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Smaller Banks Resist Federal Cash Infusions

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Community banking executives around the country responded with anger yesterday to the Bush administration's strategy of investing $250 billion in financial firms, saying they don't need the money, resent the intrusion and feel it's unfair to rescue companies from their own mistakes.

But regulators said some banks will be pressed to take the taxpayer dollars anyway. Others banks judged too sick to save will be allowed to fail.

The government also said yesterday that it will guarantee up to $1.4 trillion of private investment in banks. The combination of public and private investment is intended to refill coffers emptied by losses on real estate lending. With the additional money, the government expects, banks would be able to start making additional loans, boosting the economy.

President Bush, in introducing the plan, described the interventions as "limited and temporary."

"These measures are not intended to take over the free market but to preserve it," Bush said.

On Capitol Hill, lawmakers from both parties praised the plan and scrambled to take credit for writing provisions into the law passed almost two weeks ago that allowed the government to switch from buying bad loans to buying ownership stakes in banks.

On Wall Street, bank stocks soared even as the broader market stayed flat while investors grappled with economic concerns. The Dow Jones industrial average was down 0.82 percent, or 76.62 points, to close at 9310.99 one day after its largest percentage gain in more than half a century.

And in offices around the country, bankers simmered.

Peter Fitzgerald, chairman of Chain Bridge Bank in McLean, said he was "much chagrined that we will be punished for behaving prudently by now having to face reckless competitors who all of a sudden are subsidized by the federal government."

At Evergreen Federal Bank in Grants Pass, Ore., chief executive Brady Adams said he has more than 2,000 loans outstanding and only three borrowers behind on payments. "We don't need a bailout, and if other banks had run their banks like we ran our bank, they wouldn't have needed a bailout, either," Adams said.

The opposition suggested that the government may have to continue to press banks to participate in the plan. The first $125 billion will be divided among nine of the largest U.S. banks, which were forced to accept the investment to help destigmatize the program in the eyes of other institutions.

In rolling out the program, Treasury said it would make the rest of the money available to banks that requested it. Officials said they expected thousands of banks to participate.

But both the American Bankers Association and the Independent Community Bankers of America said that they knew of few banks that planned to participate.

"I'm not sure we've heard from any that want to participate," said Karen Thomas, vice president for government relations at the community bankers group, which represents about 5,000 banks. "That said, if any community banks do enroll, we anticipate it will be just a small minority."

Federal regulators said they did expect some banks to volunteer, though none stepped forward yesterday. But they added that they would not rely on volunteers. Treasury will set standards for deciding which banks can be helped, and the regulatory agencies will triage the banks they oversee: The institutions faring best and worst will not receive investments. The institutions in the middle, whose fortunes could be improved by putting a little more money in the bank, will be pushed to accept the money from the government.

"We will encourage institutions to apply," said John C. Dugan, the comptroller of the currency, who oversees most of the nation's largest banks.

In return for its investments, Treasury will receive preferred shares of bank stock that pay 5 percent interest for up to five years. After that, if the companies haven't repaid the government's initial investment, the interest rate goes up to 9 percent.

Participating banks cannot increase the dividends they pay to shareholders without federal permission, they must accept some limitations on compensation for their executives, and Paulson said the government would press companies to limit mortgage foreclosures.

The government decided not to impose an explicit requirement that banks use their taxpayer dollars to increase lending. But regulators said they will watch banks closely. They also noted that banks have less reason to hoard money now that they can borrow more easily. Most important, however, they said, banks want to make money.

"And the way that banks make money is by lending," Dugan said.

Also yesterday, the Federal Deposit Insurance Corp. said it will create, essentially, two new insurance programs.

The basic insurance program still guarantees all bank deposits up to $250,000. A new supplemental program guarantees all deposits above $250,000 in accounts that don't pay interest. The program basically covers accounts used by small businesses.

Some European governments had already guaranteed deposits, creating a competitive advantage for banks in those countries. Banking regulators also were concerned that small businesses were transferring deposits from community banks to larger institutions perceived as less likely to fail. Finally, small businesses contributed to the failure of Washington Mutual and the collapse of Wachovia by pulling uninsured deposits from those banks.

The FDIC estimates that this new guarantee could cover up to $500 billion in deposits. Banks that sign up for the insurance -- and bankers agree that everyone will participate, for fear of ceding an advantage to rivals -- will pay a premium of 10 cents on every $100 in deposits.

The combination of the existing and new guarantees will cover about 80 percent of the $7 trillion in deposits at the nation's banks. The bulk of the uninsured deposits are held in interest-bearing accounts, such as

certificates of deposit, that tend to be marketed and regarded as investment products.

Sheila C. Bair, chairman of the FDIC, said the agency considered guaranteeing all bank deposits but decided that any potential benefit was outweighed by the risk that a guarantee on interest-bearing accounts would attract a huge inflow of deposits currently held in money-market mutual funds.

"We're trying not to stabilize one part" of the financial system "and destabilize another part," she said.

Separately, the FDIC is creating an insurance program to encourage investment in banks by guaranteeing that investors won't lose money. Participating banks will pay the FDIC a fee of 75 cents on each $100 in debt that they sell to investors. The FDIC will guarantee through June 2012 the debt issued by participating banks before the end of June 2009. If the bank goes bankrupt, or defaults on its debt, the FDIC will pay the investors.

To prevent banks from running up massive debts on the government's tab, the program limits banks to a 25 percent increase from their current level of borrowing. The FDIC estimates that the maximum amount of debt that banks could issue under the program is about $1.4 trillion.

Bair also said that the FDIC may refuse to guarantee debt issued by banks with financial problems, though she declined to discuss specific criteria.

Bair acknowledged that the new guarantees shelter banks from the immediate consequences of misbehavior because depositors and investors have no incentive to remove their money from an institution if they know that the government stands behind it.

But Bair said the government's first priority was to stabilize the industry.

"The risks of moral hazard were simply outweighed by the need to act and act dramatically and act quickly," Bair said.

Dugan offered a slightly different perspective.

"It just means we've lost one tool and we're going to have make sure that we compensate," he said.

Staff writers Paul Kane, Lori Montgomery and Peter Whoriskey contributed to this report.

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