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FDIC figures show U.S. banking system is hopelessly bankrupt

by John Hoefle

With the economy collapsing steadily and inexorably in a process characterized by Democratic presidential candidate Lyndon LaRouche as the "great mudslide," a panicked Federal Reserve cut its discount rate by 1% to 3.5% Dec. 20, the lowest level since November 1964.

The discount rate, which is the interest rate the Fed charges for loans to banks and other financial institutions, has been steadily dropping for a year. Since July 1990, the Fed has acted 15 separate times to cut the various interest rates it controls or influences. This is reminiscent of the actions the Fed took in the wake of the 1929 stock market crash. Like 1929, these actions will not stop the depression, but rather will accelerate the collapse.

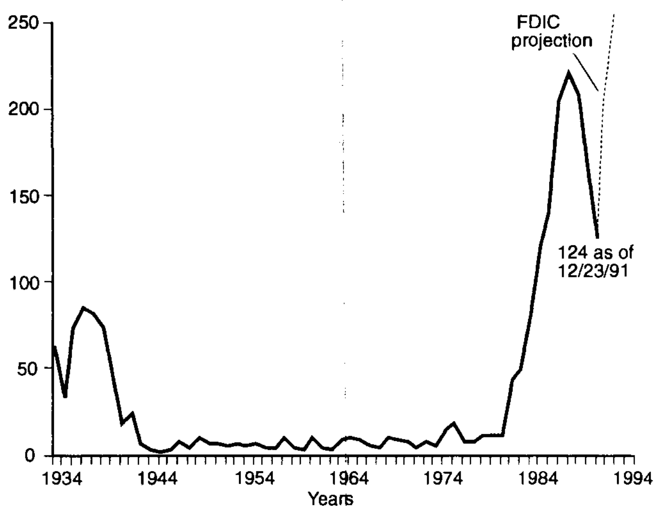
Despite the Fed's contention that such interest rate drops are intended to spur bank lending and ease the credit crunch, the real purpose of the cuts is to pump desperately needed liquidity into the increasingly insolvent U.S. banking system.

The U.S. banking crisis is out of control, as non-performing loans skyrocket, real estate values plummet, and the corporate and consumer sectors sink into oblivion. Trillions of dollars of corporate debt, consumer debt, and residential mortgages are unpayable due to the depression racking the economy of not only the United States, but the entire Anglo-American world.

The administration and the Fed have responded to this crisis not by trying to save the economy, but instead by trying to save the banks with a massive bailout reminiscent of, but on a much greater scale than, the bailout of the savings and loans institutions. This approach is both immoral and incompetent, since the failure to deal with the economy dooms any attempt to save the banks. The result is that funds needed to rebuild the productive sector of the economy are being wasted on insolvent banks, blocking any hope of a genuine recovery.

The U.S. banking system is past the point of salvation, no matter how much money is thrown at it. Commercial banks are failing at the greatest rate since the Great Depression. The failures are increasing both in terms of the number of banks failing (see **Figure 1**) and the size of the banks that are failing (see **Figure 2**) as larger and larger chunks of the banking system fail.

FIGURE 1
U.S. banks failing at record rates
(numbers of banks)



Source: FDIC (1991-94 are projections)

The figures for 1991 are deceptive. As of Dec. 23, only 124 banks had failed, short of the 137 failures the Federal Deposit Insurance Corp. had projected in October, and well under the 180 to 230 failures the agency had predicted in January. The reason for the drop in failures is not any recovery on the part of the banking system, but rather the insolvency of the FDIC's Bank Insurance Fund (see **Figure 3**). Regulators were forced to slow the closing of insolvent banks because the FDIC ran out of funds to pay off depositors. Banks that should have been closed this year, are being allowed to remain open until the FDIC obtains new funds.

