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# Op-Eds

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## Stressed About the Test

Should the Big Banks be stressed about the outcome of the stress tests being conducted by the Treasury Department? Is there really anything for them to worry about after such stellar earning reports for the first quarter?

Clearly some of the big banks, all of which have received TARP money, are stressed about the outcome of the government's mandatory tests for the nation's nineteen largest banks.

Which will pass and which will fail? That's the question on everyone's mind, or should be.

Though the tests conducted by the Treasury are not a forensic accounting they will, hopefully, give us a much better picture of the health of the nineteen banks.

Operating in a deregulated shadowy cloud for the past decade it is difficult to believe anything a banker reports. They still have not been transparent enough for us to determine how much toxic assets are still sitting on their books and how much 'real' capital they have. To believe the last quarter's earnings reports would be financial suicide.

Can we even be sure that one big bank is truly healthy?

Goldman Sachs, arguably best of the bunch, wants to pay back the $10 billion TARP money as soon as allowed. But even their health is in question.

Goldman reported a net profit for the first quarter of $1.6 billion, and raised nearly five billion dollars in private capital in a recent offering. When you dig deeper you find that a lot of the profit excludes the huge losses in December, unreported due to a fiscal accounting change.

The change in calendar was required when they attained bank status, discarding the mantle of 'just' an investment bank. The accounting change appears to have allowed Goldman to push losses into an unreported shadow month. The month of December loss could have been upwards of 7 billion dollars.

And where's the $12.9 billion they received from AIG as a counter party; taxpayer money given to failing AIG that was diverted immediately to Goldman at 100 cents on the dollar? How did the questionable transaction figure into their profitable quarter?

What about Wells Fargo who reported a $3 billion profit for the quarter, but justified them with rather strange and questionable explanations? Their dubious claim that Wachovia made money this quarter is suspect considering the ninety-eight plus billion dollars in subprime loans that should still be on Wachovia's balance sheets. A bank the lost over $60 billion the last two quarters. Did most of the loans in their subprime portfolio perform extremely well this quarter while other credit markets were continuing to deteriorate?

The same could be said about Bank of America, Citigroup, and JP Morgan Chase. They all reported much better than expected profits. But there were unreliable numbers in each of their reports; foggy elements that might give the appearance of a profit.

Bank of America reported $3 billion profit from Merrill Lynch, the same Merrill that lost $15.3 billion the previous quarter. It was a big part of the $4.2 billion profit Bank of America reported. But, they also benefitted tremendously from the change in mark-to-market accounting enacted by FASB to the benefit of the banks.

Other negative signs showed up in Bank of America's report. Credit card losses jumped by 66% from 5.19% to 8.62% in the first quarter. Non-performing assets took a big hit also rising to $25.7 billion.

There was no indication from either Citigroup or JP Morgan Chase as to how either may have benefitted from the mark-to-market accounting change. Citigroup did benefit from other accounting trickery receiving a $2.7 billion accounting boost from their declining debt. And JP Morgan received a $10 billion one-off boost from investment banking allowing them to report a $2 billion profit. Their investment banking improved from a $7.9 billion loss last quarter to a profit of $2 billion this quarter.

The big five banks all benefitted from accounting gimmickry leaving us to speculate what their actual numbers are. Again, wondering if they are using smoke and mirrors.

Results of the stress tests were scheduled to be released yesterday but have been delayed until Thursday, May 7th, apparently giving some banks time to argue their cases.

So what will the stress tests reveal?

No one is really sure, but there is a feeling the tests will show that several of the nineteen banks will be required to raise capital. The banks rumored to need capital immediately are Bank of America and Citigroup.

In my opinion three or four banks may have to raise capital immediately, and four to six may be on the edge and be required to find capital should the economy continue to decline.

Economic models of varying levels were set up to identify how each of the nineteen financial institutions would fare under different economic conditions. The results of the tests will only be valid if the economic conditions are related to 'realistic' scenarios.

If, for instance, the worst case scenario used, as rumored, an unemployment rate of 8.8% then the test could be rendered moot by Friday when unemployment could rise to nine percent.

With credit costs surging, non-performing assets rising, and greater loan loss reserves needed, the health of these stress tested banks would immediately go beyond the minimum threshold.

Credit costs are a problem across the board; all nineteen banks are feeling the pain of credit card and auto loan defaults. And the commercial bubble is just beginning to unravel, which will put pressure on many of the banks to raise even more capital.

The tests, if in fact they are thorough enough could expose a level of shadow banking that has been hidden for some time. Some may still have to be taken over by the FDIC.

The FDIC is stretched to the breaking point. On Friday, they were required to take over three more banks bringing the total to 32 in the first four months, six more than all of 2008.

This week they could not find a buyer for the largest of the three, Silverton Bank of Atlanta, Georgia. This could be another indication of the pressure the FDIC will be under for the remainder of the year.

So where do the stress tests and bank takeovers leave us? Mired in the financial morass; one that is eating up the wealth of the United States and the entire globe? The results on Thursday will tell us something. But I fear it could be something we do not want to hear!

In order to survive this financial crisis honest and transparent data is absolutely essential to be able to move ahead. Anything less would be considered a crime.