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U.S. CHAMBER OF COMMERCE

Statement of the U.S. Chamber of Commerce

ON: **The changes to the structure and function of the business of banking as a result of regulatory and legislative policy changes over the past 30 years.**

TO: **The Senate Committee on Banking, Housing, and Urban Affairs, Financial Institutions and Consumer Protection Subcommittee**

DATE: **May 9, 2012**

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations.

More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 70 percent of which have 10 or fewer employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross-section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business -- manufacturing, retailing, services, construction, wholesaling, and finance – is represented. Also, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the U.S. Chamber of Commerce's 115 American Chambers of Commerce abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

Good afternoon Chairman Brown, Ranking Member Corker, and members of the subcommittee. Thank you for the opportunity to testify, on behalf of the U.S. Chamber of Commerce, at today's hearing: *"Is Simpler Better? Limiting Federal Support for Financial Institutions"*. This is a timely hearing and is a unique opportunity to discuss the capital markets that fuel business expansion and the concurrent economic growth and job creation that occurs as a result.

I am Anthony J. Carfang, a founding partner of Treasury Strategies, Inc. Treasury Strategies is one of the world's leading consultancies in the area of treasury management, payments and liquidity. Our clients include the CFOs and treasurers of large and medium sized corporations as well as state and local governments, hospitals and universities. We also consult with the major global and regional banks that provide treasury and transaction services to these corporations. In thirty years of practice, we have consulted with businesses and financial institutions of every size and complexity on a global basis.

Last year, the Chamber of Commerce issued a report, *Sources of Capital and Economic Growth: Interconnected and Diverse Markets Driving U.S. Competition*, a copy of which is attached as part of this testimony for today's hearing. The purpose of the report was to demonstrate the wide variety and diversity of capital needed to fuel business expansion and job growth. This diverse quilt includes debt markets, equity markets, bank loans, trade finance, angel investing, venture capital, credit cards, home equity loans and the list goes on and on.

It has been my experience that all of these capital raising methods are needed as options for businesses because flexibility will allow them to meet their needs depending on the maturity of the firm, business cycle, regulatory pressures and counterparty positions. Global financial systems are needed for large corporations, but also small businesses that engage in international trade. Community banks assist small businesses, while credit cards help fuel the entrepreneurial spirit that continually reinvigorates the economy.

So while the premise of the hearing is that our financial systems need to be plainer and simpler, the fact is that we need a mosaic of interconnected products of varying size and complexity to meet the capital needs of a 21st century economy. Constraining our financial systems to look plainer and simpler would be as beneficial as reestablishing the horse and buggy as the foundation of our transportation systems. There is no guarantee that plainer and simpler translates to safer. The opposite, because of lack of diversification, might well be true. Furthermore, the loss of productivity, speed and communication would cause our economy to shrink and businesses to disappear.

Consideration of financial systems and products cannot be divorced from the way that the markets work and the purposes they serve. Viewed from this practical perspective, financial institutions and systems are a conduit—a means of transferring capital from investors to the businesses that need it. A well-regulated conduit will efficiently and reliably provide businesses with the resources needed to grow and thrive. Inappropriately restricting that conduit is analogous to blocked blood vessels that deprive the heart of needed oxygen, causing a heart attack and coronary disease.

Many aspects of our financial system are in fact already being circumscribed by legislators and regulators today. Just consider the rapid succession of far-reaching regulations that have flowed from the Dodd-Frank Act and other responses to the 2008 financial crisis—the Volcker Rule, new derivatives regulations, potential money market regulations, Basel III capital standards, systemic risk mandates, to name a few, all have one thing in common—they will impact the ability of businesses to raise capital and the ability and willingness of investors to provide it.

If we judge these regulatory initiatives in light of my earlier-stated premise that businesses need access to a mosaic of financial products and systems to raise capital number of questions must be considered: How do these initiatives impact that mosaic? How would placing artificial caps on these systems or institutions impact capital-raising for companies and the return that investors expect to receive? How would restricting diversification reduce risk? Ultimately, how could U.S. businesses compete and hire workers in a global marketplace, if their ability to raise capital is impaired?

