Another major US bank collapses

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Alabama-based Colonial Bank collapsed Friday, bringing the total number of US bank failures so far this year to 77. With assets of $25 billion, Colonial is the sixth-biggest bank failure in American history, and the biggest since Washington Mutual's banking operation was shut down by federal regulators and sold to JPMorgan Chase in September 2008.

Colonial's collapse "signals an ominous phase in the nation's banking crisis," the *Wall Street Journal* commented. "Even as some large institutions show signs of stabilizing, a slew of regional lenders remain on the ropes. And regulators appear to be giving up hope that some of them can be saved."

The demise of Colonial Bank appears to be another instance of reckless speculation combined with outright criminality. The institution had engaged in aggressive lending focused on the real estate market in Florida. The sub-prime mortgage collapse, which has especially affected Florida, led to Colonial registering unsustainable losses and write-downs. The bank lost more than $600 million in the last quarter, and by last month had $1 billion in "non-performing assets" out of total assets of $26 billion.

The bank had sought more than $500 million in bailout money from the Troubled Asset Relief Program (TARP), but this was made conditional on it raising an additional $300 million from private investors or other banks. Efforts to secure this money failed after a federal criminal investigation was launched into a proposed deal with Florida-based mortgage company Taylor, Bean & Whitaker. Agents with the FBI and Treasury Department raided Colonial's offices earlier this month.

The *Wall Street Journal* reported on August 8: "The bank said the Justice Department is investigating its lending division that originates mortgages the bank doesn't intend to keep, as well as related accounting irregularities over several years."

In an earlier incident which highlighted the impunity with which the banks have been able to operate, Colonial changed regulators when questions were first raised about its finances. In 2008, the bank abandoned its charter with its primary regulator, the Office of the Comptroller of the Currency (OCC), and opted for Alabama state regulations after the OCC highlighted its exposure to Florida's commercial real estate market.

The Federal Deposit Insurance Corp (FDIC) oversaw the fire-sale of Colonial to the North Carolina-based regional bank BB&T, now to become the eighth largest US bank measured by deposits. The transaction involved the now standard "no-loss" guarantee, with the FDIC agreeing to share losses with BB&T on $15 billion of Colonial's assets. The bank collapse is expected to cost the FDIC about $2.8 billion, further depleting its deposit insurance fund, which last March was just $13 billion.

In addition to Colonial, four smaller banks collapsed last week—Community Bank of Nevada, Dwelling House, Union Bank, and Community Bank of Arizona—costing the FDIC another $875 million.

More institutions have already collapsed in 2009 than in any year since 1992. The failure rate is accelerating—of the 77 bank failures thus far this year, 32 have occurred in the last seven weeks alone. The *Wall Street Journal* noted Saturday that the banks now failing are in far worse shape than those which collapsed during the industry's last crisis from 1989-1995, costing the FDIC substantially more.

The federal agency has listed 305 unidentified institutions as "problem banks." A *Bloomberg* analysis published last Friday found that more than 150 publicly traded US lenders have "nonperforming loans" on their books equal to five percent or more of their holdings—a level which threatens banks' entire equity. These institutions, which do not include the 19 largest banks regarded by Treasury as "too big to fail," have combined deposits of $193 billion—"almost 15 times the size of the FDIC's deposit insurance fund at the end of the first quarter."

President Barack Obama's administration has averted a full-scale collapse of the financial markets by placing trillions of dollars in public funds at the disposal of the banks—but none of the underlying problems have been addressed. Up to $2 trillion in bad debts and worthless securities (known as "toxic" or "troubled" assets) remain on the banks' books.

The Congressional Oversight Panel, the body which reports to Congress on TARP's progress, last week issued its monthly report for August. The report emphasized: "It would be foolish to think that the risk of troubled assets has been mitigated or that it does not remain the most serious risk to the American financial system."

