Financial Services Primer:
One Hundred Days in the Hundred Acre Wood
With apologies to A.A. Milne

<u>Cast of Characters</u>:

President - Christopher Robin, is everyone's best friend in the 100 Acre Wood. He is great friends with all the other characters like Piglet, Roo, Rabbit, Tigger, Kanga, Owl and Eeyore. He is always helping his friends with their problems. For example, he helps Pooh get honey, rescues Tigger and Roo from high trees in the forest, tacks Eeyore's tail back into place when it falls off, and rescues Piglet when he is surrounded by water. Although Pooh is the most revered character there is no doubt as to whom the leader is and that is Christopher Robin. He is the pivotal character in Winnie-the-Pooh, and he becomes the one to whom the other members of the 100 Acre Wood look up to for solving their problems. He always sorted out their problems, and not only did he advise them but he also engaged in their problems personally.

Vice President – Tigger is a very bouncy fella. Tigger is amongst the most exuberant creatures in the 100 Acre Wood. He will act on impulse and will make a dash on being jubilant, but that impulsive dash more often than not is jumping around without taking measure of the surroundings. This at times leads to mishaps and causes utter mayhem. What is also regarded as being one of his hobbies is that he has a tendency to exaggerate the truth. Tigger - That's T - I - Double Guh – Er!

Chief of Staff – Piglet is quite close to Christopher Robin and is capable of showing braveness way beyond his diminutive frame of a timid pink pig. Piglet has the ability to read and write, well enough to be able to write short notes. Piglet never hesitates one bit when Christopher calls upon everyone to take part in an expedition. But that’s him – Piglet, in spite of his diminutive size, takes up every challenge and has faced Heffalumps, Woozles, Wizzles and even Jagulars.

Federal Reserve Chairman - Owl is supposed to be the wisest in the 100 Acre Wood. In some sense Owl is special; he not only is knowledgeable about vast matters but has the ability to explain things as well. The most admirable thing about Owl is that he is very happy to offer his advice, anecdotes, and opinions irrespective of someone wanting them or not.

NEC Advisor - Rabbit happens to be one of the two animals in the 100 Acre Wood who has a brain. He highlights this fact when, in a conversation with Owl, he comments, “You and I have brains. The others have fluff.” For this very reason, he counts himself to be an important member of the 100 Acre Wood. He is always practical in all matters and keeps his friends on the go. At times, the other characters unintentionally raise his ire. Rabbit likes to take charge of group events, even if nothing gets done. He is probably the smartest amongst all his other animal friends in the forest (that’s his personal opinion), and he is mostly the self-appointed leader of the entire group. Rabbit at times comes across as being stubborn in his viewpoints. He also tends to overreact in haste, but all of his friends are aware that beneath his slightly bristly exterior lies a good heart.

Secretary of Treasury - Roo is a playful, curious, happy-go-lucky child who can be quite a handful at times. Roo is a joey (baby kangaroo) who stands at 10 inches in height. He also loves to get himself into trouble, but the good thing is that he always learns a lesson from his mistakes. Roo is amazingly enthusiastic and cheerful, he loves to discover new things in life, and his joy meets no end upon discovering little wonders along the way.

Speaker of the House - Kanga, a sweet caring mother, is regarded as one of the fiercer animals of the 100 Acre Wood. Among her favorite things to do is teaching Pooh how to jump. Apart from that she relishes being able to impart her motherly knowledge, advice and care to the other members of the forest.

House Financial Services Chairman - Eeyore is a favorite amongst most admirers of Winnie the Pooh characters, and he is an unbelievably loveable donkey, who is dismally gloomy for almost eternity. But that’s not Eeyore’s perception of himself. Eeyore is an intelligent animal, and is actually quite knowledgeable. His appearance is highlighted by a small light pink bow on his tail; this reflects well on this animal when there is an occasional hint of joy that surfaces in Eeyore.

Senate Banking Committee Chairman - Winnie the Pooh tends to be a bit on the slow side (his head is full of fluff, you know...a common occurrence among teddy bears) but his heart more than makes up for that. Pooh has a love of honey (or, hunny, as it is sometimes spelled) but he can also do with a smackerel of whatever tiny quantity he can get his hands onto to soothe that insatiable "rumbly in his tumbly". He often creates little tunes, or hums, about most anything at all.

Republicans – Heffalumps are fictional characters that have been mentioned in Winnie-the-Pooh. The Heffalump is considered to be a hostile animal in the 100 Acre Wood and comes in different shapes and sizes, though most often it is thought that a Heffalump resembles an elephant. The Heffalumps are shown to be the enemies of Pooh and his friends.

The first 100 days of President Christopher Robin's administration have been marked by much pressure to address the financial crisis, help the economy, and establish regulatory reform. While substantial regulatory changes have already been made, more is clearly on the way — lawmakers are in the process of debating additional, more aggressive legislation in an effort to protect consumers.

