Statement of

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Before the

Senate Committee on Banking, Housing and Urban Affairs

March 26, 2009

Thank you, Chairman Dodd, Ranking Member Shelby and Members of the Committee for the opportunity to offer my views on enhancing investor protection and improving financial regulation. These have been issues of concern to me for many years.

In offering observations to the Committee today, I am drawing on past experience as SEC Chairman from 1989- 1993, as well as my service as an Assistant to the President in the White House under President George H.W. Bush. During the savings and loan and banking crisis in the 1980s, which involved more than $1 trillion in bank and thrift assets, I was one of the principal architects of the program to restructure the savings and loan industry and its regulatory system. That effort was extremely successful, and became the model for many other countries including the Nordic countries in dealing with later banking sector meltdowns.

Early in my White House tenure, in 1982-1985 when the future President Bush was Vice President, I was staff director of a three year study of how to improve the effectiveness and efficiency of the entire federal financial regulatory system. We looked carefully at many ideas

for improving the effectiveness of federal financial regulation, including possible consolidation of banking agencies, SEC/CFTC merger and other topics.

From 2002-2005 I served as the "corporate monitor" of WorldCom, after being appointed to that position by the Hon. Jed S. Rakoff of the U.S. District Court for the Southern District of New York. Among other things, it was my job on behalf of the District Court to evaluate and approve or veto all compensation payments by WorldCom to any of its 66,000 employees in more than 50 countries. We didn't call it an "AIG Problem", but Judge Rakoff was determined to prevent exactly the type of compensation abuses that have occurred in AIG. Even though taxpayer funds were not injected into WorldCom, Judge Rakoff did not believe that a company that had destroyed itself through fraud should be free to pay corporate funds to insiders without strict monitoring and controls. I ultimately blocked hundreds of millions in proposed compensation payments that could not be justified, while allowing the company to do what it needed to do to compete for critical personnel and to emerge successfully from bankruptcy.

Over the years I have served on many corporate boards, including the boards of two major European corporations as well as U.S. companies. Today I serve as non-executive Chairman of the Board of H&R Block, Inc., and as a director of two other U.S. public companies[1]. As a board chairman and as a director, I have personally had to grapple with the issues of corporate governance, including accountability for performance and excessive compensation, that helped cause so many of our recent financial institution collapses.

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[1]The views expressed here today are solely my own. They do not represent the views of any investors in investment funds managed by Breeden Capital Management, or of any companies on whose boards I serve.

Of all my prior experiences, however, perhaps the most relevant is my experience as an investor. For the past few years my firm, Breeden Capital Management, has managed equity investments that today total approximately $1.5 billion in the U.S. and Europe. Our investors are for the most part major pension plans, and we indirectly invest on behalf of several million retired schoolteachers, firemen, policemen, civil servants and others. Their retirement security is dependent in part on how successful we are in generating investment returns. While I was pretty intense about investor protection as SEC Chairman, I can assure you that there is nothing like having billions on the line in investments on behalf of other people to make you really passionate on that subject.

I. Overview

By any conceivable yardstick, our Nation's financial regulatory programs have not worked adequately to protect our economy, our investors, or our taxpayers. In little more than a year, U.S. equities have lost more than $7 **trillion** in value. Investors in financial firms that either failed, or needed a government rescue, have had at least $1.6 **trillion** in equity wiped out. These are colossal losses, without any precedent since the Great Depression. Millions of Americans will live with reduced retirement incomes and higher taxes for many years as a result of misbehavior in our financial firms, failed oversight by boards of directors, and ineffective government regulation.

To restore trust among investors in our financial system and government, we will need to make significant improvements in our existing regulatory programs. We also must make sure that "new" regulatory programs will actually be "better" than current programs. Any "reforms"

worth the name must demand more effectiveness from government agencies, including the Federal Reserve and the SEC, that have responsibility for "prudential supervision" of banks and securities firms.

It is worth noting that the disasters we have seen did not arise due to lack of resources for the Federal Reserve, the SEC or any of the other agencies that didn't perform as well as they needed to do. The U.S. regulatory system is enormous and powerful, and it generally has adequate, if not perfect, resources. When it comes to regulation, bigger doesn't mean smarter, better or more effective. Indeed, when agencies have too many resources they tend to become unwieldy, not more vigilant or effective.

