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The bank regulators' conspiracy against regional finance

by David Goldman and Kathy Wolfe

"The financial area is probably next to nuclear war; the kind of area that can get out of control, and once out of control cannot be contained and will probably do more to upset the civilized world than about anything you can think of," said William Seidman, the chairman of the Federal Deposit Insurance Corporation, March 13.

Seidman and his counterpart at Treasury, Controller of the Currency Robert L. Clarke, are in a race against time. Mexico's impending bankruptcy, the renewed collapse of oil prices, and related debt problems, put a new global banking crisis on the agenda for this year or early 1987. The major banks intend to cushion themselves against a crash by absorbing huge amounts of banking assets from troubled, or not-so-troubled, commercial and savings banks in the regions. The regulators are determined to break the regions' opposition to such takeovers, under the cover of the oil and agriculture shocks, before the major institutions themselves go under.

As we will report below, they are also prepared to abuse the powers of government, threatening regional bankers with fraud prosecution should they fail to cooperate in their own absorption by the money-center banks.

A poignant reminder of what the regulators can do was provided in the recent sentencing of Tennessee banker Jake Butcher, who pleaded guilty to fraud charges in a series of 1983 bank failures. Bankers and industrialists caught up in the Jake Butcher bankruptcy have given *EIR* evidence that White House Chief of Staff Donald Regan and Federal Reserve chairman Paul Volcker are using the Federal Deposit Insurance Corp. (FDIC) to run political witchhunts against competitors and enemies. Watergate involved only a few dirty tricks; "Bankgate" may finish by bankrupting thousands of small banks nationwide.

"The big question every banker wants answered," the London *Financial Times* concluded in its annual banking survey published May 29, "is whether Mr. Bill Seidman and his colleagues are prepared to allow a reasonably sized bank in mid-America to fail? It is the sort of tough medicine that many bankers feel should be given to the patient—along with liberalization of the banking rules. In particular,

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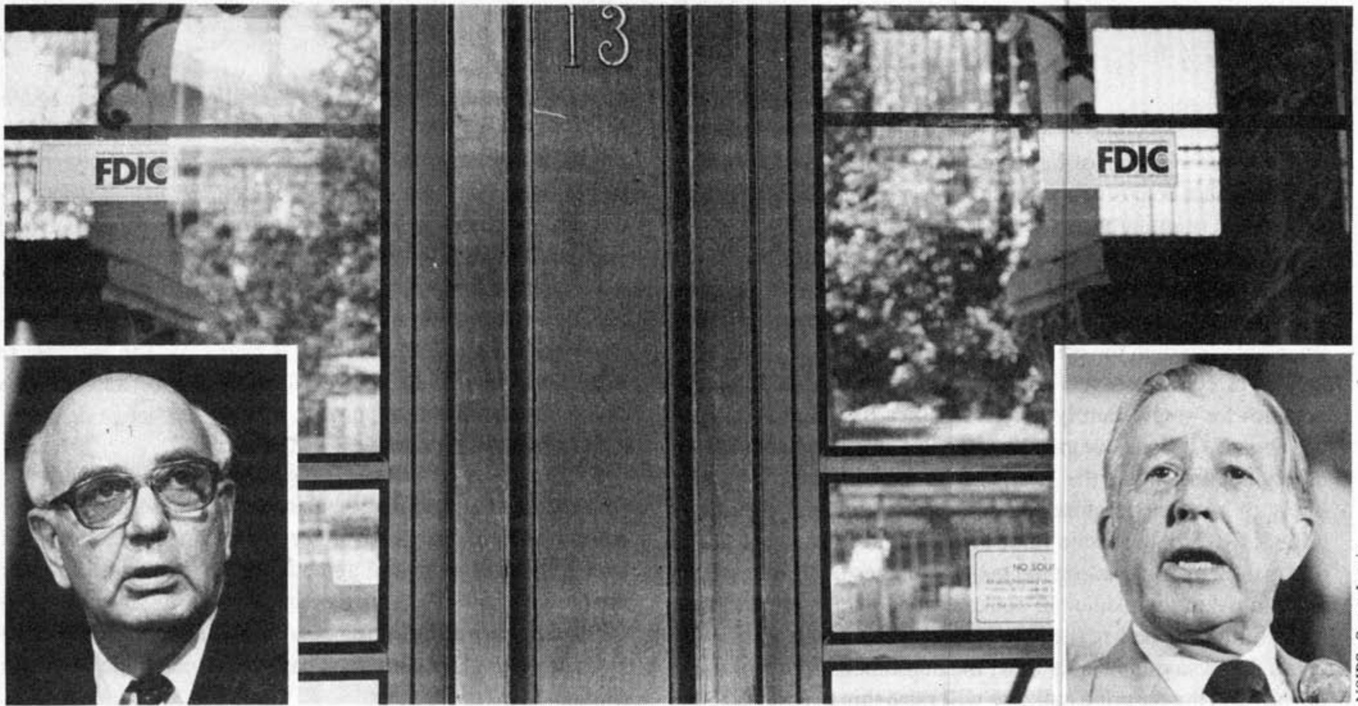

