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Joe Brannen
President and CEO, Georgia Bankers Association

Testimony to the Domestic Policy Subcommittee
of the
U.S. House Oversight and Government Reform Committee

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Atlanta Georgia

Good afternoon. My name is Joe Brannen and I am the president and CEO of the Georgia Bankers Association.

I want to thank Chairman Kucinich for scheduling this hearing in Atlanta and for inviting us to testify. We appreciate your interest in better understanding our industry and the ongoing effects of the difficult economy on our members, their customers and our communities. I'd also like to recognize and thank the other committee member, Congressman Lynn Westmoreland for his ongoing commitment to serving his constituents including many of our members in some of the hardest hit areas of our state.

The Georgia Bankers Association is comprised of 322 banks and thrifts that do business in Georgia. The vast majority of our members are smaller community banks and I want to spend most of my time today talking about how they and their customers are affected in the current economy and regulatory environment. Based on that membership and the insight they provide us about our industry, I'm going to briefly cover three areas that you've asked us to address.

First, I'll cover Georgia bank closures and our views of the reasons for those closures. Second, I'll address the factors our members are dealing with that affect credit availability for their customers. And, I'll conclude with some general ideas about how customers, bankers, regulators and policymakers can work in partnership for a stronger economic recovery.

Georgia Bank Closures

Perhaps the most visible consequence of the severe economic downturn nationally and in Georgia has been an increase in bank closures in Georgia. As of Oct. 29, 2009, 25 Georgia banks have been closed since 2008 out of 352 active banks at the beginning of that year. This is an unprecedented number for our state.

However, to put that in perspective, other states such as Nevada and Oregon have experienced a higher percentage of their banks closing than Georgia. And, the total assets of banks closed in each of five other states – Nevada, California, Alabama, Texas and Florida – exceed the total assets of banks closed in Georgia.[1]

The question you and many others ask is why have there been so many bank closures in Georgia?

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[1] See attached information compiled and supplied by the Georgia Department of Banking and Finance.

Bank performance mirrors the economy and conditions in the local communities they support. We are all painfully aware of how difficult the economy is nationally and especially here in Georgia. The detailed causes of each closure vary by bank, but in general the root cause of Georgia's high number of bank closures is the rapid, severe and prolonged trouble in the residential real estate market throughout Georgia.

Simply put, the banks were closed because their customers had trouble paying back their loans and private capital was not available to support the losses. And we recognize that few if any of those customers defaulted on their loans out of choice but rather because of unanticipated circumstances of their lives, the pressures of the economy, and the oftentimes artificial devaluation of real estate.

Keep in mind that these banks, and others throughout the state, were lending to support these small businesses that were building homes to meet the demand of a rapidly growing state. For example, it is estimated that the metro-Atlanta region alone averaged about 120,000 new residents a year – 10,000 a month – for the decade prior to 2008. All credible estimates leading up to last year showed that growth continuing for some time.

So, operating on well-defined, long-term historical data as well as reasonable estimates about future demand, builders, and the bankers that supported them through lending, continued to work toward meeting the housing demand of a growing population. Many of these banks and their residential construction customers were in areas of our state where first-time home buyers were the predominant market participants. Affordable houses were being built and because of readily available mortgages, the dream of homeownership became a reality.

However, our growth trend stopped on a dime last year as the economy seized and fewer than 25,000 people moved to the metro Atlanta area. Throughout 2008, housing sales and demand softened and then virtually came to halt in the summer and fall as mortgages of all types became much more difficult for homebuyers to get, the secondary mortgage markets evaporated, and our state unemployment numbers skyrocketed. The general lending and development cycle for new housing is between 18 months and two years, so there were many hundreds of projects underway when these markets stopped functioning.

These broad economic factors, the concentration of residential construction lending, borrowers unable to meet their obligations, and private capital sitting on the sidelines caused these banks to close.

These closures have been community banks supporting high-growth suburban areas as well as urban neighborhoods. One of our early closures was a bank that focused solely on financing the rehabilitation of homes in blighted inner-city neighborhoods. That business model became unsustainable for the same economic reasons that affected all other banks heavily invested in supporting residential real estate.

