Screws tight on Georgia banks

Sunday, August 16, 2009

By Russell Grantham

The Atlanta Journal-Constitution

Federal and state regulators have put as many as one-third of Georgia's 300 banks under intensified monitoring and recovery plans, mostly strict enforcement orders a step or two short of seizure, according to banking experts.

A majority of these 90 to 100 banks, these experts say, are operating under "cease and desist" orders that require them to complete tough turnaround plans within strict deadlines.

While regulators can be flexible on deadlines or other requirements if banks fall short, many banks that have previously been put under such sanctions have failed.

Such actions are aimed at restoring a bank to health by boosting capital and improving operations, much as a doctor might order his patient to quit smoking and lose weight, said Patrick Frawley, a former regulator with the federal Office of the Comptroller of the Currency who now works as a consultant helping banks comply with such orders.

"Unfortunately in the environment we're in right now, those are nice goals but very difficult to achieve," Frawley said.

And unless the economy improves soon, industry experts expect the number of bank failures and new enforcement orders to continue growing in Georgia, which already leads the nation in total bank failures — 21 over the past year.

Depositors generally wouldn't be affected, but a further shakeout in Georgia's banking industry would affect many of its business and loan customers and wipe out many bank investors' stakes.

Additional bank failures also put more pressure on falling property values as the Federal Deposit Insurance Corp. auctions off the defunct subdivisions and projects related to bad loans. The FDIC expects bank failures nationwide to cost its already-strained insurance fund $70 billion through 2013.

Most of the enforcement actions are not publicly disclosed, so a firm number of affected banks can't be determined. Like most states' regulators, the Georgia Department of Banking and Finance doesn't disclose its cease-and-desist orders or similar actions. Federal regulators do disclose their actions.

Through a search of those disclosures, The Atlanta Journal-Constitution identified 50 Georgia banks that were slapped with cease-and-desist orders or similar actions, or failed with no apparent sanction, in the past 20 months. More than 20 sanctions were imposed in the last five months alone.

However, some banking attorneys who have dealt with such regulatory actions say Georgia's total is much higher, affecting 90 to 100 banks currently, with more orders being issued each month.

Scrutiny stepped up?

Some experts speculate that sanctions are piling up partly because regulators are cranking up scrutiny under pressure from agency bosses who think the Georgia banking industry has been weakened by too many banks. Regulators also are racing to catch up on a backlog of examinations and enforcement efforts at crippled banks, they say.

Regulators have been criticized in recent federal audits for not stepping in forcefully enough to head off problems at Georgia banks that failed last year.

The agencies have been overwhelmed by the number of problems at banks that often haven't been examined in a year or more, said bank analyst Chris Marinac of Atlanta-based FIG Partners, which tracks industry trends. Problems "may not be recognized for 15 months because they haven't seen" the bank, said Marinac. "A lot of things have changed in the last 15 months."

Others say the rising number of sanctions is simply a reflection of the worst recession in decades.

“It’s just that the economy has wreaked havoc on these borrowers,” such as residential developers, shop owners and retail landlords who no longer can repay their loans, said John Kline, a Decatur banking consultant. “That’s the bread and butter of community banking.”

FDIC spokesman David Barr said the agency has been issuing more enforcement orders nationwide every month. But the industry still hasn’t been shaken as badly as during the savings and loan crisis, when 534 institutions across the country failed in 1988, compared to 74 this year.

‘An all-time high’

Most of the affected banks are small institutions in metro Atlanta, which has struggled to recover from a binge of heavy lending to homebuilders and developers caught in the real estate crash.

Kline, who helps Georgia banks that have been sanctioned, estimates as many as 100 banks are under some form of formal or informal sanction because of continuing losses on problem loans. “That is an all-time high,” he said.

Walt Moeling, an Atlanta banking attorney with Bryan Cave Powell Goldstein, said more than 60 of the state’s banks are operating under cease-and-desist orders. About 30 more, he said, have less formal self-improvement agreements known as memoranda of understanding, known as MOUs.

“Today, if a client calls and says, ‘I’m really upset, they’re giving me an MOU,’ I say congratulations,” because it’s not a tougher action, said Moeling. “Everybody in this market has problems,” he said.

Given all the bad news that has racked the state’s banking industry over the past two years, some industry players said a broad crackdown shouldn’t be a surprise, or a big concern to customers.

These people point out that banks typically haven’t failed while under such sanctions. When they do fail, most depositors’ accounts are covered by up to $250,000 in insurance from the FDIC.

“The two are totally separate issues,” said Georgia Bankers Association President Joe Brannen, who said he has heard that a similarly high number of banks are under state or federal sanctions. But Brannen said people shouldn’t confuse regulatory orders with the safety of their deposits.

“While ‘cease and desist’ sounds horrible, it is part of the regulatory process,” he said.

Designed to be ‘a pain’

The orders set deadlines for banks to take one or more of several actions, which include evaluating, and sometimes firing, top managers; taking a hard look at their business strategy; revamping their loan processes; trying to raise new capital; and weaning themselves off of an expensive form of deposits known as brokered deposits.

Regulators are also trying to limit further damage, said Bobby Schwartz, a banking attorney with Smith, Gambrell & Russell in Atlanta. The orders often require monthly progress reports and bar banks from making more loans to borrowers who are already in trouble.

“It’s a pain. It’s designed to be. It’s designed to force a bank to address its problems ... and report progress in specific terms,” said Schwartz.

Historically, about 80 percent of banks slapped with cease-and-desist orders have dealt with their problems and moved on, said Brannen. But it’s unclear whether that will be true with the recent crop of banks hit with such sanctions. Most troubled banks are finding it virtually impossible to revive their moribund loan portfolios or to raise new capital from outside investors.

Of the 50 Georgia banks the AJC was able to identify from publicly disclosed enforcement actions in 2008 and 2009, more than 40 percent have failed.

That sample, however, doesn’t include perhaps 60 to 70 other banks for which sanctions haven’t been publicly disclosed. And some banks, such as Alpha Bank & Trust in Alpharetta and Community Bank in Loganville, failed last year before any sanction was disclosed.

In any case, the number of Georgia bank failures is likely to grow beyond the 21 that have failed since Integrity Bank, the first to fail, was seized last August.

“These days, it’s a tough scenario,” said Frawley, the former bank regulator.

Frawley had just finished turning around a group of four Alabama banks that were slapped with multiple cease-and-desist orders when he was hired in 2007 as Integrity Bank’s new chief executive to do the same thing. Within months, Integrity was “making good progress,” he said, by cutting its reliance on expensive brokered deposits and reducing its heavy concentration on construction and development loans.

But Integrity ran into a wall trying to meet the regulators’ toughest requirement — raising about $50 million in new capital from investors such as pension funds. Every time Frawley got close to clinching a deal for new money, more bad news from Wall Street and the tottering banking industry scared off would-be investors, he said.

“In the final analysis that wouldn’t have been enough anyway because the hole was too deep,” said Frawley. A year after he was hired, the FDIC and Georgia regulators pulled the plug.

Marinac estimates that about 20 percent of Georgia’s banks, or roughly 60, will fail before the industry recovers.

“There will be more banks [that] go into receivership,” said Moeling, and perhaps at an accelerating pace if the local economy isn’t soon on the mend. “I think it’s miraculous we haven’t lost more than we have.”