

*Testimony of*

**Edward L. Yingling**

*On Behalf of the*

**AMERICAN BANKERS ASSOCIATION**

*Before the*

Committee on Financial Services

United States House of Representatives



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**October 29, 2009**

Chairman Frank, Ranking Member Bachus, and members of the Committee, my name is Edward L. Yingling. I am President and CEO of the American Bankers Association (ABA). ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than \$125 million in assets – represent over 95 percent of the industry's \$13.3 trillion in assets and employ over 2 million men and women.

Thank you for the opportunity to present the views of ABA on the Financial Services Committee's and Treasury Department's draft legislation to address the issue of systemic risk and "too big to fail" financial institutions. We believe that deficiencies in our current system must be corrected. The ABA supports reforming the regulations that govern our financial system. Almost exactly one year ago today, ABA first testified before this committee on changes that are needed. We advocated that reform legislation create a systemic oversight body, provide a strong mechanism for resolving troubled systemically important firms, and fill the gaps in the largely unregulated shadow banking industry. Since that first hearing, a consensus has been building in support of reform in these areas. We believe, as many others do, that such significant legislation will address the principal causes of the financial crisis and constitute major reform. Though differences still exist regarding how some goals are best accomplished, we believe that there is a broad consensus to address the primary issues.

While there are many elements in the draft legislation, in the rest of my statement today, I would like to focus on the key recommendations that we believe are critical to reforming our financial system and avoiding future financial crises. ABA has not had sufficient opportunity to fully analyze the new draft at the time of the submission of this testimony. Where possible, we have included some preliminary comments in this statement, and we will provide further views to the Committee as quickly as possible.

In generally, we believe any reform legislation should:

- ***Establish a Council to oversee and address systemic risk.*** This council should search for and identify potential systemic problems and put forth solutions. It should not be involved in day-to-day regulation, nor regulate individual institutions, but should have carefully calibrated backup authority when issues are not being addressed by the primary regulator. While we have some specific concerns with the authorities of the council in this draft legislation, in general ABA supports the approach in the draft. *However, ABA strongly recommends that this Council should also have oversight authority over accounting rulemaking.*
- ***Establish an agency to handle the failure of non-bank financial institutions that threaten systemic risk.*** Too-big-to-fail should not be allowed to continue, as it has profound moral hazard implications and competitive effects that must be addressed. In this testimony, we provide a more detailed approach for resolving systemically important institutions and addressing too-big-to-fail. The draft legislation appears to create a strong approach to resolution and to address too-big-to-fail. *However, ABA strongly opposes using the FDIC directly as the resolution authority.*
- ***Preserve all FDIC-insured charters and protect the dual banking system.*** In particular, *ABA has strongly advocated that the federal thrift charter be preserved and that mutual institutions not be negatively impacted by any changes made regarding regulatory agencies.* We appreciate greatly that the draft legislation does preserve the thrift charter and provides support for the mutual charter. We do have some specific concerns, however, particularly with respect to the treatment of holding companies.
- ***Close the gaps in regulation.*** Gaps between highly regulated banks and less regulated non-banking firms should be eliminated. These gaps have proven to be major factors in the crisis, particularly the role of largely unregulated mortgage lenders. Credit default swaps, credit rating agencies, and hedge funds also should be addressed in legislation to close gaps.

I would like to touch briefly on each of these themes to highlight the issues that underlie them. In addition, I suggest some additional recommendations in the areas of accounting oversight and regulation of bank holding companies that are not a part of the draft legislation and that should be considered.

## **I. There Should Be a Council to Oversee and Address Systemic Risk**

As I have stated in other hearings before this committee going back for a year, ABA supports the formation of a council to oversee systemic risk. Under the current system, each agency was looking within its piece of the puzzle, but no one was explicitly charged with looking at the overall picture. This needs to be changed.

