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# "Too Big Has Failed: Learning from Midwest Banks and Credit Unions"

**Before the Subcommittee on Oversight and Investigations**
**of the Committee on Financial Services**
**United States House of Representatives**
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Thank you, Chairman Moore. We are very pleased to have the opportunity to join this dialogue with the United States House of Representatives and specifically the Subcommittee on Oversight and Investigations of the Committee on Financial Services, as well as our colleagues from the banking sector. The country is entering a new era for financial services, after very rough times for many in the financial sector as well as consumers and businesses. We welcome this conversation.

I appreciate the comments by Tom Hoenig of the Federal Reserve Bank of Kansas City. Tom has shown outstanding leadership – both in the Fed's relationships with banks here in the Tenth District, and as a voice for sound, reasoned policy nationally. He understands what the nation needs to work our way out of the financial crisis and recession, as well as the perils we face from potential unintended consequences.

## UMB perspective on financial crisis

The context for this meeting is the very difficult economic slowdown our nation is experiencing. And from our interactions as a financial institution recognized for our principles, practices and performance, we can tell you that many businesses and consumers continue to face a challenging economy – whether through unemployment, or weak demand for products and services. This makes it especially important that we are having this conversation. The actions we take – in our businesses and in our policies as a nation – will influence how quickly and completely we recover.

Our perspective is that the financial crisis—now commonly referred to as the Great Recession—was gradual and not just a sudden, one-time event. It was not created in a vacuum or cooked up in the boardrooms or on the trading desks of Wall Street in 2008. The crisis emerged from years and years of developments – in the economy, in legislative and monetary policy, and in banking practice. Together, many changes led to what we recognize in retrospect as "the bubble."

A bubble of debt was what the nation's public and private institutions created. By 2007, it was clear that many consumers, businesses and financial institutions were overcommitted with debts backed by real estate – and people in all sectors made the erroneous assumption that asset prices would always go up. During the Great Recession, every $1 of economic output in the United States equated to $3.73 of debt –compared to $2.60 of debt during the Great Depression. And, it still appears this burden of debt will continue to plague us for a long time.

We do not need to go into detail on the causes of the bubble – or its collapse in 2008 and following. The experts can analyze that history for years to come. Certainly, some Wall Street institutions that came to be seen as "too big to fail" did, in fact, fail to manage the risks of their huge investment operations. There were lapses in judgment all up and down the line – with plenty of blame to go around. But the more urgent issue now is how to restore a vibrant financial system and recover a healthy economy.

We believe, as you do, that solid Midwestern businesses like UMB and our colleagues here today are very much part of the solution for our economy. We have some ideas to offer the nation as we go through this economic transition – a time of change that some are calling "the new normal." Rather than instituting punitive actions against an industry (which ultimately drives up the cost of doing business), sound practices that improve employment and productivity rates should be recognized and offered incentives. It is critical that policy makers in Washington focus on constructive actions now to strengthen businesses, create private-sector jobs and restore growth in places like Kansas and Missouri.

Let me comment on UMB's approach to banking and then come back to thoughts on "the new normal."

**UMB approach to banking**

First, a snapshot of UMB: We are a 98-year-old banking and financial services company with assets of $10.9 billion in the most recent quarter. We serve businesses and consumers through 135 banking centers in Missouri, Kansas, Illinois, Colorado, Oklahoma, Nebraska and Arizona. So we are a mid-sized regional bank, with a full suite of financial service businesses in asset management and asset servicing, treasury management, health savings accounts, corporate trust, capital markets, and a wide range of personal banking and financial services.

UMB ranks as the No. 2 bank in the United States according to a study by *Forbes* magazine that ranked banks on asset quality, capital adequacy and profitability. We have always been known for principled and sound practices. We simply do not chase short-term earnings or growth at the expense of our future.

Relative to an industry average, we can take great pride in the fact that UMB has posted strong and consistent earnings year-over-year during this financial crisis, and we maintain a healthy balance sheet and make loans with high standards of asset quality. Throughout the crisis, we have had no need (or desire) to seek government bailouts or outside capital infusions.

**Quality, diversity and stability**

Unlike some financial institutions, UMB did not plunge into the bubble mentality – which seized upon low interest rates and rising real estate prices to drive transactions in the form of loans that, in the long run, could not stand up economically. Instead, UMB stuck to a strategy that you could attribute to our deep-seated Midwestern values and the principles of people in the communities where we do business.

UMB has pursued three goals as the pillars of our business strategy: quality, diversity and stability. These goals have served us, our customers and shareholders well, and we commend them to other banks – and policy makers in Washington – as the path toward restoring a sound financial system and economy. Let me comment briefly on each.

- **Quality.** The development of UMB Bank has engaged members of my family more than four generations, so customer relationships and the bank's strength in our communities are near and dear to my heart. We have an unwavering commitment to quality. This is why, when fashionable business practices said UMB should be lowering our underwriting standards, we did not. When critics said we should shift more assets from safe investment securities into risky categories of credit, we did not. When some people questioned whether we should lower our capital and leverage up, we did not.

