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Despite criticism, regulators may not have itchy trigger fingers on capital

By David Hayes and Lindsey White

Banks and politicians have ramped up criticism of regulators of late. But capital levels over the past few years suggest that regulators are perhaps being more patient when it comes to issuing enforcement actions and closing banks.

SNL looked at the median risk-based capital ratios and the median leverage ratios at banks when they failed. Since the height of the financial crisis, these ratios have dropped fairly steadily and dramatically.

For example, in the third quarter of 2008, banks had a median risk-based capital ratio of 7.96% at the time of failure. By the fourth quarter of 2011, this ratio was 2.25% for failed banks.

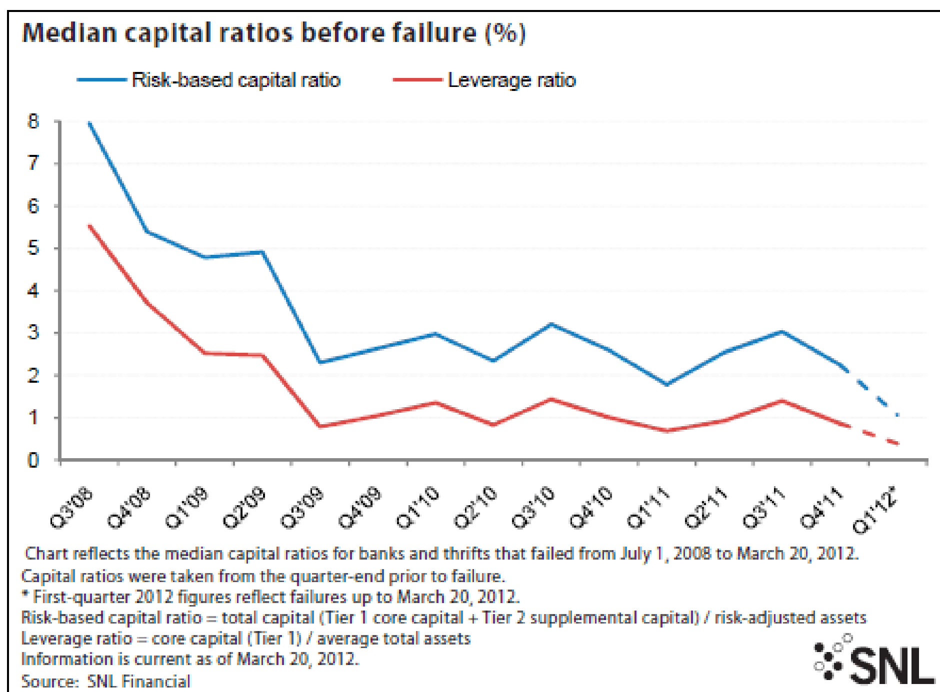

Chart reflects the median capital ratios for banks and thrifts that failed from July 1, 2008 to March 20, 2012.
Capital ratios were taken from the quarter-end prior to failure.
* First-quarter 2012 figures reflect failures up to March 20, 2012.
Risk-based capital ratio = total capital (Tier 1 core capital + Tier 2 supplemental capital) / risk-adjusted assets
Leverage ratio = core capital (Tier 1) / average total assets
Information is current as of March 20, 2012.
Source: SNL Financial

"The FDIC and the state regulators are being a little more patient and not acting too hastily," said John Donnelly, a managing director of Donnelly Penman & Partners. This delay is partly due to the FDIC's resources — observers note that the agency has a limited amount of manpower to devote to bank closures.

"The other factor is that they're hoping that some type of outside capital injection might be possible if they give the bank more time," Donnelly said. "The third factor is that we're definitely seeing a bottoming out of the credit cycle."

Christopher Spoth, a director in Deloitte & Touche LLP's banking and securities regulatory practice and a former senior executive at the FDIC, said regulators will exercise patience when an institution is taking the proper remedial steps. "They wish to avert the failures, so if an institution is making an effort to recapitalize or to adjust its risk management weaknesses, the regulators will be patient with them," he said.

The numbers appear to contradict comments from bankers and policymakers who claim that regulators are becoming increasingly demanding. Among the critics is Rep. Lynn Westmoreland, R-Ga., whose bill to bring transparency to the FDIC's bank closure process was signed into law in January.

In an earlier interview, Westmoreland said the legislation was partly a reaction to regulatory "inconsistencies." He suggested that the FDIC could have done more to prevent the high level of failures, the vast majority of which were community banks.

When presented with some of SNL's findings about historical capital levels at failed banks, Westmoreland noted that capital is not "the absolute and only barometer and measure" of a bank's financial health. "I don't think capital tells the whole story," he told SNL during a March 23 interview.

John Geiringer, a partner at Barack Ferrazzano Kirschbaum & Nagelberg LLP, made a similar point. "You can't look at capital in a vacuum," he noted. "There needs to be directional consistency between your capital cushion and the amount of classified assets. The more classified assets, the more capital [regulators] want to see."