There are many aspects to consider related to the authority of this council. The council's role should be one of searching for and identifying potential systemic problems and then putting forth solutions. This process is not about regulating specific institutions, which should be left primarily to the prudential regulators. It is about looking at information and trends on the economy, sectors within the economy, and different types of institutions within each sector. Such problematic trends from the recent past would include: the rapid appreciation of home prices far in excess of income growth; proliferation of "affordability" mortgages that ignored long-term ability to repay; excess leverage in some Wall Street firms; the rapid growth and complexity of mortgage-backed securities and how they were being rated; and the rapid growth of the credit default swap market.

The council should generally not regulate individual institutions and should primarily use information gathered from institutions through their primary regulators, together with broader economic information. In fact, involving it in day-to-day regulation could be a distraction. However, the systemic council should have some carefully calibrated and limited backup authority when systemic issues are not being addressed by the primary regulator. This council should be focused and nimble, with a small dedicated staff.

In general, the draft appears to be similar to ABA's recommendations. However, we will have further comments on the role of the council and, in particular, its role in relationship to the primary regulator.

### ***The Systemic Risk Oversight Council Should Oversee Accounting Policy***

A Systemic Risk Oversight Council could not possibly do its job if does not have oversight authority over accounting rulemaking. ***This is a major deficiency in the draft legislation.*** Accounting policies are increasingly and profoundly influencing financial policy and the basic structure of our financial system. Thus, accounting standards must now be part of any systemic risk calculation. To do anything less creates the potential to undermine any action taken to address a systemic risk. The Financial Accounting Standards Board (FASB) should continue to function as it does today, but it should no longer report only to the Securities and Exchange Commission (SEC). The SEC's view is simply too narrow. Accounting policies contributed to the crisis, as has now been well documented, and yet the SEC is not charged with considering systemic and structural effects. Moving oversight to the systemic risk council, which includes the SEC, will address this problem.

We have testified to this point on several occasions before this committee over the last year. Many others are now calling for change. Even FASB acknowledged that "the financial crisis has revealed a number of significant deficiencies and points of stress in current accounting standards."<sup>1</sup> ABA strongly advocates that the

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<sup>1</sup> Financial Accounting Foundation 2008 *Annual Report*.

Congress follow the general recommendations of the Group of 30 report, chaired by Paul Volcker, the G-20 report, and the Administration's financial regulatory reform proposal relating to accounting policy.<sup>2</sup>

ABA has strongly supported H.R. 1349, introduced by Representatives Perlmutter and Lucas, as an approach to accomplish the goals of better oversight of accounting practices. While H.R. 1349 predates specific proposals for creating a systemic oversight council, the approach it embodies is consistent with having FASB report to the systemic risk oversight council. We thank Representatives Perlmutter and Lucas for their foresight and leadership on this critical issue.

In light of FASB's current plans to expand mark-to-market accounting, let me make one final comment on accounting policy: For the last year, ABA has continued to make this fundamental point: the broad use of mark-to-market accounting is simply incompatible with a banking system that provides long-term credit to businesses, consumers, and others. This is a point that has been made by many others in recent months, and in particular, by the Group of 30 study chaired by Paul Volker. It is critical that banks remain committed to the long-term. For banks to provide long-term loans to, and investment in, businesses, communities, and consumers' futures, banks must not have their loans and investments marked to prices set in markets that are panicked or are over-exuberant. These are long-term investments, not day-to-day trades. Simply put, if FASB continues its effort regarding mark-to-market, the lesson learned from this financial disaster will be that long-term loans and investments will have their valuations destroyed, and therefore the bank will be destroyed, by mark-to-market accounting during financial panics.

Despite this, FASB currently is proposing to expand mark-to-market accounting so that individual loans will be reflected on the balance sheet at their so-called market value. Loans currently make up over 60 percent of bank assets and are, by their nature, illiquid. Given the problems faced this past year with illiquid securities, such changes would wreak havoc in the markets due to the enormous volatility being introduced to bank capital. This volatility will increase the cost of funding and, as a result, banks simply will not be able to make loans and investments with the idea that they will work through hard times with customers and communities.

Accounting policy is arcane and difficult, but it was a critical factor in turning a bubble and a recession into a full-fledged panic. If Congress does not address this issue as part of reform, it will not have addressed one of the significant causes of the problems.

