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Risky Business: Casting the Fed as a Systemic Risk Regulator

By Peter J. Wallison

Conventional wisdom in Washington is coalescing around the idea that the Federal Reserve should be empowered as a systemic risk regulator to supervise all "systemically significant" financial institutions. Last month's Outlook[1] *contended that the failure of banking regulation argues strongly against extending safety-and-soundness regulation beyond the banking sector and that designating some firms as systemically significant would create another class of companies—like Fannie Mae and Freddie Mac—that are implicitly backed by the federal government. This* Outlook *examines the notion that the Fed should be the systemic regulator, pointing out that the agency has for many years had all the powers of a systemic regulator for banks and has failed to use them effectively; that supervising industries other than banking requires skills and knowledge that the Fed does not have and probably could not acquire in any reasonable amount of time; and that a role as systemic regulator would impair the Fed's independence and create conflicts with its more important function as the nation's monetary authority. Finally, this* Outlook *questions whether systemic risk itself can be defined—and whether the commonly accepted notion of systemic risk supports the creation of a systemic risk regulator.*

Although there is no draft legislation yet available, the broad outlines of what the Obama administration is likely to propose in the wake of the financial crisis are becoming clear. The Group of Thirty report,[2] the report of the Congressional Oversight Panel that followed,[3] and statements by Barney Frank,[4] the influential chairman of the House Financial Services Committee, indicate that there is substantial support for a plan that would extend prudential (that is, safety-and-soundness) regulation beyond banking to hedge funds, securities firms, insurance companies, private equity firms, and other financial intermediaries. Not all members of these industries will be regulated for safety and soundness, only those that are deemed to be systemically significant by a new regulator of systemic risk. The agency that Frank seems determined to invest with this authority is the Federal Reserve.

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There are a number of reasons to be concerned about extending safety-and-soundness regulation beyond banking to other sectors of the financial system, and particularly doing so by designating certain companies as systemically significant. But empowering the Fed as the systemic risk regulator raises several major issues:

- The Fed has been aware of the problem of systemic risk for at least thirty years and has had the power to control it through its regulation of bank holding companies (BHCs) for at least that long. If the Fed has made any efforts to control the risk-taking of the largest banks—the financial institutions that might cause systemic risk—those efforts have failed.

- The Fed is a bank regulator; it has no expertise in regulating or understanding the details of businesses like hedge funds, securities firms, or insurance companies. Yet, as the regulator of systemically significant companies, the Fed would be required to make important decisions about such things as appropriate capital levels, leverage, products, and risk management that require deep understanding of any industry in which a systemically significant firm is located.

- There are inherent conflicts between the role of the Fed as the nation's central bank and its potential role as a regulator of systemically significant companies. The United States is one of only a few major developed countries that have authorized a monetary authority to take a role in bank regulation, and the trend in the last quarter century has been to separate monetary policy from financial regulation.

- To maintain its credibility for monetary policy purposes, the Fed must be independent of the political organs of government. But, as systemic risk regulator, it would inevitably be drawn into the politics of regulation, adversely affecting the credibility of its efforts to maintain price stability.

- As the lender of last resort, the Fed is in a particularly good position to provide financing to nonbank financial institutions that encounter financial difficulties. This will spread the federal safety net beyond banking and raise questions about whether there should be restrictions on commercial ownership of all systemically significant companies.

- There is no accepted definition of systemic risk and no generally understood idea—other than size itself—for how the potential for systemic risk might be identified before a systemic event actually occurs. The widely accepted view that systemic risk results from an external shock as well as simple contagion raises questions about the efficacy of regulating systemically significant firms. Granting to any agency the authority to determine whether a company is systemically significant or whether any activity would pose a systemic risk would be a blank check.

The Fed and Systemic Risk

In 1970, Congress granted the Federal Reserve the power to regulate and supervise BHCs. This power is extensive, and it has allowed the Fed to regulate BHCs in the same way that a bank supervisor can regulate a bank. The Fed regulates the capital of BHCs, limits their nonbanking activities, and, through the BHC, is able to influence the lending policies of the underlying bank. Although the term "systemic risk" is not used in the Bank Holding Company Act, the Fed has all the powers under the act that it might conceivably be given in any legislation in which the Fed is constituted as a systemic regulator. Nevertheless, the Fed never used these powers to stem the problems at Citigroup, Wachovia, or the other banking institutions that have had to be rescued in the current financial crisis.

