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Banking panic grips U.S. as R.I. declares bank holiday

by John Hoefle

The old saying that you can run but you can't hide was brought home with a vengeance to the Bush administration, federal banking regulators, the financial community, and the American public during the first week of 1991, when the shaky New England banking situation turned to outright panic.

The panic started on New Year's Day in Rhode Island, where just three hours after his inauguration, Gov. Bruce Sundlun was forced to declare a banking emergency and close 45 state-chartered credit unions and banks.

The wave of panic quickly spread to neighboring New England states with the Jan. 4 announcement by the Bank of New England Corp. that its fourth quarter losses had pushed it into insolvency. The news started runs at the holding company's three New England banks: the Bank of New England of Boston, the Connecticut Bank and Trust of Hartford, and the Maine National Bank of Portland. As much as $1 billion in deposits was pulled out of these banks in just two days, prompting federal regulators to take emergency action and seize the banks on a Sunday, Jan. 6.

As part of this emergency action, the Federal Deposit Insurance Corp. (FDIC) announced it would guarantee *all* deposits at the Bank of New England Corp.'s banks, including the $2 billion in deposits over the nominal $100,000 federally insured limit.

"Any abrupt action at this time, in this area, was judged to be unwise," explained FDIC Chairman William Seidman. It was, he said, "clear at this time, to protect the stability of the system, we should protect all the depositors."

The government's action marks a sharp departure from its recent posturing. For months, the Bush administration has been insisting that the current system of deposit insurance is responsible for the bulk of the troubles in the banking and savings and loan systems, and that banking reform must begin with trimming that insurance. The administration's plan was to gradually scale back federal deposit insurance until it disappeared completely, replaced by private insurance.

What the banking system needs, the Bush-leaguers insisted, is discipline. We can keep the system together during 1991, by downplaying the severity of the crisis while we implement our banking reform plans, they told themselves. The reorganization of the financial system was to be the keystone of President Bush's 1991 domestic agenda.

The entire 1991 strategy—or rather, what passes for strategy in the shallow-minded universe of the Bush administration—was blown out of the water the very first week of the year.

The only thing that stands between the U.S. banking system and total oblivion at the moment, is the perception of the population that their deposits are safe. That perception is based, not on confidence in the banks, but on the belief that the U.S. government can guarantee all deposits. Take that away, as the Bush men have proposed to do, and the entire house of cards collapses.

Bank holiday declared

Events in Rhode Island made that very point. On New Year's Day, a private company known as the Rhode Island Share and Deposit Indemnity Corp. (RISDIC) declared itself insolvent. RISDIC provided private deposit insurance to 45 state-chartered banks and credit unions. Since state law requires all banks, thrifts, and credit unions to carry deposit insurance, Rhode Island Gov. Bruce Sundlun was forced to close them all effective Jan. 2.

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"As a result of RISDIC's action," Governor Sundlun announced Jan. 1, "there are 45 uninsured credit unions and loan and investment companies in Rhode Island. On behalf of all the depositors—especially the small depositors—I am declaring a bank emergency in Rhode Island. A bank holiday will begin tomorrow, closing all the institutions formerly insured by RISDIC. I am taking this action to help insure the hard-earned savings of working Rhode Islanders." Sundlun called upon the public "to be calm and patient while we work on a plan to assist every depositor in any way possible."

The problem was that people were already panicked: The bankruptcy of RISDIC was itself triggered by runs against its member institutions.

The crisis at RISDIC began Oct. 19, when state examiners found "a significant amount of money" missing from Heritage Loan and Investment Corp., a small RISDIC-insured bank in Providence. On Nov. 8, Heritage president Joseph Mollicone disappeared, prompting then-Gov. Edward DiPrete to order an investigation into the matter.

As word of the troubles leaked out, panicked depositors withdrew $13.6 million of Heritage's $22.4 million in deposits, forcing the bank to turn to RISDIC for funds. On Nov. 16, RISDIC pumped $16 million into Heritage in an attempt to keep it afloat—depleting most of RISDIC's own reserves. Two days later, on Nov. 18, the state seized the bank. Eleven days after that, the state issued an arrest warrant for Mollicone, charging him with embezzling more than $13 million.