The problems also did not arise because of "outdated laws from the 1930s" or, except in limited circumstances, from "gaps" in statutory authority in the banking or securities sectors. The fact is that some of the laws enacted in the 1930s in the wake of the Depression, like the Glass-Steagall Act, helped prevent leverage or conflict problems. When they were repealed in order to allow the creation of Citigroup, and to permit other financial firms to expand across traditional legal barriers, we may have gone too far in "modernizing" our system without incorporating adequate alternative limits on conflicts and leverage. Other laws from the 1930s, such as the Securities Act of 1933 and the Securities Exchange Act of 1934, have been regularly updated over the years to maintain their relevance in modern markets.

Many people are today pointing at "gaps" in the regulatory structure, including "systemic risk authority". If the Fed hasn't been worried about systemic risk all these years, then

people really should be fired. The problems we have experienced grew in plain sight of all our regulators. For the most part, we lacked adequate leadership at major regulatory agencies, not legal jurisdiction. The banking and securities regulators generally had the tools to address the abusive practices, but just didn't use their powers forcefully enough or ask for new authority promptly when they needed it. Oversight of derivatives and swap markets is probably the major exception where firms like AIG were operating far outside of anyone's oversight authority. That is a good reason to refuse to bail out swap counterparties of AIG in my opinion, but we also ought to put formal oversight into place if we are going to force taxpayers to make good on defaulted swaps.

Part of the problem was an excessive faith by some regulators in enlightened self interest by banks and securities firms, and an underestimation of the risks posed by compensation practices that encouraged unsustainable leverage. Short term profits went home with the CEOs, while long term risks stayed with the shareholders. There also was a too trusting acceptance of "modern" bank internal risk models, which were used to help rationalize dangerous levels of leverage. Some regulators acquiesced to stupid things like global banks running off balance sheet "SIVs" in order to try to boost profits and compensation, even if they involved serious potential liquidity risks. Unfortunately, the risk-adjusted Basle capital rules for banks proved too simplistic and ineffective. To be fair, the SEC at the highest levels could have cracked the whip harder on Bear, Lehman and Merrill, but didn't do so.

Rather than simply calling for more authority for people who didn't use the authority they already had, we need to reexamine why our regulators missed so many of the risks staring them

in the face. My purpose is not to fault regulators who weren't perfect. I also don't want to obscure the fact that the greatest responsibility for the devastation of our economy should rightly fall on the executives of the firms engaging in wildly risky practices, and the boards that failed to provide effective oversight. However, we will never design sensible reforms if we aren't candid in acknowledging the performance failures all across the system. We can't fix things until we have a good handle on what went wrong.

It isn't enough for regulators to write rules and give speeches. More time needs to be spent conducting examinations, analyzing results, discovering problems and, where necessary putting effective limits in place to prevent excessively risky activities. Directors and regulators need backbone, and a willingness to shut down a party that gets out of control.   Regulators can't catch all the frauds any more than police can catch all the drug dealers. Nonetheless, when failures happen it shouldn't be acceptable to just ask for more resources without making the necessary corrections first. Regulators need accountability for performance failures just as much as any of us.

While we need to demand better effectiveness from regulators, we must not shift the burden of running regulated businesses in a sound and healthy manner from management and the boards of directors that are supposed to oversee their performance. Excessive leverage, compensation without correlation to long term performance, misleading (or fraudulent) accounting and disclosure, wildly overstated asset values, failures to perform basic due diligence, wasteful capital expense and other factors contributed to the financial collapses that devastated investors and undermined confidence in the entire economy. These are all issues that boards are

supposed to control, but over and over again boards at AIG, Fannie Mae, Lehman Brothers, Bank of America and other companies didn't address them adequately.

In my experience, excessive entrenchment leads many directors to believe they don't need to listen to the shareholders they represent, and who have the most at stake if the board fails to do a good job. The national disaster of self-indulgence in compensation has been opposed by many shareholders, but too many boards feel free to disregard their concerns. It is frankly almost incomprehensible how few directors of firms requiring taxpayer assistance have been forced to step down, even after investors and taxpayers lost billions because directors didn't act prudently. If you allow your CEO to spend $35 billion on an acquisition without meaningful due diligence, for example, you should be replaced as a director without delay. The failure of boards to provide informed and independent oversight badly needs to be addressed both by Congress and the SEC.

