

June 12, 2008

Sutherland Forms Regulatory Reform Task Force

In the wake of the recent credit crisis, regulators and Congress are accelerating their efforts to address the governmental oversight of U.S. financial markets. The convergence of domestic and foreign markets, the increasingly important role of large, relatively unregulated investment pools and the development of derivative products that blur the lines between banking, insurance, securities and commodity products have raised legitimate concerns. The near failure of Bear Stearns combined with lingering adverse economic conditions have increased the likelihood of action by Congress as it questions whether our existing regulatory regime can adequately maintain the competitiveness and integrity of our financial system and provide appropriate protection to investors and consumers.

To help our clients respond to this ever-changing market place and evolving regulatory landscape, we have formed a Regulatory Reform Task Force that is made up of a diverse group of lawyers with experience in banking, securities, insurance, energy regulation and enforcement. The Task Force will expand on our various practice groups' monitoring efforts to track current and future proposals to reform regulation of the financial sector of the U.S. economy and identify their potential impact on a more integrated basis. These include the recent [U.S. Department of the Treasury \("Treasury"\) Blueprint for a Modernized Financial Regulatory Structure](#) summarized below (the "Blueprint"), which proposes a complete overhaul of the existing regulatory framework through short-term, intermediate-term and long-term recommendations. Many of the Blueprint's recommendations are being or have been considered previously in different forms, such as reconciling federal banking regulation, establishing an optional federal insurance charter and merging the Securities and Exchange Commission ("SEC") and the Commodities Futures Trading Commission ("CFTC"). For example, bills are already pending before the House and Senate that would create a new Office of National Insurance and allow insurance companies to obtain an optional federal charter.

As a service to our clients, for updates on regulatory developments, as well as links to governmental and other information relevant to regulatory reform efforts, please visit our [Regulatory Reform Task Force](#) Web page. In addition, following the contact list at the end of this Legal Alert, you will find brief descriptions of each of the practice areas associated with the members of Sutherland's Regulatory Reform Task Force.

Treasury Blueprint for Regulatory Reform

Timing

There has been a mixed response to the Treasury's proposal. Immediate congressional action to implement the longer term aspects of the Blueprint is unlikely in light of upcoming elections and the current focus on alleviating the mortgage crisis. However, post-elections, Congress and a new presidential administration can be expected to offer new legislation impacting the financial services sector, particularly if adverse economic conditions continue. Moreover, the Federal Reserve is already making efforts to expand its role on Wall Street and, if lawmakers perceive that swift movement is necessary to avert an impending crisis, the pace of regulatory reform could accelerate.

More or Less Regulation?

Initial concerns raised by the proposed merger of the SEC and the CFTC are that it may yield an amalgamated agency more like the SEC's prescriptive rule-based model and less like the CFTC's more

© 2008 Sutherland. All Rights Reserved.

This communication is for general informational purposes only and is not intended to constitute legal advice or a recommended course of action in any given situation. This communication is not intended to be, and should not be, relied upon by the recipient in making decisions of a legal nature with respect to the issues discussed herein. The recipient is encouraged to consult independent counsel before making any decisions or taking any action concerning the matters in this communication. This communication does not create an attorney-client relationship between Sutherland and the recipient.

flexible principle-based model, harming the efficiency and competitiveness of the CFTC-regulated markets and its participants. The resulting regulatory framework may leave undecided existing jurisdictional struggles between the CFTC and the Federal Energy Regulatory Commission concerning over-the-counter (OTC) energy derivatives. To view Sutherland's May 19, 2008 Legal Alert: FERC Provides Guidance on Enforcement Policy Procedures, click [here](#). As a result, market participants may face lingering uncertainty over the regulations and regulators that apply. To view Sutherland's April 11, 2008 Legal Alert: PGC and Sutherland to Address Regulatory and Market Issues Affecting Purchasers of Natural Gas at GasMart 2008 in Chicago, click [here](#). The Blueprint also makes it clear that for the U.S. financial services industry to retain a dominant position in global securities markets, and even to remain a strong competitor, the U.S. must adopt a different regulatory model for its exchanges, broker-dealers and investment advisers. However, maintaining regulatory competitiveness would not necessarily mean less regulation. For example, the Blueprint raises the possibility that broker-dealers and investment advisers would be subject to greater regulation and oversight than they are currently, and that insurers could be regulated by the federal government.

