Click here for Full Issue of EIR Volume 11, Number 43, November 6, 1984

EIR Economics

The 'final solution' for the U.S. banking system

by Kathy Burdman

Comptroller of the Currency C. Todd Conover's announcement on Oct. 15 that federal regulators will now permit nationwide expansion of "nonbank banks" means the cartelization of the U.S. banking system, a source close to Conover admitted on Oct. 25. Large New York banks like Citibank will simply buy up smaller ones in other states.

The hundreds of failing farm-belt, oil-related, and other domestic institutions on Conover's list of 797 "problem banks" will be easy prey. To set up operations in other states, "the easiest thing to do is to acquire existing institutions." The U.S. banking system, with 14,700 banks, has too many banks, he said. "This is one way to solve the over-population problem. Thousands of small and medium banks will disappear soon," a *"final solution"* for the U.S. banking system.

These statements help explain the odd fact that, while the nation's top 11 mega-banks in New York and California are up to their necks in $250 billion of bad foreign debt in Ibero-America, no really major losses have yet been forced on these loans by Fed chairman Paul Volcker and his pet Washington regulators like Conover. At the annual American Bankers Association (ABA) convention in New York on Oct. 24, Citibank Chairman John Reed threatened to write off a tiny $10 million in Argentina's debt unless it paid its interest arrears. The next day, Argentina did so, and Reed delayed the write-off.

Instead, Volcker's regulators have forced domestic-oriented U. S. banks such as Continental Illinois, First Chicago, Penn Square, and dozens of smaller banks, to take major losses on domestic loans. Addressing the ABA convention on Oct. 24, Conover emphasized that his fearless examiners are "getting even tougher" on domestic "energy, agriculture, and real-estate loans."

Obviously, part of the Trilateral Commission plan for U.S. banking has been to soften up the domestic banks first, making them prey to takeovers by the New York giants. Then, when the Ibero-American debt blows out early next year, Volcker will try to bail out the mega-banks and their huge debt. The mega-banks are to abandon international lending, reducing America to a second-rate economic power, but maintaining their viability and profits by turning toward U.S. consumer and other domestic markets—the new victim for usurious loans at 20% rates, as Ibero-America was the victim in the 1970s. To get those domestic markets, they will buy out the rest of the banks.

With one false move, however, Volcker and Conover could also bring down the entire U.S. banking system.

To hell with Congress

Comptroller Conover's Oct. 15 regulatory decision is a fiat declaration by the Volcker-led regulators that they, and not the U.S. Congress and voting public, have the right to organize nationwide bank cartelization in the United States. The precise content of Conover's decision was to declare it legal under existing law for major banks and other financial conglomerates such as Sears, Roebuck to set up what are called "nonbank banks" outside their home states. A nonbank bank or "consumer bank" is legally defined as an institution which can't make commercial loans, i.e., loans to businesses.

"Nonbank banks are clearly legal under present law," the decision reads. "I feel compelled to begin deciding pending applications for nonbank banks. As of Oct. 10, my office had received applications for 332 nonbanks." Federal Reserve General Counsel Michael Bradfield told the press that the Fed, which also oversees the applications, will approve them "automatically."

But nonbanks are fully against the wishes of the U.S. public. The Congress has been unable to pass a bill clearly legalizing nationwide bank cartelization because of a massive public outcry against it. Nonbanks are the creatures of a loophole in the existing legal definition of "banks" which do

© 1984 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

make commercial loans under the Bank Holding Company Act. The Act was written in the 1930s to prohibit nationwide banking.

In his ABA speech on Oct. 24, Conover blatantly told Congress to go to hell. He urged bankers big and small to establish nationwide operations "fast," and to ignore Congress "despite" their threats. "I think the banks ought to get on with setting up shop, getting employees, and getting into business as soon as possible." House Banking Committee Chairman Fernand St Germain (D-R.I.) in a statement that day called Conover "highly irresponsible . . . to encourage the financial industry to expend its resources on these speculative ventures."

