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EIR Economics

First RepublicBank is declared insolvent

by Chris White

Late on Friday, July 29, the Federal Deposit Insurance Commission announced the insolvency of the 40 banks held by First RepublicBank of Dallas. In a press conference also attended by Comptroller of the Currency Robert Clarke, and representatives of the Federal Reserve System, FDIC chairman William Seidman announced that the banks were being closed because the Dallas-based holding company was unable to repay loans to the FDIC and other First Republic banks.

The liquidation of First RepublicBank is set to be the biggest in U.S. history, outstripping the 1984 shutdown and metamorphosis of the giant Continental Illinois. Seidman estimated at the press conference that the closure would cost the government over $4 billion, but that's before the smoke clears away. The Conti bailout was in the order of $4.5 billion. Ever hopeful, Seidman stressed that all depositors, even those with more than $100,000 in the bank, would be taken care of by the ever-loving FDIC.

It seems, though, that a sizable number of the banks' depositors had already drawn the appropriate conclusions from the earlier phases of this saga, and jumped ship. First RepublicBank was hopelessly insolvent. In the euphemistic language employed by bank regulators, and their toadies in the press corps, the "net worth" of the bank was said to be "negative $1.1 billion." Or, for the rest of us, it was over a billion bucks in the hole. And that was just the beginning. For the first six months of 1988, the bank had reported a staggering $2.2 billion loss in income, more than the previous biggest annual loss reported to regulators by any single bank. First RepublicBank of Dallas, which accounted for $17.1 billion of the holding company's $26.8 billion in assets at mid-year, had only $7.7 billion of the company's $20.2 billion in deposits. Asked to explain the discrepancy, a bank spokesman could only concede that the bank had a large portfolio of repossessed real estate.

The liquidation had been expected for some time, at least since the publication of the bank's second-quarter results. No doubt the timing was chosen on the last weekend of July, to get the matter out of the way during the month of August in the hope of the keeping the nation's banking crisis out of the newspaper headlines during the September and October months of the presidential election campaign. In the same spirit of partisanship and cronyism, the Federal Home Loan Bank Board and the Federal Savings and Loan Insurance Corporation are pushing ahead to complete negotiations for the takeover of a section of the nation's largest, and also insolvent, thrift. Here, Robert Bass of the Texas-based Bass Group is seeking federal backing to take over the American Savings and Loan subsidiary of the California-based Financial Corporation of America.

It's not such a surprise, then, to find that Dillon, Read, on whose board sits George Bush crony Nicholas Brady, tipped to replace James Baker at Treasury any day now, so Baker can go off to run the Bush election campaign, advised Seidman on how to proceed.

This rush to settlement for the biggest of the system-threatening banking basket cases, is underpinned by what Alan Greenspan of the Federal Reserve attacked as "dangerous euphoria," in his semi-annual report to Congress on the state of the economy. The *New York Times* and Merrill Lynch are hyping that euphoria in the name of what they call, for the moment at least, "optimism." The *Times* quoted Lawrence Cohn, banking analyst for Merrill Lynch, "Obviously, if you had another $25 billion bank in trouble, you might run into some problems that would affect the FDIC's cash flow, but you just don't have that on the horizon. . . . After First Republic, the FDIC should be able to lick its wounds for a

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number of years without having to dip into its reserves again." The *Times* cheerfully added, "Analysts said they do not see at this point any other bank similar in size to First RepublicBank that will need government assistance soon."

FDIC crisis looms

So, with these cases out of the way, we can forget about the crisis of insolvency in the banking system, for the next few months, right? Dead wrong.

At the present rate of bank failures, the FDIC is set to have its worst year ever. As of now, it seems that the FDIC will have to pay out more from its combination of about $16 billion in reserves, and $2 billion in income from banks' premium payments, than it will take in. The FDIC is headed for its first loss in the history of the regulatory outfit. And as for the FSLIC, well forget it. They are broke, and with each month that passes, the estimates of what it will cost to shut down the foundering system, and secure its depositors, are increasing rapidly.

