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15 Minutes With . . . Beach Business Bank's James Gray



James H. Gray, chairman of Beach Business Bank, talks about industry regulations and related issues. (Photograph by the Business Journal's Thomas McConville)

The U.S. Securities and Exchange Commission and other financial groups continue to interpret the Dodd-Frank bill – the financial reform legislation enacted nearly six months ago in response to the “Great Recession.”

The highly complex bill is proving difficult to define, even for top financial experts, who are facing numerous deadlines to implement more than 100 rules impacting financial institutions of all sizes.

One of those experts is James H. Gray, a longtime banking executive and current chairman of Beach Business Bank in Long Beach and Manhattan Beach.

Since 2009, Gray has served on a 15-member advisory committee on community banking, formed by the Federal Deposit Insurance Corporation (FDIC). He is the only appointee from California.

Gray sat down with Staff Writer Tiffany Rider to discuss the implementation of financial regulation, as well as the state of the banking industry and its future.

Gray founded Harbor Bank in Long Beach in 1974, serving as its chairman and CEO until the bank sold to City National Bank in early 1998. In 1999, he established Generations Trust Bank, which merged a year later into First National Bank, and in 2002 the nearly \$1 billion trust assets were sold to Union Bank of California. Beach Business Bank was formed in 2004.

Gray served as president of the California Bankers Association (CBA) in 1985-86 and as a member of the board of directors of the American Bankers Association (ABA) from 1991 to 1996, including three years as its treasurer.

An active member of the Long Beach community, Gray was the founding chair of the Aquarium of the Pacific, a past president of the Long Beach Area Chamber of Commerce, past member of the Port of Long Beach Harbor Commission, chairman of the United Way and was elected to the Long Beach Unified School District and the Long Beach City College District boards. He served as a trustee for the California State University system from 1990 to 1999 and received an honorary Doctor of Laws degree from California State University, Long Beach – his alma mater – in May 2000. In 2002, the Long Beach Chamber named Gray Entrepreneur of the Year, and in 2006 the CBA named him Banker of the Year for the State of California.

LBBJ: In 2010, more banks closed than in any other year since 1992. Some experts predict fewer banks will close this year, as those banks that failed – the majority of which were smaller banks – have been transitioned into ownership by other banks. Do you agree?

Gray: I think there will be significantly fewer banks closed by



Beach Business Bank Chairman James H. Gray is a member of a community bank advisory council formed by the Federal Deposit Insurance Corporation to discuss the implementation of the sweeping financial reform in the United States known as the Dodd-Frank bill. (Photograph by the Business Journal's Thomas McConville)

the FDIC, and in California particularly, there aren't that many. There's been a sea change, if you will, because several funds have been set up that have gone in and bid on banks that the FDIC was foreclosing on. . . . So now the sea change will be that mergers and acquisitions will move to the forefront, even for some of those troubled banks that are still out there, because it's much quicker to do it and far more sure to negotiate a deal. . . . It's far better for them to sit down with a potential acquirer and get something for their shareholders instead of nothing for their shareholders.

LBBJ: As the Dodd-Frank bill is being implemented, do you feel banks are coming under too much regulation?

Gray: The House Financial Services Oversight Committee circulated a 22-page draft oversight plan among Republican members that calls for them to vigorously monitor the financial regulators charged with implementing the Dodd-Frank bill. Most of the [legislation] regulations haven't been written yet. It's very vague.

Let me put it in perspective as to what the impact is. If you are Bank of America or Citicorp or someone of that size, you've got people that write policies for every regulation that comes out. Right now, our little bank has policies dealing with regulations prior to Dodd-Frank. There are 30 operational policies, 13 human resource policies, 32 administrative policies, and from the loan policy standpoint, we've combined that all into one, simple 200-page-plus policy.

The perspective of Dodd-Frank will add something like 30 to 35 *new* regulations. Each will require a policy. When I say a policy, a policy has to be written. Senior management presents it to the board of directors, they have to approve it and then you have to implement it. When you have an examination on your policies – and ours with the FDIC starts sometime this month – that used to be about a two-day review. It is now anywhere from a week to 10

days. Because of this, I talked to our director of operations yesterday and she has spent 25 hours so far just getting the prep done for them to come in. Under Dodd-Frank, you've got a whole new consumer bureau that is going to write its own regulations based on the [bill's] very ambiguous outlines.

Only our Congress could do this: they made the parameters out there, and now that [consumer] bureau is going to be under Treasury. There's going to be no connect between safety and soundness and the regulations they are going to write. That's what the 22 pages of oversight from the Financial Services Oversight Committee and Congress are going to insist on. For every regulation they write, they have to have some basis of not running it in total confusion with or in changing the current regulations that are out there written by the Federal Reserve, the Office of the Comptroller of the Currency or the FDIC. That's going to be huge. It's going to be a real problem.

LBBJ: If you could change one element of the Dodd-Frank bill, what would it be?

Gray: . . . It would be the structure of the consumer bureau. If you start from ground zero and build this bureaucracy, and within the bureaucracy you have to set up all your examination teams with absolutely zero background of what you are doing out there, why not have – whether it be under the Treasury or the Federal Reserve or wherever – the regulation-writing part of it and then test it with the regulators where it would interface or not interface or be in conflict with the current regulatory body of work, which is rather extensive anyway?

