Bauerle's Bank Notes

Motown

August 18, 2014

Thomas Storrs, the 1970's-era CEO of North Carolina National Bank, helped forge the Southeastern United States' economic miracle by getting state legislatures there to enact the Southern Regional Banking Compact. The law prohibited banks headquartered in those states from being acquired by any bank that wasn't. Storrs aimed this act of legal protectionism against Northeast, Midwest and Texas banks, which at that time could consume as an appetizer any Southeastern bank. He thereby fueled banking and business prosperity for a generation throughout the heart of Dixie.

The banking landscape Storrs feared exists today in Detroit. Not one commercial bank is based in Detroit Metro, as residents call the city and its suburbs. The National Bank of Detroit sold to today's JPMorgan Chase. Comerica moved to Dallas. JP, Comerica and regional banks like Huntington and PNC have operations in Detroit Metro. Yet Comerica's loans in Michigan are half the level of a decade ago. Of the top dozen banks in Michigan, measured by deposits, only two are based there. Flagstar Bank, a thrift institution, serves consumers not businesses. Chemical Bank is centered in Western Michigan, oriented toward Chicago more than Detroit. Detroit's social and economic problems are legion. Civic and business leaders have turned a blind eye or blamed one another, leading to public cynicism and indifference. Contrast Thomas Storrs.

Why does this matter to non-Michiganders? Aren't banks innocent bystanders or, in some cases, victims? As Storrs preached, strong banks make for strong communities and vice versa. Because our nation's employment base continues to migrate away from manufacturing, we must have regional banks that actively cultivate new centers of strength in local economies. Such banks and their leaders don't rise from the mist like Brigadoon. They must be nurtured. For its part, in my opinion, the federal government needs to do more to encourage, and reward, private equity investment in regional banks for just this reason.

Despite the worst banking crisis since the Great Depression, the Federal Reserve

System has kept the door to private equity investment in the banking industry not just shut, but padlocked with concrete poured over the portal. In 2009, the Fed relaxed a bit the legal definition of bank holding company and the OCC allowed "shelf-registration" issuance of national bank charters to enable acquisition of distressed banks. Since the crisis passed, however, the Fed has renewed its restrictive approach, including by taking the position that 5% or greater ownership of three or more banks creates a legal presumption of bank holding company status. That status is anathema to passive equity investors, since being a bank holding company subjects the investor to regulation by the Fed, the costs and other burdens of which are significant. This is bad policy: bad for banks, bad for business and bad for America.

Important economic benefits can accrue to our economy if *patient, disciplined and appropriate amounts of* private equity are invested in U.S. banks. Regulators are eager to see banks possess larger capital cushions to better absorb credit losses. Yet the fragile economic recovery and foreign banks' low capital requirements have so far impeded action to raise U.S. bank capital requirements. Meanwhile, regulators ignore the potential benefits of private equity capital, fearing it will be "hot" money served up by quick-buck artists. The concern has merit. The better response for the Fed, however, is not to reject the idea, but to frame investment requirements that reward sound behaviors.

As with the unfairly derided TARP program of 2008-09, which saved the U.S. banking system from a crisis of far greater severity, incentives can be built so patient and constructively deployed capital earns an appropriate, risk-correlated return. The cost will be dwarfed by the benefits to regional economies. Economic development professionals have reams of empirical evidence showing that government transfer payments following business failures greatly exceed the financial investment required to rehabilitate slightly or moderately broken businesses. Banks, businesses and government have a symbiotic relationship. Without mutual aid, none of them can prosper. Thomas Storrs' regional compact proved it.

Michigan banking history also validates the thesis. In February 1933, the Hoover Administration lobbied Henry Ford to subordinate repayment of $7.5 million in deposits Ford held at Detroit's Guardian Trust Company to $23 million the federal Reconstruction Finance Corporation was prepared to lend to Guardian Trust to avert its insolvency.[i] U.S. Commerce Secretary Roy Chapin, himself an auto executive before his government service, met Ford and his son, Edsel, in Dearborn on Monday, Feb. 13 (a legal holiday), to explain the domino effect Ford's refusal would have on the banking system and the economy. Ford rejected the government's proposal, saying it was the work of his enemies. He vowed to withdraw $25 million of the $50 million he had on deposit in Guardian National Bank of Commerce, which he controlled, and First National Bank of Detroit, the city's other leading bank. This act would doom both institutions, Chapin said. Ford expressed indifference, as he disdained banks, bankers, lawyers and accountants.

When it became clear Ford would not relent, the Acting Comptroller of the Currency decided that neither Guardian nor First National would open for business the following day. Ford could not be permitted to beat other depositors to the withdrawal window. Prompted by the Acting Comptroller, Michigan's governor declared an eight day, state-wide bank holiday at 1:00 a.m. Feb. 14. Thus began the nationwide cascade of bank failures, including the Guardian institutions Ford controlled and First National. Twenty days later, newly inaugurated President Roosevelt declared the national bank holiday that America's Greatest Generation never forgot.

Within the month, the U.S. Treasury Department and General Motors jointly capitalized The National Bank of Detroit in an investment partnership that continued through WW II. Chrysler Corporation and General Electric immediately placed large deposits in NBD as a public display of confidence. On the verge of being the odd man out with no Detroit bank available to meet his company's needs, Ford came to his senses. Eighty-one years ago this month, Edsel Ford capitalized Manufacturers National Bank of Detroit with $3 million. Even the new bank's name, Manufacturers, reflected Henry's egotism. Since Congress did not enact the Bank Holding Company Act until 1956, neither GM nor Ford Motor Co. was regulated by the Fed as a bank holding company while they and the U.S. government built the two banks that enabled Detroit's first renaissance.

Who says history is not worth repeating? All of Metro Detroit needs it to do so, and right away. Perhaps the rest of us could benefit too.

---

[i] F. Awalt, Recollections of the Banking Crisis of 1933, 43 BUSINESS HISTORY REVIEW 348 (1969), available at http://fraser.stlouisfed.org/docs/meltzer/awarec69.pdf. Awalt was Acting Comptroller of the Currency in 1932-33. The Hoover Administration conceived the purchase by the U.S. Treasury Department of preferred stock in banks that needed additional capital. This precedent must have been known when Treasury chose to purchase preferred stock in banks in 2008-09 rather than buy troubled assets as Congress authorized Treasury to do in the Emergency Economic Stabilization Act of 2008.

James F. Bauerle
Keevican Weiss Bauerle & Hirsch LLC
11th Floor, Federated Investors Tower
1001 Liberty Avenue
Pittsburgh, PA 15222-3725
phone - 412-355-2605
fax - 412-355-2609
email - jbauerle@kwbhlaw.com