Economic Consequences

Up to now, businesses operating in the U.S. have been the most capital efficient and productive in the world. Thanks to our financial institutions and existing banking frameworks, businesses and the U.S. economy benefit greatly from:

- The broadest, deepest and most resilient capital markets,
- The best risk management products and tools,
- The most robust and liquid markets,
- The most technologically advanced cash management services, and
- The most efficient and transparent payment systems.

As a result, U.S. businesses are extremely efficient. Consider the following Treasury Strategies analysis: companies doing business in the U.S. operate with approximately $2.2 trillion of cash reserves. That represents only 14% of U.S. gross domestic product. In contrast, corporate cash in the Eurozone is 21% of Eurozone GDP. In the UK, the ratio is even higher at 50%.

The availability of highly liquid capital pools allows Treasurers to keep less cash on hand and use a just-in-time financing system that allows companies to pay their bills and raise the capital needed to expand and create jobs.

Using this analysis to look at just two items posed by today's hearing—placing caps on the size of financial institutions or the imposition of the Volcker Rule as currently drafted—shows that America's capital efficiency will decline. This will result in corporations having to maintain larger cash buffers. Were cash reserves to rise to the Eurozone level of 21% of GDP, that new level would be in excess of $3 trillion.

Stated differently, CFOs and Treasurers would need to set aside and idle an additional $1 trillion of cash that could otherwise be used for expansion and hiring. $1 trillion dollars of idle cash is a staggering number. By way of comparison:

- It is greater than the entire TARP program.
- It is more than the Stimulus program.
- It is even greater than the Federal Reserve's quantitative easing program, QE II.

This would seriously slow the economy to the detriment of businesses, workers and consumers. To raise this extra $1 trillion cash buffer, companies may have to downsize and lay off workers, reduce inventories, postpone expansion and defer capital investment. Obviously, the economic consequences would be huge.

Why would treasurers have to idle so much more cash?

Artificial caps and the Volcker Rule, as currently proposed, will create a subjective regulatory scrutiny of trades, making a company's ability to raise capital more expensive and time consuming. They will increase administrative expenses for banks which will translate into a higher cost of capital for businesses. Real-time financing will no longer be possible for many companies. This will raise costs for most companies and make foreign capital markets more attractive for some companies, while shutting other companies out of debt markets entirely.

This is also not happening in a vacuum.

Corporate treasurers must also contend with looming money market fund regulations that may imperil 40% of the commercial paper market, Basel III capital and liquidity requirements and expected derivatives regulations.

As I said earlier all of these efforts simultaneously converge on the desk of the corporate treasurer, adversely impacting business's ability to raise capital and mitigate risk. It is unclear how well these proposals have been vetted and the extent to which their cumulative impacts have been considered and analyzed. Never before have so many unproven, high stakes regulations been imposed simultaneously. This is a dangerous experiment.

In January, Federal Reserve Governor Tarullo testified before the House Financial Services Committee that the regulators did not know or understand what normal market making or underwriting practices are. Market making and underwriting are used by non-financial firms to raise money. Yet the regulators admit that they don't understand the activity or products they are attempting to regulate—three months after the three hundred page Volcker Rule regulation has been proposed.

Similarly, no economic analysis has been performed regarding the potential impacts on our economy and job growth that may flow from capping the size of financial institutions. For instance, where will community banks go for liquidity?

There is a very close relationship between large banks and community banks that could be jeopardized by ill-considered, arbitrary regulations. Large banks are a major source of liquidity for community banks and their business and consumer customers.

For example, large banks lend to community banks via the fed funds market so that community banks will have funds to invest locally. Often, large banks will participate in loans originated by community banks, allowing that bank to better serve the community. Typically, community banks will access services of larger banks in order to meet occasional customer needs such as international wire transfers, foreign currency orders or letters of credit. Breaks in this chain can have direct adverse consequences for Main Street businesses and the smaller financial firms that service them. If community banks lose access to liquidity, by extension, Main Street businesses lose access to capital.

Similarly, if a company must go to multiple institutions to raise capital for a deal, rather than one institution, market efficiency and capital formation are impaired.

Economies of scale must be considered for the ease and efficiency of the overall economy.

