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Global Risk Watch Newsletter

“Winners” and “Losers” in the New Trump Presidency, etc.

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Financial Regulation Policy of the Trump Regime (Yuri Nakano, Senior Manager, Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC)

Contrary to the results of prior opinion polls, Mr. Trump was elected the next president of the United States. After the election, market conditions showed a tendency to betray a lot of expectations, especially the stock price of financial institutions has remained steady. Although it seems that it reflects the market expectation for the deregulation of financial industry by the next administration, the concrete policy of Mr. Trump has not been disclosed. The website on which Mr. Trump's policy only states that, "The Financial Services Policy Implementation team will be working to dismantle the Dodd-Frank Act and replace it with new policies to encourage economic growth and job creation.."

Republicans who secured the majority in both the House and Senate in the parliamentary elections which was held concurrently with this presidential election also support the easing of financial regulation. The Republican Platform 2016 published by the Republican Party on July 18, describes The Dodd-Frank Act as “the Democrats’ legislative Godzilla”, which “is crushing small and community banks and other lenders. Dodd-Frank’s excessive regulation and burdensome requirements have helped contribute to the slow economy we all endure today ”. Meanwhile, the Platform also states that “ We support reinstating the Glass-Steagall Act of 1933 which prohibits commercial banks from engaging in high-risk investment.” which suggests the strengthening of commercial banks regulation. The Platform overall can be seen that it may not have been contemplated comprehensively.

At the House Financial Services Committee chaired by Rep. Hensarling who was critical of the regulatory reform, "Financial Choice Act" bill which suggests to dismantle Dodd-Frank Act, was approved on September 13 of this year. First, the bill proposes exempting regulations significantly for banks with strong capital and management base. Specifically, banks with leverage ratio of 10% or more that are rated 1 or 2 (based on 1 for 5, lowest for 5) based on the CAMELS comprehensive rating of the Uniform Financial Institutions Rating System (5 rating items Capital Adequacy, Asset Quality, Management, Earnings, Liquidity, Sensitivity to Market Risk) are exempted from Basel capital and Liquidity restrictions, restrictions on capital distributions imposed by the regulators, submission of resolution plans, etc.. Second, in addition to abolishing the authority's monitoring system through SIFI (System Important Financial Institution) designation as a measure to "end too big to fail" and a measure to put an end to bank bailouts, the bill suggests to sharply reduce government support by restricting the Federal Reserve Discount Window and the Federal Deposit Insurance Corporation (FDIC) to establish widely available programs to guarantee banks' debt, etc. It also includes the abolition of orderly liquidation authority (OLA) and replacing it with a bankruptcy law that can cope with the collapse of large, complex financial institutions. Third, as measures to promote capital formation, the bill suggests abolishing the Volcker Rule and rewinding the regulatory reform of private equity funds. Fourth, review of and restrictions on regulatory authorities such as FSOC, Consumer Finance Protection Agency (CFPB), Federal Reserve System, Securities and Exchange Commission (SEC), Currency Supervisory Agency (OCC) is presented. Finally, as a measure to mitigate the regulation of community financial institutions, it urges financial regulators to establish regulations appropriate to individual financial institution's business models and risk profiles, and to strengthen financial institutions, including reducing the burden of reporting to the authorities.

The bill drastically reverses the strengthening of regulations since the financial crisis, by reducing the compliance burden of the industry, abolishing the SIFI regulation, and prohibiting the government's bank bailout, which suggest the small government advocated by the Republican Party. The condition for regulatory relief requires a minimum leverage ratio of 10%, far exceeding 5% of the current US regulation (required for bank holding company above a certain scale). The idea behind the regulatory exemption is considered to be that financial institutions maintaining a leverage ratio of more than 10% are less likely to collapse, therefore burdensome regulations such as Basel are not necessary. Meanwhile, many questions arise such as the necessity of monitoring liquidity risk that cannot be fully grasped by the leverage ratio or the comprehensive rating score of CAMELS, and the creation of a bankruptcy law that can respond to the collapse of large and complex financial institutions. Also, considering the fact that international regulations have been endorsed by the international agreement led by EU and US authorities since the financial crisis, it is difficult to contemplate a situation, for example, where global systemically important banks (G - SIBs) will be completely exempted out from Basel regulations. On the other hand, with regard to the ongoing enforcement of the international regulations, the major countries have different opinions, in particular, Japan and Europe against the excessive strengthening of Basel regulation whereas the US insists on stricter regulations. If the stance of the US softens with the transition of the administration, there is a possibility that the trend of the regulatory strengthening will change in the future. At this stage, the direction of financial regulation after the transition is uncertain, but it will be necessary to pay close attention to the appointment of executive personnel of the upcoming regime currently being discussed as well as the details of the financial regulation policy.

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