Statement of the U.S. Chamber of Commerce

ON: The Impact of Regulations on Short-Term Financing

TO: House Committee on Financial Services, Subcommittee on Capital Markets and Government Sponsored Enterprises

BY: Thomas C. Deas, Chairman, National Association of Corporate Treasurers on behalf of the U.S. Chamber of Commerce Center for Capital Markets Competitiveness

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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. The Chamber is dedicated to promoting, protecting, and defending America's free enterprise system.

More than 96% of Chamber member companies have fewer than 100 employees, and many of the nation's largest companies are also active members. We are therefore cognizant not only of the challenges facing smaller businesses, but also those facing the business community at large.

Besides representing a cross-section of the American business community with respect to the number of employees, major classifications of American business—e.g., manufacturing, retailing, services, construction, wholesalers, and finance—are represented. The Chamber has membership in all 50 states.

The Chamber's international reach is substantial as well. We believe that global interdependence provides opportunities, not threats. In addition to the American Chambers of Commerce abroad, an increasing number of our members engage 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.

Testimony before the Subcommittee on Capital Markets and Government Sponsored Enterprises
U.S. House Committee on Financial Services
"The Impact of Regulations on Short-Term Financing"
Thomas C. Deas, Jr.
U.S. Chamber of Commerce Center for Capital Markets Competitiveness
December 8, 2016

Chairman Garrett, Ranking Member Maloney, and members of the subcommittee:

Thank you for the opportunity to testify at this important hearing focusing on financial regulation and its impact on short-term financing. I am Thomas C. Deas, Jr., recently retired vice president and treasurer of FMC Corporation and current Chairman of the National Association of Corporate Treasurers ("NACT"), an organization of treasury professionals from several hundred of the largest public and private companies in the country. I am testifying today on behalf of the U.S. Chamber of Commerce ("Chamber"). The Chamber is the world's largest business federation, representing the interests of more than three million businesses of all sizes, sectors, and regions. NACT fully supports the Chamber's many important efforts to assure that financial regulations do not unduly burden Main Street companies whose treasurers are working every day to finance their businesses, safeguard their cash and other assets, and hedge risks in their day-to-day operations in the most efficient and effective ways possible.

There is no question that liquidity is the lifeblood of any business. Without having ample liquidity, production comes to halt, inventories run low, and bills are not paid on time. The cyclical nature of many businesses places significant importance on the availability of short-term financing so that they can operate efficiently and without disruption. For decades, the U.S. commercial paper market has been the most efficient, cost-effective short-term financial market utilized by corporate treasurers to meet their day-to-day funding requirements. In addition, access to short-term lines of credit from financial institutions and healthy capital markets for corporate debt continues to play an important role in helping corporations of all sizes manage their expected and unexpected financing needs.

We have been clear in our support of the important legislative and regulatory objectives to increase transparency in financial markets and to strengthen their safety, liquidity, and efficiency. Unfortunately, with the onslaught of new financial regulations since the financial crisis, we have seen the implementation of requirements affecting Main Street companies that often conflict with those objectives. The markets for short-term borrowing have tightened, resulting in more volatility, wider spreads, and higher rates. Corporate treasurers have faced increasing difficulty managing liquidity without tying up productive capital or incurring additional substantial financing and hedging costs.

Several regulatory initiatives have or will have significant negative effects on short-term financing. In many cases these regulations interact in ways not fully understood at inception, producing a greater negative effect than might be predicted from an analysis of the rules individually. In some cases, an economic analysis was not done during the rulemaking process leaving stakeholders with an inability to provide informed commentary. Additionally, we believe that the interaction of bank capital and liquidity rules with other rules, like money market mutual fund reform, calls for an analysis for how these rules interact amongst each other and what the collective and individual unforeseen consequences are. We reiterate our call that agencies follow the Administrative Procedure Act and similar statutes, like the Riegle Community Development and Regulatory Improvement Act, to publish an economic analysis during the rulemaking process and allow stakeholders to comment on that analysis. Additionally, in this case, we also believe that there must be a careful analysis of the cumulative effect these rules have on the financial markets when taken together to assure they meet the cost-benefit tests required under present law. To highlight two areas critical to short-term financing, let us consider money market fund reform that has contracted the commercial paper market and the proposed net stable funding ratio rule affecting the amount of capital banks are required to hold aside against loans and other advances they make to Main Street companies.

