Banking by William Jones

More trouble ahead for S&Ls

The bailout of the thrifts amounts to a federally financed "leveraged buyout"—and solves nothing.

In what federal regulators hope will be a year-end cleaning up of 200 failed savings and loan institutions, the Federal Savings and Loan Insurance Corporation (FSLIC) is planning to spend around $8 billion in a variety of rescue operations.

Using a combination of cash, notes, and federal guarantees, FSLIC is attempting to attract new owners and refinance the operations of nine institutions, including: American Savings of Stockton, California, the second-largest S&L in the country with nearly $31 billion in deposits and other funds, which will be operated by a group headed by Texas billionaire Robert Bass; a group of five Texas associations with deposits of nearly $12 billion, which will be merged and operated by a group headed by corporate raider Ronald O. Perelman; and McLean Federal Savings and Loan, which will be acquired by NV Ryan of McLean, Virginia, the nation's largest home builder, with an infusion of $66 billion in federal aid.

The Texas S&L rescue operation, according to Danny Wall, chairman of the Federal Home Loan Bank Board, is the largest capital infusion by an acquirer under the Southwest Plan, the plan to clean up insolvent S&Ls in the hard-hit Texas-Oklahoma region. FSLIC will provide an assistance package with an estimated cost of $5.1 billion to Revlon billionaire Perelman. As part of its assistance, FSLIC will issue a 10-year $866 million note to bring the combined institutions' regulatory capital to zero.

But this is just the tip of the iceberg. The Federal Home Loan Bank Board has more than 400 insolvent institutions to shut down or sell off, and hundreds of others nearing insolvency. The Treasury Department and other analysts have estimated that the total cost of cleaning up the industry will range from $50 billion to $100 billion. This will almost guarantee the necessity of a giant taxpayer bailout.

The deals have been criticized for other reasons than just the cost. The crisis was caused in part by the fact that many of the S&Ls' assets were in the form of real estate boondoggles that later collapsed. And yet the prospective buyers of the failed S&Ls are primarily being recruited from among those very people who are most deeply involved in high-risk leveraged buyouts (LBOs) and junk bond trading.

The buyers are given a stiff shot of federal assistance or guarantees to put their cash into taking over the failed institutions, as well as significant tax breaks. The recent Texas deal will significantly enhance the political and financial power of Perelman's group. The five savings institutions, when combined, would have 800,000 depositors, the largest of any financial institution in Texas. The new banking group would hold a very significant franchise, controlling 10% of all savings deposits in Texas thrifts, and 5% of total saving deposits in the state, including those of the commercial banks.

Some evil tongues are saying that the champions of the LBOs are playing the same game with the S&Ls, with the FSLIC providing the leverage.

The deal made for the California-based American Savings with Fort Worth billionaire Robert Bass involved his putting up $500 million in return for $1.7 billion of government aid. The original deal included a provision for setting up a $1.5 billion merchant banking unit that could make high-risk equity investments like leveraged buyouts. The unit was eliminated when it came under criticism from state regulators and members of Congress.

The most recent deals are also being examined by members of Congress. Sen. Tim Wirth (D-Colo.), a member of the Senate Banking Committee, commented in a letter to Danny Wall that he had "serious questions about the impact your plans will have on the federal budget, the competitive balance of the remaining thrift industry, and the concentration of power within our financial systems."

Texas Rep. Henry Gonzalez, the new chairman of the House Banking Committee, said that there will be congressional hearings on the deals. "We will be looking," he said, "at whether the Bank Board has been getting the best deals possible when it comes to these assistance deals." Gonzalez also criticized the Bank Board's decision to make non-banking investments through its newly acquired American Savings. Under the revised terms of the refinancing announced on Dec. 28, Bass will still be able to put about 3% of American's $30 billion in assets into non-banking activities, which, Gonzalez said, "leaves the thrift open to the possibility of promoting risky ventures."

The ultimate cost of the S&L crisis will undoubtedly be much higher than even the highest current estimates. The present mode of dealing with it is essentially a stop-gap measure which will make for an even worse crisis in the future, if the incoming Bush administration does not change this foolish policy course.