May 23, 2017

The Honorable Steven T. Mnuchin
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Dear Secretary Mnuchin:

We, the undersigned organizations, appreciate the opportunity to have participated in a roundtable with staff from the Department of the Treasury on April 26th to discuss some of the challenges that middle market companies face in accessing credit. To help inform your upcoming report pursuant to the President's February 3rd Executive Order ("Executive Order")[1] dealing with core principles for the financial regulatory system, we would like to provide additional information regarding some of the topics that were discussed at the roundtable.

While well intentioned, the legislative and regulatory responses to the 2008 financial crisis have created an overly complex and heavy-handed financial regulatory structure. The end result is that financing markets for middle market companies have become increasingly inefficient and in many instances businesses are having difficulty obtaining the financing they need to grow and hire new employees. The Executive Order could not be timelier as this very serious problem needs to be addressed in order to spur long-term economic growth. We appreciate this opportunity to comment on the current state of the financial regulatory system and recommend ways that it can be modernized.

Our concerns and suggestions are discussed in greater detail below:

Cost benefit requirements for financial regulators

As independent regulatory agencies, the federal financial regulators are not subject to the rigorous economic analysis requirements of Executive Orders 12866 and 13563 in addition to Office of Management and Budget Circular A-4. These

[1] https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-executive-order-core-principles-regulating-united-states

processes and procedures are essential to the effectuation of the Executive Order's core principles, and the financial regulators' failure to engage in meaningful regulatory impact analysis has produced rules that are unnecessary, costly, complicated, and untailored. Even the most ardent proponents of post-crisis regulation have begun acknowledging serious missteps in the rulemaking process.[2]

Small and mid-market companies, lacking the benefits of scale and large, well-staffed compliance departments, are disproportionately burdened by onerous regulations. Accordingly, it is essential that regulators "get their rules right." The Department of the Treasury, through the Financial Stability Oversight Council, should work with the independent regulatory agencies on the voluntary implementation of the processes described by the Executive Orders and Circular A-4. The adoption of these processes would accord with long-standing recommendations from the non-partisan Government Accountability Office and the Administrative Conference of the United States.[3]

The U.S. Chamber of Commerce has further identified legislative changes that will promote principles laid out in the Executive Order and modernize the regulatory rule-writing process.[4] While legislation is ultimately necessary to ensure compliance with regulatory best practices, voluntary implementation would be a major step forward to improving regulatory outcomes for small and mid-market businesses.

Consolidation of lenders/lack of options for borrowers

The number of commercial banks in the United States has declined from 7,022 at the end of 2008 to a little over 5,000 today, a nearly 30% decline in less than a decade.[5] A significant portion of the lost banks in the U.S. was due to their failure as a result of the financial crisis, but there has also been a large consolidation in the banking industry in no small part due to the regulatory environment created by the Dodd-Frank Act and Basel capital rules. Many banks – particularly community and regional lenders – are finding that it is in their best interest to merge with other institutions. Moreover, small and regional banks have been forced to adapt their business models to comply with new regulations, limiting their ability to serve the middle market.

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[2] *See, e.g.,* https://www.federalreserve.gov/newsevents/speech/tarullo20170404a.htm.
[3] http://www.gao.gov/assets/590/586210.pdf; https://www.acus.gov/sites/default/files/documents/Copeland%20Final%20BCA%20Report%204-30-13.pdf.
[4] https://www.uschamber.com/sites/default/files/documents/files/restarting_the_growth_engine_-_a_plan_to_reform_americas_capital_markets.pdf at 15.
[5] https://fred.stlouisfed.org/series/USNUM

The end result is that businesses find themselves with fewer options to meet their financing needs, and have limited ability to compare products or services across different lenders. This has created competitive imbalances whereby borrowers can find themselves in a position of signing up for multiple products they don't need simply to secure a relationship with a lender. Borrowers benefit when a competitive financing market exists with multiple lenders competing for their business. Regrettably, the decrease in competition and the lack of choices for middle market companies has had the effect of raising costs for these businesses, their shareholders, and their investors.

Singling out of industries

Due to pressure by regulators, at various times over the past decade a number of banks, for various reasons, have exited entire industry sectors, and in some cases have exited geographic areas around the world. While banks will always have different credit criteria or business models, it seems that sometimes regulatory decisions can be rather sudden–at times erratic–and certainly can be disruptive to corporate decision-making.

A good example is the impact on the oil and gas sector resulting from the recent deep decline in oil prices. Some lending institutions and banks have pulled their credit lines for the entire industry or at the very least oil and gas pipeline providers. There have also been plenty examples where global banks have exited entire regions around the world in no small part due to regulatory pressures.

With fewer banking resources around the world due to regulatory de-risking, all of these events can be incredibly disruptive to middle market companies and the broader economy.

ICFR / Audit costs

We believe that internal controls are important, but they should be scalable. Over the past few years, businesses—many of them middle market companies—reported elevated costs associated with internal control requirements due to the Public Company Accounting Oversight Board (PCAOB) inspection process. This has in some cases driven changes to internal controls that are eroding judgment and increasing burdens on businesses and their shareholders, without any changes to existing standards or policies.

