Indymac Bank OMG Not TBTF

For the past roughly 18 months, until July 11, 2008, when we were seized by the FDIC, as Chairman and Chief Executive Officer of Indymac Bank, I had been leading our team's significant efforts to survive this unprecedented housing and mortgage crisis. Unfortunately, due mainly to circumstances beyond our control, we did not survive.

It is important to understand that Indymac's board and management team had been successfully and profitably managing the company for 14 straight years up until 2007. We had always operated primarily as a national mortgage banker and when we were approved to purchase First Federal of San Gabriel Valley and merge all of our activities into this Federal Thrift on July 1, 2000, we were a nationwide mortgage banker and major Alt-a lender (borrowers generally with prime FICO scores and generally lower loan-to-value ratios, but who may not have fully documented their income). We made no secret, both in our approval and over the years, that we were a hybrid mortgage banker/thrift and a major Alt-a lender, not a traditional portfolio lending thrift.

Since we have struggled with losses over the past few quarters or so and especially since we failed, we have been labeled by some as a "reckless" lender. In an environment where Fannie Mae and Freddie Mac are losing billions and will lose billions more, where the FHA insurance fund just reported a $4.3 billion loss for its fiscal year (and that is on a cash basis...think what the loss would be on a GAAP basis, including fair value accounting) and all three of these entities have "monopoly-like" pricing power, and major financial institutions like Citi, Merrill Lynch, Lehman, Wachovia, UBS and many others have been "brought to their knees" by massive losses caused by mortgages and mortgage-backed securities, I believe this "reckless" label should either be applied to all of these institutions too or none of us. It should also be noted that we sold many Alt-a loans to both Fannie Mae and Freddie Mac over the years and Bank of America was reported to have originated $20 billion in Alt-a loans in the first quarter of this year alone (Alt-a loans done properly are a legitimate and needed lending product). We failed, not because we were a "reckless" lender, but because our business model (a hybrid mortgage banker/thrift) was not diversified, nor equipped to withstand what many have labeled "The Perfect Storm" or "The Worst Financial Crisis Since the Great Depression". The combination of rapid and significant declines in nationwide home prices, and a total collapse (after more than two decades of generally healthy functioning) of the entire private secondary market for mortgages and mortgage-backed securities struck at the heart of Indymac's business model.

It might help at this point to use a simple analogy to drive this diversification point home. If you were a farmer and farmed beans, lettuce, tomatoes, and peppers and there was an e-coli outbreak in tomatoes that forced you to destroy your entire tomato crop, you got hurt but likely could survive; but if you were just a tomato farmer you got wiped out (even if you were one of the better tomato farmers); unless you were a government-owned or government-sponsored tomato farmer.

This brings me to my second point. I have read a lot this past year about the free practice of capitalism, market discipline and the need to allow financial institutions who have taken on excessive risk to fail (a lot of it of this rhetoric, I believe has eminated from short sellers). It is important to understand that

financial institutions and their willingness and ability to extend credit are the "fuel" for our economy and right now that fuel is in short supply; financial institutions have now constricted credit too far and our economy is paying the price. It is important to have financial institutions fail during times of major economic stress, for if we never have a financial institution fail, credit and therefore economic activity would have consistently constrained too far; a much higher economic cost over the long run.

With that said, allowing Indymac Bank to fail, I believe, was a bad business decision and a fundamentally unfair government policy. Since this crisis period began, we have kept our primary regulator, The Office of Thrift Supervision, up-to-date almost daily on our strategies to survive, our execution on them, and our financial position and prospects. I believe strongly that they felt that we were doing everything within our power, given our business model, to keep Indymac Bank safe and sound and avoid any potential loss to the insurance fund. When we were recently unable to raise additional capital, we immediately developed an alternative survival plan that we reviewed with both the OTS and the FDIC and were told by both in a meeting on June 25 , 2008, that "we support this plan, thank you for your efforts to keep Indymac safe and sound, and we would not seize you unless we were forced to do so, because you either become 'critically undercapitalized' (under 2% capital) or you suffer a market event". Unfortunately, the very next day, a "market event" (a bank run) was created when US Senator Charles Schumer publicly released letters he had sent both our regulators and the Federal Home Loan Bank of San Francisco (our primary lender), expressing serious concerns about our financial viability. And while we did not realize it at that moment, our fate was sealed without some assistance from the FDIC/Federal Government. While it is "sour grapes", you have to ask two related questions: "Did the short sellers, upset that the FHLB has been key to many regulated financial institutions survival during this period, somehow put the Senator up to making these letters public?" and "Would some of the teetering New York-based investment banks have survived even one week, in this environment, if Senator had said the same thing about them publicly?"

Over the next week or so, as the bank run continued and other key trading partners (including the Federal Reserve Bank) tightened credit or suspended our ability to conduct business with them entirely, we attempted through the OTS to arrange a meeting with the FDIC to see if we could work together to keep Indymac Bank from failing. No meeting was forthcoming and given this fact and our deteriorating liquidity position, it became obvious that last week that we were likely going to be seized on Friday, July 11th.

