

U.S. banks—they only look safe when compared to the thrifts

by Joyce Fredman

The stock market may have crashed with a bang, but there were other financial blowouts this past year, which, although less noisy, are more devastating in consequence. The banking institutions of the United States may have their windows functioning, but beyond that, not much else is to be relied upon. They are slowly but surely sinking in a quicksand of debt. The number of failures is staggering, yet bankers insist that success is around the corner. The red ink has overflowed, but no one dares cry emergency. If their illusory accounting and shell games continue much longer, citizens will be safer with their money in a piggy bank.

There was a time in America when savings and loans, or "thrifts," had a very special meaning—they were the institutions in which workers put their hard-earned income and from which they could receive a mortgage for their home at a reasonable interest rate. In fact, when Franklin Roosevelt originally set them up, they were called building and loan associations. Banks also had specific, useful tasks—they were a place where one could obtain a loan for an automobile, a business loan, or manage a checking account in order to carry out everyday affairs.

To compensate for their services, both institutions were allowed a certain leniency, a flexibility to use such deposits, in order to make a profit. They were also regulated to insure that the functions were carried out honestly and efficiently. Building the nation was the goal, the banking system a mere vehicle to achieve that end, and therefore a certain prudence in affairs of finance was understood. Today, nothing could be further from the case.

During the past five years, there have been more bank and savings and loan failures than during the Great Depression. In 1987, the number of banks that were closed or merged due to financial difficulties reached a record 186, while the official number of banks on the "problem list" is approximately 1,600. The count is still coming in on the thrifts. The regulators have not had enough funds nor takers to begin to deal with the problem, but by all estimates, a good one-third of the country's 3,000 thrifts are in the red.

In the past two months, both the Senate and House Banking Committees have heard testimony *ad nauseam* on the banking crisis. Sen. William Proxmire (D-Wisc.) and Rep. Fernand St Germain (D-R.I.) in their capacities as chairmen of these bodies, have issued numerous statements of their own, documenting how appalling the situation has become.

One would think these boys had just walked onto Capitol Hill, to hear their surprise at the state of affairs. Only the regulators themselves have matched their astonishment. For years, *EIR* has been predicting exactly the magnitude of the crisis that this country now faces, and has identified the scams and prevarications that have prolonged this insanity.

The year of the shutout

When *EIR* initiated its practice of reporting the actual number of bank failures in May, it was not simply to start an obituary column. The statistics coming from the Federal Deposit Insurance Corporation (FDIC) were deceptive, and meant to be so. With the number of banking failures increasing at such an accelerating rate, a new system of reporting was devised by the FDIC in 1985. Three categories of "difficulty" were set up, as opposed to one.

One of the main ways in which undercounting occurs is through the holding company corporations. When any of these companies receives a bailout, *one* entity is listed as a failure, rather than the various banks involved. This bright idea came to the FDIC in 1987, when it assisted the Hallwood Group in its takeover of the troubled BancTEXAS Group Inc., a bank holding company which owned 11 separate banks (not branches). The FDIC counted this in its annual statistics as 11 "assisted" banks (a euphemism meaning the FDIC runs in and changes ownership, keeping the banks out of the "failed" category), becoming, according to the FDIC, the first situation in modern times wherein a group of banks belonging to a holding company needed simultaneous assistance. They decided later, in retrospect, that perhaps such transactions should be counted as a single event, thus preventing "misleading impressions." This came in very handy for masking the big failures.

