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EU On Collision Course With Trump Over Bank Reforms

By **Mark Taylor**

Law360, London (February 17, 2017, 12:06 AM GMT) -- The European Union is at odds with the Trump administration over financial regulation, and lawyers tell Law360 a U.S. rollback of laws installed since the last financial crisis could destabilize a fragile global banking sector.

President Donald Trump's plans to dismantle the Dodd-Frank Act, which was put in place following the 2008 crisis, have already drawn disapproval from senior EU officials as their regulators prepare to lay on still more bank capital requirements. Financial lawyers in London worry about a growing transatlantic divide over how financial markets are regulated.

"Dodd-Frank is part of an ongoing, coordinated, international effort to improve financial stability, and to reduce the risk of another banking crisis," said Chris Finney, partner and head of the financial regulatory practice at Cooley LLP. "Regulators and policymakers are still trying to finish this work, and one of their greatest fears is complacency in the face of re-emerging risk."

Should Trump succeed in loosening capital requirements for Wall Street's giants, lawyers say, concerns of regulatory arbitrage, nonequivalence for global firms, and the potential for Europe's flat sector to chase riskier bets in order to make ground on their North American rivals may arise.

"Whatever any institution might think about the benefits of relaxing any elements of Dodd-Frank or other regulations, is that in recent years, particularly since the financial crash, is there has been increasing harmonization or globalization of regulatory requirements," said Mark Compton, financial regulatory partner at Mayer Brown International LLP.

The issue of clashing regulatory frameworks has arisen in the debate around the future status of British banks when the U.K. leaves the EU, and what part Britain will play in shaping global financial laws.

"A lot has been mentioned in the context of Brexit about equivalence decisions, and if you have a situation where the U.S. starts to tear up some of its regulations, particularly where they have been declared to have been equivalent with the EU's, that would suddenly call into question those equivalence decisions, which could cause tremendous problems," Compton said.

The European Commission, the European Union's executive arm, told Law360 any move to dismantle Dodd-Frank risks unbalancing global regulation and threatens financial stability achieved since the banking crisis.

The commission is studying the executive order Trump signed directing the secretary of the U.S. Department of the Treasury and other regulators to review Dodd-Frank and determine a plan for revising the 2010 law.

Senior figures within the commission believe the move could even unravel the international regulatory framework for bank standards, the nonbinding rules known as Basel III.

One aspect of Dodd-Frank expected to be binned is the Volcker Rule, which forbids proprietary trading. Trump has said he believes this rule damaged liquidity and led to an exodus of talent from the banking sector to other fields.

The restrictions have not stopped Wall Street's domination of the market. Europe's largest investment banks, Barclays PLC, Credit Suisse Group AG, Deutsche Bank AG and UBS AG, suffered huge revenue declines last year compared with 2015, while the top five U.S. names Goldman Sachs Group Inc., Morgan Stanley, JPMorgan Chase & Co., Bank of America Corp. and Citigroup Inc. all grew.

Stringent capital requirements and regulatory headwinds from fines and sanctions were blamed for the sluggish performance in Europe. The EU is introducing some relaxation to aid its sector, and is also continuing to fight the Basel III reforms, informally referred to as Basel IV, which it believes will damage its plans for a Capital Markets Union.

Despite the U.S. sector's apparent rude health, tinkering with Dodd-Frank could cause a headache for larger names and is not likely to be welcomed by Congress or the U.S. and international regulators, Finney said.

"At least from a regulator's perspective, it's also worth remembering that almost 5,000 banks failed in the 1930s as a result of proprietary trading; that the Glass-Steagall Act of 1933 was introduced to stop proprietary trading; and that research suggests that the late 1990s repeal of Glass-Steagall led — some would say directly — to the banking crisis of 2007 to 2009," he said.

Cutting a lot out of Dodd-Frank, as Trump phrased it, is "a terrifying prospect for some," Finney said. "It's also something that will have to be done carefully, if it's to be done at all."

The delicate issue of equivalence between regulatory regimes will also be under threat if the U.S. decides to pare back some of its laws. Such processes are drawn out, lawyers say, and, could add further complexity and compliance demands despite the intentions of the Trump administration to cut red tape.

More than three years were spent thrashing out an agreement that the EU's European Market Infrastructure Regulation, or EMIR, was equivalent to U.S regulation of clearinghouses by the Commodities Futures Trading Commission, an issue which is still the subject of lobbying.

"That was fundamentally necessary," Compton said. "As otherwise you would have serious problems where you had one party in the U.S, another in the EU and they have to comply with both sets of laws, which would actually be impossible."

While it is early days, Compton said moves by the U.S. to tear up its rules and the resultant political backlash by the EU could result in "a Balkanization of financial services where it would be difficult to transact across border."

“It is not an easy, binary decision that deregulation is good,” he said. “It is early days, but the larger global organizations, set up to trade globally and in line with global rules, may find possibly problems with this.”

While Trump’s intentions to spur the domestic market may appear to be a U.S.-centric issue, the further interconnected nature of global finance means ripples quickly spread across continents, said Arun Srivastava, head of the Baker McKenzie LLP financial services group in London.

“At the time of the financial crisis and aftermath, one of the underlying causes was the loans made by American banks that had no prospect of being repaid, the contagion of that spread around the world,” he said. “So it can be difficult to entirely divorce domestic developments in the U.S. from an impact on the rest of the world; the bigger picture has been a regulatory convergence.”

He said a lot of the initiatives such as the Basel rules and the work of the G-20 nations is attempting to bring a global common standard to financial regulation, and to reverse this would trigger serious instability.

“You have a position where there are conflicting rules, say there is a European party dealing with an American party, there will always be a question of what rules prevail,” he said.

To go from one set of rules to another would also not necessarily cut compliance budgets, he added.

“Firms have spent a lot of time and money complying with Dodd-Frank, and now they might have to undo that, it may cost money to deregulate,” Srivastava said. “There are lots of competing feelings. It may be counter-intuitive.”

--Additional reporting by Carmen Germaine and Evan Weinberger. Editing by Rebecca Flanagan and Brian Baresch.
