

MEMO# 30748

June 20, 2017

Treasury Department Issues First Report in a Series on Financial Regulatory Reform

[30748]

June 20, 2017 TO: ICI Members

Bank-Affiliated Member Advisory Committee

SEC Rules Committee RE: Treasury Department Issues First Report in a Series on Financial Regulatory Reform

The Treasury Department recently issued a report entitled *A Financial System That Creates Economic Opportunities: Banks and Credit Unions* (“Banking Report”).^[1] This is the first of four reports in response to Executive Order 13772, which identifies several high-level principles intended to guide financial regulation by the Trump Administration.^[2] This memorandum briefly explains the context in which the Banking Report was issued and summarizes its recommendations.

Background

On February 3, 2017, President Trump issued Executive Order 13772, Core Principles for Regulating the United States Financial System. The Core Principles call for financial regulation that, among other things, “empower[s] Americans to make independent financial decisions and informed choices in the marketplace, save for retirement and build individual wealth” and is “efficient, effective and appropriately tailored.” The executive order directs the Treasury Secretary to report to the President within 120 days, and periodically thereafter, on (i) the extent to which existing laws, regulations and guidance promote the Core Principles, (ii) what actions are being taken to support the Core Principles, and (iii) the laws, regulations and guidance that inhibit regulation in accordance with the Core Principles.

Citing “the breadth of the financial system and the unique regulatory regime governing each segment,” the Banking Report indicates that the Treasury Department plans to divide its review among four reports:

- The Banking Report
- A report on the capital markets: debt, equity, commodities and derivatives markets, central clearing and other operational functions
- A report on the asset management and insurance industries, and retail and

institutional investment products and vehicles

- A report on other non-bank financial institutions, financial technology and financial innovation

According to recent remarks by a senior official, Treasury is hoping to issue the capital markets report and the asset management/insurance report in early September.

Two additional reports from the Treasury Secretary also are expected this fall. One report will address the processes by which the Financial Stability Oversight Council designates a nonbank financial company or financial market utility as systemically important and make recommendations for how these processes could be improved by regulation or legislation.^[3] The second report will address the orderly liquidation authority provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act and consider, among other things, whether amending the Bankruptcy Code would be a “superior method” of resolution for failing financial companies.^[4] Accordingly, the Banking Report does not cover the FSOC designation processes or the Dodd-Frank Act orderly liquidation authority.

Banking Report: Summary of Recommendations

The Banking Report explains that “Treasury’s review of the regulatory framework for the depository sector has identified significant areas for reform in order to conform to the Core Principles.” It asserts that aligning regulation with the Core Principles is essential to “breaking the cycle of low economic growth” and that “two of the most fundamental requirements for economic expansion are the presence of liquid and robust financial markets and the availability of credit.” The Banking Report observes, among other things, that “[t]he cumulative effect of a number of bank regulations implementing Dodd-Frank may be limiting market liquidity.” It states that Treasury’s review “has identified a wide range of changes that 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.”

Appendix B to the Banking Report provides a complete listing of Treasury’s recommendations. For each recommendation, the report provides a preliminary assessment as to who has “policy responsibility”—Congress and/or one or more regulators—and indicates the Core Principle(s) to which it relates. Below, we briefly summarize the areas likely to be of interest to the regulated fund industry.

Reduce regulatory fragmentation, overlap and duplication. In particular:

- Broaden FSOC’s mandate so that FSOC can assign a lead or primary regulator on issues where agencies have conflicting or overlapping jurisdiction
- Reform FSOC to further facilitate information sharing and coordination among member agencies
- Make the Office of Financial Research a part of the Treasury Department, and improve the effectiveness and accountability of the OFR

Enhance the use of regulatory cost-benefit analysis

Improve coordination among federal and state financial regulatory agencies with regard to cybersecurity

Improve the Volcker Rule. In particular:

- Exempt smaller institutions from the Volcker Rule

- Simplify the definition of “proprietary trading” by eliminating the 60-day rebuttable presumption
- Allow banks additional flexibility to engage in permissible market making activity
- Simplify the “covered fund” restrictions by, for example, extending the permissible seeding period from one year to three years and excluding from the definition of “banking entity” any foreign fund owned or controlled by a foreign affiliate of a US bank or a foreign bank with US operations

Address the US involvement in international standard setting processes (e.g., Basel Committee, IOSCO). In particular:

- Seek to narrow the scope of initiatives by international standard setting bodies (“SSBs”) by streamlining SSB mandates and eliminating overlapping objectives
- Increase transparency and accountability so that the views of external stakeholders are appropriately considered
- Advocate for international standards that are in line with domestic financial regulatory objectives

The Banking Report proposes several reforms relating to capital and liquidity requirements for banks. It contains other recommendations relating to community banks, federal-insured credit unions, foreign banking organizations, living will requirements and various forms of lending (e.g., residential mortgages, small business). The Banking Report also calls for considerable reforms to the structure and mandate of the Consumer Financial Protection Bureau.

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endnotes

[1] The report is available at <https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf>.

[2] The executive order is available at <https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-executive-order-core-principles-regulating-united-states>.

[3] Presidential Memorandum for the Secretary of the Treasury regarding the Financial Stability Oversight Council (April 21, 2017), available at <https://www.whitehouse.gov/the-press-office/2017/04/21/presidential-memorandum-secretary-treasury>. The memorandum calls upon the Treasury Secretary to refrain from voting for any non-emergency proposed designation during the pendency of this review.

[4] Presidential Memorandum for the Secretary of the Treasury regarding Orderly Liquidation Authority (April 21, 2017), available at <https://www.whitehouse.gov/the-press-office/2017/04/21/presidential-memorandum-secretary-treasury-0>. The memorandum calls upon the Treasury Secretary to refrain from approving the use of the orderly liquidation authority during the pendency of this review,

unless the Secretary (in consultation with the President) determine that the use of such authority is warranted.

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