Banking by John Hoefle

House seeks to curb Bush bailout

The Banking Committee is throwing a monkey wrench into the President's 1992 reelection bid.

The House Banking Committee, in its first full week of markup on the Bush administration's bank reform bill, took dead aim at the President's plan to paper over the insolvency of the banking system until after the 1992 elections.

The heart of the Bush scheme is to allow the big banks to stay open, no matter how bankrupt they may be, while providing them all manner of regulatory and financial assistance. It is precisely this scheme that the banking committee targeted.

From the opening bell, the committee, led by chairman Rep. Henry B. Gonzalez (D-Tex.), made it clear that the administration's power to prop up insolvent banks indefinitely, through regulatory forbearance and "backdoor bailouts" arranged through the Federal Reserve's discount window, was in jeopardy.

As we reported last week, the Fed has been pumping billions of dollars into insolvent and nearly insolvent banks, with the Federal Deposit Insurance Corp. (FDIC) ultimately liable for repayments if and when the banks fail.

Gonzalez had introduced an amendment to limit Fed discount window loans to any bank to no more than five consecutive days in any three-month period, but he temporarily withdrew the measure after a meeting with Fed chairman Alan Greenspan. The committee and the Fed will try to reach a compromise on the matter, but banking committee staffers insist that some form of the measure will be reintroduced before the bill leaves the committee.

With the Fed under fire, the committee turned its attention to the FDIC and the Comptroller of the Currency and the enforcement of capital standards, adopting a measure to force federal banking regulators to close any bank whose capital falls below 2% of assets.

Under the committee plan, a mandatory series of actions would be triggered once a bank fell below the currently required 3% capital-to-assets ratio. The bill would require that any undercapitalized bank file a capital restoration plan with regulators, and would impose increasingly strict measures as capital deteriorated.

However, according to the bill, once a bank drops to the "critical capital level" of 2% of assets, "regulators must close the institution within 120 days, unless they find some other action to be more advantageous to the insurance fund"—that is, to the FDIC. Even if the "other action" option is taken, "at the end of six months, if the institution is still below 2% capital, regulators must close the institution."

Since it is unlikely that any bank which reaches the "critical" stage can recover within such a short time—if at all—the bill in effect mandates that such banks be closed, and either liquidated or sold with assistance from the FDIC.

For capital standards to be meaningful, however, the banks must stop lying about their financial condition. The General Accounting Office (GAO), in a recent study of 39 banks which failed in 1988 and 1989, showed that the banks' actual loan losses were 348% of their loan loss reserves. The banks had set aside $2.1 billion, while post-failure examinations showed that $9.4 billion in reserves had been required.

The GAO found that bankers "have a strong incentive" to delay marking down their assets because it increases their losses and decreases their capital. "It is likely that many open financial institutions have overstated the value of their troubled assets," the study said.

Treasury Secretary Nicholas Brady insisted that due to the banks' stronger capital position, the banking crisis and the savings and loan crisis "are as different as chalk and cheese." But it is becoming ever more clear that the only real difference is that the thrifts are further along the curve of collapse than the banks, and that where the thrifts go today, the banks will follow tomorrow.

When the Bush administration first presented its S&L bailout proposal in 1989, it claimed that $50 billion would be more than enough to resolve the crisis. Thus far, the administration has spent $80 billion, and is now before Congress seeking an additional $80 billion just to fund the bailout through 1992. To the untrained eye, that would seem to be $160 billion, more than the latest official administration projection of $132 billion.

Nevertheless, the Bushmen insist that the outlays do not exceed projections, because the figures should be calculated in 1989 dollars, not the 1990 dollars they had previously used. Brady's repeated statements to Congress about 1990 dollars, the Treasury insists, was due to "a typo in the transcript."

Very clever. With one stroke, the Bushmen explain away $28 billion and set a precedent for next year, when they can claim that their $50 billion forecast was a "typo"—they meant to say $50 trillion. And some people say the administration doesn't know what it's doing.

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