It is not as though the Fed is unfamiliar with the concept of systemic risk. In 1998, the Federal Reserve Bank of New York (with the acquiescence of the Federal Reserve Board) stepped in to prevent the collapse of the hedge fund Long-Term Capital Management when it thought that the collapse would have far-reaching systemic effects. There is some question whether this was the correct judgment,[5] but there is no question that the Fed was sensitive to the issue of systemic risk. Nor is there any question that if the Fed wanted to control the risk-taking of the largest banks—the institutions most likely to be declared systemically significant—it could have done so through its control over their holding companies. Accordingly, before handing the power to control systemic risk to the Fed, Congress should want to know why the Fed has not exercised its existing power to control systemic risk in the banking system—and why it was unable to prevent the near failure of Citibank, the principal subsidiary of Citigroup and an institution that everyone would define as systemically significant.

The Fed's Expertise

The Fed is a bank regulator. It goes without saying that banking is a completely different business from insurance, which is different from securities trading, which, in turn, is different from the risk-taking and arbitrage transactions of hedge funds. The regulation of each company must take account of these differences. In order to decide on such issues as the appropriate amount of capital or leverage, the systemic regulator or supervisor of each form must have a detailed knowledge of the business practices, accounting standards, and taxation of each business model.

Accordingly, in order to be a systemic risk regulator for industries and business sectors other than banks, the Fed or some other institution would have to acquire a great deal of expertise in other fields of finance. It would be required to understand how these industries function and why they function the way they do. Every change in capital or leverage would have an effect not only on the competition within the industry in which the particular firm is located, but also on the ability of the firm to compete with other members of the financial services field. In today's financial services sector, banks, insurers, securities firms, hedge funds, mutual funds, finance companies, leasing companies, and even private equity firms compete for business, for capital, and for credit. Any significant mandated change in how the largest firms in each of these financial services industries do business will have an impact—positive or negative—on firms in every other financial services industry. It is for this reason that the Senate report on the Gramm-Leach-Bliley Act did not give the Fed the authority to supervise the nonbanking subsidiaries of financial holding companies. "It is inefficient and impractical," the report noted, "to expect a regulator to have or to develop expertise in regulating all aspects of financial services."[6] This was the judgment of Congress when securities and insurance were the only activities that were subject to any form of safety-and-soundness regulation (which, in the case of securities firms, was regulation intended primarily to protect customer accounts). If the legislation under consideration ultimately authorizes the Fed (or some other regulator) to supervise every financial intermediary that is systemically significant, it will create a giant regulator that will be required to understand in detail how each of these businesses operates and how a change in its capital, leverage, or business model will affect every other member of the financial services industry.

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The underlying theory of the proposal to constitute the Fed as a systemic risk regulator is that the agency will not only be able to supervise the systemically significant members of the financial services industry—no matter what business form they take—but will also be able to recognize the development of systemic risks before they place the financial system in jeopardy. Thus, the Fed would have to be able to forecast the effect of new products and business activities on future financial health. Not only will the agency be required to know what is the best capital level for these companies in many different businesses and with many different risk profiles, but it will also need to understand what particular activities or investments present excessive risks when undertaken by such a business. The answers to these questions for hedge funds and insurance companies, for example, are quite different from one another and quite different from those for banks. Hedge funds are traders and risk-takers; insurance companies are specialists in pooling risks. Hedge funds are financed by equity; insurance companies are generally corporations with capital ratios and long-term assets. Banks are part of a global payment system. Can any one agency make these varied judgments effectively—more effectively than the market itself?

