The Street

Why GOP's Green Light for Bank Deals Will Cover Only Smaller Firms

Congress will seek to wipe out or make changes to the Dodd-Frank Act in small chunks, with a focus first on providing relief for mid-sized regional institutions.

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Dismantling the Dodd-Frank Act, which tightened rules on the banking industry after the 2008 financial crisis but had the side effect of curbing growth, is a top priority for both Republicans on Capitol Hill and President-elect Donald Trump.

Cancelling thousands of pages of regulations based on the statute is easier said than done, however. And lawmakers are all too aware that aid to the large banks that were blamed for the crisis may not play well with voters, many of whom are still grappling with the after-effects.

Consequently, Congress is likely to narrow its focus this year to curbing regulations that hamper small- and mid-sized banks, which are more popular with consumers and have garnered bipartisan support for looser oversight since they don't pose the same level of risk to the broader economy.

Combined with the free-market appointees President Trump is likely to install in key regulatory posts, that approach suggests a hospitable environment for earnings and deal-making at regional companies such as **Huntington Bancshares** (**HBAN**) ,**Comerica** (**CMA**) , **Regions Financial** (**RF**) and BB&T (**BBT**) .

Industry giants like **Bank of America** (**BAC**) and **Citigroup** (**C**) , meanwhile, will likely continue to face regulatory headaches and prune some of their operations. Just last month, Bank of America sold its U.K. credit card business to Lloyds Banking Group for $2.4 billion.

The disparity in outlooks stems partly from Dodd-Frank's designation of banks with more than $50 billion in assets as Systemically Important Financial Institutions, or SIFIs, a label that subjects them to tighter scrutiny since their collapse could threaten the U.S. economy.

Republicans are eager to raise that limit to $100 billion or higher, which would make it easier for regional banks to merge without crossing the barrier.

"If shareholders are looking at two banks that are considering merging, it is better for them to not be SIFIs when they complete their deal because investors will know they have lower costs," said Donald Lamson, a former assistant director in the Office of the Comptroller of the Currency, an industry regulator. Once regional banks win regulatory relief, M&A will follow, he said.

Even if the SIFI threshold were lifted as high as $250 billion, however, the largest U.S. commercial lenders wouldn't benefit. **JPMorgan Chase** (**JPM**) , Bank of America, Citi and **Wells Fargo** (**WFC**) each have well over $1 trillion in assets.

Many of the restrictions on firms of that size are unlikely to be changed easily, including a rule adopted in December that requires the biggest banks to issue an estimated $49 billion of additional long-term debt that can be converted to equity capital in times of economic stress. The measure shifts the cost of shoring up the institution onto bondholders rather than taxpayers.

Big banks might get some relief, though, from the Volcker Rule, a provision named after former Federal Reserve Chairman Paul Volcker that prohibited so-called proprietary trading.

A Fed paper in December that said the measure has a "deleterious effect on corporate bond liquidity" would give President-elect Trump some political cover in de-emphasizing enforement, said Isaac Boltansky, an analyst at Compass Point LLC in Washington.

Still, "the optics of repealing the Volcker rule are sub-optimal," he said. "Dodd-Frank relief is going to take time to move its way through Congress, and once we get to the Senate, I don't think it will be at the top of the agenda."

In the House, while Financial Services Committee Chairman Jeb Hensarling, R-Texas, has become a new power broker, his bill replacing Dodd-Frank has too much give-and-take to appeal to the mega-banks.

Hensarling has proposed repealing provisions including the Volcker Rule in exchange for tougher leverage and capital restrictions on the biggest banks as well as exempting more small and mid-sized institutions from a requirement that they are supervised by a consumer protection bureau.

Despite Republican control of both houses of Congress, the degree of deregulation that's possible is uncertain. There's a strong chance that Democrats in the Senate will threaten to filibuster Republican legislative priorities.

And while Republicans might expand on Democrats' previous curbs on filibustering -- a strategy that Trump could champion, according to Boltansky -- such moves carry consequences when the balance of power changes, as the Democrats have already discovered.

Even if the filibuster were eliminated, Republicans will have only a slim 52-48 majority in the Senate, and a few GOP opponents of deregulation could block efforts indefinitely.

That means the more immediate boon for banks may come from president-elect Trump and his choice for the little-known but powerful role of Federal Reserve Vice Chairman of Bank Supervision.

Potential candidates include two libertarians -- Paul Atkins, a former commissioner at the Securities and Exchange Commission and John Allison, a member of the Cato Institute's board who was CEO of regional bank BB&T from 1989 through 2008, a period of significant acquisitions.

Atkins' appointment would be viewed as positive for both big and small banks because he would be less likely to enforce many of the Fed's tougher restrictions due to a "let markets rule" approach, noted Lamson.

"While regulatory staffers don't change, the government appointments change," Lamson said. "We'll see more bank mergers and government approval of bank mergers."