CREATING GROWTH IN THE U.S. ECONOMY - FOCUS ON SMALL BUSINESSES

April 2017

Proprietary & Confidential - Contact Adam Dener 203 454 6815 / adam.dener@fcm.com and Sergio Rodriguera 571 278 9845 sergio@thecreditjunction.com

SITUATION SYNOPSIS - STIFLED SME CREDIT ACCESS
FOUR GROWTH PROPOSALS TO ADDRESS SME CREDIT ACCESS

- Small and medium sized business (SME) are large drivers of employment, GDP and taxes
- Economic growth related to SME is constrained given impacts from re-regulation, tax policy and monetary policy manifesting in SME credit access being muted stifling economic growth
- Absent significant changes to regulation and tax policy, situation will not revert and "new normal" will remain with access to credit for SME reduced and limiting economic growth
- Increasing SME credit will drive growth and can be achieved through:
  - Modest changes to tax policy
  - Modest changes to bank regulation
  - Private sector incentives for non bank credit provision
- Proposals to increase SME credit include:
  1. Tax amnesty for U.S. companies to repatriate offshore cash provided that they lend the tax savings benefit to SME borrowers (providing credit in return for the waiver)
  2. Offer incentives for non banks to invest in SME credit by creating program to create investment management products to serve as lenders providing SME credit (stimulate non bank investment in lending to SME)
  3. Increase regulatory capital for banks for SME credit if all are held on balance sheet thereby creating incentives for more SME credit to be originated and sold by the banks (increase bank SME credit origination with assets distributed to investors)
  4. Limit tax deductions and stock buy backs for companies holding more than 10% of their cash overseas provided that they finance SME (supply chain financing enabled to SME)

STIFLED SME CREDIT ACCESS

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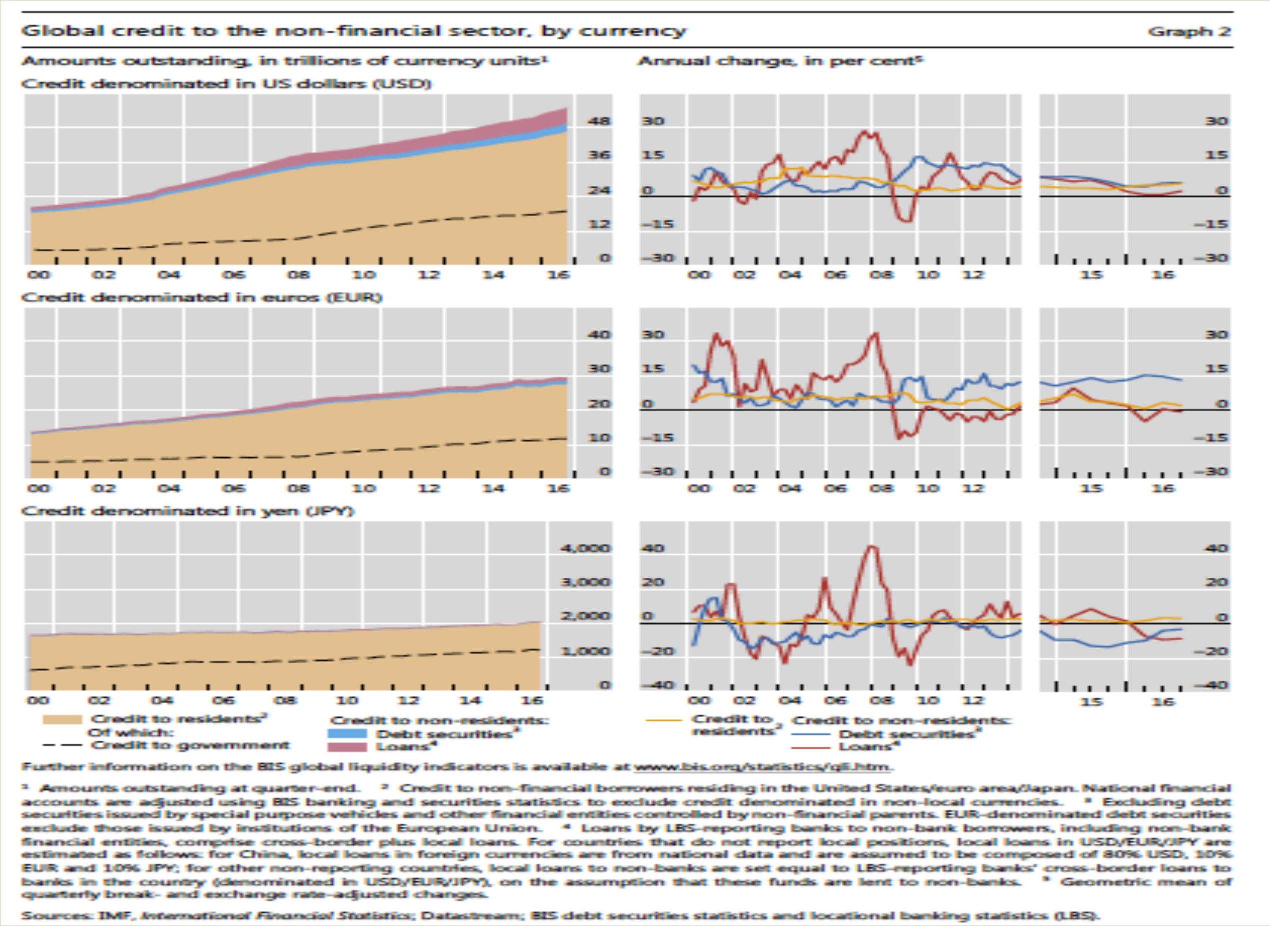
THERE IS (GLOBAL) GROSS CREDIT EXPANSION GLOBAL DATA INCLUDING BOTH BONDS AND BANK LOANS SHOW TOTAL AMOUNTS INCREASING

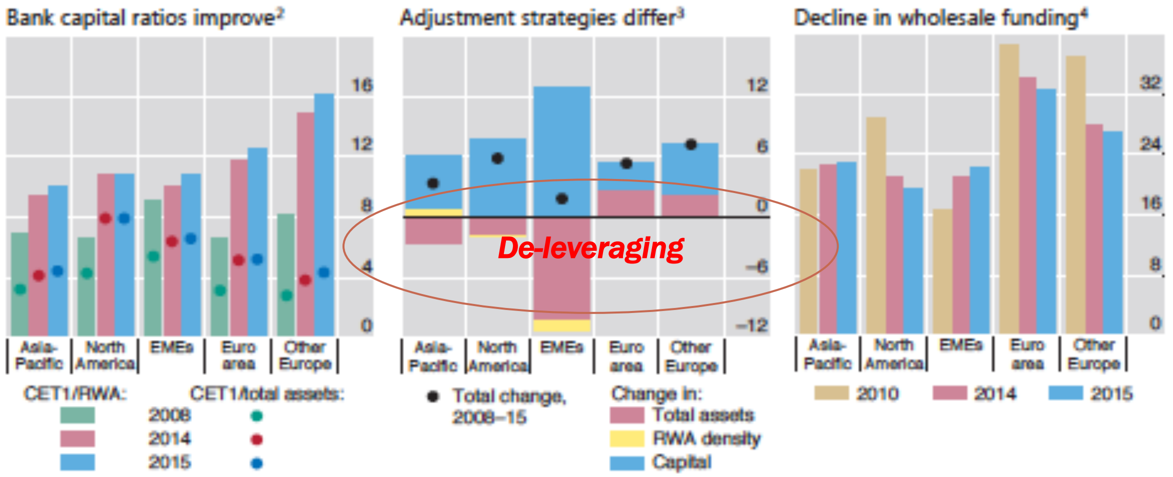


Source: BIS International banking and financial market developments March 2017

BANKING RE-REGULATION HAS HAD AND IS HAVING AN IMPACT ON CREDIT GROWTH AND ON FUNDING AS U.S. BANKS HAVE INCREASED EQUITY AND REDUCED LENDING WHILE IMPROVING FUNDING