And then, and only then, issue those regulations based on either working out what the conflict is or tying the two regulations together. Or, doing the proper homework that we've always had to do in almost everything we've gone through in our lives to get a

good result, instead of doing it and then having to undo it, and then doing it over again. Once you write it into the law, you've got to carry out what the law says.

I think it's going to be a real can of worms, and it's going to be over the next year or so as these regulations come out. I hope early on they find where there's going to be a great example of a conflict and set up some kind of a mechanism that would serve as a review, a sounding board, something, so that when they write these and place them as part of a law that has been passed, it will be one that can be done once instead of twice or three times.

LBBJ: Do you think banks in the United States are still "too big to fail?"

Gray: I think the jury is still out. The way it's written, several things need to come about. One is setting up a super fund, and I think that's one of the things we're going to miss Sheila [Bair, the current chairman of the FDIC] on because as this goes through, she is very much concerned that there may be an outline on how you do this, but again, it's the implementation and how you do it. They've got an oversight group, with primarily all the regulators, to make sure that big banks are divest of things and if it looked like they were getting critical. I think that the jury is out, and I don't think we're going to know until the next crisis comes up.

LBBJ: Where do you see the future of the banking industry going?

Gray: I think it shrinks. I think there's going to be more and more pressure, and a lot of it is on the compliance side of issues. But in my 30-plus years of doing this stuff, there's pendulum swings. Generally, the pendulum swings one side where it's way too loose and then one side where it's way too restrictive. Seldom does it stay in the middle.

There are very few de novos starting from ground zero on the horizon. But that's not to say two years from now, if the economy comes back, there won't be another bunch of de novos formed. If you look at the failed banks, a lot of them are de novos. We formed this one in 2004, but if you take the segment of banks, particularly in the 2006 range forward, you had a significant number of failures because they came in, they raised their capital . . . and then they said, 'We have to grow and use this capital.' Well the problem gets to be if you force the marketplace, you're going to make some bad decisions. A lot of those banks did exactly that.

LBBJ: In what ways do you feel debit card interchange price fixing, as through the Durbin Amendment (which mandates institutions with more than \$10 billion in assets to set debit card swipe fees at fair and proportional levels to the cost of the transaction) has impacted banks?

Gray: That's probably the first time Congress has decided to set fixed prices. It was a huge lobbying effort because the real winners of this are the retailers. It's not the customer. . . . How it's going to impact banks is . . . that fee income is going to be reduced dramatically. We're talking billions of dollars when you get into a Bank of America or a Citicorp. So the offset is . . . free checking is going to go away . . . Will [fee income] be fully replaced? Given enough time it will, but my concern about it is less about the Durbin Amendment, but the Durbin Amendment really doesn't take into consideration the cost of the security of that whole program. If you should recover your costs, that's the first time Congress has decided to put a price fixing deal by recovering your costs. But the intangible is what you have to eat in those transactions that go bad, because you're going to see a big change in the debit card world where you're responsible for your own losses.

LBBJ: Do you feel the Volcker rule (which is supposed to prevent banks from participating in proprietary trading, owning or investing in a hedge fund and limits the liabilities a bank can hold) will be helpful or hurtful to the banking industry?

Gray: The Volcker rule, from a congressional standpoint, made a lot of sense. This is one way we can really keep 'too big to fail.' We're going to say to big banks, 'You can't do these things,' or 'You have limitations on what you can do with these things.' Well, again, it's the unintended consequences.

Investing in a hedge fund? OK. Maybe Volcker understands what a hedge fund is, but I don't think anyone that voted on this bill has a concept of what a hedge fund is.

Limits the liabilities a bank can hold? Well, that depends on the individual bank. It even gets back to that broad spectrum because the details haven't been written yet. That makes it hard to say whether the Volcker rule is good or bad.

Proprietary trading? There's no question about it. That went on and went on, but they talk about it [as if it happened] in banks. That wasn't done in banks. It was done at Goldman Sachs. You read all the books [published about Wall Street]. I get a kick out of the books because that window is incredibly interesting, if you are a masochist, to see what happened in that rather short period of time. . . . I don't know how the Volcker rule is going to play out. I think there are going to be some problems with it, and I think it's going to be a very difficult thing to monitor.

LBBJ: The Federal Reserve's latest Senior Loan Officer Opinion Survey on Bank Lending Practices, released in January, indicates that large and other domestic banks are continuing to ease standards in some categories of household and business loans. Do you feel this easing could be an indicator for increased demand in 2011?

Gray: Yes, but you have to take it from my perspective. We increased our loan portfolio by 19 percent last year when others said they weren't lending to small business. That's who we lend to. . . . There's plenty of business out there, but one of the reasons that large banks are finding it difficult to deal with the companies they've done business with for a long time is, all of a sudden, sales dropped off. Now the business will try to react, but you can't flip the switch and catch your overhead at the same time. So instead of that \$500,000 line of credit, when it came due, the Bank of America would say, 'We think you ought to find someone else to do it.'

We've gotten a lot of that business, and it's good, core business. . . . The business demand is going to pick up. The consumer demand will – because it looks like every 35 minutes, when they do another survey, consumer confidence is building a little bit. ■