FedFin Client Report

Thursday, January 7, 2020

FedFin Forecast: A Run-Off, A Riot, and the New Congress

Client Report: ELECTION25

Executive Summary

It will take considerable time for Congress to absorb the meaning of yesterday's insurrection not only in institutional terms, but also and more immediately with regard to each Member's thinking about his or her own policy and political agenda. It will also take considerable time for the Senate's Democratic leadership to organize itself into new offices with additional staff and new committee line-ups and, in some cases, rules. However, clients are already requesting FedFin's assessment of implications for financial policy. This report thus provides our initial analysis, one founded on Karen Petrou's comments yesterday to NPR, that the "moderate middle" will be the Senate's and thus Congress' defining force. To be sure, the moderate middle will now tilt to the left on financial policy because of the progressive character of legislation clearing HFSC and Senate Banking, but every controversial actions – especially if these are also very costly actions – will still face floor obstacles. Because much in financial policy can be set by rule without new law, this report also assesses the implications of the shift in Senate control for the Fed and other financial regulatory agencies, noting significant implications likely as the Fed re-evaluates its own institutional political-risk profile. A separate report will assess fiscal policy, with an eye to financial-sector specific stimulus measures and action on issues such as interest on reserves and the big-bank fee advocated by President-Elect Biden during the campaign.

Analysis

In the next few days, incoming Majority Leader Schumer (D-NY) and Senate Banking Chairman Brown (D-OH) will release preliminary agendas, with HFSC Chairwoman Waters (D-CA) not only doing the same but, due to continuity on her end, providing a preliminary hearing agenda for late January. Priority will go first to pandemic-related issues and to establishing pro forma records for relatively non-controversial measures (e.g., cannabis banking) to move these quickly to enactment and, in the Senate, to the nominations we expect shortly from Mr. Biden. A reminder: Janet Yellen's confirmation and that of most other senior Treasury officials is the jurisdiction of Senate Finance, not Banking.

Other near-term actions are likely to include:

- ***FRB Action:*** There will be an immediate recalibration of Fed regulatory policy. Many recent actions under Vice Chairman Quarles' tenure received harsh criticism

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from Chairwoman Waters and Sen. Brown, but the Fed proceeded with them based not only on majority Board consensus, but also knowledge that GOP Senate control provided a critical counter-weight. While very narrow Democratic Senate control makes Review Act or other legislative reversals very challenging and thus unlikely, the political climate has changed and we expect the Fed to change with it. This will affect not only regulatory actions, but also supervisory and M&A decisions. Our prior forecast for Congressional action on the Fed's structure, mandate, and emergency-liquidity facilities (see *Client Report* **FEDERALRESERVE59**) is substantively unchanged.

- ***Regulatory Realignment:*** In addition to an immediate recalibration of the Fed's regulatory and supervisory political calculus, the OCC, CFPB, SEC, and CFTC will get new leadership via new acting chairs or acting agency heads pending appointment and confirmations. We have noted numerous OCC actions under Acting Comptroller Brooks that will be retracted and others – i.e., new charters, preemptive policies – likely to be left intact. The SEC has also finalized several highly-controversial actions, but these will take time to revoke under the APA. Most other actions will stand for some time, but even temporary agency heads will emphasize new priorities – e.g., climate change and financial inclusion/racial equity. More complex, less partisan issues – e.g., digital finance – will continue on the course forecast in our recent report (see *Client Report* **DIGITAL6**).
- ***Structural Reform:*** We do not expect near-term Congressional action on top-priority financial-policy questions raised by the pandemic that do not involve counterparties such as municipalities and homeowners. Instead the FRB, Treasury, and other agencies will proceed on MMF reform (see *Client Report* **MMF16**), Treasury-market structure (see *Client Report* **TMARKET**), and other issues (see *Client Report* **REFORM200**) as forecast. However, once policy takes shape and rules are imminent, Congress will engage. Depending on how long this takes, Democrats may in the interim have pressed for new systemic designations, nonbank standards, and other actions that will either influence or even change what the agencies have in mind. However, we expect action to be largely agency – not Congress – driven.
- ***Housing Finance:*** What the Trump Administration does to Fannie and Freddie before it leaves will determine what Congress and the Administration do on Fannie and Freddie, but narrow Senate control will block any legislative efforts to change the GSEs' charters without broader housing-finance reform. That said, there will be both Congressional and Administration pressure on affordable housing, pressure FHFA has already anticipated, greater support for FHA, and an array of policies to protect pandemic-vulnerable households. We continue to expect FSOC action on nonbank servicers, but this will take time unless precipitated by industry stress.
- ***FBOs:*** Sen. Brown was notable in his criticism of the FRB's tailoring rule's treatment of intermediate holding companies (see *Client Report* **REFORM156**). We do not expect an effort at legislative reversal, but his more protectionist view of FBOs will color U.S. policy and strengthen demands for consolidated regulation (see *Client Report* **REFORM200**), policies sure to advance in concert with Biden Administration action such as *de facto* sanctions for Chinese banking organizations and greater scrutiny of nonbank foreign financial companies seeking U.S. footholds.

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