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Treasury Department's Proposed Overhaul of the Financial Regulatory Structure: A Look at the Blueprint and a Look Ahead

On March 31st, the US Department of Treasury ("Treasury"), as part of its efforts to improve the competitiveness of the US capital markets, issued its "Blueprint for a Modernized Financial Regulatory Structure" ("Blueprint") on Monday, March 31.[1] A year earlier, in the wake of various reports regarding the competitive position of the US capital markets,[2] Treasury hosted a conference on March 13, 2007, to focus on capital markets competitiveness.[3] Treasury announced in June 2007 that it was working on a blueprint for regulatory reform,[4] and sought comment in October 2007 on a broad range of questions relating to the existing regulatory structure for financial institutions and how it might be reshaped.[5] The solicitation of public comment stated that "it is important to continue to evaluate our regulatory structure and consider ways to improve efficiency, reduce overlap, strengthen consumer and investor protection, and ensure that financial institutions have the ability to adapt to evolving market dynamics."[6]

Over the course of the past year, debate has continued regarding the relative position of the US markets in the global context of financial markets and what, if anything, should be done to bolster US competitiveness. The Blueprint concludes that substantial regulatory reform is necessary to respond to significant developments including globalization of the capital markets, innovative and sophisticated new financial products and trading strategies, growing institutionalization of the capital markets, and convergence of financial services providers and financial products.

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[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, e.g.*, Commission on the Regulation of US Capital Markets in the 21st Century (established by the US Chamber of Commerce), Report and Recommendations (Mar. 2007); "Is Wall Street Doomed?" Global Economics Weekly (a Goldman Sachs publication), Issue No. 07/06 (Feb. 14, 2007); Kern Alexander, Eilís Ferran, Howell E. Jackson and Niamh Moloney, "A Report on the Transatlantic Financial Services Regulatory Dialogue," Harvard John M. Olin Center for Law, Economics, and Business, Discussion Paper No. 576 (Jan. 2007); McKinsey & Co., "Sustaining New York's and the US' Global Financial Services Leadership" (undated, released Jan. 2007) (commissioned by New York City Mayor Michael Bloomberg and US Sen. Charles Schumer); Interim Report of the Committee on Capital Markets Regulation (Nov. 30, 2006).

[3] *See* "Opening Remarks by Treasury Secretary Henry M. Paulson, Jr. at Treasury's Capital Markets Competitiveness Conference," Treasury Press Release No. HP-306 (Mar. 13, 2007), *available at* http://www.treas.gov/press/releases/hp306.htm.

[4] *See* "Paulson Announces Next Steps to Bolster U.S. Markets' Global Competitiveness," Treasury Press Release No. HP-476 (June 27, 2007), *available at* http://www.treas.gov/press/releases/hp476.htm.

[5] 72 Fed. Reg. 58,939 (Oct. 17, 2007) (requesting comment on TREAS-DO-2007-018).

[6] *Id.*

Against this background, 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. Secretary Paulson has emphasized that the first priority of the regulators, the Administration, and Congress 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.[7]

We summarize and provide commentary on the Blueprint below.

I. The Blueprint's Short-Term Recommendations

A. Modernize the President's Working Group on Financial Markets

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"). The Blueprint recommends expanding the PWG's scope, membership, and authority, and improving its efforts at interagency coordination and communication. Specifically, the Blueprint recommends:

1. Broadening the PWG's focus to include the entire financial sector, not just financial markets, and expanding its membership to include the heads of the Office of the Comptroller of the Currency ("OCC"), the Federal Deposit Insurance Corporation ("FDIC"), and the Office of Thrift Supervision ("OTS"). The Blueprint also recommends clarifying that the PWG has the authority to engage in consultation efforts with other domestic and international regulatory and supervisory bodies.

2. Improving the PWG's facilitation of interagency 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. Clarifying that the PWG, as the coordinator for financial regulatory policy, has the ability to issue reports or other documents to the President and others.

