

Banking by Kathy Burdman

A not untypical case

Chase and Manufacturers Hanover's role in Drysdale is the proverbial tip of the iceberg.

Although Chase Manhattan, at the expense of a large share of this year's earnings, managed to swallow the Drysdale Government Securities problem, sophisticated market participants believe the problem has only started.

Ongoing Senate Finance Subcommittee and SEC investigations may provide answers to the big question, namely, how it was possible for an unknown operator to start business with \$5 million in capital and rack up \$320 million in losses within only four months of operations, and unpleasant revelations about Chase Manhattan's back office may come out.

Whatever opprobrium attaches itself to Chase Manhattan, however, the important lesson is that market practices of the sort Drysdale was engaged in are typical of the post-Volcker financial era.

The annual volume of futures in government paper is three times in excess of the U.S. national debt. And the replacement of commercial bank lending by commercial paper lending through money market funds and other forms of quasi-bank, reserve-free, unsecured business means that the actual leverage of the financial system is many times in excess of the typical 20-to-1 assets-to-capital ratio prevailing among the commercial banks.

In 1980, the panic threat came from the silver market and the Hunt brothers; after two years of Volcker and deregulation the principal

threat is on the financial side. Not merely Chase, but, to a lesser degree, Manufacturers Hanover and U.S. Trust were "throwing their names around" in support of Drysdale and "were guilty as hell," said one well-informed bank analyst.

Not merely banks, but also industrial corporations, have been driven to establish as independent profit centers such exotic entities as money-trading desks, foreign-exchange divisions, captive insurance subsidiaries, and commodity-trading operations, as the profit stream from normal business operations has dried up.

This is "zero-sum" business, where one corporation's gain represents another's loss, and volatile swings in securities, commodities, and currency values are typical. Thus a large section of corporate and banking activity has been structured to make the Drysdales of this world as indispensable as they are vulnerable.

To the extent that banks rely on what are speculative financial activities to supplement otherwise declining or risky profits, ordinary controls must go out the window.

Chase is a notoriously badly managed bank, and its managers had no idea what their trading room was doing; nor did they want to know. But the problem is not merely at Chase. At Citibank—the supposed administrative miracle of Wall Street—Chairman Walter Wriston called into the bond trad-

ing room to find out what exposure the bank actually had, after he heard the news about Drysdale. None of the control offices at the bank were able to give him a report. To one group of New York bank analysts, the Drysdale affair merely demonstrates that the system has run out of control.

The suspicion remains unproven that Chase may have been set up by financial competitors who wanted the relative parvenu to get the worst of a banking crisis that a growing plurality of financial opinion considers imminent.

The circumstances are certainly lurid: Peter Wasserman and Joseph Ossorio, the latter from the Amstar Sugar fortune, buy out a small old-line firm, Drysdale Securities, in mid-1981. At the turn of the year, they put \$5 million into preferred stock of Drysdale Government Securities, whose equity they totally control, but whose management they leave exclusively in the hands of a notoriously unstable hot-shot bond trader, Robert Heuwetter.

In four months Heuwetter manages to rack up losses 70 times the size of his capital with the help of unnamed individuals in the Chase back office. Wasserman and Ossorio, as mere "investors" in the subsidiary, have no responsibility, and Chase is left holding the bag.

The Federal Reserve officials who managed the rescue operation, i.e., pinned Chase to the wall, are dumbfounded by this chain of events, for which they can offer no explanation.

Even if the "conspiracy" hypothesis, now popular on Wall Street, turns out to be correct, no such devilry could take place except in a situation where such disasters were able to occur on their own.