The regulators and the press take a case-by-case approach on these matters, assuming that the system as a whole is sound, and will remain so. With returns on assets of 0.13% in the last year, the banking system as a whole is not generating enough income to keep its operations going. Therefore, since the system as a whole is bust, each particular bank in the system is also bust, though some are more so than others.

In this respect, the thrifts, treated as the basket case of the financial system as a whole, remain in much better shape than the commerical banks, which the *Times* and Merrill Lynch seek to protect. If freed of their interest rate-bound dependancy on external borrowings, to finance the discrepancy between what they take in as payments against mortgage debt, and what they pay out as interest on deposits, the thrifts, with their deposit base, their relationship to the construction industry, and a 15- to 30-year horizon on the lifespan of their lending transactions, would once again be the safest savings institutions in the world.

Not so the big commercial banks, which since 1982 have increasingly gotten out of the range of activities that used to make a bank a bank—lending against deposits for investments that permit wealth to be increased beyond the value of the original loan—and into speculative coupon clipping on each others' securities, foreign exchange, commodity and government debt manipulations. They no longer have a reliable income stream to set against their pyramiding liabilities.

Paradoxically, this reality is reflected in the way the FDIC has handled the First RepublicBank insolvency. The bank was put up for auction. Up front among the bidders: Citibank of New York, Wells Fargo from San Francisco, and the North Carolina bank NCNB. The amount of money that the first two were prepared to put up for the takeover efforts was too low to be acceptable to the FDIC.

In the arrangement worked out, the FDIC and NCNB will form a new bank, NCNB Texas National Bank. This "new" entity will be financed with $4 billion of funds from the FDIC and $210 million from NCNB. The ownership ratio won't reflect the proportions of the split. The FDIC will own 80% of the new operation, and NCNB the remaining 20%, though it has only put up 5% of the funds. This proposal was said to be—believe it or not—the one least costly to the insurance agency. Smells funny? You don't normally expect to get 20% of the equity in a purchase with a 5% down payment.

As usual with these kinds of transactions, there's the stench of the corruption. However, on the basis of that split, it is reasonable to assume that there's more behind the takeover than meets the eye. H. Ross Perot, the Texas billionaire, is reported to have guaranteed NCNB's stake if the North Carolina bank has difficulty raising the cash to fund its share of the transaction. But there's still something else going on.

According to the *Washington Post*, NCNB had originally proposed acquiring an initial 20% of the bank, with an option to take up to 100% over the next five years. This was rejected by the FDIC, and as a result NCNB went off to recruit foreign financial backing for the takeover. West Germany's Dresdner Bank is suspected to be the foreign partner that has underwritten the NCNB transaction. It may be that Dresdner Bank's slice of the transaction will account for the extra 15% of NCNB's share of the new partnership.

It is not surprising that this is being kept quiet. Since when did the nation's bank regulators think it was their mission in life to let foreign financial interests in on the bankruptcy liquidation of the U.S. banking system? The role of Dresdner in the transaction, and the interests for which Dresdner is acting, is sure to be the subject of much scrutiny in the period ahead.

The more so, since a report issued by the newly formed Congressional Economic Leadership Institute at the end of July, entitled "American Assets: An Examination of Foreign Investment in the United States," details the growth of foreign ownership of all sections of the U.S. economy. Foreign holdings have tripled since 1980, now reaching $1.5 trillion. Forty-six percent of prime real estate in Los Angeles, 39% in Houston, 33% in Washington, D.C. is owned by foreigners; 20% of all bank assets are held by foreigners; 25% of commercial and industrial loans outstanding are held by foreigners. And it's not the Japanese who are buying it all up. The biggest share of the growth in direct investment in plant, banks, and real estate in 1987 has been taken by the United Kingdom and the Netherlands, with the British accounting for $75 billion and the Dutch for $47 billion, compared to $33 billion on the account of the Japanese.

Could it be that the liquidation of First RepublicBank is the test case for much more to come, as the financial regulators prepare to turn over the country's assets to foreign creditors in history's biggest fire-sale? Perhaps this accounts for why Seidman told the press that the banks whose bids were rejected would be upset at the way the liquidation was concluded. They might perhaps be seeing the writing on the wall.