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Sailing into the Mystic

Ending the 115th

With all eyes focused on November 6th, we wanted to provide a brief outlook on what still needs to be resolved in the last two months of this year when current Members return to Washington for a traditional "lame duck" work period before closing the books on the 115th Congress. With hearings still being planned and spending bills that still need to be completed, there's a lot on tap for Congress when they come back on November 13th for one, two, three, four, etc. weeks to try and finalize items or wrap things up into a large ball to punt into 2019. And while this outlook is not intended to focus on the elections, it does go without saying that the midterms loom large and will dictate how much and what Congress does for the rest of the year after the results from two weeks from today are completely digested. With that overarching caveat, below is a preview of what we believe could be the focus in Washington for the rest of 2018.

Appropriations/Government Shutdown Risk

Up until this point, both the House and Senate have been able to work in a bipartisan fashion on the government funding process. The President has signed five of the twelve annual spending bills into law (Defense, Labor/Health/Human Services, Energy/Water, Legislative Branch, and Military Construction/Veterans Affairs) – these bills account for 75% of the discretionary budget of the federal government. However, these fleeting moments of bipartisanship are likely to come to an end when Congress returns. In late September, Congress passed and the President signed into law a Continuing Resolution through December 7th for the remaining seven spending bills. Included in the remaining bills are several contentious titles, so an agreement will need to be reached before December 7th to prevent a partial shutdown. The remaining bills are Agriculture, Commerce/Justice/Science, Financial Services/General Government, Homeland Security, Interior/Environment, State/Foreign Operations, and Transportation/HUD. It is important to note that since a significant portion of the federal government has already been funded, a shutdown will not be as widely felt as it has been in the past.

There are several outside factors that we believe increase the likelihood of a partial shutdown in December. These remaining spending bills will need to be passed right after the election, and there will be fallout no matter who wins each Chamber. Regardless of the election outcome, President Trump seems to be moving towards a fight over border wall funding (as noted above, Homeland Security funding still needs to be resolved). House leadership elections will be taking place, and the leadership of both parties will feel pressure to deliver a win to their caucuses. In addition, several of the traditional hooks to get Members to vote for large "omni" spending bills have already been funded – the troops will get paid, veterans will receive their benefits, senior citizens will still get their meals on wheels, etc. It is always possible that a last minute agreement could be reached, but we think regardless of the election outcome, it is hard to see a scenario where these issues are worked out without a significant fight.

Nominations

The first two years of any presidency are filled with a healthy focus on nominations. The Trump Administration's nomination process has been particularly slow given the intense battle being waged by Republicans and Democrats to usher nominees through the process. The financial services world has experienced new heads of the Federal Reserve, FDIC, OCC, CFTC and SEC. These agencies also have seen the selection of several Trump appointees to their boards, and such leadership changes likely will result in a rather dramatic shift in regulatory approach. Two other key agencies, the BCFP/CPFB and FHFA, are soon to go through shifts of their own. Acting Director Mick Mulvaney is currently leading the BCFP/CFPB pending the confirmation of the nominee Kathy Kraninger, and in January the FHFA will see Director Mel Watt step down. While these leadership changes are significant, the Trump administration also has nominated and the Senate has confirmed several key deputies and board members that are critical components of the financial regulatory team. For example, the SEC has two new Republican commissioners to assist Chairman Clayton, and the Federal Reserve received a confirmed Vice Chairman of Supervision, Randy Quarles, for the first time ever. Heading into the lame duck, there are plenty of other nominees who still need to be processed to fill out the Trump financial regulatory team. It is important to remember that any nominee not confirmed this Congress would need to be renominated, and the committees will need to hold hearings for those renominated. Some of those awaiting Senate action include:

- Kathy Kraninger, BCFP/CFPB Director, (nominee – reported favorably out of committee)
- Michael Bright, Ginnie Mae President (nominee – reported favorably out of committee)
- Michelle Bowman, Fed Board Member (nominee – reported favorably out of committee)
- Marvin Goodfriend, Fed Board Member (nominee – reported favorably out of committee)
- Kimberly Reed, Ex-Im Bank Chair (nominee – reported favorably out of committee)
- Dino Falaschetii, OFR Director (nominee – reported favorably out of committee)
- Bimal Patel, Assistant Secretary of Financial Institutions at Treasury (nominee)
- Nellie Liang, Fed Board Member (nominee)

Given the rather short lame duck session and the partisanship of the nomination process, the Senate will need to prioritize nominees to move across the Floor unless a package of non-controversial nominees can be constructed. RFA understands the Senate Banking Committee intends to prioritize and push hard to confirm Kraninger to be director of the BCFP/CFPB. Bowman will receive a floor vote to be a board member of the Federal Reserve the week of Nov. 13th per an agreement. Bright, Falaschetii and Patel are all possible candidates for a bipartisan nominees package (assuming Patel's committee hearing occurs in November). Two of the remaining Federal Reserve nominees, Goodfriend and Liang, face some degree of opposition from the Republicans, which will naturally move them to the bottom of the prioritization list and suggests to us those nominations could be in trouble.