Money Market Fund Reform

In July 2014, the Securities and Exchange Commission ("SEC") finalized new rules for money market mutual funds that came into force October 14, 2016. The Chamber together with many corporate treasurers expressed significant concerns during the rulemaking process that these changes would have far-reaching consequences on the ability of corporate treasurers to raise short-term capital and manage cash. As we—and others—exhaustively detailed during the rulemaking's comment period to the SEC, the requirement for the net asset value ("NAV") to float and be reported to the nearest hundredth of a cent significantly complicates investments in prime money market funds by corporate treasurers and government finance officers. It introduces an element of uncertainty and recordkeeping complications that are not present in stable NAV funds.

The floating NAV requires treasurers to keep track of gains and losses for federal and state income tax purposes whenever they buy money market fund shares at one price and sell them at another in the routine redemption of their investment. The Department of the Treasury issued a regulation permitting investors in a single money market fund to simplify calculation of their gains and losses.[1] However, as has often happened amid the post-financial crisis flood of regulations, an unintended, and indeed undesirable, consequence ensued. The financial crisis certainly highlighted the need for treasurers to assure, as an absolute requirement, diversification of funding sources, as well as investment alternatives. The tax simplification for money market fund floating NAV investments, however, is only available for investments in a single fund—tending to increase the concentration of investments, producing consequently higher risk.

Of perhaps even greater consequence, however, are the new rule's liquidity fee and redemption gate provisions, which represent significant deterrents for corporate treasurers and other institutional investors from participating in institutional prime funds. There is significant concern that redemption gates may limit liquidity during periods of market stress. As discussed earlier, ensuring liquidity is an absolute requirement for corporate treasurers. Additionally, the potential imposition of liquidity fees also presents uncertainty and a potential loss of principal, a great risk to a treasurer's responsibility to assure adequate funding of day-to-day operations and to safeguard the corporation's assets. Thus, this provision, which is inherent in institutional prime funds, is a major deterrent for corporate cash being invested in prime funds. Instead of stabilizing money funds against a potential run, the application of the SEC's final rule seems to be raising heightened concerns about MMF's liquidity, stability, and overall utility.

Prime funds are important for corporate treasurers not only as a flexible alternative to bank time deposits for investments of temporary excess cash balances, but also because they have been important providers of short-term funding by buying commercial paper notes issued by many corporations to meet their daily funding requirements. However, as the graph below shows, in the year running up to the October 14, 2016, implementation of the new MMF regulations, fund purchases of corporate CP declined significantly.

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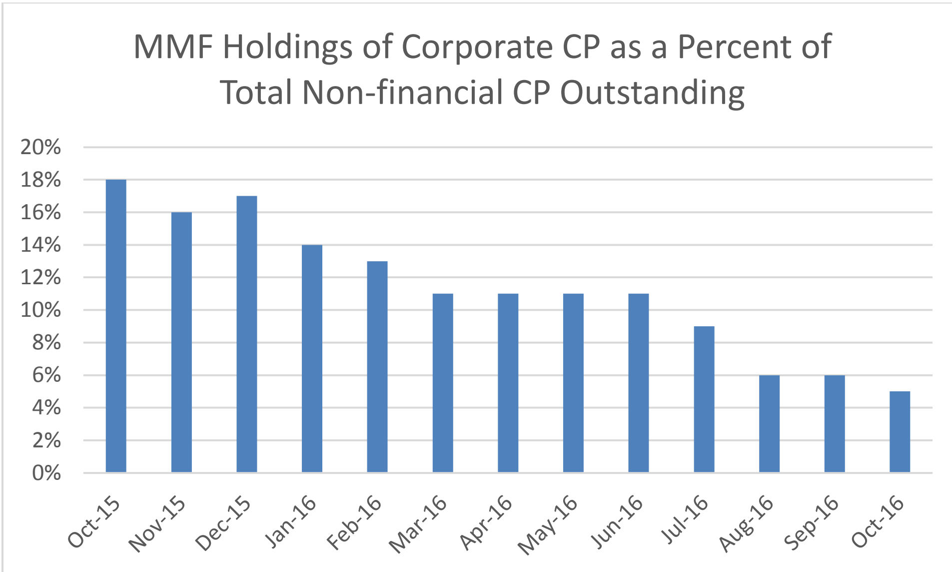
[1] *See* Department of the Treasury, Internal Revenue Service; Method of Accounting for Gains and Losses on Shares in Money Market Funds; Broker Returns with Respect to Sales of Shares in Money Market Funds, 91 Fed. Reg. 44,508 (Jul. 8, 2016), *available at* https://www.gpo.gov/fdsys/pkg/FR-2016-07-08/pdf/2016-16149.pdf.



