

Testimony of
Mr. Steve Bartlett
On behalf of
The Financial Services Roundtable
To The
Commission on the Regulation of U.S. Capital Markets in the 21st Century
U.S. Chamber of Commerce
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Good morning, my name is Steve Bartlett and I am President & CEO of The Financial Services Roundtable. Thank you for inviting me to participate in this very important undertaking to improve the U.S. capital markets. I would also like to express my appreciation to my fellow panelists, the Commissioners and to U.S. Chamber leadership for pursuing the critical goal of a competitive and efficient global marketplace.

The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives

nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for \$40.7 trillion in managed assets, \$960 billion in revenue, and 2.3 million jobs.

The Roundtable's membership of integrated financial services firms -- born out of the Gramm-Leach-Bliley concept -- have the advantage of operating in all aspects of the financial markets, nationally and globally. Our members operate across the banking, insurance and securities fields. They also have branches, offices and holdings across the entire country and, in some many cases, across the world. In sum, the Roundtable's members have a pretty good sense of what is happening locally, nationally and globally (and they're not shy about telling you).

As the head of an association with 100 CEOs, I have gotten an earful on the negative issues impacting capital market formation in the last three years. Their views are not unanimous because our members are diverse; however there are common themes. Each company has observed dramatic increases in regulation in the past three years. Most CEO's believe that the current regulatory and enforcement environment is excessive and counterproductive.

On the other hand, and notwithstanding this increased burden, our members are complying with and operating within these new regulatory constraints. They are doing so based on strong beliefs in the integrity and transparency of the markets. Our members finance the rest of the economy through lending, investing and insuring. As lenders, insurers and investors, it is essential that our members be able to rely on honest, transparent and reliable accounting and compliance. Our members are acutely attuned to and must rely on good corporate governance in the marketplace.

I must tell you, though I have been surprised by the strong negative views expressed by normally positive CEOs. I've heard phrases like "this is the worst regulatory overload that I've seen in 35 years." As well as, "I spend 80% of my time on regulations and only 20% of my time running the business." These are the financial services industry leaders and some of them have said they are "looking forward to retirement" because of the regulatory morass.

At the same time, in the last six months, I have personally observed some easing of regulatory pressure in subtle but discernible ways. I do not know if these improvements have been noticed on the front lines. Nor, do I know

if they will continue but the Roundtable continues to support efforts to eliminate outdated regulations and streamline the regulatory compliance process.

All Agree – We Have a Problem

We all agree we do have a problem. Useless laws and regulations impose significant, and unnecessary, burdens on financial services firms, which make our firms less efficient. More importantly, these burdens are also placed on our customers; this leads to reduced consumer demand and decreased production; and we all end up being less competitive in the global market place.

Others today have described the problem in various ways, but we are all adversely affected by these constraints on competition. Market participants – banks, insurance companies, securities firms – are all negatively impacted. A problem for one generally translates to a problem for all. Our markets are too integrated and too complex to address these issues in isolation.

These legislative, regulatory and enforcement restraints on competition in America's capital markets were not created over-night. Nor were these

provisions formulated by villains working in the dark. These constraints arose from the actions of smart, well-meaning policy makers to respond to political, regulatory and market upheavals. Yet, these resulting problems are still in their embryonic stages. They should be addressed immediately or these restraints will continue to grow and put increasing strains on our economy.

Capital Formation Matters.

Capital formation and growth impacts the lives of countless Americans. U.S. capital markets also impact all segments of our economy, not just banks, insurance companies and securities firms. Solutions need to be multi-faceted and deal with all aspects of and participants in the U.S. capital markets. It is also in everyone's best interest that this process is transparent, efficient and principled, just as we have done here in our meeting today.

The first step in resolving this issue has been made – acknowledging the problems. This is a good beginning. We are at the end of one election cycle and at the beginning of another. The new Congress will provide us with the opportunity for a fresh look.

The second step is to specifically identify the problems – as we have done today – and then develop specific solutions.

