Banking by John Hoefle

Thrifts riding into the sunset

Despite the much-touted 'bailout,' U.S. savings and loan institutions are dying.

The nation's thrifts continued their free-fall into oblivion in the third quarter. The Office of Thrift Supervision, the new entity created to regulate the thrift industry, revealed on Nov. 6 that 800 savings and loan institutions—nearly one-third of the 2,600 remaining solvent thrifts—currently fail to meet the new capital standards.

The new standards, which take effect Dec. 7, call for a minimum of 3% core capital—including 1.5% in tangible capital—and an additional capital reserve based upon a risk analysis of assets. These 800 thrifts, which hold some 45% of the total $1.3 trillion in thrift assets, fall short of the capital requirements by about $20 billion. They will have until Feb. 5 to file plans with the agency that detail how they intend to bring their capital-to-assets ratios up to the required level.

There are two ways thrifts can increase their capital-to-assets ratios. The best way is to increase the amount of equity capital in the thrift, either by putting profits back into the institution, or by attracting additional funds from investors. Since the thrifts are losing money at an alarming rate, there are few profits to reinvest, and investors are hard to find. The second way is for thrifts to reduce assets by selling them off, and by reducing the level of deposits. This self-cannibalization goes by the name "downsizing" and is considered clever in some circles.

The thrift business is, in fact, downsizing just as fast as it can. James Barth, the chief economist for the OTS, told the annual meeting of the U.S. Savings and Loan League in Chicago Nov. 4-5, that preliminary OTS data shows the thrifts reduced their assets by a record $15 billion in September. The previous record was for the prior month of August, when assets dropped $13.4 billion. S&Ls reduced their deposits by $9 billion in September, on top of a $5.1 billion drop in August.

Thanks to the fire sale of assets, the thrifts lost just $2.5 billion in the third quarter, the best figure since the third quarter of 1988—a period of massive government intervention—when they lost "only" $1.8 billion. Thus, neither quarter's figures reflect the depth of the crisis.

The yearly figures, suffering from the same manipulations, are nonetheless staggering. In 1988, the savings and loans lost $13.4 billion, and have lost $9.7 billion through the first nine months of 1989.

While the thrifts continue to lose money, the Resolution Trust Corporation, the new agency charged with liquidating the assets of thrifts closed by the government, has already accumulated $94 billion dollars of assets—of which $16 billion is foreclosed real estate—from 273 failed thrifts. Those figures are certain to jump dramatically.

The RTC has a major problem on its hands, since in an environment where everyone is selling, it is difficult to find buyers. The RTC won't be able to move these assets unless it sells them at rock-bottom prices, but doing so would collapse their market value—especially the real estate. Such action would prevent many still-solvent thrifts from selling sufficient assets to meet the new capital requirements, and thus they ultimately face going under themselves.

The solution the RTC is favoring, is to borrow another $50-100 billion in capital—on top of the $50 billion already authorized by Congress for the first three years—to allow the agency to hold on to the assets long enough to sell them at a reasonable price. RTC chairman William Seidman told the House Ways and Means Committee on Oct. 31 that those additional funds would be needed, and that his agency has identified an additional 223 troubled thrifts—with assets of $164 billion—that would likely be closed during the next three years.

Just like the Federal Home Loan Bank Board's much-touted "Southwest Plan," the new bailout is doomed to failure because it completely ignores the reasons for the thrift industry collapse in the first place.

Thus far, the Bush administration has responded with a series of increasingly bizarre and unworkable schemes. In October, a Resolution Trust Corporation delegation was dispatched to Japan, to try to convince the Japanese to buy RTC bonds. Seidman, in his congressional testimony, floated the idea that the administration might create a "resolution bank" to securitize the foreclosed thrift assets and sell them on the securities markets, or to issue junk bonds using those assets as collateral.

But without a change in policy, another bailout is inevitable. As Allan Bortel, a thrift analyst with Shearson Lehman Hutton, said recently, "All of this is simply laying the groundwork for Bailout Bill II. The first one was just the down payment."