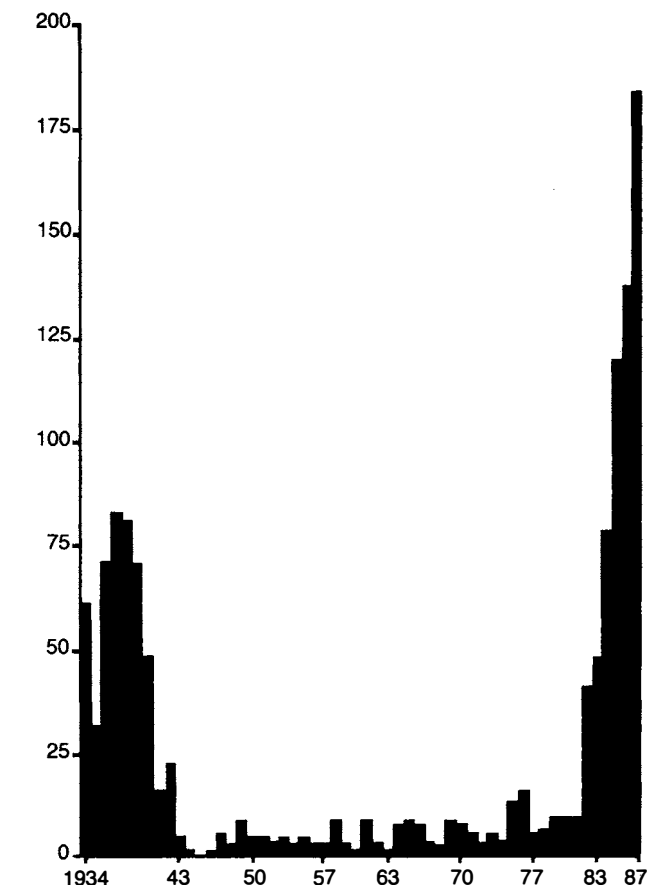
On July 29, 1988, L. William Seidman, chairman of the FDIC, held a press conference to announce the liquidation of the 42 banks held by First RepublicBank Corporation of Dallas, Texas. It was counted as a single failure. The news that the largest bank of Texas had bitten the dust was no surprise to anyone. First RepublicBank had reported a monstrous \$1.5 billion first-quarter loss and a \$758 million loss for the second quarter. The worst year ever recorded by a U.S. bank had previously been Manufacturers Hanover's \$1.14 billion loss in 1987. First RepublicBank nearly doubled that—and in half the time.

A classic example of the merger approach to insolvency, First RepublicBank typified the regulators' tack. The bank was a product of the merger between InterFirst and RepublicBank in 1987. InterFirst had been in big trouble, so RepublicBank merged with it to help out. Stockholders' equity right after the merger was \$1.5 billion as of June 1987. Since the merger, the equity dropped to -\$344 million at the end of the first quarter, then plunged to -\$1.1 billion at the end of the second quarter. In May of 1988, the FDIC gave First RepublicBank \$1 billion, and even with its new ownership—as of Aug. 1 it became the NCNB Texas National Bank—it will cost the FDIC over \$4 billion.

When Seidman tried to explain what was going on to the Senate Banking Committee, his testimony wasn't too convincing in terms of content, but he was adamant about the style. "First, our assistance . . . was not a bailout. It was not a bailout; it was not a 'too-big-to-fail.' It was, in fact, a shutout."

Whatever Mr. Seidman chooses to call his assistance to

FIGURE 7
Number of bank collapses from 1934 to 1987



the increasing number of beleaguered institutions around the country, it is clear that large sums of money are going out from regulators and the situation is decidedly worse. At this point, Seidman has lost his optimism. In the FDIC's 1987 Annual Report, his statement portends more disasters.

"The year 1988 is likely to mirror the difficulties experienced in 1987. With the number of banks on our problem list . . . at just under 1,600, any improvement in this year's failure rate is likely to be minimal. A moderate recovery in the agricultural sector of the economy during 1987 . . . may continue. But any positive development in the farm segment of the economy will be offset by negative results from the battered Southwestern energy sector, where the ripple effect of the crude oil price collapse extends to commercial real estate, and in turn, to the banks."