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<sup>2</sup> The Group of 30, for example, suggests that accounting standards be reviewed: (1) to develop "more realistic guidelines for dealing with less-liquid instruments and distressed markets"; (2) by "prudential regulators to ensure application in a fashion consistent with safe and sound operation of [financial] institutions"; and (3) to be more flexible "in regard to the prudential need for regulated institutions to maintain adequate credit-loss reserves." See in particular the U.S. Treasury Department's *Financial Regulatory Reform – A New Foundation: Rebuilding Financial Supervision and Regulation*, June 2009; the G30's *Financial Reform – A Framework for Financial Stability*, January 15, 2009, the G20's *Declaration on Strengthening the Financial System*, London, April 2, 2009, and the Financial Stability Forum's *Report of the Financial Stability Forum on Addressing Procyclicality in the Financial System*, April 2, 2009.

## II. Establish an Agency to Handle the Failure of Non-bank Institutions That Threaten Systemic Risk

ABA also strongly supports creating a mechanism for the orderly resolution of systemically important non-bank firms. Our regulatory authorities should never again be in the position of making up a solution on the fly to a Bear Stearns or an AIG, or of not being able to resolve a Lehman Brothers. The inability to deal with those situations in a predetermined way greatly exacerbated the crisis. The system for resolving bank failures is well-developed and continues to work during these difficult times. Thus, what is needed is a system to resolve the failures of non-bank financial firms.

A critical issue in this regard is too-big-to-fail. Whatever is done on the systemic oversight agency and on a resolution system will set the parameters of too-big-to-fail. No institution should be too-big-to-fail, and that is ABA's goal; but we all know how difficult that is to accomplish, particularly with the events over the last year. This too-big-to-fail concept has profound moral hazard implications and competitive effects that are very important to address. We note Chairman Bernanke's statement: "Improved resolution procedures...would help reduce the too-big-to-fail problem by narrowing the range of circumstances that might be expected to prompt government action..."<sup>3</sup>

The structure and protocols for systemic risk resolutions enacted for the future will determine in many respects the structure and fairness of the financial system. Thus, a systemic risk resolution process should:

1. create a workable resolution regime that will stand up through a full scale financial crisis;
2. protect the taxpayer;
3. end too-big-to-fail;
4. be fair to financial firms that would never be considered too-big-to-fail – in terms of both competitiveness and cost; and
5. not impair the ability of financial markets to function effectively.

Building upon ABA's previous, long-held position that no institution should be too-big-to-fail, and also building upon the Administration's proposal, recent testimony by Federal Reserve Chairman Bernanke, and statements by key members of Congress, ABA recently proposed the following approach to systemic risk resolution:

- The regulations implementing the new law on resolution would be written by the newly-created Systemic Risk Oversight Council ("SROC"). These would include specific criteria for when systemic resolution would be invoked.
- Those institutions subject to potential systemic resolution would not be named in advance. Regulators would impose more rigorous supervisory requirements on some institutions based on their specific

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<sup>3</sup> Federal Reserve Chairman Ben Bernanke, speech to the Council on Foreign Relations, Washington, D.C. , March 10, 2009.

characteristics (e.g., size, interconnectivity, etc.); but such institutions, or others, would be subject to systemic risk resolution only under the terms of the resolution rules. Only financial companies should be eligible for systemic resolution. Failed banks and insurance companies that are subsidiaries of holding companies would be resolved through the current FDIC and state insurance rules, respectively.