Taxpayers may have to protect our banking system, but they don't have to protect the bankers who caused their firms to fail or the directors who let them do it without proper oversight. Executives who gambled with the solvency of their firms and failed should be out of a job, and the same is true for the boards that didn't act as required. That is certainly how we handled the failures of the savings and loans. People who gambled and failed found new lines of work. There are few things today that would go farther to produce prudent behavior in the future than forcing the resignation of CEOs and directors when their firms have to take public funds to keep their doors open. It is long overdue to put accountability and personal responsibility front and center back into the system.

Since we are going to need vast amounts of future savings and investment, the Committee's efforts to help develop answers to the many tough issues affecting our system could not be more important. I will try to address the issues raised by the Committee's thoughtful letter of invitation, as well as several of my suggestions for reform.

A. Investor Protection

With $7 trillion in investor losses, it would appear that we have not done enough in the area of investor protection. This was ironically once one of the preeminent strengths of the U.S. market. Investors from around the world invested in the U.S. because we had stronger and better accounting rules, more timely and detailed disclosure, a commitment to openness in corporate governance and above all enforcement of the rules and liability for those that committed illegal practices. Over time our governance standards have come to be weaker than those of many other countries, and our commitment to accuracy in accounting and disclosure has slipped considerably. The SEC's enforcement program in recent years has not been as effective as the times demanded, with too many smaller cases and not enough focus on the largest problems. We frankly spent too much time worrying about the underwriting fees of Wall Street and not enough time worrying about protecting investors from false and misleading information.

Investors, those quaint people worried about their retirement, need to stop seeing the savings they worked hard to accumulate wiped out because executives took irresponsible gambles. If we care about generating a higher national savings rate, we need to start paying more attention to the interests of individual and institutional investors and spend less time listening to the CEOs of the very banks who created this mess. We shouldn't ever ignore

opportunities to reduce unnecessary regulatory costs, but we can't lose sight of the fact that people who lie, cheat and steal from investors belong in jail. We expect the cops on the beat to arrest street criminals, and we should equally expect the financial cops on the beat to use their muscle to protect the investing public.

The record of the SEC in recent years has not been perfect. The Madoff case is a tragic situation that should have been caught sooner, for example. Chairman Schapiro has made a good start to reinvigorating the agency's enforcement programs, and she deserves strong support in beefing up the agency's programs.

The SEC is a critical institution, and Congress should not throw away 75 years of SEC experience by stripping the agency of its responsibilities under the guise of creating a "systemic regulator" or for any other reason. Make no mistake, as great as it is (and the Fed really is a great institution), the Federal Reserve is not equipped to protect investors. Transferring SEC accounting, disclosure or enforcement programs to the Fed would be a recipe for utter disaster. A strong and effective SEC is good for investors, and good for the health of our economy. If the agency stops behaving like a tiger for investors we need to fix it, not abandon it.

There are many things that go into "investor protection". To me, the most critical need is for timely and accurate disclosure of material information regarding the performance of public companies. That means issuers should provide robust disclosure of information, and scrupulously accurate financial statements. Overstating the value of assets is **never** in investor interests, and if the system doesn't require accurate values to be disclosed investors will simply

withdraw from the market due to lack of confidence. There must be serious consequences if you falsify asset values and thereby mislead investors no matter how big your company.

Good disclosure includes marking liquid securities to market prices, whether or not a bank wishes to hide its mistakes. While care is needed in marking positions to models where there isn't a liquid market, in general the people who try to blame mark to market for the problems of insolvent institutions are simply wrong. The problem is that people bought stuff without considering all the risks, including a collapse of demand or liquidity. That isn't the problem of the yardstick for measurement, it is a problem of incompetent business decisions. If I bought a share of stock at $100 and it falls to $50, that dimunition of value is real, and I can't just wish it away. We need accuracy in accounting, not fairy tales.

