HOW UNIONS CAN SEIZE FINANCIAL CONTROL OF THEIR DESTINY

Unions experienced peak membership in the United States in the post-war decades, at around 36% of the workforce. It now hovers around 12%. At the same time, the widespread economic decline of the middle class is rippling throughout the economy. Without an economically healthy middle class, the country cannot prosper and thrive.

And as union membership declines, so do union dues and with that, union pension funds. The latter is one of the financial engines that fuels Wall Street and corporate America. Yet both are shortsightedly biting that hand that feeds them, fighting against the very existence of unions.

Wall Street's greed and excesses have decimated the financial portfolios of unions and other retirement funds, while loans have reduced to a trickle.

What can unions do to seize control of their funds? To escape the clutches of the big banks and Wall Street and take control of their own financial destiny? And can they turn this crisis into an opportunity to not only rebuild their financial resources, but use them to stimulate union membership and employee ownership and improve the economic health of the country's middle class? Yes, they can!

A Solution In Banking

The key is in the very tools used by big banks and their backers – banking itself. The joke "What's the best way to rob a bank? Own one" is not far from the truth. The reason banking is so profitable is that the private banking industry has accomplished something that no other industry in history has been allow to do – procured a license from the government to create money!

Most people think that the money in our wallets and checking accounts comes from the government. Not true. Approximately 97% of

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the money in circulation has been created by our 8,000+ banks when they make loans. Banks are allowed to make credit out of thin air equal to approximately 10 to 12 times their "assets."

In other words, for every $1 in assets, banks can create $10-12 in loans on their books, money that is not drawn from an existing pool, but created with double-entry accounting. And once created, that loan is "owned" by the bank and represents an "increase in assets" which then increases its ability to create even more money! That is how small banks are able to become very large banks in incredibly short periods of time and it explains why owning banks can be so lucrative.

However, that leverage cuts both ways. If the value of the assets owned by a bank goes down (including their loan portfolios and the assets represented by those loans – e.g., real estate) then the amount of lending the bank can do goes down as well, and by that multiple. That is, for every drop in asset value of $1, the bank reduces its lending limits by $10-$12.

That is one of the main reasons behind the critical shortage of credit today. Bank balance sheets have taken a huge hit, especially because of the drop in real estate values. Many are at their lending limits and have no more room to make loans. To start lending again, they need to bring in new capital or unload the "toxic assets" currently on their books (very hard to do unless you are a Wall Street bank and you can get the government to effectively give you a free lunch at taxpayer expense).

However, new banks don't have those toxic assets on their books and are in a better position to lend than many existing banks. Thus banking is a key solution for unions to reverse their fortunes.

What Could Be Done With Union-Owned Banks?

Owning banks can be a good way for unions to increase the return on their pension funds. Unions are in a position to properly capitalize new banks and begin lending. And as in any business, given the healthy condition of the balance sheets of such new banks, they would be in a position to take advantage of normal supply and demand factors in business, wherein they have supply and there is much demand.

That would put unions in another unique position to provide credit to improve the lot of unions in general. Here's how.

Credit is the lifeblood of business. Without it, most businesses could not survive and with it they are in a much better position to thrive and grow. Businesses all across the country are experiencing reductions (and in many cases elimination) of available credit for themselves, their suppliers and their customers.

Banks are in a position to cherry pick the customers they want to work with. If unions owned banks, they could choose their loan recipients. Why not lend only to companies that hire union workers or are worker owned/controlled?

If such companies receive credit and non-union, non-worker-owned companies do not, then

unionized companies stand a better chance of surviving than their counterparts. In fact, companies starved for credit may be incentivized to allow unions as a condition of receiving credit from union-owned banks. Union-owned banks can be quite creative on their lending terms and achieve objectives not possible today.

By controlling the purse strings, unions are in a position to change the game, using the very tools that have been used against them in the past.

Capital & Deposits

To understand the options open to unions in setting up, owning and running banks, we need to understand the role of capital and deposits in banking.

Capital serves a dual role:

- Funding the establishment of a bank and giving it the resources to operate until the cash flow from its operations keeps it afloat and allows it to grow
- Serving as the basis for determining a bank's upper lending limits. For example, a bank starting off with $20 million in capital can generate in excess of $200 million in initial loans.

When a loan is generated, the bank records two entries. The loan itself is entered as an asset on the balance sheet. It represents something similar to a "receivable" in traditional business terms, wherein a third party owes the bank the principal amount of the loan, plus interest. And as the borrower makes payments to the bank, those payments represent real money that is now owned by the bank. Sometimes banks "monetize" those assets and sell them to someone else, which demonstrates they have instant economic value.

