



In Focus: How Parent's Problems Could Affect Doral Bank

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By Joe Adler

WASHINGTON - A significant drop in earnings, a rise in nonperforming assets, and troubles at the parent company are likely leading federal regulators to take a close look at Puerto Rico's Doral Bank, analysts and observers said last week.

"I'm sure they're looking very carefully" at the \$10.6 billion-asset bank, said Barron Putnam, a former Federal Reserve Board official and now the president of Laclede Financial Corp., a Frederick, Md., firm that rates financial institutions.

Officials at the bank's holding company said they are actively taking steps to fix the problems, including "exploring alternative revenue streams" and several new hires.

Observers speculated that one of regulators' top concerns is ensuring that problems at Doral Financial Corp., which has lost \$66.46 million in the first three quarters of last year and must raise capital and refinance \$625 million of debt in the next six months, do not spill over to its primary subsidiary.

"It's a common regulatory practice to insulate the bank -- the insured portion that has the federal safety net protection -- against problems outside the bank," said Nicholas Ketcha Jr., a former Federal Deposit Insurance Corp. director of supervision and now the managing director of FinPro Inc., a consulting company in Liberty Corner, N.J.

"The regulators have always looked at the holding company as the source of strength," Mr. Ketcha said. "What they don't want is that the bank becomes the source of strength. If there's problems in other parts of the entity, whether it's a mortgage company or holding company or some affiliate, they don't want the bank being raided."

The Fed, which oversees the holding company, and the FDIC, Doral Bank's primary federal regulator, would not comment for this story.

The FDIC and state regulators already have taken some steps to protect the bank from tinkering by the parent company. In March the regulators issued cease-and-desist orders against Doral Bank and two other Puerto Rican banks with similar accounting problems. The orders restricted transactions between the banks and affiliates, including the payment of dividends.

But Doral Bank has been facing its own troubles. In the third quarter it earned \$3.8 million -- 80% less than a year earlier and a 92% drop from the same period in 2004, according to data from the FDIC.

Last week Laclede announced that it had downgraded Doral Bank to C, which the rating firm considers one step below investment grade, for the September rating period, "due to deterioration in asset quality." Laclede noted that third-quarter nonperforming assets jumped 50% from the second quarter, and that those assets equaled 46% of its reserves.

"It's serious," said Mr. Putnam, who ran the Fed's bank surveillance program in the 1980s. "But that

doesn't mean it can't be turned around. It depends on what shareholders want to do, and what the feds want to do."

Doral Financial officials said the bank is continuing to "serve our clients with innovative products and services."

It is also "attracting highly experienced, proven professionals in the banking industry to strengthen our team and further develop our business lines, including consumer, commercial, and mortgage banking," the bank said in response to questions from American Banker.

Doral Financial said the bank has strong capital. It had a leverage ratio of 7.1% and a Tier 1 capital ratio of 19% as of Sept. 30, the last date for which capital figures are publicly available.

Still, that has not kept observers and analysts from speculating on the future of the bank and the holding company.

Observers said regulators typically encourage troubled institutions to merge with healthier banks. But that option appeared to be all but ruled out last month, when John A. Ward 3rd announced he was resigning as the holding company's nonexecutive chairman. He wrote in a letter to the board that the company should spend more time trying to sell itself and less time raising capital to fund its debt.

Doral has begun working with investment banks to seek a private-equity infusion to solve its problems.

"Now they really only have one option, unless they somehow miraculously become extremely profitable very quickly, which I don't think is in the cards," said Bert Ely, an independent consultant in Alexandria, Va., who tracks troubled banks. "They have to raise capital."

A primary source of capital -- the holding company's stock -- has been battered in recent months. Its price has fallen 75% in the past year, closing at \$2.59 a share Friday.

The stock decline is "unbelievable," Mr. Putnam said. "It was moving toward zero" until last week, when the slide was arrested briefly.

The stock rose 23% in the first three days of last week, to \$2.53 a share by Thursday's opening, on rumors that Doral Financial was about to announce significant news. (No news has been forthcoming.)

If Doral cannot raise the requisite capital, regulators could force a sale, observers said.

"It may be the Fed is just letting this run its course," Mr. Ely said. "At some point in time, particularly if losses continue, the regulators have got to say to these guys: 'Listen, here's a deadline. You've got to get this thing properly capitalized by x date, or you've got to find a buyer.'"

The holding company also is facing a July deadline to refinance \$625 million of debt. Observers fear that it could look to Doral Bank, its primary subsidiary in nearby Catano, or its \$620 million-asset thrift in New York for funding.

The possibility of the bank's failure "is significant enough that people should recognize it," said Joseph Gladue, an analyst at Cohen & Co. That possibility is being "raised more and more frequently, and mostly in the context that they have \$625 million in debt that comes due in July, and there's some question as to whether they'll be able to refund that debt."

On Jan. 5, Standard & Poor's Corp. and Moody's Investors Service Inc. downgraded Doral Financial

Corp.'s debt. (The two firms do not rate the bank separately.) S&P lowered Doral's long-term credit rating one level, to B, with a negative outlook, while Moody's lowered Doral's senior debt one level, to B2.

"This marks the second consecutive quarter of substantial losses, and with a \$30 million loss on the sale of securities resulting from a balance sheet restructuring in the fourth quarter, another significant loss in the fourth quarter is likely," said Michael Driscoll, a credit analyst at S&P, said in a press release.

Mr. Putnam said regulators also are probably keeping a close eye on relations between Doral Bank and its parent, but are more focused on the bank itself, since that is where the insured deposits are.

"The holding company is supposed to bring financial strength to the bank, not the other way around," he said. "I don't think ... [Doral Bank is] verging on failure, but I think that there is real concern."

Any failure of this size would be unusual.

The FDIC has gone 935 days without a failure. Bank of Ephraim in Utah failed in June 2004 with \$46.4 million of assets.

The last bank to fail with at least \$1 billion of assets was the \$1.3 billion-asset Hamilton Bank in Miami, which failed in January 2002. Other billion-plus failures included Crossland Savings Bank in Brooklyn, N.Y. (\$7.4 billion), and subsidiaries of First City Bancorp. of Texas Inc. in Houston (\$8.8 billion), both in 1992.

"At its present size, if Doral were closed, it would more than double the total assets of failed banks since the beginning of 1995," Mr. Ely said.

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