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Gridlocked Government May Not Be Bad For Capital Markets

By **Tom Zanki**

Law360 (November 7, 2018, 8:09 PM EST) -- The prospect of a divided national government produced by Tuesday's midterm congressional elections likely prevents drastic policy shifts that could disrupt capital markets, making it easier to resume dealmaking under a more certain climate in the near term, attorneys say.

Tuesday's split decision — in which Democrats won control of the House of Representatives for the first time in eight years while Republicans increased their slim lead in the U.S. Senate — may shake up Washington, D.C., for the time being, but it was not an unexpected result. Unlike the 2016 presidential election, the outcome was in line with many analysts' predictions.

The lack of a big surprise resulting from the closely-watched elections that have transfixed the nation's attention for weeks — and were widely seen as referendums on President Donald Trump — enables capital markets attorneys and bankers to get back to business as usual.

Covington & Burling LLP partner Donald Murray said he spent the past few days discussing the election with bankers, noting that the outcome was anticipated and "no one seems perturbed."

"It seems to be full speed ahead for capital markets deals," Murray said. "The pipeline is strong; it seems to continue growing. To my surprise, [the election] doesn't seem to have had much of an effect on anything."

Investors appeared relieved by the outcome, sending stocks soaring on the first day after the election. The Dow Jones average gained 545 points, while the technology-heavy Nasdaq rose 195 points, or 2.6 percent, partly erasing some of the losses recorded in a choppy October.

While financial markets can be perceived as favoring business-friendly policies, deals attorneys point out that uncertainty, whether political or economic, is a bigger concern because it makes it harder to execute transactions. Plus, a certain amount of gridlock can be welcomed by market participants as a check against wild policy swings.

"It forces politics to go down the middle of the fairway," said Hogan Lovells partner David Bonser. "That's an area that the markets can understand."

That said, certain variables could rattle the political landscape over the next two years and, by extension, the deals climate. House Democrats are expected to launch investigations of Trump administration officials, and they will have more power to block White House policy initiatives.

Barnes & Thornburg LLP partner David Hooper said the potential for brinkmanship on budget or trade disputes could create an unwelcome distraction.

"When there is uncertainty regarding policy, that is never good for stability in the capital markets, particularly for [initial public offering] considerations," Hooper said.

Given the absence of consensus in both chambers for big changes, the odds of drastic policy changes appear remote.

Democratic control of the House makes it less likely that Trump tax cuts will become permanent, which Hooper noted would have been warmly received by business interests. The current House in September approved making permanent many of the individual tax cuts included in last year's overhaul legislation, but the bill hasn't gone anywhere in the Senate.

By the same token, any attempt by House Democrats to repeal tax cuts would likely face resistance in the Senate, where Republicans remain in power.

"We have our corporate tax cut and the results of the election mean no additional tax cut is likely, but nor is the Trump tax cut going to be reversed in the next two years," Linklaters LLP partner Jeffrey Cohen said. "So stability seems to be what people are inferring."

Trump has also pushed for loosening various financial regulations enacted after the financial crisis through the Dodd-Frank law. With Democrats running the House, enthusiasm for further rollbacks is expected to wane.

One legislative bill of interest to securities and capital markets attorneys that enjoys bipartisan support is the so-called JOBS Act 3.0 — the latest attempt to ease capital-raising rules since the passage of the Jumpstart Our Business Startups Act in 2012.

The bill, which passed the House in July, aims to stimulate public and private markets and contains rule changes that would ease restrictions on pre-IPO communications to investors. The legislation would also increase the population eligible to invest in private offerings, among other things.

The Senate hasn't acted on the bill, which passed the House by a 406-4 margin. Cohen said the JOBS Act 3.0 "could be a nice poster-child for bipartisan cooperation," but it's not clear that the next Congress will make it a priority.

This election season came near the conclusion of a strong year for equity capital markets that, except for several sell-offs in October and February, has produced a favorable IPO climate. Healthy IPO activity tends to lead to more secondary and follow-on offerings.

Year-to-date, 180 companies have gone public and raised nearly $45 billion, according to research firm Renaissance Capital. That's already more IPOs than in any year since 2014, which produced 275 deals total.

Deals attorneys say the pipeline is growing, with companies planning a range of IPOs in the first half of

2019. Large companies, included ride-sharing giants Uber and Lyft, are reportedly among the candidates. How prospective issues fare in their capital-raising efforts is more likely to be determined by market conditions at the time than by political events, attorneys said.

“While there is still much to be learned about how the country will be governed, in the near term I expect the markets to focus more on interest rates and global economic conditions than on domestic politics, which in my view will be a relief,” said Honigman Miller Schwartz and Cohn LLP partner Donald Kunz.

--Editing by Emily Kokoll and Alanna Weissman.

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