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Banking's veil of secrecy

By Harold Bubil

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-- Second of three parts

Raymond Vickers knows banks. Unlike many historians, he has practical experience in his field of expertise, earned from years as Florida's assistant state comptroller in the mid-1970s and a career as a banking attorney who has counseled more than 100 banks and helped charter 60.

"I know where the bones are," said Vickers.

A lot of those bones lost their flesh in the 1980s, during the savings and loan crisis. It was then that Vickers was inspired to write "Panic in Paradise" (University of Alabama Press, 1994), which placed the blame for Florida's 1920s land boom/bust squarely at the feet of unscrupulous bankers, developers and real estate promoters, who hid behind the secrecy of bank-examination records when dozens of banks failed -- and put Florida into the Great Depression years ahead of the rest of the country.

After eight years of work, the book was published, but by then the S&L crisis had eased and the real estate market was starting to come back from a falloff in the early '90s. Perhaps those factors limited the book's impact, or, it may have been criticism from established historians who were slow to accept the work of a revisionist -- and not a career historian, to boot.

But with the exhaustively researched and footnoted book now out in paperback, Vickers hopes it gets renewed attention because of what is happening in lending and real estate today.

"Fraud and insider abuse was the reason (for the 1920s real estate bust)," he said in a recent telephone interview from his Tallahassee office, "and the reason for the current collapse is fraud and insider abuse. I don't think anyone has focused on that."

Vickers agrees that relaxed lending standards led to the current subprime mortgage crisis, and that, as in the 1920s, a lot of innocent bystanders are being hurt as the speculators fall and their properties go into foreclosure.

"Think of the honest people out there today who own homes, who can't sell them because the market has collapsed," he said. "Now, they didn't do anything wrong. They just bought a house and paid mortgage payments on it, and maybe had two or three kids, and now it's time to move to a new house, and they can't move to a new house because they can't sell the old house.

"You are having to pay for the fraud and insider abuse that occurred on Wall Street and in the rarified air of these bank board rooms."

But that cannot be proven because of "secrecy," Vickers said in an interview last fall. "You probably have more access to bank records at the Kremlin that you do in the United States. You will have to wait until 2057 to write the story of the real estate bust" of today.

In "Panic in Paradise," as well as in his forthcoming book about bank failures in 1930s Chicago, "Panic in the Loop," he takes the controversial view that bank-examination records should be open for public inspection. Instead, they are exempt from the Freedom of Information Act (see box on page 5-I). One reason often cited is that the government fears depositors would panic if they knew the true financial condition of their banks. They would "run" for the tellers' windows to retrieve their savings -- a phenomenon that was common in Florida in 1926 and '27, and later during the Depression in the rest of the country.

A second reason: The lack of secrecy would hinder "cooperation and communication" among bank employees and examiners.

In Florida, bank-examination reports are held in secret forever except in the cases of banks that fail. Records of those banks are locked away for 50 years. Many other states restrict access to all records, and have destroyed records from the past -- making the job of economic historians much more difficult.

Vickers differentiates examiners' records with the "call reports" that financial institutions are required to file with the Federal Deposit Insurance Corp., and can be viewed online. He says call reports were "manipulated by bankers in the 1920s and 1930s, and by S&L operators in the 1980s. Indeed, the call-report information issued to the public was fraudulent in many cases involving problem banks that subsequently failed."

In "Panic in the Loop," he writes of the 42 Chicago banks that failed in the early 1930s:

"What is clear from the available public records is that ... the top officials of Chicago's three largest banks in the Loop (the downtown business district), verified, under oath, reports of conditions that were false, and then published them in local newspapers. Fraudulent call reports listed the nonperforming and worthless loans at their full book values, thus avoiding the appearance of devastating decreases in the banks' capital. Hence, the depositors were deceived into leaving their savings in the custody of reckless and dishonest bankers."

He also blamed regulators for failing to force the resignations of "rogue officials."

In an interview, Vickers said, "I'm not quite sure how anyone can defend secrecy at this point. After the savings-and-loan fiasco, we've had Enron and now the subprime crisis, all of which was buried in confidential bank examination reports. ... Until the disclosure rules are changed, this is going to happen over and over again. It all gets back to the same thing, and that is, a handful of bankers ... were more interested in their their incomes than their fiduciary responsibilities."

Two sides of the issue

William Becker, a professor of business history at Georgetown University, presents two sides of the bank-secrecy issue.

"Let me give you the less-cynical argument" in favor of secrecy, said Becker. "You don't want to unnerve the public about a bank, or any kind of investment, if, in fact, what the goal of regulation is, is not punitive, but corrective. What's the point of casting doubt about most of these institutions when most of them are on the up-and-up and are doing what they are supposed to do?"

Perhaps the proper analogy is the regulator as coach rather than cop.

"If the regulator is doing his job," said Becker, "he would help work out whatever the problems might be, then come back, like a health inspector."

The cynical view, Becker said, is that bank secrecy is used to "cover up chicanery." The truth "is probably somewhere in between," he said.

"I'm with Vick on this for sure: The United States promotes transparency in financial and banking systems all over the world, and then we don't have transparency here. The fact of the matter is, especially with FDIC insurance, most depositors are protected. A little sunlight on some of these banks might be very useful to protect the public, who might end up bailing out depositors when a bank fails."

Banker Lynne Pierson Doti, who is also a professor at Chapman University in Orange County, Calif., and who reviewed Vickers' book in the mid-1990s, defends bank secrecy. She also said Vickers has a point.

"As a banker, I can understand (secrecy) because it allows the regulator to be more critical of us without worrying about what bankers call the 'contagion effect' -- that if people think there's something wrong about a bank, it scares them not only about that bank, but banks in general," said Doti. "That's the source of the secrecy. When they rate banks, that is legally required to be kept a secret. ... I understand the theory, but if everyone got their ratings out there and no one had perfect ratings, perhaps the public could judge for themselves what the situation is."

As for the 50-year time requirement on the records of banks that have failed, she said, "There would be no point in that secrecy."

"You have to wonder why it takes 50 years after a bank fails to gain access to its records," said Vickers. "There was never a threat of a bank run occurring because the bank failed."

Sunshine is good, to a point

Taking a moderate view is Christine Jennings, who sold her Sarasota Bank in 2003 before running unsuccessfully for Congress in 2006.

"In Florida we are proud that we have sunshine laws. More transparency is always a good thing," said Jennings in a telephone interview. "There are certainly some parts of the (examiner's) report that could be available, but some of it could be misunderstood. ... You wouldn't want to cause alarm over something that is not serious, and then something that is serious, the public would misunderstand. When people don't understand something, they will take it and interpret it wrongly and cause some damage."

The question for today: Have we repeated the mistakes of the 1920s in the 2000s? Vickers suspects so, and said, "Sunlight is the only way to stop the madness."

Next week: Sparks can fly when it comes to writing history. Online at heraldtribune.com/realestate: Read Part I of the series and hear more from Christine Jennings.

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