It is worth noting that the seeds of change need to be planted in all areas – legislative, regulatory and enforcement. By way of analogy, if you have a losing football team, you need to look at more than just replacing the quarterback. You have to look at every player and every aspect of the teams' performance. From the linebacker, to the wide-receiver, to the coach and to the water boy, every element of this problem needs to be addressed. This means considering improvements to the legislative, regulatory and enforcement processes.

After two years of deliberation and consideration the following is a summary of our major proposed solutions to the problems facing efficient capital formation.

PROPOSED SOLUTIONS:

The Roundtable and its members, in order to foster a more competitive global market place, support the following five recommendations for changes in legislative, regulatory and enforcement provisions:

- I. Improve Implementation of the Sarbanes-Oxley Act (“SOX”)**
- II. Reform examinations and enforcement practices at the Securities and Exchange Commission (“SEC”)**
- III. Restore the attorney-client privilege**
- IV. Create an optional federal insurance charter**
- V. Reinvent a system with the Justice and Treasury Departments to effectively address anti-money laundering (“AML”)**

I. Improve Implementation of SOX

The Roundtable supports meaningful controls of a public company’s systems of financial reporting to ensure investor protection and to provide accurate information to our members to support their own investing, insuring and banking. Our members continue to urge Congress, the regulators, accountants and other market participants to make improvements in the effectiveness and reduce the costs associated with the SOX Section 404 internal control over financial reporting. As previously said, it is in everyone’s best interest that this process be transparent, efficient and principled.

Specific Roundtable Recommendations:

The Roundtable has developed a number of recommendations. These recommendations are based on significant input from our members:

1. Make Amendments to SOX 404 Implementation

- Require a risk-based, three-to-five year audit cycle with annual testing of the critical, high-level, entity-wide internal controls. Require a “base year” or full Section 404 audit every three-to-five years to include revenue recognition, significant transactions and subsidiary account reviews. Allow limited three-to-five year cyclical testing ONLY if there are: (1) no material weaknesses; (2) no restatements required and (3) no fraud is found.
- Require annual testing of critical, high-level entity-wide controls in other or “off” years.
- Companies could be given the choice of “opting in” or maintaining their current systems of full annual audits.

2. Issuance of a More Risk-Based Policy Statement

For regulatory consistency, as well as for better guidance for filers, the SEC should consider issuing a more risk-based statement on internal control

reporting, similar to the statement it adopted in 1981, following financial scandals similar to those recently experienced. At that time, the SEC issued risk-based guidelines that provided, in pertinent part:

- The test of the internal control system is whether, taken as a whole, it reasonably meets the statute's specified objectives.
- Reasonableness, as a standard, includes a consideration of feasibility. One measure of reasonableness of a system relates to whether the expected benefits from improving it would be significantly greater than the anticipated costs of doing so. Thousands of dollars should not be spent conserving hundreds.
- Considerable deference should be afforded to the company's reasonable business judgments. The selection and implementation of particular control procedures, so long as they are reasonable, remain managements' prerogatives and responsibilities.
- The accounting provisions principal objective is to reach knowing or reckless conduct, not inadvertent conduct.
- Corporate management and the board have important roles to play in monitoring and evaluating the adequacy of internal controls, but not involvement in the minutia or recording and accounting for every transaction.

The above bullet points have been taken directly from prior SEC risk-based guidance. These principles are consistent with past SEC policies and practices as they have been adopted and implemented in related statutes. These risk-based guidelines should be incorporated into the current SEC and PCAOB internal control reporting requirements.

3. Permit Reliance on the Work of Others

Auditing Standard No. 2 has been interpreted in such a way as to prevent significant reliance on the work of a company's internal auditors or outside regulators (NASD, SEC, FED, etc.) While the PCAOB has clarified that this is not the objective for low-risk areas, the requirement still exists for an auditor to perform his own work in "high risk" areas. Section 404 should be amended to allow an independent public accounting firm to rely significantly on the examinations and inspections conducted by Federal and state regulatory agencies to the extent appropriate.

