

November 7, 2018



*Day After Day, I'm More Confused*

Much will be written in detail about yesterday's election over the coming weeks and months, but we wanted to provide some quick initial takeaways on the results for the US Congress. In the House, Democrats have won at least 26 seats to capture the majority for the first time since 2010. As of this morning, there are 23 races that are still to be decided, with Democrats currently leading in up to nine of them, so the majority is expected to increase slightly over the coming days. Regardless of the final outcome, the House will look completely different with likely over 80 new Members across both parties coming to Washington in January. It was a much different story in the Senate, where Republicans look likely to increase their majority by up to four seats, knocking off at least three Democratic incumbents with two seats currently held by Democrats (FL and MT) and one open seat still to close to call (AZ), and one (MS) headed for a runoff where the Republican is favored.

Historically the president's party loses seats in a midterm, so the results in the House continue this tradition, while the Senate election changes the dynamic, although Democrats had to defend over two-thirds of the seats up in this year's election. While divided government does not automatically equal gridlock, yesterday's election is potentially a negative for large comprehensive legislative packages such as housing finance reform. However, in our view, there are areas where there is incentive for Congress to work together like addressing retirement savings provisions and reauthorizing programs such as the Farm Bill and flood insurance. Regardless of yesterday's outcome, federal financial regulators will continue with their deregulatory agenda and push for pragmatic regulatory change, but as we have previously indicated, congressional oversight from a House controlled by Democrats will divert attention away from these efforts.

As for leadership, while there likely will be some changes, things are expected to look much like at it does today in the Senate, at least at the top. In the House, leadership jockeying will begin in earnest as early as today. House Democratic leadership elections are scheduled to take place later this month on November 28th, and while the dust will settle on the top three (Pelosi, Hoyer and Clyburn) over the coming weeks, battle lines for some of the other leadership positions are starting to form. DCCC Chair Ben Ray Lujan (NM) is expected to declare his candidacy for Assistant Democratic Leader soon. Lujan should be the front runner against Reps. Cheri Bustos and David Ciciline (RI), who are already seeking the position. Rep. Hakeem Jeffries (NY) is expected to announce for Democratic Caucus Chair early this afternoon, and he also is expected to be the front runner against Linda Sanchez (CA) and Barbara Lee (CA). And the contest for Dem Vice Chair right now is between Pete Aguilar (CA) and Katherine Clark (MA), but as with all of the leadership races, others likely will join the fray. On the House Republican side, as of this morning leadership elections currently are scheduled for a week from today on the 14<sup>th</sup> (Senate Republican elections are expected the same day) with current Majority Leader Kevin McCarthy (CA) and current Whip Steve Scalise (LA) the frontrunners for the top two positions. However, Rep. Jim Jordan (OH), a member of the Freedom Caucus, has formally announced his intent to challenge McCarthy, so things could change quickly and often between now and the caucus vote, especially given the results from last night.

Below are some key issue areas with potential new leadership on the relevant committees. Please note that this again is a brief overview based on the known results from last night, and we will provide more detailed agendas and outlooks for the 116<sup>th</sup> Congress going forward. (Also, for the lame duck, please refer to our October 23<sup>rd</sup> memo, which we are glad to resend if needed.)

### Appropriations/Spending

- **Likely Chairs:**
  - ***Senate Appropriations – Richard Shelby (R-AL)***
  - ***House Appropriations – Nita Lowey (D-NY)***

Politics surrounding fiscal issues will be volatile with a divided Congress. The first funding fight will come in the lame duck, because Congress needs to pass the remaining seven government funding bills by December 7<sup>th</sup> to avoid a partial shutdown. We continue to think the risk of a partial shutdown is high in December. Looking past this fight, we think there will be significant rhetoric from House Democrats on the Administration's budget request, which will likely come in February or March. We also expect significant domestic budget cuts to be proposed – and similarly, significant rhetoric from the Administration on the Democrat's budget proposal. Debt ceiling talks also will be picking up right around the time of these budget discussions – it is currently suspended through March 1, 2019, but extraordinary measures will likely be able to take it into the summer. The House Republican conference will be more conservative in the 116<sup>th</sup> Congress, and it will be interesting to see whether congressional Republicans will once again become fiscal hawks in the minority, making deals on these fiscal issues a headache for Trump and McConnell to negotiate with Democratic leadership or whether the President's support of a deal will still be enough to bring conservative Republicans on board.

