# Navigating the New World (Dis)order

## Implications of Trump Policies on the Banking Industry

Todd Hintze, Partner
Mark Lade, Associate Partner

## Banking Industry Summary

Thus far, the banking industry has expressed optimism regarding the Trump administration's policy announcements, particularly with respect to potential rollbacks of Dodd-Frank regulations. As evidenced by the positive upswing bank stocks have experienced since the election, the banking industry is thoroughly enjoying the prospects of reduced regulations, expansionary fiscal policy, corporate tax cuts, and increased infrastructure spending.

It is no wonder banks would revel in a swing of the pendulum. Since the 2008 financial crisis, the industry has been plagued by a combination of low interest rates, increased regulation, heightened consumer demands and market disruption by non-traditional entrants. And in the midst of challenging times, the banks have had to invest in preparation for what is expected to be an unprecedented level of disruption over the next decade driven by the technology innovation of FinTechs, the service innovation of Neobanks and the financial supply chain innovation of technologies like Blockchain. Last year, these factors culminated in the largest number of bank mergers since 2009.

This new found euphoria, however, may be short-lived. Some of the potential policies being proposed by the Trump administration – particularly as they relate to global service delivery models – have strong downsides that must not be ignored. Top performing banks will be those that prepare plans to minimize the downside in addition to maximizing the upside of Trump policies.

Chief among the potential downside risks is the Trump administration's strong position on U.S. job protection. The cost challenges of the last decade have necessarily led banks to significant use of offshore labor for back-office business processes, information technology and customer contact centers. As a result, banking is at risk of becoming a target industry for the President's bully pulpit – whether individually or combined with other industries that are also heavy users of offshore labor.

In addition, the proposed visa reforms and border restrictions will reduce access to skilled technical resources at a cost-effective rate. IT outsourcing is common among banks, and adjustments to the H-1B visa program will impact the service provider's talent and cost of operations. The banks are also direct users of the H-1B visa to import talent. Combining that with the draw of FinTech and other technology firms fighting for a diminishing supply of resources, talent scarcity will impair the banks competitive position in the ever more technology-driven world of banking innovation.

Other risks aren't as clear but warrant monitoring, including the potential that trade protectionism could ultimately lead to an overall slowing of the U.S. economy, the ability to freely move corporate resources internationally, as well as any tightening of foreign ownership rules.

## Potential Risks Related to Trump Policies

### U.S. job protectionism

Current figures regarding offshoring in banking reflect the degree to which banks are exposed should President Trump's attention turn to them. Based on a sample of seven financial institutions, of the roughly 340,000 FTEs involved in business processes and IT, over 50 percent were in offshore locations as of 2016. In addition, based on a sample of banking BPO service providers, of the 79,000 FTEs they provided to the banking sector in 2015, only 11 percent (8,690) were based in North America, while a sizeable 69 percent (54,510) were offshored in India.

As evidenced by recent announcements, President Trump has been very successful in using his position to publicly influence corporate decision-making without effecting formal policy:

- Amazon announced plans to add 100,000 new full-time jobs in the U.S. over the next 18 months
- Ford abandoned plans for a $1.6 billion plant in Mexico and announced that it would add 700 jobs to its Michigan plant
- General Motors plans to invest $1 billion in U.S. factories and add thousands of jobs, measures that have been in the works for years but were announced after criticism from President Trump
- Lockheed Martin said it would add 1,800 jobs to its F-35 program
- Walmart has advertised that it will add 10,000 U.S. jobs in 2017, even though it is a fraction of their current workforce of about 1.5 million people

In addition, although the President's comments have generally been aimed at manufacturing, uncertainty remains regarding the likelihood and scope of any new border adjustment tax. Any new tax on services performed offshore would impact the typical offshoring business case, let alone one as significant as a 20-30 percent tax as has been proposed by Speaker of the House, Paul Ryan (R-Wisconsin).

