

# Fault Lines

The Policy Risks and  
Opportunities that Lie Ahead

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# TABLE OF CONTENTS

## GLOBAL RESOURCES, SUSTAINABILITY, AND TRADE

- [Trade](#)
- [Power & Utilities](#)
- [Clean Fuels](#)
- [Oil & Gas](#)
- [Environmental Commodities](#)
- [Environmental Services](#)
- [EU Energy](#)

## FINANCIAL SERVICES

- [Consumer Finance](#)
- [Insurance](#)
- [Education](#)
- [Housing](#)
- [Banking](#)

## HEALTHCARE

- [Payor](#)
- [Provider](#)
- [Pharma](#)
- [European HC](#)

# TABLE OF CONTENTS

## PUBLIC SERVICES

- [US National Defense Strategy](#)
- [State & Local Government](#)
- [Agriculture](#)
- [Immigration](#)

## COMMUNICATIONS, MEDIA, AND TECHNOLOGY

- [Telecom](#)
- [AI](#)
- [Platforms](#)

## EUROPE

- [European Sovereignty Under Trump](#)

The image features a dark blue background. In the bottom-left corner, there are several parallel diagonal stripes in a lighter shade of blue, extending from the bottom-left towards the center-right.

# **Global Resources, Sustainability, and Trade**

# THE TARIFF PILEUP

LAYERED POLICIES, RISING  
PRICES, AND GROWING RISKS



# Trade Policy 2026 Preview:

## THE BOTTOM LINE

Capstone expects tariff policy to remain front and center for the Trump administration in 2026, even as affordability pressures mount and the Supreme Court is likely to weigh in unfavorably. A slate of high-stakes negotiations with China looms, alongside multiple Section 232 investigations that will force near-term decisions. We expect the US-Mexico-Canada Agreement (USMCA) to be renewed by Q2 2026, delivering tailwinds for US automakers, steel producers, and agricultural companies.

### Outlook at a Glance

- ▶ **TRUMP WILL DIG IN ON HIS TRADE POLICY EVEN AS TARIFFS CAUSE SOME PRICES TO RISE AHEAD OF THE 2026 MIDTERM ELECTIONS**
- ▶ **THE TRUMP ADMINISTRATION WILL TAKE A TAILORED APPROACH TO SECTION 232, IMPOSING TARIFFS ON A SMALLER PORTION OF GOODS THAN THOSE COVERED BY THE SCOPE OF INVESTIGATIONS**
- ▶ **US-CHINA TRADE RELATIONS WILL BE UNSTABLE IN 2026 DESPITE THE ONE-YEAR TRUCE**
- ▶ **THE US-MEXICO-CANADA TRADE AGREEMENT WILL BE RENEWED BY THE END OF Q2 2026, WITH BILATERAL DEALS ADDRESSING SOME SECTION 232 TARIFFS**
- ▶ **EXPECT MORE US-EU TRADE FRICTION, WITH EUROPE'S DIGITAL AND ENVIRONMENTAL REGULATIONS BECOMING TENSION POINTS**
- ▶ **THE ADMINISTRATION WILL DEPLOY A BACK-UP PLAN TO IMPOSE TARIFFS AFTER THE SUPREME COURT RULES AGAINST IEEPA; OUTLOOK FOR REFUNDS IS NEGATIVE**

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# Trump Will Dig In on His Trade Policy Even as Tariffs Cause Some Prices to Rise Ahead of the 2026 Midterm Elections

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<b>Winners</b>	Cleveland-Cliffs Inc. (CLF), Century Aluminum Co. (CENX), Crown Holdings Inc. (CCK), First Solar Inc. (FSLR), MasterBrand Inc. (MBC)
<b>Losers</b>	Wayfair Inc. (W), RH (RH), Target Corp. (TGT)

## THE ADMINISTRATION REMAINS FOCUSED ON TRADE DEFICIT, REVENUE, AND MANUFACTURING

The Trump administration continues to believe that tariffs are a critical tool for reshoring US manufacturing capacity in key sectors and for solving the persistent US trade deficit. Capstone maintains its belief that the long-term outlook for US tariff policy will continue to revolve around:

- A baseline tariff on all imports to raise revenue and reduce the US trade deficit, rooted in the principles of reciprocity;
- Sectoral tariffs to reshore manufacturing in

key industries that have a national security nexus; and

- Higher tariffs on China and attempts to bring other countries into alignment with US tariffs on China.

## INCREASED SENSITIVITY TO AFFORDABILITY

Recent modifications to the reciprocal tariff indicate the administration is becoming more sensitive to the impact of tariffs on consumer goods, particularly food. On November 14th, the White House issued an executive order (EO) granting reciprocal tariff relief to imports of agricultural products. More than 200 unique HTS codes, representing more than \$62 billion in agricultural imports in 2024, were added to Annex II, thereby exempting them from reciprocal tariffs. The administration also reduced certain food tariffs on Brazil.

The focus on affordability sets up uncomfortable choices for the administration ahead of the 2026 midterms. Section 232 tariffs, which have thus far been durable for the administration, may be further tailored as Trump tries to lower prices, including electricity costs. If the US Supreme Court (SCOTUS) strikes down the reciprocal tariffs (see more below), we do not expect the administration to use that as an opportunity to remove all tariffs on a broad range of products.

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# The Trump Administration Will Take a Tailored Approach to Section 232, Imposing Tariffs on a Smaller Portion of Goods Than Those Covered by the Scope of Investigations

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<b>Winners</b>	Critical minerals: Albemarle Corp. (ALB), Lithium Americas Corp. (LAC), Standard Lithium Inc. (SLI), Corning Inc. (GLW), Wacker Chemie AG (WCH on the German exchange)  Pharmaceuticals: Dr. Reddy's Laboratories Ltd. (RDY), Teva Pharmaceutical Industries Ltd. (TEVA), Sandoz Group (SDZ on the Six Swiss exchange or SNZNY in the US)
<b>Losers</b>	Polysilicon: Sunrun Inc. (RUN), Clearway Energy Inc. (CWEN)

For example, the investigation into copper resulted in tariffs on only semi-finished copper products. The investigation's scope, however, was much broader and included copper ore and copper scrap, which were not initially included in the tariff announcement. Instead, the Commerce Department was tasked with monitoring imports of copper and its derivatives over the next year. By June 30, 2026, Commerce must issue a report to the president providing a recommendation on whether to impose a 15% tariff on refined copper starting in 2027. Instead of imposing baseline tariffs on all products, the administration has built in provisions to increase tariffs over time if necessary.

During the lumber investigation, the administration applied different tariff rates to imports of softwood lumber and to derivative products. Additionally, the administration imposed tariffs only on cabinets, vanities, and upholstered furniture, with duties scheduled to increase in 2026. The administration also asked Commerce to produce a report on hardwood lumber by October 2026 for potential inclusion.

This signals a tailored approach to Section 232 tariffs, rather than applying a broad-based tariff to all products in the scope of the investigation. We expect that strategy to continue.

## TRUMP HAS A TRACK RECORD OF TAKING A TAILORED TARIFF APPROACH TO SECTION 232

In Trump's second term, his administration completed Section 232 investigations into imports of copper, lumber, and trucks. In the tariffs on copper and lumber, the administration demonstrated a more tailored approach than in previous investigations into steel, aluminum, and autos. Notably, the administration has adopted a more targeted application of tariffs, in some cases with delayed phase-ins.

## ONGOING SECTION 232 TARIFFS

While we expect the administration to exercise greater restraint in ongoing Section 232 investigations into products such as pharmaceuticals, semiconductors, and critical minerals, we still expect the process to result in the imposition of tariffs. Possible outcomes following investigations include:

1. **Critical minerals:** We believe the Trump administration will likely implement a tiered tariff approach, in which critical minerals with substantial domestic supply chains and/or that have received US government investment are expected to be subject to 25% tariffs or greater on day one. Critical minerals with limited domestic supply chains, such as rare earths, could face no or lower tariffs initially, with future tariff increases possible.
2. **Pharmaceuticals:** The administration has confirmed that tariffs will apply only to branded drugs. Generics will receive carve-outs due to concerns about pricing.

## INCLUSIONS PROCESS LIKELY TO EXPAND SCOPE

The inclusions process, introduced by the current administration, allows companies to petition the Commerce Department to include goods in Section 232 duties. In the only such process completed so far, covering steel and aluminum derivatives, Commerce accepted all requests except those seeking tariffs on goods subject to other Section 232 duties or investigations. If domestic manufacturers across Section 232-exposed sectors petition for the inclusion of a good, it is likely to be included, thus increasing the reach of products subject to tariffs over time.

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# US-China Trade Relations Will Be Unstable in 2026 Despite the One-year Truce

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<b>Winners</b>	N/A
<b>Losers</b>	Cargill Inc., Archer-Daniels-Midland Co. (ADM), Bunge Global SA (BG), Ford Motor Co. (F), Rivian Automotive Inc. (RIVN)

## CONTOURS OF THE US-CHINA DEAL

In late October, Presidents Trump and Xi agreed to a one-year trade deal intended to provide tariff certainty. As part of the deal, the US agreed to reduce fentanyl-related tariffs by 10% and to postpone Section 301 shipbuilding duties. In return, China agreed to roll back critical mineral export restrictions and committed to purchasing soybeans through 2028.

## KEY PAIN POINTS FOR 2026

Although an agreement has been reached between the two countries, we believe significant risks of re-escalation remain in 2026. If China is unable to uphold its purchase commitments, as it did during the Phase One agreement in 2021 and 2022, we believe the Trump administration would likely—and can quickly—impose new tariffs. Similarly, if

US companies, such as car manufacturers, experience difficulties sourcing Chinese rare earth products, we expect a similar escalation. The US government will continue its engagement with US farmers and manufacturers to ensure China honors its commitments under the deal.

If the US imposes new Section 232 tariffs on key Chinese exports, such as semiconductor derivatives, active pharmaceutical ingredients, and polysilicon, China could perceive these actions as a provocation, threatening the current deal. If the US places new export controls on items such as high-performance chips, ethane, or jet engines, we would expect a similar escalation on the Chinese side.

## US TRADE AGREEMENTS WITH THIRD COUNTRIES COULD TRIGGER CONFLICT

As part of the US-Malaysia and US-Cambodia agreements, if the US imposes a duty or other import restriction on a good or service from a third country due to national security concerns, the US will notify Malaysia and Cambodia that the action is being taken, and each country shall adopt a measure with a similar restrictive effect. This suggests that each country could mirror the Section 232 tariffs the US has imposed on imports of products in sensitive sectors, including steel, aluminum, and semiconductors.

We expect the US to seek to include similar provisions in future trade deals. If the US elects to trigger these provisions, it would create new strains on China's economy and create a new risk to the current trade deal between the two countries.

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## The US-Mexico-Canada Trade Agreement Will Be Renewed by the End of Q2 2026, With Bilateral Deals Easing Some Section 232 Tariffs

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<b>Winners</b>	Ford Motor, General Motors Co. (GM), Alcoa Corp. (AA), Nucor Corp. (NUE), Archer-Daniels-Midland
<b>Losers</b>	N/A

touted the agreement's success, and withdrawing from it would effectively condemn a deal his administration negotiated in his first term while harming many US industries. USMCA-compliant products are already exempt from the 35% tariff on imports from Canada and the 25% tariff on imports from Mexico.

### USMCA REVIEW

Capstone expects the review of the USMCA trade deal will lead to a continuation of the agreement by July 2026. As part of the review, the three USMCA countries will decide whether they want to renew the agreement for another 16 years. If any country opts not to renew, the decision will trigger an annual review of the deal for the next 10 years. If, at the end of that period, the countries decide not to extend the agreement, it will terminate.

Capstone believes it is unlikely that the administration will withdraw from the USMCA. Trump has

### OUTLOOK FOR BILATERAL DEALS

The Trump administration will likely pursue side agreements with Canada and Mexico that address a variety of trade disputes. Once those are struck, the US may be willing to reduce the Section 232 tariffs imposed on Canada and Mexico. Aluminum, steel, and critical minerals are the sectors most likely to be addressed in the bilateral deals, but it is unlikely that tariffs will go to zero for these products. Mexico is better positioned than Canada to strike a deal, given the positive relationship between Presidents Trump and Sheinbaum and Mexico's progress in addressing US trade and investment concerns.

## EXPECT RULES OF ORIGIN (ROO) MODIFICATIONS

**C**urrent rules of origin (ROO) and limitations on transshipment from Canada and Mexico are likely to play a large role in the USMCA review. During the first Trump term, US trade negotiators focused on raising the USMCA content requirement for USMCA-eligible vehicles to 75%, and we expect negotiators to try to increase that percentage during the USMCA review. US negotiators are particularly interested in doing this to keep Chinese content out of USMCA vehicles as Chinese companies invest more heavily in Mexico. The administration's concessions on the autos Section 232 to USMCA-eligible vehicles and parts indicate it is prepared to tariff non-USMCA content in USMCA vehicles.

This trend may extend into other sectors where the US wants to exclude Chinese content. By overhauling the USMCA ROO more broadly, the deal parties could determine a product's origin based on the origins of its components rather than where the product is substantially transformed. Under the current regime, even if a product's components are sourced from a third country, and it is assembled and substantially transformed in Mexico, it is considered a Mexican product.

Updates to the rules of origin would limit companies' ability to strategically shift assembly to third countries to mitigate tariff exposure. The focus of such updates would be China, given longstanding US concerns about Chinese content receiving preferential treatment under the USMCA. We believe the US will eventually seek to address Chinese content in other bilateral trade deals, though ROO modifications are technically challenging and take years to work through.

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# Expect More US-EU Trade Friction, With Europe's Digital and Environmental Regulations Becoming Tension Points

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<b>Winners</b>	Cleveland-Cliffs, General Motors, and domestic manufacturers with limited exposure to the EU.
<b>Losers</b>	LVMH Moët Hennessy Louis Vuitton SA (MC on Euronext Paris), Capri Holdings Ltd. (CPRI), Pernod Ricard SA (RI on the Euronext Paris)

## TRADE AGREEMENT

**I**ncreasing tension over the implementation of the US-EU trade agreement, EU digital and environmental regulations, and US Section 232 tariffs will likely create trade friction between the US and EU in 2026.

The US will likely react negatively to the EU's implementation of new digital or environmental regulations, viewing them as a breach of commitments made to the US. On the other hand, the EU has objected to the increasing US reliance on Section 232 investigations outside the scope of the US-EU deal, including the use of the inclusions process.

The US and EU have taken positive steps to implement the trade agreement signed in July 2025. While regulations or new tariffs may complicate implementation, we do not expect a wholesale abandonment of the trade agreement. Instead, the US may walk back some commitments made in the agreement, such as tariff

reductions on auto exports and pledges to further discuss steel and aluminum tariffs.

## ROLE OF IEEPA IN US-EU TRADE

**I**f the Supreme Court strikes down the reciprocal tariffs, as Capstone expects, the US could quickly launch a Section 301 investigation into the EU to restore tariffs under a more legally durable framework. The US could also cite EU tech regulations as a justification for imposing blanket tariffs under Section 338, though we believe this is less likely. The administration's desire to maintain trade leverage over the EU makes Section 301 action appealing, particularly if IEEPA is struck down.

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# The Administration Will Deploy a Back-up Plan to Impose Tariffs After the Supreme Court Rules Against IEEPA; Outlook for Refunds Is Negative

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<b>Winners</b>	Beneficiaries of the universal IEEPA tariffs, domestic producers of products not deemed to be strategically significant enough for a Section 232 investigation.
<b>Losers</b>	Import-exposed retailers, such as Walmart Inc. (WMT), Target Corp. (TGT), Lowe's Cos. Inc. (LOW), and Dollar Tree Inc. (DLTR).

If SCOTUS requires the government to refund collected tariffs, the process would be cumbersome. Additionally, importers would not necessarily be obliged to pay refunds to downstream customers unless a private agreement was reached between those parties. While a class action may offer the potential for refunds, it would likely be several years before cash is available to importers.

Capstone believes that if the Court of International Trade finds Trump's use of IEEPA to impose tariffs to be unlawful, Trump maintains a variety of other trade authorities that could be used to replace his original measures, although they would present him with constraints. Section 122 of the Trade Act of 1974 and Section 338 of the Tariff Act of 1930 give the president tariff authorities that Trump can use to replicate the universal tariff. We believe the Trump administration may consider using these authorities as a stopgap measure while implementing new tariffs under Section 301 and Section 232 if the court prohibits the use of IEEPA.

## IEEPA LITIGATION

Capstone assigns a 70% likelihood that SCOTUS will find Trump's use of the International Emergency Economic Powers Act (IEEPA) unlawful by July 2026. During oral arguments in November, most justices appeared to doubt the government's claim that Trump has the authority to impose tariffs on national security grounds. Removing the tariffs would create tailwinds for retailers and other import-exposed firms.

We believe the outlook for refunds is negative for importers that are not plaintiffs in the SCOTUS case. During the oral arguments, the plaintiff's counsel conceded to Justice Amy Coney Barrett that refunds would be difficult to administer and said that the plaintiffs would only seek forward-looking tariff relief. Moreover, the plaintiff's counsel did not advocate for broad tariff relief to all impacted parties.

## SECTION 232 LITIGATION RISK IS UNDERAPPRECIATED

The risk of a lawsuit against the administration's Section 232 tariffs is underappreciated. Section 232 is a legally durable statute, but the administration has introduced a novel inclusions mechanism that creates legal risk. The inclusions process, introduced by the current Trump administration, allows companies to petition the Department of Commerce for goods they want covered by Section 232 duties. In the only such process completed so far covering steel and aluminum derivatives, Commerce accepted all requests except those seeking tariffs on goods subject to other Section 232 duties or investigations.

Importers that were not originally subject to Section 232 duties but find themselves tariffed via an inclusions process may point to the administration's 100% acceptance rate of inclusions petitions as alleged evidence of an illegal process or may otherwise sue over the structure and introduction of the inclusions process itself.

The Trump administration is currently expanding the list of goods covered by a variety of Section 232 tariffs. That increases the odds that importers sue. The Commerce Department is currently running the second inclusions process on steel and aluminum derivatives and launched a separate one on auto parts in October. Section 232 is correctly understood to be legally sturdy, but the inclusions process is new and therefore exposed to litigation risk.

# Data Center Squeeze

The Coming Political Debate  
Over Data Center  
Development

# Power & Utilities Policy 2026 Preview:

Capstone believes tension between states, electric utilities, and the Trump administration over data center development, affordability, and grid reliability will define policy debates in 2026, creating uncertainty for project development across energy and digital infrastructure. However, certain states, such as Texas and Pennsylvania, will improve regulatory certainty through new rate structures, with utilities likely to benefit.

## THE BOTTOM LINE

### Outlook at a Glance

- ▶ **FERC** POLICY TO ACCELERATE LARGE LOADS LIKELY TO FALTER DUE TO UTILITY AND STATE OPPOSITION; POSITIVE FOR UTILITIES, POTENTIAL HEADWINDS FOR IPPS
- ▶ **TRUMP ADMIN**, CONGRESS LIKELY TO PRIORITIZE FUNDING FOR NUCLEAR POWER GENERATION, GEOTHERMAL, AND ELECTRIC TRANSMISSION PROJECTS
- ▶ **EPA TO CONTINUE** WITH REGULATORY ROLLBACK TO BENEFIT DATA CENTERS, THERMAL POWER GENERATION
- ▶ **PJM STATE GOVERNORS** UNLIKELY TO EXIT MARKET DESPITE HIGH PRICES; WILL PUSH FOR PRICE STABILITY, MAJOR MARKET REFORMS UNLIKELY IN 2026
- ▶ **BIPARTISAN PERMITTING** REFORM DISCUSSIONS LIKELY TO CONTINUE, NEXT WINDOW OF OPPORTUNITY FOR PASSAGE END OF 2026
- ▶ **RENEWABLES** LIKELY TO BE SPARED BY TEXAS POLICYMAKERS AND ERCOT IN UPCOMING FIRING RULES; POSITIVE FOR CLEARWAY ENERGY, TESLA
- ▶ **MOMENTUM TOWARD AN** INTEGRATED WESTERN POWER MARKET WILL BENEFIT RENEWABLE ENERGY DEVELOPERS AND POWER UTILITIES
- ▶ **NORTHEAST** GRID OPERATORS TO INCREASINGLY SUPPORT DISPATCHABLE GENERATION, POTENTIAL THERMAL RESTARTS
- ▶ **STATE POLICYMAKERS** WILL INCREASINGLY TARGET CLIMATE POLICIES AND UTILITY EARNINGS TO ADDRESS AFFORDABILITY CONCERNS
- ▶ **NEW STATE-LEVEL** LARGE LOAD TARIFFS FOR DATA CENTERS EMERGE AMID FEDERAL REGULATORY UNCERTAINTY, DRIVING UTILITY TAILWINDS

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# FERC Policy to Accelerate Large Loads Likely to Falter Due to Utility and State Opposition; Positive for Utilities, Potential Headwinds for IPPs

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<b>Winners</b>	Utilities: American Electric Power Company Inc. (AEP), Exelon Corp. (EXC), Southern Company (SO), Entergy Corp. (ETR)
<b>Losers</b>	IPPs: Vistra Corp. (VST), NRG Energy Inc. (NRG), Talen Energy Corp. (TLN)

## OPPOSITION TO THE DEPARTMENT OF ENERGY DIRECTIVE TO EXPEDITE DATA CENTER INTERCONNECTION

Capstone believes the Advanced Notice of Proposed Rulemaking (ANOPR) sent by US Department of Energy (DOE) Secretary Chris Wright to the Federal Energy Regulatory Commission (FERC) on October 23rd to expedite the interconnection of 20+ MW loads, such as data centers, creates uncertainty for existing state regulations. We expect opposition from states and utilities to soften the proposal, reducing the favorability for independent power producers (IPPs).

Although the DOE's proposal aims to reduce

regulatory friction delaying data center interconnection, 20 states have already adopted or proposed their own frameworks. A prescriptive federal rule could upend these frameworks, creating uncertainty for data centers, IPPs, and utilities operating under state-directed interconnection processes.

Notably, the DOE's ANOPR directs FERC to: (1) Assert federal jurisdiction over large load interconnections (20 MW or greater) at the transmission level; (2) Create new standardized interconnection rules, including study deposit and readiness requirements; (3) Expedite approval timelines to 60 days for load-side interconnections when applicants offset demand through new supply or load flexibility; and (4) Allow new loads to contract directly with existing generators—including nuclear plants—via hybrid arrangements under specified conditions.

Bipartisan lawmakers, state regulators, and utilities are expressing concern about the DOE's ANOPR, given that large load interconnection has historically fallen under state jurisdiction. The National Association of Regulatory Utility Commissioners adopted [Resolution EL-1](#), urging FERC to revise the proposal. This sentiment was echoed in letters from Chair Mike Lee (R-UT) of the Senate Committee on Energy and Natural Resources, Senator Martin Heinrich (D-NM), the South Dakota Public Utilities Commission (PUC), and the Georgia Public Service Commission (PSC).

Given the uncertain downstream implications for state regulations, we believe FERC will soften the DOE's directive by adopting a principle-based

framework that preserves state jurisdiction while still streamlining interconnections. FERC is accepting comments on the ANOPR until December 5th. The DOE has requested final action by April 30, 2026. We expect the final rule will

retreat from two key DOE proposals: first, FERC asserting direct authority over large load interconnections, and second, data centers to self-fund grid upgrades. This outcome reflects opposition from utilities and state regulators.

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## Trump Admin, Congress Likely to Prioritize Funding for Nuclear Power Generation, Geothermal, and Electric Transmission Projects

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<b>Winners</b>	Nuclear, Geothermal, and Utilities: NuScale Power Corp. (SMR), Talen Energy Corp. (TLN), GE Vernova Inc. (GEV), Centrus Energy Corp. (LEU), Cameco Corp. (CCJ), Ormat Technologies Inc. (ORA), American Electric Power Company Inc. (AEP)
<b>Losers</b>	Renewables: First Solar Inc. (FSLR), Clearway Energy Inc. (CWEN)

Capstone believes the Trump administration will continue to use existing federal resources to support politically favored technologies: nuclear, geothermal, and electric transmission infrastructure. The DOE's Loan Programs Office (LPO) is likely to continue finalizing Biden-era conditional commitments that meet the current administration's preferences, while projects benefiting renewables are less likely to move forward. Additionally, DOE is expected to

continue terminating grants awarded by the previous administration. However, we believe moderate congressional Republicans will stave off the worst-case scenario for Biden-era recipients.

Additionally, the DOE will advance its "Speed to Power" initiative, which aims to use LPO and other offices to accelerate large-scale power generation and transmission infrastructure for data centers. We expect the Trump administration to repurpose funding from terminated awards toward this initiative and other programs the administration views as critical to US energy dominance and artificial intelligence competitiveness with China.

Beyond administrative actions, we will assess the likelihood that congressional Republicans will authorize additional federal resources to expand the domestic nuclear industry. The DOE has signaled its intent to own 10 large reactors through the US-Japan trade deal. However, explicit congressional authorization will be required for direct government procurement—either through annual appropriations or new mechanisms such as a sovereign wealth fund.

# EPA to Continue With Regulatory Rollback to Benefit Data Centers, Thermal Power Generation

<b>Winners</b>	Vistra Corp. (VST), Talen Energy Corp. (TLN), Meta Platforms Inc. (META), Microsoft Corp. (MSFT), Amazon.com Inc. (AMZN), Alphabet Inc. (GOOGL), NRG Energy Inc. (NRG), GE Vernova Inc. (GEV), Exelon Corp. (EXC), American Electric Power Company Inc. (AEP), PPL Corp. (PPL)
<b>Losers</b>	First Solar Inc. (FSLR), Clearway Energy Inc. (CWEN)

extending compliance timelines and reducing costs in the interim. We expect the Trump administration to frame much of its effort to roll back regulations on power plants as supporting data center buildout and power availability—priorities it has emphasized.

We also expect EPA to take additional action on the “50-hour rule” for backup generation, which is likely to be positive for data centers. EPA issued guidance on the matter in May 2025, but we expect them to follow this by initiating a formal rulemaking in 2026.

In the first months of 2025, the Environmental Protection Agency (EPA) initiated a deregulatory agenda to roll back regulations or push out compliance timelines across a range of sectors, including the power sector. The EPA has already initiated four major deregulatory actions: (1) repealing the Biden-era greenhouse gas emissions rule for power plants; (2) revising the Good Neighbor Plan for cross-state ozone emissions; (3) proposing to extend compliance timelines for coal combustion residuals (coal ash); (4) delaying steam Effluent Limitation Guidelines.

In 2026, Capstone expects the EPA to publish final rules based on many of these proposals and to begin defending them in court. The rules will support incumbent coal and gas generation by

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# Bipartisan Permitting Reform Discussions Likely to Continue, Next Window of Opportunity for Passage End of 2026

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<b>Winners</b>	NextDecade Corp. (NEXT), Williams Companies Inc. (WMB), Venture Global Inc. (VG), Energy Transfer LP (ET), MasTec (MTZ), Emcor Group Inc. (EME), AECOM (ACM), Dycom Industries Inc. (DY)
<b>Losers</b>	N/A

Capstone believes bipartisan consensus on permitting reform exists, but congressional gridlock and electoral politics will prevent meaningful

National Environmental Policy Act (NEPA) and Clean Water Act (CWA) reform through 2026. In 2025, committees in the House of Representatives proposed and passed legislation addressing these topics, including the Streamlined Permitting and Environmental Efficiency Deployment (SPEED) Act and the Preventing Excessive Delays in Environmental Reviews (PERMIT) Act. However, the Senate has not produced companion legislation. Action by the Senate Committee on Environment and Public Works will be critical as it holds jurisdiction over environmental laws.

Our prediction that Congress is unlikely to act before the end of 2026 reflects timing constraints and the congressional calendar: first, the October-November 2025 government shutdown paused most legislation unrelated to government funding, eliminating any possibility of a bill

passing before the end of 2025. Looking ahead to 2026, the looming campaign season before the midterm elections set a spring 2026 deadline for accomplishing most legislative priorities. Capstone believes Congress is unlikely to reach a compromise on permitting reform by spring 2026 due to Senate delays and the difficulty of reaching an enduring agreement on these challenging topics. Additionally, Democrats' strong performance in the November 2025 elections has raised expectations for the 2026 midterms, reducing Democrats' incentive to negotiate from a position of minority status. We believe that the end of 2026 (after the midterm elections) is the next real window of opportunity for a bill to pass.

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# PJM State Governors Unlikely to Exit Market Despite High Prices; Will Push for Price Stability; Major Market Reforms Unlikely in 2026

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<b>Winners</b>	Utilities: American Electric Power Company Inc. (AEP), Exelon Corp. (EXC), PPL Corp. (PPL)  IPPs: Vistra Corp. (VST), NRG Energy Inc. (NRG), Talen Energy Corp. (TLN)
<b>Losers</b>	N/A

Capstone views call from state governors in the PJM market to consider leaving the capacity market—or the regional market altogether—as political posturing. Although we expect this rhetoric to continue, we believe the focus will be on securing price stability and attracting data centers to the state. Exiting PJM would require a member state to form a new single- or multi-state Regional Transmission Organization (RTO), join an existing RTO such as Midcontinent Independent System Operator (MISO) or New York Independent System Operator (NYISO), or fully re-regulate its electricity markets to re-establish integrated resource planning.

While we expect to see continued rhetoric and the introduction of study bills (as we've seen in Illinois) or their passage (as we've seen in [New Jersey](#)), ultimately, we believe any studies would demonstrate that the costs outweigh the benefits. Reregulation is an uphill battle, as seen in the past few legislative sessions, when utilities

have attempted to leverage energy affordability and supply-and-demand concerns to advocate for owning generation.

We expect PJM's Critical Issue Fast Path (CIFP) proposal to roll out in early 2026 after FERC approval, delivering near-term relief through four mechanisms: extending the capacity price collar for the 28/29 auction, creating joint interconnection fast paths (PJM-overseen for generators, state-overseen for large loads), expanding limited demand response programs, and refining load forecasting. These incremental fixes should ease current capacity market pressures as stakeholders evaluate longer-term solutions. However, we do not expect structural reforms to gain momentum in 2026. Proposals to exit the capacity market entirely, bifurcate auctions between new and existing resources, or pursue other major restructuring face significant political and coordination barriers.

We believe these incremental changes will be positive for PJM utilities such as PPL, EXC, and AEP, which are aiming to expand their rate base through capital expenditures needed to support the integration of large loads such as data centers. On the other hand, we view the maintenance of existing market mechanisms (e.g., PJM's Base Residual Auction) as positive for IPPs. We believe a short-term extension of the capacity price collar provides price stability and developer certainty while maintaining sufficiently high prices to compensate for existing generation.

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# Renewables Likely to be Spared by Texas Policymakers and ERCOT in Upcoming Firming Rules; Positive for Clearway Energy, Tesla

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<b>Winners</b>	Clearway Energy Inc. (CWEN), Tesla Inc. (TSLA), Vistra Corp. (VST), NRG Energy Inc. (NRG)
<b>Losers</b>	N/A

reliability during high-risk events. Thermal generators, particularly independent power producers such as Vistra and NRG Energy, are cushioned from the impact of firming requirements, as thermals are inherently dispatchable and more likely to meet seasonal reliability thresholds without additional investment.

**C**apstone expects the Public Utility Commission of Texas (PUCT) to revise its original firming requirements proposal to allow battery storage as an eligible resource that can provide firming to generation resources that are unable to meet the required performance standards. This revision would avoid the worst-case scenario for Texas renewables and benefit clean energy companies such as Clearway Energy and Tesla.

Firming Requirements were created through House Bill 1500 in 2023, by lawmakers who wanted to provide dispatchable power generation resources with additional incentives to add incremental capacity to the market. Firming requirements apply to new power generation projects that interconnect to the grid in or after 2027, and they must operate at or above their average generation capability to ensure

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# Momentum Toward an Integrated Western Power Market Will Benefit Renewable Energy Developers and Power Utilities

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<b>Winners</b>	AES Corp. (AES), Clearway Energy Inc. (CWEN), Portland General Electric Co. (POR), Xcel Energy Inc. (XEL)
<b>Losers</b>	N/A

Capstone believes that California Independent System Operator’s (CAISO) Extended Day-Ahead Market (EDAM) and SPP’s Market+ are on track to go live in 2026 and 2027, respectively. While the two market frameworks each have their own competitive advantages, we believe that the continued momentum in CAISO and SPP to expand the reach of their respective wholesale energy markets across Western Balancing Authorities (BAs) bodes well for renewable developers such as AES and Clearway Energy. Solar developers will be able to export surplus solar energy, which is beneficial when dealing with transmission constraints. 23 out of 37 BAs in the West have officially committed to, or have demonstrated an intention to join, either market. We believe that utilities like Portland General Electric, which has committed to California’s EDAM, will benefit from a broader generation footprint and lower wholesale prices.

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# Northeast Grid Operators To Increasingly Support Dispatchable Generation, Potential Thermal Restarts

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<b>Winners</b>	Thermal Generation Owners in the Northeast, Thermal Developers e.g. Vistra Corp. (VST)
<b>Losers</b>	Clearway Energy Inc. (CWEN)

plants to mitigate resource adequacy concerns in the late 2020s.

In 2026, ISO-NE will redesign its capacity market, including updates to its capacity accreditation method, which determines what percentage of a generator's maximum output it can bid. We expect this to result in more favorable accreditation values for thermal generation.

Capstone believes rising demand forecasts and slower-than-needed additions to renewable generation will force Northeast grid operators, NYISO and ISO-New England (ISO-NE), to increasingly support thermal generation, benefiting thermal developers like Vistra. Increased new natural gas pipeline capacity to the region, namely the Northeast Supply Enhancement pipeline, has positioned the region to do so.

NYISO CEO Rich Dewey has highlighted the need for the state to retain and expand its existing fleet of dispatchable generation. New York's 2025 Energy Plan included a large-scale repowering of generation to renewable fuels by 2040, when the state has committed to being fully zero-emission. We doubt the state will pursue a renewable fuel approach in the long term, but in the short term, we believe NYISO will retain thermal generation, especially peaker plants in New York City. The state may also consider making long-term commitments to some existing or new natural gas

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# State Policymakers Will Increasingly Target Climate Policies and Utility Earnings to Address Affordability Concerns

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<b>Winners</b>	Vistra Corp. (VST), NRG Energy Inc. (NRG), Talen Energy Corp. (TLN)
<b>Losers</b>	American Electric Power Company Inc. (AEP), Consolidated Edison Inc. (ED), Dominion Energy Inc. (D), Ameren Corp. (AEE)

eration of similar efforts across the US would be negative for utilities.

Policymakers in states with existing climate goals may consider backing away from renewable mandates and state-sponsored procurements to address affordability concerns and allow natural gas to supply dispatchable generation. This shift would benefit states seeking to attract data centers, as dispatchable generation can more easily meet their flat demand.

**C**apstone believes energy affordability will be a defining issue in 2026 as midterm elections approach and prices rise due to demand growth. Energy affordability was a major emphasis in the New Jersey and Virginia gubernatorial elections in 2025, signaling a trend that will accelerate. We believe there will be a range of policy approaches and proposals to mitigate affordability concerns, given the various factors that have caused utility bills to rise.

Sitting legislators and candidates running for office may directly target utility spending and returns as a campaign strategy ahead of the 2026 elections, proposing to limit the Return on Equity (ROE) a utility can earn on spending or to further scrutinize the magnitude of utility spending. This year, legislators in New York proposed a bill to cap the ROE a utility can earn, and Governor Mike Braun (D-IN) has kicked off a process to appoint less utility-friendly regulators in Indiana. A prolif-

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# New State-Level Large Load Tariffs for Data Centers Emerge Amid Federal Regulatory Uncertainty, Driving Utility Tailwinds

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<b>Winners</b>	Dominion Energy Inc. (D), PPL Corp. (PPL), Exelon Corp. (EXC), Oncor (SRE)
<b>Losers</b>	Hyperscalers

Capstone believes ongoing regulatory uncertainty at FERC and PJM regarding large load interconnection and behind-the-meter (BTM) co-location is spurring state-level large load tariffs for data centers that mitigate cost shifting and stranded asset risk to residential ratepayers while providing utilities with regulatory certainty. States are adopting data center-specific electricity rates and contract provisions as large loads shop for interconnection options. We view the adoption of data center-specific contract provisions as positive for utilities, as they filter out speculative load requests and provide regulatory clarity.

As large loads, such as hyperscale data centers, shop for interconnection queues that offer speed-to-market and flexible contract terms, state large-load tariffs provide regulatory certainty. States such as Ohio, Indiana, Michigan, and West Virginia were among the first movers this year to adopt large load tariffs with provisions to protect ratepayers, such as minimum contract lengths, exit fees for early contract termination, collateral requirements, study fees, minimum charges

based on contracted demand, and rules for recovering the cost of grid upgrades.

In late November, the Virginia State Corporation Commission approved the large load tariff terms for Dominion Energy. We expect the Pennsylvania Public Utilities Commission to approve a model tariff in Q2 2026, which sets the stage for utilities such as PPL and Exelon to submit compliance filings. Utilities in Maryland will also be due to submit compliance filings or updated standards for interconnecting data centers by September 2026. Texas will implement new rules under Senate Bill 6 to provide clarity on interconnection rules and data center rates.

Capstone expects state large-load tariffs and PJM's reforms to materially reduce inflated demand forecasts, giving regulators a more accurate picture of future load. AEP Ohio recently cut its data center pipeline by almost 30%, to 13 GW, following the Public Utilities Commission of Ohio's (PUCO) tariff approval. We anticipate similar reductions in load forecasts for Dominion Energy, PPL, and Exelon as tariffs advance in Virginia, Pennsylvania, and Maryland.

We view the resulting reduction in inflated load forecasts as positive for utilities, as more accurate forecasts reduce regulatory concerns about overbuilding infrastructure. As data centers shop for their best deal, regulatory certainty is an important selling point. Utilities and regulators must balance protecting ratepayers while avoiding provisions so restrictive that they drive data center investment to other states.

Clean Fuels Policy 2026 Preview

# THE CLEAN FUELS TURNING POINT

How New Policies Will Reshape Biofuels Economics



# Clean Fuels Policy 2026 Preview:

Capstone believes clean fuel margins will expand, driven by the likely release of 45Z proposed rules and the finalization of the 2026-27 Renewable Fuel Standard (RFS). We expect incentives from state-level programs to benefit credit prices, starting with the January 31st release of market performance data under the new California Low Carbon Fuel Standard (LCFS). Clean jet fuel will gain momentum in states amid federal uncertainty.

## THE BOTTOM LINE

### Outlook at a Glance

- ▶ **FINALIZED RFS** RULES WILL INSTALL HIGH ANNUAL VOLUME REQUIREMENTS AND RESOLVE SMALL REFINER EXEMPTION WORRIES, SPARKING A SURGE IN BIOFUELS ORDERS AND CLEAN FUELS INVESTMENT
- ▶ **STATE ACTION** ON PRODUCTION INCENTIVES AND TARGETED PROJECT SUPPORT WILL DRIVE SUSTAINABLE AVIATION FUEL AS COST CONCERNS AND FEDERAL UNCERTAINTY WEIGH ON THE SECTOR
- ▶ **OBBBA CHANGES** TO 45Z WILL TAKE EFFECT, BOOSTING CROP-BASED BIOFUEL AND DAIRY RNG CREDIT VALUES; EXPECT REGULATIONS IN Q1, PROVIDING CLARITY ON KEY ISSUES
- ▶ **CHANGES TO CANADA'S CLEAN FUEL REGULATIONS** LIKELY TO TAKE A YEAR FROM THE CONSULTATION'S START DATE, INDICATING CHALLENGES FOR COMPANIES IN THE INTERIM
- ▶ **CALIFORNIA LCFS** CREDIT PRICES TO RISE IN H1 AS DATA ON CREDIT AND DEFICIT GENERATION UNDER THE NEW RULES ARE RELEASED; STATES' MOMENTUM ON CFS BILLS TO CONTINUE

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# Finalized RFS Rules Will Install High Annual Volume Requirements and Resolve Small Refiner Exemption Worries, Sparking a Surge in Biofuels Orders, Clean Fuels Investment

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<b>Winners</b>	Companies receiving small refinery exemptions (SRE) or producing renewable diesel such as HF Sinclair Corp. (DINO) and Valero Energy Corp. (VLO)
<b>Losers</b>	Large integrated refiners without significant biofuels production.

The Environmental Protection Agency (EPA) must respond to the October 2025 comments on the proposed supplementary rules before finalizing the total RFS proposal. Capstone expects the rules to be finalized in January at the earliest, as work processes at the agency return to normal after getting disrupted by a record-breaking government shutdown. We expect the final rules to stipulate a large volumetric requirement that accounts for the reallocation of SREs for 2023-2024 and estimates for 2025. However, the decisions on other rules may be affected by a delayed release.

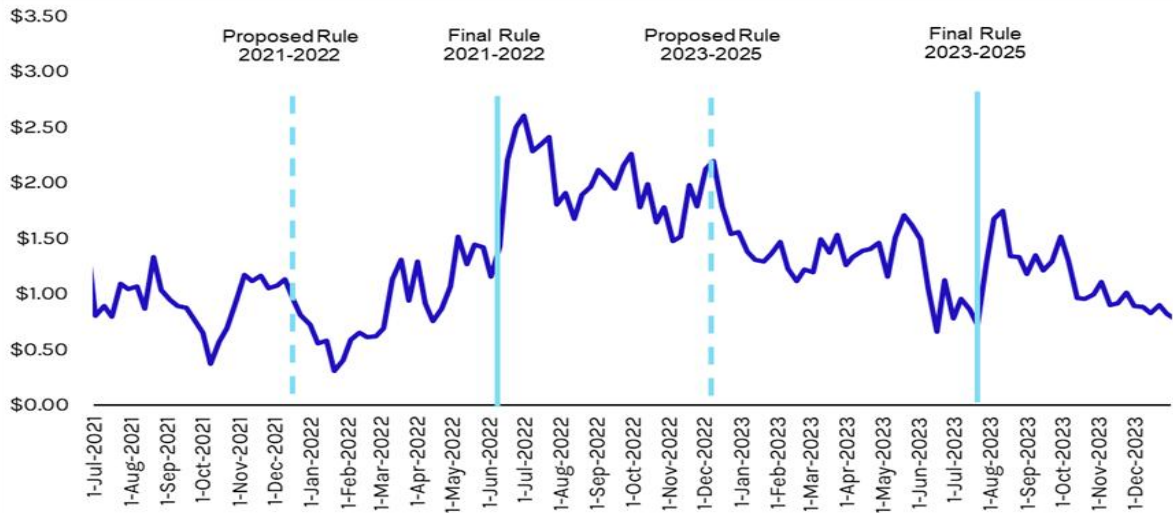
## EXPECT HIGHER BIOFUEL MARGINS AND RIN PRICES DESPITE A DELAY IN 2026-27 RULES

Capstone expects increased orders and widening margins on renewable diesel, biodiesel, and sustainable aviation fuel (SAF), along with the release of the final RFS rules for 2026-2027 rules, likely in Q1 2026. Our research shows the market is currently confident that the rules will set high volumetric requirements for biofuels and eliminate potential negative effects of SREs. However, margin improvement and large orders are yet to start as participants have historically been unwilling to act on RFS policies until they are finalized (see Exhibit 1). There is also significant uncertainty about which policies will be finalized and when.

Capstone expects eventual finalization of the proposed rule to cut 50% of the Renewable Identification Numbers (RIN) for foreign biofuels, along with the proposed reduction to 1.6 D4 RINs per gallon of RD from the current 1.7 D4 RINs. However, the EPA is usually wary of implementing rules within the year, especially for fuels with high timing sensitivity (reporting of batches often trails generation) and when biofuel loads are in transit. A delay would push these rules to 2027. Capstone had already forecasted in July that the proposed 50% reduction in RINs generation for the use of foreign feedstocks would require significant changes to traceability requirements in the RFS process, likely pushing the implementation of these rules to 2027. Despite the missing changes on RINs generation, we expect the total implied volumetric requirement proposed in June to remain relatively untouched in the final rules, with the exception of some adjustments to account for market data on reductions of biofuels imports seen in 2025.

EXHIBIT 1

Biodiesel Margin Reaction to Release of RFS Proposed Rules vs Final Rules



Source: Fastmarkets, EPA

A delay in the RFS release may end up increasing the eventual 2025 cellulosic volumes vs those seen in the June cellulosic waiver proposal. This is because each monthly data release indicates that D3 generation for 2025, primarily from renewable natural gas (RNG), has been up to 10% higher than the volumes in EPA’s cellulosic waiver proposal for 2025. Delays could increase the amount of 2025 data supporting a higher requirement for both decisions on revisions for 2025 as well as 2026-2027, for which 2025 serves as a baseline for estimates. This will be generally positive for the outlook of D3 RIN prices and companies with RNG portfolios such as Montauk Renewables Inc. (MNTK).

Capstone continues to expect SREs for 2026 and 2027 and re-emphasizes that they will transform the US refinery landscape. By removing the compliance cost for approximately 10% of domestic petroleum refining capacity, the SREs may create a 2x differential in net crack margins and product costs. This has already boosted the value for companies with small refiners in their portfolio. Combined with the expected additional margins from RD operations, companies such as HF Sinclair and Valero will have a very healthy year.

# OBBBA Changes to 45Z Will Take Effect, Boosting Crop-based Biofuel and Dairy RNG Credit Values; Expect Regulations in Q1, Providing Clarity on Key Issues

<b>Winners</b>	Crop-based fuel producers such as Green Plains Inc. (GPPE), Valero, and Archer-Daniels-Midland Co. (ADM)  Dairy RNG producers such as DTE Energy Co. (DTE) and Dominion Energy Inc. (D)
<b>Losers</b>	Fuel importers such as Neste Oyj (NESTE on the NASDAQ Helsinki), non-North American feedstock importers, and SAF producers such as Gevo Inc. (GEVO)

## OBBBA CHANGES TO BE IN FULL FORCE IN 2026

The One Big Beautiful Bill Act (OBBBA) includes several favorable changes for all clean fuels tied to the Section 45Z credit, including an extension of the credit by two years through 2029. Other changes to the credit are specifically beneficial to crop-based fuel producers and animal manure RNG producers. These fuel types will receive higher credit values starting in 2026, following major changes approved by Congress in 2025:

- Removal of Indirect Land Use Change (ILUC) Penalties: Although generic corn ethanol did not qualify for the 45Z credit in 2025, we expect it to receive roughly \$0.10 per gallon from

2026-2029 due to the removal of ILUC. Similarly, we anticipate generic soybean oil for RD production will more than double the credit value per gallon to \$0.50 from \$0.21.

- Delineation of Animal Manure Pathways: In 2025, generic animal manure RNG production received a -31 carbon intensity (CI) score, translating to roughly \$14/MMBtu of credit value. The OBBBA requires specific animal manure pathways and allows negative emission rates for these pathways, meaning dairy and swine RNG should get their own bespoke CI calculations. The credit scores are likely to be significantly more negative than -31. Other changes that will take effect in 2026 include the reduction of the SAF base rate per gallon to \$1.00 from \$1.75, in line with ground transportation values. Importantly, the restriction on foreign feedstocks, except in Mexico and Canada, will be implemented. Feedstock industry trade flows will likely be rerouted, particularly related to foreign used cooking oil, Argentinian soybeans, and Australian tallow, as domestic producers look to capture 45Z credit value from feedstocks sourced in the US, Canada, and Mexico.

## REGULATORY CLARITY LIKELY TO RESOLVE OUTSTANDING KEY ISSUES

The Treasury Department is yet to issue formal regulations for the Section 45Z credit following initial guidance published by the Biden administration in January 2025. We expect formal proposed regulations to be issued in Q1 2026,

although year-end is still possible. Several key items remain unresolved, including:

- Qualifying sale clarity to allow sales to third-party intermediaries;
- Rules surrounding renewable energy certificates;
- Potential inclusion of climate-smart agriculture practices into the 45Z emissions model;
- Ability to use proposed rules for 2025 tax purposes (e.g., safe harbor);
- Ability to book-and-claim RNG used as a feedstock or process fuel.

In addition, the Department of Energy will likely publish an updated 45Z emissions model for 2026 production, which should provide clarity on the credit values attributable to crop-based fuels and animal manure RNG following changes made by the OBBBA.

