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Regulators Urged to Encourage, Not Thwart, Private Equity Investment

BY JOSEPH A. SMITH, JR.

Recent remarks and reports from federal financial regulators indicate the banking industry is showing signs of recovery from the financial crisis and resulting economic slump.

For instance, at a field hearing conducted by the Subcommittee on Financial Institutions and Consumer Credit of the House Financial Services Committee last week, Kevin Bertsch, the Fed's Associate Director of Banking Supervision and Regulation, testified that ''In recent quarters, earnings for community banks have improved notably, and asset quality has largely stabilized and begun to improve.''

The FDIC's Quarterly Banking Profile released this week also shows progress, reporting that insured depository institutions earned an aggregated profit of $28.8 billion in the second quarter of 2011, a $7.9 billion improvement from a year before. Also, the number of institutions on the FDIC's ''Problem List'' fell for the first time since 2006, and the rate of bank failures for 2011 is down from 2010.

As a bank regulator, I am heartened by this good news. However, we must do more to ensure a stable and productive banking system. Recent market volatility has proven that our economy and financial system remains vulnerable. Further, for many of our country's community and regional banks, strengthening of balance sheets and restructuring of loan books is ongoing and necessary. This healing process requires significant capital infusions for these banks. Given this need, our supervisory policies and approaches should encourage capital investment in our banks.

One form this investment can take is through government programs, such as the Small Business Lending Fund. To date, $7.6 million of new capital has been provided to a North Carolina bank. Compared to the trillions of dollars the federal government has provided to the nation's largest banks, this may seem like a pittance. Outside of the Beltway, however, this is considered real money and has a tremendous impact upon the institutions I supervise.

More significantly, private equity investment is a crucial source of needed capital. Private equity firms have shown an interest in investing in banks, sometimes through the FDIC resolution process, but often in healthy banks. Unfortunately, their regulatory applications are often subjected to a cumbersome, slow, and even insulting process by federal regulatory agencies that can best be compared to death by a thousand cuts. Concerns about the influence of private equity firms on the risk profile of the banks in which they invest can and should be addressed, but in an expeditious way that recognizes potential benefits as well as risks.

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Private equity investment can aid the repair and restructuring of the banking industry. If the recent past has taught us anything, it is that capital moves at lightning speed to places where it is welcome. Potential investment that is here today may be gone tomorrow. If we put our minds to it, we can attract needed investment without undue risk.

My argument is not to prop up distressed banks or to keep ''zombie banks'' alive to the peril of competitors and the market. Instead, I am arguing for a change in policy to reduce the number of failures and facilitate a restructuring of the industry based upon private investment and enhanced market discipline. Fortunately, capital is available to finance this process now. I am concerned, however, that the optimistic shoots of growth we are currently seeing may lead to further delay or hindering of investment, which would result in a wasted opportunity to further heal our banks and spur economic development and job creation.

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