Bernanke’s Vision for Change

Fed Chief Calls for More Financial Oversight, Overhaul of Rules

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Federal Reserve Chairman Ben S. Bernanke yesterday laid out his most comprehensive vision yet for how to overhaul the rules governing the nation's financial system, and advocated changing accounting methods that he said have exacerbated the financial crisis.

Appearing before the Council on Foreign Relations, Bernanke said the financial system must be regulated "as a whole, in a holistic way" to avoid some of the failures that have led to the current meltdown -- which he called "the worst financial crisis since the 1930s." He said policymakers must better supervise institutions perceived as too big to fail and consider requiring firms to set aside more capital so that they have it when economic conditions worsen.

"These crises have revealed some rather shocking gaps in our regulatory oversight," Bernanke said. "I mean, who was overseeing the subprime lenders, for example? Who was overseeing AIG? There simply wasn't enough adequate oversight in those cases."

In comments on a subject that is drawing increasing scrutiny, Bernanke said current accounting standards need to be revised so they don't amplify the negative effects of a downturn.

Rules underlying what is known as "mark-to-market" or "fair-value" accounting now require companies to disclose the value of certain types of assets based on what buyers would pay for them if they were to be sold now. But because buyers have fled the marketplace, driving down prices, companies have been forced to write down the value of their assets, even if they don't plan to sell them for years.

Mark-to-market rules are intended to give investors a clear and accurate picture of the value of a company's assets. Bernanke said that remained an appropriate system, but he said policymakers "should look to identify the weak points of mark-to-market and try to make some improvements on a more expeditious basis." That would likely mean that certain kinds of assets now valued at their market price would instead be valued according to their underlying economic value, which is generally higher.

On Capitol Hill, where the American Bankers Association and other trade groups have been pushing for changes to mark-to-market accounting, Rep. Barney Frank (D-Mass.), chairman of the House Financial Services Committee, echoed Bernanke's views and said lawmakers are nudging regulators to explore the possibility of implementing new guidelines. A Financial Services subcommittee has scheduled a hearing on the issue for tomorrow.

"The mark-to-market rule has clearly got to be made better in its workings. There has to be more flexibility in its application," Frank said. "There has to be discretion in what the consequences are."

Bernanke touched on a host of other regulatory challenges in a wide-ranging speech that mapped out the ways in which stronger oversight of the financial system could help avert crises on the magnitude of the current one.

Among the most sweeping changes lawmakers are considering is the creation of a regulator to monitor firms that pose a systemic risk because they are so interconnected with other firms. The idea of a systemic risk regulator has been around for a while but has taken on new urgency following the failure of Lehman Brothers and the government takeover of insurance giant American International Group, which was brought down mainly because of losses generated by an unregulated unit based in London.

The Fed is the leading candidate to take on the job of systemic risk regulator because its already oversees bank holding companies and serves as the lender of last resort. Some analysts and lawmakers have objected to the Fed taking on more responsibility because it is already stretched thin. Bernanke responded to those concerns by saying Congress would be able to define the central bank's role.

Ann Owen, a former Fed economist, interpreted Bernanke's comments as an argument for "a more defined system to give them more authority to do this."

"I don't see how you can set up some systemic risk authority that operates independent from the Fed because at the end of the day, if there needs to be lender of last resort, it needs to be the Fed," she said.

At various points, Bernanke referred to the global nature of financial markets and the current crisis. He urged coordination with bank regulators abroad but stopped short of endorsing an international financial regulatory regime -- an idea that has been pushed by some European leaders. The issue is likely to come up when the G-20 meets in a few weeks in London.

Bernanke avoided specifics during his speech, merely making suggestions that could be taken up later by Congress. But that approach left some analysts wanting. "The issue is how do we get from Point A to Point B and what role should the Fed play," said Steven Davidoff, a law professor and an expect on securities regulation. "Nothing he's saying is not already in the works or being discussed in Congress or at the White House level."

Indeed, few of the policy ideas he offered were new. The accounting rule changes, for example, are "on everybody's list," said Hal S. Scott, a Harvard Law professor and director of the Committee on Capital Markets Regulation, a group of academics and finance industry leaders. "Our committee is looking at it. Every other group I know that is looking at the financial crisis is looking at it."

However, analysts said there was value in the Fed chairman acknowledging the consensus that has emerged among academics, former regulators and lawmakers about overhauling financial regulation.

"That's a good thing. If you compared this to [Alan] Greenspan's speeches . . . the world has changed," Davidoff said. "Greenspan was not a pro-regulatory force, and now we have someone advocating regulation across the board."

After his speech, Bernanke was asked when he expected the economy would recover.

"My forecasting record is about the same as the win-loss record of the Washington Nationals," he said.

"We will eventually recover. There's no question," he added. "There's too many underlying strengths. It's too dynamic an economy. It's a question of whether it happens quickly or less quickly."

Staff writer Zachary A. Goldfarb contributed to this report.