

October 29, 1989

Books & Business

The Risks Were Too Good to Pass Up

OTHER PEOPLE'S MONEY

The Inside Story of the S&L Mess.
By Paul Zane Pilzer with Robert Deitz.
269 pp. New York:
Simon & Schuster. \$18.95.

INSIDE JOB

The Looting of America's Savings and Loans.
By Stephen Pizzo, Mary Fricker and Paul Muolo.
443 pp. New York:
McGraw-Hill. \$19.95.

THE S&L INSURANCE MESS

How Did It Happen?
By Edward J. Kane.
181 pp. Washington: The Urban Institute Press.
Cloth, \$24.95. Paper, \$10.95.

By Anthony M. Solomon

THE insolvency of huge segments of the United States savings and loan industry marks a sorry chapter in this nation's financial history. The magnitude of the corruption, greed, incompetence and cynicism of those who mismanaged or plundered hundreds of thrift institutions — or covered up what was going on — breaks all records. Many lawyers, accountants and regulatory specialists who should have blown the whistle were either duped or inept. A disturbing number of high Government officials displayed appalling judgment. In the end, the costs to the taxpayer, the real victim, will be colossal.

Now the whole disgraceful episode, though far from over, has spawned a flock of carefully researched, well-crafted books chronicling the fiasco. Three particularly good ones are "Other People's Money," by Paul Zane Pilzer with Robert Deitz; "Inside Job," by Stephen Pizzo, Mary Fricker and Paul Muolo; and "The S&L Insurance Mess," by Edward J. Kane.

Each has a somewhat different focus and different audiences in mind, but all provide genuine value to their readers, whether they are already reasonably well informed or only casually acquainted with what has happened. If none are fully successful in coming to grips with the broadest policy dimensions and implications of the thrift industry debacle, that is surely forgivable, for the situation is still fluid.

Because Mr. Pilzer is in real estate development, he has some firsthand experience of what went on. He has teamed up with Mr. Deitz, an editor of The Dallas Times Herald, and together they have written a highly readable introduction to the thrift disaster. They recount the history, the legislative background, the gambits used to exploit new powers granted to the savings and loan institutions in the early 1980's by a deregulation-minded Congress, and the duplicity of Washington heavyweights who used their influence to stop remedial regulatory action. Of the three books, this one is probably the best all-round treatment, despite sometimes irritating overgeneralizations and hyperbole.

Mr. Pilzer reveals a key point: the dangers inherent in a system of large-scale Government insurance of deposits. These were clearly foreseen right at the outset — and by none other than Franklin D. Roosevelt in 1933, as he was about to become President. He (and others) understood the potential for abuses, and tried to head off legislation supported by populists like Huey Long and Texans like John Nance Garner (the incoming Vice President!). But the political pressures for deposit insurance were overwhelming. In 1933 the Federal Deposit Insurance Corporation (F.D.I.C.) was es-

tablished for banks; in 1934 the Federal Savings and Loan Insurance Corporation (F.S.L.I.C.) was added for thrifts.

Though the system, as Mr. Pilzer explains, held together until the 1970's, it was always fundamentally fragile. Savings and loan institutions provided long-term fixed-rate mortgages that were financed by short-term savings deposits. As long as interest rates remained relatively stable, this was a profitable activity. But when inflation dramatically escalated in the 1970's, the business was doomed. Many thrifts, subject to an inadvisable interest-rate ceiling imposed by Congress decades ago, faced calamity as deposits were withdrawn, lured by the far higher yields available on money market funds.

But interest rate deregulation, which began in 1980 under Jimmy Carter, was no panacea, either. Once free to compete, thrifts could hold onto deposits, but at the stiff price of offering higher interest to depositors — and that meant losses on the savings institutions' existing low-interest mortgage portfolios.

What ultimately proved more disastrous, as Mr. Pilzer and the other authors show, was a string of poorly thought-out decisions by Congress. The first was to increase the maximum deposit insured by the Government from \$40,000 to \$100,000. This encouraged deposit insurance brokers, who could place large sums

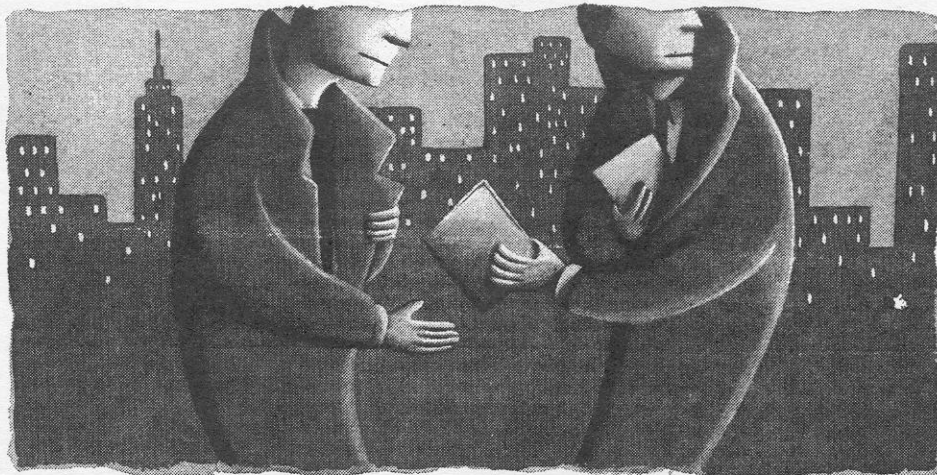
Calif. — and how they went about fleecing thrifts. The authors' thesis of organized crime involvement is provocative.

