

2010

Back in the Saddle Again: But Which Way Do We Go from Here ? A View of Agency Suggestions for Systemic Risk Regulation

Traci M. Pribbenow

Follow this and additional works at: <https://scholarlycommons.law.case.edu/caselrev>

 Part of the [Law Commons](#)

Recommended Citation

Traci M. Pribbenow, *Back in the Saddle Again: But Which Way Do We Go from Here ? A View of Agency Suggestions for Systemic Risk Regulation*, 60 Case W. Rsr. L. Rev. 559 (2010)
Available at: <https://scholarlycommons.law.case.edu/caselrev/vol60/iss2/10>

This Comments is brought to you for free and open access by the Student Journals at Case Western Reserve University School of Law Scholarly Commons. It has been accepted for inclusion in Case Western Reserve Law Review by an authorized administrator of Case Western Reserve University School of Law Scholarly Commons.

COMMENT

BACK IN THE SADDLE* AGAIN: BUT WHICH WAY DO WE GO FROM HERE? A VIEW OF AGENCY SUGGESTIONS FOR SYSTEMIC RISK REGULATION

INTRODUCTION

When you hear the term “systemic risk,”¹ what is the first thing that pops into your mind? Do you think about a “run on the bank”? The subprime mortgage crisis? The collapse of Bear Stearns or Lehman Brothers? Bernie Madoff? All of these are elements of systemic risk, and presently there is no governing body that has the ability to regulate these kinds of risks on a grand scale.

Attempts to define systemic risk have led to confusion and uncertainty. Alan Greenspan acknowledged this uncertainty as he remarked: “It is generally agreed that systemic risk represents a propensity for some sort of significant financial system disruption [O]ne observer might use the term ‘market failure’ to describe what another would deem to have been a market outcome that was natural and healthy, even if harsh.”² Through this definition and his later

* AEROSMITH, *Back in the Saddle*, on ROCKS (Columbia Records 1976).

¹ See, e.g., *Systemic Risk: Examining Regulators’ Ability to Respond to Threats to the Financial System: Hearing before the H. Comm. on Fin. Servs.*, 110th Cong. (2007), available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_house_hearings&docid=f:39903.pdf (discussing the existing regulatory structure and its ability to respond to systemic risk); Franklin Allen & Douglas Gale, *Systemic Risk and Regulation* (Wharton Fin. Insts. Ctr. Working Paper No. 95-24, 2005), available at <http://ssrn.com/abstract=787797> (discussing systemic risk and the transfer of risk from banking to insurance).

² George G. Kaufman, *Bank Failures, Systemic Risk, and Bank Regulation*, 16 CATO J. 17, 21 n.5 (1996) (quoting Alan Greenspan, Remarks at a Conference on Risk Measurement and Systemic Risk, Board of Governors of the Federal Reserve System (Nov. 16, 1995)), available at <http://www.cato.org/pubs/journal/cj16n1/cj16n1-2.pdf>.

statements, Greenspan has acknowledged that the very definition of systemic risk is “still somewhat unsettled.”³

Even honest attempts to analyze all the available definitions of systemic risk may not lead to a concrete understanding of the subject. However, the various definitions⁴ share at least one basic element—systemic risk involves a trigger event that leads to a chain reaction of negative effects.⁵ The Chairman of the Securities and Exchange Commission (“SEC”), Mary L. Schapiro, provided information about systemic risk in a recent speech. Chairman Schapiro stated that “there are two different kinds of ‘systemic risk’: (1) the risk of sudden, near-term systemic seizures or cascading failures and (2) the longer-term risk that our system will unintentionally favor large systemically important institutions over smaller, more nimble competitors, reducing the system’s ability to innovate and adapt to change.”⁶ With the various definitions for systemic risk, and the difficulty in truly understanding systemic risk, the regulation challenge is even more pronounced.

³ *Id.*

⁴ Systemic risk has been defined as “the probability that cumulative losses will occur from an event that ignites a series of successive losses along a . . . system.” *Id.* at 20. It has also been defined as “the potential for a modest economic shock to induce substantial volatility in asset prices, significant reductions in corporate liquidity, potential bankruptcies and efficiency losses.” Paul Kupiec & David Nickerson, *Assessing Systemic Risk Exposure from Banks and GSEs Under Alternative Approaches to Capital Regulation*, 28 J. REAL EST. FIN. & ECON. 123, 123 (2004). The Commodity Futures Trading Commission defines systemic risk as the risk “that a default by one market participant will have repercussions on other participants due to the interlocking nature of financial markets. For example, Customer A’s default in X market may affect Intermediary B’s ability to fulfill its obligations in Markets X, Y, and Z.” U.S. Commodity Futures Trading Comm’n, The CFTC Glossary: A Guide to the Language of the Futures Industry, http://www.cftc.gov/educationcenter/glossary/glossary_s.html (last visited Jan. 22, 2010). The Financial System Stabilization and Reform Act of 2009 defines systemic risk as “the risk that a product or activity that is financial in nature, or that a default by a financial institution, will produce failures of, or significant losses to, other financial institutions, resulting in substantial increases in the cost of capital or substantial decreases in the availability of capital, or substantial financial market price volatility.” H.R. 1754, 111th Cong. § 101(8) (2009). Steven Schwarcz also attempts to define systemic risk as “risk that [] an economic shock such as market or institutional failure triggers . . . either [] the failure of a chain of markets or institutions or [] a chain of significant losses to financial institutions, [] resulting in increase in the cost of capital or decreases in its availability” Steven L. Schwarcz, *Systemic Risk*, 97 GEO. L.J. 193, 204 (2008).

⁵ See Schwarcz, *supra* note 4, at 199 (describing the “classic example” of systemic risk as a chain reaction of negative effects among “closely intertwined” banks, such as that which occurred at the outset of the Great Depression); *id.* at 200–04 (describing another chain reaction of negative effects resulting from systemic risk problems arising out of capital markets).

⁶ *Testimony Concerning Regulation of Systemic Risk: Hearing Before the S. Comm. on Banking, Housing and Urban Affairs*, 111th Cong. 1 (2009) [hereinafter Schapiro Testimony] (testimony of Mary L. Schapiro, Chairman, SEC), available at http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=4c3a14d4-ddee-4873-b56d-c7313cd55398.

This Comment explores various agency proposals for establishing some kind of systemic risk regulation with a single entity regulator. According to Chairman Schapiro there are two different types of systemic risk regulation: “(1) the traditional oversight, regulation, market transparency and enforcement provided by primary regulators that helps keep systemic risk from developing in the first place and (2) the new ‘macro-prudential’ regulation designed to identify and minimize systemic risk if it does [develop].”⁷ The agency reports discussed throughout this Comment will focus on systemic risk regulation most similar to the types described by Chairman Schapiro. Part I will provide a background picture of systemic risk and outline the need for this kind of regulation. Part II will examine and compare the four main proposals. Finally, Part III will suggest future steps the government can take to establish a systemic risk regulator that prevents future financial meltdowns.

I. BACKGROUND

A. General Background

Following the financial collapse of 2008, the relevant agencies’⁸ main concern revolved around the means of protecting the financial systems from systemic risk. This same financial crisis also paved the way for the idea of a systemic risk regulator.⁹ The gaps in the

⁷ *Id.*

⁸ The relevant agencies here are the Department of the Treasury, the Investment Company Institute, and the Group of Thirty, each of which prepared a report regarding future management of systemic risk. *See infra* notes 14, 16, 32–33 and accompanying text.

