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First take

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Ten key points from Trump's first year

It has been a year since President Trump took office, and while Dodd-Frank has not been repealed, his Administration has already had a wide ranging impact on financial services regulation. In contrast to other headline-grabbing priorities such as healthcare, immigration, and tax reform, the Administration's actions on financial services have largely fallen under the radar. This is due in part to the fact that, as we anticipated last November,[1] the Trump Administration departed from the anti-bank populism espoused during the campaign and quickly moved on to more traditional Republican drives to (a) reduce "excess" regulation on financial institutions and the financial system, and (b) spur economic growth by streamlining and stabilizing capital requirements, enabling banks to lend and grow with greater certainty.

The Trump Administration began its deregulatory agenda by issuing a number of Executive Orders (EO) and Presidential Memoranda,[2] which unlike EOs related to immigration and healthcare, ordered studies and recommendations rather than immediate action. The most impactful EO directed the Treasury Department to conduct a comprehensive review of financial regulation,[3] which has since resulted in three reports, all of which have been positively reviewed as providing reasonable roadmaps for streamlining regulation. Most importantly, the majority of the reports' recommendations can be implemented directly by the regulatory agencies, which aligns with our prediction following the election that the greatest opportunity for changes to financial regulation would come from changing the referees (i.e., regulators) rather than changing the rules (i.e., legislation).

Within his first year, President Trump nominated new heads to six out of seven key agencies – most of whom will be able to remain beyond 2020. Notably, unlike nominees to other federal agencies, the Administration's financial services choices have been relatively moderate industry veterans. Most have taken over their posts without much fanfare or dramatic change, and all have begun to either make or announce planned changes to industry pain points.

While most in the industry have acknowledged that post-crisis reforms were necessary, many have felt that the Dodd-Frank Act went too far and too quickly, without adequately considering the relative costs and benefits of its requirements. In the new referees, the industry sees an acknowledgment of that sentiment and a promise that regulations will be right-sized and streamlined. If the recent bank earnings results and stock market growth are any indication, the industry is satisfied so far. Not only have tax cuts passed and interest rates risen, but they are also aware that while the regulatory load will be lightened, the core framework of rules that have become crucial to risk management and global competitiveness are here to stay.

With that said, below are our top ten observations of impacts to financial regulation after President Trump's first year in office:

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1. **Treasury reports are specific blueprints for change.** Last year, Treasury issued three reports on regulation of (1) banking and depository institutions,[4] (2) capital markets,[5] and (3) insurers and asset managers.[6] The reports were well received as highly professional and technical documents, with reasonable adjustments rather than wholesale dismantling of the post-crisis regulatory framework. Notably, a majority of the recommendations can be implemented by the various financial services agencies absent of Congressional action. While few formal proposals have been made by the new agency heads, the reports have given industry a clear roadmap for areas where they can expect regulatory relief. One set of recommendations that has received early attention are those to improve the Volcker Rule[7] - leaders of all five agencies charged with overseeing the rule, including those appointed by President Obama, have agreed that several adjustments can be made. Looking ahead to the rest of 2018, Treasury plans to issue one final report on financial technology and innovation early this year, and we can expect agency heads to make progress on reforms in line with the reports.

2. **New bank regulators making an impact on environment and outlook.** While the Trump Administration has not yet changed all leadership at the banking agencies, several new leaders are already making an impact. One of the most crucial positions to fill from a regulatory perspective was the vacant Fed Vice Chair of Supervision, a seat which had been informally filled by Former Governor Daniel Tarullo.[8] President Trump chose Randal Quarles for the position, and while the Fed has already released several new proposals under his purview, all were initiatives that were started under Tarullo, reinforcing the fact that targeted regulatory relief is the norm. Quarles did however, announce in a recent speech that more meaningful relief is on the horizon, including streamlining absorbency requirements and making changes to the leverage ratio, both of which would have a major impact. While the Fed is still led by Obama-appointee Janet Yellen, she will be replaced early next month by current Fed Governor Jerome Powell, who was recently confirmed by the Senate. In total, Trump has the opportunity to leave his mark on the Fed for the foreseeable future as he currently has the ability to fill a total of six out of seven seats on its board relatively early in his term.

