APPENDIX A

The U.S. Department of Treasury's Blueprint for a Modernized Financial Regulatory Structure: Summary and Issues

I. BACKGROUND

A) The U.S. Department of Treasury, as part of its efforts to improve the competitiveness of the US capital markets, began a study of regulatory structure in March 2007 and issued a "Blueprint for a Modernized Financial Regulatory Structure" on March 31, 2008, recommending substantial regulatory reform.[1]

B) The Blueprint lays out short-, intermediate-, and long-term recommendations — the last in the form of a conceptual model for an "optimal" regulatory framework — for modifying the current US financial services regulatory structure.

C) With its release, however, Secretary Paulson emphasized that the first priority should be to remedy the current market situation and the mortgage crisis, and that the Blueprint's recommendations should not be implemented until those issues have been sufficiently addressed.[2]

II. BLUEPRINT SHORT-TERM RECOMMENDATIONS

A) Modernize the President's Working Group on Financial Markets ("PWG"). The President's Working Group on Financial Markets ("PWG"), created by executive order following the stock market decline of 1987, is an interagency coordinator for financial market regulation. The PWG's current members are the respective heads of Treasury, the Board of Governors of the Federal Reserve System ("FRB"), the Securities and Exchange Commission ("SEC"), and the Commodity Futures Trading Commission ("CFTC"). Recommendations:

---

[1] Links to the full Blueprint and to a Fact Sheet summarizing it are available via Treasury's announcement of the Blueprint's release. See "Treasury Releases Blueprint for Stronger Regulatory Structure," Treasury Press Release No. HP-896 (Mar. 31, 2008), available at *http://www.treas.gov/press/releases/hp896.htm.*

[2] See "Remarks by Secretary Henry M. Paulson, Jr. on Blueprint for Regulatory Reform," Treasury Press Release No. HP-897 (Mar. 31, 2008), available at *http://www.treas.gov/press/releases/hp897.htm.*

1. Broaden PWG's focus to include the entire financial sector, not just financial markets, and expand membership to include the heads of the Office of the Comptroller of the Currency ("OCC"), Federal Deposit Insurance Corporation ("FDIC"), and Office of Thrift Supervision ("OTS").

2. PWG should facilitate better inter-agency coordination and communication in: a) mitigating systemic risk to the financial system; b) enhancing financial market integrity; c) promoting consumer and investor protection; and d) supporting capital markets efficiency and competitiveness.

3. PWG should have the ability to issue reports or other documents to the President and others through its role as the coordinator for financial regulatory policy.

4. *Comments:* Modernization of the PWG is a regulatory reform that could be implemented quickly and in the very near term through an executive order. President Bush reportedly is preparing an executive order to implement these recommendations.[3] Among the issues that may arise in connection with this "modernization" are the implications of the PWG's expanded membership: specifically, the effect that increased representation of banking regulators may have on the PWG's perspectives and priorities.

B) Federal Reserve Liquidity Provisioning. In light of the increased importance of the non-depository institutions to overall market stability, and the recent use of the discount window to lend to non-depository institutions, Treasury recommends:

1. Enhancing the current temporary liquidity provisioning process during rare circumstances when market stability is threatened, to ensure that the process is calibrated and transparent; appropriate conditions are attached to lending; and information flows to the Federal Reserve through onsite examination or other means are adequate;

2. The PWG should consider broader regulatory issues associated with providing discount window access to non-depository institutions, including

[3] See Stephen Labaton, Doubt Greets Treasury Plan on Regulation, N.Y. Times, Apr. 1, 2008.

whether this should be accompanied by intensified regulation and supervision of these entities.