Banking systems are becoming more resilient[1]

In per cent — Graph VI.1



[1] Sample of more than 100 banks with at least $10 billion of total assets in 2014. Asia-Pacific: Australia and Japan; EMEs: Brazil, China, Chinese Taipei, Hong Kong SAR, India, Korea, Malaysia, Russia, Singapore, South Africa and Turkey; euro area: Austria, Belgium, France, Germany, Greece, Ireland, Italy, the Netherlands and Spain; North America: Canada and the United States; other Europe: Denmark, Norway, Sweden, Switzerland and the United Kingdom. [2] Median ratios; values for 2008 may overstate actual values due to imperfect adjustment to new capital/risk-weighted asset (RWA) definitions. [3] The graph decomposes the change in the Common Equity Tier 1 (CET1) capital ratio into additive components. The total change in the ratios is indicated by dots. The contribution of a particular component is denoted by the height of the corresponding segment. A negative contribution indicates that the component had a capital ratio-reducing effect. All figures are weighted averages using end-2015 total assets as weights. [4] Region-wide wholesale funding divided by region-wide total assets.

Sources: B Cohen and M Scatigna, "Banks and capital requirements: channels of adjustment", *BIS Working Papers*, no 443, March 2014; SNL; BIS calculations.

Source: BIS

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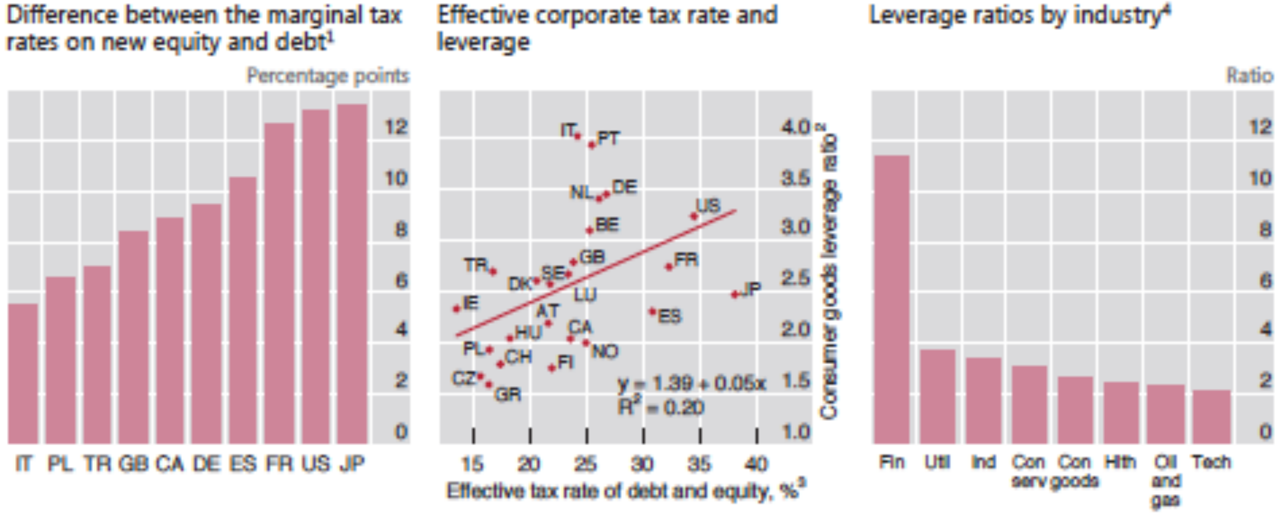
WHILE TAXES DRIVE CASH AND DEBT BEHAVIOR, PARTICULARLY IN A LOW GROWTH ENVIRONMENT AND FOR LARGER COMPANIES, LOWER OFFSHORE TAXED CASH MEASURED AGAINST BENEFIT OF INTEREST DEDUCTION & LEVERAGE

Corporate sector taxes and leverage | Graph V.6



Con goods = consumer goods; Con serv = consumer services; Fin = financials; Hlth = health; Ind = industrials; Tech = technology; Util = utilities.

[1] 2012 estimates. [2] The leverage ratio is defined as the ratio of total assets to shareholders' equity for the consumer goods sector as defined by Worldscope; end-2015 observation. [3] The effective corporate tax rate is defined as the average of the effective tax rate on new equity and debt in 2012. [4] The leverage ratio is defined as the ratio of total assets to shareholders' equity for the sectors as defined by Worldscope for the world index; end-2015 data.

Sources: ZEW Center for European Economic Research, "Effective tax levels", *Project for the EU Commission*, 2012; Datastream Worldscope.

Source: BIS

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IMPLICATIONS OF TAX POLICY IN ACTION FOR LARGE CORPORATIONS OFFSHORE CASH AND STOCK BUY BACK EXAMPLES

Consolidated Balance Sheets
Dollars in millions except per share amounts

	December 31, 2015	2014 As Adjusted
Assets		
Current Assets		
Cash and cash equivalents	$ 5,121	$ 8,603
Accounts receivable – net of allowances for doubtful accounts of $704 and $454	16,532	14,527
Prepaid expenses	1,072	831
Other current assets	13,267	9,645
Total current assets	35,992	33,606
Property, Plant and Equipment – Net	124,450	112,898
Goodwill	104,568	69,692
Licenses	93,093	60,824
Customer Lists and Relationships – Net	18,208	812
Other Intangible Assets – Net		
Investments in Equity Affiliates		
Other Assets		
Total Assets		

LIQUIDITY AND CAPITAL RESOURCES

We had $5,121 in cash and cash equivalents available at December 31, 2015. Approximately $807 of our cash and cash equivalents resided in foreign jurisdictions, some of which are subject to restrictions on repatriation. Cash and cash equivalents decreased $3,482 since December 31, 2014. We also had $401 in short-term investments, which we included in "Other current assets"

Schumpeter

Citigroup's decade of agony is almost over

The recipient of America's biggest bank bail-out has overhauled its capital base and its profits. Now it needs to grow

From the print edition | Business Mar 18th 2017

rm debts by 78%. Mr Dimon likes to say that
so, Citi's is a nuclear-bomb shelter. If another crisis
absorb four times the losses it suffered in 2008-09.
that was created in 2009, which has disposed of
ming piles of subprime bonds and Greek mortgages.

has made relatively slow progress here, but its
accounting rule means that its balance-sheet appears bloated by tax breaks relating to its losses during the crisis. Its return on tangible equity, after adjusting for this, was 9% in 2016. If the last dregs of its legacy assets are sold this year, the ratio should reach 10%. That is below JPMorgan, at 13%, but acceptable.

With its capital base restored, Citi can meet its third goal, of returning cash to shareholders. Its share price has fallen by 88% over the past decade, so they could do with some payback. The bank is producing especially strong cashflows because its former losses can be set against tax bills. It should be able to pay out $17bn-18bn in dividends and share buybacks a year, which would make it one of the seven most generous American firms for the absolute amount of cash returned. Citi shareholders should soon receive a dollar of cash a year for each $10 of stock that they own.

