June 5, 2017

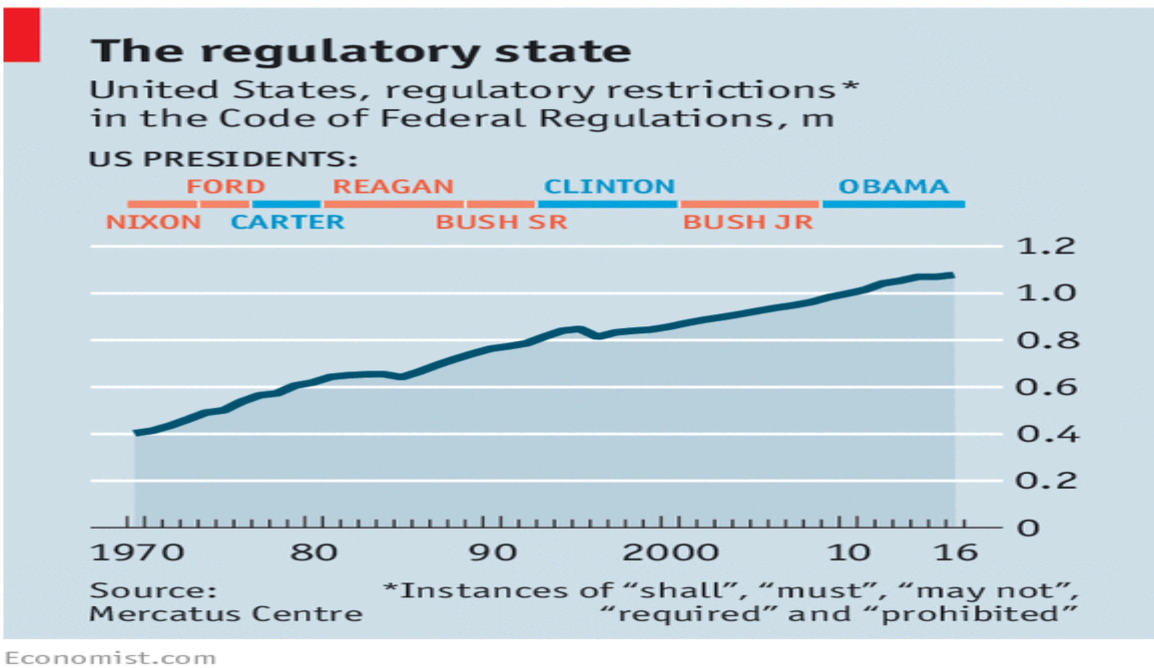
Trump's below-the-radar war on regulations

Introduction

While headlines focus on alleged collusion with Russia during the election campaign and difficulty getting major legislation passed, the Trump administration is making significant headway on the regulatory front. What makes regulatory reform a particularly juicy target is that changes can often be made without congressional approval.

To push his deregulation agenda forward, President Trump has in many cases nominated people from the private sector to lead the very regulatory agencies they spent years opposing. This is in line with what Trump strategist Steve Bannon has called the "deconstruction of the administrative state."

This report analyzes the impact of Trump's behind-the-scenes war on regulations, with a particular focus on the financial and energy sectors.



Source: "Too much federal regulation has piled up in America," The Economist, March 2, 2017

President Trump has wasted little time implementing his deregulation agenda

- On January 20 (inauguration day), he signed an executive order freezing all pending rules and regulations pending further review.
- On January 30, he mandated that all agencies eliminate two regulations for each new one created.
- On February 24, he ordered every federal agency to find costly regulations to cut. The total incremental cost of all new regulations and repealed regulations can be no greater than zero for 2017.

The courts, too, will play a vital role in advancing Trump's regulatory agenda

By getting Neil Gorsuch approved to replace Antonin Scalia, Trump has assured that the U.S. Supreme Court will continue to have a 5-to-4 conservative majority. There are rumours also that left-leaning Justice Anthony Kennedy (80 years old) might soon be retiring. This would allow Trump to stack the court with yet another conservative-leaning judge.