Comment: These recommendations could be accomplished swiftly and without legislative action by the issuance of an executive order, and thus are more likely to be implemented. Administration officials reportedly have said that President Bush currently is preparing an executive order to implement these recommendations.[8] 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. Address Gaps in Mortgage Origination Oversight

To remedy gaps and lack of clarity regarding the oversight of mortgage origination, the Blueprint recommends:

[7] *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.
[8] *See* Stephen Labaton, "Doubt Greets Treasury Plan on Regulation," N.Y. Times, Apr. 1, 2008.

1. Creating a federal Mortgage Origination Commission ("MOC") with a board comprised of the FRB, OCC, OTS, FDIC, the National Credit Union Administration, and the Conference of State Bank Supervisors. The MOC's board would be chaired by a presidential appointee. [9]

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.

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.

C. FRB 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, that appropriate conditions are attached to lending, and that information flows to the FRB through onsite examination or other means are adequate.

2. Consideration by the PWG of broader regulatory issues associated with providing discount window access to non-depository institutions, including whether providing broader access to the discount window should be accompanied by intensified regulation and supervision of these entities.

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

[9] 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.

implemented in the near term.[10] 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.[11]

The Blueprint also recommends an agreement among the FRB, the SEC, and the CFTC to provide examination information to the FRB and permit the FRB to accompany the SEC and the CFTC on financial examinations. Questions may be raised regarding the proposed structure of the FRB's access to information, such as whether information for SEC-regulated entities should flow through the SEC and whether the FRB should be allowed to examine those entities.[12] SEC Chairman Cox and FRB Chairman Bernanke have met in recent days to discuss joint examinations, though it is unclear whether a formal agreement is a goal of these discussions.[13] Another issue that should be considered is the extent to which access to the window may be used as a competitive advantage among firms. According to reports of regulators' testimony before the Senate Committee on Banking, Housing, and Urban Affairs, regulators encouraged a very low price in the negotiations for JPMorgan Chase's acquisition of Bear Stearns, in order to avert "moral hazard" concerns associated with the deal and the availability of the discount window.[14]

II. The Blueprint's Intermediate-Term Recommendations

Treasury's intermediate-term recommendations are intended to modernize the regulatory structure and to eliminate duplication. While intended to facilitate movement toward the optimal regulatory structure described by the Blueprint, these recommendations also are intended as valuable reforms in themselves.

[10] For a description of the recent changes to the liquidity provisions, see Understanding the Recent Changes to Federal Reserve Liquidity Provision (Mar. 2008). This document is 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.

[11] 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.

[12] In this context, we note that Timothy Geithner recently stated that, following the arrangement whereby the New York Federal Reserve Bank would assist with JPMorgan Chase's acquisition of Bear Stearns, "at the request of and with the full cooperation of the SEC, examiners from the New York Fed were sent into the major investment banks to give the Federal Reserve the direct capacity to assess the financial condition of these institutions." 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. The Wall Street Journal has reported that FRB staff already is examining several large broker-dealers, most of which have disclosed that they have borrowed from the FRB since it opened the discount window. *See* Kara Scannell and Sudeep Reddy, "The Fed Hits the Street: Brokerage Firms Get Cash – and On-Site Scrutiny," Wall St. J., at C3, Apr. 3, 2008 ("Fed staff is on site at Goldman Sachs Group Inc., Morgan Stanley, Lehman Brothers Holdings Inc., Merrill Lynch & Co. and Bear, which has agreed to be sold to JPMorgan Chase & Co. Each of the brokerages has disclosed that it has borrowed from the Fed since it temporarily opened its lending facility last month, while Merrill Lynch hasn't said whether it did.").

[13] *See See* Kara Scannell and Sudeep Reddy, "The Fed Hits the Street: Brokerage Firms Get Cash – and On-Site Scrutiny," Wall St. J., at C3, Apr. 3, 2008.

[14] *See, e.g.*, Kara Scannell and Sudeep Reddy, "Officials Say They Sought To Avoid Bear Bailout," Wall St. J., Apr. 4, 2008.

