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Domino Effect

Banks, Lenders Look to Shore Up Investments to Avoid Being Knocked Over by Credit Crisis

■ By DAN BEIGHLEY

What started with bad bets in home loans has had a domino effect on the financial market, knocking down banks and other lenders. Those still standing are isolating themselves to keep from toppling with tighter credit conditions and conservative investments.

More casualties are likely as the crisis is expected to carry well into next year.

The biggest local losses have come from lenders such as Brea-based Fremont General Corp., which is in bankruptcy proceedings after its business that packaged home loans for sale to Wall Street turned bad.

Some fear that Newport Beach-based savings and loan operator Downey Financial Corp. could be the next to go as it suffers from adjustable-rate mortgages made to borrowers who couldn't afford the higher rates once the loans reset.

The thrift has \$12.6 billion in assets, of which it said 14.7% were bad in August.

Government regulators have forced it to come up with cash to cushion the bad loans. It recently put its headquarters on the market to raise money.

Bank of America Corp.'s Brad Dinsmore, a West division consumer executive, says new customers from troubled banks have been a boon for it.

Deposits are up 300% in July from a year ago and likely are to be up by the same amount in September, he said.

"I've never seen a flight to quality like this," he said.

JPMorgan Chase & Co. bought failed Washington Mutual Inc. in a government-brokered deal.

That deal, among others, has consolidated the banking industry into three major players that hold 30% of deposits in the country.

Bank of America is one of the major players with its pending buyout of Wall Street broker Merrill Lynch & Co.

"It was like a drain being plugged."

— Tom Meyer, president of Fullerton Community Bank



When Charlotte, N.C.-based Wachovia Corp. is sold to San Francisco-based Wells Fargo & Co., Wells will take that third top spot in the nation.

The three banks will have the potential to set pricing on accounts and loans, but may also be subject to tighter government regulation, according to industry watchers.

Local Impact

Locally, Bank of America holds the largest share of deposits in the county with about 20%. Wells Fargo comes in second with 14% and Washington Mutual third with 11%.

Wachovia has less than 2% market share in the county.

The commercial banks also compete for loans, credit cards and investment services.

"It's moving into an oligopoly," said Greg Laetsch, an executive vice president and regional director for Smith Barney, a stock brokerage owned by Citigroup Inc..

Consolidation among brokers will make Bank of America the largest employer of licensed representatives in Orange County, followed by Wells Fargo Investments LLC and Morgan Stanley.

The pressure to compete could lead smaller institutions to consolidate.

Morgan Stanley, a Wall Street investment bank, recently sold 25% of itself to Japan's largest bank, Mitsubishi UFJ Financial Group Inc., so it could take in easier funding as a bank holding company.

San Francisco-based Union Bank of

California NA also was bought by Mitsubishi UFJ Financial Group in September as part of an acquisition of its parent company, UnionBanCal Corp.

Mitsubishi UFJ already had owned a majority of the bank and plans to take it private by July as a move to more easily acquire other banks. It's unclear what changes may occur with what Union Bank already owns.

Union Bank has an almost 5% market share of local deposits.

The bank's balance sheet has stayed healthy because of an absence of subprime loans, but Union Bank still fears a weak economy.

"There's been a real benefit to being conservative," said Scott Connella, market president in the Irvine office of Union Bank.

Local credit unions stand as some of the best financial institutions to withstand the credit crisis.

Credit unions such as SchoolsFirst Federal Credit Union in Santa Ana, which has educators as its core members, have reputations for being conservative in their lending.

But they remain defensive in the face of a weak economy.

"The business practices of SchoolsFirst have always been conservative. Even so, we are not immune to the effects of the economic conditions at large," said Rudy Hanley, president and chief executive of the union in a message to members.

Hanley says the credit union has been putting aside funds to handle potential loan

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losses.

The government's National Credit Union Administration insures SchoolsFirst depositors for up to \$250,000 through the end of next year, which is similar to the Federal Deposit Insurance Corp.'s extended coverage.

Fullerton Community Bank is hoping this temporary money protection from the FDIC will help it attract larger account holders to offset its home mortgages.

Fullerton Community Bank, with \$740 million in assets, was forced to change its business model when major lenders stopped refinancing its customers' loans, which left them as long-term investments on its books rather than quick turnovers.

"It was like a drain being plugged," said Tom Meyer, president of the bank.

As a result, Fullerton, like many other

smaller banks, doesn't have much room to do new loans, and looks to grow through deposits.

Though Meyer says his bank doesn't have a problem with bad loans, he fears a weak economy will take some casualties.

Investment bankers also are bracing for the worst.

Mergers and acquisitions have slowed to nearly a halt due to a lack of available credit.

Weaker profits from companies also are making deals less attractive, according to Hector Cuellar, president of McGladrey Capital Markets LLC, a Costa Mesa based investment bank.

Cuellar says it could be another six to nine months before things might turn around.

"We're nervous, but we'll weather the storm," he said. ■