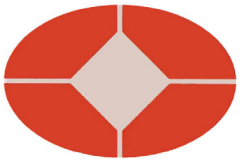

BASEL UNDER TRUMP

What, How and Will the U.S. Election Impact Global Regulation

By Jeb Beckwith and Sanjay Sharma, Ph.D.

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"The election of Donald J. Trump as America's 45th President could mean an end to years of cross-border cooperation in banking rules, making life harder for regulators as they try to keep bank excesses in check on both sides of the Atlantic... observers say that spells trouble for global standard setters such as the ***Basel Committee on Banking Supervisors [BCBS]*** *and others." – WSJ 11/14/16*

This headline captures both the hope and fear amongst financial institutions around the world who have been working towards a common regulatory framework for decades, particularly since the 2008 global financial crisis. Not only has Donald Trump been elected on a platform to revise and replace federal regulations, but he has also been swept into office with majorities in both the House and the Senate. This follows the Brexit referendum as well as the rising tone elsewhere to pursue de-globalization policies. Does a Trump victory spell the decline of coordinated, global financial regulation by the BCBS, particularly its most recent rule-making initiatives?

We sense that the U.S.-BCBS relationship could come under scrutiny, but that key initiatives such as the Fundamental Review of the Trading Book (FRTB) will remain on schedule. We arrive at this view through a three step examination of the new landscape.

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1. **The What** - We examine the governance framework of BCBS and the U.S.'s role.
2. **The How** - We examine the mechanisms through which the new administration could act promptly and other measures that would take more effort.
3. **The Will** - We provide our assessment about what the new administration is likely to actually do regarding BCBS rule making and the impact this may have on the global regulatory environment.

What Does U.S. Participation in the BCBS Look Like?

The BCBS is one of six[1] committees established by the Bank for International Settlements (BIS), a Basel, Switzerland based bank owned by its 60 central bank membership that collectively represent approximately 95% of world's GDP[2]. The BIS mandates the BCBS to be the primary global standard setter for the prudential regulation of banks and to provide a forum for cooperation on banking supervision matters. **The BCBS does not possess any formal supranational authority and, as such, its decisions do not have legal force.** Instead, the BCBS relies on its members to "*implement and apply BCBS standards in their domestic jurisdictions within the pre-defined timeframe established by the [BCBS]*"[3].

Oversight of the BCBS comes from the Group of Governors and Heads of Supervision (GHOS)[4], a 27-member subset of the general membership that approves the BCBS Charter, provides general guidance, and appoints the BCBS Chair from among its members. The U.S. is represented on the GHOS by the heads of four organizations. We refer to these collectively as the U.S. GHOS members (see Table 1).

The BIS also hosts three independent groups that have their own legal personalities. These influence both the BCBS and, more generally, the Basel Process[6]. These groups are the Financial Stability Board (FSB), the International Association of Deposit Insurers (IADI) and the International Association of Insurance Supervisors (IAIS). Although these are independent organizations, it is important to recognize the formal sponsorship by the BIS and close connection to the BCBS. In particular, the FSB is influential across the Basel Process with significant overlapping membership, including that of BCBS in the FSB. The U.S. is represented at the FSB by the BGFRS, the Securities and Exchange Commission (SEC) and the U.S. Department of the Treasury (UST)[7].

Looking next to the U.S. regulatory framework, we examine how U.S. representative organizations are structured, how their heads are appointed and their term expiration schedules. Table 2 provides a summary of key appointments and term expirations. Note that with the exception of the New York Federal Reserve Bank President, all leadership positions are appointed by the U.S. President and confirmed by the Senate.

How Can a New Administration Effect Change?

President Trump will come to office on January 20th, 2017 with immediate executive authority. These include the power to make appointments and rescind or issue executive orders. After some back and forth, we expect Senate ratification of appointments to move relatively swiftly, not only because of the Republican Senate majority, but also because of the historically close connection between Mr. Trump and Senate Minority Leader Chuck Schumer (D-NY). Of the positions described in Table 2, four appointments can be made immediately following inauguration. These positions are: the Treasury Secretary; the Chair of the SEC[16]; and two vacant Federal Reserve System Board of Governors. Other

Table 1

U.S. GHOS Members
1. The Board of Governors of the Federal Reserve System (BGFRS)
2. The Federal Reserve Bank of New York (FRBNY)
3. The Office of the Comptroller of the Currency (OCC)
4. The Federal Deposit Insurance Corporation (FDIC)[5]

