RECORD OF SOCIETY OF ACTUARIES
1991 VOL. 17 NO. 1

WHAT LESSONS CAN WE LEARN FROM THE SAVINGS & LOAN MESS?

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- All aspects of the financial services industry that have significant real estate-related assets are troubled!
- Regulatory structure and its impact have changed and will continue to change; that's not the problem.
- GIGO, garbage in, garbage out; it's obvious, but it is also fatal.
- Where is the insurance industry in the three stages (denial, underestimation or solution) of this problem?

MR. GREGORY D. JACOBS: Dan Wall graduated from the University of North Dakota. He also graduated from the Hoover Institute at Stanford. He has basically been a public servant until just recently when he formed his own consulting firm. In 1962, he was the Executive Director of the Urban Renewal Authority in Fargo, North Dakota. He moved and did essentially the same thing in Salt Lake City. He hooked up with Mayor Jake Garn of Salt Lake City and worked as the Director of Legislation for Salt Lake City in the urban renewal area. Jake Garn then was elected senator. He approached Dan in 1975 and asked him to join him in Washington. Dan promptly did that and was Director of Legislation for Senator Garn until 1979. Senator Garn was a member of the Banking Subcommittee and moved on up to become chairman. Throughout that tenure Dan Wall was his prime support person. In 1987, President Reagan asked Dan Wall to become the chairman of the Federal Home Loan Bank Board. That was the predecessor to what we now know as the Resolution Trust Corporation (RTC). As I mentioned earlier, after his tenure there, which I'm sure he will tell us a little bit about, he is now heading up his own consulting firm in Washington, D.C.

Dan has been exposed to the national press. I have a few highlights here. In December 1987, the *Institutional Investor* said, "Even in Washington, D.C., where he has worked for the past 12 years, just about everyone agrees that Wall, the new Chairman of the Federal Home Loan Bank Board, is one of the nicest guys in town. To know him they tell you is to trust him. To hang around Dan Wall you can practically smell hot apple pie and hear the crack of a baseball bat. 'No doubt about it,' said one Capitol Hill staffer, 'Danny Wall is a real Boy Scout.'" A few things then happened. A June 1989 headline in *The Wall Street Journal* said, "Dan Wall, the S&L Looter's Water Boy." That was the low I believe. Interestingly enough, there may be some redemption. Today's *Wall Street Journal* has a headline that says, "Many Sweetheart S&L Deals of 1988 Failed to Bring Much Profit Last Year." The article says, "The 1990 results indicate that about three-fourths of the 1988 deals are making relatively ordinary profits or are even losing money, suggesting that the class of 1988 is having more difficulty making money in a continuously deteriorating real estate market or that Mr. Wall may have made many more reasonable decisions than

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bad ones. 'I personally believe that Wall took a bad rap for this one,' said Warren Heller of Veribank, a research firm."

MR. M. DANNY WALL: So what lessons can be learned from the S&L mess? What happened and why is perhaps a good place to start. I'll go through a very long list of events, circumstances, and developments that caused or permitted this problem to occur as it did. It wasn't any one person, it wasn't any one sector, it wasn't any one aspect of the savings and loan industry that caused or contributed to the problem. It is a long list. What happened and why totals over a dozen elements.

First of all, you can go back almost anywhere you want in time and begin the process. I go back no further than 1974 or 1975. In 1974-75, the Federal Home Loan Bank Board proposed to authorize something called alternative rate mortgages (ARMs), or variable rate mortgages (VRMs). It hadn't even settled on a particular name at that point. It proposed to authorize these mortgages and it didn't need legislation to do it. So the idea was sent up to the Hill advising the respective leaderships of the House and Senate Banking Committees that it was considering this particular authorization to be given to the industry for which it already had the legislative authority to do. A negative answer came back from the elected representatives who were leaders on the two committees. "Don't you dare do it. If you do we'll legislate against it and we'll undo what you do." So in 1974-75 the industry could have begun to be better positioned as far as its portfolio being more adjustable on the asset side in terms of interest rates than, indeed, it had the opportunity to be.

