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Good afternoon. Arthur - thank you for that introduction. And thank you all for being here today.

We are at a defining moment in the debate about financial reform. It's been two and a half years since the crisis started. It's been nine months since President Obama first laid out a proposal for comprehensive reform. And it's been three months since the House of Representatives passed a major reform bill. This is an enormously complicated issue. We have to get it right. But we know all we need to know about the choices. Now we have to decide whether or not we are going to act.

So this afternoon – to the business community, to the financial community and to the American people – I want to present the case for financial reform.

Devastating Failures

The first argument for reform is that the failures in our system were devastating.

When a conservative Republican President – George W. Bush, a President with abiding faith in markets who proposed privatizing social security – is forced by a financial crisis to put Fannie Mae and Freddie Mac into conservatorship, companies that combined –at their peak – represented more than $130 billion in shareholder value;

When a conservative Republican President is forced by failures of financial policy to ask Congress for $700 billion in authority to stabilize the financial system and to invest this taxpayer money into banks that account for three quarters of the entire U.S. banking system*;*

When a conservative Republican President is forced by a recession, caused by financial failures, to lend billions of dollars to two of our largest auto makers;

When a conservative Republican President is forced to do all that – and he was right to do it – there's something undeniably wrong with the economy.

When the American financial system – once the envy of the world – takes trillions of dollars of savings and puts it into an unsustainable real estate boom while under-investing in innovation, infrastructure, and the technologies of the future, there's something undeniably wrong with the system.

Now, this was not a modest problem. The magnitude of the financial shock was in some ways greater than that which caused the Great Depression. The damage has been catastrophic, causing more damage to the livelihoods and economic security of Americans and, in particular, the middle class, than any financial crisis in three generations.

And what caused the crisis was not just that monetary policy around the world was too loose for too long. It wasn't just that a lot of people lent too much and borrowed too much on the unrealistic hope that housing prices would never fall. It wasn't just that the boards of directors and executives and shareholders failed to prevent massive failures in risk management.

This crisis was the result of failures in government policy and oversight, failures in the design and enforcement of rules and regulation. Our regulatory framework was built in a different era for a long extinct form of finance. It long ago fell behind the curve of market developments. Parts of the system were crawling with regulators but parts of the system were without any meaningful oversight. This permitted – and even encouraged – arbitrage and evasion on an appalling scale.

Firms that engaged in essentially the same type of financial business could shop for the weakest regulation and the most compliant regulator. Countrywide Financial took itself to the edge of the abyss after choosing to exchange the tougher constraints of Federal Reserve oversight for the more permissive regime of a thrift charter. Where the rules were weak or absent, risk and leverage built up as we saw in AIG and the monoline insurance companies; in the massive shift in market share in the consumer credit business away from banks to essentially unregulated mortgage brokers and consumer finance companies; and in the growth in leverage in investment banks such as Bear Stearns, Lehman Brothers, and Merrill Lynch.

Leverage also built up in parts of the market where there was the hope or the promise of government protection from private losses, most dangerously in the government sponsored mortgage enterprises.

And when those charged with protecting the economy from financial excess acted to rein in excess, such as the subprime mortgage guidance issued in June of 2007, it was too late. By then, the country was already heading towards the worst financial crisis in generations.

And at that critical point in our history the emergency authority of the President of the United States – the chief executive of most important financial system in the world – was limited to closing financial markets or declaring a bank holiday.

These were tragic and devastating failures.

Market Discipline Along Is Not Enough

The second argument for reform is that market discipline is not enough. A strategy that relies on market discipline to compensate for weak regulation and then leaves it to the government to clean up the mess is not a good strategy for economic growth and for financial security.

Market discipline is beneficial. It's important. It's necessary. But it cannot effectively compensate for failures in financial regulation.

The most consequential weakness in the system – the failure that made this crisis so severe and so hard to manage – was the risk that built up in what many call the "shadow banking system." There, the market financed explosive growth in a range of financial firms that were engaged in the business of banking but were not regulated as banks.

At its peak, this "shadow banking system" financed about $8 trillion in assets, almost as large as the real banking system. And – despite its name – it was not hidden away. It was operating in broad daylight with no history or reasonable expectation of government support in a crisis.

That was market discipline in action.

Financial leverage on a substantial scale funded short – meaning with funds that could leave in a heartbeat – all with comfort provided by the rating agencies. A toxic mix of leverage and maturity transformation is the classic cause of all financial crises. Ahead of this crisis we let leverage build up on a massive scale. And when confidence failed and investors started a run on this shadow financial system, we had none of the protections put in place around banks after the Great Depression to slow the panic and contain the damage. This put massive pressure on the rest of financial system, pushing us towards the abyss.

