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Regulatory predictions for 2015

Davis Polk lawyers believe Volcker rule will dominate first half

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A year ago we offered our regulatory predictions for 2014. We correctly predicted a busy year of financial reform implementation, as well as intensified discussions of the relationships among international regulators. Many of these themes will continue this year.

1. Volcker implementation efforts dominate . . .

Banking entities spent much of 2014 interpreting the new Volcker rule regulations and planning for its impact. In the final quarter, they turned their attention to implementation ahead of the July 21 compliance deadline. Those efforts will dominate at major banking institutions, particularly with respect to the proprietary trading provisions for which no time extension has been granted.

2. While interpretive challenges continue

Last year, we predicted that complex Volcker rule regulations would lead to many interpretive questions but market participants would find it difficult to obtain guidance from the Volcker regulators due to the logistical complexity of rule created by five regulators. Unfortunately, we were proven right. We see no easy solution to this problem in 2015.

3. Congress challenges the Federal Reserve

We expect the Fed to be a focus of greater attention, with several hearings by the Republican-controlled Congress exploring greater oversight of the Fed's monetary policy and regulatory activities. We also expect further efforts to make the NY Fed seat a presidential appointment, although in the end we expect the status quo to prevail.

4. SEC begins to address the security-based swap market

We were too optimistic last year in predicting the SEC would require registration of the first security-based swap dealers and major security-based swap participants. We believe that the prediction is ripe for this year, and that the SEC will finally make progress in regulating its portion of the overthecounter derivatives markets.

5. The CFTC refines its cross-border approach

New Commodity Futures Trading Commission Chairman Timothy Massad has demonstrated a willingness to re-explore some of the controversial decisions made by his predecessor, Gary Gensler. Nowhere is this more important than with respect to the CFTC's cross-border approach to the swaps markets, which has raised concerns among international regulators due to its overly-expansive approach. We expect the CFTC will continue to discuss swaps cross-border issues with foreign regulators and this will lead to discrete changes to the CFTC's cross-border swaps guidance to reflect increased co-ordination with Europe and other major jurisdictions.

6. Amendments are proposed to Dodd-Frank, but few become law

In December President Obama signed the "CROmnibus" spending bill, which included a significant amendment to the swaps pushout provision of Dodd-Frank. Those who believe this is the beginning of a series of material changes in the near-term to Dodd-Frank will be disappointed as political gridlock will mean that very few of the amendments on wish lists will make it through.

7. Congress attempts to pass insider trading legislation

Decades of regulatory actions and judicial decisions have made for a complex and not entirely consistent body of insider trading law. A number of cases in 2014, including December's controversial Newman case, have further muddied the waters and, in some cases, eroded prosecutors' power to pursue perceived violations. And ominously (for prosecutors), in November, Justices Scalia and Thomas even called into question the very premise of crimes like insider trading that have been developed by judges through what might be characterised as a common-law process. We expect attempts by Congress to pass insider trading legislation, although we do not expect prosecutors to get the fixes they are looking for any time soon.

8. FSOC will not designate any asset managers as SIFIs.

The Dodd-Frank Act provided the new Financial Stability Oversight Council with the ability to designate certain nonbank entities as "systemically important financial institutions" (SIFIs) and subject them to heightened prudential regulation. Over the past year, the FSOC has explored whether some — or all — of the asset management industry is systemically important. This focus will continue though we predict that neither the industry nor any asset managers will be designated.

9. But FSOC will start developing proposals to regulate shadow banking

The amorphous "shadow banking" market has received an increasing amount of attention from policy makers and regulators in recent years. The FSOC's push for SEC reform of the money market sector is a perfect example. Part of the difficulty in regulating shadow banking, however, comes from the difficulty in defining it. We expect regulators to spend a significant amount of time better understanding it and developing concrete proposals to bring it into the regulatory light.

10. Increased focus on bank culture Issues

After a number of high-profile regulatory lapses by banks, expect reflections on how to improve bank culture to be front and centre both domestically and internationally. This topic is on the front burner for the Financial Stability Board's Mark Carney and the NY Fed's Bill Dudley. The Group of Thirty is expected to release an influential paper addressing this challenging issue later this year.

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