In 1978 and 1982, respectively, there were two different Federal Home Loan Bank Boards under two different Presidents, Carter and Reagan, from two different political backgrounds. The two different bank boards adjusted the required capital for the industry by one full percentage point each, taking the required capital from 5% down to 3%. In 1980, the interest rate deregulation legislation was passed deregulating the liability side, that is, the deposit side, but not deregulating the asset side. It was only beginning to permit the process of the variable rate or alternative rate mortgages at that point in the process and there was not enough other attention on the asset side in that time frame. After the interest rate deregulation, the liberal state charters began to kick into effect. I say "began to kick into effect" because Texas, as some of you are probably aware, didn't deregulate its charter. It always was very liberal. But as long as there were interest rate ceilings on how much an institution could pay for deposits it didn't make any difference. They could only get deposits from within their trade area, within their community. But when the interest rate ceilings were taken away in 1980, those existing very liberal charters were able to be utilized and exploited. In fact, we were off to the races.

By coincidence, two states in this part of the country, Texas and Louisiana, had very liberal charters without any legislative action being necessary after 1980. But additionally, other states joined then in the deregulation process. California deregulated its legislative structure as did Oklahoma, Utah, Ohio, and Florida. Florida changed its legislative structure five times; not just once but five times. I promise you they weren't making it tougher in any one of those five. So you begin to see that all of these different pieces were having an effect at the same time. There was insufficient state regulatory structure at the very time that these charters were beginning to be exploited and utilized under the state chartered structures.

The Texas stock structure in the industry was an anomaly in the whole country. In Texas, 95% of the S&Ls were state chartered, for obvious reasons. They could do anything they wanted to. As well, 95% of the institutions were stock structured as opposed to mutual and, of course, I don't need to explain to an insurance audience what the difference is. So there was the stock structure in Texas with no change of control restrictions or recording mechanisms whatsoever. You could simply buy stock in the open market and you were a banker in full control of an institution that offered full deposit insurance with no interest rate ceilings. You begin to see what could happen and why the concentration was in Texas. There was not enough federal staff, to be sure. There were hiring limits in place, pay limits in place, and job classification restrictions. An entrance level examiner's opening salary was $13,800 which was the salary of a secretary in the same time frame.

In that same time frame, the Federal Home Loan Bank of Little Rock moved to Dallas. Only 12 of the professional staff made the move. So at the worst possible time in terms of what was happening in Texas, there was no professional staff or virtually none with experience. There was a booming oil and gas economy in this part of the country that caused everyone to want to have assets in this part of the country. And I don't have to remind you of the failure of Penn Square Bank in Oklahoma City. Penn Square Bank failed on the 4th of July weekend in 1982 and took with it Seattle First National Bank, and for all intents and purposes, Continental Illinois National Bank. So problems were emanating from the energy boom and the bust that was occurring emanated even in the first experience on the bank side, not on the S&L side.

Federal tax incentives were put into place in 1981 and 1982. Those tax incentives caused noneconomic real estate projects to be undertaken. It's another piece of what has contributed to this evolution of problems. And, again, that kind of real estate incentive only caused there to be more focus on the Southwest. Continental Illinois Bank had bet on $75-a-barrel oil and it was seen as one of the finest underwriting credit originating organizations in the world in that time frame until its crash came in 1982.

In 1986, oil plunged to $10 a barrel. In 1986, the income tax incentives were taken away with no grandfather provisions. Congress said, "we told you in 1981-82 you could do these things because we wanted to stimulate real estate. Well, you've overdone it, guys. It's all your fault. We're going to take them away." So the real estate incentives were taken away with no grandfather provisions. There's been a recent nonpartisan, economic think tank in Dallas that's made a judgment that took away 17% of the commercial real estate value in the state of Texas. And in some sense they suggested there's a similar kind of proportion nationwide and a 9% proportion of the value in terms of residential real estate. And whether those numbers are right or not there instantly was a significant reduction of value, much less a chilling of the whole level of activity and all of what that causes, whether you are a builder or a material supplier or a furniture manufacturer or whatever your particular function was as it related to the building boom that was going up.

