

Land + Credit, '83

Talk on land + credit

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3. Lewis Merwick article
4. VanderHue
5. Winer, M. J. Trends + Cycles in Cap. Expend. by U.S.
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6. Allan Bogue, Money at Interest. From Mortgage on
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FDIC official expects bank failures to set record

13 June 86 G-3
The Associated Press

WASHINGTON — A record number of banks — up to 160 — will fail or need government help by the end of the year, the chairman of the Federal Deposit Insurance Corp. said yesterday.

William Seidman said that between 140 and 160 banks will fall into the failed or help-required category in 1986, up from last year's record 120 which collapsed or had to find refuge under the FDIC's protective umbrella.

FDIC is the agency that insures deposits of up to \$100,000 for about 15,000 member commercial and savings banks around the country. At the beginning of the year, Seidman said, officials had estimated that about

120 banks would either fail or need assistance in 1986.

In a speech to the United States League of Savings Institutions, he said the mid-year adjustment reflects "the continuing increase in the number of institutions being added to the FDIC's problem bank list and the actual number of failures so far this year."

The agency has a policy of refusing to divulge the names of troubled financial institutions.

Bank failures and assistance transactions reached 55 by June 9, surpassing the 43 failures and interventions which occurred during the same period in 1985, Seidman said. He said that slightly more than 1,300 banks

are on the FDIC's problem bank list today, up from 1,140 at the end of 1985.

Seidman said the increases in the number of banks on the problem list reflect asset problems confronting oil and gas lenders, continuing weakness in the agricultural areas and softness in the commercial and real estate market.

In a separate statement, the FDIC said that while potential failures among agricultural lenders were included in the agency's original estimate of 120 problem institutions, "the sharp decline in oil prices and related impacts on the real estate markets were not fully anticipated."

Largest-ever private-enterprise rescue

Government takes over big bank

By ROBERT A. BENNETT
New York Times News Service

WASHINGTON — In an extraordinary intervention in the banking business, the federal government committed itself yesterday to a \$4.5 billion rescue of the Continental Illinois National Bank and Trust Co. of Chicago. It was the largest package of federal support for any private enterprise.

The three federal banking agencies said in an announcement that they were acting to keep the bank, which has billions of dollars in bad loans and is threatened by an outflow of deposits, from collapsing and to

More stories related to the Continental Illinois rescue are in Business, Page H-1.

avoid the possibility of a major international financial crisis.

A financial assistance package initiated in mid-May has proved inadequate and no other bank has been willing to buy Continental without enormous aid from the government.

Yesterday's rescue is intended to protect all depositors and other creditors of the bank, restoring confidence in the entire banking system. Faith in the nation's big banks has plummeted

in recent weeks because of Continental's problems and because of the high level of shaky loans to Latin America's debtor countries.

The new assistance package, which includes \$1 billion of fresh capital for the bank, in effect gives the government control of Continental. The government will also assume \$3.5 billion in delinquent loans.

As one of its first acts, the government replaced Continental's two top officers. Named to the positions were John E. Swearingen, 65, a nationally known retired oil executive, who will be chairman and chief executive of the holding company, and William S. Ogden, 56, a prominent

New York City banker, who will be chairman and chief executive of the bank.

The depth of Continental's financial weakness, which has been worsening since the summer of 1982, was underscored yesterday morning when it announced a loss of \$1.1 billion in the second quarter, more than four times greater than any quarterly loss ever reported by an American banking company.

In addition to the \$4.5 billion investment in the bank, the Federal Deposit Insurance Corp., which has been playing the lead role, gave an unqualified promise to pump in additional sums, if (See BANK, Page A-8)

Administration saw bailout options as slim and none

By MARTIN CRUTSINGER

WASHINGTON (AP) — The very word "bailout" causes great gnashing of teeth within the Reagan administration, but the alternative, in the case of Continental Illinois, was even more painful to contemplate.

So the administration — the champion of free enterprise — held its nose and went along with the biggest government bailout in history — a \$4.5 billion federal aid package to prop up one of the country's 10 largest banks.

News analysis

It presents the country with the irony of having a conservative Republican president preside over a government rescue effort that dwarfs the combined loan guarantees and federal outlays made to Lockheed, Chrysler and New York City.

At the White House, spokesman Marlin Fitzwater said "We think it's in the best interests of depositors and the banking industry. Although we had some reservations about the form of (See BAILOUT, Page A-8)

The
Friday

Press-Enterprise

Riverside Final

68 died as 40 ships passed

Viet refugee tells of deadly voyage

By RUBEN G. ALABASTRO

MANILA (AP) — Dozens of ships sailed by and ignored a crowded boatload of desperate Vietnamese refugees, 68 of whom died before Filipino fishermen finally rescued them, said a survivor who spent 32 days at sea.

"We saw about 40 ships and we raised our white blouses on top of our boat and we cried 'SOS! SOS!' but they didn't come near us," Dinh Xuan Hoa, 24, said from her bed in a Manila government hospital, where she was being treated for malnutrition.

Unable to survive on rainwater, fish and the six sacks of potatoes they had brought, all but 16 of the refugees perished, she said.

"We threw their bodies into the sea as soon as they died, but later on we were too weak to push them out of the boat and all I could do was cry as their bodies lay beside me."

Filipino social workers for the U.N. High Commissioner for Refugees said they had interviewed several of the survivors.

Many who survived their sea voyage have told of pirate attacks, including murders and rapes.

Dinh said the refugees, some as young as 21 months, set out from Ben Tre, Vietnam, on June 5 in a 36-foot boat. Within a week, the engine died and they ran out of food.

She said the victims included the captain — her half-brother Koan Chau Dat, a pilot in the former South Vietnamese air force — as well as 10 children.

The first to die, a week after they ran out of food, were a man and his small son.

"They boy kept on crying and crying," Dinh said. "Suddenly he was not crying anymore . . . We threw both into the sea at the same time. There were three or four people who died each day . . . They all died because there was no food and they were cold."

When the boat was out of Vietnamese waters, a storm hit, lashing the boat with rain for 10 days, Dinh said.

After their 68 companions died, the 16 survivors caught two



AP

Dinh Xuan Hoa yesterday describes a grim 32-day voyage from Vietnam during which 68 of her fellow refugees died.

Final Israeli election returns give ruling Likud bloc boost

By JAMES FERON

New York Times News Service

JERUSALEM — Final results in Israel's national elections, announced last night, seemed to strengthen chances that Prime Minister Yitzhak Shamir would be asked to form a new government.

The vote showed the right-wing bloc had gained a seat in Parliament at the expense of the Labor alignment.

With the military vote added to the tally of Monday, slightly rearranging the allocations, an extra seat went to the Tehiya Party, an ally of Shamir's 41-seat Likud bloc. This gave Tehiya five seats and made it the largest of 13 smaller parties.

Labor's loss of a seat reduced its total to 44. It remained the largest single party in the Knesset, Israel's parliament. Although long the nation's dominant party, Labor has been losing partners for a coalition. The soldiers' vote diminished those chances further.

Roni Milo, a Likud representative in the Central Election Committee, said 50 percent of the soldiers' vote went to Likud and

Kahane's election arouses Israel

By ARTHUR MAX

JERUSALEM (AP) — The election of anti-Arab militant Meir Kahane to Parliament has aroused a wave of revulsion and soul-searching in Israel, even among many of those who urge a tough policy against the Palestinians.

