

Highlights of [GAO-13-476T](#), a testimony before the Subcommittee on Financial Institutions and Consumer Credit

Why GAO Did This Study

Between January 2008 and December 2011—a period of economic downturn in the United States—414 insured U.S. banks failed. Of these, 85 percent (353) had less than \$1 billion in assets. These small banks often specialize in small business lending and are associated with local community development and philanthropy. These small bank failures have raised questions about the contributing factors, including the possible role of local market conditions and the application of fair value accounting under U.S. accounting standards.

This statement is based on findings from the 2013 report on recent bank failures ([GAO-13-71](#)). This testimony discusses (1) the factors that contributed to the bank failures in states with the most failed institutions between 2008 and 2011 and what role, if any, fair value accounting played in these failures; (2) the use of shared loss agreements in resolving troubled banks; and (3) the effect of recent bank failures on local communities. To do this work, GAO relied on issued report [GAO-13-71](#) and updated data where appropriate.

GAO did not make recommendations in the report.

View [GAO-13-476T](#). For more information, contact Lawrence Evans, Jr. at (202) 512-4802 or evansl@gao.gov.

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FINANCIAL INSTITUTIONS

Causes and Consequences of Recent Failures of Community Banks

What GAO Found

Ten states concentrated in the western, midwestern, and southeastern United States—all areas where the housing market had experienced strong growth in the prior decade—experienced 10 or more commercial bank or thrift (bank) failures between 2008 and 2011. The failures of the smaller banks (those with less than \$1 billion in assets) in these states were largely driven by credit losses on commercial real estate (CRE) loans. The failed banks also had often pursued aggressive growth strategies using nontraditional, riskier funding sources and exhibited weak underwriting and credit administration practices. Fair value accounting also has been cited as a potential contributor to bank failures, but between 2007 and 2011 fair value accounting losses in general did not appear to be a major contributor, as over two-thirds of small failed banks' assets were not subject to fair value accounting. During the course of our work, some state banking associations said that the magnitude of the credit losses were exacerbated by federal bank examiners' classification of collateral-dependent loans and evaluation of appraisals used by banks to support impairment analysis of these loans. Federal banking regulators noted that regulatory guidance on CRE workouts issued in October 2009 directed examiners not to require banks to write down loans to an amount less than the loan balance solely because the value of the underlying collateral had declined, and that examiners were generally not expected to challenge the appraisals obtained by banks unless they found that underlying facts or assumptions about the appraisals were inappropriate or could support alternative assumptions.

The Federal Deposit Insurance Corporation (FDIC) used shared loss agreements to help resolve failed banks at the least cost during the recent financial crisis. Under a shared loss agreement, FDIC absorbs a portion of the loss on specified assets of a failed bank that are purchased by an acquiring bank. FDIC officials, state bank regulators, community banking associations, and acquiring banks of failed institutions GAO interviewed said that shared loss agreements helped to attract potential bidders for failed banks during the financial crisis. During 2008-2011, FDIC resolved 281 of 414 failures using shared loss agreements on assets purchased by the acquiring bank. As of December 31, 2011, Deposit Insurance Fund (DIF) receiverships are estimated to pay \$42.8 billion over the duration of the shared loss agreements.

The acquisitions of failed banks by healthy banks appear to have mitigated the potentially negative effects of bank failures on communities, although the focus of local lending and philanthropy may have shifted. For example, GAO's analysis found limited rural and metropolitan areas where failures resulted in significant increases in market concentration. GAO's econometric analysis of call report data from 2006 through 2011 found that failing small banks extended progressively less net credit as they approached failure, and that acquiring banks generally increased net credit after the acquisition. However, acquiring bank and existing peer bank officials GAO interviewed noted that in the wake of the bank failures, underwriting standards had tightened and thus credit was generally more available for small business owners who had good credit histories and strong financials than those that did not. Moreover, the effects of bank failures could be significant for those limited areas that were serviced by one bank or where few banks remain.