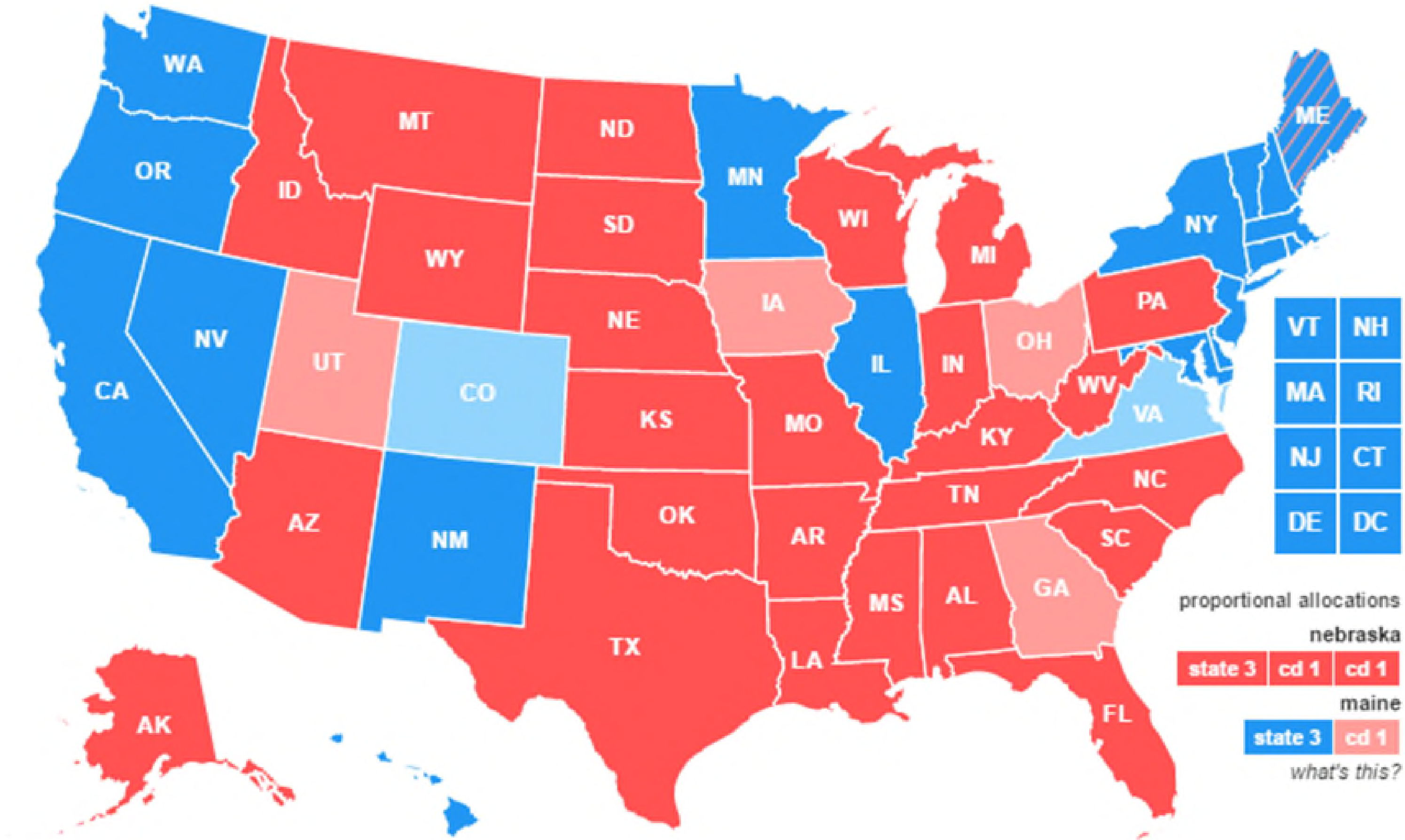
Emerging Events in U.S. Regulatory and Political Landscape

