Banking by John Hoefle

Cooking the books

The Bush administration is instructing the banks to lie about their balance sheets.

The Bush administration, in another attempt to sweep the banking crisis under the rug, issued a new set of lending guidelines for banks on March 1. These guidelines, issued jointly by the Federal Reserve, the Comptroller of the Currency, the Office of Thrift Supervision, and the Federal Deposit Insurance Corp., were presented as "policy clarifications," as if they were minor technical accounting adjustments.

"This is a combination of confidence-building measures for the banks to lend," Deputy Treasury Secretary John Robson told the House Small Business Committee on March 5. "You can't weigh it or count it, but there's no question the atmosphere will be improved by this."

The thrust of these "clarifications" is to disguise the level of non-performing loans. They will allow banks to count payments made on non-performing loans as income, as long as the bank contends it can recover at least the book value of the loan. Banks will no longer be forced to classify all loans to one borrower as bad if one of the loans goes bad. It will now be easier for banks to count "highly leveraged transaction" (leveraged buyout) loans as performing. Banks with heavy loan concentrations in one area, real estate, for example, can keep making such loans. Undercapitalized banks and thrifts can still make new loans and can work with strapped borrowers. Examiners have been instructed to value real estate loans on a bank's books at their alleged long-term value instead of their current market value, and banks have the right to challenge decisions by their examiners, including the classification of assets and required reserve levels.

In addition, the regulators voted to allow the practice of "loan splitting," in which lenders are allowed to write off a portion of a bad loan and reclassify the balance as a good loan. The loan-splitting proposal requires the approval of the Securities and Exchange Commission (SEC), but all the others can be implemented by administrative decree.

The administration is making these moves to try to calm the growing economic panic, as the deflationary collapse of the Reagan-Bush speculative bubble wipes out increasingly larger chunks of the paper assets of corporations, individuals, and banks. Pumping more money into the leveraged buyout market will, in the short run, keep the zombies afloat a while longer, but will make their inevitable collapse much more costly.

The same is true, but on a much larger scale, with the real estate market. The fact is, most of these real estate projects were never worth their "book values" in the first place, and never will be. Real estate values will continue to drop, and real estate losses will escalate.

This "head in the sand" approach comes as opposition to the administration's major banking restructuring proposal is mounting.

The General Accounting Office (GAO), in a report to Congress, blasted the administration's proposal to cut back deposit insurance, warning that "the potential consequences of such actions on the stability of the nation's financial system are simply unacceptable. . . . In considering recommendations for reform, it is important to avoid any risk of fostering a bank crisis similar to that experience in the early 1930s. . . . While reform is urgently needed, it is imperative that such reforms not trigger a repetition of the vicious circle of vanishing confidence and financial distress that undermined our banking system nearly six decades ago." The GAO also warned that the new "policy clarifications" will make it more difficult to determine the true health of a bank.

The Independent Bankers Association of America also blasted the plan. "We have to go to war," exclaimed IBAA executive director Ed Guenther. "This is a survival issue for us." Cutting back deposit insurance, he warned, will cause depositors to flee the smaller banks for the apparent safety of the "too big to fail" giant banks.

The Federal Reserve has likewise expressed dissatisfaction with elements of the Bush proposal, letting it be known that it does not intend to give up its role as regulator of the big money center banks and their holding companies.

New York Fed President Gerald Corrigan attacked the idea of non-financial corporations owning banks, as the Bush plan proposes, saying he viewed "with concern, if not alarm" the economic, financial and social implications of companies like Exxon, Ford, or RJR Nabisco owning major banks.

Some members of Congress are also upset with parts of the administration proposal. Allowing the banks to enter the securities business "raises the specter of the deregulation that led to the S&L crisis, and the kind of cozy financial relationships that gave us the Great Depression," said Rep. John Dingell (D-Mich.) on Feb. 20.

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