

Institutional Risk Analytics

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Contact: Chris Whalen (chris@rcwhalen.com) or (914) 827-9272.

IRA RELEASES Q4 BANK STRESS RATINGS FOR ALL US BANKS

IRA has released its Banking Industry Stress Ratings for all US banks as of Q4 2008 for users of the professional and consumer versions of The IRA Bank Monitor. In Q4 2008, average industry stress rose 15% to 1.77 vs. Q3 2008. The Stress Index is now 77% above the benchmark for all US depository institutions (1=1995).

Below is (1) a table showing the distribution for Stress Index ratings calculated by IRA for the US banking industry since Q1 2006, (2) the chart from our home page showing industry stress for the entire industry, and (3) a summary of the stress results for Citigroup, Bank of America, Wells Fargo and JPMorgan Chase. We shall be publishing a new commentary in [The Institutional Risk Analyst](#) later today on same.

Final note on the large bank ratings below. As we told the nice lady from C before our [shot Friday AM on CNBC](#), we don't enjoy describing the travails of dying money center banks. Printing the Q4 profile for C feels like putting down the family dog. But our first duty is to tell our clients how we see the industry. Our ratings process is conducted entirely by computer and treats the smallest and largest players consistently and transparently. Good or bad, every bank in the US knows how we rate them and why. And a growing number proudly display the "A" rating from IRA on their web sites.

What we do love is talking about and making a fuss over good banks. In that regard, we'll be featuring a bunch of same in coming weeks, starting with a conversation with Ken Joyce, President and CEO of Rurban Financial Corp (NASDAQ:RBNF) in a future issue of *The Institutional Risk Analyst*. BTW, RBNF was rated "A+" as of Q4 2008. See profile for RBNF attached to get definitions for the concepts we discuss below.

IRA Bank Stress Index Distribution – 2006-2008

Below is a table showing the distribution of letter ratings for all US bank units as of year-end 2008. Notice the way in which the banking industry has shifted from a skew in favor of "A+" rated bank units at the start of 2006 – those with stress levels below the 1995 benchmark in the Stress Index – to a situation today where the number of "A+" rated banks has been cut in half and over 2,000 bank units now are rated "F".

Lord, Whalen LLC
371 Van Ness Way, Suite 110
Torrance, CA 90501
Phone: 310-676-3300 Fax: 310-943-1570

Being rated “D” or “F” does not mean that the institution will fail, but it does mean that the bank’s current performance in Q4 2008 was far above the industry’s elevated stress levels and thus the bank gets a poor grade for this period. Indeed, in many cases institutions with relatively high levels of stress could be excellent value for investors. Users of the consumer and professional version of [The IRA Bank Monitor](#) can view ratings and profiles for all US depository institutions.

Notice too the large cluster of institutions in the “F” category compared with the 2006 period. In many cases, the Stress Index factor driving these poor scores is a sharply negative return on equity (ROE), which in turn is almost always driven by a) mark-to-market write-downs against income and b) increases in provisions, in that order of importance. If you want a visible description of the damage caused by the return to mark-to-market accounting, look no farther than the US banking industry.

**IRA Bank Stress Index
Grade Distribution – 2006-2008
(FDIC insured units)**

Period	A+	A	B	C	D	F
2008-12	3,918	1,705	119	390	98	2,003
2008-09	4,498	1,325	283	356	63	1,793
2008-06	4,884	1,248	404	326	66	1,458
2008-03	5,167	1,042	578	334	68	1,233
2007-12	5,556	610	884	315	70	1,029
2007-09	5,931	395	950	274	37	902
2007-06	6,056	354	972	273	60	824
2007-03	6,075	304	1,057	284	63	795
2006-12	6,370	134	1,165	204	39	697
2006-09	6,666	29	1,108	198	44	628
2006-06	6,729	0	1,155	194	35	613
2006-03	6,752	2	1,131	187	39	608

Source: FDIC/The IRA Bank Monitor

Note to Users: By automating these public data analytical displays for our users, we let them focus time and resources on the third leg of the risk analysis, namely privileged data exchange, channel checks and investigation. And the ratings distribution matrix above is part of the family of automated widgets created for members of IRA’s [Affiliate Program](#).

Being able to tell the zombies from the merely wounded institutions is one reason why we not only look at a bank’s current Stress Index rating, but we also look at the Economic Capital for that institution to develop a second perspective on the bank’s risk profile, which helps better support a safety and soundness assessment.

The IRA Bank Monitor Economic Capital model represents a highly stressed scenario where a Maximum Possible Loss is calculated for lending, trading and investing activities. The sum of these values is equal to Economic Capital. Notice the discussion of Economic Capital in the RFBN profile, including the very low ratio of Economic Capital to Tier1 Risk Based Capital or 0.388:1, like most smaller banks in the system. The same measures for Citigroup and JPMorgan Chase are over 4:1, as discussed below.

Below is the aggregate stress index for the entire US banking industry representing all of the institutions described above. Remember 1995 = 1 and the maximum Index value is 100, which is two orders of magnitude above the 1995 baseline.

4rd Quarter Bank Stress Update
Average Bank Industry Stress Rose to 1.77
Up 15.7% from 3Q2008.



