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No Equilibrium

As the pendulum swings toward more regulation, businesses and their lawyers try to keep it from becoming a wrecking ball

Dallas Business Journal - by Chad Eric Watt Staff writer

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OPPORTUNITY, INTERRUPTED: Dan Patterson, left, and Phil Wise formed a joint venture to buy up toxic assets from banks, but when federal regulators announced plans to put money toward that same opportunity, the flow of deals halted.

Early in the year, Dan Patterson saw an opportunity in second mortgages. For many banks, those loans and securities backed by them had become "toxic assets."

Patterson, chairman of private equity investor **Transition Capital Partners**, joined forces with private investment firm Cienda Partners to create a fund called RTR Capital to buy those loans and related securities at a discount from cash-hungry banks.

As they launched, the Treasury Department announced plans for the Public Private Investment Program, or PPIP. The program would invest alongside investors such as RTR.

RTR raised $10 million for its first fund and is raising $20 million for a second fund. In contrast, the PPIP program was first estimated to put $100 billion to work alongside big investors.

All that money was designed to be invested alongside groups such as RTR and help banks heal their balance sheets.

It did the opposite.

"It absolutely stopped the deal flow for distressed debt from February to June," Patterson said.

"The banks with the distressed stuff, they said, 'The government is going to put billions to work to buy this, so we'll hold off (on selling it),' " he added.

That's one unintended outcome of an increasingly vigorous regulatory regime and a foundering economy.

As the regulatory pendulum continues swinging from lax to more strict, businesses and their advisers are looking for new and different ways to ride that wave and avoid the regulatory wrecking ball.

Super scrutiny for banks

The finance and banking business was at the leading edge of the current recession, and industry regulators are in the cross hairs of Congress. That has regulators stepping up their scrutiny of the financial institutions they oversee.

Banking attorney Sandy Brown's desk hasn't been this messy in 18 years. That's the last time the banking industry faced a major crisis in sync with a broad economic slowdown.

“I’ve got more enforcement actions on my desk now than I’ve had since 1991,” said Brown, a partner at Bracewell & Giuliani in Dallas. “It’s like shutting the barn door after the horses are out. The regulators are making matters a lot worse than it needs to be.”

In addition to a tougher emphasis on bad loans, regulators are questioning banks on where they get their deposits.

“It’s overreaction Monday — fire the quarterback stuff,” he said. “There shouldn’t be wild swings in regulatory philosophy.”

Brown is busier with regulatory matters, but that’s balanced by less work from mergers and acquisitions.

Regulatory opportunity

How, and the degree to which banks are regulated can create headaches for those involved, but it also creates opportunities.

Stone Advisors, a Dallas financial advisory firm, is seeking regulatory permission to bid on failed banks. The group, led by veterans of the Texas banking crash, has put together $1 billion in capital commitments to make such purchases.

It is seeking a “shelf charter,” or temporary authorization from the Office of Thrift Supervision, to bid on failed institutions.

Stone Advisors is staffed by a team of veteran bankers who were involved in Bluebonnet Savings Bank FSB, a group that bought 15 failed Texas banks and operated them for 15 years before selling them off in 2003.

“This is back to the future for us,” said Brad Oates, chairman of Stone Advisors and its proposed bank vehicle Stone Bank FSB.

Stone Bank is looking for community banks that grew too quickly and took on too many risky loans.

While that is similar to the last banking-specific downturn, Oates said the current downturn and the regulatory reaction to it will be markedly different this time.

That’s because the banking crash has hit the general public in their greatest sources of wealth: their home values and retirement accounts.

“This (regulation) conversation has extended beyond the bank industry this time around,” Oates said.

And already government aid has roamed far beyond traditionally regulated industries to automakers, their suppliers and residential real estate. The government is issuing payments to encourage spending on more fuel-efficient cars and first homes.

“When someone’s received government assistance, there are certain expectations that go along with that,” Oates said.

The health care question

The business of health care and medicine is second only to the financial sector in terms of potential regulatory changes.

They're completely different businesses. But the root of seismic changes in both businesses is the same: money.

The United States needs health care reform because the system is running out of money, said Diana Hueter, a health care principal at the Thomas Group, an Irving-based process consulting business.

"There's a feeling, and probably rightfully so, that there needs to be some changes and realignment," she said. "Everyone is saying what are we doing wrong? And how can we do it better?"

But most likely, not everyone will agree on the answers.

"Unfortunately, sometimes regulation forces issues that may be on the back burner up on the agenda," Hueter said.

The pendulum will swing

Whatever reform comes to health care and whatever new regulation comes to finance, government regulation will continue to wax and wane, said Patterson, the private equity investor.

"There's a lot of smart people who try to figure ways around well-intended legislation," he said. "When there are loopholes, people will sweep in and exploit it, and that leads to calls for more regulation."

And like an economic cycle, those additional regulations will ultimately lead to calls for less regulation, until the smart people find the new loopholes, Patterson said.

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