At the same time, Israelis are fascinated by Kahane, the U.S.-born rabbi who ran on a platform of expelling the 2 million Palestinians in Israel and the occupied territories. He says Israel cannot live with them in peace.

Israel television devoted one-third of its nightly newscast Wednesday to Kahane and "Kahanism."

Newspapers have dwelt on the spread of the right wing and said it was hard to believe that Kahane's party, Kach, won the votes of 22,500 Israelis in Monday's general election, enough for one seat in the 120-member Knesset.

To celebrate his victory after three previous failures, Kahane and a small group of followers marched through the Arab-populated Old City of Jerusalem Wednesday, pushing aside Arab passers-by, insulting merchants and shouting "Death to the Arabs!"

U.S. Jewish leader Theodore Mann of Philadelphia was in the Old City (See KAHANE, Page A-6)

ment. Barring that, he might block Labor.

It is now up to President Chaim Herzog, a lifelong Labor Party member, to meet with the

The

BANKS: Bad Loans Covered Up

Continued from Page 1

an explicit, candid and forthright manner," said Robert L. Walters, senior vice president at Sheshunoff & Co., an Austin, Tex.-based research firm that collects detailed data on thousands of banks nationwide.

Such underreporting has far-reaching implications for consumers, investors and regulators.

The financial conditions of some banks may be worse than anyone knows, at a time when the banking system already is suffering from the highest rate of failures since the Depression. The FDIC classifies

721 banks nationwide as "problem" banks with serious loan, management or other problems, far above the previous high of 383 in 1977.

Underreporting could also jeopardize the funds of unsuspecting depositors, particularly those with funds exceeding the \$100,000 limit on deposit insurance. In some cases, they have lost some of their funds placed in banks that they thought to be relatively sound.

A well-publicized case of such an occurrence involved Penn Square Bank of Oklahoma City, which failed in 1982 after covering up many of its problem loans from

regulators and depositors. Persons who had more than \$100,000 on deposit lost millions of dollars.

Federal regulators admit that underreporting is a problem but concede that they do not know how widespread it is. Banks are subject to tough requirements to report bad loans and other data to regulators and to investors and are also subject to periodic examinations by regulators.

However, experts say, bankers have a lot of flexibility in whether to declare a loan as non-performing; in some cases, they have covered up these problems by lending even more money to borrowers so that those borrowers could make interest payments.

The Securities and Exchange

Commission this year brought actions against two banking firms, Denver-based IntraWest Financial Corp. and Tulsa-based Utica Bancshares Corp., charging them with understating provisions for bad loans in 1982 in their reports to investors. Both companies settled the SEC actions without admitting or denying the charges.

Federal bank examiners are doing the best they can in trying to catch cheaters, experts say, but the examiners generally have the odds stacked against them.

With limited numbers of examiners, inspections of some banks sometimes take place as infrequently as once each three years—plenty of time for problems to develop and grow.

"Everything just happens too fast for examiners to keep up," the chief executive of one major West Coast bank said.

Some contend that many of the nation's banks, such as Continental, are simply too big and complex for examiners to catch everything.

"Federal and state examiners do a reasonably adequate job looking at (smaller) banks," New York bank consultant David C. Cates said. But, when it comes to looking after the largest banks, "it's basically a hopeless challenge."

Fortunately, regulators and others contend, the vast majority of banks are generally honest, and most cases of underreporting are unintentional. For example, many cases of underreporting are due to

inexperienced bank officers who do not understand federal loan-reporting requirements, FDIC spokesman Alan Whitney said.

In an effort to stem the problem, the FDIC—which examines state-chartered banks that are not members of the Federal Reserve System—has been conducting seminars to help bank officers understand reporting rules.

More important, FDIC Chairman William D. Isaac is pushing a proposal for banks to voluntarily provide reports about their condition to depositors on request.

"The clear implication to depositors is that, if banks refuse to give it to you, you better think of going to another bank," the FDIC's Whitney says.

Bank Bail-Out Puts Focus on Loan Coverups

7-28-84
By BILL SING,
Times Staff Writer

This week's unprecedented government bail-out of Continental Illinois Corp., holding company for what was the nation's eighth largest bank, is focusing attention on a persistent industry problem: Many banks are not reporting the full extent of their bad loans.

Recent bank failures and near-failures indicate that some firms have covered up many of their bad loans, deceiving regulators, investors and depositors, who, in some cases, lost millions of dollars when the banks failed.

Chicago-based Continental Illinois itself appears to have significantly underreported the magnitude of its bad loan difficulties. At the end of March, the banking firm reported \$2.3 billion worth of non-performing loans—those on which it was collecting little or no interest.

But, under terms of the bail-out—the largest government rescue ever of a private U.S. company—the Federal Deposit Insurance Corp. will buy \$4.5 billion in bad loans from Continental, implying that the bank's loan portfolio was far worse than it had reported. The Securities and Exchange Commission is believed to be investigating the bank for violations of federal reporting rules.

"Some banks clearly have not been facing up to their problems in

Please see BANKS, Page 15

Tower error blamed for Amtrak collision

By EDWARD McCULLOUGH

WASHINGTON (AP) — Two passenger trains crashed head-on in New York City because a signal tower operator mistakenly allowed them onto the same track, the head of Amtrak said yesterday. Traces of cocaine were found in the operator's urine, a federal official testified.

But because the traces of drugs found in the urine were so small, there are "serious doubts" that drugs played any role in the accident Monday that killed one man and injured 115, John H. Riley, head of the Federal Railroad Administration, told a Senate subcommittee.

The test found evidence of cocaine and "a cannabis derivative," Riley said. Cannabis is the scientific name for the marijuana plant.

W. Graham Claytor Jr., president and chairman of Amtrak, said the tower operator had been charged with violating Amtrak rules and suspended pending the completion of an investigation.

"We simply do not have enough data yet to determine whether that cocaine usage occurred at a time near or contemporaneous with operation. It is very difficult to evaluate the potential impact of that test. I want to be very clear in saying that," Riley told the surface transportation subcommittee of the Senate

Commerce, Science and Transportation Committee.

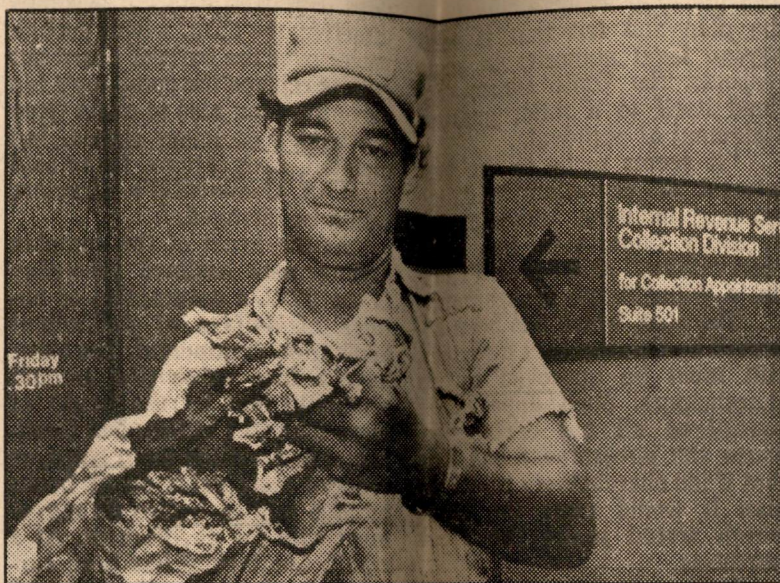
In a written statement, Claytor told the subcommittee "evidence has been developed that the tower operator in F tower failed to throw and lock the signal at Gate Interlocking in accordance with train orders and instructions."