### Visa reform

While specific immigration details or quotas have not been specified, the Trump administration has stated its intention to "direct the Department of Labor to investigate all abuses of visa programs that undercut the American worker." A draft executive order from President Trump's Domestic Policy Council states a policy of overhauling the H-1B visa process to ensure that visas are allocated more efficiently and go to the "best and brightest." The new system would favor foreigners who have earned advanced degrees from a U.S. school, have a high-paying job offer, and have preferred skills, rather than the current system in which visas are distributed according to a lottery system based on country of origin. The cutoff for a "high paying job" that would qualify for an H-1B visa is still undetermined; however, a bill sponsored by Rep. Zoe Lofgren (D-California) proposes raising minimum salaries from US$60,000 to US$132,000 per year, with alternate proposals suggesting US$100,000 per year. Given the central role immigration policy played in President Trump's election campaign and that Democrats have co-sponsored bills to limit H-1B visas, there is a high degree of certainty that some form of restricting skilled immigration will occur.

These proposed restrictions pose several potential challenges. Outsourcing is common among banks, and given that India-based service providers have been significant users of the H-1B visa program to deliver their on-shore talent, an impact to both their talent and their cost of operations is likely. When modelling a representative 3-year Application Development and Maintenance (ADM) outsourcing agreement based on standard market rates and offshoring ratios, the impact of the proposed bill would be a 5-7 percent annual cost increase. Banks are also direct users of the H-1B visa program and, should they choose to deal with the inability to bring in foreign talent by hiring domestically, this decision will likely lead to higher wages and thus higher costs. And any increases to offshoring to compensate for a decrease in cost effective foreign onshore workers will only exacerbate the likelihood that the banking sector becomes a target for U.S. job protectionism.

Finally, while far less likely, should TN visas be reviewed as part of NAFTA renegotiation, this could affect Canadian banks with large footprints in the U.S. that regularly use TN visas to move resources between their domestic and American operations.

### Executive order on immigration

The Trump administration's recently announced executive order banning refugees and immigrants from seven Muslim-majority nations is expected to have an adverse impact on the ability to attract and retain skilled employees from not just those nations but others. The degree of uncertainty surrounding the policy, such as whether it includes green card holders, the exact duration of the ban, what other measures may be taken, and whether it can legally be enforced, has contributed to a climate of economic uncertainty. Further details on the policies' effect on banking are difficult to determine as many provisions remain unclear. However, when coupled with limits on H-1B/L1 visas, the policy appears to be creating a climate where skilled foreign workers may seek employment with non-U.S. competitors due to diminished sense of opportunity in the United States.

## Potential Mitigations

While there remains a degree of uncertainty between campaign rhetoric and final policy proposals, the impact of these policies is highly likely. There are a number of potential scenarios for which banks should consider mitigation plans, in increasing order of complexity and lead time:

1. Identifying and preventing the potential loss of key talent, should immigration reform and visa restrictions combine to make the U.S. less attractive to foreign workers
2. Executing a resourcing strategy that protects the supply of talent in a more competitive environment, mitigating the higher cost of resources and increased talent poaching
3. Assessing go-forward sourcing partnerships in light of: i) increasing costs for highly H1-B-dependent providers eroding one of their key competitive advantages, ii) potential market consolidation in the service provider industry driven by slowing growth, especially amongst mid-size firms looking for economies of scale and inorganic expansion
4. Adapting current sourcing partnerships which are dependent on the H1-B visa program, while avoiding disruption of services, preserving essential talent and minimizing cost impact

5. Executing a resourcing strategy that protects the supply of technology talent in a more competitive environment, mitigating increased talent poaching and higher cost of resources
6. Accelerating ongoing digital process transformation and automation efforts, streamlining work and reducing the need for labor
7. Adjusting your onshore/offshore ratio by expanding or establishing a domestic Global In-house Center (GIC) to meet future growth, with consideration for domestic U.S. locations offering the best access to talent at the most attractive cost
8. Repatriating back office, information technology and contact center activities which are currently offshore, whether currently operating as a bank-run Global In-house Centre (GIC) or under a third party outsourcing contract, in a way that minimizes service disruption and cost impact
9. Increasing emphasis on partnerships and/or acquisitions of Fintechs in order to combat a further diminished supply of talent as banks seek to compete in a more technology-driven world

# Appendices

## Appendix A: current forces driving the U.S. banking industry

### Evolving consumer expectations

The banking industry faces pressure to attract new customers who seek personalized products, services, and experiences. Consumer preferences are evolving at a rapid pace, and the face of banks' front offices must equally evolve. While traditional brick and mortar banking will remain important for the foreseeable future, the role of the branch is changing rapidly, and consumers are demanding greater control, insight, mobility, and omni-channel parity.