Source: AT&T Annual Report 2015, The Economist – Citibank article

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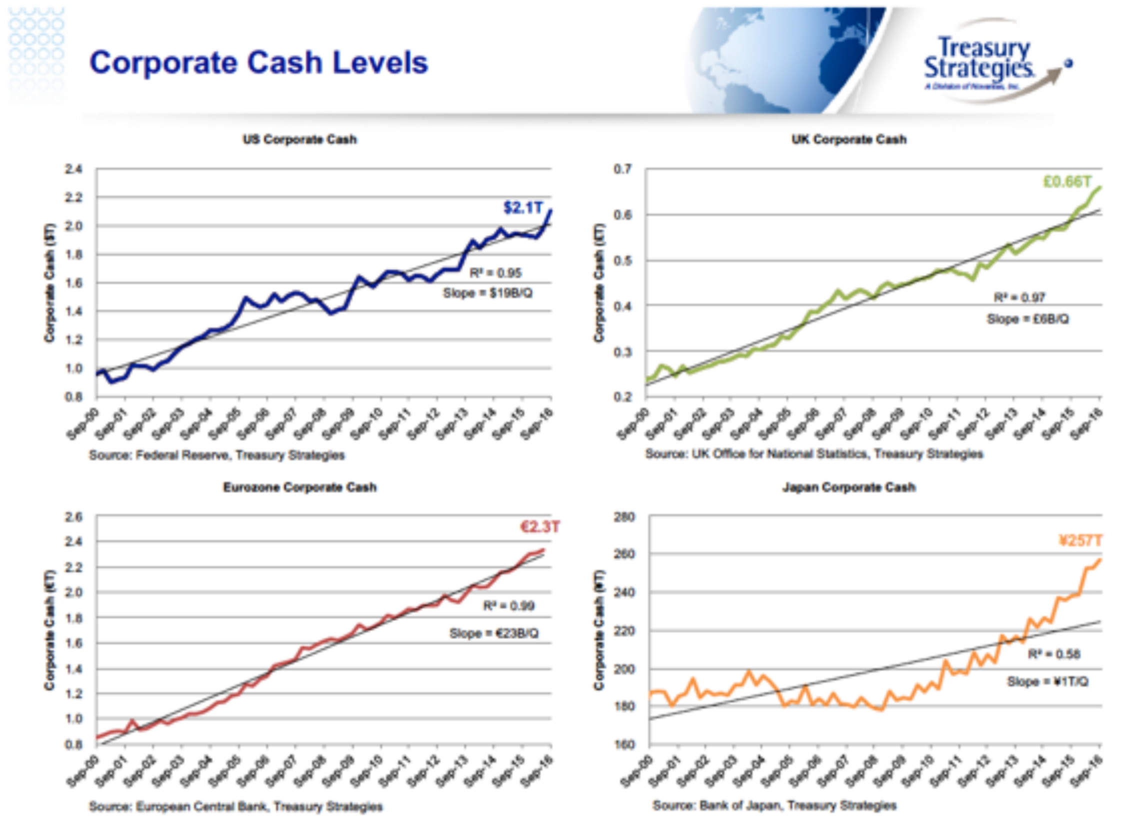
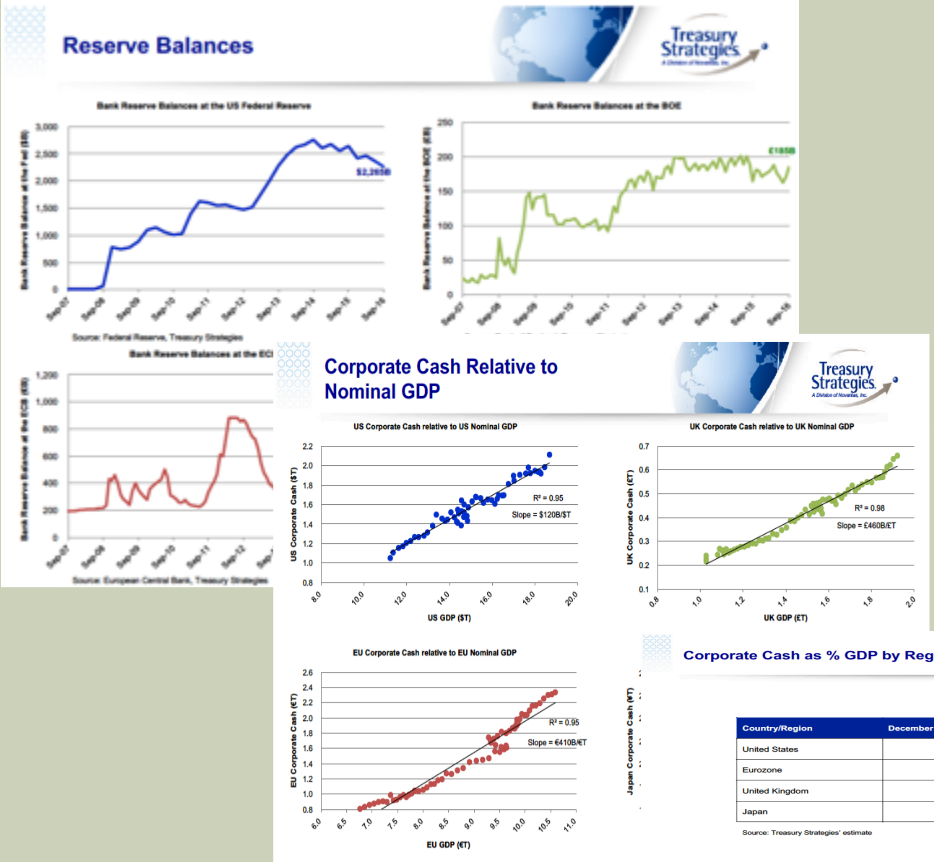
BANK RE-REGULATION, DELEVERAGING, MONETARY AND TAX POLICY HAVE LEAD TO RECORD DEPOSIT LEVELS AT BANKS AND CENTRAL BANKS LIMITING SME CREDIT ACCESS CORPORATE CASH LEVELS INCLUDE BANK'S CASH; ESTIMATES VARY OF CASH OFFSHORE





Corporate Cash as % GDP by Region

Country/Region	December 2000	September 2016
United States	9%	11%
Eurozone	15%	22%
United Kingdom	24%	34%
Japan	37%	48%

Source: Treasury Strategies' estimate

Source: Treasury Strategies, January 2017Corporate cash levels include bank's cash (previous data from Fed is for non financial corporates)

