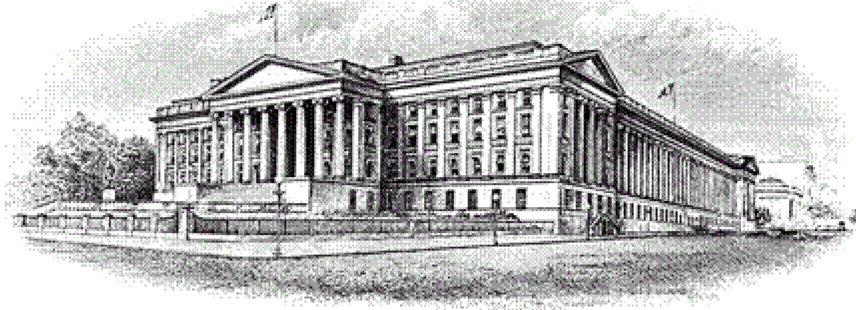

U.S. TREASURY DEPARTMENT OFFICE OF PUBLIC AFFAIRS

FACT SHEET: TREASURY RELEASES BLUEPRINT FOR A STRONGER REGULATORY STRUCTURE

"We should and can have a structure that is designed for the world we live in, one that is more flexible, one that can better adapt to change, one that will allow us to more effectively deal with inevitable market disruptions and one that will better protect investors and consumers. The challenge is to evolve to a more flexible, efficient and effective regulatory framework – and that is the purpose of this Blueprint."

- Treasury Secretary Henry M. Paulson, Jr.

- A strong financial system is vitally important - not for Wall Street, not for bankers, but for working Americans. When our markets work, people throughout our economy benefit – Americans seeking to buy a car or buy a home, families borrowing to pay for college, innovators borrowing on the strength of a good idea for a new product or technology, and businesses financing investments that create new jobs. And when our financial system is under stress, millions of working Americans bear the consequences. Government has a responsibility to make sure our financial system is regulated effectively. And in this area, we can do a better job. In sum, the ultimate beneficiaries from improved financial market regulation are America's workers, families and businesses – both small and large.

- Financial institutions play an essential role in the U.S. economy by providing a means for consumers and businesses to save for the future, to protect and hedge against risks, and to access funding for consumption or new investment opportunities.

- The current regulatory framework for financial institutions is based on a structure that has been largely knit together over the past 75 years. It has evolved in an accretive way in response to problems without any real focus on overall mission: Congress established the national bank charter in 1863 during the Civil War, the Federal Reserve System in 1913 in response to various episodes of financial instability, and the federal deposit insurance system during the Great Depression. Changes were made to the regulatory structure in the intervening years in response to other financial crises (e.g., the thrift crises of the 1980s) or as enhancements (e.g., the Gramm-Leach-Bliley Act of 1999 ("GLB Act")), but for the most part the underlying structure resembles what existed in the 1930s.

- The current U.S. financial regulatory framework includes:
    - Five federal depository institution regulators in addition to state-based supervision.
    - One federal futures regulator and one federal securities regulator. The United States also has additional state based supervision of securities firms as well as self-regulatory organizations with broad regulatory powers.

- Insurance regulation is almost wholly state-based, with 50+ regulators. This structure raises a number of issues with an international dimension that can be inefficient and costly.

- Last March, Treasury convened a blue-ribbon panel to discuss U.S. capital markets competitiveness. Industry leaders and policymakers alike agreed that the competitiveness of our financial services sector – and its ability to support U.S. economic growth – is constrained by an outdated financial regulatory framework.

- Although Treasury began this effort a year ago, market conditions today provide a pertinent backdrop for this study's release and highlight the need to examine the U.S. regulatory structure. Recent events have also reinforced the direct relationship between balancing strong consumer protection and market stability on the one hand, and capital markets competitiveness on the other.

- The United States is the world leader in financial services, so it is from this position of strength that we must constantly work to improve our system. Treasury's working assumption is that the United States is engaged in a global race-to-the-top, to achieve the optimal regulatory structure for the financial services industry. The optimal regulatory structure needs to attract capital based on its effectiveness in promoting innovation, managing system-wide risks, and fostering consumer and investor confidence.

- Capital markets and the financial services industry have evolved significantly over the past decade. Globalization and financial innovation, such as securitization, have provided benefits to domestic and global economic growth; while highlighting new risks to financial markets.

- These developments are pressuring the U.S. regulatory structure, exposing regulatory gaps and redundancies, and often encouraging market participants to do business in other jurisdictions with more effective regulation. As a result, the U.S. regulatory structure reflects an antiquated system struggling to keep pace with market developments while facing increasing challenges to anticipate and prevent today's financial crises.