"Transparency" of results to investors is the touchstone of an efficient market, and a vital protection to make sure that investors can accurately evaluate a company and its condition if the information is there and they are willing to do the work. It should never be allowable to lie or mislead investors, and people who do it should expect to be sued no matter what might happen to them in other countries. In my opinion there can be no "opt-out" of accountability for fraud and deliberate misstatements of material information. This is a bedrock value of our system and has to be defended even if business lobby groups find accurate disclosure inconvenient.

Choice is another core protection for investors. Government shouldn't try to make investment choices for investors, or allocate capital as it might wish. Particularly when it comes to sophisticated pension funds and other institutional investors, they need the right to manage

their portfolios as they believe will generate the best returns without artificial limitations. Historically some states have tried to impose "merit" regulation in which bureaucrats made investment choices for even the most sophisticated investors. Investment choice is a vital right of investors, subject of course to basic suitability standards, even though we know that investors will sometimes lose.

Healthy corporate governance practices are also vital to investors. This means accountability for performance, enforcement of fiduciary duties, maintaining checks and balances, creating sensible and proportionate incentives and many other things. One area of weakness today is excessive entrenchment of boards, and the consequent weakening of accountability for boards that fail to create value. Better corporate governance will over time lead to a stronger companies, and more sustainable earnings growth and wealth creation.

B. Systemic Risk and Supervision of Market Participants

There appears to be momentum in Washington for creating a "systemic risk" regulator, whether the Federal Reserve or some other agency. To me, this is a bad idea, and one that will weaken the overall supervisory system as well as damaging Congressional oversight.

There is no single person, and no single agency, that can be omniscient about risk. Risk crops up in limitless forms, and in the most unexpected ways. Risk is as varied as life itself. To me, our system is stronger if every agency is responsible for watching for, and acting to control,

systemic risk in its own area of expertise. It needs to be every regulator's responsibility to control risks when they are small, before they get big enough to have "systemic" implications.

Our current system involves multiple federal and state decisionmakers, and multiple points of view. Like democracy itself, the system is a bit messy and at times leads to unproductive debate or disagreement, particularly among the three different bank regulators. However, Congress and the public have the benefit of hearing the different points of view from the Fed, the Treasury, the FDIC or the SEC, for example. This allows informed debate, and produces better decisions than would be the case if those different points of view were concealed from view within a single agency expressing only one "official" opinion.

The alternative in some countries is a single regulator. Japan's Ministry of Finance, for example, traditionally brought banking, securities and insurance regulation under one roof. However, Japan still has had as many problems as other markets. Making agencies bigger often makes them less flexible, and more prone to complacency and mistakes. This can create inefficiency. More importantly, it can create systemic risk because if the regulatory "czar" proves wrong, every part of the system will be vulnerable to damage. Some regulators prove more effective than others, so a system with only one pair of eyes watching for risk is weaker than a system in which lots of people are watching. What counts is that somebody rings an alarm when problems are small enough to fix, not who pushes the button.

Of course risk often comes about not just by the activity itself, but how it is conducted. Ultimately any economic activity can be conducted in a manner that creates risk, and hence there

can be “systemic” risk anywhere. It won’t work to try to assign planning for every potential risk in the economy to a single agency unless we want a centrally planned economy like the old Soviet Union. This is an area where interagency cooperation is the better solution, as it doesn’t create the enormous new risks of concentration of power and the dangers of a single agency being asleep or flat out wrong as would a “systemic risk” supervisor.

Supervision of market participants is best left in the hands of agencies that have the most experience with the particular type of activity, just as doctors and dentists need to be overseen by people who understand the practice of medicine or dentistry. It is particularly hard for me to see a case that any single group of regulators did such a good job that they deserve becoming the Uber Regulator of the country. The bank regulators missed massive problems at Wachovia, WaMu, Citicorp and other institutions. Insurance regulators missed the problems at AIG. The SEC missed some of the problems at Bear, Lehman and Merrill. There have been enough mistakes to go around, and I don’t see evidence that putting all supervision under a monopoly agency will improve insight or judgment. Unfortunately, the reverse effect is more likely.

