Statement of the U.S. Chamber of Commerce

ON: *The Impact of the Volcker Rule on Job Creators, Part 1*

TO: House Financial Services Committee

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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. 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.

Positions on issues are developed by Chamber members serving on committees, subcommittees, councils, and task forces. Nearly 1,900 businesspeople participate in this process.

Good morning Chairman Hensarling, Ranking Member Waters and members of the Financial Services Committee ("committee"). It is an honor to be invited to testify at today's hearing: ***The Impact of the Volcker Rule on Job Creators, Part 1***. We appreciate the committee's efforts to ensure the Volcker Rule is implemented in a manner that supports a stable and robust financial system and I am pleased to be able to contribute to the discussion.

I am Dave Robertson, a partner of Treasury Strategies, Inc., and I am here today on behalf of the U.S. Chamber of Commerce. 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 advised many of the world's largest and most complex corporations and financial institutions as well as small and mid-sized companies.

Appearing on behalf of the U.S. Chamber of Commerce, I have participated in the Commodities and Futures Trading Commission ("CFTC") roundtable on the Volcker Rule, and my colleague Anthony Carfang has testified before the House and Senate Subcommittees on the subject as well.

In these forums, we raised concerns regarding the potential unintended consequences for non-financial businesses the Volcker Rule could cause, specifically:

- 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 American businesses outside of the financial services sector;
- Higher bank fees for consumers and businesses;
- Less access to capital for small business and start ups;

- Shifting of risks to other, less well regulated, sectors of the economy; and

- Capital flows into offshore markets.

These concerns are very serious and very real, and the Volcker rule's impact will resonate throughout our economy. As the banking sector becomes less able to provide American businesses both liquidity and access to credit, American businesses will be compelled to reserve more idle cash, and tap more volatile and expensive forms of credit. These costs will ultimately be borne by ordinary Americans in the form of more expensive products, fewer jobs and decreased dividends. As we have stated previously, these concerns could lead to behavioral changes by financial market participants that could be harmful to economic growth and the safety and soundness of our capital markets, in turn jeopardizing the emerging economic recovery. Though a well-intentioned response to the financial crisis the Volcker Rule was designed and formalized with insufficient consideration of its impact to the economy.

While I will discuss in greater detail some of the real and potential impacts of the Volcker Rule, many of the true effects of this mammoth regulation will not be known until the conformance period ends in July, 2015. However, some problems, which impact both businesses and individuals, are coming into focus:

1. The Volcker Rule, with its broad definition of ownership, has placed in jeopardy the ability for Collateralized Loan Obligations ("CLOs") to finance businesses. CLOs provide $300 billion in business financing;

2. Corporate treasurers may be forced to build up cash reserves. These reserves could be built up through layoffs and reduction or cancellation of dividends, an important form of income for retirees; and

3. The liquidity supports of Quantitative Easing ("QE") may mask the effects of the Volcker Rule for a period of time, but the start of the wind-down has already started to boost the yields of corporate bonds.

To address these issues the Chamber recommends:

1. The passage of H.R. 3819, the "Fairness for Community Job Creators Act." and respectfully request that the bill be amended to include an exemption for CLO's;

2. The continued use of the Financial Services Committee's oversight powers to hold the Volcker Rule regulators accountable, identify and correct unforeseen consequences harmful to America's Main Street businesses; and

3. Congress review procedures for rule-writing, especially with joint agency rulemakings, to ensure fair procedures for input and comment and hold agencies accountable in the consideration of the impacts and costs on the economy and businesses.

a. Failure to understand impacts of the Volcker Rule upon capital formation of non-financial companies.

In our previous testimonies, we expressed serious concerns that the regulators had failed to take into account the impact of the Volcker Rule upon the capital formation of Main Street businesses. While it appears that the regulators tried to address some of these concerns, the Rule's implications for CLOs shows that the financial regulators may have missed the mark, and this failure has real-life consequences that are harmful to the overall economy.

