
OPEN THE VAULT: THE URGENT NEED TO ABOLISH BANK SECRECY

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During the presidential campaign of 1912, Woodrow Wilson declared that "secrecy means impropriety." Secrecy and corruption are not new to the American banking system: in fact, the banking disasters of the 1920s parallel today's banking scandals. In both periods of speculation, fraud and insider abuse flourished because regulators, operating in secret, allowed dishonest bankers to corrupt the banking system.¹

The inescapable conclusion of *Panic in Paradise* is that bankers and regulators, bound by a code of secrecy, have created an invisible regulatory system within the government, covert regulators with "imperialistic" powers but without public accountability. As a result of the savings and loan scandal, every American taxpayer will be bailing out this clandestine government for the next generation. Now is the time to eliminate the code of secrecy that separates the public from the truth.²

Since 1913, America has had the most elaborate bank regulatory system in the world. But it has also had the highest number of bank failures. Despite eight decades of ever-increasing regulatory authority and bureaucracies, the magnitude of the current banking and savings and loan (S&L) debacle revealed that the regulatory system cannot police thousands of financial institutions. State and federal regulators had the authority to protect the public. They had the power to remove dishonest bankers and the mandate to seize insolvent banks and thrifts. Yet compliant regulators refused to assert their sweeping powers. This void allowed rogues to operate freely within the banking system.³

Throughout the twentieth century, the soundness of the banking system has depended exclusively on regulators who operate behind closed doors. The only fundamental change to the regulatory system has been that taxpayers, not depositors, now have to pay for the insider abuse that is hidden by bank secrecy laws. Franklin D. Roosevelt's fears about deposit insurance have come true. Roosevelt warned that deposit insurance would make the federal government liable for the actions of irresponsible bankers and "put a premium on unsound banking in the future."⁴

During the 1980s, regulatory secrecy bred corruption at the highest levels of the U.S. government. After reviewing the confidential records of the Federal Home Loan Bank Board, Henry Gonzalez, then chairman of the House Banking Committee, responded to the impotency of the regulatory system by declaring that "the savings and loan scandal grew in the dark basement of official government secrecy." The cost of that secrecy has been staggering.⁵

Official secrecy permitted the savings and loan scandal to grow beyond control while regulators deceived the public. Danny Wall, the nation's chief S&L regulator and the industry's leading defender, maintained throughout the presidential election year of 1988 that a taxpayer bailout was unnecessary. In March of that year, he claimed the problem could be solved with \$17 billion, but by May his calculation had risen to \$22.7 billion. In July, Wall increased that figure to \$30.9 billion and in October estimated the cost between \$45 and \$50 billion. After the election in November 1988, the same month that Wall told S&L executives to "hold your heads high," estimates rose to \$75 billion. Now the U.S. General Accounting Office (GAO) has estimated that the cost of the savings and loan bailout, including interest on government bonds, could be as much as \$500 billion.⁶

Yet the central financial question of our time remains unanswered: Why did so many banks and thrifts fail in the 1980s, a supposedly prosperous decade? Regulators and bankers blame the failures on "economic downturns in certain regions," an oil and gas recession in Texas, and real estate recessions in Florida and the Northeast. Even some respected economists, who have not reviewed the bank regulatory records and who have financial arrangements with the banking industry, argue that the regional recessions caused the epidemic of bank and S&L failures. But in 1988 the General Accounting Office reviewed examination reports of twenty-six failed thrifts, and found that they did not fail because of a weak economy. The GAO found that prudent thrifts survived the recessions of the 1980s, but that "fraud or insider abuse existed at each and every one of the failed thrifts." The GAO also discovered that regulators knew about the insider abuse and illegal activity, but had failed to stop the looting.⁷

When I began the research for *Panic in Paradise*, Florida's comptroller refused to release any banking records, insisting that it was a third-degree felony to do so. After eighteen months of legal wrangling, I finally gained access to the failed-bank records of the 1920s. A review of the antique records revealed why they had been sealed for so long. They contained evidence of an astonishing level of corruption.