### Market disruption

Banking today has seen the rise of market disruptors that are leveraging technology, low cost of entry for narrow product offerings, broad market reach, and the consumer trend to best-of-breed selection to challenge traditional banking business and operating models. Consumer demand for digital wallets, P2P transfers, mobile payments, a mobile-first digital experience, and data-driven insights is challenging banks' flexibility. The advent of Blockchain as a banking supply chain disruptor is expected to further challenge traditional banking models. Over $25 billion has been invested in an estimated 4,000 Fintechs in the last five years, with payments and lending experiencing the most disruption. FinTech firms and legacy banks are just now beginning to recognize the benefits of working together to deliver innovative solutions to an increasingly digital consumer. Banks bring their large customer base, established trust, broad product set, and experience with risk and regulation. FinTechs bring unheard of innovation and agility given their laser focus on narrow solutions and absence of legacy systems to contend with. The two logical paths forward for both parties to consider are partnerships and acquisitions.

### New regulations and compliance

In the wake of the 2008 financial crisis, new regulations and compliance issues have limited the trading positions and level of risk banks can take. Managing regulatory compliance as well as the growing involvement of the state in both the structure and daily operations of banks in the aftermath of the 2008 financial crisis have increased cost and complexity. In this environment, banks are challenged to drive profitability while navigating the increasingly complex regulatory regime.

### Challenging macroeconomic environment

Banks are under serious pressure to reduce costs and increase profitability in a macroeconomic environment in which interest rates have been near zero for the last seven years. The combination of low interest rates, regulatory cost burdens, and slow organic growth has led to the highest level of bank mergers in 2016 since post-crisis 2009. The consolidation has been predominantly in small- and medium-sized banks, with a reluctance to grow above that and attract the additional regulatory oversight and capital requirements of being deemed systemically important.

## Appendix B: potential benefits related to Trump policies

The Trump administration's stance on expansionary fiscal policy, reduced regulation, and lower taxes are expected to provide banks with increased interest spread, more capital for lending, more flexibility in trading, and reduced costs. In addition, significant infrastructure spending has the potential to create additional lending opportunities for the banks, while an overall increase in U.S. economic activity would benefit bank customers and thereby indirectly benefit banks. The resulting lift in net operating revenue presents banks with the opportunity to invest, build essential agility into often archaic systems, incubate, innovate, and partner to better compete and advance their alignment with customers' evolving digital and convenience expectations. And reduced regulation begins to level the playing field with non-traditional competitors whose narrow product lines simplify their compliance obligations.

### Reduced banking regulation

There is a high degree of certainty that financial regulation will be loosened. While signing an executive order requiring that two regulations be revoked for every new one introduced, President Trump recently reinforced his commitment to overhauling banking regulation beginning with Dodd-Frank.

While he has not been specific about which aspects of financial/environment regulation he plans to repeal, his cabinet picks have given the following specifics:

- Scaling back the Volcker Rule on proprietary trading, which will allow investment banks to increase revenue
- Reduction in capital and liquidity requirements, which will free up significant amounts of capital that banks are currently holding in deposits
- Reduction of Consumer Financial Protection Bureau (CFPB) regulations, which will drive down compliance costs
- Reduction in the Financial Stability Oversight Council's ability to deem institutions "too big to fail," which will give banks more flexibility to take riskier positions and thus reap greater returns

### Reduced environmental regulation

While the administration has offered few policy specifics regarding environmental regulation, there is a high degree of certainty that environmental regulation regarding physical assets (e.g., waste disposal, energy-saving light bulbs, carbon footprint of office space) will be scaled back, allowing banks to cut their cost of compliance.