In May 2015, the U.S. Chamber sent a letter to the Securities and Exchange Commission (SEC) Chief Accountant and Chairman of the PCAOB outlining in

greater detail many of these developments and concerns.[6] As a result, both the Chamber and Financial Executives International (FEI) have held meetings between member companies, the SEC and PCAOB to address these issues.

Since 2002, the business community, the SEC and PCAOB have implemented provisions of Section 404 of the 2002 Sarbanes-Oxley Act centered on internal controls over financial reporting ("ICFR"). Initially, the costs of implementing Section 404 were extremely expensive and burdensome for companies, but these costs ended up stabilizing in the years after Sarbanes-Oxley was passed. Improvements to financial reporting also had a positive impact, as non-reliance financial restatements declined from 977 in 2005 to 255 in 2012.

However, several developments in recent years have created a great amount of uncertainty and complexity for companies. For example, companies report that it has become more difficult to rely on entity-level controls (including management review controls) which they have come to rely upon since passage of Sarbanes-Oxley. There has also been an increasing trend towards a "one-size-fits-all" approach towards assessing processes and controls that are not appropriate for every business. Businesses report that auditors are often using generic templates to walk through PCAOB inspection points which are time-consuming and do little to enhance the overall quality of the internal controls.

Similarly, issues have also arisen around the materiality of financial disclosures. For example, in some cases auditors have insisted that if one disclosure item is deemed "material," then all required disclosures must be presented, regardless of their materiality. This issue has presented a fundamental conflict between what the PCAOB may require and disclosure effectiveness initiatives that are underway at the SEC and Financial Accounting Standards Board (FAS).

<u>Access to equity financing/accredited investor</u>

Access to equity financing is also an important consideration for start-up or established businesses that are looking to expand. The 2012 Jumpstart our Business Startups Act ("JOBS") Act took a number of important steps to modernize the federal securities laws for small and medium size businesses that are looking to raise capital. To date, the JOBS Act has been a net positive for our economy and has helped businesses raise capital through both public and private channels.

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[6] http://www.centerforcapitalmarkets.com/wp-content/uploads/2015/05/2015-5.28-Letter-to-SEC-and-PCAOB.pdf?x48633

However, the JOBS Act just scratched the surface in terms of what is needed to bring the SEC and our securities laws into the 21st Century. There are also many outstanding issues that need to be fixed in order for the JOBS Act to reach its full potential. For example, the final provisions under Title III related to equity crowdfunding created a needlessly complex statutory framework that many businesses and investors find unworkable. The SEC also proposed amendments–not required by the JOBS Act–in 2013 that would impose burdens upon Regulation D ("Reg D") issuers and investors under Title II of the law.[7] The SEC should withdraw those amendments so that businesses are able to avail themselves of the updated Reg D rules under the JOBS Act.

We would also point out that the Reg D private offering market has significantly grown over the years and is now an over $1 trillion market. Investors are only able to invest in Reg D offerings if they are qualified institutional buyers or if they are individuals deemed "accredited" by the SEC. Regrettably, the SEC's definition of an accredited investor only captures those who are deemed to be sufficiently wealthy, prohibiting millions of middle and lower income Americans from investing in certain private offerings. While this definition is ostensibly intended to advance the SEC's mission of protecting investors, it has the effect of contributing to income inequality and destroying the ability of families to build wealth. We believe that the definition of accredited investor should be modernized so that it includes more qualitative thresholds that Americans of all income levels could meet. This would grow the base of potential investors for businesses, while providing another avenue for wealth creation for millions of households.

AML / BSA

While anti-money laundering (AML) laws and the Bank Secrecy Act (BSA) serve a valuable purpose, their implementation is problematic and must be reassessed for the 21st century. Financial institutions are investing billions of dollars to comply with requirements, however "checking the box" for compliance examinations does not further the underlying purpose of these laws. Instead, the current implementation regime 1) is encouraging financial institutions to "de-risk" (or get rid of) accounts from customers or businesses that might potentially present a risk; 2) creates excessive focus on performing "low value" tasks and excessive "defensive" reporting to demonstrate strict regulatory compliance which deprives resources from being deployed on complex analysis and cross-institutional investigation; 3) does not give

[7] https://www.sec.gov/rules/proposed/2013/33-9416.pdf

adequate credit for institutions collaborating with law enforcement and regulators; 4) has produced a disconnect between "checklist" focused examination of a bank's procedures; 5) requires needless and burdensome reporting, creating a competitive disadvantage for U.S. institutions because the dollar thresholds were set as early as the 1970s, and have never been updated for inflation; and 6) does not provide clear standards for examiners to follow that are consistent with the spirit of the law.

All of these developments ultimately have the effect of disincentivizing financial institutions to serve entirely legitimate small or middle market business customers. A wholesale review of the AML/BSA regime and an examination of its effectiveness is long overdue, and we look forward to working with Treasury and other agencies on this important issue.

Sincerely,

Association for Financial Professionals
Financial Executives International
U.S. Chamber of Commerce

cc: Mr. Craig Phillips