Thus, the dip in 1991 failures, rather than representing any improvement, instead represents a further ratcheting-down of the banking system. As with the savings and loans institutions, the federal government is now leaving insolvent banks open because it cannot afford to close them. The result

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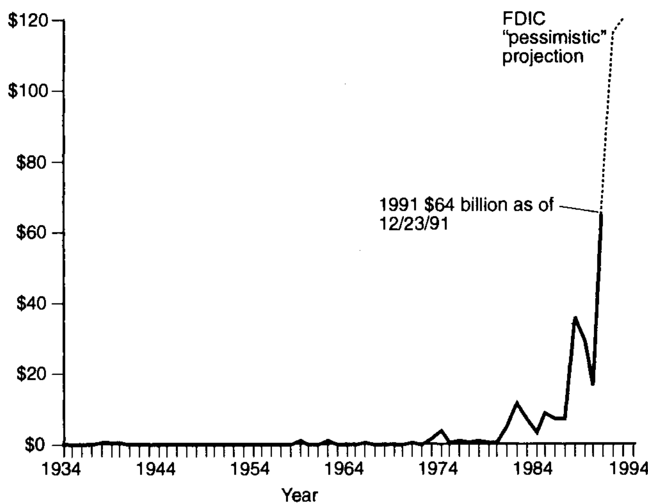
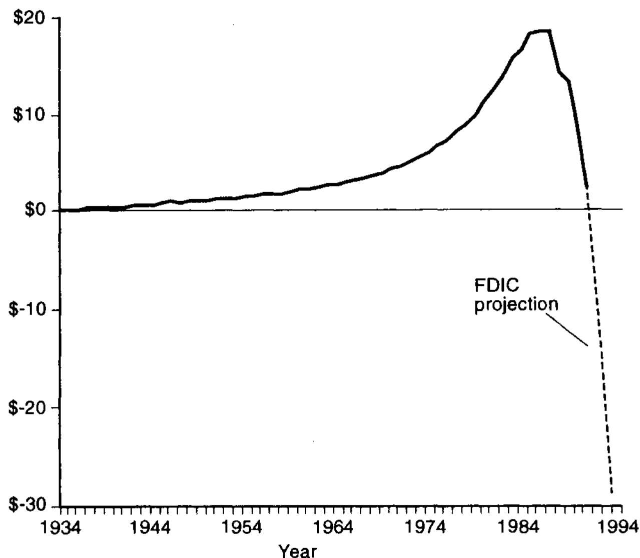
FIGURE 2
Total assets of failed banks zooms
(billions of dollars)



Source: FDIC (1991-94 are projections)

FIGURE 3
Falling Bank Insurance Fund assets show FDIC is bankrupt
(billions of dollars)



Source: FDIC (1991-1994 are projections)

TABLE 1
Bank failures, 1991
(states ranked by assets)

State	Failed banks	Total assets (millions)	% of total assets
Massachusetts	14	$17,513	27.2%
Connecticut	17	13,713	21.3%
Florida	10	10,646	16.5%
New York	2	9,953	15.5%
New Hampshire	12	4,921	7.6%
Maine	2	2,300	3.6%
New Jersey	4	1,967	3.1%
Texas	31	1,228	1.9%
District of Columbia	1	531	0.8%
Louisiana	5	238	0.4%
Kansas	1	191	0.3%
Virginia	2	171	0.3%
Illinois	2	171	0.3%
New Mexico	3	114	0.2%
California	4	112	0.2%
Arizona	1	82	0.1%
Ohio	1	69	0.1%
South Carolina	1	63	0.1%
Colorado	3	57	0.1%
West Virginia	1	49	0.1%
North Carolina	1	48	0.1%
Maryland	1	38	0.1%
Indiana	1	37	0.1%
Vermont	1	36	0.1%
Oklahoma	1	35	0.1%
Arkansas	1	33	0.1%
Hawaii	1	9	0.0%
Total, as of Dec. 23, 1991	**124**	**$64,337**	
Total New England	46	$38,484	59.8%
New England plus New York	48	$48,437	75.3%

Source: FDIC.

of such a policy, as the S&L crisis clearly shows, is to add billions of dollars to the cost of bailing out the banks—money which will come out of the pockets of the taxpayers.