In addition to shaping the Supreme Court, the Trump administration is in a position to nominate many lower-court federal judges across the country. Indeed, President Trump recently announced ten judicial nominees. In all, there are about 130 positions of the sort waiting to be filled. Former President Barack Obama made over 300 such appointments during his time in office.[1] Today, the minority party in the Senate can no longer hold up judicial appointments by filibustering. This is because the Democrats changed the rules in 2013 to allow nominations to be approved with a simple majority.

From a legal perspective, the more there are conservative-leaning judges on the bench, the greater the odds that Republican rules/legislation will successfully withstand legal challenges.

Non-enforcement of existing regulations

While certain regulations must officially undergo a long review process, including holding public hearings, before they can be amended/eliminated, unofficially their effectiveness can be significantly eroded by agencies making non-enforcement their modus operandi.

How Trump's deregulation drive is impacting the financial sector

Officially, repealing or amending the Dodd-Frank Wall Street Reform and Consumer Protection Act passed by the Obama administration in response to the financial crisis is near impossible. Although Republicans hold a majority in both the House and the Senate, they fall short of the 60 votes needed to break a filibuster in the Senate. Persuading eight Democrats to join them in rolling back one of Obama's signature achievements is highly unlikely.

But making regulatory changes to Dodd-Frank does not require congressional approval. Indeed, senior policymakers at the Federal Reserve, the Office of the Comptroller of the Currency, the SEC and the Federal Deposit Insurance Corporation all have significant powers to shape and change the regulations guiding Dodd-Frank.

In February, Trump called on the various financial regulators to identify ways to lighten the burden of regulations on the financial industry. Former BlackRock executive Craig Phillips is spearheading the administration's plan for financial deregulation. An initial report recommending policy changes is expected sometime in the next few months.

Recent nominations to head financial regulatory agencies

- **Keith Noreika, a veteran financial attorney, was named temporary head of The Office of the Comptroller of the Currency.** Temporary nominations do not require Senate approval. This allows the Trump administration to continue advancing its deregulation agenda without having yet nominated a permanent leader, which does require Senate approval and could take months to complete. The Office of the Comptroller of the Currency is one of the three main regulatory agencies responsible for overseeing nationally chartered banks.
- **Jay Clayton, a former attorney who advised Goldman and other financial institutions, was recently approved as Chairman of the Securities and Exchange Commission.** He has vowed to focus on increasing the number of IPOs by reducing regulations.
- **Christopher Giancarlo is awaiting Senate approval to be appointed Head of the Commodity Futures Trading Commission.** He has been its acting chairman since President Trump was sworn in on January 20. The head of this agency has the power to overhaul trading rules, particularly for swaps. Prior to taking this position, Giancarlo had spent the past several years lobbying the commission on behalf of clients to scale back these rules.[2]
- **Randal Quarles is expected to be nominated as the Federal Reserve's Vice Chairman for Bank Supervision.** He was once a partner at the Carlyle Group private equity firm and currently runs a private investment firm called the Cynosure Group. He also served in the Treasury Department under George W. Bush. He is slated to replace Daniel Tarullo who oversaw the implementation of much stricter banking rules in the wake of the 2007 financial crisis. It is expected that Quarles will attempt to roll back certain regulations, including lowering capital reserve requirements for banks.

Capital reserve requirements fall under the jurisdiction of the Federal Reserve, which means they can be adjusted without congressional approval. Such changes need to be approved by the Federal Reserve's Board of Governors. During the next year or so, President Trump will be in a position to fill as many as five of the seven seats on the Board, including the top spot, once

[1] 'Trump names 10 nominees to federal courts on heels of Gorsuch win," Fox News, May 8, 2017
[2] "Trump Nominates J. Christopher Giancarlo as CFTC Chairman," Wall Street Journal, March 24, 2017

Janet Yellen's term expires early next year. The odds are that he will appoint people from the private sector that support a lighter regulatory touch. They will also play a major role in setting interest rates.

