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Uncertain Election Leaves Capital Markets In Flux

By **Tom Zanki**

Law360 (November 4, 2020, 10:18 PM EST) -- The uncertain outcome of Tuesday's presidential election is leaving the capital markets world in somewhat of a quandary, though attorneys remain hopeful that clarity will soon emerge and enable corporate financing activity to resume at a healthy pace.

Several battleground states remained undecided as of late Wednesday, and neither candidate had earned the decisive 270 electoral votes to be elected president, though former Vice President Joe Biden appeared to be inching closer.

In the meantime, President Donald Trump has alleged voter fraud and threatened to pursue litigation over contested mail-in ballots to the U.S. Supreme Court, while Biden's campaign manager blasted those statements and called for patience until all votes are counted.

Razor-thin voting margins in key states and the prospect of litigation challenges — Trump had also sued on Wednesday to stop vote counting in Michigan and Pennsylvania — in an already tumultuous year are not providing much clarity for the capital markets landscape, where political and economic stability is seen as a necessary backdrop for confident deal-making.

"The biggest threat to the stability of the capital markets post-election is an extended period of uncertainty," said Covington & Burling LLP partner Brian Rosenzweig, who co-chairs the firm's capital markets and securities practice.

How the election will play out remains to be seen. Biden had a small lead in the popular vote as of late Wednesday and had secured 264 electoral votes, according to the Associated Press, although potentially decisive states including Nevada, North Carolina and Pennsylvania were still up for grabs.

Yet the absence of election finality hasn't unsettled the stock market, where investors could be anticipating a divided government with a Biden administration and a Republican Senate. The Dow Jones industrial average rose 367 points on Wednesday, following a rally on Tuesday.

In terms of financing activity, capital-raising generally goes quiet around election time anyway, as issuers tend to wrap up deals before the nation's eyes turn toward voting results. No initial public offerings by operating companies are scheduled for this week, according to the major stock exchanges.

But equity and debt markets have been robust for the past six months. Numerous companies sold debt to stockpile cash for a rainy day given the uncertainty caused by the coronavirus pandemic, while scores of technology companies and drug developers have gone public, many of which are developing software or therapies that are more sought-after in a pandemic.

Viewing matters with a longer-term perspective, capital markets lawyers expect that a healthy deal-making climate will return regardless of whether Biden or Trump is declared the victor.

"In recent years, the markets have stood up to pretty much everything the world has thrown at them, and neither of these candidates is likely to do anything transformative with respect to the capital markets," Linklaters LLP partner Jeff Cohen said.

Whatever happens in the presidential race, it appears likely that a divided government will continue to rule in Washington. Republicans were close to holding a narrow majority in the Senate as of Wednesday, while Democrats, as expected, appeared likely to retain control of the House of Representatives. Final margins were not yet determined.

Capital markets lawyers note that deal-making often functions well when the executive and legislative branches are under mixed control, which can restrain parties from drifting too far to either end of the political spectrum. Biden, who has called for higher corporate and capital gains taxes and various new spending, may have to negotiate with a skeptical GOP Senate if he wins.

"It appears that the Republicans have retained their hold on the Senate, which makes a significant tax increase less likely and also reduces the risks associated with major new spending programs," Honigman LLP partner Donald Kunz said. "In a number of respects, that result seems likely to have the greatest market impact. The presidential result takes on diminished importance in a divided-government scenario."

One pitfall is that a divided government could make it harder to enact pandemic-related relief, which markets often embrace. Trump and Speaker of the House Nancy Pelosi, D-Calif., have hit a monthslong stalemate on additional coronavirus relief. The impasse coincides with soaring infection rates, further complicating the outlook for economic recovery.

"Divided government by definition is an obstacle to relief, and there are likely to be some very angry people around Washington in the coming months," Linklaters' Cohen said. "Cooperation will be difficult."

Should market volatility escalate, companies may find it harder to price IPOs or follow-on offerings with confidence. But lawyers note that there are other capital-raising tools suited for volatile times, including convertible bonds, which have fared well since the pandemic.

Convertible notes are debt-like instruments that allow investors to convert their holdings into stock if a company's shares rise to a certain point. These hybrid tools enable investors to enjoy the safety of bonds while reserving the right to acquire equity if market conditions change.

"The convertible bond market tends to do very well in a choppier market," said Freshfields Bruckhaus Deringer LLP partner Sarah Solum, who heads the firm's U.S. capital markets practice.

Apart from near-term market moves, resolution of the White House race will determine the composition of the U.S. Securities and Exchange Commission, the nation's chief capital markets regulator. Three of the agency's five seats are controlled by the president's party.

The SEC during the Trump administration has often pursued deregulatory policies friendly to capital formation, which have been received well by transactional attorneys. A change in the Oval Office could result in a Democratic chair focused on enforcement instead of facilitating capital, which was a priority of current chairman and former corporate dealmaker Jay Clayton.

Attorneys are not expecting a change in leadership at the SEC to drastically affect capital markets, which have been resilient under both Democratic and Republican administrations, though a Democratic-led agency is likely to put a halt to the deregulatory strategy of recent years.

"If [Biden] picks someone with an enforcement background, that's going to be a priority for the agency and less so regulatory issues," said Moses & Singer LLP partner Howard Fischer, also a former SEC litigator.

But if Trump pulls out a victory and Clayton steps down after one term as expected, the agency could accelerate its deregulation plans. One candidate for chair under a second Trump administration is Commissioner Hester Peirce, who has often opposed enforcement actions and favored a more hands-off approach to encourage innovation, especially with newer realms of capital raising such as offerings involving digital assets.

If Peirce takes the helm, Fischer said, "you're gonna see the agency embarking on a very strong and aggressive deregulatory streak."

--Editing by Philip Shea and Alanna Weissman.