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OPINION

Financial & markets regulation

Six US market regulation predictions for 2018

Davis Polk lawyers expect changes and reform to key trading rules

ANNETTE L. NAZARETH AND GABRIEL D. ROSENBERG

Now that most of the Trump-era US financial regulatory principals are in place, we predict this year will bring the beginnings of concrete changes to US trading and markets regulation.

1. Regulatory agencies to take measured approach

The adage "personnel is policy" has never been more true. Virtually all of the financial regulatory agencies are or will soon be headed by Donald Trump appointees who are firmly committed to more measured and tailored regulation. What was a significant change in the tone of the US regulators in 2017 will turn to the beginnings of concrete action. For example, the Commodity Futures Trading Commission (CFTC), led by chairman Christopher Giancarlo, will implement his Project KISS to modernise and simplify the agency's rules. At the Fed, Randal Quarles, the new vice-chair for supervision, has advocated taking a "fresh look" at regulation to make refinements that could benefit the economy and enhance transparency. The Fed's recent proposal to make annual stress tests for banks more transparent is evidence of a concrete policy shift.

2. Change will be slower

Regulators are likely to feel that actions they might have otherwise taken through guidance will need to go through the formal (and time-intensive) rulemaking requirements of the Administrative Procedures Act, including public notice and comment.

Whether this is good or bad for policy development is debatable, but what is not is that changes through formal rulemaking will take longer than changes through guidance.

3. Streamlined Volcker rule regulations

Among the most criticised Dodd-Frank trading rules are the byzantine 2013 Volcker regulations. The implementation of these rules has uncovered problems with the structure and content of the regulations, including an overly detailed compliance programme requirement and a reliance on subjective intent-based analysis. We expect that a proposed rule will reorient the regulations, simplify them and remove as much subjectivity as possible.

4. SEC to seek fiduciary standard for broker-dealers

The conventional wisdom is that Trump appointees will remove, rather than add, new regulatory requirements, but there are a few critical areas that belie this expectation. For example, Jay Clayton, chairman of the Securities and Exchange Commission, has expressed a strong commitment to tackle the fiduciary standard for brokers in 2018. The Department of Labor recently delayed until mid-2019 the implementation of key provisions of its fiduciary rule that applies to transactions with retirement account clients. The delay provides breathing room for coordination on a consistent approach by the two agencies. Look for possible complications, however, due to the arrival of two new commissioners at the SEC this year, each of whom may have very different views of the necessity and impact of moving from a suitability to a fiduciary standard for brokers.

5. More enforcement actions related to virtual currencies

We expect the explosion of public interest in the trading of virtual currencies and virtual-currency-related products to continue. US regulators spent much of the second half of 2017 actively focused on these products and the regulatory issues they raised. The SEC, CFTC and state regulators all warned the public of the potential risks of trading in these products. While agencies brought enforcement actions in instances of clear fraud or manipulation, for the most part their efforts have been focused on clarifying the scope of their authority and the application of their regulations to these activities. We believe this approach is likely to shift very quickly and sharply as the regulators pivot to an enforcement mode. Market participants, particularly those involved in offering or selling unregistered securities or who deal in these products without the necessary licences, will be much more likely to face enforcement action than in the past.

6. FSOC to play more central role

A recent report by the Treasury Department's Financial Stability Oversight Council indicated a shift in emphasis from it designating individual entities as systemically important to focusing on serving as a coordinating body to oversee industry-wide risk.

This pivot will have a significant effect on how the FSOC operates and arguably will better direct its efforts. It will also provide Treasury Secretary Steven Mnuchin, as chair of the FSOC, with a greater opportunity to co-ordinate the activities of the financial regulators who are members of the FSOC, by encouraging particular regulatory reforms and avoiding duplicative or overlapping regulatory actions.

In addition to the Volcker rule, one area this may well manifest itself is greater alignment between the Dodd-Frank derivatives rulemakings of the CFTC and the SEC. The Treasury will probably also bring a greater focus on the costs and burdens of regulation and the need for appropriately tailored regulation to the FSOC's processes.

Annette L. Nazareth and Gabriel D. Rosenberg are partners in the financial institutions group of Davis Polk & Wardwell LLP, the global law firm