⁹ In a recent article, Timothy Geithner and Lawrence Summers observed the following:

Th[e] current financial crisis had many causes. It had its roots in the global imbalance in saving and consumption, in the widespread use of poorly understood financial instruments, in shortsightedness and excessive leverage at financial institutions. But it was also the product of basic failures in financial supervision and regulation.

Timothy Geithner & Lawrence Summers, *A New Financial Foundation*, WASH. POST, June 15, 2009, at A15. Although Bernard L. Madoff was not the sole reason for the financial crisis of 2008, his ponzi scheme, which defrauded investors out of \$65 billion over twenty years, gained the attention of the masses. *See* Diana B. Henriques, *\$3 Billion in Losses to Madoff Documented*, N.Y. TIMES, July 2, 2009, at B3.

During that twenty-year period, Madoff had been in the crosshairs of the Securities and Exchange Commission several different times. “Between June 1992 and December 2008 when Madoff confessed, the SEC received six substantive complaints that raised significant red flags concerning Madoffs [sic] hedge fund operations that should have led to questions about whether Madoff was actually engaged in trading.” Josh Hamilton, *SEC Inspector General Faults Madoff Enforcement, Particularly Failure to Verify Through Independent Third Parties*, CCH FIN. CRISIS NEWS CTR., Sept. 3, 2009, <http://www.financialcrisisupdate.com/2009/09/sec-inspector-general-faults-madoff-enforcement-particularly-failure-to-verify-through-independent-t.html>. The SEC conducted a number of investigations and examinations, but nothing came from those

financial system presented themselves in full force when the crisis began, at which point the flaws in the system became apparent to financial reformers.¹⁰ According to Federal Reserve Chairman Ben S. Bernanke, the present financial crisis is the worst since the Great Depression, and it has “precipitated a sharp downturn in the global economy.”¹¹ In discussing potential causes of the crisis, Bernanke further stated that the downturn occurred, at least in part, due to the fact that “risk-management systems of the private sector and government oversight of the financial sector . . . failed to ensure that the inrush of capital was prudently invested, a failure that has led to a powerful reversal in investor sentiment and a seizing up of credit markets.”¹²

The idea behind a systemic risk regulator is to have a financial system in which one group has the big picture of the entire industry, instead of the less advantageous scheme of compartmentalized regulation by single groups that only see what is within their regulatory boundaries.¹³ In the present financial system, there is not a single regulatory body with complete oversight. Instead, the system is broken down into regulators for “segregated functional lines of financial services.”¹⁴ Because of this segregated regulation there are many problems with the system, the most noteworthy being that “no single regulator possesses all of the information and authority necessary to monitor systemic risk, or the potential that events associated with financial institutions may trigger broad dislocation or a series of defaults that affect the financial system so significantly that the real economy is adversely affected.”¹⁵ The need for an

inquiries—not until the scheme had run its course and Madoff confessed in December 2008, which landed him with a 150-year prison sentence in June 2009. *See* David Stout, *Report Details How Madoff's Web Ensnared S.E.C.*, N.Y. TIMES, Sept. 3, 2009, at B1. Had systemic risk regulations been in place from a central point, it is unclear whether or not the Madoff scandal would have spread just as far as it did.

¹⁰ In a speech on March 10, 2009, Federal Reserve Chairman Ben Bernanke stated that, because the goal of any systemic risk authority is to have a broader view of the financial system, reliance on the present system is insufficient because of its decentralized nature. *See* Ben S. Bernanke, Chairman, Fed. Reserve, *Financial Reform to Address Systemic Risk*, Speech at the Council on Foreign Relations, Washington D.C. (Mar. 10, 2009) (transcript available at <http://www.federalreserve.gov/newsevents/speech/bernanke20090310a.htm>).

¹¹ *Id.*

¹² *Id.*

¹³ The Federal Reserve has been singled out as a potential candidate for an agency conversion to the systemic risk regulator. *See, e.g.*, Kara Scannell, *Frank Backs Regulator for Systemic Risk*, WALL ST. J., Feb. 4, 2009, at C3 (stating that oversight for systemic risks could be given to the Federal Reserve).

¹⁴ DEP'T OF THE TREASURY, BLUEPRINT FOR A MODERNIZED FINANCIAL REGULATORY STRUCTURE 4 (2008) [hereinafter TREASURY BLUEPRINT], <http://www.treas.gov/press/releases/reports/Blueprint.pdf>.

¹⁵ *Id.*

overarching regulatory body is important so that the industry as a whole is properly managed and consumers are adequately protected.¹⁶ Such a regulatory body could effectively gauge all risk and instill greater regulation on those institutions in which inherent risk is high and whose failure would be catastrophic.¹⁷ Unfortunately, no institution in the present regulatory scheme allows for such an overarching view of the entire financial system.

B. The Need for Change

The need for change in the existing system arises because the present regulatory system is based on a seventy-year-old structure.¹⁸ The system evolved in response to a series of financial crises ranging from the late 1800s to the mid-1900s.¹⁹ The problem with the present regulatory framework is that maturing foreign markets have the ability to “alternate sources of capital and financial innovation in a more efficient and modern regulatory system,”²⁰ thereby leaving the U.S. system struggling to find a way to continue to compete with the flexible and ever-changing global markets. With the continuous evolution of the financial markets, reform is inevitable if the U.S. wants to remain in competition with the rest of the world.²¹ The growing inability to keep pace has not only stretched the system, but has also permitted the infiltration of financial crises into the system.²²

¹⁶ Consumer protection is a very important part of systemic risk. At the present the key policies behind regulation include maintaining not only financial stability, but also the safety of deposits, efficiency within the financial system and protecting consumers. *Id.* at 42. The consumer protections that regulations currently attempt to regulate include fraud and abuse, but after the Madoff scheme, it was widely recognized that present attempts to protect consumers were not adequate. *See generally id.* at 42–44; DEP’T OF THE TREASURY, FINANCIAL REGULATORY REFORM: A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION 55–75 (2009) [hereinafter TREASURY NEW FOUNDATION], http://www.financialstability.gov/docs/regs/FinalReport_web.pdf.

¹⁷ *See generally* TREASURY BLUEPRINT, *supra* note 14, at 4.

¹⁸ *See id.* at 2 (noting that “for the most part the underlying [regulatory] structure resembles what existed in the 1930s”).

¹⁹ *See id.* First, the national bank charter was established in 1863 during the Civil War. Second, the Federal Reserve System was established, in 1913 the Federal Reserve System was established as a result of financial instability. Third, during the Great Depression, the government established the federal deposit insurance system to respond to the financial crisis of the time. *Id.*

²⁰ *Id.* The ability of the foreign markets to adjust to changing financial products allows them to more easily brand new financial products. With advances in technology and relatively new financial regulations, foreign markets are not bound to an inflexible regulatory structure like the United States. While the present United States structure has historically done quite well, the changing global financial system and the recent financial crisis struck a chord and made it clear that regulatory changes must happen if the United States is to continue in a prominent position within the global financial markets. *Id.* at 2–3.

²¹ *See id.* at 4.