- The primary regulator of an institution, the Federal Reserve, or the Treasury could make a confidential recommendation to trigger resolution. That recommendation would be considered by a subgroup of the SROC, which would consist of the primary regulator for this specific case, the Federal Reserve, and the Treasury. This subgroup would forward its recommendation to the President (or the Secretary of the Treasury) for final determination as to whether the systemic resolution process would be invoked.
- A systemic resolution agency (“SRA”) would be created. It would not have a permanent staff, but rather consist, in normal times, of a stand-by staff from the FDIC. The FDIC would be given the role of running the SRA, but it would be kept separate from the FDIC to avoid public confusion with FDIC insurance.
- Once the President authorizes a systemic resolution, the institution would be turned over to the SRA for resolution. The FDIC would implement a predetermined plan, approved by the SROC, to staff the SRA for that type of resolution, delegating existing FDIC staff and hiring additional expertise to fit the particular resolution.
- The Secretary of the Treasury, with the advice of the relevant subgroup of the SROC (noted above), plus the FDIC, would be charged with making major policy decisions involving the resolution. Those limited policy items would be specified by Congress, and the FDIC would be in charge of day-to-day resolution issues.
- Congress would clearly identify in the legislation those items for an institution being resolved – such as management, board make-up, and equity investors – where strong action would be required so that the result is a “controlled” bankruptcy of the institution and an end to too-big-to-fail. These outcomes would be identified in advance by the regulations from the SROC in order that markets, potential stakeholders, and potential counterparties would know their risk. The SRA would be authorized to create a “bridge bank” mechanism where appropriate to resolve the institution in an orderly fashion, limit contagion, and protect the taxpayers. Rules for creditors of the institution would be developed in advance based on existing bankruptcy principles, which would provide clarity and predictability to financial markets on transactions.
- Through enhanced regulation and supervision, the likelihood and cost of future failures should be significantly reduced. If a resolution does result in a loss, the costs would be covered by the Treasury

and reimbursed by assessments over time on all financial firms. Institutions with subsidiaries that have insured deposits would be given credit to reflect the fact that deposits are already covered by insurance premiums. Insured institutions below a threshold should be exempt. There would, however, need to be recognition that there are practical limits to such assessments in a catastrophic financial meltdown and that the pro-cyclical nature of assessments could overwhelm the system and be counterproductive.

In many ways, the draft is very similar to this ABA proposal. The details are very important, however, and we will submit more specific comments to the Committee. ***Nevertheless, at this point, we must express our strong objection to the approach in the draft legislation of using the FDIC – directly – to resolve non-banks.*** As ABA has stated in previous testimony, we believe such an approach is unnecessary and will create huge problems; these problems are easily avoided by following our recommendations to create a Systemic Resolution Agency that would be run largely by the FDIC.

First and foremost, putting the FDIC in charge of such resolutions would greatly undermine public confidence in the FDIC insurance for bank deposits. This confidence is critical, and it is the reason we have seen no significant runs on banks since the 1930s. The importance of this public confidence should not be underestimated, nor should its existence be taken for granted: witness the lines in front of the British bank Northern Rock at the beginning of this crisis. Yet our own research and polling shows that, while consumers trust FDIC insurance, their understanding of how it works is not all that deep. Headlines saying that “FDIC in charge of failed XYZ non-bank” would greatly undermine that trust. Just imagine if the FDIC were trying to address the AIG situation for the past year. We urge Congress not to do anything that would confuse consumers or undermine confidence in the FDIC.

Our second concern, frankly, is that the banking industry has supported the FDIC with tens of billions of dollars in premiums. During these most difficult of times, the industry is committed to paying for all FDIC insurance costs. Thousands of banks have paid premiums since the FDIC was first created. We are concerned that our premiums will be used to pay for the infrastructure of the resolution mechanism, and furthermore, if our fund is strong and a major non-bank fails, there will be a strong temptation to unfairly raid the bank FDIC fund to pay for it.

Nevertheless, we recognize there can be an important role for the FDIC in this resolution process. In addition, within the bank resolution process itself, the FDIC does appear to be handicapped by the inability to address the holding company of the failed bank, which may be very much linked to the bank. ABA would support a carefully structured approach to permit the FDIC to address holding company issues when a bank fails.

