

Regulatory Debate: Large U.S. Companies Willing to Accept Higher Funding Costs for Market Stability

May 2010

New research from Greenwich Associates shows that credit conditions for large U.S. companies are improving dramatically in 2010. However, as corporate demand for capital picks up in step with the economic recovery, ongoing efforts to reform bank regulations stand as a wildcard. Companies broadly agree that tighter regulations on banks are likely to have at least some negative impact on the availability of credit and costs of funding. Despite that recognition, corporate support for several core elements of the financial reform bills now under debate in Washington remains strong.

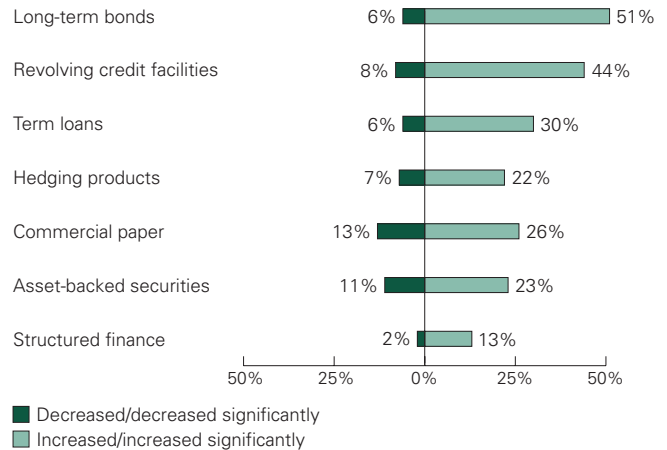
“The results of our study show that large U.S. companies see stability in the financial system as a critical goal, and one for which they are willing to pay a price,” says Greenwich Associates consultant John Colon. “The danger at the moment is that no one in Washington or elsewhere in the country can determine precisely what the impact of this massive piece of legislation will be on credit markets. Therefore, there is no way to know the costs that companies will ultimately be forced to bear in terms of increased costs of capital.”

Credit Markets Improving For Large U.S. Companies

In April 2010, Greenwich Associates conducted a Greenwich Market Pulse of large U.S. companies about credit conditions, regulatory reform proposals and their perceptions of the banks they use for loans and other services. The results, which are based on responses from companies with annual sales of at least \$500 million, demonstrate that large companies’ access to credit has improved greatly. Over the past six months:

- Forty percent of large U.S. companies say their access to bank revolving credit facilities has improved.
- One quarter of companies say it’s become easier to secure bank term loans.
- Reflecting the strong recovery in U.S. new-issue bond markets over the past year, slightly more than 50% of large U.S. companies say their access to capital through long-term bond markets has improved.
- For each of the above products, only about 12% of large U.S. companies say their ability to secure funding has decreased.

Access to Funding



Note: Based on 58 participants.

Source: March 2010 Corporate Market Pulse

Large Companies Willing to Accept Higher Funding Costs for Stability

Recently, the U.S. Senate began full debate on landmark legislation to remake regulations governing banking and other financial services. Although the entire reform effort remains a work in progress, the final law could have a dramatic impact on credit markets, hedging practices and other essential aspects of corporate finance and treasury management.

The results of the Greenwich Market Pulse study reveal that large U.S. companies are generally supportive of targeted reforms aimed at addressing specific flaws or weaknesses in the U.S. banking system but are more skeptical of some higher-level measures that would empower regulators to identify and potentially limit the size of firms that pose systemic risks to the system.

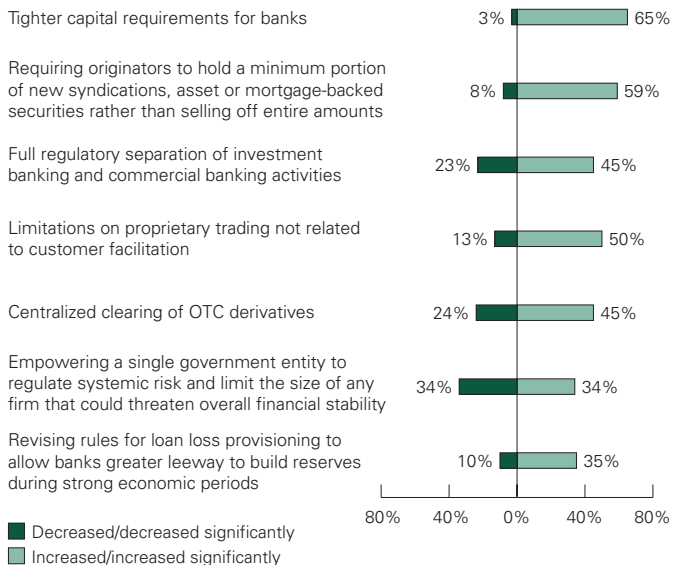
“We fully support efforts to improve transparency, accountability, and stability of financial markets, however, we have concerns that some proposals may over-regulate