Conflicts among the Fed's Roles

As the U.S. central bank, the Fed is responsible for maintaining price stability while fostering economic growth and employment. To a large extent, these roles are in conflict. As Robert E. Litan and Charles W. Calomiris noted in a 2000 article: "[W]eakness in the financial sector can tempt a central bank with supervisory authority over financial institutions to pursue a looser monetary policy than it would otherwise follow, imparting an inflationary bias."[7] For example, it might be that at a time of bank weakness, a tight monetary policy would have an adverse effect on the health of the financial institutions under the Fed's supervision. Instead of considering the overall health of the economy when it makes its monetary policy decisions, the Fed as bank supervisor or systemic regulator could defer a necessary rate increase in order to reduce the pressure on the institutions it supervises. This danger would be particularly acute if the Fed were the systemic regulator because systemically significant financial institutions are—by definition—too big to fail; they must be kept healthy lest their failure cause an adverse systemic event. The Fed would certainly be tempted in these circumstances to hold off on an interest rate increase in hopes of preserving the health of the systemically significant firms it is supervising. An opposite outcome is also easily imaginable; imagine that the Fed decides not to invoke its power to close down a weak institution because it fears that such an action will then require it to increase market liquidity in order to prevent further financial institution defaults.

Ideally, if there were to be a systemic regulator, it should have the health of the institutions it supervises solely in mind when it makes its decisions. However, the Fed's interest in promoting market stability can lead it to encourage—rather than discourage—risk-taking by the banks it supervises. One example of this phenomenon in action was the Fed's successful effort in 1982 to get various U.S. banks to extend loans to Mexico at a time when Mexico was unable to meet its foreign exchange obligations. Although the banks themselves were threatened by losses on their Mexican loans, they followed the Fed's direction and made new loans to Mexico. At the time, Fed chairman Paul Volcker assured the banks that these risky loans would not be held against them: "[W]here new loans facilitate the adjustment process and enable a country to strengthen its economy and service its international debt in an orderly manner, new credits should not be subject to supervisory criticism."[8] This is not to say that Volcker's decision was wrong in that instance, but only to point out a clear example of the conflict of interest that affects the Fed's administration of its bank regulatory functions.

It is perhaps for this reason that central banks in almost all developed countries have no role other than that of monetary policy. The European Central Bank was established with only a monetary policy role, and only the United States and Israel give their monetary authorities any role in financial system regulation. Elsewhere—Switzerland, Canada, Australia, Germany, Sweden, Spain, the United Kingdom, and Japan, to name just a few—banks are regulated by other government entities. And the trend has been strongly in this direction, with the United Kingdom, Japan, and Australia having taken bank regulation away from their central banks in recent years.

The traditional position of the Fed has been that its bank regulatory activities assist it in keeping tabs on the economy. The theory is that the examination of banks and reports from banks provide a source of confidential information, not available elsewhere, for judging the health of the overall economy. This would, in turn, contribute to the Fed's role as systemic regulator. This argument has always had a make-weight aspect to it. There is no reason for the Fed to have to examine banks or other institutions to get this information, even on a confidential basis. In reality, the Fed does not examine many banks; almost all the large banks are nationally chartered and examined and regulated by the Comptroller of the Currency (OCC). The Fed regulates and supervises BHCs, the companies that control banks. Most of the day-to-day supervisory work on BHCs is done by the regional Federal Reserve banks and not the Federal Reserve Board itself. If necessary, both the OCC and the Federal Deposit Insurance Corporation receive reports from banks and could furnish the confidential information in these reports to the Fed.

> There is no practical or policy basis for insulating the Fed's control over systemically significant companies from political influence. These decisions would be so important that they *should* be subject to political influence.

Threats to the Fed's Monetary Policy Role

The Federal Reserve System was designed to be independent of both Congress and the executive branch. The seven members of the Board of Governors of the Federal Reserve System are appointed by the president for fourteen-year staggered terms—by far the longest in the federal government—and the agency is independent of the congressional appropriations process. The chairman is appointed by the president for a four-year term, but his term is not coextensive with the election of the president, so that the Fed chair remains in office for at least the first two years of the new president's term.

