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The 2024 Election: Navigating Potential Financial Sector Shifts

We believe the outcome of the US presidential election could alter fundamental dynamics across the financial sector: Banking regulation, crypto, private equity, insurance—all stand to be shaped by the winner in November. Here is a look at some key areas and, in our view, the potential implications for investors.

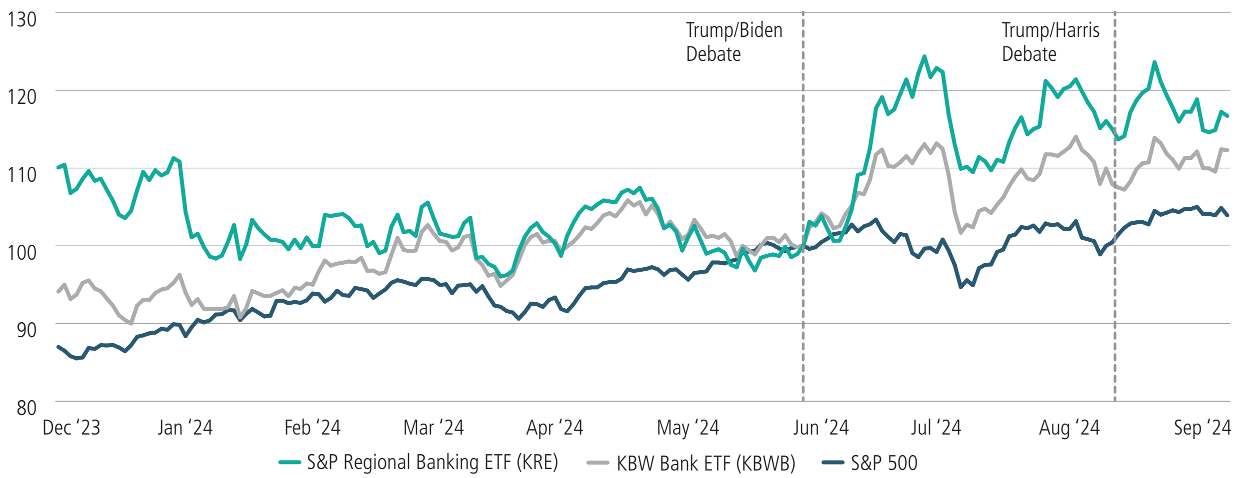
Bank Stocks Have Been Resilient

Bank stocks rallied after the Trump/Biden debate in late June, driven by investor optimism about potential regulatory easing, such as relaxed capital and liquidity rules, and increased bank consolidation opportunities (see figure 1).

Despite the transition from Biden to Harris in the race, these gains have held steady, largely due to the normalisation of the yield curve and a positive outlook for an economic soft landing. While potential changes in corporate tax rates under a Harris administration could pose a headwind, it would likely be modest and below the levels seen before Trump in 2016. Nonetheless, we believe the path of interest rates and credit performance remain the most crucial drivers for bank stocks.

