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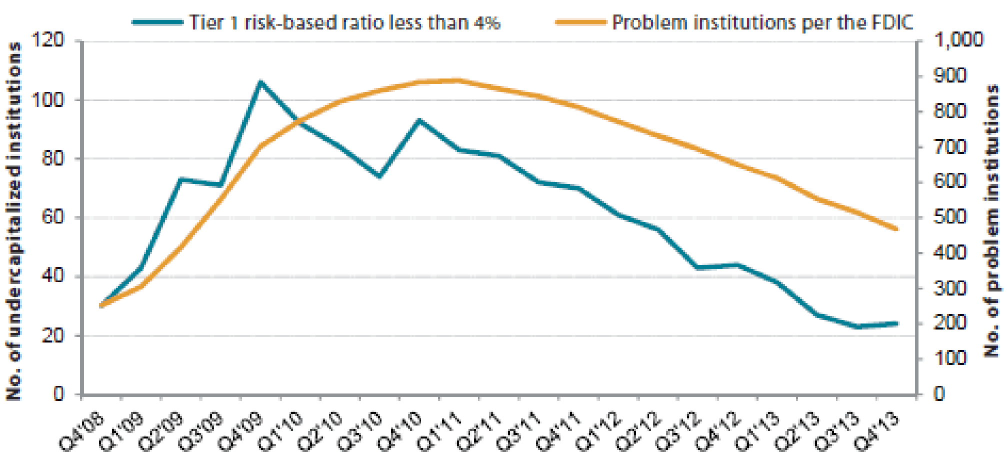
Sick banks no longer an epidemic

By Nathan Stovall and Robert Clark

As market conditions continued to improve in 2013, undercapitalized banks fell to pre-crisis levels and the number of problem banks experienced a dramatic decline.

The number of undercapitalized banks dwindled throughout 2013 and not necessarily through failures, which was the case during 2011 and 2012. More banks found their ways out of trouble through positive means in 2013 even if true success stories are still not commonplace for most troubled banks. Raising capital today is still difficult for a weaker institution, but with the economy improving, banks looking to raise funds, particularly institutions with some scale, can often find an audience with investors.

Problem and undercapitalized banks & thrifts



Data as of March 3, 2014 — 17 currently operating banks and thrifts with a Tier 1 risk-based ratio less than 4%.
Current and historical companies are included in the graph for all quarters.
Tier 1 risk-based ratios are from regulatory filings.
Sources: SNL Financial, FDIC

As one investment banker recently said to SNL, "There's more opportunity today than there was last year and there was more opportunity last year than there was the year before."

The number of undercapitalized institutions looking to raise funds now is much smaller than it was in years past. The FDIC defines undercapitalized banks as those with a total risk-based capital ratio below 8.0%, a Tier 1 risk-based capital ratio below 4.0% or a Tier 1 leverage capital ratio below 4.0%, unless the bank is a CAMELS one-rated institution. In that case, a bank would be undercapitalized if its leverage ratio was less than 3.0%.

Twenty-four banks and thrifts were undercapitalized, based on the criteria of having Tier 1 ratios below 4%, at Dec. 31, compared to 23 institutions at the end of the third quarter and 44 institutions a year ago, according to SNL data. After witnessing several quarters of sizable declines in the number of undercapitalized institutions, the decreases have moderated as the sheer number of banks still reporting low capital ratios has fallen to pre-crisis levels.

The current number of undercapitalized institutions is at the lowest level since the third quarter of 2008, when 14 banks were considered undercapitalized, and stands in stark contrast to the levels seen three years ago, when 93 banks were considered undercapitalized. Failures were the main contributor to the decrease in undercapitalized institutions in 2011 and 2012. The trend was consistent through those two years, when the number of undercapitalized banks decreased by 49 to 44 institutions. During that period, a number of banks joined the ranks of the undercapitalized and 143 banks failed, while 36 banks found their way out of trouble through recapitalizations, mergers or balance sheet shrinkage and de-risking, coupled with modest earnings in some cases.

The trend was more positive in 2013, when 16 banks, including five in the fourth quarter, found their way out of undercapitalized territory without failing or closing their doors. Just 24 banks failed in 2013 — only two banks failed in the fourth quarter.

In total, four banks previously deemed undercapitalized have failed since SNL last published the list of undercapitalized banks in the industry. When excluding banks that have failed or merged since the end of the fourth quarter, SNL data shows that, as of March 3, 17 banks were undercapitalized based on Dec. 31 data, compared to 20 banks at the last publication of the list of undercapitalized banks. The 17 undercapitalized banks reported a median Tier 1 ratio of 3.13% at the end of the fourth quarter and the group reported median linked-quarter declines in their capital ratio of 26 basis points.

