Election Update

December 1, 2020

HOW A BIDEN ADMINISTRATION WILL IMPACT BANKS AND FINANCIAL SERVICES COMPANIES

Going into the U.S. presidential election, many investors had questions around how a Joe Biden Presidency, along with potential changes in Congress, could impact the banking and financial services industry. While President Trump has not yet conceded and we are still awaiting the Georgia run-off elections for U.S. Senate, we are operating under the premise Joe Biden will be the 46th President of the United States and Congress will, for all intents and purposes, remain highly divided. More developments are unfolding around the Biden transition team, along with leadership changes in key posts that touch financial services companies. In this in-depth report, we discuss several topics, including the prospects for re-regulation and fiscal stimulus, along with Janet Yellen's role as the first female Treasury Secretary and other potential changes in government agencies.

At a high level, we expect there could be *some*, though not wholesale sweeping changes to the regulatory landscape for financial services firms and banks. Additionally, when the Administration and Congress change over, we look forward to additional fiscal stimulus measures targeted to small businesses and individuals likely in early 2021. As Treasury Secretary, Janet Yellen is an accomplished, respected economist that should garner bi-partisan support and is well-known by the international finance and central banking community. We expect her to focus on key areas such as fiscal stimulus, global economic issues such as trade, along with income/labor market inequality, climate change, while keeping key regulatory provisions for large national and mega banks intact. While there are several key agencies that do have immediate potential turnover in leadership, there are many other top roles that will remain in place for the next few years and, in turn, we expect new policy agenda items to be unveiled at a moderate pace.

RE-REGULATION OF FINANCIAL SECTOR LIKELY NOT A KEY POLICY AGENDA ITEM

Going into the election, a key concern for many investors was the potential for significant re-regulation of the financial services industry. While an understandable worry, we believe this issue was largely overstated. As developments post-election continue to unfold, we expect there could be *some,* though not wholesale sweeping changes to the regulatory landscape for financial services and banks.

- **Biden Narrative Was Never Really Focused on Financial Services Industry.** Campaign rhetoric prior to the election, and even post-election has never really centered around the financial services industry. Although corporate tax reform was indeed mentioned, so were other key items, including healthcare policy, climate change, the current state of social unrest/inequality, along with perhaps most near-term, fighting the COVID-19 pandemic and solving how to keep the economy afloat during these challenging times. As discussed below, banks have played a key role in helping to be part of the solution to the economic recovery, which stands in stark contrast to the Great Financial Crisis ("GFC") in which banks were a source of the problem. A "re-regulation" of the banking industry has not been expressly mentioned by the Biden Administration and, rather, we think the banking industry is much needed in its current form and will prevail as one of the key proponents to drive the recovery.

- **Dodd-Frank Remains Largely Intact.** The most sweeping regulatory change from the GFC was the passing of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") in 2010. When Donald Trump was elected President in 2016, he pledged to repeal Dodd-Frank. Indeed, there was some "loosening" of the reform with the passing of the Economic Growth, Regulatory Relief, and Consumer Protection Act ("Crapo Bill") in March 2018, but not comprehensive changes. The non-partisan Brookings Institution has confirmed this view by indicating that the Crapo Bill, "…Leaves intact the core Dodd-Frank framework: increasingly tougher regulation on larger banks, new authority and discretion for the Federal Reserve, enhanced authority for the federal government to unwind a failed financial institution, and the creation of new federal regulators, including the Consumer Financial Protection Bureau (CFPB). The legislation itself does not touch the CFPB, a key requirement for Democratic congressional support…If this legislation is the largest change made to Dodd-Frank during Trump's time in office, then Dodd-Frank will have survived its first major political test."