Despite official disclaimers and previous historical accounts, Florida's banking panic of 1926 was caused not by unforeseen economic conditions or a mysterious drop in real estate values but by massive fraud and insider abuse. The banking secrets, which had been buried for sixty-three years, exposed the corrupt business practices of the governor and the comptroller of Florida as well as the vice-president of the United States, Charles G. Dawes. Because of fraud and insider abuse, one hundred and fifty banks failed in 1926, causing the collapse of the great Florida land boom.⁸

During the 1980s, Florida experienced another land boom and again fraud was thriving in its banking system. When forty-nine state banks and thrifts collapsed, the state legislature launched an investigation. After reviewing secret bank and S&L examination reports, the Florida House Commerce Committee agreed with the GAO that the "crisis was preventable." Regulators were intimately aware of the corruption but refused to take action. Committee members found fraud and insider abuse at every failed institution they examined. Declaring that America's bank regulatory system is a "national disgrace," they concluded that bank secrecy prevented public accountability.⁹

Members of the committee also condemned the deplorable fund-raising practices of Florida's elected banking commissioner, Comptroller Gerald Lewis, a Democratic cabinet member who had reigned over the state's S&L and banking industries since 1975. Lewis had accepted large campaign contributions from David Paul, once the head of CenTrust Savings Bank of Miami but now an imprisoned felon, and other S&L operators and bankers. Frustrated by stonewalling from Lewis during the legislative investigation, Representative Jeff Huenink, a Republican member of the House Commerce Committee, filed an impeachment resolution against the regulator, accusing him of running the banking department with such "favoritism and cronyism" as to constitute "gross misconduct." Huenink charged that Lewis operated a "pay-to-play" system in which he took contributions from bankers and looked the other way while they looted some of the state's leading financial institutions.¹⁰

Pervasive Secrecy

Instead of explaining why today's S&L and banking crisis grew to such immense proportions, regulators have barricaded themselves behind a wall of secrecy. The public is prohibited from seeing the federal government's records of a failed bank or thrift for fifty years. The federal records of an institution that failed in 1990 will be sealed until the year 2040. Even more secret than failed bank records are the government's records of banks and thrifts that are still open. As long as a bank or thrift continues to operate, its regulatory records remain permanently sealed.¹¹

Bank secrecy at the state level is more restrictive. In forty-four states, the banking departments have either destroyed their records or permanently prohibit access. Only Florida, New Mexico, Idaho, Oregon, Oklahoma, and Alaska permit the study of records of their failed banks from the 1920s. *Panic in Paradise* established that an accurate economic history of the United States cannot be written without recourse to bank regulatory records. Until state regulators are stopped, they will continue to destroy the evidence.

Why such pervasive secrecy? The simple truth is that bank secrecy protects government officials and bankers, not the public. If the records of failed banks and thrifts were released, many members of Congress and officials at all levels of government could find themselves under investigation. The Whitewater scandal is just one example. Madison Guaranty Savings and Loan Association is only one small S&L in Arkansas that failed. Hundreds of scandals may remain covered up by bank secrecy.¹²

As long as America remains a bastion of bank secrecy, future debacles are inevitable. The regulatory system needs a drastic overhaul with disclosure, not secrecy, as its basis. By keeping the public in the dark, bankers have remained the governors of the banking system. As James Madison warned: "Knowledge will forever govern ignorance."¹³

Had the public known what regulators knew, when they knew it, the savings and loan fiasco could have been avoided. Indeed, had the public known that S&L operators like David Paul and Charles Keating were engaged in rampant insider

abuse, their institutions would not have grown large enough to precipitate a crisis when they collapsed. Disclosure of the examination reports of Paul's CenTrust and Keating's Lincoln Savings and Loan would have stopped the plunder: the adverse publicity would have forced regulators to remove the high-powered confidence men from their fancy boardrooms.

