U.S. Chamber of Commerce's Center for Capital Markets Competitiveness
Sixth Annual Capital Markets Summit
Maintaining America's Prosperity

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I have been looking forward to this event, since there is nothing as important as maintaining America's prosperity. As the CEO of one of America's main street financial institutions, a large institutional investor, prior member of the board of the Chicago Federal Reserve and current Chairman of The Financial Services Roundtable, the capital markets are an integral part of my professional life.

To maintain America's prosperity, we must maintain the strength, vitality and flexibility of our capital markets.

My goal is to convince you of three things. First, that the U.S. capital markets are critical to maintaining American prosperity. Second, we must address the role of credit rating agencies in the financial markets from the financial crisis. Third, we need to focus the Federal Reserve on a single mandate of promoting price stability.

Let's begin by discussing the role of the financial markets in the U.S. economy. We have the strongest, most vibrant and adaptable capital markets in the world. Indeed, without our capital markets, the U.S. economy would not be a global powerhouse.

The capital markets transfer and disperse risk. This gives businesses and individuals the certainty they need to commit capital to invest in economic growth. They are inextricably intertwined with the free market that makes America so special. They translate individual desires into societal good and ensure we make optimal use of our resources. Every person has a vote every day on what they want society to provide to them. Every day, society can reward individuals for their own efforts to make the world a better place.

Our capital markets also serve the role of being a shock absorber to volatility. It does not matter if it comes from good intentions, global growth, economic recessions, greed, desire for consumption, war or natural disasters.

Our capital markets are a global competitive advantage for America and are the envy of the world. Consider the size, breadth and depth of the U.S. capital markets. The global bond market is just shy of $100 trillion, of which about 35% to 40% is in the United States. The New York Stock Exchange lists almost 3,000 companies with a market value of over $12 trillion. The London, Tokyo, Shanghai and Hong Kong exchanges – when combined – have a capitalization lower than the U.S. exchanges.

We have thousands of highly specialized financial institutions, from market makers to intermediaries to proprietary traders. These institutions have invested billions of dollars in sophisticated technology that processes transactions quickly, efficiently and transparently. There are over 3 million Americans employed in the financial services sector.

What country would not want these capabilities on their side as they compete in the global economic environment?

The output of this system is without dispute. The net worth of U.S. households is $57 trillion. That is 19 times the size of China's foreign currency reserves that are held up as a sign of their economic prowess. Non-financial companies hold $2.1 trillion of cash, which is two-thirds of China's reserves.

Clearly, however, not everything is perfect today. We are facing economic challenges in the United States with high unemployment and low economic growth. Our capital markets were also challenged in 2008 and 2009.

That said, we have survived and it is now time to move forward.

Our financial institutions have focused on safety and soundness and have rebuilt their financial strength. The recent Federal Reserve stress tests show that our largest financial institutions can weather extremely adverse economic circumstances. The recently created Hamilton Financial Index shows that the largest banks are 15% stronger than they have been historically.

Insurance companies such as ours have increased capital while paying out record amounts to individuals to cover costs from an unprecedented level of natural catastrophes.

The path here was bumpy and not without debate. It was, however, the collective effort of many that has enabled us to adapt. The Federal Reserve, Congress and two Administrations took unprecedented action to protect our economy and financial system. Private institutions took losses, dismissed leaders, changed business models and raised capital. Congress passed new legislation, most notably Dodd-Frank. Regulatory agencies expanded their scope and capabilities. Consumers have reduced their debts and increased savings. Businesses have improved risk management, compliance and compensation programs.

When you compare the U.S. to the rest of the world, we have been more effective and efficient in adapting and learning from the past. We must make sure that these changes will enable the U.S. capital markets to continue driving American prosperity.

To accomplish this important objective, we must address some unfinished business from Dodd-Frank as it relates to credit rating agencies. Dodd-Frank is a massive piece of legislation that is only about 35% implemented. Thousands of well-meaning regulators and financial services professionals are hard at work implementing this law. As we do so, we should not be afraid to acknowledge that the law is not quite right in some areas or that some of the proposed regulations need to be changed.