Texas comes to the Northeast

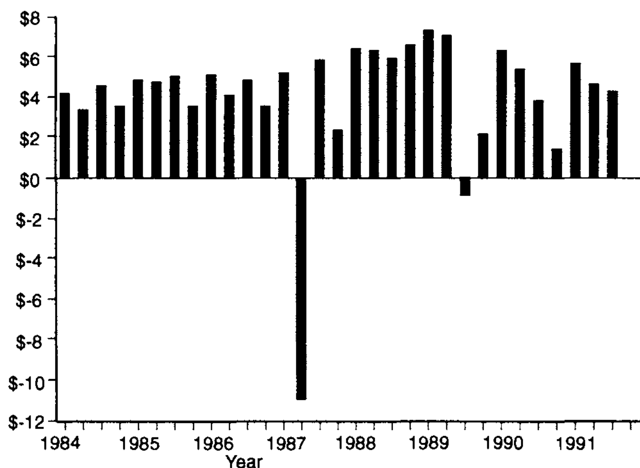
When the Texas banking system collapsed in the late 1980s, politicians, bankers, and regulators were quick to insist that the crisis was unique to Texas and would not spread to other parts of the country. The claim, like the constant talk of recovery, was nonsense.

The wave of bank failures which started in Texas has now spread to the Northeast and Florida. While Texas continues to lead the nation in the number of failed banks, it is a distant eighth when ranked by the assets of failed banks (see **Table 1**). New England alone had 46 bank failures and nearly 60% of the failed-bank assets as of Dec. 23, and this does not count the 45 non-FDIC-insured banks and credit unions which were

FIGURE 4

Despite collapse, U.S. banks are reporting high quarterly profits

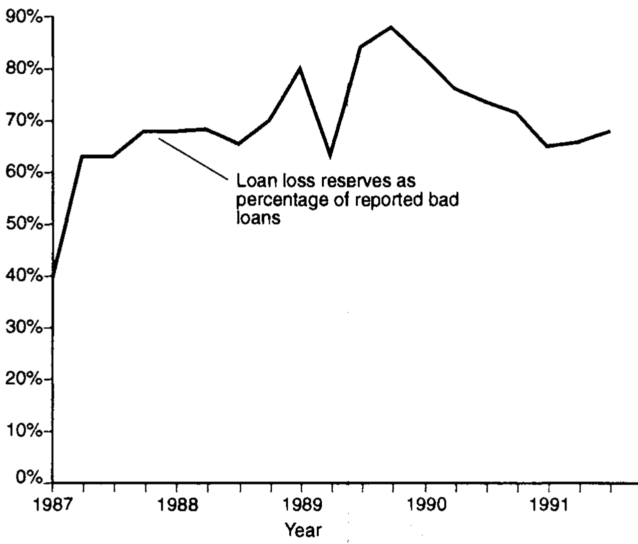
(billions of dollars)



Source: FDIC

FIGURE 5

Banks are not setting aside funds for admitted bad loans



Source: FDIC, *EIR*

closed by the state of Rhode Island Jan. 1, 1991. Together, New England and New York accounted for 75% of the assets of failed banks this past year, while Texas accounted for just 2%.

The crisis is systemic, and it is growing. The wave of collapse which devastated the Texas banks is now ravaging the Northeast, and is breaking over California. No part of the United States will remain untouched.

Phony profits

Despite this escalating rate of collapse, the banks nevertheless are managing to claim profits nearly every quarter (see **Figure 4**).

The secret to how an insolvent banking system can report profits even as it disintegrates is actually very simple: The banks are hiding the extent of their uncollectible loans and cutting back on the size of their loan loss reserves. The result is the appearance of profits, even as losses soar.

Banks are required to set aside funds as reserves for potential loan losses. Funds put into the loan loss reserve are deducted from income, but remain part of the bank's equity capital. When bad loans are actually written off, the money is deducted from the reserve and therefore from the bank's equity. Consequently, banks lose income when they add to their loan loss reserves, and lose equity capital when they write off bad loans.

Therefore, by underfunding its loan loss reserve and failing to write off some of its uncollectible loans, a bank can significantly overstate its profits and capital, disguising losses and even insolvency.

