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# Stress this: Some banks are weak

**The fact that the government will release results of the bank stress tests is good news.**
**It's about time regulators abandoned the notion that all banks are equal.**

By Paul R. La Monica

NEW YORK (CNNMoney.com) -- It looks like Washington is finally giving up on the silly idea that all banks are in the same boat. It's about time.

The Obama administration confirmed Wednesday that the government will release some of the results of the stress tests currently being conducted on 19 big banks. The results of those tests will determine how much, if any, new funding banks will need in order to survive a longer recession.

It is widely expected that none of the banks will actually fail the test. But that doesn't mean everyone is going to pass with flying colors, either.

Some will likely be given poorer grades than their rivals, which could mean that they will be forced to raise more capital.

And the banks that don't fare as well in the stress test could get punished by investors. But if that happens, so be it. It's not the job of the Treasury or FDIC to prevent investors from selling off shares of banks that have poor fundamentals.

The Treasury Department already tried to keep investors from panicking, and that failed miserably. When former Treasury Secretary Henry Paulson unveiled the Troubled Asset Relief Program, or TARP, last October, nine top banks "participated" in the first round of funding.

But some of those banks, most notably JPMorgan Chase (JPM, Fortune 500) and Wells Fargo (WFC, Fortune 500), reportedly objected to the idea that they needed government funding.

Nonetheless, those banks were force-fed TARP money so that Paulson could spin TARP as a program that "healthy institutions" would use to "build capital to increase the flow of financing to U.S. businesses and consumers."

It seems Paulson feared shares of problem banks would be crushed if the Treasury Department positioned TARP as funding only for troubled banks.

But that's exactly what happened anyway. From the time that Paulson first unveiled the TARP last October up until the market hitting its low point in early March, the banks in most dire need of capital lost much of their market value. Shares of Citigroup (C, Fortune 500) and Bank of America (BAC, Fortune 500), which both required further injections from TARP after their initial round in October, each plummeted about 90%.

But there was also little differentiation between the strong and the weak. Shares of Wells Fargo, which last week preannounced a better-than-expected profit, dropped 75%. JPMorgan Chase, which has remained profitable

Even investment bank Goldman Sachs (GS, Fortune 500), which this week posted stronger than anticipated results and announced its intention to pay back the $10 billion in TARP funds it received last year, fell about 40%.

Still, there were rumblings earlier this week that the Treasury was worried about Goldman's plan to return its TARP money because investors may wonder why other banks weren't ready to do the same.

That just smacked of Orwellian doublespeak. It's not good to show signs of strength because it makes the weak look bad!

Fortunately, it seems that Treasury has reconsidered its stance. And it probably had no choice now that the better positioned financial firms intend to force the Treasury to recognize that there are good banks and bad banks. Goldman and Wells seem hell bent on doing everything they can to distance themselves from some of their more troubled peers.

Insurer MetLife is doing the same thing. MetLife (MET, Fortune 500) confirmed Monday that it is one of the 19 firms undergoing a stress test. That's because it has a bank holding company that it set up in 2001 that has more than $100 billion in assets. But MetLife added that it decided to not apply for any TARP funds, citing its "strong balance sheet."

Expect JPMorgan Chase to tout similar strength when it reports its results Thursday morning. And that's all good. **"The men are being separated from the boys," said Daniel Alpert, managing director of Westwood Capital, an investment bank in New York. "Clearly, Treasury now believes that the strong banks, the survivors, will find demand for new money and will be able to raise it privately."**

Separating the wheat from the chaff Of course, this is not to say that the entire banking sector is out of the woods. Goldman executives are rightfully cautious about the fragile state of the economy. And some analysts have very legitimate concerns about how low Wells Fargo's reserves for future loan losses are.

Still, these two appear to be much better off than some of their peers. Credit card lender and regional bank Capital One (COF, Fortune 500) disclosed Wednesday that its net charge-offs for U.S. credit cards hit 9.3% in March. That's a bad sign since the general rule of thumb in the card industry is that default rates tend to match the national unemployment rate. The unemployment rate was 8.5% in March.

What's more, Capital One's charge-offs were up from 8.06% in February. That's an alarming one month spike and can't be good news for other banks with big credit card exposure.

Credit cards aren't the only problem, either. Many regional banks are still reeling from the collapse in housing prices and the corresponding rise in mortgage defaults and foreclosures. KeyCorp (KEY, Fortune 500), SunTrust (STI, Fortune 500), Fifth Third (FITB, Fortune 500) and Regions Financial (RF, Fortune 500) are all expected to lose money in 2009.

Jason Tyler, senior vice president and director of research operations with Ariel Capital Management in Chicago, also worries that some unhealthy banks may now rush to pay back TARP funds because they don't want to be thought of as weak.

He said some banks, such as Chicago-based Northern Trust (NTRS, Fortune 500), in which his firm owns shares, are profitable enough to pay back TARP. But many banks may still need the money.

Still, Tyler conceded that it makes sense for the Treasury Department to give more details. Otherwise, the market will merely speculate about who's strong and who's weak.

"It's better for the government to be transparent about the stress tests because the reality is that rumors would start flying regardless," he said.

And the quicker that everyone realizes that not all banks are doomed, the better.

"Some of the healthier banks that took TARP money that didn't need to were frustrated that a lot of weaker banks got TARP money,"said Blake Howells, director of equity research for Becker Capital Management in Portland, Ore. "They felt that everyone was getting it and that they were being bunched in with weaker banks."

Howells pointed to one of the banks his firm owns, TCF Financial (TCB) in Minneapolis, as an example of a company that decided to pay back TARP for this very reason.

Last month, TCF CEO Willam Cooper wrote that the bank intended to return $361.2 million in TARP funds because "public perception views those banks that took the TARP money as having done so out of weakness and a need to survive."

Other banks that are willing and able to pay back TARP money should be allowed to follow the lead of Goldman, TCF and several other smaller banks that have already returned funds to the Treasury. It's time to recognize that the banking industry has real winners and losers instead of shielding the losers from that fact.