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Bank Recapitalizations:
The 10 Life-and-Death Lessons from 2010

Presented By:

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In 2010, hundreds of banks pursued recapitalization transactions. Only a handful, however, raised the amount of capital needed to stave off failure, with the balance either tumbling into receivership and FDIC seizure or lumbering along into 2011 with faint hope of a successful future. 2010 was a laboratory for distressed bank recapitalizations and many things can be learned from the successes and failures, lessons that are sure to improve the chances of success for those banks attempting recapitalizations in 2011.

The evolution of the bank recapitalization market in 2010 was truly remarkable when you consider that in the first few months of the year there was virtually no "recap" activity or even faint optimism in boardrooms about the prospects for a vibrant recapitalization market.

Hopeful Signs

The Pacific Capital Bancorp recapitalization announced in April of 2010 and led by SB Acquisition Company LLC, a wholly-owned subsidiary of Ford Financial Fund, L.P., gave the recapitalization market a kick-start going into the second quarter of 2010. It showed the market that a recapitalization could get done and created a roadmap for distressed banks and their private equity investors to follow. This positive development occurred during the same time period when the number of regulatory enforcement actions was increasing, with orders imposing higher capital requirements on distressed banks and setting a short deadline for the bank to satisfy those higher capital standards. The problems for distressed banks worsened in the second half of 2010 at the same time the recapitalization solution became more promising.

These two simultaneous developments — namely, an intensified enforcement environment coupled with the emergence of an illustrative example of a successful recapitalization transaction — served as a catalyst for hundreds of banks to begin focusing on the need to execute a recapitalization transaction in the second half of 2010. As the bank failure rate climbed into the second half of 2010, the FDIC threatened more lawsuits against directors of failed banks, and regulators forced an increasing number of banks to record severe capital impairment charges based on deteriorated asset quality. As their balance sheets experienced increasing amounts of stress and directors were put in more legal jeopardy, many boards started to get the message that they needed to raise capital for their banks immediately or face almost certain receivership and the prospects of personal liability. Consequently, boards reached out to professional advisers for restructuring services, and the advisors pushed a recapitalization agenda.

Obstacles and Innovation

Recapitalizations of distressed banks hit a number of hurdles as the model incubated and evolved in 2010. Creativity and innovation propelled the model forward and further evolution of the structure is certain in 2011. The trustees for trust preferred bondholders, for example, posed one of the first obstacles to successful recapitalizations because trustee consent was required to accomplish several of the restructuring formats first considered. Trustees were focused on their own legal exposure and thus were disinclined to exercise discretion on any proposal put before them for a recapitalization, leaving consent rights in the underlying bondholders. In the pooled conduits, acquiring the consent of the underlying bondholders proved largely impossible. The de facto “blocking” ability of the bondholders had to be addressed to move recapitalizations forward, and the issue was overcome by redesigning recapitalizations using a bankruptcy structure.

Many distressed banks tried to launch capital-raising transactions or to market themselves in a traditional merger and acquisition process without properly preparing the company for that transaction. That preparation should have entailed first stabilizing the company’s financial condition, securing a third-party credit review and designing a recapitalization structure that would prove appealing to investors or purchasers and avoid consent hurdles, like the one posed by bondholders. Without the proper preparation work, banks wasted valuable time and in the end did not generate a viable strategic alternative to persuade the regulators to halt the receivership process that would eventually envelop the bank. It was a year of trial, error and innovation.

Urgency and a Surgical Approach

Distressed banks need a cure for their credit and capital ailments and often they need immediate and dramatic treatment to slow down or postpone receivership. If there is one lesson from 2010, it is that boards need to take more risk and to take that risk earlier to improve the chances of savings their bank. Too many boards remain in denial or are paralyzed by fear. There is a process that can work to dramatically improve a bank's chances to recover and avoid receivership while mitigating the legal exposure directors face to lawsuits by stockholders, creditors and the FDIC.

The innovation in 2010 in the design and execution of bank recapitalizations was process invention. The restructuring process had to evolve to effectively address a bank's state of severe distress and to manage the issues of a disintegrating company (like an oncologist would determine the most effective way to attack a cancer). Declaring that a distressed bank needed capital and executing on a capital-raising process or auction of the bank in the traditional fashion proved largely ineffective. A new process had to evolve that would reconcile a number of unique and competing factors threatening the institution: acute failure risk controlled by the government; a short timeline to execute on a strategic alternative to interrupt the death spiral of receivership; and all the issues attendant to a disintegrating company, including liquidity challenges, human capital retention, morale, stakeholder litigation, negative media coverage, creditor angst and ongoing regulatory scrutiny and pressure.

