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Assessing the Impact of the Dodd-Frank Act Four Years Later

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Good morning Chairman Hensarling, Ranking Member Waters, and members of the Committee. It is an honor to be invited to testify at today's hearing: ***Assessing the Impact of the Dodd-Frank Act Four Years Later***. 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 the leading consultancy in the area of treasury management, payments and liquidity. Our clients include 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 those corporations.

I am here today on behalf of Treasury Strategies and the hundreds of businesses 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 objectives of Dodd-Frank to improve accountability and transparency, reduce systemic risk, end "too big to fail," protect consumers and put an end to taxpayer funded bailouts are laudable. We applaud you for tackling such important issues.

However, we feel strongly that the rollout, rule writing and implementation of Dodd-Frank created a **climate of uncertainty** of enormous proportions. In turn, 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.

Two years ago in testimony to this committee, I posed the question: "When a business's treasurer calls a bank to raise the cash needed to meet payroll or pay the bills, will someone be there to answer that phone call?" We now know the answer is "Yes, the compliance officer." This is no way to create robust economic growth.

It is important to remember that banks are financial intermediaries. They are conduits between depositors and borrowers. Regulation resulting in higher costs and reduced flexibility for banks ultimately results in higher costs and reduced flexibility for depositors and borrowers. That is what we are here to discuss today.

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**.

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
- Technologically advanced cash management services
- The most efficient and transparent payment systems

Unfortunately, because of the climate of uncertainty created by the poor rollout of Dodd-Frank, 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 $1.9 trillion of cash reserves. If the current climate of uncertainty resulting from this legislation were to push U.S. cash holdings to the Eurozone plateau of 21% of GDP, the resulting corporate cash level would be $3 trillion. Stated differently, CFOs and treasurers would need to set aside and idle 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 would have to postpone expansion and defer capital investment, downsize and lay off workers, reduce inventories and curb growth. Obviously, the economic consequences would be 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 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 solutions.

Climate of Uncertainty

The long and unbounded rule-writing process across multiple regulatory bodies creates many challenges and introduces new risks for our clients. Compliance and audit now replace prudent decision-making and sound judgment. Vague and ambiguous terminology such as "systemically important," "proprietary trading," "know your customer," "too big to fail," "shadow banking" and "abusive practices" only add to the confusion. For example, mandates requiring banks to fund with longer-term instruments conflict directly with mandates requiring investment managers to invest in shorter-term instruments. Combined with an explosion of astronomical fines imposed by U.S. regulatory bodies, the conclusion on the part of most of our banking and corporate clients is to wait until (if) the dust settles before making major capital investment decisions or significant hiring decisions.

Climate of Risk and Fear

The Dodd-Frank implementation, only partially complete, is already having a chilling effect on business. One element of that is its creation of two ultra-powerful authorities, the Financial Stability Oversight Council (FSOC) and the Consumer Financial Protection Bureau (CFPB). These largely unaccountable agencies are designed to operate outside of the constitutional framework of checks and balances. Indeed, they even operate outside the Congressional budget processes.

For our clients, the FSOC especially, with virtually unconstrained resources, introduces new regulatory and political risks. The result is businesses and financial institutions need to operate with checklists and to seek out safe harbors, rather than to find ways to meet the needs of their customers. As a **regulator comprised of regulators**, FSOC creates double jeopardy for financial institutions. Thousands of banks, hundreds of insurance companies and hundreds of asset managers have been placed in straightjackets. They are now forced to become compliance auditors, not growth partners, of America's businesses.

Concentration of Assets in the Banking System

By declaring certain institutions as "systemically important," Dodd-Frank enshrines rather than eliminates "too big to fail." This concentrates financial activity into what was an already swollen banking system. As depositors believe that systemically important banks will enjoy special protections in a crisis, they shift assets from other investments and into banks.

Since the financial crisis, banking assets have grown by 25%. During that same period, nominal GDP (including inflation) is up only 14%. As assets move out of other investment instruments and into the banking system, overall liquidity in instruments such as commercial paper and money market funds declines. The underlying capital flows are well into the hundreds of billions of dollars and simply exacerbate the uncertainty to the economy.