   Aside from the Fed, Joseph Otting has taken over the reins at the Office of the Comptroller of the Currency (OCC) after a short-lived but active tenure by Acting Comptroller Keith Noreika. Otting has been relatively quiet about his priorities so far, but has stated that he would like to review the Community Reinvestment Act, small dollar lending, and sees a path forward for the FinTech charter initiative started under his predecessor. FDIC Chair nominee Jelena McWilliams has also not gone into great detail about her priorities, but she did express the need for reducing regulation on community banks and considering the cost-benefit of regulation in her confirmation hearing. We expect her to be confirmed soon, and having her in place will be a critical component for advancing reform of multi-agency rules and requirements.

3. **CFPB in retreat.** The Consumer Financial Protection Bureau (CFPB) has garnered a number of headlines since the early departure of former Director Richard Cordray. As an agency symbolic of stricter post-crisis enforcement, the CFPB has long been a target of Republican ire and is currently being led by longtime critic Mick Mulvaney – who is also Director of the Office of Management and Budget – after he won a court battle with Cordray's handpicked replacement. Although the CFPB is still largely made up of staff loyal to its mission, its uniquely independent governance structure has allowed Mulvaney to take significant steps to redirect and weaken the agency. Not only did he request zero funding for the second quarter of 2018, he also recently announced a review of the agency's core operations – including enforcement, supervision and rulemaking – and halted data collection activities.

   While we do not expect the CFPB to go away, as Mulvaney acknowledged in a recent op-ed, its direction will drastically change course. He has said that the CFPB will no longer "push the envelope" and will stick to the minimum enforcement required by Dodd-Frank. He also remarked that firms overseen by the CFPB are just as important as consumers, the effect of which can already be seen in the agency dropping lawsuits and enforcement actions. Therefore, we expect that major regulatory initiatives in the pipeline will go dormant and many existing regulations will be lightened or rolled back. A permanent Director, however, will eventually need to reconcile a weaker CFPB with the fact that abusive financial practices have garnered significant criticism from both sides of the aisle, causing firms to sacrifice both reputation and market share.

4. **CFTC and SEC to streamline and coordinate (finally).** Trump made early appointments to both the Commodity Futures Trading Commission (CFTC) and the Securities Exchange Commission (SEC), giving both agency heads an early start on setting their new agendas. As a former Commissioner and Acting Chairman, CFTC Chairman Christopher Giancarlo hit the ground running by announcing a broad review of the

CFTC's swap transaction reporting regime and launching "Project KISS," an agency-wide review of rules and regulations with the goal of less burdensome application.

SEC Chairman Jay Clayton, a former Wall Street lawyer, has not prioritized repealing the relatively few Dodd-Frank provisions that impacted the SEC and in fact chose to move forward with the Consolidated Audit Trail despite Republican calls to delay it.[9] It has also been reported that the SEC is planning to release its version of a fiduciary rule[10] in early Q2. However, Clayton has declared on several occasions that his focus as Chairman will be scaling back regulations that inhibit capital raising in order to make American markets more competitive.

The two agencies have overlapping jurisdictions, but the Treasury report on capital markets stopped short of recommending a merger which would be difficult given competing congressional oversight. However, both Clayton and Giancarlo have endorsed a recommendation to harmonize existing derivatives rules. Going forward, expect both agencies to be tied by concerns around the growth of cryptocurrencies. The CFTC has approved the listing of Bitcoin futures on two exchanges, while the SEC has recently warned against the risks posed by initial coin offerings (ICOs) and has even taken action against issuers of ICOs for making fraudulent claims and selling unregistered securities.

5. **Bipartisan relief for small- and medium-sized banks a near certainty in 2018.** Even in a world of Congressional gridlock, the Senate has been able to find bipartisan compromise on a bill to, as we predicted, raise the systemically important financial institution (SIFI) threshold from $50 to $250 billion, thereby reducing the regulatory burden for all but the 12 largest banks. While the bill has been labeled by some as a rollback of Dodd-Frank, banks under $250 billion have already seen their regulatory requirements significantly reduced. Under the bill, the Fed would still conduct periodic stress tests for banks between $100 and $250 billion in assets, and would retain discretion to reinstate enhanced prudential standards for banks with over $100 billion in assets in order to prevent systemic risk. We expect the Fed to remain vigilant over such banks, in particular custody banks for whom the bill would completely exempt central bank deposits from their leverage ratio calculations. The bill also exempts banks with less than $10 billion in assets from certain risk-based capital rules as well as the Volcker Rule. It will therefore have a somewhat moderate impact for banks in the $100 to $250 billion range, but it will benefit community banks and mid-size banks who will see their compliance costs dramatically reduced, and will be able to grow and merge without having to account for increased regulatory costs.

