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P R O C E E D I N G S

MR. BAILY: Good morning. I've just turned off my cell phone, so I hope you will do the same. It's better than one meeting when I castigated everybody for turning their cell phones off and then mine rang twice, which was a little embarrassing. Anyway, not this time.

I'm Martin Baily. I'm the director of the Business Initiative, and I'd like to welcome everyone to Brookings and this event on the designation of systemically important financial institutions, or SIFIs. This is an important step in the financial reform process that we're now going through.

We're going to start with Doug Elliott, who will present his paper on identifying and regulating SIFIs, the risk of under and over identification, and regulation. Then we have a very distinguished panel that are going to discuss this issue.

Doug is probably known to most of you. He's a fellow here at Brookings, working in the business initiative. He's a former investment banker, former head and founder of COFFI, his own think tank, and a very prolific and insightful writer on financial reform issues. He's currently completing his book on federal obligations called *Uncle Sam* -- rather ominously, *Uncle Sam in Pinstripes.*

Doug, thank you.

MR. ELLIOTT: I got to start plugging the book. I forgot to do that. Thank you all for coming here today. And let me just start in.

And there are a mix of people here. Most of you are quite familiar with many of the issues, but not all of you are. So forgive me if I start a little bit basically. That is to say, the Dodd-Frank Financial Reform Act that made such big changes, requires and encourages the regulation of systemically important financial institutions to be different and generally tougher than other financial institutions.

So, that brings up the question we're dealing with today, which is, what is a systemically important financial institution? Now, Dodd-Frank makes part of it easy by simply saying any commercial banking group with at least $50 billion of assets is, automatically, a SIFI. So what we're really focused on today are the non-bank SIFIs because the Financial Stability Oversight Council, which is the council of the top regulators of the financial industry, have been given the authority to expand the number of SIFIs beyond the banks that were designated by Dodd-Frank.

So, if you're going to define systemically important financial institutions you have to have some concept of what systemic risk is. And you have to have some way of measuring it, at least in some subjective manner. And are then setting a threshold to say where does something go from having too little systemic risk to worry about to enough that it should be treated separately here?

And it doesn't help that there are multiple definitions of systemic risk out there. I should mention at this point that pretty much everything in the presentation today follows along from a paper that Bob Litan and I did. He, unfortunately, couldn't be here today but all the good stuff he's at least as responsible for I am, and as usual I've done all the screw-ups here.

So, our definition, which is a little vague, like all the definitions, unfortunately, is what we want to look at are an event or a series of events which would have a cumulative impact sufficiently large that they would contribute to a substantial decline in real economic activity.

I just want to emphasize, in general we don't care that much about the financial sector for its own sake. It's nice if it runs well, but the real reason we care about it is because it can have massive knock-on effects on the rest of the economy. So that's got to be a significant part of your definition of systemic risk. It's not just risk to the financial system, it's risk to the financial system that could translate to harm to the larger economy.

So what are some of the potential sources of damage you could get from a SIFI or a set of SIFIs? The most obvious, probably, is various forms of credit risk. That is, one of the concerns about Bear Stearns and about Lehman and about AIG was that there were a number of parties out there who stood to lose money if those firms went under. They had lent money to them or effectively done the same thing by entering certain types of financial transactions of other kinds besides loans. So, that's a pretty obvious one.

So if a SIFI or a set of SIFIs that go together have created enough exposure in the rest of the financial system, they could knock over other dominoes. But another thing that's at least as scary when things are really bad is so-called contagion effects, which you can look at as -- I mean, it can occur in at least two different ways. One is, just creates irrational panic. In some ways that's a little bit like the classic bank runs, but it could also be rational panic. It could be that the markets have not been scared enough about something like the housing market. Bear Stearns or Lehman runs into significant problems in that area, or Fannie or Freddie does, and the realization of that causes firms with similar exposure to be seen as very scary and creates a run on them.

Now, related to this you could have problems with deposit-taking activities. Here we're talking about what's the damage that could go to the larger economy. If businesses and people no longer can feel comfortable with the money they have in a bank or something they thought of as similar to a bank is good money, that can quickly create problems in the larger economy causing things to freeze up and confidence to plummet.

I list maturity mismatches separately here as an issue because it can easily exacerbate all the other problems. So, for example, later I'm going to talk a little bit about the differences between insurance companies and bank-type financial intermediaries. And a significant issue is, insurance companies generally have longer maturity liability, so they have more time to recover if there's a problem.

And finally, one thing we've also seen is that our increasingly sophisticated financial system relies on certain market utilities that process in all sorts of arcane, back office ways millions of transactions. And that if one of them were to seize up, you could find that things that we're all counting on to operate would cease to operate.

Bob and I also wanted to emphasize that there's an overlapping issue that's not quite the same thing. But that is, very often the problems of financial crises, particularly the ones that are the most severe for the rest of the economy, stem from there being some sort of bubble. So, if asset prices go up well beyond what they -- where they should be, if you also have quite substantial leverage backing that up, that combination can be quite fatal. You can have a situation where, as with housing, people stopped thinking the asset prices should be where they were, and since so many loans were based on that assumption, suddenly you had many, many questionable loans and all of the knock-on effects we had from that.

And this certainly wasn't unique to this last crisis. Research shows this is -- depending on how you measure it, somewhere between half and two-thirds of major financial crises have had this as a major component of the causes for them. So, I raise it here simply to say, as we think about what we need to watch out for, what causes systemic risk, we ought to keep this mechanism firmly in mind, though it isn't the only thing.

Let me briefly go through some of the types of institutions that could be designated as SIFIs. Let me start on this page with ones that I'll call financial intermediaries, though some of the ones on the next page are technically financial intermediaries, but they're not really quite the same.

Here what we're talking about, for instance, are commercial banks. Classic financial intermediaries, they take a lot of money from depositors and financial markets, pool it together, lend it out to the economy, and they do this with a quite high degree of leverage.

The largest commercial banks are already automatically covered as SIFIs by Dodd-Frank. Dodd-Frank also effectively brings in the affiliates of the commercial banks where the groups are large enough, where they're over $50 billion in assets. So many of the affiliates will get pulled in. Because the groups are interconnected enough, there's a concern that if an affiliate went it could have knock-on effects for the bank itself.

Then you have a whole class of things that the average citizen probably thinks of as a bank, but aren't technically commercial banks: savings and loans, industrial loan companies, credit unions, et cetera. They act much like banks do, though they do have some differences, depending on the particular type we're talking about. But they're sufficiently like banks that you can think of them in the same broad category.

Similar, there's finance companies. Biggest difference between a finance company as classically structured and a bank is that they don't really have deposit sources. Instead, they take money from wholesale markets, which adds another level of risk since wholesale money will move away even faster than retail money will.