4. Conduct Complete Evaluation of Compliance Costs

There have been two recent, highly divergent studies released regarding costs for Section 404. An FEI Study in March, 2006, showed the cost of compliance with Section 404 for the average public company was reduced

by 17 percent from 2005, but still remains high at approximately \$3.7 million per company. A contemporaneous CRA Study found compliance expense reductions of 44 percent for large cap companies and 31 percent for small cap companies.

The experience of our members does not support the extent of compliance-cost reductions contained in either the FEI or CRA findings. It may be appropriate to conduct a more comprehensive SEC-sponsored study of Section 404 costs.

5. Relaxation of Restriction on Communications with Auditors

For the internal controls review required by Section 404 to be useful to a company, Section 404 should be amended to allow management of the company to communicate openly with the independent public accounting firm about the nature, scope, and structure of its internal controls without adversely affecting the independence of the firm for purposes of fulfilling its attestation function.

6. Promote Competition and Eliminate *de minimis* Conflicts

There exists a “logjam” of conflicts that has arisen with only four large accounting firms capable of servicing the larger public issuers. The SEC and the PCAOB should take all reasonable steps to increase the number of qualified accounting firms and to eliminate *de minimis* conflict of interest provisions. Given the reality of a PCAOB-regulated oligopoly of only four major accounting firms positioned to provide audits of large public companies, the PCAOB and SEC should develop and issue revised conflict provisions that reflect this new reality.

In addition, a group of four third-tier accounting firms recently formed a coalition to compete for business from larger, more complex firms.

Initiatives such as this one should be encouraged to increase competition and choice.

II. SEC Enforcement Reforms

The Roundtable supports H.R. 4618, the “the Compliance, Examinations, and Inspections Restructuring Act of 2005.” This legislation will improve the enforcement and inspection processes at the SEC and ensure its status as the preeminent securities regulator. The principal elements of the Bill include -- (1) improving OCIE’s effectiveness by, among other things,

returning its examination functions back to the operating divisions; (2) requiring formal notice of the closing of an enforcement investigation; and (3) appointing an ombudsman to handle confidential inquiries -- all of which would help strengthen the SEC and further its key missions of protecting investors and fostering strong capital markets.

Specifically, returning OCIE's inspection and examination authority to the operating divisions – Investment Management and Market Regulation – would place these crucial functions back within the divisions that oversee these aspects of the securities markets. A return to this pre-1995 structure would enhance the SEC's ability to focus its resources on companies that are not in compliance with federal securities laws by allowing examiners to operate under the expertise of the Commission staff directly responsible for these companies.

The SEC has made some improvements in its examination process by requiring full Commission approval of all "sweep" examinations. They have also committed to providing a letter to firms within ninety days of completion of the examination field work.

Second, requiring that the enforcement investigation “end” or closure date information be provided to the companies at issue would allow them to make more accurate and timely disclosures to their shareholders.

I would note that the SEC has made significant improvements in its practices to provide notice of the termination of an investigation. This will benefit companies and shareholders who need disclosure on where their liabilities begin and end, but this practice should be further strengthened and formally adopted.

Finally, appointing an SEC ombudsman, similar to those found in the federal banking regulators, would strengthen the markets by providing an opportunity for public companies to fully understand SEC requirements as they apply in specific circumstances. Also, providing some form of prudential regulation would allow companies to engage the SEC with candor and without fear of retribution.

III. Attorney-Client Privilege

On Tuesday, September 12, the Senate Judiciary Committee held a hearing entitled “The Thompson Memorandum’s Effect on the Right to Counsel in

Corporate Investigations.” Consistent with Roundtable members’ views, Chairman Arlen Specter (R-PA) and Ranking Committee Member Patrick Leahy (D-VT) made it clear that they did not agree with the Department of Justice (DOJ) policy (known as the “Thompson Memorandum”) that says prosecutors should attempt to indict a company based on the company’s lack of willingness to waive Attorney-Client privilege and turning over work product information to the government. The right to counsel is guaranteed in the Constitution and should not be abrogated by a *memorandum*.