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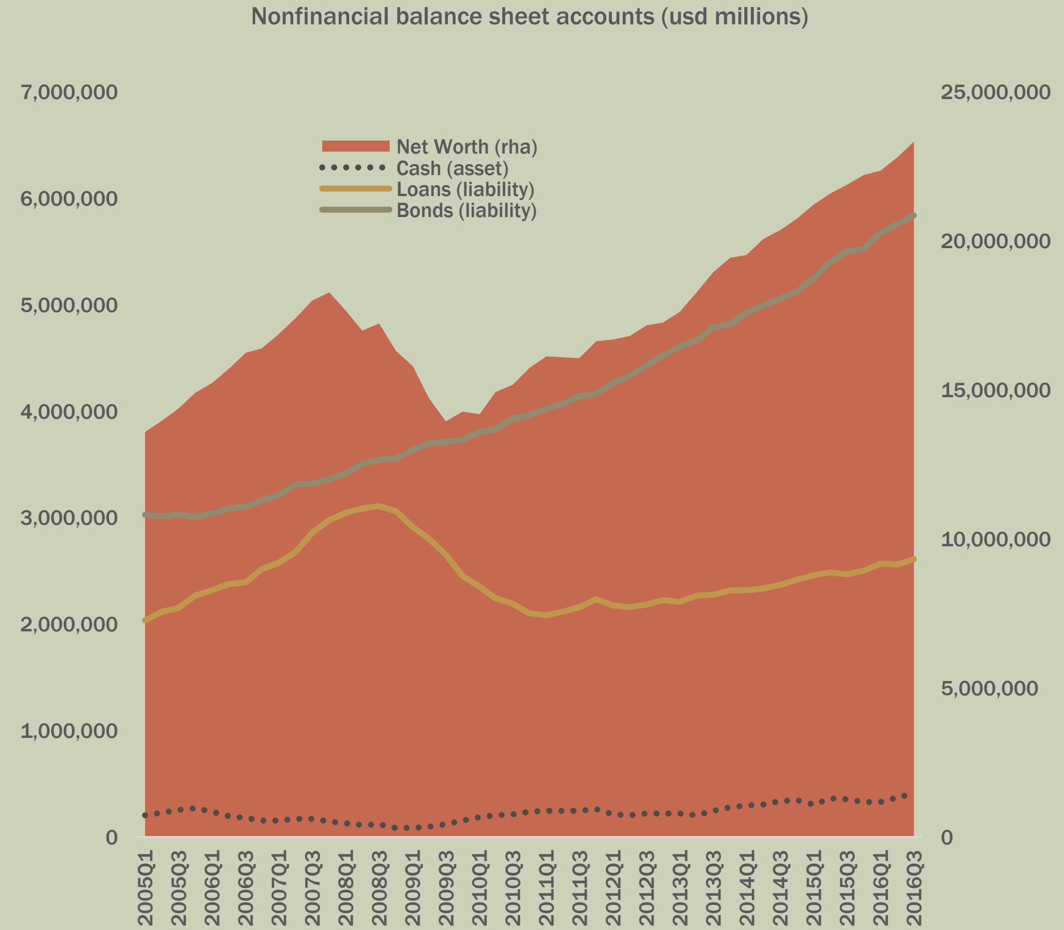
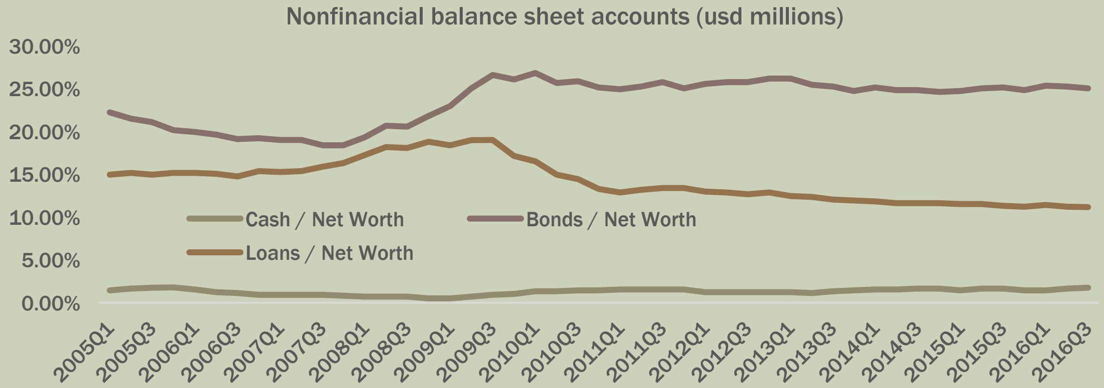
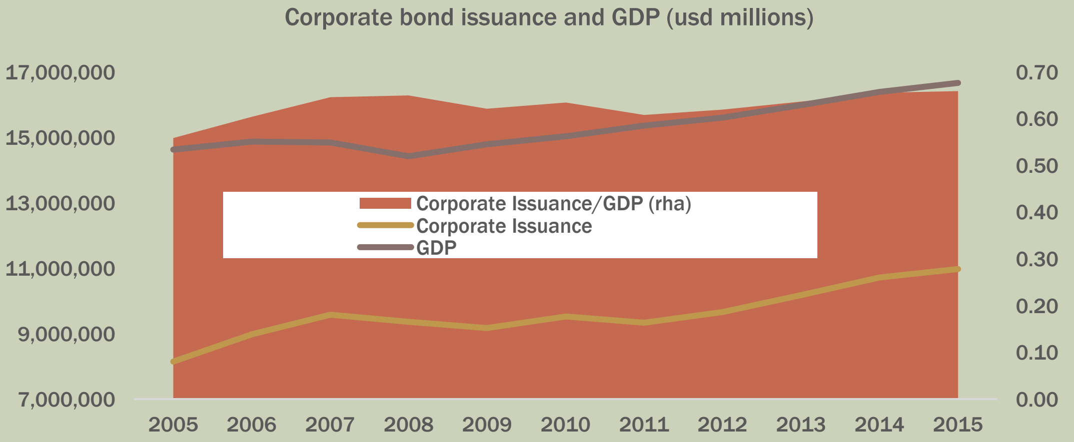
NONFINANCIAL U.S. BORROWERS WITHOUT ACCESS TO BOND MARKET HAVE BEEN LEFT BEHIND FROM CREDIT EXPANSION IN LAST DECADE U.S. CREDIT GROWTH HAS BEEN VIA BONDS WHILE LOANS DECLINED AND BOND ISSUANCE HAS GROWN FASTER THAN GDP