This is precisely what the U.S. banks are doing. The size of the aggregate loan loss reserves of the commercial banks, measured as a percentage of the banks' reported non-performing loans and leases, rose sharply from 1987 through 1989, peaking at 87% in the fourth quarter of that year (see **Figure 5**). Most of the increase in reserves came when several major banks added reserves for less developed country (LDC) loans and, to a much smaller extent, for real estate loans.

During 1990, however, the size of the loan loss reserves as a percentage of admitted non-performing loans declined sharply—even though the level of non-performing loans skyrocketed. Rather than add to reserves at the same pace that loans went bad, the banks decided to claim profits instead.

The ratio dropped to 64% on March 31, 1991—a 23 point drop in just over a year—then began slowly creeping up as federal regulators pushed the banks to keep pace with their reserves. As of last Sept. 30, bank loan loss reserves stood at 67% of admitted non-performing loans.

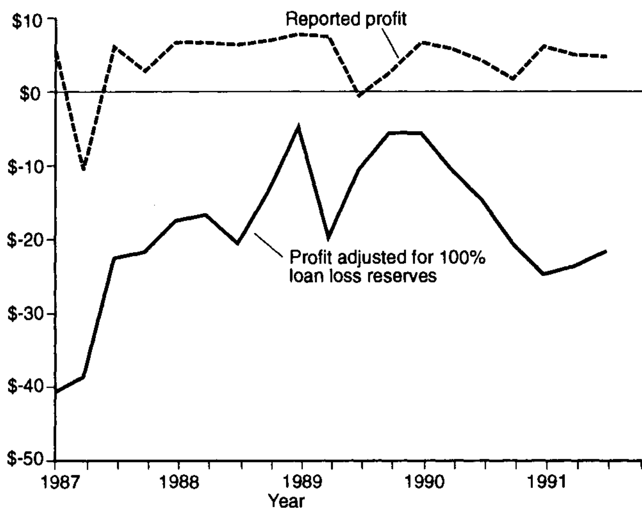
The effect of this has been to hide massive losses. Were the banks to have added $1 to loan loss reserves for every $1 in admitted non-performing loans, the income picture would be much different (see **Figure 6**). Banks would be losing money.

Banks argue that this is not a valid measurement, saying they usually recover most of such loans even when the borrower goes bankrupt, and thus should not be required to reserve at a $1 to $1 rate. While this was true during the real estate boom of the 1980s when real estate values were rising and there were always buyers, it is no longer true today.

FIGURE 6

U.S. commercial bank profit becomes a loss at 100% loan loss reserves

(billions of dollars)

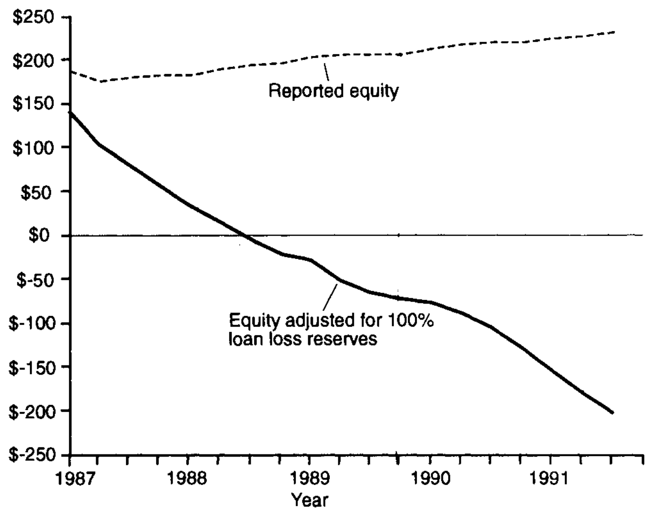


Source: FDIC, *EIR*

FIGURE 7

Equity capital of U.S. commercial banks in the red

(billions of dollars)



Source: FDIC, *EIR*

Real estate values are collapsing, down 20-50% in many areas, with many properties no longer worth the amount of money owed on them. The real estate market is glutted, awash with cash-starved sellers and precious few buyers. In this market, banks cannot find buyers for their huge portfolios of real estate at anything near book value. In order to sell the properties, the banks would have to offer them at substantial discounts. Such a policy would not only force the banks to take huge write-offs on the properties, but it would further deflate real estate values, causing further losses.