This, he explained, "permitted train 168 (the northbound New England Zip) to pass the point at which it should have been held." As a result, the Zip collided with the southbound Shoreliner.

"This (tower) operator has been charged with violation of operational rules and instructions and has been taken out of service pending the formal investigation that is required by union contracts," Claytor said.

The operator is Rodney Rosemond, said Patricia Goldman, vice chairman of the National Transportation Safety Board. She said Rosemond was a 10-year railroad veteran who had transferred to the signal job on July 2, and then had a week off.

He had "five or six hours" training on equipment new to him, and that might have been insufficient, she said. "The operator told us he asked a supervisor for more training. We have to check that," she said.



Don Barnes holds trash sack filled with his payment to the IRS.

Angry taxpayer hands over his wad to IRS

JACKSON, Miss. (AP) — The Internal Revenue Service got more than just interest on Don Barnes' unpaid taxes. The agency got the shirt off Barnes' back and \$1,317 in carefully wadded \$1 bills.

Barnes, who has waged a one-man war against the IRS for several months, surrendered Wednesday, but didn't make it easy.

"This is just my way of protesting," Barnes explained.

"You can't fight 'em. There is no legal recourse to get at them."

"The 36-year-old Richland construction worker says he never

had tax problems until 1982 — when he failed to file a tax return because he said the construction business was slow and he had no money.

Barnes admits he owed the money, and says he doesn't even mind paying the interest. "That's fair," he said.

His gripe is over the handling of his case. His wages have been attached and there's a lien against his house.

"As far as the Internal Revenue Service is concerned, you don't have any rights. I could go down on the street and kill somebody and I'd have rights, but here I don't have any."

De Lorean judge calls witness 'gun for hire'

By LINDA DEUTSCH

LOS ANGELES (AP) — A judge, calling the key informant against John Z. De Lorean "a gun for hire," criticized prosecutors yesterday for withholding crucial evidence from the defense in the automaker's cocaine trafficking trial.

U.S. District Judge Robert M. Takasugi said that because of the violation of his orders for disclosure early in the case, he would allow De Lorean's former secretary to take the stand as a surprise witness, despite protests by Assistant U.S. Attorney James Walsh.

Shortly after the ruling, Carol Winkler took the stand and identified her 1982 phone log, which contradicts testimony given by the government's star witness, informant James Timothy Hoffman.

She also identified a letter to Hoffman indicating De Lorean was seeking legitimate investments, not a drug deal in the summer of 1982.

Hoffman said he never received the letter.

Before Winkler's testimony and with jurors out of the courtroom, Takasugi said the government-withheld evidence, a teletype that said Hoffman demand-

ed a percentage of money seized in the De Lorean case, should have been given to the defense before Hoffman left the stand so he could be confronted with it.

"I find that quite offensive," Takasugi said, "especially in light of the fact that Mr. Hoffman testified he continued to help the government and was motivated by his effort to do good."

"The evidence certainly is that he was a gun for hire," Takasugi said. He said the teletype that disclosed Hoffman's demand was virtually "a smoking gun, in terms of the credibility of Mr. Hoffman . . ."

And he said wondered whether other documents were still being withheld by the government.

However, he said the late disclosure of the Hoffman teletype didn't irrevocably prejudice the case, because the defense did receive the evidence before the trial ended and was able to present it to the jury.

Winkler testified that she remembered typing a letter to Hoffman on July 9, 1982, touting De Lorean's car company as a good investment and sending along financial information.

Winkler was to return today for further cross-examination by Walsh.

Continental Illinois Is Top Business Lender

By LINDA GRANT,
Times Staff Writer

NEW YORK—Continental Illinois National Bank & Trust Co. has overtaken Bank of America as the top bank lender to American business, a survey by the daily banking newspaper American Banker disclosed this week.

American Banker said that data it compiled shows that Chicago-based Continental had the largest portfolio of commercial and industrial loans to domestic borrowers on Dec. 31, 1981, a total of \$13.5 billion. San Francisco-based Bank of America's portfolio, which was No. 1 last year, totaled \$12.3 billion at the year's end.

However, New York-based Citibank remained the leader in total business loans, including international loans. But about 70% of its \$38-billion portfolio was in loans to companies abroad, which made it only fourth in domestic rankings. New York-based Chase Manhattan Bank was third, with U.S. business loans of \$12.2 billion, about \$123 million behind B of A.

American Banker said its data is for banks only, not their holding companies, and pointed out that some results would be different if portfolios of the corporation, including other subsidiaries, could be used.

Continental Illinois' ascent to the top in domestic business loans (it ranks No. 4 in total loans) is the result of an aggressive strategy adopted in the mid-1970s. In 1976, Roger E. Anderson, Continental's

How They Stack Up

Leading U.S. commercial banks by commercial and industrial lending at home and abroad as of Dec. 31, 1981.

Company	Loans in Billions of Dollars		
	Total	U.S.	Abroad
Citibank	38.0	11.8	26.2
Bank of America	30.7	12.3	18.4
Chase Manhattan	29.8	12.2	17.6
Continental Illinois	20.6	13.5	7.1
Manufacturers Hanover	18.7	9.4	9.3

Source: Consolidated Report of Condition submitted by banks to federal regulatory agencies.

chairman, announced that the bank was embarking upon a major reorganization of its lending departments to improve services to business "and within five years to clearly position Continental among the country's top three banks for corporate customers."

Though the drive has succeeded, it has not been without problems. Continental's total of problem loans—those in default or in danger of default—has risen in recent months, a reflection of its emphasis on rapidly growing industries. Troubled customers include Chicago-based International Harvester Co. and AM International Inc., and San Diego-based Nucorp Energy Inc. and Wickes Cos.

A spokesman for the B of A said, "We have put a lot of work into loans to U.S. business but we have also placed strong emphasis on our consumer business and overseas markets. We are trying to cover three bases, not just emphasize one."

Loans to Govt. base 4.

W: Data on Cap. Recovery

U.S. Loans as % of all loans (bus. loans only)

Citi bank

31.9%

B of A

40

Chase

41

Cont. Ill

66

Mfg. Hanover

50

Banks Grapple With Unwieldy Debt Burden

By BILL SING, Times Staff Writer

Bankers heaved deep sighs of relief two weeks ago when four Latin American nations, 11 banks, the U.S. Treasury and Federal Reserve devised an 11th-hour, \$500-million loan allowing Argentina to meet a crucial deadline on interest owed to U.S. and foreign banks.

But today, many of those sighs have turned into groans. The financially strapped nation is threatening to renege on a key condition of the loan package: its promise to adopt economic austerity measures proposed by the International Monetary Fund. Meanwhile, it may default on another multimillion-dollar interest payment due June 30, and there is little hope that it will make principal payments in the immediate future.