One place where the Dodd-Frank legislation has not created an appropriate regulatory structure is related to the credit rating agencies. We need better regulation of credit ratings.

As a CEO in one of the most regulated industries in the United States, I am no stranger to regulation. While in many cases I would prefer we reduce the $1.7 trillion cost of regulation on Americans, I recognize there is a time and place for regulation.

We all know that faulty credit ratings contributed to the financial market turmoil in 2008 and 2009. The solution of removing credit ratings from the regulatory process as suggested by some, however, is simply not workable. Instead, we need more accountability, transparency and oversight.

Today, credit ratings are hard-wired into the establishment of capital standards for financial institutions. As a result, financial institutions have wired them into their capital evaluations and risk management systems. Consequently, they are integrated into business practices and ultimately the way in which the economy functions. To simply remove them from regulatory processes will not enable our capital markets to function efficiently and effectively.

An alternative would be to treat the credit rating agencies just like we do the accounting firms. The accountants give us numbers by which we make decisions. Similarly, the credit rating agencies give us letters by which we make decisions. Both accounting firms and credit rating agencies provide the market with information and analysis of a entity that seeks capital in the markets. The market uses this information to make investment and credit risk decisions.

The difference is that the public accountants work under known and accepted principles. These principles are published, subject to commentary when changes are proposed, and overseen by the FASB, PCAOB and the American Institute of Certified Public Accountants. These firms are subject to peer reviews and oversight by PCAOB, which publishes their results. Their professionals have to pass certification tests and have mandatory continuing education. They have a code of independence and compliance processes.

Credit rating agencies operate under a much different structure. They create their own rules. They can change their standards at will and without notice. They are not subject to the level of professional standards that the public accounting profession is. Credit rating agencies should be subject to greater regulation given their integration into the fabric of the capital markets.

I suggest we create a structure for the credit rating agencies, with more transparency and accountability, that is similar to that used for the public accounting profession. A good first step might be for the SEC to fund and implement the Office of Credit Rating Agencies as required by Dodd-Frank.

My last key message is that we need to focus the Federal Reserve on a single mandate of promoting price stability. The U.S. capital markets have shown a tremendous amount of adaptability and flexibility in the face of unprecedented financial turmoil. We are now able to build on our strengths to ensure American prosperity.

Just as we have changed the role of regulators, business models, view of risk and raised capital standards, so should we examine the role of the Federal Reserve in protecting the prosperity and wealth of Americans. The Federal Reserve has successfully helped guide the U.S. economy over the last four years. As we look forward, the existence of a dual mandate will inhibit the Fed from maintaining this success.

As you know, in 1977 the Federal Reserve was given the objective to (I quote) “maintain long-run growth of the monetary and credit aggregates commensurate with the economy's long-run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices and moderate long-term interest rates.”

This dual mandate may have been appropriate 35 years ago, but it is not appropriate today.

Today, the Federal Reserve should be focused on maintaining price stability so we have a currency with a stable value. An unstable currency will undermine the effectiveness of capital markets to help provide prosperity. The Federal Reserve should be released from this burden for five reasons.

First, it is impossible to fulfill. Nobody would disagree that the central bank must execute its objectives taking into account the impact on output and employment. That said, it is simply beyond the Fed's means to manage unemployment levels. Employment is the result of businesses taking risks and innovating; researchers discovering new frontiers; legislators establishing the rules of engagement; local governments, schools, universities and parents educating children; and individuals working hard and developing themselves.

It is all of us participating in the greatest free market economy in the world. Asking the Federal Reserve to be responsible for this activity is simply not practical. In fact, Chairman Bernanke recently said, "The difference between inflation and unemployment is that we can control inflation in the long run. We cannot control unemployment in the long run."

Second, it is not possible to determine what the trade-offs are between employment and inflation. The Taylor rule is often used to discuss the trade-off between inflation and unemployment. This is an incorrect use of this "rule of thumb." It is not a mathematical formula that can predict the future.

