BANK FAILURES AND GEOGRAPHY: A NEW SHELL GAME?

By Joseph Bartolotta
Marketing Strategy Principal, CAMELSolutions LLC

The seemingly simple task of tracking and listing bank failures by state can yield findings that are sometimes misleading and often surprising because of differences in location between the transacting branches and a headquarters location. Economic conditions can be very different between those two geographies. Think your bank is immune to these issues because all parts of the enterprise are local? Consider your clients, their customers and *their* customers – you may be more exposed to market conditions in other parts of the country than you thought.

'Here' is a relative term

In 2010 there were 157 bank failures. People who like to classify things sort that list by state (in many cases, just to be able to say that their own state has fewer failures than someone else's state).

But when regulators assume control of a bank, the address of record is the headquarters – or the holding company's - address. Which may or may not be in the same area (or even the same state) as where the branch or branches are located. So the failure of that bank and the tally of its assets accrue to a state whose economic condition often has little in common with the conditions that may have precipitated the failure of the bank.

Where there's smoke…

…there usually is fire. But in the banking industry, the smoke plume can be very far away from where an institution crashed and burned.

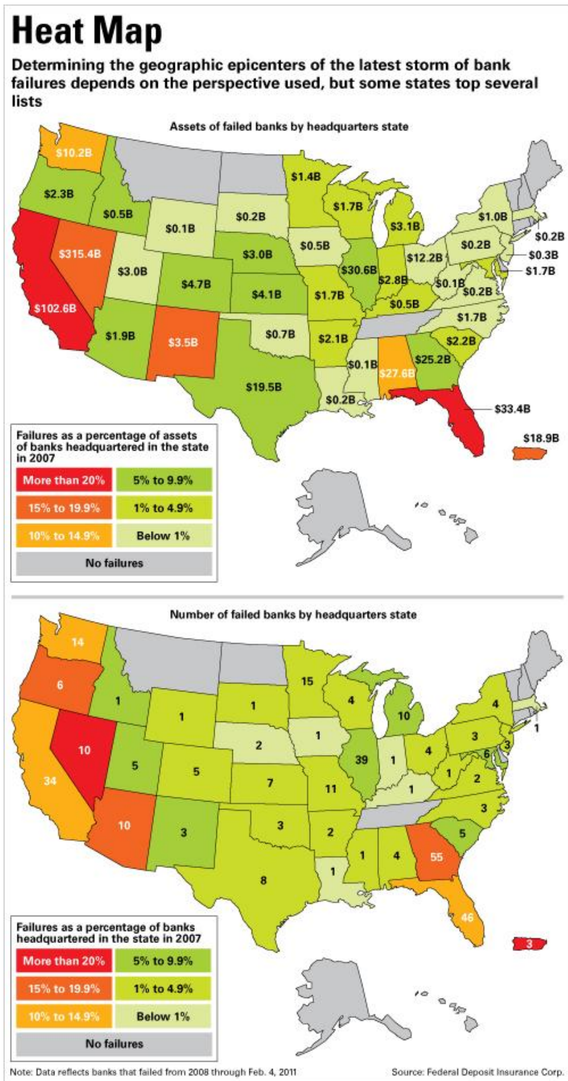
The thrift crisis in the '80s could be readily traced to institutions located in, or with close ties to, states with a high dependence on oil and natural gas production.

Casualties in the recent failure spike are similarly over-represented by states with specific economic issues (real estate free-fall in AZ, CA and FL; auto industry woes in MI; and so on).

An article in a recent issue of *The American Banker* (Bank Failures) spoke to these obvious connections, but also highlighted states like Nevada – whose high failure count included the assets of Washington Mutual Bank, ostensibly headquartered in Seattle, Washington and also included North Carolina and New York – whose low failure count doesn't reflect the assistance provided to Bank of America Corp and Citigroup, Inc. The heat map which accompanied the article illustrates both the 'expected' and these 'unexpected' failure tallies by state (see illustration, below).

No man (or bank) is an island

While it's tempting to align known economic issues with corresponding higher rates of bank failures, it's dangerous for bankers in the light green states to believe they're immune to those same economic conditions and become complacent. While your institution may not hold residential mortgage notes against CA or FL properties, or count auto industry suppliers among its loan portfolio customers you are exposed to those and other risks in direct proportion to your customers' exposure. The advertising agency with a revolving facility had developed quite a number of realty clients in FL for whom they produced glossy vacation home brochures: most of them are out of business now, and the agency is struggling to replace its lost revenue stream. The freight delivery company with a commercial real estate loan didn't have any customers in the auto industry – but it did have customers who supplied two of Detroit's automakers, and those shipments have virtually disappeared for now.



Source: American Banker, 2/22/11

The invisible hand and invisible connections

The effect isn't limited to the headline industries: isolated bankruptcies, mergers and other transactions can dramatically alter the amount and the source of a company's procurements – which in turn can have a significant impact on one or more suppliers, which may be in an unrelated sector and/or geographically separated from the initial event.

One of those suppliers could be one of your customers, who suddenly finds himself in a very different cash position than he was the day before. On a large enough scale, these seemingly unrelated events could precipitate a failure in an institution that may have already been weakened by other factors. On the surface, these events don't have an obvious causal relationship and would further confound the analysts and heat-map makers who are vainly trying to make sense of this complex industry.

More then ever, be vigilant about your customers' condition – and equally important, be vigilant of *their* customers' condition, since that can provide valuable insight – and warning time – for any necessary actions by your bank. If not for your shareholders, if not for the regulators, do it to keep those heat maps orderly and predictable.

Joe Bartolotta is the Marketing Strategy Principal at CAMELSolutions, LLC – a banking consultancy that helps clients improve their CAMELS rating and increase shareholder value. Contact him at joe.bartolotta@camelsolutions.com or
(800) 349-4709