"There is very little in the history of our business that parallels this crisis," Richard J. Flamson, chairman and chief executive of Los Angeles-based Security Pacific National Bank of Los Angeles, said last week. The solutions "will not be found by following the traditional tried and true work-out formulas" and "will probably be without precedent."

Restructuring Needed

Flamson's statement, made at a foreign trade conference in San Diego, illustrates what many bankers say is a fundamental shift in their attitude toward the international debt crisis—a shift that could pose new risks, challenges and uncertainties for their institutions and for debtor nations.

Facing mounting repayment problems and other factors, an increasing number of U.S. banks are concluding that the debt crisis will take at least five or six years to resolve, and thus significant long-term loan concessions must be made. Short-term bail-outs such as the Argentina loan—which have done little more than buy time while putting borrowers deeper into hock—will not be sufficient to stem the crisis, they say.

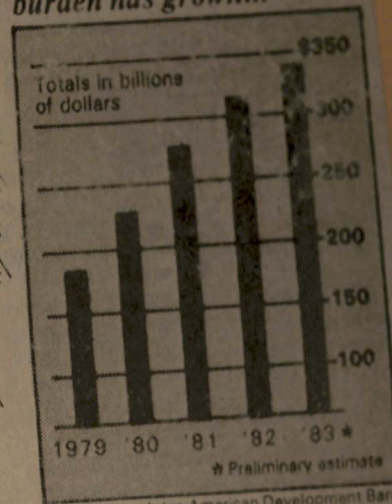
"There is a much greater realization that the problem is not going to go away soon," says Felix G. Rohatyn, who helped save New York City from insolvency in the late

1970s and who is a senior partner at the New York investment banking firm of Lazard Freres & Co. "Sooner or later, a fundamental restructuring of the loans is going to have to take place."

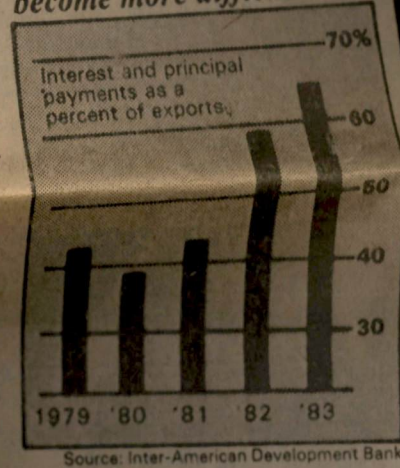
Accordingly, dramatic long-term proposals for addressing the debt crisis are making the rounds in banking circles. Of particular concern are loans to Argentina, Brazil, Mexico and other Latin American nations. With about \$330 billion of the \$700 billion in worldwide international debt, Latin American nations are generally considered to have the most severe repayment problems.

These proposals range from major cuts in interest rates and stretch-outs in payment schedules to allowing nations to temporarily skip interest payments altogether. Some bankers are talking of having Western governments or a new international agency of their creation "buy" the Third World loans at a discount in exchange for guaranteed, long-term, low-interest bonds or other securities.

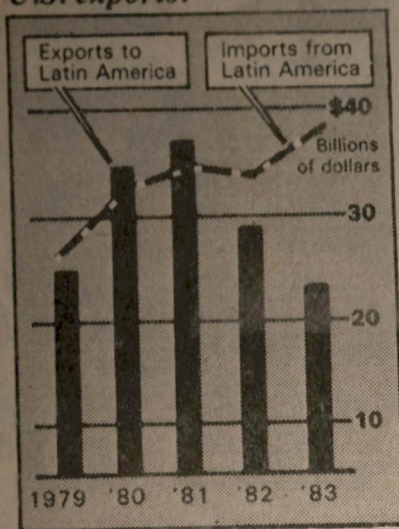
Latin America's debt burden has grown...



...and repayment has become more difficult.



The debt problem has hurt U.S. exports.



JIM OWENS / Los Angeles Times

While such ideas may never reach fruition, they would have been dismissed out of hand two years ago. And their growing currency within the banking community indicates how the world debt problem has grown messier over the last two years and how segments of the industry are groping for more permanent solutions to what many analysts consider one of their greatest threats.

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BANKS: Debt Burden Is Long Term

Continued from Page 1

The conventional industry wisdom two years ago was that less-developed nations were suffering largely from a short-term cash crunch due to the recession, high interest rates and other pressures that would be eased once the world's economies got back on their feet. Thus, banks have generally limited their concessions to extensions of deadlines for repaying loan principal while making new short-term loans to help debtors make interest payments on previous bank loans.

Since about the middle of last year, however, some banks have begun to treat certain Latin nations as insolvent, rather than in short-term liquidity crunches, one key West Coast bank executive says.

"The traditional orthodox view in banking is that when a borrower gets into trouble, it should be forced through an adjustment process in a limited amount of time," the banker says. "But the magnitude of the Latin nations' debt, and the inability of their nations to service it under existing terms, makes it impossible to push them through a three-year adjustment."

Concessions would mean major earnings cuts for banks, which so far have generally avoided sizable write-offs on Latin American debts.

Earnings Would Dive

If interest rates on loans to Mexico, Brazil, Argentina and Venezuela fell by two percentage points, for example, average earnings of the 10 largest U.S. bank-holding companies would fall by 12% this year, according to Keefe, Bruyette & Woods Inc., a New York securities firm specializing in bank stocks.

The bankers' consideration of concessions is a recognition of the growing involvement of U.S. and Third World governments in debt negotiations, largely a result of the growing politicization of the debt crisis and banks' inability to solve it alone. The U.S. Treasury and Federal Reserve were instrumental in negotiating the Argentine bail-out.

"The scope of the problem is really quite beyond the banks at this point," investment banker Rohatyn says.

This is not the first time that dramatic solutions have been recommended. Many economists, Third World officials and European bankers have been arguing for years that debts are simply too large for many less-developed nations to handle, even under the best economic conditions.

Debt Consumes Income

Brazil, the world's most indebted nation with \$97 billion in loans outstanding, is using more than 45% of total export income just for interest payments, says Yuosang Yun, manager of developing country economics at Data Resources Inc., a Lexington, Mass.-based economic forecasting firm. Mexico, with \$83 billion in debt outstanding, is using 36% of its export income for interest payments, while Argentina, with \$42 billion in debt, uses about 22%. Most economists consider 20% to 25% to be the upper range of manageability for a nation, Yun says.

Many European banks—which have relatively less exposure to Third World loans and face less restrictive regulations governing their accounting practices for bad loans—have added to their reserves to protect themselves against the possibility of nonpayment.

But until recently, most U.S. banks—trying to avoid write-downs such as those taken on bad domestic loans during the past three years—have been reluctant to consider any concessions.

Rather than lower interest rates, banks in many cases have charged higher rates on the premise that the greater risks justified greater current rewards. These higher-rate loans, which have come right back to the banks through interest payments from debtor nations, helped banks maintain higher earnings but have made their loan portfolios increasingly shaky.

But events in recent months have forced more banks to rethink their policies.

First, many Latin countries are balking at IMF-proposed austerity measures. Peru, Chile and Bolivia are joining Argentina in refusing to accept such measures as a reduction in imports and reduced government spending that they believe will throw their nations further into recession.

Second, many smaller U.S. regional banks—which have smaller relative exposure to Latin American debt—have become disillusioned with the Latin debt problems and are increasingly refusing to provide funds for new loans. That has cut the availability of overall credits to Latin nations while forcing big New York banks to take an ever increasing share of the loans.

