

RESULTS OF THE STRESS TESTS

Which banks did well? Which didn't?

Provided by Dave Gatesman

The worst-kept secret in Washington goes public. Federal regulators have now released their "stress test" evaluations of America's 19 largest banks. So how many of the 19 thrifts are adequately capitalized? Which banks will be directed to boost their capital, and where might that capital come from?

Information has been leaking for days. Now we have the official report and the Federal Reserve's opinion.

Nine banks don't need more capital. The banks in the best shape: American Express Co., BB&T Corp., Bank of New York Mellon Corp., Capital One Financial Corp., Goldman Sachs Group Inc., JPMorgan Chase & Co., MetLife Inc., State Street Corp. and US Bancorp. The government says these banks do not need to beef up their balance sheets.¹

Ten others do. The government says these banks need to raise new capital or bolster capital reserves by the following amounts: Bank of America (\$33.9 billion), Citigroup (\$5.5 billion), Fifth Third Bancorp (\$1.1 billion), GMAC LLC (\$11.5 billion), KeyCorp (\$1.8 billion), Morgan Stanley (\$1.8 billion), PNC Financial Services Group Inc. (\$0.6 billion), Regions Financial Corp. (\$2.5 billion), SunTrust Banks Inc. (\$2.2 billion) and Wells Fargo (\$13.7 billion).²

The deadlines. The government has given the banks that do need capital up to six months to raise it - and one month to come up with a plan to do so. June 8 is the plan deadline and November 9 is the deadline for raising money.³ Some may raise all the capital they need by converting government debt into private stock.

The crucial test. The Fed wanted to check and see if these banks would have at least 6% of their assets in Tier 1 capital and at least 4% in common equity by 2010 under the two economic scenarios posed. Tier 1 capital includes common shares, most types of preferred stock, and TARP funds.⁴

The options. Banks that need to thicken their capital cushion can do so by 1) selling selected assets, 2) raising new common equity from current shareholders or new investors, 3) applying any earnings that top analyst expectations toward their capital bases, or 4) converting preferred shares into common stock. Step 4 is actually a cash conservation move - converting the preferred shares wouldn't actually boost overall capital, but it would allow banks to eliminate preferred stock dividends.^{4,5}

Consolidation is also a possibility. Some analysts wonder if the smaller banks among the 19 - thrifts such as SunTrust, Fifth Third, Regions Financial and KeyCorp - could end up merging with larger banks.⁶

The Treasury is the lender of last resort. The government has instructed the banks to go to the private sector first before asking for any more federal money. Treasury Secretary Tim Geithner thinks that the “vast bulk” of thrifts needing more capital can capably find it “through private sources” in coming months.⁷ The still-developing Public-Private Investment Program (PPIP) could offer a way.

Is Washington simply managing expectations? Stress tests have occurred for years in the banking world; the findings of such tests are commonly kept private. The government revealed these results with the goal of maintaining the public’s faith in the banking system – as if to say, “Here is the open book and here is how we are directing the banks to make things better.”

Some analysts wonder how credible the results are. After all, what would the government have to gain by saying a big bank was in big trouble? Investors would flee, and the Treasury would have to shell out more TARP money. Other analysts note that generating capital and bettering the balance sheet doesn’t address the problem of removing toxic assets from the books of these banks.

On the other hand, the announcement of the stress tests did lessen the anxiety among investors this winter, when Wall Street fretted about the possibility of bank nationalization. The announced results do not look as negative as some investors had expected. Interviewed May 6 on Charlie Rose’s PBS program, Secretary Geithner noted that there are “very significant [capital] cushions in these institutions today, and all Americans should be confident that these institutions are going to be viable institutions going forward.”⁸ Additionally, a growing number of analysts see the economy improving by 2010, which will hopefully help to reduce stress for banks.

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Citations.

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