The Trump Impact: Key Issues in Financial Services Reform for 2017

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The Trump administration has provided few specifics regarding its plans for financial regulatory reform. But Republican control of the executive and legislative branches of the federal government should create a favorable environment for financial services deregulation. We expect that regulatory relief will be most advantageous for community and regional banks and will spur, over time, accelerating consolidation among those banks.

Reforming Dodd-Frank: The View From the White House

During the campaign, candidate Trump promised to eliminate or "change greatly" the Dodd-Frank Act. Rather than offer specifics, President Trump and his team have provided insights into the key goals they hope to achieve in financial reform.

President Trump, along with his nominee for secretary of the Treasury, Steven Mnuchin, expressed concern that Dodd-Frank disproportionately harms community financial institutions relative to large banks. Accordingly, we expect financial reform to focus on benefiting small and medium-sized banks. This approach also would allow President Trump to project a populist approach to financial regulation — maintaining a hard stance toward the country's largest banks while responding to constituents by easing regulation of their community and regional depositories. Mnuchin's recent testimony to the Senate Finance Committee provides further support that the administration will adopt this regulatory philosophy: Mnuchin committed to reducing regulation for local and regional banks, stated that he supports the Volcker Rule (but expressed concern about the rule's definition, including its impact on market liquidity) and noted that he and the president had discussed implementing a 21st-century version of the 1933 Glass-Steagall Act.

Perhaps the biggest question for financial regulatory reform is the degree to which the White House will prioritize it in relation to its other initiatives. Few commentators believe President Trump or Mnuchin is a financial reform ideologue. Instead, most expect that the administration will focus on health care, tax reform and infrastructure spending before addressing wholesale financial reform.

Reforming Dodd-Frank: The View From the Hill

By contrast, the House of Representatives is prepared to move forward with a comprehensive plan for financial reform. Rep. Jeb Hensarling, R-Texas, chairman of the House Committee on Financial Services, has said that his financial reform bill, the Financial CHOICE Act, will be his top legislative priority.

The Financial CHOICE Act is a comprehensive Republican-proposed financial reform bill, and Rep. Hensarling has considerable influence over financial reform legislation. The House will likely approve legislation reported by the Financial Services Committee. Therefore, we believe some version of the Financial CHOICE Act will be the framework congressional Republicans use to initiate financial reform.

Important elements of the Financial CHOICE Act include:

- allowing banks to forgo many Dodd-Frank rules by adhering to a heightened leverage ratio, including:
  - eliminating various concentration limits related to M&A activity and
  - eliminating the requirements that bank holding companies with $50 billion or more in assets notify the Federal Reserve Board of any acquisition of a company engaged in financial activities with $10 billion or more in assets;

- eliminating the Federal Deposit Insurance Corporation's (FDIC) orderly liquidation authority and replacing it with a new chapter in the Bankruptcy Code;
- downgrading the Financial Stability Oversight Council and removing its nonbank systemically important financial institution (SIFI) designation authority; and
- repealing the Volcker Rule.

Whether through the Financial CHOICE Act or other legislation, we expect the Trump administration and a Republican Congress to increase the current $50 billion automatic SIFI-designation threshold, which has been a meaningful deterrent for bank M&A activity at the regional and community bank level.

In the Senate, the path to reform is less clear. Sen. Mike Crapo, R-Idaho, the new chairman of the Banking, Housing and Urban Affairs Committee, has not yet identified his legislative priorities beyond regulatory relief for small banks and housing finance reform. Additionally, Republicans are eight votes short of the 60 votes they need to end a filibuster. So any financial services bill approved by the Republican-controlled House likely will be subject to negotiation with Senate Democrats. The degree of ultimate financial reform is not certain, and major elements of Dodd-Frank may remain.

Changing of the Guard at Federal Banking Agencies

Regulatory reform legislation is subject to obtaining the votes of Democratic senators. But regulatory appointments are not. Needing only a simple majority of senators to confirm his appointments, President Trump will have the opportunity to significantly affect the policy direction of the three major federal bank regulators through his appointment power within his first two years in office:

- In March 2017, President Trump will be able to appoint a new comptroller of the currency, who also will serve as a member of the FDIC board;
- In November 2017, President Trump will have the chance to appoint a new chairman of the FDIC, where one seat is already vacant; and
- In February 2018, Federal Reserve Chair Janet L. Yellen's term as chair expires. In June 2018, Vice Chairman Stanley Fischer's term as vice chairman expires. Two Federal Reserve Board seats are currently vacant, and the post of vice chairman for supervision, created by the Dodd-Frank Act, has never been designated. In total, President Trump will have the opportunity to appoint at least four of the seven members of the Federal Reserve Board within two years of taking office.

The Trump administration is focused on filling the role of the Federal Reserve vice chairman for supervision. This appointee will have a significant impact on the direction of financial regulatory policy in many important areas, including bank M&A and stress testing/Comprehensive Capital Analysis and Review (CCAR) policies.

Implications for Fintech

The implications of deregulatory changes on the financial technology sector remain unclear. On the one hand, deregulation should help fintech companies navigate the increasingly complicated regulatory regimes to which they are often subject (*e.g.,* Consumer Financial Protection Bureau regulation and enforcement). But on the other hand, it could be a catalyst for regulated players like banks to get back into areas they previously shunned due to the regulatory burden (*e.g.,* certain types of consumer lending).

Regulatory support for fintech firms may come from Congress. Rep. Patrick McHenry, R-N.C., vice chairman of the House Financial Services Committee, introduced the Financial Services Innovation Act of 2016 in September. The proposed bill would create a Financial Services Innovation Office in certain government agencies that would be committed to fintech. The bill also would establish a framework that would provide regulatory protection to fintech companies' new products. We expect Rep. McHenry will continue to pursue a version of the bill in the 115th Congress.

Implications for Bank M&A

Reduced regulation of banks is likely to open new opportunities for depository institutions to grow organically and by merger. Raising the SIFI designation threshold would encourage dealmaking among regional and community banks, which could be further assisted by new regulatory policy directions from federal banking agencies. Although legislation reforming the Dodd-Frank Act may take time and should not be expected earlier than mid-year, we expect the regulatory environment to become more favorable to dealmaking in 2017 and beyond.