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and Government-Sponsored Enterprises.

Good morning Chairman Garrett, Ranking Member Maloney, and members of the Committee. It is an honor to be invited to testify at today's hearing: ***The Impact of the Dodd-Frank Act and Basel III on the Fixed Income Markets and Securitizations***. 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 partner of Treasury Strategies, Inc. Treasury Strategies is a 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 commercial banks that provide treasury and transaction services to these organizations.

I am here today on behalf of Treasury Strategies and the hundreds of businesses, state and local governments and financial institutions to whom we consult.

Overview

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. We advocate pro-growth measures that stabilize and strengthen the financial system. The regulatory objectives of improving accountability and transparency, reducing systemic risk, ending "too big to fail," protecting consumers and putting an end to taxpayer-funded bailouts are laudable. We applaud you for tackling such important issues.

However, we feel strongly that several recent financial regulations such as Dodd-Frank, Basel III, Money Market Fund regulations and many more, both alone and in concert with each other, create a **climate of uncertainty** of enormous proportions. In addition, they triggered **regulatory and compliance cost burdens** that radiate through the economy. Ultimately, this has led to a **culture of indecision** that is choking the U.S. economy and paralyzing American businesses and financial companies that had nothing at all to do with the financial crisis.

It is in this context that I frame my testimony today. The climate of uncertainty and the culture of indecision brought about by these regulations are impeding normal access to capital. Legislative proposals such as H.R.4096, the "Investor Clarity and Bank Parity Act," H.R.4166, the "Expanding Proven Financing for American Employers Act," the CMBS Risk Retention Draft (and many more) are required to restore the efficient flow of capital that makes America's capital markets the broadest and

deepest in the world. These are small but important steps to ensure that Main Street businesses, municipalities and banks have access to the growth capital that they and their customers require.

Adverse Impact of Post-Crisis Regulations

The rollout of Dodd-Frank and its Volcker Rule, Basel III, and Money Fund Regulations is still ongoing. Most are in the midst of a phased implementation, so the full impacts and chain reactions of unintended consequences are only beginning to be felt. Yet we are already seeing a contraction in the availability of financial services and transaction services. Below is a partial listing of some of the dislocations we at Treasury Strategies are already seeing; we learn of new restrictions and prohibitions almost weekly:

- **There are 1,460 fewer banks today** than at the time of the passage of Dodd-Frank. The number of U.S. banks and savings institutions has decreased from 7,821 on 6/30/2010 to 6,358 on 6/30/2015. The loss of nearly 1,460 commercial banks over five years has numerous consequences, some of which are less consumer and business choice, higher borrowing costs and less access to credit.

- In the ten years prior to the 2008 crisis, the FDIC averaged 157 new bank charters per year. Going back to the earliest FDIC statistics in 1934, there was never a year in which the FDIC chartered fewer than 15 new commercial banks. That is, until 2010, when it chartered only five. **Only two new banks have been chartered in the five years**

since 2011. Again, this dearth of new banks stifles innovation as well as reduces choice and competition for businesses and consumers.

- In the two years since the money market mutual fund regulations were announced, **27 tax-exempt money funds have closed**[1] and many more are expected to follow before the full regulatory implementation in October 2016. These funds are the lifeblood of efficient, short-term financing for state and local governments, hospitals and universities. Treasury Strategies estimates that $10 billion has already left the market, and the pace has accelerated in December and January as we approach the October effective date.

- In the two years since the money market mutual fund regulations were announced, **56 prime money funds with $264 billion**[2] **have converted to government money funds**. This takes capital away from private sector businesses and shifts it to the federal government, further driving up costs for businesses.

- Basel III is changing the profit and balance sheet dynamics of banks, essentially penalizing deposits. To comply, some banks must **discourage deposits with higher fees or lower interest**.

- Basel III is also requiring banks to hold a much higher proportion of government securities instead of traditional business loans. Many are **restricting credit to all but the highest quality borrowers**. As a

[1] www.cranedata.com
[2] www.cranedata.com

result, many companies and municipalities are faced with higher borrowing costs or unable to borrow at all. The really perverse consequence is that these borrowers go "off the grid" entirely and resort to unregulated or underground lenders.