For three decades, the American financial system produced a significant financial crisis every three to five years. Each major financial shock forced policy actions mostly by the Fed to lower interest rates and to provide liquidity to contain the resulting damage. The apparent success of those actions in limiting the depth and duration of recessions led to greater confidence and greater risk taking.

Now, the recognition that markets failed and that the necessary solution involves reform; that it requires rules enforced by government is not a partisan or political judgment. It is a conclusion reached by liberals and by conservative skeptics of regulation.

Judge Richard Posner, a leader in the conservative Chicago School of economics, wrote last year, that “we need a more active and intelligent government to keep our model of a capitalist economy from running off the rails.”

And consider Alan Greenspan, a skeptic of the benefits of regulation, who recently said, “inhibiting irrational behavior when it can be identified, through regulation, . . . could be stabilizing.”

Innovation, Efficiency and Economic Growth Requires Financial Reform

A third argument for reform is that financial reform is important not just to protect consumers and investors, but to generate innovation, efficiency and economic growth. For many Americans, the cost of the crisis will always be most clearly measured by the millions of lost jobs, the millions of homes lost to foreclosure or the substantial savings lost to fraud. And our consumer and investor advocates have always been among the most forceful proponents of financial reform.

But financial reform is also about growth and innovation. It’s about the interests of the American entrepreneur, the engineer with a new patent and a new company, and the small business looking for capital.

The test of whether a financial system works is not just whether it protects consumers and investors from predation and fraud. That is vital and it is necessary, but it is not sufficient. The test is also whether the financial system does a reasonable job of channeling savings to finance future innovation.That has always been one of the great strengths of the American financial system, channeling the savings of Americans and investors around the world towards the financing of some of the great companies of our time.

But the system we have today produced a massive misallocation of investment resources, channeling trillions of dollars into real estate investments, inducing a damaging rise in borrowing by individuals. The system we have today produced waves of credit bubbles and real estate booms followed by financial shocks of ever greater damage, crises that cause massive failures of productive enterprise, followed by long periods of tight credit.

Talk to the start-up company who is still starved for capital. Talk to the large company whose suppliers can’t access to credit. Talk to their managers who can’t find enough engineers because a generation of college graduates was drawn by the promise of huge rewards in finance. Look at the damage caused by the crisis in business failures, in lost wealth, in capital investment deferred, in lost revenue to finance infrastructure.

This financial system has not been good for American business. The business community should not put up with it. And the business community should not be leaving the debate about reform to the protectors of banks and finance companies.

We Are Still At Risk

A fourth argument for reform: Our major American financial institutions are much stronger today but our economy is also much more vulnerable to the risk of future crises.

Before President Obama took office, more than $230 billion dollars of taxpayer money had been invested, necessarily, into banks that accounted for about three quarters of the assets of the entire banking system. The Federal Reserve, the Treasury and the FDIC had put in place guarantees and special liquidity facilities that amounted to trillions of dollars.

Credit markets were frozen. The global economy and our economy were declining at an accelerating rate. Americans had already lost trillions of dollars in wealth, in the value of their homes and in their savings.

So we acted. We acted quickly to break the back of the financial panic, to recapitalize the financial system with private investment, to restart the credit markets, to bring down mortgage interests rates, to enable state and local governments to borrow again at reasonable cost, to re-open the markets for equity capital and debt.

And we achieved all of that at a fraction of the expected cost, hundreds of billions of dollars less.

Reasonably conservative estimates suggest that the direct fiscal costs of this crisis will ultimately be less than 1 percent of GDP, a fraction of the over half a trillion dollars estimated by CBO and OMB just a year ago.

And if Congress joins the President in adopting a Financial Crisis Responsibility Fee, the cost of TARP to the American taxpayer will be zero. We are putting TARP to rest, having used only a fraction of the resources authorized by Congress, and having returned almost $200 billion dollars in capital, dividends, and interest to reduce our debt and future deficits.

We have encouraged a very dramatic restructuring of our financial system. And we are going to come out of this crisis more quickly and more strongly than any of the major economies caught up in this mess. But we are still living with the same financial system that brought us to the edge of collapse, and the success of the crisis response, without financial reform, will make future crises more likely.

Without reform, the actions taken to save the financial system from collapse will have added to moral hazard and will have added to the risk that private actors in the future will take risks in the expectation they will be protected from those losses. Without reform, memories of the storm will fade and the expectation that some firms are too big to fail will survive. Without reform, risk will build up again where it is not effectively constrained, and future governments will have to act again to socialize private losses in the interest of preventing catastrophic damage.

Delaying Reform Will Increase Uncertainty

A fifth argument for reform is that delaying reform will increase uncertainty and make credit more expensive.

