EIR Economics

Paul Volcker readies the big banks for cartelization

by Kathy Burdman

U.S. bank regulators under the policy guidance of Federal Reserve chairman Paul Volcker tightened capital regulations on major money-center banks beginning Nov. 16, in an apparent regulatory crackdown on the banking giants of the United States. The banks are being asked to sharply raise their existing ratio of capital to assets (mostly loans), from their current average of 4.5-5%, to 6% or above.

The regulatory moves come at the evident behest of foreign depositors who have demanded an improvement in the condition of the U.S. banking system if they are to maintain their deposits and stock ownership. In effect, the U.S. banking system is now being regulated as a colonial branch of foreign banking systems; in this respect, the move is only the latest in a series of actions by Volcker, Comptroller of Currency C. Todd Conover, and his boss, Treasury Secretary Donald Regan, who aim at the thorough cartelization of American banking in the immediate future.

Immediately hit with adverse publicity as a result of the Nov. 16 announcement were Bank of America, which announced Nov. 16 that the Comptroller of the Currency had forced it to immediately raise capital to increase its capital-to-asset ratio to 6%, and First Chicago, which was put under similar pressure.

Bank of America announced that it may be forced to sell its $500 million corporate headquarters building in San Francisco and related real-estate holdings to raise part of the cash for capital reserves.

The measures may cause a weakening of bank stocks in the market, and could also reduce new bank credit available to the U.S. and world economy. In order to raise the capital-to-asset ratio, banks will have to both raise capital and possibly reduce their rate of lending (asset creation). To raise capital, the banks will have to attempt to sell more bank stock in an already weak market for such paper.

Asked which banks are next, an official at Comptroller of the Currency C. Todd Conover's office said on Nov. 19 that "all the top 17 banks in the United States are about to be hit with similar demands by the Comptroller." Especially "sharp," he admitted, is the Comptroller's sudden new demand that banks, which had been trying to comply with regulations to raise capital for their bank holding companies, must now raise the capital/asset ratio for their banking subsidiaries instead. Bank of America's holding company was already up to regulatory par when the Comptroller suddenly criticized the bank subsidiary per se.

The official said he "certainly" expected this to have an adverse effect on the market for bank stocks—even as it compels the banks to market more stocks.

Other ways for banks to bolster capital include transferring some of their profits into their own reserves in case of loan losses, a kind of capital account. Because this reduces profits, and may force some banks to even cut dividends, it can also have a negative effect on bank stock prices.

The Comptroller official also stated that his office may in addition be soon demanding that banks also bolster reserves by cutting their dividends to investors. "The people here seem to want to take this all the way," he stated. "It may not be nice to the bank stocks."

Bank stocks have been weak to begin with. The New York banks' composit Standard and Poor's index is down 0.8% for the trading week which commenced Nov. 12. Bank of America fell −5.3% in that trading week, and −4.6% in the last 52 weeks. Citicorp has been off by −1.7% in the trading week and by −3.4% for a four-week period. Manufacturers Hanover has been flat during recent weeks, but fell by −17.5% during the last 52 weeks.

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Why would the regulators flirt with a possible bank crisis in this way?

Look at who's behind the move. It was the *foreign depositors* in major U.S. banks, starting with the run on Continental Illinois in May, who first signaled their "dissatisfaction" with U.S. banks' capital to asset ratios. Then, House Banking Committee Chairman Fernand St German (D-R.I.), who has repeatedly agreed with the criticisms of U.S. banks issued by the Swiss-based Bank for International Settlements, held major hearings in June to roast the regulators for failing to crack down on Continental Illinois.

Volcker and Comptroller of the Currency C. Todd Conover began writing the new regulations shortly thereafter, and have repeatedly stated recently that European and congressional complaints about Continental Illinois have prompted their current crackdown.

Clearly, part of the problem has been that in order to keep foreign investors in the U.S. banking system, both as depositors and as shareholders, the regulators have had to clean up the banks.

