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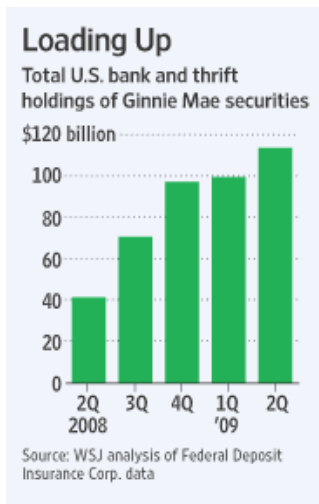
Banks Load Up on Mortgages, in New Way

By DAVID ENRICH

Banks have been silent partners in the meteoric rise of the Federal Housing Administration.

In the past year, the nation's financial institutions have snapped up securities backed by Ginnie Mae, a government-owned agency that guarantees payments on mortgages backed by the FHA. That helped drive demand for Ginnie securities and created an outlet for billions of dollars of FHA-backed loans made to borrowers who in many cases couldn't afford big down payments.

As of June 30, the roughly 8,500 federally insured banks and thrifts were holding \$113.5 billion of Ginnie securities, compared with just \$41 billion a year earlier, according to a Wall Street Journal analysis of bank financial disclosures. It is the largest amount that banks have reported holding since at least 1994.



Banks, sometimes with the blessing of federal regulators, have been loading up on Ginnie securities for one main reason: They make their balance sheets look healthier. Since the securities are guaranteed by the government, federal banking regulators have deemed them risk-free, meaning that adding them to a bank's investment portfolio, or replacing assets deemed riskier, lowers the overall risk of the portfolio in the eyes of regulators.

Some banks have used government cash infusions under the Troubled Asset Relief Program to buy Ginnie Mae bonds.

Having an eager buyer for its securities has made it easier for Ginnie Mae to increase the amount of debt it issues, though there appears to be no connection between the banks' increased appetite and the increasing supply of Ginnie Mae securities.

Because Ginnie Mae can issue significant amounts of securities, the FHA can back more loans and the high demand helps keep interest rates low. The irony is that banks that are reluctant to lend and are trying to unload their own mortgage holdings are at the same time helping to prop up the housing market by buying up securities backed by mortgages.

Through August, Ginnie had backed \$298 billion of mortgage-backed securities in 2009, the most in its 41-year history and nearly double the amount in the same period last year. That represents about 20% of total new mortgages in the U.S. In addition to FHA-backed loans, Ginnie also guarantees securities comprising mortgages backed by the Department of Veterans Affairs and other federal agencies.

Ginnie and the FHA, units of the U.S. Department of Housing and Urban Development, have become two of the most powerful mortgage financiers in the U.S. When banks make home loans, the FHA insures them against default. Then the mortgages are pooled together and packaged into mortgage-backed securities. Ginnie

guarantees that buyers of those securities -- including banks and other investors -- will continue to receive interest and principal payments on the debt, even if borrowers start to default.

FHA Paying the Price?

Over the past year, FHA has played a key role in supporting the struggling housing market by buying up mortgages made to home buyers who can't afford big down payments or homeowners who want to refinance but have little equity in their homes. The FHA may be paying a price for all its lending. Rising losses on the mortgages have drained the agency's reserves.

Holding Ginnie bonds help banks look better because federal bank-capital guidelines give the Ginnie securities a "risk weighting" of 0%. That means banks don't have to hold any cash in reserve to protect against losses. By contrast, securities backed by [Fannie Mae](#) and [Freddie Mac](#), the two mortgage giants seized by the government, carry a 20% risk weighting, meaning some cash needs to be set aside to hold them, even though most banks and investors think there is scant risk of Fannie or Freddie securities defaulting. Privately issued mortgage-backed securities can receive risk weightings of 50%, while many other types of debt carry 100%.

Because of the different risk weightings, bankers say they are selling relatively safe assets like Fannie securities and replacing them with Ginnie securities. The move doesn't shrink banks' balance sheets or remove their troubled assets. But it reduces their total assets on a risk-weighted basis. That is important because risk-weighted assets are the denominator in some key ratios of bank capital.

"With the pressure for capital, that's really made the Ginnie Maes more attractive," said John C. Clark, chief executive of First State Bank in Union City, Tenn. The bank's holdings of Ginnie securities jumped to \$66 million at June 30 from less than \$4 million a year earlier.

Like some peers, First State bankrolled those purchases partly with taxpayer dollars that were intended to stabilize the banking industry and jump-start lending. The 32-branch bank used a "significant portion" of the \$20 million it received through TARP to buy Ginnie securities, Mr. Clark said.

Mr. Clark credits the strategy with helping First State preserve its capital ratios even as loan defaults swelled to \$9.5 million on June 30 from \$1.6 million a year earlier. During the same period, its total risk-based capital ratio climbed to 11.3% from 10.7%. That gave First State some breathing room above the 10% ratio regulators require for banks to be deemed "well capitalized."

This spring, executives from Warren Bancorp Inc., a small Michigan lender struggling with rising losses, sat down with examiners from the Federal Reserve to discuss the bank's dwindling capital. Bank officials pitched the idea of buying millions of dollars of Ginnie securities

"The examiners thought it was a good strategy for us to use," said Kim Keeling, the six-branch bank's chief financial officer. She called it "the quickest and the least costly option" for addressing the bank's depleted capital ratios.

Ms. Keeling acknowledged that the strategy doesn't ease the bank's underlying problems. "The whole capital ratio can be manipulated ... in many ways to make it appear better or worse," she said.

A Fed spokeswoman declined to comment.

Some bankers and other experts criticize the strategy's benefits as largely cosmetic, saying it is an example of how the federal rules governing bank capital are prone to manipulation. Buying Ginnie securities "helps alleviate some of the pressure but doesn't address the problem at large," said Ken Segal, senior vice president with Howe Barnes Hofer & Arnett, a brokerage firm that advises small and midsize banks. "There's still the endemic problem" of bad loans.

Others say bank purchases of Ginnie securities are a prudent risk-reduction strategy. Bankers rightly perceive Ginnie securities as safer than almost any other investment, said Roger Lister, chief credit officer for financial institutions at bond-rating firm DBRS. "It may not just be for regulatory-capital arbitrage," he said.

Prosperity's Buying

In St. Augustine, Fla., Prosperity Bank increased its holdings of Ginnie securities tenfold over the past year. The lender, with 20 branches and \$1.2 billion in assets, simultaneously dumped most of its Fannie and Freddie securities, even though they seemed safe.

"There's no more risk in Fannie and Freddie securities than in a Ginnie security," despite the different capital treatments, said CEO Eddie Creamer.

Mr. Creamer worries the capital rules could inadvertently make mortgages harder to come by. As banks dump Fannie and Freddie securities, their prices are likely to come under pressure. That inflates their yields, which translates into higher interest rates on the mortgages that they finance.

"It has a broader implication on the availability of those mortgages and the costs of those mortgages," Mr. Creamer said.

—Maurice Tamman contributed to this article.

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