### Trade protectionism

As reinforced in his inaugural address, President Trump continues to highlight his “America first” position, emphasizing trade deals that create American jobs, increase American wages, and reduce America’s trade deficit. He has withdrawn from the Trans-Pacific Partnership, communicated plans to begin re-negotiating the North American Free Trade Agreement (NAFTA) with Canada and Mexico, and intends to use both legal and presidential power to combat unfair trade practices by China. He has threatened high tariffs and other tough measures against companies that move operations abroad and has continued to use his bully pulpit to motivate corporate behavior. In direct response, a number of companies have begun to publicly tout plans for U.S. job creation, including pre-existing ones, in an effort to create good will. Amazon announced plans to add 100,000 new full-time jobs in the U.S. over the next 18 months. Ford abandoned plans for a $1.6 billion plant in Mexico and announced that it would add 700 jobs to its Michigan plant. General Motors plans to invest $1 billion in U.S. factories and add thousands of jobs, measures that have been in the works for years but were announced after criticism from President Trump. Lockheed Martin said it would add 1,800 jobs to its F-35 program. Walmart has advertised that it will add 10,000 U.S. jobs in 2017, even though it is a fraction of their current workforce of about 1.5 million people.

### Monetary policy

In December 2016, the U.S. Federal Reserve modestly raised its benchmark short-term rate for the first time since December 2015, when it had raised it after keeping the rate at a record low near zero for seven years. At that time, the Fed indicated that it expected to do so three more times in 2017. However, solid economic gains combined with uncertainty surrounding the details and impact of the Trump stimulus program compelled the Fed to leave its key interest rate unchanged following its January 2017 policy meeting.

Despite that, President Trump has been critical of the Fed's low-rate policies throughout his campaign, suggesting that the Fed's ultra-stimulative policies are unfairly penalizing savers and have led to unequal implications for different segments of society. Furthermore, his stimulus program based on tax cuts and infrastructure spending at a time of almost full employment, is likely to trigger not only higher growth but higher inflation, necessitating a return to more normal interest rates.

### Increased infrastructure spend

While initial estimates from the Trump administration have put the increased infrastructure spend at $1 trillion over 10 years ($100 billion per year), there has been no proposal or policy submitted to date. Regardless of the actual amount, there is certain to be a significant increase in infrastructure spending, as President Trump has vowed to revitalize roads, bridges, and airports, and promised to deliver a massive rebuilding package within his first 100 days in office. Generally speaking, increases in infrastructure projects boost economic activity and spur job creation, although actual outcomes are dependent on the stance of monetary policy, how the investments are financed, and the degree of productive slack (the difference between the economy's productive capacity and the actual level of economic output) in the economy. For example, although the American Recovery and Reinvestment Act bill of 2009 pledged $787 billion toward stimulating the economy and producing jobs, $689 billion took the form of tax cuts directed at families, and only $98 billion went to infrastructure projects. As a result, in that case the dramatic unemployment declines that were promised to sell the stimulus did not materialize.

### Lower corporate taxes, one-time repatriation tax rate, and personal taxes

The Trump administration has stated its intention to lower the corporate tax rate from 35 percent to 15 percent. Historically, corporate tax rates in the United States have rarely been lowered, and this may cause some doubt as to whether the Trump administration will lower corporate taxes as promised. However, while the rate may not fully reduce to 15 percent, given Republican control of Congress, a material reduction in the corporate tax rate is likely, with bank profits being a beneficiary. Additionally, banks with significant overseas revenues could take advantage of the one-time repatriation tax rate of 10 percent, which is a stated Trump policy to encourage American firms to bring profits back to the United States. At the personal level, the Trump platform promises a reduction in the number of tax brackets and lowering of taxes paid across all income groups, creating buying power and investable assets.

It is worth noting that President Trump may face pushback from the Republican Party on the degree of tax cuts given that they are estimated to cost between $5.3 to $11.5 trillion. Prior Bush tax cuts caused tax revenues to dramatically decrease leading to a material budget deficit, and in comparison, cost only $2.8 trillion over 10 years.