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## California LCFS Credit Prices to Rise in H1 as Data on Credit and Deficit Generation under the New Rules are Released; States' Momentum on CFS Bills to Continue

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<b>Winners</b>	Low-CI clean fuel producers such as Darling Ingredients Inc. (DAR), Clean Energy Fuels Corp. (CLNE), and Aemetis Inc. (AMTX)
<b>Losers</b>	Refiners without significant clean fuels production

### CALIFORNIA CREDIT PRICES TO INCREASE GRADUALLY DUE TO DATA RELEASE LAG

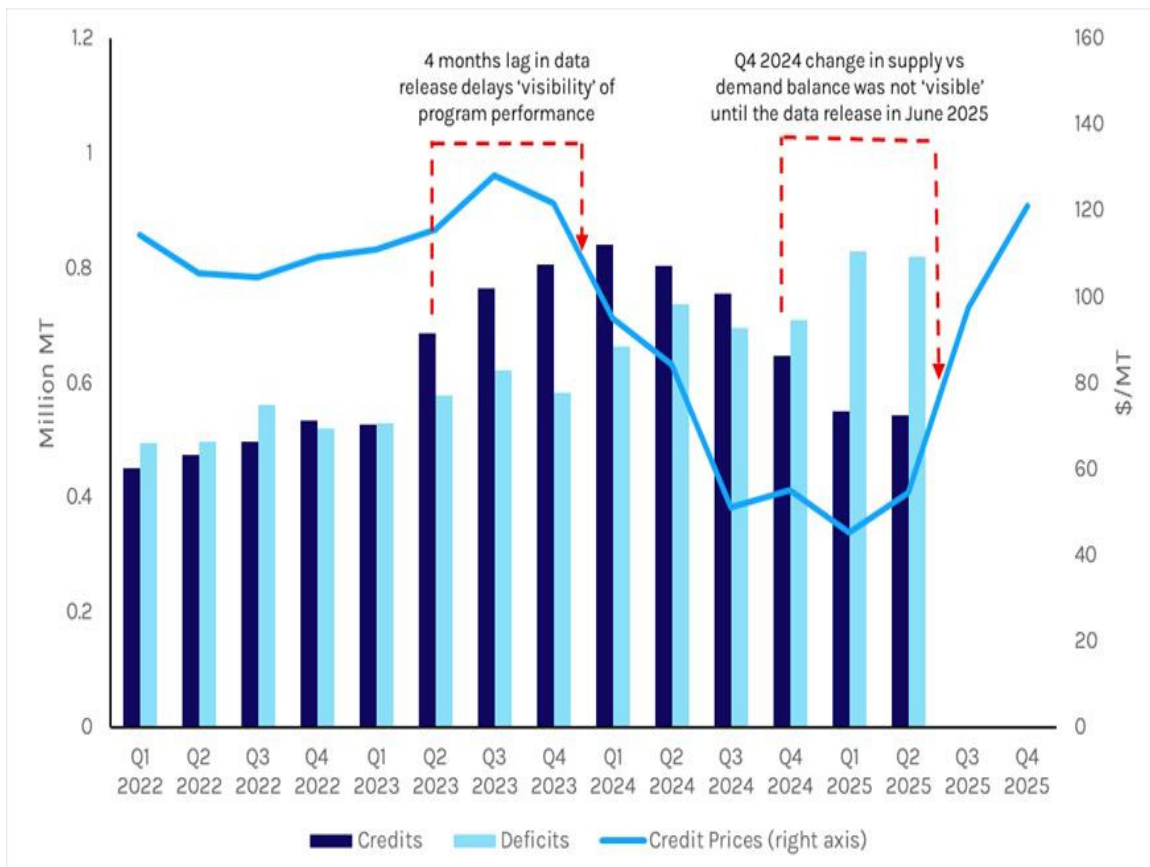
Capstone expects California's LCFS credit prices to increase gradually in H1 2026 as the effects of the new rules are reflected in data releases. Credit generation data for LCFS programs are released with a four-month lag. So, any impact of the stricter CI targets under the new LCFS rules, which took effect in July 2025, will not be visible to the market until January 31, 2026, when the Q3 2025 data will be released, and then April 30, 2026 for the Q4 2025 data. The program does have a significant bank of excess credits, which we expect will weigh on market sentiment and temper any significant boost in credit prices.

We saw this “delayed” price impact from the data release timeline in Oregon’s CFP market in 2025 (see Exhibit 2): The credit price did not reflect the switch from an oversupplied to an undersupplied market until June, when the program data for Q4 2024 was released, which showed a 15% drop in credit generation, mostly driven by a reduction in RD consumption. Then, prices soared 150% over the next few months. We expect storage

limitations to continue restricting RD uptake in Oregon, benefiting credit prices in 2026.

▶ EXHIBIT 2

Oregon Clean Fuels Program Credit Generation and Prices



Source: Oregon Department of Environmental Quality

## CFS LEGISLATION MOMENTUM TO CONTINUE IN STATES THAT INTRODUCED BILLS IN 2023-25

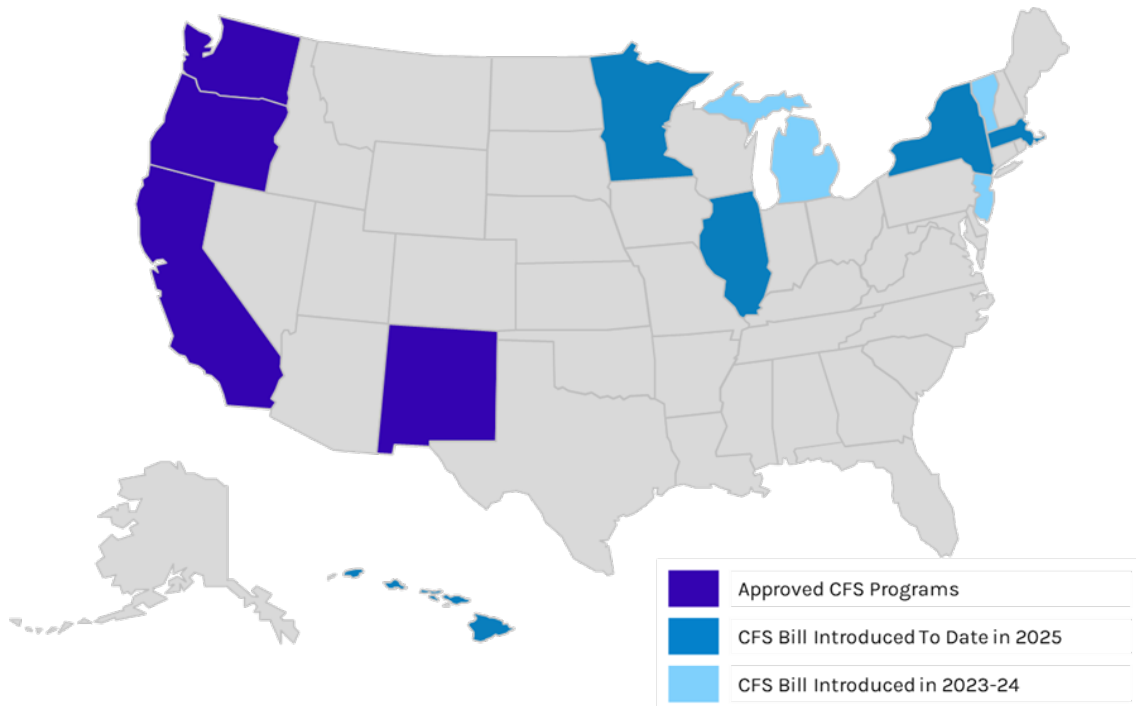
Capstone expects CFS legislation momentum will continue in states that introduced such bills during 2023-25, with passage likely in Hawaii and increased progress in New York, Minnesota, Illinois, and Michigan (see Exhibit 3). Although competing legislative priorities and specific stakeholder opposition stalled progress on bills in 2025, we expect increased bipartisan support and continued backing from biofuels, agriculture, and environmental groups to support passage for the rest of President Donald Trump's term. Additionally, with the expiration of federal electric vehicle (EV) tax credits and the revocation of state EV mandates, CFS remains one of the few policy mechanisms through which action

on transportation emission can be supported. We expect this dynamic to temper opposition from progressive Democrats, who have viewed CFS as an insufficient tool for transportation electrification, a factor that stalled CFS bills in states such as New York and Michigan in recent years.

Separately, we expect final rules for New Mexico's CFS to be in place before July 2026.

### EXHIBIT 3

Status of Recent State CFS Legislation



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# State Action on Production Incentives and Targeted Project Support Will Drive Sustainable Aviation Fuel as Cost Concerns and Federal Uncertainty Weigh on the Sector

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<b>Winners</b>	SAF producers such as Gevo, biofuel blenders like Archer-Daniels-Midland, and airlines including Delta Air Lines Inc. (DAL)
<b>Losers</b>	Biodiesel and RD producers competing for feedstocks; companies operating in states with no incentives or interest

In 2025, states with strong biofuels, farming, and aviation sectors tested the political viability of such incentives, with Iowa and Arkansas establishing their own tax credits, and tailwinds supporting bills in Michigan, New York, and Wisconsin. Michigan came very close to creating a SAF credit in 2024 before introducing an entire SAF legislative plan in May 2025. This sets up 2026 as a significant year for deliberations. In New York, interest has grown in a state-level clean fuels program, with SAF applications rising as the state is a major SAF logistics and production hub. Wisconsin has seen multiple efforts to create a credit and provide targeted project support to take advantage of the state's existing industry. Especially given the focus on farmers and local industry, SAF will likely be a significant point of interest.

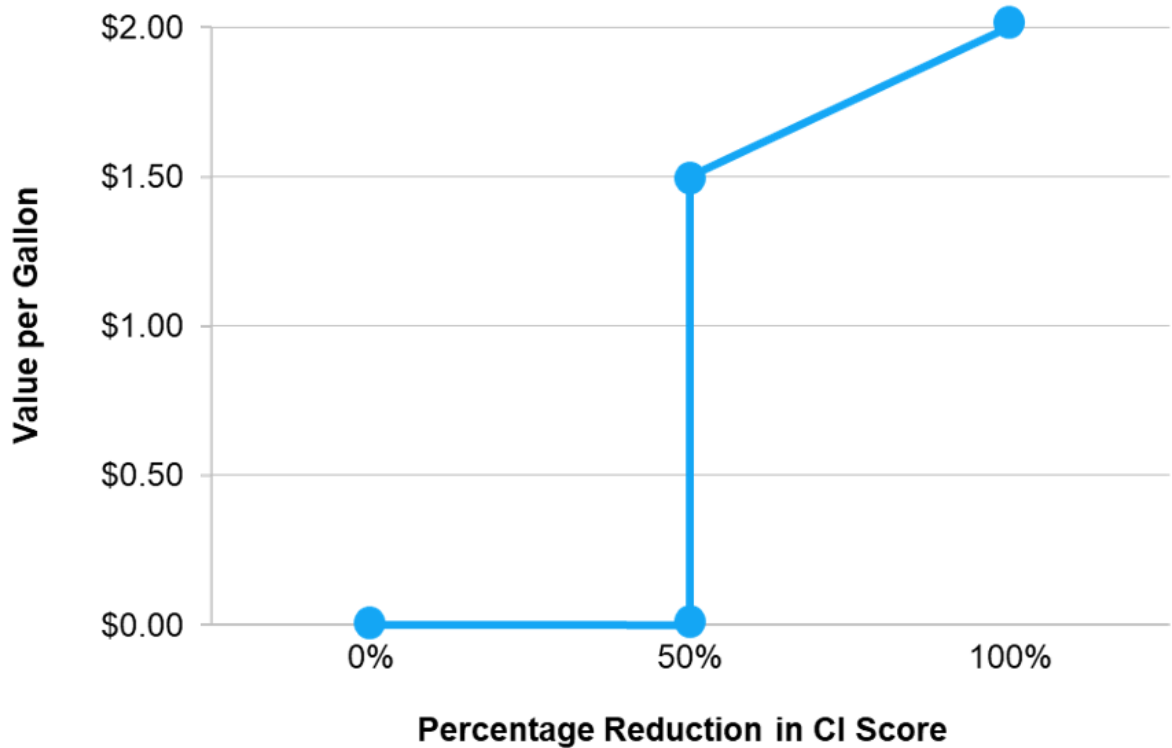
## SAF INCENTIVE TO GAIN MOMENTUM IN STATES

Capstone believes uncertainty over federal incentives and grants, following the passage of the OBBBA and several instances of funding rescissions, will continue to spur states to develop their own SAF tax credits and pursue opportunities for targeted support. Under the Biden administration, four states enacted SAF tax credits: Washington, Illinois, Minnesota, and Nebraska. This sparked a trend of interest at the state level that has gained momentum amid the Trump administration's uncertain approach to SAF. Overall, additional state incentives will enhance the incentive stack on top of 45Z and the RFS and capitalize on global interest in SAF mandates.

We believe Michigan is most likely the next state to implement a credit and expect the structure to be used by other states. This includes credit prices ranging from \$1.50 per gallon to \$2 per gallon. There is a \$0.02 increase for every CI percentage point increase above 50%. The structure will include an annual cap of \$4.5 million for year one and \$9 million for each year thereafter.

EXHIBIT 4

Proposed Structure of the Michigan SAF Tax Credit



Source: Michigan legislature

We see two key interconnected limiting factors for SAF legislation. The first is budgetary constraints as states deal with competing priorities. Even in states where SAF is the main industry, lawmakers have chosen to put off allocating funds to SAF use cases. Lawmakers in Minnesota and Nebraska put on hold considerations to enhance existing credits – either raising the annual allocation amount or the duration – pending clearer demand signals from industry. This pattern also emerged in Hawaii, Kentucky, and Nebraska, as they were all evaluating the creation of a subsidy framework when other priorities took up capacity, leading these efforts to die in committee.

The second factor is energy affordability concerns that have caused leading lawmakers and regulators to claw back investments in low-carbon technology pathways to provide immediate

support to voters and consumers. The 2026 midterm elections will be critical to watch for areas where support may emerge. Democrats will likely see tailwinds as midterm elections generally favor the party outside the White House. Should Democrat majorities emerge from the elections across several states, low-carbon industries will benefit.

# Changes to Canada's Clean Fuel Regulations Likely to Take a Year from the Consultation's Start Date, Indicating Challenges for Companies in the Interim

<b>Winners</b>	Canada-domiciled liquid renewable fuel producers such as Imperial Oil Ltd (IMO on the Toronto stock exchange, or IMO on the NASDAQ) and Tidewater Renewables Ltd (LCFS on the Toronto stock exchange)
<b>Losers</b>	US-domiciled producers of clean fuels such as Darling Ingredients

## CFR AMENDMENTS WILL LIKELY TAKE EFFECT IN LATE Q4 2026 OR EARLY Q1 2027

Amendments designed to protect domestic producers under the Clean Fuel Regulations (CFR) will likely take at least 12 months to complete, which would incorporate a consultation period by Environment and Climate Change Canada (ECCC). These changes would be in response to the implementation of 45Z, freight trade relations with the US, and restrictions imposed by China on Canada's canola exports. The amendments will likely provide economic incentives for Canada-produced fuel, instead of penalizing foreign feedstocks and fuels. These changes would benefit Canadian-domiciled renewable fuel producers once fully implemented, dissuading US-produced fuels from entering the market.

- Under the Canadian Environmental Protection Act, the country's primary environmental pro-

tection statute and legal foundation for the CFR, amendments to regulations through the rulemaking process require environmental justification, unless considered or approved by the full House of Commons. We believe this makes amendments to CFR more likely to reward Canadian producers rather than penalize US producers. If ECCC introduces restrictive measures for the CFR on foreign feedstocks, legal challenges will likely ensue.

- Feedstock and clean fuel producers say the Canadian government did not do enough in the past to support their key policy initiatives and funding priorities. Canada-based biofuel producers say that without immediate action under these CFR amendments or through an additional support mechanism, they will face increased going-concern risk due to the uneven playing field with US producers. The Canadian government has attempted to make some amends, announcing a C\$372 million temporary production tax credit (PTC) in the most recent budget. We expect these PTC funds will not be distributed until Q1 2026.

Capstone foresees a challenging business environment for clean fuel producers without additional government support for domestic products. A key catalyst to watch will be the ECCC's initiation of a consultation for targeted CFR amendments. We believe this will take at least 12 months, indicating an implementation date in late Q4 2026 or Q1 2027.

Oil and Gas Policy 2026 Preview

# Energy's Pragmatic Turn

Power, Pipelines, and the Affordability Dilemma



## THE BOTTOM LINE

Capstone expects the Trump administration to continue backing investment in conventional energy in 2026, including expanded federal oil and gas leasing and pipeline development to support growing data center demand. Energy affordability concerns ahead of the midterm elections are likely to push states toward regulatory support for natural gas infrastructure over climate-driven policies, benefiting gas utilities, while liquefied natural gas producers should gain from federal permitting decisions and trade agreements.

- ▶ **FEDERAL SUPPORT** FOR NEW DRILLING CONTINUES ON LAND AND WATER; DESPITE STRONG GOVERNMENTAL BACKING, SUSTAINED WEAK OIL MARKET WILL CHILL INTEREST FROM E&PS
- ▶ **AFFORDABILITY** AND RELIABILITY CONCERNS, COMBINED WITH DATA CENTER GROWTH, DRIVE STRONG STATE-LEVEL REGULATORY SUPPORT FOR NEW PIPELINE PROJECTS, A TREND THAT WILL CONTINUE
- ▶ **GAS UTILITIES, SERVICE** PROVIDERS WILL BENEFIT FROM STATES DEPRIORITIZING ELECTRIFICATION; LEGISLATION WILL ALSO HELP UTILITIES, GAS MARKETERS AS STATES TRY TO ATTRACT LARGE LOAD USERS
- ▶ **LNG PRODUCERS** WILL BE WELL-POSITIONED AS FEDERAL SUPPORT, THROUGH PERMITTING AND LNG USE IN TRADE DEALS, BOOSTS PROSPECTS
- ▶ **NEW REFINED** PRODUCT PIPELINE PROPOSALS HELP ALLEVIATE DELIVERY CONCERNS FOR LATE 2020S AS SHUTTERING CALIFORNIA REFINERIES CREATES SUPPLY CRUNCH

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# Federal Support for New Drilling Continues on Land and Water; Despite Strong Government Backing, Sustained Weak Oil Market Will Chill Interest from E&Ps

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<b>Winners</b>	Occidental Petroleum Corp. (OXY), EOG Resources Inc. (EOG), EQT Corp. (EQT), Antero Resources Corp. (AR), Devon Energy Corp. (DVN), Valaris Ltd. (VAL), Transocean Ltd. (RIG)
<b>Losers</b>	N/A

royalty rates on leases, and the implementation of the One Big Beautiful Bill Act's (OBBA) same-year deduction of intangible drilling costs (IDCs).

However, while leasing will allow E&Ps to secure new reserves for future production, the combination of tariff-driven breakeven uncertainty for new production, low global oil prices, and high interest rates makes it unclear when, or even if, output on the administration's new leases will materialize. Capstone believes that in the short term, offshore exploratory drillers Valaris and Transocean are best positioned to capture new revenue from the administration's expanded OCS leasing program, which we expect to be finalized in H2 2026.

## MASSIVE LEASING EXPANSION TO CREATE TAILWINDS FOR EXPLORATORY DRILLERS, E&PS

**I**n 2026, Capstone expects the Trump administration to finalize a significant expansion of oil and gas leasing on federal lands and in federal waters, including a final Outer Continental Shelf (OCS) leasing program in the Gulf of Mexico, Alaskan waters, and off California's coast; leasing in the Arctic National Wildlife Refuge and National Petroleum Reserve-Alaska; and onshore lease sales throughout the contiguous US.

Exploration and production companies (E&Ps), such as Occidental, EOG, EQT, Antero, and Devon, stand to benefit from leasing programs, lower

Also in 2026, Capstone sees potential for impactful policy developments related to the disposal of wastewater from oil and gas operations—so-called produced water—in Texas and New Mexico. We expect the Texas Railroad Commission to release draft rules implementing the state's liability exemption for both the producer and the offtaker of beneficial use recycled produced water. In New Mexico, we see potential for reform of produced water recycling regulations as the clash plays out between New Mexico Governor Michelle Lujan Grisham (D), who views produced water as a resource to address droughts, and the state Water Quality Control Commission, which considers it an environmental risk.

As these policy developments unfold, many US conventional and offshore wells will experience

production declines. The Energy Information Administration (EIA) estimates that in 2024, steep declines of 4.3 mb/d at existing wells were offset by 4.4 mb/d of new production brought online by E&Ps. Reduced drilling capex from E&Ps amid the

low oil price environment and similar production declines forecasted by the EIA pose the possibility of lower oil production in 2026.

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## Affordability and Reliability Concerns, Combined with Data Center Growth, Drive Strong State-Level Regulatory Support for New Pipeline Projects, a Trend That Will Continue

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<b>Potential Winners</b>	Williams Cos. Inc. (WMB), Kinder Morgan Inc. (KMI), Energy Transfer LP (ET), Enterprise Products Partners LP (EPD), ONEOK Inc. (OKE)
<b>Losers</b>	N/A

Capstone believes the Trump administration will continue to support the development of new natural gas pipelines to advance its goals of AI development and energy dominance, as well as its general championing of the oil and gas industry. The significant energy needs of data centers, especially for dispatchable generation, have led to subsequent demand for new gas infrastructure. We have seen the largest pipeline developers, such as Williams, Energy Transfer, and Kinder Morgan, announce open seasons or final investment decisions (FIDs) for new interstate pipelines, especially in the Southeast US.

We continue to expect developers to favor jurisdictions that combine large load projections and friendly state regulatory environments, such as the Southeast or Southwest. That said, we have also seen states that historically opposed new gas infrastructure change their tune as affordability concerns have sparked mounting political pressure, especially in the Northeast. This was exemplified by New York and New Jersey regulators recently granting Williams' Northeast Supply Enhancement Project its Section 401 Water Quality Certifications. Just a few years ago, these same regulators rejected Williams' application, demonstrating a new potential paradigm facing pipelines in blue states.

Some holdout states may remain, and without significant reforms to underlying statutes such as the Clean Water Act or Clean Air Act, they can retain their ability to delay or reject new pipeline projects in their states. We believe the Trump administration will continue to pull whatever levers at its disposal, both at the agency level and by pushing for reforms in Congress, to support natural gas and liquids pipelines.

Despite the lack of momentum in Congress, the US Supreme Court's unanimous May 2025 ruling in *Seven County Infrastructure Coalition v. Eagle County Colorado*, streamlining the environmental review process, will continue to have lasting impacts. We have already seen the DC Circuit cite this ruling in multiple opinions, rebuking project opponents, but late in 2025, we also saw the Fifth Circuit cite *Seven County* in its defense of the Federal Energy Regulatory Commission's (FERC's)

National Environmental Policy Act (NEPA) review in a decision on pipeline rates, demonstrating the far-reaching impacts of the ruling. We expect *Seven County* to continue to benefit pipeline developers facing challenges from project opponents over federal reviews of their projects.

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## Gas Utilities, Service Providers Will Benefit from States Deprioritizing Electrification; Legislation Will Also Help Utilities, Providers as States Try to Attract Large Load Users

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<b>Winners</b>	Artera Services LLC, CenterPoint Energy Inc. (CNP), Centuri Holdings Inc. (CTRI), Southwest Gas Holdings Inc. (SWX), National Fuel Gas Co. (NFG), NiSource Inc. (NI)
<b>Losers</b>	N/A

### EXPECT AFFORDABILITY CONCERNS TO OVERSHADOW REGULATORY SCRUTINY OVER UTILITY CAPEX TRENDS

**W**e believe that gas distribution and utility service providers will benefit from continued rate base growth, despite state regulators, primarily in Democratic-led states, placing increased scrutiny on gas utility capital spending. At least 13 states are currently conducting “future-of-gas” proceedings to assess how utilities can align with climate goals such as carbon neutrality and electrification of hard-to-abate sectors. The first major proceedings were initiated by Massachusetts, New York, and California, with a focus on long-term gas planning and identifying alternatives to pipelines.

We believe that ongoing “future-of-gas” discussions have led the market to overstate the risks facing gas utility infrastructure contractors, driven by concerns about the durability of gas pipeline replacement programs. These “future-of-gas” proceedings are exploratory workshops rather than enforceable actions taken by regulators. The objective is to educate stakeholders on the available options to meet long-term decarbonization goals and to provide visibility into the financial and operational feasibility of alternative methods, without displacing gas distribution from utilities’ operating framework.

We do not expect subsequent “future-of-gas” discussions to impact the outlook for gas pipeline replacement programs. As utility ratepayer concerns continue to rise across the country, we expect Democratic governors to become more amenable to the continued use and expansion of natural gas distribution and infrastructure. That atmosphere is evident in several Democratic-led states, such as New York and Massachusetts, which are rolling back previously set climate goals to align with the current ratepayer environment and acknowledge available resources. Moreover, New York and New Jersey regulators recently approved the expansion of an interstate natural gas pipeline, with the understanding that the gas will serve markets across the New York and New England power markets.

Gas utilities and service providers will likely continue to benefit from regulations that enable pipeline maintenance, as states increasingly prioritize safety and affordability over meeting climate mandates.

## LEGISLATION WILL MODERNIZE RATE-MAKING STRUCTURE TO ATTRACT LARGE LOAD USERS

We believe 2026 will usher in a noticeable increase in momentum for state lawmakers pursuing legislation that allows gas utilities to participate in alternative rate-making mechanisms, similar to SB 103 in Ohio and Nevada’s SB 417.

These moves are driven by concerns about AI data center development and grid reliability. As state lawmakers acclimate to the energy priorities of the Trump administration, we expect an uptick in proposed legislation to implement flexible rate structures for both gas and electric utilities, intended to incentivize large load users, such as data center developers, to set up shop.

Specific provisions we believe are likely to be consensus among proposed bills across state lines are:

- Enabling gas utilities to engage in multi-year rate plans, which include forecasted test years;
- Statutory deadlines on rate cases and large load agreements; and
- Formulation of rate plans that allow for automatic adjustments.

We believe such legislation will accelerate earnings growth and enhance transparency into utility cost recovery. It will also increase the competitiveness of utilities relative to Independent Power Producers (IPPs), as utilities will be able to promote new gas plant entry by creating more favorable terms for offtake agreements, particularly for behind-the-meter (BTM) or self-supply arrangements.

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# LNG Producers Will Be Well-Positioned as Federal Support, Through Permitting and LNG Use in Trade Deals, Boosts Prospects

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<b>Winners</b>	Venture Global Inc. (VG), Cheniere Energy Inc. (LNG), NextDecade Corp. (NEXT)
<b>Losers</b>	N/A

**W**e expect the Trump administration to continue to prioritize the development and permitting of LNG facilities, given domestic economic benefits and the use of LNG in trade negotiations. Recently, we saw Saudi Arabia and its associated firms sign multiple memorandums of understanding (MOUs) with US-based LNG companies, through direct investments or offtake agreements. We expect other countries or foreign energy companies to consider, and likely commit to, additional offtake agreements for future LNG projects.

The administration has maintained LNG exports as a key priority from day one, when it initially lifted the Biden-era freeze on non-Free Trade Agreement (FTA) export licenses. We expect the Department of Energy (DOE) will continue to issue non-FTA licenses to projects that request them, and other agencies, such as FERC, will also continue to issue construction authorizations.

FERC has begun creating a blanket certification process for LNG projects, similar to the one currently in place for pipeline projects. This would further the administration's deregulatory efforts by removing red tape and simplifying the approval process for certain actions that require federal authorization. This blanket certification process aligns with the pending rulemaking at the Pipeline and Hazardous Materials Safety Administration (PHMSA), which is seeking industry feedback on broader efforts to update its standards for large LNG facilities.

We expect LNG will continue to play a meaningful role in broader trade negotiations between the US and other countries. This could come in the form of additional offtake commitments, like those we saw from the EU and its Member States, joint partnerships on in-development projects, like we are seeing from Asia-Pacific countries and the Alaska LNG project, or general offtake agreements to help avoid retaliatory tariffs. LNG will likely continue to play a strategic role in security, too, with continued Western pressure on Russia and sanctions on the use of Russian gas.

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# New Pipeline Proposals Will Help Alleviate Delivery Concerns for Late 2020s as Shuttering California Refineries Creates Supply Crunch

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<b>Winners</b>	Midstream companies, such as Kinder Morgan
<b>Losers</b>	Incumbent refiners in California, such as PBF Energy Inc. (PBF)

## CA'S REFINING WOES EXPECTED TO CONTINUE; STORAGE REQUIREMENTS TO BE TOP OF MIND IN 2026

Capstone believes there are few policy maneuvers left for California Governor Gavin Newsom (D) to save one of the two refineries set to shutter in the state. The Phillips 66 (PSX) Los Angeles refinery began shutting down operations in Q3 2025. The Valero Energy Corp. (VLO) Benicia refinery is set to close in April 2026. Barring the sale of the Benicia asset to a third party, Capstone believes time is running out for a policy solution to keep the refinery open, meaning the state is likely to lose about 17.5% of its refining capacity from the two refineries.

The California Energy Commission (CEC) may impose additional regulations on refiners in the form of minimum storage and resupply requirements. The CEC's rulemaking on such actions is underway.

When the California legislature reconvenes in January 2026, we expect to see proposals to ad-

dress the regulatory environment for refiners or to provide targeted funding to entice Benicia to stay open. However, any such policy would have to go through the normal legislative process and would likely be too late to stop the closure.

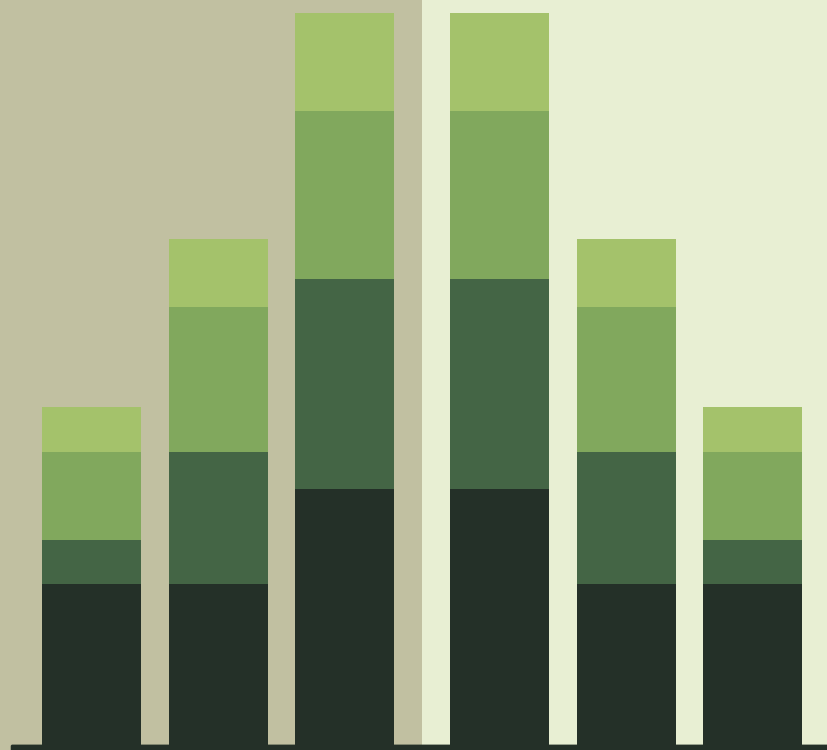
## PIPELINE EXPANSIONS INTO CALIFORNIA COULD ALLEVIATE SOME SUPPLY CRUNCH IN THE LATE 2020S

Assuming California loses significant capacity starting in April 2026, the state will likely need to fill in the supply gap with waterborne imports. In the longer term, beginning around 2029, new pipeline projects will likely come online to supply the state's petroleum demand as well as the needs of Nevada and Arizona, given their dependence on California production.

Capstone expects continued discussions on new projects, such as the Western Gateway pipeline proposed by Kinder Morgan and Phillips 66, which would reverse the flow of a pipeline that currently sends product from California to Arizona, and construct a new pipeline to Arizona. HF Sinclair Corp. (DINO) is likewise considering a multi-phased pipeline to expand its footprint on the West Coast and in the Rocky Mountains—PADD 4 and 5—to address potential supply bottlenecks. Capstone will monitor the regulatory approvals required and potential policy interventions from state legislatures should these projects or forthcoming proposals materialize.

# The Coming Volatility

Why Affordability Concerns and an Evolving Policy Landscape will Shake Up Environmental Commodity Markets



# Environmental Commodities Policy

## 2026 Preview:

### THE BOTTOM LINE

Capstone believes the approach of the midterm elections will dampen appetite for aggressive policy action across both compliance and voluntary carbon markets in 2026. California allowance prices should find support from Cap-and-Invest rulemaking despite federal legal challenges, while energy affordability concerns are likely to push states toward less stringent Renewable Portfolio Standards, weighing on compliance Renewable Energy Certificate (REC) prices.

#### Outlook at a Glance

- ▶ **CALIFORNIA ALLOWANCE**  
PRICES TO BE BOOSTED BY CAP-AND-INVEST RULEMAKING DESPITE FEDERAL LEGAL THREATS; RGGI PRICES TO BENEFIT FROM THIRD PROGRAM REVIEW IMPLEMENTATION
- ▶ **CORSIA APPROVAL AND 2026 CDM CLOSURE SIGNAL**  
GROWING OPPORTUNITY FOR CARBON REMOVALS IN UN CARBON MARKETS
- ▶ **WA MEASURES TO**  
STABILIZE ALLOWANCE PRICES BEFORE CALIFORNIA LINKAGE TO PRESSURE WCAS DOWNWARD; NOVEMBER 2027 LINKAGE TARGET AGGRESSIVE, 2028 MORE REALISTIC
- ▶ **POLITICAL**  
CONSIDERATIONS TO LIMIT RPS STRINGENCY, WEIGHING ON COMPLIANCE RECS; VOLUNTARY RECS TO FACE ENHANCED TIME AND LOCATION MATCHING RULES

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# California Allowance Prices to be Boosted by Cap-and-Invest Rulemaking Despite Federal Legal Threats; RGGI Prices to Benefit from Third Program Review Implementation

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<b>Winners</b>	California carbon allowance (CCA) prices, Regional Greenhouse Gas Initiative (RGGI) allowance prices
<b>Losers</b>	Obligated entities like industrial facilities and fuel suppliers

On the rulemaking process, we expect CARB to issue the Initial Statement of Reasons (ISOR) package, starting the one-year rulemaking timeline, by early 2026. This will likely include removing 118 million allowances over the 2027-2030 budget years to hit the 2030 emissions reduction target and permanently retiring offsets on a one-to-one basis, as required by AB 1207. The key question will be how CARB accounts for the use of offsets to prevent variability in auction revenue after the end of compliance periods.

## CALIFORNIA CAP-AND-INVEST RULEMAKING TO SUPPORT PRICES BUT FEDERAL LEGAL THREATS LOOM

**W**e believe market confidence in California's Cap-and-Invest program will continue to increase in 2026 as the California Air Resources Board (CARB) makes progress on the rulemaking process to tighten annual allowance budgets to align with the state's 2030 emissions reduction target. We expect this dynamic to provide positive support for CCA price movement. Trump administration legal challenges to the program remain a risk, but lack a strong legal argument to threaten the program. Nonetheless, we believe any adverse actions from the administration will create buying opportunities.

Given that CARB usually takes 3.5-4 months to issue a Final Statement of Reason after the ISOR, we expect a Board vote around April 2026. The Office of Administrative Law will then review the package and vote on it. We thus expect the program to become effective on September 1, 2026, in line with CARB's target date, followed by changes being implemented on January 1, 2027 (see [California Cap-and-Invest Quick Take: CARB to Cut Allowances by Lower 40% Target, Brings Offsets Under Cap; Carbon Credits to Benefit](#), October 29, 2025).

We see three main catalysts for the legal challenges from the Trump administration: 1) repeal of the Endangerment Finding, likely in early 2026; 2) linkage of California's Cap-and-Invest program with Washington state in late 2027 or early 2028; and 3) political developments such as the 2026 midterms and 2028 presidential elections prompting action from the Trump

administration (see [Trump Admin Risk to California Cap-and-Invest Persists, though Competing Federal Priorities, Legal Process, Precedent Likely to Shield Program](#), October 9, 2025). Although we expect legal action, we maintain our expectation that the administration does not have a strong legal argument to dismantle or threaten the program's existence.

## RGGI TO SEE INCREASED MARKET INTEREST AHEAD OF THIRD PROGRAM REVIEW IMPLEMENTATION

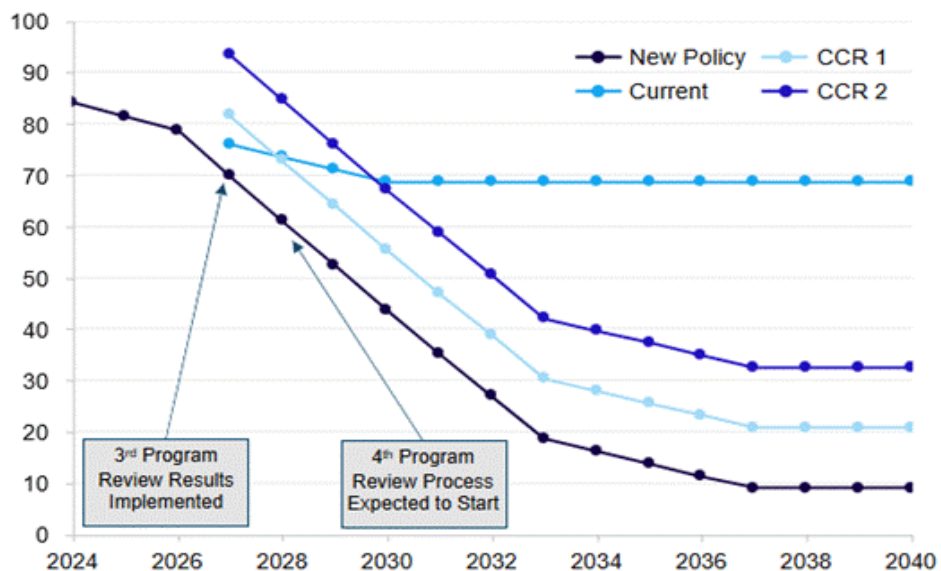
We expect allowance prices to rise across states participating in the Regional Greenhouse Gas Initiative (RGGI) as they anticipate the emissions cap to be lowered at an aggressive pace starting in 2027, when the Third Program Review is implemented. Allowance banking will be a key aspect to watch, as well as whether the Cost Containment Reserve (CCR) is fully dispersed in the first auction of 2026. Notably, RGGI will implement a second CCR

and assign fixed volumes to both CCR price tiers, departing from the current practice of calculating the price as a percentage of the annual cap, to limit price spikes.

Energy affordability concerns will remain top of mind across the Northeast. Over the next year, we will be watching how lawmakers and regulators discuss adopting the Third Program Review Results ahead of 2027 implementation. We expect all states to ratify the new changes in 2026, but we will look for signals as to how states will position themselves ahead of the Fourth Program Review deliberations, which are expected to begin in 2028. We believe states will take cues from what's happening in New York, as Governor Kathy Hochul (D) has continued to pause action on establishing the economy-wide New York Cap-and-Invest program due to energy price pressure. These discussions will serve as key signposts for what priorities may emerge in future program deliberations that we expect to see a dampening of ambition during the Fourth Program Review that could lead to a less aggressive reduction trajectory.

### EXHIBIT 1

RGGI's Third Program Review Adds a Second and Larger CCR to Prevent Price Spikes (in millions)



With Pennsylvania's participation in the RGGI off the table after a November 2025 state budget deal, we expect Virginia's path to reentry will be a key development to watch. On the gubernatorial campaign trail, Abigail Spanberger (D) had vocally supported rejoining the RGGI. Now, as governor, we believe she will use executive action in 2026 to reverse her predecessor Glenn Youngkin's (R) 2023 withdrawal executive order and stop the ongoing appeal of the November 2024 ruling.

We expect Virginia's reentry prospects to improve market sentiment for RGGI allowance prices, although their impacts will depend on the state's emissions baseline and allowance cap decisions. The earliest possible date of reentry is 2027, but we believe 2028/2029 is a realistic target, given the uncertainty of negotiations with the RGGI board on Virginia's cap-and-reduction trajectory.

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## WA Measures to Stabilize Allowance Prices Before California Linkage to Pressure WCAs Downward; November 2027 Linkage Target Aggressive, 2028 More Realistic

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<b>Winners</b>	CCA prices, Washington obligated entities including industrial facilities and fuel suppliers
<b>Losers</b>	Washington carbon allowance (WCA) prices

Capstone believes Washington state's target of achieving operational linkage with the Western Climate Initiative by November 1, 2027, is ambitious due to California and Quebec's competing priorities, ongoing rulemakings, and general regulatory delays. We view 2028 as more realistic. The state is expected to release a draft package with these updates in early 2026 and finalize it by year-end, setting an effective date of January 1, 2027, to

begin the process of operational linkage (see [Washington Cap-and-Invest Likely to Link with WCI Shared Carbon Market by End of 2028: California Allowance Prices to See Modest Lift](#), May 9, 2025).

As Washington state prepares its market for linkage, we believe implementation of HB 1975's provisions, designed to stabilize WCA prices ahead of the California linkage, will pressure WCA prices downward after record highs triggered Allowance Price Containment Reserve (APCR) auctions. These provisions include lowering the price ceiling to \$80 in 2026-2027 (currently \$94.85), extending compliance timelines, retroactively adding vintage allowances, and increasing APCR allowance supply by 2%-5%. Upon linkage, we expect modest tailwinds for CCA prices driven by increased demand. (see [Carbon Markets Monthly: WA Ecology Eyes Supply Boost: Split VA Ticket Would Delay RGGI Reentry; EPA Challenges Ozone-Depletion Offsets](#), October 29, 2025).

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# CORSIA Approval and 2026 CDM Closure Signal Growing Opportunity for Carbon Removals in UN Carbon Markets

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<b>Winners</b>	Carbon removal projects with Article 6 host country authorizations
<b>Losers</b>	US-based carbon offset projects

Capstone expects carbon dioxide removal (CDR) projects with host country authorizations to command premium prices across VCMs in 2026 as United Nations (UN) carbon markets shift toward stricter quality standards. The International Civil Aviation Organization’s approval of CDR methodologies for the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) in 2025 and the legacy Clean Development Mechanism’s closure by the end of 2026 signal growing acceptance of removal projects in UN carbon markets. However, fragmented domestic enforcement—particularly the US’s lack of a domestic CORSIA mandate—and ongoing delays in issuing letters of authorization (LoAs) will constrain supply of eligible credits and disadvantage projects without host country approvals.

## CARBON DIOXIDE REMOVALS

We believe carbon dioxide removal (CDR) methodologies will see increased opportunities within the United Nations (UN) carbon markets. During the 2025 Council session of the International Civil Aviation

Organization, novel CDR methodologies, including direct air capture (DAC) under Verra and Isometric, were deemed eligible for the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA). This marks a shift from earlier assessments that had questioned the economic feasibility of such projects. This also mirrors a similar reversal from the Article 6.4 supervisory body, which omitted any restrictions for CDR projects under the Paris Agreement Crediting Mechanism (PACM) after stakeholder pushback to initial objections.

Eventually, we expect CORSIA and PACM rules to converge, establishing a broad standard on “high quality” carbon credits across the VCM, with both CORSIA and PACM credits expected to command higher prices and facilitate increased investor confidence in the VCM. CDR projects are additionally expected to see elevated prices due to generally “higher” perceived standards on permanence and durability over other project types in the market.

## COP30 UPDATES

We expect increased opportunities for CDR after negotiators reached consensus at the UN’s COP30 Summit in November on closing the legacy Clean Development Mechanism (CDM) carbon market by the end of 2026. This change reflects growing pressure from member states to facilitate transition to the new Article 6 PACM. Governments also approved the transfer of over \$30 million from the CDM to support capacity-building efforts for the PACM. We expect CDM transitions to eventually mark the issuance of first

PACM-eligible credits through 2026. Other Article 6 decisions from COP29 remained unaltered, with discussions on permanence and risk reversals to now resume under future negotiations.

## CORSIA OUTLOOK

CORSIA implementation still faces risks from fragmented enforcing legislation across member countries, including the US, which continues to lack a domestic mandate for CORSIA (see: [CORSIA Implementation Challenges Persist, Weighing on Global Demand for Sustainable Aviation Fuel, Limiting Carbon Offset Trading Opportunities](#)). Additionally, delays in the issuance of letters of authorization (LoAs) from host country

governments - which are required for individual carbon offset projects to participate in both CORSIA and Article 6 markets - continue to constrict the supply of CORSIA-eligible credits (see: [Tight Supply of CORSIA Emission Units Unlikely to Meet 2024-2026 Demand: Opportunity for VCM Traders, Risks for Lufthansa, Air France](#)). LoA-issued projects will, however, command higher prices, with demand from both airlines and other buyers in the VCM.

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# Political Considerations to Limit RPS Stringency, Weighing on Compliance RECs; Voluntary RECs to Face Enhanced Time and Location Matching Rules

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<b>Winners</b>	Out-of-state solar projects in New Jersey, Voluntary RECs from high-demand areas (if GHG Protocol is implemented)
<b>Losers</b>	In-state solar projects in New Jersey, NJ Class I RECs, state RECs where RPS ambitions are diminishing

Capstone expects compliance Renewable Energy Certificate (REC) prices to face downward pressure in 2026 as energy affordability concerns and approaching midterm elections limit states' appetite to tighten Renewable Portfolio Standards (RPS), while voluntary REC markets see increased stringency from Greenhouse Gas Protocol guidance favoring hourly and location-matched certificates.

New Jersey's proposed approval of out-of-state solar projects for Class I REC eligibility will particularly pressure in-state solar projects and Class I REC prices.

# ENERGY AFFORDABILITY CONSIDERATIONS TO IMPACT COMPLIANCE REC MARKET ELEMENTS

In 2026, Capstone believes that energy affordability concerns and scrutiny from the federal government will limit the appetite to tighten RPS, creating fewer drivers behind Renewable Energy Certificate (REC) prices. State-level voters have indicated that rising energy prices are driving electoral outcomes, and we expect state politicians to move carefully as the 2026 midterm elections approach. At the federal level, while we do not expect the Trump administration to launch lawsuits against RPS policies, states with aggressive policies will feel looming pressure, which will weigh on further efforts to take new action.

In 2026, New Jersey and Massachusetts are two states to watch to assess how governors, lawmakers, and regulators are using compliance REC markets to reduce price pressure while keeping an eye on emissions. New Jersey just elected Governor Mikie Sherrill (D), who ran a campaign focused on affordability. We will be closely monitoring how the state's Board of Public Utilities (BPU) comes down on a proposal allowing out-of-state solar resources to be eligible for New Jersey Class I Renewable Energy Certificates (REC). The proposal has already heavily weighed on prices, and we expect BPU approval would continue the trend (see [RECs/RPS Monthly: New Jersey to Consider Out-of-State Solar as Energy Affordability and Reliability Dominate November 4th Gubernatorial Election](#), October 31, 2025).

After this proposal was brought up at the BPU's October 8th meeting, it delayed a decision for 90 days, and we believe the Board will vote in favor and pursue a subsequent rulemaking process that would likely see changes implemented in 2027. This will also translate into considerations on the state's RPS following the May 2025 freeze of Class I RPS at 35%. Once Sherrill is officially in office, we expect more clarity on how she proposes to address the issues, and we lean toward the

side that further RPS freezes in the interim are likely.

Similar to other Northeastern states, Massachusetts has considered backtracking on RPS requirements, but climate stakeholders have shown resolve in pushing back against any changes. However, we expect affordability to remain a critical battleground in 2026. In November, House Democrats on the Massachusetts Joint Committee for Telecommunications, Utilities, and Energy advanced an energy affordability [bill](#) that proposed rollbacks of the state's climate goals and renewable energy requirements, including reducing annual increases in the state's RPS from 3% to 1%.

As written, the bill would have reduced the growth in the number of RECs Massachusetts utilities are required to purchase, which would have decreased prices. However, while we believe the bill will not pass as written, we expect the legislature to push to pass a bill addressing energy affordability concerns in 2025 ahead of the 2026 election.

The proposed scale-back of Massachusetts' RPS follows adjustments to RPS programs in Connecticut and Maine in 2025, which weighed on REC prices in those states. Connecticut [reduced](#) its 2030 RPS requirement from 40% to 29%, and its 2026 requirement from 32% to 25%. The Maine legislature considered proposals to make large hydropower and geothermal facilities RPS-eligible before eventually [expanding](#) the existing RPS and establishing a new class of RECs for large hydropower and nuclear facilities. Alongside the Massachusetts proposal, these developments underscore the threat affordability concerns pose to status quo RPS programs even in historically climate-forward states.

## VOLUNTARY RECS TO SEE INCREASED STRINGENCY

**W**e expect ongoing criticism from Republican state attorneys general and guidance from the Greenhouse Gas Protocol (GHGP) to temper market interest in unbundled, annually matched RECs as firms keep an eye on reputational and legal risks. On September 20th, the GHGP opened a public consultation on its Scope 2 Guidance, which establishes the rules for the accounting of corporate emissions from purchased electricity. The public comment period was recently extended from December 19, 2025, to January 31, 2026. The Guidance is expected to be finalized in 2027, with the updated rules likely to be in effect from the 2028 reporting year.