It is clear now that the Hundred Acre Wood experienced a serious housing bubble – average house prices increased by an enormous 90 percent from early 2000 to the peak in mid-2006. Since then, they have fallen 27 percent from the peak, back to about the level of 2003. Accordingly, the Hundred Acre Wood has been forced to contend with a rapidly deteriorating economy, brought on by a severe credit crunch and the type of global banking crisis not seen in decades.

In an era of mega-banks that do everything from selling insurance to trading commodity futures, the financial markets are still regulated by a confusing patchwork of state and federal agencies that often seem to have no clear lines of authority. The Robin Administration has begun the long, difficult task of overhauling the clunky regulatory apparatus that polices the Wood's securities markets.

On January 15, the Group of Thirty (G30) issued a report entitled *Financial Reform: A Framework for Financial Stability*. The Report recommends a massive, globally coordinated restructuring of the legislative and regulatory system that governs the financial services industry. The G30 report presents a roadmap for pending legislative and regulatory reforms and will likely play a significant role in shaping the financial reform agenda in the Hundred Acre Wood and internationally.

Specifically, the proposed structure consists of a market stability regulator to address overall financial stability, a prudential financial regulator to address limited market discipline caused by government guarantees, and a business conduct regulator to address standards for business practices and consumer protection.

The G30 report is particularly significant when considered in the context of other recent efforts aimed at addressing the financial markets. Through these efforts, momentum has been building for consolidation, increased oversight, and international coordination of the legal and regulatory framework that governs the financial industry. Testifying before Congress, Owl has opined that: "our financial markets are global in scope, therefore, intensified international cooperation among regulators and strengthening of international standards, where necessary, and their consistent implementation is necessary to protect against adverse cross-border, regional and global developments affecting international financial stability."

Also in January, the Government Accountability Office (GAO) released a report, *A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System*. As denoted in the title, the report sets out a framework by which to evaluate reform proposals.

Similar to the approach in the G30 report, the GAO report recommends that (1) regulatory reforms comprehensively address all activities that pose risks, (2) include mechanisms for identifying, monitoring, and managing risks to the financial system regardless of source, (3) eliminate overlapping federal regulatory missions, and (4) regulate similar institutions, products, and risks consistently.

Under President Robin, the Hundred Acre Wood has committed to implementing policies to strengthen financial market transparency, including enhancing required disclosure on complex financial products; strengthen regulatory regimes, prudential oversight, and risk management; and reinforce international cooperation to formulate regulations in a consistent manner.

In his state-of-the-troubled-economy speech to a joint session of Congress on February 24, Christopher Robin pledged that to “ensure that a crisis of this magnitude never happens again,” he would “ask Congress to move quickly on legislation that will finally reform our outdated regulatory system.” It is time, the President said, “to put in place tough, new common-sense rules of the road so that our financial market rewards drive and innovation, and punishes short-cuts and abuse.”

On February 25, Robin held a “Regulatory Reform Meeting” in the White House between members of his economic team, including Roo and Rabbit, and some members of Congress to begin putting some flesh on those promises. As Piglet, the White House Chief of Staff, has argued repeatedly, “a crisis is a terrible thing to waste.”

The administration's proposal, which will require congressional approval, would represent a major expansion of federal authority over the financial system. It would impose tougher standards on financial institutions judged to be so big that their failure would represent a risk to the entire system. "Over the past 18 months, we have faced the most severe global financial crisis in generations," Roo testified before the House Financial Services Committee. "To address this will require comprehensive reform. Not modest repairs at the margin, but new rules of the game," he added.

Roo’s testimony outlined four principles that the Administration will follow in seeking to restructure the regulation of financial services companies. The four broad principles outlined by Roo for financial services regulatory reform are (i) addressing systemic risk, (ii) protecting consumers and investors, (iii) eliminating gaps in the regulatory structure and (iv) fostering international coordination.

Treasury’s goals as to financial services regulatory structure are to “assign clear authority, resources and accountability” for each key regulatory function. Roo stressed that the regulatory system must be comprehensive and eliminate gaps in coverage. It remains unclear how fast the rest of the financial reform agenda might move through Congress. Roo provided only a broad outline of the other proposals. Many thorny details will need to be worked out.

On the other end of Pennsylvania Avenue, the House Financial Services Committee and the Senate Banking Committee have begun hearings on legal and regulatory reform of the financial industry, including the development of regulatory regimes for hedge funds and private equity funds as well as for derivatives. In addition, both Committees are likely to have a strong focus on consumer and investor issues such as mortgage origination and securitization practices, credit card lending, shareholder rights, corporate governance, and executive compensation. Below are some of the issues to be examined:

Financial Reform - The most overarching reform likely to be considered by Congress is an overhaul of the financial services regulatory system. The current system of oversight agencies has evolved over many years and is characterized by multiple agencies with overlapping and conflicting responsibilities.

