Statement
of the
U.S. Chamber
of Commerce

ON: "Examining the Impact of the Volcker Rule on Markets, Business, Investors and Job Creation"

TO: The Subcommittee on Capital Markets and Government Sponsored Enterprises and the Subcommittee on Financial Institutions and Consumer Credit

DATE: January 18, 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 morning Chairmen Garrett and Capito, Ranking Members Waters and Maloney, and members of the subcommittees. It is an honor to be invited to testify at today's hearing: "Examining the Impact of the Volcker Rule on Markets, Businesses, Investors and Job Creation". This is a timely hearing that goes to the heart of the stability of the financial system and I am pleased to be able to contribute to the discussion.

I am Anthony J. Carfang, a founding partner of Treasury Strategies, Inc. Treasury Strategies is the world's leading consultancy 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 to many of the world's largest and most complex corporations and financial institutions.

I am here today, on behalf of the U.S. Chamber of Commerce to discuss the impact of the Volcker Rule on non-financial businesses.

In my mind the question that has not been asked and that needs to be answered by both the regulators and Congress is simply this: how does the Volcker Rule impact the ability of non-financial companies to raise capital and mitigate risk and are we willing to live with the adverse impacts of the Volcker Rule that will affect the competitiveness and the overall efficiency of the U.S. economy.

Let me first 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 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 feel strongly that the Volcker Rule, as currently constructed, will not succeed in this effort. We believe that it will make U.S. capital markets less robust, U.S. business less competitive and ultimately reduce underlying economic activity. We believe that the lack of clarity in many of the proposed regulatory provisions and the lack of a precise definition of "propriety" trading itself will cause financial institutions to scale back and even exit some of the critical services they provide.

Simply put, after the Volcker Rule goes into effect, when a business' treasurer calls a bank to raise the cash needed to pay the bills, will someone answer that phone call?

Besides reduced financing for American businesses the Volcker Rule could actually INCREASE systemic risk by consolidating assets into the banking system, exacerbating too-big-to-fail.

Process Issues

Before I discuss the impacts of the Volcker Rule upon non-financial companies please let me take a minute to discuss regulatory process issues that make it extremely difficult if not impossible for businesses to understand how the Volcker Rule will impact their ability to raise capital.

The Federal Reserve ("Fed"), Federal Deposit Insurance Corporation ("FDIC"), Office of the Comptroller of the Currency ("OCC") and Securities and Exchange Commission ("SEC") proposed their portion of the Volcker Rule implementing regulations in October and these were published in the Federal Register on November 7, 2011. The Commodities and Futures Trading Commission ("CFTC") voted on its proposal last week and to my knowledge has not published its proposal in the Federal Register.

Each of these regulators looks at a separate portion of the markets so it is only possible to understand the full scope and impacts of the proposed regulations when one can see how each of the proposed rules interact with one another and the markets themselves. While the CFTC is expected to close its comment period 60 days after publication in the Federal Register, the other regulators' comment period will close on February 13, 2012.

With competing comment periods, tt is impossible to conduct a thoughtful analysis and provide regulators with informed answers to the over 1,000 questions they have asked.

Accordingly, in terms of fundamental fairness the comment periods should be reconciled and extended for all of the regulators.

Summary

Businesses operating in the U.S. are 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 liquidity markets,
- The 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 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.

Highly liquid means of raising capital allow treasurers to keep less cash on hand and use a just-in-time financing system that allows companies to pay the bills and raise the capital needed to expand and create jobs.

Should the Volcker Rule be enacted in its present form, capital efficiency will decline, resulting in increased corporate cash buffers. Were cash to rise to the Eurozone level of 21% of GDP, that new level would be $3 trillion.

Stated differently, CFOs and treasurers would need to set aside and idle an additional $1 trillion of cash:

- That $1 trillion is greater than the entire TARP program.
- It's 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 and consumers alike. 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?

The Volcker Rule, as currently proposed, will increase administrative expenses for banks, create a subjective regulatory scrutiny of trades thereby making a company's ability to raise capital more expensive and time consuming. This will raise costs for all companies; make foreign capital markets more attractive for some, 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 regulations that may imperil 40% of the commercial paper market, Basel III lending requirements and expected derivatives regulations.

All of these efforts are converging in one place—the corporate treasury and their combined impact upon a business's ability to raise capital and mitigate risk have not been vetted or thought through.

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 transformed. So when you consider ways to reduce banking system risk, do not be tricked into thinking that risk disappears. It simply moves elsewhere.

To truly minimize the probability of future financial crises, we must understand how this risk transforms 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.

Specific Unintended Consequences of the Volcker Rule

Ambiguity surrounding provisions of the Volcker Rule is likely to have a chilling effect on precisely those banking services that account for U.S. competitiveness, capital efficiency and financial stability. This is an issue for U.S. businesses, large and small.

Some of the unintended consequences, in addition to a general slowdown in economic activity, include:

- Impaired market liquidity and reduced access to credit
- Higher costs and less certainty for borrowers
- Restricted trading in proper and allowable businesses
- Competitive disadvantage for U.S. businesses and financial institutions
- Increased compliance costs for **non-financial** businesses
- Higher bank fees for consumers and businesses
- Less access to capital for small businesses and start-ups
- Shifting of risks to other sectors of the economy
- Capital flows into offshore markets

Let's take these one by one.

1.) <u>Impaired market liquidity and reduced access to credit</u>

The Volcker Rule will impair the ability of banks to function as market makers. Banks act as significant buyers and sellers of securities to ensure that borrowers can find investors and investors can find investments.

As market makers, banks hold inventory. This could be inventory in various investment instruments, treasury debt, customer securities and foreign currencies. However, the Volcker Rule significantly constrains their ability by dictating how banks should manage their inventory. This will reduce the depth and liquidity of our capital markets.

