FALL 2017

FINANCING MAIN STREET AGENDA

Unlocking Capital for Job Creators

CENTER FOR CAPITAL MARKETS COMPETITIVENESS

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Unlocking Capital for Job Creators

True prosperity — good jobs, rising incomes, and financially secure households — is built on a foundation of strong economic growth. Strong growth is only possible when financial regulations are well-reasoned and properly tailored, ensuring our financial markets are not only stable but also diverse, liquid, and accessible.

Many of the reforms implemented in the wake of the 2008 financial crisis were narrowly focused on financial stability and did not consider the impact on economic growth. The unintended consequences of these initiatives have made it difficult for Main Street businesses to access the financing they need to get started, sustain operations, manage cash, make payroll, and create well-paying jobs. For example, arbitrary regulatory thresholds have imposed strict rules on small, midsize, and regional banks, making it harder for them to serve their communities. The Volcker Rule has made it more expensive for corporate treasurers to access the debt and equity markets. Capital and liquidity rules have restricted lending and disincentivized traditional means of cash management.

With eight years of experience and empirical data, we are in a position to fully understand the impact of the post-crisis reforms and ensure that they are properly calibrated to balance stability and growth. We've learned that more is not always better; it's time to get financial regulation *right*.

The U.S. Chamber of Commerce's Center for Capital Markets Competitiveness (CCMC) is particularly concerned by the state of small business lending. Data from U.S. Chamber surveys of small businesses, the Federal Deposit Insurance Corporation (FDIC), and the Federal Reserve show significant declines in small business lending over the last decade despite widespread demand.

- Across all FDIC-insured banks, the number of small business loans **declined 13%** between 2008 and 2017.[1]
- Small business loans reported under the Community Reinvestment Act **declined 43.5%** between 2008 and 2015.[2]
- The Federal Reserve Banks' 2016 survey of small business access to credit found serious shortfalls in small business financing despite widespread demand:
    - **60%** of small business applicants received less than the amount for which they applied.
    - **24%** of applicants were unable to obtain any financing at all.
    - **25%** of small businesses that did not apply for financing reported they were either too discouraged or the cost of credit was too high.[3]

1 Federal Deposit Insurance Corporation, Loans to Small Businesses and Farms, FDIC-Insured Institutions, 1995-2017, *available at* https://www.fdic.gov/bank/analytical/qbp/timeseries/small-business-farm-loans.xls (defining small business loans as commercial and industrial (C&I) and commercial real estate (CRE) loans less than $1 million).

2 Federal Financial Institutions Examination Council, Community Reinvestment Act National Aggregate Reports, 1 Originations and Purchases for Small Business and Farm Loans, *available at* https://www.ffiec.gov/craadweb/national.aspx.

3 Federal Reserve Banks, 2016 Small Business Credit Survey: Report on Employer Firms (Apr. 2017), *available at* https://www.newyorkfed.org/medialibrary/media/smallbusiness/2016/SBCS-Report-EmployerFirms-2016.pdf.

- U.S. Chamber surveys have found that small businesses depend on bank financing and that financial regulation directly impacts Main Street:
    - **51%** of small business executives consider banks to be their ideal credit providers, and **40%** plan on applying for a loan or line of credit over the next year.
    - Only **31%** of small businesses believe credit conditions are improving.
    - Corporate treasurers cited the Basel III capital and liquidity rules as having the **most negative impact** on their companies, among all the post-crisis reforms.[4]
- The decline in small business lending has serious impacts. According to the U.S. Census Bureau, only 414,000 small businesses were founded in 2015, **a decline of 26%** since 2006.[5]

Several factors have contributed to the steep decline in small business lending. The Dodd-Frank Act's embrace of standardization in the banking industry has undermined *relationship lending* — credit decisions informed by local knowledge and judgment. Dramatically higher compliance costs have made it more cost-effective for a bank to make one large loan rather than several smaller ones. Strict capital and liquidity standards and the stress-testing regime have penalized loans to small businesses.

