

point of view

Regulatory overhaul: Assessing Treasury's blueprint for modernizing financial regulation

Maintaining U.S. leadership in the capital markets demands a modernized system that is streamlined, agile and fair.

Highlights

1. Treasury releases its proposal to reform financial markets regulation.
2. Objectives-based model focuses on market stability, prudential regulation and conduct of business.
3. Proposal seeks to realign state-federal balance, the power of some agencies and walls between sectors.

What could the new proposal mean for business?

Launching a process

The Treasury blueprint recommends the most sweeping changes in financial markets regulation in 75 years. It moves from public discussion toward a policy for action.

Increasing competitiveness

The proposal seeks to assure the continuing preeminence of U.S. capital markets in a world that offers attractive alternatives.

Laying a foundation

The blueprint is built on a number of guiding regulatory principles: streamlining, consistency, freedom to innovate, confidence in our markets, equity for all stakeholders and latitude for professional judgment.

Advancing the debate

The proposal builds upon an important debate about the impact and effectiveness of financial markets regulation in an increasingly globalized world.

Treasury presents a proposal to modernize the mosaic of financial services regulation

“We should and can have a structure that is designed for the world we live in....”

**Treasury Secretary
Henry M. Paulson, Jr.**

On March 31, the Department of the Treasury released its *Blueprint for a Modernized Financial Regulatory Structure*, proposing a wide-ranging overhaul designed to streamline the system that oversees banks, brokerages, exchanges and insurance companies. The plan represents the broadest revamping of financial services regulation in over 75 years and an attempt to rationalize a patchwork that has been evolving since the mid-19th century.

Notable parts of the proposal shift power from states to the federal government, eliminate or redirect the efforts of some agencies and further empower others.

The proposal envisions three classes of regulators. Each agency would focus on its own functional objectives rather than on financial institution categories in order to better respond to change and to convergence of providers and products. The Treasury phases in its plans in near-, intermediate- and long-term stages, with the three-part regulatory structure scheduled last.

The Treasury model would be the first globally to attempt tripartite regulation, although similarities are shared with the Netherlands and Australia which have two regulatory classes. The single regulator model has been embraced by approximately 50 nations, including the U.K., Japan, Germany, South Korea and much of Scandinavia.

The proposal follows a year of development as well as the work of a group of industry leaders and policy makers empaneled by the Treasury to study U.S. capital market competitiveness. The panel agreed the current U.S. regulatory framework limits the competitiveness of our financial services industry and its ability to contribute to the nation's economic growth.

Among the Treasury's key recommendations is the creation of three objectives-based regulatory branches. Individual regulators would focus on:

Market stability across the financial services sector. To accomplish this, the Federal Reserve would be empowered to evaluate capital, liquidity and margin

practices and be allowed to go wherever it must in the system in order to preserve overall financial stability.

Prudential regulation to assure the safety and soundness of institutions supported by federal guarantee. This agency would consolidate all federal bank charters and bank regulators into one. A federal insurance charter is also proposed to oversee all guaranteed products that fall under its umbrella.

Conduct of business to protect consumers, borrowers and investors. This regulator would monitor business conduct across all types of financial institutions. Its responsibilities would include disclosures, business practices and chartering and licensing of certain types of firms as well as enforcement. Many of the roles of the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) would be combined to bring greater consistency to areas of overlapping requirements.

The Treasury also proposed:

Creating a new federal Mortgage Origination Commission to evaluate and report on each state's adequacy for licensing and regulation of participants in the mortgage origination process.

Introducing an optional federal charter for insurance to allow insurers to elect federal rather than state regulation. This is aimed at encouraging a more competitive U.S. industry that facilitates the development of national products and reduces regulatory redundancy that can hamper innovation.

Revoking the federal thrift charter as obsolete, transitioning to a national bank charter and merging the Office of Thrift Supervision (OTS) with the Office of the Comptroller of the Currency (OCC).

The proposal notes sufficient residential mortgage loans are available to consumers without the thrift charter.

Summing up many of the goals, Secretary Henry M. Paulson, Jr. said, “We should and can have a structure that is designed for the world we live in....”

Building from guiding principles

Whether or not Treasury's blueprint is ultimately adopted, PwC believes core principles must guide future legislation and regulation for the U.S. to remain attractive for business and globally competitive.

PricewaterhouseCoopers believes Treasury's blueprint builds upon the current debate and establishes a useful starting point for regulatory reform. By defining a vision for regulation, it takes what has been a major debate about the competitiveness of U.S. capital markets and recommends specific changes.

The report comes as the nation is taking steps to solve a lingering credit and liquidity crisis, but it represents more than a reflexive reaction to events of the moment. This year's credit crisis adds a sense of immediacy to the discussion. But the proposal's broad objectives predate this and address a range of issues that will continue to face the U.S. as it competes in a globalized and interconnected world. Continuing U.S. competitiveness depends on the order, quality and vigor of our banking and capital markets.

