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Newsletter

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US-China relations

Throughout the first four months of the 118th Congress, the relationship between the United States and the People's Republic of China has faced intense scrutiny – due in part to the newly created United States House Select Committee on Strategic Competition between the United States and the Chinese Communist Party (CCP), which held its first two hearings in primetime. So far this Congress, there have been around 150 bills introduced that mention China, a trend that is not expected to slow down anytime soon. As geopolitical forces continue to put a strain on the relationship between the world's biggest economies, we outline some important issues to consider.

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Andy Blocker
Global Head of Public Policy and Strategic Partnerships

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Letter to the reader

In this issue we are reminded how the unexpected can shift the political and policy narratives very quickly. Enter the banking crisis spurred by Silicon Valley Bank, Signature Bank and Credit Suisse. These events took over the entire global policy conversation for over a month and will continue to be a part of the dialogue for some time.

We have also witnessed how even the expected has its twists and turns, whether it's tenuous US-China relations, the indictment of an ex-president, or debt-ceiling discussions — or lack thereof — as the deadline nears. As we approach full-blown presidential election season this summer and fall, Congress will have less and less capacity to get things done other than use their voices as a megaphone for the most contentious political issues.

Can President Joe Biden and Speaker Kevin McCarthy execute on raising the debt ceiling? Can the House Select Committee on China move past the rhetoric to propose and help enact constructive policies to protect America's competitiveness? Can Republicans and Democrats come together on permitting reform which Republicans want to expedite fossil fuel exploration and Democrats want to help fuel their alternative energy ambitions?

Given recent history, the most obvious answer to each of these questions is "no." However, as Yogi Berra infamously said, "It ain't over till it's over." Maybe we will witness the unexpected.

Best,
Andy Blocker

US politics and elections

Just four months into 2023, the atmospherics in Washington, D.C., have taken another turn for the turbulent. Members of Congress returned to the Capitol after the Easter recess with just a few short weeks to address the debt ceiling before the first signs of default will emerge. In reaction to the House Republicans passing a bill to raise the debt ceiling coupled with $4.5T in spending reforms, the Senate Democratic majority has declared it dead on arrival. On May 9th, the White House will bring in the majority and minority leadership of both the House and Senate for formal talks on the debt limit, which Treasury Secretary Janet Yellen has announced will expire as soon as June 1.

On a separate track, President Joe Biden released his fiscal year 2024 budget with little chance of it being enacted as is. Speaker Kevin McCarthy responded in-kind with the House Republican blueprint for a budget. However, with only four votes to spare, the likelihood of a House passed budget resolution is dim. With a similarly tight margin in the Senate, the appropriations process is likely to play out without an agreed upon budget framework. So, as we've previously reported, the dysfunction of a divided government continues to linger.

The House GOP proudly passed a bipartisan energy package – referred to as H.R. 1 – that promises to reduce energy prices, expand energy production, and address permitting infrastructure bottlenecks – to demonstrate that McCarthy is capable of leading a challenging conference to a win on an issue of great importance for voters. They were even successful in bringing four Democratic counterparts to support the legislation (that's considered bipartisan in today's Washington), which has the national news media paying attention. With the health and well-being of Minority Leader Mitch McConnell in question for some time, the Senate GOP was left to hold the line in his absence until his recent return. While H.R. 1 shows little likelihood of success in the upper chamber, it is still seen as a victory for McCarthy after the vote-a-rama over his leadership post. Some say he is more powerful today because of it.

Meanwhile, the New York District Attorney leveled 34 felony counts against former President Donald Trump, bolstering his 2024 campaign efforts among his base and further alienating him from the 2016 supporters that left him in 2020. No political prognosticator is clear about what the arraignment will do for his 2024 successes, so for now all eyes are on the GOP field and what other potential candidates will emerge. Not surprisingly, the GOP remains unified for now in their attacks against the charges as political, while Democrats are hopeful it will clear a path for their side to retain the White House for another four years. With the former president demanding the attention and dominating the headlines for the foreseeable future with his courtside drama, it's unlikely that any beltway policy battles will change the script.

