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Banking by Kathy Burdman

S&Ls don't stand a chance with MMFs

The Treasury is using MMFs to rationalize the savings and loans institutions—and

The savings and loans are now very disturbed about money market funds, and that is fine with us," said a high-level source at the Regan Treasury this week. "The more they complain about money market funds, the more easily we can turn the argument on its head. The whole point of the debate about money market funds is not to restrain the interest rates that the funds can pay, [but] force them to pay higher rates to depositors if they want to compete with the funds. This is the year of deregulation."

I told you so. As I warned in this space last week, Federal Reserve Chairman Paul Volcker and Treasury Secretary Donald Regan are out to rationalize the nation's 4,500 savings and loan institutions by forcing the S&Ls, which now pay an average 9 percent to their depositors, to pay the market rates of 16 percent and over now paid by the unregulated money market funds (MMFs). This will mean that hundreds of smaller S&Ls, only earning 5-8 percent on their mortgage portfolios, will not be able to afford the price of taking deposits and will go under within a year.

Money market funds are the short term (usually one month) high-yield mutual funds whose shares are sold to the public like savings certificates. Because these funds, typically managed by brokerages and other non-bank financial institutions, invest only in short term, high-yield speculative instruments like commercial paper and Eurodollar certificates of deposit, they can afford to pay market rates of 14-19 percent to shareholders.

The U.S. League of Savings Associations has complained vigorously that MMFs have stolen over $63 billion in deposits that would have gone to S&Ls since MMFs were authorized by Congress in 1978. Indeed, MMFs have doubled in size since the beginning of this year, from $70 billion to over $115 billion this week and rising fast.

The U.S. League is demanding that Congress cap the rates money funds can pay, and have heavily lobbied Senate Banking Committee Chairman Jake Garn (R-Utah) to regulate the funds, to give the S&Ls a fighting chance to bid for deposits. Senator Garn will hold hearings May 13 and 14 on MMFs.

But "this is fine with us," say the Treasury deregulators. "The poor dumb S&Ls are playing right into our hands. They have all of their attention focused on this debate," said the Treasury official, "while the fact is, there is not the ghost of a chance of MMFs being regulated by Congress. First, there is no support whatsoever from the administration—the Treasury is totally for deregulation. And the MMFs are mobilizing their 6 million shareholders to write Congress—and that will be felt. Fed Chairman Volcker is against it, too.

"The bottom line is that the policy is to deregulate the S&Ls, let them pay higher rates if they want deposits. And that's what is going to happen."

Even Senator Garn himself admits that his free-market bias may allow just this. In the press release announcing the hearings, Senator Garn said, "I am not opposed in principle to money market funds since they afford small investors with an opportunity to earn higher interest. *It is not my purpose to impose new regulations.*" Although Garn honestly has the well-being of the S&Ls at heart, Treasury believes they can manipulate his free-market bias into deregulating the S&Ls instead.

Richard Pratt, the new Federal Home Loan Bank Board head supported by the U.S. League and other S&Ls the board regulates, has the same ideological flaw. Pratt, a financial consultant from Garn's home state of Utah, recently called for "temporary federal restraints" on MMFs, due to S&Ls' loss of deposits, and then turned around to say that "in the long run, one solution will be to lift government restraints on interest rates that financial institutions can pay."

The real problem facing the S&Ls is the Volcker Fed's interest-rate squeeze, which is destroying the home mortgage market S&Ls exist to serve, and jacking up their deposit rates. "But luckily, the S&Ls don't recognize their enemy, and have chosen to attack the MMFs instead," laughed my Treasury source. "Volcker's main interest is to get rid of deposit ceilings so we can index all rates to inflation. That will mean higher mortgage rates, fewer homebuyers, and fewer S&Ls. The S&Ls are going to have to be rationalized."

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