### Banking/Financial Services

#### ***Senate Banking Committee (SBC) – Likely Chair: Mike Crapo (R-ID)***

*Note – at least three current SBC Members lost their reelections – two Democrats (Heitkamp (ND) and Donnelly (IN)) and one Republican (Heller (NV)) with another still too close to call as of this morning (Tester (MT)), meaning there will be at least four open positions on the committee with Corker (R-TN) retiring.*

As indicated above, SBC is slated to have some new faces filling its ranks, but the leadership is very likely to remain the same with Chairman Crapo keeping the reins and Ranking Member Sherrod Brown (D-OH) continuing to lead the minority. With a Republican majority, Chairman Crapo will be able to easily continue processing nominees for major roles including slots on the Federal Reserve Board and the director of the Federal Housing Finance Administration. Legislatively, however, Crapo will need to continue his work reaching across the aisle, but this may prove more difficult with the loss of key SBC moderate Democrats. Below are some items we expect the Committee to prioritize in 2019.

#### **Regulatory/Oversight**

- *Implementation of S. 2155* – Crapo has been focused on ensuring full implementation in a timely manner.
- *The Volcker Rule* – Crapo has raised concerns with the proposed Volcker Rule and will push the regulators to improve on the proposal.
- *Housing Finance* – As part of a complement to legislative activity, expect Crapo to work with the Administration on ways to tackle this issue.

- *SEC* – Oversight of Chairman Clayton’s proposed Regulation Best Interest, where the Republican majority may have some concerns, and Clayton’s efforts to increase the number of IPO’s, which the Republican majority is likely to view favorably.

### **Legislation**

- *Housing Finance* – Crapo carries sentiments from the Johnson-Crapo effort in 2014 into this Congress. He has proven his ability to work in a bipartisan manner on a tough political and policy issue and may finally have an Administration and FHFA director willing to spend political capital in assistance.
- *Privacy* – Crapo has made public statements (and demonstrated a past record) about his concerns with big data collection, and how consumer data is collected, used and protected. Previously this attention was targeted at regulators but expect the private sector to also be under the microscope.
- *Capital Formation* – If “JOBS Act 3.0” is not passed in the lame duck, we expect another effort to be made to pass as a package or split into smaller vehicles.
- *AML/BSA* – This might be an area of bipartisan attention as community banks continue to highlight their significant regulatory burden, and it is becoming increasingly clear that the regime could be tweaked to better serve law enforcement.
- *Reauthorizations* – Like the House Financial Services Committee described below, SBC will need to tackle TRIA, flood insurance, and Ex-Im reauthorization. None of these will be easy lifts as the Republicans have policy differences that they need to work out to be successful in reauthorizing.
- *Cryptocurrency* – SBC (as well as HFSC) has held a number of hearings over the past year related to cryptocurrency, with the focus ranging from use cases for these emerging technologies to potential money laundering and illicit activity concerns. Treasury recently highlighted ongoing FSOC work to coordinate and clarify the Administration’s policy on cryptocurrency and blockchain technology, and noted that a “white paper” may be produced by FSOC, and that a legislative framework could be put forward. Increased Administration activity, coupled with increased Member interest could lead to more activity in this space in the next Congress.

### ***House Financial Services Committee (HFSC) – Likely Chair: Maxine Waters (D-CA)***

*Note – As a result of retirements and losses last night, at least ten Republicans on HFSC will not be in Congress next year after. Five Democrats also are not returning (retiring or running for other office), so the combination of the Members who lost or are leaving the House along with some who may move to different committees and a ratio shift, means that the makeup of HFSC will look starkly different in January than it does today. Additionally, we provided our initial thoughts on HFSC under a Chair Waters late last week and have copied these potential immediate priorities below as well but wanted to highlight again how she likely will focus on oversight of Trump Administration financial regulators, including through the use of subpoenas.*

### **Oversight**

- *CFPB* – Decisions by Acting Director Mulvaney that led to the resignation of the CFPB’s Student Loan Ombudsman (allegations that banks are charging student loan borrowers dubious fees). Waters also will focus on the CFPB under Trump generally – she recently introduced legislation to “block the Trump Administration’s anti-consumer agenda” and reverse efforts to “dismantle” the CFPB.
- *OCC* – Comptroller Otting’s proposed changes to implementation of the Community Reinvestment Act and terms of granting “fintech” charters.
- *SEC* – Chairman Clayton’s proposed “Regulation Best Interest,” which Waters has criticized for not imposing on brokers the same fiduciary duty owed to customers by investment advisers. Efforts (or lack thereof) by SEC and exchanges to promote corporate disclosures of ESG factors (environmental,

social and governance), including gender and racial diversity of boards, management and employees.