3. *Comment:* Particularly in light of public attention to the FRB's recent involvement with the JPMorgan-Bear Stearns transaction, enhancing requirements to obtain access to the discount window probably will be implemented in the near term.[4] Such a reform will require some specification of the conditions and information flows for discount window access; debate should be expected regarding what terms and conditions should be imposed on entities seeking access to the window; whether information for SEC-regulated entities should flow through the SEC to the Federal Reserve rather than the Federal Reserve having direct access and whether the Federal Reserve should be allowed to examine those entities (as they are doing at present); and whether access to the window may act as a competitive advantage among firms.[5]

C) Address Gaps in Mortgage Origination Oversight. To remedy gaps and lack of clarity, the Blueprint recommends:

1. Creating a federal Mortgage Origination Commission ("MOC") with a board comprised of the FRB, OCC, OTS, FDIC, the National Credit Union

---

[4] For a description of the recent changes to the liquidity provisions, see Understanding the Recent Changes to Federal Reserve Liquidity Provision (Mar. 2008), available as an Annex to Timothy F. Geithner, President and CEO, Federal Reserve Bank of New York, "Actions by the New York Fed in Response to Liquidity Pressures in Financial Markets," Before the Senate Committee on Banking, Housing, and Urban Affairs (Apr. 3, 2008), available at http://www.ny.frb.org/newsevents/speeches/2008/gei080403.html.

5 In recent testimony before Congress regarding turmoil in the credit markets, regulators have defended the use of the discount window to address Bear Stearns' imminent failure, describing the situation as one in which regulatory action was necessary to avert systemic effects. FRB Chairman Bernanke testified, "The sudden failure of Bear Stearns likely would have led to a chaotic unwinding of positions in [various critical] markets and could have severely shaken confidence." Ben S. Bernanke, FRB Chairman, "Developments in the Financial Markets," Before the Senate Committee on Banking, Housing, and Urban Affairs (Apr. 3, 2008), available at http://www. federalreserve.gov/newsevents/testimony/bernanke20080403a.htm. Similarly, President Geithner of the Federal Reserve Bank of New York said that the regulators "judged that a sudden, disorderly failure of Bear would have brought with it unpredictable but severe consequences for the functioning of the broader financial system and the broader economy . . . ." Timothy F. Geithner, President and CEO, Federal Reserve Bank of New York, "Actions by the New York Fed in Response to Liquidity Pressures in Financial Markets," Before the Senate Committee on Banking, Housing, and Urban Affairs (Apr. 3, 2008), available at http://www.ny.frb.org/newsevents/speeches/2008/ gei080403.html.

Administration and the Conference of State Bank Supervisors. The MOC's board would be chaired by a presidential appointee.[6]

2. Prescribing, at the federal level, uniform minimum licensing standards for state licensing systems, including minimum requirements for personal conduct, education, testing, and license revocation procedures. Congress should adopt these standards, or grant the MOC authority to do so. The MOC would provide public evaluations of the various states' systems for licensing and regulation of mortgage market participants.

3. Continuing to rely upon the FRB as the sole authority to draft regulations implementing national mortgage lending laws (currently the Truth in Lending Act, or "TILA").

4. Clarifying and enhancing enforcement authority for federal mortgage laws. In particular, clarity is needed concerning affiliates of depository institutions within a federally regulated holding company and independent participants in the mortgage origination process. In addition, the Blueprint recommends ensuring that all types of mortgage originators are covered by federal mortgage lending laws. This may require amending the TILA to make it applicable to mortgage brokers, and to provide additional protection against abusive or predatory lending practices.

5. The Blueprint supports the further development of the Nationwide Mortgage Licensing System and Registry ("NMLSR"), which is designed to increase and centralize information regarding participants in the mortgage origination process. The aim of the Blueprint's recommendations, however, is to create and implement uniform minimum licensing qualification standards.

6. *Comment:* The battle between state and federal oversight is contentious but the current crisis could give the proposal some momentum.

[6] Some lawmakers have predicted that Congress might adopt legislation in 2008 to create the MOC. See Stephen Labaton, Doubt Greets Treasury Plan on Regulation, N.Y. Times, Apr. 1, 2008.

WILMERHALE

III. BLUEPRINT INTERMEDIATE-TERM RECOMMENDATIONS

A) The Blueprint recommends creating a federal charter for "systemically important" payment and settlement systems, with federal preemption, and primary oversight responsibility residing in the Federal Reserve. The FRB would charter, regulate, and supervise any payment or settlement system it deems "systemically important."

1. *Comment:* The Blueprint lists examples of "systemically important" payment system participants, but suggests that the list is not exclusive and the FRB would have power to designate entities as being "systemically important," including non-US entities.

