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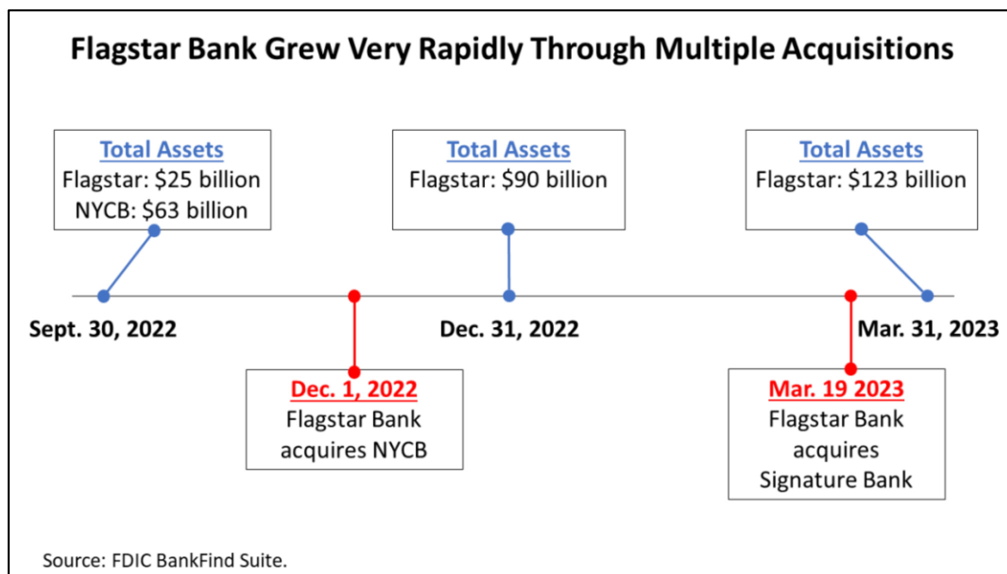
New York Community Bancorp: A Frankenstein Monster Federal Regulators Created

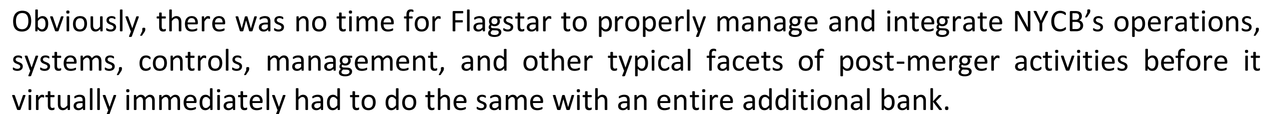
February 22, 2024

2024 began with concerns about a possible new banking crisis due to issues at New York Community Bancorp ("NYC Bancorp"), the holding company for Flagstar Bank ("Flagstar") and the former New York Community Bank ("NYCB") as well as Signature Bank. While much of the reporting has focused on NYC Bancorp's commercial real estate ("CRE") portfolio and what that might suggest about contagion due to other banks' CRE holdings, NYC Bancorp is a Frankenstein monster that needlessly ignited foreseeable concerns about precipitating another crisis.

After trying and failing to get FDIC and Fed approval, NYC Bancorp shopped for a more friendly regulator, the OCC, which resulted in Flagstar's acquisition of NYCB on December 1, 2022. The result of this regulatory arbitrage was Flagstar ballooned from $25 billion in assets to $90 billion in assets. With the ink barely dry on that merger, the banking regulators—just 100 or so days later—approved Flagstar's acquisition of Signature Bank, causing its total assets to jump to $123 billion.

At that point, ***Flagstar's growth exceeded what was reported by all three of the 2023 regional banks in the years leading up to their failures***. As shown in the graphic below, over the course of ***just two quarters***, Flagstar's two acquisitions ***quadrupled its asset size***, from $25 billion on September 30, 2022, to $123 billion on March 31, 2023. It also ***more than doubled its employee count***, from about 2,800 in September 2022 to 6,800 in March 2023.





Obviously, there was no time for Flagstar to properly manage and integrate NYCB's operations, systems, controls, management, and other typical facets of post-merger activities before it virtually immediately had to do the same with an entire additional bank.

Maybe most shockingly, the banking regulators allowed these rapid-fire mergers with full knowledge—and apparent disregard—of Flagstar's reported record of racial discrimination. Finally, the banking regulators did all this also knowing that the resulting merged entity would be uniquely vulnerable to CRE concentration risk (ranking in the 96th percentile for its peer group) and very highly concentrated in one segment of the CRE market—multifamily properties, mainly apartment buildings in the New York City area.

