

For banks, wads of cash and loads of trouble

MACON, Ga. (The NYT) — H. Averett Walker used hot money to turn Security Bank from a sleepy Southern lender into a regional powerhouse. Darrell D. Pittard used hot money to jump-start his brand-new MagnetBank, allowing it to lend hundreds of millions of dollars even though it did not have a single drive-up window or even a customer with a checking account.

It is a formula being replicated at banks across the United States. Rather than simply wooing local customers, they have turned to out-of-state brokers who deliver billions of dollars in bulk deposits, widely known as "hot money," from investors nationwide. In fast-growing regions like this one in central Georgia, the money produced record bank profits and financed whole new communities, built at a phenomenal rate.

But the hot money also came with a high cost. To lure the money from brokers, banks typically had to offer unusually high rates. That, in turn, often led them to make ever riskier loans, leaving them vulnerable when the economy collapsed. Magnet failed early this year and Security Bank is barely hanging on.

Though few people have heard of it, hot money — or brokered deposits, as it is also known in the industry — is one of the primary factors in the accelerating wave of failures among small and regional banks nationwide. The estimated cost to the Federal Deposit Insurance Corporation over the last 18 months is \$7.7 billion, and growing.

Hot money has bedeviled regulators for three decades and they are starting to fight back, albeit tentatively, devising new restrictions to keep the practice from taking more banks down. But in one of the hidden lobbying battles in Washington this year, the banks are pushing hard to keep the money flowing.

So far the banks are winning, and the hot money continues to fuel bank growth. The industry has even invented variants to get around the few rules that have been put in place by regulators.

Banks defend the use of brokered deposits as an important tool to bring in money to help communities grow. But even some industry executives acknowledge that certain banks became too dependent on the deposits, and that this abuse caused banks to fail. The consequences can be seen across the country.

The 79 banks that have failed in the United States over the last two years had an average load of brokered deposits four times the national norm, according to an analysis performed for The New York Times by Foresight Analytics, an industry research firm based in California. And a third of the failed banks, the analysis shows, had both an unusually high level of brokered deposits and an extremely high growth rate — often a disastrous recipe for banks.

The data also shows that the problem isn't likely to go away. The 371 still-operating banks on Foresight's "watch list" as of March held brokered deposits that, on average, were twice the norm. Even this year, in the depth of the recession, a number of struggling banks have been piling up hot money in a desperate effort to survive.

It is the same mix — rapid increases in hot money and heavy lending for risky real estate development — that brought down many of the savings and loans in the late 1980s.

ALL BUSINESS: Cash is king for investors

NEW YORK (AP) — That old saying "cash is king" certainly rings true these days. Investors can't seem to get enough of it, which ultimately could be bad news for the stock market and the economy.

In the past, investors would cling to cash until the market's prospects brightened and then money would pour back into stocks. That's just what the bulls today are hoping will drive a surge on Wall Street in the months ahead.

But the shock of the financial crisis — which have made leverage and risk-taking dirty words — may be changing all that. Even with today's minuscule returns, cash seems to have become a sought-after asset class among investors who intend to keep it as a part of their portfolios for the long term.

Watching this play out firsthand is Jack Albin, chief investment officer at Harris Private Bank in Chicago. In sizing up the outlook, he has to balance what the past tells him about cash tending to move back into the market and the cautionary tone that he's hearing from the bank's clients.

Historical data he has crunched shows that whenever assets in money market mutual funds — which are low-risk, highly liquid investments — exceeded 25 percent of the market capitalization of the Standard & Poor's 500 index, stocks have rallied over the following two years.

This ratio jumped to an almost-unheard of level of more than 60 percent on March 9, almost triple the median level in the early years of this decade, for two reasons. Money market fund totals have surged 30 percent since the stock market peaked in October 2007, and by early March the S&P 500's market cap had plunged 57 percent from its high point in 2007.

Today, that ratio has narrowed to about 45 percent, primarily because of a recent rebound in stocks. There is \$3.7 trillion sitting in money market mutual funds right now, and the market cap of the S&P 500 is about \$8 trillion, up from a March low of \$5.9 trillion.

Albin considers the 45 percent level still to be unusual — and a potential source of fuel for further stock



gains if investors choose to redeploy their low-yielding cash. "If the stock market keeps trending higher and corporate earnings numbers progress, some investors might feel left out and decide to buy again," Albin said. "That is driven by human nature."

