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When Time Is Not on Our Side: The Costs of Regulatory Forbearance in the Closure of Insolvent Banks

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“If you snooze, you lose.” – a popular saying

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Abstract
In this paper, we empirically estimate the costs of delay in the FDIC’s closures of 433 commercial banks between 2007 and 2014 based upon a counterfactual closure regime. We find that the costs of delay could have been as high as $18.5 billion, or 37% of the FDIC’s estimated costs of closure of $49.8 billion. We think that these findings call for a more aggressive stance by bank regulators with respect to the provisions for loan losses and write-downs of banks’ non-performing assets. More aggressive (and earlier) provisions and write-downs, or adoption of a capital ratio that penalizes nonperforming loans, would allow the concept of “prompt corrective action” (PCA) to play the role that it was meant to play in reducing FDIC losses from insolvent banks.

Keywords
Bank, bank failure; CAMELS; Commercial real estate; Failure cost; FDIC; Financial crisis; Forbearance; Insolvent

JEL codes
G17; G21; G28

I. Introduction.
During the years 2007 - 2014, 433 commercial banks and 77 savings institutions (“thrifts”) were closed by U.S. bank regulators (see Figure 1). These closures (almost always due to insolvency) were costly to the Federal Deposit Insurance Corporation (FDIC), which was the deposit insurer for these 510 institutions: The FDIC has estimated that its closure costs totaled $77.5 billion: $49.8 billion for closing the commercial banks, and $27.7 billion for closing the thrifts.
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