Richard A. Schaberg, Aaron Cutler and Michael Thomas

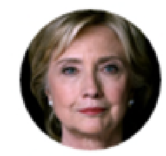
November 15, 2016

London

Election Results



Final electoral college count: **306**



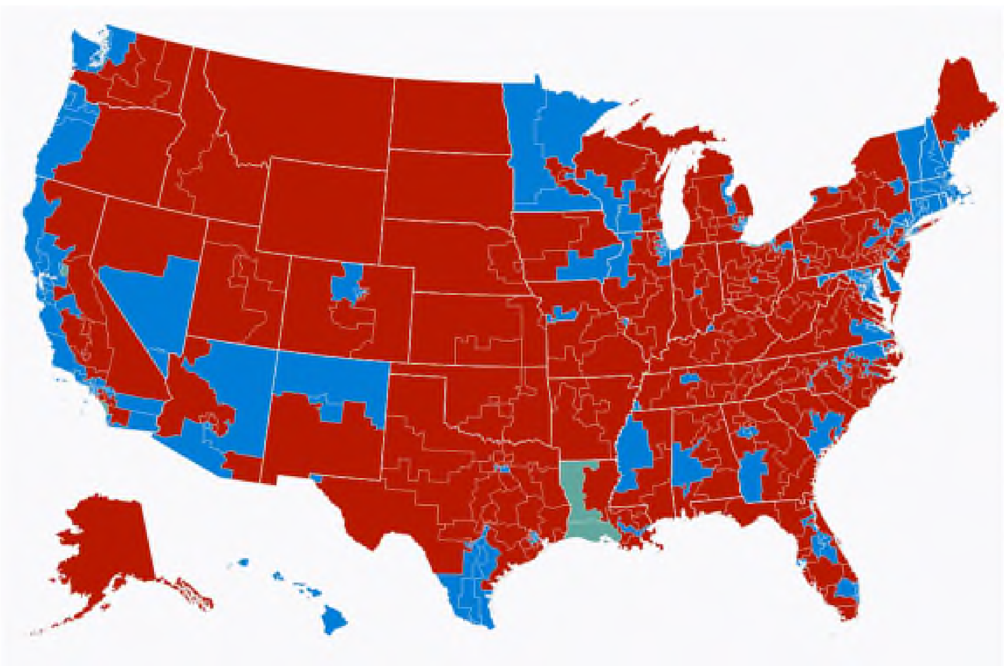
Final electoral college count: **232**

Composition of Congress

House

193 Democrats

240 Republicans

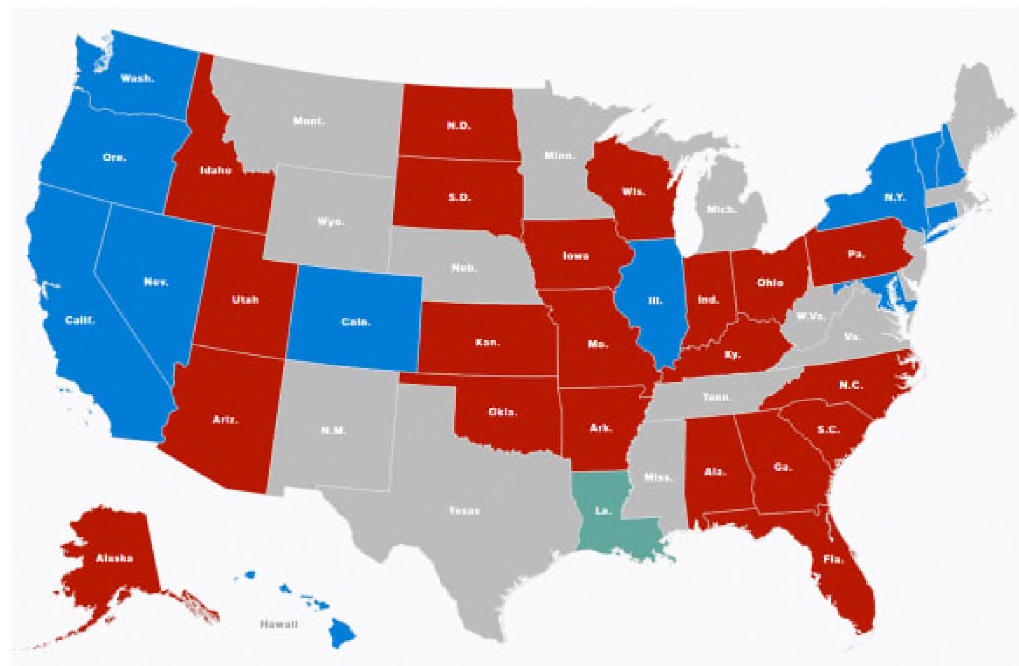


*2 House seats still in play in LA

Senate

46 Democrats
2 Independents

52 Republicans*



Donald Trump has won the presidency

- President-elect Trump has not laid out a financial regulatory policy, but he is likely to follow in the footsteps of prominent Republicans who have.
- He has said he would "rip up" the Dodd-Frank Act and called for increased accountability from the Federal Reserve.
- The Republican platform called for the CFPB to be dismantled and most of the Dodd-Frank reforms to be rolled back.

"We have to get rid of Dodd-Frank. The banks aren't loaning money to people that need it…. The regulators are running the banks."

Donald Trump, President-elect

The Republicans have retained control of Congress

- With majorities in both houses of Congress and the presidency, the Republicans may be able to pass several bills to reform the financial regulatory system.
- While bashing Wall Street was a bipartisan pastime this election, Republicans have generally favored Wall Street-friendly laws and regulations (namely, that there be less of both).
- The Dodd-Frank Act is likely to be an early target (along with Obamacare).

"Simply put, Dodd-Frank has failed. It's time for a new legislative paradigm in banking and capital markets."

Jeb Hensarling (R-TX), Chairman of the House Financial Services Committee

Personnel is Policy

