

Domestic Credit by David Goldman

Direct Treasury bailout for FSLIC?

The looming failure of the "recapitalization" plan raises the issue of emergency measures.

House Speaker Jim Wright's (D-Tex.) refusal to advance the administration's plan for an emergency \$15 billion "recapitalization" plan for the Federal Savings and Loan Insurance Corp. (FSLIC), means that a direct Treasury bailout of the bankrupt agency may be necessary within weeks, according to regulatory sources.

There is no statutory authority for a Treasury bailout, and Congress would have to vote emergency authority to prevent the indefinite freezing of depositors' accounts at bankrupt savings and loan institutions.

Wright has asked the regulators to stop the wholesale shutdown of the oil-belt banking system, and has refused to support funding for what he reportedly believes are "gestapo" tactics on the part of the FSLIC and its parent agency, the Federal Home Loan Bank Board.

FSLIC sources note that Wright is personally close to the management of the Vernon S&L in Texas, a \$1.35 billion institution shut down by regulators March 20. The decision to close Vernon will provoke Wright further, they believe.

At this point, it is not clear that even rapid congressional approval for the administration plan would do any good. The plan calls for the FSLIC to issue \$15 billion in bonds over the next five years, to be serviced by increased insurance contributions by the thrift industry—which, as a whole, is running at a loss.

The prospect of a rise in interest

rates due to the collapse of the dollar, would make the scheme unworkable, even in the very short term. Hundreds, if not thousands, of the nation's 3,500 S&Ls have hung on only because the Federal Reserve succeeded in bringing interest rates down by roughly 2% during the past two years. A reversal of interest rates would double the FSLIC's 500-strong danger list overnight.

The FSLIC would need up to \$100 billion to bail out thrifts sunk by bad real-estate loans during the next few years; against this, the administration's figure is pitifully inadequate (FHLBB chairman Edwin Gray calls for \$25 billion in new funds).

However, the FSLIC's biggest worry in the near future may not be the orderly winding-down of thrift deposits, but rather depositor runs of the type that swamped the Maryland and Ohio state insurance agencies during 1985, leaving tens of thousands of depositors with their money frozen for months.

Withdrawals exceeded new deposits at federally insured savings and loan institutions by \$2.2 billion in January, the third straight monthly decline. The net decline in new deposits compared with decreases of \$1.9 billion in December and \$2.9 billion in November.

"When usual seasonal patterns are taken into consideration, it represents a much larger deterioration" than the numbers suggest, the FHLBB said. Total retail accounts rose \$200 million

in January, after plummeting \$5.2 billion in December. But large depositors, those with certificates of deposits exceeding \$100,000, showed a substantial fall in January; holdings in the so-called jumbo accounts dropped by \$42.4 billion, to \$114.9 billion, after rising \$3.3 billion in December.

Large depositors at S&Ls, whose money is not guaranteed by the FSLIC, have already begun to pull out in a massive way. Small depositors may not be far behind; after the March 20 closing of a Maryland S&L, the FSLIC inadvertently mailed its usual "nothing can go wrong" form letter to the depositors of another, presumably sound, institution. The head teller at one Maryland S&L reported that 10 customers came in the next day to withdraw their money, arguing that the FSLIC was bankrupt and couldn't protect them; by the end of the day, the teller closed her own account.

Depositor pressure on S&Ls, along with liquidation of S&L assets, may bring to the market a large portion of the \$350 billion or so in mortgage-backed bonds held by the thrift industry, with disastrous effects on the bond market. Since these instruments make up 40% of S&L portfolios, a sell-off forced by S&L illiquidity, would lead rapidly to insolvency of the entire industry, since the total value of S&L portfolios would collapse along with the market value of their paper.

Apart from the continuing process of bankruptcy, and the continuing bleeding of deposits, any of several time bombs could go off in the industry. For one thing, the FSLIC can't find a buyer for the American Savings and Loan, despite months of trying. The company is the S&L subsidiary of Financial Corporation of America, which nearly went under in 1984; a direct takeover could cost the insurer as much as \$7 billion, because of huge problem loans.