

## HONORING OUR ARMED FORCES

LANCE CORPORAL JONATHAN B. THORNSBERRY

Mr. MCCONNELL. Madam President, I rise today to pay tribute to a young man from McDowell, KY, who bravely served his country. LCpl Jonathan B. Thornsberry was tragically killed during combat operations in Iraq back on October 25, 2006. He was 22 years old. He left behind a family and friends who love him and remember that today, March 11, is his birthday.

For his heroic service with the U.S. Marines, Lance Corporal Thornsberry received several medals, awards, and decorations, including the National Defense Service Medal and the Purple Heart.

The man called "Jon-Jon" by family and friends was following a family tradition when he elected to wear America's uniform. His brother, father, and grandfather all served in the military.

"It was just something he wanted to do," Jonathan's brother Jeff recalls of why Jonathan signed up. "It was a decision he made." Jonathan's parents, Jackie and Judy, remember their son saying, "We have to go over there. If we don't go over there, they will be here."

Jonathan grew up in Floyd County where he attended McDowell Elementary School and South Floyd High School. He played catcher on his high school baseball team. Everybody remembers how good he was, and South Floyd High has retired his old No. 13 in his memory.

The name of the McDowell Elementary School's sports team is the Daredevils. Jonathan certainly fit that description growing up, as he liked to play in the mountains, go four-wheeling, and go hunting. This is not to say he did not have any sense of responsibility.

Once when he was just 4 or 5 years old, Jonathan and his father were hunting when they climbed too high on a mountain. "We need to go down. Mommy will be worried about us," Jonathan said.

Jonathan was very close to his father, and the two of them worked together in the coal mines before Jonathan joined the Marines. Jonathan was also a father himself. He and his wife Toni Renee have a daughter, Haylee Jo. Haylee Jo recently turned 5 years old, and she likes to tell people she has her daddy's green eyes.

Jonathan was also close to his aunt, Edia Hamilton, better known in the family as Aunt Edia Girl. She would always buy candy for her favorite nephew even though she was on a fixed income.

Jonathan graduated from South Floyd High School in 2002, and after working alongside his father in the coal mines enlisted in the Marines in January 2004. He was assigned to the Marine Forces Reserve's 3rd Battalion, 24th Regiment, 4th Marine Division, based out of Johnson City, TN.

After training in California, Jonathan was deployed in support of Oper-

ation Iraqi Freedom in 2006. His family recalls he left California on September 26, and just 1 month later his life was tragically lost.

A few days before his death, Jonathan called his mother Judy to wish her a happy birthday, but she was at the grocery store and missed his call. Jonathan did get to talk to his wife Toni. Toni and Judy talked later, and Judy remembers they shared an uneasy feeling.

"I could feel God all around me that morning and I should have known something," Judy says. "I [could] feel God protecting me from the harshness of this." Later that day they received the horrible news.

Funeral services were held at the Little Rosa Church in McDowell, where Jonathan's two favorite songs, "The Old Ship of Zion" and "Amazing Grace," were played. Tributes to him were held in Frankfort and back at South Floyd High School.

Today, on Jonathan's birthday, Madam President, our thoughts are with the many loved ones he has left behind. We are thinking of his wife Toni Renee; his daughter Haylee Jo; his parents Jackie and Judy; his brother and sister-in-law, Jeff and Angela; his grandmother, Alice Moore Lawson; his nephews, Thomas and Jack; his nieces, Evelyn Grace and Julia Ann; his aunt, Edia Hamilton; and many more family members and friends.

One year after Jonathan's death, his family, friends, and fellow marines gathered to remember him at a service in Pikeville City Park. Friends recalled him as the "type of guy who would give you the shirt off his back." Another remembered the last time he saw Jonathan and what they talked about.

His wife Toni talked about how much she had lost. "We loved each other from the moment we laid eyes on each other," she said. Then she read a poem that got across how her husband was a man who did not ask for much.

"If you have a place for me, Lord, it needn't be so grand," she read.

A place of honor will be kept in the Senate for LCpl Jonathan B. Thornsberry, who sacrificed everything for his country. Today, on his birthday, I know my colleagues will join me in paying tribute to his service.

Madam President, I yield the floor.

## RESERVATION OF LEADER TIME

The ACTING PRESIDENT pro tempore. Under the previous order, the leadership time is reserved.

## MORNING BUSINESS

The ACTING PRESIDENT pro tempore. Under the previous order, there will be a period for morning business for 1 hour, with Senators permitted to speak therein for up to 10 minutes each, with the majority controlling the first 30 minutes and the Republicans controlling the next 30 minutes.

The Senator from Delaware.

Mr. KAUFMAN. Madam President, I ask unanimous consent to speak for up to 25 minutes.

The ACTING PRESIDENT pro tempore. Without Objection, it is so ordered.

## WALL STREET REFORM

Mr. KAUFMAN. Madam President, financial regulatory reform is perhaps the most important legislation the Congress will address for many years to come. If we do not get it right, the consequences of another financial meltdown could be devastating.