While it seems entirely possible a default and/or downgrade could happen in the very near future, it promises to be just the start of a very bumpy second quarter of 2023.

Washington policy and regulation

Lawmakers and regulators are considering various policy responses in the aftermath of the recent bank failures, including JP Morgan's recent rescue of First Republic Bank. Congress has already held three hearings in what is expected to be a series of testimony to explore the issue. But outside of executive accountability and compensation clawback measures, there appears to be very little bipartisan agreement at this time on a legislative response. It also seems clear that any reforms to the existing capital and liquidity framework will have to come from rulemakings under the agencies' existing authorities, rather than congressional action. President Joe Biden recommended several regulatory reforms for large regional banks, all of which regulators have the authority to implement without the need for congressional action. Barring the threat of another destabilizing market event, we view the recent release of reports on the bank failures by the Federal Reserve, Federal Deposit Insurance Corporation (FDIC) and the Government Accountability office (GAO) as the next major catalyst to be the focus of hearings in Congress over the next several weeks. Against this backdrop, Biden is also expected in the coming weeks to name a nominee for Fed Vice Chair.

The House passed Republicans' signature energy package, the Lower Energy Costs Act (H.R. 1), which seeks to reform the permitting process and promote the expansion of domestic oil and gas production. The bill kicks off negotiations for a potential deal with the Senate on permitting reform, a goal shared by most Democrats particularly as it concerns renewable energy projects. H.R. 1 was also included in the debt ceiling increase package that the House passed along a party line vote in late April. An estimated X date, for when the US runs out of cash, could be as early as June.

While Silicon Valley Bank has taken up much of the oxygen, House Financial Services Committee Chair Patrick McHenry is still focused on his key priorities, including capital formation and digital assets. Oversight of the Biden administration also remains a top priority for committee Republicans, with Securities and Exchange Commission (SEC) Chair Gary Gensler having to face a public grilling on everything from his Environmental, Social, and Governance proposals to the sheer size and scope of his regulatory agenda when he testified before the Committee on April 18. With comment periods on several key proposals closing, the SEC is expected to continue its aggressive rulemaking agenda. Consumer Financial Protection Bureau reform will also be in focus, as briefings for the Supreme Court case challenging the agency's funding structure are expected to begin in the spring and summer.

With less movement of legislation expected under a divided Congress, the Biden administration will likely focus much of its attention on finalizing its regulatory agenda; implementing the infrastructure law, the Inflation Reduction Act, and the CHIPS and Science Act; and prioritizing executive action to accomplish other policy goals. To that end, recent reports suggest the Biden administration is nearing completion of an executive order to establish an outbound investment screening process that could restrict US investments in China, including advanced dual-use technologies such as semiconductors, artificial intelligence, decryption, and quantum computing.

Financial services

Over the last few months, much of the hot air in the Capitol building has been directed at the Silicon Valley Bank, Signature Bank, and now First Republic bank failures. Never letting a good crisis go to waste, lawmakers on both sides of the aisle have seized on the failures to advance their policy – and political – agendas.

Democrats unsurprisingly are laying the blame at the feet of the Trump administration's regulatory rollback, which eased restrictions on banks with less than $250 billion in deposits, and are calling on the Federal Reserve and Federal Deposit Insurance Corporation (FDIC) to issue new rules with substantially enhanced capital and stress-testing requirements. Republicans argue that President Joe Biden's bank supervisors were asleep at the wheel and have lambasted his administration for engaging in yet another costly and reckless government bailout.

The banking crisis has already featured in several hearings with regulators from the Federal Reserve, Treasury Department, and FDIC, and has spawned dozens of letters from lawmakers demanding answers and calling for reforms. Several pieces of legislation have also been introduced. While it is too soon to know whether they will gain any momentum, legislation to provide the FDIC with explicit "clawback" authority and to create an independent Inspector General for the Federal Reserve appear to have bipartisan support.