CLOs provide over $300 billion in financing to thousands of businesses. One surprising, and troubling, development in the final rulemaking on Volcker is the excessively broad definition of "ownership interest." This definition is used to determine whether a bank owns an interest in a covered fund, like a hedge fund, that must be divested under Volcker. In the final version of the Rule, the regulators, acting without prior notice, far exceeded the requirements of the statute, and their definition of "ownership interest," includes not only equity in such a fund, but also the "right to participate in the election or removal" of the investment manager. In so doing, regulators swept certain bank bond portfolios into a prohibition directed at hedge fund ownership.

As a result many banks could be forced to sell off debt like CLOs. CLO notes are clearly debt, not equity, and have a long track record of stable and steady performance – the historic default rate of CLOs is under 1.5%, and the loss given default much lower than that. These are assets that withstood the stress of the financial crisis and continue to trade at or close to par.

Why would banks be forced to divest a safe debt instrument under a provision of law intended to cover hedge funds? Because the highest rated class of CLO debt carries with it the right to participate in the **selection** of a new investment manager if, and only if, the CLO equity owners remove a manager for cause, prior to an actual default. This right is a prudential creditor protection -- it permits senior creditors to have a voice in actions taken to avert disaster. In a sense, this is precisely the same type of power that we want our prudential regulators employing with respect to a troubled financial institution.

Banks currently own about $70 billion worth of CLO debt. Efforts to restructure this amount of debt will be overwhelming. As a result we are likely to see banks begin to sell off these performing assets, which will put downward pressure on prices and start a rush to liquidate. Ironically, this will benefit hedge funds and others who can purchase strong, performing assets at steep discounts, but it will remove significant capital from the banking system. Equally important, this will remove a major source of liquidity from the CLO market, and make it harder for business that need the CLO market for loans to find the financing that they need to operate grow, and create jobs. And we should be mindful of the fact that CLOs provide financing to businesses that cannot access the debt markets affordably, if at all. For many of these companies term loan financing is there only recourse.

This may only be the first wave of capital formation problems that may arise as a result of the Volcker Rule. Accordingly, the Chamber supports the passage of H.R. 3819, the "Fairness for Community Job Creators Act," and respectfully request that the bill be amended to include an exemption for CLO's.

b. Increased Cash Reserves

U.S. businesses benefit from the most efficient capital markets in the world. 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 11% of U.S. gross domestic product. In contrast, corporate cash in the Eurozone is 20% of Eurozone GDP. In the UK, the ratio is even higher at 32%.

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.

While I will discuss this in greater detail later in this testimony why it is too early to understand the full ramifications of the final Volcker Rule, early indications are that some of the concerns we have previously raised were not unfounded and that the Volcker Rule may create barriers to entry and make our capital markets much less efficient, and accordingly, make financing for American businesses and job-creators much more expensive.

To ensure their companies have the resources needed for their companies to grow and operate, an option for treasurers would be to build up cash reserves and take productive capital out of the financial system. If U.S. corporate treasurers were to follow the Eurozone model they 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.

c. **Harmonization of the Volcker Rule is needed**

The Volcker Rule was written by 5 separate agencies—the Federal Reserve, Federal Deposit Insurance Corporation ("FDIC"), Office of the Comptroller of the Currency ("OCC"), Securities and Exchange Commission ("SEC") and the CFTC. Each of these regulators have different areas of responsibility—banking regulations, securities regulation, futures and options regulation—with different tools, histories and processes for regulation and enforcement.

