

How Can Clients Who Need Credit Be Helped?
Thoughts about a Macro Solution
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DOMINALAW Group pc llo finds itself confronted with several circumstances in which clients with substantial business experience, historically strong profitability, and long-standing respected management skills, now need banking help. Credit has dried up. Operators who borrow large sums of money, and operate with long-standing success, now face creditors who refuse to extend new credit, or renew existing debt, because the economy's gyrations have produced limitations upon the ability of borrowers – even successful ones – to meet credit requirements, including credit ratios required by bankers who are reluctant to loan money – even on virtual gold bricks, in the current economy.

The problems are easy to identify. Initially, the banker will simply say: “Mr. Borrower, you can't meet our credit standards. We require that you have, in your operation, equity of at least 30%.”

Of course, the banker knows that what was 60% equity is now 25%, and the best borrower may be powerless to do anything whatsoever about it.

Borrowers without a Choice

The problem is not as simple as the banker sees it. If creditors were competing for loans, proven customers, with long-standing credit records, could likely find working banking arrangements, even after suffering reversals in current economic circumstances. For example, community-based banks might well support a business, even after it has undergone reversals, to preserve jobs and support the greater economy. The community banker would readily identify the need for the business and see that supporting it will support consumer loans, home loans, and other small business loans.

The out-of-town, mega banker has no such interest and could care less about the community.

So, a significant part of the problem is not on the creditor's side of the equation at all. It is with the banks.

Since 1980, U.S. banking has undergone a dramatic consolidation.¹ When President Reagan took office, the nation had approximately 4,590 chartered savings and loan associations and at least twice as many banks. Between 1980 and 1994, 1,600 FDIC

¹ See, FDIC [History of the Eighties – Lessons for the Future](#) (Dec 1997).

insured banks and 494 FSCIC insured savings and loans failed or received financial assistance.²

The *Depository Institutions Regulatory and Monetary Control Act* of 1980 and the *Garn-St. Germaine Depository Institutions Act* of 1982 eliminated distinctions between banks and other financial institutions in the United States. The legislation is often called “deregulation” and is blamed for the failure of more than 500 savings and loan associations in the 1980s. In fact, the Federal Savings & Loan Insurance Corporation (FSLIC) failed, too. Its obligations were assumed by the FDIC in 1989.

By August 2008, there were 8,430 FDIC insured commercial banks, including former savings and loans, in the United States. But four (4) of these banks, J.P. Morgan Chase, Citigroup, Bank of America, and Wells Fargo possess 64% of the assets of commercial banks.

The Obama administration appears to have considered, and rejected, nationalizing these troubled institutions, or at least a couple of them. But, there has been little talk about breaking them up. Yes – yes, *breaking them up* – just the way government action broke up American Telephone and Telegram Company when it became too concentrated and its size and market stature posed a threat to the marketplace, as well as to American security.

What to Do About It

What if the four (4) largest banks, controlling 64% (16% apiece) of all deposit assets were reduced in size so no American bank controlled more than 2% of all deposits in the country? This would mean the largest four (4) would, in effect, become 32 banks, with 2% each.

Surely, this would change credit arrangements immediately. In Nebraska, instead of one (1), or perhaps two (2), lending choices for significant loan arrangements, borrowers with special needs would have real chances to work out arrangements between their community banks, and one of the newly-formed reduced-in-size, but nonetheless substantial, “big banks”.

And, the big banks would have to compete against one another.

Presently, competition among major banks for loans is largely confined to efforts to attract credit card borrowers to sign up for new cards. Transaction fees are so great that banks care little about interest rates, although they charge them certainly. So much money is added to transactions at the point of sale to cover the charges involved in using a MasterCard or Visa that the interest component has dwindled in importance.

² *Id.*

Conclusion

Competition for loans at the credit card level is a wonderful example of the need for competition elsewhere in the credit industry.³

Of course, it would initially seem brazen, and meet with criticism, to break up the four (4) largest banks, and prohibit membership in the Federal Reserve System or FDIC by any bank with more than 2% of total U.S. banking deposits.

But these initial complaints would quickly heal through the realization that the actual upshot of competition among banks is more freely available credit, greater opportunities for borrowers, and more benefits and beneficial interests for communities.

³ University of Wisconsin researcher Martin Ruckes studied bank competition and credit standards. His article, *Bank Competition and Credit Standards, 2004 Review of Financial Studies* 17(4):1073-1102, documents, and argues a case about how competition tends to free up capital.