

briefing

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Sobering issues dominate industry meeting

What happens over the next year will set the direction for banking in America for the next 50 or 100 years—this is a historic time.” With those dramatic words, Eugene Ludwig, former Comptroller of the Currency, began his opening remarks during a panel on “Turmoil in the Capital Markets” at the ABA Annual Convention in November.

Ludwig, CEO of Promontory Financial Group, pointed out that the current crisis was not the making of the banking industry, but of a combination of factors, including unregulated entities posing as banks and a government bent on a liquidity binge. Exacerbating this is the tendency of the media and people in

government to refer to everything that happens in the ongoing crisis as a “banking” issue, when often it is not.

Similar points were made forcefully by other speakers during the convention, including ABA President Edward Yingling, who told bankers that he had testified before Congress that “banks cringed as they heard Bear Stearns, Lehman Brothers, Fannie Mae, Freddie Mac, and even AIG referred to as ‘banking failures’.”

Nevertheless, banks “are caught up in a conflagration,” as Ludwig put it, even though most never made a single subprime loan.

Ludwig and fellow panelists made several suggestions regarding

Above, ABA COO Diane Casey-Landry fields a question for OTS Director John Reich (r), and Mark Olson, PCAOB chairman.

By Bill Streeter, editor-in-chief

what banks—individually and as an industry, working through ABA—can, and must, do in the weeks and months ahead.

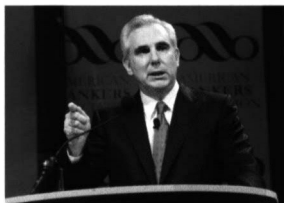
The former Comptroller advised the industry to work hard to obtain a level playing field, which primarily means regulating the unregulated players—mortgage brokers being the top candidate. They need to be brought up to the standard that banks already operate on, said Ludwig. But the great fear is that, as Yingling put it in his speech, new regulations could make traditional banking—now back in fashion—unworkable. “A wounded economy and a public mad as hell and not discriminating as who deserves their wrath,” said Yingling, along with a new Congress and a new Administration, will create a very difficult environment.

Control your own destiny

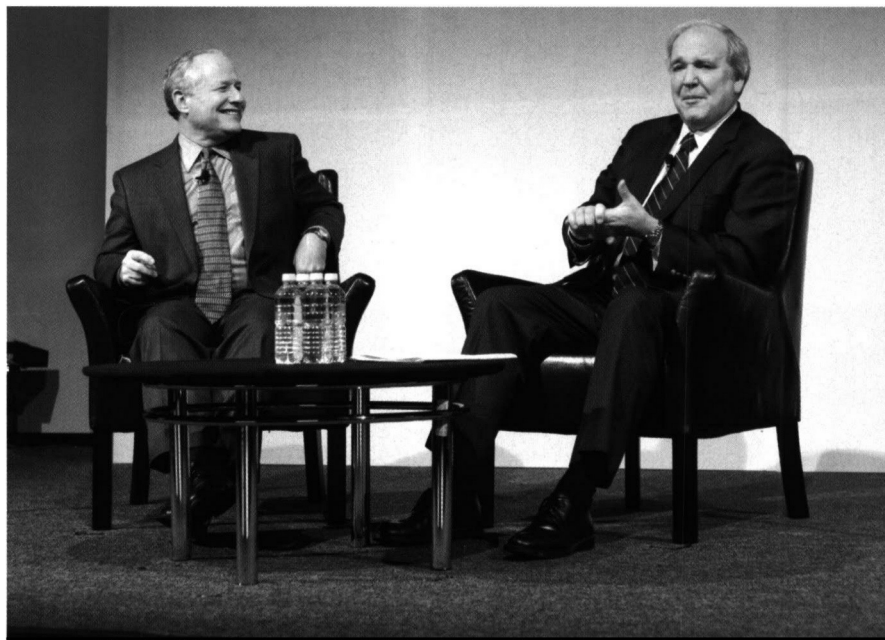
A second recommendation was to educate the public about the true causes of the financial crisis. Panelist Daniel Goldfarb, chief investment officer of OFI Institutional Asset Management, an investment company specializing in small and micro cap equities, said that while banks’ image on Main Street may still be good, the sound bites on TV and on the internet, and the clips in the newspapers have made “bank” a four-letter word.

HEARD & NOTED

“Diane Casey-Landry and I have often commented that the timing of this merger [between ABA and ACB] could not have been better. It has given us the resources and the staff and the unified voice we need”



— ED YINGLING, CEO, ABA



Political pundits Bill Kristol (l) and Mike McCurry analyzed the election for bankers. Said Kristol about the President-Elect: “Obama has the upper hand. The [congressional] Democrats owe him, he doesn’t owe them.” When polled, bankers weren’t so sure (p. 12).

“Banks have a responsibility for their own destiny,” said the third panelist, Donald Musso, president of the consultancy FinPro. “They’ve got to get out in their own communities and educate the public, and not rely on the media.” By way of example, he asked, “How will the public receive the message of whether you elected to use [TARP] capital?”

