*Dallas Morning News*

# BANKING SYSTEM FACES A REAL THREAT

Wednesday, March 2, 1988
Stephen N. Blaising

The Dallas Morning News VIEWPOINTS Wednesday, March 2, 1988

Banking system faces a real threat

STEPHEN N. BLAISING

The Wall Street Journal headlines recently heralded the multibillion-dollar problem at the largest banking company in Texas. The following day, bank officials declared unequivocally that the situation was no serious problem, and the controller of the currency interrupted his news conference to comment on the “exaggerations “ surrounding the bank’s liquidity.

It reminds me of the protagonist’s often-repeated question in the movie The Marathon Man as one tooth after another was being pulled. “Is it safe? Is it safe?”

Just because one’s money is insured by the FDIC or the FSLIC for up to $100,000 per account doesn’t mean banks can’t close their doors for an extended period of time. They did in 1929, as a lot of senior citizens still recall with some rightful trepidation.

The threat to our nation’s banking system is more real today than perhaps at any other time in U.S. history. Why?  Because $650 billion of doubtful international debt is being carried on the books of many of our nation’s largest banks as assets. Life is all fine and rosy- from the Main Streets of Smalltown, U.S.A., to the corporate canyons of Wall Street- until one recognizes these loans cannot be repaid.

Currently, these same banks continue to carry these mostly deadbeat loans as assets so their institutions can continue to lend money. Pardon my euphemism, but that’s simply ”throwing good money after bad”, and continuation may well bring the system to its knees.

Labeling such mind-boggling amounts as “non-performing assets” would require setting aside more funds as reserves for loan losses, which would dramatically reduce the bank’s lending limits. It would also alarm the general public and seriously undermine its already questionable confidence in the banking system. Nowhere would that be more true than in Texas, where nearly 100 banks have failed in the past two years.

If at any time these hundreds of billions of dollars of loans (assets) are wiped off the books, our entire banking system will fall below the reserve requirement.

Today there exists a dangerous potential for deflation and depression not unlike the 1929 crash, which, not coincidentally, was touched off by defaults on international loans.

(continues)

If a banking collapse occurs, the enormous amount of money needed for a national bail-out would devalue the U.S. dollar to all-time lows. Additionally, foreign investors in this country might panic and withdraw, compounding the problem and delaying eventual recovery.

On top of this problem, the banks never have recovered from consumer's multibillion-dollar flight to money market funds in the late '70s. From 1977 to 1982, $200 billion left checking and savings accounts for the newly discovered- and higher rewarding- money market funds.

Within three years, 1,300 institutions went on the in-trouble-of-bankruptcy lists. Bank mergers became the word of the day, just like the InterFirst and RepublicBank. By the time banking authorities eliminated Regulation Q in 1982 and allowed banks to offer money market funds, the damage was done.

The banking industry's lock on the passive funds of many Americans had been broken once and for all. To woo and court the return of those dollars, banks have had to offer interest rates more competitive with the brokerage house money funds. The banks' profit margins continued to shrink. Even as money began to return to the banking system in late 1982, real estate values began to dwindle, particularly in Texas. The bankers misery was magnified as energy loan after energy loan based on $28 per barrel oil moved into the default zone.

The bank profits earned from 1929 to 1977 are now history.

Should Texans pull out of banks completely? Absolutely not!

However, it has become important today to understand the internal workings of your bank and to get statements about its financial health. Unfortunately, banks still do not disclose all of the pertinent data concerning their assets and loans, their management and how they earn their keep.

What's worse, the public is not privy to this crucial information while seeking security and a reasonable return for hard-earned dollars.

Investors who have tied up all their money in certificates of deposit and money market funds are paying high prices in terms of taxes, inflation and potential risk. It is a foregone conclusion, not a prophecy: "More banks will fail."

Bank closures are a distinct possibility, with funds possibly tied up in a long-term limbo, which for some depositors may be tantamount to a loss. It used to be called a "bank holiday." It would be no holiday for depositors and businesses- small or large.

Depositors should neither run around like so many Henny Pennys shouting, "The sky is falling!" nor blithely fail to acknowledge current banking problems and simply accept the risk on faith.

Many banks have already learned some crucial lessons that investors would do well to emulate: Proceed with caution and maintain a well-diversified portfolio. There is no time for naiveté.

*Stephen N. Blaising, President of Financial Dynamics, Inc. of Dallas is a University Park resident.*