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The Trump Administration's Impact on Financial Regulation and the SEC

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With the incoming Trump transition team hard at work in evaluating possible cabinet picks, executive agency heads, and other political appointments, one area that has not been the focal point of Donald Trump's campaign but nevertheless faces a likely sea change is financial services regulation. The starting point for realignment at the U.S. Securities and Exchange Commission will be the appointment of a new SEC chair. As a sign of things to come, immediately after the SEC held its first ever conference on the rise of fintech innovations, Chair Mary Jo White officially announced her resignation in January 2017. While this was certainly expected, it marks the first of many departures to come: also, there are two existing vacancies at the SEC (not counting White), two vacancies on the Federal Reserve Board (Federal Reserve Chair Janet Yellen's term expires in February 2018), and two vacancies at the Commodity Futures Trading Commission. In addition, the Trump administration will appoint new heads at the Office of the Comptroller of the Currency and Federal Deposit Insurance Corp. in 2017. The appointment of financial markets regulators is one of the principal means by which the president affects regulation of financial markets.

Dodd-Frank Act

Trump's transition team wasted no time in expressing its views regarding the course of financial regulation when it issued a position statement on its website that it was crafting a plan to "dismantle the Dodd-Frank Act."[1] Trump will likely look to a bill authored by House Financial Services Chairman Jeb Hensarling (referred to as the "CHOICE Act") as a guide to dismantling or replacing what congressional Republicans consider to be some of the more onerous provisions of the Dodd-Frank Act, including the power to unwind banks and the restrictions on proprietary trading and certain investments imposed on banks by the Volcker Rule. Trump may also draw guidance from a separate financial reform blueprint released by House Speaker Paul Ryan in June 2016.[2] The CHOICE Act, which was reported by the House Financial Services Committee in September, provides for the following notable changes, among others:

- Regulatory relief for any banking organization with at least a 10 percent capital leverage ratio and a 1 or 2 supervision rating;
- Repeal of the authority of the Financial Stability Oversight Council to designate nonbanking institutions as "systemically important financial institutions";

- Repeal of the Orderly Liquidation Authority established by Title II of the Dodd-Frank Act and its replacement with a new bank holding company bankruptcy regime designed to end taxpayer bailouts and the "too-big-to-fail" problem;
- Reconstitution of the Consumer Financial Protection Bureau as a bipartisan commission that is subject it to congressional appropriations;
- Repeal of the Volcker Rule, which has been targeted for impeding capital formation; and
- Repeal of rules unrelated to the SEC's core mission, such as the conflict minerals and resource extraction rules.

In addition, it is expected that a rule requiring public companies to disclose the pay ratio between their CEOs and median compensation of all employees will be repealed. In particular, Hensarling has expressed concerns about the FSOC and its process for designating nonbanking institutions as systemically important: "I do not believe that FSOC is adding value to our economy."[3] At a minimum, the Trump administration likely will increase the $50 billion dollar threshold that subjects banks to closer supervision by the Federal Reserve and enhanced prudential requirements. Trump's advisers have expressed particular concern regarding the negative impact that Dodd-Frank has had on smaller, community banks and credit unions — in particular the regulatory costs associated with compliance.[4] In addition, the CHOICE Act would create an exemption for banks from enhanced prudential regulation if the banks can maintain a capital reserve equal to at least 10 percent of its total assets (capital leverage ratio requirement) and obtain high supervisory ratings from its regulators.

The proposed legislation would transform the CFPB into a bipartisan, five-member commission that is subject to the annual congressional appropriations process.[5] Also, under consideration is a bill that would exempt banks and credit unions with less than $50 billion in assets from CFPB jurisdiction; currently, the limit is $10 billion. It does not seem likely, with the ability of the Democrats led by Sen. Elizabeth Warren in the Senate to filibuster any such attempts, that the CFPB will be completely eliminated. While it appears clear that a Trump administration will promote a more business-friendly regulatory environment for asset managers, insurance companies, consumer lenders, and other financial firms, the outright repeal of Dodd-Frank in its entirety seems unlikely as there are enough Democrats in the Senate to filibuster any massive reform. Rather, we are more likely to see targeted amendments to Dodd-Frank. Of note, and rather ironically, while Trump has stopped short of suggesting that the big banks should be broken up as "too big to fail," he has, at times, embraced the idea of reinstating the division between commercial and investment banking that was rooted in the Glass-Steagall Act.[6] Sens. Bernie Sanders and Warren share this view, making them strange bedfellows with Trump.