This extraordinary insulation from the elected branches gives the Fed credibility with the financial markets, which are justifiably concerned that the Fed's policies on price stability will eventually start to follow election returns, allowing the dollar to devalue for political rather than economic reasons. As Laurence Meyer, a former Fed governor, observed: "The motivation for granting independence to central banks is to insulate the conduct of monetary policy from political interference, especially interference motivated by the pressures of elections to deliver short-term gains irrespective of longer-term costs . . . [and] to provide a credible commitment of the government, through its central bank, to achieve . . . price stability."[9]

The Fed's independence has spawned a great deal of controversy, as it should in a democracy. The question is whether an organization that has the power to affect the economy in such substantial ways—resulting in more growth or less in both the economy and employment—should be able to function without accountability to the elected branches. The agency's independence has been repeatedly challenged by powerful members of Congress, usually when it tightens monetary policy and suppresses economic growth in the interest of maintaining stable prices. This conflict springs from important political interests. Price stability—that is, a stable currency value—favors lenders; inflation in currency values favors borrowers because they are able to repay their loans with inflated dollars. The tribunes of the common man, like William Jennings Bryan, opposed the "cross of gold" because they saw the tight money policies implied by the gold standard as a burden on the working man (now called "working families"). This controversy continues into the modern era. In 1989, for example, then-representatives Lee Hamilton (D-Ind.) and Byron Dorgan (D-N.D.) introduced legislation intended to make the Fed "more accountable" for its decisions, a move described as follows in the *New York Times*: "The Midwestern farmers and businessmen whom Mr. Hamilton and [Mr. Dorgan] represent often favor lower interest rates or 'easy money' to make borrowing easier. . . . But the Federal Reserve has traditionally agreed with bankers and bond dealers, who typically advocate 'hard money,' or higher rates, to prevent the inflation that can devalue the loans they make and the securities in which they deal."[10]

Today, the question of the Fed's independence does not revolve around hard money versus easy money but instead around the credibility of the Fed's policies. For the past twenty-five years, with the exception of a few years after the dot-com collapse in the early 2000s and current efforts to address the financial crisis, the Fed has followed a policy of keeping inflation low by controlling the money supply or otherwise attempting to limit price increases. This has resulted in a slow rate of inflation (1 or 2 percent a year) and relatively stable long-term interest rates. Long-term rates, which are essential for investment planning by business, will remain stable as long as the credit markets believe that the Fed will continue to follow a stable price policy in the future. In the late 1970s, the Fed's commitment to price stability had lost credibility, and long-term rates rose to historic highs. It took several years of painful Fed money supply management to win back the credibility that was required to bring these rates down. The credit markets understand that the political pressures in a democracy favor inflation—there are simply many more borrowers than lenders—and so they watch carefully to determine if the Fed is buckling under pressure from Congress and the president. Thus, while the Fed's independence is inconsistent with democracy, it reflects a practical judgment that the nation's economy would be better off if its monetary policy is determined by economic rather than political considerations. A similar judgment, as noted above, has been made in many other major developed countries. Indeed, at least one study has shown that in countries where the central bank is also engaged in bank regulation, inflation rates tend to be higher.[11] This is what would be expected if the central bank is under pressure to put off credit-tightening in order to make sure that the banks it supervises are stable.

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Nevertheless, the cooperation between the Fed and the Treasury in the last year—as the financial crisis has deepened—has been unprecedented. Although there has been relatively little commentary about this in the media, it raises serious questions about the Fed's long-term independence from the elected branches and hence the credibility of its stable price policies. When the crisis comes to an end, this will surely be one of the major issues that the financial markets will worry about. Will the Fed simply have become an arm of the Treasury Department, or will it be able to separate itself in the future from Treasury policies that it has had a major role in creating and implementing? Will the Fed sop up the liquidity that it has poured into the economy, or will it again cooperate with the Treasury at least through the election of 2012? It is through this lens that the Fed's power over systemically significant companies should be viewed. Giving the Fed the power to regulate all the key financial firms in the U.S. economy would involve the agency in major decisions about how business is carried out by whole industries. Unlike monetary policy—which depends for its success on the financial markets' belief that the Fed is making its decisions on the basis of economic rather than political factors—there is no practical or policy basis for insulating the Fed's control over systemically significant companies from political influence.

These decisions would be so important that they *should* be subject to political influence.