The decline in small business lending represent startups that were never launched, jobs that were never created, and expansions that were never completed. To balance growth and financial stability, the CCMC strongly supports replacing a *one-size-fits-all* approach with *tailored* bank regulation — sophisticated rules that are properly calibrated to the risk profile of an activity or institution. Tailoring is essential to effectuate a core principle of good government: regulations should impose the least burden necessary on society.[6]

The CCMC is issuing the following recommendations to restore Main Street lending:

- Replace Asset Thresholds With Multifactor Risk Assessments
- Reduce the Burden of Stress Testing and Capital Planning While Preserving Benefits
- Harmonize U.S. Capital and Liquidity Rules with International Standards
- Reassess the Volcker Rule
- Improve the Regulatory Process

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4 Morning Consult, Survey of Small Business Executives (Mar. 30, 2017), *available at* http://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/Financial-Services-Survey-For-Small-Businesses-Growth-and-Credit-Go-Hand-in-Hand.pdf?x48633; Ctr. for Cap. Mkts. Competitiveness, U.S. Chamber of Commerce, Financing Growth: The Impact of Financial Regulation (June 16, 2016) at 15, *available at* https://www.uschamber.com/sites/default/files/documents/files/financing_growth_report_16_june_16.pdf.

5 Press Release, U.S. Census Bureau, Startup Firms Created Over 2 million Jobs in 2015 (Sept. 20, 2017), *available at* https://www.census.gov/newsroom/press-releases/2017/business-dynamics.html.

6 Executive Order 12866 (Sept. 30, 1993); Executive Order 13563 (Jan. 18, 2011).

Replace Asset Thresholds With Multifactor Risk Assessments

Section 165 of the Dodd-Frank Act created an arbitrary asset threshold for the application of regulations intended to address systemic risks to financial stability. The use of an arbitrary threshold subjected many midsize and regional banks to systemic risk regulation despite the fact that they do not generate systemic risk.[7] Midsize and regional banks follow a traditional business model of taking deposits and making loans and are a critical source of financing for Main Street businesses in their communities.

Enact the Systemic Risk Designation Improvement Act

Arbitrary asset thresholds are blunt instruments, and it is common sense that regulations intended to mitigate *risk* should be based on *riskiness*. The CCMC strongly supports H.R. 3312/S. 1893, the Systemic Risk Designation Improvement Act, which replaces the arbitrary threshold for systemic risk regulations with a multifactor assessment that considers size, interconnectedness, substitutability, complexity, and cross-jurisdictional activity. Notably, this legislation fully preserves the ability of the Federal Reserve to protect the safety and soundness of *any* institution through the application of enhanced regulations.

> "We were looking to refinance our 17,850-square-foot building in order to save money that we could use to expand our customer base. By working closely with our bank and a Missouri State program, we were able to secure a loan that allowed us to lower our interest rate and generate more cash flow. This freed up additional funds to invest in technology, training, and expansion."
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> **Jeff and Susan Sams**
> *Owners, Sams Carpet Cleaning and Repairs, St. Charles, MO*

Reevaluate the "250/10" Threshold

In recent years, the federal banking agencies have used a severely outdated threshold — \$250 billion in consolidated total assets or \$10 billion in foreign exposure, known as "250/10" — in many different rulemakings, including the liquidity coverage ratio; the supplementary leverage ratio; eligibility for the horizontal capital review in lieu of the Comprehensive Capital Analysis and Review (CCAR) qualitative assessment; and the proposed net stable funding ratio. This threshold was introduced more than 13 years ago as part of the Basel II accords to identify the very largest banks that would be subject to a more rigorous capital framework. Its application to a broad swath of banks is grossly overinclusive, and the federal banking agencies should rigorously analyze the costs and benefits of its application.

Enact the Taking Account of Institutions with Low Operation Risk (TAILOR) Act

Thresholds are incompatible with a core principle of regulation: *tailoring*. Consistent with this principle, the CCMC strongly supports H.R. 1116/S. 366, the Taking Account of Institutions with Low Operation Risk (TAILOR) Act. This bill provides critical relief for small financial institutions by requiring the federal banking agencies to consider the risk profile and business models of regulated institutions and tailor their rules accordingly. The TAILOR Act will help ensure a well-reasoned approach to banking regulation and enable small and midsize banks to focus on investing in their communities and generating economic growth.

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7 *See, e.g.*, Office of Financial Research, BCBS Systemic Importance Indicators Reported by Large U.S. Bank Holding Companies (Feb. 12, 2015), *available at* https://www.financialresearch.gov/briefs/files/OFRbr-2015-01-systemic-importance-indicators-for-us-bank-holding-companies-fig-1.pdf.

