Research Department
Federal Reserve
Bank of
San Francisco

October 15, 1982

FRB SF Weekly Letter

Sero Sed Serio

It has been almost one year since Congress undertook serious action designed to address the severe problems confronting depository institutions. A number of thrift institutions, in particular, began losing money in 1980, and their losses accelerated in 1981. In the last quarter of 1981, regulators began a patchwork of intrastate and interstate emergency mergers of failing institutions that has since been accompanied by a national reassessment of past principles regarding geographic and industry business boundaries. The reassessment culminated, for the time being, in the passage of the "Garn-St. Germain Depository Institutions Act of 1982".

Past was prologue

About a year ago, the House of Representatives passed HR 4603 by a 371–46 vote. This was the so-called "Regulators" or "Emergency Takeover" bill expanding the form and conditions under which federal regulatory and insurance agencies could extend financial assistance to a growing number of troubled depository institutions. The bill also provided for the inter-industry (commercial bank and thrift) and interstate acquisition of failed or failing savings and loans and large (approximately $2 billion in assets) failed savings banks.

However, it was not until almost a year later, on October 1, that a revised and broader "Depository Institutions Act of 1982" finally cleared both the House and Senate. This *Letter* reviews some of the conditions and concerns that led to its passage and that seem likely to shape efforts at further reform of financial market regulation next year.

In the course of the debate on HR 4603 a year ago Federal Reserve Board Chairman Paul Volcker stated that "the entire savings and loan industry was not in jeopardy," but that a number faced "transitional problems," and, depending on the course of interest rates, the legislation could save the Government "hundreds of millions of dollars" in liquidation costs. He further warned that if the Congress did not approve the legislation with its strict guidelines for interstate and interindustry emergency acquisitions, the Fed reluctantly might have to exercise its authority under the Bank Holding Company (BHC) Act to permit the acquisition of failing S&L's by bank holding companies in emergency situations.

When the House bill moved to the Senate, its provisions, with some modification, were incorporated into a much more comprehensive "Financial Institutions Restructuring and Services Act" submitted by Banking Committee Chairman Jake Garn (R-Utah) and eventually supported by the Administration. The measure quickly became the object of fierce debate. Trade groups clashed over various provisions designed to substantially broaden the lending, investment and deposit powers of federally chartered thrift institutions, and to modify the 1933 Glass-Steagall Act to permit banks and thrifts to compete more effectively with institutions such as money market funds.

Late, but earnest

The bill approved by the Senate this September after bitter inter- and intra-industry debate represented a vastly modified version of the original "restructuring" proposal. Even then, it secured last-minute support from the American Bankers Association (ABA), although not the Independent Bankers Association of America (IBAA), only because of amendments added on the floor during final debate which re-incorporated several (but not all) provisions insisted upon by the large bankers association.

The bill HR 6267, the "Depository Institutions Act of 1982," that was finally approved by both houses on October 1 includes key provisions for financial assistance to and for the emergency acquisition of failed or failing depository institutions, as well as various pro-

Research Department
Federal Reserve
Bank of
San Francisco

visions authorizing expanded powers for both commercial banks and thrifts.

A major catalyst helping to move HR 6267 was the continued decline in the net worth of the nation's S&L's through August (a drop of 20 percent over the year), and announcements by both the FDIC and the FSLIC that over the last 18–20 months each had expended almost $2 billion in financial assistance in support of troubled banks and S&L's, including aid in the mergers of failing or failed institutions. The FDIC's outlays far surpassed the $350 million total of such outlays over the past 50 years, while the FSLIC's payments, involving some 74 S&L's with $36 billion in assets, also represented a record. Moreover, both agencies indicated that they expect the number of cases requiring assistance to increase.

With this prospect in mind Congress included a key provision permitting the FDIC to approve the acquisition of large ($500 million or more in assets), closed, insured commercial banks as well as of failed mutual savings banks or failed or failing S&L's. In all cases, the acquisition can take place only after consultation with state authorities whose objections can be overridden by the unanimous vote of the insuring agency.

Priority in acquisitions permitted by the agencies is to be accorded to (1) institutions of the same type in the same state, (2) institutions of the same type in different states, (3) institutions of different types in the same state, and finally, (4) institutions of different types in different states. This order generally was favored by thrifts, concerned over the prospect of acquisitions by banks. Bankers, fearful of any weakening of present restrictions on interstate banking, generally favored according priority to intra-state mergers even when these involve industry crossovers. However, in considering interstate offers, the bill gives priority to bids from entities in adjoining states. In any case, the acquisition provisions are subject to "sunset"—expiration—after three years.

Other forms of assistance
Among the other key provisions of HR 6267 are those which would increase the forms of assistance that the FDIC and FSLIC can extend to troubled depository institutions and the conditions under which they can be extended, including the existence of severe financial problems in particular areas.

A related "capital assistance" provision gives the regulatory agencies authority to bolster institutions with government backed "Net Worth Certificates," which can be counted as additions to net worth. The assistance can range in amount up to 70 percent of operating losses, the amount depending in part upon whether an institution's net worth ranges from zero to three percent. Also, to qualify for the assistance, an institution must have at least 20 percent of its loan portfolio in residential mortgages, and must have incurred operating losses during the two previous quarters. As an institution's earnings and net worth improve, the promissory notes or certificates are to be paid off. The assistance program is subject to "sunset" in three years.