Few Signs of Strong Pick-Up in M&A

The Greenwich Market Pulse results suggest an imminent surge in M&A activity, regardless of the current status of the economic recovery. Twenty-one percent of large U.S. companies report that their need for acquisition finance has increased over the past six months.

and have unintended negative consequences,” says the head of cash management from a large food and beverage company. “Legislation should be carefully crafted to target specific issues but just as carefully designed not to hinder or discourage conservative and valuable financial tools.”

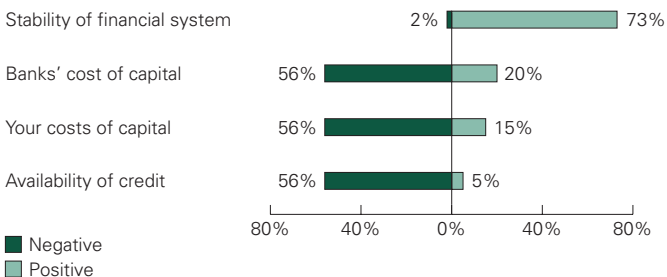
Support for Reform Proposals



Note: Based on 42 participants.
Source: March 2010 Corporate Market Pulse

Approximately 65% of large U.S. companies favor the imposition of tighter capital reserve requirements on banks, even if the move makes credit less available and more expensive. Less than 5% of these companies are opposed. “Six-in-10 large companies think higher capital requirements for banks will have a negative impact on credit availability and about 55% think it will increase their own costs of capital,” says John Colon. “But almost three-quarters of these companies believe tighter reserve requirements would have a positive impact on the stability of the financial system overall. They are apparently willing to absorb higher costs in return for that stability, but just how high a price is unclear. One can speculate that smaller companies with fewer financial resources and less flexibility might be less willing to pay this price.”

Impact of Tighter Capital Reserve Requirements

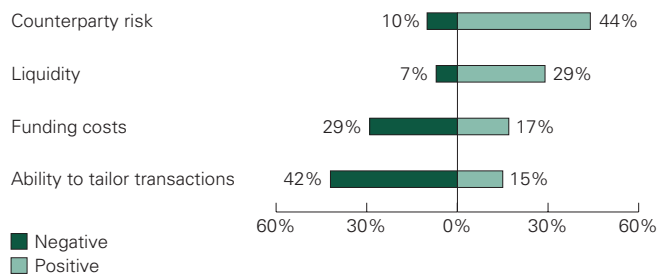


Note: Based on 41 participants.
Source: March 2010 Corporate Market Pulse

Derivatives and Securitization Reform

Large U.S. companies' enthusiasm toward regulations that would mandate centralized clearing for OTC derivatives is more tempered. They are divided in their opinions about how such a move would affect liquidity and pricing and remain concerned that the change would hamper current hedging practices. At the moment, there are several competing proposals on derivatives reform on Capitol Hill. In one version currently under debate, banks would be forced to spin off their derivatives businesses. Also included is the proposal to move OTC derivatives trading to exchanges and central clearinghouses, with the possibility of exemptions for some “end-users” to facilitate certain hedges in interest rates, currencies and commodities.

Impact of Centralized Clearing for OTC Derivatives



Note: Based on 41 participants.
Source: March 2010 Corporate Market Pulse

In the Greenwich Market Pulse, approximately 45% of large U.S. companies said they support regulations that mandate centralized clearing for OTC derivatives, with 24% opposed and 31% essentially neutral on the proposal. Almost 45% of companies think centralized clearing would be effective in mitigating counterparty risk in derivatives markets, with roughly an equal proportion expecting a shift to centralized clearing to have little impact on overall market risk levels and about one-in-10 companies saying the move would actually increase counterparty risk. Opinions are much more divided about the potential impact on liquidity: about 30% of U.S. companies think centralized clearing would increase liquidity, about a quarter think it would decrease it.