You have investment banks and broker dealers. Now, the largest ones are all now affiliates of commercial banks. So, the Goldman Sachs of the world are going to be pulled in as part of the groups that are being deemed as SIFIs. But it's important to remember there are actually smaller investment banks out there that haven't affiliated with a commercial bank and, therefore, there's a separate question. In theory, at least, some of them could become large enough or interconnected enough or leveraged enough -- the combination of the factors that you would want to think of them as SIFIs.

And then the last one here I put on this page because they are classic financial intermediaries, but, as I mentioned earlier, they have a quite different structure: insurers and re-insurers. And the ones that are most likely to be considered systemically significant are the life insurers, because they tend to be a lot bigger than the property casualty insurers and they tend to have substantially more leverage. These are institutions that have, in some cases, huge amount of assets, many complicated interconnections with the rest of the financial system, high leverage in terms of maybe having 10 percent capital, which isn't as levered as some institutions, but that's pretty levered compared to a normal company. They have enough of those elements.

On the other hand, they're less scary principally because their liability structure is a lot more solid. But certainly my prediction, if I'm going to be in the business of making predictions, is I suspect a few of the very largest insurers will be designated. We'll see about that.

Then I wanted to list other potential SIFIs here. Mutual funds have been mentioned. There are some mutual funds, particularly groups of mutual funds, that are very large. Now, one reason I made a separate page here is, you'll see both for mutual funds and a lot of the other ones that are grouped on this page, they don't have much leverage, which makes a big difference. They're much more pass-through entities, that they're holding assets on behalf of people, but without -- again, with a classic bank 9 of the $10 that you're holding were what you borrowed as an institution. But if you take, say, a mutual fund, like, say, one of -- I don't -- any of the funds out there. If you take a mutual fund classically, there's no leverage at all, though a few mutual funds have one. And so, that's why, as I say, you could think of it more as a pass through entity, which makes it considerably less dangerous.

There is a special class, though -- the money market mutual funds -- where there's an additional issue, which is, for many retail -- I'll call them depositors -- they really have thought of their money market fund as, while not quite a bank, very similar to a bank. They count on the access to the money more or less instantaneously without what they view as no risk, even though they've been told there is risk. So, that brings up a whole set of issues and it's why the federal government felt compelled to rescue the money market funds as part of the last crisis.

There's hedge funds. Hedge funds cover a very large range of activities. Some of them aren't that different from mutual funds; most of them I would say, frankly, aren't that different. Some have chosen to take significantly more risk and to hold substantially more leverage. Then they could start to look more like a financial intermediary, though there obviously are differences.

You have other fund models: venture capital, private equity firms. And again, I think the thing to think about there is whether they've come to operate much more like a bank or an investment bank or whether, as is the case with most of them, they really are much more, as I said, of a pass-through entity and, therefore, not so scary.

You also have other institutional investors. You could theoretically have pension fund or an endowment fund, whatever, be designated as a SIFI. I'll be surprised if any of them are, but it's not out of the question. They can be very large and quite interconnected with the financial system.

And I've mentioned financial market utilities before. Quite clearly, many of them will be regulated quite closely because it's clear that they're central to how things operate these days.

Which touches on, then, the question: Well, if you're a SIFI, what does that mean about regulation for you? And I group things into five categories. Some of the non-bank SIFIs will be regulated much more like banks. The ones that operate very much like banks, this could make a lot of sense to do that. If that approach is applied to ones that really aren't much like banks, there's a potential for some harmful misregulation.

Second thing is, all the SIFIs will have to report substantially more information than non-SIFIs will. So, clearly there's going to be more information reporting. You could have counterparty exposure limits so that both the exposure of a SIFI to other firms and other financial firms to SIFIs could be limited. You could have activity limits. We already have the Volcker Rule applying to many of the institutions that will be SIFIs.

There's a great deal of authority in Dodd-Frank for the regulators to expand those activity limits considerably. And then capital requirements are also a key part of how traditional financial intermediaries are regulated to the extent that that approach is taken to a wider range of SIFIs. You could find that having a real effect.

A number of the institutions that I listed earlier that could conceivably become SIFIs don't really have very much capital. And in many cases, I would argue they don't need much capital. So this is clearly an area that needs to be thought about.

So, thinking about how they're going to be regulated, then it comes to the question: If you're going to make a mistake in designation on a systematic basis, would you rather not identify enough SIFIs, under include? Would you rather identify too many? Or, as I will argue, there are dangers in both ways. It would really be good to try to get this as a balanced approach.

If you don't include all the SIFIs you should, you're going to find it harder to track all the risk out there in the system, which is a key goal of Dodd-Frank. Also, as I've already touched on a little bit, the regulators will have a lot more influence on SIFIs than they do on non-SIFIs. So, if you have a SIFI that's not designated as such but truly is one, then there won't be the same ability for regulators to act as they would have with other important institutions.

Also, if you are kind of truly a SIFI but not designated that way, you don't have any of the disincentives to take systemic risk that you would have had if you were designated as a SIFI. Because a lot of what the SIFI designation is supposed to do is to cause regulators to try to find ways to limit the systemic risk being taken at these institutions. You also have the risk of regulatory arbitrage, that if, say, a class of institutions are not designated as SIFIs even though they should have been, then you're going to find a lot of institutions wanting to claim to be in that class. Or even without that, that class of institutions will grow at the expense of institutions that were designated. So, you don't want to under-include.

But I would also argue, there are real costs to over-including as well. One that, frankly, I don't put as much weight on, but it is an issue and there are people who see it as quite a serious issue, is the moral hazard problem. There is a serious possibility that people, particularly retail investors, will see the designation of a SIFI as meaning those are the ones that the government would rescue. So, they're in the lifeboat so you might as well be in there with them. We clearly don't want to do that, because that means that you'd have investors and depositors who would stop caring about the risk they're taking because they think it's government risk. And we've seen the kind of problems that can create.

There's also a more subtle danger of a business monoculture. Now, this would only happen if the regulators are not sufficiently flexible in how they regulate SIFIs. But there is a tendency if you're walking around with a hammer to see everything as a nail. So, if, for example, you use capital requirements in most of what you do, there may well be a tendency to apply capital requirements too broadly among the institutions you designate as a SIFI.

If you put everybody into a narrow set of boxes, you're going to give them incentives to act the same way. And so, the analogy is with, say, if the entire Midwest is planted with wheat you have a real danger that if there's a wheat blight it knocks out the whole Midwest. Whereas if you have a range of crops, a range of business approaches, some of them will prove hardier than others.

There's also just in general costs of regulation. And excessive regulation brings costs that aren't warranted -- by definition, aren't warranted by the actual benefit. So, for instance, as many of you know I'm a big believer in higher capital requirements for banks than we had before. But I fully recognize that capital requirements bring a cost and that cost will get passed through, to some extent at least, to the customers.

So, you wouldn't want to create excessive regulatory burden here. You want just the right amount of regulatory burden. If you do things wrong, you're also going to create incentives to warp business models, to have firms that really should officially operate the way that they are now, feel that they have to change the way they operate. For example, to avoid being designated as a SIFI.