Saving distressed banks is about project management, not investment banking. The only way to manage a disintegrating bank is by mapping a well thought-through critical pathway over a six-to-nine month time horizon and then, using project management leadership and techniques, driving management, the board, and outside professionals along that critical pathway with measureable performance metrics and accountability. Most distressed banks are in fact disintegrating and most are in need of a strong project management protocol. The development of the critical pathway — which balances bank rescue with the mitigation of litigation risk — is a surgical approach to a complex problem. But, if done correctly, it is a planning technique that can give management and the board relief that they have a plan to attack the bank's many problems.

This article describes ten lessons from the bank recapitalization activity of 2010 and how each of these lessons affects the prospects for life or death of a distressed bank.

Lesson 1: Laser Focus on Two Basic Strategic Goals – Time and Harm Management

As complicated as a distressed bank situation is, there are two basic guiding principles that drive any effective bank rescue effort: buy time and avoid doing unintended harm.

The first goal is to buy time. This sounds simple, but without analyzing it strategically and keeping this goal always at the forefront in decision-making, valuable time often is needlessly surrendered. Indeed there is a common phenomenon in recapitalizations which, unless you have done several and step back to consider the issue, you will not notice: incremental delay. Recapitalizations are complex, and getting the bank prepared for a recapitalization and then soliciting investor or acquirer interest takes time. Every recapitalization has numerous opportunities for one-to-three week delays at every stage of the process or with every interested investor. Those incremental delays add up and often months of time are expended as the bank slides closer to receivership. Managing a timeline and milestones aggressively and taking risk is the only effective way to avoid the inevitable incremental delays in a complex recapitalization transaction. Time matters because the bank will continue to disintegrate, its options will become more limited by the day, and a looming receivership will accelerate the demise of the franchise value and recapitalization prospects.

A distressed bank is no different than any other distressed company. When it is distressed, it is slowly or rapidly disintegrating. Distressed companies face very real failure risk as liquidity threatens survival, customers lose confidence in the viability of the enterprise, companies defect with their banking business and human capital is drained when valuable employees leave for greener pastures. In the context of a bank, disintegration is accelerated by the action of the regulators and deterioration in capital, which is the statutory measuring stick for failure or survival. As a bank's capital walks step by step down the prompt corrective action ladder toward the two percent critically undercapitalized level, the time to receivership shortens and the regulators place an increasing number of operating restrictions on the bank that adversely affect its business. At this point the bank's strategic options narrow by the week.

To save a bank, realistic assessments need to be done about how much time the bank has until it fails, factors affecting its ability to survive, and the rate and probability of failure. It is difficult for a management team to make this assessment and even more difficult for a board. Management is too close to the facts and is directly affected by the financial, regulatory and environmental pressures the institution finds itself fighting against, often fighting wildly for survival and not looking beyond the new blow. In that environment it is hard for a bank to design a plan to extricate itself from the current trauma. Directors often do not have the requisite banking experience, the feel for the banking or regulatory climate, or the understanding of how financial, regulatory and environmental pressures coalesce to influence the prospects for success or failure.

A realistic timeline can only be developed with a macro-perspective on how the bank regulators are treating banks at present in the exam and receivership process and the relationship among several important "markers." Those markers, which serve as factors in whether or not a bank will fail, include:

- the timing and components of a consent order,
- the time given to raise capital,
- the composition of the bank's credit portfolio,
- the aggressive or passive way bank management has dealt with credit problems,
- the bank's history of growth and risk-taking,
- the size of the bank,
- the bank's geography,
- the ratio of brokered deposits to total deposits,
- the bank's capital level under the PCA standards,
- liquidity risk management,
- the timing of the next exam,
- special red flags noted in the last exam, and
- the FDIC's geographic priorities for bank resolutions.

Converting these risk factors into a realistic timeline (typically looking out up to nine months) and evaluating how each of these factors affects the probability of receivership gives management and the board vital information that they need to make life-or-death decisions affecting the bank's future. Armed with this information, a board can make fully informed decisions and take risks to rescue the bank.