As a result, banks are holding onto hundreds of billions of dollars of devalued real estate and real estate-backed loans. Unable to find buyers, and unable to sell if they could, the banks are holding these properties at or near book value—as if the collapse had not occurred.

Were the banks to have set aside loan loss reserves equal to their admitted non-performing assets—which are just the tip of the iceberg of actual bad loans—since 1987, their claimed $231 billion in equity capital would instead be a deficit of $204 billion, and the banking system would have been officially insolvent since mid-1988 (see **Figure 7**).

Backdoor bailouts

To cover up this accelerating insolvency, the Bush administration, bank regulators, and bankers have resorted to a scandalously wide range of backdoor bailouts, fraudulent bookkeeping, interest rate windfalls, rules changes, orchestrated mergers, and taxpayer bailouts.

The Federal Reserve has been systematically propping up failing banks with loans from its discount window, according to a study released in June by the House Banking Committee. Between Jan. 1, 1985 and May 10, 1991, the study found, the Fed routinely made "extended" loans to over 500 troubled institutions, 90% of which subsequently failed. Approximately 60% of the banks receiving such loans were borrowing money from the Fed at the time of their failure, with over $8.3 billion in such loans outstanding.

When the banks failed, the Fed turned to the FDIC for repayment.

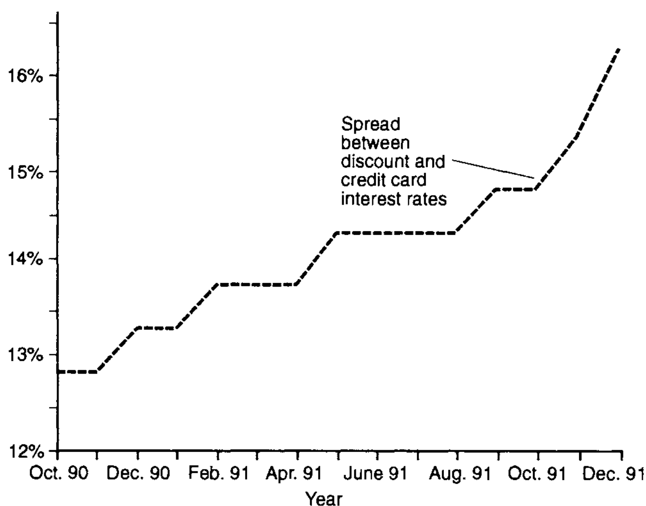
"This is a massive form of forbearance—granted in secret by the Federal Reserve—at a huge cost to the insurance funds and the taxpayers," observed House Banking Committee chairman Rep. Henry B. Gonzalez (D-Tex.). "The Federal Reserve's loans have kept brain-dead institutions open for extended periods, increasing losses for the FDIC," he added. The two biggest beneficiaries, the study found, were First RepublicBank Corp. of Dallas, and the Bank of New England, both of which subsequently failed.

The Treasury Department also helped prop up insolvent banks—notably the Bank of New England—by depositing billions of dollars of Treasury Tax and Lien funds in the banks.

The Fed has also been helping the banks by lowering interest rates, thereby reducing the banks' costs of funds. The Fed has cut its discount rate—the rate it charges to lend money to banks—six times since December 1990, from 7% to 3.5%. During this same period, the Fed Funds rate—the rate at which banks lend money to each other—has dropped nearly 3%, from 7.5% to 4.6%.

While banks have been quick to take advantage of the

FIGURE 8
Banks living off usury
(interest rates)



Source: Federal Reserve, *EIR*

lower rates, they have been slow to pass the savings on to their customers (see **Figure 8**). It is estimated that for each 1% drop in the discount rate, the banks book an extra $1.5-3 billion in profits, giving the banks a windfall over the past year of as much as $7-13 billion.