²² *See id.* The present regulatory system, which maintains separate regulatory structures

The present regulatory structure focuses on a functional approach. A functional approach means that the regulatory structure of the U.S. financial system is separated according to regulatory function including securities, futures, insurance and banking,²³ preventing any single regulator from comprehensively monitoring systemic risk.²⁴ Furthermore, “the inability of any regulator to take coordinated action throughout the financial system makes it more difficult to address problems related to financial market stability.”²⁵ Not only does the lack of a central regulatory figure hamper efforts to monitor the system and keep systemic risk at bay, but it also opens the door for jurisdictional disputes.²⁶ These disputes can hinder the introduction of new products and compel movement of financial products to offshore financial centers, while also slowing innovation.²⁷

Yet another reason for reforming the regulatory system and moving toward one with a central regulatory figure comes from the fact that “many aspects of financial regulation and consumer protection regulation have common themes.”²⁸ Providing financial strength and the ability to meet financial obligations are the most important functions of the regulatory framework. After all, “money makes the world go round.”²⁹ Without financial integrity and strong financial regulations a nation simply cannot survive.³⁰ So even if the terms of the regulations differ, the underlying purpose remains the same.

depending on the financial service involved, does not work well with market developments because of the level of segregation between the regulators. *Id.*

Recall Chairman Schapiro’s definition of systemic risk, which emphasized the longer-term risk of favoring larger institutions (like institutional investors) that do not have the ability to adapt to changing conditions. Because of the way the system has been structured, the large institutions were favored and the system did not adapt itself to the possibility of systemic failure when those large institutions began to falter. In order to remain competitive in the world markets, the regulatory structure in the United States has to find a way to innovate and adapt to change. *See supra* notes 6–7 and accompanying text.

²³ TREASURY BLUEPRINT, *supra* note 14, at 4.

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.* at 5.

²⁹ JOHN KANDER & FRED EBB, *Money Money*, on CABARET (Hip-O Records 1996) (1972).

³⁰ *See* CNN.com, Q&A: Greece’s Financial Crisis Explained, <http://www.cnn.com/2010/business/02/10/greek.debt.qanda/index.html> (last visited March 25, 2010). Greece’s financial problems, which were systemic, evolved from “unrestrained spending, cheap lending, and failure to implement financial reforms.” *Id.* (emphasis added). Greece is a prime example why financial strength through regulations and reforms are an integral part of keeping a country afloat.

II. PROPOSAL SOURCES

This section will not only provide the main points of each agency report, but will also address the best anticipated solutions to protect against systemic risk. The present regulatory system faces many challenges, and several agency proposals have sought to address them. The sources include the following: (1) The Department of the Treasury Blueprint for a Modernized Financial Regulatory Structure³¹ (“Treasury Blueprint”); (2) the Group of Thirty’s “Financial Reform: A Framework for Financial Stability”³² (“Group 30 Framework”); (3) the Investment Company Institute’s “Financial Services Regulatory Reform”³³ (“ICI Report”); and (4) The Department of the Treasury’s “Financial Regulatory Reform: A New Foundation—Rebuilding Financial Supervision and Regulation”³⁴ (“New Foundation Report”).

A. *Treasury Blueprint*

“[F]inancial institutions serve a vitally important function in the U.S. economy by allowing capital to seek out its most productive uses in an efficient matter.”³⁵ The economic significance of the financial system led the Department of the Treasury to come up with the Treasury Blueprint. Of the four proposals, the Treasury Blueprint provides the most detailed information regarding several aspects of regulatory reform. First, the Treasury Blueprint focuses on the need for change in the existing system.³⁶ Second, it provides recommendations based on three different timeframes: (1) short term; (2) intermediate term; and (3) optimal regulatory structure.³⁷ Within the optimal regulatory structure, the Treasury Blueprint mentions two different regulatory structures similar to systemic risk regulators: (1) a market stability regulator; and (2) a prudential financial regulator.³⁸

³¹ TREASURY BLUEPRINT, *supra* note 14.

³² GROUP OF THIRTY, FINANCIAL REFORM: A FRAMEWORK FOR FINANCIAL STABILITY (2009) [hereinafter THIRTY FRAMEWORK], <http://www.group30.org/pubs/reformreport.pdf>.

³³ INV. CO. INST., FINANCIAL SERVICES REGULATORY REFORM: DISCUSSION AND RECOMMENDATIONS (2009) [hereinafter ICI REFORM], http://www.ici.org/pdf/ppr_09_reg_reform.pdf.

³⁴ TREASURY NEW FOUNDATION, *supra* note 16.

³⁵ TREASURY BLUEPRINT, *supra* note 14, at 1.

³⁶ *See id.* at 3–5 (summarizing the need for review of the current regulatory system).

³⁷ *See id.* at 5–21 (highlighting the possible short- and intermediate-term changes to the regulatory system, as well as the optimal regulatory structure for the long-term).

³⁸ *See id.* at 15–19.

1. Recommendations for the Regulatory Framework

The Treasury Blueprint focuses on three different recommendations for the system.³⁹ First, in the short term, the Treasury Blueprint proposes making the President's Working Group on Financial Markets ("Working Group") an interim systemic risk regulator.⁴⁰ The Working Group was established in 1988 by Executive Order 12631 following the 1987 stock market decline, and includes the Treasury, the Federal Reserve, the Securities and Exchange Commission ("SEC") and Commodities Futures Trading Commission ("CFTC") department heads.⁴¹ As a short-term coordinator, the Working Group has the ability to promote coordination and communication for financial policy.⁴² In order to make the Working Group functional in this role, the Treasury Blueprint advocates the following updates to the Executive Order: (1) maintaining a broader focus on the financial sector, rather than solely concentrating on the financial markets; (2) striving to alleviate systemic risk to the financial system, improve market integrity, advocate consumer protections, and reinforce the market's ability to compete—all through improved communication and coordination among agencies; (3) expanding the Working Group's membership to include the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Office of Thrift Supervision; and (4) issuing reports without requiring the approval of the White House.⁴³

This kind of systemic risk regulation would abide by Chairman Schapiro's "macro-prudential" regulation, since it is designed to identify and minimize systemic risk.⁴⁴ Macro-prudential regulation, according to Chairman Schapiro, includes not only a systemic risk regulator that would have unfettered access to market-wide information, but also an oversight council, which would complement the systemic risk regulator by providing additional eyes on the issues and the necessary tools to deal with problems that arise.⁴⁵ The

³⁹ See *id.* at 5–22. The Treasury Blueprint maintains a broader focus than what is covered here, but the recommendations relative to mortgages, insurance, banking charters, and settlement systems are not included are not relevant for the purposes of this Comment.

⁴⁰ *Id.* at 75.

⁴¹ *Id.* at 75. The Working Group's objective was to "report on the major issues raised by [the] stock market decline and on actions to enhance market integrity and maintain investor confidence." *Id.*

⁴² *Id.* at 76.

⁴³ *Id.* at 76–77.

⁴⁴ See *id.*; see also Schapiro Testimony, *supra* note 6.

⁴⁵ See Schapiro Testimony, *supra* note 6.

Treasury Blueprint updates to the Executive Order would fulfill both measures of Chairman Schapiro's idea of macro-prudential regulation by furnishing market-wide information to a singular body and providing it with the tools necessary to maintain market integrity.

