

August 24, 2018

Washington Update

This Week in Congress

- **House** – The House is in recess until September 4.
- **Senate** – The Senate passed a bill to establish the “**American Fisheries Advisory Committee**” (S.1322); a bill to “**require the Secretary of Veterans Affairs to hire additional Justice Outreach Specialists**” (H.R. 2147); a bill to award the “**Congressional Gold Medal to Anwar Sadat**” (S.266); the “**J. Bennett Johnston Waterway Hydropower Extension Act of 2017**” (S.1142); the “**DOD-Labor-HHS-Education Appropriations Act of 2019**” (H.R. 6157); and a bill to “**require disclosure by lobbyists of convictions for bribery, extortion, embezzlement, illegal kickbacks, tax evasion, fraud, conflicts of interest, making false statements, perjury, or money laundering**” (S.2896).

Next Week in Congress

- **House** – The House is in recess until September 4.
- **Senate** – The Senate may consider **Lynn A. Johnson** to be Assistant Secretary for Family Support, Department of Health and Human Services. The Leader has filed cloture on sixteen other nominations which will also be considered.

TAX

Home-School Funding Method Proposal Introduced in House

Key Points:

- *The Student Empowerment Act would expand eligibility for section 529 education savings accounts to include home-school education expenses such as books and curricular materials*
- *Senator Ted Cruz (R-TX) has introduced a nearly-identical bill in the Senate*

Representative Jason Smith (R-MO) recently introduced The Student Empowerment Act

([H.R. 6674](#)) that would expand eligibility for section-529 education savings accounts to include home-school education expenses, including tuition. The bill would permit section 529 funding for such expenses as curriculum and curricular materials, books, other

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instructional materials, tuition for tutoring or outside courses, and educational therapies for students with disabilities. Senator Ted Cruz (R-TX) recently introduced a near-identical bill ([S. 3102](#)) in the Senate. A similar provision was removed from the Tax Cuts and Jobs Act (TCJA) after the Senate parliamentarian ruled that it violated the Byrd rule.

Treasury Department and the Internal Revenue Service Issue Guidance on Unrelated Business Taxable Income

Key Points:

- *The IRS and Treasury Department released guidance that addresses the allocation of directly connected deductions under section 512(a)(1)*
- *The agencies said it is possible that they will modify the underlying reasonable allocation method outlined in existing regulations as well as provide standards for allocating expenses relating to dual-use facilities and section 512(a)(6)*

On Tuesday, the Internal Revenue Service (IRS) released [Notice 2018-67](#), 2018-26 IRB 1 in regard to section 512(a)(6). The IRS said it will consider using a North American Industry Classification System (NAICS) six-digit code to be a reasonable and good-faith interpretation rather than a facts-and-circumstances test before the agency issues its proposed regulations on the new provision.

The guidance also addresses the allocation of directly connected deductions under section 512(a)(1). Specifically, both the IRS and the Treasury Department said it is possible that they will modify the underlying reasonable allocation method outlined in existing regulations as well as provide standards for allocating expenses relating to dual-use facilities and section 512(a)(6).

The guidance also stated that section 512(a)(6) may burden organizations required to treat unrelated debt-financed income, specified payments from controlled entities, and some insurance income as unrelated business taxable income (UBTI).

Internal Revenue Service and Treasury Department Release SALT Regulations; Office of Management and Budget Receives Proposed GILTI Regulations

Key Points:

- *Proposed regulations addressing the state and local tax (SALT) deduction cap explain that when a taxpayer receives a state or local tax credit in return for a payment to an entity listed under IRC section 170, the Treasury Department and IRS will consider the receipt of that tax benefit to constitute a quid pro quo that may preclude a full deduction*
- *The proposed regulations will also require a taxpayer making payments to an entity that is eligible to receive tax-deductible donations to reduce their charitable deduction by the amount equal to any state or local tax credit received for the contribution*
- *OMB received proposed GILTI regulations and has ten days to review them*

On Thursday, the IRS and Treasury Department issued proposed [regulations](#) that address the state and local tax (SALT) deduction cap. The regulations state that when a taxpayer receives a state or local tax credit in return for a payment to an entity listed under Internal Revenue Code (IRC) section 170, the agencies consider the receipt of that tax benefit to constitute a quid pro quo that could preclude a full deduction.

According to House Ways and Means Committee Chairman Kevin Brady (R-TX); “These Treasury regulations rightly close the door on improper tax evasion schemes

conjured up by state and local politicians who insist on brutally taxing local families and businesses.” He added, “Treasury is clearly seeking to preserve important state tax credit programs that were in place before tax reform that are genuinely designed to serve local charities, many of them educational.”

Specifically, the proposed regulations would require a taxpayer making payments to an entity eligible to receive tax-deductible donations to reduce their charitable deduction by the amount equal to any state or local tax credit received for the contribution. Further, the proposed regulations state; “It is estimated that approximately five percent of taxpayers will itemize and will have state and local income tax deductions above the SALT cap; these taxpayers will receive the same federal tax benefits under the proposed regulations as they received prior to the Act...The federal tax benefits available to this fraction of taxpayers could be affected by the proposed regulations only if they contribute to programs that entitle them to state tax credits of greater than 15 percent.”

Treasury Secretary Steven Mnuchin added; “We appreciate the value of state tax credit programs, particularly school choice initiatives, and we believe the proposed rule will have no impact on federal tax benefits for donations to school choice programs for about 99 percent of taxpayers compared to prior law.” The IRS has scheduled a November 5 public hearing on the proposed regulations.

On Thursday, the Office of Management and Budget (OMB) said that it has received the proposed regulations addressing global intangible low-taxed income (GILTI). Due to an agreement made by OMB and the Treasury Department earlier this year, OMB has 10 days to review any regulations related to TCJA.