While the business models of some of our banks and their customers can be questioned, we also believe that aggressive interpretation of certain regulatory policies and accounting rules has contributed to the closures. Unless these policies are modified, we will see continued stress among borrowers and the bankers that finance them. We have some recommended solutions toward the end of our statement.

You also asked us to address commercial real estate other than residential. While we are seeing growing signs of stress in that market, it is simply too early to make any reasonable predictions on how difficult that segment of the market will become. Clearly those commercial projects that were being built to support the growth of residential housing have been more immediately affected by the crisis. However, because many of these commercial projects have ongoing sources of revenue such as rents to support their loans, we are hopeful that the economy's effect on this sector will be less dramatic.

While the Georgia Bankers Association does not and will not make predictions about whether there may be more bank closures in Georgia, clearly the economic environment remains difficult. We believe that the economy, coupled with certain government and regulatory policy actions I'll discuss more in a few minutes will continue to cause financial stress on a number of banks in Georgia.

That is the summary version of the climate and causes of bank closures in Georgia.

Credit Availability

I'll turn now to the issue of credit availability for small businesses and how the economy continues to affect our members' ability to provide funding for growth in their communities.

I'll start with a reminder that most of Georgia's banks are small businesses, too. Most employ fewer than 50 people, and those employees live, work and raise their families in Georgia cities and towns. So, the people that open the doors every day at our member institutions have a personal, vested interest in the success and growth of businesses in their hometowns.

Banks are in the business of making loans to creditworthy borrowers. That's how they serve our communities, make profits and provide value for our shareholders. I hope to demonstrate to you today how the economic and regulatory environments have banks between a rock and a hard place when it comes to making more credit available to small businesses.

Here's what the most current statistics say about loans in Georgia. Despite some headlines to the contrary, banks are attempting to make loans to borrowers with good credit, low levels of debt and verifiable sources of income and repayment ability. Based on the most current consolidated information from the FDIC through the end of the second quarter, Georgia banks had over $211 billion in total loans and leases. That is down, but only slightly from year-end 2008, by about 1.7 percent.

One reason for that decline is that loan demand is down as more people are saving more to pay off debt and companies have put off expansions or additions to inventories.

However, as I mentioned, banks only do as well as do the communities they serve. So, because of the continued economic weakness, we know that credit is not as easily available as it was in the recent past. There are several reasons why.

Banks are carefully balancing the need to lend more and avoid making more loans that might not be paid back because of the economy. In a recent national survey of lenders, more than 70 percent cited the poor economy as the number-one reason for conservative underwriting. What are they basing that caution on?

First there's the more than 10 percent Georgia unemployment rate and the nearly 10 percent national unemployment rate. Business bankruptcies and loan delinquencies also continue to rise.

According to recent statistics from the American Bankers Association[2], nationally, business bankruptcies have risen from 28,000 in 2007 to more than 43,000 at the end of 2008. Those trends have continued into this year with 30,000

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[2] Sept. 23, 2009, testimony of Austin L. Roberts, III On Behalf of the American Bankers Association before the Committee on Small Business, United States House of Representatives

business failures already. Home equity loan delinquencies rose from 3.5 percent to 4.0 percent. Personal loan delinquencies rose from 3.5 percent to 3.9 percent. Property improvement loan delinquencies rose from 1.5 percent to 1.8 percent.

We're seeing those national trends play out locally, too. For example, through September there were 23,245 Chapter 7 bankruptcy filings in North Georgia. That number is already 12.5 percent higher than full-year 2008 figures and 56 percent higher than the similar nine-month reporting period from a year ago, according to new data released last week by the U.S. Bankruptcy Court, Northern District of Georgia.

So, the ongoing challenge in this environment for both a borrower and a bank is to be as certain as possible that a person or business can repay a loan, and that just takes a lot of I-dotting and T-crossing in this economy.

It may not seem like it sometimes, especially if you are a borrower, but the reality is a loan decision starts from the point of view that the bank wants to ensure that a borrower isn't taking on more risk than his or her family or business can reasonably support. That's protection for the borrower and good underwriting for the bank.