A. Banking Structure Reforms

1. Thrift Charter

The Blueprint states that thrifts are no longer necessary to ensure sufficient residential mortgage loan availability and recommends a two-year plan to phase out and transition the thrift charter to the national bank charter, and to eliminate the OTS and transfer its regulatory duties to the OCC. Specifically, the plan provides for all federally chartered thrifts to convert to national banks by operation of law at the end of a two-year transition period. As part of this transition:

a. All thrift holding companies would become bank holding companies under the Bank Holding Company Act ("BHC Act"). Unitary thrift grandfathers would retain their exemption from the activity limitations under the BHC Act.

b. Each banking agency should institute a program to accommodate voluntary specialization in housing finance and the conversion of thrifts to banks. Mutual thrifts should be allowed to opt for a mutual national bank charter.

c. All state-chartered thrifts would be treated as state-chartered banks for federal bank regulatory purposes.

In connection with the merger of the OTS and the OCC, the Blueprint recommends that the size of the FDIC Board be reduced to three members, and that Congress transfer supervision and regulation of state-chartered thrifts to the FDIC.

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.

2. Federal Supervision of State-Chartered Banks

Currently, state-chartered banks with federal deposit insurance are subject to supervision by either the FRB or FDIC, depending on whether the bank is a FRB member. The Blueprint calls for a uniform framework for federal supervision of state-chartered banks and recommends choosing, based on a study of which agency would be the most appropriate choice, either the FRB or the FDIC as the sole federal supervisor of state-chartered, federally insured banks.

B. Securities Structure Reforms

1. SEC and CFTC Merger

a. The Proposed Merger and Recommended Anticipatory Actions

The Blueprint recommends a merger of the CFTC and the SEC, with the merged agency preserving the CFTC's principles-based regulatory philosophy. The Blueprint further recommends that, in anticipation of an

eventual merger, the SEC should take action within the current structure to modernize its regulatory approach. Specifically, the Blueprint states that:

i. The SEC should use its exemptive authority to adopt core principles to apply to securities clearing agencies and exchanges modeled on those core principles established in the Commodity Futures Modernization Act ("CFMA").

ii. The SEC should issue 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.

Comment: Increased efficiency of the SRO rulemaking process already has received some attention at the SEC in recent months. In an effort to improve the efficiency of the process, the SEC recently adopted rule changes to require that all SRO rule changes be filed electronically.[15] A recent audit report by the SEC's Office of the Inspector General found that the process is in need of improvement, particularly concerning timeliness, and recommended changes for improvement.[16] Similarly, in discussions regarding exempting non-US securities exchanges from registration requirements so that such exchanges could more easily do business in the United States, concerns have been raised regarding whether the SEC would aim to act quickly on US exchanges' rule changes in order to minimize the potential competitive disadvantage that delays might impose on US exchanges in a so-called mutual recognition environment.[17]

iii. The SEC should undertake general exemptive rulemaking under the Investment Company Act of 1940 to permit certain new products — such as exchange-traded funds ("ETFs") — to be traded without registration as an investment company. Such an exemption would subject categories of new products already actively trading in the United States or foreign jurisdictions to the same terms and conditions applicable to similar, previously exempted products.

In fact (and as noted in the Blueprint), the SEC recently proposed a new rule to permit a new ETF that meets certain conditions to begin operating without the need to seek a specific exemptive order.[18] Comments are due on the proposal by May 19, 2008.

iv. The SEC should propose to Congress legislation permitting registration of a new "global" investment company. This new type of investment company should have investor protections equivalent to the existing regulatory framework in the United States for investment companies.