"A lot of the smaller regional banks are prepared to put their Latin loans on non-performing status," says Lawrence R. Fuller, bank analyst at the Wall Street firm of Drexel Burnham Lambert Inc. "Non-performing" loans are those that haven't paid interest for at least 90 days, and therefore can't contribute to bank profits under current U.S. accounting rules. Because they have much more at stake, "the big banks say they can't afford to do that . . . so they end up doing new financings increasingly by themselves," Fuller says.

Interest Costs Jump

Also heightening concern about Latin debts is the recent hike in U.S. interest rates. Each percentage point increase costs Brazil \$650 million a year in additional interest payments, notes the nation's finance minister, Ernane Galveas. Overall, each percentage point increase in U.S. interest rates adds \$8 billion to the total debt of Third World nations, says U.S. Special Trade Representative William E. Brock, who has publicly called for banks to reduce interest rates on less-developed nations' debt.

Interest rates on the loans are generally tied to the U.S. prime rate or the London interbank offered rate (Libor), which is roughly what banks pay for deposits in the overseas money markets.

The higher rates also threaten to stifle economic recovery in those nations by choking off foreign investment and demand for commodities. Also threatening debtor nations' economies are growing protectionist moves by the U.S. and other industrialized countries to control imports of Brazilian steel and other Third World products.

Another factor causing a rethinking among banks is the increasing intervention of U.S. and Latin governments in debt negotiations.

Just as they united to rescue Argentina, Latin leaders such as Mexican President Miguel de la Madrid vowed to work together to seek common concessions in future loan-restructuring negotiations. Such a united front will make it more difficult for the U.S. banks to negotiate with each nation individually, some economists say.

"Clearly there is a higher level of coordination than ever before among major Latin American nations," says Riordan Roett, director of the Latin American Studies Program at Johns Hopkins University. "These nations are clearly attempting to move future debt negotiations

Major Latin American Exposure of 10 Largest U.S. Bank Holding Companies

In billions of dollars
(As of Dec. 31, 1983)

	Assets	Mexico	Brazil	Argentina	Venezuela	Total	Total exposure as a percent of	
							Assets	Primary Capital
Citicorp	\$134.7	\$2.9	\$4.7	\$1.1	\$1.5	\$10.2	7.6%	154.3%
BankAmerica	121.2	2.7	2.5	0.3	1.6	7.1	5.9	116.7
Chase Manhattan	81.9	1.5	2.6	0.8	1.2	6.1	7.5	136.5
Manufacturers Hanover	64.3	1.9	2.1	1.3	1.1	6.4	10.0	200.3
J.P. Morgan	58.0	1.2	1.8	0.7	0.5	4.2	7.2	102.9
Chemical N.Y.	51.2	1.4	1.3	0.4	0.8	3.8	7.5	136.0
First Interstate	44.4	0.7	0.5	0.8	*	1.4	3.1	53.0
Continental Illinois	42.1	0.7**	0.5**	0.4**	0.4**	2.0**	4.7	82.7
Security Pacific	40.4	0.5	0.5	0.2***	*	1.3	3.1	58.4
Bankers Trust	40.0	1.3	0.7	0.2***	0.4	2.7	6.7	119.4

* Exposure less than minimum to disclose according to SEC guidelines. ** Exposures at Sept. 30, 1983 *** Estimated

Source: Keefe, Bruyette & Woods Inc.

Los Angeles Times

to a government-to-government level."

Despite the growing consensus on the need for long-term solutions, bankers so far have been hard-pressed to agree on just what the answers should be.

"Ninety percent of the industry agrees that a long-term solution is needed," one New York banker says. "The problem is that people are talking about different things when they mean long-term."

Most bankers say they can agree on the need to allow longer delays in principal payments. Instead of allowing debtors to skip payments on a year-by-year basis, banks say they will grant grace periods of three or four years at a time.

Many bankers also believe that short-term loans should continue to be stretched into long-term loans, so as to spread payments over longer periods of time. "The present seven, eight and nine-year loans are not long enough," Leland Prussia, chairman of San Francisco-based BankAmerica Corp., the nation's largest bank holding company, said last December.

Some bankers also say they are receptive to allowing debtors to pay in various European currencies, not just in dollars.

The main area of disagreement, bankers say, generally centers on how much to cut interest rates. Non-New York banks, including Security Pacific and Bank of America, generally are said to be more favorable to significant interest-rate cuts, while the largest New York banks, led by Citibank, generally oppose major cuts.

Want Significant Progress

Executives at many of the largest banks say they are willing to cut interest rates somewhat, but only after nations have made significant progress in improving their economies through austerity measures. Indeed, Mexico, which has made significant economic progress since 1982, was subsequently rewarded when banks cut interest rates on new loans for 1984 by about one percentage point.

But few banks are willing to consider cutting interest rates below their cost of funds, as some economists have suggested. Bankers contend that such below-cost financing, while helping debtors in the short run, would hurt them in the long run by discouraging banks from extending new loans. That would cut off the less-developed countries from badly needed financing for trade

and development to spur future growth.

"Interest rate concessions should be approached cautiously because as a practical matter (they) could postpone the day when developing countries can again attract voluntary private financing," Lewis T. Preston, chairman of New York-based Morgan Guaranty Trust Co., the nation's fifth-largest bank, said at the bank's annual meeting last week.

For the same reason, many large banks are reluctant to let debtors "capitalize" interest—that is, skip interest payments and add those amounts to the principal owed. Under current U.S. accounting rules, such an approach would not allow banks to count the interest in earnings.

Some New York bankers say they simply prefer traditional approaches partly because it is hard to reach a consensus on new approaches, and because there is little evidence that major concessions would work any better.

"I think that over a period of time, the debtor nations will come through without tremendous earnings effects on banks," says Francis X. Stankard, executive vice president for the international division of New York-based Chase Manhattan Bank. He notes that Brazil and Mexico continue to remain current on their interest payments despite their economic travails.

Seeks Rule Change

However, other bankers advocate broader solutions.

Many bankers say they support the idea of capitalizing missed interest payments. While that would cut bank earnings, it also would reduce the need to issue new loans simply to help debtors make interest payments.

"There is a lot of talk in banking circles about this," says H. Robert Heller, vice president for international economics at Bank of America. "I see the bigger banks, with one or two notable exceptions, moving in this direction."

BankAmerica's Prussia, among others, also has advocated a change in the U.S. accounting rule which requires that banks list loans on which interest is more than 90 days past due as non-performing and thus not countable in earnings. Such a rule makes it virtually impossible for banks to cut interest rates without taking a cut in profits, Prussia argues.

In any event, whatever bankers and government officials decide, it is generally agreed that banks cannot escape without making sacrifices.

New Laws Expand Banking Powers

More Joint Ownership Between Lenders and Developers Forecast

By MARTIN HALSTUK

New California banking legislation, broadening bank powers by allowing state chartered banks to invest in real estate development, will free an estimated \$5 billion in assets that previously were blocked by law for such use.

In addition, some banking authorities are forecasting a trend whereby nationally chartered banks will take advantage of California's pioneering legislation to also invest in real estate, a practice not permitted by the Federal Reserve Board and the Federal Office of the Comptroller of the Currency.