With a realistic timeline in hand, the board, with the help of a strategic advisor, can design a plan to prolong the life of the bank. There are ways to interrupt the otherwise inevitable and routine regulatory progression toward receivership. Those tactical steps are beyond the scope of this article, but the general approach has several key elements. Improving the credibility and trust of management and the board with the regulators is a crucial step in buying time. The most basic tactic in achieving this is to improve the quality and frequency of communication with the regulators, focusing on the performance factors that are important to them. Another key tactical step is to understand the bank's rights and remedies for dealing with enforcement actions, the exam process and the march down the PCA ladder toward the critically undercapitalized level. Using that knowledge to manage the regulatory relationship is important in buying the bank more time to fashion a capital solution, which benefits the bank, its customers and the loss risk to the FDIC insurance fund.

In addition to buying time, the second strategic goal in any bank rescue program is to do no harm. This is part of the physician's Hippocratic oath, and it applies with equal force to any distressed company situation including a distressed bank. When a bank is distressed and a board is called upon to make serious business decisions affecting whether the bank survives or fails, it is important that the board take action and be comfortable that the action does not have material unintended consequences. How many boards have a thorough understanding that future budgets and profit plans for the bank affect the value of the bank's deferred tax asset and the capital impairment risks involved? How many boards understand how management of the bank's non-performing asset portfolio affects the regulators' attitude toward impairment charges in the next exam? How many boards understand the different types of third-party credit review methodologies and how choosing one methodology over the other can affect the outcome of the next regulatory exam or the bank's ability to raise capital? How many boards have a good handle on the carrying costs of the bank's NPA portfolio so they can make decisions about NPA dispositions versus a carry strategy?

The point is that there are many critical save-the-company decisions that the board of a distressed bank needs to make. Making those decisions with clear insight into the possible and varied consequences of those decisions is critical. Asking management or the bank's professional advisers to explain how a board decision or inaction can harm the institution should be a routine question. The relationship between the timeline to failure and the harmful consequences of certain business decisions is obvious, and when considered together, set the stage for effective decision-making along a critical (thoughtful) pathway.

Lesson 2: Making a Realistic Franchise Value Assessment

For a recapitalization to be successful, the bank needs to have a core franchise that has value. This assessment needs to be done early and realistically. While the bank's franchise value is adversely affected by its credit problems, an investor will look past the bank's credit woes to understand whether the bank is making or can make money on a pre-provision basis and whether the balance sheet reflects core customer relationships.

A simple financial model that proves the bank has positive cash flow — while ignoring credit costs — is an important first step in determining whether the bank will be able to induce new money to invest in its future. That financial model will be valuable to share with potential investors. Likewise, investors will want to understand the nature and quality of the bank's core customer relationships. Many community banks grew the loan side of their balance sheet, relying on wholesale funding sources such as brokered deposits. Investors will discount non-core deposits and their pro forma view of the investment opportunity will shrink the bank's balance sheet to its core relationships. Investors will also want to understand how critical the current CEO is to maintaining customer relationships, because investors will often need to make a management change to induce new money into the bank. Terminating the CEO, however, may cause deposit and customer run-off that deflates the core franchise value.

Lesson 3: The Necessity for Credit Transparency

When the investment banker calls the New York private equity fund to persuade the fund to make a substantial investment in the distressed bank to recapitalize it, the first question from the fund is likely to focus on credit quality and whether there is an objective substantiation of management's view of credit losses embedded in the portfolio.

Completing a recapitalization requires credit transparency. Before a private equity firm or any sophisticated institutional investor commits its money to save a bank, it will want a third-party credit review done. The timing and methodology of the third-party credit review is one of the most serious decisions the board of a distressed bank can make.

Completing a third-party credit review shortly before an impending regulatory exam can create serious capital impairment risk in that exam when the examiners inevitably ask for and obtain the results of the review. Likewise, the methodology of the review can influence the examiner's perspective. A third-party review that assigns a realistic value to the bank's NPA portfolio, assuming it is sold in a bulk sale over a 60-day time horizon, for instance, is likely to show severe credit impairment and more than the bank has reflected on its books. A review that includes a migration risk analysis of the performing portfolio is important to investors but will be important to examiners for a different reason. There are a variety of methodologies that can be used in a third-party credit review. Thinking through the right methodology for the situation is important, and considering how the results of the review will be presented — for example, in writing or verbally — needs forethought.

Many bank management teams are scared to death of what a third-party credit review is likely to reveal about their bank's portfolio, and they should be. One school of thought is to defer and perhaps never complete a third-party credit review on the premise that the results will create a self-fulfilling prophecy, namely giving the regulators support for accelerating their demise of the bank. An opposite school of thought suggests that many banks are inevitably headed toward receivership, and taking the risk of a third-party credit review as a prerequisite to induce new equity into the company is the only logical way to save the bank. These are serious decisions that need to be made at the board level. They also need to be made with professional expertise and advice because the consequences are far-ranging and the alternative approaches many. As with everything else in distressed bank decision-making, deciding whether to do a third-party credit review, the timing of the review, and the methodology require solid strategic thinking with board involvement.