- *Treasury* – Sec. Mnuchin’s implementation of existing sanctions against Russia (or lack thereof).
- *Fed* – Fed Chair Powell and Fed Vice-Chair Quarles likely will be called to testify often to justify regulatory changes, especially to Dodd-Frank rules such as Volcker. HFSC also likely will be diligent in their oversight of the Fed’s return to normal monetary policy, which President Trump has criticized as too quick.
- *Other* – There will be efforts to try and subpoena President Trump’s bank records related to Deutsche Bank (Waters has unsuccessfully attempted to receive such information as HFSC Ranking Member).

### **Legislation**

- *National Flood Insurance Program* – Current authorization expires on Nov. 30, 2018, and we expect the lame-duck Congress to pass only another short-term extension, meaning reauthorization could be a high initial HFSC priority.
- *Export-Import Bank* – Current authorization expires on September 30, 2019, making reauthorization another likely high initial priority for the Committee.
- *Terrorism Risk Insurance Program* – Current authorization expires at the end of 2020, making reauthorization a likely priority for 2019.
- *Consumer Protection* – Waters has introduced legislation to restore the supervisory and enforcement powers of the CFPB’s fair lending office and reestablish a CFPB student loan office.
- *Housing* – Waters has introduced legislation to enhance FHFA oversight of mortgage servicers who conduct business with the GSEs, including evaluation of servicers by FHFA and penalties for failure to meet minimum standards. Another Waters bill is intended to prevent foreclosures for FHA borrowers by increasing HUD oversight of FHA mortgage servicers and providing borrowers with an appeals process and opportunities to become current after defaulting. She has also introduced a bill to reverse decisions by HUD Secretary Carson that she says would “restore fair housing protections.”
- *Capital Markets* – Waters has introduced legislation to subject waiver requests by “bad actors” to a vote by the commissioners (rather than a decision by SEC staff) after public notice and comment.

### **Tax, Trade and Retirement**

#### **Likely Committee Chairs**

- ***Senate Finance – Charles Grassley (R-IA)***
- ***House Ways & Means – Richard Neal (D-MA)***
- ***Senate HELP – Lamar Alexander (R-TN)***
- ***House Education and Workforce – Bobby Scott (D-VA)***

#### **Tax**

Since passage of the Tax Cuts and Jobs Act (TCJA) there is growing concern about the deficit and both political parties remain in fundamental incompatible positions over individual tax policy and the corporate tax rate. This split and the fact that Republican’s lack the supermajority-60 vote threshold in the Senate to clear procedural hurdles make it almost impossible to move the President’s proposed middle-class tax cut. Likewise, it is equally unlikely that Democrats can move legislation to replace key elements of TCJA to make the tax code more progressive. It will be important to watch how international taxation issues drive the US policy landscape as the EU considers a punitive digital tax, which would have a major negative impact on US telecom and tech companies.

## ***Trade***

Even with Democrats now in control of the House, we believe that the new U.S., Mexico, Canada Trade Agreement (USMCA) will eventually be approved by Congress next year after some adjustments. However, the risk of the President triggering Article 2205 and withdrawing from NAFTA as a negotiating tactic likely increases. As a result, there will be some efforts to pass USMCA in the “lame duck” session but we believe it will be difficult to bypass the International Trade Council’s process, which calls for a formal investigation that is expected to last until late Q1 2019. Presumptive incoming Ways and Means Chair Neal has supported trade deals in the past, and while he has consistently voted against fast tracking them, it remains to be seen how he would approach new agreements as chair. Overall, we do not believe that the election will change the White House’s trade agenda or Republican support for the President’s trade policies. A divided Congress is unlikely to pass legislation limiting the President’s authority to impose tariffs. Moreover, the current trade skirmish with China is generally well received in Congress.

