

REGULATORY INTELLIGENCE

U.S. elections blunt prospects of sharp direction change in financial oversight

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As control of Congress hangs in the balance after Republican gains in mid-term elections that fell short of speculation, the financial services sector appears to face a regulatory outlook with less opportunity for radical change in either direction.

Republicans moved closer on Thursday to capturing a majority in the House of Representatives, but several races remained undecided two days after the voting, and a definitive outcome could take some time. In the Senate, a December 6 runoff election in Georgia between the Democratic and Republican candidates could be the deciding factor the battle for party control.

Democrats currently control both houses of Congress, and a shift in power would give Republicans greater ability to stall the legislative agenda of President Joe Biden's administration.

However, regardless of which party controls Congress, Biden will still wield a powerful veto pen that could halt any Republican efforts to roll back his policies.

Furthermore, much, but not all, of Biden's economic agenda is being pursued away from Congress in cabinet agencies including the U.S. Treasury Department and at independent federal regulators overseen by Biden appointees.

Here are some areas in which U.S. regulatory policy could be affected by the outcome:

Environmental, Social and Governance issues

A Republican-controlled House would likely seek to curb Biden's legislative agenda, particularly regarding climate change.

It would also put financial regulators under greater pressure, with the House banking and finance committees likely to put scrutiny of ESG policies, central to the Biden administration's financial agenda, high on their priority list.

"Presuming Republicans gain the majority in the House -- regardless of who controls the Senate -- there will be more oversight over the federal financial regulators -- more scrutiny of them, more frequent hearings and information requests," said Dan Meade, a partner at the law firm Cadwalader.

"On the ESG front, that will mean at the very least putting pressure on the financial regulators to 'stay in their lane,'" he added.

Financial industry executives could also face more pressure over their firms' commitments to fight climate change or support social goals. Even in the minority, Republicans in Congress grilled industry CEOs in September over issues such as employer payment for employees' abortion costs and energy-industry financing.

Still, candidates that campaigned in support of policies to fight climate change won seats in Tuesday's voting.

"A lot of climate champions did win across states, governorships, legislatures, and more," said Frances Colon, climate policy director at the Center for American Progress, a progressive think tank.

In addition, many said the lack of a sweeping victory by Republicans meant they will not be able to reverse the Inflation Reduction Act, Biden's flagship program to green the U.S. economy.

Republican control of the House could, however, complicate the administration's efforts more broadly to combat climate change. Biden has long made shifting the United States from fossil fuels a part of his program to reduce carbon emissions.

A shift in U.S. government power toward Republicans, who have resisted international efforts to fight climate change, could weaken the U.S. negotiating stance or the credibility of any commitments Biden makes when he travels this week to the United Nations' COP27 climate summit in Egypt.

Consumer banking

The Consumer Financial Protection Bureau, which has vigorously sought to curb finance industry practices seen as abusive or discriminatory to consumers, would face more rigorous and difficult oversight hearings in a Republican-controlled House. Rep. Patrick McHenry, who would be in line to chair the Financial Service Committee, has vowed to curb the CFPB's "breakneck" speed in rulemaking that has "gone in an expansive way beyond that which we think the law permits them to act," he told Politico.



The agency retains independent funding and Congress can do little to obstruct the CFPB.

The election result also comes at a time when the CFPB has won its first, hard-won support from the banking industry, over its initiative to regulate big-tech firms entering financial services. Traditional consumer finance firms have been uncomfortable with many of the agency's consumer protection measures but have warmed up to the agency as it has issued rules to take a more active role in examining and overseeing non-regulated finance sectors.

"The banking industry and mortgage industry do not want CFPB to go away and do not want most of the regulations to be repealed," Alan Kaplinsky, the Ballard Spahr LLP senior counsel who specializes in consumer finance law.

A Republican-led congress would likely continue to push the agency for more accountability to Capitol Hill, he said. Among bills likely to be considered would be the creation of a five-member CFPB governing board and requirements for the agency to submit to budget approval by Congress.

However, the agency also faces legal challenges over its structure and activities, and any concerted legislative initiative could await the outcome of those cases, possibly to be decided by the Supreme Court.

The CFPB has been taking steps to prepare for more scrutiny from a possible Republican congress and legal challenges. It opened an Office of Litigation and Oversight under Steven Bressler, a former long-serving senior policy official at the Justice Department.

The agency over the past year also has strengthened its ties to the DOJ in enforcement anti-discrimination and anti-trust actions, in an alignment that could sustain its enforcement role if Republican lawmakers place new curbs on its powers.

The ability of Republicans to influence the agency through hearings and petitions remains to be seen. The agency has been responsive to Democratic lawmakers under the Biden administration.

