The Group of 30, which is chaired by Paul Volcker, recently published their recommendations for changes in regulation and supervision of the global financial markets. Our comments on the report and recommendations are listed below. We share many of the same concerns; however, we differ in several. Today, the size of our capital markets has grown disproportionately to the size of our economy. The structure of our financial system has changed over the past two decades and incorporates significantly more leverage and complexity. Our commercial banking system, which is fundamental to executing our central bank's monetary policy, has incurred more risk through its asset portfolio and thin capital base. Regulation and supervision have not kept pace with the growth in the sophistication of financial products and transactions. As a result, there is an increased level of risk inherent in today's capital markets.

The Size of our Capital Markets

Collectively, the size of the U.S. capital markets exceeds $45 trillion dollars. This includes the debt of the federal government, the corporate bond market, the structured securities market, the municipal bond market and the domestic publicly traded equity markets. With the GDP of the United States at approximately $14.5 trillion, the capital markets are roughly three times the size of GDP.

Initially, President Nixon's initiative to move the United States off the gold standard allowed for expansion in our domestic capital markets. Up until 1971, a specific amount of gold was required to be maintained to support the reserve base of every bank. However, without a gold backed currency, the monetary supply could expand beyond its previous limits. And, because we use a fractional reserve system which requires that banks only maintain a portion of their capital on reserve with the Federal Reserve, this expansion in our monetary base is further expanded by the multiplier effect.

The growth in securitizations in the past 15 years further compounded the expansion in our capital markets. Until the mid 1990's banks essentially made loans and kept them on their books. However, with the growth in collateralized mortgage obligations, asset-backed securities, commercial mortgage backed securities, and collateralized debt obligations, financial institutions could underwrite a loan and then immediately sell it into a conduit which accumulates similar loans that were tranched and sold to investors. The bank no longer held the loan and therefore was not required to hold reserves against it. As a result, the capital markets expanded as the growth in securitizations grew.

The Structure of our Financial System

We believe that our country will not experience sustained economic growth until we have stability in our capital markets. And, we will not experience stability in our capital markets until we address the structural problems within our financial system. The structure of our financial system has changed over the past twenty years in a manner that incorporates more leverage and more complex transactions.

Historically, commercial banks simply gathered deposits and made loans. Because they were leveraged eight to ten times, their capacity to make loans was constrained by their capital base. The banking system serves an important role in the implementation of monetary policy. The Federal Reserve can restrain or expand the flow of money by changing the level of interest rates which banks borrow and lend money. However, the repeal of Glass-Steagall has blurred the lines between traditional banking and investment banking. Although investment banking firms are important to our financial system, they are highly leveraged, do not take deposits and thus, are less integral to effecting monetary policy.

We realize that "unscrambling the egg" will be difficult; however, we support initiatives to bring back the spirit of Glass-Steagall in order to better manage the leverage and risk in our financial system. We support further regulation of the derivatives market and believe that all financial institutions should be required to post collateral on all derivatives transactions. Also, those derivatives should be standardized and traded on exchanges. Traditional banking offered reasonable compensation for loan officers and investment officers. We support compensation initiatives that incentivize the employees along with shareholders, but do not encourage one-sided excessive risk taking. We also believe that risk management initiatives, which may have the effect of reducing profits and impacting competition, should be required in order to preserve the structural integrity of the financial system.

We believe that activities, such as proprietary trading, which are not speculative in nature and not core to a bank's business model should be contained in separate business units, with separate capital levels considered appropriate for the risks.

The rating agencies are important to the structural integrity of our financial system. After their mishandling of ratings on defaulted Chinese debt in the 1990's, as well as the Enron and WorldCom bankruptcies in 2002, we believed that there needed to be better supervisory oversight of the rating agencies. There currently is no authoritative body that reviews ratings, their internal processes or their governance issues, which includes their inherent conflicts of interest. The rating agencies have successfully argued that their ratings are protected under the First Amendment of the Constitution and, as a result, there is no legal recourse to the rating agencies for their actions. The entire financial system relies on these ratings and we believe the markets are best served by thoughtful oversight of the rating agencies.

Regulation

While our capital markets and investment products have become more complex over the years, the regulation of our financial system and capital markets has clearly not kept pace. The growth in derivatives and credit default swaps which rely on complicated ISDA agreements is just one example.

We are operating at higher levels of leverage and risk, and we do not see that changing. As a result, we believe that investors and financial institutions need a more robust regulatory infrastructure. There is confusion over a large number of issues including, but not limited to, regulatory requirements for unregulated securities, fiduciary duty vs. suitability standards in the brokerage industry, regulatory requirements for pooled investment vehicles, and regulatory responsibility for different types of hedge funds. *Consistency* in supervision is critical to the stability of our financial system. Where the Financial Stability Report recommends a regulator be assigned to large investment banks and broker dealers, we agree and would recommend that it be the *same* regulator as those overseeing deposit-taking financial institutions. We need to insure consistency and minimize the incentives for institutions to avoid the appropriate supervisory oversight.