   As it stands, the bill has support from 11 Democrats and one Independent, which means that it could pass the crucial 60-vote filibuster-proof threshold. Though the bill does not go far enough for many House Republicans who would like to see more comprehensive reform in line with the CHOICE Act they passed last year, we still believe they will be able to garner the requisite 218 votes. In the longer term, despite polls and recent special election results indicating favorable results for Democrats, the 2018 Senate midterm electoral map is heavily tilted in Republicans' favor. While Republicans are therefore likely to retain a majority in the Senate, that point may be moot with the many announced retirements in the House, along with the President's low approval ratings, clearing a potential path for Democrats to regain control of the House. A split Congress would mean that any plans for bolder Dodd-Frank repeal efforts would be off the table, reinforcing our prediction following President Trump's electoral victory that regulatory relief will be left up to the financial services agencies.

6. **End of non-bank SIFIs – rules are for big banks, not insurers and asset managers.** The Trump Administration began with two remaining insurers designated as systemically important by the Financial Stability Oversight Council (FSOC), and now only one remains after AIG was de-designated last October. With the Administration dropping its challenge to Metlife's court-driven de-designation and an FSOC report from Treasury recommending a more activities-based approach to systemic risk, we expect the remaining insurer to also shed its nonbank SIFI status this year. Under the previous Administration, asset managers had also been under the spectre of potential designation and new SEC requirements.

   This Administration, however, has taken a very different position, with Treasury's third report stating that asset managers and insurers are fundamentally different from banks and that size alone does not translate into systemic importance. Treasury further recommended that the SEC put potential regulations intended for asset managers on hold, including stress testing requirements for funds and asset managers with more than $10 billion in assets as well as mandatory formal business continuity plans for investment advisers.[11] Taken together, the probability of nonbanks being designated as systemically important and facing heightened regulation has reduced to zero.

7. **Enforcement actions on the decline.** In addition to regulatory reform, one of the most highly anticipated results of a Trump presidency has been a lighter touch on enforcement. One year in, it is apparent that the desired effect has occurred. For example, SEC Chairman Jay Clayton outlined early in his term that he would take a different approach to enforcement from his predecessor by focusing primarily on major infractions. This approach seems to have held as FY 2017 SEC penalties fell by nearly 35% from FY 2016, according to the agency's annual report. Further, FY 2017 CFTC penalties dropped by 68%, from FY 2016. Although new agency leaders do not typically replace examination staff, they can substantially alter the focus of examinations and enforcement through internal guidance.

   The results of leadership changeovers at the Fed, OCC, and FDIC will become more apparent in 2018, but if the leaders of these agencies work closely together, the impact of a consistent and lighter touch in bank enforcement could be felt sooner rather than later. It is important to note, however, that a lighter touch does not mean a free pass. All of the agencies will continue to police bad behavior, and when compliance issues reach the headlines, financial institutions not only face serious reputational risk, but can also expect critical tweets from the President and unfriendly Congressional hearings from members of both parties.

8. **New focus on good governance.** Even as enforcement and rulemaking is decelerating, there is no sign that the referees have let up on core concerns around governance, risk management, and controls. In fact, the Fed has proposed new risk management guidance for Boards of Directors[12] and management[13] as part of its new bank rating system.[14] The format of the new rating system indicates that governance and controls will be just as important as capital and liquidity to the Fed's evaluation of whether a bank is "well managed." The proposed guidance therefore emphasizes the importance of governance and risk management, but is also consistent with the direction of the Administration's agenda to streamline regulation as it realigns Board responsibilities to their historical oversight function. Further, several high-profile cases in the last 18 months demonstrated that regulatory requirements are far from the only reason that banks need to have strong governance and controls, particularly when it comes to cybersecurity and consumer protection.

9. **CCAR and resolution planning out of the headlines and into BAU.** Last year, the largest US banks all passed the bar of two key post-crisis exercises - resolution planning and the Comprehensive Capital Analysis and Review (CCAR). The Fed and FDIC did not identify any deficiencies in the largest banks' 2017 resolution plans, in contrast to the prior round of feedback citing five of the eight plans as having deficiencies and being "non-credible."[15] Similarly, for the first time since CCAR began, no bank holding companies received capital plan objections last year. While expectations are set by and subject to change by the agencies at any time, we believe that, for now, the steep upward trajectory has abated. In fact, the agencies have started to lighten the load by extending resolution plan submission cycles, and, for banks under $250 billion that engage primarily in traditional banking activities, tailoring requirements and eliminating the risk of a qualitative objection to their capital plans.