Related to that, you could have a chilling or a distortion of innovation, either over regulation that makes it harder for people to come up with and implement good ideas or you could have them put all their energy into financial engineering to try to get around the rules. Speaking as a former investment banker, I'm well aware there's a fair amount of what people call gaming in the system, where you look at the regulatory rules and that influences your behavior. We don't want our finest minds out there putting all their effort into trying to get around the regulators.

So, just a few points in conclusion. I do think identifying and regulating the SIFIs -- regulate them differently than other financial institutions -- could well make the system better and safer. And whether it does or not, it’s required or, to some extent, encouraged by Dodd-Frank.

We need to balance the costs and the benefits as we normally need to do with regulation. In very general terms, I think it’s the highly levered financial intermediaries that present the most risk and most likely warrant the SIFI designation. The pass-through entities that have little or no leverage tend to present lower risk, even if they’re absolutely huge in absolute terms.

So, thank you very much. (Applause)

MR. BAILY: All right. Let me introduce our panelists while they’re getting mic'd up. I should put my glasses on before I do that.

Mike Mussa is a senior fellow at Peterson since 2001. He served as economic counselor and director of the Department of Research at the International Monetary Fund from 1991 to 2001. He served as a member of the U.S. Council of Economic Advisors from 1986 to 1988, and he was on the faculty of the Business School of the University of Chicago from ’76 to ’91.

Morris Goldstein, who is next to Mike Mussa, who is at the far end. Morris Goldstein is here. Morris held several senior staff positions at the International Monetary Fund, including deputy director of its Research Department from 1987 to 1994. From 1994 to 2010, he held the Dennis Weatherstone senior fellow position at the Peterson Institute. He has written extensively on international economic policy and international capital markets.

Brian Reid is the chief economist at the Investment Company Institute. He joined ICI in 1996 and was appointed chief economist in 2004. He leads the institute's Research Department, and oversees all institute statistical collections and analysis of the mutual fund industry. Prior to joining ICI, Reid was a staff economist in the Monetary Phase Division of the Federal Reserve Board.

Oliver Ireland, who is a lawyer at Morrison Foerster, and he focuses on retail financial services and bank regulatory issues. Mr. Ireland was named one of Washington's top banking and privacy lawyers by the *Washingtonian* magazine in 2004, and has been listed in the *Best Lawyers in America* as a leader in the field of banking law since 2006.

Now, thank you all for being here. And we're going to start, I think, with Morris Goldstein.

MR. GOLDSTEIN: Well, good morning. It's a great pleasure to be here and I want to thank Martin and Bob Litan and Doug Elliott for inviting me. It's likewise a pleasure to comment on the themes raised in this very useful paper by Elliott and Litan.

In my remarks I want to focus on three issues: first, getting some international perspective on the SIFI issue; second, size versus other characteristics relevant for identifying SIFIs; and then third, the preferred policy approach to discouraging too big to fail. Not to worry, I have a full five minutes. (Laughter)

In thinking about the too big to fail problem, it is important to keep in mind that the United States is not the only country that needs to deal with it. In fact, a comparison with the EU is instructive on at least two counts. By almost any metric, too big to fail is a more serious threat in Europe than it is in the United States.

For example, if one takes the ratio of the assets of the three largest banks in the country to GDP, where I'm using GDP as a proxy for ability to pay for a large bank failure, the U.S. figures a little over 40 percent in 2009. Whereas the comparable figures for Germany, the UK, France, Italy, Spain, Netherlands, Sweden, and Switzerland range from a little over 100 percent to over 400 percent. Obviously, if we considered Ireland and Iceland and some others, it would be much beyond that.

If you look at the 25 largest banks in the world by asset size, 12 of them -- including the 6 largest -- are all from Europe. The U.S. has four on the list. Yet despite the severity of the too big to fail issue in Europe, they're on the whole doing much less than we are.

That said, Europe at the same time provides, I think, the best example of a serious approach to confronting too big to fail. And namely, I refer to what's going on in Switzerland. They, of course, have two huge banks: UBS and Credit Suisse. UBS lost about 12 percent of risk-weighted assets during the crisis.

In October of last year, a committee of experts appointed by the Swiss Federal Council came in with their recommendations on how to deal with these two huge banks. Inter alia, they recommended a total capital requirement equal to 19 percent of risk-weighted assets, 10 percent of risk-weighted assets has to be in common equity. The other 9 percent of risk-weighted assets can be in contingent convertible bonds.

So this is much tougher than what was agreed under the Basel III agreement just recently. And to my mind, it torpedoes the notion that it's not feasible to implement a minimal capital requirement that is much tougher than your G-20 counterparts. And I would encourage the U.S. and the UK to follow Switzerland's example.

As far as determinants of SIFI eligibility go, by now everybody agrees it shouldn't just be size alone. It should be interdependence, concentration, performance of systemically important functions, et cetera, et cetera.

That said, when analysts actually make up hypothetical lists of SIFIs using these multiple criteria, it turns out they're very highly correlated with asset size. The ECB, for example, in 2006, 2007, used 19 indicators to come up with a list of the systemically important institutions using all the usual suspects to -- of criteria. And they are squared between that and asset size was .93, for example. So I'm not saying that's the only thing that counts, but asset size takes you a long way.

Last and finally, let me just say in terms of the overall approach to SIFIs, I'm for a belt and braces approach. That is, very comprehensive because I think no single measure is going to be effective enough or saleable enough to do the job. Hence, my list includes the following: a capital surcharge for SIFIs, mandatory wind-down plans, special resolution authority for all SIFIs as in Dodd-Frank, explicit size limits based on asset size relative to GDP, mandatory CoCos to supplement high equity, common equity requirements, imposition of the Volcker Rule, and giving home country supervisors greater power to impose tougher local liquidity requirements on branches and subs of foreign banks operating in their territory a la the Turner Report.

Let me stop there.

MR. BAILY: Thank you, Morris. Our next speaker -- excuse me -- is Oliver Ireland. Oliver.

MR. IRELAND: Thank you. It's a pleasure to be here and an honor to address this issue.

I may come at this from somewhat of the other end of the spectrum on SIFI designation. Before going into private practice I spent 26 years with the Federal Reserve, 10 out in reserve banks, and 15 at the Board in Washington. And a lot of those years were spent thinking about dealing with systemic risk and how to address it. And quite frankly, I think that the regulatory tools to address or prevent the recent financial crisis were all there, if they were used appropriately.

I think people make mistakes. And I think the SIFI designation concept is really a redundancy concept. It suggests that if we have multiple eyes looking at the same issue, perhaps multiple regulators in addition to the functional regulator. The Fed is an umbrella regulator looking at it that we're going to prevent the problem.

In the banking world we had multiple regulators. It fared somewhat better than some of the other areas, but it's by no means clear to me that sort of herd behavior is necessarily going to be better than good judgment by an existing regulator.