Cooking the books

In addition to these backdoor bailouts, the White House and banking regulators have issued a series of so-called policy clarifications which attempt to cover up the collapse of the real estate market and the subsequent devastation of the banks' balance sheets.

In February, Federal Reserve Board chairman Alan Greenspan complained that it is "fundamentally wrong" to make banks count their real estate holdings at market value. On March 1, the four banking regulators—the Fed, the FDIC, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision—issued a set of lending guidelines designed to make it easier for banks to roll over or hide their non-performing loans, and artificially inflate their incomes.

Deputy Treasury Secretary John Robson defined the measures as "confidence building," but "con" would be more apt. The measures will make it more difficult to determine the true health of a bank, the General Accounting Office warned. Which, of course, is exactly the intent.

As the banks continued to collapse, the Bush administration and the regulators were forced to even more blatantly political measures.

On Nov. 7, the four regulatory agencies issued a joint policy statement on the review and classification of real estate loans, which called on bank examiners to review real estate loans not "based solely on the current performance of the collateral or similar properties," but rather on the alleged "ability of the real estate to generate income over time based upon reasonable and supportable assumptions"—meaning, based upon the mythical Bush recovery in which real estate prices will climb back up to their historic highs.

To make sure that the bank examiners got the message, the regulators gathered 464 examiners together at a conference in Baltimore, Maryland on Dec. 16-17 for what could charitably be called political indoctrination.

"If America's banks are the engines for growth in this country, then you are at once the throttle and the governor," Treasury Secretary Nicholas Brady told the examiners. "On the one hand, your decisions and examinations can choke expansion. On the other, you can foster the injection of fuel that will lead to solid economic growth."

Deputy Treasury Secretary Robson told the group that part of their job was to "promote economic growth," and he encouraged examiners to give banks "the benefit of the doubt, even if it might ultimately turn out to be a misjudgment."

Two years ago, the examiners were severely criticized by the administration for not cracking down on the S&Ls. Now the administration is criticizing them for cracking down on the banks.

Bailouts out of control

The taxpayer bailout of the U.S. commercial banking system began Dec. 19, when President Bush signed the bank bill passed by Congress Nov. 27. The bill extends the FDIC's line of credit with the Treasury by $25 billion, to $30 billion, and grants the FDIC the right to borrow another $45 billion from the Federal Financing Bank (FFB).

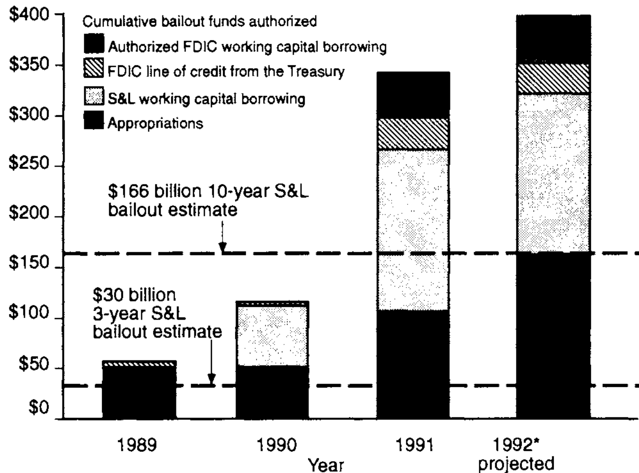
In theory, any monies borrowed from the Treasury will be repaid by the banks, through premiums paid to the FDIC for deposit insurance, while the so-called working capital borrowed from the FFB will be repaid from the sales of assets seized from failed banks.

To judge the worth of such assurances, one should look at how the cumulative S&L bailout costs have soared (see **Figure 9**).

When the Bush administration signed the Financial Institutions Reform, Recovery and Enforcement Act savings and loan bailout bill in August 1989, it said that the $50 billion being appropriated was more than enough, since the bailout should only cost $30 billion over three years and $166 billion over 10 years, excluding interest. The ink was barely dry on the bill when, in September 1989, Resolution Trust Corp. chairman William Seidman told Congress that the RTC would need an additional $50-100 billion in so-called "working capital." By December 1989, President Bush was forced to admit that the $50 billion "might not be enough."