Reduce the Burden of Stress Testing and Capital Planning While Preserving Benefits

Supervisory stress testing can promote the safety and soundness of individual institutions and the overall resiliency of the banking system. However, it has been conducted in a manner that imposes enormous burdens without providing commensurate benefits. Furthermore, new research has demonstrated that because of the nature of the Federal Reserve's assumptions and models, stress testing strongly discourages small business lending.[8]

Promote Transparency in Stress Testing

The Federal Reserve should publish and accept public comments on the assumptions underlying the scenarios and its internally developed models. If the Federal Reserve is concerned that disclosure of the assumptions and models could allow the tests to be "gamed," it should publish a rigorous analysis (1) demonstrating the likelihood of such "gaming," and (2) explaining why any anti-circumvention tools, either supervisory or regulatory, are insufficient to prevent such an outcome.

Review Company-Run Stress Tests Through the Supervisory Process

Company-run stress tests are not properly calibrated to risk. This is especially true for smaller financial institutions for which the cost of the exercise is disproportionately burdensome. The significant investment required for modeling development, validation, and documentation drains capital that could be better deployed for product innovation and the provision of financial products and services to consumers and small businesses. Moreover, the application of national scenarios to small banks with a local or regional footprint inevitably produces unreliable results.

At a minimum, the federal banking regulators should review company-run stress tests through the normal supervisory process and should not require each institution to provide its own public disclosure. As an alternative, the banking regulators could publish a summary of the results for smaller banks.

Replace the CCAR Qualitative Assessment With a Horizontal Capital Review

CCAR accompanies the supervisory stress test exercise and assesses a bank's capital plan. It is widely understood that CCAR imposes an enormous compliance burden, reduces small business lending, and may, in fact, generate systemic risk by correlating the risk profiles of the subject banks. To improve this process, the CCMC recommends that the Federal Reserve replace the CCAR qualitative assessment with a horizontal capital review (HCR) conducted as part of the normal supervisory process. In addition, the Federal Reserve should adjust CCAR to a two-year cycle while preserving its ability to review capital plans on a discretionary basis in case of extraordinary events.

Increase Transparency Into the Living Will Assessment Framework

Section 165 of the Dodd-Frank Act requires financial institutions to develop and submit plans to ensure an orderly and rapid resolution, also known as living wills. This is an exceptionally expensive process, and the requirements should be implemented to ensure that they are as effective and efficient as possible. The CCMC recommends that the Federal Reserve and FDIC provide greater transparency into the resolution plan assessment framework, thereby improving submissions and increasing public confidence in the likelihood of a successful resolution. Also, the Federal Reserve and FDIC should continue steps already

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8 Viral V. Archarya, Allen N. Berger, & Raluca A. Roman, Lending Implications of U.S. Bank Stress Tests: Costs or Benefits?, Journal of Financial Intermediation (forthcoming; last rev. Aug. 18, 2017), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2972919; The Clearing House, Are the Supervisory Bank Stress Tests Constraining the Supply of Credit to Small Businesses? (May 2017).

undertaken to move the assessment schedule to a biennial schedule and permit all "Wave 3" filers to submit tailored plans.

Harmonize U.S. Capital and Liquidity Rules With International Standards

The federal banking regulators, through the international Basel Committee on Banking Supervision, negotiated a wide-ranging framework of bank capital and liquidity standards known as Basel III. Each country is responsible for the domestic implementation of the negotiated standards. Implementation has been grossly inconsistent. U.S. regulators view international capital standards as a floor, while European regulators view those same standards as a ceiling. With respect to many of these reforms, U.S. banking regulators elected to implement regulations that were substantively more stringent than the negotiated standard. For example, the U.S. G-SIB surcharge was calibrated to be roughly *double* the international standard. Euphemistically known as "gold-plating," these much stricter standards have no demonstrated marginal benefit to safety and soundness and have put U.S. banks at a global competitive disadvantage. These standards have discouraged Main Street lending by penalizing small business loans and requiring large holdings of government debt.

> "Small businesses do not have large cash flows, cash reserves or emergency funding. Therefore, access to capital plays a paramount role in economic growth and job creation" "While passage of the Dodd-Frank law may have calmed fears of another financial meltdown, an unintended consequence of the law has been limiting small businesses' access to capital."
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> **Maxine Turner** *President, Cuisine Unlimited, Chair, U.S. Chamber's Small Business Committee, Salt Lake City, UT*

Reevaluate Domestic U.S. Capital Liquidity Rules to Ensure Global Competitiveness

The federal banking regulators should reevaluate these substantively more stringent rules and bring them into line with the global standard:

- G-SIB surcharge calibration
- Liquidity Coverage Ratio (LCR)
- Total Loss-Absorbing Capacity (TLAC)
- Operational risk calculation
- Enhanced Supplementary Leverage Ratio (eSLR)
- Net Stable Funding Ratio (NSFR; proposed)

The imposition of domestic prudential standards substantively more stringent than the international standards has placed American financial institutions at a global economic disadvantage, created an unnecessary drag on our financial services sector, and raised the costs of capital for all businesses. The effects of these layered-on requirements are even more pronounced given the imposition of other rules without parallel in the rest of the world, such as the Volcker Rule. This has a long-term negative impact on the competitiveness of the U.S. economy.