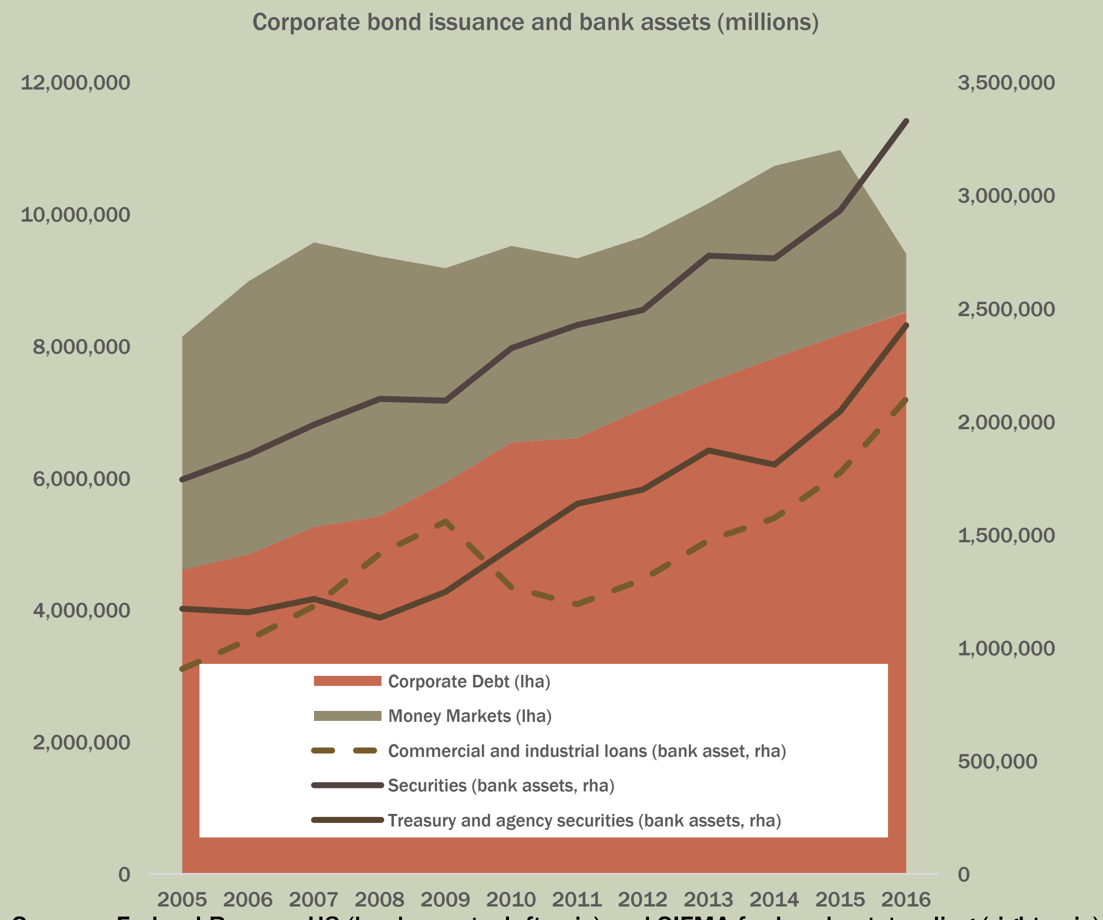




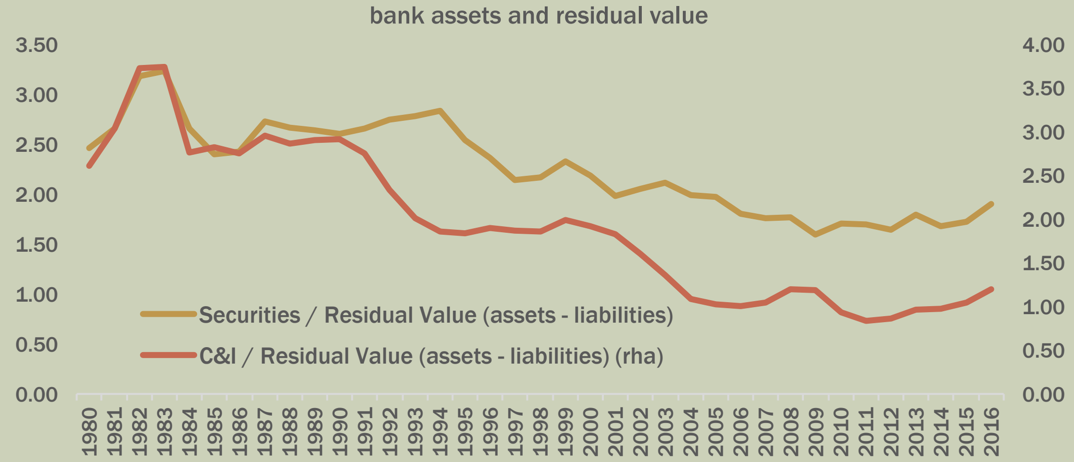


Source: Federal Reserve Z1; non financial corporate accounts; SIFMA Issuance data Excludes financial company balance sheet accounts except Corporate Issuance data

BANKS, ALONGSIDE THEIR DELEVERAGING HAVE ALSO INCREASED CASH AND TREASURY HOLDINGS WHILE REDUCING THEIR USE OF WHOLESALE FUNDING; COMBINATION OF TAX POLICY, BANK RE-REGULATION AND MONETARY POLICY IMPACTS

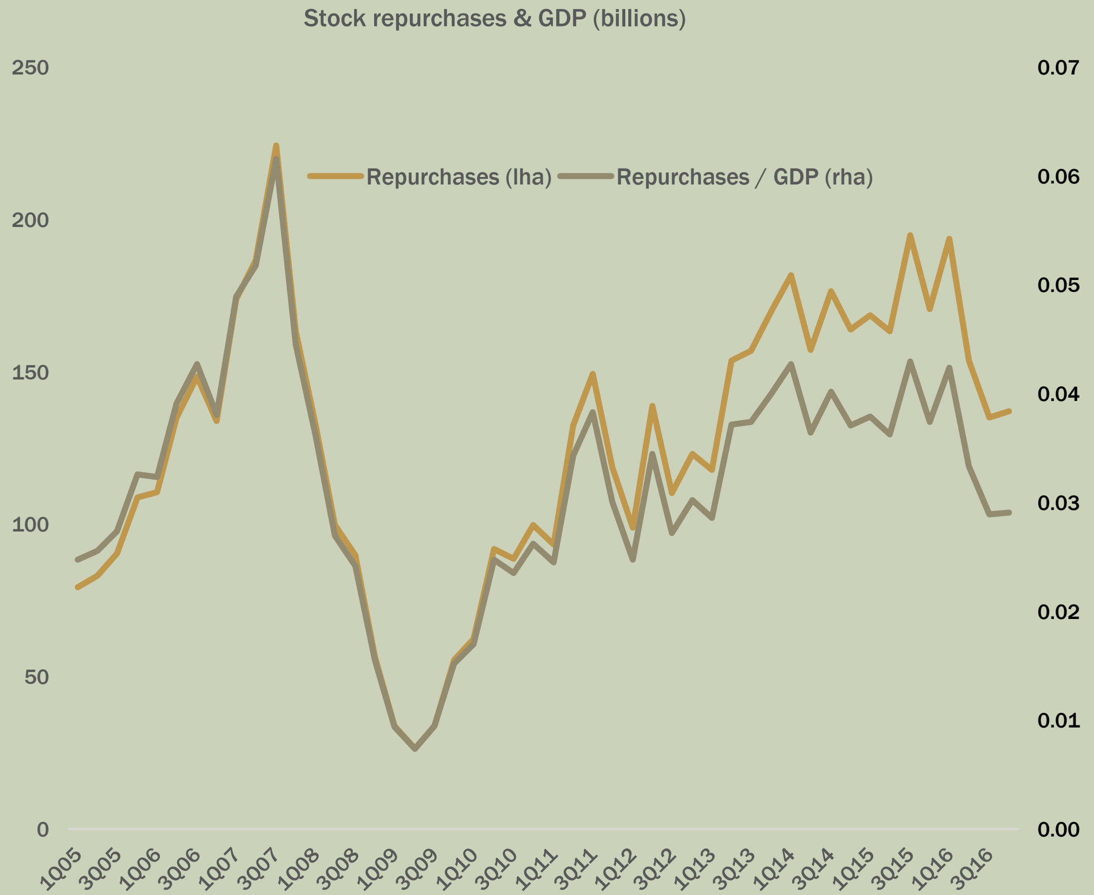


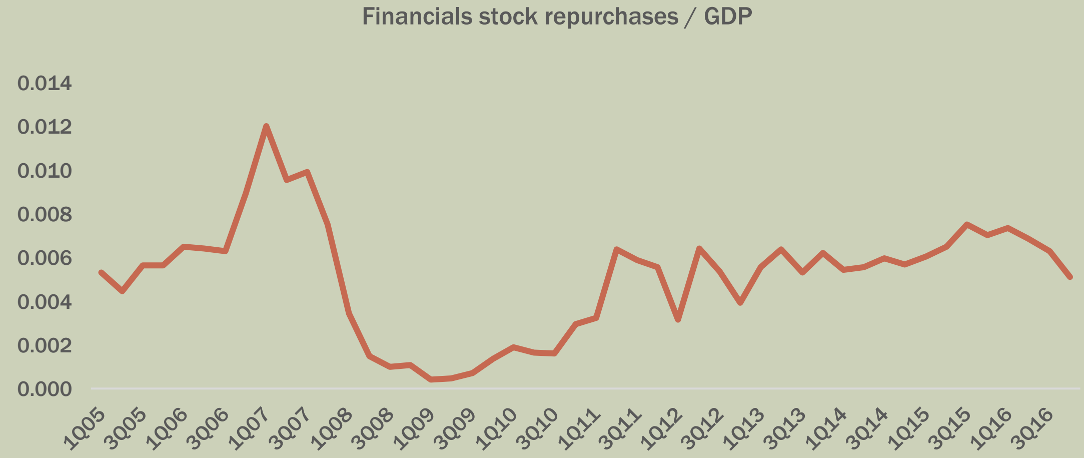
Sources: Federal Reserve H8 (bank assets, left axis) and SIFMA for bond outstanding (right axis)

