# FDIC to close sick banks, but can't cope with crisis

by John Hoefle

On Dec. 19, new bank capital guidelines, designed to allow federal bank regulators to close sick banks before they actually fail, will take effect. Under the new standards, which were mandated by the Federal Deposit Insurance Corp. Improvement Act of 1991 (Fdicia), regulators will be required to close within 90 days, any bank whose tangible equity capital is less than 2% of its assets, unless—and this is a large loophole indeed—regulators determine that the bank is on the road to recovery.

The theory behind the Fdicia capital requirements is that by closing doomed banks before they go completely broke, the costs to the government and, ultimately, the taxpayer, will be reduced, thereby helping to avoid a replay of the trillion-dollar savings and loan fiasco.

The ticking of this 90-day clock, combined with the Federal Deposit Insurance Corp.'s (FDIC) deliberate slowing of the pace of bank closures in the months before the election, has led to widespread speculation of a rash of bank failures in December, a so-called December Surprise.

That the FDIC has slowed the pace of failures is clear. The agency had predicted in October 1991 that banks with assets of $86 billion would fail in 1992, but by mid-October of this year, the FDIC had closed banks with just $29 billion in assets. That's one-third of the projected level of bank failures in over nine months, leaving two-thirds of the projected failures for the remaining two and a half months.

Federal regulators, as would be expected, have vociferously denied slowing the pace of closures.

In testimony before the Senate Banking Committee on Oct. 26, Acting FDIC Chairman Andrew Hove rejected the accusation as "simply not the case," attributing the fewer-than-expected number of closings to "lower interest rates and the ability of some troubled banks to improve their financial condition." Total bank capital increased by $16.7 billion during the first half of 1992, over twice the rate of increase during the same period in 1991, and the banks' average equity capital to assets ratio now stands at 7.23%, the highest level since 1966, Hove claimed.

"The FDIC has been far from idle during 1992," Hove maintained, calling the 85 banks with assets of $29 billion resolved as of Oct. 16 "an extremely high number by historical standards."

Hove is dissembling. In October 1991, the FDIC projected that some 200 banks with assets of $86 billion would fail in 1992. Were that forecast accurate, it would have easily topped the 127 banks with a record $63 billion in assets which failed in 1991.

Since 1987, bank failures have indeed been at extremely high levels. In 1987, some 203 banks with assets of $6.9 billion were closed by the FDIC. In 1988, another 220 banks failed, with a record $35.7 billion in assets. The figures declined a bit in 1989, to 169 banks with assets of $29.4 billion, and dropped again in 1990, to 169 banks and $15.7 billion in assets.

## Covert bailout

The government and the banks would like the public to believe that these declining levels of failures represent an improvement in the condition of the banking system, but this is not the case. The truth is that the banking system as a whole, and most of the largest banks in the country, are hopelessly insolvent. Rather than admit this unpleasant circumstance, the government has been keeping the banks open through a secret policy of covert financial aid and a virtual "no such thing as a bad loan" regulatory posture. This process will continue until an already-in-progress but far from completed restructuring and consolidation of the financial system—financed by the taxpayer—can be completed, or until



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the entire house of cards collapses.

The drumbeat for this post-election consolidation escalated in October with the publication of *Banking on the Brink, The Troubled Future of American Finance,* by Cleveland State University associate professor Edward Hill and former Citibank economist Roger Vaughan. The book was published by the *Washington Post,* which has embarked upon a mission of forcing the consolidation through limited public exposure of the crisis.

The Hill-Vaughan study, which consists of 366 pages of text and data, represents the bleakest assessment to date in the so-called major press, about the condition of the U.S. banking system.

"Nearly 1,500 banks are in deep trouble," the study found. "Together, these ailing banks manage assets with book assets of more than $1 trillion. The list of invalids includes 14 of the nation's 57 largest bank holding companies. . . . Perhaps 1,150 banks are now insolvent—and would be shuttered if their books reflected the true value of their assets."