Concentration of Assets in the Federal Reserve System

Most worrisome is the explosion in the size of the Federal Reserve Bank's balance sheet, in part a consequence of the Dodd-Frank implementation. The total consolidated assets of the Federal Reserve now top $4 trillion. That is up from less than $1 trillion just before the financial crisis. It is now 40% the size of the entire U.S. banking system. Such huge concentration is causing large-scale distortions to the economy, asset allocations, interest rates and the shape of the yield curve. Absent these independent and sound market signals, our clients are reluctant to make long-term investments since even a small change in Fed policies would have considerable impact on markets and rates.

To fund this balance sheet, the Fed began paying interest on bank reserves. In effect, the Fed is paying banks to divert funds away from their customers and their local markets. In early 2008, banks in the aggregate maintained roughly $40 billion on reserve with the Fed. That number now stands at $2.6 trillion, a sixtyfold increase. Again, our clients view the concentration of this magnitude as yet another risk to their well-being and a drag on their willingness to invest in the growth of their businesses.

Unlike the mandates to its member institutions, the Federal Reserve's balance sheet is comprised of long-term investments funded largely by overnight or one-week term bank deposits. Indeed, we could be looking at the seeds of the next taxpayer funded financial bailout.

Less Business and Consumer Access to Financial Services

Although the impact of the Dodd-Frank rollout is still in its early stages, we are already seeing a contraction in the availability of financial services and transaction services. Here 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:

- Banks are focusing on the "safe" segments, those outside the regulatory crosshairs.
- Many are discouraging deposits with higher fees or lower interest.
- Many are restricting credit to all but the most well-documented borrowers.
- Because of the ambiguities of various anti-money laundering (AML) requirements, one bank closed the accounts of foreign diplomats in the U.S.
- Due to extended interpretations of the "know your customer" (KYC) rule to include your customers' customer (KYCC), banks are exiting certain electronic benefit card segments.
- KYCC concerns are also resulting in a scaling back of the correspondent banking services with community banks.
- Because of increased documentation and process audit requirements inconsistently applied, all but the very largest banks are discontinuing product development; the fixed regulatory costs of introducing a new product are prohibitive.
- Because of unclear interpretation of AML requirements, some banks are reducing the services they offer to retailers who provide courtesy check cashing services to their retail customers.

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

Summary

The ambiguity surrounding the rollout of Dodd-Frank is already having 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

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

Finally, it is important to add that these rules are being introduced against a backdrop of massive Federal Reserve quantitative easing (QE). QE injects substantial liquidity into the banking system and the bond markets. Ominously, the true consequences of the Act will not be fully known until these artificial supports are withdrawn.

Conclusion

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

Let me reiterate that we applaud the objectives of the Dodd-Frank Act but decry its implementation. We feel strongly that the Dodd-Frank Act, as currently implemented, will not reduce systemic risk nor improve economic well-being. We believe that the lack of clarity in many of the bill's provisions, along with lack of a precise definition of terms and the inconsistencies resulting from multiple regulatory rule writing bodies has introduced significant new uncertainty and risk for America's business and financial institutions. We believe that it will make U.S. capital markets less robust, U.S. businesses less competitive, and ultimately reduce underlying economic activity.

We strongly encourage Congress to put this regulation back on the right track. That means, at a minimum:

- Dissolving the FSOC and eliminating that double jeopardy for America's businesses and financial institutions
- Eliminating the ambiguity, inconsistency and vague terminology in the rules
- 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 you may have.

Respectfully,

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About Treasury Strategies

Treasury Strategies, Inc. is the leading treasury consulting firm working with corporations and financial services providers. Our experience and thought leadership in treasury management, working capital management, liquidity and payments, combined with our comprehensive view of the market, rewards you with a unique perspective, unparalleled insights and actionable solutions.

What We Do

Corporations

We help you maximize worldwide treasury performance and navigate regulatory and payment system changes through a focus on best practices, technology, liquidity and controls.

Treasury Technology

We provide guidance through every step of the technology process. Our expert approach will uncover opportunities to optimize the value of your treasury through fully integrated technology solutions.

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