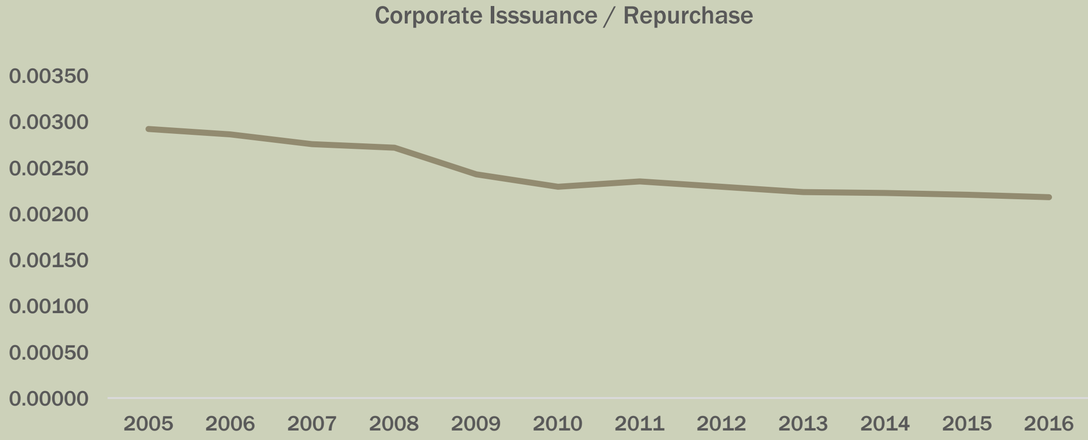


- Bank loan issuance limited as cost of capital made higher (Basel and not Dodd Frank) and de-leveraging
- Banks holding more cash and treasuries and securities holdings constrained given capital requirements (Basel)
- Central banks have set rates low, created money and bought bonds
- Re-regulation of money funds has reduced money market borrowing and issuance

STOCK BUYBACKS LIMIT GROWTH AND IS NOT AN SME BEHAVIOR WHILE CORPORATE AND MONETARY POLICY INCENT BUYBACKS; BANKS ARE LARGEST BUYBACK SECTOR







Source: Goldman Sachs repurchase, Federal Reserve GDP

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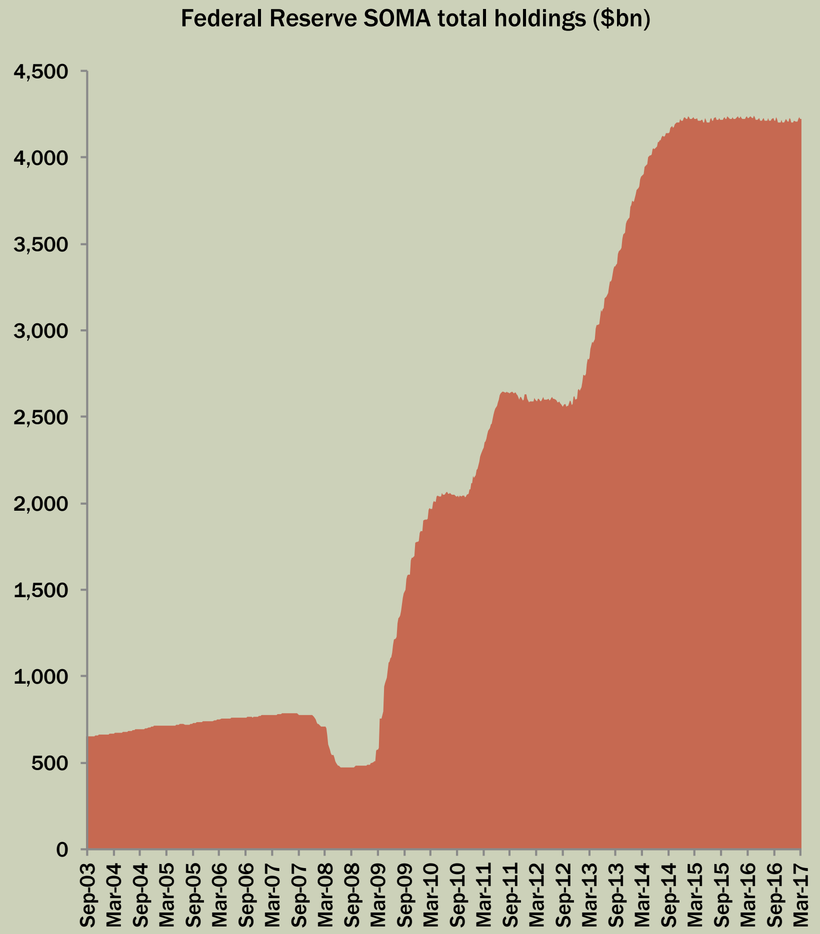
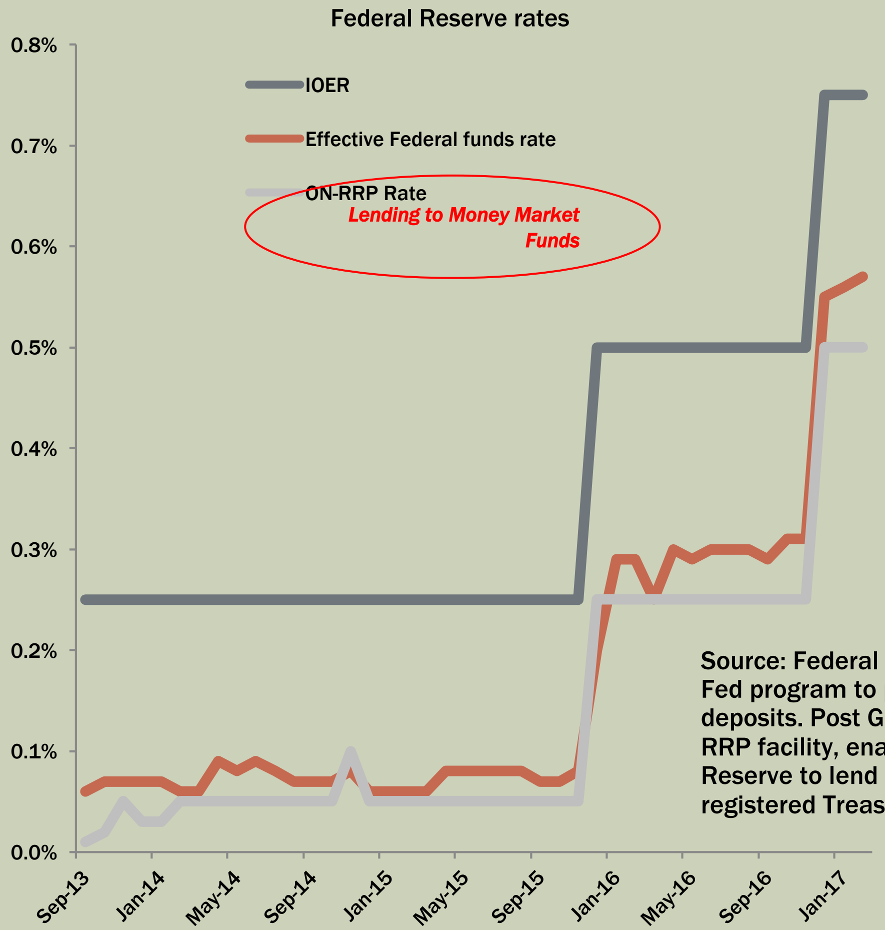
INTEREST RATE AND BOND BUYING POLICIES HAVE IMPACTED MARKET BEHAVIOR AS FED HAS “CROWDED OUT” REAL MONEY INVESTORS WHILE SUPPORTING BANKS





