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INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

LETTER FROM THE PRESIDENT

Vol. 109

The Policy Landscape in Washington
IIAC Board of Directors' Visit to Washington, DC
June 21-22, 2017

HIGHLIGHTS:

Significant progress can be made deregulating the financial sector through selective regulatory changes, without needing major amendments to the Dodd-Frank and Volcker legislation.

Comprehensive tax reform is constrained by special interests and the principle of budget revenue neutrality. Progress is likely limited to modest reductions in the corporate tax rate.

The difficulty in getting Senate confirmation of key Administration officials, not to mention the major distractions in Washington these days, complicates the Administration's policy agenda, reversing the market "Trump bump" of last fall and early winter.

BACKGROUND TO DISCUSSIONS

On June 21-22, members of the IIAC Board of Directors met in Washington with three Senators: Lindsey Graham, Jack Reed and John Boozman (members of the Senate Banking Committee, Budget, and Appropriations Committees); two Congressmen: Chris Stewart and David Kustoff (members of the House Appropriations and Financial Services Committees); senior executives from the U.S. Securities Industry and Financial Markets Association (SIFMA); officials in the Executive Office of Management and Budget; several consultants; and senior officials at the Canadian Embassy.

The purpose of these meetings was to understand the direction and focus of financial deregulation in the United States, and obtain ideas and perspectives helpful for the Canadian industry's ongoing engagement with Canadian regulators. Further, the visit provided an opportunity to better understand the debate and direction on U.S. budget and tax reform, and the background for the upcoming NAFTA trade negotiations. It is difficult at the best of times to get a clear sense of policy direction in an incoming U.S. Administration. It is especially complicated this time with an Administration determined to set a new direction for public policy, combined with the unprecedented political rancor and opposition to the Administration, the war with the media, geopolitical threats and a voluble President frequently interjecting various and conflicting opinions and viewpoints through social media.

The Republican Senators and Congressmen acknowledged, in conversation, that the Administration and Congress face a narrow window to achieve legislative results before the 2018 midterm elections. Tangible outcomes must be achieved in key policy areas before late spring 2018 to position for the upcoming elections in November 2018. All seats in the House of Representatives will be up for election, and one-third of the Senate seats. A significant number of politicians will be vulnerable to defeat, if the Republican majority fails to achieve legislative reforms demanded by the electorate.

The healthcare debate was raised in our discussions, even though not the intended focus of discussion, because the outcome of other policy priorities, like tax reform, hinged at least in part on the success of the healthcare agenda. Interestingly, Congressmen were least optimistic of a positive outcome for healthcare. While the House of Representatives passed legislation last May, eviscerating much of the Affordable Care Act (with the CBO estimating 23 million Americans losing healthcare coverage), the Senate was divided on healthcare reform. The pressing need to overhaul an increasingly unsustainable healthcare system, with insurance companies pulling out of the so-called exchanges and reducing coverage, has collided with political sensitivities of restraining the rapidly expanding Medicaid program. The skepticism about success has been borne out by the recent intractability of the Senate to reach accommodation on the House legislation. It should be noted that healthcare legislation is important, not only to get the U.S. healthcare system on a sound and sustainable footing, but to yield anticipated savings from Medicaid cut-backs to fund proposed tax cuts under the tax reform agenda, and to fund increased defense spending.

GOOD PROSPECTS FOR FINANCIAL DEREGULATION

The Senators, Congressmen and other experts participating in our discussions displayed considerable optimism about the prospects of achieving significant deregulation of financial markets, despite sweeping and complicated financial reforms put in place over the eight-year post-crisis period, embodied in the massive Dodd-Frank and Volcker legislation. Optimism reflects the fact that much change can be achieved through regulatory amendment rather than legislative change. A June 2017 U.S. Department of the Treasury Report titled "A Financial System That Creates Economic Opportunities" sets out specific proposals revising rules and scaling back the Dodd-Frank provisions, yet avoiding the need for extensive legislative amendment. In effect, the Treasury estimates 70-80% of planned deregulation can be achieved through regulatory change. A *Financial Times* article sums up the Report as follows: *"The Report does not propose doing away with any part of the regulatory regime wholesale. Capital and liquidity standards, stress testing, living wills, prudential regulation and the Volker rule are all accepted in principle. In practice, though, the report urges that they be applied with less vigour, more discrimination and greater consultation with the industry—by a streamlined set of regulations with fewer overlapping mandates."*

The success of the financial deregulation agenda, and the tax reform and budget agenda, depends importantly on appointing senior Administration officials to direct and manage the defined policy agenda. These senior appointments are essential to shape and shepherd the necessary regulatory change and legislative amendments, and drive the agenda through the government bureaucracy, and ultimately to the Senate and House of Representatives. With each incoming Administration following a federal election, the top layers of senior government officials are appointed by the new government and approved by the Senate, replacing officials from the outgoing Administration. Nearly six months into its mandate, the Trump Administration is well behind the normal pace of appointments, with only 10% of the 559 positions requiring Senate confirmation now filled.

