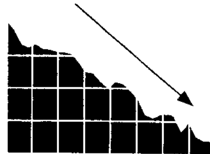
Regulation

Risky Businesses

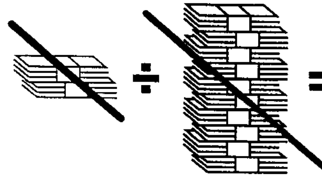
Congress last year ordered U.S. bank regulators to figure out which financial companies are the riskiest and then turn the list over to the Federal Reserve so they can be supervised more closely. The Fed, the Treasury Dept., and nine other regulators on the Financial Stability Oversight Council this spring will reveal the criteria they plan to use to decide which financial companies to tag as systemically risky; the companies will be named later this year. Economists at New York University's Stern School of Business have derived their own list, based on a model that one of them, Nobel Prize winner Robert Engle, helped develop. The model starts with a financial firm's stock price as a proxy for its capital–the money it has to make loans, buy bonds, or absorb losses. They then subject each company to a stress test, in which the stock market declines 40 percent, to find how much capital a company would need to continue holding the same amount of loans and bonds. One downside to the model: It only works for publicly traded companies, so it won't help regulators decide whether most hedge funds should make the list. —*Craig Torres*

How their formula works:

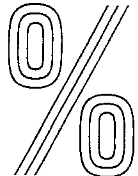
The model defines a "crisis" as a market decline of 40%, which is what happened in 2008-2009



The capital needed by each firm is divided by the $370 billion in capital some of the 100 firms in the model would need in a 40% stock market decline



The percentage contribution of each firm to the total capital shortfall is the Stern Systemic Risk Contribution or "SRISK"



1 Bank of America

SRISK: **25%**

America's biggest bank with $2.3 trillion in total assets.

"Bank of America has made significant progress over the last year" to strengthen its capital and reduce risk, says spokesman Jerry Dubrowski.

2 JPMorgan Chase

SRISK: **12%**

Second-biggest U.S. bank by assets. The NYU model shows its market value would fall almost 5 percent in a stock market decline of at least 2 percent.

3 Morgan Stanley

SRISK: **12%**

The NYU model shows the Wall Street bank is highly leveraged, with about $22 of assets sitting atop every $1 of stock market value.

4 Citigroup

SRISK: **12%**

Third-largest U.S. bank with nearly $2 trillion in assets. The NYU model shows the stock tracks the overall stock market more closely than most financial firms.

5 Goldman Sachs

SRISK: **10%**

The firm cut the size of its trading bets last year. Still, the NYU model shows the stock would lose about 5 percent of its value if the overall market declines at least 2 percent, an indicator of possible erosion of capital.

6 MetLife

SRISK: **6%**

The economists' model shows the insurance company would lose more than 6 percent of market value in a market decline of at least 2 percent.

7 Prudential Financial

SRISK: **6%**

The NYU model shows the company is highly leveraged with $33 of assets for each $1 of stock market value, making its capital vulnerable to shocks.

8 Sallie Mae (SLM)

SRISK: **3%**

The student loan company has the highest leverage in the NYU model with almost $38 dollars of assets for each $1 in stock market value.

Martha Holler, a Sallie Mae spokeswoman, says the model neglects unique factors of the company's business, including that more than 80 percent of its assets are government-guaranteed.

9 Hartford Financial Services

SRISK: **3%**

The company is risky because it is highly leveraged, with $28 dollars of assets for every $1 of stock market value.

10 Wells Fargo

SRISK: **2%**

The fourth-largest U.S. bank with $1.2 trillion in assets scores 10th because the model shows its leverage is low with $9 of assets for every $1 of market value. That means its need for capital in a financial shock may be less severe than others'.

*Spokespersons at every firm except Bank of America and SLM declined to comment.

DATA: NEW YORK UNIVERSITY STERN SCHOOL OF BUSINESS (HTTP://VLAB.STERN.NYU.EDU/ANALYSIS/RISK.USFIN-MR.MES)