



## NORTH CAROLINA BANKING INSTITUTE

Volume 13 | Issue 1

Article 24

2009

# The Decline and Fall of IndyMac How Deteriorating Economic Conditions, Inadequate Responses to those Conditions, and the Senior Senator from New York Caused One of the Largest Bank Failures in United States History

Jason Moran-Bates

Follow this and additional works at: <http://scholarship.law.unc.edu/ncbi>

 Part of the [Banking and Finance Law Commons](#)

### Recommended Citation

Jason Moran-Bates, *The Decline and Fall of IndyMac How Deteriorating Economic Conditions, Inadequate Responses to those Conditions, and the Senior Senator from New York Caused One of the Largest Bank Failures in United States History*, 13 N.C. BANKING INST. 515 (2009).

Available at: <http://scholarship.law.unc.edu/ncbi/vol13/iss1/24>

This Note is brought to you for free and open access by Carolina Law Scholarship Repository. It has been accepted for inclusion in North Carolina Banking Institute by an authorized editor of Carolina Law Scholarship Repository. For more information, please contact [law\\_repository@unc.edu](mailto:law_repository@unc.edu).

# **The Decline and Fall of IndyMac: How Deteriorating Economic Conditions, Inadequate Responses to those Conditions, and the Senior Senator from New York Caused One of the Largest Bank Failures in United States History**

## I. INTRODUCTION

Bank failures are nothing new. From 1934 through 2007, there were only two years in which no banks failed.<sup>1</sup> During the height of the savings and loan crisis of the 1990s, banks failed at a rate of one every 1.38 days.<sup>2</sup> The rate of failure slowed from 2000 to 2007, with the Federal Deposit Insurance Corporation (FDIC) reporting thirty-two bank failures during that period.<sup>3</sup> After two years without a single bank failure (2005-2006), bank failures have dramatically increased, with fourteen institutions entering FDIC receivership between February 2007 and September 2008.<sup>4</sup> The largest of these, and the third largest in United States history at the time, was the failure of California-based IndyMac Bank, FSB on July 11, 2008.<sup>5</sup>

As early as the beginning of 2007, there were warning signs about IndyMac's continued ability to survive.<sup>6</sup> IndyMac officials downplayed bad news while maintaining a business model focused on growth and claiming that the bank's high level of capitalization

---

1. Jill Konieczko, *The Ten Biggest U.S. Bank Failures*, U.S. NEWS & WORLD REPORT, July 15, 2008, available at <http://www.usnews.com/articles/business/economy/2008/07/15/the-10-biggest-us-bank-failures.html>.

2. *Id.*

3. *Id.*

4. See FDIC: HSOB Failures and Assistance Transactions, <http://www2.fdic.gov/hsob/SelectRpt.asp?EntryTyp=30> (last visited Jan. 26, 2009) (input the relevant dates for result).

5. Konieczko, *supra* note 1 (as a Federal Savings Bank, IndyMac was under the supervision of the Office of Thrift Supervision (OTS) prior to its failure) (sources render the bank's name as either "Indymac" or "IndyMac." I have chosen to use the latter throughout this Note as that is how the name appears on official OTS and FDIC materials.).

6. See Jim Cramer, *Shorts' Dirty Dozen*, REALMONEY.COM, Mar. 14, 2007, <http://www.thestreet.com/prmoney/jimcramerblog/10344308.html>.

would allow it to weather any storm.<sup>7</sup> Aside from trimming some jobs (cuts which were nearly cancelled out by the acquisition of new lines of business), IndyMac did not take any decisive action until it revamped its business model in January 2008, by which time its stock price had fallen almost eighty-five percent (85%).<sup>8</sup> Although the business model change temporarily buoyed IndyMac, a major piece of that reform was reliance on the bank's thrift branches, rather than mortgage origination.<sup>9</sup> This reliance was misplaced considering the financial difficulties faced by the thrift segment.<sup>10</sup> By March 2008, IndyMac's stock price had sunk to its previous low, and serious questions remained about the bank's ability to remain solvent.<sup>11</sup> These concerns were expressed by Senator Charles Schumer in letters written to the FDIC, Office of Thrift Supervision (OTS), and Federal Home Loan Bank (FHLB) of San Francisco.<sup>12</sup> When these letters were made public, IndyMac suffered a run on deposits with depositors withdrawing \$1.3 billion in less than three weeks.<sup>13</sup> Ultimately, IndyMac failed, and the FDIC had to take over. This Note will examine the causes of IndyMac's failure. It will demonstrate that deteriorating market conditions, IndyMac's inadequate response to those conditions, and the public concerns of Senator Schumer all had a role in the failure.

Part II of this Note will look at the deteriorating market conditions faced by IndyMac. It will show how those conditions gave ample warning signals to IndyMac officials. It will also demonstrate that while IndyMac officials can hardly be accused of fiddling while the bank burned, the half measures taken to arrest failure throughout 2007 were ineffective. Finally, it will

---

7. See, e.g., Grove Nichols, *S&P and Moody's Downgrade Bonds Backed by Subprime Mortgages*, THE IMB REPORT, July 12, 2007, <http://theimbreport.com/index.php?paged=6>.

8. See IMB INTERACTIVE CHART, <http://finance.boston.com/boston?Page=CHA RT&Ticker=IMB> (providing a two-year chart of stock price).

9. See *infra* notes 131-135 and accompanying text.

10. See *infra* notes 138-142 and accompanying text.

11. See IMB INTERACTIVE CHART, *supra* note 8.

12. See *infra* Part III.

13. Damien Paletta & Paul Enrich, *Crisis Deepens as Big Bank Fails—IndyMac Seized in Biggest Bust in Two Decades*, WALL ST. J., July 12, 2008, at A1 (stating that IndyMac had a little over \$19 billion in total deposits as of Mar. 31, 2008).

demonstrate that the new business model—with its reliance on a troubled thrift business—unveiled in early 2008 was misguided and did little to ensure IndyMac’s solvency.<sup>14</sup> Part III will examine the Schumer letters and the accusations they caused the failure by triggering a run on deposits.<sup>15</sup> Part IV will look at the aftermath of the failure, including the FDIC’s response and new allegations of fraud being investigated by the Federal Bureau of Investigation (FBI).<sup>16</sup>

## II. ANATOMY OF A FAILURE

### A. *IndyMac and Subprime Spillover*

At first glance, IndyMac was not a likely candidate for collapse. Although the subprime lending market was in a freefall, IndyMac specialized in making Alt-A loans.<sup>17</sup> These loans are riskier than prime loans, but are less risky than subprime loans.<sup>18</sup> Traditionally Alt-A loans are extended to borrowers with good credit, as most Alt-A loans require a credit score of at least 620; however, most Alt-A borrowers do not provide full documentation of assets and income.<sup>19</sup> These loans were very popular during the recent housing boom, accounting for fifteen percent of mortgage originations in the first half of 2007, compared with just two percent in all of 2003.<sup>20</sup>

Alt-A loans generally performed better than subprime loans. After examining five years of data from 2002 to 2006, First American Loan Performance found that the loss rate for subprime loans was over ten times that of Alt-A loans.<sup>21</sup> IndyMac’s Alt-A

---

14. *See infra* Part II.