The next few weeks also could see future nominees emerge. For example, the Trump administration still needs to nominate a replacement for SEC Commissioner Kara Stein who must depart by early December. It is widely reported and our expectation is that former Stein staffer, Allison Lee, will be nominated. At the FDIC, the Administration needs to nominate someone to serve in the vacant Democratic seat. One name to watch is SBC Ranking Member Brown's (D-OH) former chief counsel, Graham Steele. Finally, with Watt's time at FHFA ending, speculation as to his potential replacement has ramped up but not solidified, especially as the Administration continues to discuss making housing finance reform a priority next year.

__**Expected Activity in the Senate Banking and House Financial Services Committees**__

Hearings – As of the official calendars today, the Senate Banking Committee (SBC) and House Financial Services Committee (HFSC) will have 19 and 16 days, respectively, to complete their business once they return in November before the end of the 115th Congress. One key area of focus over these upcoming weeks is expected to be testimony from Randy Quarles, Vice Chair of Supervision at the Federal Reserve. Quarles testified earlier this month before SBC with other financial services regulators, and next month he is scheduled to appear again before SBC as well as HFSC (set for 11/14) where he inevitably will face questions on regulatory reform proposals related to capital, liquidity, stress testing and the Volcker Rule.

One area that is never bereft of attention and that will continue to receive it these last few months of the 115th is housing finance system reform. The attention at the end of this year is prompted in part by the rapidly approaching end of Watt's term at the FHFA as well as draft bipartisan legislation being circulated by outgoing HFSC Chair Hensarling (R-TX). SBC has set November 14th as the date for a postponed hearing (originally scheduled for last week) to examine the oversight of pilot programs at Fannie Mae and Freddie Mac. Testimony will touch upon Freddie Mac's Integrated Mortgage Insurance (IMAGIN) and Fannie Mae's Enterprise-Paid Mortgage Insurance pilot programs, which have been criticized for the level of transparency with which they have been implemented. Critics see these pilots as long-term threats to the traditional mortgage insurance industry, though FHFA may not extend them once President Trump appoints a new Director to replace Watt early next year. This hearing should also provide insight into whether the Federal Housing Administration (FHA) will experiment with private mortgage insurance on FHA mortgages, which could lead to mortgage insurers expanding the pool of loans for which they can write policies.

On the House side, Hensarling has indicated a desire to look closely at a draft bipartisan housing finance reform bill he floated this fall with Rep. Delaney (D-MD) and Himes (D-CT). While it is unlikely the bill will officially be introduced let alone marked-up, Hensarling could hold a hearing on the legislation as he attempts to put a lasting mark on this issue before he steps down as HFSC Chair and retires from Congress.

Also in the House, Republicans on HFSC have scheduled a second roundtable on exchange-traded funds (ETFs) for late next month on November 29th. This is a follow-up to a spring roundtable and will look at the impact of ETFs on Main Street. The earlier roundtable focused on large stakeholders, so this one is expected to concentrate on mid and small market participants.

Jobs Act 3.**0** – One additional matter Hensarling would love to see get across the finish line is the bipartisan "JOBS Act 3.0" package of 32 bills (officially S. 488) he put together with HFSC Ranking Member Waters (D-CA). While the legislation easily passed the House in July, the Senate continues to show little appetite for taking up this package, especially as it comes so closely on the heels of S. 2155, the bipartisan financial services regulatory reform bill engineered in the Senate and signed into law earlier this year. While attitudes could change after the election, passage of JOBS Act 3.0 still faces a severe uphill climb. If the Senate does not take it up *in toto*, one potential scenario is that some provisions of this legislation could be included in a large year-end spending package, especially given the amount of financial services policy riders included in the House version of the Financial Services/General Government spending bill. But even this possibility faces steep odds and competing interests, so we remain pessimistic about JOBS Act 3.0 making it to the President's desk this Congress.

Sanctions
Iran – Two days before the midterm elections, the second set of sanctions imposed by the US on Iran, this time on transactions with Iran's central bank as well as on the energy sector (read: oil), is scheduled to commence on November 4th (a result of the Trump Administration's decision to withdraw from the Iran nuclear deal). The Administration's stated position on Iran is "maximum pressure" and while waivers or extensions could be granted, indications are that they must be strongly justified. And with congressional Republicans largely supportive of these efforts, we don't expect any legislation or action to be considered on Capitol Hill this Congress raising concerns with a strong approach to Iran.

Russia – Earlier this month, the Senate Banking Committee held its third and likely final hearing this Congress on Russia sanctions. As a result of these hearings, indications are that Chairman Crapo (R-ID) and Ranking Member Brown are considering legislation to focus on Oligarchs, newly-issued sovereign debt, oil and gas technology investments and beneficial ownership, specifically regarding real estate. But any effort to move a Russia sanctions bill along these lines in the lame duck is dependent on the outcome of the elections. Recent news that President Trump plans to withdraw from an over 30-year nuclear agreement with Russia promises only to complicate matters between the two countries, including any legislative sanctions efforts.

