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Washington Mutual is seized to avert failure

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Washington Mutual, the giant lender that came to symbolize the excesses of the mortgage boom, was seized by federal regulators on Thursday night in what is by far the largest bank failure in American history.

Regulators simultaneously brokered an emergency sale of virtually all of Washington Mutual to J.P. Morgan Chase. The remainder of WaMu, the nation's largest savings and loan, will be operated by the government. Shareholders and some bondholders will be wiped out. WaMu depositors are guaranteed by the Federal Deposit Insurance Corp. up to the $100,000 per account limit. WaMu customers are unlikely to be affected.

Howard Headlee, Utah Banker's Association president, said Thursday night the purchase of Washington Mutual bank by JPMorgan Chase should have no ill effect on Utahns.

"Chase is a very stable, strong financial institution," he said.

The seizure and purchase of WaMu, Headlee said, is a positive move that should appear seamless to the public and ensure "continuity" for customers.

"Frankly, I don't think the customer will see anything," Headlee said. "There will be little to no impact on their accounts."

Headlee said he was not sure how many Washington Mutual branches were in Utah.

J.P. Morgan Chase is to take control Friday of all of WaMu's 2,300 branches, which stretch from New York to California, and will oversee its big portfolio of mortgage and credit card loans. It will also acquire all of WaMu's deposits with the sale.

For weeks, the Federal Reserve and the Treasury Department had been nervous about the fate of WaMu, among the worst-hit by the housing crisis, and pressed hard for the bank to sell itself. As panic gripped financial markets last week following the collapse of Lehman Brothers, the government stepped up its efforts, working behind the scenes, and at points going behind WaMu's back to work privately with potential bidders on a deal.

The seizure and the deal with J.P. Morgan came as a shock to Washington Mutual's board, which was kept in the dark: the company's newly-minted chief executive, Alan C. Fishman, was in flying from New York to Seattle at the time the deal was finally brokered, according to these people.

The action removes one of America's most troubled banks from the financial landscape, and helps to avoid sticking taxpayers with a huge bill for the rescue of another failing institution.

As with Lehman Bros., the government allowed Washington Mutual to fail because it was less entangled with the rest of the financial system than a behemoth like American International Group Inc., which the government spent $85 billion to take over last week while it faced collapse. On Sunday, the government approved emergency measures to help stabilize Goldman Sachs and Morgan Stanley.

Federal regulators had been trying to broker a deal for Washington Mutual because a takeover by the Federal Deposit Insurance Corp. would have dealt a crushing blow to the federal government's deposit insurance fund. The fund, which stood at 45.2 billion at the end of June, has been severely depleted from the sudden collapse of IndyMac Bank. Analysts say that a failure of Washington Mutual would cost the fund upwards of $20 or $30 billion.

The deal will end the WaMu's run as an independent company, but stabilize the bank's stabilize its finances and shore up a balance sheet crippled by a toxic mortgages. It also comes as lawmakers have reached a stalemate over the passage of a $700 billion bailout fund designed to help ailing banks.

The shotgun acquisition also marks the second time since the housing crisis began that the government has pushed a troubled bank into the arms of J.P. Morgan Chase. In March, J.P. Morgan Chase rescued Bear Stearns as it teetered into bankruptcy.

It will give J.P. Morgan branches in California and other markets where it does not have a footprint. But J.P. Morgan Chase will also inherit a big loan portfolio of troubled mortgages and commercial real estate.

The emergency takeover of Washington Mutual is yet another black-eye for its primary federal regulator, the Office of Thrift Supervision. It also oversaw IndyMac Bank, another big lender that suddenly collapsed in mid-July, and several other deeply troubled savings banks. Washington Mutual was the largest institution under its watch.

Washington Mutual long insisted that it could remain independent, but the giant thrift had quietly hired Goldman Sachs early last week to identify potential bidders. Among the banks that expressed interest in buying all or part of Washington Mutual: Citigroup, JPMorgan Chase, HSBC, Banco Santander, TD Bancorp, and Wells Fargo. Each had different reasons for making an offer, but nobody could make the numbers work. Several deadlines past without anyone submitting bid.

