

Recent Developments in Financial Regulation: The Treasury Department “Blueprint”

Treasury Secretary Henry M. Paulson, Jr. recently released the Treasury Department’s “Blueprint for a Modernized Financial Regulatory Structure.” The Blueprint, which offers short, intermediate and long-term recommendations, would dramatically alter the responsibilities of federal regulators. Among other things, the Blueprint recommends increasing the power of the Federal Reserve and adding to federal oversight in such areas as mortgage origination and insurance.¹

The Blueprint has drawn opposition from some regulators, consumer groups, securities firms, and industry groups, as well as a degree of praise from business organizations. The controversy is unlikely to be resolved in the near future, and the final shape of any reforms could differ greatly from Paulson’s suggestions. While one of the proposals — an expanded membership and role for the President’s Working Group on Financial Markets — could be achieved by executive order, many others require Congressional action that is unlikely in an election year.² Paulson himself has remarked that, with a few exceptions, the recommendations should not be implemented until after resolution of the current market crisis.³

The Blueprint’s Short-Term Recommendations

The Blueprint’s short-term recommendations include:

The President’s Working Group on Financial Markets (PWG): The PWG, also known as the “Plunge Protection Team,” was created by an executive order after 1987’s stock market crash.⁴ In March, the PWG issued a policy statement recommending reforms to address the subprime crisis. Some of the changes would strengthen regulation of the mortgage origination process and the risk management practices of global financial institutions, require credit-rating agencies to disclose more information about their methodologies, improve market discipline, enhance regulatory guidance of financial institutions, and reform the market for over-the-counter derivatives.⁵

The Blueprint would broaden the PWG’s oversight to include the entire financial sector. The PWG would be charged with improving communication between agencies in order to mitigate risks and enhance protection of consumers and investors. Its membership would be increased to include the heads of the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision.⁶

¹ The full text of the Blueprint is available at <http://www.treas.gov/press/releases/reports/Blueprint.pdf>.

² Stephen Labaton, *Doubts Greet Treasury Plan on Regulation*, THE NEW YORK TIMES, April 1, 2008.

³ United States Dept. of the Treasury, Press Release, Remarks by Secretary Henry M. Paulson, Jr. on Blueprint for Regulatory Reform (March 31, 2008) available at <http://www.treas.gov/press/releases/hp897.htm>.

⁴ Simon Dumenco, *Saved by the Cabal! Paging the president’s shadowy Plunge Protection Team*, NEW YORK MAGAZINE, Jan. 27, 2008 available at <http://nymag.com/news/intelligencer/43342/>; The Department of the Treasury Blueprint for a Modernized Financial Regulatory Structure (Blueprint), at 5 (March 2008).

⁵ The President’s Working Group on Financial Markets, Policy Statement on Financial Market Developments (March 2008) available at

http://www.ustreas.gov/press/releases/reports/pwgpolicystatemktturmoil_03122008.pdf.

⁶ Blueprint, *supra* note 4, at 75-77.

Federal Reserve Lending: In response to the subprime crisis, the Federal Reserve has lent at its discount rate to non-depository institutions for the first time since the 1930s. The Blueprint recommends that this lending practice be made “calibrated and transparent,” that conditions be attached to lending, and that the Federal Reserve ensure a process for obtaining adequate information. The Blueprint also calls on the PWG to “consider broader issues associated with providing discount window access to non-depository institutions.”⁷

Mortgage Origination Oversight: The Blueprint finds fault with the uneven oversight of mortgage origination at the state and federal levels. Treasury proposes the creation of a new Mortgage Origination Commission to develop uniform minimum requirements for participants in the mortgage market and to evaluate each state’s system of licensing and regulation. It suggests that the Federal Reserve retain sole responsibility for drafting national mortgage lending laws, and that the authority of various other regulatory agencies be clarified.⁸

Secretary Paulson has commented that “[t]his powerful Commission, coupled with the Federal Reserve’s strong regulatory proposal regarding the [Home Ownership and Equity Protection Act (HOEPA)] rules, should go a long way in preventing recent issues from recurring.”⁹ The Federal Reserve’s HOEPA proposals would require earlier truth-in-lending disclosures and restrict practices that it has characterized as unfair and deceptive.¹⁰