The House speaker's "Better Way" blueprint[7] contains other securities and financial regulation recommendations, including the following:

- Ensure the SEC focuses on capital formation and small business;
- Ensure the securities laws facilitate early-stage investment in startup enterprises;
- Reform crowdfunding rules;
- Add due process protections for respondents in SEC actions and limit the use of the SEC administrative forum;
- Curtail or eliminate the U.S. Department of Labor's "fiduciary rule."

The spending bill (H.R. 5485) that passed the House of Representatives in July 2016 includes additional provisions that suggest areas the new SEC likely will not pursue. This bill, in addition to prohibiting the SEC from developing a political spending disclosure rule, would have disallowed new rules on climate change or authorizing universal ballots as well as, consistent with the CHOICE Act, prevented enforcement of the conflict minerals rule and the pay ratio rule. Other recommendations, many of which have been suggested by the business community (including industry groups), whose views are likely to be aligned with a Trump administration, include the SEC:

- Issuing supplemental guidance to ensure that the SEC, the Financial Accounting Standards Board, and the Public Company Accounting Oversight Board use a common definition of materiality;
- Reviewing the disclosure effectiveness review to ensure that it's premised on materiality;
- Rethinking the SEC's reward program for whistleblowers, including whether they should first inform management before alerting the SEC to possible misconduct;
- Requiring more oversight over proxy advisory firms;
- Reforming Rule 14a-8 and the shareholder proposal process; and
- Curtailing its use of administrative actions, which has attracted criticism from the industry given that this process lacks some of the due process protections of an Article III court and the view held by some that SEC administrative law judges are biased in favor of the SEC.

SEC Chair

A few names have been mentioned with regard to Trump's selection for the position of SEC chair. It appears, at the top of the list, is former SEC commissioner Paul Atkins, who is part of Trump's transition team and is advising him on current vacancies and policy decisions involving Atkins' former agency. Atkins served as an SEC commissioner under former President George W. Bush, leaving the agency in 2008, and is now the chief executive of a financial and regulatory consulting firm. Trump's appointment of Atkins to help manage the Trump team's transition efforts suggests that either he is the top contender for the position of SEC chair or will be instrumental in helping Trump select the next chair.

Atkins has been a vigorous critic of the Dodd-Frank Act, from the burden that rulemaking under the act has placed on financial institutions to the expansion of the SEC's whistleblower program under the act. Atkins also has been an outspoken critic of larger corporate penalties assessed against companies that agree to settle charges; he contends that such penalties only punish shareholders who have already been victimized by a company's fraud. Instead he has at times argued for individual accountability.

Only three of the five commissioners seats are currently occupied, and with Chair White leaving in January, the Trump administration will nominate individuals to three posts. In October 2015, President Barack Obama nominated Lisa Fairfax, a law professor at the George Washington University Law School and a Democrat, and Hester Peirce, a senior research fellow at the Mercatus Center and a Republican, to fill those seats. However, their confirmations were held up by Democrats on the Senate Banking Committee, with Sens. Warren and Charles Schumer leading the charge, on account of the nominees' refusal to take a firm position on requiring corporations to disclose their political spending. Peirce is likely to be renominated, given her strong opposition to Dodd-Frank, and her close ties with Atkins, for whom she served as a counselor when he was an SEC commissioner.

White's final acts as SEC chair may include several rules governing mutual fund advisers and investment advisers: (1) a proposed rule requiring mutual funds electronically to report new monthly data to the SEC, including information regarding their separately managed accounts; and (2) a proposed rule that would limit derivatives investment by mutual funds. Other standard-setting projects that may be completed before White's departure could include rules governing security-based swaps and disclosure of incentive-based compensation plans.

Enforcement

Shortly after White became the SEC chair in April 2013, she instructed the enforcement division to adopt a so-called "broken-windows" approach of pursuing even the smallest violations, modeled on a theory of community policing in which authorities target small problems in an effort to deter crime. Since then, the SEC has brought a multitude of cases targeting areas where it believes there are widespread violations of the rules, such as violations of the short-selling rules or the rules requiring insider reporting of their transactions in company stock. The cases are typically settled for relatively small amounts. As a result, the SEC's strategy has helped the agency steadily increase the number of enforcement cases each year during White's tenure, albeit the sanctions amounts have stayed somewhat flat. The upward trend in the number of enforcement actions is considered by many within and outside of the agency as a somewhat misleading measure of the agency's success, but SEC leaders routinely cite it as empirical support in their lobbying of Congress for additional funding.