In the Senate, as we continue to move closer to consideration of a landmark bill, however, we are still far short of addressing some of the fundamental problems—particularly that of too big to fail—that caused the last crisis and already have planted the seeds for the next one. This is happening after months of careful deliberation and negotiations and just a year and a half after the virtual meltdown of our entire financial system.

Following the Great Depression, the Congress built a legal and regulatory edifice that endured for decades. One of its cornerstones was the Glass-Steagall Act, which established a firewall between commercial and investment banking activities. Another was the federally guaranteed insurance fund to back up bank deposits. There were other rules imposed on investors and designed to tamp down on rampant speculation—Federal rules such as margin requirements and the uptick rule for short selling.

That edifice worked well to ensure financial stability for decades. But in the past thirty years, the financial industry, like so many others, went through a process of deregulation. Bit by bit, many of the protections and standards put in place by the New Deal were methodically removed. And while the seminal moment came in 1999 with the repeal of Glass-Steagall, that formal rollback was primarily the confirmation of a lengthy process already underway.

Indeed, after 1999, the process only accelerated. Financial conglomerates that combined commercial and investment banking consolidated, becoming more leveraged and interconnected through ever more complex transactions and structures, all of which made our financial system more vulnerable to collapse. A shadow banking industry grew to larger proportions than even the banking industry itself, virtually unshackled by any regulation. By lifting basic restraints on financial markets and institutions, and more importantly, failing to put in place new rules as complex innovations arose and became widespread, this deregulatory philosophy unleashed the forces that would cause our financial crisis.

I start by asking a simple question: Given that deregulation caused the crisis, why don't we go back to the statutory and regulatory frameworks of the past that were proven successes in ensuring financial stability? This is basically a conservative question and I am a conservative on this issue. Why don't we go back to what has worked in the past?

And what response do I hear when I raise this rather obvious question? That we have moved beyond the old frameworks, that the eggs are too scrambled, that the financial industry has become too sophisticated and modernized and that it was not this or that piece of deregulation that caused the crisis in the first place.

Mind you, this is a financial crisis that necessitated a \$2.5 trillion bailout. And that amount includes neither the many trillions of dollars more that were committed as guarantees for toxic debt nor the de facto bailout that banks received through the Federal Reserve's easing of monetary policy. The crisis triggered a Great Recession that has thrown millions out of work, caused millions to lose their homes, and caused everyone to suffer in an American economy that has been knocked off its stride for more than 2 years.

Given the high costs of our policy and regulatory failures, as well as the reckless behavior on Wall Street, why should those of us who propose going back to the proven statutory and regulatory ideas of the past bear the burden of proof? The burden of proof should be upon those who would only tinker at the edges of our current system of financial regulation. After a crisis of this magnitude, it amazes me that some of our reform proposals effectively maintain the status quo in so many critical areas, whether it is allowing multitrillion-dollar financial conglomerates that house traditional banking and speculative activities to continue to exist and pose threats to our financial system, permitting banks to continue to determine their own capital standards, or allowing a significant portion of the derivatives market to remain opaque and lightly regulated.

To address these problems, Congress needs to draw hard lines that provide fundamental systemic reforms, the very kind of protections we had under Glass-Steagall. We need to rebuild the wall between the government-guaranteed part of the financial system and those financial entities that remain free to take on greater risk. We need limits on the size of systemically significant nonbank players. And we need to effectively regulate the derivatives market that caused so much widespread financial ruin. It is my sincere hope that we don't enact compromise measures that give only the illusion of change and a false sense of accomplishment. If we do, then we will only have set in place the prelude to the next financial crisis.

First, however, let us examine the origins—both obscure and well-known—of the Great Recession of 2008. As I have already noted, the regulators began tearing down the walls between commercial banking and investment banking long before the repeal of Glass-Steagall. Through a series of decisions in the 1980s and 1990s, the Federal Reserve liberalized prudential limitations placed upon commercial banks, allowing them to engage in securities underwriting and trading activities, which had traditionally been the particular province of investment banks. One fateful decision in 1987 to relax Glass-Steagall restrictions passed over the objections of then Federal Reserve Chairman Paul Volcker, the man who is today leading the charge to restrict government-backed banks from engaging in proprietary trading and other speculative activities.

With the steady erosion of these protections by the Federal Reserve, the repeal of Glass-Steagall had become a fait accompli even before the passage of the Gramm Leach Bliley Act in 1999. In effect, by passing GLBA, Congress was acknowledging the reality in the marketplace that commercial banks were already engaging in investment banking. As the business of finance moved from bank loans to bonds and other forms of capital provided by investors, commercial banks pushed the Federal Reserve to relax Glass-Steagall standards to allow them to underwrite bonds and make markets in new products like derivatives. Even before GLBA was passed, J.P. Morgan, Citigroup, Bank of America and their predecessor organizations had all become leaders in those businesses.