The credit created for the borrower is entered on the liability side of the balance sheet. Think of it as a new borrower checking account into which the bank has just poured the cash equivalent of the new loan (although it did so with just keystrokes on a computer and did not pull that money from anywhere). The borrower can now withdraw that money — new money available to circulate into the economy.

In a world with just one bank, we would have all we need to provide loans, generate new deposits and continue to operate. But as soon as there are at least two banks each with half of the available customers , we have to add a new ingredient — additional deposits beyond those created by the loans themselves.

When Bank A's customer writes a check to someone who deposits that check with Bank B, Bank B presents that newly deposited check back to Bank A for "settlement." At that point, Bank A has to transfer funds to Bank B to cover the check. It must pull the resources to cover that check from its assets to complete the settlement.

Bank A cannot transfer a loan document (the asset created when the bank gave the loan to the borrower) so the bank either has to use its own cash to pay Bank B or take cash left on deposit by other depositors. When we make deposits into our checking and savings accounts, the bank records those deposits two ways.

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One is by entering the deposit as a liability on their balance sheet (they have to give us our money when we demand it and thus it is a liability to the bank). But they also add it on their balance sheet as an asset. The bank lumps that money with all its other cash and makes it available for things like settlement demands between banks.

In the real world, banks are presenting checks to each other constantly. Bank A's customer might write a check to Bank B's customer and vice versa so the checks cancel each other out resulting in no transfers between the two banks, or the difference between a larger check and a smaller one. Banks keep track of these settlements daily and have to settle the differences.

Banks therefore need to take in deposits in order to cover inter-bank transfers. And such deposits give the banks needed liquidity to carry on their business. This is what is behind the growing movement encouraging people to move their money out of the big banks and into local community banks.

Unions themselves are the obvious source of the capital to fund their banks (from their pension funds and other investments) and both the unions and the union membership are an ideal source for the needed deposits.

Bank Charters & Regulators

Banks only become banks when some government authority "charters" them to be a bank. Think of it as a specialized license. In the United States, we have a dual system of banking wherein both the federal government (OCC) and the individual states can issue charters. In fact, the states preceded the federal government in chartering banks by a number of decades.

States have robust banking laws that allow them to charter banks to operate in their own state, whereas federally chartered banks are largely free to operate in nearly any state. However, most states have instituted cooperation agreements allowing banks chartered in one state to establish operations in other states, and there is little practical difference between state charters and federal charters for banks wishing to operate in multiple states.

It is the chartering process that enables a company to engage in the business of banking – i.e., to take deposits and to grant loans through the money creation process. In granting a charter to the bank, the chartering entity also subsequently provides oversight as a bank regulator.

Those regulators can not only grant a charter but revoke it if the bank does not follow the regulator's rules or becomes unhealthy beyond set boundaries defined by that regulator. That revocation not only results in the withdrawal of the license to conduct banking, but also entails a right by the regulator to seize the company in its entirety, boot out the previous owners and dispose of all the assets and liabilities of the bank as it sees fit.

When that happens, another regulator steps in, the Federal Deposit Insurance Corporation

(FDIC). As a consequence of the Great Depression and the many bank failures that occurred then, the FDIC was formed in 1933 to provide depositors with insurance that guaranteed their deposits (up to a certain limit).

All federally chartered banks were required to be part of the FDIC system, but state banks were not, that is until 1989, when Congress enacted the Federal Deposit Insurance Corporation Improvement Act of 1989 (FDICIA). With FDICIA, all commercial banks that accepted deposits were required to obtain FDIC insurance.

And given that insurance role, the FDIC has become the de facto "receiver" of seized banks, meaning that even though another regulator shut down the bank and seized its properties, that regulator normally then turns the bank and all its assets over to the FDIC for disposition. Unfortunately that is happening at an increasing rate. However, those failures also represent an opportunity for unions.

Bank Ownership

At this point it's helpful to look at one other key variable that concerns how unions can get into banking and what they will then be able to do — bank ownership. There are two broad categories of ownership and each comes with a different set of attributes.

The first is most often represented by stand-alone banks that are typically owned by a group of individuals, with perhaps some shared ownership on the part of a corporation or LLC that owns a minority interest. Such banks can open "branches" that operate under the charter of the initial bank, but are not considered separate, free-standing banks.