B) Establish an optional federal charter ("OFC") for insurers within the current state-based regulatory structure.

1. Establish the Office of National Insurance (ONI) within Treasury to regulate those engaged in the business of insurance pursuant to an OFC.

2. To provide immediate attention to the insurance sector pending action on an OFC, establish an Office of Insurance Oversight ("OIO") within Treasury to address international regulatory issues and serve as an advisor to the Secretary of the Treasury on major domestic and international policy issues.

C) Banking Structure Reforms

1. Phase out and transition the federal thrift charter to the national bank charter, so that the OTS transitions its operations to the OCC over a two-year period and is then closed.

2. Rationalize the direct federal supervision of state-chartered banks with federal deposit insurance.

a) A study examining the role of Federal Reserve Banks should make a definitive proposal, but Treasury preliminarily recommends placing all banking examination responsibilities for state-chartered banks with federal deposit insurance either with the Federal Reserve; or with the FDIC.

3. *Comment:* The proposal to merge OCC and OTS is not a novel one. In the ways of Washington, however, this suggestion will be opposed by the agency to be eliminated (the OTS) and more generally by the thrift industry. Because the major actors in the subprime mortgage market collapse were not regulated thrifts, the argument for the merger will be one of consistency and convenience, rather than the need for more rigorous examination and oversight. Thus, this could be a longer debate than suggested by the Blueprint's classification of an OCC/OTS merger as an intermediate-term proposal.

D) Securities Structure Reforms

1. Merge the SEC and CFTC

a) Preserve the CFTC's principles-based regulatory philosophy.

b) SEC should take action within the current structure to modernize its regulatory approach by:

- using exemptive authority to adopt core principles to apply to securities clearing agencies and exchanges modeled on those adopted under the Commodity Futures Modernization Act;
- issuing a rule to update and streamline the self-regulatory organization ("SRO") rulemaking process. It should consider a firm timeline for publishing SRO rule filings, expanding the types of rules deemed effective upon filing, and streamlining the approval for any securities products common to the marketplace; and
- undertaking general exemptive rulemaking under the Investment Company Act of 1940 to permit trading of those products already actively trading in the U.S. or foreign jurisdictions.
- proposing to Congress legislation permitting registration of a new "global" investment company.

c) Legislation merging the CFTC and the SEC should call for a structural merger as well as a process to merge regulatory philosophies and harmonize securities and futures regulations and

statutes, and should task the PWG with drafting overarching regulatory principles.

d) Consistent with the CFMA approach, clearing agency and market SROs should be permitted to self-certify many rulemakings, with the SEC retaining the right to abrogate such rulemakings at any time.

e) A joint CFTC-SEC staff task force should be mandated to harmonize the differences between futures and securities regulation and recommending the structure of a merged agency.

2. Congress should harmonize the regulation and oversight of broker-dealers and investment advisers offering similar services to retail investors, and should subject investment advisers to a self-regulatory regime similar to that of broker-dealers.

IV. BLUEPRINT LONG-TERM OPTIMAL REGULATORY STRUCTURE

A) Utilize an objectives-based regulatory approach focusing on:

1. Market stability regulation to address overall conditions of financial market stability that could impact the real economy;

2. Prudential financial regulation to address issues of limited market discipline caused by government guarantees; and

3. Business conduct (consumer protection) regulation to address standards for business practices.

B) Establish 3 categories of charters for financial institutions:

1. A federal insured depository institution ("FIDI") charter for all depository institutions with federal deposit insurance

a) FIDI charter would provide field preemption over state laws.

b) *Comment:* The restriction of deposit insurance to those with a FIDI charter would mark the demise of the dual banking system, because

state-chartered depository institutions would no longer be able to obtain federal deposit insurance.

2. A federal insurance institution ("FII") charter for insurers offering retail products where some type of government guarantee is present;

   a) Potentially include a Federal Insurance Guarantee Fund ("FIGF") to provide a uniform and consistent federally established guarantee structure that could supplement the existing state-level guarantee system.

3. A federal financial services provider ("FFSP") charter for all other types of financial services providers (*e.g,* broker-dealers, hedge funds, private equity and venture capital funds, and mutual funds).

