Federal Home Loan Bank Board goes off the wall

by Joyce Fredman

The largest insolvent savings institution in the United States to date, American Savings and Loan Association of Stockton, California, was the latest recipient of the federal bureaucracy's funny money. On Sept. 5, a total of $2 billion was pledged by the Federal Home Loan Bank Board (FHLBB) to assist Robert M. Bass Group, the corporation set up by Texas corporate raider Robert M. Bass, in prying American Savings and Loan away from its parent company, Financial Corp. of America.

Within 36 hours after this latest maneuver, FHLBB chairman M. Danny Wall was before the House Banking Committee, explaining his contradictory thesis, that although Congress should not be alarmed in the least, and although the FHLBB has everything under control and is fully equipped to deal with the problems of the thrifts, still the FHLBB needs the promissory notes issued by the Federal Savings and Loan Insurance Corporation (FSLIC) to be backed with the full faith and credit of the United States Treasury.

It is no accident that the hearing took place so soon after the American Savings deal. The $2 billion in assistance pledged by FSLIC is the most costly single rescue for the bank board so far. (But not the most costly transaction; that distinction goes to the merger of eight insolvent thrifts into Sunbelt Savings FSB of Dallas, where the board will inject minimally $5.5 billion.) Both the chronology of events leading up to the takeover and its new owner, Bass, were bound to raise plenty of questions.

From Financial Corp. of America to bust

On Jan. 11, 1983, Financial Corp. of America (FCA), the parent company of State Savings, in Irvine California, announced a merger with First Charter, the owners of American Savings and Loan. By August, regulators approved the merger. The new company kept the names of FCA and American Savings, and Charles W. Knapp became chief executive. Knapp's regime was part of the high-risk speculative trend that was sweeping the country. He paid high interest rates on deposits and made real estate loans that other institutions had rejected.

By August of the following year, the thrift was faced with mounting deposit losses and borrowed $500 million from Federal Home Loan Bank of San Francisco. As FCA stepped up its borrowings to fend off a worsening deposit run, regulators came down on Knapp. By Aug. 28, 1984, Knapp resigned and was replaced by William J. Popejoy.

Although FCA reported losing $6.8 billion in deposits in the third quarter in October, by January 1985, Popejoy was sanguine, announcing, "The good news is, the bad news should be behind us soon." Guess again, Bill. By March 8, FCA had revised their estimate of annual losses to $700 million. On April 1, FCA announced it had lost $512 million in the fourth quarter, bringing annual losses to $591 million, an S&L record. On May 16, American Savings disclosed that it had lost $1 billion in deposits. The saga continued in a similar vein for two more years.

By Jan. 21, 1988, FCA's net worth was wiped out by $225 million in fourth-quarter losses. FCA's red ink for 1987 was $468 million! Six days later, it requested a $1.5 billion bailout from FSLIC for American Savings. It was not until Feb. 4, 1988, that Rep. Fernand St Germain (D-R.I.) began a congressional investigation into the regulatory handling of this insanity.

But as the losses piled up, Danny Wall went into gear. On April 21, confirmation was given that an exclusive pact with billionaire Robert Bass had been signed to negotiate the sale of American Savings. The deadlines for finalization came, were extended, and passed. On Sept. 5, the agreement was reached: The Bass group invests $550 million, and FSLIC provides $500 million in promissory notes and a promise of $1.5 billion in cash over the next 10 years.

Financial Corp. of America, the nation's second largest S&L holding company, had, as of June 30, liabilities exceeding assets by $387 million. They will file a petition for Chapter 11 bankruptcy. Popejoy resigned as chairman and CEO of Financial Corp.

Bass fishing

The 40-year-old recipient of this circus has had quite an active year himself. First, Robert Bass had acquired the Westin hotel chain from Allegis Corp. for $1.53 billion. Then in March, he sold the Plaza Hotel in Manhattan to fellow billionaire Donald Trump, for $410 million. In May, he bought out the Bell & Howell Co. of Skokie, Illinois, a publishing and information service, for $702 million. Now Bass has acquired the country's largest insolvent savings institution.