Second, in the intermediate term, the Treasury Blueprint speaks to merging the SEC with the CFTC.⁴⁶ The former split between the SEC and the CFTC was understandable when the markets were truly distinct, but that is simply not the case with the present-day markets. As markets converge with the passage of time, a unification of the oversight and regulatory powers of the SEC and the CFTC makes sense.⁴⁷

Merging the regulatory systems allows for development of overarching regulatory principles that focus on systemic risk and investor protection.⁴⁸ With the advent of complex financial instruments and commodities no longer having a singular agricultural focus, the present system of futures and securities is no longer black and white.⁴⁹ As a result of the changing complexities of the financial markets, "[j]urisdictional disputes have ensued as the increasing complexity and hybridization of financial products have made the 'definitional' determination of agency jurisdiction . . . increasingly problematic."⁵⁰ While there have been attempts to defuse the problems between the SEC and the CFTC,⁵¹ the "lack of coordination between the futures and securities markets . . . may contribute to increased market volatility and may impair market participants' ability to accurately estimate their risk exposure."⁵² While a merger of

⁴⁶ See TREASURY BLUEPRINT, *supra* note 14, at 115–18.

⁴⁷ This kind of change is in line with Chairman Schapiro's systemic risk regulation of the traditional oversight by primary regulators with the intent to keep systemic risk from surfacing in the first place. See Schapiro Testimony, *supra* note 6.

⁴⁸ See TREASURY BLUEPRINT, *supra* note 14, at 108–09.

⁴⁹ See *id.* at 106.

⁵⁰ *Id.* at 107. The jurisdictional disputes have "hindered innovation, limited investor choice, harmed investor protection, and encouraged product innovators and their consumers to seek out other, more integrated international markets, engage in regulatory arbitrage, or evade regulatory oversight altogether." *Id.*

⁵¹ *Id.* at 108–09. The storm between the SEC and CFTC began as early as 1975 with the challenge over which agency had regulatory control over government securities under the Government National Mortgage Association. *Id.* at 107. These securities initially fell under control of the CFTC as commodities, but that changed in 1981 when options for the securities started trading on the Chicago Board Options Exchange. *Id.* Courts have attempted to draw the lines between these agencies, but in the process of providing clarifications, product development has either been completely shut out or heavily handicapped. *Id.* at 108. Another attempt at correcting the problems between these agencies came in the form of the Commodity Futures Modernization Act, which ultimately required cooperation between the agencies. *Id.* But ultimately, agreement between the agencies on simple matters, like margin requirements, has been elusive and effectively has limited financial product innovation in the U.S. market. *Id.*

⁵² *Id.* at 109.

the two regulatory agencies would require an act of Congress, the Treasury Blueprint recommends at least merging the agency philosophies, so as to “harmonize futures and securities statutes and regulations.”⁵³ The Treasury Blueprint’s second recommendation is pivotal in order to allow financial innovation within U.S. financial markets, enhanced disclosures to ensure that customers fully understand their risks and rewards, and ultimately to allow the financial markets to be flexible in accord with the changing world markets.

In its third recommendation, Treasury Blueprint proposes an optimal regulatory structure that focuses on an objectives-based form of regulation.⁵⁴ In this structure, the regulatory responsibilities with “natural synergies” are subject to consolidation,⁵⁵ which paves the way for systemic risk regulators—a central, uniform regulatory body, with defined regulatory lines for three types of systemic risk regulators—whose regulatory responsibilities are no longer split between agencies.⁵⁶ The Treasury Blueprint provides for three distinct regulators, all having specific focal points within financial institutions: (1) a market stability regulator; (2) a prudential financial regulator; and (3) a business conduct regulator.⁵⁷

2. Objectives-Based Regulation

First, a market stability regulator’s sole focus would be the broad issues that can impact market stability across all types of financial institutions.⁵⁸ The market stability regulator is responsible “for overall conditions of financial market stability that could impact the real

⁵³ *Id.* at 115. The Treasury Blueprint assumes that a “merger will enhance investor protection, market integrity, market and product innovation, industry competitiveness, and international regulatory dialogue.” *Id.*

⁵⁴ *See id.* at 142–46. The Treasury Blueprint provides that certain key objectives would guide regulation: “market stability regulation, prudential financial regulation, and business conduct regulation . . .” *Id.* at 142.

⁵⁵ *Id.* Such consolidation would allow the regulations within “one regulatory body . . . to focus on common elements of risk management across financial institutions . . .” *Id.* By allowing these elements to be the focus of one regulatory body, that body can better focus on key pressure points within the market.

⁵⁶ *Id.* at 143–46. The Treasury Blueprint, instead of focusing on a singular systemic risk regulator like Chairman Schapiro suggested, divides the responsibility of a systemic risk regulator in accordance with natural synergies. *Id.* at 143. The Treasury Blueprint seeks to create three different regulators by providing very clear dividing lines for those regulators. *Id.* First, a market stability regulator that takes on the task of looking after financial market conditions that could ultimately cause an impact on the economy as a whole. *Id.* at 144. Second, a prudential financial regulator, which focuses its attention on the government guarantees, like federal deposit insurance. *Id.* Third, a business conduct regulator, which focuses on consumer protections to promote full disclosure and awareness. *Id.*

⁵⁷ *See id.* at 137–38.

⁵⁸ *See id.* at 144, 146–56.

economy.”⁵⁹ Under this plan, the Federal Reserve assumes the role of market stability regulator since it is already in the role to promote “overall macroeconomic stability”⁶⁰ The Treasury Blueprint foresees this plan as one where the stability would be ensured through monetary policy and liquidity provisions.⁶¹ The plan also proposes that the Federal Reserve have broad powers focusing on the overall financial system.⁶²

In the interests of overall financial market stability, the Treasury Blueprint recommends that the Federal Reserve have the responsibility and authority to gather appropriate information, disclose information, collaborate among regulators on rule drafting, and take necessary corrective actions to prevent future collapse or catastrophe.⁶³ The Treasury Blueprint emphasizes that enhanced regulatory authority is a prerequisite in dealing with systemic risk.⁶⁴ The only way to make the Federal Reserve function appropriately as a market stability regulator is to require disclosure of detailed information on the existing regulated financial institutions, share financial reports to analyze impact and market stability, and allow the Federal Reserve to not only mandate other public disclosures, but also provide input into the development of regulatory policy.⁶⁵

Second, a prudential financial regulator would be housed within a single regulatory body (like the merged SEC/CFTC) and its sole focus would be the common elements of risk management across all financial institutions.⁶⁶ This regulator would be in place to focus on financial institutions with associated explicit government guarantees.⁶⁷ This focus is important because “explicit government

⁵⁹ *Id.* at 137.

⁶⁰ *Id.* at 137, 146. Within this role, the Federal Reserve would not only be responsible for continuing to formulate monetary policy, but would also be a lender of last resort, since “[p]rudent use of a lender of last resort authority can help to preserve market stability in certain cases” *Id.* at 147.

⁶¹ *See id.* at 137, 144. Changes in monetary policy include adjustments to the discount rate to encourage spending or control inflation. Liquidity provisions include the lender of last resort feature, which is meant to make “short-term credit available” and keep money circulating and the economy stimulated. *Id.* at 153.

⁶² *Id.*

⁶³ *Id.* at 144.

⁶⁴ *Id.* at 15. Additionally, the Treasury Blueprint recognizes that “the [President’s Working Group], the Federal Reserve Bank of New York, and the [Office of the Comptroller of the Currency] have previously stated that market discipline is the most effective tool [against] systemic risk.” *Id.* at 15 n.2.

⁶⁵ *See id.* at 15–16. The Treasury Blueprint also notes that the Federal Reserve, in the systemic regulator capacity, should have the authority to require corrective actions if it sees a problem coming down the pipeline. The Federal Reserve should also continue with its lender of last resort policy to address liquidity issues and expand that fiscal safety net. *See id.* at 16–17.

