If You Believe Banks Are Recovering …

By James Quinn
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The conspiracy theorists of the world believe the U.S. government faked the landing of Apollo 11 on the moon. They also believe 9/11 was an inside job, ordered by operatives within the government. The rationale of these acts was to distract the masses from the disastrous Vietnam War and the plummeting stock market, while escalating their control over the American people.

I believe I have uncovered the largest conspiracy in history. The government wants you to believe that banks are recovering, housing has bottomed, stimulus works, borrowing leads to prosperity and war leads to peace. President Obama and his cronies at Treasury and the Federal Reserve are trying to mislead the public regarding the health of our banking system. If you believe their spin on these issues, I have a structurally deficient bridge in Brooklyn I'd like to sell you.

The government has something up its sleeve this time. They are perpetrating the greatest fraud in the history of the world. The conspirators are Barack Obama, Timothy Geithner and the Treasury Department, Ben Bernanke and the Fed, Sheila Baer and the FDIC, and Barney Frank and the Democratic Congress.

They have colluded to commit taxpayer funds to enrich bankers that brought down the financial system, without getting congressional approval. They have delayed foreclosures and have tried to artificially prop up the housing market. They have poured billions of stimulus pork into the states praying for some of it not to be wasted. They have confiscated billions in taxpayer funds, bestowed them on reckless banks and forced them to lend it to anyone with a pulse, again.

The outrage from the public during the Trouble Asset Relief Program (TARP) confiscation made it crystal clear to courageous congressmen they didn't want to vote on something requiring fortitude and bravery again. They have outsourced their obligation to safeguard their citizen's tax dollars to unelected bureaucrats at Treasury and the Federal Reserve. They have already sacrificed their obligation to declare war to the Presidential branch. What is the point of having a Congress?

Nothing up their sleeve

Barack Obama and his henchmen in Treasury and the Fed have chosen to play for time, pretend the banking system is solvent, and hope that the average American doesn't care. As long as the ATM still spits out $20 bills, everything is OK. The International Monetary Fund has estimated total credit write-downs of $4.1 trillion, with $2.7 trillion in U.S. institutions. McKinsey has concluded that there are still $2 trillion of toxic assets sitting on the books of U.S. banks. Economist Nouriel Roubini, who has been correct from the beginning, estimates total losses on loans made by U.S. financial firms and the fall in the market value of the assets they are holding will reach $3.6 trillion ($1.6 trillion for loans and $2 trillion for securities). The U.S. banks and broker dealers are exposed to half of this figure, or $1.8 trillion; the rest is borne by other financial institutions in the U.S. and abroad. With $2 trillion of write-offs to go, how could Treasury Secretary Geithner make the following statement to a Congressional panel late last month, “Currently, the vast majority of banks have more capital than they need to be considered well capitalized by their regulators.”? Is he lying or shading the truth? Does it matter?

Roubini’s estimate of $1.8 trillion more losses for U.S. banks will cause a slight problem for the U.S. banking system. The entire U.S. banking system has only $1.4 trillion of capital. Therefore, the U.S. banking system is effectively insolvent. Mr. Geithner would contend that he was not lying. There are 8,500 banks in the United States. The top 19 banks control 45% of all the deposits in the country. These are the banks that are insolvent.

Mom & Pop Bank in Louisville, Ky., didn’t create toxic loan instruments that infected the worldwide economic system. The vast majority of the 8,500 banks in the country are in good shape. Citigroup, Bank of America, Wells Fargo and the other “Too Big To Fail” banks destroyed the economic system. The Fed, Treasury, and FDIC are already backstopping or supplying 70% of the entire banking system balance sheet. It is time to allow the well-run banks to take the deposits of the horribly run banks. The $1.8 billion of future losses do not include the commercial real estate losses, credit card losses and losses from the next wave of mortgage resets in 2010 that will wash over these banks.

Of course we all know that the “Too Big To Fail” banks all reported profits better than expected in recent weeks. CNBC said so. Let’s examine these tremendous profits at one of the banks, Bank of America. It reported profits of $4.2 billion. This included: $1.9 billion came from the gain on sale of CCB shares; $2.2 billion came from marking to market adjustments of Merrill Lynch notes; and non-performing assets that were $25.7 billion compared to $7.8 billion one year ago, a 329% increase in one year. Without these convenient accounting adjustments, Bank of America would have lost money.

Andrew Ross Sorkin pointed out in a recent New York Times article: “With Goldman Sachs, the disappearing month of December didn’t quite disappear (it changed its reporting calendar, effectively erasing the impact of a $1.5 billion loss that month); JP Morgan Chase reported a dazzling profit partly because the price of its bonds dropped (theoretically, they could retire them and buy them back at a cheaper price; that’s sort of like saying you’re richer because the value of your home has dropped); Citigroup pulled the same trick.”

In other words, the first-quarter bank profits were faked. They were manufactured as a public relations effort to convince the country that the big banks are in fine shape.