For more information about tax issues you may [email](#) or call Christopher Hatcher at 202-659-8201. Nick Karellas, Henry Homans contributed to this section.

FINANCIAL SERVICES

Senate Banking Committee Holds Hearing on Russia Sanctions

Key Point:

- *Democrats raised concerns that sanctions have not deterred Russia from engaging in malign activity, including election interference.*

On August 21, 2018, the Senate Banking, Housing and Urban Affairs Committee held a [hearing](#) entitled “Russia Sanctions: Current Effectiveness and Potential for Next Steps.” Chairman Mike Crapo (R-ID) said U.S. sanctions against Russia are in place due to military incursions into Ukraine, abetting Syrian government crimes, and conducting cyberwarfare and attacks against U.S. critical infrastructure. He added that Russia conducted efforts to interfere with U.S. elections. He declared that these efforts are a threat to national security. He stated that on August 2, President Trump signed the Countering America’s Adversaries Through Sanctions Act (CAATSA) which expands the scope of U.S. sanctions. He noted the Committee worked with the Foreign Relations Committee in a bipartisan manner to write this legislation. He said “Russia is a menace on so many different levels” and the U.S. must act in order to protect democracies around the world. He said many sanctions pertain to the Russian annexation of Crimea, and have targeted over 200 Russian individuals and entities. He stated that escalatory sanctions were imposed after the poisoning of a former Russian spy and his daughter in the United Kingdom. He declared that the Trump Administration is taking action against President Putin, his cronies, and Russian industry. He emphasized that Congress

is in a position to do more in regard to Russian banking and energy sectors. He questioned the effectiveness of current U.S. sanctions as well as the ability to cooperate with European allies for additional sanctions.

Ranking Member Sherrod Brown (D-OH) said Russia regularly conducts attacks on the U.S. as well as its allies. He observed that sanctions have had an effect on the Russian economy, but it is unclear whether sanctions have affected Russia's malign efforts around the world. He noted that Russia is still active in Korea and also through proxies in Ukraine and serves as the arsenal for the Assad regime in Syria. He added that Russian cyber-attacks have been seen in the U.S. Senate and various think tanks that are deemed to be "anti-Trump." He said the government should "send a more powerful and direct message to Putin and those within his circles." He asserted that these malicious activities must stop and President Trump needs to respect the opinion of the U.S. intelligence community and related Inspectors General (IGs). He declared that the summit in Helsinki was "widely panned on both sides of the aisle and both sides of the Atlantic." He complained that President Trump has refused to use the expanded authorities provided under CAATSA. He added that President Trump refused to increase sanctions after the use of chemical weapons components (provided by Russia) in Syria. He stated that instead of strengthening sanctions "we've gone in the opposite direction." He said the Administration needs to make further use of CAATSA and Congress needs to increase pressure against Russia. He said Russian efforts in Syria, Ukraine, and in the cyber arena need to be carefully examined. He noted that Russian interference in elections strikes at the core of American democracy. He added that the Director of National Intelligence (DNI) and Microsoft have been "sounding the alarms" about Russian cyber-attacks but little is being

done. He said dangers are also present in Estonia, Lithuania and Latvia. He encouraged the introduction of further sanctions in a bipartisan manner to curb malicious Russian behavior.

Senators Bob Menendez (D-NJ), Joe Donnelly (D-IN), Doug Jones (D-AL), Mark Warner (D-VA), and Chris Van Hollen (D-MD) argued that sanctions have not deterred malign activity by Russia. They raised concerns that the Trump Administration has utilized the full range of sanctions authorized by CAATSA, as well as with President Trump's description of Russian interference in the 2016 election as a "hoax." Senators Tom Cotton (R-AR) and Thom Tillis (R-NC) responded that the Trump Administration has taken stronger action in response to Russian election interference than the Obama Administration.

Senate Homeland Security Committee Holds Hearing on FEMA Deputy Administrator Nomination

Key Point:

- *The Committee discussed the nomination of Peter Gaynor to be Deputy Administrator of FEMA.*

On August 22, the Senate Homeland Security and Governmental Affairs Committee held a [hearing](#) to consider the nomination of Peter T. Gaynor to be Deputy Administrator, Federal Emergency Management Agency (FEMA), U.S. Department of Homeland Security (DHS). Chairman Ron Johnson (R-WI) emphasized the importance of the Deputy Administrator position. He said the Deputy Administrator helps to lead FEMA in responding to natural disasters and terrorist attacks. He noted that Hurricane Lane is bearing down on Hawaii and there was recently a severe storm in Wisconsin. He said the Deputy Administrator helps to oversee the National Flood Insurance Program

(NFIP) and assistance grants. He said FEMA makes up 22 percent of FEMA's overall budget.

Ranking Member Claire McCaskill (D-MO) said Gaynor has 30 years of experience in public service, describing him as a leader in the emergency management field. She said there many management challenges at FEMA, including preventing harassment and discrimination. She said an internal investigation showed that the former director of human resources at FEMA engaged in misconduct. She said it is unclear what, if anything, FEMA did in response to the misconduct referrals. McCaskill said the 2017 After Action Report showed that FEMA suffered from staffing shortages during the consecutive hurricanes and wildfires. She said at one point last year more than 70 percent of FEMA's workforce was directed to disaster-affected areas, leading FEMA to pull employees from other areas and agencies. She said while FEMA has made strides, it is still 5,000 employees short of its staffing goals. She questioned whether FEMA is ready to respond if the 2018 disaster season is as severe as 2017. McCaskill raised concerns related to disaster contracting. She emphasized that communities should have such contracts pre-positioned, rather than waiting until the aftermath of disasters. She urged Gaynor to work to improve pre-event contracting.