Alongside the broad economic constraints affecting credit availability, many of our member banks simply are struggling to maintain adequate regulatory capital levels because of ongoing and rising numbers of troubled loans that are a direct result of the poor economy.

Regulators rightly require banks to maintain strong capital levels to cushion the blow of losses from bad loans. However, to keep those capital levels high, banks often can't deploy that capital to provide funding for additional credit to small business and other borrowers as they must use that capital to account for current and projected future loan losses.

And, unfortunately, the economy has also led to an estimated one-third of Georgia banks being subject to regulatory enforcement orders. These orders trigger a number of punitive measures such as restricting their emergency borrowing from the Federal Reserve, getting advances from the Federal Home Loan Bank, drawing down their credit lines from correspondent banks, or requiring the banks to shed low-cost brokered deposits.

In a state with already insufficient local deposits and private capital to internally fund economic expansion and lending, the rapid reduction or elimination of these funding sources is causing a severe constriction of credit. For example, in this climate economic problems tend to be geographically located in areas that experienced high growth and expansion. Because of the widespread economic distress, all banks in those regions are experiencing similar types and levels of problems. When regulators sweep in and apply funding and lending restrictions, it constricts credit for the entire geographic area. This has a deflationary and domino effect on property values.

In addition, these regulatory orders also have the result of restricting lending in other ways, too. Based on federal guidelines, a bank under a regulatory enforcement order is often told to reduce its concentration of real estate related loans. This is problematic because many of the small businesses our members have traditionally provided credit to are directly related to the real estate development and building sector.

So, while the regulatory order may not specifically say not to make new real estate loans, the only ways the bank can satisfy the order is to either not renew existing loans or ask for early repayment of the loans already on their books. Neither option is usually in the best interest of the bank's customers.

Another option is for the bank to sell the underlying note for the loan. But again, the bank is already working with the customer and it would seem to be in everyone's best interests to allow those relationships to remain in place. While we understand the concern with over-concentration in any one sector, it is extremely difficult to rapidly change that mix of loans in a troubled economy.

In a related issue, these same regulatory enforcement orders also restrict banks from extending or sometimes even renewing credit to borrowers who have other loans that are considered troubled or delinquent. On the one hand, banks are being asked to work with their borrowers to help them get through the difficult environment, but many of the regulatory orders simply make that practically impossible. The inability to work with a struggling business leads to premature business bankruptcy, closure and higher unemployment.

These are simplified examples, and each bank and borrower would have more complex and detailed issues, but they do illustrate just how difficult the environment is for our banks and a large number of the borrowers we've traditionally financed.

Compounding the credit availability issue are other regulatory and market forces that we believe continue to depress the value of borrowers' property and collateral. These issues include:

- Regulatory interpretations of accounting guidelines/FASB 114/5; fair value of real estate. The major ongoing concerns and frustration banks are having with regulators, are related to how regulators are interpreting the rules that apply to how much capital banks should be required to reserve for losses or potential losses against those assets. These interpretations are causing banks to use real capital for theoretical real estate losses, putting further stress on bank capital levels. For example, a bank may be required to write down the value of a property that could reasonably be well worth $1 million a year from now, but today is appraised for $500,000. The bank must show that difference as a loss, even if it intends to hold that property for some time. At the same time, banks are required to reserve more for theoretical losses, regulations also restrict the amount of that reserve that can be counted toward meeting regulatory capital guidelines to 1.25 percent. This is a classic and understandable over-reaction to economic down cycles. If we look back in history, we always swing that regulatory pendulum too far and force the build-up of excessive loan loss reserves at the bottom of a cycle, and then we ride those excessive reserves out for several years into the future, clearly indicating that we over-did it again.

- Downward pressure on asset prices caused by market forces and unintended consequences of government stability programs. The effects of overly aggressive discounting hurt borrowers when the value of their real estate pledged collateral is temporarily devalued, and also results in their struggling to meet either loan covenants requiring specific levels of collateral or selling properties at these lower values to repay or pay down loans. Banks are also being required to write down their real estate portfolios to these new values, which are unnecessary hits to capital. With market forces as well as government programs and actions, even well-intended ones, driving asset prices and valuations downward this steeply and this quickly, our fear is that there is not enough capital in the marketplace to sustain many banks located in the most troubled geographic areas. If we are to assume current values are permanent, there is not enough bank capital to sustain the industry nationally.