Sensing a change in the regulatory landscape, banks have already begun lobbying Treasury Secretary Steven Munchkin, a Goldman Sachs alumni, to roll back a new accounting rule stipulating when losses from loans must be recognized. The new loan-loss rule, which is set to go into effect in early 2019, will require firms to book projected losses as soon as loans are issued. Currently, banks do not record losses until there is clear evidence the losses will occur.

Dodd-Frank: a seemingly endless source of regulations

Proponents of deregulation point to Dodd-Frank as the poster child for why regulations should be rolled back. The act—the biggest reform to financial regulations since the 1930s—was signed into law in July 2010. **It runs some 2,300 pages (versus only 1,200 pages for the Bible).**[3] Even more surprising is the fact that 111 of its 390 "rule-making requirements" have yet to be finalized.

Not surprisingly, the act has increased compliance costs for banks. It is estimated that from 2010 to 2016, U.S. banks spent 73 million hours and $36 billion complying with Dodd-Frank.[4] The number of people working directly on controls at JPMorgan Chase, America's largest bank, surged from 24,000 in 2011 to 43,000 in 2015. That amounts to one in six employees.[5] Proponents of Dodd-Frank argue that these costs pale in comparison to the damage wreaked by the financial crisis.

While larger banks can often afford to hire armies of compliance specialists to interpret regulations, the same cannot generally be said for their smaller counterparts. There is some bipartisan support for raising the assets threshold for what is considered a "systemically important financial institution" from $50 billion to $250 billion. This would allow smaller banks to be exempted from many regulations. **Smaller banks would be the biggest beneficiaries of financial deregulation.**

Advocates for Dodd-Frank point out that the six largest banks raised their capital levels from less than 8% of total assets in 2007 to approximately 14% today.[6] They argue that while Dodd-Frank could be made more user friendly, efforts to reduce capital requirements would eventually cause many banks to become over-leveraged.

The deregulation of the energy sector

Along with rules governing the financial sector, the Trump administration has also made energy and environmental regulations a top priority for reform. Before being nominated the head of the Environmental Protection Agency (EPA), Scott Pruitt was the Attorney General of Oklahoma, where he sued the EPA more than a dozen times.

Below is a list of some of the regulatory changes and executive orders that have been applied to the energy sector:

- The EPA approved the Dakota Access and Keystone XL pipelines, although in the latter case, the pipeline still needs an additional permit from Nebraska before it can be built.

[3] "Financial Services Committee," U.S. Federal Government, 2017
[4] "The right way to redo Dodd-Frank," The Economist, February 11, 2017
[5] "A decade after the crisis, how are the world's banks doing?" The Economist, May 6, 2017
[6] "The right way to redo Dodd-frank," The Economist, February 11, 2017

