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Banking by John Hoefle

FDIC data prove banks are bankrupt

Through accounting tricks, the nation's commercial banks continue to report profits while losing billions.

The Federal Deposit Insurance Corp., in its "Quarterly Banking Profile" report on the 12,150 banks it oversees, claimed that "more than 88% of all commercial banks were profitable in the second quarter, and more than half reported higher earnings than a year ago." The statistics in the FDIC's quarterly report, however, actually prove that the banking system as a whole is bankrupt, and that the deepening collapse of real estate values nationwide is pulling down the entire credit structure of the United States.

According to the FDIC's statistics, U.S. commercial banks turned an aggregate profit of $70.5 billion between the beginning of 1987 and the second quarter of 1991, turning profits in every quarter except the second quarter of 1987, when the banks lost $10.6 billion, and the third quarter of 1989, when the banks lost $0.6 billion. The profits have ranged from $1.4 billion in the fourth quarter of 1990, to $7.3 billion in the first quarter of 1989.

How the banks were able to claim such profits while they were actually losing hundreds of billions of dollars, is an interesting example of statistical fraud.

One significant reason for these phantom profits is that the banks set aside loan loss reserves considerably lower than their level of admitted non-performing loans. In the first quarter of 1987, when the banks reported a profit of $5.2 billion, their aggregate loan loss reserves stood at $29.7 billion, compared to admitted non-performing loans of $75.6 billion. Thus, reserves were set aside for only 39.3% of admitted non-performing loans. Had the banks set loan loss reserves equal to non-performing loans, the claimed $5.2 billion profit would have turned into a loss of $40.7 billion.

The banks raised their loan loss reserves considerably in the second quarter of 1987, to 62.5% of admitted non-performing loans, causing them to report a loss of $10.8 billion. However, had they increased loan loss reserves to equal non-performing loans, that loss would have totaled $39 billion. Likewise, the reported profits of $5.8 billion in the third quarter and $2.3 billion in the fourth quarter, would have turned into losses of $22.7 billion and $21.7 billion, respectively. Thus, had the banks established reserves equal to their admitted non-performing loans, they would have reported a loss for 1987 of $124 billion, instead of an alleged profit of $5.2 billion.

Likewise, the reported profit of $25.2 billion in 1988 would have been a loss of $70 billion; the reported profit of $15.6 billion in 1989 would have been a loss of $41.4 billion; the reported profit of $16.9 billion in 1990 would have been a loss of $53 billion; and the reported profit of $10.3 billion in the first half of 1991 would have been a loss of $49.1 billion.

Overall, the reported profit of $70.5 billion between Jan. 1, 1987 and June 30, 1991, would have been a loss of $267.3 billion—a difference of $337.8 billion—with losses in every single quarter, ranging from a low of $4.5 billion to a high of $40.65 billion.

A loss of $267.3 billion during the period would have been more than enough to bankrupt the entire U.S. banking system, which had, at the end of the second quarter, a reported $226.8 billion in equity capital. Just by fully reserving their admitted non-performing loans, U.S. banks as a group would have had negative equity capital of $40.5 billion at the end of the quarter. Even by the Alice-in-Wonderland standards of federal banking regulators, that is insolvency.

The banks would argue that it is not necessary for them to set aside $1 in reserves for every $1 in non-performing loans, since they are likely to recover some of the value of those loans, even in the event of a default. In ordinary times, that might be true, but we are in a depression, and the banks' actual non-performing loans far exceed the amount they have so far admitted. Real estate values are plummeting, with no hope of recovery in the near future, and individual and corporate bankruptcies are skyrocketing. Under these circumstances, any loan that is now in trouble is quite unlikely to recover, and even if a few do, they will be buried under an avalanche of newly declared non-performing loans.

Over the past year, from the second quarter of 1990 through the same period of 1991, total admitted non-performing loans at U.S. banks rose 25%, while non-performing real estate loans rose 49%.

The real estate problems are most severe in the Northeast and Southwest. Washington, D.C. led the nation with 20.4% of its real estate loans non-performing, followed by Massachusetts at 17.1%, Connecticut at 16.8%, New York at 14.3%, Rhode Island at 12.9%, New Hampshire and Louisiana at 12%, New Jersey at 11.8%, Arizona at 11.5%, and Texas and Oklahoma at 10%.

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