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Sheila Bair
Chairwoman
Federal Deposit Insurance Corporation
550 Seventeenth Street, NW, Room 6076
Washington, DC 20429

Subject: The Lack of New Bank Formation

Dear Chairwoman Bair,

I write with concerns about the lack of new bank formation. I am particularly concerned about the recent FDIC crackdown on new banks with clean balance sheets.

On August 28, Sandra L. Thompson, the FDIC's Division of Supervision and Consumer Protection, announced enhanced supervisory procedures for newly insured FDIC-supervised Depository Institutions. In her letter rolling out these procedures, Thompson argued that newer banks had a higher failure rate in the last four years and took on more imprudent risks than older banks, and therefore, that newer banks require more restrictions, including an extension of the restrictive 'de novo' period from three to seven years. Putting these kinds of extreme restrictions on new banks will prevent new investment in a sector that provides credit to the economy, and further enable politically well-connected financial actors.

During the recent extraordinary credit bubble, new banks emerged to take advantage of regulatory laxness and extreme credit conditions. Enabled by poor regulators, these banks (like much of Wall Street) did not pursue sound business models. The FDIC should have cracked down then. Instead, new banks that are forming now, during these post-bubble credit conditions where it is difficult to raise capital without a sustainable business plan, are feeling the crackdown. It is as if a regulator allowed left-handed bankers to give out loans to degenerate gamblers, and then when those banks failed, decided the problem is that those bankers were left-handed.

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This decision only formalizes a clampdown on new lending. At a hearing on March 25, 2009, I asked Vice Chairman Martin J. Gruenberg about new bank formation. Gruenberg inserted into the record the following statistics about the number of deposit insurance applications consummated by the new banks and the FDIC.

Full year 2006: **183**
Full year 2007: **186**
Full year 2008: **101**
First quarter 2009: **2**

I have personally heard from investors wishing to start new banks with clean balance sheets that they are being told to withdraw their applications from the FDIC for deposit insurance. This clampdown may be having severe consequences. In July, according the Federal Reserve, nationwide, consumer credit fell by an annualized rate of 10 percent, most of it through decreased lending through commercial banks. Local banks are paralyzed and losing ground; the Washington Post recently reported that four national banks now issue 50 percent of America's mortgages and control two-thirds of the nation's credit cards.

You have said that this consolidation "fed the crisis, and it has gotten worse because of the crisis." Yet, the FDIC's restrictive policies effectively prevent any new banks from growing for seven years. These policies are a clear signal to investors that plowing credit into a new bank is a bad decision, and they aid in further consolidating the banking industry into the hands of large commercial bank by preventing the emergence of new competitors with different lending strategies. These policies are especially odd in the context of loosened rules for private equity investors purchasing the assets of failed banks.

At this time, what is needed is leadership from the regulatory community to encourage new models for lending to consumers and businesses by small banks, not impediments that have a pro-cyclical bias. With that in mind, my questions are as follows.

1) Do you have updated statistics on new bank formation?

2) What steps are you taking to increase the availability of lending if very few new banks are being formed and the existing banks are being required to maintain elevated capital ratios which they can only meet by reducing their balance sheets (i.e., not renewing or dumping loans)?"

3) Thompson wrote that "recent experience has demonstrated that newly insured institutions pose an elevated risk to the FDIC Deposit Insurance Fund." Have newly insured institutions posed an elevated risk to the FDIC Deposit Insurance fund during non-bubble periods? What about during credit droughts? Or since the advent of the FDIC fund?

4) What regulatory incentives are you putting in place to ensure that FDIC examiners allow healthy lending? Has an examiner been rewarded for encouraging banks to make more good loans?

Thank you for your leadership in working through the crisis, and I encourage you and other regulators not to 'fight the last war' but to go forward and allow the creation and expansion of a sound banking sector.

Regards,

Alan Grayson
Member of Congress