Why when our primary regulator trusted us and had confidence in our abilities to manage through this crisis period would the FDIC refuse to meet? Was it because we had been unfairly labeled a "reckless" lender and they believed the press and some politicians and thought we were getting what we deserved? Was there a larger political agenda to "tag" the thrift industry with a big failure and work towards some in government's stated goal to eliminate the thrift charter (Treasury Secretary Paulsen was quoted just before we failed saying that "the thrift charter had run its course and that market discipline must allow financial institutions to fail")? Or was it that the FDIC just had to follow its rules, without regard to the fact that this crisis period is not the same as the last crisis period and is unprecedented, and despite the fact that the rules where being thrown out the window by the Federal Reserve and US Treasury for the likes of money center banks, investment banks, and Fannie Mae and

Freddie Mac; the Too Big To Fail (TBTF) financial institutions of America. The weekend that Indymac failed, both the Fed and Treasury went so far as to propose a full Federal guarantee of both Fannie and Freddie, fearing their imminent failure if they did not and banning short selling for the LARGEST 19 financial firms in the USA (all without extracting any value from these firms shareholders, bondholders, and/or management). And this was after the Fed had taken significant and unprecedented actions in the Bear Stearns collapse to avoid financial contagion. Had Bear been allowed to collapse and had the Federal Reserve not allowed the security broker-dealers unprecedented access to the Fed window, the counterparty and financial confidence risks could easily have taken down Lehman, Merrill and others and Secretary Paulsen might have been saying that his former industry, the security broker-dealer industry, "had run its course". Let's tell it like it is. When Secretary Paulsen said, "Financial institutions that have taken on excessive risk need to fail in order for there to be proper market discipline", he really meant to say "Thrifts and other smaller financial institutions that are not critical to our economy or do not have massive counterparty risk need to fail, but we must do everything in our power to protect the largest financial institutions in America". In other words, we have a two-tiered, unfair financial system in America, where the largest firms already have a decided advantage in scale, credit ratings (due to being TBTF), cost of funds, and monopoly pricing power (in the case of the GSEs). So what are the rest of financial institutions left with? Generally, it means that they have to take on more risk (suscepting themselves to failure in times like these) or they have to know their place and be satisfied carving out a small niche .

Let's get back to this market principle issue. If a private financial firm had insured Indymac Bank's $18 billion or so in deposits and knew that IMB was in trouble as a result primarily of market forces beyond its management's control, would they not have been proactive in attempting to meet with the board and management to "see how we could work together in our mutual interest"? It is precisely because the FDIC does not operate based on market principles that they refused to meet and work together and decided to seize Indymac Bank. Think about it, virtually over night they replaced the board, CEO, and the President of Indymac Bank and put in our place FDIC managers (some of whom came out of retirement) who have never run an operation of Indymac Bank's unique type, size or complexity. Would the private market insurers have done this in a time of systemic crisis? Not likely, especially when no one with knowledge, including Indymac's primary regulator, was challenging the competence or integrity of management or the board.

One of the issues that is a focus of the press during this crisis period is that board's and management teams need to be held accountable for this financial mess. They were greedy, took on too much risk, and/or were incompetent. Maybe some, but when you see big losses at nearly every financial services firm who originated home loans or bought mortgage-backed securities, I think it more logical to conclude that this was a massive systemic failure, with everyone (from lenders, to rating agencies, to Wall Street dealers, to investors, to consumers, and even to our government) and no one being responsible. When a major crisis occurs, we Americans and especially the press and our politicians love to blame. Boards have fired a lot of financial executives in this crisis, including the CEO's of many of the world's top financial services firms: Citi, Merrill, UBS, and Wachovia to name just a few. And as a result of the press and many consumers unfortunately losing their homes to foreclosure, our government has

spent most of its time to-date focused on blame and on preventing another crisis, neither of which is needed right now. The focus right now should be solely on solving the current crisis for consumers, financial institutions, and the economy and then and only then we should take our time to determine the new regulations and/or laws needed to prevent a similar future crisis, and then finally on pursuing those firms or individuals who may have abused our financial system.

The FDIC who now "runs the show" at Indymac is very focused on finding and placing blame with management and the board at Indymac. And they are also very focused on "getting out expeditiously", because they know unfortunately, that they will have more institutions to deal with before this crisis period is over and because they know that they are not "equipped" to hold Indymac Bank together long given as one top Indymac manager said to me recently, "They cut the head off and the heart out of Indymac Bank". As a result, they do not seem to be focused on what most of us view their primary responsibility to be when they seize an institution: preventing or mitigating a loss to the insurance fund. In further support of this point, the FDIC took the unusual step of publicly touting the fact that they had decided to temporarily freeze foreclosures on all loans that Indymac Bank owns; a pet project of the FDIC Chairman. While this may have sounded great to the public and press, the reality is that Indymac's loan servicing and loss mitigation management team was already doing everything possible to modify loans; reducing loan balances, interest rates, and mortgage payments (among many other strategies) and keep any consumer who could make any reasonable payment in their home. What rational lender or mortgage investor wants to foreclose and the sell an REO property in this housing market? The fact of the matter is that many consumers, who bought homes or pulled cashout of their existing homes and now have negative equity, do not want to stay in their home under any circumstances.