Fortunately, there seems to be some recognition of the importance of this issue on the part of Senate Banking Committee chairman Christopher Dodd (D-Conn.). At a hearing on regulatory reform on February 4, 2009, Dodd noted the danger associated with giving the Fed a major regulatory role: "We must be mindful of ensuring the independence and integrity of the Fed's monetary policy function."[12] In the same hearing, Volcker was asked about the broad authority some have talked about giving to the Fed. In response, he pointed out that there are dangers in loading up the Fed with responsibilities: "You will have a different Federal Reserve if the Federal Reserve is going to do all the regulation from a prudential standpoint. . . . You have to consider whether that's a wise thing to do when their primary responsibility is monetary policy."[13]

Use of the Discount Window

The Fed has one authority that no other regulator possesses—the ability to create and lend money without an appropriation from Congress. The flexibility of the Fed's authority as lender of last resort has been demonstrated in the current financial crisis by the agency's willingness to lend on an emergency basis to companies and organizations that are not banks or BHCs. The continued availability of this authority raises troubling questions if the Fed is to become the regulator of all systemically significant financial institutions. The Group of Thirty report[14] contains a recommendation that, in whatever form regulation might take, it should preserve the restriction in current law that prevents the commercial firms from acquiring control of insured depository institutions.

Ironically, this restriction, known as the separation of banking and commerce, has contributed substantially to the financial crisis by depriving the banking industry of the capital that could come in from outside the industry. In the past year, the Fed has made efforts to loosen its rules on what constitutes a controlling position in a bank, but there is still very little capital coming into the industry. The longstanding reason for the separation of banking and commerce has been a fear (wholly unwarranted, in my view) that if commercial firms were to control banks, the government "safety net"—which includes the Fed's discount window lending facility—would be spread beyond the banking industry.

That spreading, of course, has already occurred as a result of the Fed's efforts to keep many financial institutions afloat during the current financial crisis, but the proposal to make the Fed the regulator of systemically significant financial firms threatens to institutionalize a substantial broadening of the Fed's lender-of-last-resort functions. As discussed more fully below, the underlying reason for regulating systemically significant firms is concern that their failure will cause failures elsewhere in the economy—that is why they are called "systemically significant." Under these circumstances, giving the Fed authority to regulate and supervise these firms is essentially the same thing as giving it authority to use its lender-of-last-resort facility to provide them with the liquidity necessary to prevent their failure. The effect, of course, will be to extend the safety net far beyond the banking industry and, to the extent that the policy of separating banking and commerce is intended to prevent the spread of the safety net to commercial firms, to raise a question of whether there should be restrictions on commercial ownership of any firm that is deemed to be systemically significant. For this reason, if any agency were to be given authority to regulate all systemically significant firms, the Fed should be the last agency on the list.

Defining Systemically Significant Institutions

There is a certain glibness in the reports, papers, and proposals that recommend the regulation of systemically significant financial institutions. The idea completely avoids the difficult question of how to identify these institutions. This is not an unimportant omission. Because the notion of systemic risk has so little content, any systemic regulator is far more likely to err on the side of broadening than narrowing the range of firms it chooses to regulate. This is because of the criticism it will receive if a systemic event occurs because of the failure of an institution that was not previously designated as systemically significant.

But the far more difficult problem will be identifying what is meant by systemically significant and the relationship of this term to the concept of systemic risk. Since the beginning of the financial crisis, there has been increasing attention to the concept of systemic risk. Some commentators have noted that conceiving of systemic risk as arising from contagion—the cascade of losses coming from the failure of one institution—is obsolete at a time when assets are marked to market.[15]

In that case, the losses of one or a few institutions because of some external shock can be transmitted to others without any connection between them. That would be a fairly good description of what happened to most of the world's financial intermediaries in the current crisis—when the external shock was a sudden recognition among investors that asset-backed securities of various kinds might be far less safe as investments than the ratings on them might have implied. When this occurred in the summer of 2007, the asset-backed securities market suddenly dried up. Funding for portfolios of such securities could not be found, and intermediaries were compelled to sell these assets at distress prices. The substantially reduced market prices caused the write-down of the same or similar assets on the balance sheets of other financial intermediaries, and what has been called the mortgage meltdown began. Various academic papers have referred to this sequence of events as an example of systemic risk—the danger of widespread losses coming from a systemic shock.[16]