Introduction

In late January 2024, NYC Bancorp reported several negative results including a quarterly earnings loss and weakness in its large commercial lending portfolio. These announcements surprised investors and ignited a firestorm of public, media, and regulatory concerns, not only about the financial results but also the health of the broader commercial real estate sector. Less than a week later, Moody's downgraded NYC Bancorp to junk status, citing "financial, risk-management and governance challenges." Through February 16, 2024, NYC Bancorp's stock price remains at about half the level prior to the January announcements, despite insiders' stock purchases in an effort to restore confidence.

While these events are certainly alarming, what is being overlooked is how NYC Bancorp got into trouble in the first place, and regulators' willingness to overlook and ignore facts about discriminatory and unlawful actions by the banks. In late 2022 and early 2023, the federal banking regulators inexplicably approved not one, but two, mergers for NYC Bancorp in rapid succession. First, in December 2022, Flagstar was acquired by NYC Bancorp and at the same time Flagstar acquired NYCB. Then, only about 100 days later, Flagstar was selected as the winning bidder by the FDIC to acquire the failed Signature Bank ("Signature"). A bank acquiring and integrating any one of these transactions in isolation would be challenging under the best of circumstances, it is inexplicable that the banking regulators allowed them in tandem under extremely stressed conditions.

The NYCB/Flagstar Merger Reveals Regulatory Arbitrage and Raises Questions Related to Fair Lending Violations

In April 2021, NYCB announced plans to acquire Flagstar. At the time, NYCB had $58 billion in total assets and was about twice the size of Flagstar, with $30 billion in total assets. The two banks stated that they expected to operate nearly 400 branches in 9 states as well as 87 loan production offices in 28 states. Approval was required from the Federal Reserve Board ("Fed"), the Federal Deposit Insurance Corporation ("FDIC"), and the New York Department of Financial Services ("NYDFS") to complete the merger. The initial merger applications were submitted to these agencies on May 19, 2021. Despite the NYC Bancorp's optimism, the application process did not go smoothly or quickly, primarily because of regulator concerns.

According to one report, the FDIC was "so concerned about fair lending failings at Flagstar" that it would not support the merger. Reporting also indicates that the Office of the Comptroller of

the Currency ("OCC") had similar concerns, finding that Flagstar "wrongly charged Black homeowners more through a network of mortgage lending affiliates." Separately, the Consumer Financial Protection Bureau had also taken action against Flagstar in 2014 for discriminatory practices related to its mortgage business, and the bank has been the subject of a private lawsuit claiming discriminatory practices that hurt African American borrowers. Despite all of this, the NYDFS granted approval of the merger application, citing "collaborating with federal counterparts in processing the merger application' and completing its own 'thorough review of competitive considerations, financial stability, [New York Community's] supervisory record and managerial and operational resources in 2021."

With only the state regulator willing to approve the merger, NYC Bancorp decided to change its approach in 2022 and engage in what looks like blatant regulatory arbitrage: moving from an unfriendly federal banking regulator to a much more friendly one. In April 2022, NYC Bancorp began the process to become a national bank, stating that "a national bank charter is an appropriate charter for the combined company's banking operations," and sought OCC approval of the merger, this time with Flagstar acquiring NYCB. The regulator switch meant that the OCC, not the FDIC, would now make the decision on the merger application. Given the track record of illegal and discriminatory practices that apparently caused the FDIC and Fed concerns didn't change, and reportedly matched the OCC's own prior findings, one would think that the OCC would object to the merger. However, inexplicably the exact opposite outcome occurred.

On October 27, 2022, the OCC approved Flagstar's conversion to a national bank as well as its merger with NYCB. Even more troubling, the OCC didn't even mention its own fair lending concerns from a few years earlier. Instead, the OCC merely cited a November 16, 2020, Community Reinvestment Act rating of "Outstanding."[1] Remarkably, the OCC did reference—but dismissed—one detailed 45-page comment letter containing concerns about regulatory arbitrage and calling for a public hearing and increased transparency from the OCC to explain its decision on the merger application. The letter asked how NYC Bancorp was allowed to shift its strategy and pit one regulator against another, why the FDIC did not make a determination on the initial merger application and how the OCC will consider this in its decision-making process, and how the OCC will ensure that the bank will not continue its pattern of discriminatory practices. In its final decision, the OCC did not address the concern about regulatory arbitrage; instead it simply repeated statements from the bank about the fact that a national charter is consistent with the bank's operations. The OCC also said it would not hold a public hearing because it did not think such a hearing would be in the public interest. Meanwhile, the Fed also approved the merger,