This practice has already begun, according to Dugald Gillies, a spokesman for the powerful California Assn. of Realtors, the only state-wide organization that opposed the new legislation.

Bank Fails

Gillies notes that after the financially troubled Bank of Irvine failed last May, it was acquired by the Security Pacific Corp., holding company for the Security Pacific National Bank. The Orange County bank has been renamed Security Pacific State Bank.

"One of Security Pacific's purposes (in acquiring the Bank of Irvine) was to get into the real estate development business," claims Gillies, vice president of governmental relations for CAR.

State Banking Department records show that Wells Fargo & Co., the holding company for nationally chartered Wells Fargo Bank, submitted an application to form a state chartered bank in California last January, the same month in which the first of two new banking laws went into effect. The second bill took effect on July 10, the day Gov. George Deukmejian signed it.

More Competition

"Banks are ready to leap into the real estate business," declared Gillies, who says he objects to the new banking powers because he contends they will put banks into direct competition with developers.

This, Gillies argues, creates a possible conflict of interest when a developer applies to a state chartered bank for a loan to finance a project.

But Blair Reynolds, a spokesman for the San Francisco-based California Bankers Assn., says the new

laws will benefit not only banks but also developers.

As a result of the legislation, Reynolds forecasts "more joint ventures" between private developers and banks. Echoing the view of the banking industry, Blair said this will mean "more and better projects at lower costs," a benefit to developers and consumers.

Before California's laws were passed, state chartered banks did not have the power to invest in either commercial or residential real estate developments.

The new legislation originated two years ago when with a bill introduced by Assemblyman Ross Johnson (R-La Habra). Johnson later introduced the second bill, providing broader applications, which became law this month.

The pioneering legislation sparked similar bills that passed state legislatures in Ohio and New York last spring. These laws will not take effect until later this year.

Johnson calls the second bill (AB 2332), a "clean-up bill" designed to dovetail with the first law (AB 3469), which took effect last Jan. 1.

New Powers

Actually, Johnson had intended the new powers to take place immediately after his first bill passed in 1982, but the bill hit a snag; provisions of the federal Bank Holding Company Act of 1956 bar state chartered banks owned by holding companies from engaging in real estate investment through subsidiary corporations.

As a result, the bill failed to apply to state chartered banks that have holding company structures. Roughly, more than one-third of California's 265 state chartered banks are owned by holding companies, according to the Legislature's Assembly Minority Consultants.

Johnson's second bill got around the Holding Company Act by allowing banks to invest in real estate directly, not only through a subsidiary corporation.

The combined impact of the two bills dramatically changes the rules by giving all state chartered banks permission to go into the development business.

Limit Imposed

There is a restriction, however, said James Clark, senior consultant for finance and insurance issues to Assembly Minority Consultants.

Banks owned by holding companies can invest in real estate only up to the level of shareholders equity, typically around 6%, Clark said, while banks free of a holding company structure can form subsidiary corporations (to take advantage of a corporate shield) and invest up to 10% of the bank's assets.

Clark estimates that the new laws make between \$5 million and \$6 million available for real estate investment by state chartered banks.

The legislation's ripples of consequence reach further, Gillies said, because they apply indirectly to nationally chartered banks such as Bank of America, Wells Fargo and Crocker. Although federal law prohibits nationally chartered

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BANKS: New Powers

Continued from Page 1

banks from engaging in real estate development, they can now invest in land development by acquiring or forming a state-chartered bank.

Clark and Gillies both predict a trend in which nationally chartered banks will get involved in real estate development by using California's banking powers to own real estate, rather than being restricted simply to the role of lenders.

Clark points out that the assets of state banks are considerably less than those of national banks. For example, while state bank assets total about \$68 billion, national banks have assets in excess of \$200 billion in California.

Potential Invasion

To Gillies, this difference in financial strength means national banks "represent so much more of a potential invasion."

Gillies goes on to say that national banks will use California's law "to leverage Congress into giving them the same powers." At the present time, Congress is divided over bank deregulation, with Rep. Fernand J. St. Germain (D-Rhode Island), chairman of the House Banking Committee, against giving banks any new powers, and Sen. Jake Garn (R-Utah), chairman of the Senate Banking Committee, for deregulation.

Anthony Kriss, a California Assn. of Realtors director who also opposed the legislation, said developers will find themselves acquiring not only financing from banks but also a partner as well—the bank itself.

"And if you don't want a partner, that's not such a good deal," Kriss said.

Kriss argues that the new banking laws "concentrate too much economic power in banks and will make independent property ownership more difficult. In a confrontation between the developer and a bank, the bank's going to win."

Should a developer balk at taking on a bank as a partner, and go elsewhere to find financing, Kriss claims the bank could go ahead and acquire the property through a dummy corporation.

"This is a specious argument," Assembly Minority Consultants' Clark rebutted. He said it is not likely that a bank could acquire the property out from under a developer because, typically, a developer has already begun negotiations with a property owner, often having made a deposit, before going to a lender.

Clark also said that savings and loan associations have been able to invest in real estate development

for nearly 30 years, and the CAR has not been able to produce evidence that such abuses have ever taken place.

Another objection Kriss raises is that the new powers may place banking customers in jeopardy, because of the speculative nature of some real estate investments.

"Not all banks are going to be judicious or accommodating to clients who want to borrow money for development or land acquisition purposes," Kriss said. He noted that in California, eight banks failed in 1982, four failed in 1983 and so far this year, six banks have gone under. Total deposits of these banks is in excess of \$1.7 billion, to date, according to CAR records.

Clark called Kriss' objection a "classic case of confusing depositors with investors."

"The only ones at risk are investors," Clark said. Investors would include shareholders in the bank's corporation and investors in certificates of deposit in excess of \$100,000, the maximum amount insured by the FDIC.

Besides ownership of real estate, another benefit that the legislation offers banks is the ability to more quickly resolve the status of a project in trouble, Clark said.

For instance, under previous state banking law, if a bank made a real estate loan and the project went bankrupt, the bank could end up with a non-performing loan on its books for as long as two years, while the court resolves whether the developer has any equity in the project.

Under the new laws, a bank can step in to resolve the question of equity and decide whether to unload or complete the project.

Del E. Webb Property Sold

Del E. Webb Corp.—a Phoenix-based construction, real estate and leisure industry firm—is negotiating the sale of its 2.4-acre construction yard at 4547 Electronics Place to Central Investment Co., Glendale. The firm's administrative offices moved to Irvine early this year.

Del E. Webb Realty & Management Co. and Stevenson Dilbeck Services, Glendale, handled the \$1.1 million transaction which is expected to close Aug. 1. Del E. Webb Realty & Management Co., a subsidiary of Del E. Webb Corp., manages properties in the Southwest.

OPENINGS

Beacon Place

Ventura development of single-family homes priced from \$110,990 to \$133,990.

Story on Page 21

Canterbury Court

Covina development of Cape Cod-style town houses, \$89,990 to \$104,990.

Story on Page 13

Via Verde Ridge

San Dimas development of single-family detached houses, \$179,000 to \$239,000.

Story on Page 4

Other openings, Page 24

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CC/Part IV

Many Call for Reforms of Banking Regulators but Specifics Are Few

By BILL SING and TOM FURLONG, *Times Staff Writers*

To commemorate the 50th anniversary of the Federal Savings & Loan Insurance Corp. (FSLIC), the savings and loan industry this summer began advertising the fact that none of its savers has ever lost a penny in an insured savings account.