Clearly, the fellow has money to throw around. But like most of his set, he never had to work for it. He is an heir to his uncle's oil fortune. From prep schools like Phillips Andover Academy, he went on to Yale and Stanford. One account has it that Bass spent his free time at Yale making slugs out of soda can flip-tops for use in the parking meters in New Haven. Such are the makings of the Texas upper crust. His seedy character and ruthless raids have been the last straw for some, however, and at long last, Congress has noted that there may indeed be quite a disaster looming on the horizon.

Full faith and credit

Danny Wall came before the House Banking Committee to give testimony as to why Congress should give full faith and credit to the Bank Board. He cited the resolution of 47 "troubled" institutions (more commonly known as "zombies") in 1987 and 54 this year to date, as proof that the situation is completely under control.

Wall also explained the advantages of using notes as opposed to cash—never stating the obvious: that they don't have it. Wall said that interest on the notes is not taxable, as long as certain (vague) criteria are adhered to, as well as the fact that a holder of a note may sell it at a premium. This enables the owner to convert the note to cash. Not a bad idea, considering the note itself is considered worthless in most circles. After 20 pages of justification for his actions, Wall concluded that it is urgent for Congress to pass a resolution backing him up.

"Consequently, one can only judge whether the FSLIC is heading in the right direction based on its recent tract record." That is the most honest statement in his whole testimony.

George Gould, Undersecretary for Finance of the Treasury Department, then submitted his testimony. This testimony was even more absurd. Gould insisted that the actions of the Bank Board are backed by the full confidence of the government, and therefore any resolution would simply be redundant. Rather, everyone should let well enough alone. Particularly objectionable to the Treasury was the idea of Congress setting any limits or restrictions. "The Bank Board has told the Committee and the public that it will not issue notes beyond its available, identifiable resources over time."

Unfortunately for everyone, they already have.

According to the official figures, the total amount of FSLIC's obligations is conservatively $22.5 billion. The total annual interest outlay requirement on these obligations is estimated to be $3 billion. FSLIC's current foreseeable level of premium income is approximately $1.85 billion annually.

To put this in perspective, during the first half of 1988, FSLIC's actual cash outlays for principal and interest on its notes and bonds totaled $1.143 billion. This amount is 74% higher than FSLIC's premium and interest collections of $658 million during the same period last year.

One of the shrewder S&L watchers, Bert Ely, also pointed out that, in fact, this is the most expensive way to deal with the situation. "All the FSLIC notes do is postpone the day when cash is paid out to resolve a failed thrift. Effectively, these notes are nothing more than post-dated checks drawn on the U.S. Treasury. Yet FSLIC notes are a more costly source of funding for FSLIC than direct Treasury debt of comparable maturity." The interest rates are a good three points higher.

Stirrings in Congress

The situation is so egregious that even some of the dolts in Congress are finally waking up to the reality that *EIR* has been reporting on for years. Rep. Charles E. Schumer (D-N.Y.) testified:

"In the same breath, Chairman Wall maintains that the Congress need not be concerned, that the Bank Board has now and will continue to have sufficient resources to resolve the massive problems in the thrift industry. . . . Well, this congressman for one is deeply concerned. . . . Indeed, the ease with which the Bank Board has spoken recently of billions and billions and billions of dollars, makes them sound more like Carl Sagan than prudent regulators protecting the public's interests. . . .

"Given that the Bank Board has not provided adequate and timely information, that it has consistently underestimated the size of the problem, that it refuses to acknowledge that the crisis is bigger than the Board can handle, it is dangerous to give the Bank Board a blank check. . . . Looking at the transactions already completed, the Southwest Plan seems to be nothing more than a massive shell game in which insolvent institutions are reshuffled, the names changed, and little if any real capital injected, resulting in thinly capitalized weak institutions."

Papering over the problems until the November election is a very high-risk business. And it is becoming more expensive every day.