satisfied with the stronger financial system that results.

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