C. Common Supervisory Rules

During my time as SEC Chairman, I was pressured (mostly by foreign regulators) to agree to a new “global” capital rule that would have reduced the SEC’s limits on leverage for the major U.S. securities firms by as much as 90%. The proposed new “global” capital rule on market risks represented a good theoretical endeavor, but it was too simplistic and unreliable in

practice. It would have allowed firms that were long railroad stocks and short airline stocks to carry zero capital against those positions, even though they were not a true hedge.

The "netting" arrangements in the proposed global rule weren't economically realistic, and as a result the rule itself was largely a rationalization for allowing firms to lever themselves to a much greater degree than the SEC allowed at that time. In addition, the rule didn't distinguish at all between securities firms that were marking securities portfolios to market, and banks that were using cost accounting, which meant that the capital required would vary dramatically from firm to firm for identical portfolio positions. The SEC staff and I believed that this new standard would have undercut the stability and solvency of the major U.S. securities firms. We didn't object to banking authorities adopting whatever standards they thought were appropriate, but we weren't willing to be stampeded into adopting something that we didn't believe would work.

At the time, much of the force for pushing through a new rule came from the Basle banking committee, who wanted to be seen to be doing something relevant to market risk even if the proposed rule had problems. It was my rather contrarian view then, and remains so today, that adopting a "global" rule that is ineffective is worse than no global rule at all. This is because if all the world's major markets adopt the same rule and it fails, then financial contagion can spread throughout the world, not just one country.

Global harmonization of standards creates some economic benefits by making operations in multiple countries more convenient and less complicated for global banks. These benefits

must however be weighed against the risks that a “one size fits all” global rule may not work well in many individual markets because of differences in volatility, market size, the nature of the investor base or other economically relevant factors. Countries where the local regulator goes beyond the “global” norms to impose tougher standards on local banks, as the Bank of Spain did with reserves for derivatives and certain types of loans in the past few years, are better protected than those that have only a “global” standard that was worked out in international horse trading.

When we back tested this proposed new lower capital standard against historic trading data from the 1987 Crash, the SEC staff found that the theoretical asset correlations didn’t always work. As a result, firms that had followed the proposed rule would have failed (unlike the actual experience, where major firms did not fail because the SEC capital standards gave enough buffer for losses to prevent failures) when the market came under unexpected and extreme stress.

My colleagues and I simply said “No” and kept our capital standards high in that case because we didn’t believe the proposed new standard was ready for use. Here my fellow Commissioners and I believed in the KISS principle. It is a certainty that over time markets will encounter problems of liquidity or valuation that nobody anticipated. If you have enough capital and are conservatively financed, you will survive and won’t risk massive loss to your investors, clients or taxpayers.

This experience illustrates to me the very real risks that will be created by a "systemic" regulator if we try to do that, as well as from further "globalization" of regulation that makes the job of writing rules targeted narrowly to control specific risks more cumbersome. Active coordination across agencies and borders is vital to make sure that information and perspectives on risk are effectively communicated. Colleges of regulators work, and add real value.

However, going beyond that to impose uniformity, especially on something like "systemic risk" that isn't even defined, quite possibly will end up making regulation more costly, less flexible and potentially weaker rather than stronger. An agency will adopt rules that sound great, but just may not work for one of a million reasons. That is a particular danger if the "systemic" regulator is free to overrule other agencies with more specific knowledge. The first thing a czar of "systemic risk" is likely to do is to ***create*** new systemic risk because whatever that agency chooses to look at may take on immediate "too big to fail" perceptions, and the moral hazards that go with that status. My preference would be to have a unified or lead banking supervisory agency, and active dialogue and discussion among agencies rather than putting the entire economy in one agency's straightjacket.

There will inevitably also be risks to the independence of the Fed if it performs a systemic regulator's role, because you cannot allow an agency to impose needless costs on the entire economy without political accountability. When they fail to do anything about the next subprime issue, inevitably the Fed's stature will be tarnished. To me, we would lose a great deal from distracting the Fed's focus from monetary policy and stability of prices to have them traipsing around the country trying to figure out what risks GE or IBM pose to the economy.