Capital investment by business requires a stable and predictable regulatory environment. For the Volcker Rule to work, it is critical that its interpretation and enforcement be harmonized amongst all of the regulators to provide clear rules of the road. If the Volcker Rule is subject to three to five forms of interpretation and enforcement it will be impossible for market participants to understand or adhere to the bounds of legally permissible behavior. This will lead to either market paralysis or a system of regulatory arbitrage that undermines the safety and soundness of the capital markets. Neither one of these engenders the confidence needed for efficient capital formation.

d. Real impacts of Volcker Rule will not be known until end of conformance period and QE winds down

The Volcker Rule is a five agency rulemaking that was proposed in October, 2011 and finalized by regulators just a month ago in December, 2013. While many financial institutions have already shuttered their proprietary trading operations, the Volcker Rule will not be fully on-line until the end of the conformance period on July 21, 2015.

Because of the 18-month conformance period, it is not possible to understand the full impacts of the Volcker Rule, particularly on Main Street businesses, until the rule it is completely implemented and operational at the financial institutions.

Moreover, the continued use of the Quantitative Easing ("QE") by the Federal Reserve also masks the impact of the Volcker Rule on capital formation for American businesses. QE injects an extraordinary level of liquidity into the corporate bond market and other financial markets keeping them afloat during the financial crisis and its aftermath. How the Volcker Rule impacts the ability of market participants to issue corporate bonds, or if it is even possible to do so will not be known until the artificial supports of QE are withdrawn and a "normalized" macro environment returns.

While the end of QE may not be immediate, we are already seeing signs of how the market will react to the end of QE. However, the preliminary evidence indicates that this withdrawal will not be easy. The announcement of the Federal Reserve's reduction in asset purchases has driven portions of the yield curve higher in anticipation of reduced liquidity and corresponding decrease in demand for fixed income products. Only when the Fed finally takes its foot off the pedal will we be able to measure the true effects of the Volcker Rule on Main Street.

The conformance period should be used to identify and correct unintended consequences and regulators should provide Congress with an analysis of the impact of the QE wind down on capital formation and the interplay of the withdrawal of this support with impact of the Volcker Rule.

e. Interaction of Volcker Rule with other regulatory initiatives

Additionally, the Volcker Rule will not be implemented in a vacuum. Financial regulators, Congress, and market participants need to have a better understanding of how all the myriad regulatory initiatives interact and assess the cumulative impact of these activities.

Corporate treasurers must contend with looming money market regulations that may imperil 40% of the commercial paper market, Basel III lending requirements, Basel III disincentives for commercial lines of credits, and the implementation of derivatives regulations that may reduce the ability of businesses to mitigate risk and ensure affordable access to needed raw materials.

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

f. Process issues

The Volcker Rulemaking process also contained a number of procedural flaws that raise concerns about the level of rigor conducted in crafting the regulations implementing the Volcker Rule. First, the Volcker Rule, as proposed, contained 298 pages and asked over 1,000 questions, and regulators received over 17,000 comment letters. The final Volcker Rule contained a preamble that was over 900 pages long. A proposal of this size, complexity and breadth of agencies involved should have been re-proposed for comment before it was finalized.[1] A re-proposal would have better allowed commenters to identify unintended consequences and positioned regulators to fix them before the Volcker Rule was finalized.

For instance, a re-proposal of the Volcker Rule could have allowed the regulators to resolve the CLO and trust preferred bond issues before the rule was finalized.

Second, regulators failed to provide any sort of economic analysis of the Volcker Rule even though it is a significant rulemaking that will cost the economy more than $100 million.

This defies congressional intent. Congressman Barney Frank, in fact, stated in a congressional hearing on the Volcker Rule that cost benefit analysis "has to be applied" to the Volcker Rule Proposal.[2] The Volcker Rule shortcoming in this regard would appear to violate several applicable legal requirements and underscores the concern that the proposed regulations will have a dramatic and unforeseen negative effect on the financial markets, and the American businesses that rely on those markets for financing.

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[1] *See* Chamber of Commerce letters of November 7, 2013 asking for a re-proposal of the Volcker Rule.

