

# While FDIC Fiddles, Banks Burn

By Steven Marlin, Reporter

As the Federal Deposit Insurance Corporation tries to come up with ways to make it easier to buy failing banks, the chance that more banks will fail is increasing, David Twibell, president of wealth management at Colorado Capital Bank, told Markets Media.

Some 77 banks already have failed this year, compared to 25 in all of 2008. “Last year, Wamu and several other large banks failed,” Twibell said. “This is the year that small banks go under.”

Compared to the large bank failures that took place during the savings and loan debacle, the number is manageable. “Because the banks are smaller, it will be a lot easier for the system to digest,” Twibell said. “The banks left standing at the end will be stronger.”

Banks are struggling to shore up weak balance sheets amid a weakening economy. “A lot of banks have raised capital through TARP or a secondary offering, as painful as that may be,” Twibell said. “Some of that capital has been eaten up by loan loss reserves, but some banks have raised capital with the express intent of buying assets inexpensively.”

The weakness in the economy generally and in the commercial real estate sector in particular has created opportunities in distressed debt.

“Commercial real estate tends to lag the economy, meaning there are more problems ahead, plus significant pressure on a lot of projects,” Twibell said Friday. “A lot of projects have received financing

based on unrealistic cash flow projections, and will need to get refinanced, but banks aren't lending.”

The FDIC is considering lowering capital ratios that bidders for failed financial institutions would need to retain. The FDIC had proposed setting the Tier 1 capital ratio of acquired banks at 15 percent, but is likely to reduce that to 10 percent in light of pushback from the private equity industry.

Even if the Tier 1 requirement is reduced to 10 percent, well-capitalized banks may be able to buy failed banks more cheaply than they otherwise could. In effect, the FDIC is charging a higher premium for private equity firms to participate.

The FDIC is also tweaking the legacy loans portion of PPIP to permit PEs to invest in toxic assets without acquiring failed banks. It's testing a new type of transaction in which a portfolio of residential mortgage loans will be transferred to a limited liability company (LLC) in exchange for an ownership interest in the LLC.

Accredited investors will be offered an equity interest in the LLC under two different options: the first option is an all cash basis, with an equity split of 80 percent (FDIC) and 20 percent (accredited investor); the second option is a sale with leverage, under which the equity split will be 50 percent (FDIC) and 50 percent (accredited investor).

Posted on Aug. 24, 2009