[15] *See* Exchange Act Release No. 57,526 (Mar. 19, 2008), 73 Fed. Reg. 16,179 (Mar. 27, 2008).
[16] *See* SEC Office of the Inspector General, SRO Rule Filing Process, Audit No. 438 (Mar. 31, 2008), *available at* http://www.sec.gov/about/oig/audit/2008/438final.pdf.
[17] *See* SEC Roundtable on Mutual Recognition, Unofficial Transcript at 46-47 (June 12, 2007); Annette L. Nazareth, SEC Commissioner, Remarks Before the Security Traders Association's 74th Annual Conference and Business Meeting, Boca Raton, FL (Oct. 4, 2007) (raising similar concerns). Recent SEC announcements have indicated that international discussions regarding mutual recognition are underway. *See* "SEC Chairman Cox, Prime Minister Rudd Meet Amid US-Australia Mutual Recognition Talks," SEC Press Release No. 2008-52 (Mar. 29, 2008); "SEC Announces Next Steps for Implementation of Mutual Recognition Concept," SEC Press Release No. 2008-49 (Mar. 24, 2008); "Statement of the European Commission and the US Securities and Exchange Commission on Mutual Recognition in Securities Markets," SEC Press Release No. 2008-9 (Feb. 1, 2008).
[18] *See* Investment Company Act Release No. 28,193 (Mar. 11, 2008), 73 Fed. Reg. 14,618 (Mar. 18, 2008) (proposing new rules).

Comment: The Blueprint's proposal would appear implicitly to require, at a minimum, the repeal or amendment of Section 7(d) of the Investment Company Act, which currently requires the SEC to conclude that it is "legally and practically feasible effectively to enforce the provisions" of the Act against a foreign investment company before permitting that foreign investment company to register under the Act. In practice, this provision has proven impossible for all but Canadian funds to satisfy. Accordingly, the proposal would represent a major development for the industry and for US investors seeking to invest in foreign investment companies, and one for which there is considerable industry support.[19]

b. Merger Legislation

The Blueprint recommends that 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.

c. Self-Certification of Rules

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 those rulemakings at any time.[20]

d. Harmonization Task Force

The Blueprint recommends that a joint CFTC-SEC staff task force be mandated to harmonize the differences between futures and securities regulation and to recommend the structure of a merged agency.

Comment: The SEC and the CFTC recently entered into a Memorandum of Understanding regarding coordination in areas of common regulatory interest (for example, novel derivative products, portfolio margining, futures on foreign securities and foreign security indexes, examination and oversight of SEC-registered investment advisers and CFTC-registered commodity pool operators, and securities futures products). The agreement creates a permanent regulatory liaison between the agencies, provides for enhanced information sharing, and lays out key principles relevant to the review of new financial products that have elements of both securities and commodity futures or options. In connection with the new agreement, the agencies also agreed to undertake the joint consideration of two new derivative products.[21] In light of the Blueprint's recommendations, this formalized cooperative arrangement may take on increased importance as the discussion around regulatory reforms proceeds.

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[19] The Investment Company Institute ("ICI"), responding to Treasury's solicitation of comments on regulatory reform, advocated the creation of a new category of investment company to encourage and permit innovation and promote competition on a global scale by US financial institutions. The ICI recommended creation of a new form of investment company modeled on "highly successful fund structures found outside the United States," and proposed that the following three standards apply to such an investment company: (1) it must be subject to substantially the same tax treatment as that which applies to many foreign investment funds, (2) it must be structured so that it is "amenable to be sold on a global basis" and not encumbered by state and local corporate laws, and (3) it must have a strong and effective set of investor protections. Letter from Paul Schott Stevens, Investment Company Institute, to Henry M. Paulson, Jr., US Secretary of the Treasury (Dec. 7, 2007), *available at* http://www.ici.org/statements/cmltr/07_treas_reg_structure_com.html#TopOfPage.

[20] Former SEC Chairman Arthur Levitt expressed criticism of this proposal, stating that SROs "have acted in their own self interest too often to allow them to get out from under the oversight process." Nelson D. Schwartz and Floyd Norris, "In Treasury Plan, a Reluctant Eye Over Wall Street," N.Y. Times, Mar. 30, 2008 (quoting former Chairman Levitt).

[21] *See* "SEC, CFTC Sign Agreement to Enhance Coordination, Facilitate Review of New Derivative Products," SEC Press Release No. 2008-40 (Mar. 11, 2008), *available at* http://www.sec.gov/news/press/2008/2008-40.htm.