If the changes in the financial marketplace that led to the repeal of Glass-Steagall took place over many years, the market's transformation after 1999 was swift and profound.

First, there was frenzied merger activity in the banking sector, as financial supermarkets that had bank and nonbank franchises under the umbrella of a single holding company bought out smaller rivals to gain an ever-increasing national and international footprint. While the Riegle-Neal Banking Act of 1994, which established a 10 percent cap nationally on any particular bank's share of federally insured deposits, should have been a barrier for at least some of these mergers, regulatory forbearance permitted them to go through anyway. In fact, then Citicorp's proposed merger Travelers Insurance was actually a major rationale behind the Glass-Steagall Act. Most of the largest banks are products of serial mergers. For example, J.P. Morgan Chase is a product of J.P. Morgan, Chase Bank, Chemical Bank, Manufacturers Hanover, Banc One, Bear Stearns, and Washington Mutual. Meanwhile, Bank of America is an amalgam of that predecessor bank, Nation's Bank, Barnett Banks, Continental Illinois, MBNA, Fleet Bank, and finally Merrill Lynch.

Second, the business of finance was changing. Disintermediation, the process by which investors directly fund businesses and individuals through securities markets, was already in full bloom by the time of the repeal of Glass-Steagall. This was demonstrated by the dramatic growth in money market fund and mutual fund assets and by the fact that corporate bonds actually exceeded nonmortgage bank loans by the middle of the 1990s.

The subsequent boom in structured finance took this process to ever greater heights. Securitization, whereby pools of illiquid loans and other assets are structured, converted and marketed into asset-backed securities, ABS, is in principle a valuable process that facilitates the flow of credit and the dispersion of risk beyond the banking system. Regulatory neglect, however, permitted a good model to mutate and grow into a sad farce.

On one end of the securitization supply chain, regulators allowed underwriting standards to erode precipitously without strengthening mortgage origination regulations or sounding the alarm bells on harmful nonbank actors—not even those within bank holding companies over which the regulators had jurisdiction. On the other, securities backed by risky loans were transformed into securities deemed “hi-grade” by credit rating agencies, only after a dizzying array of steps where securities were packaged and repackaged into many layers of senior tranches, which had high claims to interest and principal payments, and subordinate tranches.

The nonbanking actors—investment banks, hedge funds, money market funds, off-balance-sheet investment funds—that powered structured finance came to be known as the shadow banking market. Of course, the shadow banking market could only have grown to surpass by trillions of dollars the actual banking market with the consent of regulators.

In fact, one of the primary purposes behind the securitization market was to arbitrage bank capital standards. Banks that could show regulators that they could offload risks through asset securitizations or through guarantees on their assets in the form of derivatives called credit default swaps received more favorable regulatory capital treatment, allowing them to build their balance sheets to more and more stratospheric levels.

With the completion of the Basel II Capital Accord, determinations on capital adequacy became dependent on the judgments of rating agencies and, increasingly, the banks' own internal models. While this was a recipe for disaster, it reflected in part the extent to which the size and complexity of this new era of quantitative finance exceeded the regulators' own comprehension.

When Basel II was effectively applied to investment banks like Lehman Brothers and Goldman Sachs, which had far more precarious and potentially explosive business models that

utilized overnight funding to finance illiquid inventories of assets, the results were even worse. The SEC, which had no track record to speak of with respect to ensuring the safety and soundness of financial institutions, allowed these investment banks to leverage a small base of capital over 40 times into asset holdings that, in some cases, exceeded \$1 trillion.

Third, little more than a year after repealing Glass-Steagall, Congress passed legislation—the Commodity Futures Modernization Act of 2000—to allow over-the-counter derivatives to essentially remain unregulated. Following the collapse of the hedge fund Long Term Capital Management in 1998, then Commodity Futures Trading Commission Chairwoman Brooksley Born began to warn of problems in this market. Unfortunately, her calls for stronger regulation of the derivatives market clashed with the uncompromising free-market philosophies of Federal Reserve Chairman Alan Greenspan, then Treasury Secretary Robert Rubin and later Treasury Secretary Larry Summers. To head off any attempt by the CFTC or another agency from regulating this market, they successfully convinced Congress to pass the CFMA.

The explosive growth of the OTC derivatives market following the passage of the CFMA was stunning—the size of the OTC derivatives market grew from just over \$95 trillion at the end of 2000 to over \$600 trillion in 2009. This growth had profound implications for the overall risk profile of the financial system. While derivatives can be used as a valuable tool to mitigate or hedge risk, they can also be used as an inexpensive way to take on leverage and risk. As I noted before, certain OTC derivatives called credit default swaps were crucial in allowing banks to evade their regulatory capital requirements. In other contexts, CDS contracts have been used to speculate on the credit worthiness of a particular company or asset.