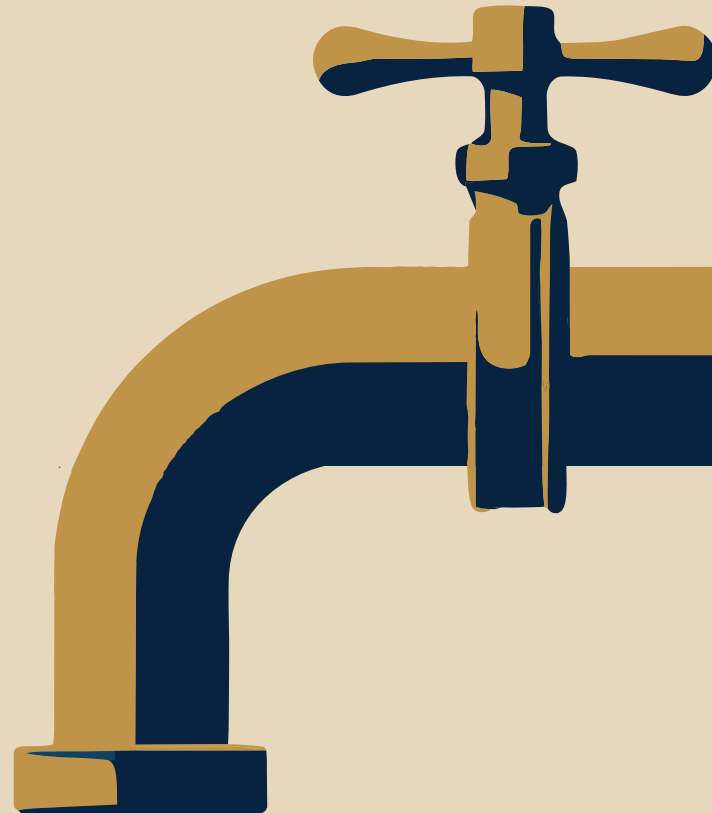
Under the proposed rules, RECs will now require

hourly matching between the issuance and electricity consumption points – a theme gaining more interest from standard-setting bodies. RECs will additionally need to be sourced from the same market boundary in which the reporting entity's operations are located, such that the generated electricity could “plausibly” be a part of the generation mix serving the load point through a connected grid. Specific exemptions and alternate reporting frameworks in the absence of more granular data will be finalized during the consultation process. Notably, Google and Microsoft have helped to support the working group and are actively advocating for 24/7 carbon-free energy procurement to limit greenwashing claims. Other tech companies, like META and Amazon, have pushed back against this, but we expect the tide to favor more accurate accounting assessments.

Environmental Services Policy 2026 Preview

# The Environmental Services Industry's Moment

PFAS, Water Utilities, and  
other coming developments



# Environmental Services Policy 2026 Preview:

## THE BOTTOM LINE

Capstone believes that despite the Trump administration's deregulatory agenda, environmental policy development will intensify in 2026. The US Environmental Protection Agency (EPA) will continue to enact PFAS regulations, with new plans on wastewater discharges. In addition, amendments to Biden-era refrigerant regulations indicate temporary headwinds for companies such as Solstice Advanced Materials Inc. (SOLS).

▶ **PFAS TREATMENT** MARKET TO BEGIN FOCUSING MORE HEAVILY ON LANDFILL TREATMENT, DRINKING WATER SPENDING TO RISE

▶ **TRUMP POLICY** ON REFRIGERANTS CREATES HEADWINDS FOR SOLSTICE AND CHEMOURS, BUT LEGISLATIVE BACKSTOP PROTECTS LONG-TERM DEMAND

▶ **WATER UTILITY** CONSOLIDATION TO CONTINUE IN 2026 AS AGING INFRASTRUCTURE DEGRADES, FEDERAL GOVERNMENT UNLIKELY TO ADDRESS \$625B IN 20-YEAR INFRASTRUCTURE NEEDS

# PFAS Treatment Market to Begin Focusing More Heavily on Landfill Treatment, Drinking Water Spending to Rise

<b>Winners</b>	Clean Harbors Inc. (CLH), Veolia Environnement SA (VIE on the Paris Exchange), Xylem Inc. (XYL)
<b>Losers</b>	Republic Services Inc. (RSG), Casella Waste Systems Inc. (CWST), Waste Connections Inc. (WCN)

Capstone believes that the PFAS treatment market will continue to grow in 2026, buoyed by the Trump administration's decisions to maintain major sections of Biden-era PFAS rules, a positive for companies such as Clean Harbors. Additional focus on landfill leachate treatment will likely increase compliance costs for large waste firms such as Republic Services and Waste Connections, as new landfill leachate treatment regulations loom. As the Trump administration's focus on per- and polyfluoroalkyl substances (PFAS) has become clearer over the last year, many water systems will be required to begin installing systems to meet the EPA's updated PFAS drinking water standards. However, additional regulatory scrutiny from the federal government on landfills and PFAS in landfill leachate will become a larger component of future PFAS treatment.

The EPA's decision to retain two PFAS compounds (PFOA and PFOS) in its National Primary Drinking Water Regulation will still drive drinking water

spending through the newly extended 2031 compliance deadline. Settlement proceeds from 3M and DuPont began flowing to utilities and water systems in summer 2025, enabling them to begin deploying capital toward treatment infrastructure more effectively in 2026.

The EPA is likely to release proposed updated effluent limitation guidelines (ELGs) targeting PFAS discharges from landfills in 2027 and finalize the rule afterward. However, states are already reviewing landfill leachate treatment options, and waste managers such as Waste Connections and Casella Waste Systems have begun implementing systems to remediate PFAS in landfill leachate before regulations take effect. Current landfill ELGs target only landfills that discharge directly into rivers and streams and do not cover the majority of landfills that transfer leachate to treatment facilities prior to discharge. The new EPA rules are likely to cover both direct and indirect dischargers, creating a large new category of regulated assets. The new requirements are likely to increase capital and operational expenditures for waste managers at all levels, including larger companies such as Republic Services. Winners from this are likely to be traditional treatment firms such as Clean Harbors or Veolia (following its acquisition of Enviro's Clean Earth arm), but smaller, leachate-focused treatment firms will also become more attractive investments.

Based on publicly announced installations of leachate treatment technologies at PFAS-impacted landfills by operators such as Waste Connections and Casella Waste Connections, we believe foam fractionation systems will likely emerge as the technology of choice for landfills.

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# Water Utility Consolidation to Continue in 2026 as Aging Infrastructure Degrades, Federal Government Unlikely to Address \$625B in 20-Year Infrastructure Needs

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<b>Winners</b>	American Water Works Co. Inc. (AWK), Essential Utilities Inc. (WTRG), California Water Services Group (CWT)
<b>Losers</b>	N/A

end of Q1 2027, pending regulatory approvals from state public utility commissions.

Firms that focus on water system consolidation stand to gain the most from a set of policies pushing for additional private investment in water systems. The Water System Restructuring Assessment Rule, a Biden-era proposal that sought to sweeten deals for aging and noncompliant water systems, will still be released by the Trump administration, but the rule's specific impacts are less certain. Additionally, burgeoning fair market value (FMV) legislation has incentivized private investment in water systems; however, the majority of states lack FMV legislation.

Capstone believes that water utility consolidation will expand in 2026, driven primarily by smaller, non-public firms buying up small water systems around the country. However, larger firms, such as American Water Works and California Water Services Group, are also likely to benefit from continuing consolidation. Despite investment from the Infrastructure Investment and Jobs Act (IIJA), water infrastructure will require significant additional investment, with the EPA estimating \$625 billion in drinking water infrastructure needs over the next 20 years. However, the EPA's current funding allotments have not met that need. Smaller utilities often lack the capital necessary for upgrades to keep systems running, driving private investment into water utilities and wastewater systems. The October 2025 announcement of the American Water and Essential Utilities merger exemplifies this consolidation trend. The deal is expected to close by the

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# Trump Policy on Refrigerants Creates Headwinds for Solstice and Chemours, but Legislative Backstop Protects Long-Term Demand

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<b>Winners</b>	Food retail industry companies like Kroger Co. (KR) and Walmart Inc. (WMT)
<b>Losers</b>	Low-global warming potential refrigerant manufacturers like Solstice Advanced Materials Inc. (SOLS) and Chemours Co. (CC)

Capstone believes that low-global warming potential (low-GWP) refrigerant manufacturers, such as Solstice Advanced Materials and Chemours, face temporary headwinds from the Trump administration's plans to delay compliance deadlines for replacing traditional refrigerant systems with low-GWP alternatives. The temporary reprieve will provide minor benefits to large food industry conglomerates such as Kroger and Walmart. With the passage of the American Innovation and Manufacturing (AIM) Act in 2020, the US is required to gradually reduce the production and consumption of hydrofluorocarbons (HFCs) by 85% from historic baseline levels by 2036. To guide the phasedown of such high-global warming potential (high-GWP) refrigerants, the Biden administration enacted the Technology Transitions Rule (TTR) in 2023. The TTR set industry-specific GWP limits for newly manu-

factured and imported end products and newly installed systems, requiring regulated industries to transition to low-GWP refrigerants like hydrofluoroolefins (HFOs) in new installations by varying deadlines.

As part of the Trump administration's rollback of Biden-era environmental regulations, the EPA in October 2025 proposed to delay the TTR deadlines for certain sectors, granting the food retail industry's request to establish an interim mid-GWP deadline ( $GWP \leq 1,400$ ), while extending the final low-GWP ( $GWP \leq 150$  or  $300$ ) deadline from January 2027 to January 2032. The proposed rule will be finalized in 2026 and seeks to provide temporary relief for both independent grocers and supermarket giants such as Kroger (KR) and Walmart (WMT), giving them more time to continue installing and using lower-cost high-GWP supermarket systems.

On the flip side, refrigerant manufacturers such as Solstice Advanced Materials and Chemours, which have begun focusing on low-GWP refrigerants, may face temporary demand headwinds as food retail systems are enabled to continue installing higher-GWP systems. This is likely to be buffered, however, by the automotive air-conditioning sector, which faces no proposed compliance delays and is further along in its transition, maintaining a substantial market for low-GWP refrigerants. Despite the EPA proposing to delay the deadline for using low-GWP refrigerants in new system installations to 2032, the food retail industry would still need to begin using mid-GWP refrigerants in 2027 under the

proposed rule. This intermediate transition to mid-GWP refrigerants, which both companies also produce, is likely to further mitigate the impact of delayed compliance.

Additionally, the AIM Act's mandate to reduce HFC use by 85% by 2036 serves as a legislative backstop, preserving long-term tailwinds for Solstice and Chemours that is further reinforced by the US' ratification of the Kigali Amendment, an international treaty enforcing the same mandate.

# Europe's Hard Choice

The Continent's Climate and Competitiveness Dilemma



# European Energy Policy 2026 Preview:

## THE BOTTOM LINE

Capstone expects Europe's energy transition agenda in 2026 to be shaped by tighter grid capacity, mounting fiscal constraints, and increasingly complex regulatory trade-offs. As the EU seeks to balance climate leadership with industrial competitiveness—against a backdrop of US protectionism and low-cost Chinese cleantech exports—we expect priorities to shift away from headline renewable build-out toward assets with secure grid access, system flexibility, and strong regulatory alignment.

### Outlook at a Glance

- ▶ **GRID CONGESTION AND DATA CENTRE DEMAND** WILL REWARD CONNECTED ASSETS AND STORAGE WHILE LEAVING UNSECURED RENEWABLE PROJECTS STALLED IN PERMITTING QUEUES
- ▶ **THE 2035 ICE 2035 BAN REVIEW** EXPECTED TO BROADEN COMPLIANCE OPTIONS FOR EU CO2 EMISSION STANDARDS TO INCLUDE HYBRIDS AND E-FUELS, BENEFITTING DIVERSIFIED AUTOMAKERS
- ▶ **THE NET ZERO INDUSTRY ACT (NZIA)** CIRCULARITY MANDATES WILL FAVOUR EU MANUFACTURERS WITH RECYCLING CAPACITY WHILE RAISING COSTS FOR IMPORT-DEPENDENT AND PFAS-EXPOSED PRODUCERS
- ▶ **CCUS WILL EMERGE AS THE MOST CREDIBLE INDUSTRIAL DECARBONISATION OPTION** AS FRAGMENTED HYDROGEN AND BIOFUELS RULES RAISE PROJECT RISK
- ▶ **DIVERGENT MEMBER STATE ENERGY-PRICING SCHEMES** WILL FRAGMENT THE EU MARKET AND SHIFT INDUSTRIAL INVESTMENT TOWARD JURISDICTIONS WITH STABLE, FAVOURABLE TARIFFS
- ▶ **ETS TIGHTENING AND STRICTER CBAM ENFORCEMENT** WILL RAISE COMPLIANCE COSTS FOR CARBON-INTENSIVE INDUSTRIES AND BOOST DEMAND FOR HIGH-QUALITY CARBON-REMOVAL CREDITS
- ▶ **IN THE UK, OFFSHORE WIND DELAYS AND GRID CONSTRAINTS** WILL STRENGTHEN THE CASE FOR STORAGE AND FLEXIBLE GENERATION

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# Grid Congestion and Data Centre Demand Will Reward Connected Assets and Storage While Leaving Unsecured Renewable Projects Stalled in Permitting Queues

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<b>Winners</b>	Grid equipment suppliers, battery storage operators, flexibility operators (including fast-ramping gas peakers), data centre developers, infrastructure providers (power and cooling systems, back-up generation, on-site grid connections), industrial users with firm grid access
<b>Losers</b>	Merchant renewables (projects relying on wholesale revenue) in grid-constrained areas, renewable developers without secured grid capacity

Capstone expects data centre demand to outpace grid capacity in 2026, favouring grid-connected assets such as storage, fast-ramping flexible generation, and well-sited industrial load, while limiting the ability of new renewable projects to secure connections. Grid-access reforms across several EU Member States are expected to shift capacity allocation away from queue position toward flexible generation, or projects that can deliver power reliably. Grid equipment suppliers, battery storage operators, and flexibility providers that can adjust output on demand stand to gain from surging data centre requirements, while renewable developers lacking secured grid connections face prolonged connection delays and revenue uncertainty.

## DATA CENTRE LOAD OUTPACES GRID REINFORCEMENT

Europe approaches 2026 with more than 1 TW of renewable projects stuck in permitting or grid-connection queues, while hyperscale data centres (driven by AI clusters, cloud expansion, and sovereign cloud requirements) request multi-GW volumes of firm capacity in already congested nodes. Regions including North Rhine-Westphalia, Amsterdam, Dublin, and parts of Sweden face constraints as digital expansion competes with electrification demand.

## GRID ACCESS REFORMS FAVOR SYSTEM VALUE OVER QUEUE POSITION

Regulators are considering shifting from first-come, first-served allocation toward models that prioritize system value - rewarding projects based on location, flexibility contribution, and security-of-supply rather than queue position alone.

However, these reforms will not fully shield industrial electrification, EV-charging networks, or heat-pump deployment from being deprioritized when digital demand grows faster

than reinforcement capacity. Throughout 2026, competitive advantage will depend on firm capacity, locational quality, and the ability to monetize local constraints through storage or demand-side response.

combined with high nuclear baseload capacity. Germany, the Netherlands, Ireland, and the Nordics face tighter constraints as industrial and transport electricity demand grows faster than grid expansion.

## GEOGRAPHIC FRAGMENTATION CREATES LOCATION-SPECIFIC WINNERS

In constrained markets, developers with projects outside congestion zones or those offering flexibility capabilities gain negotiating power.

**G**rid capacity constraints vary widely across Europe. France retains short-term headroom due to slower electrification (or adoption of electric vehicles and heat pumps),

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# Net Zero Industry Act's Circularity Focus Will Favor EU Manufacturers with Recycling Capacity, While Raising Costs for Import-Dependent, PFAS-Exposed Producers

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<b>Winners</b>	Advanced mechanical and chemical recycling providers (e.g., PET/PL recycling, solvent-based or depolymerisation technologies), waste-sorting and materials-recovery technology providers, chemical manufacturers with PFAS-free portfolios, EU clean-tech component manufacturers (batteries, solar, wind)
<b>Losers</b>	PFAS-exposed chemicals producers, import-dependent manufacturers, energy-intensive legacy industrials

**C**apstone expects the Net Zero Industry Act to accelerate investment in EU-based manufacturing and recycling infrastructure in 2026, as local content requirements and circular economy mandates move from policy to implementation. Battery, wind, and solar component makers with EU supply chains and recycling capabilities will gain market access advantages and subsidies, while manufacturers reliant on imported materials or PFAS-exposed chemical inputs face rising compliance costs and potential market exclusion.

## MEMBER STATES BEGIN NZIA IMPLEMENTATION

**M**ember States begin implementing the Net Zero Industry Act in 2026. Strategic project designations, accelerated permitting, local content requirements, and flexible state aid regimes shift from planning to execution. The Clean Industrial Deal adds emphasis on competitiveness and reshoring critical supply chains to Europe.

## CIRCULAR ECONOMY REQUIREMENTS BECOME MARKET ACCESS GATEKEEPERS

**T**he Ecodesign for Sustainable Products Regulation mandates recyclability and traceability standards, packaging waste reform increases producer responsibility, and the near-universal PFAS restriction forces rapid substitution across chemical and polymer inputs.

Compliance may become a prerequisite for market access. Non-compliant products risk being restricted or withdrawn from the EU market for the relevant product categories and may be excluded from public tenders or support mechanisms.

## COMPLIANT PRODUCERS GAIN ADVANTAGE OVER LEGACY SUPPLY CHAINS

**I**ndustrial supply chains will be split between compliant and legacy producers. Manufacturers using recycled materials, low-toxicity materials, and compliance-friendly feedstocks enjoy regulatory tailwinds and clearer growth pipelines. Conversely, PFAS-exposed chemical producers and energy-intensive legacy industries face rising costs, forced portfolio transitions, and increased scrutiny from customers, regulators, and financiers.

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# Divergent Member States' Energy-Pricing Schemes Will Fragment the EU Market and Shift Industrial Investment Toward Jurisdictions with Favourable, Stable Tariffs

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<b>Winners</b>	Energy-intensive users in stable-tariff markets, low-carbon producers in supportive regulatory environments
<b>Losers</b>	Firms exposed to volatile wholesale power prices (e.g., paper, glass, and fertiliser producers without long-term power contracts), industrial users in reactive-policy jurisdictions (e.g., manufacturers in Italy or Spain facing frequent tariff interventions), generators reliant on ad-hoc government interventions (e.g., utilities depending on revenue caps or emergency market measures)

**C**apstone expects Member States to abandon EU-wide energy market harmonization in 2026, prioritising industrial competitiveness by implementing divergent national industrial energy schemes through fixed tariff contracts and targeted state aid. Energy-intensive manufacturers and low-carbon producers in stable tariff jurisdictions (for example France (long-term regulated tariffs replacing the former ARENH [Regulated Access to Historic Nuclear Electricity] scheme) or Sweden and Finland (low-vol-

atility Nordic power prices) gain cost certainty, while firms exposed to volatile wholesale markets or to ad-hoc government interventions (such as sudden tariff freezes, windfall taxes, or emergency market caps) face heightened cost uncertainty and reduced competitiveness

## MEMBER STATES TURN TO DOMESTIC STRATEGIES TO PROTECT INDUSTRY

**M**ember States are adopting differentiated industrial energy schemes, including long-term fixed tariff contracts, compensation for energy-intensive sectors, dedicated support for strategic manufacturing, and expanded state aid frameworks. This reverses a decade-long trend toward price convergence within the EU power market.

## INVESTMENT DECISIONS PRIORITIZE REGULATORY AND PRICE CERTAINTY

**I**ndustries now benchmark locations not only on labour, logistics, and taxation, but increasingly on regulatory certainty and long-term electricity price visibility. Jurisdictions that offer durable industrial power contracting (often linked to national industrial strategies) are increasing-

ly preferred by investors. By contrast, countries relying on political interventions or tariff freezes amplify risk and deter capital.

## COMPETITIVENESS VS. CLIMATE CONSISTENCY BECOMES THE CORE TRADE-OFF

**T**he core political tension for 2026 is increasingly explicit: the EU must balance industrial competitiveness with uniform climate enforcement across markets with vastly different cost structures. As the US accelerates subsidy-driven reshoring and China expands low-cost cleantech capacity, Europe faces growing asymmetries in both pricing and policy.

Member States are therefore more willing to diverge at the margins (via compensation schemes, tailored state aid, or softer national implementation of EU rules) to shield strategic industries from rising energy and compliance costs. This creates a widening gap between the EU's harmonised EU climate objectives and the practical need for differentiated, country-specific industrial support.

In 2026, managing this tension becomes central to the EU's ability to sustain both climate leadership and global competitiveness.

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# The 2035 ICE Ban Review Expected to Broaden Compliance Options for EU CO2 Emission Standards to Include Hybrids and E-Fuels, Benefitting Diversified Automakers

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<b>Winners</b>	Hybrid/internal combustion engine (ICE) powertrain automobile manufacturers, e-fuel technology OEMs, diversified OEMs
<b>Losers</b>	Pure-play EV producers, battery-value-chain suppliers reliant solely on EV demand (e.g., cathode suppliers, cell manufacturers, or component producers without hybrid/e-fuel exposure)

Capstone expects the review of EU CO<sub>2</sub> emission standards for cars and vans (proposal due in Q1 2026) to relax the 2035 internal combustion engine (ICE) ban by expanding compliance options beyond battery-electric vehicles to include plug-in hybrids and e-fuel-compatible engines. Political pressure from Germany and Italy, combined with weak EV uptake among lower-income consumers and affordability constraints, has prompted the EU Commission to prioritise technology neutrality in its review. Diversified original equipment manufacturers (OEMs) and e-fuel/hybrid suppliers stand to gain from reduced regulatory risk, while pure play electric vehicle (EV) makers and undi-

versified battery value chain suppliers face softer demand and reduced policy support.

## POLITICAL PRESSURE DRIVES TECHNOLOGY-NEUTRAL COMPLIANCE OPTIONS

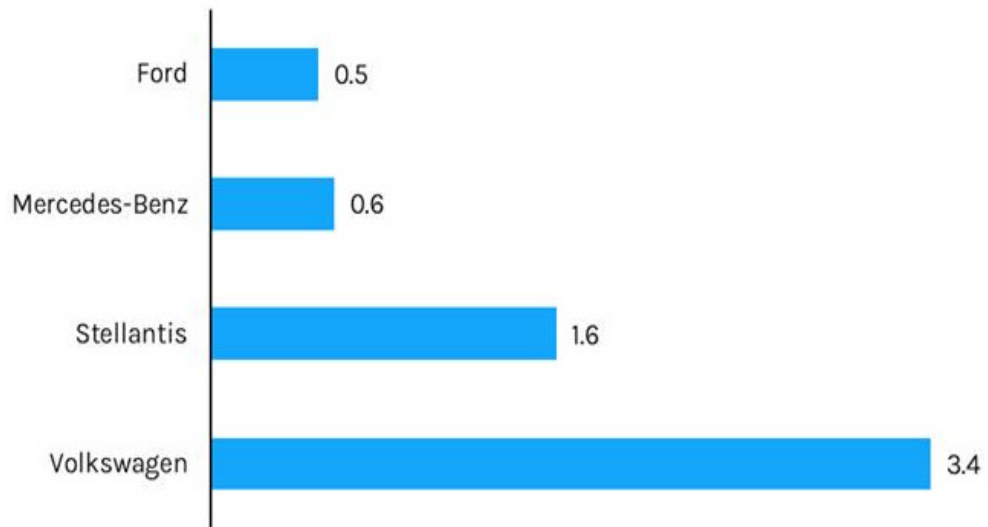
Weak EV uptake among lower-income consumers, affordability concerns, and intense lobbying from Germany and Italy have pushed the Commission to consider expanding compliance options beyond battery electric vehicles. Expanded hybrid flexibilities, dedicated e-fuel credits, and recalibrated fleet targets are all under active discussion.

## DIVERSIFIED OEMS BENEFIT FROM REDUCED TECHNOLOGY RISK

This policy shift will reduce regulatory exposure for OEMs with mixed portfolios and weaken the privileged status of battery-electric vehicles. Pure-play EV manufacturers face the prospect of slower structural demand and reduced policy support.

EXHIBIT 1

Penalty exposure of select automakers on passenger car fleets before review (€bn)



Source: ICCT, Capstone analysis

## BROADER TRANSPORT SECTOR SHOWS SIMILAR FLEXIBILITY

Aviation mirrors this trend: sustainable aviation fuel (SAF) mandates face pressure from carriers citing cost and limited supply. The EU's long-term climate trajectory remains intact, but its compliance instruments become more flexible, signalling a broader recalibration.

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# CCUS to Emerge as the Most Credible Industrial Decarbonisation Option as Fragmented Hydrogen and Biofuels Rules Raise Project Risk

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<b>Winners</b>	CO <sub>2</sub> transport and storage operators, second-generation or advanced low-cost biofuels producers, industrial emitters deploying CCUS (e.g., cement, steel, refining, and chemicals plants integrating capture into compliance plans)
<b>Losers</b>	Electrolyser OEMs, hydrogen developers without secured offtake agreements (i.e., projects with no committed buyers for their hydrogen), biofuel producers (e.g., biodiesel and ethanol plants) exposed to unfair foreign competition and regulatory uncertainty.

Capstone expects carbon capture, utilization, and storage (CCUS) to emerge as the primary decarbonization pathway for heavy industry in 2026, as fragmented regulations for hydrogen and biofuels increase project delivery risk. CCUS benefits from clearer regulatory frameworks, cross-border infrastructure projects (Porthos, Northern Lights), and NZIA-mandated storage capacity targets that drive industrial adoption.

**CCUS GAINS  
REGULATORY CLARITY**

CCUS begins to scale in 2026, as the Porthos and Northern Lights projects anchor Europe's first cross-border CO<sub>2</sub> transport backbone, and NZIA-linked storage capacity obligations pull the technology into the mainstream of industrial compliance planning. Meanwhile, biofuels remain shaped by uneven national transpositions of the Renewable Energy Directive III (RED III), particularly around feedstock eligibility and sustainability criteria. Low-carbon hydrogen faces persistently high costs, weak demand visibility, and divergent Member State strategies, despite strong EU-level ambition.

## FRAGMENTED CERTIFICATION AND CORRIDOR PLANNING INTEGRATION RISK

As these trajectories diverge, multi-country coordination becomes increasingly challenging: Guarantees of Origin systems, hydrogen and CO<sub>2</sub> corridor planning, and sustainability certification frameworks evolve unevenly across Member States. This fragmentation elevates integration risk across the "molecules" segment. CCUS is emerging as a more tangible near-term decarbonisation tool for certain hard-to-abate industries where alternatives are limited, while hydrogen and biofuels remain constrained by policy variability and uneven national implementation.

# ETS Tightening, Stricter CBAM Enforcement to Raise Compliance Costs for Carbon-Intensive Industries and Boost Demand for High-Quality Carbon Removal Credits

<p><b>Winners</b></p>	<p>Bioenergy with Carbon Capture and Storage (BECCS) developers, Direct Air Carbon Capture and Storage (DACCS) developers, high-integrity carbon removal credit suppliers, industrial emitters with hedged carbon positions (e.g., steel and chemicals firms with long-term EU ETS forward contracts such as ArcelorMittal SA (MT on the Amsterdam stock exchange) and BASF SE (BAS on the Frankfurt stock exchange))</p>
<p><b>Losers</b></p>	<p>Carbon-intensive sectors without hedged carbon positions, industrials reliant on low-quality carbon offsets, importers of CBAM goods</p>

Capstone expects Emissions Trading System (ETS) allowance tightening, stricter Carbon Border Adjustment Mechanism (CBAM) enforcement, and new high-integrity removal standards to lift compliance costs for carbon-intensive industries while boosting demand for Bioenergy with Carbon Capture and Storage (BECCS)- and Direct Air Carbon Capture and Storage (DACCS)-backed credits. High integrity credit suppliers and hedged emitters benefit from clearer price signals, whereas unhedged industrials

relying on low-quality offsets face rising exposure and regulatory scrutiny.

## ETS TIGHTENING INCREASES COMPLIANCE COSTS

Europe's ETS is entering a tightening phase. Faster allowance reductions and strict enforcement of CBAM increase compliance costs for carbon-intensive industries. The delayed launch of ETS 2 until 2028, which would have covered buildings and road transport, shifts near-term pressure on governments to come up with incentive schemes to promote decarbonisation investments, with the risks of being delayed.

## HIGH-QUALITY CARBON REMOVALS CREDITS GAIN MARKET SHARE

The EU and UK are moving to integrate domestic carbon removal credits into compliance frameworks. The Carbon Removal Certification Framework (CRCF) categorises removal credits by quality, effectively sidelining legacy offset types. This elevates high integrity removal credits - often backed by BECCS or DACCS - above lower value avoidance offsets.

## UNHEDGED EMITTERS FACE RISING SCRUTINY

**E**mitters reliant on low-quality credits or lacking hedging strategies face rising price volatility and intensified regulatory scrutiny, particularly aviation, heavy industry, and freight.

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# In the UK, Offshore Wind Delays and Grid Constraints Will Strengthen the Case for Storage and Flexible Generation

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<b>Winners</b>	Storage operators, flexibility providers (e.g., demand-side response aggregators such as Enel X (part of Enel SpA (ENEL on the Milan stock exchange)), grid-connected generation, power projects located near data centres, transmission and distribution (T&D) operators
<b>Losers</b>	Offshore wind developers, merchant renewables (wholesale-exposed wind/solar without long-term contracts), energy-intensive industries in grid-constrained regions (e.g., steel, chemicals, data centre operators)

**C**apstone expects UK grid and planning constraints (including slow permitting, local opposition, and lengthy environmental reviews) to persist through 2026, despite Strategic Spatial Energy Planning and Allocation Round 7 (AR7) outcomes. Storage operators, flexible generation, and well-connected sites will continue to command a premium, while offshore wind developers, merchant renewables, and electrification-dependent industries face elevated execution risk in congested regions.

## OFFSHORE WIND FACES ECONOMIC AND PLANNING HEADWINDS

**A**llocation Round 7, the next round of the UK's offshore wind auction, will test whether developer confidence can recover after recent offshore-wind auction failures driven by rising capex, supply chain constraints, and higher financing costs. Strategic Spatial Energy

Planning aims to clarify priority development zones, but the UK grid reinforcement timeline remains misaligned with deployment ambitions and industrial demand.

## POLICY UNCERTAINTY COMPOUNDS EXECUTION CHALLENGES ACROSS DECARBONISATION SECTORS

**P**olitical debates over EV mandates, building heat rules, and interim sectoral targets add uncertainty. Planning timelines remain long, judicial reviews frequent, and local opposition increasingly organised.

## STORAGE AND FLEXIBLE ASSETS GAIN STRUCTURAL ADVANTAGE

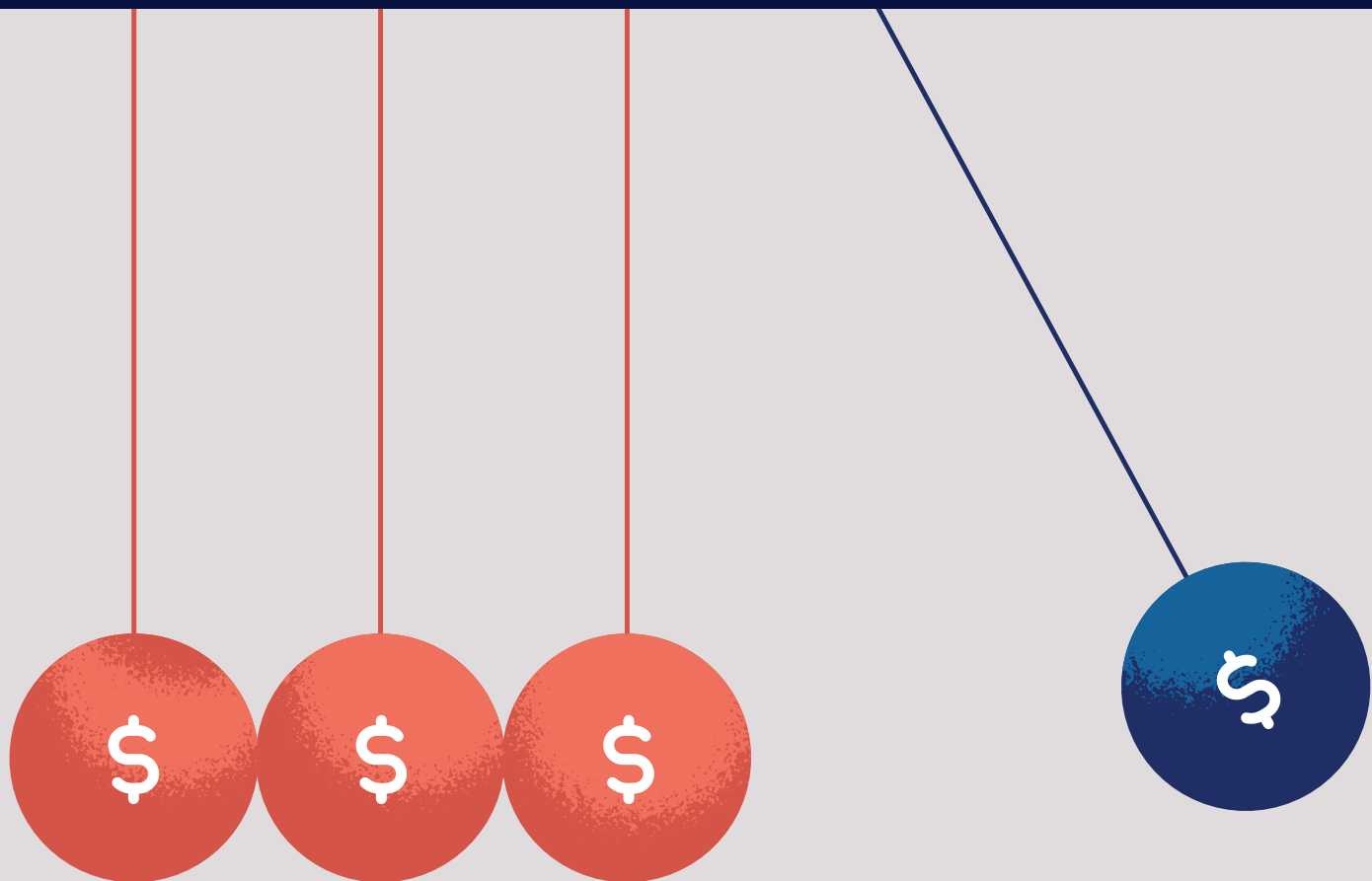
**A**gainst this backdrop, flexible generation, storage, and well-connected sites maintain a structural advantage. Offshore wind and merchant renewable developers face higher execution risk due to grid access constraints, planning delays, and evolving market design.

# Financial Services

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# The Deregulatory Pendulum Swing

Life after a Neutered Consumer Finance Protection Bureau



# Consumer Finance Policy 2026 Preview:

Capstone believes the Trump administration is intent on dismantling the Consumer Financial Protection Bureau (CFPB), even as the agency—constrained by limited budgets and staffing—moves forward with a broad deregulatory rulemaking agenda favorable to industry. As federal enforcement and supervision recede, we expect well-resourced, Democratic-led states to step in, creating a fragmented and uneven regulatory landscape.

## THE BOTTOM LINE

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### Outlook at a Glance

- ▶ **SECOND TRUMP** ADMINISTRATION WILL LIMIT CFPB'S REACH AND POWER; EXPECT NARROWER RULEMAKING BUT CONTINUED ENFORCEMENT AND SUPERVISION OF EXISTING LAW
- ▶ **LEGISLATIVE ACTION TO CURTAIL** CFPB TO FACE UPHILL BATTLE DESPITE UNIFIED REPUBLICAN CONTROL AS FILIBUSTER AND OTHER PRIORITIES LIMIT OXYGEN; STATES STAND AS BULWARK
- ▶ **CFPB LIKELY TO WALK SEVERAL** BACK BIDEN ERA RULES AND BECOME A LESS AGGRESSIVE, INNOVATION-FRIENDLY WATCHDOG

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# Second Trump Administration Will Limit CFPB's Reach and Power; Expect Narrower Rulemaking but Continued Enforcement and Supervision of Existing Law

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<b>Winners</b>	Covered financial institutions subject to CFPB supervision, enforcement, and rulemaking authority
<b>Losers</b>	N/A

## EXPECT EMPHASIS ON SUPERVISION AND ENFORCEMENT AGAINST BAD ACTORS; PERSONNEL IS CRITICAL

Capstone expects a significant recalibration of the CFPB's aggressive posture that it maintained under Director Rohit Chopra (D) toward a friendlier regulatory approach, but not a total abdication of its responsibility to supervise and enforce federal consumer financial protection laws.

As seen under Acting Director Mick Mulvaney and Trump's first confirmed CFPB Director Kathy Kraninger, personnel will have a meaningful impact on the CFPB's character and approach over the next four years. As acting director, Mulvaney appeared determined to handcuff the CFPB from the inside (most notably by [requesting a zero-dol-](#)

[lar budget](#) from the Federal Reserve in 2018). Kraninger, on the other hand, positioned herself as a champion of fair and transparent markets, focused on leveraging the screwdriver of supervision but certainly not shying away from swinging the hammer of enforcement when needed. For example, in the third and fourth quarters of 2020, Kraninger oversaw the [second and third most enforcement actions](#) (by quarter) in the CFPB's history.

The radically different approaches of Trump's prior CFPB directors inform Capstone's belief that the CFPB's approach will depend on who is nominated and confirmed to lead the agency. Initial reporting suggests that Brian Johnson (a former Kraninger deputy) and Todd Zywicki (a law professor at George Mason and former advisor to Kraninger) are being considered for the role. Both have been active in the consumer finance regulatory domain, testifying before Congress on the [bureau's activities under Director Chopra and a path forward](#), "junk fees," the [CFPB's budget](#), and [a wide range of other topics](#). It is clear that both would seek to strategically orient the CFPB away from [innovation-constraining regulation](#) and toward promoting fair, transparent, innovative, and competitive consumer financial markets.

Capstone will continue to monitor potential Trump appointees and the nomination process to better ascertain the specific priorities of the watchdog agency's next director. Nonetheless, the direction of travel is clear. The CFPB is poised to pivot from an aggressive regulator that sought to

maximize its authority under existing statutes to a strategic and tactical overseer of innovative industry.

## INFORMAL GUIDANCE SUBJECT TO HASTY REVISION AND RESCISSION; FINAL RULES WILL TAKE LONGER

Chopra will leave his role (via resignation or firing) when President-elect Trump assumes office in January 2025. As such, Director Chopra is counting days, not just for himself but for his policy priorities, which were often effectuated through [informal guidance](#), including bulletins, [advisory opinions](#), and policy statements.

These forms of informal guidance are most at risk for hasty reversal once President-elect Trump assumes office and his yet-to-be-named nominee is confirmed. Capstone expects the incoming Trump appointee to pause ongoing efforts across the consumer finance landscape and quickly revise or rescind informal guidance with which they disagree, including potentially narrowing [recent guidance](#) that sought to informally broaden the definition of “unfair, deceptive, and/or abusive acts or practices” (UDAAPs) under Section 1031 of the Dodd-Frank Act.

Proposed rules are also likely to be paused immediately. On the other hand, final rules not subject to Congressional Review Act (CRA) look-back periods will require lengthier rulemaking processes to revise and/or rescind, as they are subject to traditional notice and comment procedures, including cost-benefit analysis, comment periods, and timing requirements for publication in the Federal Register prior to their effective date. Final rules facing legal challenges are also likely to be creatively managed, with the CFPB agreeing to pause the litigation with counterparties while it revisits the rules or refusing to defend them entirely.

Capstone thus anticipates the CFPB to be highly

active throughout 2025 and beyond as it seeks to unwind some of the rulemaking activities of the Biden-era CFPB. We expect the CFPB to revisit (with differential prioritization) credit card late fees, overdraft lending and non-sufficient funds fees, open banking, digital payments, small business lending data collection, medical debt, and data brokers final and/or proposed rules.

## LIKELY REVIEW OF PENDING ENFORCEMENT ACTIONS INCENTIVIZES BRISK PACE THROUGH END OF BIDEN TERM

In addition to efforts to unwind Biden-era rules, the Trump administration is likely to review pending investigations and enforcement actions currently underway at the CFPB. This creates a dramatic incentive for Director Chopra to [accelerate the pace](#) of enforcement efforts, particularly in more aggressive cases, before President Biden’s term ends. It might also incentivize companies to stall, slow the extent of their cooperation, or refuse to negotiate consent orders or settlements with the agency.

For instance, in January 2023, the CFPB and New York Attorney General Letitia James brought an action in the United States District Court for the Southern District of New York against Credit Acceptance Corp. (CACC), a subprime auto lender. The [complaint](#) alleges, among other things, that CACC and its dealers have engaged in deceptive acts or practices in violation of Section 1031 of the Dodd-Frank Act, including by misrepresenting and hiding costs, furtively selling expensive add-on products, leveraging algorithms to set interest rates in violation of state usury laws, failing to appropriately assess borrowers’ ability to repay, and taking unreasonable advantage of consumers. The matter remains pending in court.

The CFPB’s investigation into CACC began with a civil investigative demand (CID) during the first Trump administration, so we do not anticipate new leadership will abandon the ongoing case. However, a Trump CFPB may seek to revisit the

pending litigation (assuming it is not settled before Trump takes office) and could take a narrower approach to the allegations against the company, including walking away from more novel charges such as ability-to-repay failures. NY Attorney General James may also continue to press the case forward if the CFPB steps back.

The CACC case signals how the presidential transition could impact ongoing CFPB enforcement actions, and we will continue to monitor noteworthy actions for investors.

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## CFPB Likely To Walk Several Back Biden Era Rules and Become a Less Aggressive, Innovation-Friendly Watchdog

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<b>Winners</b>	Covered financial institutions subject to CFPB supervision, enforcement, and rulemaking authority; nonbanks active in the consumer financial marketplace; fintech companies
<b>Losers</b>	TBD

Capstone believes the Republican-led CFPB will pause, refuse to defend, rescind, or initiate rulemakings to roll back certain pending and recently finalized rules. Notably, rules related to the CFPB's "junk fee" initiative face an uncertain future. We also expect the CFPB to revisit rules relating to open banking, digital payments, and small business lending. The CFPB is likely to pause more prescriptive and jurisdiction-expanding Fair Credit Reporting Act rulemakings too (see CFPB Election Outlook: Fate of Credit Card Late Fee, Overdraft, and Other Rules Hinge on Election as Additional Reg Momentum in '24 Unlikely, September 24, 2024).

We expect the CFPB to reign in its expansive rulemaking agenda and revisit some of the more

controversial rules proposed and finalized under Director Chopra. This is especially true if Zywicki, Johnson, or a like-minded appointee becomes director.

### CREDIT CARD LATE FEE RULE LIKELY ABANDONED, MAINTAINING LATE FEE LIMITS OF \$32 OR MORE

The Republican CFPB will likely abandon its credit card late fee rule, which lowers the maximum late fee a credit card issuer can charge to \$8—as long the issuer has one million or more open consumer credit card accounts. The rule would also give the CFPB more power by transitioning the fee limit's automatic annual inflation adjustment to an adjustment based on a CFPB-determined market condition analysis. We expect the CFPB to elect to rescind the rule through notice and comment rulemaking in 2025, maintaining the current limit of \$32 (\$41 for subsequent late payments).

The rule was finalized in 2024 under the Democratic CFPB, but it has not gone into effect amid a

legal challenge. On December 6th, the judge presiding over the case upheld a nationwide injunction on the rule and denied the CFPB's request to transfer the case to DC, ensuring the rule will remain stayed until Trump takes office and easing the path for his administration to vacate the rule

Republicans have pushed back on the safe harbor rule, arguing that it shifts costs from consumers that incur them through their own fault to all cardholders through higher interest rates and fees. On the campaign trail, Trump floated the idea of temporarily capping credit card interest rates at 10%, drawing praise from Senator Bernie Sanders (I-VT) and facing strong push back from credit card issuers. We believe Trump's CFPB could signal that the rescission of the rule is a means of constraining credit card interest rates, which have increased in anticipation of the rule going into effect. Such a move would limit the need to advocate for an interest rate limit that Congress is highly unlikely to pass.

## OVERDRAFT AND NON-SUFFICIENT FUND FEE PROPOSED RULES ON CHOPPING BLOCK

**C**apstone does not expect the Republican CFPB to finalize the Democratic CFPB's proposed rules and requests for comments that seek to curtail overdraft and non-sufficient fund (NSF) fees incurred by a consumer.

The proposed NSF Rule would effectively prohibit overdraft fees by allowing banks and other financial institutions with more than \$10 billion in assets to charge only a breakeven fee to cover losses associated with overdraft and NSF transactions. If covered institutions continue to generate profit from the transactions, the proposed Overdraft Lending Rule would require the institutions to disclose their interest rates, terms, conditions, and other measures to inform and protect consumers—in compliance with the Truth in Lending Act (TILA) and Regulation Z (see

Bank Overdraft Quick Take: Aggressive Proposal Effectively Caps Fees for Large Banks; Negative for Toronto-Dominion, Regions Financial, Others, January 17, 2024).

The CFPB also issued Circular 2024-05, clarifying that consumers must affirmatively opt into overdraft protection services before the institution charges overdraft fees. Outlining that Regulation E “establish[es] an opt-in, not an opt-out regime,” the CFPB declared that charging such fees without consent may constitute a violation of the Electronic Fund Transfer Act (EFTA).

Widely condemned by financial institutions and industry trade groups, the rules are also unpopular among Republicans. Potential nominees Johnson and Zywicki have also indicated disagreement with the rules.

## CFPB'S OPEN BANKING RULE FACES AN UNCERTAIN PATH FORWARD

**T**he final rule moving the US toward an open banking system has an unclear future, as it has garnered support from some Republican lawmakers. However, the rule has faced tougher opposition from industry. On the same day the rule was finalized, the Bank Policy Institute and Kentucky Bankers Association filed a lawsuit seeking declaratory and injunctive relief from the rule, creating an immediate decision point for Trump's incoming CFPB director regarding how to approach the litigation.

Mandated by Section 1033 of the Dodd-Frank Act, the CFPB issued the Personal Financial Data Rights final rule in an effort to “move the United States closer to having a competitive, safe, secure, and reliable ‘open banking’ system.” The rule aims to heighten competition and give consumers more choices. Consumers would have greater control over their personal financial data (including revocation and deletion rights and banning certain types of data harvesting) and more opportunities to shop for better rates, make

secure payments, and transfer their financial information between financial institutions.

Unlike many CFPB rules issued under Democratic leadership, this final rule received applause from certain influential congressional Republicans. For example, Representative Patrick McHenry (R-NC), the current but retiring Chair of the House Financial Services Committee, called the rule “a promising step forward to protect Americans’ financial data privacy,” while noting that Director Chopra heeded Republican “concerns regarding unreasonable restrictions on the secondary use of consumer data.” Capstone believes Republican support for the rule in Congress signals its potential political durability, though shifts in Congress and leadership of the House Financial Services Committee raise risks to its longevity.

Capstone will continue to monitor this litigation throughout 2025 given its uncertain path forward.

## DIGITAL PAYMENTS LARGER PARTICIPANT RULE A LOWER PRIORITY FOR REPUBLICAN TARGETS, BUT NOT SAFE

Unlike many current CFPB priorities, Capstone believes the digital payments rule could have greater durability under a Trump administration that has been increasingly critical of Big Tech, though both Zywicki and Johnson have expressed skepticism about the rule.

The CFPB issued the final rule to supervise large covered nonbanks (e.g., Apple, Google, Venmo, Cash App, and Samsung) that offer digital payment services, including digital wallets, fund transfer, and other peer-to-peer payment applications. The rule gives the CFPB supervisory jurisdiction over, and the ability to proactively examine, these providers if they process more than 50 million transactions annually. The rule aims to enhance CFPB oversight of digital payments companies amid growing concerns over privacy and surveillance, errors and fraud, and debanking.

Focused on enhancing supervision for the largest participants in the digital payments industry, the rule dovetails with a more traditional Republican approach to regulatory compliance favoring supervision to more aggressive tools like enforcement (which the CFPB already has over these providers). It also strategically carves out crypto, potentially diminishing the energy behind prior congressional Republican critiques. The incoming director could de-prioritize the examination of digital payments service providers rather than rescind and revise the rule amid more pressing priorities in 2025.

While the rule remains subject to the Congressional Review Act, Capstone believes congressional Republicans are likely to focus their efforts on other, more pressing priorities in early 2025. Litigation challenging the rule has yet to be filed, despite financial technology trade groups signaling a potential legal challenge and condemning the rule. This inaction signals that the groups may be awaiting clarity on the incoming administration’s perspective. Capstone believes that if Zywicki or Johnson are confirmed as CFPB director, we may see an energized effort to rescind it, despite unlikely congressional action.

## SMALL BUSINESS LENDING RULE LIKELY TO BE MODIFIED, BUT STATUTORY MANDATE FORCES CFPB ACTION

The CFPB finalized its Small Business Lending Rule in March 2023 and extended compliance dates in June 2024 following the resolution of litigation challenging the CFPB’s funding mechanism. The rule, mandated by Section 1071 of the Dodd-Frank Act, requires covered small business lenders to collect demographic, geographic, credit pricing and decisioning, and other loan-level data associated with small business financing transactions. The data is to be filed with the CFPB to facilitate fair lending enforcement, credit access, transparency, and economic development among women and minority communities. Tied up in a litigation

saga surrounding the constitutionality of the CFPB's appropriations and the breadth of the data collection, the rule survived legal challenge on the merits (subject to appeal), and compliance dates (differentiated across tiers 1, 2, 3) are scheduled for 2025 and 2026 with first filings due in 2026 and 2027.

