Regulatory Brief

Deregulation in Financial Services

How the new administration will impact the financial industry

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WHAT HAS HAPPENED SINCE THE ELECTION?

President Trump's executive order on financial regulation sets forth seven core principles. It directs the Treasury Secretary to work with the other members of the Financial Stability Oversight Council to assess existing rules against these principles.

1. Empower Americans to make independent financial decisions and informed choices in the marketplace, save for retirement and build individual wealth
2. Prevent taxpayer-funded bailouts
3. Foster economic growth and vibrant financial markets through more rigorous regulatory impact analysis that addresses systemic risk and market failures, such as moral hazard and information asymmetry
4. Enable American companies to be competitive with foreign firms in domestic and foreign markets
5. Advance American interests in international financial regulatory negotiations and meetings
6. Make regulation efficient, effective and appropriately tailored
7. Restore public accountability within federal financial regulatory agencies and rationalize the federal financial regulatory framework

WHAT IS EXPECTED TO HAPPEN IN THE NEAR FUTURE?

1. The administration is unlikely to defend the CFPB in court

The constitutionality of the Consumer Financial Protection Bureau's (CFPB's) structure (governed by a single director, currently Richard Cordray, who can only be removed for cause) was invalidated recently by a Federal Appeals Court in the case PHH Mortgage vs. CFPB.

While the previous administration was prepared to put up a vigorous defense of the CFPB, the new administration is unlikely to guide the Department of Justice to continue its defense.

There is also speculation that President Trump may replace Cordray ahead of his term expiration in July 2018.

2. Changes to Dodd-Frank

Changes will be made to the Dodd-Frank Wall Street Reform and Consumer Protection Act, but there is unlikely to be a repeal. Likewise, the CFPB likely will not be disbanded entirely, but controls will be established on its authority — starting with the leadership structure.

- Representative Jeb Hensarling (R-TX) has proposed the director serve at the will of the President
- Others have proposed a bipartisan approach for the committee (5-7 member panel) rather than a single director
- As early as the Fiscal Year 2018 Federal Budget, the CFPB may come under Congressional appropriations and oversight

Critics of Dodd-Frank have argued the burdens of compliance have discouraged lending and unfairly targeted small banks, forcing them to consider mergers. The data is mixed, however. Mergers have averaged about 250 per year for the last three years (2014-16), compared to about 200 per year for the previous three years (2011-13). That's still well below the 500-plus mergers per year of the late 1990s, pre Dodd-Frank.

Community banks are looking for:

- **Tailored regulations** — based on risk, not asset size
- **Removal of red tape** — e.g., the Home Mortgage Disclosure Act (HMDA) reporting requirements stretch resources and stifle growth for smaller financial institutions
- **Elimination of overlapping rules** — banks may comply with one regulatory body, but still be cited by another regulator
- **Decision-making power** — community banks would like to review "Know your customer" standards to take into account local market variables to assess risk associated to their client base

The bill's coauthor, Representative Barney Frank (D-MA), acknowledged that the $50 billion threshold for "too big to fail" was set too low (it covers a total of 42 financial institutions). For comparison, the Top 10 banks are subject to "stress testing" and are all above $250 billion in assets.

3. Comprehensive regulatory relief

This is being championed by the current chairmen of key committees in both the House (Rep. Hensarling, Chair of the House Financial Services committee) and the Senate (Sen. Mike Crapo, R-ID, Chair of the Senate Banking committee).

Rep. Hensarling will likely continue to pursue enactment of the Financial CHOICE Act, which contains several provisions to ease regulatory burden on financial services companies, providing opportunity for consumers and helping small businesses and job creators facilitate capital formation.

Sen. Mike Crapo is known for favoring meaningful regulatory relief, including CFPB and Dodd-Frank reforms, and to focus on data breach and consumer privacy.

WHAT ARE BANKERS' IMPRESSIONS OF THE NEW ADMINISTRATION?

In early February 2017, a survey of 250 bankers revealed:

- Roughly two-thirds (67 percent) of respondents had either a "very positive" or "somewhat positive" view of President Trump's actions to date
- Only 13 percent found his actions to be "somewhat negative" or "very negative"
- 70 percent were "very confident" or "somewhat confident" that President Trump's policies would accelerate economic growth

President Trump's support among bankers stems from their belief that his administration can deliver on promises of regulatory relief:

- 28 percent of respondents were "very confident" and 51 percent were "somewhat confident" that regulatory relief was on the way
- 81 percent believe that reform of the CFPB would be part of the administration's economic efforts
- 41 percent believe that repeal of the Durbin Amendment (limiting interchange fees) is likely
- Almost half believe that a simpler capital regime was likely to be included in any new legislation

WHAT ARE SOME ASSOCIATED RAMIFICATIONS?

1. Big banks may get back into mortgage lending

Since 2010, non-bank mortgage market share has increased from 10.5 percent of mortgage originations to 49 percent, thanks to firms like Quicken, LoanDepot, LendingTree and Caliber Home Loans entering the market.

Federal Housing Association (FHA) loans have been abandoned by the big banks (except for Wells Fargo). Because they require only a 3.5 percent down payment, they tend to be riskier.

2. De novo activity may return

Stringent regulatory pressure has all but eliminated new bank charters over the last five years. Since 2011, six new bank charters have been granted (compared, for example, to 194 new charters in 2006 alone).

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