But there is recent evidence from some big-name investors that argues otherwise, at least on the margins. The California Public Employees' Retirement System, also known as CalPERS, announced June 15 that it had boosted the target cash exposure of its \$183 billion investment portfolio from zero to 2 percent.

That helps explain why Albin is cautioning against counting on a stampede out of cash and into stocks, especially after talking to his banks' clients. They've been burned by the bear market and worry about having enough cash — especially those who invested in things like auction-rate securities that turned out not to be as easily accessible as they thought. Since credit markets remain tight, many are also finding it harder to borrow or raise money.

So they are clinging to their cash, especially in plain-vanilla accounts like money market funds, which now yield on average only 1.3 percent, according to Bankrate.com.

Albin has started giving a presentation to clients titled "Cash is an Asset Class." He discusses how investors' experiences in 2008 called into question two underpinnings of investment management — buy and hold and diversification. As a result, he sees many investors viewing cash as an important asset to have "in an environment where you need to protect yourself."

Albin's thinking jibes with what David Rosenberg, chief economist and strategist at the Canadian wealth management firm Gluskin Sheff, has been telling his clients.

Even though there is a mountain of cash on the sidelines, he says it is being deployed tactically, "seeing as demand for liquidity is running at very high rates at every level of the economy."

Rosenberg points to the record number of dividend cuts by S&P 500 companies over the last 12

months — 1,043 of them, according to S&P. That's evidence corporations are hoarding cash so that they can fund operations, buy other companies or to ensure they can satisfy their debt refinancing needs going forward.

The end result is that stock investors are seeing their cash flow squeezed. Since 1955, the average has been 15 dividend increases for every decrease. Now, it's five increases for every six decreases, according to S&P.

Shifting investor sentiment is also reflected in the surge in the personal savings rate, which was hovering near zero in early 2008 but soared to 6.9 percent in May. That was the highest rate since 1993.

Even with the massive government stimulus program, Americans are choosing to bolster their nest eggs rather than spend. According to Rosenberg's calculations, the total stimulus from the Obama administration came to \$163 billion at an annual rate in May, but consumer spending only increased at an annual rate of \$25 billion.

Stanford clients sue insurance broker Willis Group

NEW YORK (Reuters) — Several Mexican clients of Stanford Financial Group have sued insurance broker Willis Group Holdings Ltd (WSH.N), contending it was a willing participant in a \$7 billion fraud at the Texas-based investment company.

The lawsuit, filed in federal court in Dallas, said Willis "crossed the line from being mere insurance brokers" to essentially acting as sales agents for Stanford.

The investors are seeking more than \$1 billion in damages from Willis, which is domiciled in Bermuda and has large operations in New York and London. A Willis spokeswoman was not immediately available on Friday to comment on the case.

Stanford founder Allen Stanford, a Texas billionaire, and others face criminal and civil charges related to what U.S. federal prosecutors have called a \$7 billion Ponzi scheme involving high-yielding certificates of deposits issued by his bank



in Antigua.

Many Stanford customers were located throughout Latin America.

The lawsuit contends that Willis and other defendants provided Stanford Financial with certain "safe and soundness" letters that were intended to be used for marketing purposes to attract Stanford clients.

Willis lent recognition and credibility to Stanford's business, the lawsuit says.

The lawsuit was filed on Thursday by

law firms Strasburger & Price LLP and Castillo Snyder PC.

"We intend to prove that the defendants willfully misrepresented the safety of the financial products offered by Stanford," attorney David Cibrian, one of the lawyers who brought the case, said in a statement.

The lawsuit seeks class-action status on behalf of other Stanford investors.

Stanford Financial has been under control of a court-appointed receiver since February, when the U.S. Securities and Exchange Commission sued Allen Stanford for civil fraud. Federal prosecutors brought criminal charges against him and others last month.

Stanford has been ordered held without bail until trial, currently set for August. He had spent the last 15 years living primarily in the Caribbean, where he was knighted by the Antiguan government.

HSBC's Swiss bank asked clients to surrender secrecy

HSBC Holdings Plc's Swiss private bank last September asked clients and independent money managers to surrender their right to banking secrecy protection in order to keep securities invested in 28 countries.

In countries where rules demand investor disclosure, HSBC asked for permission to hand over the names of clients that want to keep their investments, the Geneva-based bank said in a letter that it e-mailed to Bloomberg News. Those countries include Brazil, China, India and Greece.

Credit Suisse Group AG is also asking clients holding French securities to let it release their details to France's financial regulator.