[1] As Better Markets has previously detailed, such ratings are deeply flawed as shown by the fact that Community Reinvestment Act examination pass rates increased from 90% in 1990 to 99% in 2020 but homeownership rates for low income families stagnated. *See, e.g.*, Dennis Kelleher & Peter Rappoport, *The Banking Regulators' Proposed Community Reinvestment Act Rule Will Not Work, But Dramatically Improving It Is Not Complicated* (Sept. 18, 2023), https://bettermarkets.org/wp-content/uploads/2023/09/BetterMarkets_CRA_Rule_Will_Not_Work_09-18-2023.pdf; Better Markets Comment Letter, *Supplement Filing Regarding the Community Reinvestment Act (CRA) Proposed Rule Reviewing Fed Data Demonstrating That the CRA Rule Will Not Work and Redlining Will Continue* (Aug. 7, 2023), https://bettermarkets.org/wp-content/uploads/2023/08/Better_Markets_Supplemental_Comment_Letter_CRA.pdf.

despite its apparent earlier reservations and publicly available information on the serious issues discussed earlier.

While this series of events alone are enough to raise significant concerns about the federal banking regulators' judgment, their subsequent actions raise even more concerns regarding the events that occurred during the spring 2023 regional banking crisis.

The Flagstar Acquisition of Signature Bank Reveals Additional Red Flags

In March 2023, only about 100 days since Flagstar's acquisition of NYCB, banking regulators selected it as the winning bidder in the acquisition of the failed Signature Bank. The results from the Signature bank auction show that Flagstar's bid was indeed the least costly to the FDIC's Deposit Insurance Fund ("DIF"). The FDIC is legally obligated to select the lowest cost bid. The FDIC "invites ***approved and qualified bidders*** to participate in acquisition opportunities by means of a bid list. Bid lists are created for each acquisition opportunity based on potential acquirer's qualifications and interests and characteristics of the failing bank such as capital ratios, regulatory ratings, assets, and core deposits as reported on the most recent Call Report and geographic location of the bank." However, the fact that Flagstar was even allowed to participate in the failed bank bidding process raises serious red flags, primarily related to the process for approving eligible bidders for failed banks.

As mentioned earlier, Flagstar had just recently entered into the December 2022 merger with NYCB. It is critical that the acquirer of a failed bank be able to restore confidence with depositors and customers. The capacity for Flagstar to do this while it is still in the very early days of implementing a significant merger with NYCB is questionable at best. Second, and far more concerning is the question of how Flagstar was considered in the first place as an "approved and qualified" bidder in the auction for Signature when the FDIC had just de facto refused to approve the prior merger application, apparently due to fair lending failings, and NYC Bancorp had just blatantly engaged in regulatory arbitrage to get around objections related to racial discrimination in lending.

The many concerns about the two banks' integrating management, operations, risk, compliance and other systems and processes, including those related to capital and asset quality evaluations, suggest that Flagstar should not have been viewed as a viability bidder for Signature. Furthermore, there were three other banks that submitted a total of four other bids for Signature. In other words, even though the bidding process was accelerated because of the regional banking crisis, there were other options for bank resolution and restoration of financial stability, that did not involve Flagstar.

Flagstar's Condition Has Predictably Deteriorated Due to Known Concentration Risks

While Flagstar's acquisition of Signature in March 2023 seemed positive at the time, it very quickly created a much larger bank that continues to present financial stability concerns for the American people and the broader banking and financial industry.

Rapid asset growth at banks has been cited as a key factor and catalyst for bank failure in the post-mortem reports from the spring 2023 banking crisis. For example, in the Fed's assessment of Silicon Valley Bank's failure, one of the main conclusions was that as the bank grew rapidly the Fed:

> [D]id not appreciate the seriousness of critical deficiencies in the firm's governance, liquidity, and interest rate risk management. These judgments meant that Silicon Valley Bank remained well-rated, even as conditions deteriorated and significant risk to the firm's safety and soundness emerged.

Similarly, the FDIC's assessments of the First Republic Bank and Signature failures cite the same concerns with rapid growth inhibiting the banks' and regulators' abilities to manage their risk. Fed Vice Chairman for Supervision ("VCS") Michael Barr reinforced these concerns in a recent speech, saying:

> [W]hen banks grow rapidly or take on new risks…supervision can lack the speed, force and agility required to keep up with those changes.

