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Huge Gains for Small Banks In Public Eye and Washington

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WASHINGTON - For many years, community banks have seen their political influence and interests generally take a backseat to their larger competitors, but 2009 was the year that changed.

As large banks continue to be derided in the court of public opinion, community bankers have emerged as a more potent political force. They won a crucial exemption from a House regulatory reform bill and are expected to have a significantimpact on the Senate debate.

Community bankers have been praised by lawmakers and President Obama, who branded executives at larger institutions "fat cats," and championed by the Huffington Post, which recently began a viral campaign encouraging consumers to close accounts at large banks and move their deposits to smaller institutions.

"It's been a good year, because it's been the first time in my banking career that Congress and the public have been able to truly differentiate between real community banks and megabanks," said Mike Menzies, president of the $159 million-asset Easton Bank and Trust in Maryland and chairman of the Independent Community Bankers of America.

Community bank popularity links to several factors including a perception that they did not engage in the types of lending that caused the crisis and they were not the primary recipients of government bailouts. The business also maintains a strong grassroots network designed to influence lawmakers.

Community banks' rise in stature has benefited the ICBA, whose political influence has grownmarkedly during the past year. The trade group was the force behind a House amendment that exempted banks with assets of less than $10 billion from primary enforcement by a new Consumer Financial Protection Agency. After that amendment passed, the ICBA was one of the only financial trade groups to support the House reform effort.

Cam Fine, the ICBA's president, said the exemption is a victory for smaller banks. Though they would still be subject to new rules by the proposed consumer protectionagency, those standards would be enforced by the existing banking regulators.

"To get an exemption from having yet another examination force that all they would be doing is enforcing the laws on the books in addition to what the prudential regulators are enforcing was a huge get for community banks," Fine said.

"They will remain under their prudential regulator. That's a huge comfort."

Others in the banking industry complain the exemption does not go far enough, arguing that the new rules, regardless of who enforces them, will be enough of a headache.

"There are still going to be real burdens on community banks," said Diane Casey-Landry, the chief operating officer of the American Bankers Association, which opposed the House bill. "By identifying community banks as the white hat, I think they [lawmakers] are trying to mute the opposition of the CFPA, and they are not going to be successful."

Still, most observers see the exemption as a coup for small banks.

"I think that's a big win, because I think it's important to have the people who examine you think about the implementation of these rules in practice," said John Douglas, a partner at Davis Polk & Wardwell and a former FDIC general counsel.

Community banks are poised to score other victories in the Senate. In his original bill, Senate Banking Committee Chairman Chris Dodd called for consolidating all bank supervision into a single agency, an idea strongly opposed by community bankers who feel the new structure would marginalize them.

That resistance played a role in Dodd's decision to revise his bill. The Connecticut Democrat has not unveiled his new plan yet, but sources expect he will propose keeping the Federal Deposit Insurance Corp. as the federal supervisor for all state-chartered banks, a key demand of community bankers.

The ICBA and other bank lobbyists were also instrumental in helping the industry defeat a measure that would have allowed judges to rework mortgages in the bankruptcy process.

Community banks' influence has grown as the lobbying power of larger banks has waned. The House regulatory reform bill included a litany of provisions that the largest institutions railed against, including tougher derivatives rules and changing how deposit insurance premiums were calculated.

Many observers said small banks' increased clout reflects the perception that they did not cause the crisis.

As Obama put it after he met with a group of community bankers at the White House on Dec. 22: "I think it's fair to say that most of these community banks were not engaged in some of the hugely risky activities that helped to precipitate the financial crisis. At the same time, they continue to try to do their best in their local and regional markets to make sure that businesses that are now being affected by the overall recession are able to pick themselves back up."

Congressional leaders started making that point last summer.

"The community banks were not the ones who did subprime mortgages; they are not the ones who did credit card abuses," House Financial Services Committee Chairman Barney Frank said in a July 27 speech.

Fine said the "crisis highlighted the difference between community banks and mega Wall Street firms, so that created a bright line...and I think that has enhanced the community banking" brand.

"I think community banks will emerge from this crisis and congressional reform efforts even stronger than they came into the crisis," he said.

The sentiment fueled an effort by Ariana Huffington, co-founder of the Huffington Post, to encourage consumers to switch their deposits to local banks. A promotional video has been viewed nearly 300,000 times on YouTube and attracted nearly 7,000 fans on Facebook. The "Move Your Money" campaign attempts to portray community bankers as George Bailey, Jimmy Stewart's character in "It's a Wonderful Life," and large banks as the evil, scheming Mr. Potter.

"It's easier to sell George Bailey than Mr. Potter," said Kip Weissman, a partner at Luse Gorman. The crisis "gave an opportunity for small community banks to take a higher profile."

Community banks also received less capital from the deeply unpopular Troubled Asset Relief Program. While 661 of the 701 institutions that received money from the program had assets of $10 billion or less, they collectively received $25 billion, compared with $180 billion given to larger institutions.

Large banks also benefited heavily from the FDIC's Temporary Liquidity Guarantee program, which provided a government guarantee to bank debt. Thirty-seven banks with assets of $10 billion or less have approximately $1.6 billion of TLGP debt outstanding, while 20 larger banks have roughly $57 billion of TLGP debt outstanding.

"My impression is they didn't get as deeply subsidized," said Mark Calabria, director of financial regulations studies at the **Cato Institute** and a former Republican Senate aide. "I don't know of any community bank where the federal government owns 80%. They have been very good at playing up that they haven't been bailed out, and there is an argument for that."

Small banks have also reaped dividends from their grassroots efforts. House Financial Services Committee Chairman Barney Frank was forced to exempt small banks from the CFPA after Democratic lawmakers began hearing from bankers in their district.

"I've always thought they had a tremendous amount of pull and couldn't be underestimated even before this," Calabria said. "In the banking committees, a lot of the members on the fence were from areas of the country where community banks play a much more dominant role. And the community banks' reputation has not been tarnished."

Lawmakers, and the public at large, generally profess to look askance at banks while regarding their own banker more warmly.

"It's sort of like Congress: People don't like the institution of Congress, but they like their congressman," said Lawrence Kaplan, a partner at Paul, Hastings, Janofsky & Walker LLP. "Community banks, they have a good image, because people like their banker. These are the same people you are going to see every day in church. They are not an anonymous name behind a letter."

That image could take a hit in 2010. Commercial real estate loan delinquencies are increasing and could be a large problem for small banks this year. Of the $1.9 trillion in CRE loans, community banks hold $890 billion, according to FDIC data.

"For community banks, this is the tsunami that is going to hit them," Kaplan said. "2010 is going to be the year for community banks."

Menzies defended the industry's concentration in CRE. He said community banks' CRE loans are typically transaction-based, owner-occupied and less leveraged than large banks'. They are positioned to weather CRE problems, he said.

"We know these people as borrowers, and there is a big difference between that and some syndicated real estate loan sold off to a large bank," Menzies said.

For now, community bankers' positive public image looks secure.

"Congress and others need there to be villains and they need there to be heroes," Weissman said. "It was very clear who the villains were in 2009... so the community bankers were the handy heroes and largely they deserved the kudos."

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