Dual Banking System

The intermediate and long term proposals for the restructuring of the banking industry raise questions about activities, branching, preemption and the viability of the dual banking system (without the establishment and acceptance of private deposit insurance). The Blueprint once again opens the door for commercial enterprises' ownership of banks, but counters with the potential for more restrictions on affiliate transactions and bank activities. In addition, bank merger transactions may become subject to competitive reviews by the Federal Trade Commission and Department of Justice under the Hart-Scott-Rodino Antitrust Improvements Act.

Enhanced Regulation of OTC Products

Given the recent response of the Federal Reserve to the near collapse of Bear Stearns, which many attribute to systemic risk posed by a Bear Stearns insolvency as a result of its trillion dollar positions in the OTC derivatives markets, it is interesting how little discussion there is in the Blueprint regarding federal regulation and supervision of the OTC derivatives market. To view Sutherland's March 17, 2008 Legal Alert: OTC Counterparty Credit Risk in the Post-Bear Stearns World, click [here](#). While acknowledging that the prevailing consensus view of federal regulators in recent years has been that "market discipline is the most effective tool to limit systemic risk," the Treasury Department now, for the first time, "recognizes the need for enhanced regulatory authority to deal with this risk." We expect an increased focus on addressing systemic risk as decision-makers come to grips with the exact form that this new regulatory authority should take.

Focus on Mortgage Market Reforms

In addition to the suggestions made by Treasury in the Blueprint, the President's Working Group on Financial Markets (the "PWG") has also considered the need for regulatory reform. The [policy statement issued by the PWG](#) on March 13, 2008 recommended additional reforms with respect to mortgage origination, credit rating agencies, securitization, financial institutions, investors, credit default swaps and OTC derivatives, and regulators. The PWG's stated objectives behind its recommendations are to strengthen (1) transparency and disclosure, (2) risk awareness, (3) risk management, (4) capital management, (5) regulatory policies and (6) market infrastructure. In February of 2007, the PWG also issued principles and guidelines relating to private pools of capital, including hedge funds, that focus on investor protection and systemic risk.

The financial upheaval in the mortgage market has triggered immediate calls for reforms that have already resulted in Congressional action to address potential foreclosures. To view Sutherland's May 20, 2008 Legal Alert: The Subprime Mortgage Crisis – Somebody Has to Pay, click [here](#). In addition, law enforcement at the federal, state and local levels has initiated investigations into mortgage-related activities of brokers, lenders and others. As companies and financial institutions continue to take large write-downs and sell off assets in the wake of subprime losses, legislators and the Federal Reserve will continue to evaluate the possible need for increased government oversight. To view Sutherland's April 3, 2008 Legal Alert: Regulators Focus on Subprime and Structured Product Issues During the Orlando SIFMA Compliance and Legal Seminar, click [here](#).

Market participants will need to follow the developments in these arenas very closely to ensure that they are not subject to unexpected regulations and/or oversight. We will continue to analyze the impact of the Blueprint and future proposals. Following is a brief summary of the Blueprint.

Blueprint Summary

Short-Term Recommendations

Treasury designed the short-term recommendations in the Blueprint to address the current credit crisis. Treasury recommends updating the Executive Order that established the PWG to include responsibility for the entire financial sector, not just the financial markets. To accomplish this goal, Treasury suggests that the heads of the Office of the Comptroller of the Currency ("OCC"), the Federal Deposit Insurance Corporation ("FDIC") and the Office of Thrift Supervision ("OTS") become members of the PWG.