That Seidman could posit improvement in the agricultural sector of the economy as a reality, is proof enough the man either lives in fairyland or is a bold-faced liar. On May 20, 1988, the Federal Land Bank of Jackson, Mississippi and its 90 branches throughout the tri-state area of Alabama, Louisiana, and Mississippi were closed down. It was the first Federal Land Bank to be put into receivership since the founding of such institutions in 1917. Land Banks had been established by the Federal Farm Credit Act of 1916 to provide a vehicle by which farmers could receive long-term credit for production. Seidman couldn't have forgotten the Mississippi episode; it was the largest banking action ever in terms of geographical impact and number of branches, and the FDIC had to lend 220 regulators to help out the 138 from the Farm Credit Administration.

As bad as the agricultural sector is, however, it is certainly not the only source of Seidman's woes. The banking system last year had a pathetic 0.13% return on assets last year. The off-balance-sheet liabilities last year were close to \$5 trillion; this year, that figure will easily double. This is the figure that commonly arises out of the debt of subsidiaries, and is therefore not listed as a liability on the balance sheet for the primary company. Because of the increase in the number of holding companies, the margin for increasing the off-balance-sheet liabilities has widened to an explosive point.

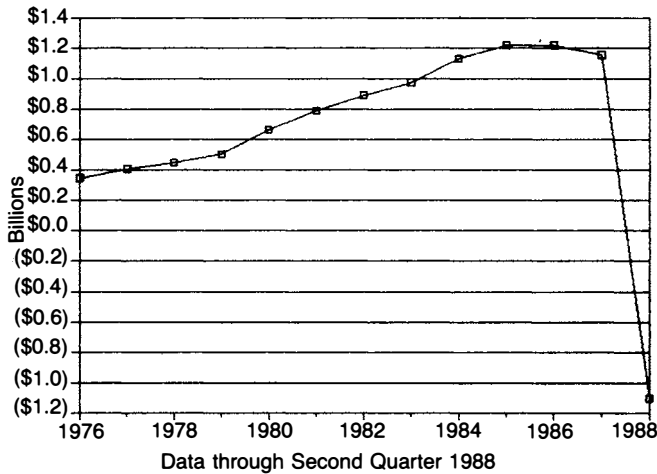
Seidman is not the only one getting a headache from the decreasing assets of the banking sector. On Aug. 19, the Office of the Comptroller of the Currency announced that it was revising its assessment schedule for national banks, as it was experiencing difficulty in getting money. The OCC assesses banks based on their assets. In the first half of the 1980s, total bank assets grew at an annual rate of 6% to 8%; since 1986, assets have grown 2% or less.

What has made the situation worse for Comptroller Robert Clarke is the merger plan his Texas buddies have been pushing. The assessments of the OCC are regressive, i.e., the amount paid per dollar decreases as the bank's total assets increase. Hence, with all the mergers, the merged "new" bank pays substantially less than the sum of the two old

FIGURE 8

First RepublicBank Corp.

Stockholders' equity



banks. As the Senior Deputy Comptroller noticed, "the fact remains that it's more expensive to supervise an increasingly complex system that has experienced problems because of difficulties in . . . the economy."

Now Seidman has decided the problem is that there are not enough regulators. Considering that 42% of the failures in the past two years were banks that had not been examined by the agency within a year prior to failure, the real question is what the regulators that are working do! And there are plenty of them: 2,000 at the FDIC, 2,500 at the OCC, and 1,500 at the Federal Reserve.

With the amount of debt outstanding, Seidman had better figure it out fast, because there are more failures to come. With the onset of deregulation, the banks and their sister institutions, the S&Ls, were wide open for lousy loans and corrupt management. Those who would guard against the demise of the banking industry have been too busy trying to cover up to even begin to find a solution. Now they have an added problem. They are being considered to help with the S&Ls. But as the American Bankers Association modestly pointed out, "From a practical viewpoint, the FDIC fund is too small to solve the thrift insolvency." Indeed, it is too small to deal with the banking insolvency.

Spendthrift thrifts

The only way the banking industry in this country maintains any shred of respectability is by being compared to the savings and loan associations. And the only man who makes L. William Seidman appear to be a competent banker is M. Danny Wall, chairman of the Federal Home Loan Bank Board (FHLBB). Danny Wall, as of this writing, has issued over

FIGURE 9

First RepublicBank Corp.

