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Viewpoint: Trust-Preferreds Measure Would Crush Community Banks

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By Mick Thompson

As members of Congress reconcile differences between the House and Senate financial reform bills, they must address a section of the base text for the bill that could have disastrous consequences for hundreds of community banks across the United States.

Section 171 of the base text, originally introduced as an amendment by Sen. Susan Collins of Maine, would exclude trust-preferred securities from Tier 1 capital for bank holding companies. I certainly support the senator's effort to enhance the quality of capital in financial institutions, especially in the wake of a financial crisis that exposed inadequate levels and quality of capital in our nation's largest banks.

However, despite claims that the amendment "tackles the 'too big to fail' problem," I fear Sen. Collins' amendment will only exacerbate the "too big to fail" problem by placing community banks at a further disadvantage to the money-center banks. More than 1,000 bank holding companies with assets of less than $1 billion have used trust-preferred securities. These organizations cannot be classified under any definition as "too big to fail," and yet it is these very institutions that will once again bear the brunt of the economic collapse and the resulting policy response.

Trust-preferred securities have proven to be a successful capital-raising mechanism for smaller institutions that have long relied on regulatory determinations permitting their inclusion in Tier 1 capital. While trust-preferred securities are a hybrid instrument at the holding company level, in most cases the proceeds flow down to the bank as loss-absorbing, common equity.

Eliminating Tier 1 treatment for trust-preferred securities would significantly impair a holding company's ability to raise capital to inject into the bank. This would interfere with strategic acquisitions and effectively bar a considerable portion of the industry from the mergers and acquisitions market. This policy would further drive industry consolidation.

At the same time, Section 171 would weaken more banks, making them ripe for purchase or even failure. By abruptly changing the rules governing trust-preferred securities, Section 171 would create an immediate capital crunch for hundreds of community bank holding companies.

By nature of their size, community banks have limited access to the capital markets, while the largest institutions enjoy considerable and relatively inexpensive access. This disparity has contributed to the rapid consolidation of the financial industry, and Section 171 would further impede community banks' efforts to raise capital.

There is no doubt that the issue of adequate capital standards should be addressed in light of the financial crisis, but policymakers must ensure that these efforts do not create a systemic capital crisis among community banks or lay the groundwork for further industry consolidation and concentration of economic power.

If enacted, Section 171 would be calamitous for community banks and delay economic recovery. I urge the congressional conferees to strike it from the reform bill.

Mick Thompson is the Commissioner of the Oklahoma State Banking Department and Chairman Emeritus of the Conference of State Bank Supervisors.

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