Another set of short-term recommendations addresses the oversight of mortgage origination and advocates the creation of a Mortgage Origination Commission that rates the licensing and regulation of each state's mortgage origination process. To further monitor mortgage origination, Treasury advises that federal legislation should dictate uniform minimum licensing qualification standards for state mortgage market participants. Treasury also advocates clarification of enforcement authority under federal laws; for example, with respect to mortgage originators that are affiliates of depository institutions within a federally regulated holding company.

The last set of short-term recommendations relate to the Federal Reserve's response to the credit crisis. Treasury suggests that the Federal Reserve's liquidity provisioning process to non-depository institutions become more transparent and better protect its balance sheet, possibly through on-site examination conducted jointly with the SEC or CFTC.

Intermediate-Term Recommendations

Treasury's intermediate-term recommendations in the Blueprint are intended to affect its long-term goal of establishing an objectives-based regulatory approach instead of the functional regulatory approach currently in place. In particular, the Blueprint advises decreasing the number of regulators in areas such as securities and commodities and banking while establishing a new federal insurance regulator.

Securities and Commodities. To achieve objectives-based regulation, Treasury recommends merging the SEC and the CFTC and outlines steps for ensuring a successful merger of the agencies. These steps include the following actions to be taken by the SEC: (1) adoption of core principles regarding exchanges and clearing agencies modeled after the Commodity Futures Modernization Act; (2) streamlining and expediting the self-regulatory organization rule approval process; (3) streamlining the approval for securities products common to the marketplace much like certain derivatives securities products; (4)

general exemption under the Investment Company Act for actively traded exempted products, such as exchange traded funds; and (5) recommending to Congress expansion of the Investment Company Act to permit registration of a new “global” investment company.

The Blueprint also endorses a new regulatory regime that would (1) treat institutional investors differently than retail investors; (2) establish a joint SEC-CFTC task force to resolve differences in key rules such as suitability and private rights of action; and (3) establish a self-regulatory organization to oversee investment advisers similar to that for broker-dealers.

Insurance. To reduce duplicative regulation, Treasury advocates the creation of an optional federal charter (“OFC”) for insurers. The OFC structure should include a system of federal chartering, licensing, regulation and supervision for insurers, reinsurers and insurance producers. States would have no jurisdiction over those entities that opted for the OFC although state tax laws and requirements to participate in state mandatory residual risk mechanisms and guarantee funds could still apply to entities with an OFC. An OFC would be issued to specify the lines of insurance that each national insurer would be permitted to sell, solicit, negotiate and underwrite. No OFC would allow an insurer to hold a license as both a life insurer and a property and casualty insurer.

For regulation of entities with an OFC, Treasury recommends the establishment of the Office of National Insurance (“ONI”). Treasury acknowledges the bureaucratic difficulties in establishing the ONI in the near future and thus recommends the establishment of an Office of Insurance Oversight (“OIO”) in the interim. The OIO would be responsible for international regulatory issues, such as reinsurance collateral, as well as standardization and coordination of state regulation of the insurance industry, e.g., insurance agent licensing. The Blueprint essentially adopts proposals on the OFC and ONI that are consistent with the bills proposed in 2007 and in prior years and becomes part of the ongoing debate in the insurance industry, and among regulators, over whether there is a need for federal regulation of insurance. To view James M. Cain’s February 2002 “National Insurance Charter – A New 2001 Odyssey” presentation, click [here](#).

Banking. The Blueprint proposes (1) elimination of the thrift charter and the OTS, (2) changes to state bank regulation, and (3) imposing new payment and settlements systems. More specifically, Treasury recommends phasing out the federal thrift charter and merging the OTS into the OCC. This would occur over a two-year period to give existing thrifts time to convert (by operation of law) to national banks and the OCC time to assume the operations of the OTS.

Treasury suggests that either the FDIC or the Federal Reserve have exclusive jurisdiction for federal supervision of state-chartered banks, and state-chartered thrifts, with federal deposit insurance. The Blueprint also calls for a study of the roles of the Federal Reserve and the FDIC in state bank regulation together with an overall study of the Federal Reserve Bank structure.