While we believe the Trump administration will generally not engage in rulemaking that broadens the remit and reach of the CFPB, the agency has previously been ordered to finalize a 1071 rule as statutorily required by the Dodd-Frank Act. As a result, Capstone anticipates that the Trump administration may seek to pause implementation of the existing final rule and initiate notice and comment on a more modest proposal in 2025 or 2026, especially in light of the somewhat bipartisan effort to nullify the rule in late 2023 (staved off only by President Biden's veto). Litigation regarding the rule remains ongoing, though the US Circuit Court of Appeals for the Fifth Circuit is expected to rule on the matter prior to the compliance deadlines and potentially before a new director is confirmed.

## PROPOSED RULES TO BAN MEDICAL DEBT AND COVER DATA BROKERS UNDER FCRA UNLIKELY TO SURVIVE

Capstone believes outspoken Republican criticism in Congress suggests that the prospects of survival are dim for the proposed rule to prohibit most credit reports from reporting medical bills. Given this dynamic, we believe the CFPB is unlikely to finalize the rule in the ongoing lame duck session as rescission of the rule through the CRA would prevent the bureau from issuing a substantially similar rule in the future, which would restrain future Democratic administrations.

In the proposed rule, the Democratic-led CFPB cited concerns about accuracy, a desire to boost credit scores, and an effort to "end the senseless practice of weaponizing the credit reporting

system to coerce patients into paying medical bills that they do not owe." The rule would seek to close a regulatory exception that allows creditors to use certain medical debts in credit decisioning. While the comment period closed on August 12th, the CFPB has yet to release a final rule. With days dwindling before President-elect Trump takes office, any final rule would be subject to CRA review and rescission.

The outlook is similarly dim for a notice of proposed rulemaking (NPRM) to broaden the definition of a "consumer report" and "consumer reporting agency" under Regulation V, the implementing regulation of the Fair Credit Reporting Act (FCRA), to include data brokers that buy and sell consumer credit and financial information. The rule proposes to treat such brokers "just like credit bureaus and background check companies" that must comply with the FCRA, protect consumers' personally identifiable information, and receive consumer consent for data-sharing. While the comment period for the data brokers NPRM does not close until March 2025, Capstone expects the rule to be withdrawn shortly thereafter and/or subject to serious legal challenge in the unlikely instance the Trump administration does seek to finalize it (see [Data Privacy Quick Take: CFPB Proposed Rule to Treat Data Brokers as Consumer Reporting Agencies Unlikely to Survive; Market Overreacts](#), December 3, 2024).

While the proposed rules dovetail with broader government efforts (cheered by some Republicans) to "protect Americans' sensitive personal data" and promote credit access, Capstone believes the Trump administration's deregulatory impetus, desire to reduce the CFPB's authority, and overarching goal to foster innovation in the consumer financial marketplace make survival of these efforts unlikely in 2025.

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# Legislative Action to Curtail CFPB To Face Uphill Battle Despite Unified Republican Control as Filibuster and Other Priorities Limit Oxygen; States Stand as Bulwark

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<b>Winners</b>	Incumbent consumer financial service providers with sophisticated governance and compliance processes
<b>Losers</b>	N/A

## FRONTRUNNERS FOR CHAIR ON KEY FINANCIAL SERVICES COMMITTEES RAISE SPECTER OF LEGISLATIVE ACTION

Capstone believes that unified Republican control, and the potential ascendance of Representative Andy Barr (R-KY) and Senator Tim Scott (R-SC) to the top seats on the House Financial Services and Senate Banking Committees, respectively, raise the specter of significant legislative action in the 119th Congress aimed at limiting the power, funding, independence, and structure of the CFPB.

Rep. Barr appears to be the frontrunner to replace retiring Rep. McHenry as chair of the House Financial Services Committee. He has announced his interest in the position, championing a four-prong platform to “roll back burdensome financial

regulations,” “foster innovation in fintech and digital assets,” “reform the [CFPB],” and “implement market-based solutions for housing finance and affordability.”

In December 2023, Rep. Barr introduced legislation aimed at transforming the CFPB’s structure, funding, and rulemaking processes. The CFPB Transparency and Accountability Reform Act would require annual congressional appropriation of CFPB funding, remove the agency from the Federal Reserve System, transform its leadership structure from a single director to a five-person commission, and create an Office of Economic Analysis in the CFPB to “review all proposed and existing guidance, orders, rules, and regulations” with a mandate to publish reports on costs and benefits of proposed regulations. As recently as October 2024, Rep. Barr introduced a bill aimed at curtailing the CFPB’s CID authority to “ensure... industry participants are given due process” and protect such participants from “extortionary CID request[s]... that amount to fishing expedition[s].”

Meanwhile, Sen. Scott has also been an outspoken critic, regularly attacking proposed and final rules during Director Chopra’s tenure. As the current ranking member on the Senate Banking Committee, Sen. Scott is poised to become chair. As recently as April, he introduced a measure to overturn the CFPB’s credit card late fee rule.

## THIN MAJORITIES, FILIBUSTER, AND COMPETING PRIORITIES BEAT BACK MOMENTUM

**D**espite unified Republican control and alignment of interests for key congressional Republicans, Capstone believes thin majorities, the legislative filibuster, and competing priorities dampen momentum for robust legislative intervention aimed at reining in the CFPB.

With only a 220-215 majority in the House of Representatives and a 53-47 majority in the Senate, Republicans will have to manage tight margins in order to pass most legislation. This is particularly challenging in the Senate where most legislation still requires a 60-vote majority in order to pass due to the filibuster (with notable exceptions, including tax bills and other measures achieved through reconciliation).

Amid priorities related to trade, tax, immigration, and defense, Capstone believes the prospects of a concerted effort to pass legislation to seriously curtail the CFPB are dim. While we anticipate Rep. Barr will propose such legislation, which the House could realistically pass, the filibuster provides a robust stopgap against such an action without the support of at least some Democratic senators. We do not believe any Democrats would support Rep. Barr's CFPB Transparency and Accountability Reform Act or broader efforts to limit the bureau's authority. We believe political capital and oxygen is, therefore, both limited and better spent on other priorities, as outlined by incoming Senate Majority Leader John Thune (R-SD) in early December.

Capstone will remain attuned to developments in the 119th Congress and potential legislation with impacts on the independence, funding, and authorities of the CFPB.

## STATES POISED TO FILL VACUUM LEFT BY A TRUMP CFPB

**I**nvestors should be mindful that states retain the power to enforce both their own consumer financial protection laws, and any real or perceived step back that emerges at the federal level is likely to be filled by active state attorneys' general and other state financial regulatory bodies. States have the authority to enforce federal prohibitions on UDAAPs under Section 1042 of the Consumer Financial Protection Act. In addition, the CFPB finalized an interpretive rule in May 2022 that clarified (and arguably expanded) state authority to enforce such laws. While such a rule is theoretically able to be revisited by incoming CFPB leadership, states have enforced federal consumer protection standards since Dodd-Frank was passed, and pre-emption is a nuanced legal question making determinative conclusions unclear at this stage.

At the least, investors should not expect consumer financial markets to become the wild west of non-compliance. Similar to California passing legislation to create the Department of Financial Protection and Innovation (DFPI) in response to Trump's first presidential term and a shift in federal oversight of consumer finance, Capstone expects states to heighten their activity in the domain if and when the Trump-era CFPB steps back from the limelight. In fact, the DFPI recently released a request for comment seeking input on additional products and services that should be regulated under the California Consumer Financial Protection Law. The regulator has already extended its authority to offerings seemingly exempt from the CFPB's oversight, such as lease-to-own, highlighting the potential for other states to follow suit.

Insurance Policy 2026 Preview

# Continued Pressure

Why the Insurance Industry  
Will Continue to Face Scrutiny



# Insurance Policy 2026 Preview:

Capstone believes the National Association of Insurance Commissioners (NAIC) will continue its multi-year effort to tighten its scrutiny of the investment strategies of insurers, and of their use of artificial intelligence (AI) and big data. We expect state policymakers to continue weighing targeted reforms to promote insurance affordability as heightened catastrophe risks shape the nation's largest property and casualty (P&C) markets.

## THE BOTTOM LINE

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### Outlook at a Glance

- ▶ **NAIC SCRUTINY OF INSURER INVESTMENT STRATEGIES SET TO CONTINUE IN 2026, WITH INITIATIVES TO EXAMINE RISK-BASED CAPITAL AND CREDIT RATINGS TAKING FULLER SHAPE**
- ▶ **AUTO INSURANCE REFORM ON THE TABLE IN 2026 AS STATES GRAPPLE WITH RISING PREMIUMS**
- ▶ **HOMEOWNERS INSURANCE SET TO REMAIN A HOT REFORM ENVIRONMENT IN 2026 AMID BURGEONING CATASTROPHE RISK AND AFFORDABILITY CHALLENGES**
- ▶ **NAIC WILL CONTINUE SCRUTINIZING INSURER USE OF AI AND BIG DATA IN 2026, WITH FORMAL REGULATORY FRAMEWORK PROPOSALS ON THE DOCKET**

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# NAIC Scrutiny of Insurer Investment Strategies Set to Continue in 2026, with Initiatives to Examine Risk-Based Capital and Credit Ratings Taking Fuller Shape

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<b>Winners</b>	N/A
<b>Losers</b>	Life insurance companies, smaller credit rating providers

Capstone expects NAIC scrutiny of insurer investment strategies to continue in 2026, with particular focus on the sufficiency of existing risk-based capital (RBC) requirements and the credit ratings informing them. Building on 2025, we expect the association, comprised of state insurance regulators, to develop and implement frameworks to better assess investment risk across alternative and complex asset classes, including structured securities and private credit, which have seen greater insurer uptake in recent years.

The initiatives, which should be understood as an effort to mature the NAIC’s prudential oversight, are likely to be slow-moving. However, NAIC’s decisions, at least to the extent they enhance RBC requirements on certain asset classes, could make it less desirable for insurers to invest in higher-yielding, complex assets, with associated impacts on investment income. This could lead to less demand for the services of credit ratings providers (CRPs) that rate such securities.

## RBC REVIEW TO GAIN STEAM IN 2026; GUIDING PRINCIPLES CREATE ROADMAP FOR POTENTIAL ENHANCEMENT

During the NAIC Summer 2025 National Meeting, NAIC President Jon Godfreed highlighted the work of the RBC Model Governance Task Force as “one of the NAIC’s most significant initiatives of the year in light of growing [insurer] interest in alternative assets.”

The RBC Task Force, formed in February 2025, was tasked with developing guiding principles to provide a strategic foundation for potential revisions to the existing RBC framework. Following several months of discussions between regulators and industry, the Task Force voted to adopt the revised principles for RBC requirements at the NAIC Fall National Meetings in December.

The new guidelines center on nine principles that encourage updates to RBC requirements only when insurer solvency risk changes and require that any potential changes account for emerging risks before they materialize. Any updates that would tighten RBC requirements on insurers are likely to reduce insurer demand for the asset classes to which they apply.

## THIRD-PARTY CRPS FACE HEIGHTENED SCRUTINY, WITH NEW FRAMEWORK EXPECTED IN 2026

**R**elatedly, we expect NAIC to push toward more closely scrutinizing third-party credit ratings of complex securities held by insurers in 2026, including by implementing its “discretion” process and refining its CRP due diligence initiative.

Third-party credit ratings are a key input in determining underlying RBC requirements for life insurers, particularly for complex securities and/or bonds that include private credit and other alternative asset classes. Amid burgeoning insurer investment in such asset classes and perceptions that NAIC relies blindly on third-party credit ratings of the complex securities that insurers hold, the NAIC adopted a “discretion amendment.” This amendment enables the Securities Valuation Office (SVO) to challenge credit ratings that are “materially higher” than SVO designations, subject to procedural protections. That process is scheduled to begin January 1, 2026, though we anticipate potential delays in implementation as the NAIC stands up the process.

Additionally, the NAIC is developing a due diligence framework for CRPs that we expect will take shape in the coming year. It is currently a relatively amorphous initiative intended to establish gating criteria for NAIC acceptance of a CRP rating for insurer investments. While there are currently no criteria for becoming a CRP for NAIC purposes beyond registration with the Securities and Exchange Commission (SEC) as a Nationally Recognized Statistical Ratings Organization (NRSRO), we believe the effort is driven by NAIC’s concern that third-party CRPs, particularly smaller firms, may provide favorable credit ratings that do not properly account for underlying investment and credit risk, thereby reducing RBC requirements for insurers.

The NAIC’s efforts to tighten its due diligence process to evaluate the approval of new CRPs to rate insurer investments could impact a key channel of demand for CRP services. In our view, the ongoing initiatives will increase NAIC oversight over credit ratings, with implications for smaller CRPs, including A.M. Best, Morningstar Credit Ratings, and Egan Jones, among others.

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# Homeowners Insurance Set to Remain a Hot Reform Environment in 2026 amid Burgeoning Catastrophe Risk and Affordability Challenges

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<b>Winners</b>	Homeowners insurance companies
<b>Losers</b>	Reciprocal exchanges

Capstone expects P&C insurance reforms to remain an important focus in 2026, as policymakers and regulators navigate the tension between ensuring that insurance is affordable and that the private insurance market remains competitive and profitable. We expect reform efforts to focus on personal lines, particularly homeowners and auto insurance.

## HOMEOWNERS INSURANCE AT A CROSSROADS IN CATASTROPHE-PRONE STATES WITH ACTION LIKELY IN 2026

Rising extreme-weather events, such as hurricanes, floods, and wildfires—totaling \$101.4 billion in claims in 2025—continue to raise pressure on insurers as they navigate complex, state-by-state regulatory frameworks. Homeowners insurance specifically has been a constant subject of reform efforts for policymakers as rates on home policies have risen by an average of 58% since 2018.

Catastrophe-prone areas, including California, Florida, and Texas, which make up some of the nation's largest P&C markets and are also the regions most exposed to catastrophes, have adopted administrative and legislative measures to encourage more underwriting by home insurers and improve affordability amid rising premiums. We expect that to remain the case in 2026.

### Insurers Set to Take Advantage of California Reforms in 2026 as Ballot Measure Threats Abate

Specific to wildfire-exposed California, rate adequacy reforms were finalized in December 2024 through the Sustainable Insurance Strategy (SIS), a suite of four major reforms to the state's insurance regulatory regime established under Proposition 103. The reforms sought to expedite the rate approval process, enable insurers to utilize forward-looking catastrophe models, factor reinsurance costs when setting rates, and beef up the solvency of the state insurer of last resort. Additionally, a suite of bills proposed in the aftermath of the Los Angeles wildfires earlier this year was signed by Governor Gavin Newsom (D), as lawmakers continued their effort to encourage more underwriting in the nation's largest P&C market.

In 2025, home insurers appear set to gradually increase underwriting in the state in 2026, contingent on underlying balance sheet exposure and wildfire risk dynamics. To date, at least five separate insurers have filed for rate increases incorporating SIS reforms, including Mercury General Corp. (MCY), Farmers Insurance - a subsidiary

of Zurich Insurance Group (ZURN on the Swiss exchange), Pacific Specialty, USAA, and CSAA. On November 21st, 2025, Farmers Insurance said it was eliminating the 9,500 cap on the number of new home insurance policies it writes each month in California. Farmers, the state's second-largest homeowners' insurer, credited the decision to the "spreading adoption of Insurance Commissioner Ricardo Lara's Sustainable Insurance Strategy" as it looks to expand underwriting to approximately 300,000 consumers in distressed areas in early 2026.

As debates over insurance availability and affordability intensify between consumer advocates, policymakers, and industry participants, two separate ballot initiatives were filed in 2025, one by an independent insurance agent and the other by Consumer Watchdog (CWD), a notable consumer advocacy group. Both initiatives seek to overhaul key provisions of Proposition 103, though in opposite directions, including the public-intervenor system, the prior rate approval system, and heightened guardrails on non-renewal issuances. Despite broad policy support for homeowners' insurance reform in California, both 2026 ballot measures were mutually withdrawn on December 2nd. Despite their withdrawal, the ballot measures suggest the fight over consumer protection, insurance affordability, and underwriting for conditions is set to continue in 2026, with meaningful stakes for carriers operating in the large, disaster-prone market.

### **Stability Likely to Drive More Entrants in Florida in 2026, with Reciprocals as Favored Model**

We expect Florida to remain a hot market for new entrants in 2026 as market stability improves, recent reforms keep costs down, and the state continues its depopulation initiative to push more policies into the private market. That said, reciprocal insurance exchanges (RIEs), the favored model among new entrants in 2025, attracted increased scrutiny from regulators this year, and we expect that to continue in 2026 as the model proliferates.

In 2023, Florida enacted comprehensive tort reforms through HB 837, eliminating one-way attorney's fees and restricting bad-faith claims, among other tactical reforms to reduce significant legal costs borne by insurers (and ultimately consumers in the form of rate increases). These reforms have helped stabilize the market, including by supporting the entry of 17 new insurers, primarily reciprocal insurance exchanges (RIEs), in Florida as of September 2025, signaling a softening and competitive market. At the same time, the state's efforts to depopulate the insurer of last resort, Citizens Property Insurance Corporation, have largely succeeded. As of June 2025, 568,914 policies were in force, down from more than 1.2 million in 2023, as private entrants to the market took advantage of the opportunity to grab market share.

Reciprocals have become more common in CAT-prone states and among private investors because they have lower capital requirements than traditional insurance carriers and greater balance sheet insulation. RIEs are a form of insurance company in which policyholders (that is, subscribers) mutually insure each other, with fees used to pay for an attorney-in-fact (AIF) who oversees the day-to-day operations of the exchange. One benefit of the model is it reduces balance sheet risk, assuming sufficient surplus capital in the underlying exchange, and the opportunity for investors in the AIF to generate fee-based revenues established under subscription agreements.

From 2017 to 2024, 27 new reciprocal entities opened for business, including 14 in Florida, four in Texas, and two in Louisiana. In 2024, RIEs collectively wrote \$15 billion in premiums (a 55% increase from 2019), accounting for 5% of total US P&C premiums. The rapid proliferation of the model in catastrophe-prone regions (for example, in Florida, Louisiana, and Texas) has drawn scrutiny from regulators, which we expect to continue in 2026.

Specifically in 2025, regulators began more closely examining the structure. During the Spring 2025 NAIC meeting, the Financial Condition (E) Committee announced the formation of the new

Reciprocal Exchanges (E) Working Group tasked with modifying applicable NAIC model laws (which must be adopted by states to take effect) to clarify that fees charged to reciprocal exchanges by their AIFs should be “fair and reasonable” and subject to regulator approval.

Private investors have historically derived substantial fee income through AIFs, typically earning fees of 25%-30% of gross premiums. On November 5th, 2025, the Financial Condition Committee approved the Working Group’s 2026 proposed charge to clarify that fees charged to AIFs must be “fair and reasonable” and should not exceed a “reasonable profit.” While the Working Group has not yet met, we expect to get additional color on its initiative in 2026. Capstone views NAIC scrutiny of management fees as raising the risk of potential downward pressure on RIE-AIF fees.

### **Texas’ Rising Homeowners Premiums Likely to Draw Further Legislative Scrutiny in 2026**

Texas, the nation’s second-largest P&C market, continues to grapple with skyrocketing premiums, which are among the highest in the US. Home insurance premiums in Texas have climbed at a 49% compounded annual growth rate (CAGR) since 2020, leading to growing scrutiny in 2025, which we expect to continue in 2026.

Texas, while vulnerable to fire, hail, wind, floods, tornadoes, and storms, promotes market competition among insurers through its “file and use” system, which allows insurers to use rates without prior approval of the Texas Department of Insurance (TDI). This approach enables insurers to set actuarially-justified rates without potential compression driven by regulatory review. Costly disasters in recent years have led insurers to implement significant rate changes, notably in 2023 when the state’s annual loss ratio reached 105.1%. As a result, insurers in Texas raised premiums an average 21.1% for homeowners’ policies in 2023 (the highest in the last decade), 19% in 2024 and estimates of continued high single-digit increases for full year 2025.

In 2025, lawmakers introduced SB 1643, aiming to require the Insurance Commissioner’s approval

for rate increases/decreases exceeding 10%. While the bill failed to progress in the House Committee, it would mark a significant shift in Texas’s approach to insurance regulation and is consistent with growing scrutiny of rapidly rising premiums in recent years. We view its potential reintroduction as likely in 2027, given Texas’s biennial legislative cycle, as legislative scrutiny of homeowners’ premiums persists. However, we expect the regulatory environment in Texas to remain generally favorable for P&C carriers in 2026.

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# Auto Insurance Reform On the Table in 2026 as States Grapple with Rising Premiums

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<b>Winners</b>	Auto insurance companies
<b>Losers</b>	Plaintiffs bar; third-party litigation finance investors

## STATES TO GRAPPLE WITH AUTO INSURANCE AFFORDABILITY WITH TORT REFORM AS KEY LEVER

**A**uto insurance affordability remains a key issue nationwide, with the Bureau of Labor Statistics estimating that premiums have increased by an average of 55% since 2020. Legislators have applied various approaches to address the cost crisis, most notably tort reforms, which benefit auto insurers by reducing legal costs. Other recent efforts, including in Michigan, to establish tighter price controls, will likely continue to be explored if rates continue to climb.

Additionally, we believe that alternative measures will also be pursued, including tort reforms, as seen in Florida and, more recently, in Georgia and Louisiana. Florida Insurance Commissioner Mike Yaworsky argued “the data is undeniable and the evidence is clear” that tort reform has been a success. In a sign of the growing strength of the Florida market, Florida Office of Insurance Regulation (FLOIR) announced that the state’s top five

auto insurers by direct premiums written reduced their rates by an average of 6.5%, which the FLOIR attributed to the reforms.

The dynamics signal a softening of the auto insurance market following tort reform initiatives in 2023. Drawing on the success of Florida’s reforms, we believe that other Southern states, such as South Carolina and Missouri, are primed to potentially pass tort reform in 2026. With tort reform remaining a major legislative priority for Governor Henry McMaster (R-SC), we view South Carolina as likely to move on the issue in the near term. Additionally, Missouri saw 36 tort reform bills proposed in the latest session alone, potentially introducing risks to plaintiff’s lawyers.

Earlier this year, Michigan lawmakers proposed SB 328, which would require insurers to charge consumers 10% less than government-approved rates. While the bill failed to advance, Capstone believes that proposed price controls on auto insurance rates could gain support in 2026 if rates continue to climb at a brisk pace. Enacting such measures would be negative for auto carriers.

## NO FAULT AND AT FAULT LIABILITY REGIMES LIKELY TO REMAIN A SUBJECT OF DEBATE IN 2026

**A**s auto insurance rate premium increases nationwide, we expect more debate of at-fault and no-fault liability regimes in 2026.

Today, 38 states operate under an “at-fault” auto insurance system, where the party that causes the accident is responsible for the other party’s injuries and damages. However, the remaining 12 states operate under a no-fault insurance regime, where insurance companies pay for their policyholders’ injuries and damages regardless of who caused the accident.

In Florida’s 2025 legislative session, elected officials proposed HB 1181/SB 1256, which aimed to transform the state’s no-fault regime to an at-fault system to lower auto insurance rates. Specifically, the bills sought to replace the mandatory \$10,000 Personal Injury Protection (PIP) coverage

requirement with compulsory bodily injury liability coverage of \$25,000 per person and \$50,000 per incident, plus \$10,000 in property liability coverage. The bills failed to advance.

Other states, such as New Jersey, also saw similar legislation introduced in 2025. While we refrain from assessing prospects for passage of any such reforms, continued increases in auto premiums would constitute a key catalyst supporting reform in 2026.

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## NAIC Will Continue Scrutinizing Insurer Use of AI and Big Data in 2026, with Formal Regulatory Framework Proposals on the Docket

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<b>Winners</b>	N/A
<b>Losers</b>	Insurtech companies, advanced analytics and data vendors with exposure to insurance end markets

### NAIC PROPOSALS TO FURTHER REGULATE INSURERS’ USE OF AI EXPECTED IN 2026 AS STATES MATURE APPROACH

Capstone anticipates that the NAIC will continue to make preliminary proposals to further regulate insurers’ use of Artificial intelligence (AI) as companies look to integrate AI into their operations.

In recent years, the NAIC has become increasingly active in issuing guidance about the use of AI by insurers: the NAIC Executive Committee adopted the NAIC’s Principles of Artificial Intelligence in

2020, and in 2023, the NAIC adopted an AI Model Bulletin, which set standards for AI use, emphasizing the need for models to comply with both state and federal consumer protection laws. So far, 24 states have adopted the Bulletin, including New Jersey, Delaware, and Wisconsin in 2025. While many states adopted these guidelines in 2024, Capstone expects a handful will likely seek to adopt the bulletin in 2026.

## NAIC AI FRAMEWORKS SET TO ADVANCE IN 2026; OVERSIGHT TO GROW ON DATA/MODEL VENDORS, INSURTECHS

**W**e expect the NAIC, and various states, on an intermittent basis, to adopt AI-related proposals in 2026 following the groundwork laid by the Big Data and AI Working Group in 2025. The proposals will enable regulators to more closely scrutinize how insurers use AI.

In 2025, the working group created a draft AI systems evaluation tool that aims to standardize how regulators assess insurers' AI use that state regulators can collect during financial and market conduct examinations. The tool would simplify data collection for regulators evaluating insurance risks across AI governance, testing protocols, high-risk models, data sources, and financial implications. If adopted at scale, the tool would give state regulators increased insight into Insurers' AI practices and expose possible violations of consumer protection laws. A final version of the tool is still several months away from being adopted, and at the December 2025 NAIC National Meeting, the working group discussed feedback and revisions to the tool, acknowledging that a third draft will likely be necessary before the pilot program is rolled out. The pilot version is expected to be adopted by 10 states for use in early 2026.

Exhibit C of the current draft is intended to aggregate information about "high risk" models, such as those which could "cause adverse consumer,

financial, or financial reports impacts." Regulators using this exhibit may be more likely to examine insurers' use of AI in business practices that pose the highest risks to consumers, such as policy underwriting and claims denials. If adopted by state insurance regulators at scale, the NAIC's AI evaluation tool is likely to increase scrutiny of insurtech companies and carriers that have incorporated AI into their claims management and risk modeling processes. Companies that contract with insurers to use AI for claims management and risk modelling would similarly be subject to greater oversight.

Additionally, in May 2025, the Big Data and AI Working Group put forward a request for information (RFI) regarding a potential model law that would govern insurers' use of AI. Working Group Commissioner Mike Humphreys said that the RFI, which received 33 comment letters, is only a preliminary inquiry into a model law to bridge the gap between existing AI guidance and the need for further regulation. While it is in the early stages, Capstone anticipates that the working group will continue to explore developing a model law in 2026.

Even in the absence of a standardized model, at least 17 states proposed bills regarding regulating AI use in various aspects of business this year. In Colorado, Governor Jared Polis (D) signed SB 24-205 into law, which established broad consumer protections to prevent "algorithmic discrimination" in consequential business decisions, including claims denials made by insurers. On November 24, 2025, Florida State Representative Hillary Cassel (R) introduced HB 527, which would require that humans review all claims denial decisions before they are finalized.

Capstone expects that in 2026, states will continue to weigh and potentially adopt consumer protections that increase AI compliance requirements for insurers. Carriers that have heavily integrated AI into the claims management process are likely to face more stringent compliance requirements if reform efforts gain sufficient momentum to pass.

## ENHANCED REGULATION OF DATA USES ANTICIPATED IN 2026 AS CONSUMER PRIVACY REMAINS IN FOCUS

**I**nsurer use of third-party consumer data will remain in focus in 2026, as the NAIC and states continue to explore consumer data privacy protections.

At NAIC's December meetings, the Third-Party Data and Models Working Group unveiled the first draft of a Risk-Based Regulatory Framework for Third-Party Data and Model vendors. The draft framework, which is currently in a 60-day public comment period that ends on February 6, 2026, requires data and model vendors to register with state insurance regulators before their models can be used in situations with "direct consumer impact." This definition includes pricing, underwriting, and claims management, among other functions. While significant revisions are expected, Capstone views the ultimate framework as likely to increase compliance burdens for smaller Insurtech and data/model vendors that serve the insurance end market. Incumbent players are likely better equipped to absorb any associated cost burdens.

In recent years, state officials have also expressed increased interest in insurers' use of third-party consumer data. In 2021, Colorado passed SB 21-169, which increased restrictions around insurers' use of external consumer data and information sources (ECDIS). In 2024, New York adopted Insurance Circular Letter No. 7, which provided similar guidance on data use. More states could be set to follow their lead in the coming year.

Education Policy 2026 Preview

# THE EDUCATION INDUSTRY'S BUDGET CONUNDRUM

How Federal and State  
Budget Drivers Will  
Drive Education Firms



# Education Policy 2026 Preview:

## THE BOTTOM LINE

Capstone expects a mixed outlook for K-12 vendors, universities, and higher education services in 2026. While federal education funding is likely to remain stable despite disruptions at the US Department of Education, state-level budget pressures threaten K-12 vendor revenues. Policies targeting international student enrollment create headwinds for universities and related service providers, while changes to graduate loan limits open opportunities for private student loan lenders.

Outlook at a Glance

▶ **RISKS STEMMING FROM**  
US DEPARTMENT OF EDUCATION  
RESTRUCTURING OVERSTATED,  
AS K-12 VENDOR FUNDING  
OUTLOOK REMAINS STABLE

▶ **FEDERAL APPROPRIATIONS**  
FOR TITLE I AND IDEA EXPECTED TO  
REMAIN FLAT; RISK TO K-12 VENDOR  
REVENUES EXAGGERATED

▶ **OBBBA TO PRESSURE STATE**  
BUDGETS, POSING A RISK TO DISTRICT  
EDUCATION SPENDING AND K-12  
VENDOR REVENUES

▶ **TAILWINDS FOR PRIVATE**  
LOAN PROVIDERS AS ED TO LOWER  
GRADUATE FEDERAL LOAN LIMITS;  
FEDERAL SCHOOL CHOICE RULEMAKING  
PRESENTS OPPORTUNITIES FOR PRIVATE  
SCHOOL OFFERINGS

▶ **TRUMP ADMINISTRATION TO**  
CONTINUE TO TARGET INTERNATIONAL  
ENROLLMENT IN 2026, POSING  
HEADWINDS FOR UNIVERSITIES,  
INTERNATIONAL STUDENT RECRUITERS,  
AND LOAN PROVIDERS

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# Risks Stemming from US Department of Education Restructuring Overstated, as K-12 Vendor Funding Outlook Remains Stable

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<b>Winners</b>	K-12 curriculum providers such as McGraw Hill Inc. (MH), special education vendors, and EdTech platforms reliant on Title I and IDEA funding
<b>Losers</b>	N/A

to other departments (see Exhibit 1). For example, those programs authorized under the Elementary and Secondary Education Act (ESEA) will shift to the US Department of Labor.

Capstone believes threats to K-12 vendors due to ongoing US Department of Education (ED) restructuring are overstated, as Title I and IDEA funding will continue to flow to states and districts despite administrative shifts to other agencies.

On November 18th, ED announced six new inter-agency agreements (IAAs) to outsource key education programs to four other federal agencies, moving the Trump administration closer towards its goal of dismantling the department. In September, Education Secretary Linda McMahon took a first step in this direction by signing two agreements—one giving the US Department of Labor shared administration of Career and Technical Education (CTE) programs, and the second transferring several ED employees to the US Department of the Treasury to support the operation of student aid functions. The agreements announced in November go a step further and move the administration of core ED programs

EXHIBIT 1

Interagency Agreements Announced by ED in November

ED Office/Program	Receiving Federal Agency
Office of Elementary and Secondary Education	Department of Labor
Office of Postsecondary Education	Department of Labor
Indian Education programs	Department of the Interior
Foreign Medical Accreditation	Health and Human Services
Child Care Access Means Parents in School Program	Health and Human Services
International Education and Foreign Language Studies	Department of State

Source: US Department of Education

Details on the mechanics of the interagency agreements are relatively scant, but available information makes clear that ED, in combination with other agencies, will continue to execute on the statutory requirements laid out in relevant education laws. Notably, while many headlines discuss the dismantling or elimination of ED, Secretary McMahon does not have the authority to shutter the agency. The 1979 Department of Education Organization Act established a number of required offices for ED and mandates that the agency oversee multiple federal education statutes; the department will technically continue to retain those prescribed authorities but will outsource execution to other agencies. For now, all administrative functions under the Individuals with Disabilities Education Act remain with ED. A coalition of 20 states and the District of Columbia has filed suit arguing that the ED reorganization plan violates ED’s authorizing statute.

Capstone continues to believe that legislation to close ED is extremely unlikely to pass in 2026. There is no legislative momentum around the small number of ED closure bills that have been put forward and we do not expect any serious consideration of those bills in the coming year.

For state education agencies (SEAs) and local education agencies (LEAs), the shift in administration to other agencies could create some modest disruption related to technical assistance, reporting, etc. More than anything, we expect the noise in the news cycle to make SEA and LEA leaders skittish about federal education support and funding stability. However, we believe that ED funding for statutory formula programs will continue to flow largely unimpeded. For vendors in the space, the negative news cycle may temporarily impact SEA/LEA buying behavior, but we do not expect funding to be materially impacted by the newly announced IAAs over the coming year.

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# Federal Appropriations for Title I and IDEA Expected to Remain Flat; Risk to K-12 Vendor Revenues Exaggerated

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<b>Winners</b>	K-12 curriculum providers such as McGraw Hill Inc. (MH), special education vendors, and EdTech platforms reliant on Title I and IDEA funding
<b>Losers</b>	N/A

Capstone believes the risk of federal K-12 education funding cuts is minimal, as Title I and IDEA appropriations are likely to remain flat, supporting stable revenues for K-12 education vendors.

As part of the Trump administration’s ongoing efforts to dismantle ED, the president’s FY2026 budget proposal sought to consolidate multiple ESEA programs into a single block-grant formula, while leaving Title I-A and IDEA funding intact. Subsequently, in July, the administration withheld ~\$6 billion in formula funding, primarily from programs slated for elimination under the budget proposal. This funding was eventually released after a nearly month-long delay. A formal budget deal for FY2026 has not yet been reached, but Capstone continues to believe federal education spending on formula programs will remain largely flat under any future FY 2026 budget and that no new block-grant program will be created.

Federal appropriations to ED were flat-funded as part of the Continuing Resolution (CR) signed into

law by President Trump on November 12th. The funding runs through January 30, 2026. Existing House and Senate appropriations bills, which will form the basis for ED funding negotiations, differ significantly in approach. The Senate’s appropriations bill includes modest increases in funding for IDEA and Title I-A, while largely keeping other program funding flat. The House’s appropriations bill would significantly reduce Title I-A funding and make cuts to a host of other programs. However, the Republican-controlled House has routinely proposed Title I-A cuts that have not been enacted.

Capstone continues to believe that the Senate’s stance on education funding is a more reliable predictor of ED funding outcomes. We believe several Senate Republicans and Democrats would oppose significant federal education funding cuts in upcoming appropriations discussions. As a result, we expect any budget deal to include flat-to-modestly increased federal education spending. This is positive for vendors serving the K-12 ecosystem, particularly in the context of threats by the president to significantly reduce spending on education and broader noise surrounding ED’s overall stability.

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# OBBBA to Pressure State Budgets, Posing a Risk to District Education Spending and K-12 Vendor Revenues

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<b>Winners</b>	N/A
<b>Losers</b>	K-12 curriculum providers such as McGraw Hill Inc. (MH), special education vendors, and EdTech platforms

**C**apstone believes OBBBA-driven state revenue pressures pose a threat to district education spending in 2026, creating headwinds for K-12 vendor revenues.

The One Big Beautiful Bill Act (OBBBA), the Trump administration's signature piece of legislation that passed in July, is projected to reduce total state revenues through a multitude of provisions (see Exhibit 2). Impacts will vary across states, but funding changes for Medicaid and the Supplemental Nutrition Assistance Program (SNAP) are concerns across most. For example, federal Medicaid revenue to states is set to decline by between 3% and 21% per state. As the budgetary impacts of OBBBA become clear, federal-to-state transfers are reduced, and new tax provisions are applied, we expect states to holistically review their fiscal health and be forced to make tough budgeting choices.

EXHIBIT 2

Projected Impacts of OBBBA Provisions on Select State Budgets

State	Projected Budgetary Impact from OBBBA
Maryland	General Fund revenue is projected to decrease by \$77.9 million in FY2026 and \$71.4 million in FY2027. Local income tax revenue, a key source of funding for public schools, is estimated to decrease by \$11 million in FY2026, and then increase by \$61.9 million in FY2027.
Michigan	Overall state revenue expected to decline by \$677 million and \$613 million in FY2026 and FY2027, respectively.
Colorado	Overall state revenue is expected to decline by \$1.2 billion in FY2026, and by roughly \$700 million across FY2027 and FY2028.
Oregon	Estimated to lose \$15 billion in federal funding because of OBBBA provisions over the next decade, with an estimated \$1 billion of this funding lost between 2025 and 2027.
Wisconsin	OBBBA is expected to cost “Wisconsin taxpayers at least \$142 million per year at full implementation, or more than \$284 million over a two-year biennial budget cycle.”
New York	The state budget is expected to decline by \$10 billion annually as a result of OBBBA.

Source: State revenue projections

States are already preparing to address the potential revenue strains created by the reconciliation package. Several states legislatively “decoupled” from the tax provisions in OBBBA, aiming to limit projected revenue shortfalls. For example, Colorado’s governor signed multiple tax bills to increase taxable income, and thus state revenue. Other states that have taken similar legislative action include Michigan, Rhode Island, California, Alabama, and New Jersey. As the 2026 legislative session begins, we anticipate that more states will take legislative action to counter projected revenue shortfalls.

Capstone will closely monitor governors’ budget recommendations and state legislative sessions

to track projected state spending on education. While we expect states to largely protect education spending, K-12 and higher education are often among the largest state budget expenditures, and downward fiscal projections may weigh on state education spending. As state funding comprises ~45% of overall education funding, any decline or stagnation in state funding will have significant knock-on effects on LEA spending.

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# Tailwinds for Private Loan Providers as ED to Lower Graduate Federal Loan Limits; Federal School Choice Rulemaking Presents Opportunities for Private School Offerings

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<b>Winners</b>	Private loan providers, private schools, K-12 providers with private school offerings
<b>Losers</b>	Universities with high concentration of non-professional graduate programs (e.g., accounting, public health, social work, nursing)

Capstone believes ED will finalize rulemaking in 2026 to lower federal loan limits for some graduate students. While this will deter some students from enrollment, we expect it to drive others to private lenders. Separately, forthcoming Treasury rules on the federal school voucher program—which will primarily create opportunities for private schools and vendors with private school offerings—will provide clarity and shape blue states’ decisions on whether to participate.

OBBBA authorized reforms to the federal student loan system and created the first federal education voucher system—the Qualified Elementary and Secondary Education Scholarships program. To establish the specifics of both provisions, the programs are subject to rulemaking by the ED and the US Department of the Treasury, re-

spectively. We expect both departments to post Notices of Proposed Rulemaking (NPRMs) to the Federal Register in early 2026, with rules being finalized before the respective program launch dates in July 2026 and January 2027.

## PRIVATE LOAN PROVIDERS TO SEE RISE IN DEMAND AS ED TO FINALIZE GRADUATE LOAN RULEMAKING

The ED Reimagining and Improving Student Education (RISE) committee convened in 2025 to develop regulations implementing federal student loan system reforms stipulated by OBBBA. As part of the phase out of graduate and professional PLUS loans, OBBBA authorized new annual loan limits for graduate and professional students and parent borrowers. Under the bill, student borrowers in “graduate” programs are limited to borrowing up to \$100,000 in total, while students in “professional” programs are able to borrow double that amount, up to \$200,000. One major point of discussion during RISE committee meetings was which programs will qualify for “graduate” versus “professional” designation, and the potential exclusion of high-demand and expensive healthcare programs from the latter designation and associated higher borrowing cap.

The RISE committee reached consensus on November 6th, defining a professional degree as a program that 1) signifies completion of academic requirements for beginning practice in a given profession and a level of professional skill beyond a bachelor's degree, 2) generally requires at least six years of postsecondary education coursework, 3) generally requires professional licensure, and 4) includes a four-digit program code consistent with ED rulemaking. While this is more expansive than ED's original proposal and will include an estimated 650 professional degree programs, it still excludes a variety of programs that had hoped for inclusion.

Notably, the proposal excludes high-demand healthcare careers, including physician assistants, nurse practitioners, and audiologists. Other excluded programs include social workers, physical therapists, architects, accountants, and educators. To the extent that these programs exceed \$100,000 in lifetime tuition, or \$20,500 in annual costs, students will be forced to seek alternative loan solutions to cover the full cost of attendance. We believe this is positive for private loan provider demand and will likely weigh slightly on program enrollment.

ED will post an NPRM on the Federal Register early next year. As the negotiated rulemaking committee reached consensus, ED is required to publish the rules as agreed. They will be open for public comment for a 30-day period, and after comment review the rule will be finalized, with regulations going into effect on July 1, 2026.

## DEPARTMENT OF TREASURY RULEMAKING ON FEDERAL TAX-CREDIT SCHOLARSHIP PROGRAM

**W**hile school choice vouchers have historically been a state-level initiative, OBBBA authorized a federal tax credit scholarship program in July

2025—the Qualified Elementary and Secondary Education Scholarships program. Funded by taxpayer donations in return for a 1:1 tax credit, scholarship granting organizations (SGOs) give donated funds to families to cover certain K-12 expenses, such as private school tuition, tutoring, technology, and costs of transportation for traveling to public or private schools. While intended as a 50-state program, states can choose whether to opt-in. Thus far, four red states—South Dakota, Nebraska, Tennessee, and North Carolina—have decided to opt in, while three blue states—Wisconsin, Oregon, and New Mexico—have declined. In the near term (0-2 years), we expect more red states to opt in, using this federal program to supplement their state-level school choice measures.

The Treasury Department is expected to commence rulemaking in 2026, given the program's expected launch date in 2027. In late November, it published an informal request for comment on potential rules for SGOs, but a more formal proposed rule will be released next year. Decisions made during rulemaking could have implications for whether the remaining Democratic states decide to opt in or opt out. A key determinant of these decisions will likely be the extent to which states are able to regulate SGO activities, which the rulemaking is expected to address. If states have autonomy to determine which organizations qualify as SGOs, state governors will be able to select organizations in alignment with their priorities. This would allow Democratic governors to choose organizations focused on the provision of supplementary K-12 services over those prioritizing funds for private school attendance. With more red states than blue states likely to opt in, we expect the program to primarily provide modest tailwinds for private school providers and vendors that have well-developed private school offerings.

Capstone will also closely monitor ED's Accountability in Higher Education and Access through Demand-driven Workforce Pell (AHEAD) Committee, which will convene to conduct negotiated rulemaking sessions on changes to the Pell Grant

program and implementing the new Workforce Pell Grant program, as authorized by OBBBA.

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# Trump Administration to Continue to Target International Enrollment in 2026, Posing Headwinds for Universities, International Student Recruiters, and Loan Providers

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<b>Winners</b>	N/A
<b>Losers</b>	Universities with high international student enrollment, international student recruitment and loan providers

In the past year, the Trump administration has continually targeted international student enrollment, citing national security concerns. We expect this to continue through formal rulemaking in 2026, posing headwinds for universities, international student recruitment firms, and loan providers. Rhetoric, unsuccessful attempts to limit Harvard’s international student enrollment, changes to endowment taxation to incentivize enrolling US students, among other measures, have already had a chilling effect.

In August 2025, the US Department of Homeland Security (DHS) announced new rulemaking to implement a four-year cap on international students attending a US university/college. Other mea-

asures include pausing visa interviews, imposing a \$100,000 fee on H-1B visas, and capping international student enrollment at 15% of a university’s total enrollment under the White House’s Higher Education Compact. According to the Institute of International Education (IIE), total international student enrollment declined by 1% during the 2025-2026 academic year. New enrollments, a subset of total enrollments, decreased by 17% for international students. We anticipate further declines in international student enrollment under the Trump administration.

## PROPOSED RESTRICTIONS ON OPTIONAL PRACTICAL TRAINING THREATEN INTERNATIONAL ENROLLMENT

On November 12th, DHS promulgated a new item in its Spring 2025 Unified Agenda to amend OPT programs. Per the agenda, “the proposed rule will better align practical training to the goals and objectives of the program while providing more clarity to the public. The proposed rule will amend existing regulations to “address fraud and

national security concerns, protect U.S. workers from being displaced by foreign nationals, and enhance the Student and Exchange Visitor Program's capacity to oversee the program." The OPT program, which enables foreign students to gain work experience at US firms after completing studies in the US, could be officially discontinued or heavily amended to discourage US firms from hiring foreign students. Currently, the program allows F-1 nonimmigrant students to work for up to 12 months before or after graduation. Those with STEM degrees can apply for a 24-month extension.

Because the OPT program is a regulation rather than a congressional mandate, DHS retains the authority to amend it without congressional approval. In 2022, the US Court of Appeals for the DC Circuit confirmed in *Washington Alliance of Technology Workers v. DHS* that the agency possesses statutory authority under the Immigration and Nationality Act to establish the "time" (duration) and "conditions" of F-1 nonimmigrants' stay in the US. DHS has already proposed a rule to limit duration. In March, House Representative Paul Gosar (R-AZ-09) proposed the Fairness for High-Skilled Americans Act of 2025 (HR 2315) to amend the Immigration and Nationality Act to eliminate the OPT program. The bill has 22 cosponsors to date, all Republicans. The bill, while broadly similar to the DHS proposal, seeks to prevent future administrations from restarting the OPT program.

While details are currently limited, we believe DHS's proposal could restrict OPT for specific majors, including STEM. This will likely significantly impact students from India. During the 2024/2025 academic year, international student enrollment grew by 5% year-over-year (y/y), primarily driven by OPT participation, which increased by 21% y/y (with Indian students a key driver of this growth). According to IIE, just under half (49%) of students on OPT programs are from India.

We believe the DHS proposed rule threatens the attractiveness of US degree programs by reducing the prospects for postgraduate employment in the US.

## WHITE HOUSE HIGHER EDUCATION COMPACT TO CONTINUE TO SEE MUTED ENGAGEMENT

In October, the White House invited nine universities to sign a Compact for Academic Excellence in Higher Education to secure preferential federal research grant funding. Notable provisions under the 10-point agreement include: 1) tuition freezes for five years, 2) a 15% cap on international student enrollment, 3) banning race-based admissions and faculty hiring, and 4) adopting biological definitions of sex. While initially sent only to nine schools (most of which declined), Trump informally extended his invitation to every school in the nation via Truth Social. The initial deadline of November 21st was extended to encourage participation.

While the Compact promises to provide signatory institutions with preferential treatment, it does not specify the statutory authority under which the federal government would grant this. We continue to believe that any attempts by the White House to grant such treatment to signatories would be met with legal challenges. To date, none of the initial institutions have signed the Compact, citing concerns related to institutional independence, academic freedom, and the view that research funding should be based on merit rather than compliance with federal policy priorities. As the White House looks to reform higher education, we remain skeptical that the

promises included in the Compact will be sufficient to drive intended reforms put forward by ED Secretary Linda McMahon and President Trump. Further, given opposition to many of the administration's education-related reforms, the prospect of midterms shifting political tides, and the lack of clarity around benefits and statutory authority associated with the Compact, we expect university receptivity to the administration's overtures to remain tepid.

Housing Policy 2026 Preview

# Housing: Unlocked

GSE Reform, Pro-Housing Legislation,  
and Mortgage Innovation Shape 2026



# Housing Policy 2026 Preview:

## THE BOTTOM LINE

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Capstone expects housing policy to be a major priority for federal and state leaders in 2026, including the Trump administration. Lawmakers are likely to begin reshaping the roles of Fannie Mae and Freddie Mac and pursue a range of efforts to increase housing supply and make homes more affordable. We also anticipate continued scrutiny of algorithmic pricing tools used in the rental and real estate markets, along with a wave of changes to federal housing programs.