For their part, the Federal Reserve and FDIC are undertaking comprehensive reviews of the supervision of the failed banks and the deposit insurance system. The agencies issued reports at the end of April that focused on the fundamental management and supervision failures at the banks. The FDIC is expected to issue a proposed rule that will set the assessments for banks to replenish the Deposit Insurance Fund, but there is strong bipartisan consensus that community banks should not have to foot the bill. The Fed is prioritizing its holistic review of bank capital requirements and is expected to issue a proposed rule that would establish stronger capital and liquidity standards for firms over $100 billion.

The bank regulators have promised action on these initiatives sometime in May, but look for both the White House and Congress to leverage the crisis for political gain well into the 2024 election cycle.

Geopolitics

SPOTLIGHT ON:

US-China relations

Views from the United States

Throughout the beginning of the 118th Congress, the relationship between the United States and the People's Republic of China has faced intense scrutiny – due in part to the newly created United States House Select Committee on Strategic Competition between the United States and the Chinese Communist Party (CCP), which held its first two hearings in primetime. The first, titled "The Chinese Communist Party's Threat to America," examined the current state of the relationship and China's role as world power in the 21st century. The second, "The Chinese Communist Party's Ongoing Uyghur Genocide," discussed the human rights abuses carried out by the CCP, particularly against Muslim minorities in the country's west. So far this Congress has introduced around 150 bills that mention China, a trend that is not expected to slow down anytime soon. As geopolitical forces continue to put a strain on the relationship between the world's biggest economies, here are some important issues to consider.

Taiwan

Taiwanese sovereignty will continue to be a preeminent issue as the potential of a Chinese invasion poses the most immediate threat for the start of an active conflict between the United States and China. Following former House Speaker Nancy Pelosi's (D-CA) trip to the island last summer, China has increased both its actions and rhetoric regarding Taiwanese sovereignty.

Various elected officials in the United States have since followed suit and visited the island themselves, including House Foreign Affairs Committee Chair Michael McCaul (R-TX). Additionally, Taiwanese President Tsai Ing-wen more recently met with a bipartisan coalition of House members, including House Speaker Kevin McCarthy (R-CA), in California. The meeting was denounced by Chinese officials.

The House Select Committee on the CCP conducted a series of war-game simulations to give lawmakers a sense of how a potential conflict between China and Taiwan would unfold. The simulation comes as China has continued to intensify its rhetoric regarding Taiwan.

Russia

While China has not explicitly voiced support for the Russian invasion of Ukraine, the relationship between Moscow and Beijing appears to have become stronger. President Xi Jinping traveled to Russia in March at the request of Russian President Vladimir Putin, his first trip abroad since being reelected to his third term as president. The visit underscored the importance of the relationship for both countries, particularly as Russia becomes increasingly reliant on China as both an import and export market, especially for products that have been sanctioned by many other large economies, such as oil and gas.

During his visit with Putin, Xi rolled out a proposal to establish peace in Ukraine, though it was met with heavy skepticism by the international community. The plan calls for a ceasefire in the conflict, though it would allow Russian troops to remain in occupied regions of Ukraine, something that Ukrainian officials have called a non-starter and Russian officials claim are not negotiable.

TikTok

The video-sharing app TikTok has been the target of a number of attacks from lawmakers, due largely to national security concerns over the safety of American user data from the Chinese government and the potential for the app to push content more sympathetic to the Chinese government. The Biden administration has suggested that the app should either be sold by its Chinese owner, ByteDance, to an American buyer or face a potential ban in the United States. Unsurprisingly, China has rejected that proposition, stating that a forced sale would undermine investor confidence in the United States. Shortly after the proposal was made public, TikTok CEO Shou Zi Chew testified before the House Energy & Commerce Committee as part of an “anti-China” forum disguised as a tech company data protection hearing. Lawmakers have also introduced several pieces of legislation that would authorize the federal government to crack down on TikTok’s activities or ban the app outright. One proposal, the RESTRICT Act, does not target TikTok in particular, but would give executive agencies a broader mandate to police foreign-owned tech companies and require greater transparency into how they manage user data. Look for Tik Tok and similarly situated companies to be a focus throughout the 118th Congress.

