## Interview: Stuart Root

# FSLIC chief warns of run on U.S. banks

by Kathy Wolfe

*Outgoing Federal Savings and Loan Insurance Corporation director Stuart Root, interviewed by* EIR *on Feb. 10, emphasized his fear that the takeover of the S&Ls' FSLIC insurance fund by the U.S. Treasury and the Federal Deposit Insurance Corporation could hurt "international investor confidence" in the entire U.S. banking system, not just in thrift institutions. The plan, he said, might easily bankrupt both the FSLIC and FDIC, which could lead international depositors to pull out of U.S. banks, beginning a run on all S&Ls and banks.*

**EIR:** You are leaving the FSLIC as of today. Why?
**Root:** I said when I came to Washington, that I would only stay for a year.

**EIR:** It has been reported that you disagree with the Brady program just announced for the Treasury and FDIC to take over the FHLBB and FSLIC.
**Root:** Oh, that all happened after I had decided to leave. . . .

**EIR:** Then, what *do* you think of the Brady plan?
**Root:** I'm not sure. I applaud bringing the Federal Home Loan Bank Board into the Treasury, in the sense that it brings the insurance [of the S&Ls] into an aligned function with their supervision. The FSLIC, you see, and the Bank Board had been stripped of supervisors and powers to supervise [the S&Ls].

**EIR:** Are you referring to what Don Regan and David Stockman did during Edwin Gray's tenure [as head of the FHLBB, 1982-87] to cut the Bank Board budget and fire the staff?
**Root:** This had been happening for some time, but the point is the Bank Board head [Mr. Root's position] until now had no staff to control actions by the S&Ls under deregulation, but was forced to take responsibility to insure them. In that sense, he was being held accountable for something with which in fact he had no staff or authority to deal.

The real question is, what will the FDIC do with the 50 billion some-odd dollars that the administration is proposing to raise on the bond markets? I do think highly of [FDIC chairman] Mr. Seidman, but I'm just not sure exactly what they can do with that money which will ameliorate the situation. . . .

**EIR:** That is, what can the FDIC do with the money that the FSLIC hasn't already tried and failed to do?
**Root:** You could put it that way. I just don't know what their plan is.

**EIR:** You told the *New York Times* that you were quitting to be able to go back to the private sector and defend the existence of the thrifts. Is that what you mean, that the FDIC will let the thrifts be wiped out?
**Root:** To the extent the [Brady] plan is neutral on this, I don't see a big problem, *if* the FHLBB, or the "Federal Home Loan Bank System" as it's about to be re-named, is able to continue its work as part of the Treasury.

**EIR:** But you do think we need a savings sector?
**Root:** I at least think we need to maintain thrifts, if not specifically for homebuilding, then at least to provide service to individual households, for individual depositors, to have a national savings policy. In my view, savings must be the emphasis, not where the savings then go.

The most important thing is that savings be protected and invested to do only one thing: to see to it that the investor is *repaid*. In that sense, housing ought not to be *the* function.

But what really worries me, is the idea of commingling the insurance funds [the FSLIC into the FDIC], which is really a tremendous dilution of the FDIC. This is not good policy, if that's what they're planning to do. The two insurance funds should be kept segregated. Commingling of the insurance funds dilutes the value of FDIC insurance. This makes me worried about depositor confidence. I would be particularly worried about international consequences.

**EIR:** Do you mean, worried about foreign depositors in U.S. S&Ls?
**Root:** Yes, the threat is that international deposits would be withdrawn, and from all sorts of institutions.

**EIR:** That is, not only from S&Ls, which were insured by the FSLIC, but also from all sorts of banks, small and large, insured by the FDIC?
**Root:** Yes, this is a great danger, particularly the larger accounts, with international investor confidence.

**EIR:** Are you pointing in particular to the danger of large "brokered funds" accounts in U.S. S&Ls? [These are large accounts at the $100,000 FSLIC insurance limit, which are placed for wealthy investors by Wall Street brokers in distressed S&Ls, which are forced to pay speculatively high rates to attract funds—ed.]
**Root:** Not just in S&Ls. I think, regarding S&Ls, that 90-95% of the deposits are actually held by individuals. No higher than 5% are brokered funds.