cfpb

Consumer Financial
Protection Bureau

FDIC

FEDERAL DEPOSIT INSURANCE CORPORATION

Office of the
Comptroller of the Currency
U.S. Department of the Treasury

Changing of the Guard

New leaders for financial regulatory agencies

The Federal Reserve

Chairman Janet Yellen's term expires in February 2018.

Treasury

Donald Trump has indicated he may select Steven Mnuchin, the campaign's finance chairman, as his Treasury Secretary.

The OCC

Comptroller Thomas Curry's term expires in March 2017.

The FDIC

Chairman Martin Gruenberg's term expires in November 2017.

The CFPB

Director Richard Cordray's term expires in July 2018.

However, as discussed in this presentation, he is likely to be replaced before his term is up and the CFPB, itself, will be dramatically altered.

The SEC

While Chairman Mary Jo White's term does not expire until 2019, there are two open commissioner positions, which this Congress has refused to fill. They will likely be filled quickly, but the SEC's enforcement authority is in the administration and Congress' crosshairs.

Consumer Financial Protection Bureau

- The CFPB has been a point of contention and derision from its inception and the Republican Congress seems poised to dismantle it.
- The recent decision in PHH v. CFPB will allow President-elect Trump to replace the head of the CFPB without cause upon his inauguration.
  - The D.C. Circuit found the agency was not per se unconstitutional, but that having a sole director who could only be removed for cause rendered it unconstitutional.
  - The CFPB has said they may appeal the decision.
- Beyond replacing the director, the CFPB may be entirely erased or reinvented, as the Financial CHOICE Act calls for.