C) Establish the Federal Reserve as the Market Stability Regulator.

1. Responsible for overall issues of financial market stability by implementing monetary policy and providing liquidity to the financial system – the focus is broad systemic risk.

2. Broad powers focusing on the overall financial system and on FIIs, FIDIs and FFSPs.

3. Oversee the payment and settlement system.

4. A separate regulator should conduct prudential oversight of GSEs, but the market stability regulator should have the same ability to evaluate the GSEs as it has for other federally chartered institutions.

5. *Comment:* Especially in the wake of Bear Stearns' failure, regulators have emphasized the need for better mechanisms to address systemic risk. SEC Chairman Cox recently told the Senate Committee on Banking, Housing, and Urban Affairs that a "supervisory gap" exists with respect to investment banks facing crisis: whereas statutes "provide . . . the FDIC with the authority to take preemptive action to resolve a troubled bank or other

federally insured depository institution and prescribe methods for resolving those that fail," no such provision exists for investment banks.[7]

D) Establish a Prudential Financial Regulator ("PFRA").

1. Focus on financial institutions with some type of explicit government guarantees associated with their business operations (federal deposit insurance and state-established insurance guarantee funds).

2. Assume the roles of the OCC and the OTS.

3. Focus on the original intent of holding company supervision: protecting the assets of the insured depository institution.

E) Establish a Conduct of Business Regulator ("CBRA").

1. Monitor business conduct regulation across all type of financial firms, including FIIS, FIDIs and FFSPs, whether federal or state-chartered; provide entry standards for firms; charter and license financial firms; authority over disclosure issues related to policy forms, unfair trade practices, and claims handling procedures.

2. Oversight of disclosure, sales and marketing practices, and anti-discrimination laws for FIDIs' banking and lending.

3. Authority to regulate FIIs' insurance business conduct issues associated with disclosures, business practices, and discrimination.

4. Oversight of operational ability, professional conduct, testing and training, fraud and manipulation, and duties to customers for FFSPs.

5. Assume most aspects of the SEC's and CFTC's roles, some aspect of FTC's role, and the business conduct regulation of the Federal Reserve, other insured depository institution regulators, state insurance regulators.

6. Would preserve the SRO model.

---

[7] Christopher Cox, SEC Chairman, Testimony Concerning Recent Events in the Credit Markets, Before the Senate Committee on Banking, Housing, and Urban Affairs (Apr. 3, 2008), available at *http://www.sec.gov/news/ testimony/2008/ts040308cc.htm.*

F) Establish the Federal Insurance Guarantee Corporation ("FIGC"), which would be a reconstituted FDIC to administer deposit insurance and the FIGF, if one is created.

G) A corporate finance regulator would be responsible for general issues related to corporate oversight in public securities markets, including current responsibilities of the SEC's Division of Corporation Finance relating to corporate disclosures, corporate governance, accounting oversight, and similar issues.

WILMERHALE

APPENDIX B

Further Reading on U.S. Financial Services Regulatory Reform

Policy Statement on Financial Market Developments, The President's Working Group on Financial Markets (March 2008).

The Financial Services Roundtable, The Blueprint for U.S. Financial Competitiveness (2007), *http://www.fsround.org/cec/pdfs/FINALCompetitivenessReport.pdf.*

Commission on the Regulation of U.S. Capital Markets in the 21st Century, U.S. Chamber of Commerce, Report and Recommendations (March 2007), *http://www.capitalmarketscommission.com/portal/capmarkets/default.htm.*

Sustaining New York's and the US' Global Financial Services Leadership (2007), *http://www.senate.gov/~schumer/SchumerWebsite/pressroom/special_reports/2007/NY_REPORT%20_FINAL.pdf.*

Financial Regulation: Industry Trends Continue to Challenge the Federal Regulatory Structure, GAO (Oct. 2007).

Interim Report of the Committee on Capital Markets Regulation (2006), *http://www.capmktsreg.org/pdfs/11.30Committee_Interim_ReportREV2.pdf.*

An Agenda for Federal Regulatory Reform, Robert E. Litan, et. al (AEI and Brookings, 1997).