- Public input has been important to our work. In addition to the range of views present at our Capital Markets Conference in March 2007, Treasury published a request for public comment in the *Federal Register* in October. Response was solid as Treasury received hundreds of letters from investor advocates, state regulators, financial institutions and many others. All public comments were posted on the internet.

- Treasury and prior Administrations previously pursued these studies with a long-term outlook for implementation. For example, both the *Blueprint for Reform: The Report of the Task Group on Regulation of Financial Services (1984)* and the *Modernizing the Financial System: Recommendations for Safer, More Competitive Banks (1991)* laid the foundation for many of the changes adopted in the GLB Act of 1999, including the concept of functional regulation.

- In this report, Treasury presents a series of short, intermediate and long-term recommendations for reform of the U.S. regulatory structure.
    - The short-term recommendations present actionable changes to improve regulatory coordination and oversight immediately, including:
        - **Modernize the President's Working Group on Financial Markets ("PWG").**
        - **Create a New Federal Mortgage Origination Commission ("MOC")** to evaluate, rate, and report on the adequacy of each state's system for licensing and regulation of participants in the mortgage origination process.

        - **Clarify Liquidity Provisioning by the Federal Reserve** to give the Federal Reserve the information it needs during this temporary period. The PWG will study the issue further.
    - The intermediate recommendations focus on eliminating some of the duplication of a functional regulatory system, but more importantly try to modernize the regulatory structure for certain financial services sectors within the current framework. Recommendations include:
        - **Transition the Thrift Charter** to a national bank charter because it is no longer necessary to ensure sufficient residential mortgage loans are made available to U.S. consumers. The Office of Thrift Supervision ("OTS") and the Office of the Comptroller of the Currency ("OCC") would merge.
        - **Create an Optional Federal Charter for Insurance** to encourage a more competitive U.S. industry.
        - **Generate Unified Oversight for Futures and Securities** by merging the Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission ("SEC") and their regulatory philosophies. The distinction between these types of financial products is increasingly blurred.
    - Treasury also includes a long term model for discussion. This model holistically addresses the inadequacies of the current functional regulatory system.
        - **An objectives-based regulatory approach** best represents the optimal regulatory structure for the future. The structure will consist of a market stability regulator, a prudential regulator and a business conduct regulator with a focus on consumer protection.

SUMMARY OF RECOMMENDATIONS

SHORT-TERM RECOMMENDATIONS

President's Working Group

- The PWG, created in 1988, is the most useful interagency coordination tool for financial services regulation.

- Treasury recommends modernizing the current PWG Executive Order to reinforce the mission and purpose of the group as an ongoing mechanism for coordination and communication on financial policy matters including systemic risk, market integrity, investor and consumer protection and capital markets competitiveness.

- Treasury also recommends expanding the PWG membership to include the OCC, OTS and Federal Deposit Insurance Corporation ("FDIC").

Liquidity Provisioning by the Federal Reserve

- Treasury recommends specific enhancements to the process of expanding access to Federal Reserve lending channels:
    - First, future lending to non-depository institutions should be calibrated and transparent.
    - Second, the Federal Reserve should have access to sufficient information on non-depository institutions with access to Federal Reserve loans. This could include on-site examinations or other means as determined by the Federal Reserve. The most important information relates to funding and liquidity.

- This will provide a framework for oversight of non-depository institutions with temporary access to Federal Reserve lending while recognizing the differences between banks and non-banks.

- These are difficult issues that should be addressed. The optimal structure tries to address some of these questions but we are learning more every day as the Federal Reserve is working with the primary dealers. The PWG should evaluate these issues.

Mortgage Origination

- The high levels of delinquencies, defaults, and foreclosures among subprime borrowers in 2007 and 2008 have highlighted gaps in oversight for mortgage origination.

- Treasury's recommendation, which sets consistent national standards for all types of mortgage originators and improves enforcement at the federal and state levels, has three components:
  - Treasury recommends the creation of the MOC, a new federal commission led by a Presidential appointee, to evaluate, rate, and report on the adequacy of each state's system for licensing and regulating participants in the mortgage origination process. Federal legislation should establish (or provide authority for the MOC to develop) uniform minimum qualifications for state mortgage market participant licensing systems.
  - Treasury recommends that the Federal Reserve continue to write regulations implementing national mortgage lending laws.
  - Treasury recommends clarification and enhancement of the federal enforcement authority over these laws.