On Jan. 7, 1990, Seidman announced that the RTC was

FIGURE 9
S&L and bank bailout costs soar
(billions of dollars)



Source: *EIR*

out of funds and that no more S&Ls could be closed until additional funds were provided. In February, the administration announced a plan to let the RTC borrow working capital from the Federal Financing Bank. The RTC was authorized to borrow $60 billion in working capital in 1990, raising the amount of funds authorized for the bailout to $110 billion, nearly four times the administration's $30 billion, 36-month estimate of just 17 months before.

The bailout accelerated in 1991. On March 23, President Bush signed a bill giving the RTC another $78 billion—$30 billion in appropriations and $48 billion in working capital borrowing authority. Total appropriations now stood at $80 billion.

In June 1991, Treasury Secretary Nicholas Brady told the Senate Banking Committee that the RTC needed another $180 billion—$80 billion in appropriations and $100 billion in working capital. Brady suggested that it might be easier for Congress to just give the administration authority to spend whatever it needed without having to ask for more.

"I'm fully convinced the RTC has lost control of the situation," observed Representative Gonzalez.

On Dec. 19, 1991, the President signed the second S&L bailout bill of the year, adding another $60 billion. Of that amount, $25 billion was in the form of an appropriation, raising the appropriated total to $105 billion, and $35 billion was added to the working capital borrowing authority, raising that figure to $160 billion. By the end of 1991, $265 billion had been allocated for the S&L bailout.

The latest appropriation is expected to keep the RTC going until April 1992, when the administration is expected to request another $55 billion. If approved, the total cost of the S&L bailout would then be $320 billion, excluding any additions to working capital. That's more than 10 times the administration's projection for the first three years, and nearly twice its projected 10-year cost. All of these figures exclude interest, which will be paid out over a 30-year period. The eventual cost of the S&L bailout will top $1 trillion.

The banking bailout will be even more costly.

In fact, even before the FDIC money was appropriated, regulatory officials were warning that $70 billion might not be enough.

In October, outgoing FDIC chairman William Seidman warned Congress that "the uncertainty of the timing and strength of the economic recovery could bring the sufficiency of the proposed recapitalization into question."

The General Accounting Office, in a report issued Nov. 12, warned that the amount of money needed by the FDIC may "be significantly higher" than the $70 billion being proposed.

On Nov. 25, William Taylor, the new FDIC chairman, told Congress that the $70 billion should be sufficient, provided the economy and real estate markets don't do anything unexpected and a "megabank" doesn't fail.

"It is impossible to certify to anyone what the cost of this will be," Taylor admitted.

Massive bank consolidation

The Bush administration's plans to save the big banks were pegged on its bank restructuring proposal, dubbed the Financial Institutions Safety and Consumer Choice Act of 1991, which was designed to give the big banks free rein to loot whatever is left of the U.S. economy. The bill would have allowed banks to set up branches anywhere in the country, sell insurance, underwrite and sell securities, and merge with non-bank companies. The resulting megabanks would be backed by the political and regulatory might of the U.S. government—and the pocketbooks of the U.S. taxpayers.

The Bush proposal would have, in effect, created a nationwide banking dictatorship, with credit controlled by a handful of big banks, to be issued in such a way as to maximize bank profits.

Thanks to determined opposition in Congress, especially by House Banking Committee chairman Gonzalez and House Energy and Commerce Committee chairman Rep. John Dingell (D-Mich.), the Bush banking proposal failed.

Nevertheless, the banking consolidation has begun. During a one-month period this summer, mergers were announced involving six of the twelve largest banks in the country (see **Table 2**).

On July 15, Chemical Banking Corp., the sixth largest in the nation, announced a merger with Manufacturers Hanover Corp., the ninth largest, making Chemical the nation's third-largest bank. On July 22, NCNB Corp., the seventh largest, announced a merger with twelfth-ranked C&S/Sovran Corp.