[2] *Joint Hearing on the Volcker Rule before the House Financial Services Subcomm. on Capital Markets and Government Sponsored Enterprises and the Subcomm. on Financial Institutions and Consumer Credit* (Jan. 18, 2012) (opening statement of Rep. Barney Frank).

Among other requirements, the SEC is statutorily required to consider the effects of certain rules on "efficiency, competition, and capital formation." These required considerations—particularly the effects on "capital formation"—are critical in connection with this rulemaking, given the fundamental role that market making and related activities have on market liquidity and the efficiency of the capital markets. In discharging these responsibilities, the SEC must "determine as best it can the economic implications of the rule it has proposed," *Chamber of Commerce v. SEC*, 412 F.3d 133, 143 (D.C. Cir. 2005), and subject that analysis to public comment, *see Chamber of Commerce v. SEC (Chamber II)*, 443 F.3d 890, 905 (D.C. Cir. 2006).

These effects on capital formation and market liquidity must be examined with more exacting review to better inform the agencies' analysis and to help minimize unnecessary regulatory burdens to companies and unintended consequences for capital formation.

The Federal Reserve, as recently as October 24, 2011, after the release of the Volcker Rule proposal was voted on, and before it was published in the Federal Register, wrote a letter to the Government Accountability Office acknowledging the need to engage in a cost-benefit analysis, and how the Federal Reserve's use of such an analysis, since 1979[3], has mirrored the provisions of regulatory reform as articulated in Executive Order 13563.[4]

Similarly, the Unfunded Mandates Reform Act, 2 U.S.C. § 1501 *et seq.* , requires agencies to prepare a budgetary impact statement for any rule likely to result in expenditures by state and local governments and private actors of $100 million or more annually. *Id.* § 1532.

It is also seems that the regulators failed to take into account issues that arose after the Volcker Rule comment period closed. After the comment period closed, the FSOC designated the first non-banks as SIFIs. When the Volcker Rule proposal was issued, the regulators specifically deferred consideration of how Section 619 of the Dodd-Frank Act would apply to designated non-banks because, at the time, the FSOC had not yet finalized the designation criteria, nor had it designated any non-banks.[5] It is still unclear how the regulators will apply Section 619 to designated non-bank SIFIs. These companies, as well as those that could be designated in the future, have no information on the requirements that the regulators will impose and have not

[3] Board of Governors of the Federal Reserve System, Statement of Policy Regarding Expanded Rulemaking procedures, 44 Fed. Reg. 3957 (1979)

[4] See 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.

[5] See Volcker Rule Proposal, fn 4, pp. 66847-66848.

been given an opportunity to comment on the record. This uncertainty could have adverse impacts on liquidity management for Main Street businesses and also have a dramatic impact on asset managers who provide individual investors with vehicles to save for retirement.

Accordingly, we would respectfully request that Congress review procedures for rule-writing, especially with joint agency rulemakings, to ensure fair procedures for input and comment and hold agencies accountable in the consideration of the impacts and costs on the economy and businesses.

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I appreciate the opportunity to appear before you today on behalf of the U.S. Chamber of Commerce. While some of the issues surrounding the Volcker Rule will not be known until QE winds down and the conformance period ends, we have already seen the first wave of impediments that the Volcker Rule has thrown into the path of capital formation by Main Street businesses. The Chamber supports the passage of H.R. 3819, the "Fairness for Community Job Creators Act," and respectfully requests that the bill be amended to include an exemption for CLO's. The conformance period should be used to identify and correct similar issues and regulators should provide Congress with an analysis of the impact of the QE wind down on capital formation and the Volcker Rule. The Financial Services Committee's oversight powers are an integral part of that process and the Chamber looks forward to working with you in the process to identify and correct unforeseen consequences harmful to America's Main Street businesses. We also ask Congress to review procedures for rule-writing, especially with joint agency rulemakings, to ensure fair procedures for input and comment and hold agencies accountable in the consideration of the impacts and costs on the economy and businesses.

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