15. *See infra* Part III.

16. *See infra* Part IV.

17. Press Release, OTS, OTS Closes IndyMac Bank and Transfers Operations to FDIC (July 11, 2008) available at <http://tradingsuccess.com/blog/wp-content/uploads/2008/07/ots-closes-indymac-bank-and-transfers-operations-to-fdic.pdf>.

18. *See Sub-Prime Woes Start to Hit Less-Risky Lenders*, L.A. TIMES, Apr. 10, 2007, at C4.

19. *Alt-A*, WASH. POST, Aug. 19, 2007, at F06.

20. *Id.*

21. *IndyMac Provides Additional Credit Loss Analysis on Alt-A and Subprime Lending*, BUSINESS WIRE, Mar. 29, 2007, [http://www.businesswire.com/portal/site/google/index.jsp?ndmViewId=news\\_view&newsId=20070329005839&newsLang=en](http://www.businesswire.com/portal/site/google/index.jsp?ndmViewId=news_view&newsId=20070329005839&newsLang=en)

loans performed even better than the industry average.<sup>22</sup> IndyMac's chairman and CEO described how Alt-A loans were more similar to prime than subprime in a more colorful manner:

Alt-A is not "slightly" less risky than subprime, it is a lot less risky . . . . I've also heard people say and read it in the press . . . that Alt-A lending is 'in between' prime and subprime lending . . . That's like saying that our headquarters in Pasadena is 'in between' Los Angeles and Las Vegas. True enough, but there's the question of degree: Pasadena is [eleven] miles northeast of Los Angeles and Las Vegas is 262 miles northeast of Pasadena.<sup>23</sup>

As the subprime meltdown continued, however, the problems in subprime loans began to "spill over" to what had been thought to be safer mortgages.<sup>24</sup> In April 2007, lenders found they were no longer able to sell Alt-A mortgages at enough of a premium to cover the costs of origination.<sup>25</sup> Instead, lenders were forced to sell the loans at par or lower.<sup>26</sup> American Home Mortgage, another Alt-A lender unaffiliated with IndyMac, was hit particularly hard, and reduced its 2007 second quarter dividend to \$.70 per share from \$1.12 per share in the first quarter.<sup>27</sup> This reduction was accompanied by an announcement that the company had earned only about half as much per share as it had expected, largely due to having to write-down many of its Alt-A loans.<sup>28</sup> This decline in the performance of Alt-A loans, which surfaced first with American Home Mortgage, would soon affect

---

(stating that subprime loans had a loss rate of 55.9 basis points of unpaid principal balance compared to 4.7 for Alt-A loans).

22. *Id.* (IndyMac's loss rate was only .81).

23. *Id.*

24. Vikas Bajaj, *U.S. Subprime Problems Spill Over to Safer Mortgages*, INT'L HERALD TRIB., Apr. 10, 2007, at 12.

25. *See id.*

26. Vikas Bajaj, *Defaults Rise in Next Level of Mortgages*, N.Y. TIMES, Apr. 10, 2007, at C1.

27. Bajaj, *supra* note 24.

28. *See id.*

other Alt-A mortgages and was instrumental in bringing down IndyMac.<sup>29</sup>

*B. Initial Warning Signs*

1. Short Selling

On March 14, 2007, about a month before the subprime crisis began to spill over into the Alt-A market, financial analyst Jim Cramer sounded the first warning for IndyMac, naming it as the number one stock being sold short.<sup>30</sup> Cramer wrote “I would not own a single one of these [securities] myself . . . . The IndyMac people are adamant they’re not in trouble, but so were the Accredited people,” a reference to a company Cramer claimed was struggling mightily.<sup>31</sup> Cramer made specific reference to “liquidity issues,”<sup>32</sup> foreshadowing what would be listed as the cause of death on the OTS’s autopsy of IndyMac.<sup>33</sup> Cramer and the short sellers were proved right as the price of IndyMac fell from a high of \$36.66 on June 5, 2007, to \$19.00 on August 15, 2007.<sup>34</sup> Although the stock would rebound briefly, the overall trend remained downward.<sup>35</sup>

Three months later, Thestreet.com, a financial news and advice web site, claimed that while “the subprime meltdown is already well under way, problems with Alt-A loans, or so-called ‘liars’ mortgages,’ are only starting to rear their heads” and named IndyMac as an institution in particular trouble.<sup>36</sup> The article cited

---

29. See, e.g., *infra* notes 118-121 and accompanying text for declining earnings data.

30. Cramer, *supra* note 6.

31. See *id.*

32. *Id.*

33. See Press Release, Office of Thrift Supervision, OTS Closes IndyMac Bank and Transfers Operations to FDIC (July 11, 2008), available at <http://trading.success.com/blog/wp-content/uploads/2008/07/ots-closes-indymac-bank-and-transfers-operations-to-fdic.pdf>.

34. See IMB Interactive Chart, *supra* note 8 (showing month-by-month price data).

35. See *id.* (providing a two-year historical price chart).

36. Nicholas Yulico, *Two Ways to Play Mortgage Lenders*, THESTREET.COM, June 25, 2007, <http://www.Thestreet.com/story/10364659/4/two-ways-to-play-mortgage-lenders.html>.

“severe pressure” on the Alt-A lenders caused by “lower gains on sale margins.”<sup>37</sup> These lower gains would be potentially disastrous for IndyMac, which had greater exposure to Alt-A loans than any other lender.<sup>38</sup> Financial analyst Robert Lacoursiere wrote that a collapse of two leverage mortgage funds managed by Bear Stearns was a harbinger of difficult times at IndyMac.<sup>39</sup> He believed the collapse of the funds indicated a decline in the Alt-A market, and that such a decline that would hit IndyMac hard, considering its large Alt-A exposure.<sup>40</sup> He believed that risk of Alt-A market decline was not reflected in IndyMac’s current stock price and advocated selling IndyMac stock.<sup>41</sup>

IndyMac dismissed the concerns by distinguishing itself from Bear Stearns.<sup>42</sup> Officials noted that the failed Bear Stearns funds were comprised of very risky collateralized debt obligations (CDOs).<sup>43</sup> IndyMac, however, did not own any CDOs.<sup>44</sup> The IndyMac response also contrasted the loans made by the Bear Stearns funds with those made by IndyMac: “Bear Stearns’ problem is with subprime securities, and subprime lending accounted for only [four percent] of IndyMac’s loan originations in 2006 and Q1 07. In the higher credit quality segment of the market that IndyMac primarily participates in, conditions, though difficult, are substantially better than in the subprime market.”<sup>45</sup>

Not all analysts shared bearish concerns. Sahul Sharma, writing in response to Lacoursiere, attempted to show that IndyMac was not a stock investors needed to sell.<sup>46</sup> He claimed that IndyMac had learned its lesson during a liquidity crunch in

---

37. *Id.*

38. MIKE HUDSON, *IndyMac: What Went Wrong? How an “Alt-A” Lender Fueled It’s Growth with Unsound and Abusive Mortgage Lending* 6 (Ctr. For Responsible Lending, ed., 2008).

