BANKS

NYCB Stock Sinks After Finding 'Material Weaknesses' in Its Loan Review Process

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Updated March 01, 2024, 2:13 pm EST / Original Feb 29, 2024, 5:21 pm EST

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The New York Community Bancorp headquarters in Hicksville, N.Y. BING GUAN/BLOOMBERG

A month after shaking the regional bank industry with a surprise provision for loan losses, New York Community Bancorp rattled nerves again by announcing a $2.4 billion December quarter earnings hit. At the same time, it said it identified "material weaknesses" in its loan review process and abruptly changed CEOs—causing its stock to tumble.

Of most immediate concern is whether the bank's run of disconcerting news will contribute to a run by its core depositors, Wedbush analyst David Chiaravini told *Barron's* Friday. The bank has previously said it has access to plenty of brokered deposits, but said nothing about deposit levels in Thursday's announcement. Chiaravini is one of the few analysts who's been right on NYCB stock, downgrading it to a Sell last year.

The bank said it needs more time to file its annual report. In a securities filing, it said that while its review of internal controls continues, it expects to report that its disclosure controls and procedures and internal control over financial reporting weren't effective as of Dec. 31. The weaknesses resulted from ineffective oversight, risk assessment, and monitoring activities, it said.

The $2.4 billion charge results from the bank reducing its balance sheet value for the intangible "goodwill" its acquired in past bank mergers—the amount NYCB paid in excess of identifiable assets such as loans, cash, real estate. So the goodwill impairment carried no cash costs and won't affect NYCB's regulatory capital or credit agreements, the bank said.

The burst of unpleasant news knocked NYCB stock down 25% by Friday afternoon, to $3.60. Coming into Friday, shares had dropped 53% this year. Adding to the pressure, Piper Sandler analyst Mark Fitzgibbon downgraded the stock from Overweight to Neutral, admitting that he had been too optimistic.

Chief Executive Thomas Cangemi will step down after 27 years with the New York-based lender. His role will be assumed by Sandro DiNello, the board chairman who had already taken executive charge of the bank after its abrupt Jan. 30 announcement of a 70% cut in its dividend and a half-billion-dollar boost in its reserve for loan losses.

The board's ousting of Cangemi as CEO seems to have been in the works for at least a week, and was opposed by NYCB's lead independent director Hanif "Wally" Dahya, an investor and veteran of several Wall Street banks. With the rest of its bad news, the bank disclosed a resignation letter that Dahya had submitted on Feb. 25, protesting DiNello's appointment as CEO.

DiNello had headed and turned around troubled Michigan-based Flagstar Bank, before merging it a year ago with NYCB. Until Thursday, he had been portrayed as sharing command of NYCB with Cangemi.

"It is my mandate as President and CEO, alongside our Board, to continue our transformation into a larger, more diversified commercial bank," said DiNello said in Thursday's announcement. "While we've faced recent challenges, we are confident in the direction of our bank and our ability to deliver for our customers, employees and shareholders in the long-term."

NYCB didn't respond to a request for comment.

Of most immediate concern to the bank's fortunes are its flow of deposits, Wedbush analyst Chiaravini said, and the bank said nothing on that score in its recent announcements. He hopes to get more information when the bank finally files its 10-K, which it has promised to do within the next 15 days.

When DiNello spoke with analysts last month, he said that deposits had grown by $1 billion since the year began, and that NYCB could acquire plenty more, in the form of brokered deposits.

DiNello didn't say at the time how much of that $1 billion were regular customer's "core" deposits and how much was brokered, Wedbush's Chiaravini points out. Banks must pay higher rates to get brokered deposits, making them more expensive than core deposits. Replacing core deposits with brokered ones would hurt NYCB's net interest margin and its earnings, the Wedbush analyst says.

And NYCB's funding costs are already under pressure because credit-rating firms downgraded its debt rating last month to junk status.

The bank said the $2.4 billion earnings charge stemmed from a recent assessment of the value of goodwill on its balance sheet.

"I'm not too concerned about the goodwill impairment and I don't think investors are, either," said Wedbush's Chiaravini. "That's because it's not a cash charge and does not affect their regulatory capital ratios."

About $30 million in other balance sheet changes will also be needed, said the bank, all related to NYCB's acquisition of assets last year from the failed Signature Bank.

More consequential than the goodwill charge might be any further loan loss reserve additions, said the Wedbush analyst. Friday morning, NYCB said that it had appointed a new chief risk officer and a new audit head.

Given the bank's admission that its loan reviews were weak, the new executives may review NYCB's portfolio and regrade loans in a way that would require new reserves and further charges beyond the half-billion dollar reserve boost that set off the bank's spiral, on Jan. 30.

"That fresh pair of eyes could lead the bank to take a more conservative tack," said Chiaravini," and more reserve building."

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