And then along came Dan Wall and his prophets in the time frame of being involved in the Federal Home Loan Bank Board. So I've identified all things that have occurred and I put them in chronological order. I haven't tried to put them in order of

significance. So I went there in July 1987, and in August 1987 Congress and the President finally finished work on recapitalizing the Federal Savings and Loan Insurance Corporation (FSLIC) which had been identified 19 months earlier as needing this recapitalization and needing $15 billion. The administration had asked in January 1986, for $15 billion of borrowing authority for the FSLIC in order for the industry to bail itself out by imposing higher premiums on itself in order to be able to borrow forward and then amortize that obligation as it went forward. Congress took 19 months to consider that request and then only approved two-thirds of what had been asked for 19 months earlier. So who was judging what the size of the problem was here? It wasn't Dan Wall. It was Congress saying, "Hey, it's not as bad as everybody says. It's not as bad as the administration says. We're going to provide $10.825 billion and you can only spend it in three years. You have to spend one-third of that a year for three years." So the Congress has very much been a part of the process and a part of the problem.

In October 1987 the stock market crashed. There's no question that fraud and mismanagement had existed through this whole period of time. As we're looking back the best judgments are that fraud and mismanagement existed in about 60% of the failures. It existed in about 60% of the failures, but it contributed to the failure or the insolvency in perhaps about 25% of the cases. So it's important to understand what the dynamic is there. Clearly, there are situations where fraud and mismanagement actually caused the institution to become insolvent, no question about it, about 25% of the cases. But there are many cases where because of the economy that they were dealing with, because of all of these things I've been talking about that were out of their control, they began to try to do things to save the farm, to bet the ranch, to bet the bank, however you want to think of it. And committed fraud or undertook mismanagement kinds of decisions. So those kinds of things existed in about 60% of the cases. They actually caused the problem in about 25% of the cases.

The Financial Institution's Reform Recovery and Enforcement Act (FIRREA) came in August 1989. It imposes higher capital standards on the thrift industry, thereby automatically causing there to be more institutions that have to be seized by the government than any of us had a way of projecting as we were trying to estimate what the size of the problem was. So the very legislation itself has caused there to be more seizures. I won't say failures because, in many cases, they're not insolvent, but they're capital-deficient and no one wants to invest in them because they are not a profitable situation in this kind of economy. And the deadline is such that they have to have this greater amount of capital by 1993, and they're not going to be able to get there unless we have some kind of immediate turnaround in the economy and nobody expects that. So the legislation itself in 1989 has caused the problem to be bigger in a financial sense.

And then, obviously, we're dealing with the current real estate recession as it has expanded out into other parts of the country and it is not now offset in this economy the way the Southwest problems in terms of real estate in the late 1980s were offset by the boom in other parts of the country. But the Southwest's resurgence ever so modest is not offsetting the problems in New England now and elsewhere in the country. So while we are a large country with regional economies, unfortunately,

right now the preponderance is down rather than up, whereas, as in the fine past it was up.

S&L bailout is a headline that's been seen often and it's about as inaccurate a term of reference as anyone could ever identify or think about. And you as insurance professionals know the kind of point that I'm making. We're not bailing out S&Ls. The S&L is dead. The management's gone. The stockholders are wiped out. There's no interest in those mutual institutions and the depositors are no longer. It's gone. What has been done is that the federal government through the FSLIC and its successor, the RTC, is making good on its deposit insurance pledge to the depositors, not to the institution. The depositors are being bailed out, no question about it. The depositors are being bailed out on the pledge that was made in 1933. And in 1933 when Congress created the Federal Deposit Insurance Corporation (FDIC) and then the FSLIC one year later, it established the premium for the banks to pay into this new fund of 25 basis points on their deposits. And it assigned insurance actuaries to look at the industry and to look at the history of bank failures going back to the passage of the National Bank Act just before the Civil War in 1863. It asked the actuaries to go back and evaluate what the premium should have been to have covered the losses that had occurred in the preceding several decades. A year later the actuarial community came back with its report and said 25 basis points wasn't right. It should be 33 basis points for the premium. And Congress promptly passed the legislation making it 8 basis points. So the seeds were sown for the failure of the FSLIC and the FDIC when they were created. It was a matter of time. We've read many times in the last several months that President Roosevelt opposed the FDIC and the FSLIC because he felt it was going to provide for this inappropriate guarantee to management. And he's now being proven right by those who would like to take that perspective. Well, we've now had over 55 years and we still haven't made the adjustments necessary, but we're beginning to move in that direction.