- Many banks, to comply with Basel III's liquidity plank, are **cutting back on issuing lines of credit** to their customers. Since most companies rely on these backup lines for emergency liquidity, their alternative is simply to hold more idle cash on their balance sheet. That sidelines productive capital and also impairs economic efficiency.

- The combination of the Volcker Rule and increased capital requirements results in financial institutions scaling back their market making activities. This results in wider bid/ask spreads and ultimately less liquidity in the market. There have been sporadic **liquidity black holes in which markets completely freeze up** or prices gyrate wildly such as the U.S. Treasury flash crash. A study by Deutsche Bank estimates that dealers have cut their inventories by as much as 80%.

- The **higher costs of hedging risk** because of the Volcker Rule and other Dodd-Frank provisions are leading some businesses to not hedge at all. That means that some businesses no longer have protection from cost gyrations in their supply chain and actually **take on more risk.** All we've done is shifted risk and made it less visible.

- Virtually all of the regulations discussed in this testimony require financial institutions and businesses to hold more government

securities. These requirements hide under names like "collateral," "high quality liquid assets," "liquidity buffers," "segregated funds," "risk retention" and other euphemisms. The net effect, however, is to **remove productive capital out of the real economy and leave it stranded in government securities**. A recent Treasury Strategies report actually warns of a pending collateral shortage that could seriously exacerbate risk in times of financial stress.

As I mentioned, this list grows with each passing week.

How High are the Stakes?

Businesses operating in the U.S. are the most capital-efficient and productive in the world. 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 **meet payroll**, **pay bills** and **raise the capital** needed to **grow** and **create jobs**.

Unfortunately, because of the climate of uncertainty created by the poor rollout of Dodd-Frank, the draconian demands of Basel III and ill-formed money market fund regulations, capital efficiency in the U.S. has declined, as evidenced by increased corporate cash buffers. The sad trend line is that corporate cash has swelled from 9% of U.S. GDP to nearly 12% of GDP, idling hundreds of billions in cash. **Companies are keeping more precautionary cash to deal with the regulatory uncertainty**.

Consider the following Treasury Strategies analysis: companies doing business in the U.S. operate with approximately $2 trillion of cash reserves, with a like amount held by smaller businesses. The current climate of uncertainty resulting from this legislation is pushing U.S. cash steadily upward. Stated differently, CFOs and treasurers are setting aside and idling an additional $1 trillion of cash. To put that in perspective, that $1 trillion is:

- Greater than the entire TARP program
- More than the stimulus program
- Greater than the Federal Reserve's quantitative easing program

To raise this extra $1 trillion cash buffer, companies are postponing expansion and deferring capital investment, downsizing and laying off workers, and reducing inventories. Obviously, the economic consequences are huge.

The Nature of Financial Risk

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 financial system risk, do not be tricked into thinking that risk disappears. It simply moves elsewhere. That's why the risk retention issue is a red herring. It's like buying car insurance. You're risk of an accident does not go down. Rather, the financial consequences shift 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 solutions.

Summary

The ambiguity surrounding the rollout of multiple financial regulations is already having a chilling effect on precisely those financial services that account for U.S. competitiveness, capital efficiency and financial stability. This is an issue for U.S. businesses and municipalities, 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

Because of the protracted rule-writing process, many rules have yet to be written. Of the rules already promulgated, most have a phased implementation. Thus, the true costs of the rules have yet to be seen.

Well-thought-out efforts to mitigate the adverse consequences of these regulations and restore the smooth flow of capital in the U.S. economy are essential. H.R.4096, H.R.4166 and the CMBS Risk Retention Draft are solid steps in that direction.

Conclusion

I appreciate the opportunity to appear today on behalf of Treasury Strategies and our hundreds of business, municipal and financial services clients.

We strongly encourage Congress to put America's businesses back on the right track by allowing/restoring the free flow of capital. That means instituting protection for those businesses and financial institutions that had nothing to do with causing the crisis.

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

Respectfully,

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