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OpEd: The Honey Trap For a New Class of Zombie Bank

Friday, October 23, 2009

Yesterday, (10/22) the Obama administration [announced](#) new lending initiatives that the White House says will get credit flowing to small businesses and encourage job growth.

But Dale Kluga, president of Cobra Capital -- which specializes in lending to small businesses - says the plan will be "virtually ineffective."

Here's his reasoning:

1. SBA programs have had little, if any, material impact on the big bank credit freeze. Providing more SBA programs are meaningless and to suggest otherwise is pure political fantasy. The SBA relies on a defunct origination system, that is, the U.S. Banking system. Adding more programs through a subsidy like the ineffective SBA does nothing to correct the underlying defunct origination system, (eg., the U.S. Banking system).

2. The U.S. Banking system, particularly the Big Banks, have no incentive to lend money with the current moral hazard that the Federal Government has engineered into our Zombie banks through the entirely ineffective TARP facility, particularly our zombie, big banks which continue to hoard cash because they are operationally and technically insolvent, (assuming they were forced to mark to market their toxic assets).

3. While on the surface, giving small, non-public community banks access to TARP money seems like a better idea than giving it to the zombie big banks, the reality is that you will primarily attract the failing, unsuccessful small banks who are already technically insolvent and will hoard the cash no different than the Zombie Big Banks. Consequently, this will create a new category of Zombie Small Banks who have the identical motivation as the Zombie Big Banks, that is, to hoard cash to survive in the naïve hope that the economy turns. Furthermore, it is naïve to believe that any Zombie Bank, Big or Small, can "earn its way out of its problems" because in order to earn the money it needs to recover, they must lend money, which the Zombie's will refuse to do.

4. The successful Small Banks are run by very street smart entrepreneurs who will reject any TARP offer because of the fatal strings attached to this dangerous temptation, which in itself, is counter-intuitive to their already successful underwriting business models. In effect, the successful Small Banks will stay on the sidelines, continue with their successful business models and wait. They will wait for the same inevitable outcome the hoarding of cash by a new category of financial monster the Zombie Small Bank.

As they wait, they will cherry pick small business customers, but they really have no incentive to step out onto the new business development highway and actively recruit small business loans. They have more to gain by being patient and waiting for the Zombie Small Banks to implode and then go in and pick up the pieces by offering pennies on the dollar to regulators who have seized defunct Zombie Small Banks and have no other exit strategy but to take whatever price these successful Small Banks have to offer.

I agree that something needs to be done now to relieve the credit freeze on small business, but it's far too simple to offer the same failed moral hazard TARP bailout to a different class of bank, particularly through the SBA which has no ability to force TARP recipients to lend out the money let alone, in a responsible manner.

As far as a solution for the big bank credit freeze on small business I do believe it involves offering a funding facility to those successful and active lenders but it should not be made available only to banks. It should be made available to successful non-banks as well who can prove their successful underwriting models and are willing to put "skin in the game" as is common with most successful entrepreneurs.

Small Business lending is not the exclusive domain of banks, there are plenty of non-bank lenders who properly diversified their asset/liability models, remain profitable and have avoided the failures of the Big and Small Zombie Banks. Let's give them a chance too.

Otherwise, Obama's program will essentially become a band aid for a severed leg rather

than the prosthesis needed to jump start small business credit. We deserve better and we should demand it. Future jobs depend upon on it.

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