The difficulty this raises is that systemic risk arises not from the failure of a large institution, or even a small group, but from an exogenous event—a shock to the system—that can come from a potentially infinite number of sources. Looking at the current financial crisis, its origin can be found in the combination of a deflating housing bubble in the United States, an unprecedented number of subprime and other nonprime mortgages, an originate-to-distribute securitization system, poor analysis by rating agencies, low costs for borrowed money, and a mark-to-market accounting system that caused asset values (and hence bank capital) to spiral down as distress sales occurred. In the current case, virtually all financial intermediaries were overleveraged in light of the rapid decline in the liquidity of their assets. Accordingly, one of the ways to prevent this ever happening again might be to regulate the various financial intermediaries in such a way as to prevent them from becoming overleveraged again. However, the next crisis may come from an entirely different combination of circumstances—one for which regulation of leverage or capital will not have prepared the regulated institutions. In fact, since regulation will force all the regulated institutions into the same approved mode of regulation, it might weaken the system by reducing the diversity that would allow some financial firms to survive the next shock. So if we do not know exactly how systemic risk will next manifest itself, how can we rely on the regulation of systemically significant institutions to protect us? Moreover, if systemic risk comes from an external shock, there is no reason to regulate only the systemically significant institutions—whatever they are—when virtually all financial institutions are likely to be affected. Why create the problems that come from differential regulation when it will not create any material difference in the outcome?

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Even if we think of systemic risk in the traditional way—as the result of a cascade of losses coming from the failure of a large and interconnected institution—how would we identify such an institution? One way, of course, is by size, but is that likely to be sufficient? The interbank payment system is one clear potential source of systemic risk. If one bank in the system were to fail to meet its payment obligations to the others, there could be a cascade of losses as the recipient banks would be unable to meet their own obligations at the end of the day. The trouble with this is that relatively small institutions can have outsized effects on the payment system if they fail to meet their payment obligations, and these institutions are unlikely to be considered systemically significant. An example is the failure of Herstatt Bank in 1974. That failure caused a systemic breakdown, even though no one would have considered Herstatt to have been a systemically significant bank.

Finally, there is the fact that what might be considered systemically significant is highly context-specific. Comparing the failure of the securities firm Drexel Burnham Lambert in 1990 with the failure of Lehman Brothers in 2008 makes this point. Drexel was a very large firm in the context of the market at the time, but its failure did not cause any systemic distress. On the other hand, Lehman's failure in September 2008, when everyone in the market was jittery, caused a worldwide freeze of interbank lending.

This analysis suggests that it is difficult to define systemic risk and what institutions can legitimately be considered systemically significant. Those who argue for regulating systemically significant institutions have not defined them, and until that happens, the suggestion that the Fed or any other agency should regulate this imaginary group has no sound basis.

The Problem of Differential Regulation

Even assuming that we can identify systemically significant institutions, what would be the consequences of regulating them—as opposed to regulating the entire industry of which they are a part? Such a step would have a disastrous effect on the competitive financial system in the United States. If a financial institution is designated as systemically significant, the financial markets will see it as a declaration that the institution is too big to fail. After all, the whole purpose of regulating systemically significant firms is to prevent them from failing, since, by definition, their failure would have an adverse systemic effect on the financial system or the economy generally.

As we have seen with Fannie Mae and Freddie Mac, any indication that a private firm has the implicit backing of the government—especially if the backing comes from an agency like the Fed, with the power to extend financing—would persuade the markets that extending credit to this institution would involve less risk than extending credit to an institution that is operating without this special designation. For this reason, a firm that is designated as systemically significant would be able to raise funds at lower cost than its competitors, would be likely be more profitable than its competitors, and would have greater access to capital. In industries such as insurance, in which the financial soundness of the company could make a competitive difference, the companies that were able to boast of implicit government backing would be the most successful in attracting customers. Overall, the systemically significant firms would grow larger in relation to others in the same industry and would gradually acquire more and more of their less successful competitors. Eventually, we would see a market much like the housing market that Fannie and Freddie have come to dominate, with a few giant companies, chosen by the government, that have pushed out all competition.

It is, of course, possible that the opposite could occur. The companies that are designated as systemically significant could face so much costly regulation that they become less profitable than their competitors. They might even weaken financially as their competitors took away more of their business by operating more efficiently and offering lower prices. However, implicit government backing, as demonstrated by Fannie Mae and Freddie Mac, can enable companies to drive all competition from their markets. The likelihood is that if the systemically significant companies encountered competitive difficulties, the Fed or any other regulator would be compelled at some time to provide them with financial assistance or regulatory forbearance.

