

**MEMO# 23285**

March 3, 2009

# ICI Outlines Detailed Regulatory Reform Proposal

[23285]

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 10-09  
EQUITY MARKETS ADVISORY COMMITTEE No. 7-09  
FIXED-INCOME ADVISORY COMMITTEE No. 5-09  
INST. MONEY MARKET FUNDS ADVISORY COMMITTEE No. 6-09  
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 6-09  
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 5-09  
SEC RULES MEMBERS No. 23-09  
SMALL FUNDS MEMBERS No. 16-09  
UNIT INVESTMENT TRUST MEMBERS No. 2-09     RE: ICI OUTLINES DETAILED REGULATORY REFORM PROPOSAL

Today, ICI issued a white paper outlining its recommendations for how to modernize and strengthen regulatory oversight of the U.S. financial services industry.\* The paper emphasizes reforms that would most directly affect the functioning of the capital markets and the regulation of investment companies.

## Overview of Recommendations

To improve the government's capability to monitor and mitigate risks across the financial system, ICI supports the designation of a new or existing agency or inter-agency body as a "Systemic Risk Regulator." More broadly, ICI 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. A new "Capital

Markets Regulator” should encompass the combined functions of the Securities and Exchange Commission and the Commodity Futures Trading Commission, thus creating a single independent federal regulator responsible for oversight of U.S. capital markets, market participants, and all financial investment products. ICI further recommends that Congress consider consolidating the regulatory structure for the banking sector and authorization of an optional federal charter for insurance companies. Such a regulatory framework – with one or more dedicated regulators to oversee each major financial services sector – would maintain specialized regulatory focus and expertise, as well as avoid the potential for one industry sector to take precedence over the others in terms of regulatory priorities or the allocation of resources.

To ensure the success of this new financial regulatory structure, ICI believes there must be effective coordination and information sharing among the financial regulators, including in particular the Systemic Risk Regulator. Stronger links between regulators and an overriding sense of shared purpose would greatly assist in sound policy development, prioritization of effort, and cooperation with the international regulatory community. The President’s Working Group on Financial Markets, with certain modifications, may be the most logical mechanism through which to accomplish this purpose.

### Systemic Risk Regulator

The Systemic Risk Regulator should have responsibility for: (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. At the same time, very careful consideration should be given to the specifics of how the Systemic Risk Regulator will be authorized to perform its functions and how it will relate to other financial regulators. In particular, the legislation establishing the Systemic Risk Regulator should be crafted to avoid imposing undue constraints or inapposite forms of regulation on normally functioning elements of the financial system, or stifling innovations, competition or efficiencies. Additionally, the Systemic Risk Regulator should not be structured to simply add another layer of bureaucracy or to displace the primary regulator(s) responsible for capital markets, banking or insurance.

How these issues are resolved will have a very real impact on registered investment companies, as both issuers and investors in the capital markets. Money market funds, for example, because of their size and their important role in the money markets, are likely to be on the radar screen of the Systemic Risk Regulator as it monitors the financial markets. The type of information about money market funds that the Systemic Risk Regulator may need to perform this function, and how the regulator will obtain that information, are just two of the specific issues that will need to be carefully considered. As a threshold matter, however, ICI firmly believes that regulation and oversight of money market funds must be the province of the Capital Markets Regulator.

## Capital Markets Regulator

ICI envisions the Capital Markets Regulator as the regulatory standard setter for all registered investment companies, including money market funds, and as the first line of defense with respect to risks across the capital markets. The new agency should be granted explicit authority to regulate in certain areas where there are currently gaps in regulation – in particular, with regard to hedge funds, derivatives, and municipal securities – and explicit authority to harmonize the legal standards applicable to investment advisers and broker-dealers. In performing its mission, the Capital Markets Regulator should maintain a sharp focus on investor protection and law enforcement. It also should be required to carefully consider the impact of its rulemaking activity on efficiency, competition and capital formation.

ICI believes that establishing the Capital Markets Regulator presents a very valuable opportunity to “get it right” in terms of how the agency is organized and managed. For example, it is imperative that the Capital Markets Regulator be able to keep current with market and industry developments and understand their impact on regulatory policy. Ways to achieve this end include hiring more agency staff with significant prior industry experience, and establishing a multidisciplinary “Capital Markets Advisory Committee” comprised of private sector representatives from all major sectors of the capital markets. There should be a high-level focus on agency management, perhaps through the designation of a Chief Operating Officer. To perform effectively, the agency must have open and effective lines of internal communication, and mechanisms to facilitate internal coordination and information sharing. ICI further suggests that the agency would benefit from a comprehensive process for setting regulatory priorities and assessing progress.

ICI identifies additional proactive steps that would maximize the effectiveness of the Capital Markets Regulator when carrying out its regulatory responsibilities:

- The Capital Markets Regulator should seek to facilitate closer, cooperative interaction with the entities it regulates to identify and resolve problems, to determine the impact of problems or practices on investors and the market, and to cooperatively develop best practices that can be shared broadly with market participants.
- In analyzing potential new regulatory requirements for registered investment companies, the Capital Markets Regulator should consider whether other investment products raise similar policy concerns and thus should be subject to comparable requirements.
- The Capital Markets Regulator should develop a strong capability to conduct economic analysis in support of various aspects of its work, including rulemaking, examinations and enforcement. In particular, when new regulations are required, or existing regulations are amended, the agency should thoroughly examine all possible options and choose the alternative that reflects the best trade-off between costs to, and benefits for, investors.
- The Capital Markets Regulator should engage in periodic reviews of its existing

regulations to determine whether any such regulations should be modernized or eliminated.

- To better equip investors to make good decisions about their investments, the Capital Markets Regulator should assign a high priority to pursuing regulatory initiatives that will help educate investors.

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#### **endnotes**

\* See Investment Company Institute, Financial Services Regulatory Reform: Discussion and Recommendations (March 3, 2009), available at [http://www.ici.org/pdf/ppr\\_09\\_reg\\_reform.pdf](http://www.ici.org/pdf/ppr_09_reg_reform.pdf).

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