Roundtable members agree that the Memorandum is coercive and has become part of the investigative culture at the DOJ. Senator Specter intends to allow the DOJ and the courts to take the first step in correcting this policy. However, if this proves to be unsatisfactory, then Congress will seek a legislative solution. The House has already indicated its intent to adopt legislation to resolve this problem. The Roundtable supports legislative relief sooner, rather than later.

Another industry solution might be the establishment of a “Self-Evaluation Privilege.” “Self-evaluations,” as described in more detail in the program’s materials, would permit a corporation or other business entities to take a

critical and probing look into its operations in order to identify and assess areas of risk and to detect weaknesses or investigate actual malfeasance or employee misconduct. The self-evaluation would result in a report to management and would contain candid reflections on such things as the company's processes, procedures and management depth.

Such a privilege is needed because existing privileges are inadequate to meaningfully protect information produced in the self-evaluative process. For example, protections afforded by the attorney-client communications privilege and attorney work product privilege are limited enhanced opportunities to preserve the attorney-client privilege when sharing documents with the SEC in the context of examinations or certain types of enforcement inquiries. Moreover, the concept of a self-evaluation privilege for broker-dealers, investment advisers and mutual funds is consistent with the securities industry's "self regulatory" posture and simply takes the regulatory/compliance review process into the firm itself. That type of initiative, if done properly by the industry, could enhance supervision and compliance activities of all market participants.

IV. Optional Federal Insurance Charter

Uniform national standards across state lines are critical for the efficient and effective delivery of products and services. Our current system of insurance regulation and supervision does not and cannot permit the insurance industry to be fully responsive to the needs of the economy or the consumers of its services. State-by-state insurance regulation is the last vestige of 19th century place-based regulation. Consumers (be they individuals, small businesses, or Fortune 500 companies), and the firms that serve them, need and deserve interstate competition now.

Several points are worth noting:

- Being licensed and regulated by a single body will save insurance agents and brokers time and money and free them to spend more time working with policyholders.
- Under a federal charter, consumers could have the ability to buy the same product nationwide, and would be able to keep their relationship with their agent if their agent has a national license.

- A national insurance charter will stabilize and lower insurance premiums by encouraging more companies to compete in more states.
- Under such a system, insurers would be able to bring their products to market more quickly because they would only have to obtain approval from a single regulatory body, rather than in multiple states.
- It can take several years for a company to roll out a product nationally. Oftentimes, the delays are caused by differences among the states in the laws governing product approval. This patchwork system of state laws and regulations lacks uniformity and is interpreted differently from state to state.
- The Federal tax code recognizes the important role that life insurance and annuity products play in protecting the financial well being of Americans
- Insurance is the only segment of the financial services industry that does not have a single national advocate to serve as an expert resource on insurance issues in which Congress and the Administration are involved and to provide a national perspective on issues of importance to the industry

V. Re-invent a System with the Justice and Treasury Departments to Prevent Anti-Money Laundering (“AML”) Activities

As financial services firms, Roundtable members perform an important role in our nation’s anti-money laundering and anti-terrorist finance system. This role includes monitoring financial transactions with customers and filing suspicious activity reports and currency transaction reports with law enforcement authorities. Our proposed initiatives are based upon our experience with these requirements. Both proposals are intended to make these requirements more effective in the fight against terrorist financing and other financial crimes.

1. Codifying the “Good Faith” Standard for Suspicious Activity Report (“SARs”) Filings

We recommend that the “good faith” standard that is expressed in the AML Examination Manual (the “AML Exam Manual”) be codified in the Code of Federal Regulations. In recent years, there has been a significant expansion in the volume of SARs filings. Much of this growth is the result of so-called “defensive filings” by firms that wish to avoid any appearance of non-compliance with the SAR filing requirement. Codifying the “good faith”

standard that appears in the AML Exam Manual would reduce defensive filings and permit law enforcement agencies to focus valuable resources on serious crimes.