Even before Congress returns to Washington after the election recess in February, Conover may have unilaterally remodeled the entire U.S. banking system by simply approving the 332 applications for nationwide nonbanks already on his desk. These include applications filed in April by New York's Citibank to open 10 nonbanks in nine other states. Similar applications were made by Chase Manhattan, Chemical Bank, Mellon Bank, and Bank of America.

By late February, Conover "could process most of them," the source close to him stated. "I just had lunch with Jim Boland, senior deputy comptroller for public affairs; he's Conover's chief lobbyist. He says they will process at an expedited rate and certainly won't drag their feet." Conover told the ABA he would approve "the vast majority" of the applications already before him post haste, in "batches of 25 to 50" at a time.

Already under way

On Oct. 22, Chicago's Sears Roebuck conglomerate announced intentions to buy the small Greenwood Trust Company of Greenwood, Delaware (assets $11 million), to expand its nationwide banking subsidiaries. Sears said it is "committed" to opening "consumer banks" in California and nationwide, eventually in every Sears store.

"Sears is obviously doing this based on prior discussion with Conover," my source said. "Normally, one doesn't go out and quick buy a little bank without talking to the regulators first. . . . To do the acquisition, they had to give the Comptroller prior notice."

Conover was contemptuous of protests by both the House and Senate Banking Committee chairmen, who, he told the ABA, are "a long way" from getting any legislation to stop him. "St Germain had a very tough time controlling his own committee" in the last session, the source said. "[Rep. Frank] Annunzio (D-Ill.) wants to make sure that Sears is secure, and he also has very close personal ties to Dimensions Corporation," another nationwide banking shell.

This really is nationwide bank cartelization. As the reader undoubtedly suspects, a "nonbank" isn't—it's a bank. "The plain fact of the matter is that a nonbank bank can do anything a bank can do," my source laughed. "What is a commercial loan is very questionable. A commercial loan isn't a very well defined term. The Fed has never said clearly just what they think a commercial loan is."

Big banks with nationwide nonbank-bank branches "will still manage to engage in what sure looks like a fairly broad range of commercial lending activities on an inter-state basis, as well as the retail side. Many of the activities which are functionally equivalent to commercial lending are not deemed to be so for a nonbank bank, and, therefore, even if you strip out the commercial loan portfolio, it still means you can effectively engage in some of the same transactions in another form. So, nonbank banks are not so nonbank-like as one might expect."

Triage the weaker first

The 332 nonbank applications pending when Conover dropped his bombshell were plans to open *new* banks. Regulators, however, expect the really massive expansion to come from large New York and California banks who will simply buy up the thousands of failing small- and medium-sized banks and S&Ls across the nation, starting with the 797 banks on the "problem bank list."

Addressing the ABA convention, FDIC chairman William Isaac disclosed the record number of banks on his "watch list," noting that it is twice the peak of 385 bankrupt banks reached after the 1975 recession, and rising. "The problem list is up from 750 a month ago to nearly 800 today," he told reporters later.

Volcker's regulators are already forcing these domestic banks to take big losses on U.S. portfolios, smaller bankers at the ABA convention worriedly told the press. The case of First Chicago, forced this month by the comptroller into $279 million in write-offs of problem loans, shows that "bank examiners are definitely being tougher," one Texas banker told *EIR*.

They said the comptroller's regulators are focusing hard on banks' farm and energy loans. The comptroller last summer issued tougher guidelines that reduced the value banks can give to certain of the collateral of energy industry borrowers, oil in the ground, and oil rigs. One Texas banker said he'd been told by the comptroller that oil rigs his bank had previously valued at 25¢ on the dollar were now valued at only 10¢ or 15¢. Another Texas banker says that if oil prices drop below $25 a barrel, banks in the state "will have real problems."

Another said that examiners "are also getting tougher on real-estate loans," apparently concerned by overbuilding in some Texas cities.

Federal Reserve statistics show that there are more banks in the major farm states of Iowa, Missouri, Kansas, and Nebraska whose bad loans now exceed their total capital than in other states. Of the 27 U.S. bank failures from June 1 to Sept. 27, sixteen were farm lenders.