2. Harmonization of Broker-Dealer and Investment Adviser Regulation

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

Comment: The SEC already has been considering potential inconsistencies in the regulation of broker-dealers and investment advisers offering similar services, particularly following the publication of the RAND Report on this topic.[22] It is unclear whether this recommendation will alter those efforts.

C. Payment and Settlement Systems Oversight

According to Treasury, the United States currently lacks a uniform, comprehensive regulatory system for major payment and settlement systems. Because of their important role in the economy, Treasury recommends creating a federal charter for "systemically important" payment and settlement systems. Federal preemption would apply. This proposal would require the FRB to charter, regulate, and supervise any payment or settlement system it deems "systemically important." The chartering scheme also should apply to payment and settlement systems based outside the United States.

Under the Blueprint, a system is "systemically important" if it has the potential to create systemic disruptions to the financial system or economy if it fails to manage risks prudently (*e.g.,* FedACH Service, CHIPS, Electronic Payments Network, the Depository Trust & Clearing Corporation, etc.). "Retail" payment systems — a category that is not defined in the Blueprint — would not be subject to the proposed scheme.

Comment: The Appendix to the Blueprint provides examples of "systemically important" payment system participants. Although the Appendix includes both DTCC and SWIFT, it does not include any of the derivative clearing organizations (*e.g*., Options Clearing Corporation). The text of the Blueprint, however, suggests that the Appendix is not an exclusive list and the FRB would have power to designate entities as being "systemically important," including non-US entities.

D. Optional Federal Charter for Insurers

The Blueprint recommends establishing an optional federal charter ("OFC") for insurers within the current state-based regulatory structure. Specifically, Treasury recommends creating an Office of National Insurance ("ONI") within Treasury to regulate those engaged in the business of insurance pursuant to an OFC. To provide immediate attention to the insurance sector pending action on an OFC, the Blueprint recommends establishing 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.

[22] *See* Angela Hung, et al., RAND Corp., Investor and Industry Perspectives on Investment Advisers and Broker-Dealers (2007), *available at* http://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf.

III. The Blueprint's Long-Term Optimal Regulatory Structure

A. The "Objectives-Based" Regulatory Approach

The Blueprint advocates what it calls an "objectives-based" regulatory approach, in which three primary regulators would share responsibility for oversight of financial institutions, with each regulator focusing on one of three broad objectives:

1. Market stability regulation to address overall conditions of financial market stability that could impact the real economy, overseen by the FRB as the new market stability regulator;

2. Prudential financial regulation to address issues of limited market discipline caused by government guarantees, overseen by a new prudential financial regulator; and

3. Business conduct (consumer protection) regulation to address standards for business practices, overseen by a new business conduct regulator.

A description of each of the three primary regulatory entities as envisioned by the Blueprint is discussed below.

B. Charters for Financial Institutions

The Blueprint envisions a regulatory scheme with three types of charters for financial institutions:

1. Federal Insured Depository Institution

A federal insured depository institution ("FIDI") charter would be required for all depository institutions with federal deposit insurance. As such, the FIDI charter would replace the separate charters for national banks, federal savings associations, and federal credit unions. Federal deposit insurance would be available only to institutions with the new federal charter. A FIDI charter would provide field preemption over state laws pertaining to banking activities, and offer operating and investment authority similar to that of a national bank.

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. Federal Insurance Institution

The Blueprint recommends creation of a federal insurance institution ("FII") charter for insurers offering retail products where some type of government guarantee is present. Potentially, this could 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. Federal Financial Services Provider

The Blueprint recommends creation of a federal financial services provider ("FFSP") charter for all other types (*i.e.*, non-depository, non-insurance) of financial services providers. Thus, FFSPs would include entities such as broker-dealers, hedge funds, private equity and venture capital funds, and mutual funds. The

FFSP charter would provide field preemption over state laws, and federal requirements would serve as a floor for state regulation of state-chartered financial service providers.

