TURMOIL & STRESS CONTINUE

by Steve Brown

Later this week, federal regulators are expected to release the results of "stress tests" on the 19 largest banks in the country. The results aren't even out and already, financial guru Warren Buffett is criticizing the effort for failing to account for strengths in "very different business models" between banks. He went on to say those different business models provide the backdrop that gives him confidence to buy even more stock in the banks already in his portfolio.

Buffet also said that the Gov't was in "an awkward position," when it came to releasing the results and that he had no idea how stress test disclosures might be handled or how the Gov't would differentiate among vastly different models. We have to agree with Mr. Buffett because he has made buckets of money over time and because we also wonder how any test the Gov't presided over could handle the complexity of these banks. Expectations among industry executives for the release are tepid at best, with some industry stalwarts such as Wells Fargo's Chairman, Richard Kovacevich, even calling them "asinine."

Regardless of how this group of 19 "stress tested" behemoths comes out, we venture to say the results will be challenged for some time to come, because they will probably be wide the mark by about the size of the Grand Canyon. Don't get us wrong, as we love financial models (because they are unemotional), but in this market, with so many unknowns, using sound fundamental risk management practices is much better than a whole lot of G.I.G.O. (garbage in, garbage out). After all, when was the last time your executive team believed anything the ALM model spit out over the past 6 quarters or the accuracy of pricing on the securities portfolio in the past 10 minutes? When things fluctuate wildly, business models are tested, some prevail, some don't and Black Swans may tend to appear on the financial pond.

We don't know about you, but when FOMC Chair Bernanke said the US Gov't was tackling "a financial crisis of historic dimension" back in late 2008, we battened down the hatches even further to weather the storm.

Now we are all faced with the stresses of the stress testing process. Banking regulators have already delayed the results until May 7 because it appears some of these 19 large banks reportedly disagreed with regulators over the results. This is to be expected, because even if the assumptions and model are accurate and even if the complexities can be taken into account, you still have to answer the question - "now what?" The problem with doing it this way is that not only does it do nothing to differentiate business models between banks (try to find just 2 banks that operate the same way in this country), but it only serves to duel the public's anxiety level and push it toward DEFCON Level 1.

The idea of the "stress test" for these 19 largest financial institutions (created by the Treasury to evaluate whether these banks could withstand increasing economic pressures and credit deterioration) was a noble idea, but without context and greater understanding, it has become meaningless.

As we have said in this publication for many, many years, there is no substitute for prudent risk management over the long-term. Here at PCBB, for example, we stress test monthly, take proactive steps to diversify risk, maintain a "super-capitalized" position, ensure extremely high levels of liquidity and maintain slow and safe loan growth to support community bank needs the nation over. We know that in times of such "stress," community bankers rely on us more than ever for cash management solutions, Federal funds, international, consulting and other services and we take our responsibility to support you seriously.

We chose to stress test our credit, liquidity, interest rates, capital and other factors long before the current events arrived. This allowed us to manage around and through the rising risk, rather than being overwhelmed and consumed by it. Modeling and measuring after the fact just assigns you a position in line for being closed. Those that don't learn the lessons of history are doomed to repeat them and those that do learn, survive and thrive no matter the scenario.

As we said on Friday in this publication, if you are a banker that is passionate about the industry, we invite you to find out why 1,000 community banks have already chosen us as their trusted correspondent banking and capital markets partner.

BANK NEWS

Closed

Regulators closed 3 banks on Friday. Silverton Bank ($4.1B, GA) was transferred into an FDIC created, owned and operated "bridge bank (called "Silverton Bridge Bank"). While it is business as usual for most product lines, the bridge bank will be supported by the FDIC/OCC and will serve to wind down operations in a timely manner. Approximately 550 banks are affected that were customers of the former bankers' bank. America West Bank ($299mm, UT) failed and will be assumed by Cache Valley Bank ($201mm, UT). Cache Valley agreed to purchase deposits and about $11mm in assets. Citizens Community Bank ($45.1mm, NJ) failed Friday with North Jersey Community Bank ($378mm, NJ) assuming all deposits for a 0.67% premium and purchasing an additional $11.5mm in assets. The last bank shutdown in the state occurred in '04.