

July 8, 2019



## **Sailing on a Summer Breeze**

Now that the fighter jets and tanks have left the city, Congress returns to Washington this week for (maybe/hopefully) the last three or four weeks of work for the summer. With August looming, the House has just twelve planned voting days this month, while the Senate is currently scheduled to be in session for an additional week. While the scars from last year's truncated August Senate recess are still fresh, and calls to stay in town likely will be made again, Majority Leader McConnell (R-KY) actually has referred to an August recess this year, indicating that he is not inclined to again forego the traditional break. However, the Senate along with the House and White House must somehow agree on FY2020 spending levels, especially with a debt ceiling cliff and another sequester threatening. Outside of that, we expect a typically busy July as Congress tries to pack in as much activity as it can – Mueller, Facebook, Powell and marijuana promise to be front and center – before the break. We highlight these and other issues below as we briefly preview what we believe will be the focus in Washington in July, subject as always to external or unexpected events that could disrupt the schedule.

### **Expected Senate Banking Committee Activity**

July is shaping up to be a set-up month for the Senate Banking Committee (SBC). With the clearance of a back-log of nominees who were confirmed in June, SBC will continue its foundational work on beneficial ownership, agency oversight, privacy and possibly marijuana banking legislation.

This week, the Committee will hear testimony from Federal Reserve Chairman Jay Powell on Thursday as part of the semi-annual Humphrey-Hawkins testimony requirement. While monetary policy is the focus, members will ask their pet issues, which often include questions related to financial regulatory reform. Expect Republican members to focus on timing of the Volcker Rule re-write, implementation of S. 2155, and macro-economic issues. Democrats are likely to attack Powell over bank tailoring regulations, leveraged lending, maybe the SunTrust-BB&T merger, and focus on Trump's criticism of Powell. Next week on July 16<sup>th</sup>, SBC will be the first mover on oversight of Facebook's newly announced cryptocurrency effort – Libra, which is discussed in more detail below.

Finally, we are closely monitoring an announcement of a possible hearing on marijuana banking legislation. This would be the first major signal of SBC interest on an issue that has seen a tremendous lobbying effort by banks across the country due to the growing problem of marijuana banking compliance challenges. Sen. Gardner (R-CO), likely the most vulnerable Republican Senator in this election cycle, could use a boost from a high profile bill to help his state, and this could be such an opportunity. We are closely watching whether additional items could be attached to marijuana banking legislation that could make it more attractive to skeptical Republican members like SBC Chair Crapo (R-ID). Specifically, watch for discussions on including legislation related to Operation Choke Point issues and broader bank de-risking, which has harmed gun manufacturers and other sectors.

Other SBC items to watch in July include housing finance reform activity and hearings for the recently announced Federal Reserve nominees. It is our understanding that SBC currently does not plan to hold a July housing finance hearing, preferring to allow additional Administration action to occur (discussed more below) and conversation to evolve with Democratic members of the Committee on interest in legislative activity. We think this posture will hold unless the Treasury and Housing and Urban Development (HUD) reports push SBC to hold a hearing to discuss the reports, and specifically the legislative recommendations. On the Federal Reserve front, we think there will be a strong push to have a hearing for Board nominees Judy Shelton and Christopher Waller, but there are a lot of process steps that need to occur for this to happen in July. We expect Democrats to slow walk their meetings and make it challenging for a confirmation hearing for Shelton and Waller before the August recess, even though Shelton already has been confirmed by the Senate as the US member of the board of directors of the European Bank for Reconstruction and Development.

### **Expected House Financial Services Committee (HFSC) Activity**

HFSC Chair Waters (D-CA) continues to keep her committee busy with an aggressive agenda for July. This month kicks off on Wednesday with Powell's mandated House appearance, where, as in SBC, questions and issues raised are likely to diverge from just monetary policy. Powell's appearance will be followed by a Capital Markets Subcommittee hearing that afternoon on proposals to improve environmental, social and governance (ESG) disclosures. The next day on Thursday the 11<sup>th</sup> sees the beginning of a marathon mark-up of potentially 21 bills, including ones focused on credit scores, diversity and inclusion, housing and investor protection. With this many bills set to be considered, the mark-up is scheduled to spill into the next week, with time set aside on the 16<sup>th</sup> for continuation of this session. As with SBC, also on tap that week is a hearing focused on Facebook's Libra on the 17<sup>th</sup> (discussed below). The following week, also concerning a proposal that has been criticized by Waters, HFSC will review the proposed merger of SunTrust and BB&T. HFSC then plans to wrap up their July work with a FinTech Task Force hearing on alternative data in credit scoring on the 25<sup>th</sup>.