## ***Retirement***

Neal is expected to make improving and reforming retirement security an early priority under his leadership. He has cosponsored retirement savings legislation, including the Retirement Plan Simplification and Enhancement Act, which is aimed at expanding retirement plan coverage generally, and the Automatic Retirement Plan Act to expand retirement plan coverage for small employers. While there is still time in the current Congress to consider retirement savings language in the lame duck, Neal is still expected to put his own mark on this general issue when he takes the Ways & Means gavel. Noteworthy is that Neal did not support retirement savings provisions passed by the House in September because they were included in a package of three bills known as “Tax Cut 2.0” and did not move forward in a bipartisan manner. The Trump Administration also has moved forward in the retirement space with an Executive Order issued by the President in August that led to the Department of Labor proposing a rule to make it easier for small businesses to band together to offer 401(k)s. While this step is laudable, Neal could still move forward with legislation that would expand availability even more than that being considered by DOL. DOL is limited by its authority under Employee Retirement Income Security Act (ERISA), where Neal and Congress could change ERISA and any other relevant laws.

## **Agriculture**

- **Likely Chairs and Agendas:**
  - ***Senate Agriculture – Pat Roberts (R-KS)***
  - ***House Agriculture – Collin Peterson (D-MN)***

## ***CFTC Reauthorization***

In the first few weeks of the 115<sup>th</sup> Congress, the House passed Chairman Mike Conaway’s (R-TX) bill to reauthorize the CFTC through 2021 on a mainly partisan 239-182 vote. Senate companion legislation was never introduced as Chairman Roberts stated that serious consideration of reauthorization was on hold until Democratic committee support is more certain. However, Ranking Member Debbie Stabenow (D-MI) said that any reauthorization bill would need to have a permanent funding mechanism for the CFTC that isn’t subject to the “whims of congressional appropriators” to receive support. With this stalemate, the CFTC still must be reauthorized in the new Congress. As Ranking Member, Rep. Peterson repeatedly voiced support for a “simple reauthorization” and stated that the reauthorization bills put forth by Chairman Conaway would hamstring the CFTC’s effort to regulate swaps trading, characterizing the proposed funding level for the agency as “punitive.” As Chairman next Congress, Peterson is likely to draft a reauthorization bill that focuses on ensuring end-user protections, an efficient and fair marketplace and more robust annual agency funding levels.

### ***Farm Bill***

In late June 2018, the House and Senate each passed their own versions of the 2018 Farm Bill. Both measures would reauthorize agriculture and nutritional programs for five years, consolidate trade promotion programs, and largely maintain the status quo for farm safety net programs. Negotiators sought to iron out differences between the two bills, but the divide regarding work requirements for the Supplemental Nutrition Assistance Program (SNAP) prevented negotiators from reaching a deal on final conference language before that date. House and Senate lawmakers have acknowledged they have until December, when the first commodity program expires, to finalize a bill and have pledged to hold a vote on a finalized agreement during the lame duck session.

The most contentious differences between the House and Senate versions of the 2018 Farm Bill still relate to SNAP work requirements. Senate negotiators are strongly opposed to changes proposed by conservative House lawmakers to tighten program restrictions and add a mandatory training program. Peterson has publicly voiced support for the Senate measure, which is likely to place pressure on the House negotiators to drop their demands on work requirements and approve the new Farm Bill during the lame duck session. Given Peterson's position and the bipartisan effort from Roberts and Stabenow, if there is no resolution in the lame duck, we would expect an easier path to passage of a Farm Bill, albeit with Peterson's imprint, in the new Congress.

### **Regulatory Agenda**

The mid-term elections likely will not impact regional bank relief from stress testing, advanced approaches and liquidity requirements. Regulators will proceed with changes for leverage ratios for custodial banks and relief from the Volcker Rule. We also expect the SEC to remain focused on finalizing a fiduciary duty requirement for all investment advice as well as also continuing to police market data pricing. It is unclear what the CFTC can accomplish in 2019, as Chairman Giancarlo has publicly stated he intends to retire when his term expires in April, which will leave the CFTC deadlocked 2-2.