Table 2

Key U.S. Term Expirations				
Organization	**Title**	**Name**	**Expiry**	**Confirmer[8]**
BGFRS	Chair	Janet Yellen	Feb 3, 2018[9]	Senate
	Vice-Chair	Stanley Fischer	Jun 12, 2018[10]	Senate
	Member	Daniel Tarullo	Jan 21, 2022	Senate
	Member	Jerome Powell	Jan 31, 2028	Senate
	Member	Lael Brainard	Jan 31, 2026	Senate
	Member	Treasury Secretary[11]	Jan 20, 2017	Senate
	Member	Comptroller of the Currency[12]		
	Apr 9, 2017	Senate		
FRBNY	President	Bill Dudley	N/A[13]	FRBNY Class B & C Board members[14]
U.S. Treasury	Secretariat	Jacob Lew		
	Jan 20, 2017	Senate		
OCC	Comptroller	Tom Curry		
	Apr 9, 2017	Senate		
SEC	Chair	Mary Jo White	Jun 5, 2019[15]	Senate
	Commissioner	Kara Stein	Jun 5, 2017	Senate
	Commissioner	Michael Piwowar	Jun 5, 2018	Senate
	Commissioner	Vacant	Jun 5, 2020	Senate
	Commissioner	Vacant		
	Jun 5, 2021	Senate		
FDIC	Chair	Martin Gruenberg	Nov 15, 2017	Senate

appointments in 2017 will be: the Chair of the FDIC; the Comptroller of the Currency; and one additional SEC commissioner. Finally, although Janet Yellen's term at the BGFRS does not expire until 2024, her position as Chair expires in January, 2018. **With the confirmation of a Republican Senate, President Trump will be able to reconstruct most of the U.S. leadership to the BCBS with his own appointees relatively swiftly.**

Under current U.S. law, Congress vests U.S. GHOS members with the authority to write implementation rules for bank supervision. This includes implementation language for the Fundamental Review of the Trading Book (FRTB), as approved by the BCBS and the GHOS. Although leadership of the U.S. GHOS will undoubtedly change in 2017, **implementing U.S. regulation for the FRTB and related BCBS rules will need to be created prior to January 1st, 2019 unless one of two events occur:**

1) The BCBS revises the formally stated rules it has spent eight years devising; or
2) U.S. GHOS members, directed by new leadership, elect not to implement BCBS rules on a timely basis or as otherwise proscribed in the rules.

Unlike past BCBS initiatives, which did not include specific implementation timelines, the FRTB mandates a specific implementation date: January 1, 2019. As a result, event 2 above would constitute a direct violation by the U.S. of its member responsibilities under the BCBS Charter, Section 5 (e). It is unclear what the consequences of such a violation would be.

Will Major Changes Occur?

First, we should distinguish information about a Trump Administration's posture toward financial regulation into what is known, what is likely, and what is speculation.

We know from President-elect Trump's stated positions that he intends to do the following:

Table 3

President-elect Trump's Stated Positions on Financial Regulation
1. Issue a temporary moratorium on new agency regulations. 2. Require each federal agency to prepare a list of all currently imposed regulations. 3. Rank each regulation from most critical to least critical with a view towards prioritized removals[17].

As recently as November 11th, Mr. Trump reaffirmed that "financial deregulation" will be a priority in his first few days in office, that the Dodd-Frank Act (DFA) is a "tremendous burden to the banks" and that "we have to get rid of [the DFA] or make it smaller."[18]

There is also reasonable visibility into some key appointees and their positions. House Financial Services Committee Chairman Jeb Hensarling (R., Texas) is widely rumored to be appointed Treasury Secretary. A financial regulatory reform bill he sponsored in September, 2016 largely overlaps with work performed by former SEC commissioner and DFA critic Paul Atkins[19]. Mr. Atkins is widely reported to be spearheading recommendations on financial deregulation policy. The websites of both Mr. Hensarling and Mr. Atkins indicate that they are fiercely opposed to Title II (Orderly Liquidation Authority) of the DFA which provides for FDIC-facilitated receivership of large banks that are in danger of default. Mr. Hensarling is also a fierce critic of the Financial Stability Oversight Council (FSOC)[20] and the Volker Amendment to the DFA. Another potential candidate for Treasury Secretary, Steven Mnuchin, has been less involved in political service and therefore has less of a public track record on regulation. Although he publicly supports less regulation generally, Mr. Mnuchin has been described as an "oasis of blankness"[21] with respect to positions on public policy. Mr. Mnuchin was tapped in April, 2016 to head Donald Trump's fundraising activities. His prior experience came as a partner at Goldman Sachs, as a purchaser of troubled finance companies (e.g. OneWest, formerly IndyMac) and as a movie producer[22].

House Speaker Paul Ryan also has put forth a detailed list of regulatory reform aspirations, many of which have already been converted into legislation awaiting ratification.

