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HeraldTribune.com

Q&A: Raymond Vickers on bank-examination reports

Published: Sunday, February 3, 2008 at 4:30 a.m.

Harold Bubil interviews Raymond Vickers, author of “Panic in Paradise,” about what he found in the bank-examination reports he used as primary sources for his book on the 1926 banking crash. (In Florida, such reports are kept secret forever unless a bank fails, in which case they may be made public after 50 years.)

Q: What is on a bank-examination report?

A: The vast majority of loans don’t appear on bank-examination reports. It’s the problem loans. For instance, loans that are in default end up in the banking-examination reports. You would see the name of the borrower; there would be a discussion of why the examiner considers the loan a bad loan. There would be a record of nonpayment; there would be a discussion of the collateral. It’s much different than the statistical information you might find in a call report, which is skewed many times because there could (be) bad loans (listed) at full value in call reports.

The bank-examination report is a narrative, a description of the business; why the examiner believes the loan is a bad loan. All of this information appears publicly once the bank takes action against the borrower to foreclose on the property, whether it’s real estate or any other kind of asset that is pledged on a business loan. If the bank files a lawsuit to collect money from a business, that is public. If the bank forecloses on a house, that is public. If a business files bankruptcy, that is public.

The problem is that all of those things are after the fact. We knew a lot about Enron after the fact because of the bankruptcy filings. That’s way too little and way too late.

Q: Let me guess: Back in the 1920s, the Palm Beach National Bank was not about to foreclose on developer-architect Addison Mizner or go after Florida Comptroller Ernest Amos for not paying back his unsecured loans.

A: (Laughing) Amos’ disguised bribe in the form of a loan -- they would be blowing the whistle on themselves. Amos would say, “You told me I didn’t have to pay it back.” (And he didn’t.)

Because all of this is confidential, then the bank many times will not file to collect the loan. A lot of these loans are written off in secret; there was a lot of favoritism on the writeoffs. The board of directors, for instance, could walk out of there scot-free, but on the other hand, the borrower who is sitting in a small house that is foreclosed on, they are thrown out into the street. The person whose house represents their life savings, they are treated far different than an insider, a bank officer or a bank director.

Q: That money went somewhere. So once they write off that loan, who pays for it?

A: If the bank fails, and back in the ’20s and early ’30s, before the FDIC was created, it would be the depositors left holding the bag. Of course, the stockholders, too, if the bank fails. The stockholders represent today a small percentage of bank assets -- 10 percent, tops. If it’s a $100 million bank, the other $90 million would be depositors' money.

There’s nothing that honest bankers need to fear about disclosing their problem loans. First of all, if a business goes bankrupt, then everybody is going to read about it in the paper anyway. It’s a public filing. That whole argument about depositors panicking because they had information about problem loans at the bank went away in the 1930s when the FDIC was created. Now, there are quiet runs, when you have people that had more than $100,000 in a bank, and you can have people pulling their money out in that situation, but normally at that level, people know to keep their deposits below $100,000 (splitting the money up among a number of accounts or banks).

We didn't see lines of depositors standing in line in front of savings and loans during the S&L crisis. People didn't run to get their money because they knew it was insured by the federal government. That's another reason to make the reports public, because banking enjoys a subsidy from the federal government. So taxpayers are subsidizing banks; the examination reports are prepared by public employees (bank examiners) -- it's just a very antiquated system, and after the savings and loan fiasco, Enron, and now the subprime loans, I think the depositors and taxpayers have paid enough and are entitled to know which banks are good banks and which banks are bad banks.

Not all banks are bad banks; not all banks failed, even during the Great Depression. But the good banks, the prudent bankers, they would benefit the most by this. You might see a shift of deposits to prudent banks, and that's a good thing. It would end up costing the government less, and it rewards prudent behavior. And it penalizes people who would engage in insider abuse and people who would treat a bank as if it were their own piggy bank, or like they are in Vegas at the roulette table. It would have a chilling effect on bankers who become involved in mismanagement, irresponsibility, and, of course, corruption.

Q: In the 1920s, were the reports handwritten or typewritten?

A: They were typewritten. People act like in the 1920s, human beings acted differently than they act today, that they speak differently than they speak today. Or their ethics are somehow different than today. People acted the same way in the 1920s and '30s as they act today. Nothing has changed. That's the fallacy. People think that the ethical standards have changed.

That's a good point about the typewriter. There are written comments on these reports, and sometimes the written comments in the margins are more important than the typed information, because you could get a sense of what the examiner or his supervisor felt was important.

It's a treasure trove of information. The problem of writing economic history without using examination reports is that you don't get a clear understanding by reading the newspaper what was going on inside the banks, and you don't understand the local economy, or even the national economy. They are very detailed about the problems. They'll say things like "too much concentration," and then they will list all the loans and all the collateral of the classified loans.

But these are just bad loans. The person that pays his loans back on time, they don't appear in the examination reports. It's only the bad loans that appear.

Q: Could the public be trusted to understand these complex reports?

A: Thomas Jefferson wrote of informed consent. The concept of American democracy is informed consent. And you cannot have informed consent when you have a system of pervasive secrecy. If we trust our citizens with the power to vote, then we have to trust them with the power of having the information necessary to make that decision, especially in an industry that is subsidized by taxpayer money.

Banks are quasi-public institutions. They are fiduciary institutions. But now they are even more so because of deposit insurance and the bailouts that take place when we have a problem. We are talking about bailing out the banking industry because of the subprime fiasco. It was something like $300 billion to $500 billion during the S&L crisis (in the late 1980s). We have no idea of what we are talking about now. It's much bigger than that. This could cost a trillion dollars.

Q: But who remembers the S&L crisis? That $500 billion just got soaked up by the economy and is sloshing around in the national debt. It doesn't really hit people every day unless they invested in a bad thrift and lost everything.

A: That's right. But today it's different because of the economy, the real estate market.

But the idea that citizens today are not smart enough or rational enough to deal with information about bad loans is to say that Thomas Jefferson and the Declaration of Independence was wrong, that we don't believe in informed consent. And then you get into the manipulations that you would find in the Soviet Union. The people who withdrew their money (in the 1920s) weren't acting imprudently.

It's just time to open up these records. It's been time for a long time.