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How to kill Main Street

Round Two of rule changes would hurt business loans

Written by Michael Whalen

The bankers on Main Street that I am talking with about financing our new projects seem paralyzed with uncertainty and more than some fear. And to exacerbate this fear, the new banking accounting rules that the Financial Accounting Standards Board (FASB) are proposing are astonishing - and that's no hyperbole. It is a lesson in How to Kill Main Street 101. Stay with me - there is a monster devil in these boring details.

The FASB is a quasi-private institution that writes accounting rules. Seems obscure and mundane, and I doubt that 95 percent of Americans know about it. But it wields enormous power. Its proposed new rules will create widespread fear among bankers, and fear is the cancer of capitalism. If bankers are scared to make loans, the free market will wither and Americans will become poorer. Very simple.

Bank regulators already have the power to force banks to write down loans they consider "bad" or potentiallyuncollectiblefor credit reasons. The proposed expansion of mark-to-market rules would extend this authority to second-guessing about the hypothetical market value of creditworthy loans. Mark to market for loans would necessarily be arbitrary - and scary.

Mark to market previously meant that banks had to "write down" the value in the short-term investment securities (where they park capital) if those investments had declined in value. That seems to make basic financial sense. But when the financial crisis hit and Wall Street trading markets dried up, the banking cops told banks on Main Street that they had to write down the value of their investment securities not necessarily because the underlying assets had deteriorated but because the banks couldn't liquidate them. This caused a lot of pain on Main Street banks and greatly exacerbated the crisis. Now they are effectively proposing extending mark to market to everyday business loans, not just complex financial instruments. This is monumental and reckless.

This change would mean that even if a bank loan is being paid on time, the feds could simply tell a bank that they don't like the underlying asset or they believe that the bank has too much exposure to a sector - like our hotels - and it must take a charge to capital. So anytime there is an economic downturn, this would be like putting the decline on steroids.

The feds might tell you it won't work that way, but it will. Rather than face that

uncertainty, the scared banker will not make the loan if there is any risk of a write-down. It will kill the longer-term loan market, meaning that Main Street businesses will have to rely increasingly on risky short-term financing that would put them in constant jeopardy if the economy slows. This is not good conservative accounting but the injection of widespread fear of uncertainty into the arteries of the free market. What sane entrepreneur invests and hires with a financial sword of Damocles hanging over his head?

The dirty little secret is that even if these rules are formally adopted, they are being informally applied now. One bank president I worked with said, "Mike, you have a great project but I'm scared they would write the loan down because they think I have too much exposure to hotels."

The mark-to-market assassin is still hunting and hurting our recovery. Let's cage him.

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