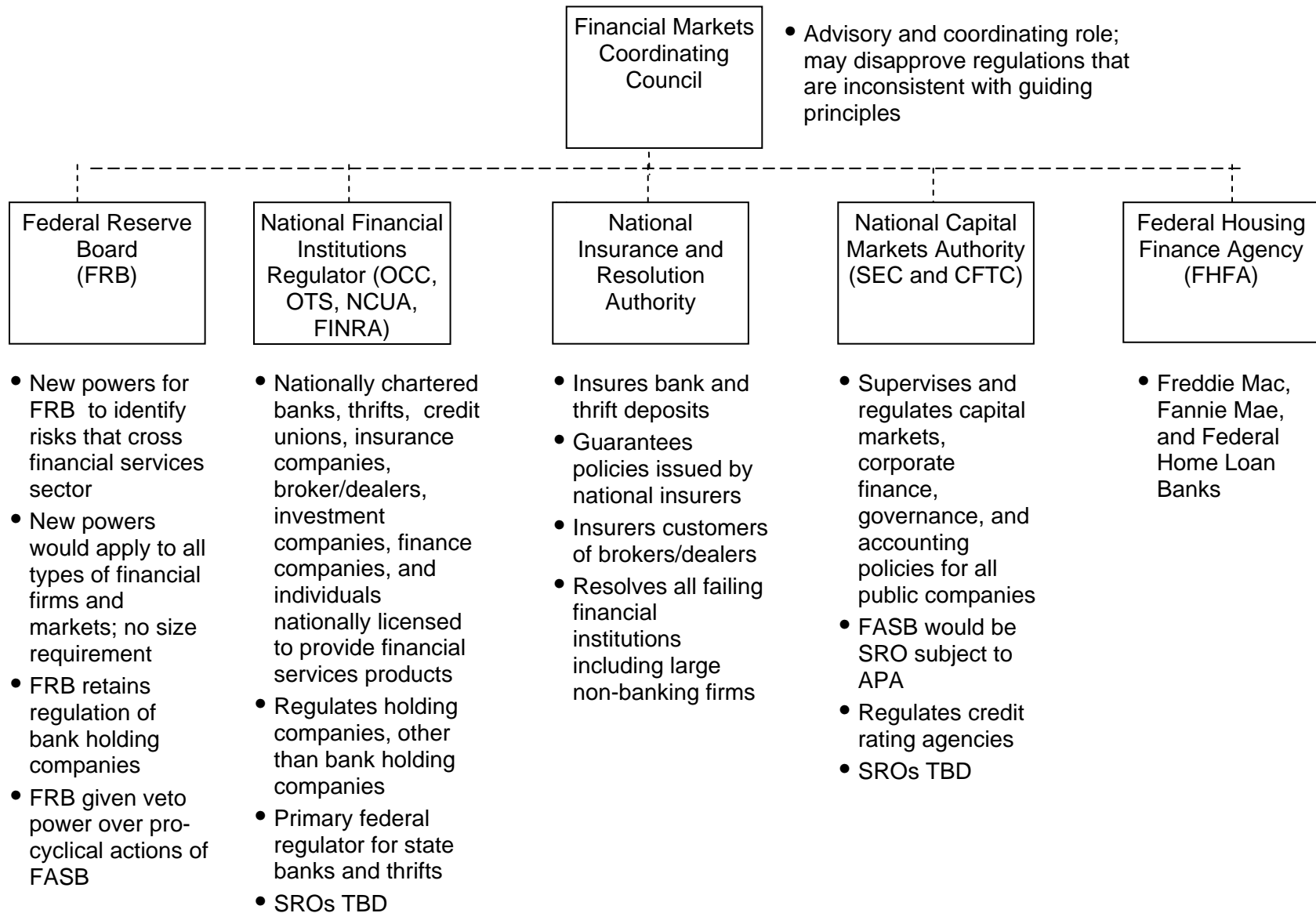


**FINANCIAL REGULATORY ARCHITECTURE PROPOSAL**



FINANCIAL SERVICES ROUNDTABLE  
PROPOSAL FOR FINANCIAL REGULATORY REFORM

In anticipation of the most sweeping financial regulatory reforms since the Great Depression, the Financial Services Roundtable's Executive Advisory Council on Regulatory Restructuring has developed six proposals for financial regulatory reform. The first proposal addresses the need for a modern financial regulatory architecture, and the remaining proposals address new regulatory standards to guide the behavior of all financial services firms and regulators.

