



The biggest banks continue to get bigger. During the past three years encompassing the financial crisis, Bank of America, JPMorgan Chase and Wells Fargo increased their combined share of U.S. deposits from 21% to 33%, with much of the growth coming via acquisitions (Countrywide, Washington Mutual and Wachovia). These same three firms accounted for 57% of all residential mortgage loans during the first three months of 2010. Can these firms be too big? How big is too big?

Along with many others, these firms were labeled 'Too Big to Fail (TBTF)' during the crisis. Pundits attach labels such as Too Big to Succeed or Too Connected to Fail, but the reality is that TBTF firms operate under an implicit government guarantee. This guarantee enables them to borrow at lower rates relative to non-TBTF firms and encourages management to take risks knowing that someone else will have to bear the costs in the event of failure. The Dodd-Frank bill contains provisions designed to eliminate TBTF, primarily the 'orderly resolution' authority. Sheila Bair, FDIC Chairman, made the following comments regarding the bill: "the new law will give the FDIC broad authority to use receivership powers, similar to those used for insured banks, to close and liquidate systemic firms in an orderly manner." "it will give regulators the tools to contain the fallout ... so that we will never have to resort to a taxpayer bailout again." Clearly, the FDIC has broad discretion in how to deal with creditors and shareholders of TBTF firms. Would the FDIC have treated Lehman Brothers differently as opposed to its bankruptcy filing? How would it have treated shareholders and creditors of Bear Stearns and Merrill Lynch? Given the historically cozy relationship between government officials and senior management of TBTF firms, why not formally mitigate the conflicts by having a well-designed, publicly-known, rules-based process under Chapter 11 bankruptcy? Some of the rules might include 1) directors and senior managers of failed firms lose their positions; 2) shareholders lose their investment; and 3) unsecured creditors take losses. As it stands, TBTF still means 'never having to say you're sorry.'

Breaking News

- **Second quarter earnings for Goldman Sachs fell short of consensus expectations, Bank of New York just met earnings expectations and State Street exceeded expectations.**
- **2-year and 10-year Treasury rates fell to 0.565% and 2.90%, respectively, before rising Tuesday. The 15-year and 30-year conventional fixed mortgage rates were 4.20% and 4.77%, respectively.**
- **A spokesman for Chrysler Financial indicated that the firm may soon return to making large loans to consumers and automobile dealers. The firm holds \$26 billion in loans, but has made less than \$100 million in loans this year.**
- **In 2008, per capita income for residents of the city of Bell, CA was \$24,800. At a city council meeting yesterday, residents protested the compensation of key city officials demanding an investigation. Last week, the L.A. Times reported that the salaries of the chief administrative office and police chief were \$787,637 and \$457,000, respectively.**

Part-time council members earn \$100,000 for their efforts. The city has sold \$50 million in general obligation bonds since 2005 to where per capita debt now totals \$1,972.

Economic News

The U.S. economy is highly dependent on the consumer, whose spending is highly dependent on employment. The Labor Department's report on June unemployment by state demonstrates that some parts of the country are doing quite well, while others struggle. Consider the following unemployment rates for select states. North Dakota, South Dakota and Nebraska lead the U.S. with unemployment under 5%, while Nevada, Michigan, California and Rhode Island have rates above 12%.

North Dakota	3.6%	Montana	7.3%
South Dakota	4.5%	Colorado	8.0%
Nebraska	4.8%	Texas	8.2%
Kansas	6.5%	New Mexico	8.2%
Iowa	6.8%	Missouri	9.1%
Oklahoma	6.8%	Arizona	9.6%
Wyoming	6.8%	California	12.3%
Minnesota	6.8%	Nevada	14.2%

States with the lowest unemployment did not experience the boom in real estate values during 2004-2006 associated with the use of non-traditional mortgage products and real estate speculation. Their economies are based heavily on agriculture and energy. Their economies and community banks subsequently suffered less, on average, with the onset of the financial crisis.

Deal of the Day

In its boom days, Countrywide ran a VIP program which occasionally offered preferential terms to select mortgage borrowers. Representative Darrell Issa, a member of the House Oversight and Government Reform Committee, recently disclosed that 30 senators or staff members, including Chris Dodd (Connecticut) and Kent Conrad (North Dakota), received mortgages with terms more favorable than terms available to the general public. In addition, 153 Fannie Mae employees and 20 Freddie Mac employees received preferential mortgages. Included on these later lists are three former CEOs of Fannie Mae, James Johnson, Franklin Raines and Daniel Mudd, whose annual compensation packages totaled \$10 million to \$21 million. Representative Issa stated that Countrywide appeared to use the program to "curry favor" by handing out these benefits.

Upcoming Events

- Existing home sales are reported on Thursday.
- Treasury auctions 2-year, 5-year and 7-year notes on Thursday. Thus far in 2010, investors bidding directly in note and bond auctions have purchased 57% of the almost \$1.3 trillion in Treasury debt sold. These direct investors are primarily foreign central banks and mutual funds.
- The Senate Judiciary Committee voted 13 to 6 to approve the nomination of Elena Kagan as a Supreme Court justice. The full senate will vote during the week of August 2.