The Financial CHOICE Act

- The Financial CHOICE Act has been proposed by Jeb Hensarling, the Chairman of the House Financial Services Committee. It is the most far-reaching proposal that has been put forth since the passage of Dodd-Frank and addresses the Republicans' most disliked portions of the law.
- CFPB: Rename it the Consumer Financial Opportunity Commission, with a bi-partisan five member commission subject to congressional oversight and appropriations. It's mission will be "consumer protection and competitive markets."
- SIFIs: Repeal the FSOC's authority to designate non-bank SIFIs and FMUs. Repeal Title II of the Dodd-Frank Act and create a new chapter of the Bankruptcy Code to deal with the failure of large, complex financial institutions.
- Basel III: A banking organization may avoid the Basel III capital and liquidity requirements, as well as the "heightened prudential standards" of section 165 of the Dodd-Frank Act, by maintaining a leverage ration of at least 10% and a composite CAMELS rating of 1 or 2.
- It calls to "eliminate the *Chevron* doctrine." It is unclear if the bill proposes to completely eliminate *Chevron* deference (and more than 30 years of precedent) or solely with regard to federal financial regulatory agencies.

The Dodd-Frank Act

Biggest Points of Contention

Title II

Republicans have railed against Title II and the Orderly Liquidation Authority from the beginning. The Republican position has been that SIFI failures should be handled under a new chapter of the Bankruptcy Code.

"Systemically Important" Designation

The ability of FSOC to designate certain non-bank institutions as systemically important, including insurance companies and clearing organizations will likely be repealed.

The CFPB

As discussed elsewhere, the CFPB will likely be dismantled entirely or rebranded with its authority thoroughly diminished.

UDAAP

One of the biggest wins for consumer protection was the creation of the UDAAP designation – unfair, deceptive, or abusive acts and practices in financial products and services violate the law. However, the designation is far-reaching and occasionally difficult to quantify. Republicans have railed against it.

Volcker Rule

The Volcker Rule, which prohibits banks from making certain speculative investments with their own accounts, among other restrictions, has been termed "job killing" by Republicans in Congress and will likely be repealed.

Fintech

- A Trump presidency is likely to have fewer proposed regulations. To wit, he has called for a temporary moratorium on new agency regulations, which likely means the current push for fintech-specific actions at both a legislative and regulatory level will slow or stop.
  - This includes Rep. McHenry's Financial Services Innovation Act of 2016 and the OCC's potential limited purpose fintech charter
- Brexit may offer a lesson in fintech. Post-Brexit, investment in UK fintech slowed significantly, despite a very fintech-friendly government. Investment in US fintech will likely slow, as well, due mostly to uncertainty. The industry did not really plan for a Trump presidency and his policy positions are unclear, at both micro and macro levels.
- Trump's one consistent position throughout his campaign was the need to scale back immigration, which could hurt the fintech industry – recent studies have found the majority of successful US startups are founded by immigrants.

Reinstating Glass-Steagall

A rare point of agreement

- While the Democratic platform and the Republican platform are starkly contrasting, one thing they both agree on is the reinstatement of some version of the Glass-Steagall Act.
- The Glass-Steagall Act was passed in 1933 and prohibited commercial banks from engaging in the investment business. It was repealed in 1999 with bipartisan support.
- Many Americans and elected officials blame the Great Recession on the repeal of Glass-Steagall, though there is not clear indication it would have changed the outcome.
- Progressive Democrats and populist Republicans have called for the creation of a modern Glass-Steagall Act.
  - Though there is bipartisan support for the idea, it seems unlikely the parties will agree on how to execute it.

Brexit and Donald Trump

The combined impact of major upsets

- Both seemingly impossible scenarios came to pass: Great Britain voted to leave the European Union and the United States elected Donald Trump.
- Many financial firms have debated whether they need to leave London in order to fully participate in the European market (if Brexit causes them to lose “passporting” rights, many will move or “rebalance” their firms to have a larger footprint on the continent).
- If Donald Trump follows through on his immigration reform and trade protection promises, it would almost certainly adversely affect global financial markets (as the IMF discussed at length in its October World Economic Outlook).

