EIR Economics

Have the Feds seized bankrupt Citicorp?

by John Hoefle

Has the U.S. government taken de facto control of the bankrupt Citicorp in a desperate attempt to keep the brain-dead giant afloat until after the presidential elections? Is the U.S. government pumping billions of dollars of taxpayers' money down the Citicorp rathole to keep this zombie alive, to hide the extent of the depression? If so—and there are a number of indications that just such an operation is under way—the savings and loan fiasco pales by comparison.

Late last July, at a hearing of the Telecommunications and Finance Subcommittee, House Energy and Commerce Committee Chairman Rep. John Dingell (D-Mich.) said that Citicorp was "technically insolvent" and "struggling to survive." Although Citicorp denied the statement as "irresponsible and untrue," investors around the world thought otherwise, withdrawing billions from Citicorp banks worldwide. That week, the Federal Reserve Bank stepped in with $3.4 billion in loans to help one or more unnamed banks, nearly all of which is believed to have gone to Citicorp to cover the runs.

It was about this time, European banking sources have told *EIR*, that a major U.S. bank, believed to be Citicorp, was put under de facto U.S. government control.

The House Banking Committee believes it too, judging from what one staff member recently told *EIR*. Citicorp is now operating under effective government control, the staffer conceded, as federal regulators desperately try to stop the hemorrhaging of the bank's loan portfolio and unwind its off-balance-sheet activities. While the government has not formally taken over the bank, the staffer said, there is "a strong federal influence" and "regulators are in there" trying to get "some idea of control of balance sheets."

Off-balance-sheet problems grow

The situation at Citicorp appears to be similar to that situation at the Bank of New England during 1990, when the Office of the Comptroller of the Currency and the Federal Reserve effectively seized control of the insolvent bank and began supervising the liquidation of its off-balance-sheet activities.

Off-balance-sheet activities do not show up in a bank's assets and liabilities totals. They include commitments to extend credit at a future time, guarantees that a third party will pay its loans, and market-related transactions such as interest rate and currency swaps. Banks like such transactions, because they do not have to set aside capital against them, and because they hide the full extent of the banks' liabilities from public view.

Off-balance-sheet figures are hard to come by, since many of those activities are not reported to federal regulators. However, according to a March 1988 General Accounting Office study, the amount of off-balance-sheet activities of U.S. commercial banks reported to federal regulators rose from $1.364 trillion at the end of 1984 to $3.14 trillion in June 1987, more than doubling in 3.5 years. These activities represented 884% of equity capital for all U.S. commercial banks at the end of 1984, and 1,791% of equity capital by mid-1987. The figures are even worse for banks with assets of $10 billion or more. At the end of 1984, the big banks had reported off-balance-sheet activities equal to 2,632% of their equity capital, and by mid-1987, that figure had jumped to 6,146%.

These figures reflect only the off-balance-sheet items reported by banks in their call reports to federal regulators. These reports, the GAO said, "do not provide a complete or clear picture since some OBS activities are unreported." As of the 1988 GAO report, only 11 off-balance-sheet categories were reported to regulators, compared to the 35 categories identified by the Federal Deposit Insurance Corp. (FDIC) in 1985 and 44 identified by Robert Morris Associates in 1983.

The danger of this off-balance-sheet frenzy was demon-

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strated with the failure of the Bank of New England during late 1989 and 1990. Although the bank was officially closed in January 1991, it had been effectively dead for more than a year, kept alive by massive federal support. The bank, which had $30 billion in assets on its balance sheet in 1989, had an even greater amount—$36 billion—in off-balance-sheet activities. During late 1989, before the bank publicly admitted its $1 billion loss for the fourth quarter, the bank quietly began to unwind its off-balance-sheet portfolio. By the time the loss was made public, the bank had trimmed $6 billion off its exposure, but it would take another year of concentrated effort by the bank and regulators to unload the remaining $30 billion and close the bank.

