Warning: The Dodd-Frank Act Has Potential Unintended Consequences for Georgia Banks

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Warning: The Dodd–Frank Act has potential unintended consequences for Georgia banks

Welcome back to all who read the first part of this series last week. As you might recall, last week we focused on the comprehensive financial reform law, the Dodd–Frank Act, and why it is more a set of principles than restrictions in parts of the financial services industry.

In essence, the law is in the “act of becoming,” and rules, guidelines and restrictions will be developed later by regulators and two new agencies, the Financial Stability Council and the Consumer Financial Protection Bureau.

Therein lies the rub. The fashionable business buzzword is “uncertainty.” Large businesses — many of which have rebounded to pre-recession peaks in profitability — use uncertainty as one justification to amass hordes of cash instead of expanding operations and creating new jobs.

Uncertainty is considered the key reason why consumer confidence and spending are ebbing. Even Fed chairman Ben Bernanke chipped in with his congressional testimony indicating we are faced with “unusual uncertainty” regarding near-term economic forecasts.

**Short-term uncertainty**

The Dodd–Frank Act creates uncertainty in the short term for the financial services industry overall, especially for community bankers. Industry trade groups — the Georgia Bankers Association, the Community Bankers Association of Georgia, the state and local chapters of the Chambers of Commerce — have expressed reservations about the law because of uncertainty over potential regulations and their likely unintended consequences.

These groups support many of the provisions, including those dealing with the “too big to fail” issue as well as extending regulatory oversight over the non-regulated segment of financial services — mortgage brokers, private equity, hedge funds and credit rating agencies.

Similarly, most organizations support restrictions and increased reporting and monitoring of highly complex customized investments that funded the unsustainable asset bubble during the past decade and contributed to the 2007–09 financial crisis.

Still, many of these organizations have voiced concerns over specific restrictions — interchange fees, increased or redefined capital requirements and an increased regulatory burden — that are likely to be imposed.

**Main street’ bank provisions**

In fairness, the Dodd–Frank Act attempts to minimize the impact of some of its provisions and potential regulatory restrictions on “main street” community banks.

Exemptions, grandfathered clauses and extended phase-in periods are provided for banks under $15 billion in asset size. Those would appear to protect all the banks in Georgia except for our two largest in-state banks, SunTrust and Synovus, as well as regional banks such as BB&T and Regions Bank.

However, many analysts believe these exemptions will prove unworkable for most “main street” banks. The fear is that local community banks will drown in the backwash of new regulatory restrictions and reporting requirements.

In practical terms, the cost of compliance and periodic reporting will be cumbersome at best and unaffordable at worst for most community banks.

**’Warm hugs’ and ‘tough love’**

What can be done about the uncertainty and the risk of unintended consequences for local banks? It would be wise for all parties to embrace the concept of “tough love” and a “warm hug” as the new agencies develop new regulations in 2010–13.

“Tough love” would be applied to “too big to fail” banks, investment banking firms (Goldman Sachs, Morgan Stanley) rechartered as bank holding companies, specific large insurance companies and all unregulated nonbank companies.

For these players, restrictions should be imposed on specific higher-risk activities and require higher capital ratios. Issuers of mortgage-backed securities must be held to tighter underwriting standards and require higher minimum down payments by borrowers seeking mortgages. Rating agencies such as Standard and Poor’s and Moody’s must be held to higher standards of performance and subject to liability. Finally, transparency and accountability for their investment opinions. Finally, light must shine on the shadowy markets and activities of private equity and hedge funds with comprehensive and robust regulatory reporting requirements.

A warm hug should be provided to local “main street” banks who finance the small and mid-size businesses that create jobs and wealth for the communities they serve. Pragmatic and workable levels of protection against regulatory overreach must be provided to these banks, as well as reasonable access to government-sponsored equity capital.

**Why the protection?**

Community banks in Georgia and elsewhere nationwide did not cause the financial crisis. They were not the generators of sub-prime loans nor the issuers of complex, poor quality asset-backed investment securities.

These banks do not present a systemic risk to the U.S. or global economy. If anything, they have been victims of the financial crisis, collapsing housing values and the great recession.

In addition to tough love and a warm hug, a dose of discipline is needed for everyone — consumers, financial institutions and especially regulators. Any new regulation should be subject to cost/benefit and “consequence” analysis, the key being the “consequence analysis” segmented by size and business operations for each group affected by new rules and reporting requirements.

A disciplined and robust impact analysis — let’s call it a CB&C review — would be required to vet potential unintended consequences and reduce the uncertainty for local banks in a slowly recovering economy.

I would like to hear what you think should be done. Please no “partisan” political rhetoric or “talking points.” Just good common-sense ideas are encouraged. Send your comments to financialservices@georgiasouthern.edu. We will review the best ideas next month in BIS.

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