Regarding TARP infusions and FDIC debt guarantees, Ludwig counseled banks to “avoid taking handouts from the federal government.” We now know that well over 100 banks traded on major exchanges have received TARP advances and hundreds more had applied for the preferred stock infusion by mid-December. For banks that chose to participate willingly or otherwise, Ludwig advised them to, “pay back the TARP advances and say goodbye to the FDIC guarantees as soon as possible.”

The reason, he said, is because “the banking industry will pay a heavy price for it with executive pay limits, extra CRA obligations, fees, new compliance responsibilities, etc. The public will simply not let the federal government extend the safety net without asking for something in return. This is an area of real danger for banks.”

Both Ludwig and Goldfarb predicted a

long and deep recession and advised banks to protect their balance sheets. “Keep excess liquidity, be well capitalized, and prudent,” said Ludwig.

“Capital is king, use it wisely,” echoed Goldfarb. These comments were an early indicator of the difficult position banks are in—caught between congressional and media expectations that they should use capital infusions to lend to help restart the stalled economy, and the cautions from regulators, consultants, and their own instincts to be prudent in a down market.

In addition to being careful with credit extension, Musso advised bankers to “spend as much time on your investment portfolio as on your loan portfolio.” His point being that investors are still seeing “crazy new issues.”

Maybe fewer branches

Musso also recommended banks focus more on expense control, because “you won’t see the growth of the last three to four years. Therefore we’ll have to make ourselves profitable by containing costs.” One way to check costs is by reexamining brick and mortar. He predicts a scale-back of branches: “I don’t want our industry to become the next Blockbuster,” which, like Starbucks, has suf-

ferred from overexpansion.

On the plus side, Musso said now is the time for banks to take back the residential mortgage business. "Mortgage brokers are done," he said, adding that there is "a slew" of talented people available.

Ludwig concluded the discussion by saying, "We're living in transformational times. We have not seen times like this since the 1930s. There will be huge changes in regulation. Whether that comes out well really depends on what happens in Washington."

Head to head on accounting

As a preview of the coming battle over mark-to-market accounting, also referred to (usually by proponents) as fair-value accounting, there was a pointed exchange during one convention session featuring John Reich, chairman of the Office of Thrift Supervision and Mark Olson, chairman of the Public Company Accounting Oversight Board. ABA Chief Operating Officer Diane Casey-Landry moderated the panel.

An electronic poll of the audience asked them to rank three regulatory issues in importance. Fair-value accounting came out as number one (see p. 12). Casey-Landry then asked: "How do we resolve the issue where fair-value accounting is neither fair nor accurate?"

"I'll dispute that," Olson responded. "Let me be blunt, you haven't made the case in opposition to fair value accounting. What we are seeing in Washington is a comparison between transparency and opacity and you tend to be losing that [comparison]. Where you can be successful, as you have been, is taking very specific narrow issues and asking for surgical cuts."

In the various reviews going on domestically and internationally, Olson said, banks can point out that the current iteration of fair value may not have anticipated some of the issues they're facing. He said a good example is the recent change in how perpetual preferred stock is treated. "But I think fair value is here to stay," Olson concluded.

John Reich said that this issue is one of the few where he and Olson have different views. "From a purist's view, I can understand the argument," said Reich, "but when there are no markets for securities it makes absolutely no sense to have institutions write the securities down to an unreasonable level. Also, it doesn't seem fair to value a limited portion of the assets on one side of the balance sheet and not consider the other side when interest rates drop and deposits become more valuable."

Olson responded, "Now I'm with

HEARD & NOTED

"Transparency and accountability will be demanded by people of their leaders and institutions. We resist that at our peril.... Put the president's pay to a shareholder vote. Don't wait for it to be regulated"



— CARLY FIORINA,
FORMER CEO, HEWLETT-PACKARD

you. I do think that the mixed attribute model makes the most sense for banking. Accounting also ought to take into consideration the role of the banking industry as a financial intermediary." He suggested that FAS 157 (which provides the framework for measuring fair value) would be a logical vehicle to address these issues.

Casey-Landry added, "ABA has not asked for the suspension of mark-to-market accounting, we have asked that judgment be applied. We believe that accounting policies have been pro-cyclical and have exacerbated the crisis that we're in today."

Later in the conference, Gene Ludwig suggested resorting to cash flows rather than market values when in a financial storm such as the current one.

Outgoing ABA Chairman Brad Rock in his convention address said, "It is plain that these rules do not work well... And if they can't be changed, then we need to re-evaluate who makes those rules,... and what purposes the rules are being designed to serve." *BJ*

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Investment manager Daniel Goldfarb (l), with OFI, suggested financial asset values be smoothed over some period of time to take out the highs and lows. Promontory Financial CEO Gene Ludwig thought that cash flows rather than market values should be used.