Net income 1976-88

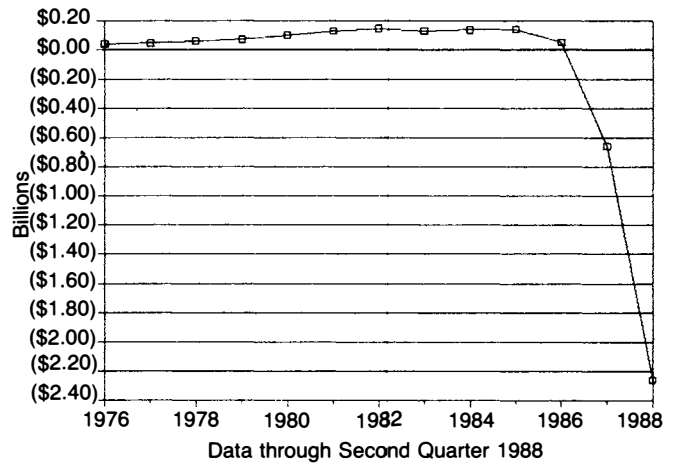
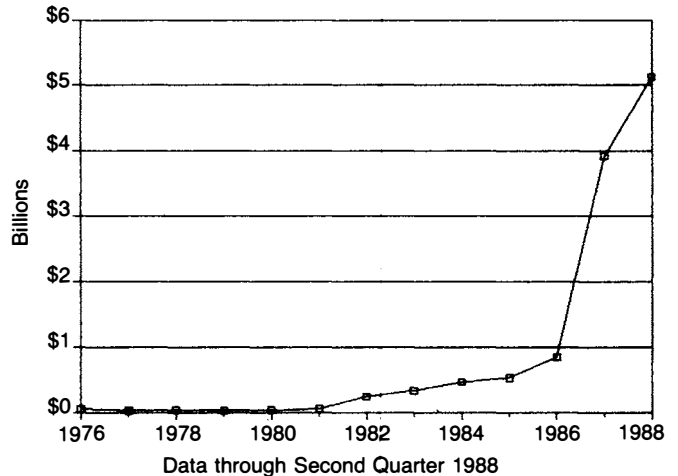


FIGURE 10

First RepublicBank Corp.

Non-performing assets



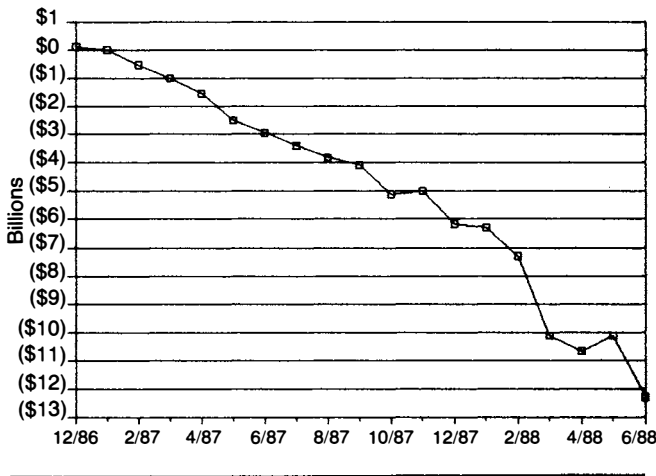
\$20 billion in promissory notes and guarantees, gaining notoriety as the easiest man in America from whom to get an IOU. When the amount of money involved in these transactions started to climb, the magnitude of the problem came to Senator Proxmire's attention. "The bailout to come will be the largest ever in the history of the United States. It will be far bigger than the combined cost of the assistance given to Chrysler, Lockheed, and New York City."