Number three, I think you need to coordinate in thinking about SIFIs, how the macroeconomic response plays out, and how it affects the risks to individual institutions. I think in the recent crisis there were failures by the Central Bank in deploying the tools it had to stabilize markets in 2007. And that if those tools had been deployed with the ingenuity they were deployed a year or so later, we would have had a much less severe crisis. And with a less severe crisis, the other regulatory concerns, I think, are -- should be lesser. In effect, you already had redundancy and ways to address it, and the redundancy failed.

Beyond that, I think you fall into two sort of broad options in SIFI designation. And we've heard one, which is size-based. And if you take a size-based approach, which the United States has taken a number of times in the past, you wind up dealing with a lot of entities that aren't really financial entities but may be affected and may be perceived as having a major effect on the economy.

When I was at the Federal Reserve Bank in Chicago in the late '70s and early '80s, the government bailed out Chrysler. And one of the theories of bailing out Chrysler was you were going to put too many people out of work and it was going to cost you more to deal with the consequences of that from the government side than it was going to cost you to bail it out. And if you take a very broad view, you're going to start picking up all kinds of people that other people would not ordinarily think of as SIFIs.

I think that the real risk in financial markets -- or two. One of them is counterparty credit risk. I think that's relatively easy to deal with in traditional supervisory models. It isn't always going to work. The models have to work, people have to have counterparty credit risk procedures in place, and they have to be enforced.

The other is panic. And panic, I think, is the characteristic of our more severe crises. It's harder to get over the panic, you have to restore confidence in the economy. And so when you see events of major panics -- the Great Depression, recent events -- you see a longer recovery time than you see for shorter term credit events.

And the panic, I think, essentially effects most strongly bank-like institutions. By "bank-like institutions" I mean institutions with short-term liabilities and hard to value assets. And people easily lose confidence in those institutions and create bank runs even post-deposit insurance. At Continental Bank we saw a wholesale run in 1984. That can happen again.

I think those institutions should be the focus of SIFI designation. That the exercise should be trying to identify those financial entities out there that are large and combine the hard to value assets with the risk that their liabilities will disappear if there's a loss in confidence. And that that's where the most productive use of the designation would be.

One final closing point on size. We talk a lot about too big to fail. A lot of that, I think -- I prepared to focus in on that. Maybe that's just the first time I heard it, in Continental. But I think it is perfectly possible -- and we've seen examples of it -- of panic spreading through asset classes. We saw it spread through asset classes this last time around and through types of institutions. In sort of a statewide sense, we saw it in the Maryland and the Ohio thrift crises in 1985. And that loss of confidence can happen to smaller institutions.

It's not clear to me that we're that much better off dealing with hundreds of little institutions that have problems as opposed to a smaller number of larger institutions.

Thank you.

MR. BAILY: Thank you. Our next speaker is Brian Reid.

MR. REID: All right. Good morning. Thank you again for the invitation.

I'm going to begin my comments in a similar place where Ollie did, and that is to make the simple point that regulators had a large and powerful toolkit to deal with the financial market risks before the passage of Dodd-Frank. Nevertheless, the Act provides regulators with an expanded set of regulatory and oversight tools, and including those that are going to give them authority to address risks posed by financial institutions and activities generally. Furthermore, the council of -- the FSOC is in a position to influence the oversight through its interactions with the primary regulators, including, but not limited to, Section 20 of the Act, which provides the authority for the council to recommend heightened standards and safeguards to be applied to potential activity or practice.

So today's paper largely focuses on one aspect of this. And probably the biggest and most powerful regulatory, that is Section 113. And this section directs the council to identify systemically important, non-big financial institutions. And other sections of the Act give the ability to apply extraordinary degree of prudential oversight and broad-ranging, risk-mitigating remedies to such designated entities.

From my point of view, this tool is more like the proverbial hammer rather than a scalpel, and should be used sparingly. Judicious use of the authority is also consistent, I believe, with a legislative intent.

One thing that I should note and that is the legislation doesn't require a formal process, per se, such as a cost-benefit analysis to make the determination that something is a systemically important institution. And yet nevertheless, I think having a structured framework that identifies the risks of an institution or activity and the remedies to address those risks, and weighing the risks and benefits is an important part of that process. And the council should first exhaust, obviously, all the available tools that it has to its disposal to address those risks before it believes an institution should be a Section 113, that is, a systemically important financial institution. In fact, I think the worst scenario would be is to sort of have the regulators write rules to sort of single out particular firms that have some a priori designation in their minds rather than determining what those risk are and best determining how to address those risks.

I think another reason to have a formal process in place is to avoid over-inclusion, which would have, I believe, adverse consequences on the market; in some cases, even potentially increase the systemic risk. So one that has already been raised is one of moral hazard. And the prime example, of course, is that too big to fail that comes from that.

But I think there are other less obvious but equally insidious effects of moral hazard. I'll give you an example. By applying Section 113 too broadly, regulators could muddy the waters of legal obligations and the rights of investors. For instance, requiring asset managers to hold capital could cause market participants to mistakenly believe that the advisor to a fund or a pool, such as a pension fund, stands ready to absorb potential losses in the portfolios it advises. And Congress has clearly indicated that it wants a better alignment of risks and rewards within the market and requiring capital where not appropriate would move in an opposite direction of realigning those risks and rewards.

The ICI has put forth sort of a framework for analyzing sort of the designation, at least identifying the risks. And as many have indicated, we have not -- we have indicated that there is no one single factor in isolation that is sufficient. Clearly, have looked at indicate that size is important. But it's really not the size, per se, but the size of the risks that's on the balance sheet of the entity.

In fact, within the legislation itself, within the Act, the -- Congress indicated that managed assets have a very different risk profile than one in which there is a great deal of leverage, because leverage in and of itself will really magnify and multiply a problem as it begins to feed through the rest of the system.

Interconnectedness is also important. But I think a couple of other factors that are important to keep in mind, and that is sort of the nature of the company's assets. Liquid assets provide much less of a problem in terms of pricing and understanding and the transparency. So, for instance, a portfolio of Treasury securities or equities that is being held by a pension fund or mutual fund, for instance, can easily be sold in deep and liquid markets and pose very little risks.

And also, the transparency of that balance sheet. A financial firm is much more likely to pose a threat to the overall economy if its assets and liabilities are difficult for market participants to evaluate. And so opacity is difficult for creditors than to monitor their -- the financial institution's health and well being.

So once these risks have been identified, the next step is really to determine how to address them. And as I have earlier argued, this process -- that identifying those risks is the first step. The next important question is the degree that existing regulation is there to address these risks. And if further regulation is required, what is the most effective remedy to address those risks?

This thought process should occur before an entity is deemed to be a systemically important institution. And I believe, in fact, this process -- if there is a structure around it, will increase the likelihood that regulators will achieve that sort of Goldilocks solution that's in the title of this panel.

Thank you.

MR. BAILY: Thank you. Mike Mussa, we lost your microphone. Probably don't need it, except are you probably recording this session?

SPEAKER: Sure. But we'll see if we can reconnect you.

MR. MUSSA: Disappeared from its clip. Just a second.