The White House has also begun laying out more concrete steps for reform, starting with Roo’s call for a "systemic regulator,” a job that Eeyore has previously said should go to the Federal Reserve. Heffalumps have argued that "any such designated 'systematically important' company will be able to drive out of the field any other competitor, so we will have very large firms dominating each of these areas, where today we have a lot of very vigorous competition.”

Other Heffalumps are concerned such duties could distract the Fed from its core role as manager of monetary policy. "Are any of you troubled with giving the Fed so much power?" asked the top Heffalump on the full House Financial Services committee. Lawmakers at the subcommittee hearing also expressed reservations about rushing ahead with a plan to create a systemic risk regulator.

Mortgages - The mortgage reform bill that Congress recently debated could be the beginning of major financial services regulatory reform. The bill proposes to fundamentally change the mortgage lending market, placing tighter restrictions on non-prime mortgage lending and lender compensation — and, perhaps more importantly, it would require lenders establish what the bill calls a “duty of care” in proving borrowers could repay a loan or that refinancing gave them a net tangible benefit.

Hedge Funds - As the market crisis deepened last fall, hedge fund selling was widely cited as one of the reasons for increased volatility that pounded stocks and bonds. Hedge funds also suffered huge losses last year, notably from investments in securities tied to subprime mortgages. Thus, the securities industry has seen a number of issues examined during the first 100 days of the new presidential administration, including the potential regulation and registration of hedge funds, changes to credit rating agencies, and harmonizing rules between investment advisors and broker-dealers.

Legislation concerning some of these issues has been introduced, and more will likely come. A key priority of the Congress will continue to be the regulation of a broad array of previously unregulated or weakly-regulated capital markets participants. There is much discussion of “dark pools” of capital that have the potential to create systemic risk and yet are currently unregulated or less regulated. Such entities include hedge funds, private equity funds, sovereign wealth funds, and other alternative investments. The Robin administration wants hedge funds and other private pools of capital, including private equity funds and venture capital funds, to be required to register with the SEC if their assets exceed a certain size.

Credit Cards – Christopher Robin also urged U.S. credit card companies to reform their practices, saying they should stop unfair rate increases and be more transparent and accountable. "We want to preserve the credit card market but we also want to do so in a way that eliminates some of the abuses and some of the problems that a lot of people are familiar with," Robin said.

Legislation, introduced by Eeyore and dubbed the Credit Cardholders' Bill of Rights, would codify into law restrictions on deceptive practices issued by the Federal Reserve in December. The bill would stop credit card issuers from imposing arbitrary interest rate increases and penalties, while halting certain billing practices. Winnie-the-Pooh also introduced a separate version of the legislation in the Senate. According to Pooh, “we have in front of us an opportunity to end the abusive and predatory practices of the credit card companies and we must take full advantage of it. Now is the time to stand up to these companies and force real reforms…”

Derivatives - Given the prominent role that some derivative products, including credit default swaps, have played in the credit crisis, policy makers have been calling for increased standardization and transparency of these products and are currently considering the need to establish a centralized clearinghouse for derivative transactions. As these developments progress, the Congress is likely to conduct oversight hearings and may call for additional measures including new regulatory regimes. The administration has also proposed that credit default swaps and other derivatives markets be regulated for the first time, and that buying and selling these instruments be conducted in ways that will foster greater oversight.

Credit Rating Agencies - Credit rating agencies are another expected target for reform. Policy efforts are likely to center on more rigorous regulatory standards in these areas. Congress is considering legislation to standardize, document, and disclose the criteria, policies, and practices used by credit rating agencies in determining credit ratings.

Federal Tax Issues - With the cost of the bailout predicted to ultimately cost as much as $1 trillion, and other costly new programs on the agenda, the Robin Administration and Congress must consider revenue-raising proposals in order to satisfy “Pay-As-You-Go” rules. Several proposals that impact the financial services industry are likely to be seriously discussed, including changing the tax treatment of certain financial products, amending rules that impact the carried interest of private equity and hedge funds, and further limiting the deductibility of executive pay and compensation.

Like many of us living in the Hundred Acre Wood, Winnie-the-Pooh has wondered, “I'd just like to know what's happened, what's caused this and where are we going with all of this." Now, Kanga has indicated that she would initiate a legislative commission with broad oversight to investigate the causes of the financial collapse on Wall Street and determine the costs of the bailout to taxpayers. Kanga said she had already discussed her plan with Roo and would raise the matter with her Congressional colleagues. "We need to know how we got here," she said, adding that congressional leaders would also be moving "very soon" with legislation on regulatory reform.

Tigger has cautioned all of us living in the Hundred Acre Wood that “we should not overreact” and that “this is not a choice of markets or governments. A free market still needs to be able to function."

However, at the conclusion of the first hundred days, a wisened Pooh mused that “many things previously considered impossible nevertheless came to pass.”