## Appendix C: Trump administration policy overview

President Trump has assumed office on the back of a campaign that has been extraordinarily different from those of other candidates in recent history. With no political experience, he has upended preconceived notions of both establishment Republican and Democrat orthodoxy, and vowed to place "America first" with a focus on tightening immigration, lowering taxes, loosening regulations, increasing infrastructure spending, and re-negotiating trade deals. President Trump's policies have been continuously evolving and carry enormous implications for the economy in general and the banking industry in particular. While uncertainties about how many of his campaign promises will translate into policies and bills remain, some are coming into clearer focus during the initial days of his presidency.

### Immigration

*Description*

President Trump has been vocal throughout his campaign about plans to curtail the H-1B visa program. Following his election win, several bills have been introduced to tighten H-1B immigration. A bill sponsored by Rep. Zoe Lofgren (D-California) proposes raising the minimum salaries from $60,000 to $132,000 per year. Another bill proposed by Sen. Bill Nelson (D-Florida) and Sen. Jeff Sessions (R-Alabama) would cut the number of H-1B permits every year to 70,000 from 85,000. In November 2016, Sen. Chuck Grassley (R-Iowa) and Sen. Dick Durbin (D-Illinois) introduced a bill that, among other provisions, mandates that all companies that want to hire workers using H-1Bs first try to hire U.S. citizens. In addition, given President Trump's promise to renegotiate NAFTA, there could be consequences for the TN immigration category as well.

*Implications*

- Tightened H-1B immigration restrictions would affect outsourcing firms, especially Indian-heritage information technology companies that send thousands of workers every year to the U.S. on H-1B visas, and this in turn would affect banks that have historically been high adopters of outsourcing business processes and technology services
- Some companies might find it cost effective to fully offshore current H-1B roles instead of meeting higher salary restrictions, unless legislation that penalizes offshoring is enacted
- Increasing uncertainty around NAFTA and TN visas in particular may have a potential impact on resource allocation across the U.S. and Canada, which will affect both Canadian banks with a U.S. presence and U.S. banks with a relevant Canadian presence

### Trade

*Description*

President Trump has abandoned the Trans-Pacific Partnership (TPP), signed among 12 Pacific Rim countries, and has called for renegotiations of NAFTA. He has stated that the U.S. will sign trade deals only with individual allies from now on. He has been emphatic regarding his intent to use both legal and presidential power to combat unfair trade practices by China, bringing anti-dumping, illegal subsidies, and other high profile cases forward. President Trump also has warned companies with offshore factories that they will face a 35 percent tax on products they want to sell back in the U.S.

*Implications*

- Protectionist trade policies have been criticized by economists as likely to dampen economic growth and would reverse a free-trade strategy adopted by the U.S. since World War II
- Firms with a global footprint, particularly with a foreign manufacturing base, will incur significant cost increases through 35 percent import tariffs. Retailing companies will be hit hard with their heavy reliance on imported products. Automakers will face high expenses as they buy car parts from overseas. Energy companies will pay for imported oil
- Many other companies will suffer if foreign governments retaliate, including U.S. banks potentially losing lucrative investment banking deals

### Taxes

*Description*

The Trump administration is likely to lower corporate taxes from 35 percent to 15 percent, which should have positive implications for the entire business community, as it will immediately impact their bottom lines. He is also encouraging reverse corporate inversion by offering a one-time 10 percent tax incentive to companies that bring overseas revenues back to the U.S. At the consumer level, the Trump platform promises a reduction in the number of tax brackets and lowering of taxes paid across all income groups.

It is worth noting that President Trump may face pushback from the Republican Party on the degree of tax cuts given that they are estimated to cost between $5.3 to $11.5 trillion and create a significant budget deficit.

*Implications*

- Increased investments in the U.S., such as reverse corporate inversion
- Increased bank profits due to lower corporate taxes
- Potential future impact on lending and interest rates due to increased budget deficits
- Increased revenue for firms with significant oversees revenues that exercise the one-time 10 percent repatriation tax incentive
- In keeping with indications of special tariffs for companies with offshore manufacturing, there is potential for additional reforms that uniquely target companies with offshore operations for the purpose of labor arbitrage

### Healthcare

*Description*

President Trump ran on a campaign promise to dismantle the Affordable Care Act (ACA), also known as Obamacare. After assuming office, he has instructed Congress to immediately repeal the ACA and pass a replacement health law. President Trump pledged that the new plan will allow people to purchase insurance across state lines. He will eliminate the individual mandate in the ACA but keep provisions that ensure patients are not denied coverage based on pre-existing medical conditions and allow children to remain on their parents' insurance policies until age 26.

