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Most banks have cushion of capital

Experts: More failures likely but not on IndyMac scale

By Mike Freeman
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Is your bank safe?

For the first time in years, that question is being asked by depositors as the decaying housing market continues to take its toll on financial institutions.

Lines of angry customers outside failed Pasadena thrift IndyMac Bancorp, as well as staggering second-quarter losses by big banks such as Washington Mutual and Wachovia, hark back to the savings-and-loan crisis of the late 1980s and early 1990s.

But even though banks probably will continue to face tough times because of the weak economy and housing losses, they are in much better shape overall today than they were during the S&L debacle, industry experts say.

That's because most banks, which are coming off several strong-profit years, are sitting on a lot of capital – money available to provide a cushion against losses.

“The core of the banking industry is fairly sound, and the reason is that it comes into this, by and large, with a fairly large capital position,” said Bert Ely, a banking industry consultant based in Alexandria, Va. “We will see more bank failures, but they will be mostly small banks that got too concentrated in certain types of risk – home mortgages, home equity loans, lending to builders, that sort of thing.”

The Federal Reserve also has made it easier for banks to borrow, so they're less likely to face a short-term cash crunch. Regulators such as the Federal Deposit Insurance Corp. have more authority and money today to deal with troubled banks, industry experts say.

Moreover, depositors have myriad ways to protect their money beyond the $100,000 FDIC insurance limit per individual account and $250,000 limit for some retirement accounts.

By opening different types of accounts, among other steps, individual depositors can insure at least $450,000 at one institution, while a couple could insure about $1 million depending on their circumstances, said Greg McBride, senior financial analyst with Bankrate.com.

For depositors, taking steps to make sure their money is insured is smarter than poring over financial statements to figure out whether their bank might fail, McBride said.

“The average consumer is in no position to be playing bank examiner,” he said.

Banks' strong capital status is the story they're telling to ease depositors' fears. Ninety-nine percent of U.S. banks are classified as “well capitalized” by the FDIC, according to the American Bankers Association. That's the FDIC's highest designation of soundness and is based on formulas for how much capital a bank maintains relative to the riskiness of its assets – mostly loans.

So a bank with a large credit card business, such as Bank of America, must have more capital to be considered well-capitalized than a bank with loans secured by high-quality mortgages, which have collateral and are considered less likely to go bad. Banks must have a total risk-weighted capital ratio of 10 percent or greater to be considered well-capitalized by the FDIC.

As of March, only 90 banks with about $26 billion in assets were on the FDIC's secret watch list of “problem” institutions in danger of failure.

The number of troubled banks is likely to rise when the FDIC releases a second-quarter update in a few weeks. But it most certainly will pale in comparison to the 2,165 problem banks with assets of $604 billion at the height of the S&L crisis in 1988.

“The FDIC says 87 percent work their way off the problem list and back to healthy status,” said John Hall, a spokesman for the American Bankers Association.

But with the meltdown in the mortgage market, some banks fail before they're on the FDIC's radar screen.

IndyMac is an example. It specialized in “Alt-A mortgages” – loans that are one rung above subprime. With $32 billion in assets, IndyMac was the second-largest bank collapse ever in the United States.

IndyMac's demise – it was seized by federal regulators July 11 – was replete with Depression-era echoes, including lines of depositors waiting to get their money out and an old-fashioned bank run that caught regulators flat-footed.

At the end of March, IndyMac wasn't among the 90 banks on the FDIC's problem list, though it did make the list in June, an agency spokesman said.

After IndyMac, the FDIC and banks themselves are cranking up efforts to calm depositors. For the past few weeks, the FDIC has been running full-page ads in newspapers nationwide, including one with a picture of a $100,000 bill – a reference to the agency's deposit insurance.

Banks have ramped up training at branches to answer questions from depositors and prospective customers looking to move deposits.

"There has been a flight to quality," said Joe Benoit, Union Bank of California's market president for San Diego. "People are being far more financially astute now because they have to be. They're protecting their investments and protecting their retirement. They're protecting their family wealth."

Benoit said a friend of his recently moved $400,000 from another institution to Union Bank because "she was nervous." The bank worked with the customer to get the maximum FDIC insurance coverage.

According to the FDIC, Bank of America, Wells Fargo, Washington Mutual, Union Bank, California Bank & Trust and Wachovia have about 65 percent of all bank deposits in San Diego County, excluding credit unions.

Four of those banks – BofA, Wells Fargo, Union Bank and California Bank & Trust – posted profits during the second quarter. Wells Fargo and Bank of America both beat Wall Street analysts' forecasts.