D. Reorganization of Failed Firms

As SEC Chairman, I handled the 1990 closure and bankruptcy filing of Drexel Burnham Lambert, then one of the largest U.S. securities firms. We were able to prevent any losses to Drexel customers without cost to the taxpayers in our closure of Drexel. We froze and then sold the firm's regulated broker dealer, transferring customer funds and accounts to a new owner without loss. Having protected the regulated entity and its customers, we refused to provide assistance to the holding company parent that had a large "unregulated" portfolio of junk bonds financed by sophisticated investors (including several foreign central banks that were doing gold repos with Drexel's holding company parent).

Though there were those who wanted us to bail Drexel out, we forced the holding company into Chapter 11 instead, and let the courts sort out the claims. A similar approach would work today for AIG and its unregulated derivative products unit, which could be left to sort out its claims from swaps customers in bankruptcy without taxpayer financing. This approach of stopping the safety net at regulated subsidiaries can be very helpful in unwinding failed firms where there are both regulated and unregulated entities at less cost and less damage to market disciplines than excessively broad bailouts.

E. Risk Management

Risk management is an important responsibility of every firm, and every regulator. However, a dangerous by-product of belief that we can manage risk in a very sophisticated manner is a willingness to tolerate higher levels of risk. After all, as long as risk is being "managed" it ought to be ok to have more of it. Ultimately unanticipated problems arise that cause even highly sophisticated models to fail to predict real life accurately.

Every risk management system, and every risk adjusted capital rule, needs a minimum standard that is simple and comprehensive. Tangible capital as a percentage of total assets is a more comprehensive, and more reliable, measure of capital than the highly engineered "Tier One" Basle capital standards. I believe Congress should seriously study mandating that U.S. banking regulators establish a minimum percentage of tangible capital to total assets even if international capital rules might allow a lower number. Creating a "solvency floor" would have prevented at least some of the failures we have experienced.

F. Credit Rating Problems

The credit rating agencies failed in evaluating the risk of "structured products". In part this reflects inherent conflicts of interest in the "for profit" structure of the rating agencies and their reliance on fees from people seeking ratings in order to generate their own earnings growth. Unfortunately a "AAA" rating acts as an effective laughing gas that leads many investors to avoid necessary due diligence or healthy levels of skepticism. If the structured mortgage

instruments that devastated the economies of the western world had been rated BBB, or even A-, a great many of the people (including boards and regulators) who got clobbered would have looked more carefully at the risks, and bought less. There is a serious issue of conflict of interest in getting paid to legitimize the risk in a highly complex "structured" product laced with derivatives.

G. Levered Short Selling

Short selling doesn't have the same benefit to the public as normal long investing. While short selling creates liquidity and shouldn't be prohibited, it doesn't have to be favored by regulators either. In my opinion the SEC should never have eliminated the uptick rule, which inhibits to some degree the ability of short sellers to step on the market's neck when it is down. Beyond that, I believe that regulators should seriously consider imposing margin requirements as high as 100% on short positions. Leveraging short positions simply creates extreme downward pressure on markets, and may seriously impair market stability.

H. Credit Default Swaps

The CDS market is large, but it lacks transparency. It may also involve unhealthy incentives to buy securities without adequate capital or study on the false presumption that you can always buy "protection" against default later. We don't appear to have enough capital for our primary financial institutions such as banks, insurance companies and brokerage firms, and

there surely isn't enough capital available to "insure" every risk in the markets. But if the risks aren't really insured, then what are the swaps?

Another thing that is troubling is the ability to use the CDS market for highly levered speculative bets that may create incentives to manipulate other markets. I can't buy fire insurance on my neighbor's house due to obvious concerns about not inciting arson. Yet hedge funds that didn't own any Lehman debt were free to hold default swap positions which would prove highly profitable if Lehman failed, and also to engage in heavy short selling in Lehman shares. I am concerned about allowing that much temptation in an unregulated and very opaque market, especially if taxpayers are supposed to underwrite it (although I can't comprehend that either).

This is a market that certainly would benefit from greater oversight and transparency, particularly as to counterparty risk. It would be worthwhile for an interagency group to consider appropriate limits on issuance or reliance on credit default swaps by regulated firms within the "official" safety net. There are huge and very murky risks in this market, and it might be prudent to consider limiting the dependence of regulated firms on this opaque corner of the markets.