*Implications*

- Ramifications for repealing the ACA remain uncertain, as no concrete replacement policies have been outlined yet. However, it is certain that portions of the ACA will be repealed
- The Congressional Budget Office estimates that repealing the ACA would increase federal budget deficits by $137 billion over the 2016-2025 period

- The cost of adjusting to new health care insurance processes will impact the health care industry, the cost of which will be borne by corporations and consumers

### Banking regulation reform

*Description*

The Trump administration has stated its goal of deep cuts to regulations, even going as far as to say that regulations can “be cut by 75 percent, maybe more.” While recently signing an executive order requiring that two regulations be revoked for every new one introduced, President Trump reinforced his commitment to overhaul banking regulation beginning with Dodd-Frank.

*Implications*

- Increased flexibility for financial sector firms and brokers leading to a potential increase in revenues
- Change in processes creating potential opportunity
- Decreased costs due to less regulatory compliance
- Freed captive funds for banks to invest in technology
- Somewhat leveling of the playing field for banks to compete against non-traditional competitors due to simplified regulation and compliance overhead

### Environmental regulation reform

*Description*

In keeping with President Trump’s themes of reduced regulation and enabling business, his cabinet picks for Treasury and Commerce have stated that they plan to withdraw from the Paris Climate Accord and eliminate the Clean Power Plan and other regulations controlling emissions. In addition, while the administration has offered few policy specifics regarding environmental regulation, there is a high degree of certainty that environmental regulation regarding physical assets (e.g., waste disposal, energy-saving light bulbs, carbon footprint of office space) will be scaled back.

*Implications*

- Increased investment in capital heavy energy sector, which will in turn benefit banks
- Decreased costs due to less regulatory compliance for banks
- Freed captive funds for banks to invest in their growth

### Infrastructure

*Description*

The Trump administration has pledged to invest heavily in infrastructure development, with the initial goal being $1 trillion over 10 years to repair aging infrastructure (roads, bridges, and airports). However, the administration has released no details regarding the form of spending (tax rebates, loans, etc.) or how it would be allocated.

*Implications*

- Increased infrastructure spending will augment opportunities for the construction and transportation industries leading to increased growth and employment
- Spurred economic growth will have a positive impact on the economy, with an indirect effect on banks as well

### Security

*Description*

President Trump has taken concrete steps toward border control and U.S. immigration policies by signing executive orders ordering the construction of a wall on the U.S.-Mexico border and boosting border patrol forces. One of his campaign policies is to ensure that a biometric entry-exit visa tracking system is fully implemented at all land, air, and sea ports. All U.S. cyber defenses and vulnerabilities, including critical infrastructure, will be reviewed. A cyber review team will establish detailed protocols and mandatory cyber awareness training for all government employees while remaining current on evolving methods of cyber-attack.

*Implications*

- The emphasis on border security will be advantageous to the surveillance and homeland security contracting industry
- Technological solutions for better border control will develop: facial recognition, RFID scanners, license plate readers, biometrics, etc.
- Increased budget for Department of Defense and Department of Homeland Security
- Banks may be expected to increase spending on cybersecurity and sensitive information storage compliance

## About Everest Group

Everest Group is a consulting and research firm focused on strategic IT, business services, and sourcing. We are trusted advisors to senior executives of leading enterprises, providers, and investors. Our firm helps clients improve operational and financial performance through a hands-on process that supports them in making well-informed decisions that deliver high-impact results and achieve sustained value. Our insight and guidance empower clients to improve organizational efficiency, effectiveness, agility, and responsiveness. What sets Everest Group apart is the integration of deep sourcing knowledge, problem-solving skills and original research. Details and in-depth content are available at www.everestgrp.com.

For more information about Everest Group, please contact:
+1-214-451-3110
info@everestgrp.com

For more information about this topic please contact the author(s):

Todd Hintze, Partner
todd.hintze@everestgrp.com

Mark Lade, Associate Partner
mark.lade@everestgrp.com