Even with improving credit markets and reduced borrowing costs, when you talk to businesses across the country, they tell you that banks are lending less in part because they're not certain what new rules are coming. If you delay reform, you force them to live with that continued uncertainty.

And if the opponents of reform succeed in slowing this down – opponents who according to a report issued today are spending $1.4 million dollars every day to lobby Members of Congress; if the opponents succeed in stretching out the debate, they may think they're helping banks in the short run, but they will be hurting the customers of banks – American families and businesses.

Reform is not going to go away. If we don't get a strong bill now, here's what will happen: We're not going to move on to other things. We're going to keep fighting for reform. We're going to keep working with those who want a strong bill enacted into law.

But in the meantime, the rest of the world is going to move on without us. If we don't lead, others will. They will move to protect their citizens and their economies with rules that fit their needs.

If we fail to act, America will lose this opportunity to set the global agenda, to define new high standards for all financial companies, and to lead the debate in shaping a level playing field on terms that play to our strengths.

If we fail to act, American firms that operate globally will face a more balkanized global financial system, with higher costs of doing business and riddled with pockets of lower standards designed to attract the exact types of risky behavior we are seeking to end.

And if we fail to enact legislation reform here at home we will be forced to use the limited and inadequate authority we have. To protect the American economy from the failures of the existing system, we will have to consider forcing parts of the financial system – the parts we can regulate – to operate with higher capital and higher liquidity requirements than would otherwise be necessary.

Broad Agreement On Reform

This is a defining moment for reform. We have the chance to enact the strongest, most important financial reforms since those that followed the Great Depression. At this stage, the debate is not really about financial reform or no reform; about re-regulation or deregulation. It's a debate about ideas, and about the best ways to improve an undeniably flawed system; about the role of government; about the balance between efficiency and stability; about how to protect consumer choice and financial innovation, while constraining predation and fraud; and about getting the incentives right.

There is no serious case against fundamental reform of consumer protection laws and enforcement, against oversight of derivatives markets, against strong constraints on risk taking of the largest institutions, better tools for unwinding failing institutions. The issues left, however, are important. Principally they are about consumer protection and "too big to fail."

First, on consumer protection, the basic issue is whether financial firms that sell credit and other financial services to consumers should be subject to rules written and enforced by an independent agency.

There are some that argue these constraints should only apply to banks but not to payday lenders or auto finance companies or debt collection agencies. This is hard to understand and harder to justify since so many of the excesses occurred outside banks.

There are some who argue that a new consumer protection agency should not have authority to enforce new rules on banks because of an inherent conflict between rules to protect consumers and rules to protect the safety and stability of banks. This is hard to understand, because we've seen what happens when you ask bank supervisors to write and enforce the rules for consumer protection.

I don't understand how anyone can argue that a system that relied on bank supervisors to write and enforce rules for consumer protection resulted in a safe and sound banking system that protected consumers from financial abuse and from predation.

How did that system turn out for the country? What risks do rules promoting better disclosure for consumers pose to the stability of the banking system? What is the inherent conflict between bank supervisors policing minimum underwriting standards and a consumer agency enforcing rules against abject predation and abuse?

That system produced terrible failures in consumer protection, failures that eventually undermined the safety and soundness of financial institutions and contributed to the worst financial crisis in generations.

Every morning bank supervisors should wake up thinking about one thing – whether banks have the capital, the liquidity and the risk-management to protect safety and soundness. And, we need a capable group of officials with a separate mission, who wake up every morning thinking only about how best to protect consumers and how best to make consumer markets fairer, more transparent, and more competitive.

That's why any bill that comes to the President's desk must include a consumer agency with an independently appointed and Senate-confirmed director, an independent budget and an independent ability to set and enforce clear rules of the road across the financial marketplace.

This used to be a shared goal.

In President Bush's 2008 Blueprint for a Modernized Financial Regulatory Structure, he proposed assigning the regulation of consumer financial markets and bank safety and soundness to separate agencies. Under his proposal, a separate business conduct regulator would have been responsible for consumer and investor protection. His Administration concluded that assigning consumer and investor protection and prudential regulation to a single agency could lead to one objective dominating the other. They called separating these functions in the long term into distinct agencies, “optimal.”

We agree.

Now, the second key issue remaining is about how to confront the problem of “too big to fail.” Across the ideological spectrum there is agreement that we should never again be forced to choose between bailing out a financial firm or risking financial collapse. The reforms in the House and Senate bill would do three basic things.

First, they would establish a bankruptcy-like regime for large financial institutions that mismanage themselves into failure and can no longer survive without special government support. In that process, equity holders would be wiped out and the firm will be placed in a form of receivership so it can be broken apart, sold over time, with no exposure to the taxpayer.