As a final, albeit disheartening point, 2010 has proven how difficult it is to get credit marks right. Many investors in bank recapitalization transactions find third-party credit reviews unreliable, and rather than risk a material error in the credit evaluation, demand that the bank sell its NPAs concurrent with the injection of new equity, thus confirming the value of the NPA book before new capital is put at risk. Obtaining a binding indicative bid on a bank's NPA book is the only dispositive way to know the value a willing buyer and a willing seller would assign to a pool of assets. Short of this, third-party credit reviews can produce a variety of different loss numbers for a particular portfolio depending on the quality of the firm used, the sampling techniques deployed, the quality of comparable asset values in the marketplace and many other assumptions. It is very difficult (and in an extreme view impossible) to get the credit marks right as a precursor to soliciting recapitalization money.

Getting a realistic credit mark is the most essential fact in any bank recapitalization. That it is so difficult to accomplish explains why very few recapitalizations have been completed. Institutional investors are logically skeptical of the credit picture presented in investor solicitations. Getting a bona fide credit mark takes time because third-party credit reviews take weeks, and in some cases months, to complete depending on the size of the book, the types of asset classes and the number and quality of personnel that have to be assembled to conduct the review. The time spent getting the review done is valuable, but the time expended — as mentioned in the incremental delay point made earlier — moves the bank that much closer toward a receivership outcome. If a credit review is determined to be an essential step to a successful recapitalization, which it almost always is, getting on with it early and managing the attendant risks to having the results of that review in writing are key decision points, indeed strategic decision points, in laying the groundwork for a successful outcome.

Lesson 4: A Realistic View of Capital Impairment and Intervening Events

Regulators fail banks when their capital falls below two percent tangible equity, meaning the bank is critically undercapitalized. The most typical requirement in consent orders is for the bank to increase its capital to an eight- and 12- percent level, representing tier one and total risk-based capital ratios, respectively. Some banks are subject to even more stringent capital requirements.

Understanding what can cause capital impairment and creating realistic stress testing scenarios of the bank's current capital ratios are fundamental to the board's understanding of the bank's risk of failure. It is only when armed with these data points that a board can make fully informed decisions about the direction of the institution. A number of events can cause capital impairment, including impairment of the bank's deferred tax asset, continuing credit deterioration and impairment risk in the bank's investment securities portfolio. The most significant capital impairment risk flows from further credit impairment.

The timeline under which the bank is operating relative to failure risk is critically important to understand in the context of capital impairment risk and intervening events. The exam environment is such that a bank can expect, almost as a matter of course, that the next regulatory exam will force meaningful additions to the bank's allowance for loan losses and related provisions for loan losses as well as charge-offs. The credit enhancement work the bank performs prior to its next exam, therefore, can affect the outcome of the exam. Likewise, securing a third-party credit review prior to the next exam can affect the outcome of the exam and capital impairment. There is no easy answer to managing capital impairment risk, but the important point is that it needs to be managed.

The starting point in managing this risk is establishing a baseline. The board needs to receive graphically on a monthly basis an analysis of where the bank's capital ratios stand relative to the PCA levels, as well as the capital ratios mandated by any consent order. Without those data points in front of them, the board cannot begin to understand the threat to the viability of the institution. Moreover, the current capital ratios need to be appropriately "stressed" for impairment risk so the board can understand the capital ratios on a realistic pro forma basis. All of this analysis supports the board's decision-making in relation to buying time with the regulators, shrinking and managing the balance sheet and identifying the amount of capital that realistically needs to be raised to save the institution from failure.

Lesson 5: Ruthless Time Management

Capital and liquidity are important in a distressed bank scenario, but the most precious commodity is time. Many banks have failed in the current cycle, not because they could not eventually be saved through a recapitalization or merger or acquisition transaction, but because they ran out of time. Likewise, many banks experiencing extreme credit stress can work their way out of those problem credits at a higher recovery rate than reflected in the carrying value of the credit, but the regulators will not give the institution the three to four years it may need to achieve the higher recovery on problem assets.