Export controls

Since taking office, the Biden administration has made export controls a central part of its strategy to counter China, particularly in the semiconductor and advanced manufacturing industries. Last fall, the Department of Commerce issued rules targeting China’s ability to import certain advanced microchips, as well as the technology and manufacturing industry’s ability to develop them. Recently, Japan and the Netherlands have announced similar restrictions, severely impacting the ability of the Chinese to acquire the types of advanced semiconductors needed for many military applications and supercomputing.

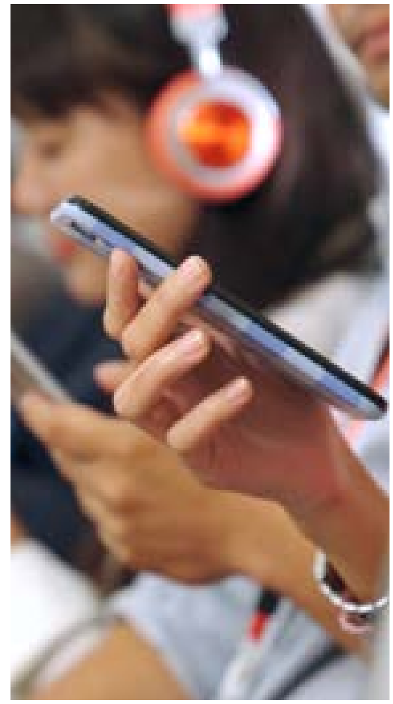
The Biden administration has been quick to utilize the Department of Commerce Entity List of companies that are subject to specific license requirements for certain specified items. Just last week, Commerce added five surveillance technology companies to the list for their role in “human rights violations and abuses in the implementation of China’s campaign of repression, mass arbitrary detention and high-technology surveillance against the Uyghur people and members of other Muslim minority groups."

It’s been reported that the Biden administration is closing in on an agreement that would limit US investment into Chinese industries that could contribute directly or indirectly to the country’s military and advanced technology sectors. The new rules are expected to impose broad limitations and reporting requirements for American investments in China.

Human rights

Members of Congress continue to express concern over China’s human rights record, particularly the ongoing genocide of Uyghur Muslims in the country’s Xinjiang province. During the last Congress, lawmakers passed the Uyghur Forced Labor Prevention Act (UFLPA), which broadens the authority of the US Customs and Border Protection to ensure that products entering the United States from Xinjiang are not made with forced labor by requiring companies to definitively prove that they are not. Since its implementation, the UFLPA has denied around 450 shipments of products, totalling around $24 million in value. Still, some lawmakers have expressed that not enough is being done to help confront China’s human rights abuses.

The new House Select Committee on the CCP recently held a hearing on “The Chinese Communist Party’s Ongoing Uyghur Genocide,” where members of the committee heard from leading experts on the issue, as well as two women who had been imprisoned by the Chinese government. It is possible that the renewed focus on human rights abuses by the committee could prompt further action on the issue.



Lawmakers introduced several pieces of legislation that would authorize the federal government to crack down on TikTok's activities or ban the app outright.

Views from China

To put it simply, Beijing's view of the world is that the West (under the US's domination) feels threatened by China's peaceful rise to power and is calling for encirclement of China both in terms of economic development and technological advancement. The sanctioning of Huawei/shutting out of Huawei from 5G network projects and the proposed banning of TikTok across different nations in the West under pressure asserted by Washington merely reinforced that belief. China, on the other hand, is firmly committed to peaceful development and international cooperation, but at the same time, it will not flinch under any external interference, nor would it tolerate any infringement on its sovereignty, security and development interests. It will try to pick the US and the EU apart and ensure that any attempt to contain and encircle China will fail miserably. It will also continue to promote the increased use of RMB as a global trade currency and an international reserve currency, to reduce its and other nations' reliance on the greenback and potential to be held hostage by US sanctions.