"Considering all the time you spend making your money, don't you want a guarantee you won't lose it?" asks one current television ad promoting the FSLIC, a government agency that insures deposits up to \$100,000.

The argument, however, is not always effective. Witness what happened this summer at American Savings & Loan Assn., the nation's largest S&L.

Others Also Concerned

Small depositors in August and September withdrew an average of \$6.8 million per day in insured accounts from Stockton-based American Savings, which had been plagued by mounting financial troubles. Many insured depositors simply didn't want to take a chance on what would happen to their money if American Savings failed. (It didn't, and small savers' confidence seems to have since returned.)

Small savers are not the only people concerned about the effectiveness of government regulatory agencies that insure deposits and try to maintain stability and safety in the nation's banking system.

With bank failures at their highest level since the Depression and with two of every five of the nation's S&Ls losing money, many legislators, bankers, analysts and even regulators themselves are questioning if the regulatory system is capable of overseeing the increasingly risky and troubled financial system.

Among the most commonly heard criticisms are these:

- Regulatory agencies have failed to keep up with monumental changes that have transformed financial services in the past several years. Deregulation has allowed banks and savings and loans to offer new products and services, but regulators don't appear to have the tools or training to fully monitor these developments.

- Regulators have been unfair in handling failures. Small institutions have been allowed to fail but big ones have not, and some uninsured deposits have been fully protected while others were not.

- Regulators cannot act swiftly to correct problems and

and to stop

REGULATORS: Reforms Urged but Specifics Are Few

Continued from Page 1

failures. In many of the failures of more than 80 government-insured financial institutions thus far in 1984, regulators knew about the problems but were unable to correct them in time.

- The federal deposit insurance funds are inadequate. The \$6.3-billion FSLIC fund, for example, is intended to insure about \$600 billion in insured deposits. The ability of the fund to absorb massive losses among many S&Ls—which occurred during the 1981-82 recession—"would be highly debatable at best," says Edwin J. Gray, chairman of the Federal Home Loan Bank Board, which regulates the S&L industry and supervises the FSLIC.

- Too many state and federal regulatory agencies oversee the financial system, often leading to confusing and even conflicting policies. The agencies often disagree and at times appear more interested in protecting their turf than coming up with broad, long-range solutions.

Though there is widespread agreement that reforms are needed, there is little agreement on specifics.

Congress has been unable to pass comprehensive banking legislation in two years, hindered in part by bickering between regulators, bankers and legislators. C. Todd Conover, Comptroller of the Currency, warns that changes must be made "before the banking system becomes too weakened."

Enormous Stakes

Conover, in charge of supervising nationally chartered banks, which account for about one-third of the nation's banks, adds that the "challenge we face is to develop a system of law and regulation that is stronger and more flexible than what we have now and one that won't contribute to a crisis in the future."

The stakes for the financial system are enormous.

If the path chosen is to reduce regulation substantially, there could be many fewer but larger institutions. On the other hand, if regulations are substantially reimposed, troubled institutions may have to be continually bailed out by the government.

The stakes are big for consumers as well.

Savers face the prospect that the amount of their deposits covered by insurance might be substantially reduced. Depositors also may have to take it upon themselves to examine an institution's financial statements to determine if it is a safe place to deposit their money. Despite the problems, the regulatory system has shown remarkable flexibility and imagination in recent years and has headed off any major collapses similar to the ones that occurred during the Depression, when hundreds of banks failed and many consumers lost their savings.

The savings and loan industry, however, has managed to survive despite being about \$4 billion in debt and one-fourth of its 4,500 members in the red. Interest-rate cuts in 1981-82. The Federal Home Loan Bank Board played a key role in guiding the industry through.

And while the number of bank failures is up, their numbers pale in comparison to the 14,500 banks nationwide that still exist. The vast majority of them are healthy, contends William M. Isaac, chairman of the Federal Deposit Insurance Corp. (FDIC), the banking industry's guarantor of deposits.

from entering risky, non-banking fields such as insurance or securities underwriting. The common ownership of banks and commercial enterprises was prohibited. Banks also were prohibited from setting up branches across state lines.

Meanwhile, their profits were enhanced because there was a ceiling on what they could pay in interest for deposits. As late as 1980, a bank could pay no more than 5¼% on savings deposits, while S&Ls could pay no more than 5½%. Neither could pay interest on checking accounts.

Such a system protected banks and S&Ls from excess competition and virtually assured them of a nice profit margin when they lent the money out. Failures were an aberration.

However, changes in the late 1970s and early 1980s began to unravel the previously stable banking world. Rules restricting what banks could pay on deposits were lifted, forcing banks to create today's popular money market deposit accounts and interest-paying checking accounts. Interest rates rose to record highs, making many low-yielding, fixed-rate loans unprofitable for banks and S&Ls. The slowdown in inflation has made many corporations and Third World nations less able to raise prices on their products to cover their debt payments.

The banking system also is increasingly prone to deposit runs, in part because depositors shop around for the best rates and because they are no longer assured that the FDIC or FSLIC will pay off uninsured accounts exceeding \$100,000. In several bank failures this year, including those of Anaheim-based Heritage Bank and Encino-based West Coast Bank, the FDIC initially paid off only 50% or less of the deposits exceeding the \$100,000 limit.

The FDIC now classifies about 700 banks on its "problem" list with financial troubles, about double the number two years ago. In addition, an estimated 60% of all S&Ls have net worths (assets minus liabilities) that fail to meet minimum federal regulatory requirements, according to Jerome Baron, a former regulator who now works as a financial analyst for the New York-based investment house of First Boston Corp.

Three Different Agencies

Under the current system, banks are regulated by three different federal agencies—the Federal Reserve, FDIC and Comptroller of the Currency—and by various state agencies. The state agency in California is the state Banking Department.

S&Ls are overseen by the Federal Home Loan Bank Board and various state regulators. In California, it is the state Department of Savings & Loan.

Each of these agencies is charged with making regular examinations at institutions, making sure that they comply with regulations and standard banking practices. If institutions are found to be not in compliance, they could be slapped with enforcement actions.

If an institution gets into serious financial trouble, the agencies have the power to close it down. Often the failed institution is merged into a stronger one.

But in some cases, it is closed for good and its loans and other assets are liquidated in order to pay off the depositors. Earlier this month, regulators closed five troubled

Loan Bank Board.

FSLIC, which is supervised by the FHLBB, goes from crisis to crisis because it has a staff of less than 100 people—not enough to keep up with industry problems, former regulators say. "They can only concentrate on a few problems at a time and hope the others don't get worse," one former FSLIC official says.

These weaknesses contribute to regulators not catching many serious problems. A recent congressional report, for example, hits regulators for not catching enough cases of bank fraud, such as illegal insider loans and falsification of records, which the report says account for more than half of bank failures. Critics add that it is all too easy for unscrupulous bankers to hide financial information from examiners.

In other cases, the examiners saw the problems but did not act in time, sometimes because the problems were not seen as severe enough to warrant immediate regulatory action. At United American Bank of Knoxville, Tenn., for example, FDIC examiners cited problems from 1978 through 1982 but did not bring any action against the bank until January, 1983. That was only a month before it collapsed in the third-largest bank failure in the past 50 years.