### Outlook at a Glance

- ▶ **TRUMP ADMINISTRATION**  
PLANS FOR GSE RECAPITALIZATION AND RELEASE TO TAKE SHAPE AMID POTENTIAL 2026 SECONDARY OFFERING, POSING UPSIDE FOR JUNIOR PREFERRED
- ▶ **FEDERAL AND STATE**  
LAWMAKERS TO PUSH PRO-HOUSING LEGISLATION CREATING TAILWINDS FOR BUILDERS, LENDERS
- ▶ **REGULATORY AND LEGISLATIVE**  
CRACKDOWN ON ALGORITHMIC PRICING TO INTENSIFY, RAISING RISKS FOR RENTALS, HOTELS, AND MORTGAGE LENDERS
- ▶ **REGULATORS EXAMINING**  
CHANGES TO MORTGAGE MARKET TO UNLOCK HOUSING SUPPLY; A POTENTIAL POSITIVE FOR LOAN SERVICERS

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# Trump Administration Plans for GSE Recapitalization and Release to Take Shape Amid Potential 2026 Secondary Offering, Posing Upside for Junior Preferreds

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<b>Winners</b>	Preferred shares of Federal National Mortgage Association (FNMA), Federal National Mortgage Association (FNMA and FNMAT), Federal Home Loan Mortgage Corporation (FMCC; FMCKI, FMCKJ)
<b>Losers</b>	N/A

Recapitalizing and releasing Fannie Mae and Freddie Mac, collectively the GSEs, from government conservatorship (GSE reform) is a top housing priority for the Trump administration that will likely begin taking shape in 2026 (see “Trump’s GSE Reform Push Likely to Gather Momentum as Soon as 2026; Over 60% Upside for Fannie Mae, Freddie Mac Junior Preferreds,” November 27, 2024). Senior officials within the Trump administration, including Treasury Secretary Scott Bessent, Federal Housing Finance Agency (FHFA) Director Bill Pulte, Commerce Secretary Howard Lutnick, and even President Trump himself, have been outspoken about the issue of GSE reform, most recently signaling intent to execute a \$30 billion initial public offering (IPO) of the entities before the end of 2025. Bessent and Pulte have indicated

that the offering would value the companies at \$500 billion and involve a sale of 3%-5% of the US Department of the Treasury’s stake in the GSEs. We believe such an offering is unlikely to be executed by year-end, as many of the obstacles and outstanding questions that GSE reform entails still remain open-ended. However, we believe the near-term intent and outspoken support within the administration is positive for likely reform within the next three years as President Trump looks to avoid falling short on the policy priority once again (see “Probability GSEs Exit Conservatorship Rises as Trump Signals a Sale, But Year-End IPO Unlikely; Near-Term Positive for Fannie and Freddie Prefs,” August 12, 2025).

## ***Remaining Obstacles***

2025 was a slow year for GSE reform as competing priorities for tax reform and trade policy took precedence in the Trump administration over the GSEs. In 2026, we expect the Trump administration will take formal steps to enable a release of the GSEs before the end of his term. Chief among remaining obstacles is how to resolve Treasury’s stake in the companies, comprised of warrant rights to assume 79.9% of common stock in both GSEs and senior preferred stock in the companies with liquidation preference that currently stands at \$355 billion and increases on a dollar-for-dollar basis with retained earnings. We believe it is possible that Treasury will take steps in 2026 to

address the question of how the senior preferreds will be treated and specifically whether the 3%-5% stake that will be sold represents a portion of Treasury's senior preferred stock, or a portion of its warrants.

In addition to how Treasury addresses the question of the senior preferreds, we believe it will be paramount that a executed public offering discloses a plan for how and when the Trump administration plans to approach a release of the GSEs (similar to Treasury's blueprint under the first Trump administration), but more importantly, the level of support that will continue to be provided to the GSEs in the form of its "implicit guarantee" and what government backstop mechanism that will remain in place (see "Probability GSEs Exit Conservatorship Rises as Trump Signals a Sale, But Year-End IPO Unlikely; Near-Term Positive for Fannie and Freddie Prefs," August 12, 2025). Treasury Secretary Bessent and other officials in the Trump administration said the most immediate priority, with respect to GSE reform, is for mortgage spreads not to widen as a result of perceived greater risk associated with the GSEs' mortgage-backed securities (MBS) without explicit government backing.

## **Outlook**

In our view, the administration's ambition in executing a \$30 billion offering of its stake in the GSEs is feasible in 2026 if some of these questions are addressed. However, it is likely that the administration is weighing the sale of a small stake in the GSEs before beginning the process of fully winding down Treasury's stake. A small sale would be less likely to cause significant disruption to the mortgage market or alter the perception of the government's support for the GSEs, which would allow the administration more time to formalize and coordinate release plans in 2026 and into 2027. The longer timeline would allow the GSEs to continue retaining earnings and building up to their capital minimums set out by FHFA (see "Trump's GSE Reform Push Likely to Gather Momentum as Soon as 2026; Over 60% Upside for Fannie Mae, Freddie Mac Junior Preferreds," November 27, 2024).

We believe reform efforts still present upside for holders of the GSEs' junior preferred stock, of which the most liquid shares trade between 55 and 70 cents on the dollar at the end of November. While the administration has yet to provide details on how or when junior preferreds will be treated in any restructuring of the GSEs, we believe President Trump is well-aware of the litigation risks that could impede the process should junior preferreds' value be wiped out. While any public offering the administration executes will almost certainly have to address this question, we believe the range of possibilities in dividend reinstatement, conversion to common at, or at a slight discount to par but above current levels, or redemption at or close to par are all viable mechanisms that the administration may ultimately utilize.

We believe continued momentum and signaling from the Trump administration in 2026 could push junior preferreds closer to par, but competing priorities within the administration to provide relief on housing affordability and congressional midterm elections could delay release. While this is possible, we continue to believe reform efforts can, and will, be executed absent Congress' intervention through FHFA's authority as conservator and Treasury's authority as consenting party and controlling shareholder.

# Federal and State Lawmakers to Push Pro-Housing Legislation Creating Tailwinds for Builders, Lenders

<b>Winners</b>	Homebuilders DR Horton Inc. (DHI), Lennar Corp. (LEN), Pultegroup Inc. (PHM), NVR Inc. (NVR), Toll Brothers Inc. (TOL), Installed Building Products Inc. (IBP); mortgage lenders UWM Holdings Corp. (UWMC) and Rocket Companies Inc. (RKT); and manufactured housing builders and developers, including Cavco Industries Inc. (CVCO) and Champion Homes Inc. (SKY)
<b>Losers</b>	N/A

Capstone believes state and federal legislators will increasingly embrace pro-housing policies in 2026. Housing and development have traditionally been state and local concerns, but escalating prices for both homes and rental units during the past 15 years have transformed housing affordability into a political priority at the national level. Academic research has highlighted regulatory barriers to construction, namely zoning, as a key driver of higher housing costs.

The Senate has passed the ROAD to Housing bill, which sponsors are referring to as the most significant housing legislation since the Housing and Economic Recovery Act of 2008 (HERA). The

bill is a composite of 27 previously introduced pieces of legislation intended to address rising housing costs and constraints on builders amid an ongoing housing affordability crisis (see “DR Horton, Lennar, Pulte, Mortgage Lenders, Manufactured Housing to Benefit from Landmark Housing Reform Bill; Passage Likely by Q2 2026,” November 3, 2025). State legislators have adopted wide-ranging reforms, seeking to unlock more development by making it easier to build more units, build denser units, and streamline permitting processes. Housing reforms are occurring across both red and blue states, and we expect to see broader adoption of these laws in 2026.

## LANDMARK HOUSING LEGISLATION ATTACHED TO NDAA

The ROAD to Housing Act comprises 40 sections of housing reforms. ROAD to Housing creates zoning reform incentives for state and local jurisdictions, updates federal regulations regarding manufactured housing, and reforms financing rules for small-dollar mortgages. Introduced by Senators Tim Scott (R-SC) and Elizabeth Warren (D-MA), it has strong bipartisan support and passed the Senate Banking, Housing, and Urban Affairs committee by a vote of 24-0. On October 9, 2025, the bill passed the Senate as a rider to the National Defense Authorization Act (NDAA).

We believe ROAD to Housing will pass in some form by the end of Q2 2026, either as a rider to the NDAA or as a separate housing package. Its passage should provide meaningful incentives for state and local governments to reform zoning regulations and expand housing development, creating substantial momentum for home builders. The bill also provides significant tailwinds for manufactured housing by reforming the permanent chassis requirement—reducing the cost of manufactured homes, and allowing higher margin multi-floor homes to be built. In addition, it enables financing for housing encouraged by these reforms by making small-dollar loans (less than \$100,000) more economically viable for bank and nonbank lenders. Roughly 30% of mortgages in urban counties, and 40% of mortgages in rural counties, were for less than \$100,000.

SB 15, reducing the lot size needed for new single-family homes. California, a state with some of the most restrictive zoning requirements, recently passed SB 79, allowing more multifamily housing near transit stops.

The impact of these reforms will be distributed unequally. Local authorities generally still retain the ability to “downzone,” or reduce the permissible level of housing unit density. Arizona, Wisconsin, Texas, and North Carolina have significant legal barriers to prevent localities from downzoning, with weaker versions in California and Massachusetts. We believe housing availability will grow faster in states with laws preventing downzoning than those without.

## STATES ADOPTING PRO-HOUSING POLICIES

In 2025, states began to ease zoning laws in an effort to increase the housing supply. The two most popular types of reforms involve allowing accessory dwelling units (ADUs) and allowing multifamily homes near transit and commercial districts. In 2025, seven states passed laws allowing the construction of more ADUs, joining 11 states that passed similar laws in 2024 or earlier. These laws permit the construction of additional housing units, such as basements and cottage-style stand-alone units in single-family areas. Maryland’s HB 1466 requires all jurisdictions to permit ADUs. Arkansas’ Act 313 and Iowa’s Senate File 592 are more typical, allowing ADUs on single-family lots.

In 2025, 10 states also adjusted zoning laws to allow or expand multifamily residential units in commercial zones or transit-oriented development. Texas has been one of the most aggressive states on this front, passing SB 840 to allow apartments in all commercial zones in large and midsize cities, SB 2477 to remove parking requirements for office-to-residential conversions, and

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# Regulatory and Legislative Crackdown on Algorithmic Pricing to Intensify, Raising Risks for Rentals, Hotels, and Mortgage Lenders

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<b>Winners</b>	N/A
<b>Losers</b>	RealPage Inc., Camden Property Trust (CPT), Essex Property Trust Inc. (ESS), Equity Residential (EQR), UDR Inc. (UDR), Caesars Entertainment Inc. (CZR), MGM Resorts International (MGM), Hilton Hotels Corp. (HLT), Marriott International Inc. (MAR), Hyatt Hotels Corp. (H), Wyndham Hotels & Resorts Inc. (WH), CoStar Group Inc. (CSGP)

Capstone believes regulatory scrutiny and lawmaker action targeting the emerging, yet novel antitrust theory of “algorithmic collusion” will continue to evolve and present risks for a range of industries in 2026. At the forefront of antitrust litigation on this issue, is Texas-based real estate software company—RealPage Inc.—alongside the multifamily property management industry, which faces antitrust lawsuits and lawmaker scrutiny on multiple fronts.

Scrutiny arose after investigative media outlet ProPublica published an article in late 2022 that claimed RealPage enabled a rent-fixing cartel among landlords nationwide through the use of

its algorithmic pricing tools, alongside reports the US Department of Justice’s (DOJ) Antitrust Division was investigating RealPage (see “DOJ to Target RealPage Over Conspiracy to Fix, Inflate Rental Rates; Risks to Camden Property Trust, Essex Property Trust, Equity Residential, UDR,” November 29, 2025). Since then, class actions, state attorneys general (AG) lawsuits, and statements and lawsuits from DOJ have been filed against RealPage and many other software companies that provide algorithmic pricing tools. This litigation continues to test what has become an emerging area of federal antitrust law.

The novel theory essentially argues that competitors’ adoption of common-use pricing algorithms can enable parallel conduct on price/supply, effectively amounting to modern-day price fixing, especially if competitors knowingly agreed to provide non-public competitively sensitive information to the software provider with the understanding that such information will inform the pricing algorithm and that competitors also participate.

While the merits of the theory have not been tested in court, no “algorithmic collusion” case has gone to trial yet, , the risks for companies providing algorithmic pricing software are significant, and we expect scrutiny to grow in 2026. DOJ announced on November 25th that it reached a consent decree with RealPage, which agreed to severe behavioral remedies that we believe will significantly implicate other algorithmic pricing providers should these terms become the basis for what constitutes a legally compliant common-use pricing algorithm (see “Quick Take: Real-

Page Settles With DOJ, Faces Stricter-Than-Anticipated Remedies; Monetary Deals in Class Action, State AG Suits Likely to Follow,” November 25, 2025). We believe DOJ’s civil antitrust settlement with RealPage will not only drive lawmaker attention, but also further activity from the plaintiffs’ bar, which already has been emboldened to pursue litigation in a range of industries, including rental housing, healthcare, luxury hotels, casino-hotels, and most recently, mortgage pricing, among others.

### ***RealPage and Property Manager Risk***

RealPage and the property management industry continue to face risks on multiple fronts that we expect will continue to proliferate in 2026. In addition to DOJ’s case, which included seven state AGs as co-plaintiffs, RealPage faces five other independent state AG lawsuits, as well as private plaintiff class action multidistrict litigation (MDL), which we estimate damages at trial could be upwards of \$73 billion if fully litigated (see “DOJ Scrutiny of RealPage and Algorithmic Price-Fixing to Continue Under Trump; Our Private Litigation Damages Estimates Raised to Up to \$73B,” December 23, 2024). In 2025, we saw 27 property managers settle, most notably Greystar Real Estate Partners LLC, which settled out of the private MDL for \$50 million, and we expect further settlements in light of RealPage’s recent deal to resolve claims with DOJ (see “RealPage Quick Take: Greystar’s \$50M Settlement in Private Litigation Sets Baseline; Pressure Rises for RealPage, Other Defendants to Follow Suit,” October 2, 2025).

Additionally, lawmakers have taken notice of the issue and signaled intent to act first to provide relief to constituents, rather than wait for courts to rule in lengthy, uncertain litigation. This year, several states introduced legislation that would outlaw the use of rent-setting algorithms used by two or more competitors and bills were passed in California and New York and signed into law. We expect further state-level efforts to restrict the use of rent-setting algorithms that rely on competitively sensitive information and are used by two or more competitors, providing direct risk not just to RealPage, but also to property managers.

We believe rental income growth for these groups could be reduced by as much as 5.5% if RealPage’s software is effectively curtailed or severely limited (see “DOJ to Target RealPage Over Conspiracy to Fix, Inflate Rental Rates; Risks to Camden Property Trust, Essex Property Trust, Equity Residential, UDR,” November 29, 2025).

### ***Hotels, Casino-Hotels, and Mortgage Lenders***

The luxury hotel and casino-hotel industry also has come under scrutiny from DOJ and litigation brought by private plaintiffs centered on the antitrust theory of algorithmic collusion with sizeable monetary liabilities at risk (see “Surging Class Actions and DOJ Crackdown on Pricing Algorithms Pose Significant Risks to Luxury Hotels and Casinos; Hyatt, Hilton Most Exposed,” October 11, 2025). While many of the cases have been dismissed at the initial briefing stage, we believe the risks should not be entirely written off as courts are still in the early days of establishing case law on the theory and many existing opinions do not touch the merits of the case.

We believe some of these “secondary” algorithmic collusion cases can see renewed traction in light of DOJ’s settlement with RealPage. However, we also recognize that the nature of DOJ settling with RealPage fails to set precedent as the court never ruled on the merits of algorithmic collusion cases. Until such an opinion comes, and through 2026, we expect algorithmic collusion cases to continue being brought in other industries. Most recently, Constellation Software’s subsidiary Optimal Blue, alongside the largest mortgage lenders in the country, were named in an algorithmic collusion lawsuit alleging that mortgage lenders entered into a collusive scheme to coordinate and share competitively sensitive information through Optimal Blue’s pricing software to artificially inflate mortgage terms. We expect this case, alongside the casino-hotel and luxury hotel cases, will continue to gain traction in 2026, extending the same monetary and behavioral remedy risks that exist for RealPage to other industries.

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# Regulators Examining Changes to Mortgage Market to Unlock Housing Supply; Potential Positive for Loan Servicers

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<b>Winners</b>	Mortgage servicers Mr. Cooper (COOP)/Rocket (RKT), UWM Holdings (UWMC), PennyMac Financial Services Inc. (PFSI)
<b>Losers</b>	N/A

President Trump and his administration have identified housing as a flagship issue heading into the 2026 midterm elections. FHFA Director Bill Pulte has suggested several potential actions to increase housing velocity, including 50-year mortgages, loan portability and assumability, and revising builder-funded rate buydowns. In our view, most of these proposals face significant legal, operational, and policy headwinds, making meaningful implementation unlikely, but assumable mortgages could become a possibility in the medium term.

## PORTABLE MORTGAGES UNLIKELY, ASSUMABILITY A POTENTIAL OPTION

Pulte suggested introducing portable and assumable mortgages several times on social media in October and November.

Both ideas are an effort to “unlock” the housing supply occupied by owners at low mortgage rates. With mortgage rates consistently above 5% since 2022, many homeowners who could be potential sellers feel locked into their existing homes because current rates are significantly higher.

Portable mortgages, which are more common in markets such as the UK and Canada, would allow a borrower to transfer their existing mortgage rate to a new property. To preserve lender economics, these products often rely on substantial prepayment penalties and structured fees. Implementing such a product at scale in the US would require significant legal and regulatory changes. The Dodd-Frank Wall Street Reform and Consumer Protection Act limits prepayment penalties to the first three years for qualified mortgages, which conflicts with how portable products are typically structured abroad. Policymakers also have to resolve jurisdictional questions over which state laws govern if a mortgage is effectively “ported” across state lines.

Assumable loans already exist in the housing market. Federal Housing Administration (FHA), US Department of Veterans Affairs (VA), and US Department of Agriculture (USDA) loans—which together account for roughly one-fifth of originations—are assumable, allowing a buyer to take over the seller’s existing mortgage rate and terms. The buyer must still fund the seller’s equity and

any excess of the purchase price over the outstanding loan balance, either in cash or via secondary financing (typically a higher-rate second lien). Agency rules (US Department of Housing and Urban Development, VA, USDA) generally cap assumption fees at \$900 per transaction, limiting profitability for servicers. FHFA, in theory, could permit or encourage assumability on conforming GSE loans and raise or remove fee caps to make the economics more compelling for servicers. That said, such a move would raise questions around how assumable loans are traded and risk-managed in the secondary market. We believe FHFA will continue to explore the expansion of assumable mortgages in 2026, which could create tailwinds for mortgage servicers, but shift demand away from home builders.

## 50-YEAR MORTGAGES FACE HIGH REGULATORY HURDLES

On November 8th, President Trump, alongside Director Pulte, shared social media graphics promoting a potential 50-year mortgage product. The proposal drew immediate criticism from industry groups, including the National Association of Realtors (NAR). Beyond the political pushback, the regulatory framework for mortgage underwriting makes the introduction of a 50-year “qualified mortgage” highly improbable. Section 1412 of Dodd-Frank explicitly defines qualified mortgages (QMs) as having terms of no more than 30 years, with only narrow exceptions allowed “such as in high-cost areas.” The CFPB’s Ability-to-Repay rule codifies this 30-year maximum term without a general exception. QM status is critical for lenders and servicers, providing safe-harbor protection (or at a minimum, a rebuttable presumption) against claims that they failed to satisfy ability-to-repay requirements. For a 50-year mortgage to qualify as a QM, the Consumer Financial Protection Bureau (CFPB) would have to undertake a formal rulemaking to amend the ability-to-repay framework. Given the bureau’s current staffing constraints, competing priorities,

and the likelihood of significant industry and consumer-advocacy opposition, we do not believe the administration will continue to pursue 50-year mortgages.

## BUILDER BUYDOWNS AND POTENTIAL EXPANSION OF GSE CONSTRUCTION-TO-PERMANENT PROGRAMS

Posts from both President Trump and Director Pulte have fueled speculation that FHFA could restrict or prohibit large homebuilders from utilizing rate buydowns in conjunction with GSE-eligible loans. Our initial assessment is this outcome appears unlikely. Limiting buydowns could align with the administration’s rhetoric that builders should be forced to adjust by lowering nominal home prices, rather than buying down interest rates to lower monthly payments. However, there is no guarantee that builders would respond by cutting prices and they instead could choose to slow sales, hold inventory, or shift product mix, outcomes that would be negative for the administration’s housing narrative, builders, and homebuyers.

Given Trump’s and Pulte’s references to leveraging Fannie Mae and Freddie Mac to improve housing affordability, one potential idea that has been floated is to expand the GSEs’ construction-to-permanent financing capabilities. This would allow homebuilders to access lower-rate mortgage loans for construction and the homebuyer then would assume the permanent mortgage at closing. The originating lender would have the option either to retain the loan with a GSE guarantee or to sell the loan into the GSEs’ pipeline under the original forward commitment. Proponents liken this to the GSEs’ multifamily forward commitment programs and argue that Fannie Mae, in particular, has relevant operational and underwriting infrastructure from prior

non-traditional products (e.g., reverse mortgages with periodic draws). We are cautious about the near-term feasibility of such an expansion. A program of this scale will likely require formal notice-and-comment rulemaking, extensive coordination with FHFA, and significant operational build-out at the GSEs, implying a timeline of at least 12 months under optimistic assumptions. Moreover, meaningfully broadening the GSEs' footprint in construction lending appears to run directly counter to the administration's stated objective of reducing the government's role in housing finance and privatizing and releasing the GSEs from conservatorship.

# Banking on Ease

How the Regulatory Burden on  
Banks Will Lessen in 2026



# Banking Policy 2026 Preview:

Capstone believes that prudential regulators will continue to lift the regulatory burden for banks of all sizes in 2026, even as they consider new stablecoin regulations that pose competitive threats to smaller banks. We expect the release of a “capital neutral” Basel III Endgame proposal and do not expect Congress to pass legislation to adjust deposit insurance thresholds.

## THE BOTTOM LINE

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### Outlook at a Glance

- ▶ **FDIC DEPOSIT INSURANCE:**  
HOUSE REPUBLICANS LIKELY TO REMAIN OPPOSED TO HIGHER DEPOSIT INSURANCE THRESHOLDS
- ▶ **FINALLY! BASEL III ENDGAME:**  
BASEL III ENDGAME RULES THAT AIM FOR CAPITAL NEUTRALITY TO BE RELEASED
- ▶ **STABLECOIN IMPLEMENTATION:**  
GENIUS ACT RULEMAKING, MASTER ACCOUNT ACCESS, AND TRUST CHARTERS ALL TO IMPACT THE LEVEL OF COMPETITION POSED BY STABLECOINS TO BANKS
- ▶ **REGULATORY RELIEF:**  
PRUDENTIAL REGULATORS TO CONTINUE TO PROVIDE A MIX OF SUPERVISORY AND CAPITAL RELIEF TO BANKS OF ALL SIZES

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# FDIC Deposit Insurance : House Financial Services Committee Leadership a Continued Roadblock to Deposit Insurance Reform

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<b>Winners</b>	Deposit Placement Networks Firms
<b>Losers</b>	N/A

Capstone remains skeptical that deposit insurance reform—specifically increasing the maximum insured amount for non-interest-bearing transaction accounts—is possible with the current leadership on the House Financial Services Committee (HSFC). The current deposit insurance reform conversation has its roots in the collapse of Silicon Valley Bank in 2023 and in a subsequent Federal Deposit Insurance Corporation (FDIC) report endorsing higher deposit insurance limits for business transaction accounts. Despite the mini-banking crisis and the FDIC’s apparent support for reform, legislators remained largely uninterested in passing reform, and the banking lobbies remained divided on the need for change. In 2025, however, support for deposit insurance reform picked up in the Senate and within the community banking lobby. Most notably, Sen. Bill Hagerty (R-TN) and Sen. Angela Alsobrooks (D-MD) proposed the “Main Street Depositor Act” (S.2999), which would provide

up to \$10M in deposit insurance coverage for noninterest bearing transaction accounts. Globally systemically important banks (G-SIBs) and any “insured branch of a foreign bank” would be excluded from the new coverage. The bill, which was initially slated for inclusion in a defense spending package and began with higher coverage limits, was endorsed by the Independent Community Bankers Association (ICBA). In a Senate hearing on the topic, both Democrats and Republicans spoke generally in support of reform. Leadership in the HSFC, however, threw cold water on S. 2999 during a November hearing on the topic. HSFC Chair French Hill (R-Ark), who has previously expressed concerns about moral hazard and higher deposit insurance limits, voiced skepticism surrounding a new \$10 million insurance limit and advocated for a more holistic approach to deposit insurance changes. Others voiced skepticism about the potential assessment costs and implementation timeline for the Hagerty/Alsobrooks bill. Given the lack of alignment within the HSFC and the apparent unwillingness to move forward with deposit insurance reform as a piece of stand-alone legislation, we view the likelihood of change in 2026 as remote, barring another mini-banking crisis.

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# Stablecoins and Trust Charters: GENIUS ACT Implementation Decisions Will Impact Deposit Stability

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<b>Winners</b>	Potential Stablecoin Issuers (CRCL)
<b>Losers</b>	Community Banks (<\$10B in Assets)

Capstone believes that a series of regulatory inflection points, including rulemaking and trust bank chartering decisions, related to the GENIUS Act and the emerging regulatory environment for stablecoins, will shape the degree to which stablecoin issuance emerges as a competitive threat to bank deposit stability in 2026. Passed in July 2025, the GENIUS Act provides a regulatory framework for stablecoins; the legislation provides a regulatory definition for payment stablecoins, limits issuance of those coins to approved entities, defines the range of reserves required to back a stablecoin, and outlines a broad penalty regime for non-compliance. The Genius Act will become effective in 2027, or 120 days following the issuance of final rules outlining stablecoin regulatory parameters.

The banking community has long expressed concern that the contours of stablecoin regulation will have significant implications for the industry and the stability of its deposit base. Industry, particularly the community banking sector, is concerned that stablecoins introduce

the risk that would-be deposits will be shifted into stablecoins and away from the banking system, eroding their deposit base and ability to lend. While the GENIUS Act seemingly addressed some of the industry's concerns about potential deposit erosion, banning yield or interest for stablecoins, and leaving Federal Reserve Master Account access eligibility requirements untouched, the banking community remains concerned that the specifics of forthcoming regulation and friendly posture toward crypto firms under the current administration may enable issuers to skirt GENIUS Act protections. While the GENIUS Act contains a prohibition on interest for holding stablecoins, a recent Advance Notice of Proposed Rulemaking (ANPRM) from the Department of Treasury asks if rulemaking should clarify the legislation's shallow legislative text and further define the scope of yield or interest that will be prohibited. Banks are specifically concerned that issuers may provide rewards or other incentives to customers while remaining statutorily compliant with the Act's yield/interest ban. Capstone expects that regulators will provide clarifying guidance to close perceived loopholes, but we will closely follow the exact language to determine how ironclad the ban on yield/interest will be. The ICBA recently released an analysis estimating potential deposit base erosion of ~\$1.3T if crypto exchanges, affiliates, or other intermediaries are permitted to pay interest, yield, or provide rewards on stablecoin holdings. Capstone is also closely monitoring ongoing developments in bank chartering for would-be issuers. We had generally expected issuers to partner with large banks to hold the reserves backing their stablecoins. The OCC, however, has conditionally approved several recent trust charter applications for likely issuers, allow-

ing them to directly manage the reserve assets backing their stablecoins rather than park those reserves with bank partners. While trust banks do not manage deposits, stablecoin-issuing trust banks would likely use other acceptable reserves to back their coin. The trust charter approvals are conditional, however, and approved entities are required to build regulatory capital and remain subject to ongoing monitoring over the next 12 months before final approval. Hiccups in capital formation, deviations from the business plan, or identified deficiencies in the ongoing monitoring phase could derail final approval of would-be issuers' charters. Additionally, we believe state regulators and trade groups may levy a legal challenge to the charter approvals. During the previous Trump Administration, state regulators sued to block a special-purpose fintech charter, though that suit was dismissed on standing grounds. Finally, despite the OCC's willingness to grant trust charters to potential stablecoin issuers, Capstone remains skeptical that the Federal Reserve will grant traditional master accounts to these non-depository institutions. While a trust charter grants additional legitimacy to potential issuers and subjects them to a higher degree of federal regulatory oversight, potential issuers will still be subject to a heightened Master Account review standard. Concerns over stablecoin issuers' access to Master Accounts were increased after Fed Governor Waller mentioned the potential for a "skinny" Master Account. That concern from the banking community seems wellfounded after the Federal Reserve released a December 19th request for information related to a limited Master Account focused on payments. Capstone believes that a limited "payments" Master Account could be utilized by issuers. While the full scope and capabilities of a limited Master Account have yet to be defined, and is likely a year or more away from rollout, it would likely reduce potential issuers' reliance on partnerships with traditional financial institutions and heighten the risk of deposit-based erosion for banks pending consumer adoption and the broadening of stablecoin use cases. Capstone will be monitoring each of these stablecoin inflection points - rules around stablecoin yields, the success of newly chartered trust institutions, and the Fed's stance

on master account access - as we consider the potential risk that stablecoins pose to traditional bank deposits. We believe community banks, in particular, are more acutely exposed to possible deposit erosion as they are less likely to partner with potential issuers to hold stablecoin reserves. Additionally, as mentioned in our 2026 Digital Assets preview, we believe large banks are likely to partner to issue their own stablecoin, creating a competitive alternative to crypto-oriented issuers.

# Basel III Endgame Finally Released

<b>Winners</b>	Category I-IV Banks
<b>Losers</b>	N/A

Capstone believes that regulators will release a “roughly capital neutral” Basel III Endgame proposal in early 2026, which will be favorable to the Category I-III banks. The relaxation of the July 2023 Basel III Endgame proposal has been expected for some time, and we anticipate it will be unveiled early next year. We expect that the proposal, which was widely panned by industry in its initial form, will be watered down significantly across multiple capital frameworks, and ultimately be favorable to industry.

While Capstone is forced to speculate on the exact nature of the B3E rollback, we anticipate that the forthcoming proposal will include much or all of the following. Category IV banks (\$100B-\$250B in assets), which we swept up in the initial July 2023 rules package, will be largely exempt from any new rules. The operational risk framework, which was viewed as unfairly punitive to US banks, particularly those highly reliant on fee income, will likely be significantly softened. Specifically, the internal loss multiplier (ILM) and approach to fee income within the operation risk framework will be relaxed. Next, we anticipate that the gold-plated credit risk elements of the initial proposal will be removed in the forthcoming version. The original proposals’ risk-weighting for

portfolio mortgages, equity financing, and retail risk weights (among others) will likely be relaxed. While we believe the market risk framework may be the most difficult to adjust downward, we do believe that the overall market risk approach will be partially relaxed, including better recognition of diversification benefits for capital calculations, adjustments to securities financing transaction rules and collateral minimums, and a more favorable approach to “non-modellable risk factors.”

Broadly, we anticipate that the revised rules will seek to harmonize the interplay between existing capital rules and stress tests, addressing the “double counting” concerns that banks have long levied against the current capital framework. The proposal, which will largely maintain the current status quo capital levels for banks, will likely have a long implementation timeline. Broadly, for banks that remain in a strong capital position, the capital-neutral Basel III proposal will support forward-looking capital planning and reduce the risk of highly punitive capital increase. Given the timing of the proposed release, early in the current administration, we do not expect issues with finalization before significant leadership turnover within the three prudential regulators.

# Continued Regulatory Relief for Banks

<b>Winners</b>	All Banks
<b>Losers</b>	N/A

Capstone expects that prudential regulators will continue to seek opportunities to provide supervisory, capital, and reporting relief to banks of all sizes in 2026. Current leadership at the Federal Reserve, the Office of the Comptroller of the Currency (OCC), and the FDIC has consistently decried the regulatory burden faced by banks and adopted an industry-friendly approach to regulation and capital. We expect that industry-friendly approach to persist in the coming year, resulting in a relaxed regulatory burden for banks of all sizes.

We anticipate that the Fed will continue to move forward with a more moderate stress testing approach that provides modest capital relief to large banks. The Fed has proposed multiple stress-testing related rules, all of which we anticipate will be finalized in early 2026, in time for incorporation into stress capital buffers for impacted banks next summer. Specifically, we believe the Fed will finalize its plan to average stress test results over a 2-year period to reduce year-over-year volatility in the stress capital buffer. Further, we believe that the Fed will incorporate feedback on existing stress-testing models, giving banks greater insight into stress-testing processes and a greater ability to manage the resulting capital effects.

We expect that prudential regulators will continue to aggressively pursue regulatory tailoring initiatives, attempting to align supervisory and capital requirements with a bank's level of complexity and the level of risk it poses to the financial system. Specifically, we expect regulators to consider linking existing capital and supervisory asset thresholds to inflation, going beyond recent FDIC rulemaking that raises multiple numeric thresholds for supervision and filing above current levels.

We also believe that the OCC will move forward with the revised definition of a community bank, which increases the asset threshold from \$10B to \$30B. Community banks will also benefit from a relaxation of the community bank leverage ratio, an alternative measure of capital adequacy. Under the current framework, banks that opt into the CBLR are required to maintain a 9% ratio; the new rules would lower the threshold to 8% and provide a more generous compliance grace period for banks that temporarily fall below it. We remain skeptical that there will be significant legislative change, despite Rep. French Hill's "Making Community Banking Great Again" agenda in the House Financial Services Committee (HFSC).

Capstone anticipates that much of the above regulatory relief will be accomplished as part of the banking regulators' ongoing Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA) review. Every ten years, bank regulators are tasked with reviewing the existing regulatory framework and making targeted changes to outdated regulations. Fed Vice Chair for Supervision has specifically noted that previous EGRPRA reviews have been largely toothless, but that the ongoing review process will result in supervisory and capital tweaks.

# Healthcare



Payor Policy 2026 Preview

# The Great Coverage Shakeup

Medicare Advantage Stability, The Shrinking of the ACA, and Implications for Healthcare Payors



# Payor Policy 2026 Preview:

## THE BOTTOM LINE

Capstone believes Medicare Advantage (MA) carriers, such as UnitedHealth Group Inc. (UNH) and Humana Inc. (HUM), will benefit in 2026 from program stability under the Trump administration. However, payors exposed to Affordable Care Act (ACA) exchanges and Medicaid, such as Centene Corp. (CNC) and Molina Healthcare (MOH), will face headwinds as reforms to ACA subsidies (and their potential expiration) and Medicaid take effect.

▶ **MA REGULATORY EVENTS**

ON THE HORIZON WILL FOCUS ON INFORMATION GATHERING FOR LONG-TERM REFORM, LIKELY FOR RISK ADJUSTMENT, STAR RATINGS

▶ **ACA MARKETPLACE DISRUPTION**

UNDERWAY DESPITE EXPECTED SUBSIDY EXTENSION; 2026 PREMIUM INCREASES DRIVE ENROLLMENT LOSSES

▶ **MEDICAID PAYORS FACE MODEST**

OBBA DISRUPTION IN 2026 BEFORE SIGNIFICANT 2027 REFORMS

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# MA Regulatory Events on the Horizon Will Focus on Information Gathering for Long-Term Reform, Likely for Risk Adjustment, Star Ratings

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<b>Winners</b>	Risk adjustment vendors, data analytics vendors
<b>Losers</b>	None

Capstone believes the Trump administration will initiate gradual, multiyear reforms to the Medicare Advantage program in 2026. With MA enrollment now exceeding 50% of total Medicare beneficiaries, the administration is balancing its stated goals of ensuring continued enrollment growth while stabilizing the program’s long-term financial viability. We believe these priorities will limit reforms to areas of perceived overspending, calibrated with industry input to avoid significant market disruption.

Two key areas of potential reform for the Trump administration are risk adjustment and star ratings, due to the perceived cost associated with both programs. Consistent with this view, the proposed CY27 Medicare Advantage and Part D Policy and Technical Changes rule removes 12-star rating measures and introduces a sweeping

request for information (RFI) related to alterations for the current risk adjustment system.

Capstone believes the RFI indicates the administration’s intent to ensure enrollment growth does not falter because of regulatory action. We believe the solicitation of stakeholder input, before the implementation of more material reforms in 2027 and 2028, is incrementally positive and reflects the administration’s favorable view of the program.

Potential changes in the risk adjustment and star ratings programs present opportunity for payor adjacent vendors that support these processes. As exhibited by Biden-era reforms such as the v28 risk model revision and the Tukey Outlier star ratings methodology change, volatility in the risk adjustment and star ratings programs create demand for vendor services to combat headwinds. For risk adjustment, as emphasis is on clinically proven risk adjustment factor (RAF) increases, vendors that bridge the gap between payors and providers, as well as vendors that focus on analytics and aggregation of clinical data, will stand to benefit. For star ratings, as process-oriented measures that payors can “game” are phased out, emphasis on clinical outcomes (HEDIS measures) and patient experience (Consumer Assessment of Healthcare Providers and Systems, or CAHPS, measure) will drive the need for partners that can aid in increasing overall star ratings in the new scoring regime.

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# ACA Marketplace Disruption Underway Despite Expected Subsidy Extension; 2026 Premium Increases Drive Enrollment Losses

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<b>Winners</b>	Third-party brokers and administrators for employer-based coverage, compliance vendors
<b>Losers</b>	None

The enhanced premium tax credits (EPTCs) face expiration or extension at the end of 2025, creating uncertainty that will reshape the ACA exchanges, regardless of the outcome. Rising utilization in the ACA population has already squeezed payor profitability, driving plan exits in certain geographies and defensive bid restructuring.

Capstone expects a partial extension of the EPTCs for plan year 2026, but permanent extension remains highly unlikely. As participating payors plan for 2027 and beyond, we believe they will adapt operations and plan designs to accommodate shifting risk pools and enrollment patterns in an environment of subsidy uncertainty.

Republicans opposed to extending the EPTCs support an emerging alternative proposal that would redirect funding meant for the subsidies

into HSAs. While full reform of the subsidies before expiration is unlikely, the White House is reported to be considering a proposal that includes an HSA component to incentivize higher-deductible plans, suggesting that tax-advantaged accounts could be integrated into the plan to offset consumer costs regardless of subsidy extension.

Changes to the ACA present opportunities for vendors throughout the market. The recent allowance of HSAs for Bronze and Catastrophic coverage presents a potential opportunity for administrators and navigators to aid in account and coverage compliance. Similarly, Republican appetite for ICHRA reform creates opportunities for brokers and consultants that focus on employer-sponsored coverage to facilitate cost savings via an exchange plan. While the eventual expiration of the EPTCs after 2026 appears likely, avenues of growth in the exchange for employer-sponsored coverage will grow as a result of population shifts. Additionally, HSA vendors could see opportunity if the Republican-backed proposals to redirect subsidy funding into HSAs gain serious traction.

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# Medicaid Payors Face Modest OBBBA Disruption in 2026 Before Significant 2027 Reforms

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<b>Winners</b>	Tech-enabled education vendors, specialized providers
<b>Losers</b>	None

The One Big Beautiful Bill Act, signed into law on July 4, 2025, initiates three years of enrollment pressure for Medicaid MCOs. The law's work requirements will disproportionately disenroll low-acuity members, deteriorating risk pools for insurers already facing elevated utilization trends. Capstone does not expect Congress or the White House to take steps to mitigate these effects in 2026, creating headwinds for MCOs into 2027 as enrollment shrinks, and for hospitals as uncompensated care costs increase.

While hospitals and insurers face headwinds as a result of OBBBA, Capstone believes certain pockets of providers that serve high-acuity populations will be shielded from the law's negative effects. Due to carve-outs of disabled populations from work requirements, applied behavior analysis (ABA) therapy and disability care providers will be shielded from disenrollments. As MCOs attempt to combat disenrollments of lower-acuity beneficiaries, tech-enabled vendors that can help with beneficiary and provider education on eligibility will be in high demand. Reclassification of Medicaid beneficiaries as qualifying through disability instead of income via Medicaid expansion will provide opportunities for these tools to help payors and providers alike.

# PROVIDER PRESSURE

The Looming Headwinds for Medicaid  
Exposed Providers



# Provider Policy 2026 Preview:

## THE BOTTOM LINE

Capstone expects Medicaid-exposed providers to face incremental, rather than severe, headwinds in 2026. While rate growth is likely to remain constrained, we see broad reimbursement cuts as unlikely given relatively strong state budget conditions and political pressure to protect providers serving vulnerable populations. However, as the Centers for Medicare & Medicaid Services (CMS) Medicare market basket growth slows, providers may remain exposed to ongoing inflationary pressures.

### Outlook at a Glance

- ▶ **DESPITE** PRESSURE ON MEDICAID BUDGETS, CAPSTONE CONSIDERS THE RISK OF BROAD-BASED CUTS TO BE LOW, AS OVERALL STATE BUDGETS ARE HEALTHY
- ▶ **DECLINING** MEDICARE MARKET BASKET UPDATES RISK UNDERESTIMATING PERSISTENT OR SHARP INCREASES IN INFLATION
- ▶ **PROVIDERS** SERVING VULNERABLE POPULATIONS ARE PARTICULARLY WELL-POSITIONED TO AVOID TARGETED RATE REDUCTIONS OR COST CONTAINMENT MEASURES

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# Despite Pressure on Medicaid Budgets, Capstone Considers the Risk of Broad-based Cuts to be Low, as Overall State Budgets Are Healthy

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<b>Winners</b>	None
<b>Losers</b>	Community Health Systems Inc. (CYH), Tenet Healthcare Corp. (THC), HCA Healthcare Inc. (HCA), LifePoint Health Inc.

State Medicaid budgets are under mounting pressure heading into 2026. The expiration of enhanced federal funding implemented during the COVID-19 emergency has removed a significant funding cushion just as states confront a projected 8.5% increase in non-federal Medicaid expenditures for FY26. Meanwhile, enrollment is stabilizing after two years of post-pandemic [unwinding](#). Two-thirds of state Medicaid directors [see](#) at least a 50-50 chance of Medicaid budget shortfalls in FY26, up slightly from FY25.

Despite these pressures, Capstone believes broad-based provider cuts are unlikely. Overall, state budgets remain healthy despite [slowing revenue growth](#) and [rising costs](#), with “rainy day funds” near all-time highs. At the same time, Capstone believes states are reluctant to further squeeze Medicaid providers amid uncertainty around Affordable Care Act (ACA) subsidies. However, policy uncertainty about work requirements, provider tax restrictions, and state-directed payments will likely constrain growth rates rather

than drive active rate cuts.

Federal policy changes will increase uncertainty in 2026. The One Big Beautiful Bill Act (OBBBA) will cut federal Medicaid outlays by ~\$91 billion over the next decade, adding to the fiscal stress of states already operating under constrained budgets (see [One Big Beautiful Bill Act Healthcare Overview](#), July 25, 2025). While the bulk of these changes will not impact state Medicaid budgets until 2027 and beyond, initial impacts are expected to emerge in 2026 through spending on work requirement verification programs and managed care organization (MCO) tax revenue losses in affected states (see [Medicaid Tax Quick Take: Impact of CMS Rule Closing Tax Loopholes Primarily Limited to Managed Care-Focused Taxes, Limited to 7 States](#), May 13, 2025).

At least two states have already implemented Medicaid cuts in response to anticipated shortfalls. However, we believe these cuts reflect idiosyncratic circumstances, rather than broader trends. Idaho’s 4% provider rate and MCO payment cuts (through 2027) [address](#) a \$58 million projected state budget shortfall. North Carolina cut provider rates by 3%-10%, and capitated MCO payments by 1.5%, after the state General Assembly failed to appropriate sufficient funding. Capstone believes the political dynamics in North Carolina appear significant (see [North Carolina Medicaid Outlook Call: Conversation with State Rep. Sarah Crawford](#), November 5, 2025).

Many provisions in the OBBBA may yield modest state savings starting in 2027. Capstone believes

net savings from work requirements and the increased eligibility checks on expansion populations should partially offset provider tax revenue declines (beginning 2028) and new state-directed payment ceilings.

Capstone believes that the anticipated compression of state Medicaid budgets and the resulting cost containment measures that may be nec-

essary are incrementally negative for healthcare providers. This impact may be especially severe for providers with disproportionate concentration in “first-mover” states such as North Carolina (e.g., LifePoint Health) and California (e.g., Prime Health). However, we expect healthy overall state budgets to defer the need for broad-based Medicaid rate cuts.

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## Providers Serving Vulnerable Populations Are Particularly Well-Positioned to Avoid Targeted Rate Reductions of Cost Containment Measures

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<b>Winners</b>	Providers treating vulnerable populations under mandated coverage or in low-cost-of-care sites, such as Aveanna Healthcare Holdings Inc. (AVAH)
<b>Losers</b>	Providers covered under optional benefits (e.g., adult dental)

**S**ince 1967, the Early and Periodic Screening, Diagnostic, and Treatment (EPSDT) benefit has required states to provide comprehensive, medically necessary services to Medicaid beneficiaries, specifically the pediatric population under 21. The benefit focuses on early intervention and preventive services, including vision, hearing, dental, and applied behavioral analysis (ABA) and personal care services (PCS) when medically necessary.

Relevant reforms have focused on expanding EPSDT coverage and enhancing state oversight of the benefit to protect medically necessary services for Medicaid-eligible individuals under 21. Recent bipartisan federal action has increased oversight of state EPSDT programs to ensure proper compliance. Furthermore, despite significant cuts to the Medicaid program made under the OBBBA, continued bipartisan support and state protections lead us to believe that EPSDT benefits will remain protected relative to other coverage and services. However, we warn that other optional Medicaid benefits, such as adult dental, could be targeted for cost savings and are not equally protected by federal statute or codified exemptions.

We also believe that the intellectual and developmental disability (IDD) population will be insulated from major negative impacts resulting from the OBBBA. Individuals with IDD are classified as “medically frail” and are exempted from the Medicaid work requirements implemented during reconciliation. This protects relevant providers from significant enrollment losses under the bill.

Additionally, pediatric IDD populations typically receive services through EPSDT.

The two circumstances outlined above create a protected class of individuals who are exempt from work requirements, have statutorily mandated coverage for certain services, and are politically difficult to target for cuts. Though these benefits are less at risk of elimination or reduction, they may still be affected by across-the-board cuts associated with reconciliation. However, revoking certain benefits and coverage for young and vulnerable Medicaid populations remains extremely unpopular at both the state and federal levels, which encourages our view that both EPSDT and IDD providers will be relatively insulated from deep cuts.

Despite budgetary pressure and policy uncertainty, Capstone believes EPSDT and IDD providers face a lower risk of targeted cuts relative to other service lines. EPSDT's mandated comprehensive services enjoy bipartisan support, while IDD populations are exempted from work requirements as "medically frail," limiting enrollment losses. Though both segments face potential rate stagnation as a cost-cutting measure, statutory mandates and political resistance to cutting benefits to services for vulnerable populations provide relative insulation versus optional benefits.

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## Declining Medicare Market Basket Updates Risk Underestimating Persistent or Sharp Increases in Inflation

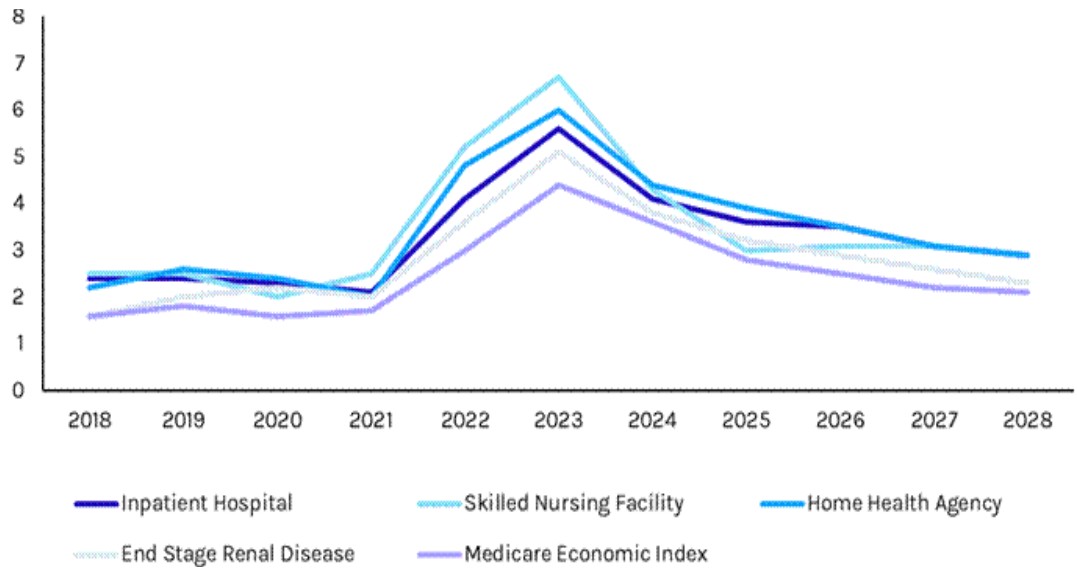
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<b>Winners</b>	Medicare providers benefit when CMS' prospective market basket estimates exceed actual cost growth. The ~3% 2026 updates provide margin expansion if inflation moderates toward the Federal Reserve's 2% target, as projected.
<b>Losers</b>	These same providers face asymmetrical downside risk. CMS' lag in responding to inflation spikes means sudden cost acceleration leaves them absorbing uncompensated input cost increases.

**A**fter finalizing 2026 market basket updates of ~3%, CMS expects that future updates will decline toward pre-pandemic levels by 2029. However, Federal Reserve policy shifts could alter this trajectory. Historical patterns show that CMS lags sudden inflation spikes without retroactive adjustments, creating margin risk for providers if inflation remains elevated. While the agency typically overestimates during stable periods, pandemic experience demonstrates significant downside when cost growth accelerates unexpectedly, leaving providers exposed to uncompensated increases in input costs.