Source: Federal Reserve; IOER is Fed program to pay banks for their deposits. Post GFC monetary tool, RRP facility, enables Federal Reserve to lend directly to registered Treasury Money Funds

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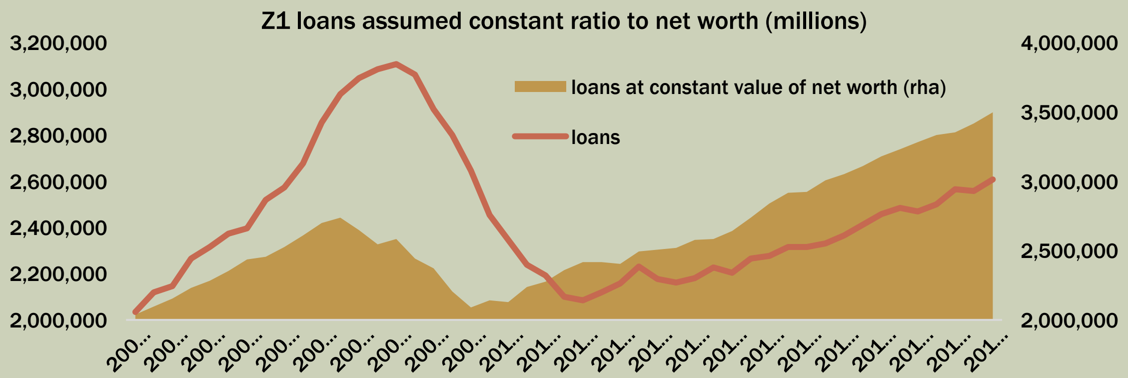
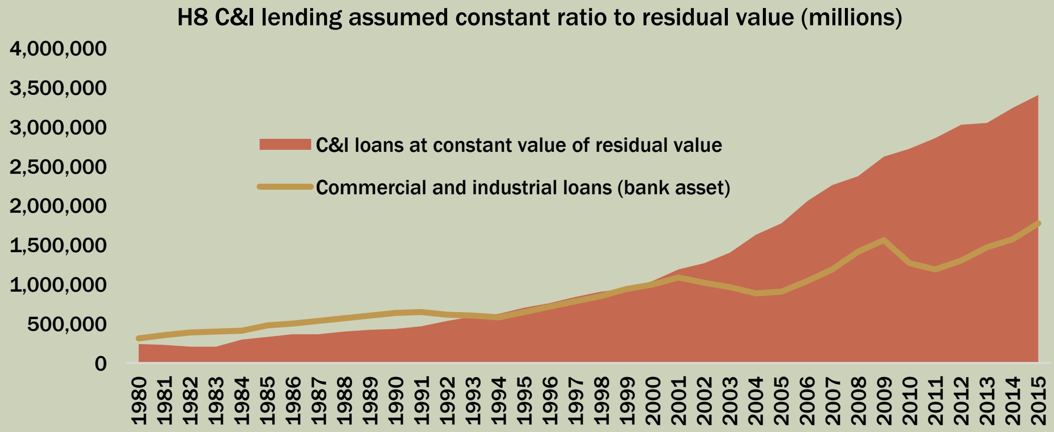
CORPORATE CREDIT GAP IS $750 BILLION TO $1.5 TRILLION AND MOSTLY A SME ISSUE, LIMITING ECONOMIC GROWTH

1. Business credit reduced for those without access to bond market; bank funding / access to bond market is also reduced given bank and money market fund re-regulation
   1. Holding more cash and high quality securities as assets
   2. Deleveraging
   3. Dissuaded from wholesale funding – either bank deposits with other banks or short duration capital markets funding like commercial paper increasing bank to bank lending further crowding out other borrowers
2. Tax policy creates incentives to:
   1. Leave money offshore to increase earnings
   2. Issue debt
   3. Buyback stock (banks largest re-purchasers)
3. Significant cash build up:
   1. Banks need hold more liquid assets and cash
   2. Low productive use of cash at Central banks
   3. Corporations have trapped "tax" cash offshore





Source: Federal Reserve, estimates/ Z1 data through 3Q/2016; Estimates based on Fed data for either nonfinancial corporates (top right) or total bank loans (lower right)