But they pose other problems as well. Since derivatives represent contingent liabilities or assets, the risks associated with them are imperfectly accounted for on company balance sheets. And they have concentrated risk in the banking sector, since even before the repeal of Glass-Steagall, large commercial banks like J.P. Morgan were major derivatives dealers. Finally, the proliferation of derivatives has significantly increased the interdependence of financial actors while also overwhelming their back-office infrastructure. Hence, while the growth of derivatives greatly increased counterparty credit risks between financial institutions—the risk, that is, that the other party will default at some point during the life of the derivative contract—those entities had little ability to quantify those risks, let alone manage them.

Therefore, on the eve of what was arguably the biggest economic crisis

since the Great Depression, which was caused in large part by the confluence of all the forces and trends that I have just described, the financial industry was larger, more concentrated, more complex, more leveraged and more interconnected than ever before. Once the subprime crisis hit, it spread like a contagion, causing a collapse in confidence throughout virtually the entire financial industry. And without clear walls between those institutions the government insures and those that are free to take on excessive leverage and risk, the American taxpayer was called upon to step forward into the breach.

Unfortunately, the government's response to the financial meltdown has only made the industry bigger, more concentrated and more complex. As the entire financial system was imploding following the bankruptcy filing by Lehman Brothers, the Treasury and the Federal Reserve hastily arranged mergers between commercial banks, which had a stable source of funding in insured deposits, and investment banks, whose business model depended on market confidence to roll over short-term debt.

Before the Lehman bankruptcy, Bear Stearns had been merged into J.P. Morgan. After the Lehman collapse, one of the biggest mergers to occur was between Bank of America and Merrill Lynch. And Ken Lewis, the CEO of Bank of America at the time, alleges that it was consummated only following pressure he received from Treasury Secretary Hank Paulson and Federal Reserve Chairman Ben Bernanke.

As merger plans for the remaining two investment banks, Goldman Sachs and Morgan Stanley, faltered, another plan was hatched. Both Goldman Sachs and Morgan Stanley—neither of which had anything even close to traditional banking franchises—were both given special dispensations from the Federal Reserve to become bank holding companies. This provided them with permanent borrowing privileges at the Federal Reserve's discount window—without having to dispose of risky assets. In a sense, it was an official confirmation that they were covered by the government safety net because they were literally “too big to fail.”

Following the crisis, the U.S. mega banks left standing have even more dominant positions. Take the multi-trillion-dollar market for OTC derivatives. The five largest banks control 95 percent of that market. Let me repeat that. The five largest banks control 95 percent of the over-the-counter derivatives market. With such strong pricing power, these firms could afford to expand dramatically their margins. The Federal Reserve estimated that those five banks made \$35 billion from trading in the first half of 2009 alone. Of course, they used these outsized profits from trading activities in derivatives and other securities not only to replenish their capital, but also to pay billions of dollars in bonuses.

Large and complex institutions like Citigroup dominate our financial industry and our economy. MIT professor Simon Johnson and James Kwak, a researcher at Yale Law School, estimate that the six largest U.S. banks now have total assets in excess of 63 percent of our overall GDP. Only 15 years ago, the six largest US banks had assets equal to 17 percent of GDP. This is an extraordinary increase. We haven't seen such concentration of financial power since the days of Morgan, Rockefeller and Carnegie.

As I stated at the outset, I am extremely concerned that our reform efforts to date do little, if anything, to address this most serious of problems. By expanding the safety net—as we did in response to the last crisis—to cover ever larger and more complex institutions heavily engaged in speculative activities, I fear that we may be sowing the seeds for an even bigger crisis in only a few years or a decade.

Unfortunately, the current reform proposals focus more on reorganizing and consolidating our regulatory infrastructure, which does nothing to address the most basic issue in the banking industry: that we still have gigantic banks capable of causing the very financial shocks that they themselves cannot withstand.

Rather than pass the buck to a reshuffled regulatory deck, which will still be forced to oversee banks that former FDIC Chairman Bill Isaac describes as “too big to manage, and too big to regulate,” we must draw hard statutory lines between banks and investment houses.

We must eliminate the problem of “too big to fail” by reinstituting the spirit of Glass-Steagall, a modern version that separates commercial from investment banking activities and imposes strict size and leverage limits on financial institutions.

We must also establish clear and enforceable rules of the road for our securities market in the interest of making them less fragmented, opaque and prone to collapse. The over-the-counter derivatives market must be tightly regulated, as originally proposed by Brooksley Born—and rejected by Congress—in the late 1990s.

Finally, I believe the myriad conflicts of interest on Wall Street must be addressed through greater protection and empowerment of individual investors. Our antifraud provisions, as represented for example by rule 10(b)5, under the 1934 Securities Act, need to be strengthened.

One key reform that has been proposed to address the “too big to fail” problem is resolution authority. The existing mechanism whereby the FDIC resolves failing depository institutions has, by and large, worked well. After the experiences of Bear Stearns and Lehman Brothers in 2008, it is clear that a similar process should be applied to entire bank holding companies and large nonbank institutions.

