

Failed Bank Investors Lose Appetite For Loss Sharing Agreements

Investors interested in purchasing failed banks are ready to wean themselves off the public life support put in place during the credit crunch, according to FDIC data and sources familiar with the matter.

The shift away from the agreements is palpable. According to FDIC data, only 10 of the last 20 failed bank purchases utilized loss-share agreements (LSAs), compared to 15 of 20 of the final failed bank sales in 2010.

Less attractive terms, restrictive sale policies, price stabilization and discovery are just a few reasons investors are more comfortable taking direct exposure to troubled assets, said a banker, an FDIC source and **John Bielefeldt, partner at Crown Realty Advisors**, a banking advisory group in Jacksonville, Florida. Regulators intentionally tightened the loss-share terms so that the private sector, and risk takers, would pick up the slack in cleaning up failing banks, Bielefeldt said.

The FDIC had been put on the defense when certain circles anointed the initial arrangements as a symbol of “Bailout Nation.” The Indymac/OneWest deal emerged as a bailout poster child with some questioning why lump sum payments would be triggered if loss thresholds were crossed.

Though there are other economic factors at play, the public perception question — whether accurate or not — is in the back of the FDIC’s mind, according to sources. “It seems [regulators] are playing hardball,” Bielefeldt said.

Most recently on 18 February, Pacific Premier Bank of Costa Mesa, California assumed essentially all of the USD 416m assets and deposits of Canyon National Bank of Palm Springs, California without the use of a loss share agreement, according to an FDIC press release. One week prior, Royal Bank of Elroy, Wisconsin bought the USD 150m assets and deposits of Badger State Bank of Cassville, Wisconsin, also without the use of a loss-share, according to an FDIC press release. “The condition of the banking industry has changed,” said **David Barr, spokesperson for the FDIC**. In late 2008, the agreements were necessary because nobody wanted to take on the assets, he said.

Increasingly, acquiring institutions are choosing to assume all of the losses associated with the purchase, in an effort to cut their chords completely with the FDIC. The FDIC has left the decision in the hands of the acquiring institution, Barr said. With banks now more able to anticipate exposure to losses on those assets, they are reducing their reliance on the security LSAs provide, Barr said.

More data, more daring

More than two years into the process, firms that have aggregated a critical mass of assets from multiple banks — and, more importantly, critical performance data — are the ones able to make informed bids and reduce overall volatility, according to an industry source, who has aggregated more than USD 1bn of impaired assets. Armed with fairly robust performance on those assets, these specialist investors have an edge that allows them to get more comfortable entering into new deals, the source said. “I do think that in a year from now we will be looking back saying this was the bottom,” the source said.

The FDIC has helped buyers step away from the security blanket, too, by tweaking the rules. Traditionally, dating back to the 1990s, LSAs were structured 80/20, where the FDIC would reimburse 80% of the losses incurred by the acquirer on covered assets up to a stated threshold, with the acquiring bank absorbing 20% of the losses.

After losses exceeded the certain threshold, sharing losses shifted to a 95/5 basis. With the elimination of this step-up provision in March, more banks have inched toward 60/40 or even 50/50 loss sharing structures on a case-by-case basis, Barr said.

No strings attached could spur secondary

The cutting of government ties should also usher in a more robust secondary market, as assets will not be tied up in loss sharing agreements that can limit liquidations for up to eight years. Banks are bound to strict reporting requirements on a quarterly basis to monitor the performance of the assets, and the FDIC must approve bulk sales, in order to maximize the value of assets. Loss-share agreements have been one of the main reasons a healthy supply of nonperforming assets have not hit the secondary market.

In a market where the risk trade is back, the additional fuss of LSAs is getting in the way of profits, the sources said. “I don’t see the attractiveness of loss-share agreements,” said a former winner of FDIC failed bank assets and an active bidder. Although the FDIC limits the downside, it substantially limits the upside as well, he added.

Pricing has stabilized for most assets, especially commercial loans, which has helped acquirers become more comfortable with purchasing failed banks, Bielefeldt said.

Through September, approximately USD 160bn of assets were under loss share agreements, according to the FDIC. Since then, more than 50 banks have failed, where the majority of the acquisitions utilized loss-share agreements, according to FDIC data.