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New law shines spotlight on FDIC's bank failures

January 11, 2012
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On Jan. 3, President Barack Obama signed into law legislation intended to bring transparency to the FDIC's bank closure process — lawmakers' latest attempt to put regulators under greater scrutiny.

Rep. Lynn Westmoreland R-Ga.
Source: Rep. Lynn Westmoreland

During a Jan. 10 interview, the author of H.R. 2056, Rep. Lynn Westmoreland, R.-Ga., said the new legislation was partly a reaction to regulatory "inconsistencies" and suggested that the FDIC could have done more to prevent the high level of bank failures.

Among other things, the congressman questioned regulators who require an institution to raise capital while slapping it with an enforcement action. "Who's going to put money into a bank under cease and desist?" he asked. "I'm not a banker, but this isn't rocket scientist stuff."

The new law requires the FDIC inspector general to conduct a comprehensive study of the impact of bank failures, and it also calls for the Government Accountability Office to carry out a study of the causes of high levels of bank failures.

The studies will look at banks in the 10 states with the most failures: Arizona, California, Florida, Georgia, Illinois, Michigan, Minnesota, Missouri, Nevada and Washington.

Westmoreland said the newly mandated studies will be followed by hearings to ensure that the FDIC OIG does not simply "regurgitate" the material-loss reviews and failed-bank reviews that it already writes.

Number of failures by asset size

	<$500M		<$1B	
Year	Number of failures	Percent of total (%)	Number of failures	Percent of total (%)
2011	74	80.43	86	93.48
2010	115	73.25	138	87.90
2009	94	67.14	113	80.71
2008	12	48.00	16	64.00

Data compiled as of Jan. 10, 2011.
Assets from regulatory filings available at date of failure.
Source: SNL Financial

Failed bank statistics

		Assets at assumption ($M)		
Year	Number of failures	Aggregate	Average	Median
2011	92	35,026.9	380.7	198.5
2010	157	92,085.0	586.5	248.2
2009	140	169,709.2	1,212.2	259.7
2008	25	371,945.5	14,877.8	528.0

Data compiled as of Jan. 10, 2011.
Assets from regulatory filings available at date of failure.
Source: SNL Financial

"I hope it will at least draw some attention to the number of community banks we've had fail here in Georgia," he told SNL.

Georgia continues to experience more than its share of bank closings. A quarter of the 92 bank failures in 2011, 23 in total, took place in Georgia, a state still plagued by troubled banks.

"What's interesting about this is that most of these banks are community banks, those that are really supporting the small businesses of this country," said Thomas Borgers, a managing director at Mesirow Financial Consulting and a former senior investigator for the FDIC and the Financial Crisis Inquiry Commission. "For the vast majority of these banks, the primary regulator was the FDIC, so I think it's a good thing to understand why these banks failed."

According to SNL data, more than 80% of banks and thrifts that failed in 2009 had less than $1 billion in assets. This figure rose to nearly 88% in 2010 and more than 93% in 2011. The median size of banks that failed in 2008 was $528 million in assets. By 2011, this number had dropped to $198.5 million.

Borgers noted that banks under $1 billion in assets had far fewer resources to help them through the financial crisis than their larger counterparts. "We had TARP and everything else for the big banks, and we gave them so many different avenues," he said, adding that smaller community banks "really do need the support of the government, too, when they get into crisis."

Westmoreland agreed, arguing that the FDIC should look for more cost-effective, "common-sense" alternatives to bank failures. A better option, he suggested, would be for the FDIC to loan troubled banks 50% of the capital they need, free of interest for seven years and without recourse. For example, if the FDIC required a bank to raise $20 million to comply with regulatory capital ratios, the agency would provide a $10 million loan and the institution would have a certain time period to raise the other half.

While some banks should fail, others could have been saved if they had received this kind of assistance, Westmoreland said. "That's a helping hand. It's not a bailout," he added.

H.R. 2056 is not the only legislation that has recently aimed to put regulators under greater scrutiny. In November, Rep. Shelley Moore Capito, R-W.Va., and Rep. Carolyn Maloney, D-N.Y., introduced H.R. 3461, which aims to give bankers a way to respond to examinations without fear of reprisal from regulators. Like Westmoreland, Capito pointed to "inconsistencies" in regulatory examination procedures.

Prior to this, Rep. Bill Posey, R-Fla., sponsored a bill that would have allowed banks to consider certain nonaccrual loans as accrual for capital purposes. The legislation, which was defeated in November, was an attempt to counter overzealous examiners who, fearing that banks will falter on their watch in the wake of the financial crisis, are punitively addressing banks' assets and, as a result, crimping lending, Posey said.

Borgers said it makes sense that regulators are facing closer analysis, as markets demand greater transparency and more careful evaluation of risk after the recent financial crisis. "These institutions did take on too much risk, and that caused the bulk of the problems," he said. "[Regulators] did made mistakes, and some of these mistakes were major." *i*

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