Insight

A Proposed Financial Regulation Agenda for President Trump

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A Donald Trump presidency brings with it a lot of uncertainty. However, with Republicans controlling the House and Senate it's likely that many of the post-financial crisis policy changes, especially those to come out of Dodd-Frank, will be upended. Which ones and to what extent are anyone's guess, but if President Trump's goal were to eliminate those regulatory or legislative provisions that were the costliest and most burdensome, the following items are most worthy of revisiting:

Nix the Fiduciary Rule

One of the "legacy" rules of the Obama administration, the fiduciary rule is a poorly-constructed, overbearing regulation that will end up doing more harm than good, especially for investors and retirement savers with smaller account balances. It is also the most expensive regulation of 2016. A best interest standard of conduct for investment advisors is a perfectly fine idea that future administrations should consider, but the current fiduciary rule, as written, is wholly unacceptable – not to mention the fact that it is estimated to cost $31.5 billion initially, $2 billion annually, and result in 56,833 paperwork burden hours. The rule was finalized in April 2016, but won't go into effect until April 2017, leaving the Trump administration and/or Congress with a few months to either repeal it completely or stall its implementation until the new Department of Labor can amend it to make it less harmful and more workable.

Don't Reinstate Glass-Steagall

One moment of unity in the 2016 campaign came when both Hillary Clinton's and Donald Trump's campaign platforms called for reinstating Glass-Steagall, the Depression-era law meant to break up banks by forcing them to separate out their commercial and investment banking activities. It was bad policy then, and it would be horrible policy now. By way of background, recall that both parties have said that the repeal of Glass-Steagall in 1999 – and the resulting comingling of commercial and investment banking activities – caused the most recent financial crisis; hence their desire to do a policy u-turn. That is simply not the case. In fact, the financial crisis wasn't caused at all by the combined activities at banks. As Treasury Secretary Tim Geithner said, "[M]ost of the losses that were material…came overwhelmingly from what I think you can describe as classic extensions of credit." This is the easiest item on the list as it requires exactly no action. Just leave Glass-Steagall (and the ideology therein) alone.

Glass-Steagall came before both the Congressional Budget Office (CBO) and the Paperwork Reduction Act (PRA), so there's no bright line agreement on what reinstating it might cost. However, the Gramm Leach Bliley Act, which repealed Glass-Steagall was scored by the CBO which estimated that implementation of the Act's requirements would save the federal government $31 million in its first year and $146 million over the next four years. Similarly, many of the nation's largest banks that provide both commercial and investment banking services to their customers, estimate that the repeal of Glass-Steagall has saved them billions of dollars each year by being able to cross-sell products and share costs and employees. Just last year, JPMorgan reported that cross-selling products across banking and wealth management sectors accounts for $15 billion, or more than 15 percent of the bank's annual revenue.

Fully Repeal the Volcker Rule

Not all that unlike Glass-Steagall, the Volcker Rule – a product of Dodd-Frank – prohibits banks from engaging in proprietary trading and subjects those banks that do trade to enhanced prudential monitoring by the Fed. It also limits banks' ownership of hedge and private equity funds. As Rep. Jeb Hensarling, Chairman of the House Committee on Financial Services, said, it's "a solution in search of a problem." Authors of the rule claim that the activities it prohibits are overly speculative and ultimately caused the financial crisis. That's simply untrue. In fact, the Volcker Rule may be causing the exact harm it is seeking to prevent.

At over 1000 pages, resulting in 2,392,440 paperwork hours, and costing $4.3 billion, the Volcker Rule is burdensome on its face. But the real issues lie in the consequences of its enforcement. As banks are forced to shed their market-making operations, consumers lose their ability to trade quickly and at a steady price. Further, with Dodd-Frank's other heightened capital requirements, they're not taking up any excess space holding inventories of assets awaiting a buyer. JPMorgan carried $2.7 trillion in corporate bonds in 2007. By the end of 2015 that number was down to $1.7 trillion and falling. That lack of liquidity hurts consumers directly, as their options for financial products and services are limited, and indirectly, as less liquid U.S. banks lose competitiveness – Europe and the rest of the world are not restricted by bans on proprietary trading, etc. The Trump administration would be wise on a number of levels to do away with this costly, and futile, rule.

Do Something about the CFPB

The Bureau of Consumer Financial Protection (CFPB) is a contender for the absolute worst thing to come out of Dodd-Frank. Not only does it hastily write rules that have imposed billions of dollars in costs and tens of millions of paperwork burden hours on companies, but its organizational structure was just ruled unconstitutional by a federal court. In short, the U.S. Court of Appeals for the D.C. Circuit, decided that CFPB's single director, who isn't answerable to the president or subject to congressional appropriations, yields too much autonomous power as head of an independent agency and ordered a restructuring. By most accounts, CFPB will move to a commission structure similar to the SEC (which is what the original Dodd-Frank language called for anyway). A more effective restructuring would be to make the CFPB subject to congressional appropriations. If the CFPB retains its single director, even if he becomes answerable to the president, that still leaves the agency with unconditional funding each year. In order to truly ensure that the CFPB does not continue to unconstitutionally burden American companies, the Director should have to report to Congress each year, and Congress should be able to decide how much funding, if any at all, the Bureau will get the following year. (Alternatively the Trump administration could just get rid of the CFPB entirely as most of its functions are already carried out by other agencies anyway.)