39. *Id.*

40. *See id.*

41. *Id.*

42. *See* Grove Nichols, *IndyMac’s Response to The Street.com*, THE IMB REPORT, June 27, 2007, <http://theimbreport.com/index.php?paged=6>.

43. *Id.*

44. *Id.* (capitalization in original).

45. *Id.*

46. *See* Sahul Sharma, *IndyMac: Not Just Another Subprime Mortgage Lender*, SEEKING ALPHA, June 27, 2007, <http://seekingalpha.com/article/39518-IndyMac-not-just-another-subprime-mortgage-lender>.

1998, and because of that would be well-positioned to continue operations through the current downturn.<sup>47</sup> Sharma believed, that if necessary, IndyMac would be able to sell Financial Freedom—the nation’s largest originator of reverse mortgages—for around \$800 million, a sizeable increase over its 2004 purchase price of \$112 million.<sup>48</sup> Sharma also believed that IndyMac would not get caught up in a spillover into Alt-A loans because not all Alt-A loans were created equal.<sup>49</sup> IndyMac’s Alt-A loans tended to be much less likely to default than those of competitors; the average FICO score of an IndyMac borrower was 700,<sup>50</sup> although borrowers with credit scores as low as 620 were generally eligible for Alt-A loan products.<sup>51</sup> Sharma concluded that IndyMac was undervalued, historically trading at 1.6 to two times book value, but currently trading at only 1.3 times book value.

Sharma remained a lone voice in the crowd, however, and by the end of June 2007, analysts from Keefe, Bruyette & Woods (KBW) wrote that IndyMac was underperforming.<sup>52</sup> KBW looked at “\$58 billion of [IndyMac] private label securitizations,” and concluded that their previous earning per share (EPS) evaluation had to be revised downward, and established a target price of twenty-five dollars per share for IndyMac stock.<sup>53</sup> In making that analysis, KBW looked at a rise in delinquencies and stated lower EPS estimates were a result of lower gain on loans sold and “more conservative expectations for the net interest margin.”<sup>54</sup> IndyMac pointed to several flaws in the study: (1) it looked at only one-third of IndyMac’s servicing portfolio; (2) IndyMac was exposed to credit risk on a little over three percent of the holdings analyzed; and (3) KBW neglected to look at most of IndyMac’s earnings base—the study examined only a portion of mortgage servicing, while IndyMac derived a substantial portion of earnings from

---

47. *See id.*

48. *Id.*

49. *Id.*

50. *Id.*

51. *See Alt-A*, WASH. POST, Aug. 19, 2007, at F06.

52. Grove Nichols, *IndyMac Response to KBW Equity Research*, THE IMB REPORT, June 29, 2007, <http://theimbreport.com/index.php?paged=6>.

53. *Id.*

54. *Id.*



mortgage production and its thrift business as well.<sup>55</sup> While IndyMac may have been justified in thinking these shortfalls left “no way to assess the validity of [the] assumptions and analysis,” it was clear that by the end of the second quarter in 2007, the mood on the street regarding IndyMac was pessimistic.<sup>56</sup>

## 2. Ratings Decline

Starting on June 28, 2007, there were concrete reasons to be concerned about IndyMac.<sup>57</sup> On that date, two classes of Residential Asset Securitization Trust (RAST) bonds owned by IndyMac were placed on Watch Negative by Fitch Ratings, one of the three major credit rating agencies.<sup>58</sup> The rating itself was not significant to IndyMac; the company had bought the bonds for revenue in 2004, and Kurt Johnson, IndyMac’s Senior Vice President of Retained Asset Management, wrote that the bonds had performed better than had been expected.<sup>59</sup> The only real significance of this downgrade is what it represented: From this point on, IndyMac would enter a slow—but continuous—downward spiral in terms of credit ratings, as will be described below.<sup>60</sup> This downgrading of IndyMac RASTs was, like the assassination of Franz Ferdinand, the initial trivial event that became a harbinger of cataclysm.

IndyMac’s downward slide picked up momentum, in a more dramatic fashion, a little over a week later.<sup>61</sup> On August 7, 2007, the Standard and Poor’s (S&P) credit rating agency placed 207 separate residential mortgage-backed securities “on CreditWatch with negative implications.”<sup>62</sup> All of the securities

---

55. *Id.*

56. *Id.*

57. See Kurt Johnson, *Fitch Places 2 Classes on Watch Negative from IndyMac RAST 2004-A2*, THE IMB REPORT, June 28, 2007, <http://theimbreport.com/index.php?paged=6>.

58. *Id.*

59. *See id.*

60. *See infra* notes 61-69.

61. See Press Release, Standard and Poor’s, Ratings on 207 U.S. Alt-A RMBS Classes Placed on CreditWatch Negative (Aug. 7, 2007), available at <http://www2.standardandpoors.com/portal/site/sp/en/us/page.article/3,1,1,0,1148446518820.html>.

62. *Id.*

were backed by Alt-A mortgages, which S&P claimed were facing rising rates of delinquency.<sup>63</sup> S&P also had the “expectation that losses on the collateral will exceed historical precedent and may exceed . . . original expectations.”<sup>64</sup> The reasons S&P gave for a lack of confidence in Alt-A securities—high loan-to-value ratios, declining home prices, loose underwriting standards, and speculative borrowing—were all concerns that had been expressed about subprime loans earlier.<sup>65</sup>

For IndyMac, this watch was much more significant than the one issued a little over a week previously; in addition to showing a lack of confidence in IndyMac’s main product, this watch hit the books more severely.<sup>66</sup> Seventeen of the 207 downgraded bonds were issued by IndyMac, and, even more significantly, the company still owned ten of them, with a book value of \$8.6 million.<sup>67</sup> Notwithstanding the downgrade, there were still reasons for optimism.<sup>68</sup> IndyMac Chairman and CEO Mike Perry noted that the loans downgraded by S&P may not have been typical of IndyMac Alt-A loans, which typically had a lower loan-to-value ratio and performed as well as fully documented jumbo loans.<sup>69</sup> As noted by Sahul Sharma above, the average FICO score of an IndyMac Alt-A loan was 700, placing most IndyMac loans in this more sustainable strain of Alt-A loans.<sup>70</sup>

Despite the fact IndyMac loans may have looked better on paper, the rating slide continued the following month.<sup>71</sup> On September 17, 2007, Moody’s downgraded its issuer rating on IndyMac Bancorp and IndyMac Bank to Ba1 and Baa3,

---

63. *Id.*

64. *Id.*

65. *Id.*

66. See *Bond Portfolio Update*, THE IMB REPORT, Aug. 7, 2007, <http://theimbreport.com/index.php?paged=5>.

67. *Id.*

68. See Mike Perry, *Email from Mike Perry, Chairman and CEO: Standard and Poor’s Press Release*, THE IMB REPORT, Aug. 7, 2007, <http://theimbreport.com/index.php?paged=5>.