I. Regulatory Reform

Immediately prior to my service as SEC Chairman, I served as Assistant to the President in the White House under President George H.W. Bush where I helped lead the Administration's highly successful 1989 program to deal with the +$1 Trillion savings and loan crisis. This

program was embodied in legislation called FIRREA that was passed by Congress in the summer of 1989. As some of you will remember, the savings and loan crisis, like our current crisis, had grown for years without effective government intervention to defuse the mortgage bomb of that era. Among other things, we created the Resolution Trust Corporation to take hundreds of billions in toxic mortgage assets out of bankrupt institutions, repackage them into larger and more coherent blocks of assets, and sell them back into private ownership as quickly as possible.

We designed our intervention in the banking system to operate swiftly, and to recycle bad assets as quickly as possible rather than trying to hold assets hoping they would ultimately go up in value. Generally, troubled assets go down, not up, in value while under government ownership. Believing that the ice cube is always melting, we designed our intervention for speed. We also didn't believe that any zombie banks should be allowed to linger on government life support competing with healthier firms that had not bankrupted themselves. We didn't give bailouts to anyone, but we did provide fast funerals.

One thing President Bush (41) was adamant about was that the taxpayers should never have had to divert hundreds of billions of dollars in tax revenues to paying for the mistakes and greed of bankers. I quite vividly remember his unambiguous instructions to me to design regulatory reforms to go along with the financial intervention so that "as much as humanly possible we make sure this doesn't happen again." As part of that mandate, we imposed strict capital and accounting standards on the S&Ls, merged the FSLIC into the FDIC and beefed up its funding, established important new criminal laws (and the funding to enforce them), and

abolished the former regulatory body, the Federal Home Loan Bank Board, which had failed in its supervisory responsibilities.

Hopefully the Treasury's newly announced Public-Private Program for purchasing distressed bank assets will work as well as the RTC ultimately did. The principles of using private sector funding and workout expertise are similar, and this is an encouraging attempt to help unlock the current system. Hopefully we will also eventually look to marrying taxpayer TARP money with greater accountability and more effective oversight as we did then.

II. Specific Reforms

In response to the Committee's request, set forth below are several specific changes in law that I believe would improve the current system of investor protection and regulation of securities markets.

1. Merge the SEC, CFTC and PCAOB into a single agency that oversees trading in securities, futures, commodities and hybrid instruments. That agency should also set disclosure standards for issuers and the related accounting and audit standards. Most importantly, this agency would be primarily focused on enforcing applicable legal standards as the SEC has historically done. These closely intertwined functions have nothing to do with bank regulation, but a great deal to do with each other. I do not suggest a merger out of any lack of respect for each of the three agencies. However, a merger would help eliminate overlap and duplication that wastes public resources, and also reduces effectiveness. If a similar consolidation occurred of

the bank supervisory programs of the Fed, the Treasury and the FDIC, then we would have a strong agency regulating banks, and another strong agency regulating public companies, auditors and trading markets.

2. Allow the five (or ten) largest shareholders of any public company who have owned shares for more than one year to nominate up to three directors for inclusion on any public company's proxy statement. Overly entrenched boards have widely failed to protect shareholder interests for the simple reason that they sometimes think more about their own tenure than the interests of the people they are supposed to be protecting.

This provision would give "proxy access" to shareholder candidates without the cost and distraction of hostile proxy contests. At the same time, any such nomination would require support from a majority of shares held by the largest holders, thereby protecting against narrow special interest campaigns. This reform would make it easier for the largest shareowners to get boards to deal with excessive risks, poor performance, excessive compensation and other issues that impair shareholder interests.

3. Reverse or suspend the SEC decision to abandon U.S. accounting standards and to adopt so-called "International Financial Reporting Standards" for publicly traded firms headquartered in the U.S. At a time of the greatest investor losses in history and enormous economic stress, forcing every company to undergo an expensive transition to a new set of accounting standards that are generally less transparent than existing U.S. standards is not in investor's interests. This will avoid considerable unproductive effort at a time businesses need to minimize costs and focus on economic growth, not accounting changes. Investors need more

transparency, not less, and the SEC should not abdicate its role of deciding on appropriate accounting and auditing standards for firms publicly traded in the U.S.