- Difficulty of obtaining reasonable and consistent property appraisals continues to put downward pressure on property and collateral values. Obtaining good appraisals in the current market is extremely difficult. Because the real estate market is so weak, appraisal assumptions sometimes do not realistically reflect absorption periods that take into account the naturally increasing demand as the economy recovers. This is especially true for vacant lots as their values will improve once today's excess inventory of homes and lots is absorbed. Regardless of the type of property being appraised in this environment, the result is appraised values seem unreasonably low when considering more realistic sales and absorption periods.

- On October 1, 2009, amendments to Regulation Z, the Truth in Lending Act, became effective that address consumer protections for certain mortgage and home-equity loans. Intended to prevent unscrupulous subprime lending, parts of the new regulation apply to all loans secured by a consumer's principal residence. An unintended consequence of these new rules is that the loans covered by the definition of "higher-priced loans" are some home purchase loans, home-improvement loans, refinancings and home equity loans that had previously been considered by our members as prime loans. For most community banks, these are bread and butter mortgage loans made by community banks to customers who simply don't qualify for loans eligible for sale in the secondary market. These are not the negative-amortization, option-payment, short-term-teaser-rate, investment-grade loans traded by investors and Wall Street investment banks that have been so problematic throughout the recent financial crisis. These are three- or five-year balloon loans with an intended 15-20 year amortization. These are mortgages that are conservatively underwritten and the vast majority of our banks' customers never miss a payment. The purpose of the three-year term was to provide consumers with certain tax savings. With the new guidelines, these low-cost, in-house home mortgages have become impossible for many banks to make. Under the new requirements, underwriting for this type of mortgage must show that the borrower can repay the loan in full within three years as opposed to the intended 15-20 year period. The result is that the new provisions actually make reasonable mortgage credit less available for consumers in markets throughout Georgia where there are few options. In many cases, the costs and compliance risk associated with the new rules are causing many banks to simply stop making these types of mortgage loans available.

- We also understand that the Home Valuation Code of Conduct deployed in May 2009 by Freddie Mac and Fannie Mae is causing concern from banks and appraisers related to valuations. With its implementation, banks are more frequently using Appraiser Management Companies to order appraisals. The concern is that while the intent is to ensure fair and accurate independent appraisals, it may be having the unintended consequence that non-local appraisers are sometimes being assigned to do work when they aren't as familiar with local markets. Work is often awarded simply to the low-cost provider, which also affects appraisal accuracy. These appraisers have more difficulty in determining appropriate valuations because of their lack of local market knowledge and history, creating valuation disruption in the lending process.

Ideas and possible solutions

So, that's a broad overview of the environment for our banks and borrowers. Unfortunately, there are no easy fixes for these issues. As with any recovery from widespread economic stress, the key elements necessary are generally time for the economy as a whole to recover and flexibility from all parties involved.

However, we've identified several ideas and solutions we believe would strengthen our marketplace, keep more people in their jobs, more companies in business, and prevent more banks from being closed.

- Protect real estate values
    - Encourage more flexibility and less drastic interpretation of fair-value guidance and property valuations.

- Conserve and replenish bank capital
    - Allow a higher percentage of loan loss reserves to be counted as regulatory capital. There is an artificial cap of no more than 1.25% of a bank's loan loss reserve to be counted as Tier 2 capital. This capital is already on the banks' balance sheets, so allowing this as regulatory capital would

not create any further risk to the bank or the FDIC fund. Of the 324 Georgia banks in operation as of June 30, seventy percent (226) of all Georgia banks were adversely affected by the restriction.
- Eliminate restrictions and barriers to private capital investment in the banking industry.
- Give serious consideration to responsible implementation of the Treasury's recent proposal for providing specific capital investments in viable community canks with less than $1 billion in assets.
- Encourage the FDIC to consider longer-term alternatives to replenish the Deposit Insurance Fund than continuing to levy immediate and short-term assessments on banks. This can be done through borrowing from the banks or by utilizing the emergency borrowing authority from Treasury.
- Enact legislation to lengthen the net-operating-loss carryback provision from two to five years for all banks