I make the observation that any entity that is in the real estate business today is troubled. And, again, I don't think I need to point out to you that many, many insurance companies are in the real estate business. And I understand that somebody has been propounding that I have some kind of a domino theory. The only time I think about Domino is once a month when we have pizza. I don't have any theories of dominoes or any cause and effect in that regard, but I do have a clear understanding that institutions, be they insurance entities, be they banks, be they individual investors, be they mutual funds, whatever, if they're in the real estate business they're troubled. Depending upon how well they've managed their risk and their exposure they may be insolvent or they may simply be troubled. And there's a lot of ground in-between but, indeed, there's a lot of wreckage in-between as well.

In those thoughts that I had shared in advance of this session I identified GIGO, garbage in, garbage out. And if there's one piece of experience I would identify for you and challenge all of you to use everyday, it's to challenge the data that you get. Challenge the numbers that you get. As I went through the 32 months in public office, we went through three different restructurings of the data collection mechanism that was there and when I got there there wasn't any. We had to start the first time with nothing in terms of trying to collect the data. And we were trying to collect the data in an economy in the Southwest that was in an absolute free fall. So

in the process, the examiners or the accounting profession, or whomever were trying to estimate the value of collateral that was plunging daily.

I'll give you a very real anecdotal piece of history that happened to me in that time frame. We had a problem with appraisers in Texas. They would go out in the field and do their work, come back, put it into the word processor, and before it was out they would refuse to sign it, because there were new comparables out there in the market. Somewhere else there had been a liquidation sale at a lower value. So all of us were trying to put a value on and do an evaluation of a market that was absolutely in free fall and we were being asked to do it in a 30-year time frame. Now that's not very impressive to you folks because of the time frames you have, but I've got to tell you in the government that Congress can't deal with an annual budget, much less we were being expected to be perfect with a 30-year projection. You know there's frustration. World class economists can't tell us when we're in a recession until they can tell us historically looking backward that we've been in it for three quarters. Yet we were supposed to make predictions for 30 years. Well, you can see it was an impossible kind of a process, but really what the whole thing was all about in that regard was there were all of these things that contributed that I've identified, some of which were private sector, some were public sector, some were on the legislative side, some were on the executive side, some were state, some were federal and there had to be some way to beat on the issue and why not a Boy Scout? No one in the process has questioned my integrity, my honesty, and my straightforwardness and think about that.

I have hardly talked about commercial banking but needless to say, commercial banking is in deep trouble. There's no question about it. In New England the financial institution sector banks and thrifts don't have to mark to market. If they did have to mark to market how many of those banks would be alive? In New York how many of the money center banks would be alive? There is deep hurt and deep difficulty out there; there are a lot of problems, no question about it.

But I look at that sector or I look at the insurance sector and begin to try to think of some of these theories and some of these tests that are put to this kind of a question. There are three stages of a problem that have been identified by psychologists, economists, politicians, theoreticians, or whomever. This is not any one terminology, but it's kind of a distillation of many different sources. The three stages of a problem are (1) denial, (2) underestimation, and (3) developing a solution. There are those in your profession, in your industry, who are in each of those three steps or in each of those three aspects of a problem. Many are still denying that there's a problem and, indeed, in their respective institutions there may not be. But, ladies and gentlemen, there's a problem in the industry. There's no question about it and it's in real estate.