Since many of the off-balance-sheet transactions are long-term, a high credit rating is the only assurance banks have that their trading partners in the unregulated off-balance-sheet market will still be around when the contracts come due. Once the word began to spread that the Bank of New England was mortally wounded, international banks began to refuse to enter into long-term agreements with the bank, and demanded cash up front in all transactions. Banks began moving to reduce their exposure, fearing that BNE defaults would set off a chain reaction of defaults worldwide. The Bank of New England had become a pariah in the world banking system.

Unable to get credit in the interbank market, the bank turned to the Chicago Mercantile Exchange's International Monetary Market, hiring Shearson Lehman and Prudential Securities to handle its foreign-exchange futures trades. The move caused chaos at the Merc, but without the IMM, BNE treasury operations chief Arthur Meehan would later admit, federal regulators would have been forced to take over BNE's trading positions.

Meltdown scenario threatens

While the crisis at the Bank of New England was ultimately resolved and the bank closed, many observers considered the incident a harbinger of things to come.

"If we had a real problem with one of the larger banks, a meltdown scenario would be a possibility," a senior examiner with the Office of the Comptroller of the Currency told the *Wall Street Journal*.

Is such a meltdown scenario now being played out at Citibank? While the extent of Citibank's off-balance-sheet activities is a closely guarded secret, in 1988, Salomon Brothers estimated the bank's exposure at $659 billion, over three times the 203.7 billion in assets it had at that time. Given Citibank's propensity to try to speculate its way out of bankruptcy, it is likely that its off-balance-sheet activities now exceed $1 trillion.

Another indication that the problems at Citicorp are out of control came early in November, when the bank announced its new strategy for dealing with its growing real estate losses. Henceforth, the bank said, it would deal with them the same way it dealt with its loans to less developed countries (LDCs)—it would ignore them.

Citicorp is notorious among the big U.S. banks for refusing to write down its LDC loans. Even as competitors like J.P. Morgan wrote off billions in such loans, Citicorp held pat, insisting the loans had not lost value. Now it proposes to do the same with its real estate.

"The real estate portfolio has turned out to be an immense problem," Citicorp Chairman John Reed recently admitted. "We would like to get some recovery of the value for our stockholders . . . but we are not in a fire-sale mood. We'd rather hold it. We think it is better for the stockholders to hold it."

The real estate market nationwide continues to collapse, taking the banks with it. Citicorp's non-performing real estate loans rose 120%, to $2.6 billion, during 1990, and nearly doubled again, to $4.5 billion, by mid-1991. The New York City real estate market is severely depressed, and vacancy rates are skyrocketing in California, where Citicorp has nearly one-third of its commercial real estate loans. In Los Angeles, where nearly one-quarter of existing office space is vacant and several major office buildings are nearing completion, desperate developers are taking losses on rents to attract tenants.

Credit card business also falters

Citicorp's credit card business is also in trouble. The company is the nation's largest credit card issuer, with some 29 million cards outstanding, and it also processes credit card sales for some 97,000 businesses. However, the bank recently fired a dozen upper-level executives in its credit card arm after it was discovered that the bank had overstated its credit card profits for the past two years. The bank portrayed itself as the victim of this activity, lamely blaming the fraud on executives seeking higher bonuses, but it seems more likely that the bank was caught red-handed cooking its books by federal regulators overseeing the restructuring.

Even if the reports of a massive rescue operation at Citicorp are premature, there is no question that such an operation will be necessary in the near future. The bank is hopelessly bankrupt, and will not be able to save itself. A taxpayer bailout is on the agenda. The FDIC itself is bankrupt, and, in a replay of the S&L crisis, has been forced to suspend closing banks due to lack of money—a process which inevitably leads to larger losses.

Citicorp and the other big banks are pushing for the repeal of all restrictions on their activities, to allow them to loot the rest of the economy to keep themselves afloat. The Bush administration is pushing for the same thing, hoping to keep these lemons on the tree until after the elections. But as Representative Dingell recently warned, the big banks "are just like the reformed drunks with a half a gallon of good hooch. The first thing they'll do will be to take these powers and rush out and build upon the collapse that they've already brought upon themselves."