For example, corporations, municipalities, healthcare providers, and universities rely upon the "market making" activities of banks in order to secure affordable funding in the bond market. Without these "market making" activities, banks would be unable or unwilling to underwrite these public and private bonds. Thus, if banks can no longer hold inventory, it will be much more difficult for businesses, municipalities and schools to raise capital.

Bank trading activities are what create market liquidity and enable the market to provide an efficient clearing price. Without these activities, markets take a giant step backward to bilateral 'deals' and, in effect, a barter or auction system.

2.) <u>Higher costs and less certainty for borrowers</u>

The Volcker Rule will increase the cost of capital for all companies. With reduced market liquidity, transaction spreads widen, risks increase and price changes become more volatile. To compensate for these new risks, investors will demand higher rates.

Because banks can currently underwrite a bond issue for a customer and hold any unsold bonds in inventory, credit worthy borrowers can be reasonably assured of timely access to credit. However, under the Volcker Rule in its current form, banks may not be able to hold that inventory. They therefore, may decide to defer or delay underwriting those bonds for their customers until buyers are found in advance.

Imagine a municipality or a hospital facing a critical funding need. Under the Volcker rule, they would go bankrupt waiting for a bank to line up the funding. Or, they end up paying a crippling rate.

3.) <u>Restricted trading in proper and allowable businesses</u>

The Proposed Rule is inherently complicated and forces regulators to define the intent of a trade. Worse, they require banks to "prove" the intent of each trade. This cannot be done in any reliable and consistent way. One entity's proprietary trade is another entity's market making activity. 'Proprietary trading' defies a symmetrical definition.

The complexity and vagueness of the Volcker Rule will force banks to adopt the most conservative interpretation of the rule and the least favorable "intent" of any trade. With the burden of proof on the banks, the compliance costs become prohibitive. The net result will likely be the elimination of perfectly acceptable "market making' activities. This could result in banks exiting or scaling back such routine activities as commercial paper issuance, cash management sweep accounts and multi-currency trade finance. These are services which all of Treasury Strategies clients view as critical solutions to execute sound financial management.

4.) <u>Competitive disadvantage for U.S. businesses and financial institutions</u>

The United States' major trading partners have rejected the Obama Administration's request to follow the Volcker rule. This puts American businesses and financial institutions at a disadvantage. By eliminating a core revenue stream from U.S. banks, the Volcker Rule would effectively reduce the ability for U.S. banks to compete and grow. Additionally, in order to avoid the territorial jurisdiction of the Volcker Rule, foreign financial firms may retreat from the U.S., further depriving American businesses of capital and degrading the ability of U.S. regulators to oversee and regulate financial activity.

Finally, most companies will still have financial risks that need to be managed. U.S. businesses will increasingly turn to foreign banks in overseas markets. Perversely, this will simultaneously weaken U.S. banks while strengthening foreign banks.

5.) Increased compliance costs for **non-financial** businesses

The reach of the Volcker Rule can extend to non-financial businesses, although they present no systemic risk whatsoever. Many businesses offer financing services to their customers. They may own a bank, have a commercial or consumer finance subsidiary or have a credit card company. These businesses will incur increased costs and higher compliance burden. Some will pass these costs on to their customers. Others will simply discontinue the financial or card services. In any event, the result is higher cost credit for those willing to pay and less credit for most small businesses and consumers.

6.) Higher bank fees for consumers and businesses

The cumulative effect of regulatory changes such as the Volcker Rule and Basel III will reduce or eliminate core banking revenue. At the same time, the Volcker rule will materially increase the costs of regulatory compliance. In order to continue providing high quality, technologically advanced banking services, U.S. banks will need to increase banking fees on a wide range of services. They may also need to become more selective in the customer segments they choose to serve, thereby reducing the general availability of banking services.

7.) Less access to capital for small businesses and start-ups

As banks restrict the availability of their services and increase the price, an inevitable "crowding out" will occur. The very highest rated corporations and those who transact in the highest denominations will still have access to credit and risk management products. However, the less credit worthy customers and start-ups will be left out. Many traditional services will be no longer cost effective. Some may not be available to those segments at all.

8.) <u>Shifting of risks to other sectors of the economy</u>

As we stated, risk is neither created nor destroyed. It can only be transformed. 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. Simply precluding a bank from helping the company hedge those risks, the Volcker Rule does not make those risks go away. Indeed, the risk becomes less transparent and thus more potent.

CFOs and treasurers will undoubtedly conclude that some risk management techniques and some heretofore efficient transactions will no longer be cost effectively. They will decide to "go naked" and retain that 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.

9.) <u>Capital flows into offshore markets</u>

Corporate treasury is the financial nerve center of the firm, daily facing, and managing the complexities of the global markets. Most treasurers select a lead bank as their primary source of capital, information, and advice. That bank must be one that both give the company global visibility, and can seamlessly operate in markets far and wide. The Volcker Rule would virtually eliminate U.S. banks from contention for that important 'lead' role.

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.

Many U.S. multinational companies are already selecting lead banks for each region of the globe, eroding the dominance of the U.S. banks. Many companies are establishing 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.

<u>Conclusion</u>

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

We feel strongly that the Volcker Rule, as currently constructed, will not reduce systemic risk nor improve economic well-being. We believe that it will make U.S. capital markets less robust, U.S. business less competitive and ultimately reduce underlying economic activity. We believe that the lack of clarity in many of the bill's provisions and the lack of a precise definition of "propriety" trading itself will cause financial institutions to scale back and even exit some of the critical services they provide. Finally, we are deeply concerned that the Volcker Rule will increase concentration of assets into the banking system and actually increase systemic risk.

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