Banking by Joyce Fredman and John Hoefle

Colorado industrial bank crisis

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Despite the efforts of those in the Reagan-Bush administration, as well as the financial regulatory agencies, to stem the tide, banking failures are occurring fast and furious. Collapses have become so commonplace in America's southwest, that the story of Colorado's financial woes, which five years ago would have rightfully made headlines, is now buried in the back pages of a few newspapers.

Colorado is currently undergoing a major crisis involving its "industrial banks," a group of some 80 privately insured, limited banks. Although Colorado ranked among the top six states in 1987 as far as bank failures, none of the 14 industrial bank failures which occurred last year were included in those statistics. Technically, they remain open, with one minor difficulty—none of the depositors can get their money!

As might be expected, this has caused quite a furor among those depositors. In response, the state legislature has created a Financial Management Task Force (FMTF), to act as receiver for the failed banks, to try to keep them open and save the depositors' money. The FMTF, an entity created by the combination of a bank consulting firm, a law firm, and an accounting firm, is under tremendous pressure to manage the crisis. Some angry depositors have filed intents to sue, and the number of people suing is growing. The depositors are suing everyone in sight, including the governor, the legislature, the state banking commissioner, the banks, and the FMTF.

In 1923, the Colorado Legislature authorized the creation of industrial banks, which are not commercial banks, but are similar to what in other states are considered industrial loan companies. At the time, the commercial banks were not too keen on lending to blue-collar workers, and the savings and loans were primarily making mortgage loans. Hence, the industrial banks were formed to make Second Deed of Trust loans, and loans to blue-collar workers. These institutions, often referred to as "poor man's banks" or "poor man's thrifts" were not full-fledged commercial banks. They offered only savings accounts: No checking accounts were allowed (although some currently offer NOW accounts).

Until 1973, they had no form of deposit insurance. To attract deposits, therefore, they offered slightly higher interest rates than their commercial bank competitors. Then in 1973 the legislature created a non-profit deposit-guarantee fund, financed by fees paid by the member industrial banks. Deposits were thereby insured, up to $20,000 per account. In 1983, that amount was raised to $40,000.

In 1986, Colorado passed a new law, requiring all industrial banks to join the Federal Deposit Insurance Corporation (FDIC) by 1989, and to apply by September 1987. At the September deadline, 14 of the industrial banks had either failed to apply or qualify for FDIC insurance. These 14 banks had about $45 million in deposits belonging to some 9,000 depositors. Beginning Sept. 21, 1987, the banks were systematically shut down. The guarantee fund, which was considered well-funded by insurance standards, had $14-15 million a couple of years ago. But that was not nearly enough to handle the crisis and the banks were declared insolvent.

Existing state law mandated that the failed industrial banks be liquidated, so the state legislature quickly changed the law to permit the banks to be put into receivership, to try to recapitalize them, combine them, or somehow get FDIC insurance.

Some have suggested that the depositors are entitled to the protection of the state, which should stand behind the guarantee fund. A state bailout, however, is impossible. Colorado is broke and can't afford to pick up anyone's tab.

The latest scheme is almost laughable. The Colorado Legislature passed a law permitting out-of-state banks to enter the Colorado market in 1991, but the out-of-state banks can get in a couple of years early by buying an existing commercial bank—provided they help in some way with the industrial bank crisis. Such aid could come by way of taking over and reopening a failed industrial bank, having their newly acquired Colorado commercial bank take over one of the failed industrial banks and honor its liabilities, or simply by writing a check to the state. What a deal!

Perhaps these wizards in Colorado expect First RepublicBank of Texas to come in with their new credit line and take over; after all, they've had such a tremendous rate of success with mergers themselves. Most ridiculous of all, of course, is the idea that these guys are scrambling for the protection of the FDIC, which is itself facing billions of dollars of liabilities it is in no way prepared to handle.