Source: FDIC/The IRA Bank Monitor

There is a description of the [IRA Banking Industry Stress Index](#) on our home page. In the example attached for RBNF, you will see the different index components described along with the bank's aggregate rating.

The bottom line on the table and the graph above is that the banking industry is skewing upward in terms of rising loss rates to the same degree that loss rates and risk indicators skewed down toward 0 during the housing market boom and related financial foolishness. We continue to project an average loss rate experience for the industry of 2x 1990 levels, which equates to average charge-offs near 4%. That said, there remains a growing disparity between the large institutions that are the outliers of the group in terms

of Stress Index and Economic Capital measures and the thousands of smaller institutions in the industry that display far lower levels of stress and higher levels of tier-one capital, etc. than their large bank peers.

Remember, as we shall discuss in the next issue of *The Institutional Risk Analyst*, the FDIC data for Q4 understates the losses to the industry to date because Washington Mutual is virtually absent from the results. And was that risk weighted assets we saw C using in its press release after the conversion of government and private preferred into common?

Below is a summary of the IRA Banking Industry Stress Index values and associated letter ratings, as well as the current ratio of Economic Capital to Tier 1 Risk Based Capital¹ for Citigroup, Bank of America, Wells Fargo and JPMorgan Chase. Remember these are “bank only” rollups that focus on the FDIC insured bank subsidiaries of each bank holding company.

Large Bank Stress Index & Economic Capital Measures

	Q4 2008 Stress Index Value	Q4 Stress Index Letter Rating	Q3 2008 Stress Index Value	Q3 Stress Index Letter Rating	EC to Tier 1 RBC (12/31/08)	Efficiency Ratio (%) (12/31/08)
JPM	1.3	A	1.27	A	4.5:1	52.76
BAC	1.61	A	1.44	A	1.9:1	44.92
C	21.54	F	9.35	D	4.59	71.82
WFC	1.47	A	1.26	A	2.1	52.44
Industry Benchmark	1.8	NA	1.5	NA	1.24	61.02

Source: FDIC/The IRA Bank Monitor

Comments on the results:

JPM: The Stress Index results from JPM continue to be the best among the top-four banks, although the organization is slightly above industry stress sub-indices for defaults and capital. JPM’s ratio of EC to Tier 1 RBC is up slightly from Q3. But the difference, IOHO, is the 20 point advantage in terms of operating efficiency between JPM and C.

¹ Tier 1 RBC excludes about 2/3 of the intangibles from a typical large bank but is not nearly as harsh a measure as “tangible common equity” or TCE, which is common equity less all intangibles. The leverage ratio numbers in The IRA Bank Monitor, on the other hand, are far closer to TCE in terms of excluding intangibles and affecting assets used in the calculation of capital adequacy. That said, since most large banks have roughly similar proportions of intangibles to total assets, the EC/T1RBC ratios remain valid to illustrate the order of magnitude difference between different bank business models.

And remember, that JPM sold their RMBS business to GMAC, GE et al. (LOL) and paid pennies on the dollar for WaMu. We like Jaime Dimon and JPM more and more, but problems still lie ahead.

BAC: With the second highest stress level in the top four after C, BAC is in the unenviable position of being number two on our list of banks likely to be resolved during 2009. While the lead unit has a Stress Index score of 1.4, the score for FIA Card Services (FKA MBIA) at 4.0 drags up the stress score for the aggregate BAC bank rollup. Only time will tell whether the accumulated financial and legal issues due to the Countrywide and Merrill transactions force BAC to go back to the government for more capital.

C: With a Stress Index Score of 21.5, the aggregate scores for the subsidiaries of C are more than an order of magnitude above the industry average stress levels. The score is driven primarily by negative ROE, which maxed out at 100 on the ROE sub-index in Q4 2008. Sub-index scores for defaults at 4.0 and capital at 1.5 (vs. 2.2 and 1.0 for the industry, respectively) also contribute to the high score for C. Perhaps most telling, however, is the aggregate bank unit efficiency ratio calculated by the FDIC, now above 70%, a measure of the cost effectiveness of the subsidiary banks.

WFC: Now reflecting the acquisition of Wachovia, WFC's 20 FDIC insured units are showing a significantly higher level of stress than before that transaction. That said, the aggregate bank only profile for WFC at Q4 2008 is above industry stress levels only with respect to capital at 1.3 vs. the 1.0 industry benchmark. The consolidated, bank-only WFC profile is not a thing of beauty, however. Lending returns have fallen sharply and the ratio of Economic Capital to T1 RBC is now above 2:1 vs. 1.4:1 in Q3 2008. Indeed, comparing the pre- and post-Wachovia profiles for WFC is a sobering exercise. Stay tuned.

Final Note: Even though the stress in the US banking sector is rising due to ROE degradation and charge-offs, stress levels in terms of capital adequacy at 1.0 at year end 2008 remain very low, again reflecting the conservative business models of the smaller banks in the system. All now depends on how fast or even whether the public sector spending being dumped into the economy by Washington affects the loss rate experience of financial institutions during 2009.

Our judgment is that the decrease in spending and concomitant increase in savings by consumers remains far ahead of public stimulus efforts, thus loss rates are likely to remain on trend for a 2x 1990 loss rate peak during 2009. But remember that as much as two thirds of the overall losses to the financial industry this year could be concentrated in the top-four institutions. That is the good news. LOL