Table 4

Speaker of the House Initiatives on Financial Regulation[23]
1. FSOC: Place restrictions and transparency on FSOC's ability to designate SIFIs including eliminating the $50 Billion test in favor of a multi-factor test[24] 2. Federal Reserve. Preserve the FRS's independence, but increase requirements for reporting, transparency and, most substantially, subject the Fed's prudential regulatory activities to the congressional appropriations process[25] 3. Regulatory Reduction through Benefit-Cost Analysis (BCA). Streamline regulations, eliminate duplicative or conflicting regulation and require regulators to take into account the cumulative weight of regulatory burden[26] 4. Harmonization of OTC Derivative Rules. Build "seamless rules for derivatives market participants" between SEC, CFTC and prudential regulators.

Basel Under Trump: The Global Implications

Where does this leave us?

The still forming Trump administration, backed by a Republican House and Senate, will undoubtedly push to make dramatic reforms to financial regulation. So far, these reforms seem to be focused on the DFA, Volker Amendment, the CFPB, Title II and other regulations that are perceived to detract from bank lending. Given the size and clout of U.S. GHOS members, future BCBS rule-making activities are likely to

be constrained. Some rules, particularly those impacting smaller financial institutions, may be pared down over time. The big question for the global community is "**What happens if the U.S. does not implement existing BCBS directives on a timely basis, most notably the FRTB which carries a specified implementation date?**"

If the U.S. violates its BCBS member obligations by failing to implement the FRTB as proscribed, then U.S. sponsorship of the BCBS, a by implication of the BIS itself, may come into question. This could lead to an unraveling of the global framework for coordinated bank regulation. For these reasons, we do not believe it is in the interest of a new administration to jeopardize its standing within the BCBS by undercutting rules already promulgated. For these reasons, and given other priorities already described, **we believe that the FRTB is here to stay**.

We will follow the new administration's positions on these matters and provide updates on a regular basis.

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1. In addition to the BCBS, other BIS committees are the Committee of the Global Financial System, the Committee on Payments and Market Infrastructures, the Markets Committee, the Central Bank Governance Forum, and the Irving Fischer Committee on Central Bank Statistics.
2. From BIS statistics as of November, 2016. https://www.bis.org/about/index.htm?m=1%7C1
3. BCBS Charter, Section 5 (e), http://www.bis.org/bcbs/charter.pdf
4. Currently, the 27 members of BGOS consist of central bank governors and non-central bank heads of supervision from the following countries: Argentina, Australia, Belgium, Brazil, Canada, China, European Union, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States.
5. BCBS committee membership on the BCBS, https://www.bis.org/bcbs/membership.htm
6. For a complete description of the Basel Process, please access this link: https://www.bis.org/about/basel_process.htm
7. See FSB membership. http://www.fsb.org/about/fsb-members/
8. Note that, with the exception of the FRBNY, all appointments are made by the President of the United States with confirmation required by the United States Senate
9. Ms. Yellen's term as a member of the BGFRS expires on January 31, 2024
10. Mr. Fischer's term as a member of the BGFRS expires on January 31, 2020
11. Ex-officio member, i.e. membership is vested in the office holder
12. Ex-officio member, i.e. membership is vested in the office holder
13. The President of all U.S. Federal Reserve member banks, including the FRBNY, serves at the pleasure of the Class B and Class C board members.
14. Class B board members (3) are elected by member banks but cannot be employees or directors of any bank. Class C members are appointed by the FRB.
15. The WSJ reports that Mary Jo White will resign from her post concurrent with the new administration
16. Provided that Mary Jo White resigns her post in January as reported by the WSJ
17. Donald J. Trump's stated positions on regulation. https://www.donaldjtrump.com/policies/regulations/
18. WSJ, November 11th, 2016, http://www.wsj.com/articles/full-repeal-of-dodd-frankisnt-main-focus-of-trump-transition-1478882550?mod=djemFinancialRegulationPro&tpl=fr, *Full Repeal of Dodd-Frank Isn't Main Focus of Trump Transition*
19. Mr. Atkins criticisms of the DFA are captured in this testimony to Congress from September 11th, 2011. http://financialservices.house.gov/uploadedfiles/091511atkins.pdf His resume can be found at his firm's website here. https://www.patomak.com/paulatkins
20. FSOC is a creation of the DFA designed to foster cooperation and coordination amongst disparate US financial regulators as well as to implement consolidated rulemaking around G-SIFI's. The FSOC has 10 voting members including three of four US GHOS members. The US Treasury Secretary serves as Chair. More information can be found at https://www.treasury.gov/initiatives/fsoc/rulemaking/Pages/default.aspx
21. Bloomberg Politics, *Trump's Top Fundraiser Eyes Deal of a Lifetime*, August 31, 2016
22. Filmography found here: http://www.imdb.com/name/nm6518391/
23. From www.abetterway.speaker.gov/_assets/pdf/abetterway-economy-policypaper.pdf
24. See H.R. 1550, 3557, 3857, 3340 and 1309
25. Much of this comes from the Fed Oversight Reform and Modernization Act (the FORM Act) sponsored by Rep. Bill Huizenga
26. See H.R. 414, 2354, 2187 and 1675