Wachovia and Washington Mutual reported hefty losses. Wachovia, which posted an $8.9 billion loss, has a video on its Web site with Chief Executive Robert Steel touting the bank's strong capital position.

Wachovia's loss stemmed from moves to boost reserves for loan losses and write down the value of its 2006 acquisition of World Savings parent Golden West. The Charlotte, N.C.-based bank has seen a surge in defaults on risky mortgages from Golden West.

The loss didn't affect Wachovia's 11-branch operation in San Diego, said Jim Foley, head of the bank's retail business in the West. Deposits increased 3 percent from June to July and now total $2.7 billion locally, he said.

Washington Mutual lost $3.3 billion in the quarter as it also beefed up its provision for loan losses.

Washington Mutual spokesman Derek Aney said the bank has $50 billion in liquidity and is well-prepared for mortgage losses.

"Wall Street performance isn't the same as Main Street performance," Aney said. "We are well-capitalized. We have $50 billion in liquidity, and that's pretty darn good."

Aney added that most of WaMu's mortgages are loans for which it is first in line to get paid in the event of foreclosure. So even though current provisions for loan losses are less than the bank's nonperforming assets, it has plenty of collateral that will allow it to recoup losses, he said.

The main problem for banks is that home prices continue to plunge in the wake of mounting foreclosures, said David Ely, a banking professor at San Diego State University. So it's hard to say just when a bank's mortgage losses will end.

Critics of banks say they've been slow to write down the real value of their mortgage holdings, including mortgage-backed securities. The market for such securities has shrunk dramatically, as evidenced by Merrill Lynch's decision last month to sell off a huge portfolio of mortgage-backed securities at 22 cents on the dollar.

If banks do face additional mortgage write-downs, they could be forced to raise more money to hit federal guidelines for being well-capitalized.

Even though they're facing trouble with mortgages, big banks today are diversified with several lines of business outside of housing, Ely said. They also operate in many regions across the country, and they continue to be able to raise additional capital if they need to.

Ely noted that the panic surrounding IndyMac seems to have subsided. The FDIC took over two other much smaller institutions last month – Reno-based First National Bank of Nevada and First Heritage Bank of Huntington Beach – without the hoopla that accompanied IndyMac.

Mutual of Omaha Bank acquired all the deposits of the two failed institutions, including uninsured deposits, so no depositor lost money.

"I think we're going to see additional bank failures. But is this a long-term trend? I don't know about that," Ely said. "Some banks on the edge are probably going to fail. But I think the failures will be similar to these last two and less similar to the IndyMac case."

■Staff librarian **Denise Davidson** contributed to this report.

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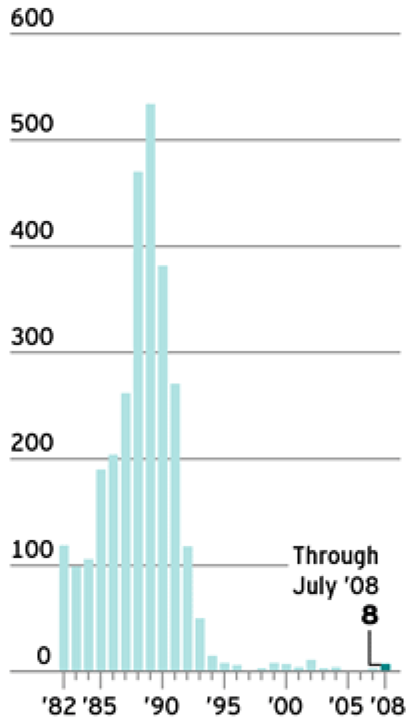

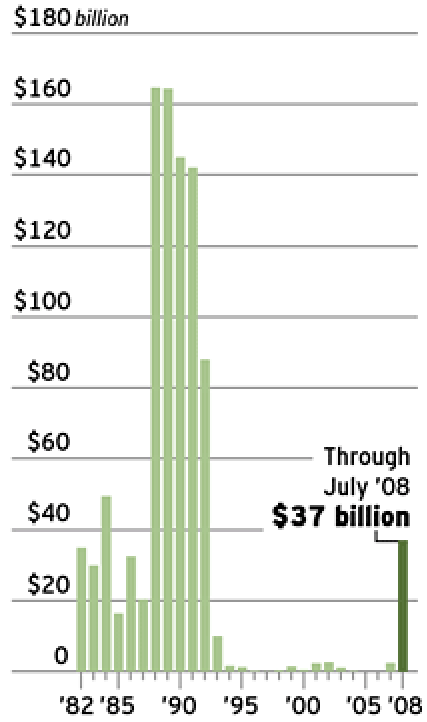

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