Senate Banking Committee Approves CFPB, SEC, Export-Import Bank, OFR Nominations

Key Point:

- *The Committee favorably reported Kathy Kraninger to be Director of the CFPB by a vote of 13-12 along party lines. Democrats criticized Kraninger for her lack of experience in consumer protection, as well as her role in the Administration's family separation policy.*

On August 23, the Senate Banking Committee held an [executive session](#) and approved the following nominations:

- Ms. Kathleen Laura Kraninger, to be Director, Bureau of Consumer Financial Protection (CFPB), by a vote of 13-12 along party lines.
- Ms. Kimberly A. Reed, to be President of the Export-Import Bank (Ex-Im Bank), by a vote of 25-0.
- Mr. Elad L. Roisman, to be a Member of the Securities and Exchange Commission (SEC), by voice vote.
- Mr. Michael R. Bright, of the District of Columbia, to be President of the Government National Mortgage Association (Ginnie Mae), by voice vote.
- Ms. Rae Oliver, of Virginia, to be Inspector General, U.S. Department of Housing and Urban Development (HUD), by voice vote.
- Dr. Dino Falaschetti, of Montana, to be Director, Office of Financial Research (OFR), U.S. Department of the Treasury, by voice vote.

Chairman Mike Crapo (R-ID) said the nominees will play key roles in protecting consumers, overseeing the financial markets, and facilitating trade. He emphasized Kraninger's leadership experience and expressed support for her nomination. He suggested that Kraninger will make the CFPB more transparent and accountable. He said Reed will lead the Ex-Im Bank in a positive direction while reducing waste, fraud, and abuse. Crapo noted that Roisman served as Chief Counsel for the Committee and as a staffer for former SEC Chairman Dan Gallagher. He also expressed support for confirming Oliver, Bright, and Falaschetti. Crapo said the CFPB was the most polarizing

part of the Dodd-Frank Act (DFA), with Kraninger and former Director Richard Cordray's nominations being contentious. He stated that Kraninger has provided all of the documents required by the Committee, disputing claims from Democrats that she has refused to provide requested documents.

Ranking Member Sherrod Brown (D-OH) and Senators Jack Reed (D-RI), Bob Menendez (D-NJ), Elizabeth Warren (D-MA), Catherine Cortez-Masto (D-NV), Jon Tester (D-MT), and Mark Warner (D-VA) spoke in opposition to Kraninger's nomination. Brown stated that Kraninger has no relevant experience in finance or consumer protection and has not adequately answered questions from the Committee. He raised concern that Kraninger will not be an independent advocate for consumers. He asserted that it is outrageous that Acting Director Mick Mulvaney has declared that the CFPB will no longer protect service members from payday lenders, noting that Kraninger has not spoken out against this decision. He said Mulvaney has dropped lawsuits against payday lenders. Brown said Kraninger participated in the "botched response" to the devastating hurricanes in Puerto Rico. He stated that Kraninger was also a part of the decision to separate families at the border, but she has refused to answer questions on this issue.

Bank Regulators Issue Interim Final Rule on the Treatment of Certain Municipal Securities as High-Quality Liquid Assets

Key Point:

- *The interim final rule would treat liquid and readily-marketable, investment grade municipal obligations as level 2B high quality liquid assets.*

On August 22, the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency

(OCC) jointly issued an [interim final rule](#) regarding the treatment of certain municipal obligations as high-quality liquid assets (HQLA). As noted in the rule, Section 403 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCA) requires the agencies, for purposes of their Liquidity Coverage Ratio (LCR) rule, to treat a municipal obligation as HQLA (that is a level 2B liquid asset) if that obligation is "liquid and readily-marketable" and "investment grade."

The rule will take effect upon publication in the *Federal Register* and will be subject to a 30 day comment period.

SEC Approves Final Rule on Municipal Security Disclosures

Key Point:

- *The final rule is intended to enhance transparency regarding the liquidity and creditworthiness of municipal security issuers.*

On August 20, the SEC adopted a [final rule](#) intended to enhance transparency in the municipal securities market. As described in an SEC [press release](#), the amendments to Rule 15c2-12 of the Securities Exchange Act "will focus on material financial obligations that could impact an issuer's liquidity, overall creditworthiness, or an existing security holder's rights."

The press release included the following summary of the final rule:

The amendments to Exchange Act Rule 15c2-12 amend the list of event notices that a broker, dealer, or municipal securities dealer acting as an underwriter in a primary offering of municipal securities subject to Rule 15c2-12 must reasonably determine that an issuer or obligated person has undertaken, in a written agreement for

the benefit of holders of municipal securities, to provide to the Municipal Securities Rulemaking Board within 10 business days of the event's occurrence.

Specifically, the amendments add two new events to the list included in the rule:

- Incurrence of a financial obligation of the issuer or obligated person, if material, or agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation of the issuer or obligated person, any of which affect security holders, if material; and
- Default, event of acceleration, termination event, modification of terms, or other similar events under the terms of the financial obligation of the issuer or obligated person, any of which reflect financial difficulties.

The final rule will take effect 60 days after its publication in the *Federal Register*. The compliance date for the rule will be 180 days after publication in the *Federal Register*.

UPCOMING EVENTS

September 13

Investor Advisory Committee: The Securities and Exchange Commission (SEC) will hold a meeting of its Investor Advisory Committee (IAC). The agenda for the meeting includes: (1) Discussion Regarding the U.S. Proxy Voting Infrastructure (which may include two separate panel discussions); (2) Discussion Regarding the Commission's Proposed Transaction Fee

Pilot in NMS stocks (which may include a Recommendation of the Market Structure Subcommittee); and (3) Discussion Regarding the Implications of Passive Investing.

September 17

Credit Access: The Consumer Financial Protection Bureau (CFPB) will hold a symposium entitled "Building a Bridge to Credit Visibility."

September 20

Investor Roundtable: The SEC will hold an investor roundtable to discuss the Commission's recently proposed rules regarding the obligations of financial professionals to investors.