⁶⁶ *See id.* at 144, 157–70.

⁶⁷ *Id.* at 137–38. The Treasury Blueprint notes that “[t]he most prominent examples of

guarantees often erode market discipline”⁶⁸ The market discipline is eroded because when government guarantees are present, risk no longer remains in the equation because the guarantee provides a safety net.⁶⁹ This safety net can lead to banking practices that go against the grain, searching for the biggest profit and not necessarily serving the needs of communities.⁷⁰ The Treasury Blueprint explains that it is important to have prudential regulation, but that it should resemble “the current regulation of insured depository institutions, with capital adequacy requirements, investment limits, activity limits, and direct on-site risk management supervision.”⁷¹

Third, a business conduct regulator would primarily be responsible for consumer protections, providing uniformity among disclosures so that consumer awareness is elevated and uniform.⁷² Not only does the optimal structure provide for dedicated risk management, but it also allows for a better focus on the financial markets as a whole because the regulator no longer splits its focus between different concerns.

While the Treasury Blueprint did mention implementing a single consolidated regulator—a true systemic risk regulator—the report outlines several problems, ultimately deciding that the objectives-based approach is a better fit.⁷³ The Treasury Blueprint discusses several benefits to having a single, consolidated regulator.⁷⁴ First, there is an enhanced efficiency in combining common functions into a single body.⁷⁵ Second, the approach allows for a clearer view of overall risks to the financial system.⁷⁶ Third, the approach avoids issues associated with overlapping jurisdiction.⁷⁷ In response to these benefits, the Treasury Blueprint also outlines the problems with the single, consolidated regulator.⁷⁸ These problems were enough to persuade the Treasury Blueprint to adopt the objectives-based approach. The report first mentions the potential problem that “housing all regulatory functions . . . in one entity may lead to varying degrees of focus on these key functions.”⁷⁹ Second, this

government guarantees in the United States are federal deposit insurance and state-established insurance guarantee funds.” *Id.* at 157.

⁶⁸ *Id.* at 144.

⁶⁹ *See id.* at 159–64.

⁷⁰ *See id.* at 161.

⁷¹ *Id.* at 158.

⁷² *See id.* at 144, 170–80.

⁷³ *See id.* at 141.

⁷⁴ *See id.*

⁷⁵ *See id.*

⁷⁶ *See id.*

⁷⁷ *See id.*

⁷⁸ *See id.*

⁷⁹ *See id.*

consolidated approach may actually lead to less market discipline.⁸⁰ Third, this would be difficult to implement in comparison to other jurisdictions, like the United Kingdom.⁸¹ Fourth, a high degree of coordination would be required with the central bank to try and keep things in line.⁸² The Treasury Blueprint's ultimate proposal focuses on making the system work as a whole without splitting the focus between various responsibilities.

B. Group of Thirty Framework

The Group of Thirty Framework took shape as the global financial crisis entered its second year. The information in the report focuses on how the financial system can change after the crisis has passed, attempting to find ways to bring greater stability to the existing system.⁸³ The report focuses on a series of recommendations: (1) eliminating the gaps and weaknesses in the coverage and supervision of prudential regulation; (2) improving the quality and effectiveness of prudential regulation and supervision; (3) strengthening international policies and standards concerning risk management and governance; and (4) increasing transparency within the financial markets and products.⁸⁴

The Group of Thirty Framework differs from the Treasury Blueprint in that it proposes consolidated regulatory supervision.⁸⁵ The Group of Thirty Framework argues a consolidated approach is essential for meeting "high and common international standards."⁸⁶ The Group of Thirty Framework also indicates that larger banks—those whose failure increases the chance of systemic failure—should be limited in the amount of high-risk activities in which they can participate.⁸⁷ The Group of Thirty Framework further indicates that

⁸⁰ See *id.* The concern over less market discipline comes from the idea that the "same regulator would regulate all financial institutions, whether or not they have explicit government guarantees." *Id.* The government guarantees that many consumers are used to, such as federally insured deposits, are not universal, and in fact encompass a range of explicit guarantees. *Id.* Consolidating a regulator for such a non-universal system would potentially give market participants a false sense of security with regard to the safety of their investments, ultimately leading to a more relaxed market environment and less market discipline—the very concern enunciated in the Treasury Blueprint. *Id.* at 158.

⁸¹ See *id.* With global financial markets, maintaining stability through regulation has become commonplace and having regulations that are simple to implement makes it easier for the global enterprises to know what they can or cannot do in the global financial markets.

⁸² See *id.*

⁸³ THIRTY FRAMEWORK, *supra* note 32, at 7.

⁸⁴ See *id.* at 7–8.

⁸⁵ See *id.* at 28 (recommending that in all countries, the activities of "deposit-taking institutions" should be subject to consolidated supervision).

⁸⁶ See *id.*

⁸⁷ See *id.*

money market mutual funds wishing to “continue to offer bank-like services, such as transaction account services [and] withdrawals on demand . . . should be required to reorganize as special-purpose banks, with appropriate prudential regulation”⁸⁸ The framework’s recommendations continue by suggesting the creation of a national prudential regulator with the authority to require periodic reports and public disclosures from managers of private pools of capital, something that is not presently in place.⁸⁹ These steps are all part of a process designed to eliminate the weaknesses and gaps in the present prudential regulation coverage.

The second recommendation involves improving the quality and effectiveness of prudential regulation.⁹⁰ The Group of Thirty Framework suggests removing unnecessary overlaps and gaps in the regulatory framework in order to improve coordination, not only between the existing regulatory bodies, but also on a grander international scale.⁹¹ The report, like the Treasury Blueprint, proposes that the Federal Reserve have a greater role in promoting and maintaining financial stability.⁹² In addition, much like the Treasury Blueprint, the Group of Thirty Framework also suggests that the Federal Reserve continue to have emergency lending authority, but it seeks tighter regulations for non-bank institutions.⁹³ The Group of Thirty Framework also favors a greater degree of international cooperation regarding oversight of the largest international banks, which are the banks whose failures create immense risk for more than a single country.⁹⁴

The third recommendation involves strengthening the policies and standards relating to risk management and governance.⁹⁵ The Group of Thirty Framework seeks to ensure that there are “board-level reviews and exercises aimed at establishing the most important parameters for setting the firm’s risk tolerance and evaluating its risk profile relative to those parameters.”⁹⁶ The report also emphasizes keeping the risk management and auditing functions “fully

⁸⁸ *Id.* at 29.

⁸⁹ *See id.* at 31.

⁹⁰ *See id.* at 34.

⁹¹ *See id.* at 35.

⁹² *See id.* at 36 (recommending this enhanced role for central banks on an international scale).

⁹³ *See id.* at 37.

⁹⁴ *See id.*

⁹⁵ *See id.* at 40 (“Institutional policies and standards must be strengthened, with particular emphasis on standards for governance, risk management, capital, and liquidity.”).