- Take other key steps to stabilize banks
  - Postpone a new FDIC regulation scheduled to go into effect Jan. 1, 2010, that requires banks that are less than well capitalized to use an FDIC national deposit product rate cap to set their rates. In many Georgia markets, the local rate is well above what will be the allowable national rate cap. If these banks cannot offer a responsible, local market rate, it will be difficult for them to keep their current depositors, much less attract new business.
  - Provide certain banks time and flexibility for reducing brokered deposits and allow them to renew at least a percentage of brokered deposits that are already on their books. Merely allowing banks to maintain their existing wholesale funding base would substantially increase the funding available for loans in Georgia.

- Support policy and regulatory actions that enable lending
  - Look for flexible or reasonable methods to slow the pace of federal regulatory enforcement actions that trigger lending restrictions on banks.
  - Re-examine Regulation Z "high-priced" loan categories that have resulted in less credit being available to many customers of traditional banks.

Working in partnership, we believe that banks, regulators and policymakers can use these ideas and solutions to speed economic recovery and market stability.

In Conclusion

Georgia's highly-regulated banking industry has been a key foundation for the growth and success our communities have enjoyed before the current recession. And, there is no argument that the past two years have been difficult for all Georgians, our businesses and our banks.

There's work to be done from all quarters to help get our economy back on track, and I assure you that the Georgia Bankers Association and our members are fully committed to working in cooperation with borrowers, businesses, regulators and policymakers to ensure that happens as quickly as possible.

Thank you again for having me today.

Comparison of Number of Failure Transactions to Number of Banks

State	# of Failures *	# of Total Banks	% of Total Banks
Nevada	6	44	13.6%
Oregon	3	40	7.5%
Georgia	**25**	**352**	**7.1%**
Idaho	1	19	5.3%
Arizona	3	57	5.3%
California	15	313	4.8%
Washington	3	97	3.1%
Utah	2	68	2.9%
Florida	9	317	2.8%
Illinois	17	671	2.5%
Wyoming	1	43	2.3%
Colorado	3	159	1.9%
Michigan	3	164	1.8%
New Jersey	2	125	1.6%
West Virginia	1	68	1.5%
Alabama	2	160	1.3%
Minnesota	5	430	1.2%
Missouri	4	350	1.1%
South Dakota	1	89	1.1%
Maryland	1	97	1.0%

** Indicates the number of failure transactions since 2008 to date.*

NOTE: Only includes States whose # of Failures as a % of Total Banks is greater than 1%.

States with Assistance Transactions Comparison to Number of Banks

State	# of Assist *	# of Total Banks	% of Total Banks
Delaware	1	33	3.0%
Nevada	1	44	2.3%
California	1	313	0.3%
South Dakota	2	89	2.2%

** Indicates the number of assistance transactions since 2008 to date. Includes institutions where assistance was provided under a systemic risk determination.*

Top 10 States with the Largest Amount of Assets for Bank Failure Transactions

(in millions)

State	#	Total Assets	Total Deposits
Nevada	6	314,264,924	194,800,387
California	15	58,808,292	40,504,131
Alabama	2	26,041,698	20,559,469
Texas	4	18,718,548	15,829,247
Florida	9	15,935,347	10,370,229
Georgia	25	15,029,088	13,123,428
Illinois	17	12,518,086	12,123,805
Indiana	1	2,839,747	2,254,025
Colorado	3	2,175,626	1,795,612
Arkansas	1	1,895,545	1,815,691

** Indicates the number of failure transactions since 2008 to date.*

Total Assets and Deposits of States with Bank Assistance Transactions

(in millions)

State	#	Total Assets	Total Deposits
Nevada	1	1,207,007,000	230,042,000
South Dakota	2	78,112,860	42,657,867
Delaware	1	19,599,414	7,231,013

** Indicates the number of assistance transactions since 2008 to date.*