

Dodd-Frank in the Crosshairs

What Does It Mean for Due Diligence?

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EXECUTIVE SUMMARY

- President Trump is making good on his campaign promise to reduce regulatory burdens
- Trump's focus with regard to this Executive Order is to reduce capital reserve burden on FI's, which will enable them to free up capital to lend to individuals and small businesses, which in turn will help the economy grow
- This Executive Order is expected to have little impact on customer due diligence
- CSR will continue to gain momentum as governments around the world adopt new regulations to mitigate bribery and corruption, end forced labor, and promote diverse supply chains

INTRODUCTION

President Trump is laying the groundwork to roll back regulations, in particular the Dodd-Frank Wall Street Reform and Consumer Protection Act, which has impact on the United States financial system. An Executive Order issued by the President on February 3, 2017 announced a regulatory system anchored on the following core principles:

- Empower Americans to make independent financial decisions and informed choices in the marketplace, save for retirement, and build individual wealth
- Prevent taxpayer-funded bailouts
- Foster economic growth and vibrant financial markets through more rigorous regulatory impact analysis that addresses systemic risk and market failures, such as moral hazard and information asymmetry
- Enable U.S. companies to be competitive with foreign firms in domestic and foreign markets
- Make regulation efficient, effective, and appropriately tailored
- Restore public accountability within federal financial regulatory agencies, and rationalize the federal financial regulatory framework.

In an accompanying directive to the Secretary of the Treasury, the Executive Order directed the Secretary to consult with the heads of the member agencies of the Financial Stability Oversight Council and report to the President within 120 days on the extent to which existing laws, treaties, regulations, guidance, reporting, and recordkeeping requirements and other policies promote the core principles, and what actions have been taken and are currently being taken to promote and support those principles. That report will then identify elements that are inconsistent with the core principles.

The President ordered a complete review of Dodd-Frank, a law that he criticized as failing to effectively regulate financial institutions. Republicans on the House Financial Services Committee are moving forward to replace Dodd-Frank with the Financial CHOICE Act. Separately, the administration moved to delay implementation of the Fiduciary Rule, which regulates financial advisors.

OPPOSING VIEWS

Critics of the administration's moves argue that Dodd-Frank is necessary to prevent another financial crisis like the one we experienced in 2008. The financial services industry, however, have complained about the expense of complying with regulations. The hope is that both sides can come together and find a regulatory environment that safeguards the U.S. financial system while freeing up funds to grow businesses and create jobs. But there is another huge concern lurking in the background.

OTHER CHANGES AFOOT?

This push to roll back Dodd-Frank does not signal the end of Know Your Customer (KYC), anti-money laundering (AML), anti-bribery/anti-corruption, and OFAC Sanctions regulation.

These regulatory reviews are primarily focused on resolving capitalization issues, in order to free up cash to lend to companies to spend on growing their business and creating jobs.

 Terrorists use a wide variety of methods to move money within and between organizations... 

– FATF-GAFI Financial Action Task Force Terrorist Financing

President Trump has been vocal about fighting terrorism and trafficking. In addition, global governments have been painstakingly putting laws and regulations in place to stymie the shadowy financial network funding terrorists, traffickers, and other criminals. It appears clear that Dodd-Frank rollbacks will not hinder that effort.

FATF HAS ADDRESSED THE NEED TO DISRUPT TERRORIST FINANCING:

“Terrorists use a wide variety of methods to move money within and between organizations, including the financial sector, the physical movement of cash by couriers, and the movement of goods through the trade systems. Charities and alternative remittance systems have also been used to disguise terrorist movement of funds...Disrupting funding flows creates a hostile environment for terrorism, constraining overall capabilities of terrorists and helping frustrate their ability to execute attacks. Disrupting terrorist financing involves both systemic safeguards, which protect the financial system from criminal abuse and targeted economic sanctions informed by counter-terrorism intelligence...”

—FATF-GAFI Financial Action Task Force
Terrorist Financing

The potential Dodd-Frank and related rollbacks are not unraveling legislation and regulations in the AML, Sanctions, or anti-bribery/anti-corruption. There has not been any reference to dismantling the FinCEN Final Rule, OFAC 50% Rule, the Patriot Act, FATCA, and similar laws and regulations. Globally, it is recognized that financial institutions and businesses generally need to know and understand their business partners, including the beneficial owners owning or controlling those businesses. This knowledge is essential to conducting responsible, ethical, and successful business operations.

ENSURING PROTECTION

That being said, customer and third-party due diligence goals must be protected under any potential regulatory rollbacks. The Volcker Rule requires banking entities to have a robust compliance program as part of the requirement to refrain from conducting certain investment activities. Dodd-Frank Sec. 1504 requires the extractive industries to report on payments to governments, and Dodd-Frank Sec. 1502 requires certain industries to conduct due diligence and identify conflict minerals in their supply chains. While the extractive

and conflict minerals-impacted verticals are not financial institutions, they nonetheless come under the purview of Dodd-Frank. Even if these laws and regulations are repealed, similar requirements for due diligence including identifying beneficial ownership, PEPs, and sanctioned parties will remain intact under other laws including OFAC regulations and the Foreign Corrupt Practices Act.

Globally, governments and companies with strong corporate social responsibility programs should focus on conducting appropriate due diligence of business partners, including customers and third parties, to ensure terrorists, traffickers, and other criminals are not inadvertently financed through business ventures. In Europe, there are similar laws regulating the extractive industries and businesses with possible conflict minerals in their supply chains. Global companies will still need to comply with the European regulations even if they are rolled back in the United States.

VIEWING THE FULL PICTURE

What we can expect is that the full ramifications of the new administration’s regulatory rollbacks will include an analysis of their impact on counter-terrorism financing and anti-corruption/anti-bribery safeguards, as many in Congress, other governments, and business themselves support those safeguards. In fact, some in the financial services industry have openly stated that they have already expended monies for compliance, and do not want to have separate programs to meet different governmental requirements across the globe.

In addition, changes to or repeal/replacement of the laws can take months to years to accomplish. Even rule changes can take months to put in place. It is more likely that the Trump administration will replace the current heads of the regulatory agencies, which will result in changes in enforcement policies.

Ultimately, it is possible to modify regulations affecting the financial services industry that will keep U.S. companies competitive with foreign firms and advance U.S. interests globally without jeopardizing the safety and security of the nation from terrorists, traffickers, and other criminals.

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