

# Strengthening Regulation Of Core Markets And Market Infrastructure

In recent years, the structure of the financial system has shifted, with dramatic growth in financial activity outside the traditional banking system. Markets for mortgage-backed and other asset-backed securities, credit default swaps, repurchase agreements and securities lending have become critical elements of our financial system. But regulation has not kept pace with financial innovation. As a result, regulators were unable to track or prevent the massive buildup of risk in these markets, which played a central role in producing this crisis. Under the President's plan, the securitization markets will be strengthened and credit default swaps and other OTC derivatives will be made subject to comprehensive regulation. A new Financial Services Oversight Council will be given broad authority to collect information about activities in financial markets that may pose a threat to financial stability. And the Federal Reserve will be given authority to oversee and strengthen the infrastructure of financial markets—payment, clearing, and settlement systems.

## Addressing The Critical Markets That Contributed To Today's Crisis

### **Strengthen Supervision of Securitization Markets:**

- Under the President's plan, banking regulators will issue regulations that require the originator of a securitized loan, or the sponsor of a securitization to retain 5 percent of the credit risk of securitized exposures.
- The SEC will continue its efforts to increase the transparency and standardization of securitization markets, and be given clear authority to require robust reporting by issuers of asset-backed securities.
- The SEC will continue its efforts to tighten the regulation of credit rating agencies, including measures to ensure that firms have robust policies and procedures that manage and disclose conflicts of interest and otherwise promote the integrity of the ratings process.
- Regulators will reduce their use of credit ratings in regulations and supervisory practices, wherever possible.

### **Bring Comprehensive Regulation to the Markets For All Over-The-Counter Derivatives, Including Credit Default Swaps:**

- As part of the President's plan, credit default swap markets and all other "over-the-counter" (OTC) derivatives markets will be subject to comprehensive regulation in order to:
  - Prevent activities in those markets from posing risk to the financial system
  - Promote transparency and efficiency of those markets
  - Prevent market manipulation, fraud, and other market abuses
  - Prevent OTC derivatives from being marketed inappropriately to unsophisticated parties
- These goals will be reached through comprehensive regulation that includes:
  - Requiring transparency for all OTC derivative trades and positions, through recordkeeping and reporting requirements
  - Empowering market regulators to take vigorous enforcement action against fraud, market manipulation, and other market abuses
  - Requiring conservative regulation of all OTC derivative dealers and all other major participants in the OTC derivatives markets
  - Requiring standardized OTC derivatives to be centrally cleared and executed on exchanges and other transparent trading venues
  - Requiring higher capital charges for customized OTC derivatives

### **Harmonize Futures and Securities Regulation:**

- Under the President's plan, the CFTC and the SEC will make recommendations to Congress on how to eliminate differences in statutes and regulations with respect to similar types of financial instruments that are not essential to achieving investor protection, market integrity, or price transparency.
- The CFTC and SEC will complete a report by September 30, 2009 with their recommendations.
- If the CFTC and SEC cannot reach agreement by the above date, their differences will be sent to the Financial Services Oversight Council, which will be required to make recommendations to resolve the differences within 6 months of its formation.

### **Broad New Authority to Monitor Threats to Financial Stability from Activities in Financial Markets**

- A new Financial Services Oversight Council will have broad authority, through a permanent staff in Treasury, to require reports from any U.S. financial firm for the purpose of assessing whether activity in a financial market poses a threat to financial stability.
- The Council would be responsible for referring emerging risks to the attention of U.S. regulators with the authority to respond.

### **Strengthening Oversight Of Systemically Important Payment, Clearing, and Settlement Systems**

- As part of the President's plan, the Federal Reserve will be given stronger statutory authority to oversee systemically important payment, clearing, and settlement systems.
- Under the President's plan, the Federal Reserve will be required to consult with the Financial Services Oversight Council to identify systemically important systems and in setting standards for those systems.
- In the case of clearing and settlement systems for regulated markets, the Federal Reserve will be required to coordinate its oversight with the CFTC or the SEC, which will remain the primary regulators of such systems.