EXHIBIT 1

CMS Market Basket Update Moving Averages for Q1, 2018-2028



Source: CMS

# BITTER PILLS

The Pharmaceutical Industry's  
Turbulent Year Ahead



## THE BOTTOM LINE

Capstone believes 2026 will mark a fundamental power shift in pharma economics. Policy interventions are redistributing value across the supply chain as pharmacies and wholesalers bear margin compression and drugmakers seek leverage through Most Favored Nation (MFN) frameworks. Execution risk is high as untested systems, pending litigation, and regulatory uncertainty determine whether the transition unfolds gracefully or chaotically.

▶ **IMPLEMENTATION** OF THE INFLATION REDUCTION ACT IMPOSES MARGIN HEADWINDS ON THE PHARMA VALUE CHAIN

▶ **MOST FAVORED** NATION DEALS PROVIDE TARIFF RELIEF, BUT REVENUE THREAT TO PHARMA DEPENDS ON IMPLEMENTATION SCOPE

▶ **REGULATORY INSTABILITY** AND GEOPOLITICAL TENSIONS CREATE EXECUTION RISK FOR BIOTECH

▶ **GRAB BAG:** OTHER AREAS TO WATCH IN 2026 AND BEYOND

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# Implementation of the Inflation Reduction Act Imposes Margin Headwinds on the Pharma Value Chain

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## COUNTING DOWN TO MEDICARE TRANSACTION FACILITATORS: CHAOS IS A RISK FOR INDEPENDENT PHARMACIES

**T**he first IRA-negotiated drug pricing discounts (maximum fair prices, or MFPs) take effect January 1st. To implement the discounts while preserving manufacturers' Wholesale Acquisition Costs (WACs), the Centers for Medicare & Medicaid Services (CMS) is using external vendors called Medicare Transaction Facilitators (MTFs) to route chargeback payments from drugmakers to pharmacies.

Under this system, manufacturers are fully responsible for ensuring refunds reach pharmacies, even if the MTF misroutes funds. Pharmacies must finance the payment difference for up to 14 days, creating cash-flow strain that will be particularly acute for independent pharmacies.

The MTF system's complexity serves a purpose. Preserving WACs protects manufacturer revenues while preventing margin compression for pharmacies and wholesalers who rely on gross-to-net spreads. However, if the system proves dysfunctional, Capstone believes legislative intervention could eliminate chargebacks and mandate outright WAC reductions instead, a simpler approach that would drive severe margin compression across the supply chain. While Capstone views this as an edge risk, it remains a meaningful tail scenario if operational chaos demands emergency action.

## IN A NEGATIVE FOR CVS, THE 340B REBATE PILOT PROGRAM WILL TRANSFORM HIGH-MARGIN BUSINESS MODEL

Contract pharmacies face potentially significant losses from the 340B rebate pilot program launching in January 2026. Currently, pharmacies generate substantial fees by capturing part of the spread between 340B-discounted acquisition costs and reimbursement rates. The pilot eliminates this mechanism entirely. Contract pharmacies will purchase IRA-negotiated drugs at full price, and covered entities will file for rebates directly with manufacturers, cutting contract pharmacies out of the transaction.

The pilot is mandatory for covered entities and voluntary for manufacturers. All eligible drugmakers chose to participate. Covered entities have raised concerns about increased administrative burden, extended rebate-collection cycles, and the potential for manufacturer disputes over unpaid rebates. Drugmakers contend that the model addresses concerns about duplicate discounts.

On December 1st, the American Hospital Association (AHA) filed suit against the Department of Health and Human Services (HHS) to block the pilot program, alleging violations of the Administrative Procedure Act. The court has not yet ruled. Capstone views the lawsuit outcome as a significant 2026 wild card with material implications for drugmakers, contract pharmacies, and covered entities.

## LOWER WHOLESALE ACQUISITION COSTS REDUCE SPREAD-BASED PROFITS FOR PHARMACIES AND WHOLESALERS

In response to recent legislation penalizing high gross prices, manufacturers are voluntarily lowering WACs, narrowing the gap between gross and net prices. This behavior has accelerated following the passage of the IRA and other inflation-linked rebate programs. Over the next two months, manufacturers reportedly plan to reduce list prices for at least 13 branded drugs, and Capstone expects more drugmakers to follow suit.

This trend puts pressure on downstream participants in the pharmaceutical supply chain. Pharmacies and wholesalers typically contract based on gross pricing benchmarks or retain a portion of the gross-to-net spread. Capstone believes that as manufacturers continue to tighten this spread, participants will see corresponding erosion in gross profit.

Pharmacies, such as CVS Health Corp. (CVS), Walmart Inc. (WMT), and Cigna Group (CI), and wholesalers, including Cencora Inc. (COR), Cardinal Health Inc. (CAH), and McKesson Corp. (MCK), face mounting pressure from three converging dynamics.

First, the MTF chargeback system launching January 1st requires pharmacies to float the difference between WAC and negotiated MFPS for up to 14 days, straining working capital. It also may lead them to steer away from IRA-negotiated drugs, creating volume risk for affected manufacturers, including Johnson & Johnson (JNJ), Bristol-Myers Squibb Co. (BMY), Novartis AG (NVS), and AstraZeneca PLC (AZN). While larger chains have greater financial capacity to absorb delayed reimbursements than independent pharmacies, operational complexity is significant, and the system's ultimate efficacy remains unknown.

Second, the 340B rebate pilot program, beginning

January 2026, eliminates high-margin contract pharmacy operations entirely by requiring covered entities to purchase at full price and seek manufacturer rebates directly. Already, Walgreens has stopped processing 340B claims for pilot drugs ahead of the deadline. The AHA lawsuit seeking to block the pilot is a major 2026 wild card. If the pilot proceeds, pharmacy margins face meaningful headwinds, while drugmakers benefit incrementally from added friction to providing 340B rebates and enhanced oversight over duplicate discounting.

Third, manufacturers are voluntarily lowering WACs. As gross-to-net spreads tighten, supply chain participants relying on spread-based contracts will experience a corresponding erosion of gross profit. An edge risk is that dysfunctional MTF operations may prompt further legislative intervention, requiring outright WAC reductions rather than chargebacks, which would drive severe margin compression by further collapsing spreads across the entire supply chain.

<b>Winners</b>	Drugmakers
<b>Losers</b>	Pharmacies, including CVS Health Corp. (CVS), Walmart Inc. (WMT), and Cigna Group (CI), and wholesalers, such as Cencora Inc. (COR), Cardinal Health Inc. (CAH), and McKesson Corp. (MCK)

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# Most Favored Nation Deals Provide Tariff Relief, but Revenue Threat to Pharma Depends on Scope

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## CMS WILL USE CMMI DEMONSTRATIONS TO IMPLEMENT MFN PRICING

**O**n December 19th, CMS announced a notice of proposed rulemaking for Global Benchmark for Efficient Drug Pricing Model (GLOBE) and Guarding US Medicare Against Rising Drug Costs Model (GUARD). These mandatory CMMI demonstrations will implement MFN pricing in Medicare Parts B and D, respectively. The demonstrations will apply to a randomly selected subset of 25% of the Medicare population. Capstone believes that, if implemented, these models would materially reduce manufacturers' revenues, as Medicare net prices substantially exceed international prices.

Surprisingly, there appears to be no carveout for companies that struck MFN deals with the White House, and it appears to apply to nearly all currently marketed single-source (branded) drugs (rather than only newly launched drugs) above the spending thresholds. While CMMI has broad authority to conduct demonstrations under Section 1115A, a mandatory demonstration of this scale may exceed the intended statutory authority. We expect an immediate legal challenge from the pharma industry.

It is unclear why the administration would pursue these models now. Pharma has been cooperative with Trump's voluntary MFN framework, with the expectation that compliance would prevent precisely this sort of mandatory intervention. By initiating these demonstrations, the administration is abandoning a functional collaborative approach for a legally vulnerable, more punitive alternative.

CMS will also use a demonstration to implement

MFN in Medicaid. The GENEROUS model enables MFN pricing in Medicaid. As we predicted, GENEROUS is a voluntary demonstration that allows pharmaceutical manufacturers to provide supplemental rebates to Medicaid to lower prices. The use of supplemental rebates means that these discounts are excluded from Best Price calculations, preventing additional gross-to-net losses in other channels.

## TARIFF THREATS REMAIN AN OVERHANG FOR PHARMA STOCKS

Threats of tariffs on pharmaceutical products were a persistent headwind to drugmakers in 2025. Over the course of the year, it became clear that President Trump intended them as leverage to advance his broader pharmaceutical agenda. His aim was to secure more voluntary agreements to expand domestic manufacturing and ensure pricing parity between the US and non-US markets. The tariffs have not yet taken effect, but we believe the administration will continue to use trade policy to incentivize domestic manufacturing and MFN pricing.

## MOST FAVORED NATION DEALS PROVIDE A PATH TO EXEMPTION

Lower drug prices have remained a policy priority of both Trump administrations. In July 2025, the president wrote directly to pharma CEOs, exhorting them to adopt a voluntary MFN framework. Relative to the risk of noncompliance—especially after Trump invoked the threat of retaliatory tariffs—Capstone considers the MFN framework to be quite manageable for drugmakers, and we believe that companies should play ball.

The administration has since struck MFN deals with 14 companies. While the contours of each deal are generally consistent with the framework outlined in the CEO letters, the deals with Eli Lilly & Co. (LLY) and Novo Nordisk A/S (NVO) introduced a highly impactful new provision: CMS has committed to covering the companies' GLP-1 products under Medicare Part D.

Coverage may begin as early as April 1, 2026, through a pilot program, potentially a voluntary demonstration through the Center for Medicare and Medicaid Innovation (CMMI). It is unclear how this demonstration would compel Part D plan sponsors and other stakeholders—which operate through a series of private contracts—to cover these drugs, especially given concerns over high usage increased plan liability for drug spending.

## MEDICARE DRUG PRICE NEGOTIATION PROGRAM RAISES QUESTIONS ON MFN-MFP INTERACTION

On November 25th, CMS published MFPs negotiated under the IRA's Medicare Drug Negotiation Program for 15 drugs covered under Medicare Part D, including Novo Nordisk's Wegovy.

As an IRA-negotiated product, Part D plan sponsors will be required to cover Wegovy. However, this requirement does not override the statutory exclusion on covering drugs used for weight loss.

Beyond 2026, it is unclear how the two prices (MFP and MFN) will interact when both are in effect in 2027, especially as the negotiated MFP for a 30-day supply of semaglutide is higher (\$274) than the MFN price for Medicare (\$245), although the ultimate cost will vary based on dose. While CMS issued a brief statement suggesting that MFN prices would supersede those negotiated under the IRA, it remains unclear how the voluntary MFN arrangement would trump the statutory MFP.

The GLOBE/GUARD models, if implemented, would substantially lower revenues for drugmakers selling through Medicare. Our preliminary view is that, surprisingly, the demonstrations do not provide

carveouts for companies that struck MFN deals. While we expect a strong legal challenge against the demonstration, implementation would be a significant headwind for pharma in 2026 and beyond.

Beyond the risk of GLOBE/GUARD, we believe the MFN frameworks are generally manageable for pharma. The Lilly and Novo Nordisk deals are uniquely favorable, offering (1) substantial new Part D market opportunities, (2) expedited approvals, and (3) a three-year tariff reprieve. For Lilly and Novo Nordisk, the net financial impact in 2026 and beyond will depend on the extent of coverage offered by Part D plan sponsors, and whether increased volume offsets the voluntary pricing concessions made to gain access to this substantial new patient population. Capstone believes that there may be a delay before the positive financial impact of higher volumes offsets the revenue pressure of lower prices.

GLP-1 coverage timing and mechanics remain uncertain. Mid-year implementation would likely require Part D plans to resubmit already-finalized 2026 bids, and it's unclear how CMMI could compel private plan participation. Should coverage proceed in 2026, we believe the impact would be negative for Part D sponsors as increased utilization likely outweighs savings from lower MFN prices across the rest of LLY and NVO's portfolios, especially under the Part D redesign that increases plan cost-sharing. We believe this negative impact may be temporary, as plans can adjust bids accordingly in 2027 and beyond to accommodate the increased utilization.

<b>Winners</b>	GLP-1 manufacturers Eli Lilly & Co. (LLY) and Novo Nordisk S/A (NVO), benefiting from new markets to offset voluntary price reductions.
<b>Losers</b>	Drugmakers (if GLOBE/GUARD go into effect) Part D plan sponsors, including Humana Inc. (HUM), CVS Health Corp. (CVS), UnitedHealth Group Inc. (UNH), and Centene Corp. (CNC), who face increased utilization if they cover GLP-1s for obesity.

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# Regulatory Instability and Geopolitical Tensions Create Execution Risk for Biotech

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## FDA POLICY CHANGES

**T**he US Food and Drug Administration (FDA) has adopted an innovation-friendly posture, taking steps to disrupt established processes, expedite drug approvals, and ease regulatory burden. In 2026, we believe drug-makers would benefit from additional measures that streamline review or clarify approval standards. However, staff churn risks reducing the agency's efficacy. Greater leadership stability in 2026 would benefit biopharma, providing greater assurance that the "rules today" will indeed be the "rules tomorrow." At the staff level, it is not yet clear if turnover is slowing administrative operations, such as drug review timelines.

## BIOSECURE ACT AND US-CHINA BIOTECH TENSIONS

The BIOSECURE Act creates manageable transition risk for biotechs exposed to Chinese Contract Development and Manufacturing Organizations (CDMOs). While the restrictions would disproportionately impact small- and mid-cap biotechs that rely on low-cost, high-quality Chinese CDMOs, we believe the generous implementation timeline provides ample opportunity for at-risk companies to shift operations to domestic or ex-China partners before the 2033 deadline.

We believe BIOSECURE favorably positions ex-China CDMOs such as Charles River Laboratories International Inc. (CRL), Fortrea Holdings Inc. (FTRE), and Lonza Group AG (LONN on the Swiss exchange) to capture market share as at-risk drugmakers pivot away from Chinese exposure in the supply chain. The prominent and popular Chinese CDMO

WuXi AppTec Co. Ltd. (2359 on the Hong Kong exchange) is not currently designated as a Biotech Company of Concern (BCC), but that may change in Q1 2026. Listing WuXi as a BCC would eliminate a major revenue driver for the company, as US revenue accounted for 64% of WuXi AppTec's total 2024 sales, despite the risk of BIOSECURE.

## CAPSTONE EXPECTS NATIONAL INSTITUTES OF HEALTH FUNDING TO REMAIN STABLE

As Capstone predicted, Congress rejected the Trump administration's attempts to drastically reduce the National Institutes of Health's (NIH) budget in 2025.

We consider it unlikely that Congress will make meaningful cuts to NIH funding in 2026. Not only does Congress broadly support the NIH's critical role in basic scientific research, but it also respects the economic impact of NIH funding. Major academic health centers are among the largest regional employers in many states, including the key swing states of Pennsylvania and North Carolina. Additionally, we find it unlikely that the administration will pursue, or succeed in enacting, further reductions in the indirect costs associated with NIH grants.

<b>Winners</b>	Ex-China CDMOs, such as Charles River Laboratories International Inc. (CRL), Fortrea Holdings Inc. (FTRE), and Lonza Group AG (LONN on the Swiss exchange)
<b>Losers</b>	Clinical-stage biotech companies, Chinese CDMOs, including WuXi AppTec Co. Ltd. (2359 on the Hong Kong exchange)

# Grab Bag: Other Areas to Watch in 2026 and Beyond

## INCLUDING THE MFP IN ASP CALCULATIONS MAY DESTABILIZE COMMERCIAL REIMBURSEMENT BENCHMARKS

**M**anufacturers must include IRA-negotiated MFPs in Average Sales Price (ASP) calculations, immediately lowering reported ASP for negotiated drugs. This creates two direct impacts once Part B MFPs become effective in 2028: (1) lower revenue for Part B manufacturers, and (2) margin compression for physicians and providers who earn the same percentage spread on a lower ASP base. We expect pressure on manufacturers of IRA-selected Part B drugs once they are announced by February 1st.

The disruption extends beyond Medicare. Commercial and Medicare Advantage plans rely on ASP as the primary pricing benchmark in reimbursement contracts. With CMS publishing only MFP rather than ASP in quarterly pricing files starting in 2026, payors lose their standard benchmark, creating three potential outcomes for commercial contracting:

- Commercial payors default to MFP as a new benchmark. Capstone believes this will be negative for Part B manufacturers, while providers see lower gross profit (but stable margins).
- Commercial payors freeze contracts at the last published ASP. Capstone believes this is unlikely but neutral for manufacturers and providers in the short term.

- Market shifts to alternative pricing benchmark (e.g., Average Wholesale Price). Capstone believes this outcome would be favorable for all stakeholders. However, it would require significant coordination. Progress towards such a solution is an area to watch in 2026.

Congressional intervention represents a wild card. Representative Greg Murphy's (R-NC) Protecting Patient Access to Cancer and Complex Therapies Act would maintain physician reimbursement at ASP+6%, rather than shifting to MFP+6%. The bill has gained limited traction to date, but we are continuing to monitor it in case it gains traction.

<b>Winners</b>	None
<b>Losers</b>	Part B Manufacturers selected for IPAY 2028 Providers with significant Part B drug exposure

## PBM REFORM LIKELY MODEST DESPITE CONSTANT LAWMAKER SCRUTINY

Congressional reform remains a perennial threat to the operations of Pharmacy Benefit Managers (PBMs). Their perceived role as middlemen, concerns over business practices and consolidation, and strong lobbying efforts from hospitals and pharmaceutical companies eager to shift blame for high drug costs ensure constant attention from lawmakers and regulators.

Bipartisan PBM reform bills (Pharmacists Fight

Back Act and PBM Price Transparency and Accountability Act) introduced towards the end of 2025, while unlikely to pass, set baseline expectations for 2026 efforts. Capstone believes that, while incremental reforms are plausible, drastic federal overhauls remain unlikely. We expect the most likely reforms will focus on transparency requirements. More aggressive structural changes face significant political and practical hurdles.

PBMs are adept at navigating policy headwinds. Sustained regulatory pressure has pushed PBM operations towards greater transparency and alternative pricing models, as they seek to demonstrate enough self-reform to avoid a legislative crackdown and keep earnings drivers one step ahead of potential regulation.

PBMs offering more transparent pricing models have gained market share, pushing larger PBMs to respond in kind. Cost-plus arrangements, such as Mark Cuban's Cost Plus Drugs, have gained traction by offering more transparent generic pricing rather than spread-based economics. Traditional PBMs, meanwhile, have launched early iterations of pass-through pricing options for employers, though uptake remains limited.

<b>Winners</b>	None
<b>Losers</b>	PBMs, such as UnitedHealth Group Inc. (UNH), Cigna Group (CI), CVS Health Corp. (CVS)

# The EU's Healthcare Policy Moment



Why Policy Will Drive More  
Opportunities and Risks in the  
EU Healthcare Sphere

# European Healthcare Policy 2026 Preview:

## THE BOTTOM LINE

Capstone expects three key developments to shape European healthcare markets in 2026. First, tariff threats from the Trump administration are likely to push modest increases in EU drug prices, benefiting manufacturers and pharmacies while raising costs for payors. Second, the European Union will advance the details of its pharmaceutical reform agenda, with mixed implications across the sector. Third, regulators are expected to maintain close scrutiny of private equity ownership.

▶ **TRUMP TARIFF** THREATS TO SPUR MORE MFN AGREEMENTS IN EUROPE; MODERATE DRUG PRICE INCREASES POSE TAILWINDS FOR MANUFACTURERS AND PHARMACIES, HEADWINDS FOR PAYORS

▶ **EU REGULATORS** TO CONTINUE PE TRANSACTION SCRUTINY IN 2026, BUT COMPREHENSIVE OWNERSHIP LEGISLATION IS UNLIKELY

▶ **ORIGINATOR** MANUFACTURERS PREPARE FOR HEADWINDS AS EU IRONS OUT IMPLEMENTATION DETAILS FOLLOWING PHARMA REFORM DEAL; GENERIC MAKERS TO SEE MODEST TAILWINDS

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# Trump Tariff Threats to Spur More MFN Agreements in Europe; Moderate Drug Price Increases Pose Tailwinds for Manufacturers and Pharmacies, Headwinds for Payors

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<b>Winners</b>	EU-based Drug Manufacturers, Pharmacies
<b>Losers</b>	Payors

Capstone expects the Trump administration's Most Favored Nations strategy to drive additional drug pricing agreements across Europe in 2026 as European governments look to strike deals to avoid pharmaceutical tariffs.

## MFN PRICE INCREASES

The administration has already used the threat of tariffs to secure favorable MFN deals with major manufacturers. For example, earlier in 2025, Bristol-Myers Squibb Co. (BMY), AbbVie Inc. (ABBV), and Eli Lilly and Co. (LLY) pledged to increase list prices for certain new and existing drugs in the UK to align them more closely with US prices. While list price increases can be mitigated by manufacturer rebates, the Trump administration's deal with the UK includes provisions to prevent this. Per the agreement signed in December, the UK will take measures to raise net prices of new drugs in exchange for

the exemption of UK-origin pharmaceuticals and pharmaceutical ingredients from Section 232 tariffs and the exemption of UK drug pricing practices from future Section 301 investigations.

These measures will include reducing clawback rates for manufacturers to 15% (from 23.5%) through at least 2028 and raising the cost-effectiveness threshold at which the UK deems new treatments to be too expensive by 25%. The threshold increase will allow a subset of moderately more expensive products to be reimbursed in the UK but does not translate directly into a net price increase for new or existing drugs.

Capstone believes the administration will continue to use tariff threats to pressure other European countries to sign similar agreements. The specific terms of each agreement will vary depending on each country's unique drug pricing regime but are likely to include modest changes to existing price control regimes in exchange for tariff exemptions, in line with the UK deal. Deals are unlikely to result in the magnitude of net price increases sought by the Trump administration, but manufacturers will still see modest gains from favorable changes to reimbursement and price control measures. Pharmacies, which often operate based on fixed percent margins, may see modest tailwinds from higher net prices.

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# Originator Manufacturers to Prepare for Headwinds as EU Irons Out Implementation Details Following Pharma Reform Deal; Generics Makers to See Modest Tailwinds

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<b>Winners</b>	Generic manufacturers
<b>Losers</b>	Originator manufacturers

Capstone believes the EU's recently finalized pharmaceutical reforms will be positive for generic drug makers and moderately negative for originator manufacturers. The reform package includes an incentive-based exclusivity structure and a mandatory launch provision that would require manufacturers to supply products to unprofitable markets. Most provisions of the legislation are expected to take effect at the beginning of 2028, with the EU to develop guidance and implementation details in 2026.

## EU PHARMA REFORM PACKAGE

In 2023, the European Commission proposed a package of reforms that would restructure the EU's current patent exclusivity system by tying exclusivity periods to a series of incentives. The goal of the reforms is to streamline generic market entry and incentivize EU-based research and development. The Commission's original pro-

posal cut baseline exclusivity periods from eight to six years, with manufacturers able to gain up to two additional years of exclusivity for meeting strategic benchmarks like conducting EU-based clinical trials and developing new antimicrobials. The provisional agreement reached in December by the Council and Parliament is generally weaker than the Commission's initial proposal. It maintains the current eight-year period and allows manufacturers to earn up to eleven total years of exclusivity for meeting benchmarks like addressing an unmet medical need and conducting clinical trials in the EU.

However, the agreement also includes Article 56a, which allows Member States to require a manufacturer to supply a drug in their market. Currently, manufacturers have discretion to launch products only in some EU markets. Many manufacturers refrain from launching products in some Member States, usually those that are smaller and unable to offer adequate reimbursement. Article 56a aims to increase equitable access to innovative drugs across the EU by requiring manufacturers to supply products to markets that would otherwise be considered unprofitable. Failure to comply within three years will result in a reduction to the product's exclusivity period in the requesting Member State. However, specific aspects of how this provision will be enforced still need to be ironed out in subsequent guidance and it remains to be seen how aggressively Member States intend to use this new authority.

Overall, the final legislation is significantly weaker than the Commission's original proposal, as it maintains existing data protection periods. The legislation will likely result in some modest headwinds for originator manufacturers due to streamlined generic entry, mandatory launch provisions, and more onerous shortage monitoring. In contrast, it is generally positive for generic manufacturers who will benefit from an expanded Bolar exemption (which allows generics to conduct research and testing on patented drugs

before the patent expires) and who are excluded from mandatory launch requirements (although the impacts are less positive than under the initial proposal).

The Council and Parliament must now formally endorse the legislation. Over the course of 2026, the EU will develop more specific guidance and iron out implementation details. Most provisions are currently expected to take effect in 2028.

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## EU Regulators to Continue PE Transaction Scrutiny in 2026, But Comprehensive Ownership Legislation Unlikely

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<b>Winners</b>	Non-patient-facing service providers such as back-end providers, ancillary and third-party services, healthcare operating infrastructure
<b>Losers</b>	Provider chains

Capstone believes growing concerns about private equity (PE) investment in healthcare will prompt greater transaction scrutiny in 2026, but we do not expect comprehensive regulations to be implemented. Where regulations are enacted, we expect these to be similar to existing corporate practice of medicine (CPOM) and merger and acquisition (M&A) laws enacted in the US, which have not significantly restricted PE activity.

Public health systems in Europe have historically provided few avenues for private investment, resulting in a regulatory environment that lags behind the US in terms of PE ownership and CPOM. However, over the past decade, European markets have opened up new opportunities for private investment in the healthcare sector, prompting concerns about the impacts of PE ownership. Several countries have ramped up scrutiny of transactions in the healthcare space. Notably, authorities in the Netherlands and the UK have launched investi-

gations into several consumer-facing industries. Scrutiny thus far has focused mainly on anti-competitive practices by provider groups, with some regulators specifically calling out provider roll-ups as a target for intervention. Less consumer-facing entities, like back-office and third-party services providers, are likely to remain more insulated from scrutiny.

While transaction scrutiny and antitrust enforcement have increased, policies restricting PE ownership and CPOM have been relatively sparse. Some of the strongest reactions to PE ownership have been in Germany, given opportunities for investment in ambulatory care centers (MVZs). In 2024, Health Minister Karl Lauterbach proposed aggressive reforms such as geographic- and specialty-specific ownership restrictions aimed at limiting PE investment in MVZs. However, Lauterbach failed to garner sufficient support for his proposal and measures were not included in major health-care reform legislation that subsequently passed in 2024. Lauterbach's failure to push through these changes suggests that strict PE ownership regulations are likely to face an uphill battle, although political support will vary across different countries.

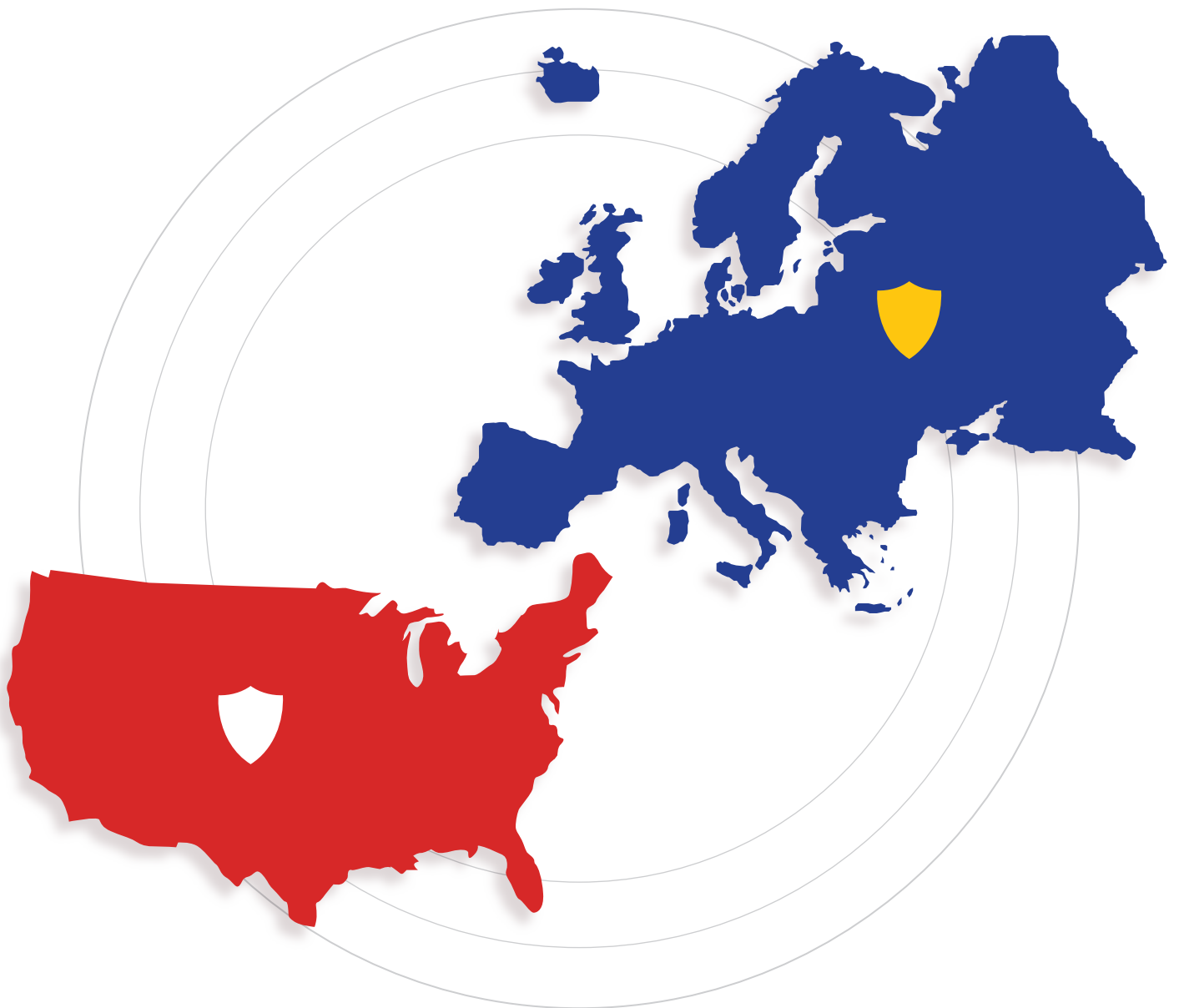
Overall, the EU's response to PE ownership concerns has been largely reactionary and heavily focused on transaction-level enforcement. Capstone believes Europe's regulatory environment is still in an early development phase, with material reforms unlikely in 2026. CPOM legislation is likely to be the next step for many countries—but based on how these laws have unfolded in the US, Capstone does not expect them to materially restrict PE activity in European healthcare.

# Public Services





# THE **US** BOOST TO DEFENSE AND THE **EUROPEAN** RESPONSE



# Aerospace and Defense Policy 2026 Preview:

Capstone believes new investment in defense and homeland security-focused capabilities will accelerate in 2026 as Washington restores focus on the Western Hemisphere in what it is calling the Trump Corollary to the Monroe Doctrine. The perception of a US retrenchment also is driving Europe to reinvest in its own capabilities, leading to what we believe will be a 60% increase in defense spending in major European markets by 2030.

## THE BOTTOM LINE

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Outlook at a Glance

▶ **PIVOT TO HOMELAND DEFENSE**  
WILL DRIVE 2026 PENTAGON  
PRIORITIES, BUT RUSSIA AND CHINA  
WILL CONTINUE TO TEST US RESOLVE

▶ **RISING NATO DEFENSE**  
SPENDING TO DRIVE SIGNIFICANT  
WHITE SPACE FOR A&D SECTOR  
WITH 60% INCREASE IN SPEND  
EXPECTED BY 2030

# Pivot to Homeland Defense Will Drive 2026 Pentagon Priorities, but Russia and China Will Continue to Test US Resolve

<b>Winners</b>	Homeland security-oriented defense technology firms such as Anduril Industries, Palantir Technologies Inc. (PLTR), Leidos Holdings Inc. (LDOS), and Elbit Systems of America (ESLT); US critical minerals developers; Western infrastructure and energy firms
<b>Losers</b>	None

## MIDTERM DYNAMICS WILL DOMINATE TRUMP ADMINISTRATION FOREIGN POLICY IN 2026

The Trump administration faces competing factions vying for control of US foreign policy. Traditional Republican hawks advocate for aggressive postures toward adversaries, while Make America Great Again (MAGA) constitutionalists push for non-interventionism—particularly seeking an end to the Ukraine conflict and restraint in Venezuela. Despite these tensions, two strategic priorities unite the administration: 1) pivoting toward Western Hemisphere defense to counter crime, drug trafficking, and illegal immigration; and 2) degrading Chinese dominance of critical mineral supply chains that are essential to US defense and energy sectors. Venezuela policy, Ukraine

negotiations, and China strategy heading into 2026 must be viewed through this lens.

The White House sees crackdowns on drugs, crime, and immigration as resonant political messages heading into the 2026 midterms, particularly for a MAGA audience skeptical about foreign intervention. President Trump also will likely seek to lower energy prices to address affordability concerns, and getting Russian and Venezuelan oil and minerals back on the market would advance that goal. Treasury Secretary Scott Bessent explicitly referenced the link between Ukraine, Venezuela, and oil prices stating: “[I]f something happens with Russia-Ukraine, if something happens down in Venezuela, we could really see oil prices go down even more. Oil and gasoline prices are down substantially under President Trump, and that is really the key to affordability: lower energy. And energy goes into food prices.” Vice President JD Vance also framed ending the Ukraine war in terms of focusing on US domestic economic challenges.

While there are significant disagreements on issues like combating Chinese military and economic influence, defending US borders and targeting drugs will serve as a point of unity in President Trump’s foreign policy. The Trump administration’s National Security Strategy (NSS), released this month, underscores these domestic security priorities. We believe this pivot will create opportunities for companies focused on homeland defense, particularly with the US Department of Homeland Security (DHS) and the US Customs and Border Patrol (CBP), US Coast Guard, and those with enabling technologies for inspections,

detections, and supply chain mapping.

Companies that are already supporting the administration in border security-related efforts include Anduril, Palantir, and Elbit and they will likely be among the beneficiaries of the \$550 million in the One Big Beautiful Bill Act (OBBBA) to fund the construction of a smart wall comprised of physical barriers and other infrastructure, as well as technological solutions. Several infrastructure and construction groups also have been awarded CBP funds under OBBBA as of October 2025, and more will likely follow.

The Trump administration and Congress will likely also prioritize protecting critical undersea fiber-optic cables in the Western Hemisphere from Chinese and Russian threats through deployment of sensors, surveillance satellites, and joint Coast Guard patrols with regional allies and partners—measures recommended by the US-China Economic and Security Review Commission, as even a pivot to “homeland defense” does not reduce the intensity of the global competition between the US and China.

The long-awaited National Security Strategy (NSS) that the US Department of Defense (DOD) published on December 5th reflects this hemispheric shift and cites what it calls the Trump Corollary to the Monroe Doctrine. The NSS serves as a compass and doctrinal justification for the administration’s defense policies and spending priorities. While the document acknowledges China as a major national security threat, it nevertheless signals a pronounced pivot toward the Western Hemisphere—a departure from decades of focus on the Middle East, in particular. This shift will signal spending priorities on the defense industrial base, allies, and adversaries for the next four years. US Southern Command is now, and will likely remain, a major locus of US military activity in 2026.

## MAJOR FOREIGN POLICY ISSUES IN 2026

### **Venezuela: Sustained US Military and Diplomatic Engagement**

US military action against Venezuelan President Nicolas Maduro’s regime appears increasingly likely, with the hawkish faction led by Secretary of State Marco Rubio prevailing for now over MAGA non-interventionists. At a minimum, we expect unprecedented levels of US military engagement in Venezuela to pressure President Maduro to leave office. In addition to combating narco-terrorism and organized criminal activity, the Trump administration also is eyeing the restoration of the country’s vast oil production to global markets, as well as enabling US firms to develop the country’s critical minerals and rare earth resources—both of which would require a US-aligned government in Caracas.

Should the Trump administration succeed in toppling the Maduro regime, there will be intensive diplomatic efforts to negotiate unfettered commodity access with a US-aligned successor government. However, achieving this objective will demand continued US military involvement to stabilize any transition and enforce agreements. Significant uncertainties surround post-Maduro governance, including whether an opposition-led government would emerge friendly to US interests or military factions would continue to dominate. Additionally, rebel groups currently control areas containing most of Venezuela’s critical mineral deposits, meaning a new government will require US military support to assert territorial control sufficient to guarantee supply access.

A stable, democratic post-Maduro Venezuela is unlikely to emerge and sustain itself in 2026 given the decades of dictatorship, economic disarray, and anti-American stance across Venezuela’s political spectrum. And a disorderly transition could further pressure other US priorities, such as reducing the flow of migrants to the US border. As a result, the year ahead is likely to be only the beginning of a renewed US engagement in

Venezuela and the broader region that will drive resources and attention for the DOD and the defense industrial base.

### **Ukraine-Russia: Expect More Pressure**

The administration will continue pressuring Ukraine toward a final peace agreement as President Trump is quite eager to achieve his campaign promise of negotiating an end to the war in Ukraine. But the details of this agreement matter greatly and will set the conditions for the long-term stability of the country and for NATO and European security architecture. More tactically—but of great interest to markets—is, absent White House support, Congress is unlikely to advance its sweeping Russia sanctions legislation in the near term as President Trump and a small group of advisers will continue to set the terms of US policy. The administration’s policy remains divided on how best to resolve the conflict and manage Russia, with the fault line between Secretary Rubio’s hawkish approach and Vice President Vance’s push to reduce US involvement on terms more favorable to Moscow, remaining as wide as ever.

Russian President Vladimir Putin’s intransigence will likely generate calls for additional sanctions against Moscow. The Kremlin continues raising obstacles to negotiation, including claims that there is no legitimate government in Kyiv with which to conclude a peace agreement. As the 2026 midterms approach in the US, congressional Republicans will loudly encourage the White House to escalate pressure on Russia should no deal be reached. While likely to undergo additional revisions, we believe the current sanctions package that Republican Senator Lindsey Graham (R-SC) and others support would present underappreciated risks to global energy markets in general and the uranium market in particular.

Under more positive scenarios, a sustainable peace deal between Russia and Ukraine would kick off a vast reconstruction of the war-torn country, providing numerous investment opportunities for Western firms, with billions already committed by European governments and

international funding mechanisms. Winners will be large construction conglomerates and energy companies tapped to rebuild Ukraine’s energy infrastructure. US, European Union, and Asian defense companies also will benefit, with EU countries likely providing security commitments.

### **Indo-Pacific and China: The Year Before 2027**

Capstone believes 2026 also will be notable because it is one year shy of the often referenced 2027 date by when the People’s Liberation Army has been ordered to achieve the capabilities to invade Taiwan. Capstone expects hostile rhetoric over Taiwan to accelerate in 2026, and how the Trump administration handles the Ukraine conflict will serve as a critical indicator for how the US could be expected to defend Taiwanese interests in the event of an invasion or hostile actions that, while short of an invasion, test decades of US policy.

China will remain the “pacing threat” that drives US defense spending toward more advanced technologies and modernization, particularly efforts to fortify the US defense industrial base. The Trump administration also will continue to invest in critical minerals projects, leveraging defense appropriations and Development Finance Corporation infrastructure funding to secure supply chains. The administration will build on Biden-era initiatives to deepen military partnerships with South Korea, Japan, and Southeast Asian allies, including the Philippines and Malaysia.

These relationships will generate significant defense procurement opportunities, particularly for emerging technologies such as unmanned aerial systems and autonomous maritime vehicles, in shipbuilding, and across the defense industrial base. The administration also will prioritize countering Chinese threats to undersea cable infrastructure in the region, among other challenges.

To be sure, the NSS states that Washington seeks to “maintain a genuinely mutually advantageous economic relationship” with China. But Capstone believes the Indo-Pacific theater will remain a key area of defense planning and investment in 2026

to maintain military superiority, regardless of how the relationship evolves along trade and economic fronts.

### **Middle East: Economic Cooperation over Military Spending**

The US and its Gulf partners are consolidating gains following two years of dramatic regional developments, including US strikes on Iran, Israeli operations targeting Hamas and the degradation of Hezbollah, and the conclusion of the two-year Israel-Gaza conflict. MAGA constitutionalists will continue pressuring the administration to withdraw US forces from the Middle East and reduce support for Israel. However, these efforts are unlikely to successfully shift policy in 2026.

Instead, the Trump administration will prioritize economic engagement over new military commitments. Capstone expects intensified efforts to deepen US-Gulf cooperation on artificial intelligence (AI) investment, data center infrastructure development, and technology partnerships, particularly as Gulf States position themselves as critical nodes in global AI supply chains. Defense cooperation will continue at current levels, focusing on maintaining existing security architectures rather than expanding the US military footprint. This approach aligns with the administration's broader strategy of leveraging economic statecraft while redirecting military focus toward the Western Hemisphere. The Gulf States' massive capital reserves and appetite for advanced technology infrastructure create natural alignment with US objectives to secure AI capabilities and counter Chinese technological dominance without requiring sustained military escalation in the region.

# Rising NATO Defense Spending to Drive Significant White Space for A&D Sector with 60% Increase in Spend Expected by 2030

<p><b>Winners</b></p>	<p>Dassault Aviation SA (AM on the Paris exchange), BAE Systems Plc (BA on the London exchange), Safran SA (SAF on the Paris exchange), Leonardo SpA (LDO on the Milan exchange), Rheinmetall AG (RHM on the Frankfurt exchange), KNDS Group, Thales SA (HO on the Paris exchange), Hanold AG (HAG on the Frankfurt exchange), MBDA, Naval Group, Fincantieri SpA (FCT on the Milan exchange), PGZ SA, and Airbus SE (AIR on the Paris exchange). Hanwha Aerospace (012450 on the Korean exchange), Korea Aerospace Industries (047810 on the Korean exchange)</p>
<p><b>Losers</b></p>	<p>None</p>

aerial defenses, and increasing concerns about the durability of US security commitments to the European defense. With strategic autonomy in the minds of many European policymakers, major defense spending packages will be largely targeted to domestic markets and will catalyze both public and private sector investment across defense value chains.

In the top five European defense markets, comprised of Germany, the UK, France, Italy, and Poland, Capstone estimates that even a conservative investment trajectory could lead to a nearly 60% boost in spending by 2030, from \$346 billion in 2025 to \$550 billion in 2030.

The investment case is clear. European defense capabilities have atrophied substantially since the end of the Cold War and there is a significant disparity between the demands on NATO militaries today and their capacity to meet them. Even the largest European militaries struggle to field full-spectrum capabilities similar to those of the US. Now, rising uncertainty over their security in light of Russia’s invasion of Ukraine and the Trump administration’s mercurial approach to trans-Atlantic defense issues are shifting the emphasis on increasing defense capacity that is less reliant on US support. To be sure, coordination with the US—which necessitates enhanced interoperability—as well as the leading position of US industry in key areas will still create opportunities for US defense firms. European NATO counterparts are not yet capable of meeting short-term Continental needs for high-end military capabilities, including air and missile defense and preci-

## LASTING IMPACT OF UKRAINE WAR IS THE REANIMATION OF NATO DEFENSE INDUSTRIAL BASE

**N**ATO member state commitments to revitalize domestic defense industrial supply chains are growing teeth, accelerated by the ongoing war in Ukraine that is now seeing Russia test European border and

sion strike capabilities. As a result, US firms will continue to have ample opportunity to participate in the revitalization of Europe's defense industry as local governments strive for longer-term parity. However, it is and will continue to be a key priority of European policymakers that the majority of spend flows to domestic companies.

Acknowledging the political sensitivities and complex dynamics around defense spending across NATO member countries, Capstone nevertheless believes the geopolitical environment sets the conditions for serious and durable commitment to bolstering European security. We believe this to be true whether or not Russia and Ukraine reach agreement in the year ahead.

## COUNTRY-LEVEL INVESTMENT DYNAMICS

Based on the new NATO 2025 guidance and countries' public plans for increased defense spending, Capstone believes Germany, the UK, France, Italy, and Poland will continue to be leaders in domestic spending for the next several years, both in aggregate dollar values and on a growth rate basis. Should the five largest European defense spenders close half the gap between their current spending levels and the goal of 3.5% of GDP by 2030 (and Poland remain steady at its current rate), Capstone projects that their collective spending will increase by 59%, or approximately \$204 billion annually (see Exhibit 1). This will create a significant uplift for the major European defense players, as well as the entire defense industrial base across these markets and beyond.

Capstone's "halfway framework," where the five largest European defense spenders close half the distance between their current defense spending in percent GDP and the 3.5% target, showcases directionality and magnitude of the defense industry opportunity in Europe while acknowledging that domestic political factors within each of these five countries could meaningfully impact actual spending and timelines.

### Germany

Germany is positioned to drive the largest increase in defense spending for the aerospace & defense industry within Europe. Capstone predicts its defense spending will rise by \$69 billion in current-year dollars annually, or by 72%, should the nation close half the country's gap with the 3.5% goal by 2030. Beginning with former Chancellor Olaf Scholz's landmark *Eigengene* speech following the Russian invasion of Ukraine, when he announced the creation of a special €100 billion special defense fund, Germany has made dramatic moves to reinvest in the country's defense and defense industrial infrastructure. Current Chancellor Friedrich Merz continues to expand the last government's drive to increase defense investment with new plans reportedly calling for doubling national defense spending as of June 2025, independent of NATO guidelines.

The German defense industry is advanced and capable, and national champions such as Rheinmetall, Hensoldt, and its portions of multinationals Airbus, MBDA, and KNDS are well-positioned to benefit from new German spending. Leaked German procurement plans also reveal an interest in keeping new equipment purchases within Europe as feasible. Of €80 billion in new equipment procurement proposed for the next year, only 8% by value would be US-sourced.

### United Kingdom

Capstone projects that the UK will hold steady as the second-largest European defense market in 2030. The country has maintained comparatively high defense spending levels through the early 2000s as the rest of Europe cut spending in this sector. As a consequence of this, the British defense market would require less growth to reach NATO's 2035 goals. However, the current government's significant political commitments to meet NATO's spending targets notwithstanding, the country is far more hamstrung by fiscal constraints than Germany or some other European states. Should the UK close half the percent GDP gap with NATO's 3.5% target by 2030, its defense budget as defined by NATO would rise by \$56 bil-

lion current-year dollars annually, or 61%.

The UK defense industrial base is well-established and home to major international player BAE Systems, as well as a range of other firms across the defense industrial supply chain. The UK's participation in major multinational defense programs such as the next-generation Global Combat Air Programme (GCAP) highlights national capabilities. The UK also has maintained strong defense industrial ties with the US to a degree unlike other European players, including Germany and France. This relationship has been further strengthened in recent years via the US-UK-Australia AUKUS partnership, and new regulatory work will enable further technology transfers.

### **France**

French President Emmanuel Macron has been a highly prominent advocate for a Continent-driven approach to European security and increased freedom of action independent of the US. His government has championed major increases in European defense spending, a stronger emphasis on building out the European defense industrial ecosystem, and a larger role for the EU and Europe-centric constructs in continental security. Capstone predicts that, should France close half the country's gap with the 3.5% goal by 2030, its national defense spending will rise by \$38 billion current-year dollars annually, or 57%.

Following NATO's 2025 Hague meeting, President Macron announced plans to speed planned defense spending hikes, doubling France's defense budget from 2017 levels. Despite his strong rhetoric and commitment to expanding France's role in European security, the nation's high debt loading and political instability present challenges for his administration and the broader French establishment to navigate.

France has traditionally pursued a highly capable and independent domestic defense industry. French companies such as Thales, Safran, Naval Group, and Dassault offer world-class capabilities and are well-positioned to take advantage of rising domestic defense spending. France also is

home to major portions of large European multinationals such as MBDA and KNDS, driving further integration into the continental ecosystem.

### **Italy**

Even compared to other European NATO members, Italy's defense budget has been a comparatively small percentage of national GDP. Capstone predicts that, should Italy close half the country's gap with NATO's 3.5% goal by 2030, national defense spending will rise by \$28 billion current-year dollars annually, or 57%

Italy faces major economic pressure, similar to the UK and France, against increasing defense spending and must balance NATO commitments against sizable welfare spending needs and an often euro-skeptic public. Despite these challenges, the Italian government has taken meaningful steps to advance defense investment. Reflagging Italian Coast Guard components as military units to count under NATO spending rules, or attempting to treat a new bridge as critical military infrastructure have drawn criticism. However, Italy also has applied for €15 billion in Security Action for Europe (SAFE) low-interest loans from the European Union and is planning to take advantage of EU policies that would allow it to increase its deficit to fund defense spending.

Despite long-term budgetary challenges, Italian defense firms such as Leonardo and Fincantieri have a long history of providing up-to-date offerings for the domestic armed forces and collaborating with other European players on major international programs, including the Eurofighter and GCAP aircraft programs.

### **Poland**

Unlike the preceding four highest European defense spenders, Poland's defense budget is already quite high in terms of percent GDP at 4.5%. And this is particularly true in comparison to other European states. Polish spending is driven by the country's close proximity to Russia and the ongoing war in Ukraine, dramatically driving up the NATO ally's perceived risks. While

Poland projects even higher defense spending in the medium term, the country has less room to grow compared to its counterparts. This defense spending has placed pressure on Poland's fiscal situation but has robust political backing. Poland requested that national defense spending be excluded from the EU's national deficit rules similar to Italy in order to increase borrowing.