Recapitalizations are complex and they lend themselves to incremental delays that, when accumulated, can jeopardize the bank's future simply because too much time was burned in each of a series of incremental steps in the recapitalization process. By way of example, a third-party credit review decision can take the board several weeks to deliberate, the bid solicitation process can take several more weeks and the actual review can take several weeks more, all adding up to several months of delay. Likewise, recapitalizations often do not follow a linear path. That is, often one interested investor group is given priority because of their prospects, and several weeks or months are spent in the courting process. When that opportunity falls through, a second opportunity is presented with another investor group and the process repeats itself. The serial nature of the due diligence and negotiation process expends valuable time, and the project manager for the recapitalization needs to be vigilant to these incremental delays and minimize them, which may involve making spontaneous decisions that pose risk to a successful outcome but nonetheless place a priority on speed.

How many banks have failed because the board woke up too late along the receivership continuum only to realize that most of the bank's viable options for a recapitalization or merger or acquisition transaction had evaporated during their slumber? How many boards have not realistically assessed the amount of capital the bank needs and put an ineffective process in place to raise an insufficient amount of capital resulting in the bank's demise? How many boards had an unrealistic view of credit valuations only to be criticized by the examiners for inadequate allowance methodology and inappropriate delays in charge-off recognition, causing the examiners to force a retrospective restatement of the bank's reserves and retrospective capital impairments, thus accelerating the tumble toward receivership?

The proffering of a consent order by the regulators is often the first jolt the board feels, and only after this happens does the board start to focus on the seriousness of the threats to the institution's survival. But that is often too late in the process, because the regulators will put the board on a 120-day clock to raise capital, and the bank can be seized within six to nine months of the effective date of the consent order, which is not a lot of time to find a capital solution.

Boards need to act with a sense of urgency now. They need to assess the bank's capital position relative to the PCA standards, focus like a laser beam on the bank's credit risk, and understand the regulatory and operating environment in which the bank is operating. Moreover, having a clear sense of the bank's upcoming interaction with the regulators, an estimate of balance sheet blows, and a timeline for that trauma going forward gives the board an opportunity to take steps to interrupt what may otherwise be inevitable events as the regulators ratchet up the pressure on most institutions. Again, this is strategic planning and the goal must be to save the institution even when it may appear to the board that the long-term viability of the bank is not in jeopardy. That assumption needs to be tested by the board.

In short, the board needs to institute a process whereby it can get the necessary assurance from management that credit risk is appropriately managed and recorded, capital impairment risk is well understood, and the risks that may flow from future examinations have been considered. Time management needs to be ruthless because banks are competing with one another for a finite amount of capital in the market, and everyday that passes without strategic decision-making means opportunities to alter the bank's future path are lost.

Lesson 6: More and Earlier Risk-Taking

There is danger all around us and as many as another thousand or two thousand banks are likely to fail over the next three to four years. Community banks with less than $1 billion in assets, heavy concentration in real estate-related loans, large percentages of brokered deposits, latent credit loss recognition and inattentive boards are the most likely to fail.

Turning a bank around and trying to rescue it from failure requires strategic planning, assumptions and courageous execution. Without risk-taking the bank is likely to fail, and many have because the board failed to take the necessary risks to pull the plane out of the tailspin or waited too long to take the dramatic action required. Not every bank is in desperate shape and risking probable failure, but many are.

Lesson 7: It's About Project Management, Not Investment Banking

Too many boards have placed too heavy a reliance on their investment banker to solve the bank's capital problems. Managing a distressed and disintegrating company requires project management skills, with investment banking capabilities playing an important but ancillary role. That is, the solution to a distressed bank's problems may be solely capital, but sole reliance on an investment banker to solve the capital deficit often proves ineffective. The investment banker is only one important part of the solution to a bank facing pressure from multiple sources.

In the current climate, for a capital raise to be successful, the bank has to be prepared over a period of several months to enhance the chances for a successful capital raise. This is not 2004 and 2005 when it was a sellers' market and investment banks could put a pitchbook together and easily secure a half-dozen bids on the bank that was for sale. Today, strategic buyers with strong balance sheets are actively evaluating failed bank acquisitions using the FDIC-assisted transaction formula, and therefore tend to be less interested in open bank acquisitions. Private equity firms and other institutional investors are getting hundreds of pitchbooks from investment bankers soliciting capital to recapitalize their bank clients. Competition for capital is extreme, particularly for banks with less than $1 billion in assets.

