

When the Dust Settles

Editorial by Chairman & CEO Mariner Kemper, UMB Financial Corporation

As featured in the *Kansas City Star*, *St. Louis Business Journal*,
Denver Business Journal, *Wichita Eagle* and *Monett Times*



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When the dust settles, will Washington's drive to reform regulation of financial institutions actually make U.S. banks safer and stronger? And will consumers really be better off?

Congress is just starting to debate the Obama administration's package of proposals to transform financial regulation. Change definitely *is* needed after the crisis that seized global markets, caused big investment banks to collapse, and pushed the economy into recession.

As a banker in a healthy mid-sized financial institution, I am eager to see our nation come to grips with causes of the crisis, deal with troubled institutions, and put in place longer-term solutions. But we need to approach this complex task realistically and rationally – not follow a herd instinct that rushes to *do something* but may do real damage in the long run.

We want new laws and rules that yield sustainable benefits for consumers, businesses and the financial system. Reforms should place greater emphasis on bringing back sound banking principles.

Confront systemic risks. We need to focus where the problem is. Reforms should target financial service conglomerates at the heart of the financial crisis – described as “too big to fail” because their troubles

represent systemic risks to global markets. These Wall Street-driven giants are different from the other 8,000-plus banks in the United States.

Traditional banking – gathering core deposits in a bank's territory and lending those funds out to customers the bankers understand – did not cause the economic crisis. Most commercial banks do not pose systemic risks. Even in a recession, the challenges of traditional banks are manageable, and the system of banking oversight continues to work well.

Financial service conglomerates are a different story. In recent years, some investment banks and finance companies expanded way beyond traditional banking. Greatly inflating their leverage in a low-interest rate environment, they created liquidity and transferred risk by packaging loans into exotic financial products and selling them all over the globe. The banking maxim “know your customer” ceased to matter. Publicly chartered agencies like Fannie Mae and Freddie Mac encouraged these securitized products to promote the government's goal of expanding home ownership. The bubble grew, and then it collapsed.

The problem with “too big to fail” institutions is not only their size, but their complexity – including massive but unrecognized risks accumulated from hundreds of interrelated businesses and assets. The Wall Street-driven giants became *too big to manage*.

We agree with the administration that financial reforms must confront and resolve these sources of systemic risk. Congress should require regulators to identify financial conglomerates that are too complex to be successful and establish a mechanism to break them up. Oversight could come from the Federal Reserve or another agency.

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But *resolving* these situations – shutting down failed businesses and spinning off viable enterprises as agile, focused competitors – should be the goal. Keeping “too big to fail” institutions on taxpayer-funded life support only prolongs the agony.

Regulate financial products and markets. The tale of the financial meltdown is written in “innovative” financial products: subprime mortgages, asset-backed securities, collateralized debt obligations, credit default swaps and so on. And the regulatory system, for the most part, didn’t see or deal with the risks built into these financial products.

We believe reform proposals are on the right track with efforts to strengthen and modernize the regulation of credit derivatives and securities, as well as requiring issuers to retain a meaningful portion of the risk. In addition, standards to determine and disclose the fair and intrinsic value of financial derivatives will help unravel the complexity of these assets.

On the other hand, we do not believe markets or banks would benefit from intrusion into the corporate affairs of healthy institutions – political side issues such as mandates on executive pay levels or federalization of laws governing proxy proposals by shareholders.

Protect consumers through sound practices. No question, consumers need more effective enforcement of laws regulating financial transactions. Two aspects of the bubble mentality in recent years hurt consumers: Imprudent lending allowed individuals to over-borrow in light of their assets and incomes, and aggressive marketing of mortgages and other products led to fraud and abusive practices by a minority of financial companies.

While the administration has proposed creating a whole new government agency to oversee consumer finance transactions, existing laws already ban these abusive practices. We don’t think another agency will help. Current oversight agencies should be given better resources to more effectively enforce sound credit practices and honest lending relationships.

Ensure a level playing field. Amid the rush to prop up big institutions at the top, we need to be reminded that healthy competition is the foundation of the U.S. banking system. Consumers, businesses and the economy are best served by competition in financial services, and ensuring a level playing field should be a major goal of reforms.

For example, as Washington strengthens bank capital requirements, we support the proposal to make capital levels tiered and risk-based. Requiring a greater safety cushion for institutions that invest in riskier assets (e.g., subprime loans, asset-backed securities or off-balance sheet transactions) keeps the burden of those activities from falling on customers of traditional banks that do not engage in those risky ventures.

This summer, the nation will hear a great deal about banking and financial reforms. As Congress debates reforms, the time has come to shift our focus from the immediate crisis among a few large institutions to ensuring an environment for a sustainable, competitive banking system with strong incentives for sound practices.

Mariner Kemper is chairman and CEO of UMB Financial Corporation, a well-capitalized multibank holding company in Kansas City, Missouri with assets of more than \$11 billion.