Until recently, Washington Mutual was one of Wall Street's strongest performers. It reaped big profits quarter after quarter as its then chief executive, Kerry Killinger, enlarged its footprint by buying banks on both coasts and ramping up mortgage lending.

His goal was to transform what was once a sleepy Seattle thrift into the "Wal-Mart of Banking," which would cater to lower and middle class consumers that other banks deemed too risky. It offered complex mortgages and credit cards whose terms made it easy for the least creditworthy borrowers to get financing, a strategy the bank extended in big cities, including Chicago, New York and Los Angeles. WaMu even rolled out Starbucks-style branches where tellers stood behind kiosks to reduce waiting times in line.

With this grand plan, Killinger built Washington Mutual into the sixth largest bank in the United States, with roughly 2,300 consumer and small business branches, total assets of $310 billion, and total deposits of $182 billion.

But underneath the hood, the bank's machinery was failing. Even as it grew in size, it underinvested in the technology needed to gauge how its vast loan operation was performing. Killinger, who once boasted of the giant he had created, struggled to integrate the many banks he had picked up. Near the top of the housing market, WaMu had nine different mortgage underwriting systems.

Then the housing market began to crumble.

Like so many other financial institutions, the bank tried to hedge its mortgage bets - but did so poorly. It retrenched on its ranch-building ambitions. But none of that was enough to deflate ballooning losses on mortgage loans, or defuse ticking time-bombs like interest-only and pay-option amortization products that had reeled in bottom-grade borrowers. WaMu's now-enlarged presence in California and Florida, two epicenters of the housing crisis, made the situation worse.

With rising mortgage payments and higher gas and food bills, WaMu's losses in its big credit card loan portfolio also spiked. In spring, shareholders grew more impatient as finances buckled. Even so, Washington Mutual's board insisted that Killinger deserved more time to orchestrate a turnaround.

By then, however, WaMu's troubles had set off alarm bells on Wall Street, which ground its share price down daily. Suddenly, the bank that once circled its prey became a target.

With options narrowing, WaMu frantically reached out to several banks and big private equity firms, including the Carlyle Group and the Blackstone Group. But the more they dug into its ledgers, the more they were stunned by the potential size of the losses, and became wary of pouring in their own capital. Some thought the bank's potential losses could exceed $30 billion.

The pressure on WaMu to shore up its balance sheet kept mounting. In March, J.P. Morgan Chase saw an opportunity and urged WaMu in a letter to consider a quick deal. On the same weekend that J.P. Morgan's chief executive, James Dimon, negotiated his daring takeover of Bear Stearns, he secretly dispatched members of his team to Seattle to meet with WaMu executives. When J.P. Morgan Chase offered WaMu $8 a share, largely in stock. But Killinger balked at the price - and that he would lose his job.

In April, the vision of a white knight appeared on the scene. David Bonderman, a founder of the TPG private equity firm, and a group of institutional investors agreed to infuse $7 billion of capital into the bank. Killinger kept his job, and Bonderman, who had served as a WaMu director from 1997 to 2002, returned with board seat and 176 million WaMu shares priced at about $8.75 each - steep discount of more than 25 percent to that day's share price.

While the deal was sweet for Bonderman, it eroded the value for existing shareholders, enraging them. With its financial position worsening, they moved June 2 to strip Killinger of his chairmanship. Bonderman, meanwhile, watched his golden bet turn to dross.

In mid-July, as the tsunami of the mortgage crisis engulfed IndyMac Bancorp of California, marking one of the largest bank failures in American history, WaMu, drowning in its own sea of volatile mortgage products, posted its biggest loss ever in the second quarter. Shares in the bank plummeted to just over $3.

Bank depositors grew so worried after federal regulators seized IndyMac on July 11 that WaMu, already strapped, was forced to pay more on its certificate of deposit rates just to hold together a consumer base.

On September 6, WaMu entered into an agreement with the OTS that effectively put the bank on probation, and the board ousted Killinger from the post he had held for 18 years, replacing him with Alan Fishman, a longtime banking executive with experience turning around a troubled mortgage lender.