After poring everything I had into Indymac and all of its stakeholders for more than 15 years, to on July 11th, almost immediately upon seizure, be read my rights by a Special Investigative Agent of the FDIC and answer under oath a dozen or so questions and then be escorted by security out of the building, just because we were unable to raise more capital in this crisis period, is beyond decency. Something no American should be forced to experience. Especially, given the fact that I had offered on more than one occasion to work for nothing for the FDIC, for as long as it took, to "hold the team together" and prevent or mitigate any loss to the insurance fund. After this tragedy for Indymac Bank, its shareholders, its loyal and hard working employees, its customers, and for the FDIC, it took me several days before I could read the papers.

The one issue in the press coverage that shocked me (and every manager, director and advisor of Indymac Bank that I talked to) was the FDIC's estimate of a $4 to $8 billion loss to the insurance fund. Our most recent internal projections did not have us depleting the banks existing private capital; let alone creating a loss of this magnitude for the insurance fund. And with the FDIC's ability to abrogate contracts in seizure and their ability to borrow at much cheaper Federal rates than we could given our troubled state, if they kept the bulk of the Indymac management team in place and let the assets "run down" over time or at least until the markets recover (the way the Federal Reserve is doing with the roughly $29 billion in mortgage assets that they own from the Bear Stearns collapse), I and others believe that the insurance fund would suffer little to no loss. So where is their loss estimate coming from? As I understand it, they have hired Lehman Brothers (isn't this more than a bit of a conflict given

that they a major Alt-a and subprime lender and securitizer? And didn't we buy Financial Freedom, Indymac's reverse mortgage company, from them?) to sell Indymac in whole or in pieces within a very short (I have heard 90 day) timeframe. So, where is this loss coming from? Not from Indymac Bank's management and board who worked so hard over the last 18 months to avoid a loss to the insurance fund, but from the FDIC's need for expediency over the reality that the current market is highly illiquid and as a result, the FDIC will not obtain anywhere near a fair price for Indymac's assets. Why do you think, as I heard recently from one of Indymac's managers, that Bill Gross (PIMCO) personally called to talk to the FDIC about buying IMB's assets? Do you think he did it because he is trying to help the FDIC and his Country? Are you kidding. He knows that his firm can make billions if the FDIC really believes that Indymac has a $4 to $8 billion loss embedded in its balance sheet. The reality is that the FDIC, with a little "creativity" and trust and coordination with Indymac's management and board, could have created a win win situation for the insurance fund and Indymac's stakeholders. The FDIC could have invested their own capital into Indymac Bank (senior to all of our existing private capital) to ensure we were well capitalized, guaranteed our liabilities with the FHLB and Fed, taken warrants or stock in the holding company, and kept the management team and board in place to execute on its already agreed to plan. If everything went according to plan, the FDIC would be able to get out within roughly three years with no loss and possibly a profit. If things went worse than expected and all of Indymac's private capital was depleted, then they could have decided to seize the institution down the line. Unfortunately, the FDIC seems to be more focused on blame and expediency rather than preventing or mitigating losses for the insurance fund.

I read somewhere recently that the FDIC Chairman said she would replenish the insurance fund by charging troubled financial institutions (which are expected, unfortunately, to grow significantly over the next several quarters) higher deposit insurance assessment fees. Just like the FDIC's decisions to seize Indymac Bank and its decision after seizure to rapidly firesell Indymac into this illiquid market, this is another, long-standing irrational policy that hurt Indymac Bank's ability to survive and will hurt other financial institutions too. Troubled financial institutions are generally struggling to stay or become profitable and yet the FDIC who has far more insurance risk (if they fail) is going to charge them a higher deposit insurance premium (it is 8 BPs on deposit for a healthy institution and it is 54 BPs; 6 times higher for the most troubled institutions) making it even harder for them to return to health. This is a "penny-wise and pound-foolish policy"; especially in a time of systemic financial crisis. The FDIC and the Fed understand this issue for troubled consumers; they want financial institutions to lower mortgage and credit card rates and waive late fees. Why doesn't the FDIC understand this issue for the financial institutions that they insure?

A better deposit insurance system would be to charge those TBTF institutions (and therefore their shareholders who benefit) a much higher amount than those NOT TBTF institutions.

Housing and mortgage lending is crucial to our American way of life and to our economy. An independent Thrift industry, dedicated and focused on housing and mortgage lending, is as crucial to our economy as Fannie and Freddie. Let's not pretend that we have a free market system in financial services; we don't. Shouldn't we then, as an issue of fundamental fairness, treat all financial institutions equally in times of crisis?