NSIPS: Stuart Lewis

If you thought the FDIC sticker on your bank's door means that your deposits are safe, Fed chairman Paul Volcker (inset left) and White House Chief of Staff Don Regan (right) are among those conspiring to bankrupt regional institutions and turn them over to the New York megabanks.

they argue it would send a signal to the large uninsured depositors who have provided much of the funding for the growth of the more aggressive banks in the region. However, it is also the type of treatment which could have some unexpected side-effects in a U.S. financial system which is marked by increasing volatility. Given this caveat it seems unlikely that the regulators would be prepared to take such a gamble until they are satisfied that they have adequate contingency plans in place."

In fact, such a signal went out in the first week of May, when Houston's billion-dollar Mainland Savings failed, leaving depositors with accounts exceeding the federally guaranteed $100,000 level in the lurch—the first time that either the FDIC or its sister agency, the Federal Savings and Loan Insurance Corporation (FSLIC), have permitted big depositors to suffer losses.

A second signal went out two weeks later, when news media *incorrectly* reported that the Bank of Commerce in Tulsa, Oklahoma, had suffered the biggest (and best-publicized) run since the 1930s. The same *Financial Times* survey revealed, "There was a traffic jam in the center of Tulsa, Oklahoma, as nervous depositors rushed to withdraw their federally-insured deposits from the failing Bank of Commerce." But the signal was less from depositors, than from the regulators themselves: There was no traffic jam, and not so much a run as a small crowd of curious onlookers, who assembled in front of the bank after morning-news radio reports warned of a depositors' stampede against the failing institution. The onlookers did not have much time to watch, since the federal regulators closed the bank a half-hour after its normal 9:00 a.m. opening.

The regulators were the apparent source for the news radio reports of an impending run, and the whole affair resembles an exercise in mass-profiling of popular reactions. Bill Seidman and his colleagues already have the experience of the 1985 freeze on savers' deposit withdrawals from thrift institutions in Ohio and Maryland, where real runs occurred. In Maryland, savers beat down the doors of S&Ls after Federal Reserve chairman Paul Volcker himself warned that the Ohio experience was about to be repeated.

The Regan-Volcker combination has postponed the financial reckoning for the 1,200 national banks on the Controller's "problem list," just as the nation's chief savings-bank regulator, the Federal Home Loan Board Bank (FHLBB), has permitted almost 500 savings and loans to continue to operate in the red. But the administration's economic policy, including the soon-to-be-passed tax reform, creates conditions under which these and many more cannot outlast 1986. The bank regulators and the policy-makers are the same people, and they have positioned themselves to control a banking crisis worse than that of the 1930s.

Matters come to a head

The FDIC tied its full faith and credit to the safety of large commercial banks in the spring of 1983, when it and the Fed offered virtu

tinental Illinois Bank of Chicago, the nation's 20th largest. Continental Illinois had suffered a mass withdrawal of funds from largely overseas depositors, and was on the point of stopping payments, due to its inability to fund short-term

deposits.

Matters have come to a head since then. For a variety of reasons, the collapse of large sections of the U.S. banking system cannot be postponed much longer, perhaps not through the present calendar year:

1) The collapse of the oil price June 6 back to the $12 range, following the misleading rise in prices during the preceding two weeks, has written the death warrant for the financial system in the oil belt;

2) The collapse of real-estate values, including 40% price declines for single-family homes in cities like Houston and Oklahoma City, accompanying the oil price collapse has barely begun.
likely to be signed before the end of the summer, stand to wipe out 40% of the resale value of debt-financed commercial real estate, by eliminating the tax advantages of commercial and multi-family residential construction. There are perhaps $100 billion of bad real-estate loans on the books of commercial and savings banks now; the combined effects of the tax bill and the oil price collapse will raise this to about $250 billion.