4. Broaden the ability of shareowners to put nonbinding resolutions on any topic related to a company's business on its annual proxy statement, including any proposal by shareholders relating to the manner of voting on directors, charter amendments and other issues. Legislation would clarify the confusing law relating to the ability of shareholders to hold a referendum on whether a company should adopt majority voting for directors, for example. Shareholders own the company, and in the internet age there is no reason to limit what shareholders can discuss, or how they may choose to conduct elections for directors. SEC resources should no longer be devoted to arbitrating whether shareholders should be allowed to vote on resolutions germane to a company's business.

5. Prohibit "golden parachute" payments to the CEO or other senior officers of any public company, in the same way that Sarbanes Oxley prohibits loans to such executives. Golden parachutes have proven to be extraordinarily abusive to shareholders, and boards have proven themselves unable to control excessive payouts. Eliminating supercharged severance will not unduly prejudice any company's ability to recruit since no company will be able to offer or make abusive awards to failed executives. This provision would NOT prohibit signing bonuses or annual bonuses, as it would solely apply to payouts to executives who are departing rather than continuing to work. The fact is that paying failed executives to walk out the door after damaging or destroying their company is wrong, and it is part of the culture of disregard of shareholder interests that needs to change.

6. Split the roles of Chairman of the Board and CEO in any company that receives federal taxpayer funds, or that operates under federal financial regulation. The traditional model of a Chairman and CEO combined in one individual weakens checks and balances and increases risks to shareholders compared with firms that separate those positions. Splitting these roles and requiring a prior shareholder vote to reintegrate them would reduce risks and improve investor protection.

7. Eliminate broker votes for directors unless any such vote is at the specific direction of a client. Brokers should not cast votes on an uninstructed basis to avoid unwarranted entrenchment of incumbents or tipping the outcome of elections under federal proxy rules. Indeed, it may be time to consider a broader Shareholder Voting Rights Act to address many barriers to effective shareholder exercise of the vote.

8. Establish a special "systemic bankruptcy" court composed of federal District or Circuit Court judges with prior experience in large bankruptcy or receivership cases similar to the Foreign Intelligence Surveillance Court. This new Systemic Court would handle the largest and systemically important bankruptcies with enhanced powers for extraordinary speed and restructuring powers. Use of such a Systemic Court would help limit *ad hoc* decisions by administrative agencies including the Fed or Treasury in handling large financial institution failures and treatment of different types of classes of securities from company to company.

Utilizing a court with enhanced and expedited reorganization powers would allow reorganization or conservatorship proceedings rather than nationalization, and would facilitate the ability to break up and reorganize the largest failed firms under highly expedited Court supervision. Fed and Treasury officials would be able to focus on liquidity assistance under the aegis of the Systemic Court, which would allow enhanced priorities for taxpayer funds and control of compensation and other nonessential expenses. The Systemic Court should be authorized to appoint a corporate monitor in any case pending before it to control compensation expense or other issues.

9. Establish effective and meaningful limitations on leverage in purchases of securities and derivative instruments where any person or entity is borrowing from a federally supervised bank or securities firm, or where such firms are establishing positions for their own account.

10. Establish a permanent insurance program or liquidity facility for money market funds. Given recent experience, the uninsured nature of MMFs is an uncomfortably large risk to market stability.

11. Establish strict liability for any rating agency if it awards a AAA or comparable other top rating grade to a security of a non-sovereign issuer that defaults within 3 years of issuance. While I would not create private rights of action for any other rating decisions, rating agencies should appreciate that awarding a AAA overrides many investor's normal diligence

processes, such that liability is warranted if the agency proves to be wrong. The SEC should generally revoke commercial ratings as an element of its disclosure or other regulations.

12. Eliminate the deductibility of mortgage interest and replace it with deductibility of mortgage principal payments with appropriate overall limits. This would create incentives for paying off family debt, not perpetuating the maximum possible level of mortgage debt. At the same time, such a provision would result in significant new liquidity for banks as borrowers repaid performing mortgage loans. Middle class families would see real wealth increase if deductibility allows the effective duration of home mortgage loans to be reduced from 30 years to 15 years, for example, saving an average family hundreds of thousands of dollars in interest. Federal assistance would help families reduce the level of their debt, thereby strengthening the economy and boosting savings.

Thank you for your consideration of these views and ideas.