Aside from racketeering and fraud, they make clear that the incentives to take excessive risks, even for law-abiding thrift managements, were overwhelming. The Government insurance funds, not the borrower or the depositor, were underwriting the financial outcomes. The philosophy was: "It's heads I win, tails the F.S.L.I.C. loses."

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Mr. Kane's book is a scholarly monograph that basically arrives at the same conclusions as the other two. While he approaches the subject analytically, rather than by poring over the egregious cases, he, too, believes that the savings and loan crisis was an inevitable consequence of the ways Congress restructured deposit insurance and the thrift industry at the start of the 1980's. "The S&L Insurance Mess" demands a good deal from the reader, but for serious students of the issue the effort is worthwhile.

All of the authors are plainly of the view that the Government deserves a tremendous amount of blame for the thrift crisis, and I agree with them. The books name names. In Congress, Fernand J. St Germain, Jim Wright and Tony Coelho have been forced out (though



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divided into lots of \$100,000 each, to shop for the thrift willing to pay the highest interest rate — no matter how shaky its assets or bad its management. These so-called "brokered deposits" poisoned the system.

Egged on by thrift industry lobbyists, the Reagan Administration went beyond mere interest-rate deregulation. Aided by willing Democrats, they hustled through Congress an incredibly shortsighted piece of legislation, the Garn-St Germain Act of 1982, which removed regulatory barriers to thrift industry business activities. No longer was the industry largely confined to financing housing. Overnight, the sky was the limit.

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The results were devastating, as all of the authors show. Before the ink was dry on the new act, the staid thrift industry was invaded by all manner of promoter, swindler, land speculator, junk bond player and money launderer. Some of the more outrageous cases, spun out in rich detail by the authors of "Inside Job," are so lurid that a novelist would blush to invent them.

Mr. Pizzo, Ms. Fricker and Mr. Muolo are investigative journalists and they have put together a chilling account, cast almost in cinematic terms, of greed and criminality. While tales of political interference by Washington officials on behalf of crooked savings and loan magnates are not ignored, the real juice of "Inside Job" is in the fascinating descriptions of the private-sector perpetrators — such as Charles H. Keating Jr., principal owner of Lincoln Savings and Loan in Irvine,

for varying reasons, not all of them connected to the thrift scandal), yet incumbents like Jake Garn, Alan Cranston, Dennis DeConcini, Donald W. Riegle Jr. and many others have a lot of explaining to do.

Within the Reagan Administration, the authors of the three books have amassed convincing evidence of the questionable actions and interventions of several Presidential appointees. One of them, M. Danny Wall, once an aide to Senator Garn, remains chairman of the Office of Thrift Supervision (formerly the Federal Home Loan Bank Board).

But the person who stands out as exhibiting the most appalling lack of judgment is Donald Regan. As the Secretary of the Treasury, he was the nation's top financial official, with the ultimate fiduciary responsibility to the taxpayer, and he continued to play a pivotal role on this issue after he left his Treasury post to become White House chief of staff. As these books conclude, he pitted his entire political weight against those, especially the thrift regulator Edwin Gray, who were trying to avoid a catastrophe. Mr. Regan prevailed; the taxpayer lost.

The regulatory officials deserve a share of the blame, however, as the books underscore. They were amateurish in dealing with emerging cases, and left the impression in the industry that they were not in control. They failed to educate the public about the abuses of the deposit insurance system, did not alert the press to the scandals in the making and showed poor leadership in

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dealing with Congress on reforming the system.

Others share the guilt: Outside auditors did a lax job in questioning rosy profit results that should have been seen as too good to be true. Independent directors of many failed institutions did not exercise their fiduciary responsibilities. Depositing institutions knowingly placed large amounts in the weakest thrifts without caring what the consequences of their activity might be. The national news media failed utterly to see the public policy implications. And probably most cynically, the lobbyists for the solvent thrift institutions effectively delayed legislation to restructure the F.S.L.I.C. As a result of their efforts, the problem became so large that the Government has been forced to carry the bulk of the rescue operation's financial burden (which could approach \$300 billion), thereby letting the industry off the hook.

Common to all three books is the sense of outrage and exasperation they leave in the reader. The outrage stems from the fact that most of the guilty are getting away without any meaningful punishment, either by the courts in the case of the thrift industry crooks, or by the voters in the case of the large number of Congressmen — Democrats and Republicans alike — and executive-branch officials who did not protect the public interest.

Still, what may be worse is the feeling of exasperation: after everything that has happened, nothing was included in the recently enacted bailout legislation to eliminate the essential abuses of the deposit insurance system.

These three books were completed before the final compromises on the Bush program were known, but it is fair to infer that all of the authors would be mightily disappointed in what was done. There is a surprisingly strong consensus among them about what the major elements of true reform would be: substantial cutbacks in the size of deposit that the Government would fully insure, along with the imposition of deductibles; meaningful curbs on brokered deposits; better supervision of thrifts through upgraded personnel and tougher rules; better coordination and cooperation between bank and thrift supervisors on the one side and the Justice Department and the F.B.I. on the other; careful screening of thrift officers, directors and owners; realistic accounting; and, finally, significant increases in capital requirements, probably the only major reform of the Bush program and the legislative compromise that resulted.

A final thought. These books force us to face up to an embarrassing and painful reality: we as a nation are badly governed in situations where our lawmakers and executive-branch officials are preoccupied either by ideology or by the narrow interests of a relative handful of big campaign contributors. In this case, and no doubt in others to come, the public interest has simply been ignored. □