Conclusion

The case for creating a systemic risk regulator has not been made. There is no clear definition of systemic risk, and specially supervising companies arbitrarily designated as systemically significant would seriously disrupt competition in every field in which a systemically significant company were to operate. In addition, even if it were possible to identify systemically significant companies and to overcome the competitive problems such a policy would entail, the Federal Reserve would be a very poor choice for the systemic supervisor. Such an assignment for the Fed would create significant conflicts with its monetary policy role and impair the independence that the agency needs to carry out that role effectively.

Notes

1. Peter J. Wallison, "Regulation without Reason: The Group of Thirty Report," *Financial Services Outlook* (January 2009), available at www.aei.org/publication29285.

2. Working Group on Financial Reform, *Financial Reform: A Framework for Financial Stability* (Washington, DC: Group of Thirty, January 15, 2009), available at www.group30.org/pubs/recommendations.pdf (accessed January 21, 2009).

3. Congressional Oversight Panel, *Special Report on Regulatory Reform* (Washington, DC: Government Printing Office, January 2009), available at http://cop.senate.gov/documents/cop-012909-report-regulatoryreform.pdf (accessed February 19, 2009).

4. Stacy Kaper, "Fed First as Hill Tackles Reg Reform in 2 Parts," *American Banker*, February 4, 2009.

5. See Shadow Financial Regulatory Committee, "The Issues Posed by the Near-Collapse of Long-Term Capital Management," September 28, 1998, available at www.aei.org/docLib/20051114_ShadowStatement151.pdf.

6. *Financial Services Act of 1998*, 105th Cong., 2nd sess., September 18, 1998, S. Rep. 105-336.

7. Charles W. Calomiris and Robert E. Litan, "Financial Regulation in a Global Marketplace," in *Brookings-Wharton Papers on Financial Services: 2000*, ed. Anthony M. Santomero and Robert E. Litan (Washington, DC: Brookings Institution Press, 2000), 292.

8. Quoted in Bernard Shull, *The Fourth Branch: The Federal Reserve's Unlikely Rise to Power and Influence* (Santa Barbara, CA: Praeger, 2005), 150.

9. Laurence H. Meyer, "The Politics of Monetary Policy: Balancing Independence and Accountability" (speech, University of Wisconsin, La Crosse, WI, October 24, 2000), available at www.federalreserve.gov/BOARDDOCS/SPEECHES/2000/20001024.htm (accessed February 20, 2009).

10. Louis Uchitelle, "Moves On in Congress to Lift Secrecy at the Federal Reserve," *New York Times*, August 24, 1989.

11. Carmine Di Noia and Giorgio Di Giorgio, "Should Banking Supervision and Monetary Policy Tasks Be Given to Different Agencies?" (Working Paper 411, Department of Economics and Business, Universitat Pompeu Fabra, Barcelona, October 19, 1999), 8, available at www.econ.upf.edu/docs/papers/downloads/411.pdf (accessed February 19, 2009).

12. Christopher Dodd, "Modernizing the U.S. Financial Regulatory System" (remarks, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, February 4, 2009), available at http://dodd.senate.gov/?q=node/4752 (accessed February 19, 2009).

13. Quoted in Steven Sloan, "Dodd Voicing Doubt on Fed Systemic Role," *American Banker*, February 5, 2009.

14. See Peter J. Wallison, "Regulation without Reason: The Group of Thirty Report."

15. See, for example, Markus Brunnermeier et al., *The Fundamental Principles of Financial Regulation*, Geneva Reports on the World Economy, preliminary conference draft (Geneva: International Center for Monetary and Banking Studies, 2009), 14–15, available at www.voxeu.org/reports/Geneva11.pdf (accessed February 19, 2009).

16. Ibid.; see also Philip F. Bartholomew, "Banking Consolidation and Systemic Risk," in *Brookings-Wharton Papers on Financial Services: 2000*, ed. Anthony M. Santomero and Robert E. Litan (Washington, DC: Brookings Institution Press, 2000), 373.