For more information about financial services issues you may [email](#) or call Joel Oswald at 202-659-8201. Alex Barcham and Rebecca Konst contributed to the articles.

ENERGY AND ENVIRONMENT

EPA Releases Proposal to Replace Obama Administration's Clean Power Plan

Key Points:

- *On Tuesday, the EPA released a package of proposed rules intended to replace the Clean Power Plan.*
- *The Obama Administration issued the Clean Power Plan regulations in 2015, which were designed to reduce greenhouse gas emissions from existing power plants by 32 percent below 2005 levels by 2030.*
- *The Supreme Court issued a stay blocking implementation of the Clean Power Plan in 2016.*
- *A separate proposed rule published by the Trump Administration EPA would repeal the Clean Power Plan.*

On August 21, the Trump Administration unveiled its long-awaited proposal to replace

the Obama Administration's Clean Power Plan. The Obama regulations, which would have required cuts in emissions from existing power plants, were already subject to a stay ordered by the Supreme Court. The proposal will be subject to a two-month public comment period, and then will be drafted as a set of final regulations.

Obama Administration Clean Power Plan:

On October 23, 2015, the Obama Administration's Environmental Protection Agency (EPA) published the [final rule](#) establishing the Clean Power Plan. The regulations would have restricted greenhouse gas (GHG) emissions from existing electric power plants. States were intended to play a central role in implementing the Clean Power Plan, however the program would have been enforced by the EPA, which could step in to establish a Federal Implementation Plan (FIP) for any state that failed to meet the requirements of the regulations. The Clean Power Plan would have directed states to take actions reducing GHG emissions from existing power plants by 32 percent below 2005 levels by 2030. The Supreme Court issued a stay on enforcement of the rule on February 9, 2016.

Proposal to Repeal the Clean Power Plan:

On March 28, 2017, President Trump signed an Executive Order titled "Promoting Energy Independence and Economic Growth" ([E.O. 13783](#)), which directed the EPA to "review the [Clean Power Plan]...and, if appropriate...publish for notice and comment proposed rules suspending, revising, or rescinding" the final rule. On October 16, 2017, the EPA published a [Notice of Proposed Rulemaking \(NPRM\)](#) titled "Repeal of Carbon Pollution Emission Guidelines for Existing Stationary Sources: Electric Generating Units". Public comments on the NPRM were due on April 26, 2018.

Proposed Replacement for the Clean Power Plan:

On a separate track from the effort to repeal the Obama Administration regulations, the EPA began the process late last year of developing a replacement rule for the Clean Power Plan. On December 28, 2017, the EPA published an Advanced Notice of Proposed Rulemaking ([ANPRM](#)) titled "State Guidelines for Greenhouse Gas Emissions from Existing Electric Utility Generating Units". In the ANPRM, the EPA solicited comments on how "to limit greenhouse gas...emissions from existing electric utility generating units (EGUs) and...information on the proper respective roles of the state and federal governments in that process, as well as information on systems of emission reduction that are applicable at or to an existing EGU, information on compliance measures, and information on state planning requirements under the Clean Air Act (CAA)."

On August 21, 2018, the EPA released a [notice](#) titled "Emission Guidelines for Greenhouse Gas Emissions from Existing Electric Utility Generating Units; Revisions to Emission Guideline Implementing Regulations; Revisions to New Source Review Program". The notice announces "three distinct actions", proposing:

- "to replace the Clean Power Plan (CPP) with revised emissions guidelines (the Affordable Clean Energy (ACE) rule) that inform the development, submittal, and implementation of state plans to reduce...GHG...emission from certain EGUs";
- "new regulations that provide direction to both EPA and the states on the implementation of emission guidelines"; and
- "revisions to the New Source Review (NSR) program that will help prevent NSR from being a barrier to the implementation of efficiency projects at EGUs".

Regarding the new emissions guidelines, the EPA explains in a [fact sheet](#) that the rule calls for “making on-site efficiency upgrades, or ‘heat rate improvements.’” The agency notes that “[e]fficiency upgrades reduce the amount of CO2 that is released per unit of electricity generated.” This approach contrasts with the expansive emissions reduction “building blocks” that would have been utilized to meet the goals of the Clean Power Plan. An Obama Administration [fact sheet](#) noted that one building block would have allowed for reductions in “the carbon intensity of electricity generation by improving the heat rate of existing coal-fired power plants”. The other two building blocks would have had states direct changes in the mix of generation sources, including by “substituting increased electricity generation from lower-emitting existing natural gas plants for reduced generation from higher-emitting coal-fired power plants”, and “substituting increased electricity generation from new zero-emitting renewable energy sources (like wind and solar) for reduced generation from existing coal-fired power plants.” The package of materials released to accompany Tuesday’s announcement includes a “[Comparison of ACE and CPP](#)”.

Next Steps: Public comments are due within 60 days of publication of the notice in the Federal Register. Upon receiving these comments the EPA will then draft a final rule, which could be promulgated in 2019.

Once finalized, the EPA’s replacement of the Clean Power Plan will be subject to court challenges. The California Attorney General signaled in a [press release](#) issued following the EPA’s announcement that the state will participate in a suit to overturn the final regulations.

Upcoming Hearings and Events

September 11-12

Pipeline Safety Research and Development: The Pipeline and Hazardous Materials Safety Administration (PHMSA) will hold a “[Pipeline Safety Research and Development Forum](#)”.

For more information about energy and environment issues you may [email](#) or call Frank Vlossak at 202-659-8201. Updates on energy and environment issues are also available on [twitter](#).

