WaMu: The Mutual Bank that De-Mutualized and Melted Down

By Henrich Greve

Wall Street Journal contributor Kirstin Grind has written a book on the downfall of WaMu, the second largest bank failure in the US (so far) and the name that has come to symbolize risky mortgage lending in the USA. I expect to enjoy reading it when it comes out, and learn more about the inside story. Here is some of what we know already.

WaMu started as a mutual bank, meaning that it was owned by its depositors. Mutual Banks come in different forms, but traditionally they are focused on savings deposits and mortgage loans rather than loans to businesses. They usually have low interest rates on loans and instead select their borrowers carefully to have low losses. Mutual banks are a traditional; one might even say old-fashioned, form of bank that is often heavily committed to the local communities and avoids having many branches. Hayagreeva Rao and I are doing research on such community organizations, and we have found that they can have a big and positive impact on the development of their communities.

For WaMu, however, the period as a mutual ended in 1983. Mutuals can de-mutualize, and this is done both in banking and in insurance (many insurers are also mutuals). De-mutualization means that they turn into regular joint-stock firms, but often they keep their name. There is nothing preventing a non-mutual from calling itself a mutual. They can keep their business practices too, but most often do not. Mutuals are very efficient organizations as long as they don’t grow, but de-mutualization means that they can grow quickly, adding branches and getting new lenders. Shortly before failing, de-mutualized WaMu had tens of thousands of employees and hundreds of branches, and a strong electronic-banking presence. More worryingly, due to permissive loan practices and incentives for loan generation, it has a loan portfolio that was bloated and risky when compared to its capital. Losses on loans started to mount, triggering a depositor bank run that was fast and furious thanks to the ability to transfer money electronically: it is estimated that 16.7 billion dollar in deposits left WaMu in nine days.

What happened? WaMu had become a commercial bank with commercial bank ambitions but a shortage of commercial bank experience. It also had some bad luck: 2008 was not a good year for having a large mortgage loan exposure, because the subprime loan crisis was in full swing. Its failure shows some of the problems of changing from one form of organization to another. Strategies can change quickly, but the capabilities to back those strategies take longer to develop.

In the book she reports another side to the story too, however, and one that shows in a better way how WaMu did not totally outgrow its roots as a mutual organization. When WaMu started experiencing problems collecting loans, they sent out a team to investigate how they might improve payments from their borrowers. This team made interviews on video tape documenting how people had been blindsided by the fall of the housing market and found themselves unable to pay. When they showed this footage to the president of WaMu’s Home Loans Group, David Schneider, he ordered a revision of loan collections to take a softer approach. In the end, it is hard for a firm with mutual in its name and history to escape the idea that mutuals are a way for people to help each other.

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