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# Op-Eds

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## Raising Cain

A week ago banks rushed to make their offerings to the Gods of Wall Street; hedge funds and private equity firms. This modern day story of Cain and Abel has everyone in the financial world scrambling for their sustainable lives. The outcome could be either uplifting or devastating.

The results are in from the National Stress Tests, or more loveningly referred to as the BS Tests.

The nineteen largest banks in the U.S. were graded by the Fed, Treasury, and FDIC on their potential solvency under various levels of adverse economic conditions. We now know how they fared.

More than 50% received below average grades, some actually garnering the equivilance of an F from the team that tested them. It was originally rumored that this was not a pass/fail scenario and that none of the banks would actually fail.

But leaks, prior to the release, indicated that at least ten banks would need to raise funds to meet capital requirements sufficient to weather this financial crisis should it continue to the level of the gov's worse-case scenario.

Can we even be sure that one big bank is truly healthy? Fifty-three percent of the banks failing does not sound like a very good outcome; especially when they must collectively raise over $75 billion.

With more banks than anticipated needing to raise capital, vying for what little private investment is available, the new challenge for the banks will be which will succeed in that endeavor and which will fall short. The other concern is, who would want to invest in a failing bank? The answer will reveal itself soon.

The good news is, the banks will have to raise 'real' money. They won't be able to revert to accounting manipulations, or trickery.

They will? They won't have to raise 'real' money? Who says?

It seems the Treasury and the Fed have decided that there are several ways that a TARP recipient can meet the capital requirements determined by the Stress Test. Bringing in private capital is only the first option. It is, of course, the preferred option. There are other ways, it seems, to get around the private money issue.

But the emphasis of all the big banks will be to prove they can bring in private investors to overcome their failings. The second imperative is to raise the capital without guarantees from the government.

Like Cain and Abel, the long awaited day has come for the banks to make their offerings. The game is afoot and, in a rush to be first, the banks may throw quality aside for fear that waiting may lead to rejection by the

financial gods.

On Friday, May 8, several of the banks presented their offer and others announced their intent to tender an offer over the next few days. Both Bank of America, required to raise $34 billion, and Wells Fargo, in need of nearly $14 billion, were Friday participants, though with different programs.

Goldman Sachs, one of the nine that did not need to raise capital had already been successful at raising $5 billion in an offering two weeks earlier. Both Wells and BofA hoped to take advantage of that success by being the first banks to offer their common shares.

Others have already come to market with mixed success. Six of the banks have completed their stock sale; four that did not need to raise capital and only two that did. Wells Fargo was able to raise $8.6 billion of its requirement while Morgan Stanley was able to raise more than two times what they needed.

Bank of America, KeyCorp, and PNC Financial are selling shares 'at the market;' selling shares everyday over a period of time. SunTrust has joined them announcing its intent to raise $1.25 billion in the same manner. That leaves three of the ten deficient institutions remaining to determine which options they will employ to meet the Fed's mandate.

But SunTrust may be too late which doesn't bode well for the three that have not yet announced plans. And those trying to sell shares 'at the market' may be too late also.

Is there a limit to the amount of investment capital available to recapitalize the banks? There is a better than average chance that well has already begun to dry up.

The fate of the banks in need of reserves was not helped by healthy banks and corporations jumping into the market, and signs of diminishing returns are already evident.

Bank of New York Mellon, credit card issuer Capital One, and U.S. Bancorp saw an opportunity to raise capital and took advantage of it, possibly to the detriment of banks that need to raise funds. They raised $5.3 billion which helps them get closer to paying back the $13.2 billion they took in TARP funds collectively. Instead of being good corporate citizens, allowing those that are required to raise capital to tender their offer first, greed seems to have spurred them to take advantage of the situation.

And it was of no help to the remaining banks that Dow Chemical, Ford, Anadarko, and MGM/Mirage, all in dire need of money, jumped into the pool sucking up valuable investment resources. Even a loser in the recent economy like Forrest Investment sees opportunity to raise capital in this narrow window.

MGM/Mirage's offering may be the first sign of the end of the investment community's willingness to take a chance in the tough economic environment. Though MGM/Mirage was successful in meeting their financial goal they had to sell twice as many shares as anticipated; shares were sold at $7.00 after being offered at $14.00 each. The sale grossly diluted the value of existing shares.

So how does this affect future offerings? The question is, has the appetite for dubious investments run its course?

Quite possibly the ability to raise money through secondary stock offerings is over. That leaves the banks that have not yet raised capital with options two and three.

Whether there is a fourth option is still unclear, but there is the second option, to sell assets to reach the demand placed on them by the test. Some banks have already made plans to sell a number of their assets. SunTrust expects to raise $300 million of the required $2.2 billion through the sale of assets. Others have implied they would do that also.

The third option is to convert preferred shares to common shares which will, somehow, change the balance sheet to meet the governments requirements. Of course, they would like to convert private preferred, but may have no other choice but to convert the government's preferred shares from the TARP bailout funds they've already received. Sounds very much like accounting gimmickry to me.

And what seems to be the fourth option may be wishful thinking given the volitility of the banking industry and environment for even greater losses. Banks have six months to conform to the requirements and can, over that six month period, earn their way to successfully meeting or reducing the demand.

Earnings over the next two quarters can help banks reduce their capital needs. But, that won't be likely.

Using KeyCorp as an example, a bank that was edging toward being taken over by the FDIC just months before the Treasury infused $2.5 billion into the bank as TARP recipients, could prove the point.

The Stress Test indicated that KeyCorp needs $1.8 billion to meet its worse-case scenario. Key's decision to make stock available 'at the market' may have been not only too late, but ill-fated.

With investment funds drying up and the possibility of stock prices declining they may have little success raising the capital they hope to raise. And the thought of earning their way out will be near impossible unless the economy makes a dramatic turn-around. But there are only little indications that the economy may be near a bottom and continuing foreclosures and credit defaults will affect every bank's ability to maintain positive earnings.

In the last two quarters KeyCorp has lost over $1 billion, and though the first quarter was better than their Q4 earnings, Keycorp is still exposed to potentially huge non-performing assets and defaults.

If the market for private capital investment is dead, then what?

If the economy is moderating then only a few banks, those that are unable to fulfill their capital requirements, will face bankruptcy or dissolution. But if the economy proves to be less healthy than some believe, many more banks will find themselves in grave circumstances.

Regions Financial, Fifth Third, and GMAC have not yet announced their plans and could find themselves in tenuous positions.

Smart people understood the market for bank stock was limited and that would favor those that managed to get to the market early, enticing even the healthiest banks to jump into the market.

In one interpretation of the story of Cain and Abel it is believed that quality made the difference between acceptance and rejection. Abel's offering was the best he could possibly offer and he did it willingly. Cain's oblation was of lesser quality and he, by comparison, brought it grudgingly.

None of the banks have acted in a way that is worthy of acceptance, deceiving their customers and investors, yet they continue to ask for help.

Investors have already begun to reject what the biggest nineteen bank's are offering. Some have already been judged and some have yet to discover their fate. Given the way the big banks have treated their client's money it is surprising the financial gods have not rejected the giant financial institution's offerings as God reportedly rejected Cain's.

It remains to be seen whether the recapitalization effort is successful. If the secondary equity offerings begin to decline and end up diluting the existing shares then the effort will have failed. The next six months will provide the evidence of the 'real' health of the banks and the economy. I would be fearful of what it will show.

God help us all.