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Conference of State Bank Supervisors

1150 Connecticut Avenue NW, Washington, D.C. 20036

CSBS: Time Has Come To Fix Key Regulatory Weaknesses

WASHINGTON – The Conference of State Bank Supervisors presented state financial regulators' perspectives on the Obama administration's proposal for financial regulatory reform at a Congressional hearing today.

Testifying before the House Financial Services Committee, CSBS Chairman Joseph A. Smith Jr. offered a number of suggestions for improving selected parts of the plan as set forth in the recently released white paper, "Financial Regulatory Reform: A New Foundation."

Smith, who is Commissioner of Banks in North Carolina, said CSBS believes some form of regulatory reform is absolutely necessary. He applauded the Administration and the Committee for undertaking such a challenging mission.

"The financial crisis and the recent economic downturn have exposed weaknesses in financial oversight, identified gaps in statutes and regulations, uncovered harmful industry practices and products, highlighted imprudent consumer habits, and sparked an important debate among regulators, the industry, consumer groups, the Administration and Congress," he said.

Smith cited several CSBS-supported provisions in the proposal, including the continuation of the current supervisory structure for state-chartered banks; the recognition of the importance of state law and law enforcement; and a comprehensive approach to consumer protection in the financial services arena.

However, Smith said the Administration's plan inadequately addresses the systemic risks posed by large complex financial institutions and leaves open the significant possibility of creating a bifurcated industry, with one class of systemically significant large institutions that enjoy real and perceived federal preferences and "the rest." He also criticized the proposal's lack of state representation in the oversight councils proposed in the plan.

Smith's testimony focused on four elements of the plan:

- Consumer Financial Protection Agency
- Consolidated supervision of large, interconnected financial firms
- Proposed new resolution regime for failing bank holding companies
- Creation of a new Financial Services Oversight Council

Consumer Financial Protection Agency

Should a Consumer Financial Protection Agency be created, CSBS expressed concerns over separating consumer compliance regulation from prudential supervision and the risk of creating additional unnecessary regulatory burdens, especially for state-chartered depository institutions that are already subject to both federal and state regulatory oversight.

Smith said the primary focus of such an agency, if created, should be on rulemaking and information gathering and analysis. He added that examination authority over safety and soundness and consumer protection compliance should remain with prudential regulators with back-up examination and enforcement powers for the Agency.

“Additionally, any federal consumer protection legislation must ensure that state authorities continue to have the power to enforce applicable state and federal laws for all financial entities operating within their borders, regardless of charter type,” he said. Any proposal to create a federal consumer financial protection agency must preserve for states the ability to set higher, stronger consumer protection standards.

He also said that reform legislation must include mandated consultation between the CFPB and state banking regulators and the agency’s board should include one member with state bank supervisory experience, mirroring the structure of the current FDIC Board.

Smith also expressed concern about how a new federal agency would be funded and said that funding must be equitably spread across the industry and not deplete state regulatory resources.

Consolidated Supervision of Large, Interconnected Financial Firms

CSBS agrees with the concept that the regulatory system would benefit from a single agency tasked only with risk posed to the entire financial system. The Federal Reserve Board would be a logical candidate for this systemic risk regulator. However, consolidated supervision in a single agency eliminates valuable checks and balances and minimizes resources and expertise. CSBS suggested that any agency charged with supervision and regulating large, interconnected institutions should report to the Financial Services Oversight Council.

CSBS also said the Administration’s plan concedes that some Tier 1 FHCs will always be too big to fail – an assumption that needs to be challenged.

CSBS urged Congress to prevent firms from becoming too big to fail in the first place

New Resolution Regime

CSBS supports the creation of a resolution regime for closing failing bank holding companies that would have serious adverse effects on the financial system (including Tier 1 FHCs) based on the FDIC’s systemic risk exception, but as proposed, such a regime leaves open the possibility that an institution might be propped up indefinitely for “systemic” reasons, continuing business as usual.

The proposal would allow the regime to stabilize a failing institution by providing loans, purchasing assets, guaranteeing the liabilities or making equity investments in the firm.

“Congress must not allow the resolving regime to have the power to bail out failing institutions. Firms that are not able to remain in business on their own accord must fail,” Smith said. He suggested that the FDIC be designated conservator or receiver of any institution that would come under the new regime.

Financial Services Oversight Council

While CSBS agrees there is a need for a council of multiple regulators charged specifically with the coordination of supervisory efforts to limit the systemic risk posed by certain financial firms, but such an oversight council should include a provision for state involvement.

“The vast majority of insured financial institutions operating within the United States are chartered and regulated by the states. States also have oversight of those financial service providers that are not affiliated with a depository institution, such as mortgage brokers, money services businesses, check cashers and consumer finance companies,” Smith said.

“Because of our proximity to and knowledge of the entities we regulate, the local economic conditions and consumers, states are often the first to identify emerging trends, practices, products or threats that impact the financial system,” he added.

“An oversight council that does not include some mechanism for state involvement will not be informed by this knowledge and proximity and, accordingly will be less likely to fulfill its statutory mission,” Smith said.

Smith added that it is imperative that any plan for financial regulatory restructuring must reduce systemic risk, assure fairness for consumers, preserve the unique diversity of the nation’s financial system, and enhance state-federal coordination to create a seamless network of supervision for all industry participants.

“Taken as a whole, this system of state regulators is one of the largest financial regulatory bodies in the United States. The states must continue to play a major role in any new regulatory regime,” Smith added.

Smith’s written testimony may be found at

http://www.house.gov/apps/list/hearing/financialsvcs_dem/hrfc_072409.shtml

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The Conference of State Bank Supervisors is the nationwide regulatory organization for state banking, representing the bank regulators of the 50 states, the District of Columbia, Guam, Puerto Rico and the Virgin Islands. The CSBS is responsible for defending state authority to determine banking structure and the products and services state-chartered institutions can offer and for improving the quality of state bank supervision by providing department performance evaluation and accreditation programs and supervisory education/training programs for state banking department personnel.

CSBS Information Contact: Mary White, Vice President, Communications, mwhite@csbs.org (202) 728-5715