While no doubt necessary, this is no panacea. No matter how well Congress

crafts a resolution mechanism, there can never be an orderly wind-down, particularly during periods of serious stress, of a \$2-trillion institution like Citigroup that had hundreds of billions of off-balance-sheet assets, relies heavily on wholesale funding, and has more than a toehold in over 100 countries.

There is no cross-border resolution authority now, nor will there be for the foreseeable future. In the days and weeks following the collapse of Lehman Brothers, there was an intense and disruptive dispute between regulators in the U.S. and U.K. regarding how to handle customer claims and liabilities more generally. Yet experts in the private sector and governments agree—national interests make any viable international agreement on how financial failures are resolved difficult to achieve. A resolution authority based on U.S. law will do precisely nothing to address this issue.

While some believe market discipline would be reimposed by refining the bankruptcy process, Lehman Brothers demonstrates that the very concept of market discipline is illusory with institutions like investment banks, which used funds that they borrowed in the repo market to finance their own inventories of securities, as well as their own book of repurchase agreements, which they provided to hedge funds through their prime brokerage business.

Investment banks, the fulcrum of these institutional arrangements, found themselves in a classic squeeze. On one side, their hedge fund clients and counterparties withdrew funds and securities in their prime brokerage accounts, drew down credit lines and closed out derivative positions, all of which caused a massive cash drain on the bank. On the other side, the repo lenders, concerned about the value of their collateral as well as the effect of the cash drain on the banks' credit worthiness, refused to roll over their loans without the posting of substantial additional collateral. These circumstances quickly prompted a vicious cycle of deleveraging that brought our financial system to the brink. With such large, complex and combustible institutions like these, there can be no orderly process of winding them down. The rush to the exits happens much too quickly.

That is why we need to directly address the size, the structure and the concentration of our financial system.

The Volcker rule, which would prohibit commercial banks from owning or sponsoring "hedge funds, private equity funds, and purely proprietary trading in securities, derivatives or commodity markets," is a great start, and I applaud Chairman Volcker for proposing that purely speculative activities should be moved out of banks. That is why I joined yesterday with Senators JEFF MERKLEY and CARL LEVIN to introduce a strong version of the Volcker rule. But I think we must go further still. Massive institutions

that combine traditional commercial banking and investment banking are rife with conflicts and are too large and complex to be effectively managed.

We can address these problems by reimposing the kind of protections we had under Glass-Steagall. To those who say "repealing Glass-Steagall did not cause the crisis, that it began at Bear Stearns, Lehman Brothers and AIG," I say that the large commercial banks were engaged in exactly the same behavior as Bear Stearns, Lehman and AIG—and would have collapsed had the federal government not stepped in and taken extraordinary measures. That is the reason why commercial banks did not go under, because we were protecting them because they were too big to fail. We let Bear, Lehman and AIG—go under because they were not. This seems like a circular argument on why we should not do more about commercial banks in this country that are so incredibly large and we would be stuck with the same situation we were in during the meltdown. Moreover, in response to the last crisis, we increased the safety net that covers these behemoth institutions. The result: they will continue to grow unchecked, using insured deposits for speculative activities without running any real risk of failure on account of their size.

We need to reinstate Glass-Steagall in an updated form to prevent or at least severely moderate the next crisis.

By statutorily splitting apart massive financial institutions that house both banking and securities operations, we will both cut these firms down to more reasonable and manageable sizes and rightfully limit the safety net only to traditional banks. President of the Federal Reserve Bank of Dallas Richard Fisher recently stated:

I think the disagreeable but sound thing to do regarding institutions that are ["too big to fail"] is to dismantle them over time into institutions that can be prudently managed and regulated across borders. And this should be done before the next financial crisis, because it surely cannot be done in the middle of a crisis.

A growing number of people are calling for this change. They include former FDIC Chairman Bill Isaac, former Citigroup chairman John Reed, famed investor George Soros, Nobel Prize winning economist Joseph Stiglitz, president of the Federal Reserve Bank of Kansas City, Thomas Hoenig, and Bank of England Governor, Mervyn King, among others. A chastened Alan Greenspan also adds to that chorus, noting:

If they're too big to fail, they're too big. In 1911 we broke up Standard Oil—so what happened? The individual parts became more valuable than the whole. Maybe that's what we need to do.

Alan Greenspan, in my opinion, has never been more right.

But even this extraordinary step of splitting these institutions apart is not sufficient. Cleaving investment banking from traditional commercial banking will still leave us with massive investment banks, some with balance sheets that exceed \$1 trillion in assets.

For that reason, Glass-Steagall would need to be supplemented with strict size and leverage constraints. The size limit should focus on constraining the amount of nondeposit liabilities at large investment banks, which rely heavily on short-term financing, such as repos and commercial paper.

