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Guest Editorial No. 2

Congress Should Not Bail Out Wall Street

By John A. Allison¹

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My company, [Branch Banking & Trust Co.](http://BranchBanking&TrustCo.com) (BB&T) is a \$136 billion multistate banking company. We have 1,500 branches throughout the mid-Atlantic and Southeast states. While we have been impacted by the real estate markets, we continue to have healthy profitability and a strong capital position.

We think it is important that Congress hear from well-run financial institutions as most of the concerns have been focused on the problem companies. It is inappropriate that the debate is largely being shaped by the financial institutions which made very poor decisions. Here are the issues that we believe are relevant from the perspective of healthy banks.

- Freddie Mac and Fannie Mae are the primary cause of the mortgage crisis. These government-supported enterprises distorted normal market risk mechanisms. While individual private financial institutions have made serious mistakes, the problems in the financial system have been caused by government policies including, affordable housing (now sub-prime),

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combined with the market disruptions caused by the Federal Reserve holding interest rates too low and then raising interest rates too high.

- There is no panic on Main Street and in sound financial institutions. The problems are in high risk financial institutions and on Wall Street. While all financial intermediaries are being impacted by liquidity issues, this is primarily a bailout of poorly run financial institutions. It is extremely important that the bailout not damage well-run companies.
- Corrections are not all bad. The market correction process eliminates irrational competitors. There were a number of poorly managed institutions and poorly made financial decisions during the real estate boom. It is important that any rules post "rescue" punish the poorly run institutions and not punish the well run companies.
- A significant and immediate tax credit for purchasing homes would be a far less expensive and more effective cure for the mortgage market and financial system than the proposed "rescue" plan.
- This is a housing value crisis. It does not make economic sense to purchase credit card loans, automobile loans, etc. The government should directly purchase housing assets, not real estate bonds. This would include lots and houses under construction.
- The guaranty of money funds by the US Treasury creates enormous risk for the banking industry. Banks have been paying into the FDIC insurance fund since 1933. The fund has a limit of \$100,000 per client. An arbitrary, "out of the blue" guarantee of money funds creates risk for the taxpayers and significantly distorts financial markets.
- Protecting the banking system, which is fundamentally controlled by the Federal Reserve, is an established government function. It is completely unclear why the government needs to or should bail out insurance companies, investment banks, hedge funds and foreign companies.
- It is extremely unclear how the government will price the problem real estate assets. Priced too low, the real estate markets will be worse off than if the bail out did not exist. Priced too high, the taxpayers will take huge losses. Without a market price, how can you rationally determine value?
- The proposed bankruptcy "cram down" will severely negatively impact mortgage markets and will damage well run institutions. This will provide an incentive for homeowners who are able to pay their mortgages, but have a loss in their house, to take bankruptcy and force losses on banks. (Banks would not have received the gains had the houses appreciated.)

This will substantially increase the risk in mortgage lending and make mortgage pricing much higher in the future.

- Fair Value accounting should be changed immediately. It does not work when there are no market prices. If we had Fair Value accounting, as interpreted today, in the early 1990's the United States financial system would have crashed. Accounting should not drive economic activity, it should reflect it.
- The proposed new merger accounting rules should be deferred for at least five years. The new merger accounting rules are creating uncertainty for high quality companies that might potentially purchase weaker companies.
- The primary beneficiaries of the proposed rescue are Goldman Sachs and Morgan Stanley. The Treasury has a number of smart individuals, including Hank Paulson. However, Treasury is totally dominated by Wall Street investment bankers. They do not have knowledge of the commercial banking industry. Therefore, they can not be relied on to objectively assess all the implications of government policy on all financial intermediaries. The decision to protect the money funds is a clear example of a material lack of insight into the risk of the total financial system.
- Arbitrary limits of executive compensation will be self-defeating. With these limits, only the failing financial institutions will participate in the "rescue", effectively making this plan a massive subsidy of incompetence. Also, how will companies attract the leadership talent to manage their business effectively with irrational compensation limits?

Congress should carefully consider these issues before voting on any bailout plan.