Some would say Chairman Wall has no choice; the insurance arm of the Bank Board, the Federal Savings and Loan Insurance Corporation (FSLIC), is as bankrupt as the S&Ls

FIGURE 11

Texas savings & loans

Total regulatory capital



themselves. According to the official figures, FSLIC's obligations are conservatively \$30 billion. The total annual interest outlay requirement on these is estimated to be \$3-4 billion. FSLIC's current foreseeable level of premium income is approximately \$1.85 billion annually. Put another way, during the first half of 1988, FSLIC's actual cash outlays for principal and interest on its notes and bonds totaled \$1.143 billion, an amount 74% higher than FSLIC's premium and interest collections of \$658 million during the same period. Mr. Wall has no money. All he can offer is promissory notes.

The history of how the savings and loan institutions found themselves to be the most bankrupt sector of the United States is a hard-earned lesson for the promoters of the "free-market" ideology. The interest rate hikes and the deregulation of the banking sector sounded the death knell for the thrifts. Even if the "Great Recovery" had ever taken place, it was far too late for the S&Ls.

When these institutions were first set up, there was a policy known as "Regulation Q," which allowed the S&Ls to pay higher interest rates for depositors. The mortgage rates were without a doubt, the best that could be offered to anyone wishing to own a home.

But by the 1950s, something called disintermediation had occurred. Depositors started going into bonds. A bond is a U.S. government obligation of five years and up, that is a coupon issue, i.e., interest is paid twice a year. By 1959, people were investing in the "Magic 5s," a Treasury note with a 5% coupon, at a time when the S&Ls were offering approximately 3%.

By the time Paul Volcker became head of the Federal Reserve under Jimmy Carter (1979), the thrifts didn't have a

prayer. Interest rates went sky-high and it became impossible to make a profit on home mortgages, the original purpose of the institutions. Around the country, speculative real estate investments, wind farms, ethanol plants, and other crackpot investments became standard fare.

This attracted managers who had a flair for the fast buck. Men like Charles W. Knapp of American Savings and Loan—recipient of a \$2 billion note, the single most costly rescue for the Bank Board to date—and "fast Eddie" McBirney of the Sunbelt Savings and Loan—the end result of a merger of eight insolvent thrifts and the recipient of minimally \$5.5 billion in pledges from the Bank Board—were exactly what the doctor ordered. They have turned over their legacy to the likes of Robert Bass, corporate raider, and Club Corporation, the largest U.S. owner and operator of private dining and country clubs. Such are the managers of the repositories of the savings of American workers. The days of "It's A Wonderful Life" have long since past.

If lack of regulators is a poor excuse for the state of the banking industry, it borders on the absurd when it comes to the thrifts. There are 3,092 savings and loans in the United States (including the "brain-dead" as the failures have come to be known); there are close to that many regulators within the FHLBB, FSLIC, and the various other agencies that theoretically manage the thrifts. But management has come to mean cover-up.

The regulators spend their time merging small disasters into big disasters and coming up with incentives to foist them onto someone else. The most recent and one of the more incomprehensible of these gimmicks is something called the pocket charter. A pocket charter is given to the new acquirer of a failed S&L along with the FSLIC promissory note (which is fast losing its appeal).

This is a charter for a new, separate thrift in case FSLIC defaults on its note. Once FSLIC defaults, the note is put into the new, pocket-chartered thrift as the thrift's sole asset. (No one has yet figured out who would want it.) Also put into the new S&L is an amount of deposits equal to the amount of the note. These deposits will no longer have interest paid on them, and they become liabilities of the new thrift. The new thrift is owned by the depositors (who are no longer receiving interest) and the acquirer of the original S&L would have neither ownership nor responsibilities to the depositors. FSLIC would guarantee the new thrift—but as this whole scheme is premised on the idea that FSLIC will go under, the guarantee is a joke.

The bad jokes and lies are becoming more costly every day. The \$100-150 billion will ultimately come from the taxpayers. A number of Wall Street traders have noted how the market and banking had historically been completely separate, but one of the benefits of deregulation was the meshing of the two. The geniuses who brought us the October 1987 crash have advised the banking industry. The American citizen is about to pay dearly for such counsel.