Analyze the Costs and Benefits of Substantively More Stringent Standards

At a minimum, the federal banking regulators should be required to describe their rationale for the more stringent regulations and publish for public comment a comprehensive analysis of the costs and benefits of the difference between the U.S. regulation and the corresponding international standard. Furthermore, this analysis should consider the cumulative effect of *all* substantively more stringent requirements and standards. Finally, the federal banking regulators and their international counterparts should coordinate on implementation timelines to ensure that the U.S. doesn't lead without others following.

Reassess the Volcker Rule

The CCMC has long believed that the Volcker Rule is conceptually unworkable, is a solution in search of a problem, and has a negative impact on market liquidity and access to capital. The CCMC has in the past proposed stronger capital standards for those that engage in proprietary trading, as a pro-growth means of addressing concerns. Instead, we now have both the Volcker Rule and higher capital standards. The rule's ambiguities, particularly in the areas of market making and underwriting, have created inefficiencies in the ability of Main Street businesses to raise capital, access the debt and equity markets, and manage cash.[9]

These issues should have been addressed in the rule-writing process, yet the implementing agencies ignored statutory requirements and presidential directives on the use of economic analysis in rulemaking. Many of the problems that are coming to light, including periods of unexplained stress in the corporate bond markets, could have been avoided had smart regulatory tools been used, empirical evidence collected, and decisions made through the use of facts.

Pending Repeal of the Volcker Rule Conduct a Rigorous Economic Analysis

The CCMC strongly supports repeal of section 619 of the Dodd-Frank Act. Pending action by Congress, the CCMC offers the following recommendations to the implementing agencies:

- The agencies should conduct a rigorous economic analysis of the Volcker Rule. This analysis should consider direct impacts on financial institutions and indirect impacts on market liquidity, access to capital, U.S. businesses, and economic growth.
- Banks that do not engage in proprietary trading should not be required to have a Volcker Rule compliance program.
- Any negative impacts of the Volcker Rule are potentially exacerbated by concurrent regulatory initiatives. Accordingly, the agencies should conduct a cumulative impact assessment of major regulatory initiatives undertaken since the financial crisis. This assessment should include but not be limited to the Volcker Rule, risk retention rules, money market fund regulations, the Liquidity Coverage Ratio rule, the Net Stable Funding Ratio proposed rule, the Total Loss Absorbing Capacity rule, the Foreign Banking Organizations rule, and rules promulgated under section 165 of the Dodd-Frank Act.
- Following this analysis regulators should report to Congress whether the Volcker Rule should be repealed outright or amended.
- Congress and the administration should take steps to ensure that the federal banking agencies conduct an economic analysis with all rulemakings, as required under the Riegle Community Development and

9 *See, e.g.*, Jack Bao, Maureen O'Hara, and Alex Zhou, Finance and Economics Discussion Series 2016-102: The Volcker Rule and Market-Making in Times of Stress (2016), *available at* https://www.federalreserve.gov/econresdata/feds/2016/files/2016102pap.pdf; CFA Institute, Secondary Corporate Bond Market Liquidity Survey Report (Sept. 2016), *available at* https://www.cfainstitute.org/Survey/bond_market_liquidity_survey_report.pdf; Center for Capital Markets Competitiveness, U.S. Chamber of Commerce, *Financing Growth: The Impact of Financial Regulation* (June 16, 2016), *available at* https://www.uschamber.com/sites/default/files/documents/files/financing_growth_report_16_june_16.pdf.

Regulatory Improvement Act of 1994 and the Administrative Procedure Act (APA). This analysis should consider direct impacts on financial institutions and indirect impacts on market liquidity, access to capital, U.S. businesses, and economic growth.

Improve the Regulatory Process

Increase Transparency and Accountability at the Federal Banking Regulators

The CCMC strongly believes that all regulators must be fully transparent in their deliberations and decision making and must invite and address public input as part of the policymaking process. The federal banking regulators are no exception — their rules not only affect the financial institutions they regulate but have a direct impact on Main Street businesses. Those Main Street businesses have seen a reduction in access to credit and liquid and efficient capital markets. The federal banking regulators need to consider factors such as competition and growth, in addition to financial stability, when writing rules. The CCMC supports both structural and procedural changes that will make the federal banking regulators more transparent and accountable.