- **"Blue Wave Scenario" Did Not Quite Unfold as Predicted Which Means Significant Changes Unlikely.** Heading into the election, political pundits and investor sentiment was more optimistic for a "Blue Wave Scenario" in which Democrats would win the White House, take back the Senate, and continue to maintain control in the House. A Blue Wave Scenario could have presented some risk for more significant legislative changes on regulation for the financial services industry. While we are still waiting primarily for the results from the Georgia run-off for U.S. Senate on January 5, 2021, below we show the current makeup of the Senate and House. Republicans have a modest lead in the Senate, but currently no one party has a majority. While the Democrats do maintain a majority in the House, the lead is quite modest after the Republicans picked up eight additional seats in the election. At the end of the day, we still need to see what happens in Georgia, but based upon the present composition with no one party having a convincing stronghold in Congress, the practical opportunity to make sweeping regulation changes requiring legislative approval largely has diminished.

Senate – 51 Needed for Majority		
Party	**Total Seats**	**Seats Gained / Lost**
Republican	50	- 1
Democrat	46	+ 1
Other	2	--

House of Representatives – 218 Needed for Majority		
Party	**Total Seats**	**Seats Gained / Lost**
Republican	205	+ 8
Democrat	222	- 7
Other	0	- 1

*33 of 35 seats in the Senate elections have been called and 427 of 435 seats in House elections have been called.

- **Risk of Senator Elizabeth Warren Having a Major Role in the Administration Seems to Have Come and Gone.** Investors in financial services were understandably concerned that Senator Elizabeth Warren could have played a significant role in a Biden Administration. Her name had been floated as a potential vice-presidential running-mate, but that quickly dissipated when Kamala Harris was named. Subsequently, Warren had been considered a potential, though low probability candidate for Treasury Secretary, but that also dissipated when Janet Yellen was named. Regardless, given Warren's more left-leaning views particularly toward the financial services industry, such as the creation of the CFPB, if she had a significant role in the Administration, more industry regulation would have been likely.

- **CFPB Could Be One of the More Influential Agencies.** While President-elect Biden will have the opportunity to put in a new Director of the CFPB, Warren's name does not seem to be at the top of the list. Rather, potential Director nominees may include Representative Katie Porter (D-CA), former CFPB Deputy Director Leandra English, or FTC Commissioner Rohit Chopra. Porter seems to be a leading candidate in our view as a former consumer protection attorney, though Chopra could have a good chance given he helped launch the CFPB and held the role of CFPB Assistant Director. The CFPB under a Biden Administration could lean towards more robust enforcement actions on top of larger monetary penalties. Additionally, the CFPB could focus on other key areas to revive fair-lending investigations based upon the principle of "disparate impact", along with other focus points such as payday lending, overdraft fees, credit reports, student lending/servicing, and consumer data.

FURTHER FISCAL STIMULUS SHOULD BE HIGH ON THE AGENDA

We believe one of the most important and highly probable events under the Biden Administration is the resumption of COVID-19 relief in the form of additional fiscal stimulus. While there have been media reports of new stimulus legislation being introduced in the next few days, we do not expect to see a new package passed until at least early next year once the new Congress and Administration take over. Perhaps more so, we still need to solve shutting down the government by December 11 before Congress breaks for its holiday recess. Nonetheless, future stimulus is something we look forward to in early 2021 and we believe this will serve as a favorable catalyst for the economy, credit, long-term interest rates, and, in turn, bank stocks.

- **A "Skinny" Package Seems Reasonable.** We believe the next round of stimulus could be more to the tune of $500 billion to $1 trillion, compared to the $2.2 trillion Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"). Given the current state of the economy, favorable development toward a vaccine, along with our current knowledge of the virus, passing a large package seems unlikely. More so, with a divided Congress in which the Democrats barely have a majority in the House, combined with the current Republican lead in the Senate, a large broad-based spending package that all can get on board with seems unlikely.

