A Whale of a Giant Quack to You

by Steve Brown

An art installation by a Dutch artist is slowly making its way around the world as it has since 2007. It is called the Rubber Duck Project and it consists of an enormous, four story tall rubber duck. The duck has graced the waterways of Hong Kong, Sydney and Amsterdam and it can currently be found floating benignly in the Pittsburgh harbor. Its artist has said that he believes the duck has healing powers. We think there could be something to that since it certainly brings a smile to one's face, which has been known to heal.

Similarly, there are a number of very large banks in the US, with branches sitting benignly on corners almost everywhere. These enormous banks have only grown larger since the collapse of Lehman, the implosion of AIG and the folding of the major US investment houses into super-sized bank holding companies. According to Bloomberg, the six biggest banks in the US have increased combined assets by 28% since 2007.

The biggest banks have been prodded by regulators to cut risk and raise capital in order to survive the next hiccup. As such, the amount of capital at the 6 largest US banks has almost doubled since 2008, but is it enough? By most measures, we would have to say probably not. While the banking system may have more safeguards, many still see a system that is too complicated and interconnected. Insufficient capital at these big banks leaves little margin for error and the interconnected system also means large failures could still have catastrophic consequences.

Problems still abound these many years after the crisis, despite the measures already implemented. Even an interagency group designed to allow regulators to work together to oversee the system remains in process. As the six regulators struggle with overlapping authority, we wonder if even today the country is yet equipped to act should the need to unwind a big bank arise.

Still, there remains little transparency in some dark pools and areas of the arcane, murky and far reaching marketplace. In fact, the latest analysis finds that not even half of Dodd Frank has been completed, so more work is required.

As far as progress along the way, regulators have been able to double the amount of high quality capital held by the biggest banks and subjected them to stress tests. This has resulted in less leverage in the system overall and increased equity cushions in the event of another major problem somewhere further out in the pond. Lower rates and Fed actions have also flooded the system with liquidity and customer deposits have increased as wholesale funding has declined sharply.

Now, with rates set to rise in the next 12 to 36 months (and depending on whom you believe), we wonder which feathers will be ruffled as this great experiment is unwound slowly but surely and we eventually return to normal. Can such large interconnected banks really ever be allowed to fail, or are they simply too big for that to ever happen? We know that is what everyone wants and it sure sounds good when you think about the financial system and its viability, but we wonder if it looks like a duck and quacks like a duck, it probably is still a duck.

It certainly feels like the biggest banks have ducked many of the very measures intended to make the industry safer as community banks struggle with the legacy these whales created prior to and following the crisis.

BANK NEWS

Job Cuts

OmniAmerican Bank ($1.3B, TX) will cut 8% of its work force, eliminate the position of chief operating officer and discontinue the purchase of auto loans originated through auto dealerships.

ATM Expansion

Fifth Third Bank said it will install 169 ATMs at RaceTrac Petroleum Inc. convenience stores throughout FL and another 74 ATMs at stores in GA.

Rate View

Bloomberg reports Federal Reserve forecasters now expect a struggling economy will keep the Fed funds rate below 2% at least through 2016, tapering is likely to begin this year and end in mid-2014 and significant risks to the outlook remain (including fallout from fiscal wrangling and higher interest rates).

Stress Testing

A Deloitte Global risk management survey finds the most common ways institutions use stress tests is to understand the risk profile of the organization (86%), report to senior management (85%), report to the board (85%), assess adequacy of regulatory capital (85%), for regulatory inquiries (84%), to define or develop risk appetite (73%), strategy or business planning (68%) and assessing concentrations and setting limits (67%).

More Capital

The IMF reports banks in Spain, Italy and Portugal face $339B in potential losses on their business loans over the next 2Ys (about 20% of all corporate loans at risk of default).

Insight

Bankers looking to improve their equity valuations can look no further than recent credit ratings comments by Fitch on a number of regional banks. They focused upgrades on banks that had solid liquidity profiles, sound capital positions, improving asset quality, stable asset quality, a strong tangible capital base and a strong earnings profile.

Always On

The Mobile Marketing Association reports 91% of Americans have their smartphone or other mobile device within reach at all times.