Geiringer said the atmosphere between bankers and examiners is slightly more relaxed now than in previous years, but he did not buy into the idea that regulators are being more patient. "I think it's a numbers game," he said, noting that if a bank's leverage ratio drops to 2%, regulators have no choice but to put the institution into receivership. "They have no discretion whatsoever under the law."

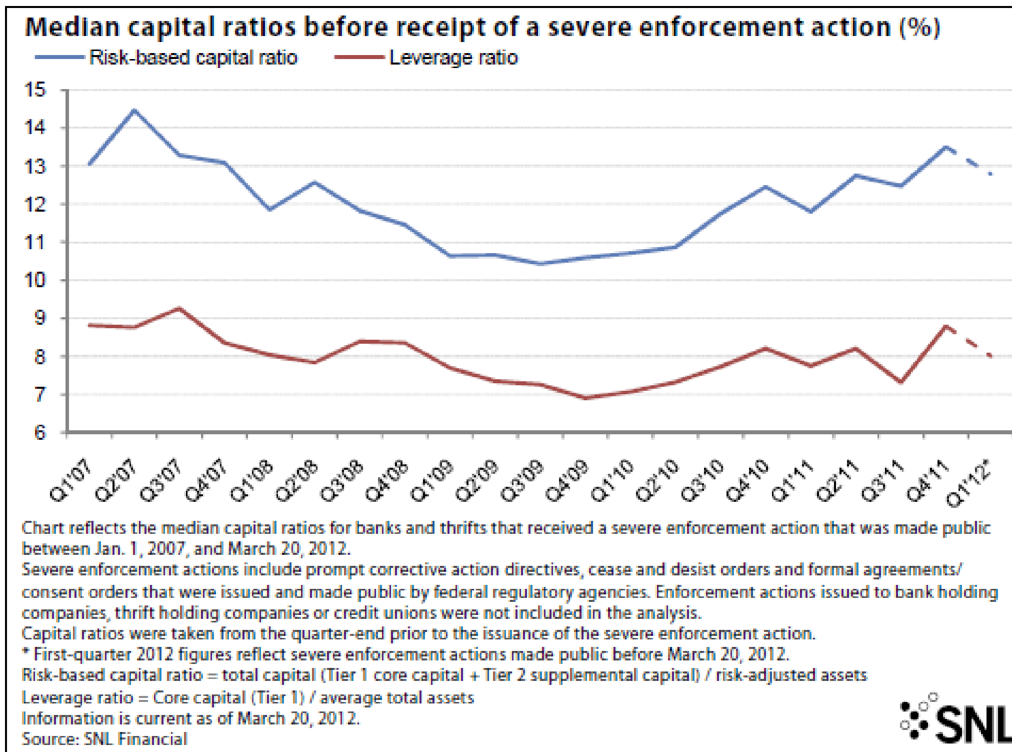

Chart reflects the median capital ratios for banks and thrifts that received a severe enforcement action that was made public between Jan. 1, 2007, and March 20, 2012.
Severe enforcement actions include prompt corrective action directives, cease and desist orders and formal agreements/ consent orders that were issued and made public by federal regulatory agencies. Enforcement actions issued to bank holding companies, thrift holding companies or credit unions were not included in the analysis.
Capital ratios were taken from the quarter-end prior to the issuance of the severe enforcement action.
* First-quarter 2012 figures reflect severe enforcement actions made public before March 20, 2012.
Risk-based capital ratio = total capital (Tier 1 core capital + Tier 2 supplemental capital) / risk-adjusted assets
Leverage ratio = Core capital (Tier 1) / average total assets
Information is current as of March 20, 2012.
Source: SNL Financial

While capital levels at failed banks have followed a steady downward path, capital ratios for banks receiving severe enforcement actions have taken a slightly different trajectory. The median leverage ratio for a bank receiving a prompt corrective action directive, cease and desist order, formal agreement or consent order was 8.79% in the fourth quarter of 2011, and the median risk-based capital ratio was 13.50%.

These ratios have crept back up since the second quarter of 2010, but are still below the peak level: In the second quarter of 2007, banks receiving severe enforcement actions had a median risk-based capital ratio of 14.47% and a median leverage ratio of 8.76%.

Thomas Borgers, a managing director at Mesirow Financial Consulting and a former senior investigator for the FDIC and the Financial Crisis Inquiry Commission, said this suggests that the FDIC wants to help community banks, which do not have the same resources as larger peers but contribute heavily to the nation's small-business lending.

"I think the government is a little bit more understanding of community banks because they are the backbone of our Main Street economies," Borgers told SNL. "Without the support of the federal government, I think a main artery of growth will not materialize for this recovery."

The FDIC certainly appears to be making an effort to reach out to community banks — the agency held its Future of Community Banking conference in February and is undertaking a series of initiatives in 2012 to boost communication with community bankers around the country.

Still, Westmoreland stood his ground in his criticism of regulators. "Maybe they realize that what they've done has been a disaster in a lot of communities," he said. "We have communities that don't even have a community bank anymore."