C. The FRB as the Market Stability Regulator

The role of market stability regulator would be filled by the FRB, which would have responsibility for monitoring systemic risk, implementing monetary policy, and providing liquidity to the financial system. It would have broad powers focusing on the overall financial system and on each of the three types of chartered institutions, and it would oversee the payment and settlement system.[23] The FRB would remain involved in bank regulation only at the macro level. To achieve its objectives, the FRB could require the prudential regulator to share all financial and examination reports and could impose reporting requirements of its own. The FRB also could provide input into the development of prudential and protective regulations to the extent the regulations would impact overall market stability. Similarly, the FRB's examination authority would be restricted to joint examinations with the prudential and business conduct agencies, and its examinations would be targeted on practices important to market stability. The FRB could impose corrective action to ameliorate broad threats to the market. Corrective action would focus primarily on particular types of institutions or asset classes, and generally would not be aimed at specific individual institutions. According to the Blueprint, a separate regulator should conduct prudential oversight of government-sponsored enterprises ("GSEs"), but the FRB should have the same ability to evaluate the GSEs as it has for other federally chartered institutions.

Comment: Especially in the wake of Bear Stearns' failure, regulators have emphasized the need for better mechanisms to address systemic risk — including mechanisms that recognize the evolving roles of the various types of financial institutions. 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.[24] President Geithner of the Federal Reserve Bank of New York told the same committee that "changes in the relative roles of traditional commercial banks and investment banks have changed the nature of financial stability. In the United States, the regulatory framework and most of the tools that were created to prevent and manage financial crises were developed in a bank-dominated era, and we have had to adapt those tools to deal with current market realities."[25]

In addition, if the FRB is to take on responsibility to serve as an all-encompassing market stability regulator due to the "changed nature of financial stability," at least two additional structural issues will arise. First, Chairman Bernanke already has noted his concern that the FRB have powers commensurate with its

[23] The proposed role of the FRB has been analogized to that of a "free safety" roaming the regulatory landscape to identify potential systemic risk or as the über-Regulator for macro concerns.
[24] 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.
[25] 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.

responsibilities.[26] Second, if the FRB is to be given these additional responsibilities for, and powers over, non-commercial banks, possibly the FRB's own composition and structure, created in a commercial bank context, will have to change also.

D. The Prudential Financial Regulatory Agency

The Prudential Financial Regulatory Agency ("PFRA") would regulate financial institutions with some type of explicit government guarantees associated with their business operations (federal deposit insurance and state-established insurance guarantee funds). Thus, it would regulate FIDIs and FIIs. It would assume the roles of the OCC and the OTS and consolidate the safety and soundness regulation of all of the current bank regulators into one body. The PFRA's focus would follow the original intent of holding company supervision: protecting the assets of the insured depository institution.

E. The Conduct of Business Regulatory Agency

The Conduct of Business Regulatory Agency ("CBRA") would regulate the business conduct of all financial institutions. The CBRA would consolidate into one body the consumer and investor protection functions of the CFTC, the SEC, and all of the federal bank and insurance regulators. With respect to FIDIs' banking and lending activities, the CBRA would oversee disclosure, sales and marketing practices, and anti-discrimination laws. The agency would administer the FFSP charter and set minimum standards for firms entering into certain lines of business, such as financial and reporting requirements. For FFSPs, it would oversee operational ability, professional conduct, testing and training, fraud and manipulation standards, and duties to customers. For FIIs, the CBRA would have authority to regulate insurance business conduct issues associated with disclosures, business practices, and discrimination. The self-regulation model would be preserved.

Comment: It is unclear what, if any, role is envisioned for "prudential" regulation of FFSPs entities that are not otherwise subject to the PFRA. Apparently, those entities that do not benefit from a federal financial guarantee only would be subject to conduct of business regulation and market stability oversight for systemic risk. In addition, it is unclear where market oversight (apart from payment systems) would reside. Presumably market actors would be FFSPs subject to business conduct regulation.