Under pressure from Democratic lawmakers, for example, large banks sharply scaled back or eliminated overdraft fees after the CFPB issued a report showing large banks generating billions of dollars in fees for check overdrafts.

"It's hard to say whether banks feared new regulation, new legislation, bad publicity, competition, or had bigger fish to fry with their overseers. Whatever the reason, the dam burst," said a recent Brookings Institution report.

Health insurance and health care policy

Abortion-rights measures won frequently in the midterm elections. Pro-choice Democratic candidates in Michigan helped the party capture control over both houses of the state legislature. In Pennsylvania, where Republican state legislators were advocating abortion restrictions, Democrat Josh Shapiro cruised to victory in the race for governor, where he will hold veto power over any efforts to limit abortion.

"When voters were given a chance to definitively vote on abortion, they resoundingly supported preserving and expanding access and we saw that last night," said President of NARAL Pro-Choice America Mini Timmaraju.

Vermont, Michigan and California voted to enshrine reproductive freedom into their constitution, while Kentucky rejected an amendment that would have codified a ban on abortion into their constitution.

Voters in Montana similarly rejected a move to recognize an embryo or fetus that is born, including as a result of abortion, with a heartbeat or other signs of life as a legal "person" with rights to all healthcare services

Voters in Republican-led South Dakota approved a ballot initiative to allow expansion of the state Medicaid low-income health program to cover more people. In Georgia, however, Republican Governor Brian Kemp defeated Democrat Stacey Abrams, whose campaign heavily focused on increased healthcare access and Medicaid expansion.

Some Republican candidates in the campaign had called for reshaping entitlement programs including Medicare old-age health insurance. Representative Kevin McCarthy, current House Minority Leader who would be expected to become Speaker in a Republican-majority House, has Republicans might tie future must-pass debt ceiling legislation to spending cuts, but he would not specify whether the cuts would include reforms to Social Security and Medicare.

Cryptocurrencies

The politics of digital-asset regulation have often cut across party lines. Countless pieces of bi-partisan legislation have been introduced in Congress but have not progressed. In a new Congress, legislative efforts seeking regulatory clarity over digital assets may become a higher priority.

Several Republican supporters of digital assets in the House were re-elected. If the party succeeds in capturing the chamber it will control important committees and potentially exert more influence over digital-asset regulation.

Leading crypto supporter Representative Patrick McHenry, a Republican from North Carolina, and a member of the Blockchain Caucus, won re-election and would be poised to chair the House Financial Services Committee in a Republican-run house.



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"For years, I have advocated for Congress to develop a clear regulatory framework for the digital asset ecosystem, including trading platforms," McHenry said in a statement on Tuesday commenting on digital-asset market developments. "It's imperative that Congress establish a framework that ensures Americans have adequate protections while also allowing innovation to thrive here in the U.S. "

Federal regulators have said additional legislation may be necessary to establish some digital-asset policies. However, the Biden administration has also moved to

The collapse of major crypto exchange FTX this month could also have an impact on the administration and Congress's approach to oversight of the digital assets industry.

Sanctions

With, at most, modest gains for Republicans, there is no clear mandate to shift U.S. policy on aid to Ukraine nor to take a different approach on Russia sanctions.

While some Republicans have been skeptical of U.S. involvement in Ukraine and raised questions about the utility of continued Western sanctions against Russia, the apparent modest shift in political winds does seem to signal a shift in policy in the near-term.

Democrats have suggested for months that Republicans might curb assistance to Kyiv.

U.S. House of Representatives Republican leader Kevin McCarthy, who hopes to become speaker if Republicans take control of the House, previously said U.S. aid to Ukraine should not come in the form of a "blank check."

But even he felt the need to clarify those remarks just before the election, telling CNN: "You always need, not a blank check, but [to] make sure the resources are going to where it is needed. And make sure Congress and the Senate have the ability to debate it openly."

Furthermore, other party leaders have suggested they support U.S. aid for Ukraine in general.

Based on election results as of Wednesday afternoon, there remains no reason to think that sanctions compliance professionals – who are still working long hours to ensure adherence to the deluge of complex sanctions Washington has imposed on Russia since its February invasion of Ukraine – will see any relief.

Enforcement

The Biden administration's enforcement stance toward financial industry misconduct and compliance shortfalls is unlikely to change.

"While I don't expect any significant changes in the examination and enforcement agendas in the short term, it is reasonable to expect that rule making priorities may be adjusted to reflect political realities," said Ken Joseph, a managing director and head of the Financial Services Compliance and Regulation practice for the Americas at Kroll.

(Written by Randall Mikkelsen, Regulatory Intelligence, with reporting from Todd Ehret, Henry Engler, Richard Satran, Brett Wolf, Antonita Madonna and Melissa Berry. Additional reporting by Reuters News)

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