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Comment: 13 Regulatory Reform Predictions for '13

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Last year we offered our 12 Regulatory predictions for '12 with a number of hits and a few misses. We accurately predicted an increase in court challenges to regulatory reform but were wrong in our view that the Consumer Financial Protection Bureau would remain directorless. So with the clear warning that all crystal balls are slightly cloudy, here are our predictions of 13 key regulatory issues for 2013.

1 New top regulators but few policy shifts

The aftermath of a presidential election typically brings major turnover at regulatory agencies, and this time will be no different. None of the replacements on the senior financial regulatory team in the second Obama administration will likely have policy priorities that differ much from their predecessors. Securities and Exchange Commission (SEC) chairman Mary Schapiro stepped down from her position last month and was immediately replaced by her close colleague, Elisse Walter. Commodity Futures Trading Commission chairman Gary Gensler has completed his term but may serve in his position until December 2013. Any successor to Secretary Geithner, who is expected to leave this month, is unlikely to plough new ground and indeed may be less focused on financial regulation in general.

2 Regulators adopt final Volcker rule regulations…

In October 2011 regulators released a complex and controversial 298-page proposal to implement the statutory "Volcker Rule" restrictions on proprietary trading and relationships with hedge funds and private equity funds. There has been very little public movement since, even though the statutory Volcker Rule came into effect last July. However, behind the scenes, regulator discourse has been active and fruitful. We expect the result to be a final Volcker Rule in the first half of the year, largely consistent but with the potential for different treatment of different types of entities.

3 … but extend the conformance period for at least another year

Congress included in the statutory Volcker Rule a "conformance period" for institutions to come into compliance with it. This conformance period, originally expected to be at least two years, ends in July 2014. Given the delay in final regulations, we predict that the Federal Reserve will push the end of the conformance period until at least July 2015.

4 The SEC moves on key initiatives, including security-based swap rules

The SEC will make progress on a number of regulatory reform efforts. While the CFTC has finalised rules that meet 81 per cent of its swap rulemaking requirements, the SEC has finalised 34 per cent of its security-based swap rulemaking requirements.

5 Swap market structure begins to change

The CFTC's swap rules will largely come into force in 2013. The first swap dealers have already registered with the CFTC and most of the reporting, record-keeping and other requirements will phase in over the course of the year. This, coupled with the effectiveness of mandatory clearing and (likely) trade execution requirements, will significantly change how swap instruments are priced, traded, managed and used.

6 Regulators fix problems with swap pushout rule amid repeal efforts

The controversial swap pushout rule, championed by former Senator Blanche Lincoln, prohibits insured banks from engaging in certain types of swap transactions, forcing them to move the activity to affiliates. The rule becomes effective in 2013 without the need for implementing regulations. However, since the passage of Dodd-Frank, market participants have identified a number of technical problems with the rule. In the coming year, we expect that regulators will fix these problems through guidance, while efforts to repeal the rule will continue.

7 Regulators begin to assess comparability of foreign regimes

As foreign jurisdictions implement their own regulatory reforms, US regulators will begin to assess those regimes and determine the extent to which deference is appropriate. This will begin with derivatives, where the CFTC has proposed offering "substituted compliance" to foreign swap dealers where rules are comparable. These determinations will be highly politicised and will involve immense pressure from foreign governments and regulators.

8 Market participants begin to move business offshore

The hard line that US regulators have taken in implementing reform will push financial institutions to move business offshore. Where exactly that business goes remains an important question, which will be informed by the extent to which G20 regulatory regimes converge. Regulators throughout the world will face the difficult task of promoting systemic stability while ensuring that financial business does not regionalise or move offshore, both of which could result from rules that are too rigid or overlap.

9 Federal Reserve becomes de facto supervisor of most large broker-dealers

Last month, the Federal Reserve issued a controversial proposal related to its regulatory and supervisory oversight of "foreign banking organisations" doing business in the US. The Fed's proposal would mandate the creation of intermediate holding companies for foreign banking organisations, requiring that most activities in the US, including brokerage activities, be held under an intermediate holding company and be subject to the Fed's umbrella oversight.

10 US Basel III capital rules finalised but mitigated for community banks

Basel III capital reforms in the US are behind schedule, but we expect the rules to be finalised and to take effect largely as proposed, with the possible exception of improved treatment under some aspects of the proposed rules for community banks.

11 GSE Reform Waits Another Year

Comprehensive reform of government-sponsored entities – particularly Fannie Mae and Freddie Mac – has been high on the agenda of regulatory reform advocates since the subprime mortgage crisis. This political hot potato will be passed another year, with talk but no real action.

12 Higher profile for the Consumer Financial Protection Bureau

Skirting our prediction, President Obama used a rare recess appointment a year ago to install Richard Cordray as the first head of the CFPB. While the CFPB brought a few high-profile actions last year, we believe that its profile will expand significantly this year.

13 Further court challenges to regulatory rules

As regulators finalise rules implementing Dodd-Frank's provisions, the financial industry's fight has moved from the agencies to the courtroom. In September, the DC District Court overturned the CFTC's controversial position limits rule. The CFTC has promised to appeal. In December, the same Court dismissed the industry's suit regarding amendments to commodity pool operator registration requirements. With much at stake, perhaps including the Volcker Rule, the courtroom will remain a key regulatory reform battleground.

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