Poland is a major defense buyer, but has a less developed domestic defense industrial base than the other included countries. State-owned PGZ (Polish Armaments Group) is Poland's primary military supplier. Notably, in recent years Poland has entered into a strategic partnership with South Korea to field large quantities of that country's arms and has begun domestic production of South Korean weapons. While South Korea has seen increasing arms export success within Europe, Poland stands alone as by far the largest South Korean arms importer within the continent signing deals worth billions of dollars. Continued Polish defense spending, therefore, also increased the opportunity for Korean firms to grow into the European market, alongside US firms who have traditionally dominated Polish defense imports. Poland is largely balancing a high-low mix of imports, where slower to deliver and more expensive US capabilities form the high end and still very capable but less expensive Korean weapons form the low end.

▶ EXHIBIT 1

Projected Top Five Largest European Defense Budgets in 2030

	2025 Defense Spend (\$)	2025 Defense Spend % of GDP	2030 Projected Defense Spend % GDP	2030 Projected Spend (current \$)	% Change in Defense Spending 2025e-30	2030 Additional Defense Spending Value over 2025e (\$)
Germany*	\$96 billion	2.4%	3.0%	\$165 billion	72%	\$68 billion
UK	\$91 billion	2.4%	3.0%	\$146 billion	61%	\$56 billion
France	\$67 billion	2.1%	2.8%	\$104 billion	57%	\$38 billion
Italy	\$49 billion	2.0%	2.8%	\$76 billion	57%	\$28 billion
Poland	\$44 billion	4.5%	4.5%	\$58 billion	32%	\$14 billion
TOTAL	\$346 billion			\$550 billion	59%	\$204 billion

Source: NATO; IMF; \*NATO budget data for Germany unavailable, separately sourced from the Bundestag and Reuters

# THE BUDGET SQUEEZE

When State and Local  
Revenue Falls and  
Federal Funding  
Disappears



Capstone believes state and local budgets will face mounting pressure in 2026 from underperforming tax revenue and cuts to federal funding. States politically opposed to Trump, such as California, New York, and Illinois, face the highest risk of having their transit, climate, and disaster relief grants withheld. However, all states will suffer if Congress fails to reauthorize the Infrastructure Investment and Jobs Act by October 2026.

## THE BOTTOM LINE

### Outlook at a Glance

- ▶ **STATE BUDGETS FACE** SHORTFALLS IN FY26 AS REVENUES UNDERPERFORM AND CUTS TO FEDERALLY FUNDED PROGRAMS HIT
- ▶ **CONGRESS MUST RENEW THE** INFRASTRUCTURE INVESTMENT AND JOBS ACT, A POTENTIAL RISK TO STATE AND LOCAL GOVERNMENTS DEPENDENT ON FEDERAL TRANSPORTATION FUNDING IJA
- ▶ **TARGETED CUTS TO SOME** FEDERAL PROGRAMS AIMED AT BLUE STATES WILL LIKELY PUT EVEN MORE PRESSURE ON THEIR BUDGETS

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# State Budgets Face Shortfalls in FY26 as Revenues Underperform and Cuts to Federally Funded Programs Hit

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<b>Winners</b>	Texas, Florida, and other states with a history of outperformance.
<b>Losers</b>	New York, California, Maryland, Illinois, Washington, and as many as a dozen other states that have already warned of softer-than-expected revenue and the potential impact of cuts to Medicaid, SNAP, and other federally funded programs on state budgets.

**C**apstone believes state budgets will come under increasing pressure in 2026 as general revenue trends normalize, with fewer states collecting more than they projected.

States have enjoyed that status for most of the last decade. In almost every year since 2018, more than 35 states exceeded their revenue projections, and in six of those years, fewer than five states missed their estimates.

The only year since 2018 in which a significant number of states missed their revenue estimates was 2020, and that was almost entirely due to widespread business closures caused by the COVID-19 pandemic.

However, even in 2020, when tax revenue under-

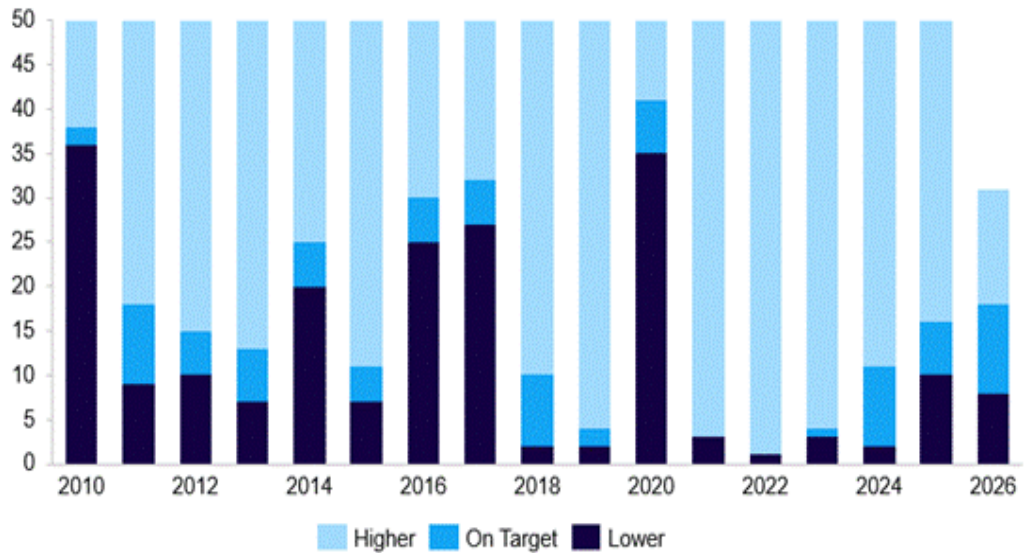
performed, state and local governments received generous federal funding, including \$150 billion in flexible aid through the Coronavirus Aid, Relief, and Economic Security (CARES) Act and \$350 billion from the Coronavirus State and Local Fiscal Recovery Fund. The influx of funding from these and other programs more than offset any lost tax revenue and ensured that state and local governments had more than sufficient revenue in 2020 to make it through the year without imposing meaningful austerity measures to respond to a 4.3% year-over-year decline in tax revenues.

It appears that conditions are changing in the current fiscal year, as states are reporting softer-than-expected monthly tax collections. Thirty-four states have released preliminary revenue estimates for the first couple of months of FY26, and eight are already underperforming; 10 states report collections are on target. Only 13 states (38%) have indicated that collections in FY26 are better than expected.

Excluding COVID, this is the first time since 2017 that more states report flat or below-expected tax collections than report above-expected tax collections.

EXHIBIT 1

FY General Fund Revenue Collections Compared to Original Revenue Estimates



Source: NASBO Fall 2025 Fiscal Survey

Source: NASBO Fall 2025

Even before states began releasing preliminary monthly revenue reports, it appears their budgets will be under pressure in FY26. General fund expenditures are expected to remain nearly flat in most budgets, and revenue is projected to grow by an average of only 0.7% across all states in FY26. This lackluster revenue growth in FY26 is despite several states having imposed modest revenue-raising measures to support the general fund budget.

It is also important to note that some states found it particularly difficult to pass their FY26 budgets in 2025. North Carolina failed to pass a budget at all—and will likely not pass one until early 2026. Massachusetts, South Carolina, Pennsylvania, Michigan, and several other states passed their budgets after constitutionally required deadlines, with most operating for a short period on continuing resolutions to fund the government.

An unusually large number of states failed to pass budgets on time, largely because of significant disagreements between governors and lawmakers over spending priorities and tax policy. Those conflicts were exacerbated by revenue fore-

casts that projected flat-to-slightly up y/y revenue growth across most states.

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# Targeted Cuts to Some Federal Programs Aimed at Blue States Will Likely Put Even More Pressure on Their Budgets

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<b>Winners</b>	None
<b>Losers</b>	State and local governments that run afoul of the Trump administration enough to have discretionary federal funds withheld. The most likely candidates are California, New York, and Illinois.

Federal funding for state and local governments (SLGs) accounted for roughly \$1.1 trillion of the \$6 trillion that SLGs spent in FY25. According to the US Census Bureau's report on state and local government finances, 58% of this federal funding went to healthcare-related programs such as Medicaid, with the rest supporting education, transportation, and social programs for lower-income people.

Most of that funding flows through well-established programs such as Medicaid, where states receive matching federal funds on a reimbursement basis to cover healthcare costs for eligible beneficiaries. However, other funds are provided through a variety of discretionary grant programs, in which the federal agency has greater discretion in their distribution.

Capstone believes some types of federal funding available to state and local governments are at risk in 2026 because the Trump administration

has used its control over the funds to advance its political agenda. Exactly which funds are most at risk is difficult to determine, but we believe funds where federal agencies have some latitude to impose more onerous compliance requirements on states, or where funds are awarded competitively, are likely the most at risk.

Funds provided to SLGs on a formula basis or through reimbursement under long-established policies and procedures are likely to be at the lowest risk. Examples of funds where we see little risk are ordinary-course reimbursement payments made to states under the Medicaid program and formulaic funding provided to state departments of transportation under the National Highway Performance Program (NHPP).

There have already been numerous examples of the Trump administration withholding federal funds, and we believe these examples highlight the kinds of funding most at risk of disruption. A few examples:

- The US Department of Transportation (DOT) has frozen roughly \$20 billion in funding for transit and rail infrastructure projects in and around New York City and Chicago. The DOT cited concerns over contracting policies that favor disadvantaged business enterprises and run afoul of a recent DOT interim final rule that bans providing preferential treatment to contractors based on gender or race.
- The Trump administration delayed the release of hundreds of millions of dollars of federal disaster relief funding from the Federal Emergency Management Agency (FEMA) related to

the California wildfires earlier this year, even though the expenses were incurred in response to a federally declared natural disaster. This delay has put a significant strain on both state and local budgets.

- The administration has cancelled, delayed, or restructured several grant programs viewed as being “too green” to align with Trump’s policy priorities. Examples of programs that have experienced disruptions in funding include a \$5 billion grant program for electric vehicle (EV) chargers, a \$1.2 billion program for low-carbon materials for state DOTs, roughly \$23 billion in climate funding across different appropriations bills, and more than \$800 million in Department of Justice (DOJ) grants to support funding for programs established by state and local governments.

The disruption of this kind of one-off funding is probably not a large enough risk to state and local budgets to bankrupt any of them, but it can lead to sudden, unexpected budgetary holes that are painful to close. A clear example is the \$1 billion deficit in the City of Los Angeles for the current fiscal year, which was forecasted when the city was developing its budget in early 2025. The deficit was partly caused by FEMA withholding funds and by the need to use city resources for recovery expenses that the city originally expected to be covered by disaster relief.

The city closed the anticipated \$1 billion deficit through a combination of layoffs, cuts to non-essential services, and the transfer of some workers to agencies such as the Port of Los Angeles, which are outside the city’s general fund budget. More than 1,600 city workers lost their jobs, and it is likely that at least some of those jobs would have been saved had federal funding arrived as expected, without delays or disruptions.

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# Congress Must Renew the Infrastructure Investment and Jobs Act, a Potential Risk to State and Local Governments Dependent on Federal Transportation Funding

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<b>Winners</b>	States such as Florida and Texas that spend most IIJA funds on highways, and where lawmakers are most likely to increase funding in any extension or renewal of IIJA. Government contractors, including United Rentals Inc. (URI), Caterpillar Inc. (CAT), Vulcan Materials Co. (VMC), Martin Marietta Materials Inc. (MLM), Nucor Corp. (NUE), and Sterling Infrastructure Inc. (STRL).
<b>Losers</b>	States, such as New York, California, Illinois, New Jersey, and Washington, that spend disproportionately on climate-related initiatives and transit. These funding categories are most at risk of being eliminated, reduced, or frozen in any IIJA extension.

The Infrastructure Investment and Jobs Act (IIJA) is a \$1.2 trillion infrastructure funding package enacted during the Biden administration that must be reauthorized by October 1, 2026. That would not only allow already appropriated funds to continue to be spent, but also provide additional funding after the current fiscal year.

IIJA includes dozens of specific programs covering a range of infrastructure funding needs, but its core is the more than \$670 billion in surface transportation funding for roads, bridges, mass transit, and intercity rail. State and local governments receive over \$1 trillion in federal grant funding each year, and in 2025, roughly 10% of this funding, or just over \$100 billion, was specifically for transportation.

Capstone believes Congress has no choice but to pass an infrastructure funding package in 2026. The details are uncertain, and that is where state and local governments face risk. The primary options Congress would consider in a future infrastructure funding package are:

- A clean one-year extension of funding at current levels for most of the programs included in the IIJA, which would give policymakers time to negotiate a multi-year funding bill after the 2026 elections.
- A multi-year funding bill that covers most

of the major categories of infrastructure funding needs included in IIJA but excludes one-off increases in funding for programs the Trump administration has indicated it would not support, such as broadband infrastructure, EV charging, EV buses, and “green” programs unrelated to transportation.

- Whether to maintain current funding levels beyond 2026 or to instead account for inflation since the IIJA became law in 2021. Inputs for highway construction increased 17.2% in 2021 and 16.1% in 2022 due to a shortage of both labor and construction materials.

Federal transportation funding is crucial for supporting infrastructure investments; state and local governments depend on it. Federal funding accounts for 25% of state and local transportation spending, and most of these funds support capital investments. At the same time, state and local funding is heavily weighted toward operating expenses, such as routine road maintenance and mass transit operations.

By law, federal funds can be used to cover up to 80% of the cost of highway projects, 40% of the capital funding needs of state departments of transportation, and more than 40% of the capital funding needs for transit systems in 2024. Without federal infrastructure funds, state and local governments would lack the resources to expand their road networks and transit systems, invest in new rolling stock and buses, or undertake major capital improvement projects, such as repaving highways and constructing new bridges.

# FOOD FIGHTS

SNAP Cuts,  
Trade Shocks, and  
the New Agricultural Order



# Agriculture Policy 2026 Preview:

## THE BOTTOM LINE

Capstone expects US agriculture to face a difficult 2026 as farmers grapple with weak crop prices, elevated input costs, and persistent trade uncertainty. The Trump administration's push to narrow Supplemental Nutrition Assistance Program (SNAP) eligibility—including new work requirements—introduces fresh risks for major grocers and packaged-food companies. With limited federal relief expected, producers and food retailers should prepare for tighter margins, uneven demand, and policy headwinds that will shape the sector's performance in the year ahead.

### Outlook at a Glance

- ▶ **ROW-CROP FARMERS** WILL FACE MOUNTING PRESSURE FROM WEAK COMMODITY PRICES AND INFLATION, WHILE BEEF PRICES WILL CONTINUE TO SOAR DUE TO DECIMATED SUPPLY
- ▶ **ROW-CROP FARMERS** WAIT ANXIOUSLY FOR TRADE BAILOUTS AS USDA PREPARES FUNDS; EXPECT MORE RELIEF PAYMENTS TO PRODUCERS IN 2026
- ▶ **TRUMP'S PROPOSED** SNAP RESTRICTIONS AND USDA MESSAGING WILL CREATE RISKS FOR GROCERS AND FOOD PRODUCERS IN 2026

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# Row-Crop Farmers Will Face Mounting Pressure from Weak Commodity Prices and Inflation, While Beef Prices Will Continue to Soar Due to Decimated Supply

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<b>Winners</b>	Crop insurance brokers and underwriters, such as Chubb Ltd. (CB), QBE Insurance Group (QBE on the Australian exchange), Sampo Holdings Inc. (8630 on the Tokyo exchange), and beef producers, including JBS NV (JBS), Cargill Inc., Tyson Foods Inc. (TSN), National Beef
<b>Losers</b>	Agricultural lenders; equipment manufacturers, including Deere & Co. (DE), CNH Industrial NV (CNH), The Mosaic Co. (MOS)

Despite row-crop farmers achieving relatively high yields, many of them are concerned that, given the economic and political unpredictability of President Trump's second term, their operations will not make money. An August 2025 [survey](#) by the American Bankers Association, in partnership with Farmer Mac, found that only 52% of farm borrowers expect to be profitable in 2025, signaling a period of significant financial distress. Liquidity, farm income levels, and inflation were the top concerns for producers.

Trump's focus on illegal immigration threatens farms, as the US Immigration and Customs Enforcement (ICE) has targeted the agricultural sector. Farm work, particularly during the harvesting season, is incredibly labor-intensive, and producers often rely on undocumented immigrants to do the job. Trump's Labor Department has only recently [admitted](#) that US food production requires foreign workers, but not before ICE [deported](#) over half a million people in 2025 and another 1.6 million voluntarily self-deported, leaving producers struggling to hire adequate staff.

## LOW FARMER INCOME LIKELY TO CONTINUE INTO 2026 AS LABOR, TRADE, AND INFLATION HEADWINDS PERSIST

**A**s tough as 2025 was for row-crop farmers—with prices for many of their products reaching their lowest levels in four years while costs increased for labor, machinery, fertilizer, and energy—Capstone believes 2026 is shaping up to be worse. Trade volatility with China and worldwide tariffs on agricultural products have led to a decline in US crop exports, particularly soybeans. Crop insurance underwriters and brokers are likely to be the only beneficiaries of the headwinds; we expect farmers to increase purchases of margin- and yield-protection policies.

To combat labor shortages, the Trump administration in October rolled out alterations to the federal H-2A visa program, which allows producers to hire foreign laborers for temporary farm work. The changes direct the Department of Homeland Security (DHS) to approve H-2A visas more quickly. The new rules also reduce the minimum wage required to pay temporary farm workers. Though these changes will undoubtedly

help producers, we expect labor issues to continue into 2026 as undocumented immigrants wait for their chance to return to work.

Another burden for producers, price increases for farm equipment, is expected to persist in 2026. The US Department of Agriculture (USDA) tractor price index increased 25% between 2021 and 2024. Now, producers are ordering less new equipment, distributors are sitting on significant excess inventory, manufacturers are cutting back production due to weak demand, and many farmers have poor credit histories. That mix makes it difficult to finance the purchase of new equipment, even if producers want to buy. Equipment manufacturer Deere has reported higher-than-expected losses in its agricultural accounts, citing rising delinquencies and poor economic conditions, including high interest rates. Management at both Deere and CNH has scaled back farm machinery production and announced multiple rounds of layoffs. CNH has also declared its intent to [close](#) its Burlington, Iowa, tractor plant by Q2 2026.

Fertilizer is one of the major operating costs for farmers. It can represent as much as 30%-40% of operating costs for row crops like wheat and corn that require both phosphate and nitrogen-based fertilizers. Much of the fertilizer in the US, and the raw materials used to make it, is imported. The recent volatility in trade policy has led to a meaningful increase in fertilizer prices. Phosphates have seen the biggest price increases, with products like gulf diammonium phosphate (DAP) rising from \$583 per ton in January 2025 to \$800 in August. Since phosphate is mostly extracted from finite geological deposits in Morocco, China, and Algeria (unlike nitrogen-based fertilizers, which are made from ammonia derived from natural gas), soybean farmers have been hit especially hard by rising costs.

China's refusal to import US soybeans for several months in 2025 caused prices to collapse. The sale of soybeans to China only recently resumed after trade [negotiations](#) held at the APEX summit in South Korea at the end of October.

Soybean farmers, like other row-crop producers, were also hit by a combination of high interest rates, rising utility costs, and climbing rent and property taxes in 2025, forcing farmers to make critical budgeting decisions that will likely have lasting negative effects in 2026.

One opportunity for reprieve from the economic challenges is the One Bill Beautiful Bill Act (OBBBA), which included several provisions designed to modestly help row-crop farmers by strengthening the USDA's commodity support programs. The law expands the federal crop insurance program (FCIP), increases insurance subsidies for new farmers, and raises coverage levels on many crop insurance policies. Unfortunately, the changes are not scheduled to take effect until October 2026, leaving our overall outlook for the agriculture sector unfavorable for the coming year.

## CATTLE SHORTAGE CONTINUES DRIVING UP BEEF PRICES WHILE MEATPACKERS FACE ANTITRUST SCRUTINY

**W**hile row-crop farmers are going through a rough patch, cattle ranchers are also experiencing disruptions that will persist into 2026.

Years of severe drought that swept across the western half of the US starting in 2021 reduced feed-grain yields and rendered water supplies inadequate to support cattle. Ranchers were forced to sell their valuable breeding cattle to generate cash, thereby reducing the number of calves born in subsequent years. Calf supply is down 8% from 2020, and the US has the lowest cattle inventory since 1951. That is helping to boost margins for beef and dairy operations. Since February 2020, steak prices have increased 54% and ground beef prices 52%, with no sign they will stabilize anytime soon.

It will take a long time for ranchers to rebuild their herds to more normalized levels. On average, it takes two full years for a heifer to produce a calf, followed by another 18 months for the calf to reach market weight. We believe that beef ranchers will enjoy elevated pricing and margins for the foreseeable future as livestock producers hesitate to replenish their herds and US demand for beef keeps prices elevated.

The limited supply of cattle has hurt the meatpacking industry. For example, Tyson Foods announced in November it would [close](#) its plant in Lexington, Nebraska. Tyson is one of the “Big Four” meatpacking companies that process 85% of beef in the US. It reported a \$426 million loss from its beef business in 2025.

Labor is another issue for meatpacking companies, as rising costs are pushing beef prices higher. The industry has traditionally relied heavily on immigrant labor, but with the administration’s enforcement of immigration laws and the increased removal of undocumented immigrants, the available workforce has diminished. Larger facilities in rural areas, in particular, are struggling, as there are not enough workers to produce the necessary inventory to make a profit. With illegal immigrant enforcement and a shortage of available workers, meatpacking companies have had to raise wages to attract new workers, adding additional financial pressure.

On November 7, 2025, Trump [directed](#) the Department of Justice (DOJ) to investigate meatpacking companies that, he said, “are driving up the price of Beef through Illicit Collusion, Price Fixing, and Price Manipulation.” He singled out “Majority Foreign Owned Meat Packers” for jeopardizing “the security of our Nation’s food supply.” While it is true that the “Big Four” meatpackers—JBS, Cargill, Tyson, and National Beef—combine for 85% of the US beef-processing market, and JBS and National Beef are based in Brazil, we believe any DOJ investigation will provide no material evidence that the meatpacking companies are colluding or price fixing.

Agricultural reciprocal tariffs have also been a concern for the meatpacking industry. On November 14<sup>th</sup>, Trump issued an [executive order](#) (EO) removing the reciprocal tariff on certain agricultural products, including beef, negatively impacting US cattle ranchers while providing relief to retailers through 2026.

The EO poses a risk to meatpacking companies that have relied on the reciprocal tariffs to protect them from foreign competitors, who now have greater access to the US meatpacking markets. This is beneficial for US retailers, as they no longer have to pay the reciprocal tariff on beef imports from countries such as Brazil. The price impact of removing the reciprocal tariffs for U.S. beef consumers remains to be seen.

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# Row-Crop Farmers Wait Anxiously for Trade Bailouts as USDA Prepares Funds; Expect More Relief Payments to Producers in 2026

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<b>Winners</b>	Large Row-Crop Farmers, including Archer-Daniels-Midland Co. (ADM) and Cargill Inc.; Crop Insurance Brokers, and Underwriters
<b>Losers</b>	Small-Scale Farms

For years, US soybean farmers have relied on China purchasing more than half of US soybean exports. Trump's trade war put an abrupt halt to that. China opted to cease purchasing US soybeans and instead turned to Brazil. China recently agreed to resume buying US soybeans, but the damage has largely been done. The significant drop in demand from China in 2025 led to a collapse in US soybean prices. Experts estimate that farmers will lose \$44 billion in income in the 2025-2026 crop year due to low prices for crops such as soybeans, corn, and wheat. This collapse in farm incomes is where the potential for bailouts from the Trump administration comes in.

The USDA's Farm Service Agency (FSA) formerly issued trade- or tariff-related bailouts through the Market Facilitation Program (MFP). The MFP sets a precedent for USDA spending without congressional approval, tapping into the agency's Credit Commodity Corporation (CCC) fund, which takes out loans from the US Treasury but must be replenished through appropriations. During the 2018-2019 trade war with China, the CCC issued

\$28 billion in MFP payments to farmers to offset trade losses. Trade bailout funds disproportionately benefited large-scale farming operations.

As part of Congress' November 10<sup>th</sup> passage of the [Continuing Resolution](#) (CR), the CCC was replenished with \$30 billion. However, as far as we are aware, no money was released in 2025, with USDA blaming the 43-day government shutdown for the delay in releasing funds to farmers.

According to reports, the USDA is teeing up another wave of trade-related bailouts. However, the exact amount and timing remain to be seen. Experts speculate the so-called second wave of bailouts may be as high as \$15 billion and begin as early as December 2025, though this will certainly not make up for all the losses that farmers experienced. Crop insurance providers stand to benefit from the bailout payments, as producers often use bailout funds to purchase insurance policies to further limit their risk in the upcoming crop year.

We expect several more waves of trade-related bailouts to be issued in 2026 as the Trump administration tries to rebuild the farm economy to sustainable levels.

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# Trump's Proposed SNAP Restrictions and USDA Messaging Will Create Risks for Grocers and Food Producers in 2026

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<b>Winners</b>	N/A
<b>Losers</b>	PepsiCo Inc. (PEP), Coca-Cola Co. (KO), Keurig Dr Pepper Inc. (KDP), Hershey Co. (HSY), Archer-Daniels-Midland, Mondelez, Cargill, Nestlé SA (NESN on the Swiss exchange), Walmart, Kroger Co. (KR), Dollar General Corp. (DG), Dollar Tree Inc. (DLTR), 7-Eleven

## EXPANDED WORK REQUIREMENTS MAKE IT CHALLENGING FOR SNAP PARTICIPANTS TO RECEIVE BENEFITS

Capstone believes that Trump's USDA will use administrative actions in 2026 to continue to push to reduce spending on the Supplemental Nutrition Assistance Program (SNAP). The goal appears to be limiting federal SNAP spending by reducing the number of enrolled beneficiaries. USDA will also likely continue to support states' prohibitions on beneficiaries using SNAP dollars to buy junk food and sugary drinks. These changes pose risks to grocers and food manufacturers who rely on SNAP dollars.

Some of the structural changes we expect to see in 2026 include implementing SNAP changes in

the OBBBA, expanding state SNAP food restriction waivers, and reforming broad-based categorical eligibility (BBCE). We also expect federal policymakers to require states to require beneficiaries to reapply for SNAP benefits, a proposal originally floated to reduce SNAP fraud but quickly abandoned, likely because it would be expensive for state governments to implement.

Another SNAP provision in the [OBBBA](#) is the imposition of expanded work requirements. Starting November 1, 2025, the population of Able-Bodied Adults Without Dependents (ABAWDS) subject to work requirements expanded, lowering the age requirement to 54 and the dependent age to 14. Individuals are given a 3-month grace period to find work; if the requirements are not met after three months, they may not receive benefits. This would decrease the number of people eligible for SNAP, posing a risk that food spending at grocery stores and other retailers would fall in 2026.

## 12 STATES WITH FOOD RESTRICTION WAIVERS TO LIMIT GROCERY STORE SPENDING ON NON-NUTRITIOUS FOOD

**A**long with newly added work requirements, grocers and food manufacturers face risks as [12 states](#) have been approved for food restriction waivers under the larger Make America Healthy Again (MAHA) initiative, and an additional [seven states](#) are seeking USDA waivers to impose similar restrictions. The approved waivers prohibit SNAP benefits from being spent on non-nutritious food items (e.g., candy, soda, prepared cakes). These changes start as early as January 1, 2026, for eight states and could result in fewer junk food sales, negatively impacting grocers and the manufacturers of products on the no-buy list.

## SNAP WILL LOSE PARTICIPANTS DUE TO A PROPOSAL REMOVING BROAD-BASED CATEGORICAL ELIGIBILITY

**I**n addition to expanded work requirements and food restriction waivers, the USDA submitted a [proposed rule](#) on October 24, 2025, to reduce SNAP participation through reforming broad-based categorical eligibility (BBCE). BBCE is a state policy adopted in 40+ states that makes it easier to qualify for SNAP. The Trump administration views BBCE as a workaround that allows states to expand SNAP coverage beyond

what Congress intended.

Historically, under BBCE, households that receive benefits from the federal Temporary Assistance for Needy Families (TANF) program are “categorically eligible” for SNAP without having to meet SNAP’s income or asset tests. For example, under normal SNAP rules, income must be at or below 130% of the poverty line, and assets must be under \$2,250. If you receive TANF benefits, which could be as little as receiving a brochure, states waive the income and assets requirements.

States adopted BBCE to help working families who earn slightly above SNAP eligibility and to prevent the “benefit cliff,” ensuring that families do not lose benefits after earning a small raise. USDA’s proposed rule would alter TANF’s categorical eligibility for SNAP to include only households that receive cash or substantial assistance from TANF. This ensures that “categorical eligibility” is extended only to households that receive substantial, ongoing assistance from TANF.

Of the more than 42 million individuals currently receiving SNAP benefits, roughly 6 million are categorically eligible for SNAP through TANF. If USDA’s proposed rule becomes law, it could cause most, if not all, of these individuals to lose their SNAP benefits, decrease USDA SNAP spending by as much as 14%, and, consequently, reduce grocery store spending, putting retailers and food manufacturers at considerable risk in 2026. It is important to remember that 12% of all grocery spending by US households is funded by SNAP.

The USDA proposed the [same rule](#) in 2019 during Trump’s first administration. It was ultimately [withdrawn](#) under President Biden in 2021. The withdrawal of the rule in 2021 and the lengthy timeline lead us to lower the likelihood of this rule coming to fruition in 2026; however, if it does, it would be highly impactful, decreasing SNAP participants by almost 14%.

## SNAP PARTICIPANTS AT RISK OF LOSING ELIGIBILITY AS USDA DISCUSSES REAPPLICATION

The USDA has issued messaging about several changes that could have occurred in 2025 but were not formalized, including initiating a reapplication process for SNAP participants. On November 13th, Secretary of Agriculture Brooke Rollins [announced](#) that the 42 million SNAP beneficiaries will need to reapply for SNAP benefits to eliminate suspected fraud by individuals receiving improper amounts. Rollins has argued that USDA data from 29 states showed that 186,000 deceased enrollees still receive benefits, and 500,000 enrollees have received benefits twice.

On November 20<sup>th</sup>, Rollins [reversed direction](#). Currently, individual SNAP participants or SNAP households are required to report their income and basic information every 4 to 6 months to be fully recertified for SNAP at least every 12 months.

Although USDA's reapplication plan has been put on hold for now, there is still a possibility that it

will return to its previous position and establish a uniform reapplication process in 2026. This would target individuals who have incorrectly reported information and could remove them from the program, aligning with the Trump administration's efforts to cut federal SNAP spending in 2026.

More formalized changes to SNAP, including expanded work requirements, food restriction waivers, and a proposed rule reforming BBCE, along with informal, back-and-forth messaging from USDA about fraud and reapplication measures, signal the administration's intent to structurally change SNAP. This would align with the administration's goals to reduce federal spending, limit participation, and promote a healthier diet for Americans, negatively impacting grocers and manufacturers and posing a substantial risk in 2026.

# RIPPLE EFFECTS OF IMMIGRATION

Why Labor Shortages and  
Wage Reform Loom

# Immigration Policy 2026 Preview:

Capstone believes the Trump administration's policy of accelerating deportations will pose an underappreciated threat to US homebuilders, one-quarter of whose labor supply is immigrants. We expect the courts to block the administration's proposed \$100,000 price tag for H-1B visas, and that prevailing wage reform will spark higher labor costs, another underappreciated headwind, this time for foreign IT outsourcers.

## THE BOTTOM LINE

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Outlook at a Glance

- ▶ **MARKET UNDERAPPRECIATES**  
THE GROWING RISK TO  
HOMEBUILDERS' LABOR FORCE  
AS THE TRUMP ADMINISTRATION  
EXPANDS MASS DEPORTATION  
EFFORTS VIA INTERIOR  
ENFORCEMENT SURGES
- ▶ **PREVAILING WAGE REFORM**  
WILL DRIVE AN UNDERAPPRECIATED  
LABOR COST HEADWIND FOR  
FOREIGN IT OUTSOURCERS
- ▶ **TRUMP ADMINISTRATION WILL**  
CONTINUE H-1B REFORM AGENDA AS  
LEGAL CHALLENGES TO THE \$100,000  
FILING FEE PLAY OUT

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# Market Underappreciates the Growing Risk to Homebuilders' Labor Force as the Trump Administration Expands Mass Deportation Efforts via Interior Enforcement Surges

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<b>Winners</b>	---
<b>Losers</b>	US homebuilders, including D.R. Horton Inc. (DHI), Lennar Corp. (LEN), PulteGroup Inc. (PHM)

President Trump and border czar Tom Homan have ardently endorsed this strategy. In recent press hits, Homan has stated that the administration will prioritize future enforcement across both red and blue states in “sanctuary cities” and “cities where crime is an issue.” While initial surges targeted blue states (New York City, Los Angeles, and Chicago), recent surges have begun to include red states (Memphis, TN; Charlotte, NC; and New Orleans).

Crucially, the Trump administration is armed with significant new funding to support this mission. The One Big Beautiful Bill Act (OBBBA), passed via reconciliation and signed by the President on July 4, 2025, provides \$170.7 billion in additional funding for agencies’ core appropriated budgets, to be spent over 4.25 years for immigration enforcement. This includes \$74.9 billion for ICE (the primary agency responsible for interior enforcement), a 276% annualized increase from ICE’s FY2025 budget. Funding will mostly target agent hiring and increasing detention capacity.

Moreover, the recent growth of the 287(g) program, which can empower state and local law enforcement agencies with immigration enforcement functions, will further boost manpower targeting undocumented immigrants. Of the 1,198 memorandums of agreement involving 287(g) between ICE and state and local law enforcement agencies, 89% were signed in 2025.

## INCREASED INTERIOR IMMIGRATION ENFORCEMENT IN 2026

Capstone expects the Trump administration to significantly expand its mass deportation agenda in 2026. This includes mobilizing forces from Immigration and Customs Enforcement (ICE), Customs and Border Patrol (CBP), and other federal agencies to cities where it has already conducted major enforcement operations. It also likely includes initiating operations in more cities in the South and Sun Belt to support the administration’s stated goal of achieving 1 million deportations annually—a goal Capstone continues to believe is unrealistic.

## ESCALATING IMPACT OF INTERIOR IMMIGRATION ENFORCEMENT ON HOMEBUILDERS

Capstone believes the market underappreciates the risk that rising immigration enforcement poses for major US homebuilders, including D.R. Horton Inc., Lennar Corp., and PulteGroup Inc. The Home Builders Institute (HBI) and National Association of Homebuilders (NAHB) estimate that immigrants comprise 25.5% of the US construction labor force, and much greater portions of the workers in trades essential for home building, namely 61% of plasterers and stucco masons, 61% of drywall and ceiling tile installers, and 52% of roofers.

In 2025, the Trump administration's immigration enforcement policies had already begun to impact the homebuilder labor force. The Associated General Contractors of America (AGC) H1 2025 Workforce Survey indicates that 92% of contractors struggled to fill open positions, and 35% of building construction contractors were affected by immigration enforcement actions.

What is most underappreciated is that this data reflect issues prior to the influx of OBBBA funding for immigration enforcement. Indeed, we expect growing labor challenges for homebuilders as ICE and CBP hire more agents and scale operational forces in H1 2026.

## ADDITIONAL IMMIGRATION ENFORCEMENT POLICY CONSIDERATIONS IN 2026

Capstone believes additional policy and legal developments will have mixed impacts on the Trump administration's immigration enforcement agenda and homebuilders' labor supply.

**1. Immigration or Visa Reform:** While homebuilder and construction industry groups are

advocating for policies to support the immigrant workforce, Capstone believes major changes will not materialize in 2026. We do expect the Trump administration to release additional H-2B visas (temporary non-agricultural workers) for FY26, as the Biden administration did in FY25. However, we do not expect Congress to pass comprehensive immigration reform or targeted visa relief (e.g., increasing the H-2B cap or creating a new visa category for homebuilders and other construction workers).

**2. Limited Immigration Court Capacity:** Most undocumented immigrants apprehended in the US interior may only be deported if they receive a removal order from an immigration judge (IJ) through a proceeding in immigration court, an administrative court in the Department of Justice's Executive Office for Immigration Review (EOIR). Insufficient IJ staffing continues to be a bottleneck that is frustrating deportation efforts across the US, and the OBBBA-imposed hiring cap of 800 total IJs precludes a hiring surge as a solution.

**3. Legal Challenges to Enforcement Tactics:** The Trump administration has faced numerous successful legal challenges against some of its most aggressive immigration enforcement tactics, including its expansion of the use of expedited removal and mandatory detentions. While the legal challenges in isolation would not fully halt the administration's mass deportation agenda, they combine to create modest barriers throughout the immigrant apprehension, detention, legal, and removal processes.

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# The Trump Administration Will Press Ahead With Its H-1B Reform Agenda as Legal Challenges to the \$100,000 Filing Fee Play Out

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<b>Winners</b>	Apple Inc. (AAPL), Qualcomm Inc. (QCOM), Cisco Systems Inc. (CSCO), and other technology firms that already compensate at Level II-IV wages
<b>Losers</b>	---

While immigration hardliners in the administration continue to advance an agenda that includes a proposed blanket ban on new H-1B issuances, Trump has signaled a more pragmatic stance aligned with technologists and other pro-business stakeholders in his coalition. Capstone expects that these internal divisions will lead to inconsistent rulemaking and enforcement of skilled immigration. That said, the risk is low of materially more extreme restrictions beyond the September 2025 H-1B proclamation, and we think the litigation risks to the order are underappreciated (see *Two Trump H-1B Visa Orders Unlikely to Survive Litigation*; Cognizant, Infosys, Tata Consultancy, and PE Portcos To Avoid Worst-Case Scenario, October 7, 2025).

We expect legal challenges to the \$100,000 mandatory filing fee requirement—the headline policy change in the September proclamation—to play out primarily in 2026. In the Chambers/AAU case,

the court has already been fully briefed on the matter and is likely to issue a ruling on the merits in early 2026, ahead of the FY27 lottery cycle. We expect the judge to enjoin the fee requirement, given the strength of plaintiffs’ arguments that the rule exceeds the Department of Homeland Security’s (DHS) statutory authority and is “arbitrary and capricious” under the Administrative Procedure Act (APA).

Similarly, we expect the weighted-selection rule to trigger litigation once a final rule is published in the Federal Register. We believe that rulemaking is vulnerable to challenge under the authorizing statute, which directs that H-1B visas be allocated “in the order in which petitions are filed for such visas,” a provision US Citizenship and Immigration Services (USCIS) has historically implemented through a randomized lottery.

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# Prevailing Wage Reform Is Likely to Drive an Underappreciated Labor Cost Headwind for Foreign IT Outsourcers

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<b>Winners</b>	---
<b>Losers</b>	Healthcare staffing and recruitment firms, IT outsourcers such as Cognizant Technology Solutions Corp. (CTSH), Infosys Ltd. (INFY), Tata Consultancy Services Ltd. (532540 on the Bombay stock exchange).

on where DOL anchors the updated wage levels within the occupational wage distribution.

**W**e continue to believe that the Trump administration's plans to reform prevailing wage requirements under the H-1B program are underappreciated. We expect the Department of Labor (DOL) to initiate a notice of proposed rulemaking (NPRM) in the first half of 2026. Assuming the administration follows a standard notice-and-comment process, we expect the courts will uphold the rulemaking, given that the Immigration and Nationality Act (INA) explicitly delegates authority over prevailing wage levels to the DOL.

If implemented, the new requirements could pose material headwinds to a broad cross-section of H-1B-dependent sectors, including healthcare staffing, IT outsourcing, and higher education institutions. The prior prevailing wage rulemaking under the first Trump administration—though later struck down on procedural grounds—raised wages across H-1B occupations by ~26.2%. The magnitude of the impact of a new rule will depend

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# **Communications, Media, and Technology**

# The FCC's Green Light

The Pro-Merger  
Era Continues



# Telecom Policy 2026 Preview:

Capstone expects the Republican-led Federal Communications Commission (FCC) to continue rolling back regulations and take a more welcoming approach to mergers in 2026. The agency is also likely to use its broad authority over what qualifies as “in the public interest” to push companies for certain concessions during reviews. Overall, we anticipate a surge in consolidation across both broadcast media and the broadband industry through 2027.

## THE BOTTOM LINE

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### Outlook at a Glance

- ▶ **FEDERAL COMMUNICATIONS COMMISSION** TO BE FRIENDLIER TO MERGERS, LICENSE TRANSFERS, WAIVERS, OTHER APPROVALS, AND MOVE AHEAD ON SCRAPPING MOST MEDIA OWNERSHIP RULES
- ▶ **FCC WILL LEVERAGE PUBLIC INTEREST STANDARD** AS A TOOL TO FORCE COMPANIES TO ADOPT POLICIES TRUMP ADMINISTRATION SUPPORTS
- ▶ **SPECTRUM POLICY** WILL BE A KEY AREA OF FOCUS IN 2026 AS THE FCC MOVES FORWARD ON PREPARING FOR A SERIES OF LICENSE AUCTIONS STARTING IN 2027
- ▶ **ACCELERATING GROWTH** OF DOMESTIC LEO SATELLITES TO REMAIN FCC PRIORITY OF FCC, WITH FASTER LICENSING, PRO-BUSINESS ATTITUDE, AND REDUCED INTERFERENCE PROTECTIONS FOR GEOS

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# Federal Communications Commission to be Friendlier to Mergers, License Transfers, Waivers, Other Approvals, and Move Ahead on Scrapping Most Media Ownership Rules

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<b>Winners</b>	EchoStar Corp. (SATS), T-Mobile US Inc. (TMUS), Verizon Communications Inc. (VZ), AT&T Inc. (T), Nexstar Media Group Inc. (NXST), Tegna Inc. (TGNA), Charter Communications Inc. (CHTR), SpaceX, Cox Communications, and deals expected to be announced in 2026
<b>Losers</b>	None

The Trump-era FCC will continue to be more accommodating to mergers and license transfers than it was under the Biden administration and we expect all the transactions currently under consideration to be approved. The FCC will continue to evaluate each transaction on its individual merits and subject them all to a thorough review process, but will not reflexively block transactions that lead to greater industry consolidation. Major transactions involving the sale of wireless licenses by EchoStar to the other major wireless carriers, the merger of Charter Communications and Cox Communications, and the merger of Nexstar and Tegna should all be approved in 2026.

Capstones notes, however, that mergers in the broadcast television market could face a slightly longer approval process in the year ahead since current FCC rules limit the number of stations and audience households one broadcast television station group can own in a given market. FCC Chair Brendan Carr views media ownership rules as outdated, with broadcast television in direct competition with streaming services, virtual multichannel video programming distributors (vMVPD), cable companies, and other business models. These non-traditional business models now represent more than half of all TV viewership and pose an existential threat both to over-the-air broadcasters and cable companies, which helps to explain why Carr supports easing or eliminating the FCC's television broadcast media ownership rules. Eliminating, easing, or waiving media ownership rules is critical in approving transactions between television broadcast station groups as it will be nearly impossible for larger transactions like the Nexstar/Tegna acquisition to close under the current rules.

We also believe a Carr-led FCC in 2026 will more strictly define what is in the public interest when evaluating transactions and not reflexively block deals that could lead to hypothetical harms or greater industry concentration, which was the case under the Rosenworcel-led FCC during the Biden administration. A more pragmatic FCC under Carr should easily approve the sale of EchoStar's spectrum licenses in 2026 to the three major wireless carriers and other similar transac-

tions.

There appears to be a general recognition by Carr that some level of consolidation in both the wireline and wireless broadband industry will be beneficial, particularly if it does not lead to excessive consolidation at the local level and leads to better service or to scarce resources like wireless spectrum being more efficiently used to serve the needs of subscribers. One could even argue that the FCC's dissatisfaction with how inefficiently EchoStar was using its wireless spectrum is a major reason why these licenses were sold to the other wireless carriers, which are likely going to

use the spectrum more intensely than EchoStar could.

The FCC's scrutiny of EchoStar and whether the company was meeting its network buildout requirements and actually using the spectrum it held licenses to operate on generally are cited as a major reason why the company divested these licenses.

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## FCC Will Leverage Public Interest Standard as a Tool to Force Companies to Adopt Policies Trump Administration Supports

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<b>Winners</b>	Broadcast television station groups like Nexstar and Sinclair, broadband providers like Verizon, and other companies seeking to get mergers approved that have proven willing to engage with the Trump administration.
<b>Losers</b>	Companies unwilling to engage with the Trump administration

**T**he FCC must approve all transactions and license renewals involving telecommunications companies and broadcasters, as they hold FCC licenses and fall under the commission's regulatory jurisdiction.

An FCC license can be transferred only in a merger or an asset sale if it is deemed to be in the public interest. The FCC also approves or eliminates regulations based only on this public interest standard. However, the public interest standard is ambiguous and can mean different things to different people.

Democrats used the public interest standard to help block transactions that did not seem to be traditionally anti-competitive. For example, the Biden-era FCC refused to approve Standard General's acquisition of television station operator Tegna, contending that the transaction could lead to higher cable subscription prices for consumers and a loss of jobs in newsrooms. The FCC under Democrats also imposed onerous rules, including broadband nutrition labels on internet service providers (ISPs), and slashed per-minute calling

rates for Incarcerated Peoples' Communications Services (IPCS), maintaining that these regulatory changes were in the public interest.

A Carr-led FCC in 2025 saw the FCC using its broad discretionary authority in interpreting the public interest standard. An example of this was when Chair Carr signaled that he would use the FCC's authority over mergers in the telecommunications and broadcast media space to block transactions that had adopted diversity, equity, and inclusion (DEI) policies. This led Verizon and T-Mobile, which had transaction reviews before the commission, to eliminate their DEI programs.

Capstone believes DEI, which the White House perceives as anti-Trump bias in the media, and the contentious relationship between local broadcasters and major networks will all be areas of focus in 2026, when the FCC under Carr will likely seek to extract concessions from companies seeking approval for deals or rulemaking. Broadcast television stations and both wireline and wireless broadband service providers are probably most at risk as the FCC is most active in these sectors with respect to merger approvals, license transfer requests, and deregulation.

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## Spectrum Policy Will be a Key Area of Focus in 2026 as FCC Prepares for a Series of License Auctions Starting in 2027

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<b>Winners</b>	AT&T, Verizon, T-Mobile, SES SA, Intelsat
<b>Losers</b>	Comcast Corp. (CMCSA), NextNav Inc. (NN), Charter

**W**e believe identifying and clearing spectrum for auction for flexible use is top of mind for the Carr-led FCC following the passage of the One Big, Beautiful Bill Act (OBBBA) in July. The legislation requires the commission to auction 800 MHz of flexible-use spectrum by 2034, most of which we anticipate will be won by large wireless carriers for 5G network deployments.

The first milestone will be an auction of upper C-band (3.98-4.2 GHz) spectrum, which must be completed by July 2027. The FCC recently issued a proposed rule to begin reshaping the band—which is currently occupied by satellite operators for content distribution—to flexible use by using funds raised from the imminent auction to

pay existing operators to relocate. This will have read-throughs for incumbent Intelsat, which has contingent value rights (CVRs) to the proceeds from repurposing the band. It remains to be seen how much the FCC will pay operators to incentivize accelerated clearing of the band, a detail crucial for bondholders. Most of the total 800 MHz of spectrum required to be auctioned still must be identified.

Spectrum will continue to be a key priority for this FCC, and we believe these auctions will take up a significant amount of the commission's bandwidth in 2026. Additionally, satellite spectrum reform and license transfers resulting from the sale of EchoStar's spectrum assets are high priorities. We believe that less time-bound issues, such as

NextNav's petition for a lucrative spectrum swap in the lower 900 MHz band (902-928 MHz), will land on the back burner, increasing the likelihood that operators that already own the spectrum needed to back up the Global Positioning System (GPS) will be awarded licenses.

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## Accelerating Growth of Domestic LEO Satellites to Remain FCC Priority, with Faster Licensing, Pro-Business Attitude, and Reduced Interference Protections for GEOs

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<b>Winners</b>	SpaceX, AST SpaceMobile Inc. (ASTS), Amazon.com Inc. (AMZN), other low earth orbit (LEO) operators
<b>Losers</b>	EchoStar, Viasat Inc. (VSAT), DirecTV, other geosynchronous (GEO) operators

**W**e believe the FCC will continue to be proactive in efficient licensing and revamping interference protections in 2026 to ensure that relatively new competitors—massive LEO satellite constellations—can scale quickly to increase US soft power abroad. The commission views the LEO satellite race against China as the “second space race” and aspires to finalize its current proposed reforms.

To boost domestic LEO satellite broadband providers SpaceX and Amazon Leo (formerly Project Kuiper), the FCC has introduced reforms to 1) create an “assembly line” process for licensing

satellite and earth station licensing; 2) free up 20,000 MHz of spectrum ranging from 12.7 GHz to 114.25 GHz for satellite broadband use; and 3) reshape how spectrum sharing between LEO and GEO operators functions by changing how harmful interference is measured. For massive LEO operators that are constantly launching; require new licenses for larger constellations; and operate using free, shared spectrum in the Ka-/Ku-bands, these reforms will increase both total constellation and per-satellite throughput. While these reforms are positive for LEOs and the broader race against China, decreased interference protection for GEOs to increase LEO bandwidth is indicative of the competitive shift toward lower orbits seen in recent years.