TABLE 2
Banking consolidation under way: U.S. banks as of June 1991

Rank	Assets (billions)	Bank holding company
1	$217.0	Citicorp
2	110.7	BankAmerica Corp.
3	98.1	Chase Manhattan Corp.
4	93.1	JP Morgan & Co.
5	84.7	Security Pacific Corp.
6	73.0	Chemical Banking Corp.
7	65.3	NCNB Corp.
8	63.6	Bankers Trust New York Corp.
9	61.5	Manufacturers Hanover Corp.
10	56.2	Wells Fargo & Co.
11	51.4	First Interstate Corp.
12	51.2	C&S/Sovran Corp.

Source: *American Banker*.

This is what the banks look like today, counting the announced mergers:

Rank	Assets (billions)	Bank holding company
1	$217.0	Citicorp
2	195.5	BankAmerica Corp.[1]
3	135.0	Chemical Banking Corp.[2]
4	116.0	NationsBank[3]
5	98.1	Chase Manhattan Corp.
6	93.1	JP Morgan & Co.
7	63.6	Bankers Trust New York Corp.
8	56.2	Wells Fargo & Co.
9	51.4	First Interstate Corp.

1. BankAmerica + Security Pacific, Aug. 12, 1991
2. Chemical + Manufacturers Hanover, July 15, 1991
3. NCNB + C&S/Sovran, July 22, 1991

to form NationsBank, the fourth-largest U.S. bank. BankAmerica Corp. solidified its position as the nation's second-largest bank with its Aug. 12 announcement of a merger with number-five Security Pacific Corp. A number of second-tier banks have also announced mergers.

These mergers were orchestrated by the Federal Reserve, to prevent several of these big banks from failing, according to informed sources.

Conspicuously absent from the merger list are Citicorp and Chase Manhattan Corp.

Nationalization

Citicorp, the largest and most bankrupt of the big banks, is at the center of the banking crisis. According to well-informed European banking sources and members of the staff of the House Banking Committee, Citicorp has been taken over by the Federal Reserve Bank of New York in a top-secret government bailout. According to these sources, the Fed seized Citicorp near the end of the third quarter of 1991, but is keeping the move secret to avoid setting off financial panic. Were the word to get out, regulators fear, it could provoke a flight from the dollar and runs against Citicorp and other banks. Meanwhile, regulators are struggling to contain the bank's growing insolvency and unwind its off-balance-sheet activities, which total several times its $217 billion in assets on the balance sheet.

The crisis at Citicorp is reportedly one of the primary reasons the Fed has been dropping interest rates. The bank, which runs the largest credit card operation in the United States with nearly 20 million cards issued, benefits enormously from the rate drops, reportedly reaping half of the total windfall earned by the banking system due to dropping rates, giving the bank an extra $3.5-6.5 billion in income over the past year.

Citicorp is the leader among U.S. banks in the $60 billion credit card securities market, accounting for $19.6 billion of the total. Credit card securities are pools of credit card receivables, sold in the securities market.

Citicorp's dependence on credit card income was at the center of the furor over President Bush's Nov. 12 call for the lowering of credit card rates, and the Senate's passage of a bill to cap those rates. The measure set off a firestorm of protest from the banks, who threatened to cancel half of their 120 million credit cards.

The Bush administration immediately backtracked on the issue. White House press secretary Marlin Fitzwater issued a statement saying that a legislated cap on credit card interest rates "could be quite disastrous to the banking industry." Treasury Secretary Nicholas Brady denounced the measure as "wacky, senseless legislation," and Council of Economic Advisers chairman Michael Boskin called it "economically dangerous."

Federal Reserve chairman Alan Greenspan warned that the measure would have a "negative effect of banks' earnings" at a time when there are already "concerns about capital positions."

Sen. James Sasser (D-Tenn.), a senior member of the Senate Banking Committee, put it more bluntly. "The thought around here," Sasser said, "is that Citicorp might go under, and that millions of folks would lose their credit cards, and that is causing a lot of wringing of hands and gnashing of teeth."

The fact is, millions of folks have already lost a lot more than their credit cards: They've lost their jobs, their homes, and even their lives. This depression, and worse misery to come, will not be ended until the Federal Reserve System is replaced with a system of national banking based on fostering growth in the physical economy.