Treasury considers payment and settlement systems to be “a critical underpinning of the financial services sector, and of the economy as a whole.” The Blueprint recommends creating a federal charter for payment and settlement systems that are of systemic importance to the U.S. financial system and economy in order to minimize associated risks and increase efficiency. The Federal Reserve would grant the charters and have primary regulatory authority.

Long-Term Recommendations

Treasury designed the Blueprint’s long-term recommendations to create an objectives-based regulatory approach that moves away from the current institutionally-based functional regulatory system with the goal of separating out the oversight of consumer based transactions from that of business to business transactions. The proposed objectives-based regulatory approach would (1) formally establish the

Federal Reserve as a Market Stability Regulator and set up a single federal payment and settlements regulation regime, (2) create a Prudential Financial Regulator, similar to the OCC, to focus on safety and soundness of institutions, expenses guaranteed by the U.S. government such as FDIC deposit insurance and potentially including government sponsored enterprise (so called GSE's), *i.e.* Fannie Mae of Freddie Mac, (3) form a new Business Conduct regulator, similar to the SEC and CFTC but with broader authority, to monitor and regulate the financial services industry overall and (4) a Corporate Finance Regulator, responsible for corporate disclosure and governance, and accounting oversight.



If you have any questions regarding this alert, or the services we provide, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

Eric A. Arnold	202.383.0741	eric.arnold@sutherland.com
James M. Cain	202.383.0180	james.cain@sutherland.com
Warren N. Davis	202.383.0133	warren.davis@sutherland.com
B. Knox Dobbins	404.853.8053	knox.dobbins@sutherland.com
Neil S. Lang	202.383.0277	neil.lang@sutherland.com
Peter H. Rodgers	202.383.0883	peter.rodgers@sutherland.com
Stephen E. Roth	202.383.0158	steve.roth@sutherland.com
Holly H. Smith	202.383.0245	holly.smith@sutherland.com
Annette L. Tripp	713.470.6133	annette.tripp@sutherland.com
Daphne G. Frydman	202.383.0656	daphne.frydman@sutherland.com
Mark D. Sherrill	202.383.0360	mark.sherrill@sutherland.com

SUTHERLAND'S REGULATORY REFORM TASK FORCE PRACTICE DESCRIPTIONS

BROKER-DEALER AND INVESTMENT ADVISER

Sutherland has one of the most dynamic and experienced broker-dealer/investment adviser practice groups in the country. Our clients include wirehouse firms, regional brokerage firms, independent firms, bank- and insurance-affiliated firms, institutional and retail investment advisers, and financial planners. Our services span the full spectrum of legal, business and compliance issues ranging from regulatory requirements, to business transactions and arrangements, to litigation and arbitration. On the broker-dealer side, we regularly assist with: new membership applications to Financial Industry Regulatory Authority ("FINRA"), and applications for business expansions; compliance and risk management audits and other required or prudential internal reviews; day-to-day compliance issues (including Anti-Money Laundering, privacy, registration, and compensation); disciplinary proceedings, arbitration and litigation. On the investment adviser side, our practice regularly includes: investment adviser registration, exemption, and status issues; investment company regulation preparation and review of compliance manuals; risk management audits; and assistance with financial planning, wrap fee and managed account services provided in the retail market.

DERIVATIVES

For more than 20 years, Sutherland has played an active role in the development of the over-the-counter ("OTC") derivatives markets, which has paralleled the evolution of the futures markets to encompass financial and energy products. The Sutherland Derivatives Group represents industrial corporations, insurance companies, energy concerns, hedge funds, mutual funds, pension plans and other non-profit entities in evaluating and negotiating critical master agreements and related transaction documents. The practice draws upon our experience in tax, energy, securities and banking, in addition to its core knowledge in OTC and exchange-traded derivatives.

