In the wake of stress tests

Banks move to shake off government restrictions

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Following last week's release of the Obama Administration's bank “stress test” results, several banks have moved to quickly repay money loaned to them by the government and to raise the capital required by regulators. The goal in every case is to dump any restrictions associated with government intervention and get back to the business of unbridled speculation.

The stress tests paint a much rosier picture of the banking system than previous estimates, in part by denying that the banks are holding significant amounts of bad assets on their books.

The Federal Reserve, which conducted the tests, said that 9 out of the 19 banks reviewed were completely healthy and would not be required to take any action to prevent losses. The remaining banks were ordered to raise $75 billion in capital.

The banks have another month to announce how they will respond to the program, and another five months to implement the government's requirements. The administration said that it will inject further capital into any bank that does not raise the amounts required by the end of that period.

The sums required by the government are minuscule compared to the trillions of dollars of credit losses already incurred, but not acknowledged, by the Wall Street. Moreover, the Obama administration has introduced new loopholes designed to allow banks to avoid raising even these small amounts.

According to the *Financial Times*, lenders were told by the government that they would not have to raise the capital mandated by the program if their earnings for the year proved better than expected. Given the relaxing of rules on earnings reporting and the strong first-quarter profits shown by the banks, such an outcome is beginning to look less unlikely.

Banks have moved quickly to take advantage of the government's leniency. Most prominently, Wells Fargo, which was estimated to require an additional $13.7 billion in additional capital, immediately issued and sold $7.5 billion in new stock and said it would raise the balance through profits by November. It also said that it plans to repay the $25 billion lent to it by the US government "as soon as practical."

Wells Fargo had a significantly larger capital gap than other undercapitalized banks. Citigroup and Morgan Stanley, which were instructed to raise $5.5 billion and $1.8 billion, respectively, already announced that they would issue enough stock to cover their requirements.

The banks that regulators said were adequately capitalized, meanwhile, have moved to shake off any further government oversight by paying back their TARP funds. Three of the nine banks given a clean bill of health by the Fed, Capital One Financial, US Bancorp, and BB&T, said on Monday they would raise a combined $7.55 billion through the issue of new shares to pay back loans made to them by the government.

Since these loans came with certain minimum requirements on capital holdings, types of permissible investments, and executive compensation, banks have sought to repay their TARP loans as rapidly as possible.

The essential purpose of the stress tests was to present the US banking system in the best possible light. Far from presenting an objective and impartial analysis of the situation facing banks, it represents an

attempt to obscure the extent of losses and minimize as much as possible government oversight of the banking system.

In fact, the government was negotiating with the banks over what figures to report in the run-up to the figures' release. Press reports indicate that the banks were allowed to bargain down the amount of capital they would be required to raise. Bank of America, for instance, was initially told to raise over $50 billion, before pressuring the Fed and the Treasury and getting the figure reduced to $33.9 billion. Similar ratcheting down took place at many other banks.

The stress tests concluded that, in the worst-case scenario, banks might stand to lose $600 billion by the end of 2010, and that these losses would be compensated for by earnings if the banks were able to raise the additional capital mandated by the government.

The results sharply contradict the analysis made by the International Monetary Fund, which concludes that the US banking system was essentially insolvent, and that banks were holding some $2.7 trillion in bad assets on their balance sheets.

The methodology used by the tests is highly dubious, to say the least. The stress tests provide for two possible scenarios, one normal and one “adverse.” But the basic indicators of economic activity have so far been far worse than those envisioned in either of the two outcomes. For example, the “adverse” scenario assumes the unemployment rate will reach 8.9 percent by the end of the year. But the real unemployment rate hit that level last month, and has shown no signs of slowing down.

The stress test maneuver insures a further payout for Wall Street regardless of how banks fare in the future. If the current upturn in bank profits continues, the banks will be free to return to unbridled speculation with no additional restrictions by the government. If bank profits suffer, all the resources of the Treasury will be put at Wall Street's disposal by the Obama administration.

After the public furor over the granting of multimillion-dollar executive bonuses at AIG, the banks have sought to extricate themselves from any obligations to the government, while operating with the explicit understanding that the Treasury will pick up the tab for any further losses they incur.