The growth of those funding markets in the run-up to the crisis was staggering. One report by researchers at the Bank of International Settlements estimated that the size of the overall repo market in the United States, Euro region and the United Kingdom totaled approximately \$11 trillion at the end of 2007. Incredibly, the size was more than \$5 trillion more than the total value of domestic bank deposits at that time, which was less than \$7 trillion.

The overreliance on such wholesale financing made the entire financial system vulnerable to a classic bank run, the type that we had before we instituted a system of deposit insurance and strong bank supervision. Remarkably, while there is a prudential cap on the amount of deposits a bank can have—even though deposits are already federally insured—there is no limit of any kind on liabilities like repos that need to be rolled over every day. With a sensible limit on these liabilities at each financial institution—for example, as a percentage of GDP—we can ensure that never again will the so-called shadow banking system eclipse the real banking system.

In addition, institutions that rely upon market confidence every day to finance their balance sheet and market prices to determine the worth of their assets should not be leveraged to stratospheric levels. To ensure that regulatory forbearance does not permit another Lehman Brothers, we should institute a simple statutory leverage requirement, that is, a limit on how much firms can borrow relative to how much their shareholders have on the line. As I have said in a previous speech, a statutory leverage requirement that is based upon banks' core capital—i.e., their common stock plus retained earnings—could supplement regulators' more highly calibrated risk-based assessments, providing a sorely needed gut check that ensures that regulators don't miss the forest for the trees when assessing the capital adequacy of a financial institution.

This would push firms back towards the levels of effective capital they had in the pre-bailout days—like in the post World War II period when our financial system generally functioned well. To be sure, this would move our core banks from being predominantly debt financed to substantially based on equity. But other parts of our financial system already operate well on this basis—with venture capital being the most notable example. The return on equity relative to debt would need to rise to accommodate this change, but—as long as we preserve a credible monetary policy—this is consistent with low interest rates in real terms.

I would also stress that a leverage limit without breaking up the biggest banks will have little effect. Because of their implicit guarantee, “too big to fail” banks enjoy a major funding advantage—and leverage caps by themselves do not address that. Our biggest banks and financial institutions have to become significantly smaller if we are to make any progress at all.

Turning now to derivatives reform, I have already noted how large dealer banks completely dominate the OTC marketplace for derivatives, an opaque market where these banks exert enormous pricing power. For over two decades, this market has existed with virtually no regulation whatsoever.

Amazingly, it is a market where the dealers themselves actually set the rules for the amount of collateral and margin that needs to be posted by different counterparties on trades. Dealers never post collateral, while the rules they set for their counterparties are both lax and procyclical, meaning that margin requirements tend to increase during periods of market turmoil when liquidity is at a premium. The complete lack of oversight of these markets has almost brought our financial system to its knees twice in 10 years, first with the failure of LTCM in 1998, and then with the failure of Lehman Brothers in 2008. We have known about these problems for over a decade—yet we have so far done nothing to make this market better regulated.

That is why I applaud CFTC Chairman Gary Gensler’s efforts in pushing for centralized clearing and regulated electronic execution of standardized OTC derivatives contracts as well as more robust collateral and margin requirements. Clearinghouses have strong policies and procedures in place for managing both counterparty credit and operational risks. Chairman Gensler underscores that this would get directly at the problem of “too big to fail” by stating: “Central clearing would greatly reduce both the size of dealers as well as the interconnectedness between Wall Street banks, their customers and the economy.” Moreover, increased clearing and regulated electronic trading will make the market more transparent, which will ultimately give investors better pricing.

A strong clearing requirement, however, should not be swallowed by large exemptions that circumvent the rules. While I am sympathetic to concerns about increased costs raised by non-financial corporations that use interest rate and currency swaps for hedging purposes, any exemption of this sort should be narrowly crafted. For example, it might be limited to transactions where non-financial corporations use OTC derivatives in a way that qualifies for GAAP hedge accounting treatment. In any case, we should recognize more explicitly that when such derivatives contracts are provided by too big to fail banks, the end users are in effect splitting the hidden taxpayer subsidy with the big banks. And remember that

this subsidy is not only hidden—it is also dangerous, because it is central to the incentives to become bigger and to take more risk once any financial firm is large.

Given that one of the key objectives behind increased clearing is to reduce counterparty credit risk, it also seems reasonable that derivatives legislation place meaningful constraints on the ownership of clearinghouses by large dealer banks.

Finally, we need to address the fundamental conflicts of interest on Wall Street. While separating commercial banking from investment banking is a critical step, there are still inherent conflicts within the modern investment banking model.

Let’s take the example of auction rate securities. Brokers at UBS and other firms marketed these products, which were issued by municipalities and not-for-profit entities, as “safe, liquid cash alternatives” to retail investors even though they were really long-term debt instruments whose interest rates would reset periodically based upon the results of Dutch auctions. In other words, these unsuspecting investors would be unable to sell their securities if new buyers didn’t enter the market, which is exactly what happened. As credit concerns by insurers who guaranteed these securities drained liquidity from the market, bankers continued to sell these securities to retail clients as safe, liquid investments. There was a blatant conflict of interest where the banks served as broker to their retail customers while also underwriting the securities and conducting the auctions.