Not only that, since its formation in 2011, the CFPB has finalized 28 rules totaling 16,994,580 paperwork burden hours and costing $2.8 billion. It has also levied, at the whim of its independent director, well over $8 billion in fines on companies and financial institutions, many of which were given via administrative consent order which prevents the company from appealing.

Get Rid of FSOC

Another contender for the absolute worst thing to come out of Dodd-Frank is the Financial Stability Oversight Council (FSOC). Most recently FSOC has found itself in an expensive and lengthy legal dispute with MetLife in which one federal court has already ruled that FSOC's decision-making process is "arbitrary and capricious" and failed to properly measure the costs against the benefits of its designations. In its short, six-year life, FSOC has designated four companies as being systemically important financial institutions (SIFIs), subjecting them to enhanced oversight and regulation along with billions of dollars of heightened regulatory and compliance costs as a result. The SIFI designation forced General Electric Capital Corporation (GE) to sell off nearly $200 billion of its assets, thereby resulting in a rescission of its designation. Since the Secretary of the Treasury is the head of FSOC and since the Secretary of the Treasury will be appointed directly by President-Elect Trump, the Trump administration could easily put FSOC to rest with the right Treasury Secretary.

Had FSOC conducted a cost benefit analysis as the court suggested it should have, it would have found the costs of designation to be immense. Immediately following the court's decision in favor of MetLife, rescinding FSOC's designation, MetLife's publicly-traded shares climbed 5 percent, adding $2.3 billion to its market capitalization, thereby suggesting that the market values a SIFI designation (or lack thereof) at least $2.3 billion.

Put Ex-Im Back to Work

The Export-Import Bank (Ex-Im) has long been an asset to American companies wishing to do business overseas. Unfortunately, in June of 2015, Congress let Ex-Im's authorization expire leaving it unable to operate at all. In December of 2015, Congress reauthorized Ex-Im, but failed to bring up for confirmation any of the appointees to Ex-Im's board. And without a quorum on the board, Ex-Im is only able to authorize loans under $10 million – a drop in the bucket for most of the deals on which American companies seek Ex-Im assistance. In fact, since Ex-Im was either fully shut down or not fully operational, over 4000 loans have gone unauthorized totaling nearly $25 billion, most of which, by law, would have gone to small businesses. The Trump administration must ensure either that one more board member is confirmed by the Senate, or that Ex-Im rules are modified to allow it to fully perform its duties even without a quorum on the board. If no action is taken, American companies will continue to lose out, and that's no way to make American great again.

Do Away with the Conflict Minerals Rule

If a rule about minerals seems out of place in a paper about financial services, it's because it is – and it was out of place when the authors of Dodd-Frank stuck it in the law, too. To make matters worse, before the swap rules were finalized last year, the conflict minerals rule was the most costly both in dollars ($4.7 billion) and hours (2,225,273) to come out of Dodd-Frank. But the real cost lies in the Congo, where the rule had the greatest impact.

In 2010, seeking to comply with Dodd-Frank's provisions, Congo's government shut down the entire mining industry for six months before proposing a certification process to assure U.S. companies that the country's minerals do not come from conflict zones. The delays and politics of the process all but stalled the country's mining industry, which has resulted in a lack of demand and a sharp decline in prices. After the law was passed, nearly 99 percent of the country's mines failed to meet Dodd-Frank's standards, and a kilogram of tin, for example, went from $7 to $4 – even in the certified mines. The Congolese mining industry employs around 11 million people, most of whom now are being forced to find work elsewhere, which, more often than not, ends up being with an armed militia – the very groups this rule in Dodd-Frank aimed to curtail.

Reform Fannie Mae and Freddie Mac

The Obama administration did a lot by way of rulemaking and landmark legislation (Obamacare, Dodd-Frank) signing, but what it failed to do was make any major reforms to Fannie Mae and Freddie Mac (the GSEs), which fueled the financial crisis, remain under government conservatorship, and continue to cost the taxpayers billions of dollars. There have been calls for quick or temporary fixes such as recapitalizing the GSEs and releasing them from conservatorship, but these proposals don't do anything to fix the fundamental flaws in the GSEs' business model. Not to mention the fact that they can't compete as genuinely private enterprises. Further, the idea of recapitalizing the GSEs is just an introduction of artificial accounting and asset swaps. Since the taxpayer owns the Treasury and the GSEs, how the money gets divided between the two changes nothing.

With no reform, the GSEs will continue to cost taxpayers billions – even without the need for a bailout. Their operating expenses have increased by 36 percent since 2012. By June of this year, Fannie Mae's new headquarter was already $36 million over budget.

If Fannie and Freddie are to be truly fixed in such a way as to prevent their involvement in a future financial crisis, it's not going to be a quick fix, and it certainly won't be a temporary one. Congress, and the Federal Housing Finance Agency (FHFA) (the GSEs overseer) need to make thoughtful meaningful reforms to the structure and functions of the GSEs. They must not confuse goals of affordable housing with burden to taxpayers. If an administration is truly concerned about financial stability and entities that are too big to fail, it would be well-served to look at the GSEs first.

Conclusion

Even if President Trump only loosely follows this list, and works with Congress to achieve necessary legislative changes, he will be off to a good start. He will save taxpayers nearly $50 billion; he will put over $25 billion in export credit back to work; and he will allow companies to continue to run efficiently, saving the largest companies billions each year and allowing them not only to boost their revenues through more efficient operations, but also to boost their market value from a more favorable regulatory environment.