⁹⁶ *Id.* at 41.

independent and adequately resourced”⁹⁷ within each firm, as well as conducting periodic reviews of the firm’s vulnerability to risk.⁹⁸

The fourth and final recommendation involves making the financial markets and products more transparent.⁹⁹ The Group of Thirty Framework favors restoring confidence in the securitized credit markets by holding them to “regulatory, disclosure, and transparency standards at least comparable to those that have historically been applied to the public securities markets.”¹⁰⁰ The recommendation also suggests changes to the risk ratings to accurately reflect the risk of potential valuation losses from a “full range of potential risk factors”¹⁰¹

C. ICI Report

The ICI Report has the best structure to follow regarding systemic risk regulators. The ICI Report recommends changes to create “a regulatory framework that enhances regulatory efficiency, limits duplication, closes regulatory gaps, and emphasizes the national character of the financial services industry.”¹⁰² According to the report, the financial system is “vulnerable to risks that have the potential to spread rapidly throughout the system and cause significant damage.”¹⁰³ The ICI Report surmises that the “future of the [financial] industry depends on the existence of strong, well-regulated financial institutions operating within a well-regulated financial marketplace that will promote investor confidence, attract global financial business and enable [the] institutions to compete more effectively.”¹⁰⁴ The report specifically addressed: (1) the creation of a systemic risk regulator; (2) the benefits and drawbacks of said regulator; and (3) the proposed responsibilities of the systemic risk regulator.¹⁰⁵

⁹⁷ *Id.*

⁹⁸ *Id.*

⁹⁹ See *id.* at 48 (“Financial markets and products must be made more transparent, with better-aligned risk and prudential incentives.”).

¹⁰⁰ *Id.* at 49.

¹⁰¹ *Id.* at 51. The full range of factors includes not just default probabilities of loss from defaults but also liquidity and price volatility risk factors. *Id.*

¹⁰² ICI REFORM, *supra* note 33, at i. The changes suggested by the ICI Report are similar to those made by Chairman Schapiro during her testimony before the United States Senate Committee on Banking, Housing and Urban Affairs. Chairman Schapiro wanted to minimize systemic risk by “address[ing] structural imbalances that facilitate the development of systemic risk by closing gaps in regulation, improving transparency and strengthening enforcement . . . [and] establish[ing] a workable, macro-prudential regulatory framework consisting of a single Systemic Risk Regulator” Schapiro Testimony, *supra* note 6, at 2.

¹⁰³ ICI REFORM, *supra* note 33, at i.

¹⁰⁴ *Id.* at 1.

¹⁰⁵ See *id.* at 2–3.

1. Creation of the Regulator

The ICI Report, like the Treasury Blueprint, suggests combining the SEC with the CFTC for regulatory purposes.¹⁰⁶ The reasoning behind the proposed merger mirrors that found in the Treasury Blueprint.¹⁰⁷ The ICI Report addresses the importance of having a capital markets regulator—in addition to a systemic risk regulator¹⁰⁸—which largely undertakes the current regulatory responsibilities of the SEC and CFTC.¹⁰⁹ The capital markets regulator's responsibilities would include overseeing money market funds,¹¹⁰ and it would have the authority to harmonize the legal standards between investment advisors¹¹¹ and broker-dealers¹¹² for consumer protection.¹¹³ The proposed responsibilities of the capital markets regulator are necessary changes because the current state of the financial markets no longer allows for the written distinction between investment advisors and broker-dealers, let alone the subtleties that allow for a distinction between the governance of the SEC and CFTC. The use of a capital markets regulator, working in conjunction with a systemic risk regulator, allows for a specialized regulatory focus and expertise, thereby increasing efficiency by removing the overlap in resources and regulatory priorities.¹¹⁴

¹⁰⁶ See *id.* at 5.

¹⁰⁷ See *supra* text accompanying notes 46–53.

¹⁰⁸ In the ICI Report, “systemic risk regulator” refers to an agency acting to improve the government’s capability to monitor and mitigate risks across the U.S. financial system. See ICI REFORM, *supra* note 33, at 3.

¹⁰⁹ *Id.* at 6.

¹¹⁰ *Id.*

¹¹¹ Investment advisors are defined by the Investment Advisers Act of 1940 as “any person who, for compensation, engages in the business of advising others . . . as to the value of securities or as to the advisability of investing in, purchasing, or selling securities” Investment Advisers Act of 1940, 15 U.S.C. § 80b-2(a)(11) (2006).

Investment advisers have a fiduciary duty with respect to all of their clients and, while the line between investment advisers and broker-dealers is very tenuous, the SEC continues to try to find ways to reconcile the subtle differences between investment advisers and broker-dealers. See, e.g., Elisse B. Walter, Comm’r, U.S. Sec. & Exch. Comm’n., *Regulating Broker-Dealers and Investment Advisers: Demarcation or Harmonization?*, Speech Before the Mutual Fund Directors Forum Ninth Annual Policy Conference (May 5, 2009) (transcript available at <http://www.sec.gov/news/speech/2009/spch050509ebw.htm>). See generally Barbara Black, *Brokers and Advisers—What’s in a Name?*, 11 FORDHAM J. CORP. & FIN. L. 31 (2005) (describing the subtle differences between investment advisers and broker-dealers, as well as attempts by the SEC to make the delineation clearer for investor purposes).

¹¹² The Securities Exchange Act of 1934 defines broker-dealers in two parts. A broker is defined as a person “engaged in the business of effecting transactions in securities for the account of others,” and a dealer is “engaged in the business of buying and selling securities for [its] own account” Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(4)(A), (5)(A) (2006).

¹¹³ ICI REFORM, *supra* note 33, at i–ii.

¹¹⁴ See *id.* at i.

Working in conjunction with the capital markets regulator, the goal of the systemic risk regulator would be to provide “greater overall stability to the financial system as a whole.”¹¹⁵ However, the ICI Report emphasizes that the systemic risk regulator must be implemented such that it does not impose “undue constraints or inapposite forms of regulation on normally functioning elements of the financial system,” or stifle innovation, competition, or efficiency.¹¹⁶

The combined creation of a capital markets regulator and systemic risk regulator, according to the ICI Report, will not only protect against regulatory inefficiency and gaps in the present investor protections, but this dual regulator structure is important because of the changes in the financial markets—namely, the convergence of the securities and futures markets. In order to be effective, the capital markets regulator must combine the scope of authority presently divided between the SEC and CFTC, as both have the underlying premise of protecting market users and the public from fraud, manipulation and abusive practices.¹¹⁷

2. *Benefits of the Regulators*

According to the ICI Report, the principal benefits of establishing a systemic risk regulator and a capital markets regulator are numerous. First, the proposal improves the government’s capability to monitor and mitigate risks across the financial system.¹¹⁸ Second, it creates a regulatory framework that “enhances regulatory efficiency, limits duplication, and emphasizes the national character of the financial services industry.”¹¹⁹ Third, it closes regulatory gaps to “ensure appropriate oversight of all market participants and investment products.”¹²⁰ Fourth, it preserves “specialized regulatory focus and expertise and avoid[s] potential uneven attention to different industries or products.”¹²¹ Fifth, it cultivates “consultation and dialogue among . . . financial regulators to promote collaboration on issues of common concern.”¹²² Sixth, it “facilitates coordinated

¹¹⁵ *Id.* at 4.

¹¹⁶ *Id.*

¹¹⁷ *See id.* at 6.

¹¹⁸ *Id.* at 3, 15.