Prophets of Regulation

Throughout American history, industries vital to the nation's economy have been compelled to disclose their finances. Charles Francis Adams and Louis D. Brandeis, historian Thomas McCraw's "prophets of regulation," were responsible for opening the books of the railroad and investment banking industries. Adams, grandson and great-grandson of two American presidents, was the author of the Massachusetts sunshine law of 1869, which compelled railroad companies of the Gilded Age to disclose their finances.¹⁴

After the Panic of 1907, Brandeis, later a U. S. Supreme Court justice, made the call for an end to bank secrecy in *Other People's Money and How the Bankers Use It*. His 1914 book became a national sensation by sharply criticizing the influence of the "money trust" on the nation's economy. It publicized the majority findings of the Pujo subcommittee's investigation of insider abuses in the banking and securities industries.¹⁵

Brandeis declared that sunlight was the "best of disinfectants; electric light the most efficient policeman." Disclosure would, he believed, cure the bankers of greed. Congress debated Brandeis's ideas of disclosure for twenty years before taking action. After the Bank Holiday of 1933, Congress opened the investment banking industry to public scrutiny with the passage of the securities acts.

Commercial bankers escaped disclosure during the New Deal by convincing Congress that revealing the true conditions of the nation's banks would cause violent bank runs. The history of federal deposit insurance has eliminated that argument. The recent banking and thrift crisis proved that depositors do not panic when their deposits are insured. Though the press published the names of insolvent banks and savings and loans, Depression-style runs did not occur.¹⁶

Any regulatory system would fail, Brandeis argued, if it denied public access to financial information and relied solely on the government. He called for "real disclosure" by revealing banking activities to the public. The publicity would create an informed consent similar to the labeling requirements of the Pure Food Law. But the power of bankers in Washington and in state capitals has kept their activities shrouded in secrecy. The cost of that secrecy has been staggering.¹⁷

Abolish Bank Secrecy

Does the public have a right to know how its money is invested? Because of federal deposit insurance and taxpayer bailouts, banks and thrifts are public institutions whose true conditions should be on the public record. A banking-in-

the-sunshine law, mandating full disclosure for financial institutions, their officers and directors, and regulatory agencies, is the only way for the public to regulate its banking system. Disclosure of self-dealings and bad loans would have a chilling effect on bankers who misuse their public trust for private profit and on borrowers who take advantage of public institutions.

Disclosure of insider deals, bad loans, and political involvement would empower the public and restrain the widespread insider abuse. Release of the examination reports of existing banks and thrifts, which are now sealed by criminal penalties, would prevent bankers from protecting their directors and business partners. It would also reveal whether a banker has made loans to regulators and politicians and whether those loans are in default.¹⁸

Moreover, taxpayers have a right to know if a borrower defaults on a loan at a federally insured institution. If a bank chooses to sue a delinquent borrower, the bad loan becomes public knowledge. And bankruptcy proceedings are public, so it seems reasonable to require disclosure of delinquent borrowers before they file for federal protection. Delinquent borrowers would then be treated the same as delinquent homeowners, who are listed in the local newspaper when they miss the deadline to pay property taxes.

Another conclusion of *Panic in Paradise* is that bankers are public officials who should receive the same scrutiny as other public officials. Broad classifications of local, state, and federal officials must file financial disclosure statements. But bankers, who enjoy the privilege of a public subsidy and who use the public's federally insured money for private profit, are not required to disclose their personal finances. It should be public knowledge if a banker has personal loans at his own bank or other federally insured institutions. Disclosure would expose the cozy lending practices among colleagues in the banking fraternity.

Bankers exercise more influence over the public interest than most other officials. But their power is disproportionate to their investment. Banks and thrifts are unique entities because stockholders own less than 10 percent of the institution's assets and depositors, whose accounts are insured by taxpayers, own more than 90 percent. As trustees of the public's money and to prevent conflicts of interests, bankers should be compelled to disclose their finances.