There is an open issue of why such transactions did not constitute securities fraud, for example under rule 10(b)5—which prohibits the nondisclosure of material information. Civil actions are still in progress and perhaps we will learn more from the outcomes of particular cases. But no matter how these specific cases are resolved, we should move to strengthen the legal framework that enables both private parties and the SEC—both civil and criminal sides—to bring successful enforcement actions.

Individuals at Enron, Merrill Lynch, and Arthur Anderson were called to account for their participation in fraudulent activities—and at least one executive from Merrill went to prison for signing off on a deal that would help manipulate Enron’s earnings. But it is quite possible that no one will be held to account, either in terms of criminal or civil penalties, due to the deception and misrepresentation manifest in our most recent credit cycle. We must work hard to remove all the loopholes that helped create this unfair and unreasonable set of outcomes.

We can begin by strengthening investor protection. Currently, brokers are not subject to a fiduciary standard as financial advisors are, but only subject to a “suitability” requirement when selling securities products to investors.

Hence, brokers don’t have to be guided by their customers’ best interest when recommending investment product offerings—they might instead be focused on increasing their compensation by pushing proprietary financial products. I am not saying they are doing that, but we have to be aware and deal with clear conflicts of interest. By harmonizing the standards that brokers and financial advisors face and by better disclosing broker compensation, retail investors will be able to make better, more informed investment decisions. Even Lloyd Blankfein, the CEO of Goldman Sachs, has stated that he “support[s] the extension of a fiduciary standard to broker/dealer registered representatives who provide advice to retail investors. The fiduciary standard puts the interests of the client first. The advice-giving functions of brokers who work with investors have become similar to that of investment advisers.”

It has also become known that some firms underwrite securities—promoting them to investors—and then short these same securities within a week and without disclosing this fact, which any reasonable investor would regard as adverse material information. In the structured finance arena, investment banks sold pieces of collateralized debt obligations—which were packages of different asset-backed securities divided into different risk classes—to their clients and then took—proceeded to take short positions in those securities by purchasing credit default swaps. Some banks went further by shorting mortgage indexes tied to securities they were selling to clients and by shorting their counterparties in the CDS market. This is how a firm such as Goldman Sachs could claim that they were effectively hedged to an AIG collapse.

Unfortunately, the use of products like CDS in this way allows the banks to become empty creditors who stand to make more money if people and companies default on their debts than if they actually paid them. These and other problematic practices that place financial firms’ interests against those of their clients need to be restricted. They also completely violate the spirit of our seminal legislation from the 1930s, which insisted—for the first time—that the sellers and underwriters of securities disclose all material information. This is nothing less than a return to the unregulated days of the 1920s; to be sure, those days were heady and exciting, but only for a while—such practices always end in a major crash, with the losses disproportionately incurred by small and unsuspecting investors.

Investors should also have greater recourse through our judicial system. For example, auditors, accountants, bankers and other professionals that are complicit in corporate fraud should be held accountable. That is why I worked on a bill with Senators SPENCER and REED to allow for private civil

actions against individuals who knowingly or recklessly aid or abet a violation of securities laws.

Admittedly, this is not an exhaustive list of financial reforms. I also believe we need to reconstitute our system of consumer financial protection, which was a major failure before our last crisis. We must have an independent Consumer Financial Protection Agency, CFPB, that has strong and autonomous rulemaking authority and the ability to enforce those rules at nonbanking entities like payday lenders and mortgage finance companies. Most importantly, the head of this agency must not be subject to the authority of any regulator responsible for the “safety and soundness” of the financial institutions.

This is basic. If you are involved, like most of our banking regulatory agencies, in the Treasury, their primary responsibility is the safety and soundness of those financial institutions. We need an organization such as the CFPB, which looks out totally for the interest of consumers and consumers alone.

Unfortunately, like the public option in healthcare, the CFPB issue has become something of a “shiny object”—though certainly an important one—that has distracted the focus of debate away from the core issues of “too big to fail.”

Beginning with the solutions for “too big to fail,” each of these challenges represents a crucial step along the way towards fixing a regulatory system that has permitted both large and small failures. Each is an important piece to the puzzle.

I know there are those who will disagree with some, and perhaps all of these proposals. They sincerely advocate a path of incrementalism, of achieving small reforms over time. They say that problems as complex as these need to be solved by the regulators, not by Congress. After all, they are the ones with the expertise.

I respectfully disagree.

Giving more authority to the regulators is not a complete solution. While I support having a systemic risk council and a consolidated bank regulator, these are necessary but not sufficient reforms—the President’s Working Group on Financial Markets has actually played a role in the past similar to that of the proposed council, but to no discernible effect. I do not see how these proposals alone will address the key issue of “too big to fail.”