DIDC mandate
Yet another—and, according to some bankers, the key—provision of the bill mandates the DIDC to create, within 60 days, a new account directly equivalent to and competitive with money funds. The account must include no interest ceiling and a limit of three third party and three preauthorized or automatic transfers a month if it is not to be subject to System reserve requirements on transactions accounts. While DIDC is to work out the details, the House-Senate Conference Report expressed the view that the minimum of the account should be no higher than $5,000. The ABA strongly supports such an account —which, unlike money market funds, will be insured—but many small bankers and some thrifts expressed fear over its potential for "cannibalizing" their remaining low rate passbook savings. Related provisions also mandate the DIDC to forego the imposition of an interest rate ceiling or rate differential on any new deposit account, and to eliminate all

interest rate differentials between banks and S&L's by January 1, 1984.

Other key provisions permit S&L's and mutual savings banks to place an increasing proportion of their assets in commercial and agricultural loans, up to a maximum of 10 percent after January 1, 1984, with related authority to offer demand deposits to persons having a business relationship.

The measure also overrides state laws which permit enforcement of "due on sale" clauses in outstanding conventional home mortgage loans. This override means that lenders (state as well as federally chartered institutions) will be able to prevent the assumption of mortgage loans that they hold when a house is sold. The override will not affect transactions involving assumptions that occurred prior to the bill's becoming law, but generally will apply to outstanding as well as to newly originated loans containing due on sale clauses. The bill contains an exception for loans made or assumed during periods when state laws preventing enforcement of due on sale clauses were in effect, creating a three-year "window period" during which the state laws can remain in force.

Another provision will exempt from Fed reserve requirements the first $2 million of depository institutions' reservable liabilities. The exemption will affect an estimated 21,000 credit unions, S&L's and commercial banks. While these represent about half of all depository institutions, they account for less than 2 percent of total deposits and thus do not materially affect the System's ability to implement its monetary policy responsibilities.

Industry reactions

Industry responses to the new bill vary. Thrifts generally welcome the financial assistance provisions and broadened lending and deposit authority, although some view the new deposit instrument and interest rate differential provisions with some misgiving. The ABA warmly welcomes the provision for a deposit instrument "truly competitive" with money market funds but laments the provisions that generally prohibit bank holding companies from offering property and casualty insurance and the absence of authorization to underwrite municipal revenue bonds.

The Independent Bankers opposed the bill outright. They object to the extension of any additional asset and deposit authority to the thrifts and, wary of takeovers by interstate bankers, do not welcome the inclusion of failed large commercial banks among the institutions potentially eligible for acquisition by out-of-state banks and bank holding companies.

For his part, Senator Garn notes that there still are "large issues that we were not able to address" but which "have not gone away and will have to be dealt with fully and openly by the next Congress."

Just how congressional perspectives on the remaining "large issues" will be influenced by the forthcoming electoral festivities remains to be seen, but most assuredly, the issues of interstate banking and the continued viability of the selective restraints of the McFadden Act (whose branching restrictions do not apply to thrifts or money market funds) and of the Glass Steagall Act (whose restrictions on the formation of security subsidiaries apply only to national and state *member* banks—not to non-member banks) are certain to remain on the front burner.

California's legislature and the governments of some other states have recently authorized interindustry acquisitions by banks and thrifts and authorized both industries to operate money market funds. When actions on these as yet unresolved issues do come at the federal level, it may well be prompted, as past actions have been, by market developments and the actions of state legislators. Consequently, they, too may be "sero sed serio" —"late but earnest."

Verle Johnston

Research Department
Federal Reserve
Bank of
San Francisco

Alaska • Arizona • California • Hawaii
Idaho • Nevada • Oregon • Utah • Washington

PRESORTED
FIRST CLASS MAIL
U.S. POSTAGE PAID
PERMIT NO. 752
San Francisco, Calif.

FIRST CLASS

BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 9/29/82	Change from 9/22/82	Change from year ago Dollar	Change from year ago Percent
Loans (gross, adjusted) and investments*	162,511	427	9,345	6.1
Loans (gross, adjusted) — total#	142,650	452	10,435	7.9
Commercial and industrial	45,812	212	5,706	14.2
Real estate	57,567	5	2,867	5.2
Loans to individuals	23,517	47	319	1.4
Securities loans	2,652	– 99	1,127	73.9
U.S. Treasury securities*	6,568	25	877	15.4
Other securities*	13,293	– 50	– 1,967	– 12.9
Demand deposits — total#	38,473	– 369	– 3,910	– 9.2
Demand deposits — adjusted	26,694	– 760	– 1,826	– 6.4
Savings deposits — total	30,795	– 196	1,206	4.1
Time deposits — total#	100,653	340	15,318	18.0
Individuals, part. & corp.	90,584	215	13,189	17.0
(Large negotiable CD's)	38,019	90	4,163	12.3

Weekly Averages of Daily Figures	Week ended 9/29/82	Week ended 9/22/82	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves (+)/Deficiency (–)	88	81	222
Borrowings	70	10	99
Net free reserves (+)/Net borrowed(–)	18	71	123

* Excludes trading account securities.
# Includes items not shown separately.

Editorial comments may be addressed to the editor or to the author . . . . Free copies of this and other Federal Reserve publications can be obtained by calling or writing the Public Information Section, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco 94120. Phone (415) 544-2184.