

Viewpoint: The Trouble with Section 405

American Banker ■ Friday, May 26, 2006

By Charles J Thayer

The Financial Services Regulatory Relief Act, which passed the House in March and is now being considered by the Senate, contains a provision that is not in the best interests of the banking agencies and would neither improve the banking system's health nor protect the deposit insurance fund.

Section 405 of the House bill (HR 3505) would give banking agencies the authority to enforce agreements obligating bank directors, investors, and others affiliated with a bank to provide financial guarantees with unlimited liability.

The banking agencies already have the power to deny new charters, mergers, or acquisitions that they believe are not financially sound. A regulatory requirement to impose personal guarantees in selected situations simply provides an additional but unnecessary tool to prohibit unsound transactions.

What's more likely is that this new authority would be used after a bank has gotten into trouble. However, it is doubtful that directors or officers in that type of situation would be willing to sign such an agreement and take on unlimited personal liability.

It's far more likely that board members and officers alike will elect to resign if such a demand is made by a banking agency. As a result, the people who may have contributed to the institution's problems will not be subject to the proposed new legislation.

Without question, the legislation could provide an effective tool if the banking agencies wish to force resignations. However, the banking agencies already have vast powers to take affirmative action to correct deficiencies.

On the other hand, a troubled bank frequently needs to attract new board members, new management, and new investment to save it from failure. That is bad enough in the best of circumstances and would be impossible if they are required to assume unlimited liability.

Even if the requirement of unlimited liability were "waived" initially, the potential for such an agreement will certainly discourage new people and new investors from helping a troubled bank.

Section 405 is an interesting concept that would have unintended and undesirable consequences. The banking agencies would be wise to reconsider their support and request that this provision be withdrawn from any final legislation.

All financial institutions have a vested interest in sound legislation and regulation by the banking agencies. As a member of the American Association of Bank Directors' advisory board, I am pleased the group has taken a position opposing Section 405. I encourage you to contact the association, your senators, representatives, and regulators if you believe Section 405 should be withdrawn from HR 3505.

Mr. Thayer is the managing director of Chartwell Capital Ltd. of Fort Lauderdale, Fla., a private investment banking firm that specializes in advisory services to banks, corporations, and institutional investment clients. He was a director of Republic Bank in St. Petersburg, Fla., which BB&T Corp. bought.

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