69. See *id.*

70. See Sharma, *supra* note 40.

71. See Grove Nichols, *IndyMac’s Response to Moody’s Downgrades*, THE IMB REPORT, Sept. 19, 2007, <http://theimbreport.com/index.php?paged=4>.

respectively.<sup>72</sup> Although this was another cause for pessimism about the overall health of IndyMac, there was little actual impact on IndyMac.<sup>73</sup> The issuer ratings only mattered when a corporation was seeking long-term debt financing, something IndyMac was not interested in pursuing.<sup>74</sup>

By this time, there had been a consistent downward trend on IndyMac issues and the company itself, but IndyMac officials remained optimistic. Although it had been hit hard in the third quarter of 2007, Director of Corporate Communication Grove Nichols expected that quarter to be the lowest point for IndyMac and predicted “solid” profits in the immediate future.<sup>75</sup> He also stated that IndyMac’s Alt-A losses were only one-fifth those of the industry average.<sup>76</sup> Some ratings agencies even maintained optimism. S&P wrote that not only had IndyMac “managed its secured funding prudently to avoid margin or collateral calls from its lenders,” it could also call upon FHLB advances if it needed quick access to unsecured liquidity.<sup>77</sup>

But even with this slight cause for optimism, the fears that caused S&P to place the Alt-A loans on Credit Watch negative in the first place were playing out. Moreover, delinquencies on IndyMac’s servicing portfolio continued to rise across the board. The rate of delinquency increased over IndyMac’s entire portfolio from July-August 2007 was ten basis points (bps).<sup>78</sup> The increase for IndyMac subprime delinquencies (although a small part of their overall portfolio) was 22.45%.<sup>79</sup> IndyMac claimed a 23.4 bps loss on subprime loans in the second quarter.<sup>80</sup> Delinquencies on prime first mortgages (accounting for ninety-three percent of the

---

72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.*

76. Grove Nichols, *Update on Delinquencies in Our Mortgage Loan Servicing Portfolios*, THE IMB REPORT, Aug. 24, 2007, <http://theimbreport.com/index.php?paged=4>.

77. Press Release, Standard & Poor’s, IndyMac Bancorp Summary Analysis (Aug. 16, 2007) (on file with author).

78. Grove Nichols, *Update on Delinquencies in Our Mortgage Loan Servicing Portfolios*, THE IMB REPORT, Sept. 20, 2007, <http://theimbreport.com/index.php?paged=4>.

79. *Id.*

80. IndyMac Bancorp, Inc., Second Quarter Review 25 (2007).

overall portfolio) rose at a rate of seven bps.<sup>81</sup> For the first time, IndyMac's delinquency rate rose above the industry average, a fact directly attributable to its reliance on Alt-A loans.<sup>82</sup> The ratings game was also beginning to have an effect on IndyMac's bottom line, with downgrades of IndyMac securities leading to increased write downs.<sup>83</sup> Although IndyMac's loans continued to perform better than subprime, they were now performing markedly worse than prime, and the spillover from subprime threatened to flood out IndyMac with its Alt-A-heavy product mix.

On November 29, 2007, Moody's, the third of the major credit rating agencies, downgraded IndyMac on three fronts: "IndyMac Bank F.S.B.'s long-term deposit rating [dropped] to Ba1 from Baa3 and its short-term deposit rating [fell] to not prime from P-3. IndyMac Bancorp, Inc.'s issuer rating was downgraded to Ba2 from Ba1."<sup>84</sup> Again, however, the signals were mixed. IndyMac remained in a "strong liquidity position," having increased liquidity from \$4.1 billion to \$6.3 billion as a result of a forty-three percent increase in deposits.<sup>85</sup> IndyMac remained well over the capitalization levels required to be considered well-capitalized by the OTS, and in remarks justifiable at the time, but unfortunate in hindsight, Grove Nichols again claimed he was "confident that [IndyMac had] the liquidity, capital and reserves to weather the current storm in [the] industry."<sup>86</sup>

By early 2008, the ratings slide was over. On January 23, Moody's withdrew IndyMac's ratings.<sup>87</sup> The ratings ended at IndyMac's request, ostensibly to save money for a service which was not needed since IndyMac "never relied on the corporate debt markets for funding."<sup>88</sup> While the company did admit that the ratings were eliminated because the downgrades created a

---

81. Nichols, *supra* note 71.

82. *Id.*

83. IndyMac Bancorp, Inc., Third Quarter Review 5 (2007).

84. Grove Nichols, *IndyMac Responds to Moody's Downgrades*, THE IMB REPORT, Nov. 29, 2007, <http://theimbreport.com/index.php?paged=3>.

85. *Id.*

86. *Id.*

87. Grove Nichols, *IndyMac's Request to Withdraw Ratings*, THE IMB REPORT, Jan. 23, 2008, <http://theimbreport.com/index.php?paged=3> (last accessed Nov. 10, 2008).

88. *Id.*

perception of a credit risk, it denied there was any risk to IndyMac in reality.<sup>89</sup> In other words, despite the fact that IndyMac did not need the ratings for any operative purpose, the steady stream of pessimism was having an effect on the bottom line. IndyMac's relationship with Moody's was only a year old at the time it asked the agency to withdraw the ratings.<sup>90</sup> Although the first part of that year was uneventful, the latter part of the relationship was tumultuous, with IndyMac being downgraded on four occasions from June to November 2007.<sup>91</sup> The freefall would not end, however, and IndyMac would collapse within six months.<sup>92</sup>

### 3. The Texas Ratio

That collapse was prognosticated by analyst Gerald Cassidy of RBC markets over a month before it happened. Based on his experience with failed banks in Texas and New England during the financial crises of the 1980s and early 1990s, respectively, Cassidy formulated the Texas ratio, which measures credit problems as a percentage of the capital a lender has available to deal with them. It is calculated by dividing a bank's non-performing loans, including those ninety days delinquent, by the company's tangible equity capital plus money set aside for future loan losses. Banks with a ratio over one hundred percent tend to fail.<sup>93</sup> In May 2008, IndyMac's Texas ratio was 140%.<sup>94</sup> The article claimed the best way to lower a high Texas ratio was to boost deposits by offering highly competitive rates on certificates of deposit (CDs).<sup>95</sup> In May 2008, IndyMac offered CD rates so attractive one commentator called them "a bonanza . . . [not] just edging competitors on yield [but] trouncing them."<sup>96</sup> Bankrate.com listed IndyMac as giving

---

89. *Id.*

90. *Id.*

91. *See supra* notes 57-86 and accompanying text.

92. *See infra* Part IV.

93. Alistair Barr, *Bank Failures to Surge in Coming Years: IndyMac, Corus, UCBH Under Pressure as Credit Crunch Slows*, MARKETWATCH.COM, May 23, 2008, available at <http://www.marketwatch.com/news/story/bank-failures-surge-credit-crunch/story.aspx?guid={2FCA4A0C-227D-48FE-B42C8DDDF75D838DA}>.

94. *Id.*

95. *Id.*

96. Tom Petruno, *IndyMac CD Rates Surge as its Stock Price Plunges*, L.A.

the highest rate in the country on one-year CDs.<sup>97</sup> A high Texas ratio had been encountered by Countrywide the year before.<sup>98</sup> Their response (high CD rates) had been the same. Unfortunately, so would the end result.