Meanwhile, the same European investors who pulled the plug on Conti may be having a field day buying up the U.S. bank stocks now, while they are cheap and while the banks are desperate to sell more new stock.

Since January 1982, the 20 largest U.S. banks have increased their capital, mostly through stock sales, by over $20 billion—much of it purchased by foreign investors, either as equity or as convertible debentures, which are bank bonds sold on the Eurodollar market in London, convertible to stock later.

More generally, there is in progress a rather large dilution of U.S. banks' stock, as banks desperately market stock, which may be increasing foreign investors' overall leverage.

Also being sold for a song are many of the U.S. banks' big headquarter buildings. In addition to the proposed Bank of American sale, Crocker Bank of San Francisco sold its headquarters in October for $358 million; InterFirst of Texas sold its headquarters, and Security Pacific of Los Angeles sold its headquarters for $310 million in September. Bank of America had previously been forced to sell off the Seattle headquarters of Sea-first Bank when Bank of American took that bank over months ago.

Shakeout of the banking system

Interestingly, however, the regulators have not touched the real problem—the banks' bad assets in $250 billion of Latin American debt, some $100 billion of which is owed to U.S. banks. They continue to sidestep this issue, while forcing asset write-downs by lenders to the U.S. domestic economy such as First Chicago.

In fact, the idea is to reorganize and attempt to strengthen the largest banks, so that they become the "survivors" of the coming shakeout in the U.S. banking system. As "survivors," however, they will be in fact colonial branch offices of the foreign banking powers for which the Bank for International Settlements speaks.

In this connection, Conover's announcement Oct. 15 that federal regulators will now permit nationwide expansion of "non-bank banks"—those who do everything but make "commercial loans," which the regulators refuse to give any precise definition—is highly significant. The hundreds of failing farm-belt, oil-related, and other domestic institutions on Conover's list of 797 "problem banks" will be easy prey to takeover by the large New York banks—as Volcker's regulators have forced these domestic-oriented institutions to take major losses on domestic loans. Addressing the ABA convention on Oct. 24, Conover emphasized that his fearless examiners are "getting even tougher" on domestic "energy, agriculture, and real-estate loans."

These domestic banks are being forced to take big losses on U.S. portfolios, smaller banks at the same convention worriedly told the press. The case of First Chicago, forced by the Comptroller into accepting $279 million in write-offs of problem loans, shows that "bank examiners are definitely being tougher," one Texas banker told *EIR*.

Particularly targeted are banks' farm and energy loans. Federal Reserve statistics show that there are more banks in the major farm states of Iowa, Missouri, Kansas, and Nebraska whose bad loans now exceed their total capital than in other states. As they go, so go America's farmers. Of the 27 U.S. bank failures from June 1 to Sept. 27, 16 were farm lenders.

The Comptroller's office has also issued tougher guidelines reducing the value banks can assign to the collateral on their energy loans—oil in the ground and oil equipment. One Texas banker said he'd been told that oil rigs his bank had previously valued at 25¢ on the dollar were now valued at only 10¢ or 15¢.

Obviously, the plan pursued by Volcker, Conover, and their Swiss masters is to soften up the domestic banks first, making them prey to takeovers by the New York giants. Then, when the Ibero-American bomb blows up early next year, Volcker will try to bail out the megabanks and their huge debt. The mega-banks are to abandon international lending, reducing America to a second-rate economic power, but maintaining their viability and profits by turning toward the U.S. consumer and other domestic markets—the new victims of usurious loans at 20%, as Ibero-America was the victim in the 1970s. To get those domestic markets, they will buy out the rest of the banks, now being forced into a sell-out-or-die position by the selective action of Volcker's regulators.

So, as part of this planned cartelization of the U.S. banking system, the recent actions by U.S. banking regulators under the policy guidance of Paul Volcker, forcing the giants to improve their capital-to-asset ratio, are part of preparing these large money-center institutions for the next blow-up of the Latin American debt bomb.