Just the fact that there are so many different regulatory agencies inevitably leads to confusion and bureaucratic differences—a point well illustrated in mid-August when American Savings was nearing the nadir of its financial problems.

While state regulators were making reassuring statements about American Savings, federal regulators were so worried about its financial health that they moved to oust Charles W. Knapp, chairman of the S&L's parent company, Financial Corp. of America.

Both had jurisdiction because American Savings was both state-chartered and federally insured. As later interviews confirmed, state regulators had a far more tolerant view of Knapp and his aggressive lending practices than did Bank Board Chairman Gray, who viewed the fast-growing company as a grave threat to the undersized FSLIC insurance fund.

Regulators sometimes are criticized for abusing their enormous power and latitude by closing down institutions prematurely. Edward A. Forde, former chief executive of San Marino Savings & Loan Assn., claimed that the S&L was healthy and profitable when regulators seized it last February on grounds that Forde was running it in an "unsafe and unsound" manner.

"Don't mess with the regulators," Forde, who challenged the seizure in court and lost, says today. "They're going to win. They always do."

Regulators also have been criticized for being unfair because they will not allow big banks to fail in the same way that they have allowed small banks to collapse. In an effort to stave off a possible failure at Continental Illinois National Bank & Trust Co. of Chicago, then the nation's eighth-largest bank, the FDIC this summer took the extraordinary step of guaranteeing all of its deposits, even those above the \$100,000 limit.

However, it did not take a similar step in the failures of much-smaller Heritage and West Coast banks, much to the anger of small banks, which contend that these actions

"would require that we keep examiners in all the banks at all times, 24 hours a day . . . and I don't think that's what Congress wants," the official says.

Regulators also complain that the Justice Department often has not had adequate staff to prosecute alleged cases of bank fraud.

However, regulators are moving to correct some of the problems.

Some agencies are making more frequent examinations of troubled institutions. The office of the Comptroller says its staff now visits troubled banks and largest banks twice a year, instead of once. Strong banks and smaller banks, however, may get examined only once every three years, ample time for problems to develop, critics contend.

The Comptroller also is initiating more enforcement actions against offending institutions. It, along with other agencies, also is pushing for banks to increase the reserves they set aside to protect against bad loans. These agencies also are trying to require banks to disclose more financial information to investors and depositors.

But many experts, including regulators themselves, say more fundamental reforms are needed. Unfortunately, there is considerable disagreement on what they should be.

Perhaps the most talked about reform would make riskier banks pay higher premiums for deposit insurance provided by FDIC or FSLIC. Now, banks and S&Ls pay the same rate—one-twelfth of 1% of their deposits—regardless of their financial condition.

Opinion Divided

The current system "doesn't make any sense" because it penalizes healthy institutions, says Robert F. Adelizzi, president of San Diego-based Home Federal Savings & Loan Assn.

Proponents of the risk-based system, such as FDIC's Isaac, FHLBB's Gray and many bankers, argue that it would discourage institutions from pursuing overly risky policies and would provide more money to the insurance funds to cover failures.

But others say that risk-based insurance will do little to discourage bad banking practices, and by raising the costs to riskier banks, it could force some of them out of business sooner. Experts also wonder how such a system can be designed to be fair.

"Developing an effective and efficient risk-premium system will take time," Isaac admits.

A growing number of experts and officials, including Treasury Secretary Donald T. Regan, are beginning to talk about experimenting with deposit insurance plans provided by private companies, or reducing the present insurance limit to perhaps \$60,000 per account.

Some reformers argue that because of regulators' inherent shortcomings, the ultimate solution is to reduce regulation and let the marketplace play the role of regulator. They argue that financial institutions must be freed from old and outdated restrictions that prohibit them from engaging in interstate banking and from entering other businesses such as securities underwriting. That, they argue, would allow strong banks to boost their profits and thus become healthier.

Others, such as Rep. Fernand J. St Germain (D-R.I.), chairman of

Bank . . .

(Continued from Page C-5)
loans. But she said that a bank officer to whom she presented the memo "didn't share the same

view or concerns that I had."

At the time that Penn Square failed in July 1982, Continental had bought about \$1.1 billion in oil and gas loans and nearly all of them have gone bad. These loans have proven to be a major reason for Continental's own problems.

Subcommittee members questioned how federal bank examiners missed the problems being raised by Kenefick.

Richard Kovarik, the head of the federal auditing team in 1977 and 1982, said that the bank examiners identified many of the same problems Kenefick raised. He said the bank had been moved to correct the problems but it could not do anything about problem loans already on its books.

But several members of the subcommittee questioned whether Kovarik and John Meade, who conducted the bank's 1976 audit, and Allan McCarte, who conducted the audits in 1979, 1980 and 1981, failed to recognize problems and force the top leaders of the bank to address them.

"What went wrong with the auditing procedures? Something very badly went wrong," said Rep. Charles Schumer, D-N.Y.

McCarte said, "What we did was totally appropriate to the circumstances and we followed the guidelines to the letter."

The bank was not audited in 1978.

The hearing will continue today with Comptroller of the Currency C.T. Conover scheduled to testify.

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Continental Illinois probbers rap audits

By MARTIN CRUTSINGER

WASHINGTON (AP) — Congressmen investigating the \$4.5 billion government bailout of Continental Illinois National Bank accused federal banking regulators yesterday of ignoring early warning signals that the giant Chicago bank was in trouble.

During a lengthy hearing before a House Banking subcommittee, examiners and officials of the Office of the Comptroller were accused of failing to aggressively force management of the bank to improve their internal controls once problems began surfacing in the late 1970s.

House Banking Committee Chairman Fernand St Germain, D-R.I., said that apparently federal regulators had learned nothing

from the failures of other banks, notably Penn Square National Bank in Oklahoma in 1982.

"For those of us who have ridden the failed bank circuit, the deja vu qualities of Continental are discouraging," St Germain said. "It appears that the only thing the regulators have improved is their ability to make excuses."

After big depositors began a run on the bank earlier this year, federal banking regulators implemented the biggest bailout of a private company in U.S. history. Under the plan, the Federal Deposit Insurance Corp. will put up \$4.5 billion to rescue the bank.

While federal regulators have said that no taxpayer money will be spent on the rescue because

the money is coming from insurance fees paid by all banks, St Germain labeled this argument misleading.

He said the rescue was likely to cost taxpayers at least \$500 million and they could end up, in a worst-case scenario, being stuck with a tab of between \$2 billion and \$3 billion. The congressman did not elaborate on those figures.

Subcommittee members spent more than five hours questioning three men who had headed the comptroller's audits of the bank from 1976 through 1982. The Office of the Comptroller is charged with regulating banks with national charters.

In addition, they heard from Kathleen Kenefick, a former loan

officer at Continental Illinois, who wrote a July 29, 1981, memo expressing concern about questionable loan practices involving Penn Square, one year before the Oklahoma bank failed.

"The status of the Oklahoma accounts, particularly Penn Square Bank, is a cause for concern and corrective action should be instigated quickly to stem any future deterioration," she wrote in the memo.

Kenefick, who left Continental soon after writing the memo, told the committee that she was worried about the paper work being used to document some of the oil and gas loans and a lack of enough bank personnel to monitor the growing number of these (See BANK, Page C-9)

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