**Banking** by John Hoefle

# The $12 trillion asterisk

*The FDIC finally admits the banks' huge "off-balance-sheet derivatives" exposure.*

When a $12 trillion item suddenly appears on a $3.6 trillion balance sheet, one can safely assume some highly creative bookkeeping has occurred and that the numbers are not worth the paper upon which they are printed. That is precisely what happened with the Federal Deposit Insurance Corp.'s (FDIC) *Quarterly Banking Profile* for the third quarter, which ended Sept. 30.

According to the FDIC, U.S. commercial banks had $3.63 trillion in assets as of the third quarter, up slightly from the $3.57 trillion in the second quarter. These assets consist mainly of loans, securities holdings, buildings, and the like. In theory, the banks' assets, which consist primarily of deposits and debt, equal their liabilities.

However, there is a new entry on the FDIC's aggregate condition and income data table, which shows the entire balance sheet to be a fraud. That entry is "off-balance-sheet derivatives," which stood at $11.99 trillion for the third quarter, more than three times the $3.63 trillion listed for assets and liabilities.

Although reporting the numbers for the first time, the FDIC has data on derivatives back to the first quarter of 1990. That data, obtained by *EIR*, shows that U.S. banks' holdings of derivatives have doubled during the period, from $6.19 trillion on March 31, 1990, to the current $11.99 trillion.

During 1990 and 1991, the size of the banks' derivatives portfolios increased gradually, ending 1991 at $7.34 trillion, or a $1.15 trillion increase over that 21-month period. The banks' derivatives holdings rose sharply in 1992, peaking at $9.72 trillion in the third quarter and ending the year at $8.77 trillion.

In the three quarters of 1993, however, the banks' derivatives holdings have skyrocketed, to $9.77 trillion in the first quarter, to $10.95 trillion in the second quarter, and to $11.99 trillion in the third quarter, an increase of 37% in nine months.

These numbers must be taken with a grain of salt, however. Federal Reserve vice chairman David Mullins, for example, put the banks' holdings of derivatives at $7 trillion for the first quarter of 1993. If Mullins were right, the banks' holdings of derivatives have jumped 71% in just six months.

Whatever set of numbers one chooses to believe—or disbelieve—the growth of the banks' derivatives holdings is phenomenal. The big banks aren't banks any more; they've become speculators, players in a huge international casino which must ultimately collapse.

That is the background against which the FDIC's hyperbole about so-called record profits must be judged.

According to the FDIC, U.S. banks reported "record profits of $11.45 billion in the third quarter of 1993, surpassing the previous quarterly record of $10.8 billion, set in the first quarter of this year." For the first nine months of 1993, the banks reported $32.6 billion in profits, surpassing the record $32.1 billion earned by banks in all of 1992. With three months yet to report, the banks are on the way to topping $43 billion in profits this year.

The FDIC attributed the third-quarter profits to lower loan loss provisions and increased non-interest income.

According to the FDIC, non-current loans and leases stood at $50.2 billion at the end of the quarter, a 28% decline from one year earlier. Loans and leases 30-89 days past due stood at $28.7 billion, down 16% in 12 months. The banks' other real estate owned (OREO) stood at $19.9 billion, down 29% for the same period.

Thanks to this claimed improvement in asset quality, the banks set aside just $3.9 billion in loan loss provisions for the quarter, the smallest amount since the first quarter of 1989, and $2.8 billion below the $6.8 billion in the third quarter 1992. For the first nine months of 1993, the banks have added $12.9 billion to loan loss reserves, or 35% less than the $19.7 billion set aside during the same period in 1992.

Even though the banks' aggregate loan loss reserve has dropped 3% during the past year, to $53.9 billion as of Sept. 30, the rapid drop in non-performing loans has left them with a claimed $1.07 in reserve for every $1 of reported non-current loans.

In fact, the FDIC reported, "The combination of high reserve coverage levels and the improving trend in asset quality has resulted in a number of banks taking *negative* loan-loss provisions, i.e., taking funds out of reserves and adding them to operating revenues. In the third quarter, there were 482 commercial banks reporting negative loan-loss provisions totaling $172 million."

With profits rising and bad loans plummeting, the banks would appear to be safe and sound—as long as nothing happens to that $12 trillion in off-balance-sheet derivatives.



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