After requiring a generation of taxpayers to pay as much as \$500 billion for the S&L bailout, how can Congress justify the bank secrecy laws? The public has paid for the right to know how its money is invested. Full disclosure would allow competition to function in the banking industry because informed depositors could select financial institutions free of insider abuse. Then meaningful reform of the deposit insurance system could be achieved.¹⁹

Yet the sunshine law would go far beyond reforming the banking industry. Relying on the banking secrets of two generations ago, *Panic in Paradise* revealed how bankers, regulators, and politicians joined together to violate their public trust. The banking scandal of 1926 reached from the statehouses of Florida and Georgia to the chambers of the vice-president of the United States. Releasing today's banking secrets would purge from the political and financial establishments those who were responsible for the savings and loan scandal.

When Jefferson wrote the phrase "consent of the governed" in the Declaration of Independence, he meant informed consent. Democracy and capitalism cannot function without a well-informed electorate and market. Disclosure would dismantle the system of favoritism and prevent the next banking crisis.

Throughout the American experience, landmark financial reform has been enacted only after a calamity has shocked the nation. The national banking system was formed during the Civil War, the Federal Reserve System was created after the Panic of 1907, and Congress passed the deposit insurance and securities disclosure acts during the 1930s. For the first time since the Great Depression, Americans have the opportunity to abolish bank secrecy. Instead of merely paying for the scandal, all of us should demand that Congress open the secret vault.

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NOTES

1. Arthur M. Schlesinger, Jr., *The Imperial Presidency* (Boston: Houghton Mifflin, 1973), 336; see Raymond B. Vickers, *Panic in Paradise: Florida's Banking Crash of 1926* (Tuscaloosa: University of Alabama Press, 1994).
2. In 1932, a federal appeals court complained that the comptroller of the currency's power was "too sweeping and imperialistic." Nevertheless, that same court upheld those powers: "Unquestionably Congress contemplated the upheaval and cataclysm to which the financial structure is subject, the importance of its stability, and the necessity which exists for action unhampered by technicality in emergency" *U.S.N.B. of LaGrande v. Pole*, 2 Fed. Supp. 153, 157.
3. Ravi Batra blamed the economic problems of the 1920s, in part, on deregulation. Deregulation was not the problem in the banking industry. See Batra, *The Great Depression of 1990* (New York: Simon & Schuster, 1987), 96-104, 134, 193-96, 214. In 1927, the U.S. Fourth Circuit Court of Appeals ruled that the comptroller of the currency had "almost imperialistic powers." *Liberty National Bank of South Carolina at Columbia v. McIntosh*, 16 Fed. 2d 906; *National Bank Act, 1927*; *Bank Failure: An Evaluation of the Factors Contributing to the Failure of National Banks* (Washington DC: Office of the Comptroller of the Currency, June 1988).
4. John Steele Gordon, "Understanding the S&L Mess," *American Heritage* 42, no. 1 (February/March 1991): 65; James J. White, *Banking Law* (St. Paul, MN: West Publishing, 1976), 65-67, 715, 868-73; Vincent P. Carosso, *Investment Banking in America: A History* (Cambridge, MA: Harvard University Press, 1970), 352-81.
5. Teresa Simons, "Banking On Secrecy," *Washington Monthly*, December 1990, 31; James Ring Adams, *The Big Fix* (New York: John Wiley & Sons, 1990), 11-12.
6. Stephen Pizzo, Mary Fricker, and Paul Muolo, *Inside Job: The Looting of America's Savings & Loans* (New York: Harper Perennial, 1991), 486; Adams, *The Big Fix*, 281-84; Martin Mayer, *The Greatest-Ever Bank Robbery: The Collapse of the Savings and Loan Industry* (New York: Charles Scribner's Sons, 1990), 2; L. William Seidman, *Full Faith and Credit: The Great S&L Debacle and Other Washington Sagas* (New York: Times Books, 1993), 196-97; *New York Times*, September 18, 1991, July 30, 1992, March 16, 1993; *Washington Post*, October 29, 1991; *Wall Street Journal*, September 15, 22, October 6, November 4, 18, 1988.
7. "Failed Financial Institutions: Reasons, Costs, Remedies and Unresolved Issues," Statement of Frederick D. Wolf before the U. S. House Committee on Banking, Finance and Urban Affairs, U.S. General Accounting Office Testimony, January 13, 1989, 9, 10, 11, 13, 21, 22, 40; "State of Connecticut Failed Institutions," Records of the Connecticut Department of Banking, Hartford, Connecticut; *New York Times*, December 15, 1989, January 5, 7, 8, 10, February 2, August 27, October 27, November 15, 1991, January 2, 1992.