  Commitment to quality is why UMB's loan charge-offs and nonperforming loans stayed low throughout the financial crisis. While the industry's median nonperforming loans jumped from 0.68 percent in 2007 to 3.39 percent at the end of the second quarter of 2010, UMB experienced only minimal change during that same time span – from 0.17 percent to 0.52 percent. We remain far below industry averages in the various measures of problem loans. This was not good luck. This success came from following sound underwriting practices and making quality loans in the first place. Sound banking should not be something that comes in and out of favor.

- **Diversity.** An important pillar of our strength is the diversity of our business. UMB serves all types of customers – personal, commercial and institutional – with an array of needs from basic financial services to sophisticated payment technologies. For example, we are the 12th-largest issuer of purchasing cards in the United States according to the Nielsen Report. We provide administrative services to top asset-management firms. UMB products or services are used by one-in-eight U.S. banks. We provide financial solutions to the healthcare industry by administering health savings accounts and flexible spending accounts. And so on.

  These varied businesses add up to diversification for UMB: In 2009, more than 50 percent of our total revenue came from what bankers call fee income. We continue to grow the scale of these services through internal investment and acquisitions that augment and complement our existing businesses. This diversity helps protect UMB from the dramatic ups and downs of interest-rate cycles, as well as cushioning the impact of the difficult credit environment that has crippled many banks. While others from all spectrums of the industry were lured into reckless practices, we remained focused on building our top line quality business. UMB remains strong, in part, because we have built our position as an increasingly diversified financial services company.

- **Stability.** Finally, stability is a commitment for UMB – and a strategic advantage. Our banking and related businesses have always placed a high premium on risk management, liquidity and a strong balance sheet. UMB's financial strength tends to match the profile of our customers. As bankers we attract quality businesses and individuals who take pride in responsible, long-term engagement in the communities where we live and work. While much of the banking industry has been distracted by recent turmoil in the credit markets, the stability of UMB allows us to focus on serving customers.

Since 2008, many bankers and policy makers have rediscovered the benefit of high capital levels as a safeguard against tough economic times. UMB has always recognized the importance of high capital levels. We have consistently maintained capital in the top 15 percent of the industry. While some banks have scrambled recently to raise capital through government contributions, going to the stock market or selling off assets, UMB has continued to increase our capital – thanks to old-fashioned earnings.

So that is UMB's perspective on the banking industry and where we are today. Let us turn to the future.

**Financial system faces "new normal"**

We are entering a new financial era. This "new normal" for banks and other institutions is a time of change that will affect every consumer and every business – our customers. In 2010, it is hard to do more than sketch out a few incomplete outlines of the new normal, because the financial system is still adapting after a tumultuous time of crisis. Rather than focusing efforts on fixing what is broken, we ought to consider what kind of system we would like to emerge.

Let me mention two characteristics that are already in place, already affecting the real economy:

- The *hangover from a period of financial excess* and the ensuing crisis is very much affecting our financial system – and the lending environment – as the country strives toward recovery. The underlying fundamentals of business and lending will reflect a "new normal" for years to come.
- The *increase in regulatory involvement* with banks and other financial institutions has only begun. Passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act this summer was the beginning, not the end, of the process – and many questions remain unanswered.

These are "facts of life" in the post-crisis era, and we expect each of them to have significant repercussions.

**The lending environment** is a topic of much concern. People outside of banking are worrying about whether "the banks are lending," because this has an influence on the ability of businesses to survive and expand. If the economy is to recover and create millions of jobs, the reasoning goes, banks must lend money to small businesses and other enterprises that can create those jobs. Bankers understand this concern.

Let me assure you, UMB Bank never stops making loans and has plenty of liquidity to meet the needs of qualified perspective borrowers. This is true of most other banks we have contact with across the country. But the situation is more nuanced than simply whether "banks are lending." Our experience at UMB is that we have increased our total loan balances through the 2007 to mid-2010 period, expanding our lending an average of five percent per year. And overall, our total commercial loan commitment figures have increased 40 percent since 2007.

As the economy has slowed down, however, we have experienced a decline in demand for commercial and industrial loans. The strains of recession have caused many businesses to scale back their borrowing plans. For example, we have expanded commercial lines of credit, but customers are

not utilizing as much of this funding. Meanwhile, credit card and home equity lending have increased faster.

As bankers, *we are in business to lend* – but the economic landscape has a great impact on the demand for loans, as well as the ability of business borrowers to qualify for loans. We believe it is a mistake for banks to loosen underwriting standards and take on speculative loans. Just as the subprime lending boom led to big problems, so would relaxing lending standards in an attempt to return to 'normal' levels. In reality, expectations may need to be reset as to what lending volume should be versus what they were in an irresponsible environment.

In terms of stimulating business prosperity and promoting sound financial practices, political leaders should act on counsel from leaders in the private sector who identify specific actions that would help the country address these complex issues.

