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An Open Letter to President Clinton on Financial Reform

By Shadow Financial Regulatory Committee

December 09, 1996

Statement No. 135

Dear Mr. President:

Financial innovations, technological changes, and an enhanced competitive environment have profoundly changed what financial institutions do and how they do it. Government regulation, however, has not kept pace with developments in the private sector. Changes in regulation have been piecemeal and have lacked both coherent objectives and clear public policy principles. You have the opportunity to introduce and support legislation that establishes a clear vision of the role that government should play in regulating financial institutions and markets in the future.

As economists and lawyers who have devoted much of their professional lives to the study of financial markets and institutions, we would like to submit eight interlocking principles that have proven fundamental to our thinking about the role of government in financial markets.

1. It is folly to continue to try to segment financial markets and institutions by imposing government or charter restrictions on the activities that different financial institutions can engage in. A fundamental objective should be to permit financial institutions to compete across the full spectrum of financial services, without limitations by the government.
2. Government subsidies to participants in the payments system should be eliminated so that participants compete on equal terms without prospect of taxpayer liability.
3. Participation in the Fedwire system should be open to nonbank institutions.
4. Residual government subsidies associated with deposit insurance should be eliminated.
5. Government subsidies associated with government-sponsored financial entities should be eliminated.
6. There should be incentives for financial institutions to provide public disclosure that is sufficient to make their activities transparent to depositors, investors, and creditors, so that private markets can effectively discipline poorly-managed and inefficient institutions.
7. The objectives and decisions criteria employed by regulators should be disclosed in a way that makes their activities transparent and permits an objective evaluation of their performance by taxpayers and Congress.
8. Finally, the thrust of government prudential regulation should be to ensure the efficiency and stability of the payments system, and not to maintain the solvency of individual financial institutions or to protect uninsured depositors, non-deposit creditors, or the stockholders of individual institutions.

We recognize that there are alternative legislative approaches to regulating financial institutions and strong opinions about which approach is preferable. Any approach that satisfies the foregoing principles will be a vast improvement over the financial and regulatory system that we have now.

We would be pleased to discuss our views in detail with members of your administration as they begin the process of formulating an approach to restructuring the financial system. Thank you for the opportunity to be heard on this issue.

It is the Committee's policy that members abstain from voting on policy statements if they have direct personal or professional involvement in the matter that is the subject of the statement. Accordingly, Robert Litan abstained from voting on this statement.

Shadow Financial Regulatory Committee

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