MR. BAILY: We would have been more than happy to provide, pass over a glass ---

MR. MUSSA: Usually there's somebody from the Federal Reserve who is more than anxious to distribute liquidity, but I guess Ben isn't here today. (Laughter)

SPEAKER: All right, I think.

MR. MUSSA: The thing that I found most useful in preparing for this session was actually watching television the last couple of nights and observing the Westchester Kennel Club Dog Show, the ultimate outcome of which was to pick the Best in Show dog, which we can think of is much like picking what is the systemically important financial institution? Now, I could sort of understand how judges could judge what was the best cocker spaniel or the best Chihuahua. When it got to judging between the deerhound and the cocker spaniel, I thought, gee, they're both dogs biologically, but this is not a particularly sensible undertaking. And I've a similar concern with the concept of the systemically important financial institution, more so actually in the paper, in some sense, than in the comments from -- around the table.

In order for that notion to be useful and meaningful, obviously the lines can't be clear and bright in all instances. But it ought to be the case that there is some centrality of meaning so that those institutions that are "systemically important" have more in common with each other than they do with institutions that are not so designated. And I can see applying to commercial banks and other depository institutions this notion.

And I buy Morris' and other comments on the relevance of size in this regard. But it just seems to me that a mutual fund, even a money market mutual fund, and other insurance companies, so forth, are sufficiently different as institutions. To try and have a uniform concept or reasonably uniform concept of systemically important financial institution is undoubtedly a mistake. And the fact that Congress has mandated it is, I believe, the ultimate proof that it's a mistake. (Laughter)

Now, this does not mean that one should not apply a higher standard of scrutiny to large or potentially more dangerous institutions. But I think that this was true before and is true now. And whether there should be higher capital standards for such institutions is, I think, an interesting question as applied to individual classes of institutions like banks. And I think probably for larger systemically important banks, a higher standard of capital is important. But it needs to be applied in a quite different way, since the complexities of the balance sheet of JPMorgan Chase are considerably different than the complexities of the balance sheet of a bank that has $50 billion of assets or a bank that has $500 million of assets.

But surely, we want a higher level of scrutiny on those very large institutions whose individual problems might become by themselves systemic. And I think -- as I said, I think it's appropriate to do that. But having a general definition of what constitutes a systemically important institution and trying to get the whole range of them into the same definition, as I say, is just a mistake. And what I think the committee should say to the Congress is, this is a mistake and we're not going to do it.

Next point, which was also raised by other panelists. The legislation and the need of international standards and agreements gives particular meaning to this notion of systemically important and how it will be applied. But there's a more general notion of too big to fail and moral hazard and other issues. And here I wanted to reinforce a couple of comments that were made by other members of the panel.

First, we can get into a lot of financial trouble from small institutions as well as big institutions. Now, I don't know -- because it depends upon how it was defined. And I assume home savings and loan probably would have met the criteria. But if you go back to the savings and loan crisis of the 1980s, most savings and loans would not have been systemically important financial institutions. But we had a systemically important mess on our hands. So, we don't want to think that if we deal with the systemically important institutions we've then dealt in some serious way with potential systemic problems. That's an illusion. And the savings and loan crisis is not, by any means, the only example of that.

When President Roosevelt declared the bank holiday in March of 1933, 25,000 banks went on vacation. Six thousand of those banks never returned. They were almost all small banks. So, you can get into a lot of difficulty from smaller institutions and systemic risk is not uniquely related to the larger, more systemically important individual institutions.

Too big to fail is, in that regard, I think a problem. But it is by no means the only problem. And I think the attention that has been devoted to this issue in many recent policy discussions has substantially exceeded its practical importance. Again, I go back to the savings and loan crisis. The same thing that -- to an important extent, not exclusively -- motivated the special incentives and so forth that were provided to the savings and loan industry.

It is very much the same philosophy that promoted the GSEs. In fact, the death of the savings and loan industry, to a considerable extent, as a special thunder of housing in the U.S. helped to promote the role of the GSEs in that regard. And particularly in the eyes of Congress that gave a sort of increasing latitude to the GSEs to expand their activities in that area.

We will not solve that problem by creating -- by re-creating the S&L industry with a larger number of smaller GSEs. That's not going to do it. So long as we continue to subsidize that industry by providing disguise subsidy to risk-taking by those who write mortgages. We're going to recreate the difficulties which we've now seen twice materialize in the last 30 years.

So, systemically important in the sense of, yes, special scrutiny for big institutions and probably higher capital standards for banks and similar institutions. But the notion that this is the be all and end all of improved financial regulation? Certainly not.

MR. BAILY: Thank you. Maybe we can try and clarify a little bit what the differences are and what the similarities are? In the sense -- Mike's last comments was that designating SIFIs is not the only thing that's going to save the financial system next time around. But at the same time, you seem consistent with the idea we should have some special designation.

So let me just sort of throw this back to the panel. Can you help us sort of clarify this? Is it -- we shouldn't be doing this at all? You think we should? Or you don't think this is the only thing that we need to do, though, right? Can I ask you for a sort of response to some of the comments on the rest of the panel?

MR. GOLDSTEIN: Well, I don't think it's the only thing we ought to do. I think it's an important thing to do. I would not have done the 50 billion -- you know, I would have tried to make up the list of the 30, 40 bank and non-bank institutions, or whatever number it is, that have similar characteristics and gone in that direction. So I don't think we need to apply it -- I don't think we need to lump together the Chihuahuas and the deerhounds, to use Mike's terminology.

But I think we ought to do that. It's true, you can have -- you know, crises are of many different kinds. And you can have them with small institutions, you can have them in asset classes. But that doesn't, for me, eliminate or weaken the argument that we also ought to have it for the -- we ought to have special attention for the very large institutions. Ninety percent of the losses in this crisis were in the -- really in the larger institutions. So, I think you got to take a lesson away from this very severe crisis that we had.

But, you know, regulation has lots of other things. I was, as I implied, disappointed about Basel III. I think the minimum cap requirements that came out of that were about half of what we needed. So, the fact that we didn't get more there makes me think, you know, we're going to need a surcharge on SIFIs that ought to be not trivial.

But there's lots of other aspects of regulation. You know, the regulation derivatives of the market, resolution authority. One could go on and on, compensation reform, et cetera, et cetera. So, I think this is an important component. I'd like to see more done than we have thus far. But I would stick to institutions that are roughly similar. As I said, I wouldn't have done the 50 billion thing. I think that's a little bit too wide.

MR. BAILY: The 90 percent includes Fannie and Freddie? Or -- when you say 90 percent of the losses were in large institutions.

MR. GOLDSTEIN: I think this is worldwide --

MR. BAILY: Oh, this is worldwide. Okay.

MR. GOLDSTEIN: This is out of a Bank of England calculation. I think they did worldwide. So I don't know whether Fannie and Freddie are in there.

