Intelligence MEMOS

From: Jeremy M. Kronick

To: Superintendent Jeremy Rudin

Date: January 20, 2017

Re: **FINANCIAL REGULATION UNDER PRESIDENT TRUMP**

Today Donald J. Trump was inaugurated as the 45th President of the United States. And with it comes increased uncertainty for financial regulation post-Great Recession. The new administration appears to view regulation, such as Dodd-Frank and Basel commitments, with a negative light. What they will actually do is unclear, meaning Canada might not have much time to craft an appropriate response.

If we reasonably assume a lighter touch in the U.S. what might this mean for Canadian competitiveness? On the one hand, given lower cost burdens for U.S. financial institutions, this could spark a regulatory race to the bottom to avoid a loss of domestic bank competitiveness. On the other hand, if countries remain committed to Basel III and the U.S. removes or does not implement some of Basel's prudential measures, Canada could fill the vacuum created by the potential inability of U.S. financial institutions to lend in foreign markets.

A series of research papers, by the International Banking Research Network, looks at the historical effects of prudential regulation on both a host country, as well as their foreign counterparts, and shows a mixed set of results in terms of what Canada might expect.

For instance, a U.S. paper from this series found that a tightening of foreign prudential regulation - which should be the equivalent of the U.S. loosening regulation – leads to an increase in lending within American borders. U.S. global banks, as well as U.S. affiliates of foreign banks, are both responsible for this increase in claims. Therefore, Canadian banks should be able take advantage of easier U.S. lending standards.

However, the results also show only a weak change in lending by U.S. global banks in jurisdictions that tightened regulations, with lending abroad actually increasing on occasion. This suggests that U.S. banks have strong enough balance sheets that tighter foreign regulations do not restrict their ability to lend in these locations. Unfortunately for Canadian banks this result implies less of a market lending gap for them to fill than previously thought.

Another paper from the aforementioned series, which looked at Canada specifically, showed that tighter domestic regulation may result in foreign lending increases by Canadian banks. Canadian banks do optimize lending, meaning there may be a reduction in domestic lending, but overall lending remains the same.

On the whole, a regulatory race to the bottom is likely not necessary nor wise. While it remains true that regulation is costly – especially for smaller financial institutions – Canadian bank competitiveness should not be worse off, and may be better off, if, as expected, the incoming U.S. President loosens financial sector regulation. Evaluating the merits and implications of current regulation is prudent, worrying about the soon to be President's plans for financial sector regulation is not.

Jeremy M. Kronick is a Senior Policy Analyst at the C.D. Howe Institute.