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Financial Meltdown Sending Big Chill Across L.A.

By Richard Clough and Charles Proctor *Staff Reporters*

As Wall Street struggled last week through one of its worst crises since the Great Depression, the Los Angeles financial industry didn't escape the turmoil.

Panicked investors phoned their brokers while insurance customers fretted over policies. Banks began assessing their exposure to the struggling companies. Hedge fund managers hoped for a miraculous turnaround in the markets.

Some of L.A.'s wealthiest residents did not escape the carnage, either, with some sustaining losses of possibly a billion dollars or more due to the government bailout of insurance giant American International Group Inc.

Moreover, as the week neared end, it appeared the region's second largest depository institution, Washington Mutual Inc., the Seattle-based thrift, was about to get gobbled up by a competitor, which would redraw the banking and thrift landscape here.

"It's a major reshuffling of the deck," said Lloyd Greif, president of Los Angeles-based Greif & Co., a middle market mergers and acquisitions firm. "We're going to see new players emerge. It's a brave new world and it is – I hate to say it – the Great Depression of 2008."

The turmoil on Wall Street last week, which included the bankruptcy of investment bank Lehman Brothers and the acquisition of Merrill Lynch by Bank of America Corp., hit New York harder than Los Angeles. In the span of just a few days, billions of dollars in shareholder equity was wiped out and several of the country's largest financial institutions ceased to exist as independent companies – all stemming from toxic home loans, many made and sold in Southern California.

But, for Los Angeles, the crisis followed by just months the upheaval caused by the area's unenviable position as ground zero for the subprime fiasco – which saw the sale of giant Countrywide Financial Corp. and the failure of IndyMac Bancorp and other lenders – causing thousands of immediate local job losses.

So, by the end of the week, local financial players were counting at least some blessings.

"This is a case where L.A. has, by and large, dodged the bullet," said Nancy Sidhu, a senior economist with the Los Angeles County Economic Development Corp. "This is nice because we caught all the bullets that were flying last year when the subprime mortgage problems broke out."

Bated breath

Still, there are thousands of Southland jobs and untold amounts of money at risk as the local financial services industry is reshaped in the coming months.

The Los Angeles office of Irvine-based Millennium Corporate Solutions spent much of the week watching the latest news and taking questions from customers, said Fritz Mutter, the office's managing general partner.

Mutter himself answered phone calls from several large clients, and while no one asked him to replace their policies, he conceded, "We kind of expected them to."

When speculation swirled over the health of AIG, Mutter had his staff prepare a list of customers who held AIG policies in case the firm went under. Now that the Fed has bailed out the company, Mutter said, "We've bought ourselves some time. But we're not out of the woods yet."

That was indeed the case for some of L.A.'s wealthiest, such as Eli Broad, who sold his financial company Sun America to AIG a decade ago in 1999 for $18 billion. As of June he had $800 million worth of AIG stock that would now be worth just $72 million. Such losses, if not recouped, could put a crimp in the L.A. philanthropic community, something Broad has been a leader in with donations to art museums, schools and other institutions.

Mutter also predicted that local companies would get hit hard as insurance companies quickly hike rates to compensate for poor returns on their investments. "The insurance market has been soft, and rates were down. This is going to turn the market. It will get harder and more expensive," he said.

Many other financial services firms also reported a sharp increase in inquiries as people made sure their insurance policies, investments and other assets were safe.

Capital Research & Management, the Los Angeles-based advisor for the giant American Funds family, has been handling higher volumes of calls and e-mails from the outside investment advisors who market their mutual funds. But spokesman Chuck Freadhoff said the conservative investment company has not had to take extraordinary steps to shore up its portfolios.

The company posted messages to clients on its Web sites, noting that the company has successfully grappled with several market downturns since it was founded in the depths of the Great Depression. It was closely monitoring American Funds' cash reserves, and its risk exposure to the firms through which it buys and sell securities.

"We have been busy and working long hours, but no, we haven't been setting up cots," Freadhoff said.

Silver lining

Some firms are already trying to put a positive spin on the economic crisis.

A number of investment banks that had minimal exposure to risky subprime-related investments said they now have room to expand as larger competitors fall and customers abandon the large brokerage houses for smaller firms perceived to be safer.

"From a competitive point of view, even though we've had a hard time servicing our clients in terms of profits, because of security and safety, we've become very attractive," said Edward Wedbush, president of Los Angeles-based investment bank Wedbush Morgan Securities Inc. "We are interviewing personnel to open new offices. We are looking at opening offices all over California."

Many firms are looking to snag talent as these Wall Street titans fall. Some Merrill employees are expected to leave as the company is absorbed into Bank of America, while Lehman Brothers is expected to announce layoffs as a result of its bankruptcy.

Though the job losses will likely be felt most severely in New York – some estimates say more than 10,000 – Los Angeles will not escape unscathed. As of February, Merrill had more than 800 employees in Los Angeles County and Bear Stearns, the investment bank that collapsed in March, had 275. Lehman Brothers, which has two offices in Los Angeles and two in Orange County, could not be reached for comment, but it also had a significant local presence.

As of July, state figures show nearly 160,000 people in total worked in L.A. County's banks, brokerages, insurance offices and other financial companies.

"We're already looking at possible hires – it's a great opportunity for us to add muscle," said Greif. "There's clearly talent that's going to be out there on the street looking for a good home."

He said there are emerging opportunities for his firm to expand into allied fields, such as private equity or money management, adding, "This is a time when healthy firms will prosper."

One firm that is already seeing a flood of new business is Northern Trust Corp. Since last Monday, local entrepreneurs, families and business owners have rushed to the Los Angeles office of Northern Trust because they perceive it to be a low-risk institution to stash their money, executives said.

Susan Mallory, president of Northern Trust's Southern California division, said business growth over the past week is "running in the hundreds of millions of dollars range. And that's just here in Los Angeles."

Patrick Everett, a chief investment officer for Northern Trust, added, "What's happening in the marketplace has made people become very aware of where their exposures are. And investors are saying: 'If I have any risk, I don't want that. I want to be comfortable at night.'"

A number of observers said they expect the next year to be a game of survival of the fittest as the impacts of the financial crisis ripple throughout the financial sector. The Federal Deposit Insurance Corp. has said that up to 300 banks may fail in the coming months. In the meantime, investors are taking it on the chin.

Bryant Riley, general partner at Riley Investment Partners, which manages about $120 million in assets, said managers of local funds that are long on commodities and short on financials have taken an especially hard blow.

"I've heard challenges everywhere, and not just in L.A.," he said.

Riley admitted his hedge fund, which specializes in small companies with market capitalization less than $200 million, has taken a hit, but declined to disclose numbers.

"I think it's fair to say it's a challenging market," said Riley, who is also president of B. Riley and Co., a Los Angeles investment house. "Sometimes you have to deal with bad markets, and it's painful."