DEFENSE

Senate Passes FY 2019 DOD Appropriations

Key Points:

- *The Senate followed the House in passing a funding package for the DOD*
- *However, it seems unlikely a full-year bill will be passed before the beginning of FY 2019 and a continuing resolution may be needed*

On August 23, the Senate finished work on a two-bill package of appropriations ([H.R.6157](#)), including the “Department of Defense Appropriations Act, 2019,” by passing the legislation by a [85-7 vote](#) after invoking cloture on the [substitute amendment](#) offered by Senate Appropriations Committee Chairman Richard Shelby (R-AL). Yet, even though the House passed its “Department of Defense Appropriations Act, 2019” ([H.R.6157](#)) by a [359-49 vote](#) in late June, the Senate’s pairing of the “FY2019 Labor, Health and Human Services, and Education (Labor-HHS) Appropriations Act” with its Department of Defense (DOD) funding vehicle suggests Senate Democrats would be inclined to oppose passage of a bill funding only national security activities. Additionally, the House has not taken up a FY 2019 Labor-HHS Appropriations Act.

In Late June, the Committee asserted that its “Department of Defense Appropriations Act, 2019” ([S.3159](#)) makes available “\$675.0 billion, an increase of \$20.4 billion over the FY2018 enacted level... [including] \$607.1 billion in base funding and \$67.9 billion for Overseas Contingency Operations (OCO) funding” according to its [press release](#). The [Committee Report](#) explained that:

In fiscal year 2018, the Congress appropriated \$652,360,608,000 for activities funded in this bill. This amount includes \$582,274,519,000 in base appropriations and \$65,166,000,000 in overseas contingency operations appropriations provided in Public Law 115-141 and \$4,920,089,000 in emergency appropriations provided in Public Laws 115-96 and 115-123.

New IG Report Shows Mixed Picture in South Asia

Key Point:

- *A new quarterly report details ongoing challenges to the Trump Administration and Afghan government in fighting the Taliban and the Islamic State of Iraq and Syria-affiliate in the region*

This week, the Lead Inspector General (IG) For Overseas Contingency Operations (OCO) released its 13th “[quarterly report](#) on Operation Freedom’s Sentinel (OFS),” which showed slightly decreasing of overall levels of violence but increasing attacks on civilians and a continuing shortfall in Afghan troops and security personnel. This latest government assessment of operations in Afghanistan comes at a time when the government in Kabul and the Trump Administration are trying to negotiate with the Taliban to end hostilities in the 17-yearlong conflict. Further complicating

these efforts are Russian efforts to become part of negotiations. Moreover, President Donald Trump has reportedly remarked to his advisors that a change in U.S. strategy is needed.

The IG stated that “[s]ince the Administration announced its South Asia strategy in August 2017, the U.S. Government has increased the amount of troops and equipment in Afghanistan, increased offensive strikes against the Taliban, expanded training and assistance for Afghan forces, and sought to pressure Pakistan to eliminate terrorist safe havens.” The IG claimed that “[o]verall, the strategy seeks to drive the Taliban to enter into negotiations for a political settlement.”

The IG contended that “[w]hile it is difficult to fully assess the overall progress under the strategy, this report explores key developments during this quarter... [but] [c]ommanders in Afghanistan stated that the strategy is working.” The IG added that “[c]ommanders also stated that Afghan forces showed improvement and that the Taliban was largely unsuccessful in seizing district centers.” The IG stated that “[i]n June, the Afghan government and the Taliban implemented ceasefires... [and] [a]t the time, Afghans and members of the international community expressed hope that the ceasefires would be first steps toward reconciliation.”

The IG stated that “[h]owever, fighting resumed after the ceasefires ended.” The IG stated that “[t]he Taliban maintained its hold on rural parts of the country and launched attacks on Afghan forces and population centers.” The IG asserted that “[d]uring this quarter, civilian deaths reached historically high levels, and violence displaced tens of thousands of Afghans.” The IG claimed that “[i]n addition, despite operational successes against the Islamic State in Iraq and Syria-Khorasan, this terrorist organization continued to recruit

and carry out high-profile attacks that killed hundreds of civilians.”

The IG offered the following observations:

- Since the announcement of the South Asia strategy in August 2017, Resolute Support coalition members increased their troop contributions to the operation. NATO reported that as of June 2018, there were 15,997 coalition troops supporting the Resolute Support mission
- During the quarter, U.S. air sorties continued at a historically high level. The number of weapons released increased compared to last quarter. U.S. Air Forces Central Command reported that U.S. forces suspended offensive strikes against the Taliban during the cease re, but continued strikes against ISIS-K and other terrorist groups during that time.
- According to Resolute Support, the Afghan government made no significant progress in increasing the percentage of the population living in areas under government control or influence, a metric President Ghani and U.S. commanders have cited as an indicator of the security situation in Afghanistan. Resolute Support reported that, as of May 2018, 65 percent of Afghans lived in areas under government control or influence, 12 percent lived in areas under Taliban control or influence, and 23 percent lived in contested areas. Those numbers are identical to the previous quarter.
- While violence remained widespread during the quarter, available data indicates that the number of violent incidents decreased during this

period...However, this reported drop in violence does not necessarily demonstrate lasting improvement in the security situation in Afghanistan. Violence in Afghanistan is cyclical in nature. Enemy attacks peak in the late spring through early fall and then can drop o significantly in the winter

- The Afghan National Defense and Security Forces (ANDSF) continue to meet recruiting targets, but the target is below maximum authorized strength. As of June 2018, the ANDSF numbered 313,728 personnel. This total is approximately 11 percent less than the 352,000 personnel slots authorized by the Afghan government.
- While overall ANDSF casualty figures remain classified, United States Forces-Afghanistan (USFOR-A) reported that in the past 6 months, ANDSF casualties during offensive operations decreased, while casualties during defensive operations and incidents increased. In particular, casualties suffered during local patrols and checkpoint operations from December 2017 through April 2018 were 14 percent higher than the same period the year before.

For more information on defense issues you may [email](#) or call Michael Kans at 202-659-8201.