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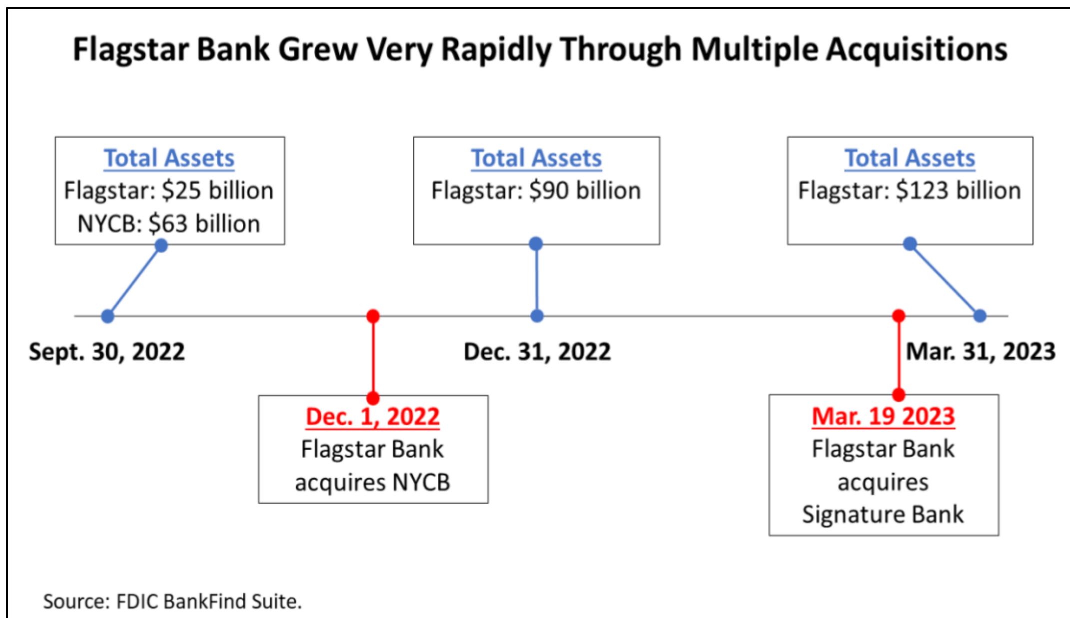
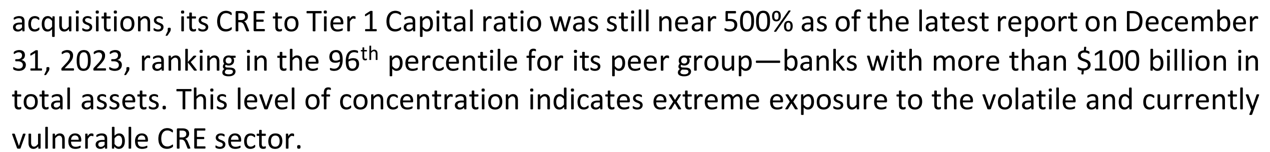


Moreover, CRE lending concentration has been a frequently cited vulnerability for NYC Bancorp and Flagstar. While Flagstar's concentration levels declined somewhat with its recent



acquisitions, its CRE to Tier 1 Capital ratio was still near 500% as of the latest report on December 31, 2023, ranking in the 96th percentile for its peer group—banks with more than $100 billion in total assets. This level of concentration indicates extreme exposure to the volatile and currently vulnerable CRE sector.

To make matters worse, Flagstar is very highly concentrated in one segment of the CRE market—multifamily properties, mainly apartment buildings in the New York City area. This makes the bank uniquely vulnerable to stroke-of-the-pen risk with city laws that limit the amount that landlords can raise rents, which cause the value of CRE loans that rely on rental income to decline.

Conclusion

While Flagstar's acquisitions certainly raise a number of serious financial concerns, the regulatory and consumer protection questions that they present are even more important. The American people rely on the banking regulators to protect them, and the broader financial system and the facts related to this situation suggest unacceptable failures in these areas.

The apparent lack of regulatory coordination and the ability of a bank to switch regulators and receive a different decision on a merger application is shocking and literally unbelievable. However, what is worse is the apparent willingness of regulators to overlook all that ***and*** racial discriminatory conduct by merger participants on multiple occasions in approving the final merger transaction. The American people deserve better from their financial regulators, and financial stability depends on it.

Just as the failures of Silicon Valley Bank and Signature Bank precipitated investigations of what the regulators did or did not do in connection with those failures, a thorough, but independent investigation of the regulators' conduct in connection with the multiple mergers leading to ongoing NYC Bancorp problems must be conducted.

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