

OpEd

In the past 20 years, the Federal Deposit Insurance Corp. has granted an average of 100 new bank charters per year, including 270 in the peak year of 1999. Approximately one-third are no longer in existence; most were sold to other banks, and in the last couple of years some have even failed.

So what impact has the loss of these banks had on their communities? Not much, since most were in developed markets that already had an abundance of banks. That's why I'm arguing that unless bank organizers can make a compelling case that, in certain communities, consumers and business owners aren't being served by existing banks, regulators should continue to clamp down on new charters. What follows are my top three reasons why we don't need new banks.

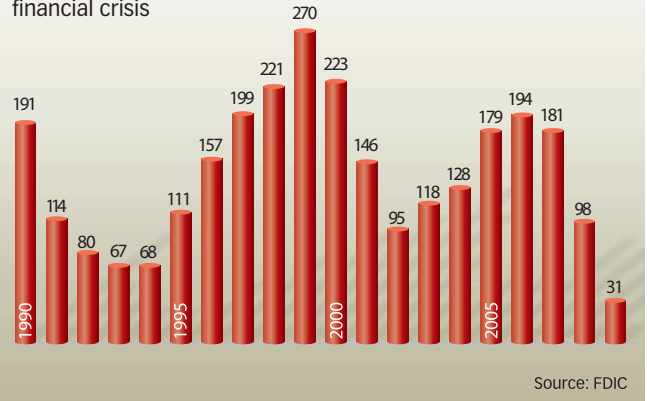
Financial accounting rules. On May 26, the Financial Accounting Standards Board issued an exposure draft proposing that financial institutions begin marking their loan portfolios to market, much like they do with their available-for-sale securities. Many laud the proposal as bringing transparency to the banking industry. But one unintended consequence could be that character lending will be marginalized or eliminated altogether.

Imagine a long-term customer that has survived many economic cycles but whose 2009 financial statement showed that her business had an awful year. The customer has had rough years in the past but has still managed to pay her loans on time. Now, under the proposed FASB guidelines, when the borrower has less of a cushion to withstand a severe drop-off in business, the bank must mark down the loan. This will make lenders very leery of making loans to cyclical businesses, meaning underwriting will become standardized—much like mortgage underwriting is today—and character loans will fade into the past. In this kind of environment we don't need a new bank, because there are plenty of banks out there that can make plain-vanilla loans.

Government domination. According to the San Francisco Federal Reserve Bank, banks owned 75 percent of the mortgage market in the mid-1970s. By 2008, with Fannie Mae and Freddie Mac dominating the secondary market, that figure had shrunk to 35 percent, and has likely declined even further since, as the federal government has ramped up its role in housing finance. As one

End of an Era?

Hundreds of new banks have opened each year since 1990, but the pace has slowed considerably since the start of the financial crisis



banker told me, the Federal Housing Administration is “the new subprime lender.” If the federal government maintains its dominance in mortgage lending, why do we need another bank?

Similarly, the Small Business Administration continues to increase its activity. Although the SBA doesn't make loans, it creates the standards by which it will guarantee them, therefore dictating underwriting standards. The chief executive of a community bank said to me that small-business banking is one of the last customer segments where a community bank can differentiate itself in its markets. If small business lending becomes more dependent on government programs dominated by large financial institutions, do we need another bank?

The 30-second rule. According to Michael Porter, professor at Harvard and author of *Competitive Advantage*, businesses gain an edge on competitors by achieving either a cost advantage or a differentiation advantage. Given the size of our largest financial institutions, it is difficult for me to envision a community bank achieving a cost advantage over the long term. Therefore, to succeed, the startup bank must differentiate. If you can't say in 30 seconds what makes your bank different from its competitors, then we probably don't need that bank.

Why We Don't Need Any More Bank Charters

By **Jeff Marsico**

Executive vice president, The Kafarian Group Inc.