Two positions critical to the financial deregulation agenda have been announced, but not yet been confirmed—Joseph Otting, as Comptroller of the Currency, and Randal Quarles, in the key Federal Reserve Board of Governors position of Vice-Chair of Supervision. Many positions below these individuals remain unfilled. This slow process of confirmation that partly reflects procedural moves by the Democrats jeopardizes the timeliness of proposed policy measures.

TAX REFORM LIKELY LIMITED TO MODEST REDUCTIONS IN CORPORATE TAX RATES

In our discussions, there seemed broad consensus that progress will be made on the tax reform agenda. However, the reforms will fall far short of the comprehensive overhaul of the U.S. tax system envisioned by House Speaker Paul Ryan and the U.S. House Committee on Ways and Means. It is generally thought there is insufficient consensus and political will to overcome the resistance of special interest groups to achieve comprehensive reform of the detailed provisions in the Internal Revenue Code. The likelihood is for some reduction in the U.S. corporate tax rate, from the current 35% to somewhere in the range of 25%, but not as low as the proposed 15%. The debate on tax reform, and notably the move to lower tax rates, revolves around the concept of revenue neutrality. Without compensating revenue from the proposed border adjustment tax (meant to discourage U.S. companies from manufacturing products overseas and then importing them back into the U.S. for sale) or savings from healthcare reform to fund lower corporate tax rates, tax adjustments will be limited. We were told that the proposed Border Adjustment Tax, a value-added tax on imported goods and materials when products are sold into the United States, appears "dead in the water", reflecting resistance from U.S. retailers and consumers. Indeed, on July 27 a joint statement released by House Speaker Paul Ryan, Senate Majority Leader Mitch McConnell and Treasury Secretary Steve Munching stated the border adjustment tax will not be included in the tax reform legislative package. This move, driven by intense opposition from the U.S. retail industry, will be great relief for Canadian companies, particularly oil and gas exporters to the U.S. Many expect that the Administration and Congress will proceed, however, with a one-time repatriation of offshore earnings taxed at a special low tax rate. In 2005, the Bush Administration allowed such a repatriation of corporate funds at a special 5% rate. In terms of additional sources of revenue, it was clear there was little to no support for a gasoline or carbon tax, or a federal value added sales tax.

CANADA CAN EXPECT ROBUST NAFTA RENEGOTIATIONS

The discussions in Washington confirmed the mixed signals about the NAFTA Agreement and prospects for cross-border trade. One promising note was there has been an open and constructive dialogue between U.S. and Canadian officials on trade matters. The best guess at the time of our meetings was that the renegotiation of NAFTA will result in some incremental adjustments to the treaty, with the failed Trans-Pacific Partnership (TPP) providing a useful template in areas like financial services.

Since the June Washington visit, the U.S. Trade Representative released the U.S. objectives for the upcoming NAFTA negotiations. The U.S. signalled its intention to eliminate Chapter 19 of the Agreement, in which the parties rely on a bilateral panel of arbiters to resolve trade disputes. The resolution mechanism would fall to the Courts. The U.S. document also referred to the supply management policies in the Canadian dairy, wine and grains industries as barriers not addressed in the current Agreement. The first round of trade negotiations begins August 16-20 in Washington.

CONCLUSION

There is a consensus among the Republican Administration and Congress, and among others, that policy reform is badly needed, to overhaul healthcare, lower tax rates and reform tax legislation, achieve significant and targeted financial and environmental deregulation, and reform the entitlement system. The consensus, however, begins to disintegrate along political lines and special interests. The intractability of reforming the healthcare legislation is indicative of the powerful conflicting forces in the policy arena. Progress will likely be made on tax reform and the deregulation agenda, but the changes to policy will be limited, even with a Republican majority in the House and Senate. The hope and expectation is that progress will be enough to boost economic momentum and job creation in the United States.

Yours sincerely,

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August 2017