The study found that only two of the 57 bank holding companies with assets exceeding $10 billion, and only 30 of the 207 bank holding companies with assets between $1 billion and $10 billion, had appropriate levels of capitalization.

"Fifty of these holding companies, with total assets exceeding $682 billion, have real net worths that appear to have fallen below zero," the study found. "In other words, they would be declared insolvent if their books reflected the true value of their assets."

The fourteen $10 billion-plus bank holding companies on Hill-Vaughan's "deep trouble" list at the end of 1991 included Citicorp, Chase Manhattan Corp., and Marine Midland banks of New York; Security Pacific Corp. and Wells Fargo & Co. of California; Midlantic Corp. and UJB Financial Corp. of New Jersey; Shawmut National Corp. of Connecticut; MNC Financial Inc. of Maryland; Michigan National Corp. of Michigan; Valley National Corp. of Arizona; Barnett Banks Inc. of Florida; the Bank of Boston Corp. of Massachusetts; and C&S/Sovran Corp. of Virginia. Together, these 14 holding companies had $668.7 billion in book-value assets at the end of 1991.

Some of these doomed banks have already disappeared via mergers into allegedly healthy banks. BankAmerica Corp. has acquired Security Pacific, NCNB bought C&S/Sovran and renamed itself NationsBank, and Banc One of Ohio is in the process of acquiring Valley National.

Had the government closed all of the 1,179 banks which were effectively insolvent at the end of 1991, the Hill-Vaughan study reported, it would have cost the FDIC $50 billion; by August 1992, that cost had risen to an estimated $75 billion. "If all the bank closings and mergers that are now inevitable are stretched out over an unnecessarily long period of time, the total cost might easily be twice that," the study said. "Beyond this, surviving banks might need as much as $150 billion to rebuild their depleted capital."

Thus, according to Hill-Vaughan's figures, the commercial banking system will need a bailout of as much as $300 billion, or 10 times the original projected cost of $30 billion for the S&L bailout.

## Fear of runs

Fearing that such news could trigger depositor runs which would quickly overwhelm the government's covert bailout operation, federal regulators held an extraordinary press conference on Oct. 23 to rebut the book and insist that the banking system is fundamentally sound. Acting FDIC Chairman Hove accused the authors of "some poor, sloppy computational methods" and of adopting an "end of the world syndrome." Federal Reserve Board governor John LaWare cited the $7.9 billion in profits claimed by the banks in the second quarter, saying, "the banking industry has improved significantly in 1992."

Three days later, on Oct. 26, LaWare, Hove, and Acting Comptroller of the Currency Stephen Steinbrink repeated this "hear no bankruptcy, see no bankruptcy, speak no bankruptcy" routine.

"There is no basis for assertions that there are large, unreported problems in the banking system," insisted Steinbrink. "Problems with non-performing real estate loans will continue to be a drag on earnings. But . . . they do not pose a serious threat to the overall health of the national banking system."

## Where do we go from here?

The question of what to do about the bankrupt U.S. banking system is a politicial question rather than a financial one. By any honest accounting standards, the U.S. banking system as a whole is insolvent, and any attempt to save it is both futile and an immoral waste of resources that are badly needed to begin the process of rebuilding the physical economy.

During the presidential campaign, President-elect Bill Clinton explicitly defended the Federal Reserve, and his appointment of Goldman, Sachs vice chairman Robert Rubin as his economic czar is an indication that the economic policy of the Clinton administration will be dominated by Wall Street financial interests, just as his predecessors have been (see article, page 62).

In plain terms, that means a continuation of the evil policy of letting the financial vampires deplete the shrinking human and capital resources remaining, throwing the United States and the world deeper into depression.

Were the Clinton administration forced by public pressure to break with this insane policy, to abolish the Federal Reserve, and to return to a national bank as provided for by the U.S. Constitution and called for by Lyndon LaRouche, in which the welfare of the population was paramount, then this situation could be reversed.

Absent that dramatic policy shift, the United States is headed into an economic black hole. Against that, the question of a "December Surprise" is irrelevant.