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A fourth-quarter fantasy

The reappointment of the Comptroller of the Currency is another futile attempt to paper over the depression.

When President Bush reappointed Comptroller of the Currency Robert Clarke to a second five-year term Dec. 11, nine days after his first term had expired, most observers took the delay to be a signal from the White House that federal banking regulators should ease up on the banks. Federal Deposit Insurance Corp. (FDIC) chairman William Seidman, who is in a position to know, called it a "shot across the bow."

Clarke, in a statement issued upon his reappointment, said, "We can work through the current problems if lenders assume their responsibility to make loans and take reasonable risks, and if regulators follow a responsive, balanced approach that takes into account . . . the very significant national interest in not unnecessarily depressing credit availability."

"Now is a time for common sense, a time when neither regulators nor lenders should overreact or be unresponsive," Clarke said.

Since Clarke's reappointment, federal regulators have made a series of moves to ease the crisis afflicting the U.S. banking system.

On Dec. 18, the Federal Reserve Board voted unanimously to drop the discount rate—the rate the banks pay to borrow money from the Federal Reserve—by 0.5%, to 6.5%. The last time the discount rate was changed was Feb. 24, 1989, when it was raised 0.5%. The discount rate hadn't been lowered since Aug. 21, 1986. The action, the Fed said, "was taken against the background of weakness in the economy, constraints on credit, and slow growth" in the money supply.

The Fed also lowered the Federal Funds rate, which is the rate banks charge each other for loans. The Fed has dropped the Federal Funds rate four times since July.

The ostensible purpose of these interest rate decreases is to induce the banks to lower the interest rates they charge their customers, in order to help ease the credit crunch. However, as of year's end, only one major money center bank, First Chicago Corp., had reduced its prime rate; the rest kept their 10% prime rate. Many of the banks have lowered the interest rates they pay to their depositors, while maintaining the rates they charge for loans. They have, as the Fed knew they would, kept the extra money for themselves, to bolster their disastrous balance sheets.

Another signal that the Bush administration has decided to try to paper over the banking crisis for the fourth quarter, is the announcement by Citicorp that it was adding a mere $340 million to its loan loss reserves for the quarter. Citicorp's loan loss reserves are ludicrously low, even by the standards of the other major banks. Citicorp would have to add some $2.5 billion to its reserves for the quarter just to bring it up to the still-inadequate level of the other big New York banks. To seriously address its nonperforming loans problem, Citicorp, with $230 billion in assets, would have to add at least $5-10 billion to its reserves for the quarter.

Since federal bank regulators had just finished an examination of Citicorp's books, and knew full well that the $340 million was no more than a token, they should have objected, loudly. But they didn't, because the administration does not want the true condition of Citicorp to be known.

One of the guiding tenets of bank regulators has been the doctrine of "too big to fail," under which large banks are closed only when they become so hopelessly insolvent that they simply cannot continue in business. Even then, under this doctrine, all deposits have been protected by FDIC insurance, even those exceeding the nominal $100,000 limit.

The underlying goal of the "too big to fail" doctrine is to protect the stability of the banking system. By guaranteeing the safety of large deposits, the government reduced the likelihood that weak banks would be hit with devastating runs on deposits.

But the doctrine itself has now become an impediment to the regulators, given the government's stated plans for large-scale consolidation of the banking system. Treasury Undersecretary Robert Glauber recently admitted that the administration is working on "a mechanism that would make it much less likely that regulators would intervene" to keep large banks from failing. Even so, Glauber said, the doctrine cannot be eliminated entirely, because "there really is such a thing as systemic risk."

Thus, the Bush administration is in effect writing the epitaph which will appear on its tombstone: "Too Big to Fail."

Other measures under consideration by federal bank regulators to ease the pressure on the banks, include giving the banks more leeway to pretend that their nonperforming loans are still good, and to maintain artificially high values on collateral taken for loans, especially on real estate.

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