MR. BAILY: Because a lot of the bad mortgage loans were originated in smaller institutions, right? I mean, they may have ended up eventually in --

MR. GOLDSTEIN: Yeah. But, you know, when you add your UBS and your RBS, you'll get up to a big number and most of it will be from large institutions.

MR. BAILY: Oliver or Brian, do you have responses to what's been said?

MR. IRELAND: Yes. I agree with a lot of what Mike said. I, however, took as a starting point that Congress passed this legislation and that we're going to deal with it. And that as a political reality, the Financial Services Oversight Council appears to be bound and determined to go ahead with designations at a more rapid pace than --

MR. BAILY: Would it affect you, though? I mean, presumably if you don't think it was a good idea to begin with, you should maybe minimize the number you designate? Or would that not?

MR. IRELAND: Oh, I would minimize the number I would designate. I think that most of what this bill does is benefit lawyers, which I guess I can't object to too much.

But more fundamentally --

MR. BAILY: Everything we do seems to benefit lawyers.

MR. IRELAND: -- they should have, I think, the focus on getting functional regulation or regulation of regulated entities right and making that work. I think there were some gaps there and there were some mistakes that could have been addressed much more particularly. And I also think that updating the Central Banks' tools to deal with problems in the private markets would have been a good idea, though they didn't touch that at all. In fact, rolled back some of the Central Banks' authorities to deal with crises, which in a way that concerned me somewhat.

So I think you could have gone at this much more targeted way under the existing regulatory structure. And I think that the concept of SIFIs itself is probably a mistake and that the moral hazard alone, let alone the other problems, is, in the long run, going to be counterproductive.

MR. BAILY: Do you want to add?

MR. REID: Yeah. I would echo both Mike and Ollie's points. The first is, is that, you know, if there are a set of risks that financial institutions or a group of entities pose, the first place you want to look is, well, what are the tools that we have? What are the resources that we have to contain those? This designation process seems to be sort of starting down the road before it really asks that first fundamental question.

And then once you've asked that question of what the risks are, then what are the remedies? And thinking again is, what are the remedies that are in place that the regulators -- the functional regulators can put in place? And so I think that is really in line here. And to try to sort of begin to designate a number, I think, is really the cart before the horse.

And my concern generally is that we are going to convince ourselves that we have fully identified all the risks and then something is going to come up, because we are human beings and we can look back very well and try to write rules around to prevent what happened in the past. And something is going to arise in the next 10 or 15 years that we did not anticipate and then we're going to wonder why we didn't catch it.

And rather than sitting and looking and to say, okay, there are risks in any financial system, there are risks in any economy, let's try to manage those risks as well as we can, but to begin to put this sort of wraparound label on that sort of artificially sort of taps somebody on the back and says you're it, I don't think is a very productive way of going about and trying to address the risks that are out there.

MR. BAILY: I'd like to get Doug involved. In fact, I'm sorry he's not up here on the panel, really. But can you give a response to some of these comments? And in terms -- both in terms of the SIFI designation and the international issue was raised, also. If you could comment a bit on both of those.

MR. ELLIOTT: Sure. I mean, first of all, I thought it was a very useful set of comments presenting a range of views on this. So I don't -- I agree with quite a lot of what was said, but obviously not everything.

I think one of the central points of debate is to what extent are there a set of particularly dangerous institutions that kind of per dollar of size, or whatever set of measures you use, represent more risk than the average? Because I think we can certainly all agree that it's possible for small institutions collectively to create very large problems. So, some of the examples given, I think, are good examples of that.

And frankly, if you look at what happened with the small banks in this crisis, in percentage terms some of them made huge mistakes. And there are enough of them there are big numbers when you add them up. So, we know that. But then Congress clearly felt, though, that the largest and most interconnected banks represented more risk than simply -- there was kind of an exponential risk created once you crossed some threshold. And they'd like the regulators to figure out what that threshold is.

Now, I think it's hard to do. I certainly agree that there's an issue that you have different types of institutions you're trying to compare. But I don't think its' a crazy thing to be trying. I think it's actually a useful thing to try, even if there may be some problems in the execution.

I'd also touch on -- I mentioned in the presentation that I was less worried about the moral hazard issue than some others, including some on the panel have indicated. Let me just say a reason for that is, first of all, I'm assuming that the designations will be more on the modest side rather than completely sweeping. If I'm right about that, I think you'll find that the institutions that are designated are virtually all ones that the markets already assumed would be rescued in another severe financial crisis. That is, I think we already have the moral hazard problem in almost all those cases.

So, I'm not that worried about having it seem a little more formalized. I'd love to get rid of the moral hazard problem, but I don't see that we're going to accomplish that.

In terms of the international comparisons, I agree if you think of SIFIs and too big to fail as largely the same issue, certainly our too big to fail issue is not nearly as bad as that of Europe. And I've been spending a lot of time talking to people in Europe about this. And frankly, as everyone on the panel knows, a big reason they're not going to do anything is because these things are so big that they can't figure out how to deal with it without dramatically changing their systems in ways that are politically infeasible for them.

We've at least got this sort of more borderline case where the SIFIs aren't quite as bad a problem. Again, there are different solutions that could come to mind on the basis of that observation. I would agree with one of the comments that several people made, including Michael. I think, while too big to fail is an important issue, it's gotten a lot more press than it actually deserves.

I think there are many people out there who think too big to fail is half of the problem. I suspect it's 10 percent or something. I don't know how to put a number on it. It's an issue we ought to take seriously, but if we got rid of it we'd still have a lot of other issues to be concerned about.

MR. BAILY: Let me go back to you, Mike, for a minute because you took a pretty strong position. You said Congress has told you to do this, but don't do it. You know, tell them to get lost. Now, supposing they go ahead and do it anyway, which I assume at least until 2012 is probably what's going to happen. What would be the bad consequences that flow from doing this? What are you afraid of that would happen?

MR. MUSSA: Of course it depends on what they, in fact, do. I think what would concern me was if they spent a lot of time and staff effort attempting to define in some comprehensive way what is a systemically important financial institution across a very broad array of very different institutions. I think that's simply a mistake.

They have been told by law banking organizations -- and when we say things like banks that have more than 50 million -- are systemically important. I think that's too low a threshold for my --

MR. BAILY: What's the cost? What's the downside here? What's going to happen?

MR. MUSSA: Well, what needs to happen, in my view, is that those primarily responsible for the stability of the financial system need to focus their primary attention on that issue. Or at least a key part of it.

Now, you know, we're told that, well, no one had responsibility for systemic financial stability. Bullshit. I mean, why do we have a Central Bank created under the panic of 1907 that was further empowered after the Great Depression and so forth? It's their key job to diagnose when there is a major threat of instability in the financial system that might seriously destabilize the economy. And they failed miserably to do that and have not been held to account for that failure.

