INDYMAC, RISK, CONFUSION AND STONE PILLOWS

by Steve Brown

Everyone knows that the Ancient Egyptians created the pyramids, but few know they also slept on pillows made of stone, shaved off their eyebrows to mourn the death of their cats and paid taxes in honey. Freaky, maybe, but you can't argue given how well their civilization flourished (at least for awhile).

The same might have been said about the freaky nature of the way IndyMac was taken over. While no pharaohs were hurt during the takeover, some zany things happened nonetheless, that some say resembles the curse of the mummy.

Take for instance the picture in the newspaper of depositors standing in line outside the bank waiting to get in to get their money. Anyone who saw that picture could have easily done a split screen in their head and placed scenes of people standing outside banks before the Great Depression alongside recent ones of IndyMac. It interesting to note that despite all the hype about how community banks don't get along with large banks, we could not find a single community banker that was happy in any way about Senator Charles Schumer's (D-NY who caused the $1.3B problem) remarks or the editor that allowed the newspaper picture in question to go to press. Both of these people put a black eye on the entire industry and both should have, at the very least, had their eyebrows shaved off, Egyptian-style.

The failure at IndyMac also points out that the FDIC needs to staff up to deal with issues like this in the future. The good news is that this issue has already been recognized by Shelia Bair and the wheels are turning. There is little doubt that all banks will have to pay higher premiums. Right now, 97% of institutions pay between 0.05% and 0.07% on liabilities for an insurance premiums according to the FDIC, but the top line level can run as high as 0.43%. Banks with concentrations of a riskier sort (i.e. either assets or liabilities) should be gearing up to pay more.

The IndyMac problem was one of liquidity, not credit quality. Sure, credit quality was a significant contributor (real estate loans delinquent or in default accounted for 25% of the bank's available capital), but the actual failure was caused by a liquidity event. Back in the 80's and 90's, when it came to credit quality, you could almost graph out when institutions would be taken over, as the drop in their capital level was quite predictable. Liquidity events, on the other hand, deliver a dynamic that is much more difficult to predict. Banks in weakening credit positions should gear up to post collateral to maintain liquidity lines if things don't quickly improve.

Customers have also been thrown into turmoil and the repercussions are just starting to be felt. Many other large bank names have surfaced in the press as possibly being the next shoe to drop (please shut up reporters) and fear has reached out to mom and dad customer. In fact, some of our community bank clients said they saw net customer deposit inflows as a result of the takeover, which probably shows some people remain worried about overall safety and are spreading out their money among different banks to be sure it is all insured. We have also heard tale of customers asking their brokers why certain banks are paying such high rates for deposits. They want to know "what is wrong with them" that would cause them to pay higher rates in the brokered CD market. Obviously, that kind of talk could bring down funding costs, but fear is no one's ally and every banker we know is inching forward carefully in this environment.

We urge regulators to do a much clearer job of communicating with bankers and depositors alike. Saying home equity lines of credit are frozen, but letting construction loans to individuals be paid as scheduled is confusing to customers of a failed bank. Similarly, telling depositors they will have access to their money up to $100k, but then reading press accounts where large banks down the street are placing holds for up to 8 weeks on cashier's checks for amounts above $5k deposited is ludicrous. Recent action by media has made the entire deposit base of the industry less interest rate sensitive, but more credit/headline sensitive. The economy is in turmoil, news reports are dire and fear is rampant. We need to be careful and judicious about what and how we say about our industry.

Finally, we sound off on behalf of all community banks with limited access to global funding options. Reports are circulating that the FDIC may be considering charging banks more if they use FHLB Advances. If true, it could slam shut one of the last few borrowing sources for community banks and encourage some to reduce liquidity to save money just when it is most needed. If true, we hope someone tells whoever might be authoring such a regulatory promulgation to consider switching to goose down pillows from stone.

BANK NEWS

Bank Stocks

Analysts from Morgan Stanley indicate short positions in bank stocks have reached the highest level in history at 11.2% (the sheer amount is only second to short positions in the auto sector at 13.8%). The company has been collecting this type of data since 1994.

Branch Banking

Contrary to general assumptions, when it comes to personal banking, those 29Y and younger prefer conducting financial transactions in person more so than those aged 30Y to 62Y.