IndyMac responded by calling into question some of Cassidy's figures and claiming a Texas ratio between sixty-eight and seventy-five percent.<sup>99</sup> IndyMac officials also pointed out that the bank did not offer high CD rates across the board, but merely on one particular product as a promotional item.<sup>100</sup> IndyMac claimed to be "well capitalized" with "strong total operating liquidity."<sup>101</sup> That capitalization and strength would be called into question a little over a month later by Senator Charles Schumer.<sup>102</sup>

### C. *Inadequate Responses*

Despite the pervasiveness of the warning signs, IndyMac's response was largely ineffective. IndyMac spent much of 2007 alternatively expanding and cutting costs. On July 19, 2007, IndyMac cut over 400 jobs, almost four percent of its total workforce.<sup>103</sup> The cuts were spurred by a twelve percent decline in dollar loan volume in the second quarter of 2007.<sup>104</sup> The cuts were expected to save over \$30 million per year, and further personnel cuts were expected on a smaller scale at a later date.<sup>105</sup>

In addition to cutting costs, IndyMac announced that the company was going to be "very hardnosed in redesigning . . . processes in our drive to become the low cost provider in the

---

TIMES, July 10, 2008, at C4 (showing that IndyMac's six-month CD yielded 4.1%, the next highest competitor's rate was 3.7%).

97. Barr, *supra* note 93.

98. *Id.*

99. Grove Nichols, *IndyMac Responds to MarketWatch Article on Expected Surge in Bank Failures*, THE IMB REPORT, May 28, 2008, <http://theimbreport.com/index.php>.

100. *Id.*

101. *Id.*

102. *See infra* Part III.

103. Mike Perry, *IndyMac Announces Right-Sizing of Workforce to Current Market Conditions*, THE IMB REPORT, July 19, 2007, <http://theimbreport.com/index.php?paged=6>.

104. *See id.*

105. *Id.*

mortgage industry.”<sup>106</sup> That new process was fully unveiled a month later. Stating that IndyMac could not “continue to fund \$80 to \$100 billion of loans through a \$33 billion balance sheet . . . unless we know we can sell a significant portion of these loans into the secondary market . . . and right now, other than the [Government-Sponsored Entities] (GSEs) and Ginnie Mae . . . the private secondary market is not functioning,” CEO and chairman Michael Perry introduced new underwriting guidelines.<sup>107</sup> Effective immediately, IndyMac began writing loans to facilitate sales to the GSEs and GNMA, with a goal of selling sixty percent of all loans originated.<sup>108</sup> Any unsold loans were to be held in IndyMac’s investment portfolio.<sup>109</sup>

The new “hardnosed” process, however, did not prevent the additional layoffs that had been anticipated; furthermore, the new layoffs, contrary to expectations, were more extensive than the original set. By the end of the third quarter 2007, IndyMac had reduced its workforce by 1,547, approximately fifteen percent of the pre-layoff workforce.<sup>110</sup> Over 1,100 of those jobs were cut in September, two months after IndyMac claimed that future layoffs would not be as dramatic as the layoffs in July.<sup>111</sup>

There was a net increase in IndyMac employees during this period, however, as the job cuts were more than offset by the acquisition of new businesses. During the third quarter of 2007, IndyMac hired 600 mortgage professionals released by American Home Mortgage’s own cost-cutting measures.<sup>112</sup> The bulk of the new hires were involved in retail loan operations, expected to “generate quarterly production of roughly \$1 billion for”

---

106. *Id.* (internal quotations omitted).

107. Mike Perry, *Email from Mike Perry, Chairman and CEO: Conditions in the Private Secondary Markets and Their Implications for Our Industry and IndyMac*, THE IMB REPORT, Aug. 2, 2007, <http://theimbreport.com/index.php?paged=5> (ellipses in original).

108. *Id.*

109. *Id.*

110. Mike Perry, *IndyMac Announces Results of Previously Announced Plans to Right-Size Workforce to Current Conditions*, THE IMB REPORT, Oct. 12, 2007, <http://theimbreport.com/index.php?paged=4>.

111. *Id.*

112. Press Release, IndyMac Bancorp, *IndyMac Expands its Retail lending Group Nationwide* (Aug. 28, 2007), [http://www.businesswire.com/portal/site/google/index.jsp?ndmViewId=news\\_view&newsId=20070828005985&newsLang=en](http://www.businesswire.com/portal/site/google/index.jsp?ndmViewId=news_view&newsId=20070828005985&newsLang=en).

IndyMac.<sup>113</sup> IndyMac also acquired the retail lending division of New York Mortgage Company in the second quarter of 2007.”<sup>114</sup>

This was not the end of IndyMac’s expansion, as the company made arrangements to acquire portions of Barrington Capital in Newport Beach, California in August 2007.<sup>115</sup> All told, this round of expansion was expected to raise total loan production by approximately \$1.5 billion.<sup>116</sup> The expansion was part of the new business model with a focus on higher margin retail business at the expense of “low margin, Alt-A conduit business.”<sup>117</sup>

The expansion did not work as planned. IndyMac’s earnings for the third quarter of 2007 showed just over \$16 billion in loans produced by the mortgage banking segment.<sup>118</sup> IndyMac sold \$13.8 billion worth of loans that quarter at a net loss of \$157 million.<sup>119</sup> The numbers did not get any better in the fourth quarter of 2007, after the new acquisitions had been integrated into the company. IndyMac produced fewer loans, only \$11.7 billion worth, and sold \$16.5 billion in loans at a loss of \$121 million.<sup>120</sup> The first quarter 2008 numbers were even more disappointing: under \$9.4 billion was produced, just over \$10.1 billion was sold, and a loss of \$134.9 million was suffered.<sup>121</sup> The acquisition of the new businesses was unable to arrest IndyMac’s decline.

The new strategy also included rescinding a moratorium on jumbo loans, which, at the time, were for amounts over \$417,000, the highest dollar amount loan the GSEs will buy. This move also

---

113. *Id.*

114. *Id.*

115. *Id.*

116. *Id.*

117. *Id.*

118. IndyMac Bancorp, Inc., Quarterly Report (Form10-Q) at 11 (Nov. 6, 2007) available at <http://idea.sec.gov/Archives/edgar/data/773468/000095013407022945/v34346e10vq.htm>.

119. *Id.*

120. IndyMac Bancorp, Annual Report (Form 8-K) at 12 (Feb. 12, 2008) available at <http://idea.sec.gov/Archives/edgar/data/773468/000095013408002262/v37879e8vk.htm>.

121. IndyMac Bancorp, Quarterly Report (Form 10-Q) at 11 (May 12, 2008) available at <http://idea.sec.gov/Archives/edgar/data/773468/000104746908006343/a2185707z10-q.htm>.



proved to be ineffective. On August 22, 2007, IndyMac reinstated its jumbo product in several ARMs as well as in fifteen- and thirty-year-fixed mortgages.<sup>122</sup> The loans promptly sold—albeit for a price “outside historical ranges . . . [but still] an improvement over several fire sale trades made by others in recent weeks.”<sup>123</sup> Although Communications Director Grove Nichols claimed the sale supported the “decision last week to re-enter the prime jumbo mortgage market,” the wisdom of a fragile institution re-entering a market where the gains are only over fire-sale prices is questionable.<sup>124</sup> In fact, the anticipated thaw in the jumbo market did not come until April 2008, when the federal government permitted the GSEs to purchase jumbo loans of up to \$625,000. IndyMac’s calculated gamble on re-entering the jumbo mortgage did not pay off. By the time the GSEs agreed to buy the loans, IndyMac had been forced to institute further cutbacks in the workforce and was only three months away from collapse.