I ran into a friend of mine in Washington the other day who has a number of corporate clients, one of which is a national insurance company. His insurance company client is paying one million a week to the state guaranty fund. A few weeks ago I made a speech in Orlando to an audience of business people. I said that none of them could identify an insurance company that has failed and yet the hurt is that big, so as to cause one company to have to pay $1 million a week. Two points. The irony was the next day the North Carolina Insurance Commissioner closed an institution in Orlando, Florida. So I know there were a lot of people waking up and

saying, "Wall was right on." And the other point is, of course, we now are all looking at First Executive. So I can no longer challenge an audience without being able to identify an institution that's failed but, on the other hand, I don't know what the updated number is going to be to that $1 million a week and there's no way to budget for it.

There is excess capacity in this country in financial institutions. That's part of the problem as well. In Texas alone there were 1,800 branches of savings and loans. There were 1,700 banks, not branches, banks. The Constitution of the State of Texas did not permit branch banking until 1986. We have an overcapacity and we're wringing it out the worst possible way through insolvency, through failure, through a lot of blood on the ground. There is overcapacity whether we're talking about banks, thrifts, credit unions, or insurance companies and we have to deal with it.

What do we do about real estate? I don't have any magic formulas, but one writer's theory that I've seen recently and that I like and that makes sense to me is a way of trying to deal with some of the aspects of the real estate incentives that were put into place in the Tax Act in 1981-82 and then taken away in 1986. The suggestion is that we reduce the capital gains tax, that we have a shorter capital recovery period, which is to say depreciation, and that we eliminate the passive investor rules. We've got to get out of this recession by housing as typically is the case at least in the near term.

I would like to sum up some odds and ends here and then look to your questions. The Federal Reserve did a review of what's happening to savings and where those savings are entrusted in this country. The two years of comparison are 1946 and 1989, and these are Fed statistics. The insurance industry in 1946 had 23.3% of the savings. In 1989, it had 16.8%, down by a third of the total. Obviously, dollars are up significantly. Banks had 57.3% in 1946. They had 30.9% in 1989, down by a half. The S&Ls and savings banks had 12.3% in 1946. In 1989, they had 14.6%, a modest increase and, of course, that increase has been lost as a market share as there have been failures in that industry. Credit unions have had an unbelievable growth but, obviously, on a small base. In 1946, .2% was in savings; today, there is 2.1%, ten times the amount. And of course, the increase occurred in real numbers in the pension sector. The pensions in 1946 had, 2.7%. In 1989, they had 19%. The savings have been moving around. They have been moving around for a lot of different reasons. Some of it is out of the control of individuals. In pensions, for example, there are more firms that offer pension funds and so on and some of it was in their control had they been chasing after quality.

Credit crunch. Those are two words we hear a lot these days and I'll give you one anecdotal example of why it's significant and how it can happen so quickly. A friend of mine is in the bank analytical business, bank analysis. He looked at two states, Connecticut and Massachusetts, the two states he knows best. He grew up in one and went to school in the other. There are 400 financial institutions in those two states, banks and savings and loans and savings banks, co-op banks and so on. But he only looked at 39 of them, which is to say 10% of the institutions in those two states. Those 39 institutions in the fourth quarter last year lost $4 billion in capital; $4 billion out of 10% of the institutions in Massachusetts and Connecticut. If you put a simple 10 leverage on that, and many would observe that a more accurate

leverage of capital to the size of an institution and credit offered would be 17, that's $400 billion of credit that's not available. So there is a credit crunch, a very real credit crunch and it is not over yet, no question about that. Now we're dealing and we're looking at accounting changes. The accounting profession is trying to tighten up and provide for some more tidiness in its backyard. I can't make any simplistic observations. Maybe I can't because I'm not a politician. They have them, but I don't. There the question is, is the accounting profession going to paper over the problems or is it going to make a realistic representation of what's out there? That's the challenge for the accounting profession and it has that challenge today like it has never had it before. And more and more it is being looked to.

For my closing thought, back to the war in the Persian Gulf, many have said that the United States had to go to Kuwait's assistance, because in August 1990 after the invasion, Kuwait was a banking system without a country and the United States was a country without a banking system. So I would very much like to hear your observations, comments, or be able to answer your questions if I might.

MR. ROBERT J. LAUX: Mr. Wall, I have not heard the words "junk bonds" in your talk yet. I was wondering what you think the role of those were in the S&L debacle?

