Bankers push forbearance to keep debt bubble afloat

by John Hoefle

U.S. bankers and banking regulators have launched a full-scale push for forbearance, and for further deregulation of the already-insolvent and fast-sinking U.S. banking system. This con job by the banks to save themselves by further looting of the physical economy and the public, is being presented to the public not as the thievery and fraud that it is, but as an attempt to stimulate the "recovery" and benefit the consumer.

The bankers and their pet regulators are pushing the line that "overregulation" of the banks is hampering their ability to make loans and thereby help the economy. Ease up on us, the bankers recently told President-elect Bill Clinton, and we can pump $86-100 billion in new loans into the economy, and get this recovery moving.

That's like a vampire telling its victim, "Let me bite you and I'll fill you with blood."

The claim that regulators have been too hard on the banks is ludicrous. There is no adversarial relationship here: the regulatory system is, as a whole, dominated by the big banks and exists to protect and subsidize them—at the expense of the economy and the population.

Over the past year, the government has pumped billions of dollars into the big banks to keep them afloat. The most blatant example is the Treasury securities scam, in which government lends the banks money at 3% interest rates to buy Treasury securities, for which the government then pays the banks 7-8% interest, giving the banks a 4-5% profit. This life-support system amounts to a direct government subsidy to the banks, with the taxpayer picking up the tab in the form of increased federal debt.

While the government has been pumping money into the banks, it has also conspired with them to hide the extent of their losses from bad loans and devalued assets. It is this combination of government funds and unreported losses which has allowed the banks to claim record profits for 1992. Those artificial profits, and the corresponding phony increases in equity capital, are the cornerstone of the pretense that the banking system returned to health in 1992. But were these claims of financial health true, there would be no reason for this near-hysterical push for deregulation.

In fact, 1992 was a disastrous year for the U.S. banking system. Many problems were swept under the rug during the election season, and those problems are now resurfacing with a vengeance, much worse for having been ignored. That is especially true with real estate, where values continue to drop with no end in sight. Many banks will attempt to clean up their balance sheets in the coming period, writing off some of their real estate and other losses. At some point after Congress reconvenes, the Resolution Trust Corp. will be refunded, and the liquidation of S&Ls will resume, dumping even more real estate on an already-overloaded market. Many real estate developers and other investors are also trying to sell their properties in order to meet their debt payments or cut their losses. With more than $850 billion in direct real estate loans on their books, and property values down 50% or more from their peaks in many places, the banks have suffered catastrophic losses. It is against that backdrop that the latest push for forbearance must be viewed.

Replay of the S&L crisis

Forbearance, which essentially is the practice of allowing banks to lie about the values of the assets and liabilities on their balance sheets, is nothing new to federal regulators. Regulators routinely overlooked the losses run up by the S&Ls in the late 1980s, helping to turn what could have been a manageable problem into a trillion-dollar fiasco. In the wake of the so-called S&L bailout, regulators and politicians fell all over themselves promising that such forbearance would never happen again. But then the banking crisis hit with full force, and the cries for forbearance began anew. But this time, the word "forbearance" being politically incorrect, the code phrase "deregulation" is being used.

The policy of forbearance was stated explicitly one year ago by federal regulators, who summoned 500 federal bank examiners to Baltimore, Maryland on Dec. 16, 1991, to demand that the examiners overlook the lies on the banks' balance sheets. "You have a tough job," Deputy Treasury Secretary John Robson told the examiners. "We want you to carry it out in a way that promotes economic growth and protects the public. . . . You are encouraged to give the benefit of the doubt, even if it might ultimately turn out to be a misjudgment.

"Do not assume a doomsday scenario," Robson instructed the examiners. "Our economy will turn around and so will troubled credit." "If America's banks are the engines for growth in this country, then you are at once the throttle and the governor," Treasury Secretary Nicholas Brady added. "On the one hand, your decisions and examinations can choke expansion. On the other, you can foster the injection of fuel that will lead to solid economic growth."

Having informed bank examiners of the virtual no-such-thing-as-a-bad-loan policy, federal regulators then began to dismantle regulations which exposed the unpleasant truth about the health of the banking system.

In January 1992, the Federal Reserve, the Comptroller of the Currency, and the Federal Deposit Insurance Corp. (FDIC) eliminated the requirement that banks report separately their highly-leveraged transaction (HLT) loans. HLT loans are the loans which occur when buy-out bandits take over a corporation with borrowed money, then make the acquired company pay the debt. Many of these takeovers were funded with nearly worthless junk bonds. The effect of this rule change is to further hide the losses to the banks arising from the junk bond-takeover bubble.

On April 2, the Federal Reserve cut to 10%, from 12%, the amount of reserves a bank must set aside for transaction accounts such as checking accounts and negotiable order of withdrawal accounts. By doing so, the Fed supposedly gave the banks an additional $8-9 billion with which they could make loans. The primary beneficiaries of this change were the big banks, which used much of these new funds to buy Treasury securities instead.

On April 7, the FDIC board overrode an FDIC staff recommendation and postponed action on a proposed 8% increase in the insurance premiums charged to the banks for deposit insurance. This, at a point in which the FDIC's Bank Insurance Fund was admitted to be some $7 billion in the red, having lost money for six straight years.

"Deferral of the increases until next January provides a politically attractive means of reducing costs to banks and eliminating the politically unattractive spectacle of closing banks during an election year," House Banking Committee Chairman Henry B. Gonzalez (D-Tex.) observed at the time.

On April 24, President Bush announced a series of regulatory reforms for financial institutions which would, he claimed, save taxpayers "tens of billions of dollars." Among the items in the package was one to reduce the number of bank examinations by federal regulators, while another measure would allow banks to avoid property appraisals when the banks felt they were unnecessary.

In June, the administration sent to Congress legislation to repeal parts of the FDIC Improvement Act of 1991. Treasury Secretary Brady called upon legislators to repeal "antiquated laws" that prohibit big banks from establishing nationwide branch networks and underwriting and selling securities and insurance. "These reforms are long, long, long overdue," Brady told bankers at the International Monetary Conference in Toronto on June 1.

Unjustifiable actions

The effect of these so-called reforms were not lost on some regulators, however. "It is difficult to even imagine, let alone justify, why such actions are being taken while a record number of bank failures are occurring, and that the Bank Insurance Fund has a $7 billion deficit," Comptroller General Charles Bowsher told the House Banking Committee on June 30.

In July, Standard and Poor's released a report which claimed that U.S. banks are "substantially over-reserved" for their loans to lesser developed countries, in large part due to the increased creditworthiness of the major Ibero-American debtors. "The primary lesser developed country lenders—Bank of America, Bankers Trust, Chase Manhattan, Chemical Bank, Citicorp and J.P. Morgan—are now able to redeploy a portion of their LDC reserves to cover current domestic problems," S&P claimed.

What made these countries suddenly more creditworthy, even as they are being bled dry by the banks and International Monetary Fund conditionalities? According to June 30 testimony by Gonzalez, the "U.S. Treasury [is] backing developing countries' bond issues," providing "guarantees" to "big, big private banks" that "have been, for at least 2-3 years, being rescued by the U.S. Treasury."

In October, federal regulators decided to further relax guidelines on real estate lending, and in December, *American Banker* reported that regulators are planning to ease restrictions on banks' securities dealings.

Finally, the Federal Financial Institutions Examinations Council, which consists of the Fed, the FDIC, the Comptroller of the Currency, the Office of Thrift Supervision, and the National Credit Union Administration, released a report which concluded that "the regulatory burden on the banking system is large and growing," and called for "statutory changes to further reduce regulatory burden."