VERIBANC®, Inc.

The B.E.S.T. Banking Investment

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THE B.E.S.T. BANKING INVESTMENT

(Balanced, Effective, Seasoned, Transparent)

When is a bank - Too Big?

Two objective measures, Return on Assets, and Safety and Soundness, help determine the answer.

To establish context, a widely held view bears attention: "Mega Banks", those with assets over $100 billion, enjoy a special consideration by regulators. "They are too big to fail." Outright failure would be too costly to the banking industry and to the Bank Insurance Fund. Should the smallest Mega Bank fail it would deplete the Bank Insurance Fund.

An example seems to confirm the too-big-to-fail position. Line items from the December 31, 2004 Call Report of SunTrust Bank, Atlanta, GA, show total deposits less uninsured deposits equal $68 billion. According to the FDIC, as of December 31, 2004, the Bank Insurance Fund's ending balance is $34.8 billion.

Turning to Return on Assets (ROA), over the past five years show that the Mega Banks do not compare well to the Very Large Regionals (assets of $50 - $100 billion), the Large Regionals ($10 - $50 billion), or the Large Community Banks ($1 - $10 billion). The Mega Banks' ROAs fall between the Medium Size Community Banks ($500 million - $1 billion) and the Small Size Community Banks ($100 - $500 million).

Click Here for the supporting ROA chart.

One measure of safety and soundness, as well as insight into management's ability to underwrite loans and contracts, is the ratio of problem loans† to assets. In the most recent four quarters Mega Banks have outperformed most other Asset Groups.

Presumably, Mega Banks have an advantage in diversification and sophistication. However, the data over the last five years does not support this popular notion. While all Asset Groups experienced a cycle in the problem-loans-to-assets ratio, Mega Banks lead in volatility. From the current low of 0.42 percent to a high of 1.08 percent, Mega Banks averaged 0.78 percent over the five years. The differences, 0.30 percent from the high to the average, and 0.36 percent from the average to the low, are the largest swings among the Asset Groups.

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Interestingly, the Very Large Regionals are near the bottom of the Asset Groups, in terms of the volatility of their problem-loans-to-assets ratios.

Further study would be needed to determine if the volatility at the Mega Banks is due to a greater sensitivity for risk management strategies, modifications to these strategies, the inability for effective implementation of risk management strategies, or some other set of dynamics.

Click Here for the supporting Problem Loans chart.

† Problem Loans include all loans and contracts that are 90 days or more past due, nonacrrual, and renegotiated and restructured.

Arguments for banks to create Mega mergers, thereby allowing them to leverage economy of scale, are not supported by the cited data. The additional risk with mediocre underwriting results, does not agree with claims that diversification and sophistication are a prudent rationale for Mega Bank mergers or acquisitions. To the contrary, Mega Banks' increased risk potential argues against mergers and acquisitions.

Our approach to analyzing the data leads us to echo and support the conclusions of William M. Isaac, former chairman of the FDIC and John D. Hawke, Jr., former Comptroller of the Currency: further thought should go into the Basel II process.

We purposely restricted this analysis, not considering other metrics such as derivative portfolio risk or legal risk, so we could focus on widely accepted measures.

Our findings show that the Mega Banks have poor returns on assets as compared with other Asset Groups. We are concerned about the Mega Banks' loan loss volatility. We question whether any return to Mega Bank investors is worth the imbedded risk to the taxpayer and the economy.

Are banks over $100 billion worth the risk?