If the banks are in such good shape, why has the government had to use taxpayer funds to rollout the two dozen rescue plans? And now we breathlessly await the results of the stress tests. The FSP (Financial Stability Plan for those not in the know) rolled out by Geithner was supposed to save our banking system. The plan was described by Treasury as:

Increased Transparency and Disclosure: Increased transparency will facilitate a more effective use of market discipline in financial markets. The Treasury Department will work with bank supervisors and the Securities and Exchange Commission and accounting standard setters in their efforts to improve public disclosure by banks. This effort will include measures to improve the disclosure of the exposures on bank balance sheets. In conducting these exercises, supervisors recognize the need not to adopt an overly conservative posture or take steps that could inappropriately constrain lending.

Coordinated, Accurate, and Realistic Assessment: All relevant financial regulators — the Federal Reserve, FDIC, OCC, and OTS — will work together in a coordinated way to bring more consistent, realistic and forward looking assessment of exposures on the balance sheet of financial institutions.

Forward Looking Assessment – Stress Test: A key component of the Capital Assistance Program is a forward looking comprehensive "stress test" that requires an assessment of whether major financial institutions have the capital necessary to continue lending and to absorb the potential losses that could result from a more severe decline in the economy than projected.

It is fascinating that in the first paragraph they specifically state they don't want to be overly conservative. Which of the top 19 banks in the country have run their businesses in an overly conservative manner in the last 10 years? Has the Federal Reserve been overly conservative in the last 10 years? Have the SEC and FDIC been overly conservative in the last 10 years? Have consumers, homebuilders, credit card companies and retailers been overly conservative for the last ten years? If there was ever a time to be overly conservative, it is now.

It is also nice to know Treasury wants accuracy and better disclosure, but then twists the arm of the Financial Accounting Standards Board to relax mark-to-market rules, so banks can continue to lie about the value of "assets" on their books. They allow Goldman Sachs to bury the fact that they left December out of their financial results deep in their footnotes. Shockingly, Goldman lost $1.5 billion in December. They continue to allow banks to report one time gains as part of ongoing operations, but billions in losses that are recorded quarter after quarter are not from ongoing operations. The folks at CNBC report whatever the banks say, no questions asked.

Stress-Test Sham

This brings us to the stress tests for the 19 biggest banks in the land. The most stressful conditions are supposed to be 10% unemployment and a 20% further fall in home prices. That doesn't sound too stressful to me. Considering the government reported figures are a manipulated lie, we already have unemployment between 15% and 20% in the real world. A 20% further decline in home prices is a given. The Case Shiller futures index forecasts that the New York Metro area will fall by 31% by the end of 2010. The massive overhang of housing inventory, the coming onslaught of mortgage resets in 2010, and the millions of foreclosures in the pipeline guarantee at least 20% further downside in housing prices. I have a feeling these 19 banks are going to need to study a little harder for their test. Professor Geithner is giving them an open book take home exam and gave them the answers. They will still flunk.

William Black is a former senior bank regulator. He is currently an associate professor of economics and law at the University of Missouri. Mr. Black held a variety of senior regulatory positions during the S&L crisis. He managed investigations with teams of examiners reporting to him, redesigned how exams were conducted, and trained examiners. He calls the stress tests conducted on the 19 biggest banks in the country a complete sham. In his own words:

- "You can't conduct a meaningful stress test without reviewing (sampling) the underlying loan files and it seems likely that the purchasers of securitized instruments (not just mortgages) do not even have the loan file data. Moreover, loss ratios vary enormously depending on the issuer, so even a bank that originates (or has purchased a bank that originates) similar product cannot simply take its own loss rate and extrapolate it to the measure the risk on the value of securitized credit instruments.

- "It is vastly more difficult to examine a bank that is engaged in accounting control fraud. You can't rely on the bank's books and records. It doesn't simply take more, far more [employees]. It takes examiners with experience, care, courage, and investigative instincts and abilities. Very few folks earning $60,000 are willing to get in the face of the CEO and CFO making $25 million annually and tell them that they are running a fraudulent bank and they are liars. FYI, this is one of the reasons why having "resident examiners" never works.

- "Examiners certainly can't do the stress testing that Geithner describes or evaluate the reliability of a large bank's proprietary stress test. If they were serious about constructing reliable stress tests, which they aren't, you'd require their analytics to be made public. You'd have the industry fund independent investigations by rocket scientists chosen by a committee selected by the regulators of the soundness of the analytics. You'd also have the industry fund competitions to rip them apart (a bit like we hire legit hackers to test security by trying to defeat it) and show where they produce absurd results. The concept that there are 100 examiners with these skills, suddenly freed up from all other duties, assigned to CONDUCT stress tests is a lie."

On Thursday, we will see how much transparency and disclosure the Treasury and Fed will provide regarding the not-so-stressful tests. Obama's minions have been hinting that six banks have failed. Sheila Baer stated that the $110 billion left in the TARP kitty should be enough to cover the capital shortfalls. This is a lie.

As we saw previously, the U.S. banking system will need close to $1 trillion more capital to stay viable. If the Fed was so keen on disclosure and transparency, why hasn't it released the names of the banks that have borrowed from them, and the collateral provided for the loans? Because the Fed has taken worthless toxic paper onto their books and loaned newly printed dollars against the worthless paper. The taxpayers are on the hook.

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