Our take: PwC FS update

Change remains a constant in financial services risk & regulation. Here's "our take" on key developments impacting the industry.

5.12.17 Topics: FBI & FS reform * Treasury report and FSOC * OCC on Volcker * SEC and CFTC * Resolution plan FAQs * Agency tracker *

1. FBI firing will slow FS action

In the latest surprise move by the Administration, the Director of the Federal Bureau of Investigation (FBI), James Comey, was fired on May 9th. While Democrats were quick to voice support for an independent investigation, many Republicans in both chambers took the opportunity to distance themselves from the President and expressed concern about the timing and justification for Comey's termination. Although a few Republican Congressmen mentioned the possible need for an independent committee to investigate Russia's efforts to influence the 2016 presidential election, it was not a widely held position.

Our take

Change in Washington is a momentum game and financial services regulatory change is no better than a third priority issue even if the Administration did have the wind at its back. With some level of bipartisan support needed to simply accelerate appointments to open Agency leadership positions, it's difficult to envision how the tougher tasks of changing existing regulations, removing current leaders such as the head of the Consumer Financial Protection Bureau, and enacting new more bank friendly regulations, can possibly get accomplished in the short-term. Moreover, inquiries into the Administration's decision to fire James Comey are likely to take up valuable Congressional committee and floor time over the next several weeks (or even months), and thereby push financial services regulatory reform efforts even further to the back burner. Without positive momentum for the Administration, status quo will continue to be the new normal in the FS world.

2. Treasury's deregulatory momentum builds

As Congress becomes distracted by other priorities and the legislative timeline for financial services reform continues to be pushed back, several agencies are pushing forward under new leadership, holding true to our narrative that the Administration's biggest bang for its buck is changing the referees (i.e., regulators) and not the rules.

Earlier this week, Treasury Secretary Steven Mnuchin led his third meeting of the Financial Stability Oversight Council (FSOC) and continued discussions of Treasury's report on regulatory reform that is rapidly approaching its June 3rd deadline. Treasury's read out of the meeting confirmed that one of the clear targets of the review is the Volcker Rule. During the meeting, the FSOC member agencies discussed the "efficacy" of the Volcker Rule and Secretary Mnuchin reportedly asked the five agencies that administer the rule to conduct a separate review of its requirements.

It has been suggested that the regulatory reform report will be issued piecemeal due to staffing capacity and competing priorities at the Treasury Department. The report was ordered in a February 3rd Executive Order (EO) that outlined seven "Core Principles" for financial regulation and instructed Treasury to consult with the FSOC member agencies to produce a report on whether financial regulations "inhibit" or "promote" the seven principles. In addition to coordinating with the

FSOC agencies, Treasury has been receiving wishlists from industry associations (such as FIA).

Our take

As we predicted, where there are new referees, they are beginning to change the game. In the new FSOC agendas and progress of the Treasury report, we are seeing the formation of the path to deregulation with wishlists from industry coming through. Even if the Treasury report is delivered piecemeal, we expect primary industry pain points – the Volcker Rule, capital rules, and structural liquidity requirements – to receive the earliest attention.

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3. Volcker rule pressure building at the OCC

In another example of both deregulatory momentum building and the impact of changing the referees, Acting Comptroller of the Currency Keith Noreika outlined broad plans for streamlining national bank regulation in an interview with the *Wall Street Journal*. As part of this review, Noreika suggested that the Office of the Comptroller of the Currency (OCC) could act unilaterally on the Volcker Rule, including by reinterpreting what constitutes proprietary trading and identifying exempt transactions as a path to clarity.

Other priorities for Noreika include improving morale and "defending and promoting" the national bank charter. He declined to comment on FinTech charters and leveraged lending, two areas of focus by the prior Comptroller.

Our take

Noreika signalled a strong turn toward White House deregulatory themes which, prior to this Administration, would be unusual for a placeholder hire. Even with an activist bent, unilateral change to the Volcker Rule is not likely since Dodd-Frank mandates consultation and consistency among the five agencies with authority over the rule. Nevertheless, we are starting to see the impact of initial changes.

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4. SEC and CFTC Chairmen promote markets

A change in tone at the top was also seen at both the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) as Acting Chairman of the CFTC Christopher Giancarlo and Chairman of the SEC Jay Clayton both gave speeches this week highlighting priorities for their respective agencies.

In his speech, Giancarlo became the first financial services agency head to announce results of a review of regulations under the White House's Core Principles EO (see point 2 above). He identified three priorities: (1) recalibrate capital and leverage ratio-based disincentives to bank dealers providing market liquidity; (2) reverse the "misapplication" of the supplemental leverage ratio (SLR) to cash collateral for cleared swaps and reduce costs for bank-owned futures commission merchants; and (3) fix the US swap execution rules that promote market fragmentation and provide comity to other regimes in place of comparability.

SEC Chairman Clayton also highlighted access to markets as a priority in his first public remarks since taking office. Specifically, he plans to focus on facilitating capital-raising opportunities including for small- and medium-sized businesses. Early targets for discussion and potential action are finders, underwriting of small offerings, and the tick size pilot as finders.

Our take

Giancarlo is focused on unburdening big dealers while Clayton is focused on helping the small firms. Expect action in both categories, although not necessarily these particulars. One Giancarlo wish list item – excluding cleared swap cash collateral from the leverage ratio – repeats a long-held industry view. While this is another clear example of the impact of changing the referees, it is not enough to make immediate changes. The Federal Deposit Insurance Corporation (FDIC) will not be supportive of aiding derivatives trading, but such reforms could gain more traction when a new FDIC Chair is appointed later this year.

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5. Resolution planning FAQs

On May 5th the Federal Reserve and FDIC (together, Agencies) released a set of answers to FAQs on their April 2016 guidance for the eight largest US banks' 2017 resolution plans. The FAQs cover several topics that were deemed deficient in several of the banks' last filings, such as legal entity rationalization and shared services. They also cover liquidity and explain how the liquidity forecasting models (i.e., RLAP and RLEN) were clarified and refined.

The Agencies noted that they had sent these answers to the eight banks last year, but have made them public now in order to enhance transparency around the resolution planning process – a call which has been heard from several critics.

Our take

While the Agencies noted that the FAQs pertain only to the eight largest US banks, this additional insight into their guidance should be beneficial to the four largest Foreign Banking Organizations (FBOs) that are required to file resolution plans. The next filing for these FBOs was pushed back to July 2018, and they have received guidance that is substantially similar to their US counterparts. We expect the Agencies to maintain a high level of scrutiny on the US banks' next filings, but as the next filing for the FBOs will not occur until after leadership has changed at both the Agencies, there is some uncertainty about the strictness of their review.

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6. Financial services agency appointments outlook*

*This is a projection of possible results; actual results may differ.
<u>Key assumptions</u>: All agency leads filled with Republicans; all open seats filled upon expiry of prior term; current occupants depart when term expires; Fed Chair and Vice Chair resign at end of chairmanships.

Additional information

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