Companies are most concerned about the impact mandatory centralized clearing would have on their ability to tailor derivatives transactions to specific exposures. Approximately 40% of companies think centralized clearing would significantly impede their ability to do so. Thirty percent of companies are also concerned that a shift to centralized clearing will over time increase their overall funding costs. “Many derivatives are used in non-speculative ways to manage and reduce risk,” explains one study participant. “If laws force unacceptable levels of standardization, create high clearing costs, mandate excessive reporting requirements, and shrink the pool of available dealers, those laws will create more risk for U.S. businesses.”

Finally, companies favor focused measures designed to reform and strengthen the securitization process. In the securitization market, the Senate bill championed by Senator Christopher Dodd would require issuers and sponsors together to retain a certain share of a transactions' credit risk unless the deal meets some yet-to-be-determined underwriting standards. The baseline seems to be a credit retention threshold of 5%, although the exact share could vary by asset class. Approximately half of U.S. companies favor new rules that would require securitization issuers and sponsors to retain credit risk, as opposed to selling off the entire amount. Only about 5–10% of companies oppose such a measure, with the remainder undecided.

Bank Structure and Systemic Risk

By more than a two-to-one margin, companies participating in the study support proposals that would place specific restrictions on the business activities of individual banks in an effort to reduce risk in the banking system.

Approximately 50% of U.S. companies support the reform proposals included in what is commonly referred to as the "Volcker Rule," after one of the measure's main proponents, Paul Volcker, former Chairman of the Federal Reserve and current Chairman of the President's Economic Recovery Advisory Board. This rule would restrict banks from engaging in proprietary trading not related to customer facilitation and place other limits on bank's ability to invest in hedge funds, private equity and other "speculative" investments. Only about one-in-10 companies say they oppose such measures, with the remainder undecided. The bill now under discussion in the Senate would empower a commission to study the possible implementation of the Volcker Rule.

"Taking that sentiment one step farther, 45% of the companies favor reinstating Glass-Steagall-style provisions that would entirely separate investment banking and commercial banking activities," says Greenwich Associates consultant Steve Busby.

Companies are much more skeptical about reform measures that would vest considerable new powers in the Fed and other agencies to identify individual firms as systemically important and to limit their size or take other actions aimed at addressing levels of systemic risk. The Dodd bill would grant the Federal Reserve the power to break up firms deemed as systemic threats by a newly created "Financial Stability Oversight Council (FSOC)." This council would be chaired by the U.S. Secretary of the Treasury and could vote to mandate Fed supervision for non-bank firms seen as posing systemic risk. The bill would also raise \$50 billion through new taxes on banks to create a fund that would be used to finance government efforts to wind down failing financial service firms. The fund could be employed only with the approval of the Treasury Department, the Federal Reserve, the FDIC and three bankruptcy judges.

U.S. companies are divided in opinion about proposals to create a government entity empowered to act on systemic risks through actions such as those outlined in the Dodd bill. Roughly three-in-10 companies are supportive of the idea, an equal share oppose, with the remainder neutral or undecided.

Conclusion

Large U.S. companies are supportive of bottom-up reforms that would address regulatory shortcomings revealed during the market collapse in credit, securitization and derivatives markets. Reforms in these areas are seen as so important to the stability of the U.S. financial system that large companies are willing to incur higher financing costs and potential disruptions to current funding and hedging practices in order to achieve them. The intensity of that support ultimately will be determined by the level of costs imposed.

Companies are also favorably disposed to structural reforms in the banking industry seen as limiting risk levels in the U.S. banking system. However, companies are much more skeptical about current proposals that would significantly increase the authority of the Federal Reserve and other regulators to name individual firms as systemically important and take action to eliminate or reduce perceived systemic risks. "Large U.S. companies recognize the need for structural reforms that will reduce the risks of future crises," says John Colon. "However, even if companies accept that there will be a price associated with reform, lawmakers must not forget that efforts to prevent future crises will have consequences that could affect the current recovery."

Greenwich Associates consultants John Colon, Don Raftery and Steve Busby specialize in U.S. banking.

Methodology

Greenwich Associates surveyed chief financial officers, treasurers and assistant treasurers at 58 companies in the United States via the internet in March 2010. Participants were asked about overall trends in the marketplace as well as their particular banking relationships.

The findings reported in this document reflect solely the views reported to Greenwich Associates by the research participants. They do not represent opinions or endorsements by Greenwich Associates or its staff. Interviewees may be asked about their use of and demand for financial products and services and about investment practices in relevant financial markets. Greenwich Associates compiles the data received, conducts statistical analysis and review for presentation purposes in order to produce the final results.

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