



OP-ED

How Regulators Are Inhibiting an Economic Recovery

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The credit crisis has reduced consumer and business access to credit and stifled economic growth. To date, the political response has consisted of one-time stimulants and federal spending - which may have prevented economic calamity, but will not provide for long-term economic recovery. For long-term recovery, banks need to increase lending, which will allow companies to grow, thus spurring private-sector employment, encouraging consumer confidence, and initiating a real estate recovery.

This simple axiom illustrates the conundrum that banks are currently facing. How can banks grow loans when one-size-fits-all regulatory stances are inhibiting the economic recovery by decreasing the banking industry's ability and willingness to lend?

Clearly, heightened regulatory pressure is required to rein in banks that took excessive risks. However, extrapolating such pressure onto the entire industry has the effect of punishing responsible banks. Regulators are pushing higher capital requirements, increasing loan-loss allowances and reserve coverage ratio requirements, establishing rigid, inflexible loan concentration thresholds, and discouraging de novo bank formation. These broad-brush policies are directly limiting the ability and willingness of well-managed, safe and sound banks to lend and are choking off new capital that wants to invest in the industry.

Raising capital levels for banks deters new lending. Now is not the time for higher capital standards, but for enforcing standards already in place. Unless dictated by the condition of an individual institution, capital requirements should be kept at current levels because any increase forces banks to shrink their balance sheets and decrease overall lending.

The regulatory stance of increasing reserve coverage ratios (which is the allowance for loan and lease losses divided by nonperforming assets) is also inhibiting economic recovery. As most loans are backed by collateral, it is unrealistic to assume that all banks will have to charge off the majority of their nonperforming assets. While no one argues that these loans are impaired, not all are worthless. Historically, the allowance has acted as a buffer, with industry coverage ratios ballooning to over 200 percent in good times and dipping below 50 percent during downturns. Artificially inflating the allowance decreases lending capacity. Besides, the fixation on the allowance is excessive. Banks should use the allowance they built up during good times and only add to reserves as they make new loans or experience further deterioration in their lending portfolios.

While loan concentration thresholds have been around for years, the over-emphasis on commercial real estate makes little sense. The current threshold guidelines treat all CRE and construction loans, regardless of debt service coverage and underwriting quality, the same. Regulators should focus on the underwriting of individual loans and individual banks and avoid making blanket assumptions about all CRE loans. Current practices create a self-fulfilling decline in CRE lending and exacerbate the decline in real estate values.

While there is no explicit ban on de novo banks, it is clear that applications are being strongly discouraged. With this stance, regulators are preventing willing capital from entering the industry. Investors might put capital into existing banks instead. But typically, injecting fresh capital into a troubled bank goes toward funding chargeoffs, not new lending. In a de novo, all new capital directly funds lending growth.

Also, regulators should not discourage willing capital from entering the market by forcing private equity to abide by special rules. Private equity should be allowed to infuse capital into the system provided they play by the same rules as the rest of the industry.

Following these suggestions will stabilize current loan balances and prime the pump for new lending, which will drive economic recovery.

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