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Banking by John Hoefle

Funds flow into securities

The FDIC's latest "Quarterly Banking Profile" stats for 1991 look good—by ignoring the bad news.

One of the benefits of a regulatory environment in which no bad news is allowed, is that the bankrupt U.S. banking system can lose money like mad, yet still claim to have made substantial profits.

According to the Federal Deposit Insurance Corp.'s (FDIC) latest Quarterly Banking Profile, the U.S. commercial banking system earned $18.6 billion in profits in 1991, a 15% rise over the $16.1 billion in earnings the banks claimed to have made in 1990.

In the fourth quarter of 1991, the banks claimed a profit of $3.7 billion, a 306% increase over the $907 million profit for the fourth quarter of 1990. Reported profits for both the fourth quarter and the year were the highest since 1988.

A major factor in these so-called profits is the income derived from the banks' using their own funds to buy and sell Treasury notes, mortgage-backed securities, currency futures, and the like.

Profits from the sale of such securities accounted for $2.96 billion (16%) of the banks' reported profits for 1991, up 515% from the $481 million earned in 1990. During the fourth quarter, the banks earned $1.4 billion from securities sales, which was 40% of the quarter's net income, a 462% increase over the $256 million earned in the fourth quarter of 1990.

The securities profits especially benefitted big banks. The 49 banks with assets greater than $10 billion would have registered an aggregate loss for the year without the trading gains, and only 57% made profits with them. For the year, reported income at the big banks was down 20%.

A prime example of this is J.P. Morgan, which reported a profit of $1.15 billion for the year, thanks to $1.3 billion in income from securities trading. Without the securities dealings, Morgan would have lost money for the year.

Another major factor which boosted bank profits is the failure of the banks to admit the extent of their loan losses. Admission of these losses would require the banks to boost their loan loss reserves and increase their charge-offs, reducing both income and equity capital.

While the banks added $33.9 billion to their loan loss reserves during the year—second only to the record $37.5 billion added in 1987—the total amount set aside as reserves for bad loans actually *dropped* $561 million, to $54.95 billion, during the year.

Banks set aside $10.1 billion for loan loss reserves during the fourth quarter of 1991, some $1.6 billion less than the $11.7 billion set aside in the fourth quarter of 1990. The largest reductions occurred in the Northeast, where fourth-quarter loan loss provisions were $2 billion smaller than the same period in 1990. Banks in the western United States increased their loan loss reserves by $875 million.

The banks charged off a net $32.6 billion for the year, a 10% increase over the $29.7 billion charged-off in 1990. For the fourth quarter, net charge-offs were $9.4 billion, a 7% increase over the $8.8 billion charged-off in the fourth quarter of 1990.

While the assets of the banking system grew 1.2% to $3.43 trillion in 1991, total loans and leases shrank 2.8% to $2.05 trillion. The amount of commercial and industrial loans fell by 9% to $559 billion and loans to individuals fell 2.9% to $391 billion. Meanwhile, real estate loans rose 2.5% to $851 billion and farm loans rose 5% to $35 billion.

With assets growing and loans shrinking, where did the money go? The answer: securities.

During 1991, the amount of securities with maturities greater than one year held by the banks rose to $514.4 billion, a 14.2% increase over the $450.3 billion in 1990. Temporary investments rose 11%, to $501 billion from $451.4 billion.

Securities holdings have risen sharply since, for securities (unlike loans), banks do not have to set aside a percentage of the total amount as capital.

As a consequence of the Bush administration's decree to federal bank examiners to look the other way on bad real estate loans, the amount of reported non-current loans and leases dropped 2.6% in 1991 to $76.1 billion, down from $78.1 billion at the close of 1990, while loans and leases 30-89 days past-due dropped 12.9% to $41.8 billion, from $48 billion. Restructured loans and leases rose 11.2%, to $9.8 billion from $8.8 billion, and "other real estate owned" loans jumped 31.9%, to $26.4 billion from $20 billion.

This alleged drop in non-performing real estate loans is absurd, during a year when the paper value of the nation's real estate holdings fell by hundreds of billions of dollars.

The FDIC's statistics are further removed from reality by the omission of the banks' off-balance-sheet liabilities, which are at least twice the size of their admitted liabilities.

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