FIGURE 1: BANKS ARE OUTPERFORMING THE S&P 500 INDEX HEADING INTO THE ELECTION

Performance Indexed to 100 at Trump/Biden Debate on 6/27

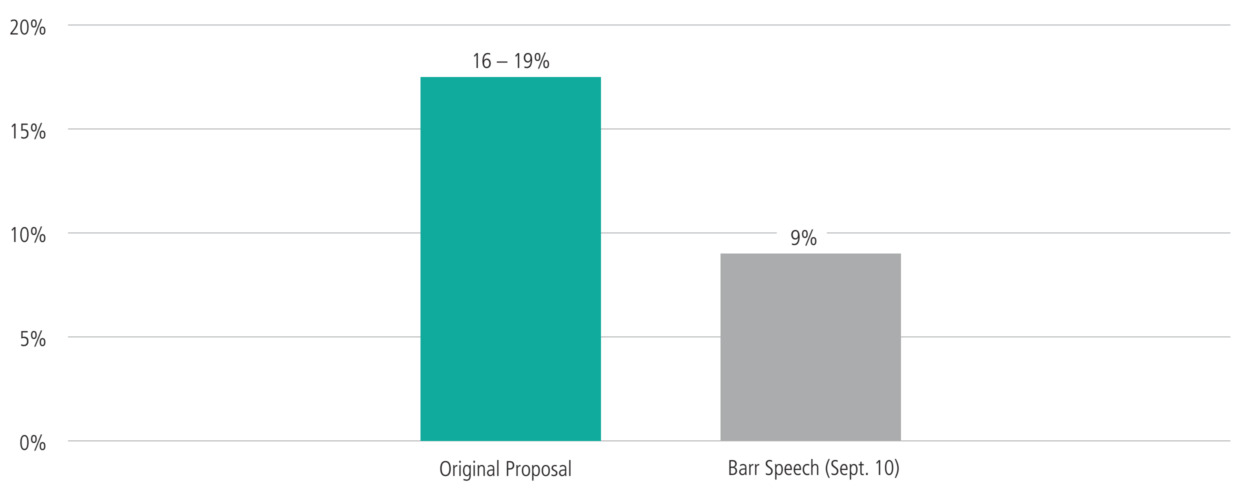


Source: FactSet, data as of October 7, 2024. For illustrative purpose only. **Past performance is not indicative of future results.**

The Basel 3 Endgame Remains a Significant Regulatory Focus

Federal Reserve Vice Chair Michael Barr recently proposed easing some of Basel 3 Endgame's planned requirements, including a roughly 50% reduction in the expected capital charge for Global Systemically Important Banks (G-SIBs), as shown in figure 2. This response addresses industry concerns over potential impacts on lending and the economy, and includes tailored requirements for other large banks.

FIGURE 2: THE FED VICE CHAIR PROPOSED HALVING THE CAPITAL CHARGE FOR SYSTEMICALLY IMPORTANT BANKS



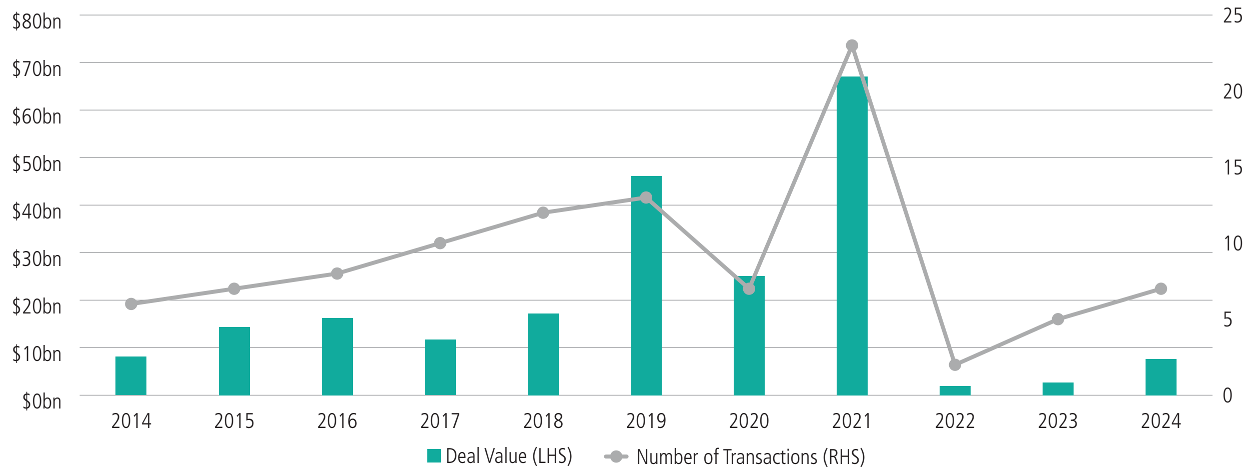
Source: Federal Reserve.

While Barr's recent speech is a positive development for the banking industry, it was largely in line with investor expectations since the end of 2023 and early 2024. Despite these changes, disagreements among financial agencies persist, casting doubt on the timing and resolution of B3E, regardless of the election outcome. Additionally, banks may consider litigation, especially given the US Supreme Court's decision on the Chevron doctrine, potentially delaying B3E further.

A Mixed Outlook for Banking Consolidation and Regulatory Consent Orders

Conflicting views among various regulators have muted and delayed bank M&A activity in recent years (see figure 3). While we believe the Biden Administration's general opposition to market concentration is seen as a headwind to M&A transactions, a Trump administration might favor increased M&A activity—though Trump's running mate, J.D. Vance, has expressed support for current FTC Chair Lina Kahn, indicating possible caution on antitrust policy.

FIGURE 3: BANK M&A DEAL VALUE HAS BEEN BELOW TREND DURING THE BIDEN ADMINISTRATION



Note: Deals with target assets +$3bn. For illustrative purposes only.
Source: KBW Research, SNL Financial / S&P Global Market Intelligence, Company Documents; data as of September 30, 2024.

We believe a Trump administration may be more likely to lift longstanding regulatory consent orders on several large banks. Lifting some of these orders—which have been in place for many years and are considered key stock-specific catalysts among investors—could be beneficial in the form of lower expenses, increased buybacks or both.