   However, banks should remain vigilant, with one eye focused sharply on the agencies' tea leaves while the other watches closely over evolving risks, both of an internal and external nature. Further, having achieved the new normal, banks can now turn their attention to improving the efficiency of capabilities related to the current CCAR and resolution planning expectations. Further, with the elongation of resolution plan cycles, banks can start to focus on how to derive business benefits from the vast information contained in their service catalogues.

10. **Cybersecurity & AML to headline 2018 risks.** Because several high-profile financial crime incidents in both the anti-money laundering (AML) and cybersecurity[16] spaces occurred during Trump's first year, we expect to see continued focus from politicians and regulators. In fact, the Senate Banking Committee began the year with a hearing on improving the existing AML regime with many proposed reforms tied to the Administration's goals of streamlining regulations, and others seeking to align the US with its global peers.[17]

    Cybersecurity is an area where we have seen a strong focus from regulatory agencies on enforcing existing rules with agency heads continuing to beat the drum in public speeches that cybersecurity is a priority. However, there has been limited federal action to advance expectations beyond existing requirements.[18] Instead, individual states and foreign regulators have stepped up by releasing their own sets of requirements.[19] Regardless of regulatory expectations, the onslaught of cyber-attacks last year show that cybersecurity should be a priority for both IT and senior stakeholders, as failing to proactively focus on improving cyber risk management and controls could not only lead to regulatory penalties but to major reputational damage as a result of lost customer data.

Endnotes

1. See PwC's *First take, Donald Trump's victory: Ten key points* (November 2016).
2. See PwC's First take, *Ten key points from Trump's first 100 days* (April 2017).
3. The Core Principles from the Executive Order are: 1. Empower independent financial decisions; 2. Prevent taxpayer-funded bailouts; 3. Foster economic growth through rigorous impact analysis; 4. Enable American companies to compete with foreign firms; 5. Advance American interests in international meetings; 6. Efficient, effective, tailored regulation; and 7. Publicly accountable and rationalized regulation.
4. See PwC's *First take, Ten key points from Treasury's first financial regulation report* (June 2017).
5. See PwC's First take, *Five key points from Treasury's second financial regulation report* (October 2017).
6. See PwC's First take, *Ten key points from Treasury's third financial regulation report* (November 2017).
7. See PwC's Regulatory brief, *Volcker rule: Under review until further notice* (July 2017).
8. See PwC's First take, *Five key points from Governor Tarullo's farewell speech* (April 2017).
9. To learn more, see PwC's Regulatory brief, *Consolidated Audit Trail: The Cat's out of the bag* (June 2016), and PwC's First take, *Ten key points from the final Consolidated Audit Trail plan* (December 2016).
10. See PwC's *Regulatory brief, DOL fiduciary rule: Beyond the headlines* (February 2017).
11. See PwC's *First take, Five key points from the SEC's business continuity plan proposed rule* (July 2016).
12. See PwC's First take, *Five key points from the Fed's new board expectations guidance* (August 2017).
13. See PwC's First take, *Five key points from the Fed's new risk management guidance* (January 2018).
14. See PwC's First take, *Five key points from the Fed's new rating system for large financial institutions* (August 2017).
15. See PwC's *First take, Ten key points from Agencies' resolution plan feedback* (April 2016).
16. For example, the WannaCry ransomware attacks and a major data breach that affected over 140 million consumers highlighted cyber vulnerabilities in the past year. For additional information, see Strategy&'s *Cybersecurity after WannaCry: How to Resist Future Attacks* (May 2017) and PwC's *Financial crimes observer, Cyber and fraud: How to mitigate and prevent the next data breach* (September 2017).
17. For example, the proposed reforms included creating a beneficial ownership information registry and developing a "regulatory sandbox" to allow financial institutions to test FinTech innovation for AML without fear of regulatory enforcement.
18. A proposal for heightened cyber risk management expectations issued by Fed, OCC, and FDIC in late 2016 has since stalled. For additional information on the banking agencies' proposal, see PwC's *Financial crimes observer, Cyber: Banking regulators weigh in* (November 2016).
19. These include New York, California, Colorado, China, Hong Kong, and Singapore. Additionally, the National Association of Insurance Commissioners is expected to finalize a model cybersecurity law this year, which would subsequently be passed by all 50 states. For additional information on New York's cyber rule, see PwC's *Financial crimes observer, Cyber: New approach from New York regulator* (January 2017).

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