3) The unraveling of the Mexican debt in the wake of the renewed collapse of oil prices threatens not only the major international banks, some of whom still have loans to Mexico approaching their total shareholders' capital, but most of all the same Texas banks who are hit worst by the oil-belt real-estate catastrophe.

The federal budget blowout

EIR's current *Quarterly Economic Report* (1st quarter 1986) warns that the combined expense to the banking regulators in the event of a general bank crisis would approach $50 billion, an impossible sum for the U.S. Treasury, in light of the present squeeze on the budget. It appears that the bank regulators' actions are guided by cost-saving above all: If it is possible to prop up major institutions by feeding them the deposit bases of weaker institutions, and thereby increase their profitability, they will do so, rather than risk having to pay cash to sustain the smaller institutions. It is not that such a strategy is likely to succeed; it is that the regulators, swimming in the goldfish-bowl confines of the Gramm-Rudman-Hollings budget legislation, do not have any other idea.

In this light, Controller of the Currency Robert C. Clarke told the Boston Economic Club on May 14 that the solution to collapsing bank profitability was to permit the largest banks to expand in all possible directions, through so-called diversification.

The national banking system, Clarke said, is "trapped in an industry that is becoming less and less profitable with each passing year—both in an absolute sense and relative to the risks banks assume. As a result, the *system* is losing strength."

Banking profitability is at the lowest level in 20 years. The average return on assets for America's 4,200 national banks with assets of less than $300 million, representing 85% of the total regulated by Clarke's office, declined in 1985 for the sixth consecutive year. The average return on assets for these banks fell from 1.13 in 1980 to 0.53 in 1985. During the same period, the average return on assets for all national banks fell by more than half, from 1.08% to 0.45%.

Clarke also dismissed the apparent rise in bank profits reported for the first quarter of 1986, as the result of "sideshows to traditional banking." He said that the increase in profits was largely due to capital gains on government bonds portfolios, bond-trading profits, foreign-exchange dealings, sales of assets, service fees, and so forth.

These types of income are generated by the creation of what the regulators call off-balance-sheet liabilities. In other words, a bank may earn a fee for setting up a so-called foreign-exchange "swap" agreement, but it remains liable for the performance of the parties involved during the entire life of the agreement. Or, it may earn a so-called service fee for guaranteeing a loan, but must pay on the loan if the borrower cannot.

In that sense, Clarke did not go far enough in making his own case: The banks showed short-run profits, both in market speculation and in the creation of liabilities, which could turn into much greater losses in the future. The 15 largest American banks have more than $1.25 trillion in "off-balance-sheet liabilities," in addition to the $850 billion or so in balance-sheet liabilities. That is, their total liabilities are two-and-a-half times larger than their listed assets, and perhaps three times their earning assets!

"As a bank supervisor," Clarke said, "I see an *omen*—tremors in the banking system. The tremors tell me that things are not as steady as they used to be. At this point, they don't indicate an *eruption*. They *do*, however, indicate an *erosion*. And that *erosion* is of concern to me."

So, the answer to a weakening population of banks, in Clarke's view, is to feed the weak ones to the strong ones. That corresponds precisely to Italian Finance Minister Nino Andreatta's warning to a banking seminar in Venice in mid-May, that only 25 or 30 banking institutions will exist by the end of the century. Andreatta was a participant in the Trilateral Commission's annual meeting May 17-19, where the reorganization of the banking system was a prominent agenda item.

FDIC chief Bill Seidman, a Michigan accountant whose chief qualification for his 1970s White House post was a long-standing friendship with Gerry Ford, replaced William Isaac as chairman of the bank insurance agency last October. Isaac, the apostle of bank deregulation, had been viewed by regional bankers the way chickens look at a fox. The irony is that Seidman, a souvenir of the comparatively halcyon days of the Ford administration, came across as a more sympathetic figure. Nonetheless, the amiable Bill Seidman may become an Attila to the regional banks.

The stretchout trap

Supposedly, bank regulators at the U.S. Treasury and Federal Reserve eased accounting standards early into the 1986 oil price collapse, in order to permit regional banks to "carry" energy and agricultural borrowers who might otherwise fail. In fact, the regulators eased the rules while preparing a reaction against such easing, permitting regional banks to dig themselves deeper into a financial hole, in preparation for a crackdown later this year.