Saudi Arabia – There have been bipartisan calls for sanctions on Saudi Arabia in connection with the slaying of journalist Jamal Khashoggi, including from Republican Sens. Graham (R-SC) and Corker (R-TN). President Trump has signaled a willingness to work with Congress on ways to punish the Saudis but has continued to defend the sale of US weapons. This story is expected to play out over the next few weeks.

National Flood Insurance Program (NFIP) – The NFIP is set to expire (again) on November 30, 2018. The program remains massively in debt and Congress is still split on how it should be reformed. This disagreement over the policy aspects of the program coupled with its expiration date (right before the Continuing Resolution expires on December 7th) leaves the program at real risk of a temporary lapse. The NFIP lapsed twice early in 2018, but neither lapse was for more than two days. Any lapse is strongly opposed by the jurisdictions prone to flooding. Mortgages in flood prone areas are required to have flood insurance if the mortgage is made, guaranteed or purchased by a federal agency, federally regulated lending institution or government-sponsored enterprise. Because of this requirement, uncertainty on whether the program will be reauthorized has economic ripple effects and can put deals on hold and keep families from purchasing new homes. The current expectation is that Congress will find a way to extend the program on a short-term basis into Q1 2019, although the probability of a short-term lapse remains significant.

Trade/USMCA

Trade continues to be at the heart of the Trump Administration's economic agenda. Reaching agreement with Canada and Mexico on the United States-Mexico-Canada Agreement (USMCA), also known as NAFTA 2.0, was a major milestone and campaign promise for the Administration. However, the agreement must still be ratified by Congress, and how quickly that can be done depends partially on the elections and if the President decides to force the hand of Congress by formally submitting notice to withdraw from NAFTA. The consensus estimate is that the USMCA cannot pass Congress until Q1 2019 at the earliest, but if Democrats take the House or Senate then the President may urge the Senate to pass the USMCA during the lame duck session prior to the beginning of the new Congress on January 3, 2019.

Meanwhile, the Administration formally set in motion trade talks with the European Union, Britain and Japan in hopes of replicating its USMCA success with those jurisdictions. The trade "skirmish" with China also continues to escalate with 10% tariffs on $200 billion of Chinese goods already in place and a looming deadline of January 1, 2019 after which the tariff on those goods will rise to 25%. The Administration also announced plans to withdraw from a postal treaty that gave discounted rates to Chinese companies shipping packages to the United States, and President Trump also has signaled he is willing to tariff the remaining Chinese goods as he works to balance the U.S.-China trade relationship.

Tax/Retirement

We believe provisions of the Hatch (R-UT)-Wyden (D-OR) "Retirement Enhancement and Savings Act" (RESA) remain contenders for enactment during the lame duck session. The question will be whether Republicans and Democrats can agree on a legislative vehicle, such as a spending bill, to carry these provisions. Not only do these provisions have the support of the Senate Finance Committee Chairman and Ranking Member, an identical bill introduced by Rep. Kelly (R-PA) has 82 bipartisan cosponsors. The House passed many of the RESA provisions in September as part of a package of three bills marketed as "Tax Reform 2.0," but it was not done in a bipartisan manner as the package included provisions opposed by Democrats such as making 2017 individual income tax rate cuts permanent.

The RESA provisions are intended to increase the availability of, participation in, and retirement security provided by defined contribution plans. The legislation would make it easier for small businesses to band together to offer 401(k) plans. Among other things, the legislation also would remove the current 10% cap on auto escalation of employee contributions; require disclosure to plan participants of lifetime income streams; provide a safe harbor for the selection of lifetime income providers by plan sponsors; and allow employees to transfer plans while preserving lifetime income options. If these measures aren't enacted this year, they could potentially be considered early in the 116th Congress. Additionally, President Trump issued an Executive Order in August instructing the Department of Labor (DOL) to examine policies to expand access to workplace retirement plans, and yesterday DOL proposed a rule that would make it easier for small businesses to join together to offer 401(k)s to employees.

Finally, President Trump recently announced that the Administration is studying a middle-class tax cut plan that seems to differ from the House Republican efforts to make the 2017 tax cuts permanent. While details were not released, one provision that may be proposed is indexing capital gains for inflation. Notwithstanding, it is very unlikely Congress could pass additional tax cuts by the end of the year.

Farm Bill

As of October 1st, authority for the Agriculture and Nutrition Act, better known as the Farm Bill, expired. And while expiration will create new concerns, the real impact is minimal at this point but reauthorization either through some form of compromise legislation or an extension until next year will not occur until after the midterms. Throughout the negotiations on competing House and Senate bills, differences on changes to the Supplemental Nutrition Assistance Program (SNAP) – the House bill would impose new work requirements on SNAP recipients – have dominated the concerns, but recently divisions have emerged on other parts of the bill. As of now, an extension until next Congress is likely, but negotiations continue in an effort to resolve differences and reach a compromise that can be considered during the lame duck.