Source: Fitch Ratings and Crane Data

Concerns about investors fleeing prime money market funds have proven true. Assets in prime money market funds have fallen over $1 trillion to a mere $376 billion[2] since the rule was finalized. The outflow of funds accelerated over the summer in anticipation of the implementation in October, which led prime funds to invest in instruments that had a shorter duration (see chart below). The increasing reluctance to hold instruments such as commercial paper and municipal debt that matured beyond the October 14, 2016, compliance deadline resulted in a significant drop in demand for high-quality, short-term debt instruments. Additionally, the outflow of funds from prime money market funds has resulted in spreads widening by 20 to 25 basis points for prime funds compared to government funds. This quantifies the penalty for Main Street companies at the expense of relatively lower government funding costs.

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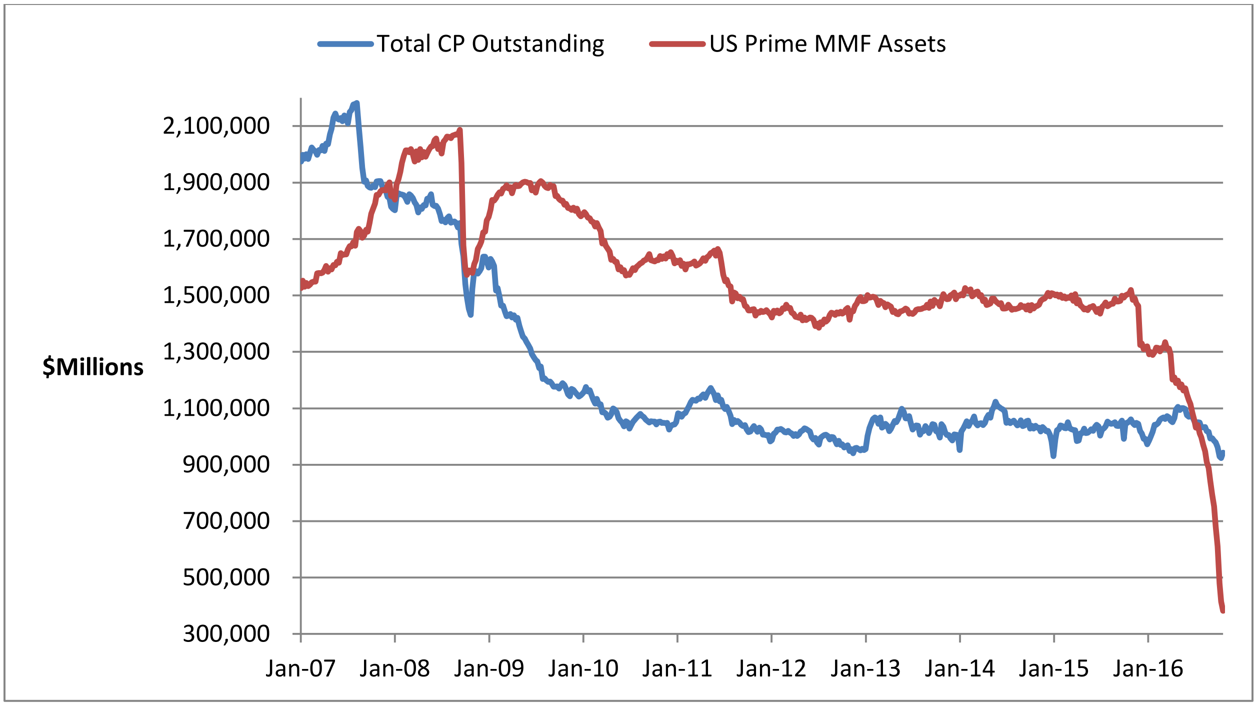
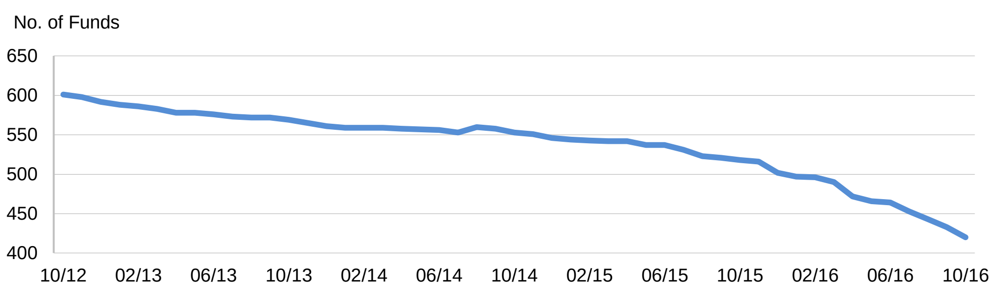
[2] *See* "Money Market Fund Assets—Dec. 1, 2016," Investment Company Institute, *available at* https://www.ici.org/research/stats/mmf/mm_12_01_16.