**Six Proposals for Financial Regulatory Reform**

**1. New Architecture.** *Our financial regulatory system should be better aligned with modern market conditions and developing global standards.*

**2. Consumer and Investor Protection Standards.** *Financial services firms engaged in offering comparable products and services should be subject to comparable prudential, consumer, and investor protection standards. In the event of multiple oversight authorities, uniform standards should apply nationwide.*

**3. Balanced and Effective Regulation.** *Financial regulation should be focused on outcomes, not inputs, and should seek a balance between the stability and integrity of financial services firms and markets, consumer protection, innovation, and global competitiveness.*

**4. International Cooperation and National Treatment.** *U.S. financial regulators should coordinate and harmonize regulatory and supervisory policies with international financial regulatory authorities, and should continue to treat financial services firms doing business in the United States as they treat U.S. financial services firms. The United States should continue to play a leadership role in the current G-20 process to develop new international norms for financial regulation across markets.*

**5. Failure Resolution.** *Financial regulation should provide for the orderly resolution of failing financial services firms to minimize systemic risk.*

**6. Accounting Standards.** *U.S. financial regulators should adjust current accounting standards to account for the pro-cyclical effects of the use of fair value accounting in an illiquid market. Additionally, U.S. and International financial regulators should coordinate and harmonize regulatory policies to develop accounting standards that achieve the goals of transparency, understandability and comparability.*

## **Discussion of Proposals**

The on-going crisis in world financial markets has revealed both market failures and fundamental weaknesses in the U.S. financial regulatory system. Our fragmented financial regulatory system has resulted in gaps in regulation, which allowed imprudent lending and investment practices by both regulated and unregulated financial firms. Our diverse national and state financial regulatory agencies do not share a common vision and approach to supervision. There is no coordinating body where all regulators can meet to identify problems, exchange information, and devise solutions. Our rules-based system of regulation makes it difficult for regulators and firms to adjust policies and practices in response to rapidly changing market developments.

The Roundtable's six proposals are intended to guide the reform of the financial regulatory system. The Proposals would not only enable regulators to focus on desired policy outcomes and material risks to markets, but also reduce the potential for consumers to fall through gaps between the national and state legal and regulatory systems.

**Proposal 1. New Architecture** — *Our financial regulatory system should be better aligned with modern market conditions and developing global standards.*

Proposal 1 calls for the existing financial regulatory system to be better aligned with modern market conditions. The "Draft Financial Regulatory Architecture" that is described below is one possible approach to meeting this proposal. The "Draft Financial Regulatory Architecture" is designed to: preserve state financial regulation; provide for greater coordination among all financial regulators; provide for national regulation for insurance companies and insurance producers; reduce regulatory overlap; promote uniform regulation and supervision; limit systemic risk; and create a failure resolution mechanism for non-banking financial firms.

### *Financial Markets Coordinating Council*

To enhance coordination and cooperation among the many and various financial regulatory agencies, we propose to expand membership of the President's Working Group on Financial Markets (PWG) and rename it as the Financial Markets Coordinating Council (FMCC). This Council should be established by law, in contrast to the existing PWG which has operated under a Presidential Order. This would permit Congress to oversee its Council's activities. The Council should include representatives from all major federal financial agencies, as well as individuals who can represent state banking, insurance and securities regulation. The Council should serve as a forum for national and state financial regulators to meet and discuss regulatory and supervisory policies, share information, and develop early warning detections.

The Council should not have independent regulatory or supervisory powers. However, it might be appropriate for the Council to have some ability to review the goals and objectives of the regulations and policies of federal and state financial agencies, and thereby ensure that they are consistent.

*Federal Reserve Board*

To address systemic risk, the Federal Reserve Board (Board) should be authorized to act as a market stability regulator. As a market stability regulator, the Board should be responsible for looking across the entire financial services sector to identify interconnections that could pose a risk to the financial system. To perform this function, the Board should be empowered to collect information on financial markets and financial services firms, to participate in joint examinations with other regulators, and to recommend actions to other regulators that address practices that pose a significant risk to the stability and integrity of the U.S. financial services system. The Board's authority to collect information should apply not only to depository institutions, but also to all types of financial services firms. This authority should not be based upon the size of an institution. It is possible that a number of smaller institutions could be engaged in activities that collectively pose a systemic risk. As the market stability regulator, the Board must work in coordination with the primary regulators of the financial services firms.

*National Financial Institutions Regulator*

To reduce gaps in regulation, we propose the consolidation of several existing federal agencies into a single, National Financial Institutions Regulator (NFIR). This new agency would be a consolidated prudential and consumer protection agency for banking, securities and insurance. The NFIR would reduce regulatory gaps by establishing comparable prudential standards for all of these of nationally chartered or licensed entities. For example, national banks, federal thrifts and federally licensed brokers/dealers that are engaged in comparable activities should be subject to comparable capital and liquidity standards. Similarly, all federally chartered insurers would be subject to the same prudential and market conduct standards. Each industry would be legally and functionally separated within the NFIR.

In the area of mortgage origination, the NFIR's prudential and consumer protection standards should apply to both national and state lenders. Mortgage lenders, regardless of how they are organized, should be required to retain some of the risk for the loans they originate. Likewise, mortgage borrowers, regardless of where they live or who their lender is, should be protected by the same safety and soundness and consumer standards.