For instance, the Business Roundtable – some of the best business minds in our nation – has called on Congress for "real tax reform" to help U.S. corporations stay competitive and get on a path to expansion, which in turn would bolster economic prosperity and job creation. The U.S. corporate income tax rate is tied for the dubious honor of the highest tax rate among developed countries, which hinders growth.

The roundtable has identified "double taxation" of two kinds, which both create a drag on U.S. growth:

- U.S.-based companies often must pay U.S. taxes on income earned abroad, in addition to the relevant foreign tax. It puts U.S. businesses at a disadvantage to multinational corporations headquartered in other countries, which often do not pay taxes twice on their foreign income. Congress ought to create a more level competitive playing field.

- Another "double taxation" aspect of the U.S. tax code is that profits are taxed first at the corporate level, and then again when profits are distributed in the form of dividends to shareholders. While all major U.S. trading partners have either permanently eliminated or lessened this practice, U.S. corporations are left at a competitive disadvantage.

Another concrete example is in the regulation of banking and finance. Speaking as one of the financial institutions that has remained sound throughout the recent crisis, we encourage strengthening bank capital requirements, including increasing both the tiered and risk-based capital levels.

In a risk-based approach, Washington should focus on incentives rather than regulatory penalties. For example, a greater safety cushion in capital could be required for institutions that invest in riskier assets such as subprime loans, asset-backed securities or off-balance sheet transactions.

Additionally, Washington should fashion insurance premiums in a similar manner. That is, the higher the risk profile, the distinction should be made that these institutions clearly pay a higher rate insurance premium. The reverse should also be true, in that the more sound and less risky the profile, there should be clearly be a lower rate in the premium. This should certainly drive the principled behavior that poses less systemic risk, such as UMB consistently demonstrates.

If we really want to bring on economic recovery and put people to work, we need to stimulate *business spending* – not by increasing government spending or pressuring banks to lend, but rather by reducing the tax burden on businesses. I hope you will consider tax cuts for businesses as one of the most important items on your economic agenda. Productivity equals earnings and jobs, which ultimately leads to a more stable tax base.

**The increase in regulatory involvement** is, frankly, a response we have seen after nearly every financial crisis. History has a tendency to repeat itself. We have had about 36 recessions since the 1860s, and each time we've come out with new regulations. The collapse of the dot-com bubble and Enron led to the Sarbanes-Oxley Act, but then another bubble followed and another financial collapse. It is dangerous to talk about "Never again!" because economic cycles and financial crises seem to recur throughout history.

The Dodd-Frank Act has some positive aspects, such as addressing capital standards and shadow banking – although we are just now learning about the myriad of exemptions for those who qualify as lenders to consumers. Adjusting to the many regulatory changes, however, will be part of the "new normal" for financial institutions and our customers for years to come. What we do know is that we can anticipate more than a hundred new regulations and, as one could imagine, many smaller banks like those in the Midwest will likely have a difficult time dealing with that. Certainly, banks and other financial institutions comply and will subsequently incur additional costs of doing business.

Overall, the Act moves in a positive direction by establishing a mechanism to deal with systemically important failures. Hopefully, this will end the too-big-to-fail issue and ensure that future failures can be addressed quickly, without burdening the taxpayer.

But this is not the end of the too-big-to-fail issue. While a Resolution Authority is in place, it is imperative that the Systemic Risk Council created by the Act be able to address risks in advance of a crisis. There is a moral dilemma when trends in the financial markets are popular – but potentially harmful – at the same time. The industry has resources in place to control risk management issues and to make tough decisions in the face of adversity, but during the bubble years very little was done to stop the bus of "progress." The challenge will remain in the coming years—as at the height of the Great Recession – to make certain we all have the discipline – as a nation, as legislators, as industry leaders – to step in and do what's right at the right time.

Although the Dodd-Frank Act was designed with the good intention of addressing excessive leverage and the "too-big-to-fail" issue, it has unfortunately become a mechanism to regulate bank profitability as well as product design and competition. History tells us that lack of regulation is not the catalyst for a financial crisis, but rather that stability of the system is highly contingent on the will of business and political leadership to do what is right, when it is right. If we truly wish to change the behavior and counter the forces of human nature, we need to provide incentives for sound financial disciplines.

Details of this wave of new regulation, of course, are mostly to be worked out by the regulatory agencies as they develop rules under the Act. Where we have expertise to contribute, we hope to be a constructive part of the dialogue in that process. It is important not to overburden the system with costs and create disincentives that run counter to the interests of businesses and consumers as banking customers.

**Summary**

Allow me to conclude by going back to core issues. We believe banks and other players in the financial system – including policy makers and regulators – would do well to pay attention to quality, diversity and stability. We will achieve long-term recovery by encouraging sound financial practices at every level from banks to businesses to consumers and even our government.

One of my favorite quotes is from President Truman, our plain-speaking president from Missouri, and it seems to apply to shaping this new era for our financial system:

> “Men make history and not the other way around. In periods where there is no leadership, society stands still. Progress occurs when courageous, skillful leaders seize the opportunity to change things for the better.”

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