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Statement of the Shadow Financial Regulatory Committee

On

A Financial Agenda for the New Congress

December 9, 2002

In December 2000, the Shadow Financial Regulatory Committee issued an open letter to the new President and Congress proposing an agenda for financial reform. In the two ensuing years, little has been done on the specific proposals in this agenda. However, developments during this period have further demonstrated that Congress should devote attention to the issues that the Committee initially identified, discussed below.

1. Further modernize laws governing separation of financial and nonfinancial activities

In 2000, the Committee argued that the distinction between financial and nonfinancial activities—as established in the Gramm-Leach-Bliley Act (GLBA)—was artificial and untenable, and should be removed from the current law. The Committee also questioned the efficiency of the Fed's administration of the Act up to that time. Some light has been shed on both these issues since 2000.

The Federal Reserve Board has had before it for two full years the question of whether real estate brokerage is a financial activity and thus an eligible activity for financial services holding companies. The inability of the Fed to make a decision on this question, and the fact that the issue can be argued effectively either way, demonstrates the conceptual difficulty of drawing a line between financial and nonfinancial activities. The fact is that no line can be drawn between activities that are financial in nature and those that are not, and Congress should recognize this fact.

Having said this, we are not excusing the Fed from its failure of responsibility to decide the question of whether real estate brokerage is or is not a financial activity for purposes of GLBA. The Fed asked for and received authority from Congress to draw a line between finance and commerce, and now it must live up to the responsibilities it has been given. We understand the political pressures that have been brought upon Congress and the Fed, but that is no excuse for Fed's failure to discharge its regulatory duties.

2. Set a uniform national policy on privacy of financial information

In 2000, the Committee commented on the fact that Congress, in GLBA, permitted the states to enact rules on the sharing of financial information that were more stringent than Congress had enacted. The Committee argued that this could lead to a chaotic system in which the states might adopt numerous inconsistent requirements that would make national operations difficult and costly for financial institutions, thus raising costs for consumers. This process has begun. In the intervening period, a number of state legislatures have considered their own state laws on sharing financial information and at least one has been adopted. Others are pending. As we did in 2000, we would urge Congress, in the interest of preserving a national market in financial services, to pre-empt state laws on the sharing of financial information and establish one uniform national standard.

3. Privatize Government Sponsored Enterprises

The Committee also discussed Government Sponsored Enterprises (GSEs) in its 2000 statement, recommending privatization for these enterprises. There has been some movement in this direction during the past two years. To forestall Congressional action on the Shays-Markey bill—that would have entirely eliminated their exemption from the securities laws—Fannie Mae and Freddie Mac agreed voluntarily to file annual and periodic reports with the Securities & Exchange Commission. This was an important but insufficient step toward complete privatization. The Shays-Markey bill should be enacted. Two of the largest corporations in America—with millions of shareholders and investors in their mortgage-backed securities—should be subject to the same disclosure requirements as other public companies. This is especially true, since Fannie Mae and Freddie Mac enjoy reduced market scrutiny because of the perception that they are government backed.

4. Adopt an optional federal charter for insurance companies

In 2000, the Committee recommended the adoption of legislation creating an optional federal charter for insurance companies, unless the state system of regulation were substantially reformed by the reducing the necessity for insurance company filings in every state in which they do business. Despite some consideration of this issue within the National Association of Insurance Commissioners during the past two years, there hasn't been sufficient reform to convince the insurance industry that an optional federal charter is unnecessary. This is a very complex issue that will require a good deal of debate in Congress. We believe the state commissioners have had enough time to consider reforms, and in any event an optional federal charter takes no jurisdiction from the states but only provides an alternative to state regulation at the federal level. Accordingly, we believe this Congress should take up legislation for an optional federal insurance charter.

5. Retain deposit insurance ceilings and resolve insolvencies at lower cost

Finally, when the Committee issued its statement in 2000, there had been no legislative proposal for deposit insurance reform. Legislation on this issue was introduced in 2001 but not enacted. The Committee has issued statements opposing provisions in the legislation that would, among other things, increase the $100,000 ceiling on insured deposits and eliminate the requirement that the FDIC restore any deficiency in the Bank Insurance Fund and the Savings Association Insurance Fund within a year after any deficiency occurs. This is important because it will reduce the probability of regulatory forbearance.

It also appears that in recent years the agencies have failed to meet the standards Congress mandated in FDICIA, to resolve insolvent banks at low cost. Although there have been relatively few bank failures over the last two years, many that have occurred have resulted in very large losses in relation to the size of the institutions involved. This should not happen. Indeed, studies have shown that the ratio of losses to bank asset size have not significantly declined since the adoption of FDICIA. It is true that many of these losses have been the result of fraud, which can be difficult to detect. But in each case where fraud occurred there were signals in advance that the bank was not being properly managed, and these should have resulted in the prompt and special attention from supervisors that would have limited losses thereafter. Moreover, with fewer bank failures, the staffs of the supervisory agencies should have had the time to devote this special attention to the few cases where large losses to the fund were likely.