Georgia’s Banks: The Impact of Regulatory Stabilization Efforts

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During the past 12 months, 12 programs have been implemented by the U.S. Treasury Department, The Federal Reserve Bank and the Federal Deposit Insurance Corporation in an effort to stabilize financial markets and the financial services industry.

The most notable and newsworthy was the first key program — the Troubled Asset Relief Program and under its wing, the Capital Participation Plan. Many of these programs ran parallel to efforts by the Treasury Department to lower short-term interest rates by the Federal Reserve. The FDIC did its part by increasing insurance coverage on consumer bank accounts and non-interest bearing business accounts.

Several of these initiatives brought immediate relief. Other programs provided support for companies and banks to raise funds in the capital markets.

A few programs are still in the development stage but provide an opportunity for private investment sources to buy nonperforming assets and undervalued securities held by banks.

On the positive side, the increase in FDIC insurance coverage for individual and business accounts has protected banks’ embedded customer base and maintained liquidity and core deposits. Georgia banks, large and small, have benefited from these initiatives, which have been extended for customer deposit insurance coverage.

Most of the focus of these programs centered on the 50 largest financial institutions and, perhaps understandably so, as this group accounts for approximately 70 percent of the assets, loans and deposits in the banking system.

The consequences

Yet, the impact of these programs has led to unintended consequences for many groups, including smaller community banks in Georgia (and elsewhere) with less than $1 billion in assets.

Georgia has about 260 banks with assets between $50 million and $1 billion. This represents about 82 percent of the banks within the state. These community banks have been negatively affected by several recovery initiatives, including the decision to lower short-term interest rates by the Federal Reserve.

First, most community banks’ balance sheets are considered to be “asset sensitive” — in short, a higher percentage of the banks’ assets are re-pricing sooner than their deposits as market rates change. This time lag exists because most community banks have deposits (e.g. certificates of deposit) with rates fixed for specific contractual periods.

As rates move down suddenly, as happened in the first and fourth quarters of 2008, net interest margins — the primary driver of community bank profitability — shrank and earnings decreased. Offsetting margin decreases by increasing loan volume has been difficult because of weak quality loan demand at the bottom of the economic cycle.

Second, the uneven and limited distribution of Treasury Department capital investments in Georgia has placed many banks at a competitive capital disadvantage in handling the sale of nonperforming properties. As of the end of the third quarter, 26 banks received a combined total of $6.3 billion under the Capital Participation Plan.

Of this amount, the three largest bank groups in the state received $6 billion. The other 23 banks shared $300 million, and most of the remaining consequences have received no assistance.

This distribution of funds has permitted the largest banks to flush out nonperforming loans from their balance sheet, often at 30-40 cents on the dollar as reported in the Atlanta Journal-Constitution. This is a prudent, if somewhat costly, strategy to strengthen their balance sheets.

However, selling real estate properties at distressed prices by the larger banks affects the market value of other properties that serve as collateral for loans held by most community banks.

Fragile profitability

Many of these banks have fragile profitability at this point in the economic cycle, and, although most are currently well-capitalized, they cannot afford the losses and impact on capital by selling nonperforming assets at “current market rates.”

Nor do they have the safety net of new capital from CPP funding to hold the assets, periodically writing down loans based on impairment, and ride out the storm until real estate markets improve.

In the past 60 days, Sheila Bair, chairwoman of the FDIC, and Timothy Geithner, the Treasury Department secretary, have acknowledged more needs to be done to support community banks.

Well, there is no time like the present to assist the community banks in Georgia. Good intentions need to be translated into action or more banks will fail in the state — banks that with additional time and money could otherwise rebound with an improving economy.

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