Second, the reforms would limit the ability of the Federal Reserve and the FDIC to provide loans and guarantees that would sustain failing financial institutions.

And third, the reforms would put in practice the principle that large institutions should bear the costs of any losses to the taxpayer.

Those three dimensions of reform – along with our proposals to limit risk taking and to substantially increase capital requirement on the large institutions and to strengthen the basic shock absorbers in the financial system – those reforms, are essential to reduce the risk of future crises and they will substantially reduce moral hazard. Investors would no longer sustain weak and risky institutions in the hopes they will be protected from loss. Our successors in the Fed and the Treasury will be able to allow firms to fail without fear that the fire will spread to viable institutions.

I do not believe there is a credible alternative to this basic structure. The normal bankruptcy regime cannot work for banks, because banks need funding to operate even as they are being wound down. Without funding they would have to liquidate in a disorderly manner. In a crisis, there is no plausible private source of temporary financing, like debtor in position financing for companies in bankruptcy.

Congress recognized this many decades ago in establishing a special resolution process for banks. We propose to simply adapt that mechanism for the major bank and bank-like entities that exist today.

Some have argued that this proposed resolution or quasi-bankruptcy process would establish a permanent TARP or a permanent bailout fund. This is not true. Neither the House nor Senate bills provide authority to inject capital into viable banks or to purchase assets from banks or from the markets.

What the bills do accomplish, however, is to limit the ability of the government to protect firms from the consequences of their mistakes. Under these bills, if a firm manages itself so poorly it can no longer operate without special government intervention, the government cannot step in to protect it from failure. It can only act to put the firm in a form of receivership so that it can be dismembered safely, at less cost to the government and less risk of damage to the financial system as a whole.

We need to build a system that is strong enough to allow us to be indifferent to the fate of a future Lehman or AIGs.

This depends on authority to limit risk taking and prevent excess concentration in the financial system. It depends on forcing the system to run with stronger financial cushions in the form of capital and liquidity and margin. But it also depends on legislation that provide a workable regime to put those firms out of existence safely.

You can’t solve “too big to fail” by promising not to act to protect the economy in future crises.

Last fall a senior senator gave a very thoughtful speech on this critical part of financial reform. He said we need a “resolution regime for large failing financial institutions will provide the clarity to credits and to the market.”

He said, “such a regime will operate similarly to bankruptcy proceedings, with clearly delineated procedures for settling claims. Whereas ordinary bankruptcy proceedings would likely be too slow to respond to short-term counterparty exposures, a resolution regime must be nimbler.”

He said, “a well crafted resolution regime may require rapid access to liquidity. That liquidity should provide confidence to counterparties – reducing the need to redeem short-term claims in the face of dwindling assets. Short-term resources necessary to avert panics and runs must be available promptly, but most not lead to taxpayer losses. As with deposit insurance, assurances must come at a cost to those needing the resources, not at a cost to taxpayers. Those responsible for risk taking must bear these losses.”

I agree with everything Senator Shelby said then.

The bill the Senate Banking Committee is considering up today meets those objectives.

Let me take a moment to commend and thank Chairman Dodd for his leadership in producing such a strong bill.

And let me also thank Chairman Frank for his leadership in producing the strong bill that passed the House in December. I urge everyone to watch this process closely, for it will be a test of our capacity as a nation to deal with complex and consequential problems.When you see amendments designed to weaken the basic protections of reform; when you see amendments to exempt certain types of financial firms or financial instruments from rules; ask why we should be protecting those private interests at the expense of the public interest.

These are difficult issues and our legislators and their staffs often look to the financial industry for advice as they try to sort out what makes sense. This is important to get right but be careful whose voice you listen to.

Listen less to those whose judgments brought us this crisis. Listen less to those who told us all they were the masters of noble financial innovation and sophisticated risk management. Listen less to those who complain about the burdens of living with smarter regulation or who oppose having to pay a fee for the costs of this or future crises.

Instead, listen to the families and businesses still suffering from this crisis. Listen to those who borrowed responsibly but today can't get a loan or can't refinance their mortgage. Listen to those who lost their jobs and their healthcare and their pension savings. Listen to them.

The test we face is whether we enact real reforms that provide strong protection for consumers, strong constraints on risk taking by large institutions, and strong tools to protect the economy and taxpayers from future crises. We will not accept a bill that does not meet that test.

To borrow the language of a general: financial reform is not a war of choice; it is a war of necessity. And to use the language of theology, this is a just war. The great strength of America has always been that in times of crisis we come together, we act forcefully, and we emerge stronger than before.

The foundations of our economy and the foundations of the global economy rest on that capacity to act. That is why it's not just the American people watching what we do.

The world is watching. We are close. We need to finish the job.

Thank you.

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