SIFI Designations

A potential boon to the "smaller" big banks

- Congressional Republicans have been calling for the $50 billion threshold for designation as a SIFI and the resulting increased capital and regulatory requirements, especially the requirement to draft living wills, to be increased. Republicans have called for a $500 billion threshold, but it is more likely to end up between $125 billion and $250 billion.
- Increasing the asset requirement for SIFI designation means lightening restrictions on those under the threshold, especially on M&A activity.

Key Lawmakers, THE BIG 4 + Warren

- Rep. Jeb Hensarling

- Rep. Maxine Waters

- Sen. Mike Crapo

- Sen. Sherrod Brown

- Sen. Elizabeth Warren

Elizabeth Warren

The voice of Progressives

- Sen. Warren made her name fighting for the creation of the CFPB.
- Her tenure in the Senate has made her a star for Progressive Democrats, especially in taking on Wall Street.
- With Donald Trump's election, we can expect her star to rise.
- Democrats may take Clinton's loss as a sign they should embrace the far left as exemplified by Warren and Sanders.
- Warren's call that "banking should be boring" and vilification of Wall Street firms and people has brought her the adulation of Progressives, especially young people.
- Her opinion of potential nominees for administrative agency, court, and cabinet positions will likely be viewed as gospel by the Democrats. (Conversely, her disapproval will likely be a badge of honor for some Republican nominees/ appointees).

Q&A Discussion

Richard A. Schaberg

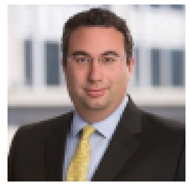
Head of Financial Institutions Sector, Americas

Richard Schaberg, head of the U.S. Financial Institutions Practice Group, is a recognized "go to" trusted advisor to financial institutions for all facets of corporate, securities, mergers and acquisitions (M&A) , capital offerings, and complex bank regulatory matters.

For over 30 years, Richard has played a lead role for financial institution clients in debt and equity offerings, M&A, corporate governance matters, proxy contests, securities law compliance, and exchange listing standards. He uniquely combines deep corporate transactional experience with an acute and seasoned knowledge of bank regulatory issues, providing valued business solutions for his regulated bank clients.

Richard practices before the Securities Exchange Commission (SEC), all federal banking agencies — including the OCC, Federal Reserve, FDIC, and NCUA — and most state banking agencies.

Aaron Cutler



Financial Services Legislative Partner

With the experience he gained as a senior House staffer, Aaron Cutler contributes high-level knowledge of policy and regulatory matters to his practice at Hogan Lovells. Now a partner in our Legislative Practice Group, he lobbies Congress in energy and natural resources; banking and financial services; and technology, media, telecom sectors. He provides strategic advice to CEOs and executive managers on transactions and risks related to those transactions, and monitors companies and investment funds.

For several years before joining Hogan Lovells, Aaron served as senior advisor for Policy and Outreach for House Majority Leader Eric Cantor (R-VA). In this role, he was the Leader's direct liaison to the House Committees on Financial Services, Natural Resources, and Energy and Commerce, and helped shepherd more than 100 bills on the floor. He coordinated legislative strategy with Chairmen, members and their staff, and other Leadership and Committee offices, and led outreach efforts to the business and finance community.

Michael Thomas

Financial Services Partner,

As a partner in our financial services team, Michael Thomas has spent his career advising all types of financial institutions on a wide range of matters. The core of Michael's practice is the provision of financial services regulatory advice. Michael advises firms on how financial services regulation will apply to them from their initial set-up, to their on-going business, and in relation to key events such as corporate transactions or outsourcing arrangements. In addition to regulatory advice, Michael advises financial institutions on commercial transactions, such as major outsourcing arrangements and distribution deals. Michael was a key member of the team awarded 'Outsourcing Advisor of the Year', for advising on most of the key outsourcings in the asset management, insurance and life and pensions sectors, at the National Outsourcing Association Awards 2011.

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