Midterm Surprises and Financial Policy Certainty: The Prospects for Substantive Action on Critical Questions

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Well, I must say I'm glad our practice doesn't include political polling. Ever since the midterm results came in over the weekend with enough certainty to call control of at least some of the Congress, pollsters who mistakenly predicted electoral outcomes pivoted to prognosticating what this all means for the next Congress and the 2024 election. Widespread conviction now has it that America is mostly a purple country in which candidates dubbed able to govern mostly prevail over those who hew too far to the left or right. But, just as the last three elections transformed overnight to unexpected outcomes, this seeming certainty could change by 2024 because many externalities are sure to change, so even this conclusion on my part is tentative and, generally not germane to what you asked me to discuss: the future of U.S. legislation on the most critical financial-policy questions the last Congress left wholly untouched.

First, big picture. I think bills that stay out of the partisan buzzsaw will advance after Members absorb a sobering lesson about the need to show Congressional capacity to govern. Second, Republicans in the House will do everything they can to thwart Rohit Chopra and Gary Gensler but largely land only rhetorical blows. Any new rules from any of the regulators Republicans don't like may also get a scolding and even House passage of Congressional Review Act repeal legislation. However, none of these bills will be enacted into law and Senate Republicans aren't likely to add to these legislative initiatives because they're going to be busy trying to block Biden Administration nominations. Republicans will also pillory "woke" financial institutions without being able to force change at companies which wish to stay at least sort of woke.

All of these activities will be awkward for everyone involved, but largely inconsequential. What might happen and thus really make a difference?

Mapping the Cryptoverse

Digital finance of course falls squarely in the bucket of phenomena that many knew would end badly but on which Congress was unable to act enough in advance to avert the inevitable. And, as is almost always the case, after it has failed, Congress will over-correct. The new U.S. crypto regime will look nothing like the light-touch CFTC construct envisioned by the now-disgraced FTX founder. Sadly, it will also look nothing like the same-risk/same-rule framework that would actually make sense and prevent both domestic and international regulatory arbitrage. Instead, as with so much of Dodd-Frank, I fear the new digital-finance construct will be a patchwork of different rules under the aegis of different regulators because inter-agency jurisdictional disputes are as intractable as ever. Where the new law is likely to make the most sense is for stablecoins because thinking is most advanced on how best to govern them. Where new law will likely fail is leaving sufficient scope for innovation under sensible standards that allow regulated entities such as banks to venture into the cryptoverse or even lead the way to sound products for vulnerable consumers and meaningful market-use cases. And, anything other than stablecoin legislation will take a while to craft, leaving considerable scope for new rules under current law that will at the least alter new law or even deter it.

Demanding More for Depositors

One issue on which I think populists and progressives could come quickly to agree is the extent to which banks are remunerating depositors “fairly” in light of recent Federal Reserve rate increases. CFPB director Chopra early on said they aren’t, but a moderate voice – Sen. Jack Reed – recently chimed in. There are many reasons most banks aren’t rewarding depositors even as they hike borrowing rates starting with the fact that some of the biggest banks remain flush with funding, but this is an easy-to-understand issue of market “fairness” about which Democrats can rally, populists rail, and moderates decide the better course of valor is discretion. It’s hard to see new law in this arena, but a lot more political risk that spills over to decisions on mergers and CFPB edicts is more than possible.

Frustrating the Fed

Speaking of issues where each side of the political spectrum meets, there’s the U.S. central bank. As the campaign wore on, the Fed’s support with progressive Democrats wore thin and the Administration’s bear-hug disappeared. Republicans targeted their economic ire at the White House during the election, but many are mindful of the role ultra-accommodative policy and the Fed’s “team transitory” played in historic inflation levels. If these grow higher and/or economic conditions worsen, the Fed is likely to be another target at which both ends of the political spectrum take aim. Even if this risk dissipates, the Fed’s independence from what Republicans believe to be its callous disregard of payment-system access accountability will lead to legislation on which virtually all sides of the aisle along with its middle will concur.

Considering the Conservatorships

GSE reform is a perennial also ran in terms of Congressional action no matter how loudly an Administration calls for it nor how high the recognition that it’s long overdue. Absent catastrophe – and one is always lurking at the fringes of U.S. housing markets – GSE reform will rest undone unless or until it joins the lists of problems overlooked that provoke crises to come that then lead to rapid-fire over-responses.