In light of some of Atkins' statements, the enforcement posture and philosophy of the SEC will likely change course under a Trump administration and focus on more bread-and-butter securities actions, e.g., insider trading, accounting fraud and financial fraud. It is also possible that, consistent with statements by Atkins, the SEC will place a greater focus on individual misconduct, though that remains to be seen. The question is also raised as to who will be the new head of the SEC's enforcement division, an appointment made by the SEC chair. It would be premature to suggest that an SEC under Trump would be weak in enforcement against large financial institutions given Trump's populist bent during the campaign. Nevertheless, we can expect a general slowing down in the rulemaking and enforcement areas — areas that have seen a big upsurge during White's tenure.

Two other significant issues that have been before White during her tenure involve admissions of wrongdoing and waivers of statutory or regulatory disqualifications arising from violation of the securities laws. While neither Trump nor the transition team has expressed its position on these issues, it is likely that, under the next commission, admissions of wrongdoing will not increase and waivers of disqualification will remain steady or increase.

Audit Regulation and the PCAOB

Most commentators believe that the chairman of the Public Company Accounting Oversight Board, Jim Doty, whose term expired in October 2015, will not be re-appointed by the incoming SEC chair. Atkins has been a fierce critic of the PCAOB since its inception on matters ranging from the board's budget and outsized salaries to some of its more controversial standard-setting projects, such as auditor rotation. Doty's tenure has been fraught with political and internal infighting and tensions with the SEC's Office of Chief Accountant. In the last three years, the PCAOB has finalized only three standard-setting rules — one relating to the reorganization of its standards. The SEC, which must approve all PCAOB standards, has been critical of the PCAOB's standard-setting agenda; a PCAOB under the Trump administration is likely to focus on core auditing areas, rather than disclosure standards. In this regard, given the current environment and the likelihood of a new PCAOB chairperson, it seems unlikely that the reproposed auditing standards on the auditor's report[8] will be finalized before Trump takes office or even soon thereafter.

While the PCAOB has had success in reaching agreements with foreign counterparts providing for cross-border inspections, an agreement with the Chinese regulators has remained elusive. In the most recent year, the PCAOB board has remained largely silent on its progress, or lack thereof, with the Chinese regulators on an agreement that would allow PCAOB inspectors to examine the work papers of Chinese companies listed in the United States and audited by PCAOB-registered firms. To date, the PCAOB has chosen not to bring enforcement actions, in part due to political pressure and the negative consequences associated with a declining initial public offering market in the United States. Atkins, who testified against the SEC in its action against the Big Four firms in China that ultimately resulted in a settlement, is unlikely to be sympathetic.

Conclusion

In sum, the financial services regulatory landscape is undoubtedly in store for sweeping changes — the extent of which will be determined in the coming weeks and months as President-elect Trump makes his cabinet selections as well as choices for agency heads at the SEC and other financial regulators.

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Notes

[1] See "Donald Trump's Transition Team: 'We Will 'Dismantle Dodd-Frank,' Wall Street Journal", Nov. 10, 2016.

[2] A Better Way: Our Vision for a Confident America — The Economy, http://abetterway.speaker.gov/; http://abetterway.speaker.gov/?page=economy.

[3] See Fiduciary Rule Under Fire, Wall Street Journal, Nov. 17, 2016.

[4] See Is Trump the Community Banking Candidate? American Banker, July 20, 2016; This Congressman Could Turn the Dodd-Frank Financial Reform Upside Down, Fortune.com, Nov. 15, 2016.

[5] On Oct. 11, the U.S. Court of Appeals for the D.C. Circuit issued a ruling that changed the CFPB director's status, allowing the director to be removed by the president "at will" rather than "for cause." PHH Corp. v. Consumer Financial Protection Bureau, 15-1177, U.S. Court of Appeals, District of Columbia Circuit (Washington, DC).

[6] The Glass-Steagall Act was repealed during the Bill Clinton administration.

[7] See A Better Way: Our Vision for a Confident America — The Economy, June 14, 2016.

[8] See Proposed Auditing Standards on the Auditor's Report and the Auditor's Responsibilities Regarding Other Information and Related Amendments https://pcaobus.org/Rulemaking/Pages/Docket034.aspx