"The Comptroller of the Currency and the FDIC are coming in and simply shutting down many banks," a Minnesota farm banker said May 30. "It seems that they don't want anyone to have our assets—they don't want there to be any assets. If you quote me, they'll finish me off.

"The way it's done is that the Republicans in Washington, like Senator Boschwitz and Senator Durenberger, both Republicans from Minnesota, tell us farm bankers that they want us to show forbearance to the farmers, not to collect or close the loans. So we stretch the loans out. Then, wham, the Comptroller or FDIC examiners come in and classify the loans substandard and kill us, make us write them off.

"My bank in particular has been turned from a viable bank into a wreck by this. In late 1984, we were negotiating with a St. Paul bank to buy us up, so we could get more capital and clean out these loans. The Fed approved it in December 1985, but then the Regan Treasury's Comptroller refused, and in March 1986 they finally told us no. Well, during that time they had bled our loans down to the point where no one would buy us out now, and we can't get new capital.

"The only thing I can conclude is that they wanted the bank just shut down. They didn't want any bank, small or

The FBI hands Oklahoma banks to organized crime

The drop in the price of oil and farm commodities has flattened the economy of Oklahoma, where the top three banks are in deep financial trouble, and five banks have already gone under in 1986. Farm foreclosures occur at record rates, and the state government faces a record budget deficit. In this context, with the aid of U.S. bank regulators and the U.S. Justice Department and FBI, the state is falling prey to organized crime, and those who launder its drug proceeds, the big money-center banks.

The first step in the organized-crime takeover was legalization of race tracks with pari-mutuel betting, a move sold to legislators as a way to enhance state revenue. The state's political leaders offered to license Oklahoma's first race track to the notorious Edward J. DeBartolo group, known to be connected to organized crime. DeBartolo agreed to build the first race track if he were granted a monopoly and if all his financial reports were kept secret, in violation of state law. State officials agreed.

The project ran into opposition in the legislature, most notably from Rep. Kevin Cox, one of two blacks in the State House. The track was to be built in Cox's district.

The next step for Dope, Inc. was to establish interstate banking. In April, the Oklahoma Bankers Association proposed emergency legislation to allow out-of-state banks to take over Oklahoma banks. There was resistance, but assaulted by media scare stories of imminent bank failures, pressure tactics from the OBA, and FBI intimidation, the resistance to interstate banking collapsed. In April, the bill was passed under an emergency suspension of the rules, allowing virtually no debate.

Opponents of all this have been subject to a Justice Department witchhunt. Since 1982, the FBI, through the office of U.S. Attorney William Price, has used wiretaps and informants to engineer the indictment and conviction of almost every county commissioner in the state. Price had an FBI informant wired for sound, pose as a construction contractor, and induce a targeted county commissioner to take a kickback. After getting one conviction, Price intimidated the others into pleading guilty. Said one attorney familiar with the case, "There were guys pleading guilty out of pure fear, who hadn't done anything illegal."

In early May 1986, Price indicted Sen. Bernard McIntyre, the chairman of the Banking Committee, on charges of distribution of cocaine. McIntyre, a colleague of Cox and one of only two blacks in the State Senate, had killed legislation favorable to out-of-state bankers, and opposed the interstate banking bill.

Price's case against McIntyre stems from tape recordings made by an FBI informant linked to drug-dealers. On the tapes, one hears an FBI agent telling the informant "Get him to ask you for some cocaine," and the informant asking the FBI, "How do I get him to take the cocaine?"

After being indicted, McIntyre made a speech on the floor of the Senate saying that before he was indicted, Price offered to go easy on him if he would agree to being wired for sound, and help Price make a case against other state legislators. One of Price's primary targets, McIntyre said, was State Rep. Kevin Cox, the opponent of the DeBartolo race track!

medium, loaning any money up here to the farmers."

In interviews throughout the oil belt and the farm belt, bankers described "incomprehensible" practices on the part of the FDIC and OCC. In some cases, like the one described above, the federal regulators delayed approval for mergers until the bank's capital was exhausted, and then moved in like gangbusters. In other cases, the FDIC insisted on "classifying" (assigning negative ratings to) loans in cases where borrowers were still current on payments. Perhaps $40 billion of U.S. banks' lending is collateralized by oil deposits in the ground, at a collateral value established when the oil price exceeded $30 per barrel. The collateral value has since collapsed, and bank examiners have insisted that banks make preparations to write down loans whose collateral has evaporated, even if the borrower is still current in payments.

