GLOBAL FINANCIAL REGULATION – THE DECADE AHEAD – PART 1: UNITED STATES

16 October 2017 | Global
Legal Briefings

Central to the response of the international community to the global financial crisis was a move to strengthen international regulatory standards and to improve cooperation and coordination amongst regulators. A question for the decade ahead is how much of that global approach will survive?

A focus on the United States is below.

Has momentum stalled?

In the early days of his administration, President Trump issued a set of Core Principles for Regulating the United States Financial System (Principles) and declared it to be the policy of his administration to regulate in a manner consistent with those Principles.

Many of the Principles could be expected to receive bi-partisan support: for example, principles to empower Americans to make independent financial decisions and informed choices in the marketplace, save for retirement, and build individual wealth; to prevent taxpayer-funded bailouts; to foster economic growth and vibrant financial markets to enable American companies to be competitive with foreign firms in domestic and foreign markets.

Other Principles, however, especially when considered alongside contemporaneous correspondence that issued from influential members of Congress and criticism of aspects of the Dodd-Frank legislation might suggest that the US intends pulling back from efforts to reach an international consensus on the content of regulation.

Would “America First” be inconsistent with the approach to regulation pursued with vigour since that 2009 G20 meeting in London?

There is nothing necessarily troubling about Principles to advance American interests in international financial regulatory negotiations and meetings, nor in the wish to restore public accountability within Federal financial regulatory agencies and there have long been calls to rationalise the Federal financial regulatory framework, but there are questions nonetheless about US commitment.

And it matters. A breakdown in regulatory consensus makes cross-border business more complex and expensive and increases operational risk. As a practical matter, in most areas of the financial markets if there is no US agreement, there is no meaningful regulatory consensus.

The real test of US intentions and a guide to the future would follow from the second part of President Trump's decree. The Secretary of the Treasury was directed to consult with the heads of the member agencies of the Financial Stability Oversight Council (including the Federal Reserve, SEC and CFTC) and to report to the President within 120 days on the extent to which existing laws, treaties, regulations, guidance, reporting and record-keeping requirements, and other Government policies promote the Principles and what actions have been taken, and are being taken, to promote and support the Principles.

In June 2017, the Treasury duly reported and identified what it described as significant areas for reform in order to conform to the Core Principles. The review identified a wide range of changes that it said could meaningfully simplify and reduce regulatory costs and burdens, while maintaining high standards of safety and soundness and ensuring the accountability of the financial system to the American public.

The Treasury report runs to nearly 150 pages and again, many of the proposals will surely enjoy bi-partisan support but what stands out is how inward looking that report is. There is remarkably little regard paid to international fora nor to the importance of international consensus. Where reference is made to international standards, it is often to recommend a pause in implementation to better assess the appropriateness of that standard for the US domestic market. Even allowing for the historic distinction made by US regulators leading to the non-application of Basel standards to some US domestic banks, there seems to be a real change in attitude to the international order. For example, Treasury recommends delaying the domestic implementation of the Basel Net Stable Funding Ratio and Fundamental Review of the Trading Book rules until they can be appropriately calibrated and assessed. It is said that “both of these standards represent additional regulatory burden and would introduce potentially unnecessary capital and liquidity requirements on top of existing capital and liquidity requirements. US regulators, it is said, should also rationalise and improve the risk-based capital regime over time through, for example, reducing redundant calculation approaches and improving risk sensitivity in the measurement of derivative and securities lending exposures”. Of course, the US authorities were leading participants in the Basel discussions that led to agreement on all those international standards. Going forward, one may ask, will the US continue to participate in the international fora in the same way as an opinion leader in efforts to shape international consensus? Or will they operate on the basis that convincing others to accept their view may be desirable but no longer regarded as important? Anecdotally, regulators from other jurisdictions have noticed a change in approach by US regulators to the discussions in those key international fora.

The US Treasury report recommends increased transparency and accountability in international financial regulatory standard-setting bodies and improved US inter-agency coordination before concluding that international regulatory standards should only be implemented in the US through consideration of their alignment with domestic objectives and should be carefully and appropriately tailored to meet the needs of the US financial services industry and the American people. At one level, one might say that is a very sensible, indeed responsible approach but it does seem to foreshadow a significant change in attitude.

For example, Treasury recommends additional study of the recalibration of standards for capital and liquidity that have been imposed on US globally systemically important banks. These regulations are said to add significant complexity to capital and liquidity requirements and there is concern they may have adverse economic consequences that can be addressed without impacting safety and soundness. In other words, the US is walking away from the consensus, built up over several years and commencing with that G20 meeting in April 2009 on how to ensure the effective and consistent prudential oversight of the world's largest internationally active banks.

The US Treasury does “generally” support efforts to finalise remaining elements of the international reforms at the Basel Committee, including establishing a global risk-based capital floor, because it believes banks in other jurisdictions receive more favourable treatment than US banks and “in order to promote a more level playing field for US firms and to strengthen the capital adequacy of global banks, especially non-US institutions that, in some cases, have significantly lower capital requirements”. Regulators in other jurisdictions will, of course, dispute the premise of Treasury’s “general” support: support for international standards because you believe that they are bringing others up to the standards required domestically is qualified support, at best.

There is, however, some good news for those who believe in the importance of international regulatory consensus. In its report, Treasury considers foreign investment in the US banking system to be an aid to diversifying the risk of the financial system and propelling economic growth. It is recommended, therefore that regulatory standards on living wills and liquidity, should be recalibrated and greater emphasis should be given to the degree to which home country regulations are comparable to the regulations applied to US bank holding companies. That is a change for the better when compared against the previous policies of the US FDIC and shows that a willingness to recognise and rely upon regulation in other jurisdictions remains part of the US approach, at least where there is a discernible US interest.

Other regulators do not necessarily follow where the US leads but, one may ask, in the absence of strong US support for international standard setting, should we expect the drive for global consistency to fall away?

This article is an excerpt from “Global financial regulation – the decade ahead”, currently appearing in the *Global Bank Review 2017* publication. Other articles in this series include:

- **Part 2: Europe**
- **Part 3: Asia-Pacific**
- **Part 4: Australia: regulation by litigation**

To download the complete version of this article click here.

The bank of 2040 hub

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

ANDREW PROCTER
PARTNER, LONDON

+44 20 7466 7560
Andrew.Procter@hsf.com

LEGAL NOTICE