Beijing sees itself as a great world power and a force to be reckonded with.

One of the central themes underlying President Xi Jinping's rule is rejuvenation of the Chinese nation. Beijing sees itself as a great world power and a force to be reckoned with. Under President Xi's rule, China has stepped up its role in international multilateral organizations and has been forging closer bilateral ties with nations which have been overlooked by the US. With China fully opened to the world once again after COVID, such foreign policy of Beijing will persist.

Beijing's view is also that Washington has not been respecting its territorial integrity and instead it has repeatedly been pushing to cross China's red lines. Beijing sees Taiwan as an inseparable part of its territory since ancient times, and complete reunification is critical to China's national rejuvenation. China has reiterated again and again that it will use utmost efforts to achieve peaceful reunification with Taiwan, but it will not renounce the use of force and it reserves the option of taking all necessary measures. Taiwan remains the one red line which cannot be crossed, and any indication of the US attempting to establish official communication channels or diplomatic relations with Taiwan touches the nerve of Beijing and would be seen as a blatant violation of the One China Policy. In response to House Speaker Kevin McCarthy's recent meeting with Taiwan President Tsai Ing-wen in the US, China did not hesitate to show its objection and disapproval by staging days of military drills over Taiwan (including simulating a strike on Taiwan soil).

Aside from flexing its military muscles over Taiwan and increasing its defense budget by 7.2% this year, China is also challenging the current international order by reinterpreting and coming up with new narratives of well-accepted western concepts, such as human rights and democracy, with Chinese characteristics. To counter Washington's narrative on human rights, on March 28, 2023, the PRC State Council issued The Report on Human Rights Violations in the United States. The report characterizes 2022 as a year of landmark setbacks for US human rights and refers to "Dysfunctional Civil Rights Protection System," "Hollowed-out American-style Electoral Democracy," "Growing Racial Discrimination and Inequality," and "Wanton Violation of Other Countries' Human Rights and Trampling on Justice" in its description of the state of affairs in the US. Likewise, the Ministry of Foreign Affairs also released a report entitled "The State of Democracy in the United States: 2022" on March 20, 2023, alleging that the "US's imposition of 'democracy' has caused chaos around the world."

In fact, Beijing has become much bolder and has little reservation in calling out the US by name in its criticism of the West. When giving his speech at the Chinese People's political Consultative Conference in March this year, President Xi even singled out and named explicitly the US as "leading the West in implementing all-around encirclement, containment, and suppression of China, which has brought unprecedented severe challenge to China's development." It would not be a surprise for US-China relations to remain on rocky ground until at least after the next US presidential election.

Global lens

SPOTLIGHT ON:

ESG politics and policy

Europe

by Elizabeth Gillam

Having introduced far-reaching sustainable finance regulation in record time over the past few years, the ideologically driven zeal that has characterized sustainable finance debates over the past five years is starting to cool and pragmatism is returning to the discussions. This was triggered in part by bruising political battles over the inclusion of nuclear and gas in the EU's defining of green investments, the recognition that some of its core regulatory initiatives such as the Sustainable Finance Disclosure Regulation (SFDR) was not delivering, as well as the fight moving out of the financial sphere and into real economy legislation as part of the EU Green Deal.

The future focus will be on pragmatic implementation of the current rules and consolidation of what has been achieved to date. For example, the new Platform on Sustainable Finance, which advises the European Commission on the Taxonomy (the EU's list of green investments), will focus on useability and implementation as compared with its previous focus on developing thousands of pages of thresholds and criteria — and we understand that planned criteria for nature-based investments will exclude any controversial sectors such as agriculture.

However, regulators continue to debate and battle over the perceived threat of "greenwashing" by the financial services industry, with the current rules having done little to address this and may, in the case of SFDR, in fact prove to be counterproductive. However, the current European Commission is constrained as it approaches the end of its political mandate to enact any legislative changes, and therefore regulators are stepping in the breach, potentially creating a complicated patchwork of rules for the industry.