HEALTH

HHS Releases Progress Report on Drug Pricing Blueprint

Key Point:

- *The Department of Health and Human Services published a report providing updates on steps taken by the agency to implement the President’s drug pricing blueprint.*

To mark the first 100 days since President Trump released the “American Patients First Blueprint to Lower Drug Prices and Reduce Out-of-Pocket Costs,” the Department of Health and Human Services (HHS) published a report on what actions have already been taken to implement the blueprint. The report is authored by Dan Best, Senior Advisor to the Secretary for Drug Pricing Reform

It sites two major shifts in drug pricing behavior since the release of the blueprint: (1) 60 percent fewer brand-drug price increases than the same period in 2017; and (2) 54 percent more generic and brand-drug price decreases than the same period in 2017.

The report highlights a number of other major steps taken so far:

- Increased competition through a record number of Food and Drug Administration (FDA) generic drug approvals;
- FDA steps to stop drug companies from gaming the system;
- Given Medicare Advantage new negotiation tools to drive down prices; and
- Solicited comments on ways to use private-sector acquisition for Medicare Part B.

It notes many of the large proposals in the blueprint are still in the works. Some of these areas include examining restrictions on the use of rebates, stronger negotiation in Medicare Part D, and requiring list prices to be displayed in direct-to-consumer advertising. The report asserts these reforms can be accomplished through administrative action, but notes there is also room for legislation.

The full report can be read [here](#).

Upcoming Hearings and Meetings

August 29

FDA: The Senate Health, Education, Labor and Pensions Committee will hold a hearing on “FDA Oversight: Leveraging Cutting-Edge Science and Protecting Public Health.”

For more information about healthcare issues you may [email](#) or call Nicole Ruzinski Bertsch or George Olsen at 202-659-8201. Michaela Boudreaux contributed to this section.

TRANSPORTATION AND INFRASTRUCTURE

FMCSA Looking To Revise HOS Rule

Key Points:

- *The federal regulator of truck drivers is looking to revise the rules under which these employees work*
- *These rules were last revised during the Obama Administration following years of litigation*

This week, the Federal Motor Carrier Safety Administration (FMCSA) released an [advance notice of proposed rulemaking \(ANPRM\)](#) for a possible revision of certain aspects of the hours of service (HOS) regulations. Specifically, the FMCSA “seeks public input in four specific areas in which the Agency is considering changes: the short-haul HOS limit; the HOS exception for adverse driving conditions; the 30-minute rest break provision; and the sleeper berth rule to allow drivers to split their required time in the sleeper berth.” The HOS rules have been subject to significant litigation and legislation action over the last 20 years, and this rulemaking could give rise to more of both.

The FMCSA summarized the current HOS rule:

the HOS rules limit CMV drivers to 11 hours of driving time within a 14- hour window after coming on duty following 10 consecutive hours off duty (except that drivers who use sleeper berths may combine 2 hours of off-duty time with 8 consecutive hours in the sleeper berth). Drivers must take at least 30 minutes off duty no later than 8 hours after coming on duty if they wish to continue driving after the 8th hour. Drivers must record their on- and off-duty time in records of duty status (RODS) – previously captured in paper “logs” but today (with some exceptions) through electronic logging devices (ELDs). Drivers may not drive after having accumulated 60 hours of on-duty time in 7 consecutive days, or 70 hours in 8 days, but they may restart the 60/70-hour “clock” by taking 34 consecutive hours off duty.

The FMCSA also [announced](#) an August 24 public listening session regarding possible rule changes in Dallas, Texas.

For more information on transportation issues you may [email](#) or call Michael Kans at 202-659-8201.

TECHNOLOGY

Cyber Threats Hearing

Key Point:

- *Following the release of a DOJ report on cyber-digital threats, a Senate Judiciary Subcommittee examined the current threat landscape and discussed possible policy and statutory responses*

On August 21, the Senate Judiciary Committee’s Crime and Terrorism Subcommittee held a [hearing](#) entitled: “Cyber Threats to Our Nation’s Critical

Infrastructure.” Topics discussed in Panel II of the hearing included: (1) Russia; (2) Legislation; (3) NIST Cybersecurity Framework; (4) International Cooperation; (5) Workforce; (6) Voting Systems; and (7) Classified Information. Topics discussed in Panel III of the hearing included: (1) Russia; (2) Electricity Infrastructure; (3) Threats/Vulnerabilities; and (4) Industry Collaboration/ Incentives.

Full Committee Chairman Chuck Grassley (R-IA) said this is a timely hearing because that morning a group affiliated with the Russian government created a phony version of six websites, some related to the U.S. Senate. He argued their goal was to trick people interested in visiting the sites. He stated this hearing will focus on ways to identify and combat botnets and ransomware. He noted incidents in which law enforcement was able to interdict botnets, including Gameover Zeus in 2014. He stressed the importance of private sector and international cooperation. He submitted questions for the record.

Subcommittee Chairman Lindsey Graham (R-SC) recalled the moment President George W. Bush was informed of 9/11 and said this is a similar moment. He stressed that foreign entities are attempting to interfere with U.S. democracy. He noted that Microsoft discovered Russian interference which targeted the Republican Institute, the Hudson Institute, and the U.S. Senate. He said this hearing will focus on ways to counter this threat. He asserted that the U.S. is not acting quickly enough to combat cyberattacks and advocated for implementing sanctions against Russia.