In the brief history I outlined earlier, the regulators sat idly by as our financial institutions bulked up on short-term debt to finance large inventories of collateralized debt obligations backed by subprime loans and leveraged loans that financed speculative buyouts in the corporate sector.

They could have sounded the alarm bells and restricted this behavior, but they did not. They could have raised capital requirements, but instead farmed out this function to credit rating agencies and the banks themselves.

They could have imposed consumer-related protections sooner and to a greater degree, but they did not. The sad reality is that regulators had substantial powers, but chose to abdicate their responsibilities.

What is more, regulators are almost completely dependent on the information, analysis and evidence as presented to them by those with whom they are charged with regulating. Last year, former Federal Reserve Chairman Alan Greenspan, once the paragon of laissez-faire capitalism, stated that “it is clear that the levels of complexity to which market practitioners, at the height of their euphoria, carried risk management techniques and risk-product design were too much for even the most sophisticated market players to handle properly and prudently.” I submit that if these institutions that employ such techniques are too complex to manage, then they are surely too complex to regulate.

That is why I believe that reorganizing the regulators and giving them additional powers and responsibilities isn’t the answer. We cannot simply hope that chastened regulators or newly appointed ones will do a better job in the future, even if they try their hardest. Putting our hopes in a resolution authority is an illusion. It is like the harbor master in Southampton adding more lifeboats to the *Titanic*, rather than urging the ship to steer clear of the icebergs. We need to break up these institutions before they fail, not stand by with a plan waiting to catch them when they do fail.

Without drawing hard lines that reduce size and complexity, large financial institutions will continue to speculate confidently, knowing that they will eventually be funded by the taxpayer if necessary. As long as we have “too big to fail” institutions, we will continue to go through what Professor Johnson and Peter Boone of the London School of Economics has termed “doomsday” cycles of booms, busts and bailouts, a so-called “doom loop” as Andrew Haldane, who is responsible for financial stability at the Bank of England, describes it.

The notion that the most recent crisis was a “once in a century” event is a fiction. Former Treasury Secretary Paulson, National Economic Council Chairman Larry Summers, and J.P. Morgan CEO Jamie Dimon all concede that financial crises occur every 5 years or so.

Without clear and enforceable rules that address the unintended consequences of unchecked financial innovation and which adequately protect investors, our markets will remain subverted.

These solutions are among the cornerstones of fundamental and structural financial reform. With them we can build a regulatory system that will endure for generations instead of one that will be laid bare by an even bigger crisis in perhaps just a few years or a decade’s time. We built a lasting regu-

latory edifice in the midst of the Great Depression, and it lasted for nearly half a century. I only hope we have both the fortitude and the foresight to do so again.

#### IRAN REFINED PETROLEUM SANCTIONS ACT OF 2009

Mr. KAUFMAN. Madam President, I ask unanimous consent that the Banking Committee be discharged from further consideration of H.R. 2194, the Iran Refined Petroleum Sanctions Act of 2009, and the Senate then proceed to its consideration.

The ACTING PRESIDENT pro tempore. Without objection, it is so ordered.

The clerk will report the bill by title.

The legislative clerk read as follows:

A bill (H.R. 2194) to amend the Iran Sanctions Act of 1996 to enhance United States diplomatic efforts with respect to Iran by expanding economic sanctions against Iran.

There being no objection, the Senate proceeded to the consideration of the bill.

Mr. KAUFMAN. Madam President, I ask unanimous consent that the substitute amendment, which is at the desk and is the language of S. 2799 as passed by the Senate on January 28, 2010, be considered and agreed to, the bill, as amended, be read three times, passed, and the motion to reconsider be laid upon the table; that upon passage, the Senate insist on its amendment, request a conference with the House on the disagreeing votes of the two Houses, and the Chair be authorized to appoint conferees on the part of the Senate with a ratio of 4 to 3, without further intervening action or debate.

The ACTING PRESIDENT pro tempore. Without objection, it is so ordered.

The amendment (No. 3466) was agreed to.

(The amendment is printed in today’s RECORD under “Text of Amendments.”)

The amendment was ordered to be engrossed and the bill to be read a third time.

The bill (H.R. 2194), as amended, was read the third time and passed.

The ACTING PRESIDENT pro tempore appointed Mr. DODD, Mr. KERRY, Mr. LIEBERMAN, Mr. MENENDEZ, Mr. SHELBY, Mr. BENNETT, and Mr. LUGAR conferees on the part of the Senate.

Mr. KAUFMAN. I yield the floor.

The ACTING PRESIDENT pro tempore. The Senator from Tennessee.

Mr. ALEXANDER. Madam President, I ask unanimous consent that the Republican Senators be able to engage in a colloquy.

The ACTING PRESIDENT pro tempore. Without objection, it is so ordered.

#### HEALTH CARE REFORM

Mr. ALEXANDER. Madam President, the Senator from Arizona and I and Senator BARRASSO, who will be here in a few minutes, had the privilege of