While both banks are seeking to comply with securities regulations, the moves may increase investor concern after Swiss banking secrecy came under attack from the U.S. and Europe this year.

"It might be a way to undermine the secrecy system," said Christian Stark, a banking analyst at Credit Agricole Cheuvreux in Zurich. "If Switzerland was suddenly inundated with insider trading requests, it would be obvious what's behind it."

Under Swiss law, bankers can be fined or jailed for disclosing a client's identity without permission.

"The main objective of this document



is to obtain the prior consent of the client to renounce Swiss banking secrecy before investing in regulated markets which demand the disclosure of his identity," HSBC said in the letter. Regulator Requests

HSBC also "strongly recommends" that independent money managers renounce banking secrecy for clients who want to invest in the U.S., Germany, the UK, Russia, Singapore and seven other markets. Regulators in those countries can request investor identities, the bank said.

Credit Suisse, in a June 24 letter, gave clients until Sept. 1 to respond, or their French positions would be sold. Switzerland's biggest bank by market value has already taken similar steps with securities in Norway, South Korea and Taiwan, as well as France.

Switzerland, which treats tax evasion as a civil offence and tax fraud as a crime, agreed in March to cooperate

with foreign tax authorities, lifting the anonymity of banking secrecy where there is evidence of either. It already waives banking secrecy for criminal investigations.

The U.S. Internal Revenue Service is trying to force UBS AG, the Alpine nation's biggest bank, to reveal the names of 52,000 American customers after the company admitted helping wealthy clients evade taxes. That came after UBS agreed to pay \$780 million in penalties and gave the IRS more than 250 clients' names.

In court filings and a diplomatic note, the Swiss government has said the lawsuit would "seriously jeopardize" efforts to revise a 1996 tax treaty.

Under that treaty, Switzerland can turn over account data only on a reasonable suspicion of "tax fraud or the like," according to a UBS court filing.

In the wake of April's Group of 20 summit in London, Switzerland was placed on a "gray list" of countries that have yet to comply with Organization for Economic Cooperation and Development tax standards. The Swiss government says the country isn't a tax haven. Other financial centers on the OECD list include Austria, Belgium, Luxembourg and Singapore.

(Source: Bloomberg)



GM thrives in Latin America

For all its miscues at home, General Motors Corp. has built a powerhouse operation in Latin America, where its fuel-efficient vehicles could play a crucial role in returning the battered company to health.

Since it filed for bankruptcy a month ago, the automaker has been striking deals to shed much of its operations, including its Hummer, Saturn and Saab brands and its Opel division in Europe. GM is closing more North American factories, laying off workers and slashing its U.S. dealership ranks.

But despite rumors this spring, GM's thriving Latin America operations are likely to escape the ax, analysts said.

The region is an important, low-cost manufacturing platform for the U.S. market. And to Latin American consumers, GM remains a respected brand with the highest market share -- 21% -- of any carmaker, said Guido Vildoza, an auto analyst with IHS Global Insight in Waltham, Mass. While GM's sales declined 23% last year in the U.S., they rose 3% in Latin America, and thanks to some timely government support, this year's sales are on track to match 2008's.

The automaker has been in the region for decades, opening its first factory in Argentina in 1925. It has kept ahead by continuing to invest billions of dollars, including on a new assembly plant in San Luis Potosi, Mexico, and a design center in Sao Jose dos Campos, Brazil, that the automaker hopes will become a source of cutting-edge know-how for gas-sipping cars it may someday sell in the United States.

"Latin America will keep its strategic role in the new GM," said Michel Pardal, chief Latin America market forecaster for J.D. Power and Associates in Troy, Mich. "GM has a good image, has been there for many years, and their engineers' capabilities are impressive."

In May, Italian automaker Fiat was said to be in negotiations to acquire GM's operations in the region as part of its bid to buy Opel. Fiat ended up gaining control of Chrysler -- and has plans to expand that automaker's undersized reach in South America -- but did not haul in Opel or GM's Latin America unit.

Perhaps because of those rumors, however, GM Brazil chief Jaime Ardila took the trouble last month to assure employees that not only would the unit remain part of GM, but slated investments totaling \$1.5 billion would also go forward. Much of that money is going into a flex-fuel motor plant under construction in the southern state of Santa Catarina.

GM's Brazil operation, second only to its China outfit in foreign unit sales, has helped keep Detroit afloat. The company has "repatriated" annual profits of up to \$800 million in some years this decade, at a time when GM's U.S. operations were bleeding cash, informed sources said.

(Source: Los Angeles Times)