> "Our bank has been a key partner in Viking Masek's success over the last 16 years. When the company decided to transition from a sales organization to an integrated manufacturer in 2006, our bank provided the critical financing needed to purchase our facilities and then remained alongside us three years later when our continued growth required a new addition to our building. The close relationship we have built with our bank has been a key ingredient in the success of our business, which now employs more than 50 people."
>
> **Robert "RC" Huhn**, *Chief Financial Officer, Viking Masek, Oostburg, WI*

Require All Agencies to Conduct Economic Analyses and Consider Cumulative Impact

The federal banking regulators should subject their rules and standards to transparent and robust cost-benefit analysis. When developing regulations, the banking regulators should publish an economic analysis that is subject to public notice and comment. This includes the publication of alternative regulatory approaches that were considered and why they were dismissed, plus an opportunity for public participation and periodic review of their rules. As the CCMC has noted in a number of comment letters, under the Riegle Act, the banking regulators are required to consider the costs and benefits of their regulatory proposals. Courts have held that this requires the publication of an economic analysis that is subject to public notice and comment.

As part of its cost-benefit analysis, the banking regulators should assess the following:

- What is the marginal benefit of the proposed regulation to the financial stability of the U.S. economy, after taking into account the effect of existing rules.
- What is the marginal benefit of the proposed regulation to the safety and soundness and resolvability of banking organizations, after taking into account the effect of existing rules.
- Whether the proposed regulation would conflict with the objectives of any existing regulations and, if so, for what reasons should the proposed regulation move forward despite such conflict.
- How the proposed regulation would affect market liquidity.
- How the proposed regulation would affect the competitiveness of U.S. financial institutions.

- The extent to which the proposed regulation would increase costs for businesses, adversely affect capital formation for businesses, or harm investors.

When implementing new rules or amending existing ones, the federal banking regulators should always consider the *cumulative impact* of the entire regulatory regime and not simply the costs and benefits of the individual regulation. The incremental cost of any individual change may be easy to justify. Analyzing the cumulative impact of existing regulations, in addition to the proposed change, will better indicate the likely impact of the change on the availability of credit and other services.

Bring Transparency and Accountably to FSB and BCBS Through Congressional Engagement

The federal banking regulators work through international standard-setting bodies, including the Financial Stability Board (FSB) and the Basel Committee on Banking Supervision (BCBS), to create international financial standards and regulations. Regulatory mandates normally come from the U.S. Congress. Through these international bodies, the banking regulators effectively create their own legal mandate for some of the rules they write. Therefore, the federal banking regulators should be required to do the following:

- Notify Congress and the public prior to entering into international negotiations.
- Report to Congress regarding the formulation of American positions on matters before FSB or BCBS.
- Publish the text of any completed FSB or BCBS agreement and provide a notice and public comment period of no less than 60 days before signing it.
- Brief members of Congress on the status of negotiations.
- Post summaries regarding all meetings with other FSB and BCBS members and their staff on their websites.

The CCMC also recommends that FSB be reconstituted through a treaty negotiated among its member countries and subject to congressional approval. The approval process would permit Congress to ensure that FSB is transparent and that its directives are subject to APA-style procedural safeguards, including public comment and publication of an economic analysis. In addition, a reconstituted FSB must have the means to ensure that all members implement its directives in substantially similar ways.

The CCMC further recommend that the U.S. representative to FSB be a presidential appointee, subject to the advice and consent of the Senate. U.S. regulators have used FSB to drive domestic regulation. Regulators should not treat the FSB as being legally binding on the U.S. without explicit congressional authorization to do so. Given the central role of the U.S. in FSB and the organization's reach, the Senate should be able to review the credentials of our representative and receive necessary and appropriate commitments regarding his or her service at FSB.

Conclusion

Bank regulation serves a critical purpose — to promote the safety and soundness of the financial system. Yet these regulations must be properly calibrated and well-reasoned, to allow the financial system to serve *its* purpose: providing the financing and capital Main Street businesses need to start, hire, thrive, and contribute to broad economic growth.

By using tailored, risk-based regulation instead of arbitrary thresholds; satisfying regulatory objectives through the least burdensome tools; and rigorously analyzing regulations' impact on small business lending and capital formation, we can help put Main Street and the U.S. economy back on the path to growth. The CCMC looks forward to working with the regulatory agencies and Congress toward this common goal.

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1615 H Street, NW | Washington, DC 20062-2000 | www.uschamber.com