Core services of this group include: the analysis and negotiation of derivatives documentation (e.g., International Swaps and Derivatives Association, Inc. ("ISDA") Master Agreements, credit support documentation and cross-product and cross-affiliate master netting agreements); advice with respect to the tax and disclosure implications of derivative transactions; regulatory counseling with respect to futures trading; Commodity Futures Trading Commission ("CFTC"), Securities and Exchange Commission ("SEC"), insurance and banking compliance training and counseling with respect to futures, derivatives and cash market transactions; representing clients before the CFTC, SEC and the Federal Energy Regulatory Commission ("FERC") in regulatory investigations; evaluating and developing internal guidelines and controls for clients' derivatives activities and reviewing risk management policies; representing clients in disputes involving derivatives against other market participants in mediation, court and arbitrations; and bankruptcy litigation involving the analysis and valuation of terminated derivative transactions.

INSURANCE

Sutherland has one of the leading insurance practices in the U.S. Our practice spans the full gamut of legal and compliance areas affecting the insurance industry at both the federal and state levels, as well as legal and compliance issues related to offshore operations. Areas in which we regularly assist our clients include: company formations, corporate governance, mergers and acquisitions, reinsurance, finance and structured finance transactions, product development and approvals, product advertising and sales practices, insurance company and product tax, and real estate and alternative investments. We also represent clients in regulatory investigations and examinations, in nationwide class action litigation and in arbitrations. We represent our clients before state insurance departments, the U.S. Department of

the Treasury and the Internal Revenue Service (“IRS”), the SEC, FINRA, state securities regulators and the U.S. Department of Justice (“DOJ”).

BANKING

Our banking lawyers have in-depth knowledge of the complex fabric of state and federal regulations, as well as industry practices, that affect our clients’ operations. We are well-versed in regulatory matters affecting the latest innovations in the banking industry and are experienced in merger and acquisition transactions. We regularly coordinate with other practice groups to serve the needs of our banking clients in other areas, including securities laws, securitizations, derivative products and the regulation of investment advisers, broker-dealers and investment companies.

SECURITIES ENFORCEMENT

Sutherland represents broker-dealers, insurance companies, investment advisers, investment companies, other financial service providers, public companies, and individuals confronted with examinations, investigations, and disciplinary or administrative proceedings brought by the SEC, CFTC, federal or state prosecutors and self-regulatory organizations. Our team includes former senior attorneys of the SEC, FINRA and the DOJ. We provide a full range of services, from advice and support during compliance and regulatory examinations, to internal investigations, to defense and guidance during civil and/or criminal investigations and to vigorous litigation in self-regulatory, administrative, civil, and criminal enforcement proceedings, trial and, if necessary, appeals.

SUBPRIME LENDING AND STRUCTURED FINANCE

Addressing the regulatory, litigation and restructuring issues arising from the credit crisis spreading across world markets involves a diverse set of legal disciplines. Subprime lending and structured finance issues can be exceedingly complex. Central to the ability to deal with controversies involving subprime instruments and structured products is a thorough understanding of the mechanics of the products, the accounting for and valuation of these products, and the myriad ways these products find their way into the marketplace. At Sutherland, our transaction lawyers have been intimately involved in the creation of derivative instruments and their use as financing vehicles as well as the securitization and collateralization of credit instruments. Our professional liability and regulatory lawyers have been involved in assisting clients in resolving both professional liability and regulatory issues as markets have become more volatile and accounting rules have changed how companies value such instruments. The end result of the volatility and change, all too often has been litigation involving disparate claims reaching all aspects of the creation, valuation, disclosure and distribution of such products. Sutherland possesses the variety of skills and knowledge to cost effectively address the issues.

ENERGY

Sutherland represents clients through our energy and environmental practice in every major sector of the energy industry in sophisticated transactional, regulatory, finance, tax and litigation matters. Our clients are industrial end-users and end-user groups; independent power producers and electric cooperatives; petroleum, power and natural gas marketers; domestic and multinational traders; hedge funds and financial institutions; refiners and crude oil producers; leading companies in the nuclear energy business; and energy lenders. More than 65 of our attorneys regularly serve the legal needs of Sutherland’s energy industry clients in domestic and international business transactions and litigation.