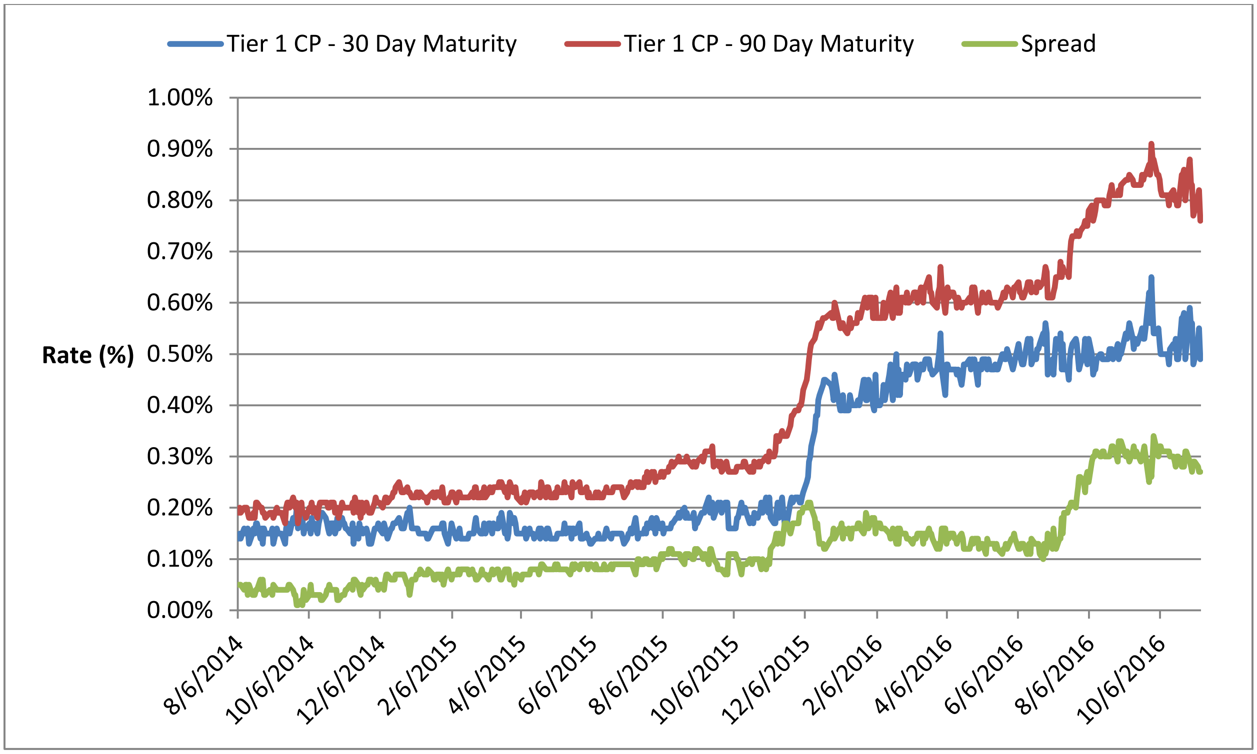
Source: Federal Reserve, iMoneyNet, Fitch Ratings

Number of Money Market Funds



Source: SEC

The supply-demand imbalance, as well as the continued closing of institutional prime funds (see chart above) has forced companies and municipalities to pay higher borrowing rates to fund working capital and other short-term needs. This has been especially true for treasurers issuing 90-day commercial paper in October to obtain funding beyond the year end, faced with the October 14^{th} MMF new rules implementation (see chart below).



Source: Bloomberg, Fitch Ratings

Money market fund reform has indeed added additional burdens to corporate treasurers to manage liquidity efficiently. Thus, we support legislative efforts that ease the economic burden on Main Street businesses to manage liquidity through affordable short-term financing and unrestricted access to cash investments and commend the sponsors of H.R. 4216 that have taken a step forward in this regard.

