INTERNATIONAL SECURITIES EXCHANGE

Executive Summary of ISE's Proposal for Regulatory Reform for the U.S. Markets

- The **current U.S. system** of bifurcated regulation by financial instrument is **outdated and ineffective.**
  - The division between SEC and CFTC suffers from regulatory gaps, jurisdictional stalemates, and inconsistent regulation of financial products and industry participants.

- ISE proposes a new regulatory regime that reallocates responsibilities by function among **three aspects of financial regulation**:
  - **Financial Systemic Risk**: financial and capital matters involving commercial and investment banks, as well as futures commission merchants, investment companies and hedge funds.
  - **Disclosure**: disclosure/risk analysis for investors, which would cover corporate issuers, investment companies, and product-specific risk.
  - **Financial Industry Operations:** operation of financial markets, trading platforms and financial service providers, including but not limited to the services traditionally provided by broker-dealers, investment advisors, hedge funds and futures commission merchants.

- As a registered securities exchange, ISE's focus is on the Financial Industry Operations area of regulation. In this area, ISE proposes that Congress establishes the **U.S. Financial Markets Commission (FMC) as the sole regulator of financial industry operations:**
  - FMC would encompass the current SEC and CFTC regulatory and policing functions.
  - FMC would oversee all financial products and trading platforms, removing the artificial regulatory distinction among exchanges, ECNs and ATSs.

- **Risk-based regulation** allows regulators and those they regulate the ability to proactively identify practical methods to address risk and to focus on results-oriented compliance.
  - Based on **specific regulatory objectives** designed to address areas of highest risk.
  - Requires **greater collaboration between regulators and regulated**, and a **higher level of regulatory expertise** than rules-based regulation.

- To create the FMC, Congress should adopt **new risk-based regulation that replaces the 1934 Act and Commodity Exchange Act.**
  - FMC would establish its own regulatory objectives and "safe harbors" for compliance that meet the Congressional guidelines.
  - FMC would focus on areas of highest risk to the system and conduct cost-benefit analysis for regulatory initiatives.
  - Self-regulatory organizations (SROs) would rewrite their rules to comply with FMC objectives and would work closely with FMC to ensure ongoing compliance.

- Congress establishes an **18 month transition period** and appoints a **Transitional Authority (TA)** to oversee compliance with the new statute by the FMC.
  - TA works with SEC and CFTC to move the relevant parts of their organization into the FMC.
  - TA will provide education on the transition to a risk-based regulatory system.