Before launching a recapitalization transaction, the bank has to be stabilized, have its core franchise value evaluated, credit transparency reached, and a compelling investment thesis prepared to be successful. Moreover, the board has to be prepared for significant stockholder dilution or the very real prospect that the only way to save the bank is to sell it out from under the holding company in a Section 363 sale followed by a bankruptcy of the holding company, meaning stockholders are zeroed out.

As the distressed bank disintegrates, it faces special liquidity challenges, media and customer relations problems, requirements for a strategy for buying time with the regulators, and satisfying a myriad of requirements imposed under the consent order and in the exam report. It is easy for any management team to become overwhelmed, demoralized and distracted. All of these moving pieces need to be managed through a rigorous project management protocol led by the CEO, a Chief Restructuring Officer or its equivalent.

Lesson 8: Preparation to Launch the Recap

Complicated problems demand simple solutions. The problems facing a distressed bank are complicated and recapitalizing a bank is probably the most complicated restructuring transaction imaginable because of the regulatory framework involved and the timeline constraints imposed at the sole discretion of the bank regulators. To be successful in a recapitalization requires tireless and meticulous preparation followed by flawless execution; this has to happen while managing serious time constraints, observing the bank's financial performance weakening, and dealing with traditionally reliable counter-parties scrambling to protect their own interests to the bank's detriment.

In addition to completing a third-party credit review and developing a recapitalization structure, a company must populate an electronic data room so investors and other potential counter-parties have ready access to all key due diligence material. The board needs to receive a realistic assessment of the prospects for success from the investment banking firm before calls start. If the success of the recapitalization depends on moving NPAs off the balance sheet before the equity injection, provisions need to be made for that result. Given the competition for capital, a unique story needs to be developed so the particular recap stands out from the other banks seeking capital, improving the chances for success. Finally, the timing of the launch needs to be considered in light of the bank's current capital status and future prospects as well as estimates concerning the actions forthcoming by the regulators.

Lesson 9: Managing Emotional Encumbrances

The banking industry is under siege from examiners, the media, small business owners and politicians. As more banks fail and the FDIC files more lawsuits against directors of failed banks, bank boards and management teams are under increasing scrutiny and stress. The emotional element in distressed bank scenarios cannot be ignored because it can result in impaired judgment, misguided interactions with the regulators and paralyzed decision-making.

There is no silver bullet to these emotional elements, which often interfere with and encumber a successful recapitalization. It is important that boards recognize and acknowledge this as a real issue. Fear easily creeps into management and board decision-making in this environment. It has to be acknowledged for what it is and not allowed to interrupt sound business judgments.

If the board is fortunate enough to have a CEO with high emotional intelligence, the bank is in the best position possible to succeed in the recapitalization transaction. If the emotional intelligence of the CEO is weak, the risk to a successful outcome is heightened. Managing a distressed bank, given all that is at stake, is high-stress and high-stakes. The board has to rely on a leader with high emotional intelligence. If the CEO does not have it, the board needs to look to the outside for it, because without it, managing through the distress and the complexity facing the troubled bank will be impossible.

Lesson 10: Preparing for Failure

Many banks pursuing a recapitalization transaction will, unfortunately, not survive. Thus, the project needs to be managed on a dual track — one track driving toward a successful outcome and the other preparing the company and the directors for failure. This is the harsh reality of distressed bank recapitalizations.

In preparing for failure, certain legal and financial steps need to be taken over a period of many months to address this contingency. For instance, at the holding company level, provision needs to be made to ensure the holding company has sufficient cash to wind up its affairs in the event the operating company is seized. Likewise, a bank headed toward receivership means the directors of the bank face litigation risk from the FDIC while the directors of the holding company face litigation risk from stockholders and creditors. There are bona fide techniques to mitigate these litigation contingencies, and they need to be addressed proactively and early.

Conclusion

Boards of distressed banks need to take more risk earlier to save their bank from risk of receivership. As a bank disintegrates, its strategic alternatives narrow by the day. Developing a critical pathway to address the disintegration and prepare the bank for a recapitalization transaction needs to be a priority in the boardroom. This takes planning, critical thinking and leadership. It also requires a deep working knowledge of the regulatory and examination framework, credit risk, accounting and finance and capital markets. Getting organized as a management team and a board, setting strategic priorities and a tactical plan and then creating a project management structure that holds people accountable is the only way to succeed.

In 2010, many banks failed, and in 2011, unfortunately, many more banks are likely to fail. How many of the boards of the at-risk banks understand the depth of their bank's problems today and are willing to take risks to avoid receivership? More and more boards will face true bet-the-company decisions and doing so on a fully informed basis, like always, shows good judgment.

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