Ranking Member Sheldon Whitehouse (D-RI) stressed that cybersecurity should transcend party politics. He stated that cybersecurity will require a whole-of-government effort and partnership with private enterprise. He said this hearing will examine the Attorney General’s

recent Cyber-Digital Task Force [report](#) and the Department of Homeland Security's (DHS) new National Risk Management Center. Whitehouse asserted there is "every reason to expect" that Russia will interfere in the 2018 midterm elections and noted 2016 Russian attacks on the U.S. electric grid. He said the recent attack on the Hudson Institute was particularly troubling because of it targeted the Kleptocracy Initiative, which attempts to limit crony finances practiced by Russian oligarchs. Whitehouse noted there are 16 critical infrastructure sectors, some of which are operated entirely by the private sector and lack necessary cybersecurity capabilities. He advocated for stress testing the National Institute of Standards and Technology (NIST) Cybersecurity Framework on private enterprises. He said it is unknown whether the NIST Framework is producing "real security." Whitehouse expressed support for the "International Cybercrime Prevention Act" ([S.3288](#)), which would expand the Department of Justice's (DOJ) authority to shut down botnets. He noted cybersecurity is spread across 73 Inspectors General and argued there needs to be a "roving Inspector General" to conduct cybersecurity oversight. Whitehouse emphasized the need to improve communication with the public and expressed concern about over-classification of information. He stated that deterrence requires developing international norms and signaling clear consequences to potential actors. He argued the U.S. needs to consider giving "hack back" authority to responsible private entities so they can respond to foreign attacks.

Associate Deputy Attorney General Sujit Raman praised the "Clarifying Lawful Overseas Use of Data Act" (CLOUD Act) (P.L.115-141) and said the legislation will improve DOJ's work. He stated that combatting cyberattacks is a top DOJ priority and highlighted the creation of the agency's Cyber-Digital Task Force (Task

Force). He stated the recent report from the Task Force details threats that target U.S. democratic institutions. Raman said DOJ's investigations can yield more than criminal charges, including civil charges and technical operations to combat cyberattacks. He emphasized the importance of robust information sharing. Raman said cyberattacks on critical infrastructure systems are particularly concerning because they involve all critical functions of American society. He stated that protecting this infrastructure is a shared priority and that DOJ's role is to prosecute violators and share information with federal partners. Raman noted the Task Force's report advocates for targeted enhancements to the Computer Fraud and Abuse Act (CFAA), which is the primary federal law against hacking. He noted this legislation has historically changed to meet evolving threats but has not been updated since 2008. He advocated for listing CFAA violations as "predicate acts" under the federal racketeering statute. Raman expressed support for the "International Cybercrime Prevention Act."

Cyber Threat Intelligence Integration Center (CTIIC) Director Michael Moss said that the Intelligence Community is postured to provide appropriate warnings for potential cyber threats. He added the top priority is to identify threats and provide timely warnings to federal, state and private entities. Moss noted the CTIIC is the newest intelligence center under the Office of the Director of National Intelligence (ODNI). He explained CTIIC supports policy makers by building an understanding of foreign cybersecurity threats by integrating information from the federal cyber centers. He said that Presidential Policy Directive (PPD) 41 named CTIIC as one of the three federal leads, along with DHS and FBI, for combatting cyberattacks. Moss stated that Russia, China, Iran, and North Korea present the greatest threats but that other individuals

and groups are also using cyberattacks against the U.S. to gain a strategic advantage. Moss asserted that Russia is poised to deploy even greater cyberattacks to sow discord in American institutions. He noted that cybercrimes cost Americans over \$1.4 billion in 2017 and said this figure is projected to increase.

The Department of Homeland Security's (DHS) National Risk Management Center Director Robert Kolasky advocated for Congress to create the Cybersecurity and Infrastructure Security Agency (CISA) at DHS. He said the agency would incorporate the existing National Protection and Programs Directorate into a new agency within DHS. Kolasky emphasized that the cybersecurity threat landscape has grown in recent years and said international cyberattacks are targeting critical infrastructure and resulting in significant economic losses. Kolasky noted that DHS and the FBI have identified Russian government actors who were targeting U.S. government and private infrastructure in the energy, water, aviation and critical manufacturing sectors. He said the multi-stage intrusion campaign involved leveraging existing relationships between initial cyber victims and intended infrastructure targets in order to hide the activity. Kolasky asserted that the Russian government intends to interfere with U.S. elections and that DHS recognizes the threat this presents in the upcoming midterm elections. He added DHS is working to improve international cyber threat information sharing. Kolasky stated the National Cybersecurity and Communications Integration Center (NCCIC) brings various partners together to provide technical assistance and guidance for improving network security. He stated he was named the first director of DHS' National Risk Management Center and said the center was developed to facilitate partnerships between government and industry.

Senate Rules Postpones Markup of Election Cyber Bill

Key Point:

- *A bill to help states with election cybersecurity is pulled from a committee's schedule amid pushback from the White House and state officials*

This week, the Senate Rules Committee postponed indefinitely a [markup](#) on a compromise bill to provide states additional assistance in securing elections from interference, the "The Secure Elections Act" ([S.2593](#)). Reportedly, there was concern among state officials that a provision requiring audits of election results would be in effect an unfunded mandate even though this provision was softened at the insistence of Senate Republican leadership. However, a White House spokesperson indicated in a statement that the Administration opposes the bill, which may have posed an additional obstacle to Committee action. However, even if the Senate were to pass this bill, it seems unlikely the House would consider companion legislation ([H.R.6663](#)).

In her [statement](#), S.2593 co-sponsor and Senate Rules Committee Ranking Member Amy Klobuchar (D-MN) stated that "[a]ny changes that were recently made to the bill were made to accommodate the Republican leadership, and while some of us would have preferred the bill in its original form, we were ready to vote for the Chairman's mark." She contended that

The bill contains important provisions for protecting our election infrastructure and would (1) require backup paper ballots for all states — including the nine that have partial paper ballots and the five that do not have them at all— in order to receive federal election funding; (2) require that

all fifty states conduct post-election audits; and (3) require homeland security to immediately notify states of election infrastructure breaches.

