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VIEWPOINTS

2010 Will Be Tough, But Don't Despair



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Last year was not an easy year to be a banker. This one will not be a great deal better. But if banks take the right steps now, opportunities will emerge in the long run. There are indeed glimmers of light at the end of this dismal tunnel.

On the negative side, we have to be prepared for a year in which bank examinations will be tougher. The experience of the recent past has taught bank examiners to be even more skeptical than normal, and this will be reflected in more rigorous loan grading and portfolio analysis, tougher ratings and little tolerance for excuses when it comes to formal and informal orders.

Furthermore, the capital and liquidity

coverage bars are being raised. And, regardless of whether the Fed retains rule-writing authority for consumer compliance matters, banks should be prepared for increasingly onerous compliance rules and enforcement.

Of even greater concern should be the underlying economy. It may not be called a recession and the statistics nationally may even look better than expected, but on the ground, certainly in many parts of the U.S., 2010 will not feel like a recovery. Unemployment will stay stubbornly high, prices of real estate depressed and growth restrained as the consumer and many businesses save more and spend less.

So what should bankers do in this environment? And, why am I optimistic about the industry in the long run? Let me address each question in turn.

First, continue to make every effort you can now to clean up your balance sheet. Wherever possible, sell distressed loans, increase reserves and continue to raise capital. Yes, dilution can be troubling and selling loans below what we know they are worth hurts, but minimizing regulatory distress pays dividends. What's more, focusing less on work out and more on building business for the future gives you a head start vis-a-vis competitors, whether one builds through organic growth, the addition of displaced star talent, or the acquisition of failed institutions.

Over the next several years we will witness a wave of consolidation. The future belongs to the banks that emerge from this economic malaise in stronger financial shape.

Next, clear away all regulatory criticisms as quickly as possible. "Matters requiring attention" are ticking time bombs if not dealt with promptly. Prepare for your next examination, and consider self-imposing your own version of a memorandum of understanding or a cease-and-desist order in advance of anything dire happening.

And now is the time to spend on needed systems and technology and to take other steps to operate more efficiently and effectively in the months to come. Regulators will be willing to let you seize opportunities to only a limited extent if you do not have the systems to scale safely.

Even if you execute smoothly and jump these hurdles, life will still not be easy over the next couple of years. Banks benefit from having an economic wind at their backs, and for the next several quarters at best there will be a tepid breeze blowing in the right direction in some parts of the country and a gale force wind blowing the wrong way in other parts of the country.

Yet I remain optimistic, especially when looking out two to five years.

The plain fact of the matter is that you can run an economy without many manufacturing or service components, but you cannot run a modern economy without the banking system. The banking system must revive and prosper for the country to prosper.

In addition, the cleansing that is occurring will leave perhaps a bit smaller financial services pie, but with many less mouths to feed. We are at roughly 8,500 banks today. No

one knows for sure what the number will be when the current debacle is behind us, but I predict an industry in the mid-7,000s.

Finally, even great recessions do end. Certainly for a while this “recovery” will be different, but America will get back to work on new business activities, which will drive robust growth. And while competition from

abroad — particularly Asia — will exert real pressure, I have faith in the American system and doubts about the ability of autocratic nations to expand endlessly their influence in the financial sector.

The American private sector is materially more flexible and innovative than virtually any other in the world. And our democratic

institutions are more stable and resilient than other systems around the world.

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