If the owners want to own more than one bank (separate charters), things can get complicated in treating each bank as a fully separate entity. At that point it becomes more convenient to form an umbrella company that owns all such banks and the investors own this umbrella company. This is known as a bank holding company. If the bank is controlled (majority owned) by another corporation or LLC, it would be considered a subsidiary under a bank holding company and that has regulatory ramifications as described below.

Even if there is only one bank in the picture, the owners may elect to form a bank holding company because of the greater financial flexibility that affords. Banks are legally constrained as to the type of financial transactions in which they can engage, whereas bank holding companies are free to engage in a wide variety of activities including insurance, stock brokerage, private equity funds, venture capital funds, hedge funds and more, all as separate subsidiaries under the holding company. That is what the "big banks" on Wall Street are and what gives them so much power.

A key point is that in establishing a bank holding company, the owners now have to engage with another regulator, the Federal Reserve . However, bank holding companies bring a host of benefits from a union perspective.

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Going It Alone or Pooling Resources

Individual unions can go it alone or they can join forces to spread risk and increase their collective influence. For unions, the bank holding company model provides the ideal vehicle for either approach (rather than single stand-alone banks).

We believe the joining forces approach will provide the participating unions with better overall results, which in turn translates to better individual results. The following strategy is built around that approach, but can just as easily be adopted by an individual union going it alone.

By forming a bank holding company, unions are able to pool resources into a common vehicle, which in turn can be used to not only form new banks (called de novo banks) or acquire existing ones, but can also form venture funds, hedge funds and other financial entities. That is what the "big banks" on Wall Street have done. Such a holding company can be started by just one union. Others can join later and the holding company can even be taken public to bring in additional outside funds.

We recommend that such a holding company commence with banking and then explore some of the other options available to bank holding companies. In particular, Commonwealth Group can provide guidance on a new form of private equity funding that can translate into much better results than normally realized by traditional private equity funds, while simultaneously using such a fund or funds to further aid companies who hire union workers or are owned/controlled by their employees.

Fastest Way To Jumpstart This Process

As we mentioned, the two paths to owning a bank are to build one from scratch (de novo) or buy one.

Buying one is generally much faster than forming a de novo bank. The regulatory review process for starting a new bank takes longer than the review of an application to transfer ownership of an existing bank. Beyond that, there is the practical matter of the infrastructure (buildings, computers, software, loan procedures and policies etc.) required for a new bank. Even if a buyer of a bank wants to change that bank's policies (like unions redirecting their loan policies to specific kinds of companies), that can take substantially less time than starting from scratch.

The downside of buying an existing bank is that the buyer inherits all that is good and bad about that bank and its management. But with a good oversight group in place, even poorly run banks or banks in bad condition can still be made healthy faster than building up a new one.

In addition, one of the biggest benefits of an existing bank is that they come with an existing clientele, including depositors. Since deposits play a key role in the ongoing liquidity of a bank, new banks have to build up their depositor base and that takes time.

What Kind of Bank?

All in all, buying existing banks is the quickest way for unions to realize the benefits of bank ownership. Banks are available for purchase on the open market, some healthy and some not. Commonwealth Group can assist unions in locating each type and facilitate the negotiations.

Banks are also available from the FDIC after the agency has seized such banks and is tasked with disposing of them. Potential buyers register with the FDIC to get on a "bidders" list and receive notification shortly before the seizure. Given the number of banks that failed last year and the even larger number anticipated to fail this year, FDIC has had to resort to better and better "sweetheart" deals and to open the bidding process up to others (like hedge funds) in order to get enough qualified bidders.

Such purchases represent the best purchase price possible and even though the banks have problems, the cost of getting them healthy and the ways in which FDIC will allow the buyer to redo the books, along with loss guarantees by FDIC, make these very attractive acquisitions. Such an acquisition strategy would allow unions to very rapidly grow their banking operations and realize much greater return in the process.

As with other acquisition plans, Commonwealth Group can assist with the FDIC acquisition process. We also can assist unions in formulating plans to establish one or more bank holding companies, assist in the structuring of policies, procedures, priorities and plans for putting together such enterprises and even help in the recruiting and oversight of the banking professionals needed to help establish and run them.

The current economic climate has presented unions with a unique opportunity to take control of their investments, expand membership and help stabilize the country's middle class. The Commonwealth Group has the resources to help reach those goals.

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Commonwealth Group is the leading consulting firm in the country on the topic of government-, non-profit- and union-owned banks (and other public benefit financial institutions) and has gathered a team of banking professionals including former regulators, bankers, bank attorneys, consultants, trainers at graduate banking programs and more. Interested parties should contact:

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