¹¹⁹ *Id.*

¹²⁰ *Id.*

¹²¹ *Id.*

¹²² *Id.*

interaction with regulators in other jurisdictions, including with regard to risks affecting global capital markets.”¹²³

Increased consolidation of financial service regulators, combined with the establishment of a systemic risk regulator, robust interagency coordination, and information sharing, would help facilitate monitoring and mitigation of risks across the entire financial system.¹²⁴ In addition, ICI suggests that implementation of a systemic risk capital markets regulator, in conjunction with such regulatory consolidation, would increase the competitiveness of the U.S. financial markets.¹²⁵ International coordination is also more feasible when there are fewer agencies and individuals to coordinate.¹²⁶

The final benefit of the ICI Report plan addresses the concerns of individuals who fear that sector-based regulators prevent full exposure of the big picture when it comes to the financial markets by creating a plan that not only provides a full view of the financial system, but also strengthens “inter-agency coordination and information sharing.”¹²⁷ The ICI Report maintains that its proposal for regulation through the combined efforts of a systemic risk regulator and capital markets regulator actually enables regulators to better manage the full spectrum of financial markets and helps prevent the problem of singular regulators gravitating towards a single issue and dismissing or ignoring the remaining issues that may not seem to be as urgent.¹²⁸

3. Responsibilities of the Regulators

According to the ICI Report, the systemic risk regulator has numerous responsibilities. These include:

- (1) monitoring the financial markets broadly;
- (2) analyzing changing conditions in domestic and overseas markets;
- (3) evaluating the risks of practices as they evolve and identifying those that are of such nature and extent that they implicate the health of the financial system at large; and
- (4) acting to mitigate such risks in coordination with other responsible regulators.¹²⁹

¹²³ *Id.* Chairman Schapiro advocated closing regulatory gaps by making sure the “same rules apply to the same or similar products and participants.” Schapiro Testimony, *supra* note 6, at 2. The ICI Report’s structure would enable those gaps to be closed.

¹²⁴ ICI REFORM, *supra* note 33, at 15.

¹²⁵ *See id.*

¹²⁶ *See id.*

¹²⁷ *Id.* at 16.

¹²⁸ *See id.*

¹²⁹ *Id.* at 4.

The capital markets regulator would also have a variety of responsibilities within the new regulatory framework: (1) setting the regulatory standards for all registered investment companies; (2) maintaining explicit authority to regulate where there are presently gaps, and integrating the legal standards for investment advisers and broker-dealers; (3) prioritizing investor protections; (4) considering the impact of rulemaking on factors such as efficiency, competition, and capital formation; (5) serving as the “first line of defense” regarding risks across the capital markets; and (6) proactively working to maximize effectiveness through promotion of industry dialog, up-to-date monitoring of industry developments, and utilization of strong analytical capabilities.¹³⁰

The overall structure of the ICI Report emphasizes the need to streamline the system and avoid compartmentalizing regulatory structures and duties, since compartmentalization appears to stifle coordination and provides for insufficient attention to financial areas that are not as high profile as others.¹³¹ The lack of attention to certain areas can lead to future systemic risk problems, which is something the proponents of the ICI Report seek to avoid through their proposed structure.

D. New Foundation Report

The New Foundation Report is the most recent report, but it reiterates many of the same concepts introduced by the Treasury Blueprint, Group of Thirty Framework, and ICI Report. While the New Foundation Report does not go as far as the previous three reports in consolidating agencies or changing agency roles, the purpose of the report is to focus on the essential changes needed to address the current financial crisis and prevent similar crises in the future.¹³²

The relevant objectives in the New Foundation Report include: (1) “[p]romot[ing] robust supervision and regulation of financial firms;”¹³³ (2) “[e]stablish[ing] comprehensive supervision of financial markets;”¹³⁴ (3) “[p]rotect[ing] consumers and investors from financial abuse;”¹³⁵ (4) “[p]rovid[ing] the government with the tools it

¹³⁰ *Id.* at 2.

¹³¹ *See id.* at 16.

¹³² *See* TREASURY NEW FOUNDATION, *supra* note 16, at 4 (“We focus here on what is essential: to address the causes of the current crisis, to create a more stable financial system that is fair for consumers, and to help prevent and contain potential crises in the future.”).

¹³³ *Id.* at 3.

¹³⁴ *Id.*

¹³⁵ *Id.*

needs to manage financial crises;”¹³⁶ and (5) “[r]ais[ing] international regulatory standards and improv[ing] international cooperation.”¹³⁷

With regard to the first goal, the New Foundation Report proposes an oversight council with the sole purpose of identifying emerging systemic risks and improving interagency cooperation.¹³⁸ The report also advocates expanding the authority of the Federal Reserve to supervise all firms, even if they are not classified as banks that can threaten the financial stability of the country.¹³⁹ Such expansion would place the Federal Reserve in a position to continually analyze both the connections among major financial firms and the major financial markets’ dependence on those firms in order to track the potential impact of a failure.¹⁴⁰

The present regulation of financial firms is very compartmentalized,¹⁴¹ and the new proposal seeks to improve the framework and increase supervision so that a single point within the system remains aware of all that happens. The New Foundation Report emphasizes that “[d]iffusing responsibility among several regulators would weaken incentives for effective regulation”¹⁴² It also emphasizes that the public has an absolute right to expect that a “clearly identifiable entity” will set the standards to protect the financial system and public from the risks of failed entities.¹⁴³

The New Foundation Report advocates altering the regulations so they take into account highly leveraged institutions and the potential systemic impact upon failure.¹⁴⁴ The report also proposes consolidating operations among regulatory agencies, since the fragmentation rampant in the present system generates loopholes that harm investors.¹⁴⁵ The report also brings money market funds under

¹³⁶ *Id.* at 4.

¹³⁷ *Id.*

¹³⁸ *See id.* at 3. The New Foundation Report further seeks to provide the government with the tools necessary to handle the financial crises as they arise. *See id.* at 4, 76.

¹³⁹ *See id.* at 26.

¹⁴⁰ *See id.*

¹⁴¹ *See id.* “The financial crisis has demonstrated that a *narrow* supervisory focus on the safety and soundness of individual financial firms can result in a failure to detect and thwart emerging threats to financial stability that . . . have other systemic implications.” *Id.* (emphasis added).

¹⁴² *Id.* at 22.

¹⁴³ *Id.*

¹⁴⁴ *Id.* at 22, 26.

¹⁴⁵ *See id.* at 12. The proposal subjects non-bank financial institutions to “robust, consolidated supervision and regulation” regardless of their non-affiliation with a bank. *Id.* at 10. The proposal also recommends that the risk of these non-banking financial institutions be considered as risk imposed upon the entire system, not just a particular sector. *See id.* at 10–11.

the supervisory framework, creating a consolidated and consistent framework for all financial institutions.¹⁴⁶

To further its goal of comprehensive supervision of the financial markets, the New Foundation Report proposes enhanced regulation of securitization markets, including new requirements for market transparency and stronger regulation of credit agencies.¹⁴⁷ The increased transparency extends to the protection of consumers and investors from financial abuse.¹⁴⁸ Risk management under the current regulatory system is unable to keep up with innovation because the present model does not properly deal with risk distribution. For instance, securitization and over-the-counter derivatives were both elements of the financial crisis because risk could not be properly accounted for under present risk management systems.¹⁴⁹ The supervision element is also necessary for credit rating agencies, since investors are not only overly reliant on the reports from the credit agencies, but the agencies typically do not fully disclose everything they should when publishing ratings information, like ratings methodologies indicating what “the credit ratings are designed to assess.”¹⁵⁰

The need to protect consumers led the New Foundation Report to propose the establishment of a single regulatory agency with the authority to ensure that “consumer protection regulations are written fairly and enforced vigorously.”¹⁵¹ Unlike the Treasury Blueprint or the ICI Report, however, the New Foundation Report increases authority within existing agencies, and does not focus on consolidating agencies.¹⁵² The systemic risk regulation for the New Foundation Report appears to be split between the various elements of the proposal by increasing authority within existing agencies, adding to the government’s arsenal of crisis-related tools, and

¹⁴⁶ *Id.* at 38–39. The New Foundation Report also emphasizes that it would like to see the regulatory framework around money market funds increased by:

(i) requiring MMFs to maintain substantial liquidity buffers; (ii) reducing the maximum weighted average maturity of MMF assets; (iii) tightening the credit concentration limits applicable to MMFs; (iv) improving the credit risk analysis and management of MMFs; and (v) empowering MMF boards of directors to suspend redemptions in extraordinary circumstances to protect the interests of fund shareholders.

