TRADE FINANCE ADVISORY COUNCIL

GETTING MORE CREDIT TO SMEs TO INCREASE GDP

BACKGROUND ON SME LENDING INVESTIGATION AND POSSIBLE ACTIONS

Small and Medium Sized Enterprises (SME) have experienced a reduction in access to bank lending as a function of capital rules, monetary policy, funding rules, and tax policy creating a relative deficit of approximately $1.5 trillion in lending to U.S. corporations including SMEs. Absent significant regulatory changes to Basel and SEC regulation or in monetary or tax policy this deficit will remain. Proposals for recommendation to Treasury to consider repatriation of large corporate’s offshore earnings with the capital used for lending to SMEs and / or development of Commerce or Treasury managed incentives program for nonbank SME lending would offer opportunity to create greater SME credit availability increasing employment and GDP.

RECOMMENDATION STATEMENT

SMEs are large drivers of employment, GDP and taxes. Economic growth related to SMEs is constrained by credit access and TFAC recommend to create more lending to SMEs through two non-mutually exclusive potential proposals: (1) recommend that Commerce recommend that Treasury consider offering a tax repatriation waiver to create non-bank funding that can be lent to SMEs using funds from large corporations with lower taxed overseas cash holdings; and / or (2) creating an incentive program for companies to manage direct lending programs to SMEs that provides grants to investment managers to set up new product offerings to acquire, purchase and/ or originate and fund SME credit. Both programs will enable growth among SMEs leading to increased GDP. **<u>We would suggest that creating program limitations to prioritize export based credit would be preferable.</u>**

SUMMARY & NEXT STEPS

As per our remit, The TFAC has analyzed the lending market to SMEs based upon information from the Federal Reserve, Bank of International Settlement and other market data and statistics and have determined:

- Current credit extended to this business sector is significantly smaller than required with the gap estimated at approximately $1.5 Trillion on an outstanding basis.
- No quantitative mechanisms exist to segment corporate credit utilization specifically targeted at U.S. exports, by size of the corporation or the type of credit utilized.
- SME credit is more limited due to lack of access to the bond market for most businesses.
- Additionally, bank funding and bank access to bond market funding is limited by changes to bank and money market fund regulations.

- Banks are deleveraging and hold more cash and high quality securities as assets while increased regulatory requirements dis-incentivize wholesale bank funding through the bond and deposit markets; bank lending has also been curtailed by the required capital increased under the Basel regulations.
- These changes are further impacting bank funding and are increasing the need for more inter-bank lending which further "crowds out" SME borrowers.
- Tax policy has created incentives for large corporations to leave earnings offshore and has led to increasing bond issuance given incentives for stock buy backs.
- Significant cash build up has occurred as banks hold more liquid assets and cash creating a significant low productive use of cash at central banks given money supply creation; alongside corporate trapped "tax" dollar cash (offshore) all contribute to reduced SME credit availability.

In consideration of the TFAC mandate to make recommendations based upon credit conditions and identifying additional sources of capital, we are considering recommending that Treasury consider a tax repatriation waiver to create non-bank funding that can be lent to SMEs and creating an incentive program for companies to manage direct lending programs to SMEs.

For the avoidance of doubt, we are suggesting the following potential tax repatriation proposal with an indicative example: Large Corporate "A" brings $100 billion onshore avoiding s a $20 billion tax payment (assuming a 20% repatriated income rate). The $100 billion is lent by A over a period of time to a universe of SMEs "1,2,3,4, n". Accounting limits on how lending funds to 1,2,3,4, n would be treated for A requires that the loans to be short duration to limit impact on the A's balance sheet and precludes using funding for longer dated credit provision such as infrastructure.

For the avoidance of doubt, we are suggesting the following grant proposal: a government agency would create an incentive program for corporations to arrange funding capital to be lent to SMEs. Investment products focused on the non-credit rated universe of borrowers that can either purchase such unrated credit is small. To attract investors and investment management firms to extend credit to such borrowers, incentives are needed to induce such investors to take on the additional costs and responsibilities managing these investments. The goal of such program is for the incentives to be one time in nature such that the funds that are set up are sustaining sources of ongoing lending.

The goal of both prospective programs is to address the gap in SME financing which will lead to stimulate U.S. economic growth. Simultaneously each proposal enables the creation of a new "channel" for the flow of credit to the real economy, intermediated directly by the private sector and is consistent with the TFAC remit to identify alternative sources of capital that can be directly purposed to expand exporting.

Implementation and compliance can be overseen by the Departments of Commerce and Treasury. As tax policy and reform are key priorities for the Administration, as is supporting small businesses, we are also recommending that consideration be expedited for any formal recommendation brought forward for as soon as practical.

EXPECTED EFFECT OR IMPACT

The tax waiver proposal creates multiple benefits by bringing onshore money currently trapped offshore, by creating a SME lending pool of capital for those otherwise not able to get loans both of which enable growth creation. Amnesty benefits a small number of large corporations, approximately 75 technology, pharmaceutical and industrial companies that collectively have several trillion dollars offshore, mostly held in Europe. In order to lend that money, large corporations will require service providers, whether by hiring staff or 3rd parties, to deploy funds brought onshore into short-term loans and purchases of receivables. The incentive program will enable service providers to hire staff. With both potential programs – repatriation and investment management incentives - it is likely that the 3rd parties may also be SMEs themselves.

The objectives of both recommendations are to quickly develop sizable pools of private capital to be allocated in the real economy while minimizing government resources and/or interdependency in order to increase SME export lending as there is reduced availability from banks and there is limited private capital allocated to private SME credit. In both cases the outcome will enable SME lending and increase GDP. The current Administration has made manufacturing a priority for job creation. Looking at SMEs, especially exporters and providing more credit is key for these businesses to grow and hire more workers and financing SMEs is a non-partisan issue that has widespread support from Congress and the White House.

METRICS TO TRACK SUCCESS

Managing compliance and controls associated with any program is important. Capital deployment can be accomplished by leveraging the expertise of registered investment managers and aligning incentives via fee deferrals targeted at losses.

Losses can be targeted for a government waiver with a share allocated to service providers with the goal to limit losses not only through controls but also with the oversight of asset management's involvement and with loss alignment around fee deferrals and/or; bank involvement underwriting capacity and demonstrated experience and loss sharing.

Metrics will be utilized to monitor and track credit extension through tracking credit extended to SMEs through investment managers.