The good faith standard in the AML Exam Manual reads as follows:

In those instances where a bank has an established SAR decision-making process, has followed existing policies, procedures, and processes and has determined not to file a SAR, the bank should not be criticized for the failure to file a SAR unless the failure is significant or accompanied by evidence of bad faith. (Page 46 of the AML Exam Manual)

This standard reflects the inherently subjective nature of SAR filings and the impossibility of detecting and reporting all illicit transactions that flow through an institution. These are features of the current system, and both are acknowledged in the AML Exam Manual. (See pages 40 and 46 of the AML Exam Manual)

While this good faith standard is designed to focus attention on policy, procedures and processes, it has not deterred defensive filings. It has not done so because it is an “informal” statement of policy, rather than a “formal” regulatory standard. Therefore, we recommend that the standard be formally codified in applicable anti-money laundering and anti-terrorist financing regulations. By adopting the standard as a regulation, Treasury would send a strong signal to all financial services firms that the focus of SAR compliance is on policies, procedures and processes, not individual filing decisions. This would reduce defensive filings and permit law enforcement agencies to focus their resources on serious crimes.

2. Analysis of the Effectiveness of Existing Bank Secrecy Act (“BSA”)

Requirements

Our second recommendation is that Treasury analyze the effectiveness of the anti-money laundering and anti-terrorist financing requirements applicable to financial services firms. This proposed analysis is an attempt to reduce the over \$ 1 million SARS filed annually to a number that has some actual correlation to real suspicious activities.

The members of The Roundtable are committed to the goals of the BSA. However, many of the existing requirements have been in place for years, and some were imposed in response to specific developments. In addition, since the enactment of the BSA in 1970, there have been significant advances in business practices and technology, and some of the requirements may not utilize the cutting edge of existing practices and technology.

An analysis of the effectiveness of the existing requirements and their implementation would help to ensure that the requirements applicable to financial services firms do, in practice, deter financial crimes and lead to the prosecution of those crimes. An outline for our proposed analysis appears below.

A. Identify each of the anti-money laundering and anti-terrorist financing requirements applicable to financial services firms. This listing of existing requirements sets the scope of the analysis.

B. Determine if the original purpose behind the identified requirements remains valid. Each existing requirement was put in place for a specific purpose. Does that purpose remain valid? If the original purpose behind a

requirement remains valid, are there preferable ways to achieve the same purpose?

C. *Assess the connection between each requirement and law enforcement activities.* What is the flow of information between financial services firms and law enforcement agencies? Is that information flow efficient?

Complete? How do law enforcement agencies use the information supplied by financial services firms? Is it possible to quantify the connection between the requirements imposed upon financial services firm and prosecutions for financial crimes?

D. *Review the relationship between existing requirements and the nature of financial crimes.* What types of financial crimes are identified through the current requirements? Should the requirements be more targeted to specific types of financial crimes?

E. *Review the impact of technology on existing requirements.* How does technology inhibit or enhance the ability of financial services firms to meet the goals of the BSA? Do existing requirements recognize and take full advantage of technological advances?

Legislative Landscape

The time is ripe for SOX reforms in three areas: legislative, regulatory, and enforcement. It starts with Congress. It is resolved to reviewing the effectiveness of SOX and to making changes in response to increased costs to their constituencies with little or no corresponding value. The original sponsors of the law, Sen. Paul Sarbanes (D-MD) and Chairman Mike Oxley (R-OH), have acknowledged the need for reforms.

It is time to make our suggestions to Congress on how best to improve this law. Some argue that we should not push for SOX to be reopened because of greater risks. I disagree because Republicans have already said they want amend certain SOX provisions and, if the Democrats attain a majority in the House, they will push for changes too. Given these facts, the financial services industry should strive to play a role in this process, in order to push for our priorities. The bottom line is SOX reforms need to be pursued immediately at the legislative level. The regulatory and enforcement levels will then follow suit.

Conclusion

The Roundtable and its members strongly support a competitive global market place and advocate that changes be made at all levels -- legislative, regulatory and enforcement. To summarize, Roundtable members urge:

- Improvements to the Implementation of SOX;
- SEC Enforcement Reforms;
- Restoration of the attorney-client privilege;
- Creation of an optional federal insurance charter; and
- Reinvention of a system with the Justice and Treasury Departments to effectively address AML.

THANK YOU