On the direct-to-device (D2D) side, the FCC has been highly permissive and flexible with its goals for intensive spectrum use and reducing launch delays. This would include granting AST Space-Mobile broad authority to launch into orbit 20 of the largest satellites (~2,400 square feet each) instead of evaluating the performance of the first satellite and then deciding on further launches. We anticipate this permissive attitude to apply to spectrum issues as well, with SpaceX likely to receive a waiver under the Supplemental Coverage from Space (SCS) framework to use terrestrial midband spectrum purchased from EchoStar for D2D.

It remains to be seen how the FCC will handle D2D spectrum harmonization in other countries and whether it will wield the US's soft power to do so, similar to how Starlink broadband access reportedly became a part of the Trump administration's tariff negotiations with Lesotho and other countries. A prime indicator of this will be the European Union's upcoming 2 GHz reallocation decision. With SpaceX now technically an incumbent after purchasing EchoStar's S-band licenses, the European Commission now must decide whether to preference quality of service for its citizens or sovereignty and support of its IRIS2 initiative. The license winners will gain access to the EU market and significantly increase revenue as LEO satellites will be orbiting the continent regardless—a huge boon to profit margins.

# The Great Chip Chase

Implications of the Trump Administration's Strategy  
to Win the AI Chip Race with China



THE  
BOTTOM  
LINE

Capstone expects the Trump administration to maintain a pro-artificial intelligence, hands-off regulatory posture in 2026, with states and courts stepping in to fill the gap through targeted restrictions and case-by-case rulings. We also anticipate a transactional approach to semiconductor export controls, allowing chip-makers to continue selling advanced hardware to China, alongside continued federal support for data center development despite growing local opposition.

- ▶ **AS THE FEDERAL GOVERNMENT** FOCUSES ON INVESTING IN AI RATHER THAN POLICING, STATES AND COURTS WILL FILL THE REGULATORY GAP
- ▶ **DESPITE THE WHITE HOUSE'S PRO-AI POLICIES,** STATE AND LOCAL RESISTANCE WILL STALL DATA CENTER PROJECTS OVER ENVIRONMENTAL AND AFFORDABILITY CONCERNS
- ▶ **WHITE HOUSE WILL CONTINUE** DEALMAKING FOR SHIPMENTS OF ADVANCED CHIPS AS EXPORT CONTROLS RULEMAKING SLOWS, THOUGH RESTRICTIONS ON CAPITAL EQUIPMENT WILL STAY

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# As the Federal Government Focuses on Investing in AI Rather Than Policing, Courts and Narrowed State Laws Will Fill the Regulatory Gap

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<b>Winners</b>	Amazon.com Inc. (AMZN), Oracle Corp. (ORCL), Microsoft Corp. (MSFT), and  Alphabet Inc. (GOOG), Palantir Technologies Inc. (PLTR), Reddit Inc. (RDDT)
<b>Losers</b>	Workday Inc. (WDAY)

Capstone believes the Trump administration will prioritize developing the US AI industry by expanding the US government's role as a major AI customer and by continuing to deregulate the industry. In our view, Congress is unlikely to pass AI legislation in 2026, including any preemption of state AI regulation. While the Trump administration will likely try to preempt state AI regulation through executive order (EO), we believe the effort will ultimately be struck down by the courts. Without federal AI legislation, federal courts will shape the regulatory landscape, and states will continue to generate a patchwork of narrow AI regulation.

## FEDERAL GOVERNMENT

Capstone anticipates that the US government will remain a major AI customer and support AI infrastructure development in the coming year. In the aftermath of significant staff attrition across the federal government in 2025, the Trump administration and agency leadership have continued to signal that they see AI as a key resource in backfilling diminished federal capacity. In August, Gregory Barbaccia, the government's chief information officer (CIO), indicated that he expects AI to mitigate staffing shortages, and the Securities and Exchange Commission (SEC) reportedly is restructuring around incorporating AI into workflows.

The White House's AI Action Plan gives a clear directive to increase the usage and availability of AI across the federal government. At the end of November, the administration announced the Genesis Mission, a Manhattan Project-style AI program that, if funded in the FY27 budget, would make the US government one of the primary users of AI cloud compute.

Given the administration's focus on leveraging AI and supporting the industry, we do not expect federal AI regulation in 2026. The Trump administration has indicated support for a moratorium on state AI regulations, and a draft EO has circulated that would make \$42.5 billion in state Broadband, Equity, Access, and Deployment (BEAD) funds contingent on state AI deregulation. However, we

believe the EO will not survive court challenges and that Congress will not be able to agree on the scope of a state AI regulatory moratorium.

## AI LITIGATION

As clear legal standards for the training and use of AI, established through a federal statute, are likely years away, Capstone believes that litigation remains the driver of de facto regulation in the AI space. AI companies like OpenAI, Microsoft Corp. (MSFT), Anthropic, Perplexity, and others face a growing number of class actions around issues such as copyright infringement, data scraping, privacy, and AI discrimination. (See Capstone's AI Litigation tracker for live coverage of these cases.)

In his July speech following the release of the AI Action Plan, which did not address copyright issues, Trump said that stringent copyright enforcement for AI training would be unsustainable and would prevent the U.S. from competing with China in the AI race. However, Trump administration officials later reportedly clarified that decisions around the legality of unauthorized AI training should be left to the courts, echoing the Copyright Office's May 2025 report on AI training. Therefore, with the courts leading the way, the outcomes of these copyright infringement cases will likely shape the path forward for future AI legislation and large language model (LLM) development practices.

Federal judges have continued to handle copyright infringement and data scraping lawsuits on a case-by-case basis, in line with our expectations following the Copyright Office's report that concluded that "some uses of copyrighted works for generative AI training will qualify as fair use, and some will not." However, recent court decisions in *Bartz v. Anthropic* and *Thomson Reuters v. Ross Intelligence* suggest that judges are increasingly ruling that the use of pirated or unlicensed content is illegal (see *Recent Court Wins for AI Firms Narrow, Reveal Legal Uncertainty Rather Than Set Precedent; Foreign Firms Like Alibaba and Baidu to Gain Edge*, June 30, 2025).

These judicial opinions have led, and will increasingly lead, AI developers to invest in legally acquired datasets and to be more inclined to pursue licensing deals to minimize potential liability from infringement allegations. We expect these agreements, which could include revenue-share contracts, to serve as settlements in ongoing litigation, especially since the bar for monetary settlements was set high by Anthropic's \$1.5 billion settlement in *Bartz v. Anthropic*. The increase in demand for licensing deals will benefit companies holding large amounts of user-generated data, such as Reddit Inc. (RDDT), which already receives 10% of its annual revenue from just two licensing agreements.

Federal courts are also determining where liability lies in AI-related discrimination cases. In the US District Court for the Northern District of California, Judge Rita Lin allowed a class action, *Mobley v. Workday, Inc.*, to move forward on a novel theory of liability, in which Workday Inc. (WDAY) could be held liable for alleged employment discrimination as an agent of its customers due to the role its AI-enabled tools allegedly play in hiring-related decision making. We expect the parties in the case to settle in 2026 and for copycat litigation to follow in areas where similar discrimination protections exist, like housing and consumer credit

## STATE REGULATION

In the absence of federal regulation, states are working to fill the gaps, primarily by addressing constituent concerns. While some states have tried to pass comprehensive AI regulations—most notably Colorado's AI Act (SB 24-205), which places restrictions on model training—states have generally shifted toward passing narrow AI bills focused on specific issues. These bills have focused on healthcare, employment, and education, including Illinois HB 3773, which prohibits AI-driven employment discrimination and takes effect January 1, 2026. In our view, state legislatures will continue to focus on these areas for AI regulation in 2026.

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# White House Will Continue Deal-Making for Shipments of Advanced Chips as Export Controls Rulemaking Slows, Though Restrictions on Capital Equipment Will Stay

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<b>Winners</b>	Advanced Micro Devices Inc. (AMD), ASML Holding NV (ASML), Nvidia Corp. (NVDA)
<b>Losers</b>	Applied Materials Inc. (AMAT), Lam Research Corp. (LRCX)

Capstone believes the Trump administration will continue to pursue policies liberalizing exports of the US AI technology stack internationally, but will seek visibility into these shipments through the licensing framework. Furthermore, while Trump has eased the government's approach to controlling end products such as Nvidia integrated circuits (ICs), we do not expect a comparable shift in posture toward semiconductor manufacturing equipment (SME) and other chokepoint technologies.

## CHINA

Despite Trump's initial desire to allow Nvidia to ship some Blackwell chips to China, the president was ultimately persuaded by more hawkish

members of his Cabinet to refrain from raising the issue during a meeting with President Xi. Still, the underlying appetite persists, as expectations are growing that the Commerce Department will approve H200.

Separately, Treasury Secretary Scott Bessent has suggested that the US could eventually approve an even more powerful product. This is likely to create flashpoints with Congress, which has recently sought to assert greater oversight of licensing decisions, including through the proposed GAIN AI Act, which would give lawmakers a 30-day window to block export licenses for advanced AI chips destined for adversarial nations.

While the US may continue to relax export controls on advanced ICs, we do not expect a parallel easing of restrictions on SME tools, a nuance that we believe is underappreciated. The administration continues to engage allies, including the Netherlands and Japan, on servicing and maintenance controls, while more hawkish stakeholders, such as the United States House Select Committee on Strategic Competition between the United States and the Chinese Communist Party, press for broader restrictions on lithography systems. Nevertheless, US partners may interpret the administration's softer rhetorical posture towards China as affording some incremental breathing room.

## OTHER COUNTRIES

We also expect the Trump administration to expedite efforts to approve chip shipments to third countries. In a November 2025 press release announcing the authorization of licenses to G42 in the United Arab Emirates (UAE) and Humain in Saudi Arabia, the Bureau of Industry and Security (BIS) signaled it will continue supporting “the export of the American AI technology stack to Saudi Arabia, the UAE, and other allies and partners around the globe.”

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# Despite the White House’s Pro-AI Policies, State and Local Resistance Will Stall Data Center Projects Over Environmental and Affordability Concerns

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<b>Winners</b>	Amazon.com Inc. (AMZN), Alphabet Inc. (GOOGL), Meta Platforms Inc. (META)
<b>Losers</b>	CoreWeave Inc. (CRWV), Nebius Group NV (NBIS), IREN Ltd. (IREN)

**C**apstone believes local and state governments will increasingly resist data center expansion, citing concerns over utility costs, water consumption, and land use. This creates hurdles to development despite

concerted efforts by the Trump administration to streamline data center permitting.

The Trump administration has established itself as pro-AI infrastructure, most notably through its announcement of the Genesis Mission, a Manhattan Project-style initiative accelerating AI-driven scientific research. Additionally, a Trump EO aimed at easing permitting restrictions on data centers signals a whole-of-government approach to removing supply-side constraints on AI infrastructure, primarily creating structural advantages for large, established hyperscale cloud providers by streamlining federal permitting for qualifying projects meeting either a 100 MW load threshold or a \$500 million capital expenditure commitment. Despite federal efforts, state and local opposition remains a binding constraint.

Congress is unlikely to ease the data center development process by preempting state and local governments or even streamlining federal processes. While Congress could theoretically accomplish this through National Environmental Policy Act (NEPA) streamlining for AI-designated projects or grid interconnection fast-tracking via the Federal Energy Regulatory Commission (FERC), such proposals have faced steep opposition (see Permitting Reform and Data Centers Policy Day Takeaways: Reform Unlikely Before End of 2026; FERC Interconnection Rule to Face Pushback, November 25, 2025), making a sweeping state and local preemption highly unlikely.

widespread, stalling over \$160 billion in investment across 24 states, including high-profile setbacks in late 2025, such as the court-blocked Digital Gateway in Virginia and Google's withdrawn proposal in Indiana.

Common themes in successful data center opposition campaigns include higher utility bills, water consumption, noise, property values, and green space preservation. These concerns have proven potent enough to override the economic development arguments that previously dominated local zoning debates.

## STATE-LEVEL DYNAMICS

States have competed aggressively to attract data center investment through generous tax incentives, primarily sales and use-tax exemptions on equipment purchases. However, the political calculus is shifting as states confront the fiscal and infrastructure costs of unconstrained data center growth—forgone revenue compounds while ratepayer concerns mount. Virginia, for example, has forgone substantial tax revenue since creating its exemption in 2008: \$1 billion in FY24 alone and \$2.7 billion over the last decade. States such as Georgia and Washington have moved to reassess this relationship, introducing legislation and establishing task forces to address tax incentives, grid impacts, and carbon-neutrality goals.

## LOCAL GOVERNMENTS: SUCCESSFUL OPPOSITION AND CORE GRIEVANCES

At the local level, community opposition has proven capable of blocking or substantially delaying even multibillion-dollar projects. For emerging AI cloud providers like CoreWeave Inc. (CRVV), incremental delays incur costs they cannot absorb as easily as legacy hyperscalers such as Amazon, Alphabet's Google, and Microsoft.

Recent tracking suggests local resistance is

# TOO BIG TO HIDE



Why Big Tech Platforms Will  
Face Continued Scrutiny

# Platforms Policy 2026 Preview:

## THE BOTTOM LINE

Capstone expects regulators to take an increasingly multifaceted approach to curbing harmful activity on platforms operated by Alphabet Inc.'s Google, Meta Platforms Inc., Apple Inc., and Roblox Corp. Age verification requirements, children's safety litigation, and evolving content liability standards create near-term headwinds, though First Amendment considerations may limit their reach. We also expect antitrust actions—particularly targeting app store practices—to continue.

▶ **2026** WILL BRING CLEARER APP-STORE FEE STRUCTURES ON BOTH SIDES OF THE ATLANTIC; APPLE AND GOOGLE WILL BENEFIT FROM RESOLVING

▶ **GROWTH** IN CHILD SAFETY LITIGATION WILL DRIVE USER LOSS ON YOUTH-HEAVY PLATFORMS IN ADVANCE OF AGE VERIFICATION LAWS

▶ **STATE ENFORCEMENT** OF AGE VERIFICATION LAWS REMAINS UNEVEN DUE TO VARYING DEFINITIONS AND COURT CHALLENGES, WHILE A WEAKENED FEDERAL KIDS ONLINE SAFETY ACT GAINS STEAM

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# 2026 Will Bring Clearer App-Store Fee Structures on Both Sides of the Atlantic; Apple and Google Will Benefit from Resolving US Litigation, but Face Mild Headwinds in the EU

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<b>Winners</b>	Apple Inc. (AAPL), Alphabet Inc. (GOOGL), Large app developers
<b>Losers</b>	Smaller app-developers, Spotify (SPOT), Match Group Inc (MTCH), Netflix Inc (NFLX)

Capstone expects 2026 to be a pivotal year as litigation in the US regarding app-store payments in Epic v. Apple and Epic v. Google is resolved. We believe outcomes driven by private lawsuits, rather than rulemaking or legislation, will be incrementally better for Apple and Google, though also a material improvement for developers relative to the pre-2020 baseline before the lawsuits were filed. We expect Apple and Google to avoid the worst-case outcomes, with Apple likely to avoid a prolonged zero-commission regime and Google well-positioned to secure terms more favorable than those contemplated in the original injunction.

In the EU, Capstone expects the European Commission to approve Apple’s and Google’s revised fee structures, changes that would lower developer fees and resolve the current investigations under the Digital Markets Act (DMA).

## EPIC V. APPLE

We believe the Ninth Circuit Court of Appeals appeared open to reversing a contempt order issued by Judge Yvonne Gonzalez Rogers of the Northern District of California and sending the case back to district court, where we anticipate the approval of a negotiated commission structure rather than the current zero-commission rule for out-of-app purchases. At an October hearing, Apple asserted its right to charge “reasonable fees” for access to its ecosystem and argued that the contempt order exceeded the scope of the original 2021 injunction, which did not prohibit commissions on external purchases.

The removal of a zero-commission remedy would be positive for Apple and a headwind for developers relative to the post-May 2025 environment, when the contempt order took effect. It has prompted major platforms, including Spotify Technology SA (SPOT), Netflix Inc. (NFLX), Amazon.com, Inc. (AMZN), and Match Group Inc. (MTCH), to expand alternative billing. Spotify highlighted the benefits during its July earnings call, while Match noted that “both Apple and Google combined are our single largest cost- \$700 million a year we spend on fees.”

## EPIC V. GOOGLE

We expect District Court Judge James Donato of the Northern District of California to approve the parties' proposed settlement next year, which was submitted in early November. He expressed skepticism during the status conference, saying that he wants to examine the broad implications of the settlement beyond the preferences of the parties. Cases of this type are typically resolved based on "public-interest" considerations. The parties can emphasize the global scope of remedies, the longer duration of the settlement (seven years versus three), and the immediate implementation timeline. Rejecting the agreement also risks US Supreme Court intervention, as Google's cert petition remains active.

The settlement is more favorable for Google than the existing injunction, and more positive for large developers than small ones. It allows Google to retain commissions on out-of-app transactions and scales back several remedies that developers, particularly smaller ones, had received under the original injunction. For example, developers must be shown side-by-side billing options, but Google is not required to provide catalog app access. While third-party app stores will not pay commissions, developers using alternative billing systems will still face fees up to 20% (and 25% for alternatives that mirror Play Billing). This narrow 5-percentage-point difference relative to in-app purchases limits the incentive for developers to adopt alternative billing.

## EUROPEAN COMMISSION INVESTIGATIONS

We expect the European Commission to approve the changes that Apple and Google have proposed to their app store fee structures in early to mid-2026. The Commission may seek additional concessions, but we do not expect it to fundamentally redesign pricing frameworks, particularly against the backdrop of heightened US-EU trade tension and political pressure from a protectionist US administration. The changes we expect would benefit developers in the EU. Apple has proposed capping commissions

at 17% for external purchases, while Google's proposed cap is roughly 13%. Both frameworks would reduce friction in out-of-app payment flows and support greater viability for third-party app stores and out-of-app purchases.

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# Growth in Child Safety Litigation Will Drive User Loss on Youth-Heavy Platforms in Advance of Age Verification Laws

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<b>Winners</b>	Meta Platforms Inc. (META)
<b>Losers</b>	Roblox Corp. (RBLX), Alphabet Inc. (GOOGL), ByteDance Ltd.'s TikTok

Capstone believes that platforms such as TikTok, Roblox, and Meta Platforms Inc. will continue to face lawsuits alleging harm to minors in 2026, creating company-specific pressures distinct from pending legislative mandates. Companies facing such litigation must choose between implementing stricter age-gating measures, which could significantly impact revenue for platforms with large youth user bases, and bearing costly legal risks.

For example, Roblox, an online game platform with users who are largely under 18 years old, faces a slew of lawsuits brought by states (such as Kentucky, Louisiana, and Texas) and private parties for allegedly exposing children to explicit content and facilitating exploitation.

In response to this scrutiny, Roblox announced that beginning in January, it will require facial age checks for access to its chat features globally, using artificial intelligence (AI) to categorize users into age groups. While this addresses some safety concerns, messaging is only one of the platform's

interactive functions, so this measure is unlikely to eliminate the risk of additional litigation. News reports also indicate that minors have been able to use AI to bypass these protections. Capstone believes that these lawsuits will continue to accumulate against online platforms in 2026.

## YOUTH-FOCUSED PLATFORMS

Capstone believes platforms with high percentages of child users will lose the biggest share of their users from age gating, while the headwinds for companies geared towards adults will be comparatively modest. As we previously calculated, approximately 1.7% and 2% of users on Meta's Facebook and Instagram platforms, respectively, are under 13. The risks are much greater for Roblox, nearly 40% of whose users are under 13 (though the percentage may be even higher, as many children claim to be older).

Child safety lawsuits and resulting changes to age-gating infrastructure are likely to disproportionately disadvantage companies that appeal to children. Furthermore, while the majority of Meta's revenue comes from advertising, Roblox's primary revenue source is sales of its virtual currency, 'Robux,' making user activity vital to its bottom line.

The implementation of age-gating methods will likely make platforms less accessible for users, therefore decreasing their overall user count. In addition to users under 18, we expect many adult users to stop using platforms as a result of new measures that require them to enter personal data (such as government IDs) to use platform features.

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# State Enforcement of Age Verification Laws Remains Uneven Due to Varying Definitions and Court Challenges, While a Weakened Federal Kids Online Safety Act Gains Steam

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<b>Winners</b>	N/A
<b>Losers</b>	Meta Platforms Inc. (META), Snap Inc. (SNAP), Alphabet Inc. (GOOGL), Apple Inc. (AAPL), Roblox Corp. (RBLX),

Capstone believes that while states have implemented age verification mandates to strengthen protections for children online, the lack of uniformity across jurisdictions dilutes their impact. Online platforms face a patchwork of conflicting requirements, with variations in state laws and pending federal bills providing differing standards and mandates that make it difficult for companies to address the issue. Additionally, First Amendment challenges to state age verification laws have succeeded in blocking many of them, allowing companies to continue using existing practices.

## FIRST AMENDMENT CHALLENGES

In the absence of federal action, many states have attempted to pass laws to protect children online,

often through strict age verification mandates. These provisions require platforms to implement “commercially available” methods to determine the identity and age of users, likely through the collection of sensitive personal data. Capstone previously calculated that a national age verification framework would threaten up to 18% of revenue for platforms like Meta’s Facebook and Instagram and Snap Inc.’s Snapchat.

However, state and federal lawmakers have struggled to craft legislation to strengthen protections for children online without running into First Amendment concerns. Several states, including Arkansas, Utah, Texas, Mississippi, and California, which have passed laws requiring social media companies to verify users’ ages have faced court challenges brought by industry groups such as NetChoice and the Chamber of Progress.

These challenges have centered on age verification mandates and content restrictions. While courts have upheld several laws, concerns about these provisions remain. While the US Supreme Court denied NetChoice’s request to temporarily block Mississippi’s Walker Montgomery Protecting Children Online Act (HB 1126), a 2024 statute imposing age verification requirements, Justice Brett Kavanaugh said in a concurring opinion in that decision that the statute would “likely violate its members’ First Amendment rights”.

While these decisions add to the momentum to pass federal and state children’s privacy legisla-

tion, questions remain about whether age verification provisions are constitutional. We expect state-level age verification laws to spread, but to also face challenges that will delay implementation and mitigate worst-case scenarios for platforms.

## DEFINITION OF “COVERED ENTITIES”

Online safety laws vary in how they define “covered entities.” While some state and federal children’s privacy laws tailor provisions to “social media platforms,” others adopt broader terms, such as “online platforms” or “digital services.” California’s Age-Appropriate Design Code applies to online services “likely to be accessed by children,” including streaming services and online gaming platforms. By contrast, Utah’s Social Media Regulation Act (HB 464) limits its coverage to social media companies.

These differing approaches create a legal grey area for companies that fall within the scope of some states’ laws but not others. These platforms face competing risks: the cost of over-compliance or the legal risks of under-compliance. For example, Alphabet’s YouTube could be classified differently across jurisdictions: some children’s privacy statutes may treat YouTube as a streaming platform, while others categorize it as social media. Similarly, Roblox, while typically defined as an online game platform, also has social media and messaging features. Social media companies like Meta and Snap are subject to most online safety laws.

Notably, multiple states have shifted liability from social media companies to app stores by requiring app stores to administer and enforce age restrictions before allowing downloads. Adult-content websites have alternatively urged tech platforms and lawmakers to enforce device-based age verification. Capstone believes these approaches could bypass First Amendment challenges by targeting access rather than content.

## FEDERAL CHILDREN’S PRIVACY LEGISLATION

We continue to believe Congress will pass online safety legislation for children, such as the Kids Online Safety Act (KOSA) or the Kids Off Social Media Act (KOSMA), by the end of this year. However, we do not expect it to include an age verification mandate, given how courts have ruled in First Amendment challenges. We expect Congress to continue viewing online privacy legislation as a precondition to AI regulation, providing additional momentum for legislation like KOSA, KOSMA, and the Children and Teens’ Online Privacy Protection Act (COPPA 2.0).

On December 2nd, the House Energy and Commerce Committee discussed a 19-bill package aimed at protecting children online, centered around a pared-down version of KOSA. The newest House version of KOSA, however, excludes its “duty of care” provision, which gives platforms a legal obligation to take “reasonable steps” to protect minors from harmful content on their services and age verification measures to avoid constitutional challenges.

The 19 bills are also packaged with AI-related safety measures, such as limitations for chatbots, algorithmic recommendations, and deepfakes, which will likely help foster support for action on children’s privacy. Regulators have indicated, and Capstone has reported, that legislative or regulatory action in the AI space is contingent upon movement towards protecting kids’ privacy online, so bundling these issues could advance both agendas simultaneously. However, the most material provisions, namely age verification and duty of care, are unlikely to be enacted, avoiding a worst-case scenario for social media companies and other online platforms.

# Europe



European Policy 2026 Preview

# EUROPEAN SOVEREIGNTY UNDER TRUMP

Europe's push for autonomy, isolation,  
and competitiveness



# European Policy 2026 Preview:

In 2026, we believe Europe's policy outlook will be shaped by the struggle for strategic autonomy. A year into Trump's 2nd term, Europe is increasingly vulnerable to external pressures. Policymakers will spur plans to boost digital sovereignty, competitiveness, and resilience to security threats. We see underappreciated support in strategic sectors, including AI, digital infrastructure, steel, semiconductors, and defence tech.

## THE BOTTOM LINE

Outlook at a Glance

- ▶ **AS THE EU COUNCIL AND PARLIAMENT DEBATE THE €1.8 TRILLION MULTIANNUAL FINANCIAL FRAMEWORK, TECH AND BIOTECH EMERGE AS WINNERS, WHILE FARMING AND TOBACCO LOSE**
- ▶ **MOMENTUM IS BUILDING FOR A REVISED EU CHIPS ACT, WHICH WOULD LIKELY FOCUS ON DESIGN RATHER THAN MANUFACTURING GIVEN THE EU'S STRUCTURAL DISADVANTAGES**
- ▶ **POLICYMAKERS WILL AIM TO STRENGTHEN THE EU'S COMPUTING INFRASTRUCTURE, SIMPLIFY REGULATION, AND REDUCE DEPENDENCY ON NON-EU TECHNOLOGY**
- ▶ **EU TRADE TENSIONS WITH THE US AND CHINA WILL PERSIST IN 2026, WITH EUROPEAN STEELMAKERS TO BE THE RELATIVE WINNERS WHILE AUTOMAKERS SUFFER**
- ▶ **INCREASES IN MEMBER STATE AND EU DEFENCE SPENDING WILL BENEFIT COUNTER-DRONE MANUFACTURERS, AIR AND SPACE SHIELDING TECHNOLOGY, AND PROTECTION OF EASTERN FLANK**

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# As the EU Council and Parliament Debate the €1.8 Trillion Multiannual Financial Framework, Tech and Biotech Emerge as Winners, While Farming and Tobacco Lose

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<b>Winners</b>	<p>Semiconductor equipment makers, including ASML Holding NV (ASML) Cloud providers, such as SAP SE (SAP) and OVH Groupe SA (OVH on the Paris exchange)</p> <p>Biotechs that benefit from EU funding, including BioNTech SE (BNTX) and Evotec SE (EVO)</p>
<b>Losers</b>	<p>Agriculture equipment manufacturers, such as CNH Industrial NV (CNH)</p> <p>Tobacco companies, including British American Tobacco PLC (BTI), Imperial Tobacco Group (IMB on the London exchange), and Scandinavian Tobacco Group AS (STG on the Copenhagen exchange)</p>

priorities by establishing spending categories (headings) and maximum annual budget levels (ceilings). While a simple majority in the European Parliament is sufficient for the proposal to move forward, it requires unanimous approval from all 27 EU Member States—representing the EU Council—for adoption.

The proposal for 2028-2034 would establish four major spending headings: National Cohesion, Agriculture & Maritime; Competitiveness, Prosperity, & Security; Global Europe; and Administration.

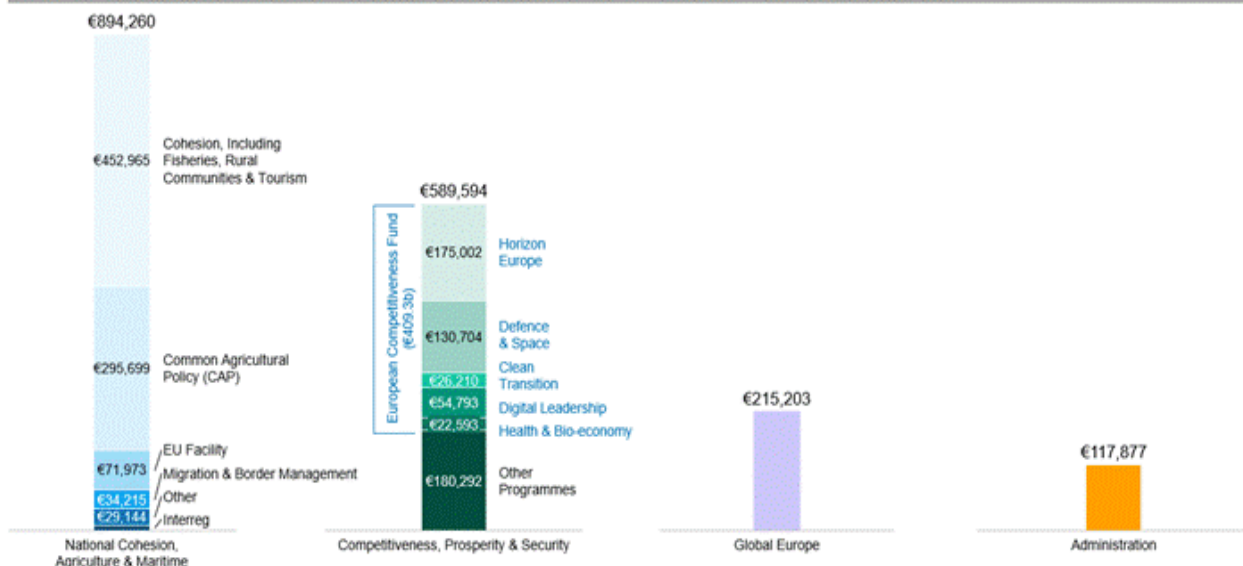
## THE EUROPEAN COMPETITIVENESS FUND PICKS WINNERS AND LOSERS

The proposed MFF includes the launch of the €409 billion European Competitiveness Fund (ECF) under the Competitiveness, Prosperity, & Security heading. The ECF identifies areas it classifies as critical to EU competitiveness: Defence & Space; Clean Transition and Decarbonisation; Health & Bio-economy; Digital Leadership; and the Horizon Europe research and innovation programme.

## THE 2028-2034 MULTIANNUAL FINANCIAL FRAMEWORK

**F**or most of 2026, the EU Council and Parliament will debate the European Commission's proposed €1.8 trillion Multiannual Financial Framework (MFF), the EU's long-term budgetary planning tool. The MFF enables the EU to set its strategic policy

European Commission Proposed 2028-2034 Multiannual Financial Framework by Spending Category (€m, current prices)



The Digital Leadership component’s €55 billion allocation over the 2028-2034 period represents a substantial increase over the current MFF, which allocated €8.2 billion to the similar Digital Europe Programme and €2.6 billion to the Connecting Europe facility. Several subsectors of the broader digital space will benefit, such as AI gigafactories, high-performance computing, quantum technologies, semiconductors, robotics, large data and cloud technologies, and 6G. EU semiconductor equipment maker ASML and cloud providers, such as SAP and OVH Groupe, are likely to be winners.

The Health and Bio-economy component of the ECF, a €22.5 billion envelope, includes EU4Health, which is heavily geared towards research and development and is one of 14 existing competitiveness programs that the Commission is streamlining into the ECF. This change represents a policy pivot by the Commission, from prioritising fundamental research to funneling resources to improving market-driven competitiveness. EU biotechs, including BioNTech and Evotec, stand to benefit.

Agriculture and Tobacco Will Be Hit by Budget Cuts and Taxes

In the proposal, the Common Agricultural Policy (CAP)—the EU’s flagship rural development and

support programme—has been reduced from €386 billion to €300 billion, a roughly 30% cut in real terms. Spain and Italy are resisting the change.

The €86 billion reduction would negatively impact companies that generate revenue from CAP-driven spending, such as agricultural equipment manufacturer CNH Industrial.

The MFF proposal includes a new tax called the Tobacco Excise Duty Own Resource (TEDOR). It will enable the EU to collect a 15% share of tobacco revenue. In parallel, the EU also launched a review of the Tobacco Excise Tax Directive (TED), which could increase minimum tax rates to €215 per 1,000 cigarettes and 63% of the weighted average retail price. As expected, the proposal has provoked strong opposition from the tobacco lobby, while the governments of Sweden, Italy, Greece, Romania, Bulgaria, and Portugal have expressed concerns about TEDOR’s impact on national budgets.

We believe the TED will negatively impact EU- and UK-based tobacco companies, including British American Tobacco, Imperial Brands, and Scandinavian Tobacco.

—Aaron Gao, agao@capstoneeu.com

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# Momentum Is Building for a Revised EU Chips Act, Which Would Likely Focus on Design Rather Than Manufacturing Given the EU's Structural Disadvantages

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<b>Winners</b>	Fabless chip designers, including Melexis NV (MELE on the Brussels exchange), Elmos Semiconductor SE (ELG on the Frankfurt exchange), and Nordic Semiconductor ASA (NOD on the Oslo exchange)
<b>Losers</b>	N/A

## MEMBER STATES AND INDUSTRY ARE LOBBYING FOR A NEW EU CHIPS ACT

**M**omentum is building for a revised European Chips Act (EUCA 2.0 or Chips Act 2.0) following the July 2025 decision by Intel Corp. (INTC) to halt its German and Polish investments—a setback that underscores the limitations of the current legislative framework in driving meaningful expansion of EU semiconductor manufacturing capacity.

The Intel news followed a 28 April 2025 report in which the European Court of Auditors (ECA) concluded that the EU was not on track to meet the policy goal of 20% of global chip production, es-

tablished with the first Chips Act (EUCA) in 2023. The auditors estimated that the EU was responsible for only 7%-8% of global production.

Member States, at the initiative of the nine most important EU countries for the semiconductor industry (Austria, Belgium, Finland, France, Germany, Italy, Poland, and the Netherlands), launched the Semiconductor Coalition to develop a coordinated approach to strategic funding and policies. On the industry side, both SEMI Europe and the European Semiconductor Industry Association have been actively pushing for an EUCA 2.0.

The EUCA was set up to mobilise more than €43 billion of public investments and matching private investments for a target of €86 billion in funding. However, the Commission is directly responsible for only €4.5 billion of those investments through Horizon Europe and the Digital Europe Programme. Member States were slated to contribute €35.3 billion, while €2.1 billion came from leveraged equity support and €1.4 billion from the EU's long-term budget and the European Investment Bank through the InvestEU programme.

Currently, while the EU boasts equipment maker ASML and automotive- and industrial-chip-focused integrated device manufacturers NXP Semiconductors NV (NXPI), Infineon Technologies AG (IFX on the Frankfurt exchange), and STMicroelectronics NV (STM), it lacks global players in advanced manufacturing and back-end processes.

The EU faces structural challenges in semicon-

ductor manufacturing, including dependence on raw materials, high energy costs, environmental regulations, and skilled-labor shortages. These constraints, coupled with competition from other governments (e.g., US Chips Act grants and Chinese equity funding), make it difficult for the EU to achieve its goal of 20% of global semiconductor production by 2030.

On 21 October 2025, the Commission published its 2026 work programme, which moved a planned evaluation report from Q3 2026 to Q1 2026. We believe the EU's accelerated legislative timeline could lead to the adoption of a new EUCA 2.0 by Q4 2026 or Q1 2027. On 5 September 2025, the Commission launched a public consultation and call for evidence on the evaluation and review of the Chips Act. The 12-week consultation period allows stakeholders to provide feedback on the EUCA's current functioning.

As described in our EU Chips Act report, we continue to hold the view that the Commission is likely to place greater emphasis on supporting chip design. We believe the Commission is likely to involve a mix of increased funding, particularly from the EU rather than Member States, and a more focused approach to promoting projects that require less capital investment.

This policy change benefits smaller fabless EU players, which design chips but do not manufacture them. They include Melexis, Nordic Semiconductor, and Elmos Semiconductor.

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# EU Policymakers Work to Strengthen the EU's Computing Infrastructure, Simplify Regulation, and Reduce Dependency on Non-EU Technology

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<b>Winners</b>	European data centers, cloud providers, and open-source-based companies, such as Deutsche Telekom AG (DTE on Frankfurt Stock Exchange) and OVH Groupe SA (OVH on Euronext Paris); defence technology and AI companies
<b>Losers</b>	N/A

## EU AI CONTINENT ACTION PLAN AND DATA UNION STRATEGY TO DRIVE EU COMPETITIVENESS

Policymakers are looking to strengthen the EU's computing infrastructure, access to high-quality data, and AI algorithms through a more business-friendly regulatory framework. To that end, in April 2025, the EU launched its AI Continent Action Plan to drive the bloc's data and AI ambitions. The Data Union Strategy (DUS), published 19 November 2025, reframes EU digital policy around three pillars: infrastructure development, regulatory simplification, and reassertion of data sovereignty.

EU policy has shifted from regulating emerging

technologies to fostering an environment where they can be developed. This follows similar plans in the UK under the AI Opportunities Action Plan, set out in January 2025, which also aims to enhance sovereign compute capacity and boost AI adoption.

Pillar I of the DUS aims to close Europe's infrastructure and data centre capacity gap relative to the US and China by stimulating investment and driving voluntary data sharing. Capstone believes that the forthcoming Cloud and AI Development Act, in particular, has the potential to support new data centre development and AI compute capacity through clear targets. The strategy will also build on existing initiatives, such as Common European Data Spaces and new EU Data Labs, to expand AI-ready datasets and strengthen cross-sector collaboration.

## DEFENCE, SECURITY, AND DIGITAL SOVEREIGNTY EMERGE AS STRATEGIC PRIORITIES

Since their launch in 2020, data spaces have seen slow progress. The Healthcare Data Space is currently the most advanced. A new defence data space has been established under the DUS, which we believe will likely be prioritised as an emerging strategic priority. Additionally, an EU Defence Industry Transformation Roadmap was published, which will, among other initiatives, allocate EU funding and encourage Member States to dedicate c. 10% of arms budgets to emerging and

disruptive technologies.

Pillar III of the DUS aims to enhance EU data sovereignty as part of a broader push toward digital sovereignty, a key emerging priority. It gained momentum at a Franco-German summit on 18th November, at which a strong political consensus emerged with all 27 member states committing to reducing dependencies on non-EU technology and strengthening digital resilience.

## REGULATORY SIMPLIFICATION INITIATIVES WILL ENABLE AI INNOVATION

Regulatory simplification is a key part of the DUS, enabling growth. Pillar II aims to reduce the regulatory burden for EU businesses and unlock high-value data flows for AI. The Digital Omnibus package has the potential to bring commercially significant changes for businesses across sectors. It seeks to rationalize overlapping regulations, including the General Data Protection Regulation (GDPR), the E-Privacy Directive, the Data Governance Act, the Data Act, and Cybersecurity rules. One key proposed area of simplification is to expand the legal basis under the GDPR to include “legitimate interest” for processing personal data during AI model development and operation, provided safeguards are met. This would remove prior legal uncertainty and make it much easier for organizations to use personal data for AI development.

The “digital fitness check” process should also be closely monitored by businesses across all sectors. It will serve as a systemic review of the digital rulebook, assessing the cumulative regulatory burden and impact on competitiveness.

## WHAT TO EXPECT IN 2026

We expect legislative momentum in 2026 to cultivate innovation in AI and to harmonize and reduce regulatory burdens for businesses. The Cloud and AI Development Act will likely be pro-

posed in Q1 2026, and feedback for businesses as part of a “digital fitness check” is open until March 2026. This is likely to inform potential further simplification or harmonisation measures. The Digital Omnibus package is expected to be finalized and adopted by the end of 2026. These will clarify investment frameworks for AI infrastructure, enhance regulatory predictability, and catalyze new capital formation across digital industries.

Results from the Digital Sovereignty Taskforce will be presented at the Franco-German Council of Ministers in 2026. EU procurement rules will also be revised in 2026, with greater emphasis on digital sovereignty. Public authorities and enterprises across several Member States are already looking to reduce reliance on US digital infrastructure providers and enhance private infrastructure capacity. They are turning to European-based cloud offerings and open-source-based tech businesses, such as the technology programs provided by Deutsche Telekom, (DTE on Frankfurt Stock Exchange) with its Open Telekom Cloud, and OVH (OVH on Euronext Paris) with OVHcloud.

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# Trade Tensions With the US and China Will Persist in 2026, With European Steelmakers to be the Relative Winners While Automakers Suffer

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<b>Winners</b>	EU steelmakers: Aperam SA (APAM on the Amsterdam exchange), ArcelorMittal SA (MT on the Amsterdam exchange), ThyssenKrupp AG (TKA on the Frankfurt exchange), and SSAB AB (SSAB on the Stockholm exchange)
<b>Losers</b>	EU automakers: Volkswagen AG (VOW on the Frankfurt exchange), Mercedes-Benz Group AG (MBG on the Frankfurt exchange), BMW Group (BMW on the Frankfurt exchange)

and tariff agreement establishing a 15% tariff rate across most sectors, including automobiles, semiconductors, pharmaceuticals, and lumber. This rate represented a significant reduction from President Trump's earlier threats. However, the US tariffs on steel and aluminum remain unchanged. As part of the agreement, the EU committed to purchasing \$750 billion in US energy and to making new investments totaling \$600 billion in the US, all by 2028. Despite the EU-US trade agreement, there is still a risk that US tariffs could be raised or reinstated, particularly in strategic sectors.

Meanwhile, trade tensions between the EU and China have been building for years. The issues are wide-ranging, including market access, intellectual property, state subsidies, and geopolitical competition. The EU views China's economic practices as undermining fair competition; China's push for self-sufficiency and its perceived support for Russia are also sticking points. In this context, the EU has introduced a de-risking policy to reduce dependence on China for strategic goods.

## TRADE TENSIONS WITH THE US AND CHINA

**O**n 8 May 2025, the EU and UK reached a trade deal under which the US reduced auto tariffs from 27.5% to 10% and maintained a 10% baseline tariff on the UK, while the UK removed tariffs on US beef and offered a duty-free tariff-rate quota for US ethanol. The UK also agreed to reduce non-tariff barriers and work with the US on trade security (focusing on China).

On 27 July 2025, the EU and US reached a trade

## WHAT TO EXPECT IN 2026

Despite the trade agreement reached between the US and the EU, we see downside risks in 2026. In 2025, Trump threatened to impose tariffs on countries that target major US tech giants, such as Alphabet Inc.'s Google (GOOG) and Amazon.com Inc. (AMZN), through taxes and regulations. We continue to believe the US is considering launching a Section 301 investigation into the

EU's digital regulations and the Digital Services Taxes implemented by European member states (see EU Digital Regulations Increase Risk of US Tariff Action Under Section 301; Unlikely to Derail Trade Agreement, but Risks for Luxury, Beverage Products, 23 October 2025). Additionally, there are growing risks that the EU-US trade deal could collapse if the EU fails to meet its commitments.

Summit talks in July 2025 between China and the EU did not reach an agreement on tariffs for electric vehicles (EVs). The EU continues to impose countervailing duties on Chinese-made EVs, ranging from 8% to 35%. However, the effectiveness of EU tariffs has been called into question, as Chinese EV brands saw their market share in the EU double last year, now accounting for roughly 10% of the total market. We expect the EU to take further action in 2026.

Starting in early 2026, the EU will impose duties on small packages ordered online from platforms such as Shein and Temu (PDD). These charges will be implemented two years earlier than initially planned, as part of the EU's broader reform of its Customs Union, which includes ending the duty-free exemption for low-value parcels. The UK is similarly in the process of removing the low-value duty exemption.

Steel tariffs will be a key battleground in 2026 as the EU tries to address Chinese overcapacity and win relief on US steel tariffs. In October 2025, the Commission proposed new steel tariffs as the current safeguards will expire in June 2026. The Commission's proposal would tighten steel import rules, cutting tariff-rate quotas by 47%, doubling tariffs from 25% to 50%, and introducing a new "melt and pour" rule of origin requirement. EU steel producers stand to benefit from tightened steel tariffs, while automakers are likely to face increased costs.

Given the current geopolitical climate, we anticipate future trade policies will increasingly prioritise national security, resulting in greater protectionism and heightened trade tensions with China and the US. China is likely to retaliate against EU trade measures by targeting EU luxury

goods makers or wine and spirits producers, consistent with its past actions.

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# Increases in Member State and EU Defence Spending Will Benefit Counter-Drone Manufacturers, Air and Space Shielding Technology, and Eastern Flank Protection

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<b>Winners</b>	<p>Drone and counter drone companies: Hensoldt AG (HAG on the Frankfurt Exchange)</p> <p>Air Shield: Leonardo SpA (LDO on the Milan Exchange)</p> <p>Space assets: Airbus SE (AIR on the Paris Exchange)</p>
<b>Losers</b>	N/A

**A**mid persistent criticism from the Trump administration, which culminated in its December National Defence Strategy urging Europe to take “primary responsibility” for its own defence, the continent is pursuing strategic autonomy in military matters. Given the sustained fiscal challenges facing most European states, we believe the EU will continue to play an outsized role in Europe’s rearmament over the medium term. As a result, we expect the market to underprice the significance of the EU’s Readiness 2030 roadmap and investment focus. Manufacturers of drones, air and space shielding technology, and defence systems

that can protect the EU’s eastern border will especially benefit.

## NATIONAL SPENDING PLANS

At the 2025 NATO Summit, EU Member States committed to investing 5% of GDP on core defence (3.5%) and resilience-related (1.5%) spending by 2035. This is a material increase, representing hundreds of billions, given that some EU Member States currently spend c. 1% of GDP on defence. In parallel, the EU’s 2030 Readiness plan aims to shift from the current fragmented model of national defence efforts to a more combined effort. Despite the commitment to NATO, we anticipate that several European capitals will struggle to meaningfully increase their defence allocations. We believe the EU will spend only 2% of GDP this year, and Europe as a whole is unlikely to hit the 3% mark by 2030, also making it unlikely they will reach 3.5% by 2035. In an era of strained welfare states and mounting demographic pressures, sustaining higher defence spending will require difficult trade-offs that few governments have confronted.

Several large European states, including France and Spain, lack clear or credible paths to meet the obligation, given ongoing political or fiscal challenges. The UK plans to increase defence spending to 2.6% of GDP by April 2027, but this is funded mainly through overseas aid cuts that

cannot sustain further increases, and the government plans on reaching 3% only in a second term, which polls currently suggest is unlikely. There are some exceptions. Germany has committed to doubling defence spending (from €86B to c. €156B) to reach the 3.5% target by 2029, financed by relaxing its previously conservative fiscal policy.

## EU'S READINESS 2030 ROADMAP

In October 2025, the European Commission published its Readiness Roadmap 2030, confirming its intent to launch nine “capability coalitions” to fill defence gaps: air and missile defence,

artillery/munitions, cyber/AI/electronic warfare, strategic enablers (lift, refueling, C4ISTAR, space), ground combat, maritime, military mobility, and protection of critical infrastructure. Each “coalition” will be led and co-led by individual Member States, and are designed to drive multi-country procurement and industrial projects starting in 2026. These will then feed into four higher-level “flagship” projects underpinning future European security:

Flagship	Key Milestones
<b>European Drone Defence Initiative:</b> Establishing comprehensive drone and counter-drone capabilities	Q1 2026: Launch End 2026: Initial capacity End 2027: Functional
<b>Eastern Flank Watch:</b> Fortify eastern borders against Russia/Belarus	Q1 2026: Launch End 2028: Functional
<b>European Air Shield:</b> Integrated missile defense with NATO	Q2 2026: Launch End 2026: Prioritized in work programs
<b>European Space Shield:</b> Protect space assets, reduce dependencies	Q2 2026: Launch 2026+: Coordinated procurement

This intra-EU capacity-building initiative will be financed through multiple sources. The EU’s SAFE instrument, adopted in May 2025, will provide €150 billion of EU-backed loans to Member States to finance joint procurements of defence equipment (for which a priority is placed for the above nine capability areas). SAFE aims to be at least 50% disbursed by Q3 2028, with priority given to procurement that supports the capability coalitions and flagships. To a lesser extent, the European Defence Industry Programme (EDIP) will also provide financing by co-funding industrial projects meeting these priority areas.

defence and open eligibility for defence funding from broader funding buckets, according to initial proposals. The €7.95 billion European Defence Fund and EDIP are being subsumed, along with substantial additional capital, into a new segment of the European Competitiveness Fund for Defence, valued at c.€131 billion. Military Mobility spending is similarly set to increase tenfold from €1.74B to c.€17.6B. Other non-Defence funds will become more open to defence and dual-use bids, such as the EU’s Horizon Europe Fund, worth c. €175 billion.

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The EU is set to materially increase funding for