Moreover, the FDIC does have expertise and an existing structure that can be helpful in resolving non-banks. As detailed above, ABA would support tapping that expertise, but only in a manner that protects the

public's perception of, and confidence in, the FDIC and that fully walls off the FDIC insurance fund. Merely making the non-bank resolution authority a separate part of, or subsidiary of, the FDIC would not be enough. ***The resolution agency should be entirely separate from the FDIC and have attributes that make it clear that the "Systemic Resolution Agency" is its own agency, with its own funding, while it does use FDIC expertise.***

### **III. Preserve all FDIC-Insured Charters and Protect the Dual Banking System**

Having choices of charters enables a bank to match the best charter to its philosophy and business strategy. This also allows regulation and supervision to be targeted to meet the particular risks that may arise. This helps preserve the diversity of financial institutions without sacrificing safety and soundness.

Charter choice also remains an important consideration as financial institutions' business models evolve. For instance, while a community bank may conclude that a state charter is best when the bank first begins operations, it may conclude later that its expansion plans would best be facilitated by a national bank or federal thrift charter. Or a large institution may conclude that some services are best met with a mix of charters, perhaps concentrating mortgage business in one, commercial lending in another, credit card activities in yet another, and trust activities in still another. The combinations are as diverse as the markets and customers to be served.

***The ABA strongly supports retaining the federal thrift charter.*** The thrift charter was created to provide a focus on home lending and building communities. This focused charter has provided the foundation for building and restoring communities and promoting savings. Thus, there is a solid case for keeping such thrift charters and their holding companies, which include stock federal savings associations, mutual federal savings associations, savings and loan holding companies, and mutual holding companies. These institutions are generally smaller banks that have outstanding community relationships. In fact, the median size of a mutual thrift is \$100 million and the median size of a stock thrift is \$250 million.

We also want to emphasize the importance of the mutual structure. Mutual institutions have stood the test of time and continue to serve their communities in exemplary fashion. ***As Congress looks at restructuring regulatory agencies or charters, it is critical that mutual institutions not be negatively impacted.***

We are very pleased that the discussion draft does not follow the Administration's original proposal to eliminate the thrift charter, nor does the draft negatively impact mutuals. We particularly thank Chairman Frank for his leadership on this issue. The process of moving the thrift charter to the new combined OCC-OTS does raise significant technical issues. We believe the draft does a good job as a first cut in addressing these issues, but we will have further recommendations in this area on important transition issues.

## ***Consolidation of Agencies into a Single Regulator is Not Needed***

We are pleased that the draft legislation does not include the concept of merging the bank regulatory functions into one regulator. As we stated in a recent joint letter with ICBA<sup>4</sup>, the current system of bank supervision, while complex, provides a healthy check against any one regulator neglecting its duties, overlooking important issues, focusing on one part of the industry to the detriment of others, growing overly bureaucratic and ineffective, or otherwise falling short in meeting its full set of responsibilities. One recent example – the FDIC’s insistence on retaining a leverage capital ratio when other regulators were inclined to eliminate it as part of Basel II – illustrates well the benefits of having variety in regulatory perspective. A single regulator is only good when it is right; when wrong, the outcome could be catastrophic. It is noteworthy that Great Britain adopted a single regulator model, and the problems in its banking sector were deeper than in the U.S.

Regulatory consolidation would inevitably undermine the dual banking system, which has served our nation well for nearly 150 years. Experience in other countries shows that a new monolithic federal regulator, responsible for the supervision of all of the nation’s depository institutions, could be expected to focus first and foremost on the largest institutions. With regulatory power concentrated in Washington, it is natural that bank regulation will favor programs supervised from Washington. With 5,490 state chartered banks today (67 percent of all banks), we are deeply concerned that state-chartered institutions would take a back seat over time. A state-chartered bank would find that regulatory burdens disadvantage state banks and conclude that it is more efficient to operate as a national bank. Having separate bureaus for state and federal charters would not solve this fundamental problem.

Our diverse banking system has served our country well. Unlike any other country, we have a broad range of small, mid-size, and large banks that meet different market needs. We believe strongly that this diverse system would be greatly undermined by the creation of one, large regulatory agency.

