TFAC Meeting 18 September 2017

DAS Sullivan: Trade finance if a policy priority for the Trump administration, especially for US SMEs. Sullivan expresses his and the administration's commitment to supporting TFAC and trade finance.

Chris Bozek: TFAC will help the Secretary find options for/obstacles to trade finance. The primary goal is to help US exports. TFAC is developing impactful recommendations that will:

- Leverage best practices for SME credit
- Reduce the information gap for exporters
- Find process obstacles to SME credit

In particular, TFAC will be deliberating recommendations for the Secretary for SME assistance that is tied to tax reform.

Adam Dener: TFAC's Charter is to help the Secretary identify ways to help expand access to finance for US exports, especially SMEs. This takes the form of 3 objectives:

1. Evaluate credit conditions and specific financing challenges
2. Identify emerging financing sources that would address those challenges
3. Recommend specific activities that could be implemented to achieve the goal of expanding SME credit.

Two inputs for the evaluation leading the recommendations:

- No data sources on credit consumption specific to SMEs, nor on credit use for exports
- A focus on private sector capital sources as opposed to government programs

Five principles used in development of the recommendations:

1. Attempting to address a $1.5 trillion credit gap
2. This credit gap is for corporate lending only, excluding lending to banks or from overseas
3. Cannot specify credit consumption, thus cannot determine whether the credit gap disproportionally impacts SMEs or exporters
4. Interpreting "emerging financial sources" to mean non-governmental sources of capital
5. Minimize incentives required to enable action and the role of government

Drivers of the corporate credit gap include:

- Bank regulation
- Funding regulation
- Monetary policy
- Tax policy

Focus is on two key prospective capital sources:

- Either directly or through investment managers, institutional investors in the broad fixed income market

- And a subset of these institutional investors, corporate treasuries, and most specifically large corporate treasuries with the multi-trillion dollar pool of offshore money held at a lower tax rate.

Decision was not to securitize private credit for SMEs given post-financial crisis response to that type of activity. Thus the focus on an alternative route of funding development not dependent on securities, but for investors to do direct investing as lenders or working with Investment Managers. Potential issues with this route:

- That type of credit will not have a credit rating, thus investors will need detailed risk analyses
- Investors typically don't have the infrastructure to make loans to SMEs nor to evaluate loans to SMEs made by others

Regarding the recommendations, the aim was to make positive incentive-based recommendations rather than punitive recommendations, leading to the two non-mutually exclusive recommendations presented.

First Recommendation: the Secretary should recommend to the administration to consider a tax repatriation waiver with the waived taxes used to create private capital funding for loans to SMEs. Analysis suggests a large build-up of off-shore earnings that are a sizable potential source of capital. Commerce should recommend that the administration consider waiving taxes on un-repatriated earnings, provided that the tax waiver beneficiary agrees to lend the repatriated amount to SMEs in consideration of the waiver.

Second Recommendation: create an incentive program for companies to manage direct lending programs to SMEs. The Commerce-administered program would provide one-time grants to Investment Managers to arrange capital loans to SMEs. The idea is to incentivize investment managers to create new products, arrange investors and invest in the infrastructure to originate or acquire loans made to SMEs, in order to increase the size of the market that can purchase this kind of unrated credit so that investors and firms extend credit to such borrowers.

Caveats: limits should be placed on any program, including limits on stock and debt repurchases in the case of repatriation. Oversight of either initiative will need to be developed.

The goal of these recommendations is to address the gap in SME financing, and they seek to create a new "channel" of credit flow to the real economy. Speed is crucial in considering them, as impending changes in tax policy and already-occurring changes in monetary policy will likely exacerbate the SME credit gap.