Now we've got this systematic panel, somewhat broader, that could be useful. But that's what their job is, to figure out when it is that we might be getting into systemic difficulty, whether it's because of some large institution or some group of small institutions or from some other cause. I mean, in this country we don't peg the exchange rate, so we don't have to worry about that issue. But that's been an important cause of systemic difficulties in many other countries around the world. You need to figure out, you know, when are you digging yourself into a deep hole. And neither we -- and I would add, the Europeans, I think -- did a very good job of that. And that's where the accountability, I think, needs to be.

And I see this as a potential diversion. What we need to do is figure out what's a systemically important institution. I'd say, no, that's not your job.

MR. BAILY: Okay. So the problem here is that it's a red herring to the main task.

MR. MUSSA: Well, it could be a serious diversion and distortion of what they really should be focusing on most importantly.

MR. BAILY: Brian, can you comment on that? What's the cost going to be to institutions? Supposing we do this and we over-designate, for example? What problems is it going to present?

MR. REID: Sure. So, first of all, I think, as Mike has pointed out, this risk of all this attention on one aspect of trying to address and manage the risks in the system. If it gets devoted there it really takes the attention off other places; it's going to rise. And everyone has listed ways in which, you know, risks can rise up in the system and actually put the financial system at risk. That may not be anticipated now, and that is a distraction going on.

I think the other problem is that if you have this sort of over or broad designation that, you know, the rules for a systemically important financial institution and what to do about them, there's a certain prescription within the act itself. And that prescription of capital may not even be the right prescription for addressing the issue.

And I think that, you know, while there is some wiggle room in some portions of the Act that can give some discretion, I think that, you know, the real issue is, what are we worried about? What are the risks there, and what are the tools that are available to address those risks? And let's apply those rules as opposed to some kind of wet blanket on top of the entire financial system?

MR. BAILY: Well, one of the things that I -- maybe you're saying this implicitly, but one of the things I'm not hearing is that somehow SIFI -- this whole structure of SIFIs will make it difficult, will make for an unlevel playing field in the financial sector or will make it difficult to compete globally. Is that a concern of the industry?

MR. IRELAND: Oh, I would think absolutely. I think that an efficient financial system is, first of all, key to a market economy. Number two is that the U.S. economy is not an industrial economy anymore. It's increasingly service-based.

The financial system has been a leader -- a world-leader in innovation. And the SIFI designation by itself may not do it, but the mindset that creates -- would follow a broad SIFI designation -- of course, it depends on what they do -- could start to hurt the U.S. as a leader in financial services. Hurt the U.S. as the dollar is the reserve currency of the world, and could have very serious repercussions for the economy in the long run.

MR. BAILY: Okay. Mike, I acknowledge you in a second. But we know that the UK is making changes. We know that Switzerland is making changes. Aren't other countries also responding? I mean, shouldn't we at least --

MR. REID: I regularly give --

MR. BAILY: -- make sure the U.S. is keeping pace?

MR. REID: I regularly give thanks that other people are doing worse than we are. (Laughter)

MR. BAILY: Okay. Mike, you had a --

MR. MUSSA: Yeah, I just wanted to reinforce that I think this is where the diversion of interest and attention is really going to come, that there's going to be enormous pressure from the various lobbies. Our class of institutions is disadvantaged relative to your class or relative to foreigners or so forth. And the regulatory authorities are going to be deluged with complaints about relative cost competitiveness. The Congress is going to be continually petitioned on this issue. And so all of the attention is going to focus on that subject -- who is being relatively advantaged or disadvantaged by designating particular institutions as either yes or not systemically important and imposing this or no restriction on their behavior -- rather than on the question of where is there really potentially important systemic risk developing in the system?

I think that's what we saw before. I mean, the whole controversy over Glass-Steagall and all the rest of it didn't focus on the question of the implications of Glass-Steagall for systemic financial stability. It focused on the relative competitiveness positions of the securities, brokers, insurance dealers, God knows what. And you know, of course, produced hundreds of millions of dollars of campaign contributions to Congressional races for 40 years. But I don't necessarily consider that a public good.

MR. REID: I guess -- can I just jump in, too, and just say that, again, when you have this sort of mono-designation you're going to get mono sort of approaches to solutions. I'll give you one for Basel III.

Basel III is clearly going to elevate the amount of sovereign debt that banks have to hold to meet their liquidity and capital standards and whatnot. I would raise the question if we have not just set up in stage and put in place for the next financial crisis down the road.

MR. BAILY: I want to throw it out to the audience. A couple people, I want to see if they want a chance. One is -- they can refuse to speak, but one is Charles Taylor, who is the executive director of the Pew project on financial reform. And the other one is Don Kohn, who may or may not want to say anything, who is -- was former vice chair of the Federal Reserve.

Do either of you guys -- Charles, do you -- would you want to make a comment on -- oh, okay. Don’s got the microphone. Don, why don’t you start us off?

MR. KOHN: So I’m glad to say I agree with Doug. I think this is a non-trivial issue, the business of the systemically important financial institutions. And if I think about -- and I agree that it’s possible that it would -- there’s an opportunity cost dealing with these things, deflecting attention, but I think it’s going to be paid at the beginning of the process. And there are years -- or a long time to get the rest of the supervision right.

And I do think -- because I think through the crisis that when it came to Bear Stearns and Lehman and AIG, there was something different about those guys that accentuated the crisis. It wasn’t just another firm going down or another firm in trouble. So, I do think there was something a little different. And it’s worth spending a little time trying to figure out which ones are so critical or so interconnected or large -- and I agree, you can't apply the same criteria to all different kinds of institutions -- that that will make the system a little safer and a little more resilient. It's not the whole answer, that's for sure. But I think it's worth trying to do and do right.

There are classes of institutions that are -- still worry me, Brian, like money market funds. They were a very important source of systemic risk in the fall of '08. And in my view, the SEC has only taken a small step towards correcting that. Now, they're not individually perhaps not systemically important, but that's a class of institutions that needs more attention. And there are other classes of institutions out there. There are classes of transactions, like tri-party repo, that needs more attention.

MR. BAILY: Thank you. Charles?

MR. TAYLOR: Thank you, Martin. Yes, I would agree with Don's last comment that there are classes of instruments, and financial transactions are an important part of the puzzle. But it feeds into Mike's point that, basically, I think Morris' point that it's only a small percentage of the problem, the systemic risk problem, if we address SIFIs as well. We've still got an awful lot else to do.

A couple of quick observations, I'd say. I think the point was made that small institutions -- having a group of small institutions go south could be just as damaging as having one large one. And while I agree with that, I think it's worth thinking a little bit more about that, and I'd raise the question whether we shouldn't really look at and consider how we could generally increase the diversity of the financial system.

So, I think if you compare one large institution with a hundred little ones, sort of Ma Bell and the Baby Bells, or one GSE and a hundred little GSEs, sure there's not much to tell between the two of them. But, on the other hand, if you think about a hundred small diverse institutions with different portfolios of business, with different geographic coverage, with different sorts of risk, different kinds of response functions to any particular perturbation, you may get a lot of systemic resilience out of that compared with having one large institution conducting a similar package of business in toto. So I think we should acknowledge that it's possible to have diversity if you have relatively small institutions, and that being an advantage for the system stability as a whole.