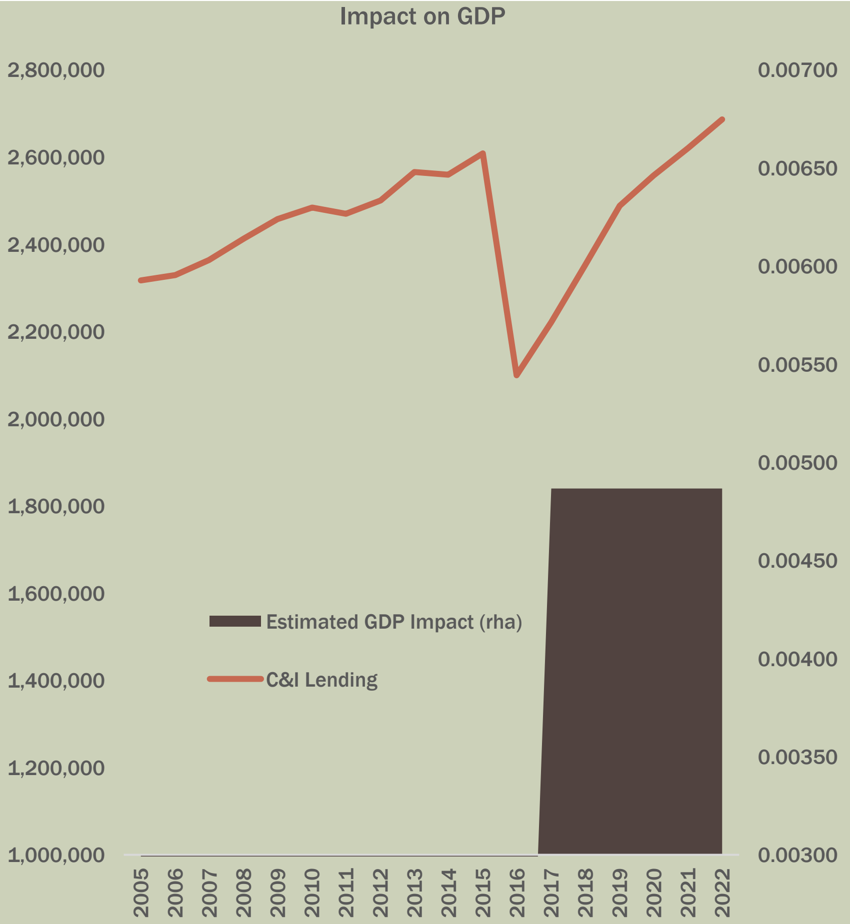
FOUR GROWTH PROPOSALS

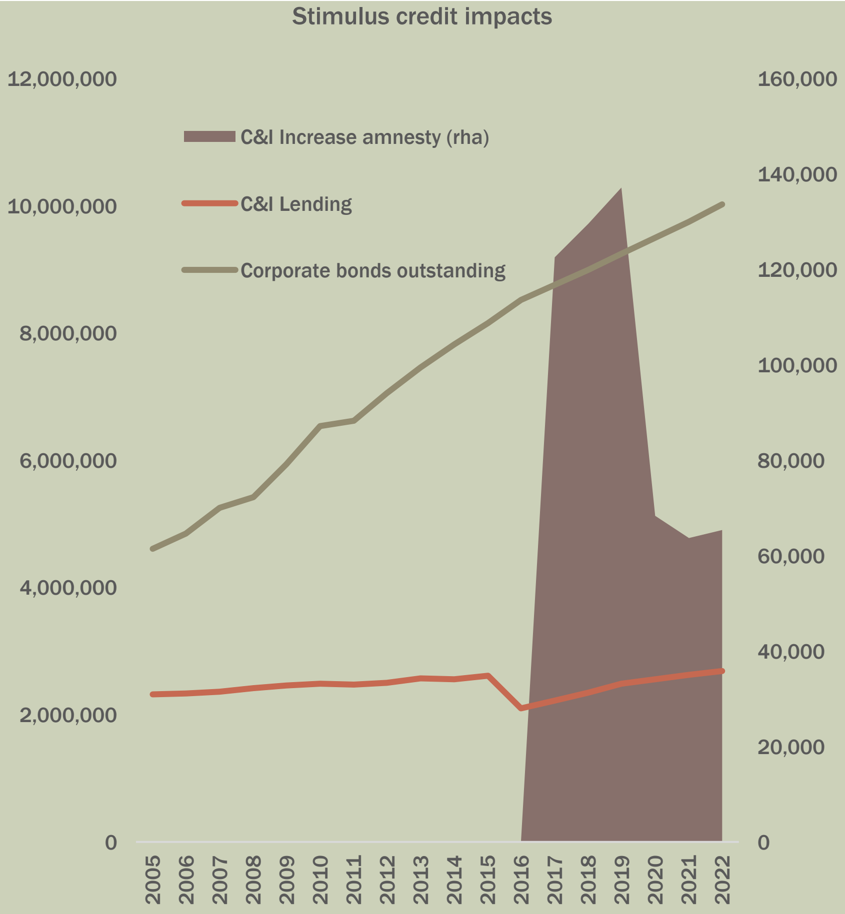
April 2017

SUMMARY

- Increasing SME credit will drive GDP growth
- Modest changes to tax policy can create SME credit growth increasing GDP
- Modest changes to bank regulation can increase SME credit growth increasing GDP
- Private sector incentives for non bank credit provision to SME can increase SME credit increasing GDP
- Four Growth Proposals to increase SME credit:
- Proposal 1 - Tax amnesty for U.S. companies to repatriate offshore cash provided that they lend the tax savings benefit to SME providing credit in return for the waiver
- Proposal 2 - Offer incentives for non banks to invest in SME credit by creating program to create investment management products to serve as lenders providing SME credit
- Proposal 3 - Increase regulatory capital for banks for SME credit if all are held on balance sheet thereby creating incentives for more SME credit to be originated and sold by the banks
- Proposal 4 - Limit tax deductions and stock buy backs for companies holding more than 10% of their cash overseas

INCREASING LENDING BY $150 BILLION TO SME WOULD STIMULATE GDP





Source: Federal Reserve, SIFMA, estimates

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PROPOSAL 1 - TAX AMNESTY TO REPATRIATE OFFSHORE CASH PROVIDED THAT TAX SAVINGS ARE LENT TO SME BORROWERS

- Tax amnesty to bring large corporate cash onshore to lend to SME
- Incentivize corporations to deploy the cash brought onshore as credit (lending capital or receivables purchase capital for SME) for multi year earn out of repatriation tax waiver (tiered for benefit realizations)
- Credit loss absorption structured as part of tax waiver (i.e. annual percentage write off tied to lending)
- Prevent stock buy backs and leveraging for large corporates opting to qualify for tax waiver program
- Requires non government service providers
- Asset generation (lending) requires cash and large corporates require services to deploy cash as credit - asset managers, fintech and bank services – and service providers

PROPOSAL 2 - OFFER INCENTIVES FOR NON BANKS TO INVEST IN SME CREDIT BY CREATING PROGRAM TO CREATE INVESTMENT MANAGEMENT PRODUCTS TO SERVE AS LENDERS PROVIDING SME CREDIT

- Most easily distributed investor products have credit ratings
- Most SME credit is not rated unless SME credit is structured into securitizations to be rated
- Investor universe that can either purchase credit that is not rated or willing to originate credit is relatively small
- Investment management firms require incentives to take on the additional costs and responsibilities to manage un rated credit investments
- Establish a new program "SME Investment Management Office" that provides direct incentives to investment managers to set up new product offerings to acquire and purchase or originate and fund SME loans
- Requires non government service providers
- Asset generation (lending) requires cash and large corporates require services to deploy cash as credit - asset managers, fintech and bank services – and service providers

PROPOSAL 3 - INCREASE REGULATORY CAPITAL FOR BANKS FOR SME CREDIT IF ALL ARE HELD ON BALANCE SHEET THEREBY CREATING INCENTIVES FOR MORE SME CREDIT TO BE ORIGINATED AND SOLD BY THE BANKS

- Incentivize banks to originate and sell credit and extend new credit
- Banks not to increase balance sheet
- Banks required to maintain a certain portion of each loan
- Provided that they hold 10% of each loan the bank is able to reduce the capital charge on their holding by 10%
- Requires non government service providers
- Asset generation (lending) requires cash and large corporates require services to deploy cash as credit - asset managers, fintech and bank services – and service providers

PROPOSAL 4 - LIMIT TAX DEDUCTIONS AND STOCK BUY BACKS FOR COMPANIES HOLDING MORE THAN 10% OF THEIR CASH OVERSEAS

- Create incentives for companies to deploy cash by investing in their businesses:
- Supporting lending to their U.S. SME supply chains
- Requires non government service providers
- Asset generation (lending) requires cash and large corporates require services to deploy cash as credit - asset managers, fintech and bank services – and service providers

ABOUT THE AUTHORS

Adam Dener is a managing principal and a founding partner of Fermat Capital's trade-finance investment strategy. Adam has over 25 years experience in banking, accounting and trade-finance management services with specialization in private-placement credit origination, cash management, and collateral management. In 2016 Adam was appointed to the Department of Commerce’s Trade Finance Advisory Council by Secretary Pritzker. Prior to joining Fermat Capital in 2015, Adam was the managing director of trade finance at Conning. While there, he developed and led a ground-breaking initiative known formally as Working Capital Finance Investments (WCFI) and now codified as NAIC regulation SSAP 105. This initiative brought together banking and insurance regulators to establish trade credit as a permitted investment class for insurance companies. Prior to Conning, from 2008 to 2011, Adam was an executive in residence at Aquiline Capital Partners, where he developed a trade finance venture backed by private equity. Throughout his career Adam has managed various treasury business units and served as an advisor to banks, insurers and regulators. Adam holds a B.S. degree in from Cornell University (1984) and is a Cornell Tradition Fellow.

Sergio Rodriguera, Jr. is the Chief Strategy Officer of The Credit Junction. Sergio oversees the strategic initiatives of the company. Prior to joining us, he was a Professional Staff Member on the Committee on Financial Services in the U.S. House of Representatives, Office of Majority Leader Eric Cantor, and a Special Advisor at the Department of Treasury. He holds a Top Secret clearance in the Navy Reserves and is a veteran of the Afghanistan war. In 2016 Sergio was appointed to the Department of Commerce’s Trade Finance Advisory Council by Secretary Pritzker. Sergio graduated from the University of California at Santa Barbara and Naval War College.