Private Equity: Puts and Takes

The private equity (PE) industry currently faces limited support in Washington, in our view. Regardless of whether Trump or Harris is in power, PE's own investing activities might encounter increased antitrust scrutiny.

Meanwhile, the carried interest tax loophole continues to be a target for reform. Its closure is more likely under Harris, but still possible with Trump. The impact, however, is reduced given that publicly traded alternative asset managers have converted to C-corporations.

One upside, in our view, is PE's potential ability to penetrate the multi-trillion dollar 401(k) market. A Trump victory could unlock opportunities for greater access to this market, while a Harris administration might take a more cautious approach.

Acknowledging the challenging political landscape, we believe private market firms have thrived over the years regardless of the political environment. Also importantly, they have expanded well beyond their historical North American private equity roots, continue to diversify, and have consistently created value for both limited partners and shareholders.

Uncertainty Looms Over Credit Card Late Fees and the Consumer Finance Protection Bureau

The Consumer Financial Protection Bureau's (CFPB) proposal to decrease the safe harbor for typical credit card late fees to $8 from $32 is one of the larger regulatory issues facing credit card issuers. For some, late fees represent a substantial proportion of their revenue (as much as 20% or more of their total top line), so a substantial reduction could have a significant negative impact. The CFPB's rule, originally slated to go into effect in May 2024, is currently embroiled in litigation, and many investors believe a Trump administration would pull back from trying to implement it.

More broadly, Republicans are seen as more hostile toward the CFPB. On the one hand, a Trump administration might dial back oversight by the CFPB, a potential benefit for credit card issuers and other consumer lenders; on the other hand, Trump's appeal to the more populist faction within the Republican party could present challenges. (On the campaign trail, Trump floated the idea of capping credit card interest rates at 10%.) Therefore, while we think a Trump administration would likely be viewed as more likely to rein in the CFPB, we'd expect voices within the administration to argue for keeping the pressure on.

Cryptocurrency Catalysts

The current Administration has leaned anti-crypto, as has the Securities and Exchange Commission (SEC); Trump, meanwhile, recently launched his own crypto company. More recently, key Democrats appear to have softened their stance, and we think Harris could follow suit: Crypto-focused PACs have raised and deployed large sums of money in this investment cycle, which, in our view, have played some role in both candidates' postures.

Harris has not made it clear whether she would support a leadership change at the SEC, and despite some Democrats' change of heart, we think a Trump administration will be seen as more crypto-friendly than a Harris administration. Therefore, we expect a Trump victory to support the sector.

The Corporate Tax Rate and DOL Fiduciary Rule Weigh on Insurers…

The direction of corporate tax rates could have the biggest direct impact on the insurance industry, in our view. Tax rates not only drive reported earnings, they can also impact the calculation of the amount of capital that insurers need to set aside to meet regulatory requirements, which in turn can shape their capital deployment decisions.

Based on current policy proposals, we believe a Trump win would lower the corporate tax rate, which would be a net positive to earnings growth yet (counterintuitively) decrease risk-based capital ratios broadly, forcing insurers to fatten their capital cushions. Furthermore, if lower corporate income taxes trigger inflation in the broader economy, we think costlier claims could impair Property & Casualty (P&C) insurers' nearer-term underwriting profitability (though higher interest income could help offset those negative effects if rates remain high).

Insurers are also eyeing the Department of Labor's Fiduciary rule, which aims to protect investors from financial advisors' potential conflicts of interest. Although a Texas state court recently blocked the rule, the election's outcome could sway its prospects.

The Obama and Biden administrations have pushed to tighten the rules holding advisors liable for pushing higher-commission products. In our view, another Democratic administration could reignite those efforts—perhaps applying more pressure on annuity writers that rely on independent marketing and sales channels—while we expect Republicans likely would not.

…While a Change in the SALT Deduction Could Be Good News

Trump recently suggested reversing the State and Local Tax (SALT) deduction limit put into place as part of the Tax Cuts & Jobs Act. We think either candidate taking a similar stance would be an indirect benefit to P&C insurers over time. Since 2016, lower state and local taxes have led to a significant population influx into southern states and the sunbelt—areas that are also prone to higher weather-related catastrophic events like hail, hurricanes and storms. If SALT limitations are removed, we could see Northern states, which tend to be less exposed to weather-related catastrophic events, gain population.

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Index Definitions

The S&P 500 Index consists of 500 US stocks chosen for market size, liquidity and industry group representation. It is a market value-weighted index (stock price times number of shares outstanding), with each stock's weight in the Index proportionate to its market value.

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