MR. WALL: The junk bond is another aspect of where Congress overreacted in the FIRREA legislation in 1989. It predetermined that the junk bond market was going to have serious problems by telling the thrift industry it had five years to unload it. The accounting profession says that means there is a market to market today. So whether they were healthy or not, the industry was faced with having to reprice its junk bonds. The junk bonds in the thrift industry were part of the problem, not a significant part, other than in perhaps three institutions. In terms of the junk bond investor, clearly, First Executive outshines everybody. But there's no question. There is an aspect of the problem that's junk bond related, but in the thrift industry it had all these other things happen. Those three institutions perhaps would have failed and not much else.

FROM THE FLOOR: You were close to the process through the years on the staff of the Senate Banking Committee. Why was it that the politicians, the elected representatives, acted in a perverse way?

MR. WALL: For a lot of reasons, not the least of which is politics, and for money for reelection. And underlying the whole strength of the S&L industry in Congress, in Washington, before these problems we've talked about, was its contribution to housing the families of this country, which was real. Many of the elected people who are in Washington have been there too long. They think the world is the way it was when they were out there making a living before they went to Washington. There are a lot of different reasons. And some of them, indeed, perverse. Some of them have been identified as illegal and have been criticized in other cases. Some have decided to resign their positions rather than be put to the test, rather than be examined. I think there are many stories there that will never be told, but you're right. They made perverse decisions in a substantive sense. You really can't forget the politics and forget the campaign financing, but let me come to the substantive side because I think it's important that you understand there are those aspects as well. On the substantive side of things the members of Congress do not have a long

enough time horizon. They are critical of corporate America but are only concerned with its next quarterly report. Congress is only concerned with its next 20-second sound byte and I mean that in a substantive way. I don't mean that in a partisan way.

Why wasn't the S&L problem an issue in the Presidential campaign in 1988? I'll take a minute to give you a little 24-hour history here. Candidate Dukakis put out a one-page critique on what Vice President Bush had done as the chairman of the Bush task force looking at regulatory structure, not the industry itself, but how it was regulated. But Dukakis tried to make that some kind of criticism that Bush ought to know the problem, and ought to be able to deal with the problem. Michael Dukakis, candidate for President from the Democratic Party, has as a running mate Senator Lloyd Bentsen of Texas. His backyard was burning up in an S&L sense. It was crashing. Can you imagine the phone call that went from Senator Bentsen to Dukakis asking him what he was doing with that one-page criticism? That's behind the scenes. What happened in front of the cameras was that the Republicans went to the floor of the Senate. Republicans went to the floor of the House and criticized Democrat involvement in the Congress and Democrat involvement among candidates for President who had been in the chase earlier and the whole process had a 24-hour half-life. Because in a political sense everybody had their hands on it and their fingers in it. A long answer but, obviously, a very complicated universe.

FROM THE FLOOR: What do you think as to the appropriateness of deposit insurance, government sponsored, vis-a-vis, the management of the chartered institutions?

MR. WALL: Our country's financial institutions have had much more stability than any other country's financial institutions since FDIC. Really FSLIC in an international sense is insignificant. FDIC was in place. There's no question that has contributed to stability in this country, has maintained liquidity at times that otherwise would have been calamitous. There clearly are problems on the other hand. It was underpriced and there needs to be some way to relate the risk to the amount of capital that an institution has to have and/or the risk to the amount of premium it has to pay. Well, an international agreement now has struck a risk-based capital formula, so that's being phased into place. So there is one side to that set of options and I think a logical addition would be to try somehow to provide for at least some modicum of risk base for the premium as well. Somebody's going to have to play God. There's no question about it and that's the problem the politicians have in that area. And they were told they ought to have risk-based deposit insurance premiums a few years ago. And they couldn't come to grips with it because somebody was going to play God. Somebody, some bureaucrat was going to decide as to whether the president (whom they played golf with) of that bank in their home town, was running an institution that had one-third of its portfolio in Class one or Class two riskiness in a sense. Well, somebody's going to have to play God.