Moreover, regulatory consolidation would eliminate the benefits gained by the Federal Deposit Insurance Corporation and the Federal Reserve Board from their knowledge of the banking industry. As these agencies have stated repeatedly<sup>5</sup>, their ability to insure deposits and conduct monetary policy (respectively) is enhanced by their deep understanding of the banking markets obtained from hands-on bank supervision.<sup>6</sup>

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<sup>4</sup> Joint letter from ABA and ICBA to Chairman and Ranking Member of House Financial Services Committee and Chairman and Ranking member of Senate Banking Committee, dated October 19, 2009.

<sup>5</sup> *See, e.g.*, Statement of Sheila C. Bair Chairman, Federal Deposit Insurance Corporation, on Strengthening and Streamlining Prudential Bank Supervision, before the U.S. Senate Committee on Banking, Housing and Urban Affairs, August 4, 2009 (“Senate Hearing”); Daniel Tarullo, Governor, Board of Governors of the Federal Reserve System, in response to questions of Senator Dodd at the Senate Hearing.

<sup>6</sup> One argument that is used to support this regulatory consolidation is that charter switching was a major contributor to the financial crisis. This argument, we submit, is simply not supported by the facts. Fannie Mae, Freddie Mac, Lehman Brothers, and AIG did not switch charters. Subprime lending, the runs on money market mutual funds, problems with derivatives and rating agencies, and excess leverage in Wall Street firms had nothing to do with charter choice. With respect to the two institutions often cited as having switched charters – Countrywide and Colonial – their switch of charter had no

Changes in our regulatory system are needed. Consumers, banks, and the country at large would benefit from better systemic supervision, and having input from several regulators will increase the chances that we can overcome the danger of systemic supervision suffering from blind spots. As noted above, there also should be a system capable of unwinding any financial institution regardless of size or complexity, and drawing upon the specialized expertise of the existing banking regulators will play an essential role in that effort. None of these changes requires or would benefit from the dramatic and distracting consolidation of all the regulatory functions of the agencies into one.

***We strongly support the fact that the draft legislation does not contain a single regulator. We also support the language designed to protect explicitly against the possibility of charter shopping by a troubled bank, which largely codifies existing policy.***

### ***Holding Company Regulation***

The draft legislation gives the Federal Reserve a broadened authority over certain holding companies that may raise systemic issues. In general, the overall structure in the draft legislation of the regulation of such entities seems appropriate and is central to a strong new regulatory regime. The ABA, however, will need to analyze the specifics of the greatly expanded regulatory authority given to the Federal Reserve, as well as the interaction between the Federal Reserve and the primary regulator.

However, as the Federal Reserve is given broader powers over some holding companies, ABA urges Congress to take the logical step of moving the regulation of other bank holding companies to the primary prudential regulator. For example, there is no sound reason for the Federal Reserve to continue to regulate and examine the holding companies of community banks that are not members of the Federal Reserve. Many community banks have holding companies that are virtually shells, and yet the Federal Reserve comes in and examines them. It is an unnecessary duplicative regulatory cost to banks and a distraction to the Federal Reserve, particularly given its proposed expanded powers. This is an opportunity to streamline regulation, save banks and regulators unnecessary costs, and have clearer lines of regulatory authority and responsibility. There are a number of issues raised by the holding company provisions in the draft legislation, including the practical implications of the very broad new authority given the Federal Reserve and the treatment of certain thrift holding companies and grandfathered ILC holding companies. ***ABA has serious concerns in these areas and believes these issues need a good deal more work.***

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material impact on their problems. If the Congress is concerned about problem institutions switching charters in order to avoid strong regulation, that should be addressed directly and simply through a provision prohibiting such switching for institutions under special supervisory scrutiny, and, in fact, the regulators have already adopted rules designed to achieve that goal.

#### **IV. Closing the Gaps in Regulation of Non-banks is Critical to Preventing Any Recurrence of the Current Problems**

A major cause of our current problems is the regulatory gaps that allowed some entities to escape effective regulation. An obvious, but often ignored truth is this: where similar activities are not similarly regulated, business naturally flows to the poorly regulated sector, in part because of lower costs. This flow undermines the regulated sector, making it weaker. Too often, the poorly regulated sector then has a blow-up, which even further weakens the regulated sector. It is now apparent to everyone that a critical gap occurred with respect to the lack of regulation of independent mortgage brokers. Legitimate questions have also been raised with respect to derivatives, hedge funds, and others.