'What hidden agenda?'

Congress is still balking at legislation prepared by the Controller of the Currency's office in April, which would permit shotgun takeovers of failing regional institutions by out-of-state money-center banks. Fed chairman Volcker, OCC Director Clarke, and White House Chief of Staff Donald Regan are less concerned about congressional opposition than appearances suggest: They have set Congress up to take the fall for a generalized banking panic, should Congress refuse to sacrifice regional constituencies in advance. As matters stand, Congress would have no choice under conditions of panic, except to grant the regulators the emergency powers they have demanded.

This was the background to congressional debate over legislation (H.R. 4701 and S. 2372) introduced jointly by the OCC, the FDIC, and the Federal Reserve, to permit out-of-state takeovers of banks exceeding $250 million in deposits, where the regulators deem such takeovers necessary. The Treasury had to defend itself against charges of a "hidden agenda" from the outset; on April 28, Undersecretary for Finance George Gould told the spring meeting of the Independent Bankers Association of America, "We are not trying to use this as some hidden agenda for interstate banking."

The regions think different, whether or not they support the bill. Oklahoma, hit by 28 bank failures since the July 1982 collapse of the Penn Square Bank, including 5 so far this year, pre-emptively passed legislation in April permitting out-of-state takeovers, and on June 2 Louisiana's lower house passed phase-in legislation for interstate banking.

Texans are less convinced. On May 8, Texas Bank Commissioner James Sexton told the House Banking, Finance, and Urban Affairs Committee that he is more worried about the regulators than he is about the banks, and cautioned the committee to think twice before approving the emergency banking bill. Sexton said the new rules would "lubricate" deals that would allow big, multi-state banks to expand their empires. Sexton would prefer the FDIC to take over problem banks and operate them temporarily, while shopping for local ownership. "I'm advocating an in-state solution being sought first," he said. Asked if the committee should delay acting until the need became clearer, he replied: "Well, that would be exciting."

The Spanish Inquisition

Texan recalcitrance may have persuaded FDIC chief Seidman to wait for a May 28 address to the Southwestern Graduate School of Banking at Dallas' Southern Methodist University, before showing the bankers the instruments of torture.

Most banking business in most towns in the United States brings together a relatively small circle of long-term acquaintances, including real-estate men and their bankers. Under the type of fraud-statute FDIC chief Seidman threatens to employ, any banker who loses money on a loan to a developer with whom he has personal financial ties, could go to jail for fraud.

Seidman noted that, according to a recent FDIC survey of 75 bank failures between 1980 and 1983, "Criminal misconduct by insiders was a major contributing factor in 45% of the failures." Therefore, regulators "must take the view that finding fraud is a primary objective of bank examinations—not an incidental activity." Seidman also cited the Justice Department's current proposals to make money laundering a crime, adding that prosecutors would have to build their case against banks merely on the strength of banks' failure to file reports of large cash transactions.

The Justice Department's money-laundering bill, however, makes no distinction between money-laundering related to a serious crime, e.g., narcotics traffic, and legally hazy transfers of funds unrelated to serious crime. That, however, appears to be what the FDIC and OCC want: They worked with the Justice Department to draft the legislation. The ill-defined legislation offered by Justice provides regulators with the means to break down political opposition to their plans, using the threat of jail sentences.

Most banking business in most towns in the United States brings together a relatively small circle of long-term acquaintances, including real-estate men and their bankers, whose personal financial interests often overlap. Under the

type of fraud-statute Seidman threatens to employ, any banker who loses money on a loan to a developer with whom he has any personal financial tie, could go to jail for fraud.

Seidman, in his address to Southern Methodist University business graduates, referred to the 1983 failure of the group of Tennessee banks owned Jake Butcher, a prominent Democratic party funder. If the FDIC's anti-fraud campaign resembles the handling of the Butcher affair, then regional bankers will have a right to suspect that the Spanish Inquisition is back in business.

"I do business all over Latin America and nothing is worse than the corruption right here in this administration," a Tennessee manufacturer who formerly did business with Butcher's banks complained May 30.

The "Bank-gate" scandal, first exposed in *EIR*'s 1983 Special Report, *The Coming Reorganization of U.S. Banking,* has now grown into a multi-billion dollar version of Watergate. Manufacturers and farmers complain that the FDIC deliberately bankrupted Penn Square Bank in Oklahoma, Midland Bank in Texas, the Butcher banks of Tennessee, and thousands of smaller farm-belt banks in Minnesota and other states.

