Bank failures top 100, only part of industry woes

By DANIEL WAGNER, AP Business Writer Daniel Wagner, Ap Business Writer – OCTOBER 24 2009

WASHINGTON – The cascade of bank failures this year surpassed 100 on Friday, the most in nearly two decades. And the trouble in the banking system from bad loans and the recession goes even deeper than the number suggests.

Dozens, perhaps hundreds, of other banks remain open even though they are as weak as many that have been shuttered. Regulators are seizing banks slowly and selectively — partly to avoid inciting panic and partly because buyers for bad banks are hard to find.

Going slow buys time. An economic recovery could save some banks that would otherwise go under. But if the recovery is slow and smaller banks' finances get even worse, it could wind up costing even more.

The bank failures, 106 in all, are the most in any year since 181 collapsed in 1992, at the end of the savings-and-loan crisis. On Friday, regulators took over three small Florida banks — Partners Bank and Hillcrest Bank Florida, both of Naples, and Flagship National Bank in Bradenton — along with American United Bank of Lawrenceville, Ga., Bank of Elmwood in Racine, Wis., Riverview Community Bank in Otsego, Minn., and First Dupage Bank in Westmont, Ill.

When a bank fails, the Federal Deposit Insurance Corp. swoops in, usually on a Friday afternoon. It tries to sell off the bank's assets to buyers and cover its liabilities, primarily customer deposits. It taps the insurance fund to cover the rest.

Bank failures have cost the FDIC's fund that insures deposits an estimated $25 billion this year and are expected to cost $100 billion through 2013. To replenish the fund, the agency wants banks to pay in advance $45 billion in premiums that would have been due over the next three years.

The FDIC won't say how deep a hole its deposit insurance fund is in. It can tap a credit line from the Treasury of up to a half-trillion dollars to cover the gap.

The list of banks in trouble is getting longer. At the end of June, the FDIC had flagged 416 as being at risk of failure, up from 305 at the end of March and 252 at the beginning of the year.

Yet the pace of actual bank failures appears to be slowing. The FDIC seized 24 banks in July, 11 in September and 11 in October.

If any bank poses an immediate danger to customers or the broader financial system, regulators close it immediately, bank supervisors said. The issue is murkier for troubled banks that might qualify to close but whose closings might still be postponed or even prevented.

The FDIC's first priority, spokesman Andrew Gray said, is to maintain public confidence in the banking system. "As evidenced by the stability of insured deposits throughout last year, this mission has been a success," he said.

He said public confidence isn't reason enough to delay a bank closing, because legally the decision to close rests with whoever chartered the bank — a state or federal agency.

But more than a dozen experts, including current and former regulators, bankers and lawyers, say the FDIC's mission to maintain public confidence in the banking system contributes to the go-slow approach.

"The FDIC was set up to create confidence and prevent bank runs," says Mark Williams, a former bank examiner for the Federal Reserve. Being too aggressive about bank closings "can be counter to the mission."

Sarah Bloom Raskin, Maryland's top banking regulator, said: "Technically it's the states who decide, but in reality it's the FDIC calling you to say" when the bank will be closed.

Last fall, the financial turmoil was rooted in bad bets that the nation's biggest banks, like Citigroup Inc. and Bank of America Corp., had made on complicated, high-risk mortgage investments.

Smaller banks have been undone by something more conventional — real estate, construction and industrial loans that have soured as the recession has deepened. Defaults are up as developers abandon failing projects and landlords can't meet their loan payments.

Small- and mid-sized banks hold lots of those loans and have been hurt more than big ones by the sinking commercial real estate market, especially in states like California, Georgia and Illinois. As defaults rise, these banks must set aside more money to cover losses.

For the banks, this means mounting losses and shrinking reserves.

In a healthy economy, Williams said, the Fed and the FDIC would be inclined to close such weak banks. But these days, those agencies and other regulators prefer to hold off, hoping an economic recovery will eventually restore the health of some of the banks.

But the recovery is expected to be slow. Americans remain hesitant to spend money because of job losses, flat wages, tight credit and high debt. Their cutbacks have triggered tens of thousands of business failures.

Abandoned retail space in downtowns and suburban malls means no rental income for property owners. As landlords default on real estate loans, they weaken the banks that hold the loans.

The situation now is especially grave in Southern California, Georgia and Illinois, which have some of the highest home foreclosure rates. Twenty banks have closed in Georgia alone.

Individual bank depositors aren't at risk when a bank fails. Their money is guaranteed up to $250,000 by the government. Ever conscious of maintaining public confidence, agency officials hammer this point in public statements.

When weak banks are allowed to stay open, their growing losses potentially can drain the FDIC's deposit insurance fund faster, says Bert Ely, an independent banking consultant.

Federal agencies aren't the only ones with an interest in slowing the pace of bank closings. State regulators with closer ties to local communities want to avoid the ripple effects when a town loses its main source of consumer and business credit, Williams said.

But finding buyers for wobbly banks has been tough.

FDIC Chairman Sheila Bair acknowledged as much in testimony this month before a Senate panel. The FDIC has been offering to share buyers' losses on the assets being transferred, she said.

"In the past several months investor interest has been low," she said in prepared testimony.

In an effort to find more potential buyers, the FDIC has relaxed the rules for private-equity firms to buy banks. In the past, regulators had feared such a move would allow investors to protect themselves from the cost of bank failures, escaping serious consequences while drawing down the FDIC's fund.

An early success of the new strategy was a deal announced this month to sell assets from Corus Bank of Chicago to a group of private investors. But there still aren't enough buyers to absorb quickly all the assets held by at-risk banks.

That's because there are so many weak and failing banks on the market — and so few others strong enough to buy them. That's one reason it's hard to know how many more banks could be closed in coming months, said Daniel Alpert, Managing Partner of the New York investment bank Westwood Capital LLC.

"How many banks will survive?" Alpert asked. "Loans are still deteriorating, but there are glimmers of hope in the economy. Ultimately, it's all about employment."

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