After IndyMac, Who's Next?

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I'm outside **IndyMac** headquarters all day Monday (or should I say IndyMac Bank FSB), as every depositor in America watches to see what happens when a big bank fails and the FDIC comes in to take over. I feel like a kid again. Back in the '80s I was chasing Charles Keating around a federal courthouse and trying to track down then-California Senator Alan Cranston, one of the "Keating Five" (which included John McCain).

Americans want assurances that if what happened at IndyMac happens at their bank, their money is safe and accessible--at least the federally insured amount of $100,000 per individual account ($250,000 for many 401k's). The FDIC is even promising IndyMac customers 50 cents on the dollar for uninsured deposits, with hopes to be able to pay the whole thing at some point. IndyMac depositors can even cash out their CD's early without penalty, but the FDIC says that isn't necessary.

Fasten your seatbelts.

Chris Thornberg at Beacon Economics says, "IndyMac was the first major institution that wasn't too big to fail." He says as the Feds are busy worrying about "the big boys"—Fannie and Freddie—hundreds, maybe thousands, of smaller, regional banks will now realize they have no savior. Thornberg says investors in those banks have to ask themselves, "Is this institution fundamentally safe?" Depositors with accounts insured by the FDIC don't have to worry…unless the FDIC starts to run low on funds. That looks unlikely at the moment. It has $53 billion, and says IndyMac—by far the largest bank takeover this year—will cost it between $4 billion and $8 billion.

So who's next? Two interesting takes on that.

Thornberg says, "We're still early in this cycle." He says regional banks don't suffer the bulk of their problems until late in a credit downturn. We can expect to see home loan delinquencies to continue to spread to personal loans, car loans and student loans. He also says the next big shoe to drop is regional banks with a lot of exposure to builders, including commercial builders who are building condos or other projects that will fail. Thornberg says banks often hold onto part of the loans they give builders, in essence paying themselves and keeping the loans current. "The books aren't even reflecting the potential problems in those loans." But when I asked which banks in particular, he said he doesn't want to name names. I suggested he was afraid of being the next Chuck Schumer, after regulators blamed the New York Senator for causing the run on IndyMac. "A lot of people are blaming Chuck Schumer," Thornberg says. "All Chuck did was point out what investors should've known all along. IndyMac was in big, big trouble."

Richard Bove at Ladenburg Thalmann has a different take on who may be next. In a report, he looks at all the FDIC-backed institutions, comparing each bank's bad loans to its overall assets through two ratios. First, he divides the "non-performing assets" of an institution--bad loans, late loans, foreclosed assets--by all of its outstanding loans. "A radio above 5 percent suggests danger." The overall industry ratio is below 2 percent. That's good news. But it's not so good for individual names like **Downey Financial** , with a 13.86 percent ratio (on Sunday, Downey Financial reported its non-performing assets were over 14 percent, up from 1 percent a year ago). Other names in the "danger zone" are Corus **Bankshares** at 13.18 percent, **Doral Financial** at 12.82 percent, **FirstFed Financial** at 6.73 percent, **Oriental Financial** at 6.12 percent, and **BankUnited Financial** at 5.36 percent.

Then Bove ran a second set of numbers dividing a bank's non-performing assets by its reserves plus common equity. "A ratio about 40 percent is the danger zone." This is where it gets interesting. You have all the same names as listed before, PLUS **WASHINGTON MUTUAL** , which comes in with a ratio at 40.6 percent. Bove calls this being "on the edge" of danger but not quite there yet. (**See the video for more from Bove**).

Bove blames regulators for not doing much of anything to prevent us from getting to this point. "Regulators should have the courage to stand in front of a mania and stop it," he says. "This requires a courage that simply is not in evidence in Washington either on the positive or negative side." He's concerned about what happens next. "All of the actions are to deepen the trend. It really is beyond inexcusable for top policymakers to argue that large financial institutions should be allowed to fail. It is, of course, just as inexcusable to look the other way while excesses are driven through the system."

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