### **Nominations**

The new Senate rule to limit debate in order to speed up nomination considerations allowed for an expedited confirmation for a number of nominees, including Allison Lee as SEC Commissioner in June. Lee fills the Democratic seat of former Commissioner Stein, which has been open since the beginning of the year while rumors are still stirring around Democratic Commissioner Jackson's departure from the agency. Other key nominees confirmed by the Senate in June include Bimal Patel as Assistant Secretary of Financial Institutions at Treasury and Dino Falaschetti to be director of the Office of Financial Research at Treasury. The Federal Deposit Insurance Commission (FDIC) still awaits a selection for the vacant Democratic seat on their board. Looking forward, as mentioned above, we anticipate a nominations hearing for Shelton and Waller to fill the two remaining seats on the Federal Reserve Board of Governors.

### **Appropriations/Budget/Debt Ceiling**

The House passed 10 of the 12 annual funding bills before leaving Washington for the 4<sup>th</sup> of July recess, but without a larger budget caps deal with the Senate and Trump Administration, we view this as largely a messaging exercise. In order to make real progress towards funding the government for FY 2020, a budget caps deal will need to be reached. Negotiations are ongoing, but a deal does not seem likely in the immediate future. Senate Majority Leader McConnell (R-KY) has said publicly that he would like to see a caps deal in place before the Senate moves forward with any appropriations bills.

Regardless, the House likely will attempt to move closer to finishing their appropriations efforts under their own discretionary spending level. Funding for Homeland Security and the Legislative Branch have not been considered by the full House, although both of those already have passed through the Appropriations Committee. July should see full House action on Legislative Branch funding, but because the Homeland Security spending bill will be contentious (most of the same issues that were raised by some Democrats on the border supplemental funding measure are still at issue here), it is unclear whether Democratic leadership wants to force consideration of those issues again now. They will need to be resolved at some point, though, but without an agreement on overall spending, House Dems are unlikely to try and move DHS funding, at least separately, in July.

And if there are no agreements and the funding process is not complete by September 30<sup>th</sup>, a continuing resolution will need to be reached in order to prevent another government shutdown. Making this time of year even more complicated is the debt ceiling, which is set to expire in late summer or early fall.

### **House Floor**

Outside of appropriations, other issues on tap in the House this month include legislation to raise the minimum wage, and national defense and intelligence authorization. Additional Floor possibilities include legislation related to prescription drug prices, flood insurance, marijuana banking, offshore drilling, and reauthorization of the Export-Import Bank, but that particular bill still needs to pass through HFSC and currently is not on the list to be considered at the July 11<sup>th</sup> mark-up mentioned above.

### **Regulatory Agenda**

A few items on the regulatory agenda continue to see progress and we anticipate could potentially be resolved in the coming months, as financial regulators begin to recognize the need to finalize rules and regulations before 2020 to prevent any potential Congressional Review Act challenges if a Democratic President were to occupy the White House in 2021.

Last month, the Securities and Exchange Commission (SEC) adopted a package of rulemakings and interpretations designed to enhance quality and transparency of retail investors' relationships with investment advisers and broker-dealers. Included in the package are the new Regulation Best Interest rule (Reg BI) and the new Form CRS Relationship Summary, as well as two separate interpretations under the Investment Advisers Act of 1940, which will now be published in the Federal Register. The rules and forms will be effective 60 days from publication in the Federal Register and the interpretations will be effective upon publication.

Also in the pipeline and gaining significant interagency progress, are both the decision on whether to finalize or re-propose the Volcker Rule, as well as reform of the Community Reinvestment Act (CRA) regulations. FDIC Chairman Jelena McWilliams recently emphasized that modernization of the CRA remains a priority among the FDIC, Office of the Comptroller of the Currency (OCC) and the Federal Reserve, with a focus on clarifying exactly what bank activities qualify for CRA credit. Looking forward, we also anticipate there will be a Financial Stability Oversight Council (FSOC) meeting in the next couple of months, where we expect the activities-based approach regulating system to be voted on and finalized.

## **Housing Finance Reform**

July is shaping up to be a pivotal month for next steps in housing finance reform. First, it is our expectation that the Treasury and HUD reports to the President on reform recommendations will be submitted and publicly released in July. These reports will include recommendations to reform the housing finance system consistent with the principles outlined in the Presidential Memorandum on Housing Finance Reform released in March. It is our expectation these reports will include legislative and administrative recommendations. We are closely watching potential recommendations related to capital levels of the GSEs, loan limits, the Qualified Mortgage (QM) patch, and systemic risk-related recommendations. While the past Treasury reports on financial regulation were helpful to scoping financial regulatory reform discussions early in the Administration, we view the forthcoming housing finance reforms to be more significant. They will serve as this Administration's first real and concrete signal on the subject, and the recommendations are being closely coordinated across the executive branch to ensure high-level buy-in.