In the UK, the focus to date has been on integrating the Task Force on Climate-related Financial Disclosures (TCFD) recommendations across the economy. The UK approach has been focused on promoting globally consistent standards for business while developing its own approach when it comes to UK consumers in the form of Environmental, Social, and Governance investment labels, with

few of the EU initiatives being adopted in the UK. However, other initiatives such as wider corporate sustainability disclosures and a taxonomy (based on the EU framework) stalled as the political rollercoaster in 2022 called into question the UK's commitment and approach to sustainable finance (as well as Net Zero more broadly). A revised Green Finance Strategy, released in late March, is expected to provide greater clarity about the government's intentions and to what extent it intends to align with either international or EU rulebooks. However, early indications seem to suggest that we can expect the status quo ante, with a continued focus on global alignment, for example with the new standards from the International Sustainability Standards Board, albeit with more discretion to diverge from the EU than we might have expected previously on files that are derived from EU law.

Asia Pacific

by Cindy Wong

The Asia-Pacific region has for the most part successfully avoided the polarization of the US and the overzealousness of the EU in its approach to Environmental, Social, and Governance (ESG) issues. The region has navigated a pragmatic path on ESG issues, which have tended to be more principles-based as opposed to the more prescriptive rules in Europe. Developments in Asia-Pacific have tended to focus on a number of core areas of activity:

Climate risk disclosures:

Hong Kong, Singapore and Japan have recently introduced mandatory requirements for financial services firms to disclose and manage climate-related risks in line with the Task Force on Climate-Related Financial Disclosures (TCFD) framework; however the Singapore rules go further and also include broader environmental risks. Australia recently announced its intention to introduce mandatory climate risk reporting in line with the TCFD.

ESG product disclosure and standards:

Several jurisdictions, including Singapore and Taiwan, have recently introduced rules regarding standards and disclosure for ESG products. Meanwhile Japan has also proposed requiring ESG investment trusts to provide a clear narrative description of their investment strategies and the manner in which their ESG status is reflected in their portfolios, or they can no longer carry "ESG" in their product name. While the requirements are largely principles-based, and therefore avoid the prescription of the EU regime, many of these frameworks are notable in that they explicitly call out exclusionary ESG strategies as not being sufficient to be designated as ESG products. Helpfully, we are seeing some level of deference in Asia to other jurisdictions. For example, European UCITS products complying with Sustainable Finance Disclosure Regulation are considered to meet the Hong Kong and Singapore requirements — although in the case of Hong Kong, the funds must incorporate ESG factors as their key investment focus and reflect such in the investment strategy, and enhanced disclosure in the fund's specific strategies and risks may also be necessary, whilst in the case of Singapore, funds are still required to meet the local naming requirements.

Taxonomies:

China has had a green bond catalogue for some time, and the People's Bank of China's latest issuance of the Green Bond Endorsed Projects Catalogue in 2022 was a renewed effort to bring standards of domestic green bond issuances closer to international practices. Other jurisdictions in Asia-Pacific have started to explore the idea of green taxonomies, including Singapore, an ASEAN project, and Australia, albeit most of these initiatives are currently voluntary both for companies and for market participants.

On the horizon

Key Washington Dates

May-June 2023

05.01: FDIC expected release date of reports on the Comprehensive Review of Deposit Insurance System and the FDIC's Supervision of Signature Bank

05.01-08: House of Representatives in recess

05.02-04: May Federal Reserve Open Market Committee Meeting

05.05: Bureau of Labor and Statistics April jobs report

05.22: Comments due for SEC proposed rule on "Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development." Note this rule was reopened.

05.29-06.02: Senate in recess

06.02: Bureau of Labor and Statistics May Jobs Report

06.02-06.06: House of Representatives in Recess

06.03-06.05: Senate in Recess

06.13-06.14: Federal Reserve Open Market Committee Meeting

06.24-07.9: House of Representatives and Senate in Recess

June TBD: House Appropriations Committee Chair Kay Granger aims to markup annual spending bills in May, with the goal of bringing measures to the floor by June.

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