The FDIC spent some $1 billion in taxpayers' money in *each* closing, they charge, much of which was kicked back to RNC cronies in Republican-run "survivor" banks.

Sources assume Jake Butcher and others were bankrupted because they were Democrats, but as *EIR*'s 1983 report noted, the motive is that Dope, Inc.'s largest institutions, like Regan's Merrill, Lynch and David Rockefeller's Chase Manhattan, are themselves bankrupt. Regardless of the victim's party preference, the big banks need to eat up billions in smaller banks' deposits, to survive.

The plan, we wrote, was to "shut down, permanently, thousands of smaller banks . . . to limit the amount of credit to be issued to the U.S. economy and the number of banks."

Bankgate began in 1982 when then Treasury Secretary Regan wrote his Financial Institutions Deregulation Act, to create megabanks modeled on the 1920s Morgan syndicate, whose cartel abuses helped cause the Crash of 1929. "Worries are overblown, that the Crash of 1929 could come back," Regan told the Senate in July 1983. He set out to implement a plan written by Jimmy Carter's Controller of the Currency, C. Todd Conover, for a system which has "an acceptable number of bank failures, but avoids the collapse of a larger member. . . ."

Irate Tennessee industrialists say that the Regan FDIC's "dry out" of Jake Butcher's United American Bank (UAB) of Knoxville was "pure politics." The FDIC shut the bank in February 1983 without even a minor depositors' run. "There is no doubt the regulators intended to stick it to the Butchers," locals said then.

The Butcher case "is the model for what is going to happen to small banks all over the United States," Barry Putman at the Washington Federal Reserve Regulation Department told *EIR* in February 1983. "It's time for a shakeout."

The Treasury moved in when, in November 1982, Jake Butcher challenged for control over the state and won, backing Democratic candidates against not only Republican Gov. Lamar Alexander, but even against the daughter of Republican Senate leader Howard Baker. "Baker, a top member of the Trilateral Commission, said 'That's it for Butcher!'" one source stated. "He put the word out to the RNC, starting with RNC Chairman Bill Brock, another Trilateral from Tennessee, and to Governor Alexander.

"Regan and Volcker came in, and had the FDIC shut UAB," he continued. "Why didn't they shut Continental Illinois, Seafirst, or Chase? They were much more bankrupt!

"The FDIC could have spent a mere $50 million by accepting B. Ray Thompson's offer to re-capitalize the bank, but instead spent $1 billion.

"After the FDIC closed UAB, they brought in a Republican bank, First Tennessee from 390 miles west in Memphis, turned over all UAB's assets to them, and gave them a payoff. Instead of encouraging First Tenn to help UAB's borrower companies, like mine, the FDIC paid them to bankrupt some $458 million in perfectly good loans to all the corporate borrowers of UAB. The FDIC paid First Tenn 40¢ on the dollar—over $183 million in taxpayers' money.

"The FDIC made First Tenn into bounty hunters—just because they were a Republican bank. First Tenn could only earn 12-15% interest on the loans—versus the 40% they were paid off for bankrupting not only the bank, but all the borrowers! First Tenn deliberately lied to all the companies for 18 months, telling us that our loans were just fine and they wanted our business. Meanwhile, they cut all our credit lines, and construction projects like mine simply failed. Then, they put me in involuntary bankruptcy, and took my dead skin to the FDIC for the payoff.

"They actually shut down the entire economy of eastern Tennessee doing this. You figure manufacturers with $458 million in loans were put in involuntary bankruptcy, each of whom owed their vendors three to five times that, and you've put all of Knoxville into a 10-year depression. We have more than 10 bankruptcies a day here.

"Mike Edwards, the liquidator for the FDIC, told me personally in front of my lawyer, 'I'm going to break you. I'm going to ruin you in this community and no one will ever do business with you again,' he said.

"The FDIC and the FBI down here have made it perfectly clear to the Democrats involved that if we say a word to anyone, they'll put us away," he said. "If you use my name, in 90 days I'll be indicted for something."

"I heard a man from Washington tell the FDIC guys that they had created a 'billion-tax dollar bubble' from nothing. He added it up: $458 million in lost loans, plus $183 million payout to First Tenn, plus $70 million in lost interest, plus eight years paying the FDIC and FBI on the case."