

Clamoring for Reforms, But What Kind?

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By Emily Flitter

Bankers surveyed for the latest Financial Services Executive Forum were divided over how best to fix the financial regulatory system, and the size of their institutions had a lot to do with where they stood on the issue.

Though a majority of the 206 executives responding to the survey, conducted in August, said the current regulatory regime was too burdensome and that they supported some form of regulatory overhaul, they differed on the specifics. The respondents considered the capital injection program that officials set up using money from the Troubled Asset Relief Program the most successful of all financial rescue efforts.

"The belief sometimes espoused that bankers want the status quo couldn't be further from the truth," said Wayne Abernathy, executive vice president for policy and regulatory affairs at the American Bankers Association.

More than 71% of bankers from large banks said regulatory agencies should be consolidated as part of the regulatory reform effort that is under way in Washington. But executives from smaller banks, who made up a larger proportion of the respondents, were less enthusiastic. Only 39% supported consolidation.

"The big banks are probably seeing every regulatory agency come in at them at most of the time," said Nicholas J. Ketcha Jr., a managing director at the bank consulting firm FinPro and a former director of supervision for the Federal Deposit Insurance Corp. "The Federal Reserve regulates their holding companies and the Office of the Comptroller of the Currency is their primary regulator if they are nationally chartered banks, and then if they have any problems at all they probably have the FDIC in there."

Consolidation, Ketcha said, would help the biggest banks — nationally chartered institutions with bank holding companies — by allowing them to deal with fewer examiners.

"The smaller banks still prefer the choice," he said. "There are a lot of them that like to be a state charter, because they feel they have a more local ear with the state regulators."

Regardless of the difference, observers said it was no surprise that more than half of the respondents feel put-upon by the current regulatory structure.

"I would have thought there would be more" of an outcry, Ketcha said. "I would have expected that the regulatory overload is just killing all banks right now."

Karen Garrett, a counsel based in Kansas City, Mo., with Bryan Cave LLP, said banks carry "an enormous regulatory burden."

"We talk about regulatory restructuring — the truth is it isn't that banks weren't highly regulated before, just the wrong things were regulated," she said. "We have been regulating minutiae."

Garrett pointed to the Bank Secrecy Act, which has strict standards for monitoring customers' financial activities.

"It is part of a social agenda and it is required by our government," she said. Banks "are implementing law enforcement, with drastic criminal and civil penalties if they don't do it right, and they are not compensated for it."

Community banks felt they had even more of a reason to protest new regulations that could result from the financial crisis, Garrett said. "You can imagine the frustration of community bankers who feel that they are bearing a disproportionate share of the cost while having very little to do with the meltdown," she said.

Camden Fine, the president of the Independent Community Bankers of America, said community banks also did not favor regulatory consolidation because it could offer the country's largest banks another advantage.

"The reason the big banks want the regulatory agencies consolidated is because that plays into their hands," Fine said. "That allows them to have much more influence over whatever single regulator exists. When you have less than 10 banks that control over 50% of the financial assets of the United States, who do you think the single regulator would be captive to?"

Respondents to the survey were split on which entity should be the systemic risk regulator. Thirty-five percent said it should be the Fed, as the administration has proposed, and 34% said the authority should go to a council of regulators. (In the previous survey a majority of respondents did not support the creation of a single systemic risk regulator.)

"I think bankers generally tend to trust the Fed and see them as a fair and useful regulator and service provider," Garrett said. "I don't think they're generally as suspicious of them as people in Washington are at this point."

The survey also sought opinions about the government's response to the credit crisis.

Congress agreed to put \$700 billion in public funds toward a rescue of the financial system. Officials led by then-Treasury Secretary Henry Paulson and Fed Chairman Ben Bernanke had originally pledged to use the money to buy bad assets from banks' balance sheets to restore financial institutions' confidence in one another. But Paulson and Bernanke quickly changed tacks and created the Capital Purchase Program, which provided fresh capital to banks in exchange for preferred shares and stock purchase warrants.

The survey respondents were asked to assess the CPP; the Temporary Liquidity Guarantee Program, an FDIC initiative to let banks issue fresh government-guaranteed debt; asset purchases by the government; and the Term Asset-Backed Securities Loan Facility, a Fed program to take illiquid securities as collateral in exchange for loans to purchase new securities. They were asked which program they thought had done the most to stave off a systemwide collapse and which was the least helpful. In both cases a majority said they were not sure, but the capital injections regulators made in banks starting in October through the CPP drew the largest number of positive votes.

Paul Miller, a managing director at Friedman, Billings, Ramsey & Co. Inc., said that although Talf had been helpful in many markets, the injections were the most crucial component of the rescue efforts. "The capital injections really got private money to start investing in the space," he said. "The big banks knew they were looking in the abyss."

Bankers said the asset purchases were the least helpful of the four programs, a reaction many observers attributed to the fact that such a program has yet to be launched on a large scale. After Paulson abandoned the plan in the early days of the rescue effort, his successor as Treasury secretary, Tim Geithner, attempted to revive the idea, announcing the creation of several funds that would combine government money with private funds to buy bad loans off of banks' books. But aside from an FDIC pilot program to buy whole loans, the idea for the funds remained largely undeveloped.

"For bankers, that was the big disappointment — that they couldn't basically get these bad assets backstopped by the government," said Ron Glancz, a partner at Venable LLP. "I think we were all sort of looking for a government legacy loan program that would somehow avoid significant writedowns," Glancz said.

A majority of the bankers surveyed said it was too soon to tell whether the government's response to the financial crisis had been, on the whole, a success or an overreaction, but more bankers said the government overreacted than that it had succeeded at preventing a collapse.

"People may not understand the interconnectedness of the entire financial services world and why it was incredibly important that the banks that were 'too big to fail' didn't fail," Garrett said. "But if you are a banker that didn't take advantage of any of those programs and you didn't think they were necessary, you may very well think it was an overreaction."

Miller said the government definitely prevented chaos in the short term. "I would think that if Bank of America had failed it would have taken out a lot of people," he said. Whether the bailout will prove the right action in the long run "doesn't matter," he said. "We're still alive. I was of the mind-set that we were going into the abyss."