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[26] In testimony on April 2nd, Chairman Bernanke told Congress's Joint Economic Committee: "One of the ideas of this blueprint is to give the Federal Reserve sort of broad authority via a financial markets stability regulator . . . We would want to be sure that if we were given that very important responsibility that we had adequate powers, authority, expertise, and so on to make sure we could do it effectively . . . I think we would continue to require the ability to evaluate and in some cases make rules concerning the financial systemic stability of major financial institutions. We could not successfully carry out this mission if we had to rely entirely on second-hand reports from primary supervisors of these individual institutions." "Highlights: Bernanke's Congressional Testimony," Reuters.com, Apr. 2, 2008 (quoting Bernanke's responses to questions following his prepared testimony). Consistent with these remarks, Chairman Bernanke has argued in the past that "the Fed's ability to deal with diverse and hard-to-predict threats to financial stability depends critically on the information, expertise, and powers that it holds by virtue of being both a bank supervisor and a central bank." Ben S. Bernanke, FRB Chairman, "Central Banking and Bank Supervision in the United States," Speech at the Allied Social Science Association Annual Meeting, Chicago, Illinois (Jan. 5, 2007), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20070105a.htm.
Others also have noted with skepticism that, under the Blueprint, the FRB would no longer monitor banks' operations directly. *See* Neil Irwin, "Under the Treasury's Plan, Fed Would Lose a Key Power," Wash. Post, at D1, Apr. 1, 2008 (quoting a former FRB official as stating that the Blueprint would "take[] away a lot of authority, power and involvement" from the FRB).

F. Other Regulators

In addition to the three objectives-based regulators, the Blueprint recommends establishing two other regulatory entities. The Federal Insurance Guarantee Corporation ("FIGC") would be a reconstituted FDIC to administer deposit insurance and the FIGF, if one is created. A corporate finance regulator would be responsible for general issues (*i.e.*, issues not specific to financial institutions) 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.

IV. Conclusion: What Should We Look for Next?

The Blueprint calls for a variety of legislative efforts, as well as further exploration of certain aspects of its recommendations. We can expect the Blueprint's recommendations to provide fuel for debate and change for a significant period to come. Nevertheless, some of the recommendations advocate immediate planning and action, as noted in the preceding discussion. In summary, as regulators, legislators, the Administration, and others hone in on the specifics of the recommendations, some of the actions and debate we may see in the near term include the following:

A. The proposed modernization of the PWG to broaden its scope and membership, bolster its role as interagency coordinator (and consulting body with domestic and international regulatory bodies), and clarify its ability to issue reports may be accomplished quickly through issuance of a new executive order.

B. Concerning mortgage origination, debate can be expected regarding the adoption of uniform minimum licensing qualification standards and the creation of a Mortgage Origination Commission. In addition, members of Congress may act on the suggestion that the TILA may need to be amended to ensure that it provides adequate protection to consumers.

C. Regarding the FRB's liquidity provisions, further discussion can be expected concerning the terms and conditions that should be attached to non-depository institutions' access to the discount window. Among the questions likely to receive further attention is how information about the relevant firms should flow to the FRB (*e.g.*, directly, or via the firm's primary regulator), as well as what ongoing examination capabilities should be maintained and for how long.

D. The SEC can be expected to consider the reforms recommended by the Blueprint with an eye towards the continuing debate around a possible merger of the SEC and the CFTC.

E. The SEC may consider updating and streamlining its SRO rulemaking process, particularly as this objective already has received some focus at the SEC.

F. In line with the Blueprint's recommendation that the SEC create a general exemption from registration under the Investment Company Act of 1940 to permit trading of certain new products, rather than continuing to require individual exemptions for such products, an SEC rule proposal is pending to provide a general exemption for ETFs meeting certain criteria.

G. The SEC may consider whether to recommend to Congress the creation of a new registration category for "global" investment companies. A key issue for such a category will be how to identify as adequate the investor protections applicable to such companies. This issue may intersect with current discussions regarding mutual recognition agreements between US and foreign securities regulators.

H. Treasury's call for an optional federal insurance charter may spur renewed debate on pending legislation addressing this issue, but its interim recommendation for an Office of Insurance Oversight within Treasury is likely to have more traction in the near term.

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