Net Stable Funding Ratio

The Chamber believes that the Federal banking regulators' proposed net stable funding ratio ("NSFR") rule does not take into account its dramatic impacts on corporate end-users. Specifically, the NSFR structurally discourages banks from investing in corporate debt and further restricts end-users' ability to hedge by increasing the cost of risk management, thus impacting the short-term financing markets and sidelining productive uses of capital.

The NSFR's treatment of corporate debt could hinder end-user capital raising efforts. The NSFR does not adjust for the maturity of end-user-issued debt when determining a dealer's required stable funding and would restrict liquidity in the corporate debt markets by requiring dealers to raise 50-85% long-term funding to support their inventory, which would discourage market making. End-users rely on market-based funding and the liquid markets for corporate bonds and commercial paper. As we prepare for the Federal Reserve's move to increase short-term rates and the yield curve moves up and steepens in anticipation of higher future short- and long-term interest rates, these effects will be exacerbated.

To cite a real-world example of the costs and diminished liquidity from these rules, corporate treasurers issuing commercial paper to balance their daily funding requirements at times are faced with a same-day payment that they identify too late in the day to place with an end-investor in the market. Often their bank commercial paper dealer will take the paper overnight for its own account and fund-out the requirement the next day. The NSFR rules require the bank to hold 85% of that overnight funding as long-term funding—at a cost over ten times the overnight amount. Ultimately this liquidity will no longer be available to end-user treasury departments. Accordingly, the federal banking regulators should carefully consider the impact of the NSFR's 50-85% long-term funding requirements on end-users.

Additionally, we also have concerns related to the add-on costs associated with derivative liabilities. For example, requiring dealer counterparties to provide required stable funding for 20% of the negative replacement cost of derivative liabilities (before deducting even for variation margin posted in cash) is a clear example of the direct burdens affecting end-users' ability to mitigate risk efficiently. The costs to hedge are likely to be passed on to end-user companies in the form of increased fees or transaction costs, less favorable terms, and collateral requirements.[3] Moreover, many have questioned why this 20% "add-on" is necessary and how it was developed, as it was not included in previous proposals from the Basel Committee on Banking Supervision. In fact, the European Union ("EU") has moved forward with a lower charge to reflect these concerns, placing U.S. companies and the U.S. financial institutions supporting them at a disadvantage relative to their EU competitors.

We believe that the Federal banking regulators would have avoided this unfair penalization of corporate treasurers and potential damage to our economy had they conducted and published economic analysis for public review and comment, as required under the Administrative Procedure Act and other similar statutes. In particular, the federal banking regulators are required under the Regulatory Flexibility Act ("RFA") and the Paperwork Reduction Act ("PRA") to conduct an assessment of the economic effect of regulations on small business and consideration of less burdensome alternatives. The PRA requires assessment of the paperwork burden on small entities and ways to reduce or mitigate it. In addition, those regulators are subject to the Small Business Regulatory Enforcement Fairness Act ("SBREFA").

[3] A January 2015 study of the OTC derivatives market by Oliver Wyman concluded that the NSFR's treatment of OTC derivatives would require an additional $500 billion in long-term funding, generating $5-8 billion in incremental costs to the industry, with a cost increase of 10-15% for derivatives transactions.

Among other things, the portion of SBREFA known as the Congressional Review Act states that rulemaking agencies must submit to GAO, and make available to each house of Congress, "a complete copy" of any cost-benefit analysis prepared for a final rule for which such an analysis is performed.[4] Other statutes, like the Unfunded Mandates Reform Act ("UMRA"), require the OCC to conduct economic analysis, and the Federal Reserve has vowed to abide by similar requirements under Executive Order 13563.[5]

Finally, and as we have repeatedly noted in our comment letters to the Federal banking regulators, the Riegle Community Development and Regulatory Improvement Act ("Riegle Act," 12 U.S.C. §4802(a)) requires a rigorous economic analysis that has not been performed here. In particular, the Riegle Act mandates that "[i]n determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions, each Federal banking agency shall consider, consistent with the principles of safety and soundness and the public interest—(1) any administrative burdens that such regulations would place on depository institutions, including small depository institutions and customers of depository institutions; and (2) the benefits of such regulations."

