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Comment:

Eight US regulatory predictions for 2016

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Last year we offered our 10 regulatory reform predictions for 2015, which turned into a busy year in the financial regulatory space. Here are our predictions for 2016:

1. Pace of new regulation slows in face of election

This year will provide a (brief) respite from the recent frenetic pace of financial regulatory rulemaking, due largely to the looming presidential and congressional elections. With some possible exceptions, regulators will be reluctant to propose or adopt controversial rules that could have political implications. For example, while much work is probably going on behind the scenes in preparation for regulation of the shadow banking system (see prediction #8), we believe the election will mean that these proposals will not see the light of day until 2017.

2. Intense focus by banks on new derivatives margin rules

At the end of 2015, US banking regulators and the Commodity Futures Trading Commission adopted margin requirements for uncleared swaps. These rules come into effect starting in late 2016 and, after a multiyear implementation period, are estimated to require banks to post and collect more than $1tn in margin annually. Banks will spend much of the year analysing these rules and the complex interplay between the US rules and those that will be adopted overseas, in an attempt to determine how to continue to run swap businesses most economically.

3. Regulatory examinations provide clarity on unresolved Volcker issues

Last year, we noted the many open interpretive questions surrounding the Volcker rule, and the difficulty that market participants have had seeking guidance due to the logistical complexity of a five-regulator rule. We think that regulatory examinations in 2016 will start to elucidate the answers to some of the most complicated issues. We hope the answers will come in a co-ordinated and consistent manner across regulators and examined banks.

4. DOL fiduciary rule finalised

Having survived a well-organised Hill strategy by the securities industry to impede its adoption, the Department of Labor's fiduciary rule will be finalised in early 2016, handing the Obama administration a signature victory. We expect the rule to be effective before year-end. The Securities Exchange Commission, however, is unlikely to make fiduciary duty rules for securities brokers a priority in 2016.

5. Compensation rules coming to fore

Noticeably absent in 2015 was a joint rulemaking required by Dodd-Frank to curb compensation arrangements deemed excessive or that could expose an organisation to material loss resulting from inappropriate risk-taking. Regulators proposed a controversial rule in 2011 but have failed to take further action. Despite the challenges of reaching consensus on this issue, we believe a final rule could come in 2016.

6. Cyber security and algorithmic trading-related rules

Cyber security and algorithmic trading issues will continue to be a regulatory priority in 2016, given their systemic significance. Regulators will push for greater transparency of risk controls and other safeguards regarding the electronic systems of financial services firms. We expect the securities industry to raise significant confidentiality and intellectual property concerns over efforts by regulators to obtain proprietary source codes for algorithmic trading, which many view as highly sensitive commercial data.

7. Banking committee will move on SEC nominees, but not others

We anticipate few nominations to move in the last year of the administration. This does not bode well for nominees for Federal Reserve or Treasury department positions. One notable exception will probably be the nominees to the SEC, where there is strong bipartisan support on the Hill and a desire by the chairman of the Senate Banking Committee to act on the nomination of a former staffer.

8. Further analysis of the shadow banking sector

Having substantially enhanced the regulation and oversight of banks and brokers, policymakers are likely to increase their focus on the lightly regulated "shadow banking" sector. The G30 plans to release a study in the spring that will analyse the extent to which activity in shadow banking may pose financial stability risks, which will spur greater industry focus on this issue.

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