- **What Could Next Round of Stimulus Look Like?** We discuss three key features from the CARES Act that could be included in the next round of stimulus as the programs are set up and can quickly deploy funding to those in need. Additionally, these are perhaps less controversial elements of a stimulus program compared to state and local government funding.
    - **Assistance for Small Businesses**. Another round of the Paycheck Protection Program ("PPP") to aid small businesses could also find its way into the next stimulus program given the significant success of the initial $525 billion of approved funds. While the setup, technology, application process, etc. were a little clumsy initially given the makeshift nature of the program, PPP was a massive success overall as nearly 5,500 lenders disbursed over 5.2 million loans to small businesses. Importantly, lenders with $10 billion or less in assets accounted for 53% of total loans or 45% of the dollar amount disbursed. Including institutions with under $50 billion in assets, the totals rise to 67% and 64%, respectively. More so, small businesses received much needed funds to keep employees on the payroll and their businesses open. This was undoubtedly "credit positive" for banks, a sizeable incremental driver of earnings and capital, while also a key mechanism in driving new customer relationships into their "virtual" doors.
    - **Assistance for the Unemployed.** Finally, we believe a next round of stimulus could look to address expiring unemployment benefits. The CARES Act had extended the duration of unemployment benefits from 26 weeks to 39 weeks, but these expire December 31, 2020. Those filing for Pandemic Emergency Unemployment Compensation

("PEUC") totaled 4.51 million for the week ending November 7. The CARES Act also provided an additional $600 per week as part of unemployment benefits called Federal Pandemic Unemployment Compensation ("FPUC"). President Trump extended this by executive order on July 31, though lowered the amount to $300 a week. Most states have exhausted this extra funding which officially is set to expire December 27. Additionally, the CARES Act also had another initiative called Pandemic Unemployment Assistance ("PUA") which provided relief for those who typically would not qualify for unemployment, including self-employed workers, contractors, and gig workers. PUA will expire December 31. For the week ending November 7, there were 9.15 million people filing for PUA.

  - **Assistance for Individuals.** President-elect Biden along with Speaker of the House Nancy Pelosi have said they support a second round of $1,200 stimulus checks sent to individuals which under the CARES Act amounted to ~$270 billion. While this could be a sticking point for Senate Republicans, we believe it is one potential item to be on the lookout for in the next round of stimulus.

- **If Nothing Else, Less "Name Calling" Should Aid in Striking a Compromise.** We believe President-elect Biden has a strong historical working relationship with Senate Majority Leader Mitch McConnell, as both have served significant time together in the Senate. While they have different beliefs, we think the two can work together in a compromising fashion as both are career politicians and "know the game and how it's played" in an institutional manner. Importantly, with the Democrats now holding a slimmer majority in the House than prior to the election, we believe Speaker of the House Nancy Pelosi faces increased pressure to support a more targeted relief package. We believe President-elect Biden could be more likely to send "direction" down toward Speaker of the House Nancy Pelosi to "get on board" with a smaller stimulus package given the higher likelihood of passage and, most importantly, the package can help small businesses and consumers immediately.

  - **CARES Act Collaboration was Extraordinary.** In late March, we were extremely impressed by the effective speed and cooperation amongst Congress and the White House toward passing the CARES Act. The coordination between all sides in arriving at a swift and comprehensive solution to the virus was nothing short of remarkable.

  - **Subsequent Negotiations were Far Less Successful.** Unfortunately, since then, negotiations on additional stimulus have reached gridlock. The $3 trillion Health and Economic Recover Omnibus Emergency Solutions Act ("HEROS Act") passed the House in May but was stopped short in the Senate. After a series of fits and starts in the Summer, the two sides failed to reach an agreement on new stimulus measures. Discussions picked back up in October with the House passing a new $1 trillion HEROS Act, but ultimately negotiations failed as Senate Republicans had their own agenda, as did the White House, with all sides never quite seeing eye to eye on the next round of fiscal action. With lots of name calling and partisan agendas running against each other, the government failed to come to agreement on the next round of stimulus.

JANET YELLEN NOMINATED AS FIRST FEMALE TREASURY SECRETARY

Since the election, there had been three front-running candidates for Treasury Secretary: Lael Brainard, Robert Ferguson, and Janet Yellen. Each would be highly qualified candidates based upon their previous experience. Additionally, any of the three would present historical significance as Brainard or Yellen would be the first female Treasury Secretary, while Ferguson would be the first African American to fill the role. We do think it is further corroboration that a Biden Administration may be more focused on equality, diversity, and inclusion as part of its guiding social principles. Following recent buzz out of Washington, President-elect Biden confirmed on November 30 that he would nominate Yellen for the role of Treasury Secretary. With a fairly divided Congress, Yellen is likely the most mainstream candidate of the three that could secure affirmation by the Senate. Yellen received bipartisan support in her 2014 nomination as Chairwoman of the Federal Reserve ("Fed"), including 11 votes from Republicans. Yellen is a traditional economist who should garner enough backing from both parties this time as well.

