No.13

2017.2.27

Mr. Trump's Big Turn toward Financial Deregulation

Mitsuru Yaguchi, Deputy General Manager
Institute for International Monetary Affairs

President Trump, who had been urging an abolishment of the Dodd-Frank Act throughout his election campaign, finally moved to review financial regulations. On February 3, he signed an executive order laying out "core principles on regulations of the US financial system", which indicated 7 basic principles and directed the Treasury Secretary to examine whether or not existing laws align with these core principles and submit a report on possible changes within 120 days.

The Dodd-Frank Act was enacted in 2010 by the then Democratic administration aiming at comprehensively reinforcing the financial regulations so as never to repeat a financial crisis. The current executive order does not mention the law directly, but the core principles contain items like "preventing taxpayer-funded bailouts' and "making regulation efficient, effective and appropriately tailored" that show intentions of the administration to revise the law.

Yet, even if the revised draft of the Dodd-Frank Act were submitted to the Congress, its smooth enactment could not be expected as there is a high possibility that the revisions may get filibuster because the gap is small in the seats between the Republicans and the Democrats in the Senate. In the real life, therefore, each regulatory authority such as the FRB (Fed), the SEC, and the CFTC will promote its deregulations on a lower level that will not require law amendment.

Already some of the key persons of regulatory authorities are going to be replaced by pro-deregulation members. Namely, at the FRB, Mr. Daniel Tarullo (Democrat), a Board member who has been acting as a de fact vice chairman in charge of bank oversight, has already expressed his intention of resignation possibly on April 5 and Mr. David Nason, CEO of GE Energy Financial Service (Republican) is regarded as a strong candidate to replace him. Also both chairmen at the SEC and the CFTC resigned from their post on January 20, on the day President Trump took office. Pro-deregulation Republican members have been already nominated or expected to be nominated as their successors.

What attracts our attention here is the impact of the rollbacks of the US financial regulations on Japanese financial institutions and international regulatory frameworks. For instance, at the press conference of the Japanese Bankers Association, the chairman pointed out the need (1) to prepare for the impacts of application of US regulations on foreign banks (so-called extra territorial application) and (2) to watch the impact on the reform process of regulations by the Basel Banking Committee, since the presidential order included such principles as "Enable American companies to be competitive with foreign firms in domestic and foreign market" and "Advance American interests in international financial regulatory negotiations and meetings."

In practice, impact will reach a broader range of business. The problem of extra territorial application indicated by the sentence (1) above has already risen to surface in the form of application of the Volcker rule (prohibition of proprietary trading and funds investment) and regulations on Swap Dealers (obligation to report details of derivative transactions) on some of the Japanese large financial institutions. What should be taken care in the future is about the possibility that the Japanese financial institutions doing business in the US cannot get the benefit of the US financial deregulations. President Trump aims at reducing the burdens of local small and medium-financial institutions. Therefore, there will be a case where the financial deregulation of such rules as the Volcker rule will be only applied to the American financial groups under a certain size, with foreign financial groups (including Japanese financial institutions doing business in the US) excluded from the application. This will place the Japanese financial institutions in a relatively less favorable position.

As regards the point (2) shown above, the near term attention will be drawn to the impact on the reform process of the Basel international regulatory framework for banks. But taking a long-range view, there is a concern that goes far beyond that. The bill to comprehensively revise Dodd-Frank Act (Financial CHOICE Bill) submitted last year by an influential Republican Congressman (Chairman Hensarling of House Financial Service Committee) includes ideas conflicting with the international financial regulatory framework, such as exemption of application of various financial regulations to those with leverage ratio of more than 10%, and comprehensive review of bankruptcy procedures for large financial institutions (application of normal bankruptcy law, i.e. Chapter 11). The "America First" attitude on financial regulation seems to have been shared not only by President Trump but to some extent by the Republican Party as a whole. It can't be denied, therefore, that in the worst case the US may withdraw from the internationally agreed frameworks on financial regulations.

As international fora for discussing international financial regulatory framework, we can expect the G20 Finance Ministers and Central Bankers Meeting to be held on March 17-18 in Baden-Baden in Germany and the G20 Hamburg Summit to be held on July 7-8. As for the review of the US financial regulations, we should give sufficient attention, not only to the direction of the US domestic deliberations, also to their influence on the statements and decisions of these international meetings.