Consumer confidence in the financial sector as a whole suffers when non-bank actors offer bank-like services while operating under substandard guidelines for safety and soundness. Thus, the fundamental principle for closing the gaps in regulation is that similar activities should be subject to similar regulation and capital requirements. For example, capital requirements should be universally and consistently applied to all institutions offering bank-like products and services. Credit default swaps and other products that could pose potential systemic risk should be subject to supervision and oversight that increase transparency, without unduly limiting innovation and the operation of markets.

Another example is the payments system. Banks have long been the primary players in the payments system, ensuring safe, secure, and efficient funds transfers for consumers and businesses. Banks are subject to a well-defined regulatory structure and are examined to ensure compliance with the standards. Unfortunately, the current regulatory scheme does not apply comparable standards of performance and financial soundness for non-banks that participate in the payments system. Nor are non-banks subject to regular examinations to ensure the reliability of their payments operations. In other words, this is yet another gap in our regulatory structure, and one that is growing.

The Administration's reform plan envisioned granting more authority to the Federal Reserve for the oversight of systemically important payments systems. We believe such additional authority is appropriate to assure smooth functioning of the critical payments infrastructure should any disruption occur in the future. Such authority does not necessarily fully close the gaps that exist between regulation of banks and non-banks offering payments products.

In recent years, non-banks have begun offering "non-traditional" payment services in greater numbers. Internet technological advances combined with the increase in consumer access to the Internet have contributed to growth in these alternative payment options. The rapid technological growth and increasing consumer use of mobile telephones capable of accessing the Internet for the purpose of making or receiving payments demonstrates how fast the marketplace is changing. These activities introduce new risks to the system. Another key difference between banks and non-banks in the payments system is the level of protection granted to

consumers in case of a failure to perform. It is important to know the level of capital held by a payment provider where funds are held, and what the effect of a failure would be on customers using the service. This information is not always as apparent as it might be. Customers using these payments systems are unlikely to understand their risk – that in the event of a failure, they could be uninsured creditors, for example.

ABA believes that standards for reliability of the payments system should apply to all payments services providers, comparable to the standards that today apply to payments services provided by banks. As part of expanding the oversight authority of the Federal Reserve for systemically important payments systems, Congress should clarify the authority of the Federal Reserve to set basic payments system integrity standards that would apply to all payments system services, bank as well as non-banks. Such standards should cover operational controls and could also extend to other relevant matters, such as adequate capitalization.

We appreciate that the draft takes a broad and comprehensive approach to these payments system issues, and ABA will provide the Committee with detailed comments on the new draft legislation.

The ABA also has deep interest in the securitization language in the draft legislation, and we will provide further comments on that subject. We understand the legitimate public policy issue of wanting lenders to have “skin in the game.” Certainly the recent history of the securitization of bad subprime loans has demonstrated that there can be problems when the originator has no incentive to underwrite safely. However, we continue to be very concerned about proposals that do not fully take into account the accounting treatment that applies to securitization.

## **V. Conclusion**

For over a year, the ABA has testified in support of reforming the regulations that govern our financial system. As we have done consistently over the course of the last year, we reiterate today our support for creating a systemic oversight body, for providing a strong mechanism for resolving troubled systemically important firms, and for filling the gaps in the largely unregulated shadow banking industry.

The draft legislation contains many positive provisions and, in general, the ABA supports the direction taken on the major issues. However, we do have serious concerns about the impact of the proposal on the FDIC and depositors’ view of the FDIC, the approach to holding companies, and the failure to address the critical accounting issues. We also want to express our appreciation for the retention of the thrift charter.

We will quickly provide the Committee with more detailed input on this complex legislation, and we stand ready to work with this Committee to enact meaningful reform that truly corrects the underlying deficiencies in our current system.