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Will Chase win suit for Maryland S&Ls?

by Stephen Pepper

The Maryland General Assembly will have to let it be known shortly whether it seriously intends to reject Chase Manhattan Bank's suit to relieve the state of three thrift institutions as the ticket for admission into the Baltimore-Washington market, or whether it is playing the role of the coy mistress who hopes merely to extract greater expressions of attention from her suitor. If the legislators are playing the latter game, they will soon find that not only has Chase put a pistol to their temples, but it is quite prepared to pull the trigger.

The New York bank, one of the biggest drug-money-laundering outfits in the world, has treated the state of Maryland as if it were several notches below El Salvador in its list of political colonies. Chase Vice-President Stanley Burns, in charge of the negotiations for the home bank, gave Maryland Gov. Harry Hughes just about three days to present to the legislature the complex deal whereby Chase would acquire Merritt Commercial, Friendship, and Chesapeake Savings, which it would convert into commercial banks, receiving in addition a $25 million bonus to compensate it for absorbing the losses of the three troubled thrifts. In addition, the very suspect Gerald Klein, the chief operating officer of Merritt, would in effect become Chase's associate in at least four properties, in which he would be allowed to retain proprietary interest. Since Klein is generally accused of having crossed the line between mismanagement and fraud, that he should walk away with a profit seemed outrageous.

The man who suddenly blocked the deal was the president of the Maryland Senate, Melvin A. Steinberg. The deal, said Steinberg privately, had a "smell" about it.

The smell was that of Governor Hughes's flesh being roasted by his former Chase associates. "In our view, the most appropriate thing for us to do is very gracefully depart the scene," said Burns, Chase's chief negotiator. "We can't make the deal work absent the financial help we've discussed."

The governor, prodded by Chase's ultimatum, rushed to address a joint session of the legislature to compel it to vote up an acceptable version of the deal—acceptable, that is to Chase. In effect, he accepted the terms of the bank: "We are dealing with curing a cancer with one surgical incision. And while it will not be painless, it will be nothing compared to the pain that will ensue of we don't operate." Or as one observor put it more pointedly, "It's either the greatest game of 'chicken' or Chase takes a walk."

How the S&Ls were wrecked

But the real issue is not the merits of different details of the deal, but rather the whole rotten process whereby a drug bank like Chase can be allowed to come in and pick up the pieces of the wreckage of the once viable thrift industry in a state such as Maryland. How did this come to pass?

The Savings and Loans across the country are among the prime victims of the policy of Paul Volcker, chairman of the Federal Reserve. From 1979, when Jimmy Carter appointed Volcker, his explicit policy of "controlled disintegration" of the U.S. economy, executed through double-digit interest rates, shattered the financial viability of S&Ls because there was no way they could compete for liquidity, tied as they were to long-term assets with fixed yields. Instead of attacking the Volcker policy, Congress compounded the problem by "saving" the S&Ls through deregulation, meaning that the institutions would be diverted from their main purpose of providing the funds by which most families in this country are able to buy or own homes. Instead, the S&Ls would become rivals of the commercial banks in drug-money laundering, real estate scams, and other swindles. Over the last five years the rate of failures in the industry has increased threefold, and there is no end in sight.

Under these circumstances, the thrifts have become targets for the wolves on the prowl for ever greater pools of liquidity. In Ohio recently, Chemical Bank had everything positioned to move in and swallow the drug-laundering Home State Bank, owned by Marvin Warner. But before Chemical could snap its jaws, a home-grown fox, financier Carl Lindner, stole the meat.

In Maryland, it was Volcker himself who brokered the arrangements between Hughes's office and Chase. The governor held a meeting with the Fed chairman during the third week of August, at which time Volcker gave assurances that the Fed would raise no objections to a deal involving an out-of-state bank. Neither he nor anyone else saw any conflict of interest between his role as regulator of such deals and his former employment at Chase.

The irony of the situation is that if anyone cared to examine the reality of Chase's financial position, they would find that Chase is in far greater need of a bailout than the thrifts. If non-performing loans totaling billions were removed from its assets, Chase would be seen to be bankrupt. Instead, as one legislator pointed out, "Harry Hughes didn't just blink, he closed his eyes."

So we are treated to the spectacle of the governor and the Maryland legislature fighting over who can make the best deal with a bankrupt Chase Manhattan, in a no-win situation created by Paul Volcker, the very man who gave the green light to the Chase deal.

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