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BANK START-UP SCARCITY IS DUE TO SIN-TAX CAPITAL STANDARDS, NEW PAPER CONCLUDES

Capital standards set at levels that might have averted the crisis before 2008 have acted as a tax on 2017 start-ups, penalizing them for sins they did not commit and which the post-crisis regulatory framework goes a long way to prevent. A better-balanced set of application requirements would keep some of the safety-and-soundness burden on investors, but also share it with supervisors held responsible for start-up bank risk-taking to ensure that under-served markets get more competition from new banks eager to offer products and services targeted to their needs.

WASHINGTON, DC, August 16, 2017 – In the wake of a dispute between the FDIC and OCC over the scarcity of new U.S. bank charters, an issue brief from Federal Financial Analytics (FedFin) concludes that agency jurisdiction will make no difference in the number of traditionally-focused new banks as long as what the paper calls a capital sin-tax applies on Day One. Although the FDIC has recently reduced the time a new insured depository must pay this sin tax from seven to three years, it nonetheless demands an eight percent leverage ratio – 25 percent higher than that imposed on the largest U.S. banks – on even the smallest and most traditional institutions. Start-up investors typically demand long-term return of at least twenty percent, high for most banks under the post-crisis framework but virtually impossible with the start-up sin tax. The paper proposes an alternative approach: set start-up capital based on each applicant's risk profile and require regulators to supervise start-ups with vigor and discipline.

"The reason start-up banks fail more than legacy ones isn't that start-ups are necessarily riskier by nature," said FedFin managing partner Karen Shaw Petrou. "It's that regulators before the crisis did not stop banks quickly from taking undue risk. When the cost of these risks came due, banks without established businesses failed more often than long-established institutions not only because they were late to the party, but also because they had fewer legacy resources with which to attract the acquirers necessary to forestall failure," she continued.

Based in part on FedFin's own experience trying to charter a new bank, the paper says the start-up regulatory framework should:

- right-size capital requirements based on an applicant's business model. The banking agencies have lots of stress tests. Use them or demand that applicants do so to stress test their plans and show how much risk-based and leverage capital is required to withstand them; and
- keep new charters on a tight leash. If governance falters, capital erodes, management quiets, or other warning signs blink, then regulators must intervene. Charters premised on clear business plans with milestones for next steps can and should be well supervised to balance profit and growth with safety and soundness.

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