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WASHINGTON POLICY STRATEGY

Potomac Perspective

As the week draws to a close, it appears Congress will avoid a partial government shutdown and, more importantly, sequestration cuts next month. While this is a positive for the market, prospects are diminishing that Congress will pass a tax bill that would have positive implications for sectors with high R&D spending. Also, prospects for a foreign aid bill are murky at best. Finally, we look at an FDIC proposal on bank mergers which seeks to limit large bank deals, but in reality, would have a limited impact.

SPENDING BILL

On Friday, the House passed a package of appropriations bills that cover defense and homeland security budgets, as well as several other agencies, for the remainder of fiscal year 2024 (ending September 30, 2024). The Senate is expected to pass the bill over the weekend, thereby avoiding a government shutdown. More importantly, the bill avoids the sequestration process that would have kicked in after April had Congress merely passed a Continuing Resolution for the remainder of the fiscal year. This is a positive for the defense sector since it eliminates a possible cut in defense spending.

TAX BILL

The corporate tax bill which passed the House in January is on life support in the Senate. The bill would temporarily change rules regarding R&D expensing, bonus depreciation, and the formula used to calculate the business interest deduction. The bill would also expand the Child Tax Credit (CTC), which is the sticking point in the Senate. Some Senate Republicans, including Senate Finance Committee Ranking Member Mike Crapo (R-Idaho), oppose some of the changes to the CTC. While there are several Republicans who might vote for the bill, it seems getting 60 votes in the Senate will be difficult.

The legislation would benefit sectors with high levels of R&D spending. The failure to pass the bill represents a missed opportunity, but we are skeptical investors have priced in passage of the bill. We see a limited market reaction if the bill fails to pass.

FOREIGN AID

When Congress returns to Washington, D.C. after Easter, it could consider the foreign aid supplemental bill which passed the Senate several weeks ago. There is significant bipartisan support for the bill which would provide funds for Israel, Ukraine, and Taiwan. There is, however, also bipartisan opposition in the House, which makes passage complicated.

Conservative Republicans who oppose Ukraine funding could block the bill in the House Rules Committee, which would force Speaker Mike Johnson to bring the bill to the floor under a suspension of the rules requiring a two-thirds majority. Under this scenario, progressive Democrats who want to place conditions on aid to Israel could join with conservative Republicans who oppose additional aid to Ukraine.

Some House members are attempting to use a Discharge Petition, which circumvents the leadership and brings a bill directly to the floor. A Discharge Petition requires 218 signatures. Since some Progressive will not sign the petition due to their position on Israel funding, a successful petition would need the support of numerous Republicans. However, many Republicans, including those who are supportive of Ukraine aid, will be reluctant to buck their party leadership and sign the petition.

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We continue to believe a foreign aid bill can pass the House if it gets to the floor. Getting the bill to the floor, however, is a high hurdle.

FDIC PROPOSES NEW MERGER RULES

On Thursday, the Federal Deposit Insurance Corporation (FDIC) proposed an update to its Statement of Policy (SOP) on Bank Merger Transactions. The proposal follows proposed guidance from the Office of the Comptroller of the Currency (OCC) regarding its Bank Merger Act (BMA) rules. The FDIC's proposal also follows two years of interagency discussions (including the Federal Reserve Board) to update BMA rules. We have a few quick takeaways regarding the FDIC's proposal.

1. Divestitures – The SOP proposes that where divestitures might be needed, the FDIC would expect that the divestures would occur before the merger is completed, rather than afterwards.
2. Convenience and needs – Under the proposal, banks would be required to show that the resulting bank will "better meet" the convenience and needs of the community to be served than would be the case absent the merger. Public hearings would be held for any proposed merger that results in a bank over $50 billion in assets or for which there are a "significant" number of Community Reinvestment Act protests.
3. Financial stability – The proposed SOP would assume that mergers in excess of $100 billion are more likely to cause potential financial stability concerns and therefore would be subject to heightened scrutiny. As a practical matter, the proposal would have little impact on large bank mergers since the FDIC regulates very few of them. The FDIC oversees state-chartered banks that are not members of the Federal Reserve System, and the overwhelming majority of its regulated banks are smaller banks. As of year-end 2023, of the 33 banks with assets in excess of $100 billion, only four are regulated by the FDIC and one of them, Discover, could be merged into an OCC-regulated bank if its proposed merger with Capital One is approved.

The FDIC's proposal is more proscriptive than the OCC's earlier proposal. This outcome was somewhat surprising since the Comptroller of the Currency sits on the FDIC's Board and voted for yesterday's proposal. We expected fewer differences between the two proposals. That suggests significant differences of opinions among the regulators and might signal why the Federal Reserve Board has yet to issue its own proposal.

Furthermore, the FDIC's proposal cannot be seen in a vacuum. The proposal also came on the same day as the Department of Justice announced an antitrust lawsuit against Apple. The FDIC's announcement could be interpreted as part of a coordinated strategy by the administration. The Biden administration has made antitrust enforcement a priority and it figures to be a talking point in the 2024 campaign.

The proposal will be subject to a 60-day public comment period, which will end around Memorial Day. The FDIC will then consider the comments and draft a final SOP. It is unclear whether this can be accomplished before the end of the year. If the FDIC does not finish the SOP by the end of 2024 and Donald Trump is elected, the composition of the FDIC would change. We think the proposal would then be scrapped, based on the fact the two Republican members of the FDIC Board voted against it.

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