INTERMEDIATE-TERM RECOMMENDATIONS

Thrift Charter

- Treasury recommends transitioning the federal thrift charter to a national bank charter over a two-year period. Treasury also recommends the merger of the OCC and the OTS during this period.

- The thrift charter, now subject to significant competition in the mortgage finance market from several non-thrifts, has become obsolete.

State Bank Oversight

- Treasury recommends the rationalization of direct federal supervision of state-chartered banks. Treasury recommends a study be conducted to streamline the regulation of state-chartered banks with a federal guarantee by either the Federal Reserve or the FDIC.

- Rationalization in this area would result in a more efficient and less duplicative regulatory system.

Payment Systems

- Treasury recommends the creation of a federal charter for systemically-important payment and settlement systems. The Federal Reserve should have primary oversight responsibilities for such systems.

- Existing payment systems would benefit from coordinated regulation.

Insurance

- Treasury recommends the establishment of a federal insurance regulatory structure to provide for the creation of an Optional Federal Charter. This structure is similar to the current dual-chartering system for banking. An Office of National Insurance within Treasury should oversee this federal regulatory structure.

- Treasury also recommends that, as an intermediate step, Congress establish an Office of Insurance Oversight within Treasury to establish a federal presence in insurance for international and regulatory issues.

- These reforms would provide more effective, efficient, and consistent regulation for national insurers and would enhance product choice and innovation.

Futures and Securities

- Treasury recognizes the convergence of the futures and securities markets and the need for reform and unified oversight and regulation of the futures and securities industries.

- Treasury recommends a merger of the CFTC and the SEC.

- Treasury recommends the following changes to reform the SEC's process for the securities market to prepare for the merger:
    - The adoption of core principles for exchanges and clearing agencies.
    - An expedited self-regulatory organization ("SRO") rule approval process.
    - General exemption under the Investment Company Act for already actively trading exempted products, such as exchange traded funds, to improve the new product approval process consistent with SEC investor protection standards.
    - New Congressional legislation to expand the Investment Company Act to permit a new global investment company.

- Treasury recommends statutory changes to harmonize the regulation and oversight of broker-dealers and investment advisers offering similar services to retail investors. Treasury also recommends that investment advisors be subject to a self-regulatory regime similar to that of broker-dealers.

LONG-TERM OPTIMAL REGULATORY STRUCTURE RECOMMENDATION

Overview of the Optimal Model

- The current system of functional regulation, which maintains separate regulatory agencies across segregated functional lines of banking, insurance, futures, and securities, is largely incompatible with today's financial markets. Functional regulation has several fundamental problems, including the lack of a single regulator to monitor systemic risk.

- Treasury is seeking an objectives-based approach designed to address particular market failures by focusing on three key goals:
    - Market stability regulation to address overall conditions of financial market stability.
    - Prudential financial regulation to address issues of limited market discipline caused by government guarantees.

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

- Three distinct regulators would focus exclusively on financial institutions: a market stability regulator (i.e., the Federal Reserve), a new prudential financial regulator (roles of the OCC, OTS and National Credit Union Administration ("NCUA")), and a new business conduct regulator (most roles of the CFTC and SEC, and some roles of bank regulators).

Market Stability Regulator

- The Federal Reserve would have the responsibility and authority to gather appropriate information, disclose information, collaborate with the other regulators on rule writing, and take corrective actions when necessary to ensure overall financial market stability. To fulfill its responsibilities to gather information, the Federal Reserve would have authority to join in examinations with the prudential and business conduct regulators.

- This new role will replace the Federal Reserve's more limited, traditional role as the supervisor of financial holding companies, bank holding companies, and certain state-chartered banks.

- The Federal Reserve would have the ability to monitor risks across the financial system.

Prudential Regulator

- A single prudential regulator focusing on safety and soundness of firms with federal guarantees, similar to the OCC, but with appropriate authority to deal with affiliate relationship issues.

- Prudential regulation in this context would be applied to individual firms, and it would operate like the current regulation of insured depository institutions, with capital adequacy requirements, investment limits, activity limits, and direct on-site risk management supervision.

- The prudential regulator would oversee firms with explicit government guarantees.

Business Conduct Regulator

- A new business conduct regulator would monitor business conduct regulation across all types of financial firms. Business conduct regulation in this context includes key aspects of consumer protection such as rule writing for disclosures, business practices, and chartering / licensing of certain types of financial firms.

- The new business conduct regulator subsumes most roles of the SEC and CFTC and has authority over rules such as mortgage disclosure.

- This framework would eliminate gaps in oversight and provide effective consumer and investor protection.