On January 15, 2008, IndyMac announced it was cutting 2,403 jobs—twenty-four percent of the total workforce.<sup>125</sup> Chairman and CEO Mike Perry claimed that since the previous round of layoffs “conditions have gotten worse in [the] industry. The private secondary market remains virtually frozen.”<sup>126</sup> The balance sheet was adversely affected by an increase in future credit losses, with the credit reserve jumping seventy-one percent in the fourth quarter of 2007, to a total of \$2.4 billion.<sup>127</sup> The loan pipeline suffered, falling twenty-eight percent in December 2007, and the forecast for loan volume in 2008 was significantly lower than the previous two years.<sup>128</sup> The layoffs, which forced the closure of five regional wholesale mortgage centers, were expected

---

122. Grove Nichols, *IndyMac Provides Update on Recent Secondary Market Activity*, THE IMB REPORT, Aug. 27, 2007, <http://theimbreport.com/index.php?pageid=4>.

123. *Id.*

124. *Id.*

125. Mike Perry, *IndyMac Announces Further Right-sizing of its Workforce*, THE IMB REPORT, Jan. 15, 2008, <http://theimbreport.com/index.php?paged=3>.

126. *Id.*

127. INDYMAC BANCORP, INC., FOURTH QUARTER REVIEW 8 (2008) ([http://media.corporate-ir.net/media\\_files/irol/11/118924/2007-Q4-Earnings/NDE4Q07EarningsPresentation.pdf](http://media.corporate-ir.net/media_files/irol/11/118924/2007-Q4-Earnings/NDE4Q07EarningsPresentation.pdf)).

128. Perry, *supra* note 118.

to yield annual savings of \$136 million.<sup>129</sup> Perry wrote that he expected further layoffs of between 500 and 1,000 workers at some point before July, and also made a blunt admission that the previous business model was no longer viable: “IndyMac’s previous core business . . . non-GSE mortgage banking . . . is currently gone” and the company had to initiate a business model focused on conforming loans.<sup>130</sup>

The new lending model Perry envisioned was based on IndyMac’s “structur[ing] its own mortgage securities and sell[ing] directly” to GSEs.<sup>131</sup> He was also determined to maintain a jumbo mortgage product, which he believed was “essential to being a full-service mortgage banker,”<sup>132</sup> regardless of the lack of a thaw in the jumbo market since IndyMac had re-entered it.<sup>133</sup> The final prong of the plan called for focusing on Indymac’s thrift (or branch banking) business by growing IndyMac’s foundation of thirty individual branches.<sup>134</sup> Perry was optimistic this plan would allow IndyMac to weather the financial storm and projected a total profit of \$13 million in 2008, following on fourth quarter 2007 losses of \$509.1 million.<sup>135</sup>

KBW analysts disagreed, calling IndyMac’s credit deterioration “stunning.”<sup>136</sup> The KBW analysts added IndyMac’s “‘historic business model is broken and will continue to depress earnings,’ and that its new model as an originator of agency mortgages will fail to build regulatory capital, which it needs most.”<sup>137</sup>

IndyMac’s own numbers also suggested the speciousness of relying on the thrift business to weather the financial storm. IndyMac’s second quarter 2007 earnings press release noted that

---

129. *Id.*

130. *Id.*

131. Harry Terris, *IndyMac Chief Exec Outlines a Post-Recovery Road Map*, AMERICAN BANKER, Feb. 14, 2008, available at <http://www.americanbanker.com/article.html?id=20080213DN52AC5A>.

132. *Id.*

133. See *supra* note 124 and accompanying text.

134. Terris, *supra* note 131.

135. *Id.*

136. *Id.*

137. *Id.* (internal quotation marks omitted).

the thrift section “[p]erform[ed] poorly.”<sup>138</sup> By the fourth quarter of 2007, that poor performance had become even worse, with the thrift segment reporting a net loss of over \$186 million.<sup>139</sup> This loss was across every section of the thrift segment, with the exception of the Warehouse Lending Division, which had a net gain of \$18,000, for a return on equity (ROE) of two percent.<sup>140</sup> Performance did improve in the first quarter of 2008, with the thrift segment responsible for a net loss of only \$63.9 million.<sup>141</sup> Whether Perry or KBW was correct about the long term viability of focusing on the thrift business will never be known because the new model did not have time to generate meaningful results. Only two months later, the thrift branch deposits essential to IndyMac’s liquidity and Perry’s plan suffered a run that resulted in the bank’s collapse.<sup>142</sup> The run was tied to the concerns of Senator Charles Schumer.<sup>143</sup>

### III. THE SCHUMER LETTERS

On June 26, 2008, Senator Charles Schumer<sup>144</sup> wrote letters to Sheila Blair, Chairman of the FDIC; John Reich, Director of the OTS; Ronald Rosenfeld, Chairman of the Federal Housing Finance Board; and Dean Schultz, President and CEO of the FHLB of San Francisco. The letters expressed worry over the “safety and soundness” of IndyMac, citing concern “that IndyMac’s financial deterioration poses significant risks to both taxpayers and borrowers, and that the regulatory community may not be prepared to take measures that would prevent the collapse of IndyMac or minimize the damage should such a failure occur.”<sup>145</sup> Schumer wrote that IndyMac’s stock price had fallen

---

138. Press Release, IndyMac Bancorp, *supra* note 112, at 2.

139. IndyMac Bancorp, *supra* note 118, at 23.

140. *Id.* This can be contrasted with the mortgage-backed securities division, which lost almost \$124 million for a ROE of -169%.

141. IndyMac Bancorp, *supra* note 120, at 21.

142. *See infra* note 156.

143. *See infra* Part III.

144. Sen. Schumer was a member of the Senate Banking Committee and Chairman of the subcommittee overseeing the Federal Reserve and economic policy.

145. Letter from Charles Schumer, United States Senator, to Ronald Rosenfeld, Chairman, Fed. Housing Finance Bd., and Dean Schultz, President and Chief Executive Officer, Fed. Home Loan Bank of San Francisco (June 26, 2008) (on file

ninety-five percent over the past year, and that its new loan production had dropped by two-thirds over the same period.<sup>146</sup> Schumer noted that IndyMac's portfolio had a delinquency rate twice as high as Countrywide.<sup>147</sup> Schumer's greatest concern was IndyMac's reliance on brokered deposits.<sup>148</sup> He noted that such deposits had accounted for sixty-four percent of deposit growth since December 2006 and that they made up thirty-seven percent of the total deposit amount.<sup>149</sup> Schumer echoed Cassidy and his Texas ratio—banks in trouble should attempt to raise deposits; however Schumer believed brokered deposits, because they are prone to sudden withdrawal, were not going to give IndyMac the reserves necessary to survive. In his letters, Schumer directed four questions to the FDIC and OTS:

[f]irst, has the FDIC verified that insured loans are not supporting loans that do not meet the Joint Banking Guidelines on ability to repay and documentation? Second, has the FDIC considered ordering IndyMac to reduce its reliance on brokered deposits? Third, has there been any discussion between the FDIC and the OTS about IndyMac's increased reliance on brokered deposits? Fourth, what steps has the OTS taken in response to IndyMac's deteriorating loan performance?<sup>150</sup>

The senator's letter included a prescient statement, "I am concerned that a significant move by IndyMac's depositors to

---

with author).