*National Capital Markets Agency*

To focus greater attention on the stability and integrity of financial markets, we propose the creation of a National Capital Markets Agency through the merger of the Securities and Exchange Commission (SEC) and the Commodities Futures Trading Commission (CFTC), preserving the best features of each agency. The NCMA would regulate and supervise capital markets and exchanges. As noted above, the existing regulatory and supervisory authority of the SEC and CFTC over firms and individuals that serve as intermediaries between markets and customers, such as broker/dealers, investment companies, investment advisors, and futures commission merchants, and other intermediaries would be transferred to the NFIR. The NCMA also should be responsible for establishing standards for accounting, corporate finance, and corporate governance for all public companies.

*National Insurance Resolution Authority*

To protect depositors, policyholders, and investors, we propose the creation of the National Insurance and Resolution Authority (NIRA) to act as the insurer of bank deposits, the guarantor of retail insurance policies written by nationally chartered insurance companies, and a financial backstop for investors who have claims against broker/dealers. These three insurance systems would be legally and functionally separated. Additionally, this agency should be authorized to act as the receiver for large non-bank financial services firms. The failure of Lehman Brothers illustrated the need for such a better system to address the failure of large non-banking firms.

*Federal Housing Finance Agency*

To supervise the Federal Home Loan Banks and to oversee the emergence and future restructuring of Fannie Mae and Freddie Mac from conservatorship we propose that the Federal Housing Finance Agency remain in place, pending a thorough review of the role and structure of the housing GSEs in our economy.

**Proposal 2. Common Prudential and Consumer and Investor Protection Standards.**

*Financial services firms engaged in offering comparable products and services should be subject to comparable prudential, consumer, and investor protection standards. In the event of multiple oversight authorities, uniform standards should apply nationwide.*

This proposal calls for comparable prudential standards (e.g., capital requirements and financial reporting) for financial services firms engaged in comparable activities. Such standards would reduce the potential for regulatory arbitrage and the potential for gaps in regulation. The proposal also calls for comparable consumer and investor protection standards for specific financial products and services. For example, residential mortgage loans should be subject to the same consumer protection standards regardless of what type of entity offers the loan. This would ensure that consumers are protected, regardless of where they live.

**Proposal 3. Balanced and Effective Regulation** — *Financial regulation should be focused on outcomes, not inputs, and should seek a balance between the stability and integrity of financial services firms and markets, consumer protection, innovation, and global competitiveness.*

Balanced, effective regulation requires: (i) greater reliance on principles-based regulations that are responsive to changes in market conditions and are focused on desired regulatory results; (ii) greater reliance on a system of prudential supervision that is based upon an on-going exchange of information between regulated firms and regulators that seeks to solve common problems before they pose a risk to consumers or the financial system; and (iii) a reduction in the pro-cyclical effects of accounting and capital requirements.

**Proposal 4. International Cooperation and National Treatment** — *U.S. financial regulators should coordinate and harmonize regulatory and supervisory policies with international financial regulatory authorities, and should continue to treat financial services firms doing*

*business in the United States as they treat U.S. financial services firms. The United States should continue to play a leadership role in the current G-20 process to develop new international norms for financial regulation across markets.*

This proposal calls for the coordination of international financial regulations and the continuation of the national treatment for foreign firms doing business in the United States. The on-going financial crisis indicates that global financial markets require coordination and cooperation among financial regulatory authorities. Also, the benefits of national treatment for foreign firms operating in the U.S. are proven. National treatment promotes open, fair competition not only in the U.S., but abroad.

**Proposal 5. Failure Resolution** — *Financial regulation should provide for the orderly resolution of failing financial services firms to minimize systemic risk.*

This proposal calls for the establishment of orderly resolution procedures to apply to large non-banking firms. The failure of Lehman Brothers illustrated the limitations of existing receivership procedures. As discussed above, it is envisioned that the National Insurance Resolution Agency would perform this function.

**Proposal 6. Accounting Standards** — *U.S. financial regulators should adjust current accounting standards to account for the pro-cyclical effects of the use of fair value accounting in an illiquid market. Additionally, U.S. and International financial regulators should coordinate and harmonize regulatory policies to develop accounting standards that achieve the goals of transparency, understandability and comparability.*

This proposal calls for a review of the use of current accounting standards, such as fair value accounting and impairment accounting, when there is an illiquid market. Accounting requirements to write-down securities to observable prices encourages some companies to sell sooner than they otherwise would, further depressing prices in an illiquid market. Problematic pro-cyclical effects have created further problems in the areas of purchase accounting, accounting for annual pension expenses, mergers/acquisitions, adjustment of loan loss reserves, and auction rate securities. This proposal also recommends that the U.S. work with International Regulators to develop and harmonize accounting standards around the globe, providing both U.S. and foreign companies the opportunity to remain competitive in a global marketplace.