In a statement to *Yahoo!*, White House spokesperson Lindsey Walters asserted that DHS “has all the statutory authority it needs to assist state and local officials to improve the security of existing election infrastructure.” She added that “[w]e cannot support legislation with inappropriate mandates or that moves power or funding from the states to Washington for the planning and operation of elections.”

For more information on technology issues you may [email](#) or call Michael Kans at 202-659-8201. Thomas McGrath and Riyad Carey contributed to this section.

TRADE

U.S., Mexico Reach Agreement on NAFTA Rules of Origin

Key Points:

- The U.S. and Mexico were able to reach a deal on rules of origin, which has been one of the most significant sticking points throughout negotiations; Canada is expected to agree to the changes.
- Negotiators are still working towards an agreement on the sunset clause, investor-state dispute settlement (ISDS), and a late energy proposal made by Mexico.

The U.S. and Mexico have reportedly agreed to a provision that would allow the U.S. to subject non-conforming automobiles made at a new plant to a tariff higher than 2.5 percent, the current rate for imports from most-favored nations (MFNs). To increase the non-

conforming tariff rate above 2.5 percent the Trump Administration would have to raise the current MFN tariff rate on automobiles. Previously the Administration has used Section 232 to exceed the MFN tariff rates on steel and aluminum. Sources believe the 232 investigation into the national security effects of automobile and auto part imports is the reason the U.S. insisted on this provision. The two parties also agreed that NAFTA-eligible vehicles should contain 75 percent regional content with 70 percent of the steel, aluminum, and glass sourced from North America. Current rules of origin state automobiles must contain 62.5 percent regional content to be NAFTA-eligible. Finally, they agreed that 40 percent of a NAFTA-eligible passenger vehicle’s final assembly must be done by employees making at least \$16 per hour. Canada is reportedly likely to agree to these provisions, as Canadian automakers are better able to comply with the stricter rules than Mexican automakers.

Mexican President-elect Andrés Manuel López Obrador’s (AMLO) chief negotiator Jesús Seade told reporters that negotiators are still working on state-to-state dispute settlement and the U.S. proposal for a five-year sunset clause. Mexico reportedly offered a late provision that would allow the Mexican government to “manage the ongoing privatization of Mexico’s energy resources.” There is concern that this proposal could be used by AMLO to reverse Peña Nieto’s liberalization of Mexico’s oil and natural gas industries. Seade identified the end of August as the goal for a finalized NAFTA deal. U.S. Trade Representative (USTR) Robert Lighthizer has also indicated he is hoping to finish negotiations by the end of August so President Enrique Peña Nieto can sign the deal.

U.S., China Meet as \$16 Billion Tariffs Go into Effect

Key Points:

- American and Chinese officials met this week for the first time since they both imposed tariffs on \$50 billion of goods.
- The U.S. implemented 25 percent tariffs on \$16 billion of Chinese goods on August 23; China responded with its own tariffs on \$16 billion of U.S. goods.

The U.S. and China concluded two days of mid-level discussions Thursday with no apparent breakthroughs. The White House offered few details, saying in a statement: “We concluded two days of discussions with counterparts from China and exchanged views on how to achieve fairness, balance, and reciprocity in the economic relationship, including by addressing structural issues in China such as those identified in the Section 301 report. China was reportedly seeking to avoid stricter export restrictions that could arise from the recent passage of the Foreign Investment Risk Review Modernization Act (FIRRMA). FIRRMA updates the Committee on Foreign Investment in the United States (CFIUS) review process and expands the scope of covered transactions. These talks came amidst the countries imposing 25 percent tariffs on \$16 billion of goods. Both the U.S. and China have now imposed 25 percent tariffs on \$50 billion of the other’s goods. The Trump Administration is still advancing its proposed 25 percent tariff on \$200 billion of Chinese goods, with public hearings scheduled to take place next week.

Senate Approves Export-Import Bank Head

Key Point:

- The Senate Banking Committee voted unanimously to approve nominee

Kimberly Reed to lead the Export-Import Bank (Ex-Im).

On Thursday, the Senate Banking Committee voted unanimously to approve the nomination of Kimberly Reed for President of Ex-Im. However, Senator Pat Toomey (R-PA) indicated he will continue to block a quorum on the board. Senator Toomey explained that he voted for Reed so she can implement changes but stated he will keep holds on three board nominees the Committee approved last year: ““It takes a quorum to approve certain large transactions and no doubt there are other things that require a vote of the board, but it’s my understanding... there are really substantial reforms that she has the power to implement as president. And she has committed to working towards doing that -- that’s why I supported her confirmation, but I’m not prepared at this point to lift the hold on the other board members.” Ex-Im requires a quorum of three board members to approve transactions over \$10 million; the bank has been without a quorum since 2015.

UPCOMING EVENTS

August 20-24, 27

Public Hearings on Proposed Section 301 Tariff List: The Office of the U.S. Trade Representative (USTR) will hold public hearings regarding proposed tariffs on approximately \$200 billion worth of Chinese products.

August 27

Senate Homeland Security and Governmental Affairs Committee field hearing: “Examining the Effects of Tariffs and Trade Policy on Missouri Manufacturing and Agriculture” Witnesses: Brian Schaezler, vice president and general manager for distribution transformers at ABB, Inc.; Stuart Feldstein, executive vice president of Albaugh, LLC; Hudson Moore, senior

director for packaging procurement at Anheuser-Busch, LLC; Ben Breazeale, vice president of Cargill, Inc.; Greg Schuerich, president of CNC Machine Products, Inc.; Benjamin Michael Cast, president of Lowe Boats; Mark Weisheit, vice president and general manager of Nidec Merkle-Korff Industries; Ken Mcinnis, director of supply chain Americas and global purchasing at RotoMetrics

For more information on trade issues you may [email](#) or call Christopher Hatcher at 202-659-8201. Riyad Carey contributed to this section.

This Week in Congress was written by Ryan Schnepp.