**EIR:** I've heard estimates of up to 50% of S&L deposits being hot money brokered funds.



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**Root:** No, perhaps 10%, but no more than 5-10%. That is clear from the fact that we [S&Ls] have about 100 million accounts, with a total of $1 trillion in deposits.

**EIR:** You mean that $1 trillion divided by 100 million accounts is an average of more like $10,000 per account, rather than $100,000 per account?

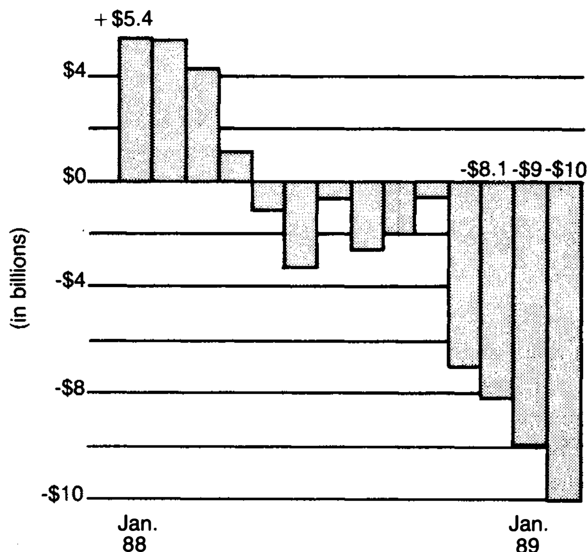
**Root:** Yes, these are largely domestic and smaller individual depositors. But the international depositors are what I'm worried about.

**EIR:** Yes. You mean that the 5-10% of larger accounts would be the ones to begin a deposit outflow?

**Root:** There could be an outflow from not only S&Ls, if they commingle the funds, but from all sorts of institutions. This is not good policy.

**S&L money flow**

Monthly net change in 1988-89




Source: Federal Home Loan Bank Board

# Savings: today's economic Rosetta stone

by Stuart D. Root

*The article excerpted here was first published in the* Federal Home Loan Bank Board Journal *in 1987. Mr. Root was at the time a member of the law firm of Cadwalader, Wickersham, and Taft, New York and Washington, D.C., counsel to the Federal Home Loan Mortgage Corporation.*

The time has come to retrain our sights on savings, and on the latent power of this resource to answer some pressing economic concerns.

Heading the list of concerns is a less than desirable rate of industrial production. It was one of the last indexes to move upward as the nation went into economic recovery, and it now has leveled at a rather unsatisfactory plateau at best or may even drop at worst. High interest rates have attracted foreign funds and strengthened the value of the dollar, leading to an upsurge of imports at the expense of domestic industries. Internationally, the United States has become a debtor nation, with no end to the debt in sight. There is extreme weakness in the farming and raw materials sectors of the economy. Calls for protection of ailing industries through raised tariffs, restrictive quotas, or other measures are becoming stronger every day. The high interest rates bedevil farmers, while state and local governments defer the maintenance or replacement of infrastructure in their intensely developed regions and cities.

Financial institutions wrestle with assets, booked during heady inflationary times, that have now turned sour, such as oil and gas loans, real estate loans and direct investments, and, for large commercial banks, loans to sovereign nations and their companies. The strains in today's financial system—highlighted by the problems of very large institutions plus privately insured thrifts in Ohio and Maryland, and the collapse of some government securities dealers—are evident in numerous bank and thrift insolvencies. Too many savings institutions are still attempting to grow out of their problems through borrowings of "hot" money that are used to finance high-risk assets.

Monetary policy has been managed with some success. But even Zeus would be constrained in responding to the current array of U.S. economic vulnerabilities, any one of which could spark intense inflationary pressures.

## Return to saving

But today the United States imports savings, much to the dismay of her allies and the alarm of financial regulators. Economic analyses are presented to the public with nary a nod to the difference that savings could make. Saving is indeed the forgotten economic element—yet it could be, if rediscovered, the Rosetta stone of our economic puzzlements.

Meanwhile, our major trading partner, Japan, continues at home to emphasize and reemphasize personal saving. This allows Japan to have a very high per capita national debt while interest rates are about one-half U.S. rates, providing incentives for reindustrialization. The educational program instituted in Japan in 1952 to explain the importance of saving may be producing manifold dividends for its citizens, in terms of both individual wealth and national capacity. . . .