The Blueprint’s Intermediate-Term Recommendations

Intermediate-term recommendations, which are intended to address issues over the next two to eight years, include:¹¹

The Office of Thrift Supervision: The Blueprint would phase out the OTS as “no longer necessary to ensure sufficient residential mortgage loans are made available to U.S. consumers.” Its responsibilities would be assumed by the Office of the Comptroller of the Currency.¹²

Supervision of State Banks: Treasury recommends that the existing system of federal supervision for federally-insured, state-chartered banks be “rationalized,” possibly through consolidation in either the Federal Reserve or the FDIC. The Blueprint proposes that a study be conducted on the appropriate federal supervisor for the banks.¹³

Regulation of Payment and Settlement Systems: The Blueprint concludes that regulation of payment and settlement systems is based on a series of unrelated, ad hoc

⁷ *Id.* at 83-86.

⁸ *Id.* at 78-83.

⁹ United States Dept. of the Treasury, *supra* note 3.

¹⁰ Board of Governors of the Federal Reserve System, Highlights of Proposed Rule to Amend Home Mortgage Provisions of Regulation Z, *available at* <http://www.federalreserve.gov/newsevents/press/bcreg/highlightsregz20071218.htm>.

¹¹ United States Dept. of the Treasury, *supra* note 3.

¹² Blueprint, *supra* note 4, at 8, 89-99.

¹³ *Id.* at 99-100.

decisions. It suggests the creation of a federal charter for certain systems with oversight authority resting primarily in the Federal Reserve.¹⁴

Insurance: The Blueprint argues that state-based insurance regulation creates inefficiencies and impedes the competitiveness of United States insurers in the global marketplace. The Blueprint would create an optional federal charter pursuant to which insurers could choose regulation at the national level. Treasury recommends that an Office of National Insurance be created to regulate insurers operating under the optional charter. However, because of continuing debate on this issue, Treasury proposes the establishment of an Office of Insurance Oversight to address international regulatory issues and ensure uniform implementation of state regulation until a permanent solution can be devised.¹⁵

Futures and Securities Markets: Because market convergence and globalization “have rendered regulatory bifurcation of the futures and securities markets untenable, potentially harmful, and inefficient,” Treasury proposes a merger of the Securities and Exchange Commission (SEC) and Commodity Futures Trading Commission (CFTC). In addition, Treasury suggests that a self-regulatory system similar to that for broker-dealers be created for investment advisors.¹⁶

The Blueprint’s Long-Term Recommendations

The most radical feature of the Blueprint is probably its proposed long-term overhaul of the financial regulatory structure. The Blueprint would replace the current system of regulation divided by industry with a system focused on three regulatory agencies, each with a specific objective. The new agencies would be:

Market Stability Regulator (The Federal Reserve): The Fed’s role would be expanded to permit it to monitor risks throughout the financial system. Other regulators would be required to share information with the Fed, which would have authority to develop new reporting requirements and to release information on overall market stability to the public. The Fed would have the ability to take action to address threats to market stability.¹⁷ Secretary Paulson has described this part of the regulatory structure as directed at “the root level where the health of financial firms is intertwined,” unlike the current system which focuses above-ground at the “tree level.”¹⁸

Prudential Financial Regulator: The Prudential Financial Regulator would have responsibility for ensuring the soundness of governmentally-guaranteed financial institutions. Regulation “should be applied to individual firms, and it should operate like the current regulation of insured depository institutions, with capital adequacy requirements, investment limits, activity limits, and direct on-site risk management supervision.”¹⁹

¹⁴ *Id.* at 100-06.

¹⁵ *Id.* at 126-33.

¹⁶ *Id.* at 106-26.

¹⁷ *Id.* at 146-56.

¹⁸ United States Dept. of the Treasury, *supra* note 3.

¹⁹ Blueprint, *supra* note 4, at 18, 157-170

Business Conduct Regulator: The Business Conduct Regulator would supervise “key aspects of consumer protection such as disclosures, business practices, and chartering and licensing of certain types of financial firms.”²⁰ The Regulator’s broad oversight of all types of financial institutions would replace the authority of the Federal Reserve and other regulators, many of the roles of the CFTC and SEC, and some roles of the Federal Trade Commission.²¹

²⁰ *Id.* at 19.

²¹ *Id.* at 170-80.