The critical principles that should guide regulatory reform include:

Streamlining for efficiency, effectiveness and simplicity. Regulatory agility and modernization are needed in a fast-moving world where an increasing range of sound alternatives are available to investors that seek safety and quality and businesses that seek financing. The U.S. is no longer the unchallenged magnetic pole for capital flows, and we will be less attractive if our system appears overly cumbersome and difficult. At a minimum, any new rule should pass a test for cost-effectiveness and maintain the health of our economy if not benefit it.

Consistent supervision, execution and enforcement across the system.

This goes hand in hand with efficiency and effectiveness. The prudential safety and soundness of financial institutions and customer fairness demand a regulator able to act from a comprehensive vantage point.

Balancing the freedom to innovate with safeguards to prevent abuses. If regulation strangles innovation, it will cut a traditional lifeline of America's economy. The regulatory system should be sufficiently nimble to protect investors as well as to react to

complex innovations. Simplicity in and of itself does not necessarily deliver quality or embrace the potential intricacy of emerging ideas. Resilience must be engineered into the system with principle and care.

Supporting systemic confidence in our markets by assuring all sources of risk are effectively covered and contained.

Regulators should adopt a long-term, supervisory relationship that is forward-looking and flexible rather than one that stresses only short-term enforcement.

Equitable treatment for all investors, borrowers and customers. The need for consumer equity is especially plain in a nation where over 100 million people manage their own retirement funds. The health and well-being of our capital markets and economy are intertwined with the prosperity of our people; both sides must be strong for the U.S. to remain at the leading edge of today's world.

Allowing latitude for professional judgment to work. Detailed, prescriptive systems are not likely to advance the quality, efficiency, effectiveness and agility our capital markets need for continuing success on a global plane.

In short, Treasury's proposal stands as a beginning. Collaboration will be needed to fashion a regulatory policy with the resilience, foresight and prudence required to drive U.S. competitiveness into the future.

Momentum on these six guiding principles, however, should continue for the benefit of our nation, our people and our partners in the world.

Weighing practical considerations and long-term needs

Q&A

Q: Why is the Treasury blueprint to restructure financial regulation important?

A: Banking and capital markets regulatory policy must be modernized for the U.S. to retain its leadership and remain competitive in a world of increasing choices for investors and businesses. The Treasury has taken a needed first step in that direction.

Q: How will the Treasury framework make U.S. capital markets more competitive?

A: The proposal seeks to streamline the regulatory system, bolster efficiency and effectiveness, add consistency and better monitor liquidity, among other proposals.

Q: Does PricewaterhouseCoopers advocate or oppose any particular positions in the Treasury proposal?

A: No. We believe the Treasury proposal moves a major debate to the next level and toward action. It is critical that this momentum continues. And the Treasury framework provides a sensible beginning for constructive discussion.

Q: Does Treasury seek to act on the problems that caused the current subprime credit crisis?

A: The guidelines are intended to be broader and do not do that specifically. This proposal is the product of a yearlong development process that predates the credit crisis. In fact, Secretary Paulson notes credit crisis issues should not be decided nor any of these actions implemented during a time of market strain. However, elements of the guidelines do address factors that may have contributed to the current market stress. These include liquidity provisioning, mortgage origination and consistency of oversight.

Q: Is the plan geared principally toward correcting problems in and protecting the financial markets?

A: Capital market soundness and U.S. competitiveness worldwide are critical goals in themselves. Our history of quality and our financial dynamism have been foundations of our ongoing economic strength. But for any regulatory reform plan to succeed, all stakeholders must be treated fairly—all investors, borrowers and customers, as well as financial institutions and capital markets. The Treasury guidelines do open the door to consider comprehensive stakeholder interests.

Q: Will anything happen soon?

A: That is unlikely. The guidelines are bringing the dialogue of the past few years to the next level, providing a direction for change and suggesting a structure in which it can occur. As such, the proposal will enable more constructive and directed discussion and action. But many stakeholders have to weigh in, and the legislative process must work its course.

Q: Do the federal elections later this year make the Treasury blueprint a moot point?

A: Even with changes in the Executive Branch, the Treasury guidelines merit serious consideration because of the constructive goals they embody. The structure and details may change with a new Administration, but the momentum is likely to continue.

Contact Information

To have a deeper discussion about how *The Department of the Treasury Blueprint for a Modernized Financial Regulatory Structure* might affect your business, please contact:

Dennis Nally
U.S. Chairman and Senior Partner
PricewaterhouseCoopers LLP
Phone: 646-471-7293
Email: dennis.nally@us.pwc.com

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