146. *Id.*

147. *Id.*

148. Letter from Charles Schumer, United States Senator, to Sheila Bair, Chairwoman, FDIC, and John M. Reich, Director, OTS (June 26, 2008) (on file with author). Brokered Deposits are smaller deposits collected by a broker who will aggregate them and buy jumbo certificates of deposit from the institution offering the highest interest rate. These products are very rate-sensitive and brokers will generally withdraw the funds and deposit elsewhere if a higher interest rate is available.

149. *Id.*

150. *Id.*

redeem their deposits could leave the firm in a disastrous financial situation.”<sup>151</sup>

IndyMac responded four days later with an implicit rebuke to Schumer’s presaging a bank run, stating it was important “we all work together to keep institutions like IndyMac Bank safe and sound” and that Schumer’s letters “leave the wrong impression with respect to three matters.”<sup>152</sup> IndyMac wrote that the federal regulators were aware of IndyMac’s situation and all parties were “working on a plan . . . to further improve the safety and soundness of IndyMac.”<sup>153</sup> The response then turned to the issue of brokered deposits, claiming that they were not used to fuel “rapid and . . . irresponsible growth” as Schumer claimed, but were instead used “to meet the higher margin requirements imposed by the FHLB and to pay off completely all of [IndyMac’s] market funding sources,” a move that many other banks made during the credit collapse that occurred in the summer of 2007.<sup>154</sup> IndyMac officials hoped to rely less on brokered deposits in the immediate future and claimed that they presented no risk to IndyMac’s solvency, but instead improved “safety and soundness during this turbulent period.”<sup>155</sup>

The response claimed that in the two days after Schumer’s letters were made public, there had been a run on IndyMac deposits, and \$100 million had been withdrawn.<sup>156</sup> IndyMac’s response laid the responsibility for the run squarely at Schumer’s feet: “as a result of Sen. Schumer making his letters public and the resulting press coverage, we did experience elevated customer inquiries and withdrawals in our branch network.”<sup>157</sup>

IndyMac was not the only party to blame Schumer for the bank run, which continued unabated even after IndyMac responded to Schumer’s concerns. Between the time Schumer’s comments were made public and IndyMac failed, more than \$1.3

---

151. *Id.*

152. Grove Nichols, *IndyMac Responds to Letters Sent by Senator Charles Schumer*, THE IMB REPORT, June 30, 2008, <http://theimbreport.com/index.php>.

153. *Id.*

154. *Id.*

155. *Id.*

156. *Id.*

157. *Id.*

billion was withdrawn in a little over two weeks.<sup>158</sup> John Reich, the Director of the OTS claimed Schumer gave IndyMac a “heart attack” and blamed Schumer’s comments for IndyMac’s failure.<sup>159</sup> Reich pointed out that before Schumer’s letters were made public, IndyMac’s cash flow had been positive, and the bank was not even on the FDIC’s problem bank list.<sup>160</sup>

Former IndyMac employees also blamed Schumer, urging California Attorney General Jerry Brown to initiate a probe into the Senator’s actions.<sup>161</sup> The employees claimed “[f]rom the day [Schumer’s] letter was made public on June 26 until the closure of the bank, a run on the bank took place and the failure became inevitable,”<sup>162</sup> and called Schumer’s actions a “malicious, politically motivated act.”<sup>163</sup> Attorney General Brown declined to investigate.<sup>164</sup>

Schumer, in turn, pointed the finger at the OTS: “If OTS had done its job as regulator and not let IndyMac’s poor and loose lending practices continue, we wouldn’t be where we are today . . . . Instead of pointing false fingers of blame, OTS should start doing its job to prevent future IndyMacs.”<sup>165</sup>

The IndyMac employees may have been right in ascribing a political motive to Schumer, however. According to the *Wall Street Journal*, Oaktree Capital Management had been looking over IndyMac’s books prior to making a decision about investing in the bank shortly before it failed.<sup>166</sup> Although Oaktree decided not to invest, it continued to “scout[ for] assets that might become

---

158. Paletta & Enrich, *supra* note 13.

159. *Id.*

160. Joe Adler, *FDIC Sees Big Premium Hike over IndyMac*, AMERICAN BANKER, July 15, 2008, <http://www.financial-planning.com/asset/article/624891/fdic-sees-big-premium-hike-over.html>.

161. John Poirier, *California Mulls Probing Senator Over IndyMac Crash*, REUTERS, Aug. 20, 2008, <http://www.reuters.com/article/politicsNews/idUSN2045763020080820>.

162. *Id.*

163. Tim Petrino, *Brown Decides Against Probing Schumer on IndyMac*, LA TIMES BLOG, Aug. 22, 2008, [http://latimesblogs.latimes.com/money\\_co/2008/08/california-atty.html](http://latimesblogs.latimes.com/money_co/2008/08/california-atty.html).

164. *Id.*

165. Paletta & Enrich, *supra* note 13.

166. Susan Schmidt, *U.S. News; Schumer Ripped IndyMac as Democratic Donors Probed Books*, WALL ST. J., Oct. 18, 2008, at A3.

available if the bank failed.”<sup>167</sup> Schumer denied any wrongdoing and claimed to know nothing of Oaktree’s interest before he wrote his letters, but the Democratic Senatorial Campaign Committee received more than \$700,000 in contributions from Oaktree in the four years it was chaired by Schumer.<sup>168</sup> Oaktree chairman Howard Marks also denied any impropriety, claiming he only knew Schumer socially and he never discussed business with him.<sup>169</sup>

Regardless of the reason for Schumer’s concerns, those concerns led to depositors fleeing IndyMac. The bank desperately tried to raise new capital and cut costs, going as far as eliminating its mortgage program and eliminating half of its workforce.<sup>170</sup> The company also attempted to attract new depositors and hold on to current ones by offering very high rates on CDs.<sup>171</sup> These actions were to no avail, and in face of the \$1.3 billion run, IndyMac was forced into an FDIC conservatorship on July 11, 2008, just two weeks after Schumer’s letters went public.<sup>172</sup>

#### IV. THE AFTERMATH

The FDIC initially estimated the failure would cost between \$4 and \$8 billion.<sup>173</sup> Despite the magnitude of the failure, the FDIC had IndyMac up and running on the next business day following the takeover.<sup>174</sup> The FDIC’s COO, John Bovenzi claimed, “[f]rom an operational point of view of getting it up and running, getting insured deposits ready, it was a very effective process.”<sup>175</sup> This was so despite the run on IndyMac assets which continued even after the takeover—an event some commentators had believed was impossible.<sup>176</sup>

---

167. *Id.*

168. *Id.*

169. *Id.*

170. Mike Perry, *IndyMac Issues Stakeholder Letter*, THE IMB REPORT, July 7, 2008, <http://theimbreport.com/index.php>.

171. Petruno, *supra* note 96 (IndyMac’s annual rate on a 6-month CD, for example, was 4.1%, compared to 3.7% for the next highest competitor).