As an executive in the financial services industry, I have become appropriately wary of relying on models or formulas that predict the future. When evaluating models, we need to look at the underlying assumptions. In this case, the Taylor rule was validated in a period of time with modest variability – certainly not reflective of the current global economic environment.

In this case, we need to rely on our judgment and experience that shows it is not possible to collapse our economy into a formula.

The third reason to move to a single mandate is that the Federal Reserve should not be responsible for making the decision on how much economic wealth to shift away from savers to promote employment. It has been suggested that tolerating a 1% increase in inflation would be worth a 3% drop in unemployment.

Let's do the math in a simplified way and see if you agree.

The net worth of U.S. households is $57 trillion. Reducing the value of that by an incremental 1% through higher inflation would be a cost of $570 billion. Reducing the unemployment rate by 3% would employ another 4.8 million people. The wealth transfer would about $119,000 per job. This is almost three times the average annual wage, which is expensive.

I recognize that this is incomplete in that there are many interrelated secondary and tertiary outcomes of higher inflation and lower unemployment. This just highlights how impossible it is to do this well. The Federal Reserve should not be given the mandate to decide how much wealth to take from savers to increase employment.

Fourth, we have been lulled to sleep on the ability of inflation to escalate rapidly. The financial markets are assuming that inflation and interest rates will remain low through 2014 because the Federal Reserve says so. Inflation can and has accelerated at rapid rates in the past.

The CPI-U in 1940 was 0.7% and two years later, in 1942, it was almost 11%. 1945: was 2.3%, two years later, in 1947, it was 14.7%. 1972: was 3.3%, 1974: was 11%. 1977: was 6.5% and 1979: was 11.2%. History has many rapid increases in inflation rates.

Much has changed since those times. Clearly, the economic situations were unique in every one of those periods.

Today, our economic situation is no less unique. The U.S. is spending massive amounts of resources in two foreign wars. Our fiscal trajectory is unfavorable. European governments are over-leveraged and do not have a clear plan to improve their fiscal situation. State and local governments in the U.S. have large unfunded retirement obligations.

Rapid growth of emerging economies creates both economic opportunity and risk. We need the Federal Reserve to be unfettered in its attention to inflation. Inflation has the ability to destroy massive wealth in a short period of time. If inflation were to increase by only 5% for one year, this would decrease the purchasing power of the $57 trillion dollars of U.S. household net worth by an amount nearly equal to the foreign reserves held by China. If we returned to the level of inflation of 1974 or 1979, the wealth destroyed in one year would be more than 1.5 times China's reserves.

Another reason to support a single mandate is that the dual mandate is currently interfering with capital markets appropriately pricing risk. Transparency and clarity are vital to free markets functioning effectively.

The Federal Reserve is currently purchasing massive amounts of debt issued by the Federal government in the hopes of maintaining economic growth. As a result, they are disrupting the ability of private investors to tell the federal government what the true price for this unfunded spending should be. This inhibits the capital markets from fulfilling their function of appropriately pricing and dispersing risk.

The Federal Reserve's mandate should be narrowed to promoting price stability in this economic environment. It is beyond the ability of monetary policy to control employment levels. It is not possible to accurately trade off inflation and employment. Society should not ask our central bankers to reallocate wealth. Inflation is highly volatile and needs unmitigated focus to protect American prosperity.

Lastly, our capital markets function most effectively in pricing risk with minimal artificial interference.

Let me close where we began.

Our economy and capital markets are the envy of the world. Everybody would like to be us. So let's be us. Let's adapt, but stay true to our principles of free and open markets where individual choice and accountability drive economic prosperity.

We need to complete the unfinished business of improving the utilization of credit ratings in our capital markets.

We need to free up the Federal Reserve by focusing it on price stability.

Congress, the private sector and regulators need to come together as One America. It is time to put aside our differences and make sure the U.S. capital markets remain a competitive advantage in competing globally. This will be good for the United States and the world.

Thank you.