BANKTHINK INFORMED OPINION

Blocking Newcomers Is Bad for Banking

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Last week's *American Banker* included an article by Richard J. Parsons warning of the dangers of de novo banks and the lack of adequate talent in the industry. The article essentially argues for elevated barriers to entry and for bankers to "protect themselves" from the "severe talent shortage" and excess competition by opposing de novo bank formation. One can only hope that this protectionist approach, which sometimes seems pervasive, will be rejected as the industry and the economy recover and a more fertile environment for bank formation takes hold.

It is no secret that de novo banks face an uphill battle in establishing their franchises. Small businesses in any industry often exhibit higher failure rates, and banking is no exception. Recognizing the role that banks play in maintaining public trust, there are already special requirements for de novo banks that extend several years. At the same time, the de novo analysis is somewhat misleading. After all, some of the nation's largest banks, with assets dwarfing all the de novos by far, may well have failed had they not been provided significant government assistance. Let's not lose sight of the forest for the trees.

New entrants in any industry ensure competition, spur new product development and drive enhanced customer service. Pressure from new participants is uniformly associated with any healthy industry. Show me an industry with artificially high barriers to entry, and you will almost certainly find dissatisfied customers paying higher prices to large, protected providers.

As Maryland's banking commissioner, I have seen banks fail, and I have seen de novo banks succeed. Some of our younger banks are also among our most vibrant and well managed. These institutions play a key role in sustaining our community banking system which, in turn, remains a critical lending resource, particularly for small business. "Protecting" bankers through excessive de novo restrictions will only impede competition – hardly a desirable outcome given the recent warning by Richard Fisher of the Federal Reserve Bank of Dallas that our nation's twelve largest institutions control 70% of banking assets.

Parsons points to professional sports to support his argument, noting that NFL expansion teams lose 80% of their games in their first three years. As a Baltimorean, I draw a far darker lesson from our NFL history, one which points directly to the problems of consolidation rather than the benefits of limited competition.

In 1984, my community watched as Colts owner Robert Irsay moved the team to Indianapolis on a dark, snowy night while the NFL leadership did nothing. When Baltimore submitted its "de novo application" in an expansion competition roughly a decade later, the NFL and its owners followed Parsons' prescription to the letter. They "protected themselves" by selecting southeastern cities, Jacksonville and Charlotte, for expansion largely to avoid competition between Baltimore and Washington. Ultimately, Baltimore football fans were served not by a de novo franchise, but by the Browns vacating Cleveland in 1996 to become the Ravens.

As a fan of the 2013 Super Bowl champs and a season ticketholder, I'm a happy customer served by a great organization that is an asset to the community. But even the most diehard football fan can see serious structural issues. While the league has enjoyed anti-trust protection and a small group of owners and players reap millions of dollars, fans face sky-high prices, repeated demands for public subsidy in stadium packages and strictly limited product availability. Viewed through that lens, professional football should serve as a warning regarding the dangers of consolidation in financial services, rather than a source of policy guidance.

Ultimately, de novo demand is driven by fundamental business opportunities, and the current economic and interest rate environments do not invite de novo formation. At the same time, drawing the conclusion that we should be happy about that because we don't have enough smart people to run or supervise de novo community banks is neither warranted nor productive.

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