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# Domestic Credit by S. Pepper

## Nearing collapse

*The FSLIC is holding billions of dollars in paper assets, and a reorganization along the lines of the farm sector is imminent.*

On Nov. 30, Jack Anderson reported in his column that the potential widespread collapse of the U.S. thrift industry would have repercussions for the entire domestic credit system. The Sword of Damocles hanging over the industry is the inability of the Federal Savings and Loan Insurance Corp. (FSLIC) to even come close to meeting its obligations to insure deposits in federally chartered institutions. Not only is this situation brought on by the weakness of more than 150 such S&Ls currently in the program, but recently, in Ohio and Maryland, the federal program has just taken on new obligations because of the failure of the state insurance systems.

Now a new attack has been launched on the highly vulnerable FSLIC which could precipitate a crisis that will allow the Treasury to intervene to force a contraction of the entire thrift industry in line with the approach Treasury took in the Farm Credit System crisis. Former FSLIC director Peter Stearns has received widespread publicity for saying that the insurance corporation has issued notes to the thrifts against overvalued collateral. In effect, he is saying that, if the federal insurer had to collect on its note, the assets are not there to cover them.

The FSLIC has only $4.88 billion of funds in reserve at this time, not nearly enough to cover the number of institutions now in trouble. To avoid disbursing cash, the insurer has deferred recognizing losses from collapsed S&Ls by either ignoring the losses or assigning them to healthy thrifts in what is called the management consignment program. The 23 institutions so placed so far have received FSLIC notes, which they count as capital.

These notes are secured by assets of the thrift, which issues capital certificates to the FSLIC. In turn, the FSLIC has counted these certificates as actual capital, and thereby has added about $1.4 billion to its reserve fund by this accounting. Stearns, who resigned in November as director of the FSLIC, claims that, within nine months, the FSLIC will have collected about $2.5 billion of such certificates, but that "for all intents and purposes these loans are worthless."

According to Stearns' accounting, the FSLIC has overstated the value of its reserve by $1.4 billion and, over the coming nine months, this gap will widen to $2.5 billion. In effect, the FSLIC is carrying on its books as assets what will prove to be liabilities were it ever to try to collect against its notes.

The situation is heading for a major collapse. According to Stearns, at least 30 more S&Ls, mainly in Texas and Louisiana, will soon collapse into the consignment program. Since the funds are not there to insure deposits, the Corporation will continue to issue its notes against highly inflated real estate assets. And he adds, "The agency is looking at some unbelievable losses, up to $500 million a crack from some of the big S&Ls currently in the program."

It now appears that the General Accounting Office is preparing to call the question on the FSLIC. An official of the GAO recently said that the agency will carefully scrutinize FSLIC loans to failed thrifts as part of its year-end audit of the fund. "We will be looking at how collectible they are," he said. The pressure to review these loans is increased because the managers of the insolvent thrifts to whom they have been assigned in the consignment program are planning to claim additional write-offs of their portfolios as a result of recent audits.

The stage is now set for a total reorganization of the thrift industry, and, through it, the U.S. domestic credit system. The FSLIC and its parent, the Federal Home Loan Bank Board, are in exactly the same situation that the Farm Credit Administration and its banking arm, the Farm Credit System, were previously in. Congress has just finished a reorganization of both on the basis of a Treasury Department plan that essentially contracts the system by forcing an orderly write-off of billions of bad debt. The chairman of the Agriculture Committee, Kiki de la Garza (D-Tex.), admitted that this bill did not provide the direct aid sought by the FCS, but instead sent an "important message" of congressional support to the bond market.

The same will now happen to the FSLIC. And, undoubtedly, the Treasury will use the Farm Credit bill as its model. It will force the industry to provide billions to refinance the bad debt, and will then reorganize it to ensure that the availibility of credit will decline. What is going on, in other words, is that Treasury is continuing its policy of forcing a bankruptcy and reorganiztion of the U.S. economy.



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