Id. at 38.

¹⁴⁷ *See id.* at 3, 44–46.

¹⁴⁸ *See id.* at 45.

¹⁴⁹ *See id.* at 43.

¹⁵⁰ *Id.* at 46.

¹⁵¹ *See id.* at 7.

¹⁵² *See id.* at 63, 70–73 (proposing new authority for the Federal Trade Commission and the SEC to enhance protection of consumers and investors).

generally improving regulatory standards.¹⁵³ However, the New Foundation Report does not focus on providing overarching supervision of the financial services market in order to create a single systemic risk regulator with a comprehensive view of financial markets and institutions, along with the potential to forecast the impact of a financial institution's failure.

In order to provide the government with the tools necessary to effectively manage financial crises, the New Foundation Report proposes revising the Federal Reserve's emergency lending—also proposed by the Treasury Blueprint—as well as figuring out how to deal with the possibility of non-bank financial institutions defaulting on their obligations and causing systemic failure.¹⁵⁴ The New Foundation Report also proposes creating a new authority to enable the government to adequately respond to the potential failure of bank holding companies or non-bank financial institutions when that failure could cause instability within the financial system.¹⁵⁵

III. WHERE TO GO FROM HERE?

In the four agency report recommendations on dealing with systemic risk regulation, several coveted a common element: appointing the Federal Reserve to the position of the systemic risk regulator. Unfortunately, because of the politics involved, it has become quite clear in recent months that the Federal Reserve will likely not take on this role. Although, as an initial matter, it was suggested that the Federal Reserve become the systemic risk regulator, unfortunately, as House Financial Services Committee Chairman Barney Frank noted, “[t]here was a lot of resistance to [putting the Federal Reserve in that position].”¹⁵⁶ Mr. Frank essentially put the idea to rest, asserting that “. . . politically, it is clear that [making the Federal Reserve the systemic risk regulator] is not going to happen.”¹⁵⁷ With the Federal Reserve out of the race for the appointed regulator, Frank indicated “lawmakers may be more enthusiastic about bestowing a council of regulators with the authority to regulate systemically vital institutions.”¹⁵⁸ While such a step does

¹⁵³ See *id.* at 3–4.

¹⁵⁴ See *id.* at 26.

¹⁵⁵ See *id.* at 76–78 (discussing the creation of a new “resolution regime” to address potential failures of bank holding companies and nonbank financial institutions).

¹⁵⁶ Ronald D. Orol, *Frank: Fed Won't Be Systemic Risk Regulator*, MARKETWATCH, July 28, 2009, <http://www.marketwatch.com/story/frank-fed-wont-be-systemic-risk-regulator-2009-07-28-102000> (quoting Barney Frank, Chairman of the House Financial Services Committee).

¹⁵⁷ *Id.*

¹⁵⁸ *Id.*

not vest regulatory power in a single regulator as some of the reports suggested, it could nonetheless help make the collapses and failures of institutions that plagued the years 2007 to 2009 become a thing of the past.

In March 2009, the House of Representatives introduced the Financial System Stabilization and Reform Act of 2009 (the “Reform Act”),¹⁵⁹ and, at present, the bill has been referred to various committees and is sitting with the Subcommittee on General Farm Commodities and Risk Management.¹⁶⁰ The Reform Act seemingly takes its information from the various agency reports. For instance, the members of the council would include the Secretary of the Treasury, the Chairman of the Federal Reserve, the Chairman of the Federal Deposit Insurance Corporation, the Chairman of the National Credit Union Administration, the Chairman of the SEC, and the Chairman of the CFTC.¹⁶¹ The responsibility of this council would include “review [of] all potential rules, regulations, and regulatory actions of the Federal financial regulators . . . to determine those which relate to systemic risk affecting the financial system of the United States”¹⁶² The Reform Act also provides for unfettered access to data in order to accurately monitor the potential for systemic risk,¹⁶³ something each of the above agency reports emphasized as a vital reform.

With the Reform Act in committee and the agency reports published and in general circulation, Congress, at this juncture, must take a close look at the provisions in the various reports, particularly the Treasury Blueprint and the ICI Report. The Treasury Blueprint provides a comprehensive look at the system as a whole, outlining the problems with the existing system, and proceeding to lay out in a simple fashion wide-ranging means of correcting the enormous problems facing the entire U.S. financial system. The ICI Report complements the Treasury Blueprint by focusing on the need for coordination to be successful. By combining the long-term objectives-based approach outlined in the Treasury Blueprint and emphasizing the mission of the ICI Report—protecting consumers and filling the gaps of the regulations—Congress would have a

¹⁵⁹ H.R. 1754, 111th Cong. (2009) (creating “a systemic risk monitor for the financial system of the United States, to oversee financial regulatory activities of the Federal Government, and for other purposes”).

¹⁶⁰ See Open Congress for the 111th United States Congress, H.R. 1754 – Financial System Stabilization and Reform Act of 2009, http://www.opencongress.org/bill/111-h1754/actions_votes (last visited Jan. 25, 2010).

¹⁶¹ H.R. 1754, § 111(d).

¹⁶² *Id.* § 112(a)(1)(B).

¹⁶³ See *id.* § 112(b)(1).

greater grasp on handling the present financial crisis that continues to plague this country.¹⁶⁴

Between the Treasury Blueprint and the ICI Report, and the language already in place in the Reform Act, there just may be a way to pull the United States' financial regulatory structure out of the 1930s and put it in a position to compete with today's changing markets. Congress should attempt to adopt a regulatory structure similar to the objectives-based approach laid out in the Treasury Blueprint, as it casts the broadest net and may have the best potential for preventing a similar financial crisis in the future. While it is unclear what will happen with the Reform Act, or what will happen with the agency recommendations, one thing the past few years have taught us is that something must be done. Otherwise, we will simply be waiting for history to repeat itself once again.

TRACI M. PRIBBENOW[†]

¹⁶⁴ While the New Foundation Report and the Group of Thirty Framework provide helpful insight, they do not seem to merit the same attention as the ICI Report and Treasury Blueprint. For starters, the Group of Thirty Framework proposes a consolidated regulatory supervisor, but as the Treasury Blueprint outlined, the cons of a consolidated system outweigh the pros. *See supra* notes 79–82 and accompanying text. The New Foundation Report basically reiterates the most important elements of the Treasury Blueprint and ICI Report while maintaining the focus on attempting to prevent the financial crisis from happening yet again.

[†] J.D. Candidate 2010, Case Western Reserve University School of Law. Many thanks to Joel Emans and Thomas Bogle for introducing me to this topic.