Second, the QM patch extension has been a hot topic of discussion in DC policy circles since Federal Housing Finance Agency (FHFA) Director Calabria's series of speeches earlier this summer. The patch, set to expire in January 2021, is arguably the administration's single largest unilateral tool to control the size of the GSEs portfolio. The Consumer Financial Protection Bureau (CFPB) under Director Kraninger already has sent signals that the patch has over-stayed its purposes, and Calabria has highlighted forthcoming action. The key question is what type of action occurs? Based on our conversations, we expect a rulemaking proposal from the CFPB later this summer on the patch. This will include a lengthy public notice and comment process and provide ample transition time and market digestion time before January 2021. We know Treasury, the CFPB and FHFA have been asking market participants for data and projections to loan flow and availability under different scenarios. Our expectation is the patch will not be renewed, but also will not be removed completely. The CFPB and FHFA are cognizant of the effect on mortgage costs with their decision on this issue, and we are headed into a presidential election cycle with the President running on a strong economy. Expect some type of gradual complete phase out, but with a scaled back patch in the transition years.

Other things to watch in July – we know senior Administration officials have been holding behind-the-scenes high-profile meetings with CEOs of major market participants on housing finance reform. To us, this signals sensitivity on the part of the Administration about market reaction and the need for some degree of market buy-in. These meetings also signal Wall Street's strong desire to be involved with any IPOs that could come with reform. Watch for news of additional meetings and pay close attention to the meeting participants.

## **Facebook Hearings and Privacy**

### *Facebook*

As previewed above, Facebook and the Libra Association will face significant scrutiny when Libra is the subject of hearings in both HFSC and SBC this month. Chair Waters and other senior Democrats on HFSC have called on Facebook to halt their cryptocurrency plans until Congress and Federal regulators have had a chance to review them. Waters has expressed privacy, consumer protection, and national security concerns, and said that the lack of a regulatory regime for crypto products presents significant investor protection concerns. We expect these to be key themes from HFSC Democrats at the hearing.

In SBC, the hearing will likely focus on potential financial stability, competition, and privacy concerns (more below) – there has been bipartisan skepticism and criticism following the announcement and this hearing will allow Members to use this high-profile example to express broader concerns related to cryptocurrency and tech emergence into financial services. We also expect SBC Chair Crapo and Ranking Member Brown (D-OH) to focus heavily on Facebook’s consumer data privacy efforts, and follow-up on their joint oversight letter sent this spring.

### *Privacy*

While privacy continues to be a major policy topic on Capitol Hill for just about every sector of the economy, in financial services and technology, clarity is emerging about the direction Chairman Crapo and Ranking Member Brown are headed. The narrow issue around consumer data’s role in the offering of financial services products has quickly risen to the top of the bipartisan effort. SBC has already held hearings this spring focusing on the role of third-party data aggregators and how they are becoming major players in the financial services sector. Along with the Facebook hearing, we are closely monitoring whether a hearing with industry participants comes together as SBC majority and minority staff have demonstrated a strong desire to hear from data aggregators in a public setting.

Therefore, industry should be closely monitoring and evaluating its relationships with third-party data sources and “non-financial services” tech companies to understand exposure to policy oversight that SBC is conducting. Specifically, the industry should closely monitor how consumer data related to character, reputation, and other “non-financial” indicators is being incorporated into marketing and offering of financial services. We continue to expect legislation to emerge at some point this year that places new limitations on these data sources by amending the Equal Credit Opportunity Act and Fair Credit Reporting Act.

With the broader privacy debate stalling because of perennial committee jurisdiction challenges, a narrow, bipartisan bill on privacy in the financial services sector could emerge as the front runner to reach the President’s desk.

## **International**

### *China*

The Administration has been active on the international stage in recent weeks. President Trump said talks with China were “back on track” after meeting with Chinese President Xi at the G-20 summit in Japan. The two leaders agreed they would not impose new tariffs while talks continue. They also agreed to again allow US sales of parts to Huawei and that China would purchase an additional 544,000 tons of soybeans from US farmers. Markets reacted with significant gains, but whether those gains last is unclear after recent remarks from China’s Ministry of Commerce cast doubts on the talks stating that all tariffs must be removed before a deal can be reached. Next up, negotiations continue with no definite timeline, but White House aides have indicated an in-person meeting between the two sides may be in the near future.

### *North Korea*

President Trump also made history with a last minute meeting with North Korean leader Kim Jong Un where Trump became the first American President to cross the DMZ and step foot into North Korea.

While no specific outcomes resulted from the meeting, there was mutual agreement to resume long-stalled nuclear talks.