The failure of Heritage prompted runs at other RISDIC-insured banks and credit unions, as nervous depositors rushed to withdraw their funds. Unable to meet the outflow, RISDIC was forced to close its doors, stranding 35 credit unions and 10 banks, with $1.7 billion in some 300,000 accounts.

While 22 of the 35 closed credit unions have qualified for federal deposit insurance under the National Credit Union Association and have reopened, the remaining 13 will not. The NCUA rejected 11 credit unions as "not currently insurable," stating that "These credit unions were found to hold a high proportion of commercial, real estate, and other loans which are non-performing or are poorly underwritten. Some credit unions have extremely high delinquency and in some cases solvency is in question." Two of the closed credit unions did not even bother to apply for NCUA insurance.

Of the ten closed banks, only five, with deposits of $365 million, applied to the FDIC for federal insurance. The FDIC rejected all five applications as not meeting federal standards.

Faced with an angry citizenry, scared bankers, and pressure from the state legislature, Sundlun promised to stand behind the depositors of the 23 institutions which failed to qualify for federal insurance. "It will be our policy to see to it that depositors . . . receive payment for their deposits up to a limit of $100,000," he said Jan. 3.

Where the state will find the money remains to be seen. The state already faces a deficit of $162 million—the highest per capita deficit of any state in the nation. Estimates of the cost of bailing out the depositors range from $250 million to $1 billion. Complicating matters, the state's balanced budget law requires that the budget be balanced by June 30, the end of the fiscal year. So either the state finds a way to bail out the depositors with money it does not have, or the depositors get wiped out.

Bank runs escalate

The banking panic quickly spread to Massachusetts, where runs quickly sank the Bank of New England, perhaps the leading example of zombie banking in the country. The Bank of New England Corp., at one time one of the ten largest bank holding companies in the country, spent most of 1990 selling its assets and vainly attempting to shrink fast enough to salvage its capital-to-assets ratio. The bank fell from $32 billion in assets in 1989, to $22 billion at the time of its seizure. Many depositors had fled the Bank of New England, but some die-hard individuals stayed on, perhaps emboldened by the presence of deposit insurance, or perhaps reluctant to admit the danger.

The Bank of New England's final crisis began Jan. 3, when word began to leak out about the bank's dismal fourth quarter performance. The deposit leak turned into a torrent the next day, when the bank announced that due to fourth quarter losses of some $450 million, it was technically insolvent. During Friday and Saturday, depositors pulled an estimated $1 billion out of the holding company's three banks. Futhermore, the run was spreading to other banks in the region and beyond.

Faced with this rapidly spreading banking panic, and not daring to face the horrors awaiting them on Monday, federal regulators hastily abandoned their "market discipline" illusions and rushed to plug the leak. On Sunday, Jan. 6, the U.S. Comptroller of the Currency closed the Bank of New England Corp. of Boston's three major subsidiaries.

To ease public panic, the FDIC immediately announced that it would insure all of the deposits at the failed banks, including the $2 billion of the $16.8 billion in total deposits which exceeded the agency's nominal $100,000 limit. The FDIC also announced that the three banks would reopen on Monday, as FDIC-owned and operated "bridge banks," until buyers could be found. To meet any "unusual liquidity needs" of the three banks, the FDIC said, it would immediately pump in $750 million. As Seidman said, the "stability of the system" was at stake.

While the FDIC's actions may have slowed the deposit runs a bit, they did nothing to restore "stability" to the system. The collapse of the banking system is inevitable, because it is the final phase of the bankruptcy of the United States. As economist Lyndon LaRouche has repeatedly stressed, the physical economy has already collapsed, leading to the bankruptcy of the financial superstructure. All that remains is the runs on the banks, when the public catches on. And the runs have begun.