Banking by William Jones

New woes for the beleaguered FSLIC

Contrary to Washington's claims that "everything is under control," the price for bailing out insolvent thrifts keeps rising.

Federal Home Loan Bank Board chairman Danny Wall raised the price tag for the government bailout of the bankrupt Federal Savings and Loan Insurance Corporation (FSLIC), in testimony before the House Committee on Banking, Finance, and Urban Affairs on July 7. He added $12.3 billion to the previous 10-year projection of what the FSLIC would require, bringing the sum needed by the 259 "grossly insolvent thrifts" and the 252 "potentially insolvent" institutions to $42.5 billion.

Even that sum, however, is grossly underestimated.

The FSLIC is pursuing a policy of primarily reconsolidating bankrupt savings and loan institutions under new management, rather than pursuing outright liquidation, which would require that the FSLIC pay off all the insured depositors of the liquidated thrifts. By consolidating insolvent thrifts under "new management," the deposits remain solvent—at least on paper—and the FSLIC just pays for the costs of the consolidation.

Not everybody is satisfied with this solution, however.

The solvent thrifts are somewhat perturbed at having to bear the burden of the unhealthy thrifts. Many thrifts, in a desperate attempt to mobilize capital for continuing operations, are offering exorbitant interest rates to depositors. This forces the healthy thrifts to raise their own rates, in order to compete for funds.

Many solvent thrifts have been eager to change their status from S&Ls to commercial banks, in order to qualify for falling under the insurance umbrella of the somewhat less insolvent Federal Deposit Insurance Corporation (FDIC). They have been prevented from doing so, however, as it is understood that if all the solvent S&Ls abandoned ship, the federal government would have to foot the bill for all the basket cases that were left.

Certain proposals have been made for integrating the FSLIC with the FDIC, although such proposals have been totally rejected by FDIC chairman William Seidman. Seidman feels that he has enough trouble dealing with his own tottering house of cards in the world of commercial banking. And perhaps he's right.

The biggest problem area is the Southwest of the United States. The oil crisis, combined with the agricultural crisis, sent real estate prices tumbling down. The FSLIC, which deals primarily with home loans and real estate, was heavily hit. With Wall's new figures, the cost for FSLIC's Southwest Plan, originally estimated at $7 billion, will now be $15.2 billion. This estimate will undoubtedly continue to rise.

But, contrary to what FSLIC representatives maintain, the problem is by no means confined to the Southwest. On July 18, the FSLIC closed Farmers Savings of Davis, California, and has now begun issuing checks to pay off the thrift's $324 million of insured deposits.

According to Danny Wall, Farmers Savings had become a "hot money desk," using jumbo certificates to fuel risky commerical loans. "There were no teller stations, virtually no retail deposits, and no franchise value to offer an acquirer," said Wall. One month earlier, on June 6, the FSLIC paid out $1.35 billion in cash to liquidate two other southern California thrifts, American Diversified Savings Bank and North America Savings and Loan Association, both based in Costa Mesa. That reportedly took about 40% of the FSLIC's cash on hand.

After the Farmers Savings liquidation, the FSLIC will have a cash balance of $2.08 billion.

Wall will now attempt to liquidate assets like rental apartments, condominiums, and commercial buildings—which liquidation itself could provoke a panic in the real estate markets, and drive more thrifts into bankruptcy.

Coming east, we discover that the situation is by no means under control, as Wall would have us believe. On July 8, the FSLIC placed the McLean Savings and Loan Association, of McLean, Virginia into "management consignment," creating a new federal mutual association to take over the offices, assets, deposits, and other liabilities of the old association. The failure occurred because of "imprudent loan underwriting and mismanagement."

And so it goes, as the administrators try to keep the ship afloat, until the day of reckoning. Wall continues to ooze optimism: The Texas economy is turning around, there's a downward trend in the cost of thrift deposits, some of the worst cases have been resolved. The reasons given for optimism are manifold, but few people are giving any of them any credence.

The fact is that the "Reagan Recovery" has been a lot of hot air—real estate speculation, fly-by-night financial transactions, a failure to distinguish between what is real and what is not. But that distinction will make itself felt with a vengeance, before too much time has elapsed.