The second point I would make is this sort of underlying assumption, I think, in Doug's paper and in much of the discussion is that it has to be a very sharp distinction between being designated and not being designated. I think given the type one and type two errors that Doug talked to, one of the things we should think about is how small a distinction that can be. Obviously, since we want as institutions get more systemic, to put them under greater scrutiny and tighten up micro-prudential regulation, at some point or with some gradual increase as you pass this threshold you'd hope to see the intensity of regulation increase.

But actually, at the threshold -- let's suppose, just for the sake of argument, it was $50 billion -- being an institution, a bank of $49 billion and being one of $51 billion, not designated and then designated, it shouldn't be such a big deal. It should be that the regime you are under in the hands of the OCC, let's say, is very similar to the deal -- the regime you're under in the hands of the Fed on either side, whatever this threshold is. And then as you become more interconnected, as you become more complex and so on, then regulation (inaudible) oversight can become more intense.

MR. BAILY: All right. Is there a lot of potential questions from the audience? Let me throw it open and see there is. Yes, a question here.

SPEAKER: What do you think the rule --

MR. BAILY: Wait one second. Could you identify yourself?

SPEAKER: My name's (inaudible).

SPEAKER: You're fine, go ahead.

SPEAKER: I guess my question was, what do you think of the role of aligning risks (inaudible) of management with shareholders? And what do you think claw-back provisions might do, whether it's a small institution or a large institution in cutting down on risk-taking?

MR. BAILY: The aliens have landed. I don't know.

(Laughter)

MR. IRELAND: Can I address that comment? Because we started to see -- or I first started to see that in the mid-'90s. That talked to banking institutions about how they compensated traders. And they would say we have a program in place because we like traders to make more money, but we don't like them to make more money by taking more risk. And that -- I think that makes sense.

I think it's very easy to go down that road into a very prescriptive set of rules and get yourself very, very little in terms of reduced risk in the financial system, recognizing that you don't want to get rid of all risk. You're just trying to control unnecessary risk. But there are, in certain cases, compensation and return rewards, including in stock price, for example, that are relatively short term and you want to look at longer term performance in evaluating people. I don't think that was the cause of the recent problems.

MR. BAILY: Other questions? Yes.

MR. LEVINSON: Hi, I'm Mark Levinson. To what extent -- it's a question, really, for Doug Elliott. To what extent should companies whose business is primarily not financial be designated as systemically important financial institutions? What criteria should be used?

MR. BAILY: Can I -- I think we've pretty much run out of time, so maybe I'll run through everybody. I don't know, Doug, do you want to give your last words and answer the question? And then I'll ask if the rest of the panel have final comments.

MR. ELLIOTT: I'm not sure I do have final comments, so I'll just briefly answer that question. If they really aren't primarily financial --

MR. BAILY: I'm not sure that microphone is on. So why don't you --

MR. ELLIOTT: I'll just speak loudly. If they really aren't --

MR. BAILY: I think they may be recording this, though. So, let's --

MR. ELLIOTT: Sorry. If they really aren't primarily financial, they shouldn't be designated. How you make sure you achieve that outcome gets into very technical things we don't have time to go over here. But I think everyone agrees on wanting that outcome. It's just the details that can be hard.

MR. BAILY: Morris?

MR. GOLDSTEIN: Well, just in brief. I'm not worried about diversion of supervisory attention to the SIFI problem. I'm not worried about loss of competitiveness of world-class U.S. financial institutions. I am worried about the kind of things that happened during this crisis when we're talking about CitiGroups and UBSes and RBSes and Goldman Sachses and the like. I think you need to do something about that. Dodd-Frank is far from perfect, but in my view much better than the very light touch regulatory stuff that was an alternative.

MR. BAILY: Thank you. Oliver.

MR. IRELAND: I think SIFI designation is a reality. We're going ahead with that. We have seen the Financial Services Oversight

Council come out with two rulemakings already on SIFI designation.

These rulemakings are unique, in my experience, in that we have learned almost nothing in a public sense as to what their designation criteria will be. I think that if you're going to engage in this exercise, greater transparency would be beneficial. I get calls from institutions that, to my mind, could not remotely be considered SIFIs but are concerned about that because of the broad general statutory criteria out there and FSOC's apparent inability or refusal to further define those criteria. And I think it would be desirable for them to go through a public transparent process to further define those criteria before they start designating people in what may appear, at that point, to be an arbitrary manner.

MR. BAILY: Brian.

MR. REID: So, I think just to kind of clarify the main points that I was trying to make. I think process is really important. And process because each one of these identified either systemically important institutions or activities may have a set of remedies that may not be universally applied to all of these entities.

To Don's point, I mean, there is an opportunity cost up front. I would hope that regulators don't get so distracted by trying to do this that we don't address other issues that are clearly out there. In other issues that have a means and a process to begin to take care of those and address those risks, because I think if that is the case, we will leave some of these other issues unattended to and unaddressed. And so, really, the goal here is to try to identify these and find -- and use tools and processes in existing institutions to sort of take care of those risks that are in place.

MR. BAILY: Mike?

MR. MUSSA: Well, I want to mention something which has been kind of under the table. And that is, after all, the point of all of this is not to protect systemically important financial institutions or financial institutions in general. It's to protect the rest of us from them. That's what the issue is about. And in that regard, the fact that a number of, I think, inappropriately managed financial institutions, including some large ones, took some very big and inappropriate risks and took some enormous losses is not a bad thing. They got, in some sense, what they deserved.

The problem is that the spillover effects of that to the rest of the economy have been not good. And I can say, as a shareholder, in some of these institutions, well, I took my losses. But I resent the fact that the rate of return I earn on my money market savings has been reduced from 5 percent to 0 because the Federal Reserve has felt compelled to liquefy the system in order to bail out the people who took excessive risk. Still irritates me to find this and I think we want to focus a little bit more on that.

The purpose of regulating these institutions is not so much to protect them from themselves, but to protect us from them. And part of the way of doing that is making sure that when they make mistakes, they pay the cost of those mistakes. That's what gets them to behave in a generally socially more appropriate manner, if they rather than somebody else is absorbing the cost.

MR. BAILY: Good. Well, I think, Doug, you did make that point that -- protect the rest of us.

MR. ELLIOTT: Absolutely. It's on page 1 or 2.

MR. MUSSA: Yes, it was. But it got lost later on.

MR. BAILY: Thank you to the panel, which I think has provided a terrific discussion. (Applause) Thank you to the audience for being here. And this is adjourned.

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CERTIFICATE OF NOTARY PUBLIC

I, Carleton J. Anderson, III do hereby certify that the forgoing electronic file when originally transmitted was reduced to text at my direction; that said transcript is a true record of the proceedings therein referenced; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and, furthermore, that I am neither a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

/s/Carleton J. Anderson, IIi

Notary Public in and for the Commonwealth of Virginia

Commission No. 351998

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