American farms are being crushed under a $215 billion

debt burden. Farmers in the Midwest are now operating, in general, at a loss. As of March 31, $2.2 billion, or 3%, of the loans held by the Farm Credit System (FCS) were overdue by 90 days or were in the process of liquidation. Last year, the grouping in the FCS which makes operating loans, the Production Credit Associations, reported loan losses of $237 million, up from $159 million in 1982 and $42 million in 1981.

Documentation

The following is excerpted from the Oct. 24 address of C. Todd Conover, Comptroller of the Currency, before the American Bankers Association convention in New York.

Like most of your customers, I hate to be kept waiting. I thought that by now I would be able to obtain new products and services at my local bank. But if I want to obtain the full range of financial services, I still have to do business with Sears.

That's disappointing. And there is no simple way to explain why banks came out of this Congress empty-handed. . . .

In order to make any progress in the future, I believe that Congress and the consumer must first understand how modernizing the laws will result in a strong banking system. . . .

First, let's talk about the need for new powers. In my first three years as Comptroller, I have witnessed some impressive victories by a banking industry that stuck together and hung tough. The cry of "Let us compete" that came out of your 1981 convention was still ringing in the air when I took office. In fact, the reverberations of that cry are still heard in Washington and in state houses around the country. . . .

Recent progress

Back in 1981, there was a lot of talk about a four-year schedule for the phase out of rate ceilings on deposits. You ended up getting price deregulation in little more than two. Back in 1981, the main topics of conversation were All Savers and Small Savers certificates and the new market for Individual Retirement Accounts. Today, the talk has advanced to insurance, securities, and real estate. That's progress. . . .

Throughout those three years, the Comptroller's Office has been helping banks to find new ways to successfully compete in the marketplace. Specifically we allowed banks to offer discount brokerage and investment advisory services, to operate futures commission merchant subsidiaries, to lease space to insurance agents, to underwrite credit life insurance, and to offer plain English trusts. We also permitted banks to provide common trust funds for the collective investment of Individual Retirement Account contributions. This action was overruled by one court but we believe the court's decision was bad public policy and intend to appeal it.

The point is that now that consumers have eaten steak, they're not about to let banks serve peanut butter again. They want value in financial products, and they want that value from their bank. That is an advantage you must exploit. . . .

There are still many critics that oppose change. . . . These critics charge that banks are abusing their market freedoms. They claim banks have raised service fees arbitrarily. They assert that the minimum deposit requirements on market rate accounts are too high. They profess that chaos reigns as a result of branch closings and forcing customers to use ATMs. They argue that the increase in the number of bank failures is a direct result of deregulation. . . .

The reality is that banks can only serve their customers when they are making a fair profit themselves. And using the collapse of Continental as a reason to curtail further deregulation is a convenient but very misguided response. Providing banks with new powers will strengthen, not weaken, the banking system because banks will be able to engage in new, less risky, activities.

Granted, there have been some problems and growing pains associated with banks paying market rates of interest on time deposits. But they have been minor compared to the major consumer benefits that have resulted. The real problem is that most of the legal framework governing financial services still needs to be modernized. Banks need new product powers and geographic freedom in order to offset the lost earnings that resulted from removing interest rate ceilings. . . .

Laws must change

Much of the current legal structure under which banks must operate was based on a completely different set of circumstances. It was developed in reaction to public policy concerns that arose after the Great Depression. From 1921 through 1932, more than 12,000 banks shut their doors. That's more than 40% of the banks that existed in 1921.

In reaction, Congress looked for ways to make banking safe and sound. They barred banks from the investment business; they added deposit insurance and an elaborate system of bank regulation; they limited the potential for geographic growth; and they prohibited the common ownership of banks and commercial enterprises. . . .

That system worked when banks had unique products and services that no one else could offer. Today that is no longer the case. In fact, there is no longer a single product or service unique to commercial banks. I can keep my checking account at Dean Witter. I can get a commercial loan from a savings and loan association. I can get my mortgage from a real estate company or a mortgage bank. And I can get my VISA card from the American Automobile Association. . . .

It's not that banking needs more regulations; it doesn't. It needs different regulation—regulation that permits banks to compete for the benefit of consumers, instead of regulation designed to protect banks from competition.