- **Former Fed Experience at the Highest Level.** As former Chairwoman of the Fed from 2014 to 2018 and Vice Chairwoman from 2010 to 2014, Yellen has deep experience and knowledge of Fed policies, procedures, and current personalities who sit on the Board. As seen in the Trump Administration, Chairman Jerome Powell worked with the Treasury Secretary on numerous occasions – particularly as it related to COVID-19 relief in the form of both monetary policy and fiscal stimulus. This relationship seems to have soured, with current Treasury Secretary Steven Mnuchin refusing to extend certain 13(3) emergency Fed credit facilities, while requesting the Fed to return unused risk capital from the CARES Act. We are optimistic Yellen can reinvigorate ties between the Treasury and the Fed given her past working relationship with Powell, who served on the Fed when Yellen was Chairwoman.

- **A Global Economic Ambassador.** Given Yellen's previous experience as Fed Chairwoman, she has extensive relationships and is highly regarded by foreign finance ministers and central bankers. This could prove to be invaluable as the Biden Administration works with major foreign nations on global economic policies, along with how the Administration approaches other key issues such as trade policy with China.

- **Favorable on Further Stimulus.** Yellen has been supportive of fiscal stimulus, citing the need to fight unemployment and keep small businesses up and running. She has warned against the dangers of prematurely ending fiscal stimulus, indicating that now is not the time to withdraw from spending, particularly as the inflation outlook remains low. To that end, we think Yellen will also look to reestablish additional Emergency Stabilization Fund ("ESF") support so the Treasury can backstop Fed funding programs.

- **Not Overly Concerned by Inflation.** Given her role at the Fed, we believe Yellen will take the view that the Treasury should also help to promote an environment that can drive inflation up to more targeted levels. This would include incremental deficit spending in the form of fiscal stimulus as mentioned above. However, the key is that we do not think Yellen is overly concerned with the potential inflation implications, as she has previously warned that the U.S. should be concerned about repeating mistakes made by other countries such as Japan, which has been suffering from deflation for decades.

- **Financial Services Regulation.** Yellen has defended efforts to improve bank supervision following the GFC. As the head of the Financial Stability Oversight Council ("FSOC"), we think Yellen could focus her efforts on key macroprudential type risks, including market structure given the illiquidity and correlation that occurred across asset classes in the March 2020 drawdown. Additionally, as the head of FSOC, Yellen likely will have some level of influence regarding Biden's nominations over heads of future agencies. We do not think she will present sweeping wholesale changes of the broader banking environment, but rather focus on key issues such as capital standards for large national and mega banks, while perhaps also looking deeper at the non-bank financial services landscape that could drive financial stability concerns.

- **Labor Market and Equality.** During her tenure at the Fed, one of Yellen's focus areas was on the promotion of a strong labor market. She also highlighted the need to boost the participation of women in the workforce while emphasizing income equality that was driving unevenly distributed growth in the economy. In turn, we think Yellen could be a support mechanism for marginalized workers and that, over time, this could form some of the Administration's policies.

- **Climate Change.** Recently, Yellen has also been outspoken on the risk of climate change. Yellen has supported a carbon tax as an effective means to reduce greenhouse gas emissions, which eventually could find its way into a proposed change to the tax code. Biden has also highlighted the desire to have a White House Climate "Czar", so while Yellen may not lead this effort, she may ultimately participate in some fashion if this develops.

WHAT HAPPENS TO LAEL BRAINARD?

Current Fed Governor Lael Brainard will be the only Democrat remaining on the Fed Board. Although she will not be Treasury Secretary, her chances of replacing Powell as Chairwoman of the Fed when his term expires in 2022 have now increased. Alternatively, she could also replace Randal Quarles as the Fed's Vice Chairwoman for Supervision when his term expires in late 2021.

