Financial Crisis Management Alert

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Dealing With the Big Problem

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Steven A. Meyerowitz will be filling in for Ken Guenther while he recovers from surgery. Mr. Meyerowitz is the editor-in-chief of Sheshunoff's The Banking Law Journal, Financial Fraud Law Report, Privacy & Data Security Law Journal, and Journal of Bankruptcy Law. He also blogs about financial fraud law issues at http://www.financialfraudlaw.com/.

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The most important news story of last week for banks was not the financial regulatory plan updates proposed on Thursday by President Obama. No, the most significant development was Tuesday's special election in Massachusetts to fill Senator Ted Kennedy's seat and the fact that a heretofore unknown and untested Republican state senator handily won the race. That has Democratic officeholders running scared and Republicans trying to ride the tea party tiger for their own benefit. In 48 hours, the uproar over the election led to President Obama's new proposals, and his statement that he will "fight" for the changes. But there's more -- a lot more -- to consider. In particular, for community banks and thrifts, the key issue now is how -- not whether -- to separate themselves from the big banks. The answer to that is rather straightforward: Get out there and spread the message to all constituencies that community banks can help to solve the problems facing us now.

We are certainly all in this mess together, yet, just as certainly, not everyone -- and not every institution -- is equally to blame. Though many big bank executives may quote Ben Franklin's statement, "We must, indeed, all hang together, or most assuredly we shall all hang separately," this is not the time for blind banker unity. The risk is too great that politicians and reformers will paint with too broad

a brush, hearing only that there is populist rage and not seeing the important distinctions or drawing the careful lines that are necessary when legislation is enacted or regulations proposed. That rage came "thisclose" to dooming the reappointment of Federal Reserve Chair Ben Bernanke. Although reasonable people certainly can have different reactions to his reappointment, it seems clear (at least to me) that rejecting him at this point would damage the economy for all of us (perhaps it was fear of that, and the growing attacks on banks and other institutions, that led the stock market to its worst week last week in nearly a year). Time magazine's Person of the Year is not perfect, he made mistakes, and certainly he has his own biases, but, as I have suggested on my Financial Fraud Law blog, it would be disastrous if the Senate were to reject him after President Obama decided to put him up for another term. Fortunately, as of this morning, it appears that a sufficient number of Senators (ironically, a bipartisan group) will support Bernanke. Perhaps this is a sign that some bit of statesmanship remains in the Senate. While no profiles in courage will be written for any of those senators for supporting Bernanke, a favorable vote may suggest that cooler heads recognize that they are dealing with important issues that they actually have to think about.

That brings us to the most recent iterations of the government's bank regulatory plans.

The economy is affecting big and small banks alike, as FDIC head Sheila Bair told the Commercial Mortgage Securities Association annual conference in Washington, D.C., last Wednesday. At that meeting, Bair also discussed the FDIC's changes to credit underwriting practices, to which small banks should pay particular attention. A lot of what Bair highlighted – verification of a borrower's income, reviewing credit history, independent collateral appraisal, economically sustainable repayment terms, and the like – are part and parcel of best practices, and should be second nature to most bankers. It is important that community bankers identify them, adopt them, and follow them.

Bair also focused on loan modifications and restructuring existing loans, and the recent regulatory guidance for handling commercial real estate loan workouts – something that should be photocopied and on every officer's desk and in every briefcase. Keep in mind that that guidance has specific examples, with analysis under generally accepted accounting principles. Community bankers also are likely to see, if they have not already, their local FDIC examiners come in for a visit, where they are going to determine whether the banks are applying the guidance accurately. (It should be noted that Bair told the group that economic activity is slowly but steadily turning around after the longest and deepest U.S. recession since the 1930s – a bit of good news.)

Bair's talk was a relatively gentle opening for President Obama's announcement on Thursday. Keep in mind that the President spoke only two days after the Massachusetts election.

At the very, very beginning of his remarks, the President referenced the economic crisis, stating that it started as a financial crisis, "when banks and

financial institutions took huge, reckless risks in pursuit of quick profits and massive bonuses." The President mentioned that he had proposed a financial crisis responsibility fee, "to be paid by the largest financial firms," to recover the funds the government disbursed to avert the financial meltdown. And then he dropped the hammer, declaring that he is proposing two new reforms to "strengthen the financial system while preventing future crises."

One might refer to these proposals as "Scope and Size" limits. First, the President proposed something he said he is calling the "Volcker Rule." Under this rule, banks will no longer be allowed to own, invest, or sponsor hedge funds, private equity funds, or proprietary trading operations for their own profit, unrelated to serving their customers.

Second, with the statement that, "never again will the American taxpayer be held hostage by a bank that is too big to fail," the President said that he is going to seek to prevent "the further consolidation of our financial system." He stated that he will seek a cap on total market share of any individual bank's nondeposit liabilities, adding that the "American people will not be served by a financial system that comprises just a few massive firms."

The president did not give details about either of these proposals; that suggests that they are malleable and can be (and probably will be) tweaked. The Gibson Dunn law firm, out of the box quickly with a summary of the president's ideas, noted that it is not clear how they will affect the Congressional debate over how to reform the financial regulatory system.

Yet, one thing does seem clear: now is the time for individual community banks to get involved in this process, if they have not done so already. R. Michael Menzies, chair of the Independent Community Bankers of America and president and CEO of Easton Bank and Trust Co. in Easton, MD, and Camden R. Fine, ICBA president and CEO, followed up Obama's announcement with a statement setting the ICBA apart from "too-big-to-fail firms" and supporting efforts to end the "dangerous overconcentration" in the system. Community banks are not the problem, but rather are the solution to a great deal of what went wrong with the economy and is still wrong with the system.

Bankers must get out there with their story, contact their elected representatives, and engage the public – customers, prospective customers, former customers, and future customers – to let them know what it is community banks do and how they are a key to the recovery. In addition to following, the FDIC's dictates to help get the economy back on track, local bankers must reach out to their communities – Rotary and Kiwanis groups, local schools, business people, reporters – with their message. Community bankers know why they are there and what they do, and how they help to build neighborhoods and create jobs. Spread that information widely, and make it clear that compensation concerns, the "bonus bonanza," Wall Street, and big banks' problems are not the problems of community banks.