172. *See* OTS, *supra* note 17.

173. Adler, *supra* note 160.

174. Joe Adler, *FDIC Defends Handling of IndyMac Run*, AMERICAN BANKER, July 18, 2008, <http://www.americanbanker.com/article.html?id=20080717GER1W9J6>.

175. *Id.*

176. *Id.*

Others were less sanguine about the results of the takeover. In the days following the takeover, worried customers seeking to withdraw their deposits were allowed only limited access to IndyMac branches.<sup>177</sup> While forced to wait in line (outside the branches) to withdraw their money, an elderly woman fainted, and other depositors were threatened with arrest, causing one commentator to call the immediate aftermath to the takeover a “three-day run of federal incompetence” and “a financial hostage drama.”<sup>178</sup> James Barth, an Auburn University finance professor, was more measured in his criticism, blaming the lines and continuing run on the “total lack of coordination and information that [was] being provided to [depositors].”<sup>179</sup> He believed the FDIC did not adequately explain deposit insurance coverage, fomenting unfounded fears in the minds of depositors.<sup>180</sup> Banking consultant Bert Ely bluntly claimed the FDIC “botched” the takeover, but he did concede the institution may have been caught flat-footed by the sudden run after the Schumer letters.<sup>181</sup>

After stabilizing the situation with IndyMac depositors, the FDIC turned its attention to underperforming IndyMac mortgage loans. About a month after the takeover, the FDIC unveiled a plan to “rehabilitate” distressed mortgages.<sup>182</sup> The agency planned to use reduced rates (capped at 6.5%), extended amortization, and principal forbearance to achieve a thirty-eight percent debt-to-income (DTI) ratio for borrowers who were seriously behind on mortgage payments or already in default.<sup>183</sup> The program proved so successful that it is expected to be applied on a much larger scale as part of the \$700 billion rescue bill.<sup>184</sup>

---

177. Peter Viles, *The IndyMac Fiasco: A Three Day Run of Federal Incompetence*, LA TIMES BLOGS, June 16, 2008, <http://latimesblogs.latimes.com/laland/2008/07/the-indymac-fia.html>.

178. *Id.*

179. Adler, *supra* note 160.

180. *See id.*

181. *Id.*

182. Press Release, FDIC, Loan Modification Program for Distressed IndyMac Mortgage Loans (Aug. 20, 2008) (<http://www.fdic.gov/consumers/loans/modification/indymac.html>).

183. *Id.*

184. Joe Adler, *Plan to Guarantee Modified Mortgages Makes Headway*, AMERICAN BANKER, Oct. 30, 2008, <http://www.americanbanker.com/printthis.html?id=2008102924R6BH2K>.



In addition to the continuing run and allegations of botching the takeover, there was one other irregularity of the IndyMac failure: a federal investigation of fraud. Anonymous sources reported to CNN that the FBI was looking into “whether the bank engaged in fraud when it made home loans to high-risk borrowers.”<sup>185</sup> While the FBI did not specifically confirm it was investigating IndyMac, it did note that it was “investigating twenty-one corporations in the subprime lending market for possible mortgage fraud.”<sup>186</sup> CNN’s source confirmed the investigation was targeted at the company itself, not any individuals.<sup>187</sup> At the time this Note was written, there had been no further developments or public comments about the FBI’s investigation.

## V. CONCLUSION

Although the failure of an individual bank is nothing new, there may be something distinctive about the questions raised by the IndyMac failure. The most obvious question—is IndyMac only the tip of the iceberg—seems to be well on its way to being answered. The subsequent failure of Washington Mutual and near death experience of Wachovia suggest that IndyMac was only the first in line.

The FDIC’s handling of the failure calls into question how adequately the institution communicates with the public. The whole idea behind deposit insurance is that it will prevent bank runs by ensuring ordinary depositors will not lose any money. That was clearly not the case after the failure of IndyMac. Whether the continuation of the bank run after the FDIC stepped in resulted from inadequate communication by the agency, poor dissemination of information by the mass media, or ordinary depositors’ having a poor understanding of what FDIC insurance meant, it is clear the mechanism is broken somewhere.

---

185. Kelli Arena, *Source: FBI Investigating IndyMac for Fraud*, CNN.COM, July 16, 2008, <http://www.cnn.com/2008/US/07/16/fbi.indymac/index.html>.

186. *Id.*

187. *Id.*

More troubling is the stability of the FDIC itself. The institution's reserves stood at \$45 billion at the end of June 2008, before the failure of IndyMac.<sup>188</sup> Although the FDIC claims to be well positioned for additional bank failures, it announced in late September 2008 that it would be seeking to increase the premium it charges banks for deposit insurance.<sup>189</sup> That increase is likely to be substantial.<sup>190</sup> The FDIC expects to lose \$40 billion by 2013, almost totally wiping out the \$40 billion reserve established before IndyMac failed. (The IndyMac failure is expected to account for almost \$9 billion of the loss.)<sup>191</sup> At the time this Note was written, thirteen banks had failed, and 117 remained on the FDIC problem bank list, leaving the agency with a ratio of reserves to insured deposits of 1.01%—fourteen basis points below the statutory minimum.<sup>192</sup> In order to re-establish the minimum required reserves and put itself in a position to survive the next five years, the agency is expected to double the average premium it charges member banks.<sup>193</sup> It remains to be seen if this will be sufficient to ensure the FDIC's solvency. While IndyMac's failure is expected to cost the agency \$9 billion, the bank had only \$32 billion in assets. On the other hand, Washington Mutual, whose failure narrowly avoided falling onto the FDIC's tab, had \$307 billion in assets.<sup>194</sup> Even with a premium increase, it is questionable whether the FDIC has the reserves to survive a catastrophic bank failure.

Perhaps the most important question is the one left unanswered: how effective would IndyMac's new business model have been in the long term? The obvious corollary to this is inevitability of failure in the current market: are troubled financial institutions able to take action to save themselves, or will they all

---

188. John Poirier, *U.S.: FDIC Plans Significant Bank Premium Increase*, REUTERS, Sept. 23, 2008, <http://www.reuters.com/article/etfNews/idUSN2338443920080923>.

189. *Id.*

190. Steven Sloan, *FDIC Eyes Doubling of Average Premium*, AMERICAN BANKER, Oct. 8, 2008, <http://www.americanbanker.com/printthis.html?id=20081007NR6E2T21>.

191. *Id.*

192. *Id.*

193. *Id.*

194. Joe Adler, *FDIC's 'Big One': Long Prelude Gave Way to a Sudden End*, AMERICAN BANKER, Sept. 29, 2008, <http://www.americanbanker.com/printthis?id=20080926ZNMBEAUT>.

head inexorably to failure absent a government bailout? The most problematic aspect of the Schumer letters is not whether or not they directly caused IndyMac's failure, but that they may have robbed us of the chance to discover whether troubled financial institutions can fight for survival, or if hiding money under the mattress is again a viable savings plan.

JASON MORAN-BATES