<u>The nature of financial risk</u>

I would like to add a statement about managing financial risk. A common understanding among our clients is that, like energy, risk can neither be created nor destroyed but only transferred. So when you consider ways to reduce banking system risk, do not be tricked into thinking that risk disappears. It simply moves elsewhere. Our system relies on the presence of actors who view the potential rewards of accepting this risk as sufficient to prompt them to do so. If they should come to view the costs and risks as outweighing any potential reward, the flow of capital will come to a standstill.

To truly minimize the probability of future financial crises, we must understand how this risk moves and where it will show up next. Risk is managed most efficiently when it is transparent, properly understood and the market responds with robust, efficient and liquid hedging solutions.

A corporate CFO whose company imports a raw material from the Far East, for example, must manage currency risk, commodity price risk, interest rate risk and operational shipping risks. By simply precluding a bank from helping a company to hedge these risks, the Volcker Rule or size limitations does not make those risks go away.

CFOs and Treasurers will undoubtedly conclude that some risk management techniques and some heretofore efficient transactions will no longer be available, or, if they are available, they will no longer be cost effective. They will decide to "go naked" and retain more risk internally. The upshot of this is that they will hold even more precautionary cash on their balance sheets as a buffer. This will take money out of the real economy, stall economic growth, stunt the creation of new jobs, and destroy existing jobs.

The corporate treasury is the financial nerve center of a business, which must make countless decisions on a daily basis to identify and manage the complexities of the company's cash flow in global as well as local markets. To assist them in this critical and ongoing task, some companies require a bank that can deliver global economies of scale. Other companies require a broad array of services that only a full service bank can provide. Still others require specific knowledge of local markets that regional and community banks best provide. Most companies required all of the above at some point in their life cycle. The Volcker Rule and size caps would virtually eliminate U.S. banks from offering both the scale services, scope services and localized specialties that today's U.S. businesses need.

Many companies have recently engaged Treasury Strategies to assist in upgrading their treasury technology. Their intent is to get a real time view of their cash, and implement automated tools to easily move that cash around the globe. In this frictionless environment, cash can easily move to the most favorable jurisdictions.

Thus, regulations that limit a financial institution's ability to provide a full range of services erode the dominance of the U.S. banks. Many companies have already established regional treasury centers for functions traditionally housed in the U.S. All of this leads to capital flowing out of the U.S. and competitiveness declining.

Let me also state that Treasury Strategies and our clients fully support well thought out efforts to improve economic efficiency and to reduce the likelihood of another systemic failure. The U.S. Chamber's position is the same and it has advocated for stronger capital rules, rather than a unilateral ban on proprietary trading, as a pro-growth means of stabilizing the financial system and avoiding systemic failure.

However, we are in danger of developing an overly complex hodgepodge of unproven regulations that will be extraordinarily vague and create regulatory risk and legal uncertainty. In short we may deprive the American economy of one extraordinary advantage—the efficiency associated with predictability and legal certainty in the rules governing our financial systems.

We could deprive our economy of competitive advantages at the same time that it must become more globally competitive to grow our economy and put America back to work.

Conclusion

I appreciate the opportunity to appear before you today on behalf of the U.S. Chamber of Commerce.

Financial regulatory reform is an unfinished project that must take into account the needs of treasurers and businesses to meet the demands needed to grow and operate in an increasingly competitive and global environment. Proposals to impose artificial and arbitrary caps on the financial industry, or the Volcker Rule (as currently proposed), or additional money market regulation will not reduce systemic risk. Instead they will only shift that risk. They will force the non-financial companies that are the engines of our economy to retrench, enhance their cash positions and face a much tougher time raising the capital needed to operate, grow and create jobs.

This is about a grand trade-off: are we willing to jeopardize America's capital raising and job creating engine in exchange for a vague, unproven hope of reducing financial risk? As stated earlier, risks can only be shifted, not eliminated. We believe that these regulations will make U.S. capital markets less robust, U.S. business less competitive and ultimately harm all Americans by slowing America's economic activity.

In thinking through these difficult problems, I would respectfully suggest that policy makers ask this question before proposing new laws or approving new regulations governing America's financial system:

When a business' treasurer calls a U.S. bank or financial firm to raise the cash needed to meet the pay bills or fund expansion, will someone be there to answer that phone call?

If not, the business will suffer, as will the economy and job creation.

I am delighted to discuss these issues further and answer any questions you may have.