Need for Cumulative Impact Study

An inherent conflict of regulatory objectives further demonstrating the need for an analysis of cumulative impacts can be seen in money market fund regulations and the NSFR Proposed Rule as they affect bank funding and ultimately the cost for funding of Main Street companies. The SEC's rules aiming for greater liquidity for money market funds to meet short-term redemptions drove their investment holdings maturing in a week or less at November 28, 2016, to 68%, up from 54% at June 30, 2016. Many of these MMF investments have been bank certificates of deposit and bank commercial paper. Additionally, the NSFR rules force much greater reliance on long-term funding for banks. Taken together, the decline in money market prime funds' ability to buy short-term bank paper, and the NSFR rules mandating higher cost long-term funding for banks, must in the end result in higher short-term funding costs for Main Street companies. The costs compared to the benefits of these moves have not yet been fully determined.

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[4] 5 U.S.C. 801(a)(1)(b)(i))

[5] *See* Board of Governors of the Federal Reserve System, Statement of Policy Regarding Expanded Rulemaking procedures, 44 Fed. Reg. 3957 (1979) *and* letter from Scott Alvarez, General Counsel of the Federal Reserve, to Nicole Clowers, Director of Financial Markets and Community Investment of the General Accountability Office.

A bipartisan effort by Congress, supported by a majority of the members of this committee, clarified that end-users should be exempted from clearing any uncleared margin requirements to preserve end-users' ability to hedge their commercial risks effectively.[6] The Federal banking regulators should respect Congressional intent and modify the NSFR Proposed Rule to eliminate any potential impact on nonfinancial corporates to the extent that the Proposed Rule contradicts the value of congressionally mandated exemptions. While the Proposed Rule does not undo these exemptions, the consequences of the proposal would not be isolated to covered companies, which would pass on costs of the funding requirements to end-users.

Conclusion

We believe the legislative intent of the Dodd-Frank Act was not to make it exceedingly difficult for corporations to manage their short-term financing and liquidity needs. In fact, Congress specifically exempted nonfinancial corporations from having to use their own capital for unproductive purposes in other contexts, such as the mandatory margining of derivatives transactions. Sidelining productive capital through regulatory requirements diverts funding from investment in business expansion and ultimately costs jobs. Moreover, Congress felt it unnecessary to include additional reforms for money market funds in the Dodd-Frank Act as the SEC had already enhanced regulations under its Rule 2a-7 in 2010.

As a result, we strongly urge you to direct financial regulators to conduct a study of major regulatory initiatives for cumulative impacts on all financial institutions, their customers, and economic growth, which is a key recommendation in our 2017 agenda *Restarting the Growth Engine: A Plan to Reform America's Capital Markets*.

In fact, a recent survey from the U.S. Chamber of Commerce underscores the need to examine our financial services regulatory structure. The Chamber's *Financing Growth: The Impact of Financial Regulation* report asked more than 300 corporate finance professionals, including CFOs and treasurers, to report on the impact of financial services regulatory reform on the availability and cost of the products and services most crucial to the growth of Main Street businesses.

One key finding from the report includes the fact that access to credit remains their top concern. However, more than three-quarters of American companies of all sizes believe that the cumulative effect of financial regulations adopted over the past six years is making it harder for them to access the financial services they need. In

[6] *See* 7 U.S.C. § 2(h)(7); 7 U.S.C. § 6s(e)(4).

addition, 79% of respondents indicate that they are affected by changes in financial services regulation, resulting in 39% of respondents absorbing higher costs and 19% delaying or cancelling planned investments.

Consequently, the larger point, which I know this Subcommittee appreciates, is that the new money market mutual fund and bank structural and capital regulation threatens to impose undue burdens on corporate end-users. The indirect but potentially even more onerous regulation of end-users through bank capital and liquidity requirements serves to pass on substantial new costs to corporate end-users.

In sum, without a robust financial services system that can provide short-term financing, our nation cannot sustain adequate economic growth. Regulatory efforts to ensure financial stability must be accompanied by equally vigorous, data-driven analysis to make certain that Main Street companies continue to have access to the financial services they need. And, as in the case with the NSFR, a failure to conduct rigorous economic analysis as required by law can result in unfair and harmful penalization of regular activities by nonfinancial corporations and other end users outside of the financial system. As a result, Congress must examine the consequences stemming from regulatory initiatives, like money market mutual fund reform and the NSFR, and ensure that there continues to be affordable access to short-term credit and other financing needs.

Thank you and I am happy to address any questions you may have.