The report also noted that "it is likely that an overwhelming portion of the troubled assets from last October remain on the bank balance sheets today." These assets are largely comprised of defaulted mortgages and the edifice of securities and other speculative mechanisms built upon the mortgage market.

The Congressional Oversight Panel warned: "If the economy worsens, especially if unemployment remains elevated or if the commercial real estate market collapses, then defaults will rise and the troubled assets will continue to deteriorate in value. Banks will incur further losses on their troubled assets."

No one is yet aware of the true extent of the crisis. In an extraordinary admission, the Congressional Oversight Panel report stated: "It is impossible to resolve the argument about whether banks are or are not solvent because of the uncertain value of their loans."

In other words, policy makers in the world's leading capitalist economy are proceeding without even knowing whether the national banking system is solvent.

This ignorance is partly due to changes in accounting regulations enacted in April this year by the Financial Accounting Standards Board. Under the old guidelines, banks were required to maintain up-to-date market value reports of its asset holdings, but now banks can suspend this reporting principle if market prices for securities and other toxic assets are deemed to be based on a "distressed market," or in cases where assets are not intended for immediate sale. In these instances, assets can be listed at their initial purchase price, concealing the true value.

The Congressional Oversight Panel explained: "Once a bank sells a legacy security or legacy loan, it must book the sale value, but if the bank holds the asset, it may continue to mark the asset at the higher value permitted by the new rule. Thus any sale at less than amortized cost value would forgo the benefit of being able to avoid distress pricing and force perhaps substantial write-downs... To the extent banks have not written down troubled assets, they are in effect continuing to invest in those assets by holding them for a future return ... postponing the day of reckoning if it turns out that, rather than appreciating, the assets depreciate."

The banks' estimate that their troubled assets will prove more valuable in the future is based on political rather than market calculations. The toxic assets relating to the sub-prime mortgage industry are effectively worthless and would never regain their former value in normal market conditions. Mortgage defaults have spread far beyond the sub-prime category and are continuing as the unemployment crisis worsens and as property prices continue to fall. The TARP report cited a Deutsche Bank estimate that by 2011, 48 percent of US homeowners will owe more than their house is worth.

In addition, the commercial real estate market may be set to crash, also bringing down commercial real estate securities. The Congressional Oversight Panel explained that this would create a new class of troubled assets, and place "more general renewed pressure on bank balance sheets that would again call into question the true value of residential mortgage loans."

The banks are nevertheless holding onto their toxic assets in the expectation that the Obama administration will eventually intervene and use additional public funds to buy the worthless securities at prices equivalent to their listed value before the financial crisis. Alternatively, if direct government purchase proves unviable, the banks expect the government to provide additional no-loss guarantees and public subsidies to allow toxic assets to be sold at a profit to other private buyers.

In the meantime, the toxic assets provide the banks with a convenient pretext for maintaining restrictive lending practices which are badly affecting consumers and small businesses. The TARP fund was supposed to provide billions in public funds to make credit more accessible and less costly—but this was not made mandatory and the banks have simply used the money to shore up their bottom line, and, in many cases, continue to pay out exorbitant bonuses to the very executives responsible for creating the crisis in the first place.

The latest Congressional Oversight Panel TARP report emphasized that mid-sized banks, those with assets between $600 million and $100 billion, are at most risk of going under and may need additional public capital of up to $21 billion. The report included a series of recommendations to shore up these strata of the banking sector, including expanded modeling to test the longer-term security of their asset and capital holdings and greater disclosure regulations to force banks to reveal the toxic assets on their books. Neither the Treasury Department nor the Federal Reserve is inclined to enact these recommended measures.

The Obama administration has proven itself as a ruthless defender of the financial elite's interests. Acting as the instrument of the major banks, it is using the accelerating rate of bank collapses to restructure the industry. Smaller and less competitive institutions are being deliberately purged, with federal regulators taking on their bad debts and handing over remaining assets and infrastructure to larger financial institutions. The result will be a further consolidation of the economic and social power of a small network of mega-banks.