### *USMCA*

The USMCA took another step toward passage in June, as Mexico became the first country to formally ratify the agreement on June 19, 2019. However, a long road remains ahead with congressional Democrats demanding changes to enforcement, labor, environment and drug pricing provisions. With only twelve legislative days between the July 4<sup>th</sup> recess and the August break, not much time remains for congressional leaders to find agreement on these sticking points. Both sides appear to be making good faith efforts to reach consensus with Democratic working groups meeting weekly with the US Trade Representative on their concerns.

### **Other Issues of Interest**

A handful of other legislative items continue to remain a focus among lawmakers including reauthorization of the Commodity Futures Trading Commission (CFTC) and National Flood Insurance Program (NFIP), as well as retirement savings legislation.

#### *CFTC reauthorization*

The Senate Agriculture Committee held a hearing last month to gain perspective on potential reforms as discussions arise around reauthorizing the CFTC. The hearing gave no clear timeline in terms of a reauthorization date but Chairman Roberts (R-KS) and Ranking Member Stabenow (D-MI) showed bipartisan acknowledgement of the need for both reauthorization and reform, as the agency has seen no reauthorization in a decade. Committee members recognized the need for proper funding to ensure the agency has the enforcement tools and resources needed to adapt to a growing global industry, particularly in the cybersecurity space. We anticipate activity at the agency to heighten, as incoming CFTC Chairman Heath Tarbert will officially assume office on July 15<sup>th</sup>, with reauthorization and reform to be of top priority. Additionally, House Agriculture Committee Chairman Peterson (D-MN) also has indicated CFTC reauthorization as a priority.

#### *National Flood Insurance Program (NFIP)*

Last month, the House Financial Services Committee unanimously passed comprehensive legislation (HR 3167) to reauthorize the NFIP until September 30, 2024, with a number of reforms to increase affordability, improve mapping, enhance mitigation and modernize the program. The bipartisan bill will now move to the full House for consideration – we anticipate it will pass as it has backing from flood-prone Louisiana Reps. Scalise and Graves, as well as support from the U.S. Chamber of Commerce. Although, even with the 59-0 vote out of HFSC, and the likely passage out of the House, we expect potential obstacles in the Senate. Louisiana Sens. Cassidy and Kennedy have stated that the current legislation from the House lacks the reforms to ensure sustainability and affordability for those dependent on the program, particularly in their state. Looking forward, lawmakers remain diligent in hopefully reaching an agreement for a long-term extension before the September 30<sup>th</sup> expiration date.

#### *Retirement Savings*

The SECURE Act's bipartisan vote through the House in May instilled hope for a swift passage out of the Senate in the coming months. House proponents had hoped to push the bill through using unanimous consent, meaning the Senate would vote on the bill unchanged, but the bill has remained stagnant with

no vote in sight since arriving there. The delay is primarily due to disagreements over whether to include a proposal to expand the use of 529 funds, with an effort led by Senator Cruz (R-TX) to include the provision. Cruz argues that the proposal to allow families to pay for homeschooling in tax-sheltered 529 accounts must be included in any legislation passed by the Senate and was removed from the House bill by Speaker Pelosi (D-CA) due to pressure by special interest groups. Looking forward, the path for passage out of the Senate before the August recess looks less likely than it did only a few weeks ago.

### **Political**

Round two of the 2020 Democratic presidential debates is set for the last two days of this month in Detroit. As of today, the 20 candidates likely to appear at the Fox Theatre over these two July nights are the same as the ones who debated in Miami last month. However, Montana Governor Steve Bullock has posted impressive fundraising numbers and may bump someone like Rep. Swalwell (CA) or former Colorado Governor Hickenlooper from the stage. One interesting point to note is that it is unclear who will appear on which night – NBC randomly divided low and high polling candidates for the June debates, but the July host, CNN, has not indicated how the candidates will be divided this month. All of this again likely will serve only as August media fodder, as the field is expected finally to narrow this Fall with additional hurdles that must be met for appearances at debates in September and October. Reportedly, five candidates have already passed these thresholds – former Vice President Biden, Sen. Sanders, Sen. Warren, Sen. Harris and Mayor Buttigieg – so it will be interesting to see whether candidates such as former HUD Secretary Castro, Sen. Booker or Sen. Klobuchar, among the numerous others, also are able to meet these requirements to have their campaigns continue in earnest. Regardless, it is still extremely early, so what's past is likely not prologue, but instead, in the immortal words of Donald Rumsfeld, this is what we should keep in mind during these debates and the early stages of the campaign for the 2020 Democratic presidential nomination:

As we know, there are known knowns; there are things we know we know. We also know there are known unknowns; that is to say we know there are some things we do not know. But there are also unknown unknowns—the ones we don't know we don't know.