Undercapitalized banks and thrifts

Currently operating commercial banks and savings banks as of March 3, 2014, with a Tier 1 risk-based ratio less than 4%

Company (top level ticker)	City, state	Total assets ($M)	Tier 1 risk-based ratio (%)[1]	Change from Q3'13 (bp)	Adjusted Texas ratio (%)[2]
Horry County State Bank (HCFB)	Loris, SC	434.7	3.13	23	438.39
Enterprise Bank of South Carolina	Ehrhardt, SC	323.4	-0.08	-509	376.40
Capitol City Bank & Trust Co. (CPTY)	Atlanta, GA	287.9	3.41	-20	587.01
Advantage Bank	Loveland, CO	256.8	3.68	-226	302.45
First City Bank of Florida	Fort Walton Beach, FL	233.3	3.25	-21	639.12
New Millennium Bank (NMNB)	New Brunswick, NJ	178.5	3.37	34	90.73
Eastside Commercial Bank	Conyers, GA	170.1	3.08	-67	1,030.75
Gulf Coast Community Bank	Pensacola, FL	159.2	2.96	6	622.96
Slavie FSB (MHC) (SFBI)	Bel Air, MD	142.8	3.85	-86	283.21
Foothills Community Bank	Dawsonville, GA	89.9	2.96	-9	629.19
Valley Bank	Fort Lauderdale, FL	88.8	3.75	1	123.96
GreenChoice Bank fsb	Chicago, IL	75.6	3.50	-115	418.87
American Patriot Bank	Greeneville, TN	74.9	3.01	-26	607.08
AztecAmerica Bank	Berwyn, IL	66.3	3.15	37	534.37
FirstSecure Bank and Trust Co.	Palos Hills, IL	56.5	1.37	-312	241.44
Trust Co. Bank	Memphis, TN	32.1	2.58	-171	198.51
Northern Star Bank (NSBK)	Mankato, MN	20.7	2.78	-45	132.12

Data as of March 3, 2014.
All financial data is as of Dec. 31, 2013, and is based on regulatory filings.
[1] Tier 1 risk-based ratio is Tier 1 capital divided by risk-adjusted assets.
[2] Adjusted Texas ratio is nonperforming assets plus loans 90 days past due, excluding government-guaranteed loans and OREO, divided by tangible common equity plus loan loss reserves.
Source: SNL Financial

A total of six banks escaped undercapitalized territory during the fourth quarter, in line with the number of institutions that escaped those ranks in the third quarter.

One of the institutions escaping undercapitalized territory in the fourth quarter, Hunt Valley, Md.-based Community First Bank, actually ceased its operations. The FDIC filed a termination of deposit insurance proceeding against Community First Bank dated Sept. 30, ordering that its status as an insured federal savings bank would be terminated on Dec. 31. A FDIC spokesman told SNL that Community First Bank was not a traditional commercial bank and did not take in deposits and was in the trust business.

Three other banks previously deemed undercapitalized were involved in mergers, but two of those institutions entered into transactions that amounted to last-minute lifelines. In fact, former Capital Bancorp units Bank of Las Vegas and Sunrise Bank of Albuquerque, which were previously deemed undercapitalized, agreed to sell to Talmer Bancorp Inc. in a transaction conducted under Section 363 of the U.S. Bankruptcy Code.

While some banks found their way out of undercapitalized territory, others joined those ranks in the fourth quarter. Seven banks, all of which had less than $350 million in assets, gained undercapitalized status during the fourth quarter. The banking industry as a whole, though, finds itself on the mend, with credit quality having improved considerably from the depths of the crisis. Commercial banks' adjusted nonaccrual loans fell to 1.24% of total loans in the fourth quarter, from 1.38% in the prior quarter and 1.71% a year earlier, while net charge-offs declined to just 0.60% of average loans, from 0.61% in the linked quarter and 0.99% one year ago, according to SNL data.

With the improvements, the number of banks on the FDIC's "problem list" continues to decline and even dropped at a faster rate than the decrease in undercapitalized institutions during 2013. The number of institutions on the problem list fell to 467 at the end of the fourth quarter, compared to 515 institutions in the third quarter and 651 a year ago, a 9.3% drop from the linked quarter and down 28.3% from the year prior. The number of problem institutions stood at 813 two years ago.

Banks that continue to grapple with issues and remain on the problem bank list and in undercapitalized territory are largely in areas that suffered from stress during the cycle. The Southeast remains home to more undercapitalized banks than any other region.

Florida, where 70 banks have failed this cycle, had three operating banks falling below the 4% Tier 1 risk-based capital threshold at Dec. 31. Georgia also had three operating, undercapitalized institutions as of March 3, using Dec. 31 data. Eighty-eight banks have failed in Georgia this cycle.

Illinois, the state with the third most bank failures this credit cycle, also had three operating, undercapitalized institutions as of March 3, using Dec. 31. data.