- Pending further review, the EPA postponed implementation of a regulation requiring companies both to retrofit drilling equipment to prevent leaks of methane — a greenhouse gas — and to collect more data on how much of the gas is released into the air. A review process (including public consultations) must be completed before this rule can be officially amended or eliminated.
- The freeze on new coal leases on public lands has been lifted. It is important to note, however, that the main culprit behind coal's problems is the abundance of cheap natural gas—not excessive regulation.
- The Trump administration intends to repeal or revise a rule requiring companies to take extra steps to prevent groundwater contamination caused by hydraulic fracturing. It has also ordered the review of a rule that protects tributaries and wetlands under the Clean Water Act, a measure strongly opposed by farmers, real estate developers and golf course owners.
- Elimination of the requirement stipulating that, when evaluating infrastructure projects, federal agencies must take into account the level of greenhouse gas emissions that could be created.
- Elimination of a rule requiring oil, gas and mining companies to disclose payments to foreign governments.
- The review of Obama's order to permanently ban offshore drilling along the Atlantic coast and much of the waters around Alaska. Aside from the numerous legal challenges this action will provoke, it is important to note that many coastal politicians from both parties oppose offshore drilling in their districts.
- President Trump announced the intention to roll back fuel efficiency standards adopted during the Obama administration. Under these standards, cars must attain 54.4 miles per gallon by 2025, up from 35.5 mpg today. The standards are locked in through 2021, but they can still be altered for 2022 to 2025. Standing in the way of Trump's intention to lower the targets are waivers that permit California and other states to maintain their own stricter fuel standards. This means automakers will still be compelled to produce more fuel-efficient cars so long as regulations in California, the country's largest car market, remain in place. An attempt by the government to cancel these waivers could set the stage for a long court battle.
- President Trump signed an executive order instructing the EPA to review the Clean Power Plan, which mandates a 32% reduction in power plant carbon emissions by 2030 compared with 2005 levels. Implementation of the order is currently delayed pending the outcome of the legal challenge brought forth by 28 states and more than 100 companies. They argue the EPA exceeded its powers by seeking to remake the energy industry without congressional approval. The Appeals Court recently approved the Trump administration's request to put the lawsuit on hold during the review process.
- The Trump administration has announced it will withdraw from the Paris Climate Agreement, and only agree to re-enter if the U.S. is able to negotiate much better terms. Under the original deal, the Obama administration pledged to cut domestic greenhouse gas emissions 26%-28% below 2005 levels by 2025 and give $3 billion to a fund created to help poorer nations address climate change. Even if Trump had chosen to stay in the agreement, his intent to cancel the Clean Power Plan would have made it near impossible to meet this target (which is legally nonbinding). It is important to note that many congressional Republicans also strongly support this withdrawal. **The Obama administration avoided calling this deal a treaty in order to bypass the need for a two-thirds vote of approval in the Senate – a move strongly opposed by the Republicans at the time. Ironically, this permitted Trump to withdraw from the agreement without going through Congress.** In reaction to this decision, 30 mayors, three governors and more than 100 businesses are reportedly preparing to submit a pledge to abide by the Paris Climate Agreement.
- One of President Trump's main justifications for pulling out of this accord is that many other countries have much easier targets than the U.S. China is his number one case in point. In contrast to America's pledge to reduce greenhouse gas emissions by 26%-28% below 2005 levels by 2030, China only promised to cut its carbon intensity -- i.e., the amount of carbon dioxide created for each dollar of economic growth. That means China's emissions can keep increasing as the economy grows, albeit at a slower rate than the economy, until at least 2030. **China feels that as a poorer country it should not be held to the same strict standards on greenhouse gas emissions as rich countries; while the Trump administration views China as a formidable economic competitor that should not be given any special treatment.**

It is important to note that while weaker regulations could reduce operating costs significantly, the ability and/or willingness of fossil-fuel companies to ramp up oil and gas production depends much more on energy prices. However, if regulations are relaxed, the U.S. oil sector would be in a much better position to rapidly expand production should prices rise significantly.

Conclusion

While the Trump administration has been beset with difficulties in getting major legislation passed, deregulation is one area where significant progress is being made. This is largely due to the fact that many regulatory changes do not require congressional approval. As for regulations (particularly in the energy sector) that must undergo a long review process before they can be officially amended, the simple act of not vigorously enforcing existing regulations will have a significant impact.

Indeed, one can argue that when it comes to the financial and energy sectors, the vast majority of Trump's goals will be realized on the regulatory front, as opposed to getting legislation approved by the Congress.

All things being equal and notwithstanding concerns over the longer-term effects on the environment, the combined impact of less regulation in the U.S. energy and financial sectors could place certain Canadian companies at a competitive disadvantage vis-à-vis their U.S counterparts.

Finally, it should be noted that, if the Republican Party loses the presidential election in 2020, many of these executive orders and/or regulatory changes are likely to be reversed. **Indeed, the growing tendency of both the Democrats and the Republicans to govern by executive order when their side is in power as a way to overcome congressional gridlock could, if left unchecked, negatively impact America's business climate over the long term.** Companies will find it increasingly difficult to formulate long term business plans (including capital investments) if every time the presidency changes parties, the new administration tries to completely undo the executive orders of the prior government.

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