8. See the examination reports, correspondence, and other regulatory records of banks in Florida and Georgia that failed during the 1920s, U.S. Office of the Comptroller of the Currency, RG 101, Records of the Examining Division, 1863–1935, Washington National Records Center, Suitland, Maryland; Office of the Comptroller of the Currency, Records of the Division of Insolvent National Banks, 1865–1950, National Archives, Suitland, Maryland; and State Comptroller Records, RG 350, Series 64, Closed Bank Records, 1898–1942, Florida State Archives, Department of State, Tallahassee, Florida; see also *State of Georgia v. W. D. Manley*, Case Nos. 26668, 26729, 26730, 26732, 26733, 26734, 26735, 26736, 26737, 26738, 26739, 26740, 26741, 26742, 26743, 26744, 26745, 26746, 26747, Criminal Division, Fulton County Superior Court, Atlanta, Georgia; and *United States v. Wesley D. Manley, Joseph A. Sasser, Paul J. Baker, Lorne R. Adams, and John D. Russell*, indictments for fraudulent use of mails, and sentences to the United States penitentiary, Criminal Docket No. 13423, United States District Courts Records, RG 21, Northern District of Georgia, 1847–1942, National Archives, Atlanta, Georgia.
9. *Explanation of Major Provisions of CS/HB 2471 Financial Institutions Regulatory Reform Act of 1992 and Regulatory Sunset Report*, Florida House of Representatives Committee on Commerce, Art Simon, Chairman, February 26, 1992.
10. *Ibid.*; “Impeachment Resolution” filed by Representative Jeff Huenink in the Florida House of Representatives, March 12, 1992; *Tampa Tribune*, November 15, 1991, February 9, 14, 19, 29, March 2, 3, 4, 6, 7, 11, 13, 17, 20, 25, 1992; *St. Petersburg Times*, November 15, 19, 1991, February 20, 29, March 1, 3, 4, 5, 6, 7, 8, 13, 17, 20, 22, 25, 1992; *Miami Herald*, February 23, March 3, 4, 7, 13, 1992.
11. *Guide to the National Archives of the United States* (Washington, DC: National Archives and Records Administration, 1987), 161.
12. See Florida’s regulatory records of forty-nine state banks and savings and loans that failed during the 1980s, State Comptroller Records, Department of Banking and Finance, Tallahassee, Florida; *New York Times*, January 4, 23, 1995.
13. Schlesinger, *The Imperial Presidency*, 332–33.
14. Thomas K. McCraw, *The Prophets of Regulation* (Cambridge, MA: Harvard University Press, 1984), 1–25.
15. Louis D. Brandeis, *Other People’s Money and How the Bankers Use It* (1914; reprinted from *Harper’s Weekly*, New York: Frederick A. Stokes, 1932), 92–108.
16. *New York Times*, March 8, May 31, December 27, 1984, February 14, 1989.
17. Brandeis, *Other People’s Money*, 92–108; Vincent P. Carosso, *The Morgans: Private International Bankers, 1854–1913* (Cambridge, MA: Harvard University Press, 1987), 639–40; White, *Banking Law*, 80–82; Adams, *The Big Fix*, 6, 135.
18. Raymond B. Vickers, “Sleazy Banking in the ‘20s and Today,” *Wall Street Journal*, May 23, 1989.
19. Pizzo, Fricker, and Muolo, *Inside Job*, 486; Adams, *The Big Fix*, 281–84.