OTHER REGULATORY AGENCIES AND ROLES IN FOCUS

Under the Biden Administration, there will be turnover in several agencies and key posts within the financial services landscape. However, it is important to understand that there will be many key posts that will not turn over in the near-term. Practically speaking, it could take 12 to 18 months before the new heads of agencies really get a lay of the land in their new roles, understanding current personnel in place, future needs, policies, procedures, funding, capabilities, etc. before any meaningful new actions are taken. For now, we expect the current state of the financial services industry at these agencies to be more status quo.

Entity	Position	Name	Term End	Removable by Biden?
CFPB	Director	Kathy Kraninger	December 2023	Yes
FDIC	Chairman	Jelena McWilliams	June 2023	No
FDIC	Vice Chairman	Vacant	NA	NA
OCC	Comptroller	Brian Brooks	Acting	Yes
Federal Reserve	Chairman	Jerome Powell	February 2022 (Chair) January 2028 (Board)	No
Federal Reserve	Vice Chairman	Richard Clarida	September 2022 (VC) January 2022 (Board)	No
Federal Reserve	Vice Chairman for Supervision	Randall Quarles	October 2021 (VC) January 2032 (Board)	No
Federal Reserve	Board	Michelle Bowman	January 2034	No
Federal Reserve	Board	Lael Brainard	January 2026	No
FHFA	Director	Mark Calabria	April 2024	No, but pending Supreme Court ruling
SEC	Chairman	Jay Clayton	June 2021	No

A MORE "TRADITIONAL" PRESIDENT COULD EASE EQUITY MARKET VOLATILITY

Over the last four years, many investors have lived "Tweet by Tweet" which has been one driver of elevated market volatility, particularly in the bank space. While this is not a criticism of the current Administration or its underlying policies, we believe this non-traditional style is inherently correlated with higher volatility in the equity markets, and particularly banks, given the more cyclical and economically sensitive nature of the group.

- The average one month realized volatility of the NASDAQ Bank Index has been nearly 26% annualized under the Trump Administration, quite elevated compared to the 17.3% average and 16% median over the last eight Presidential terms.
- Likewise, the percentage of days the NASDAQ Bank Index was up or down at least 1% was 38.8% under the current Administration versus the average of 27.8% and median of 29.6% over the last eight Administrations.
- Similarly, the percentage of trading days the NASDAQ Bank Index was up or down at least 2% was 16.8%, compared to the 8.9% average and 6.8% median over the last eight Administrations.

Regardless of ones view on politics, which candidate won, etc., we are hopeful a more "traditional" president such as Joe Biden can result in lower equity market volatility, particularly in the banking sector. While lower volatility is not indicative of future returns, we think overall it will help concerns and allow investors to be more comfortable investing in the bank space.

Presidential Term	Average 1-Month Annualized Realized Volatility NASDAQ Bank Index	% of Trading Days NASDAQ Bank Index >1% or <-1%	% of Trading Days NASDAQ Bank Index >2% or <-2%
George H.W. Bush	9.54%	11.1%	1.7%
Bill Clinton: First Term	6.78%	4.0%	0.3%
Bill Clinton: Second Term	15.49%	26.2%	6.7%
George W. Bush: First Term	14.73%	27.2%	4.5%
George W. Bush: First Term	22.60%	35.1%	14.5%
Barack Obama: First Term	26.81%	47.7%	19.6%
Barack Obama: Second Term	16.60%	32.1%	6.9%
Donald Trump*	25.69%	38.8%	16.8%
Average	**17.28%**	**27.8%**	**8.9%**
Median	**16.04%**	**29.6%**	**6.8%**

***Through November 23, 2020**

ABOUT FJ CAPITAL

FJ Capital Management, an *SEC* Registered Investment Adviser, was established in 2007 by Martin Friedman, a recognized leader in the bank space, with over 30 years of experience. The senior investment team has over 150 years of combined experience covering U.S. banks.

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