FROM THE FLOOR: With the ability or inability that banks and S&Ls have had to run their own business in the last few years, what is your view of their getting into the insurance business?

MR. WALL: I think there's no question they ought to be permitted to be in the insurance agency business. There would be very little risk in a fiduciary sense. But they are not ready for insurance company business. I would have the same kind of answer with more explanation required for the securities business. There are certain financial commercial banks that are better underwriters of securities than many of our securities firms are, but that doesn't mean they all ought to be permitted to get the business. Those are the kinds of problems you have and really that's the way it's working right now. A few banks have been able to get more securities powers from the regulators on a case-by-case basis and maybe that's the best way. Certainly, it's the only way that's been able to happen.

FROM THE FLOOR: Should there be some sliding scale on whatever portion is covered?

MR. WALL: It seems to me that makes sense. It seems to me that is something that Congress might bring itself to do but not in the near term. I just don't see a willingness on the part of Congress to bite that kind of a bullet. There wouldn't be a lot of private anguish from depositors back home, but because they can move their money there would be cries of anguish from financial institutions that are fearful. In fact, they would see disintermediation occur. No question about that.

FROM THE FLOOR: Should we be covering 100% of the deposits or up to the $100,000 limit in institutions?

MR. WALL: The extreme is always what's looked at in Washington, but it is a logistical problem and I'll give it to you very quickly. Continental Illinois Bank was teetering in 1982, as I've indicated earlier. The bank regulators, the FDIC, made the assessment that it didn't have enough computer time or capacity and that it didn't have enough blank check stock to pay out the deposits in Continental Illinois Bank. Now that's a real problem. On the other side of it, there were 2,000 banks in the Midwest for whom Continental Illinois was a correspondent bank, meaning 2,000 banks had much more than $100,000 in Continental Illinois and would have lost everything over $100,000. How many of those 2,000 would have failed? In other words, what kind of a domino process would have occurred in that situation? Perhaps the most conservative guess I've heard was that 200 would have failed. What would it have been like to one day see 200 institutions fail in the Midwest in that time frame when that part of the country was hard hit with drought and farm prices that were down significantly? So there are those kinds of logistical problems that are somewhat of a limitation. The FDIC, the RTC, or before that the FSLIC made 100% payouts or gave 100% assurance.

But on the other side let me tell you another one. And that is that the law says that we are to take the least costly course of action for the insurance fund and we will get a better price on institution A. Forget Continental. Let's talk about a $200 million institution in Nowhere, South Dakota. You get more of a premium for that institution when you sell it to an acquiring entity, when you sell $200 million worth of deposits, than if you sold $150 million and you had just caused $50 million worth of those deposits to have been lost. That means under that criterion the least costly course of action would be to cover all the deposits and sell them, because it costs you more

than the difference to have sold the deposits in only the insured form and only to the insured levels, so those kinds of limitations are there as well.

FROM THE FLOOR: The S&Ls by law were mandated to lend mortgages long and borrow short.

MR. WALL: When their regulator in 1974-75 wanted to adjust ever so slightly that lending long side and at least price it to the market with a variable factor, the S&Ls weren't permitted by Congress to do it. It was predestined to fail. Everybody tries to give the 10-second answer to the problem. If I were to take one thought and identify it as to what has caused or contributed to or in a major way permitted this to happen, I would say to you in 1980 if I had told you that we were going to have ten years, now into the eleventh year, where we would have average inflation of less than 4%, you would have thought I was nuts. But we have had inflation on average of less than 4% in the last ten and a half years. We could previously heal a lot of hurt by inflation and movement in real estate. It has certainly contributed to the problem that we're dealing with in many, many ways.

FROM THE FLOOR: I heard some very cynical speculations that one of the major reasons the U.S. is involved with Kuwait is that it was necessary to protect the Kuwaiti investors in the U.S. Do you think the banking system is really that vulnerable to a pull-out by foreign deposits?

MR. WALL: It is foreign depositors who actually triggered Continental Illinois' failure. Billions of dollars left overnight. So in a very real sense, a bank, a major world-class money center bank, did fail when foreign depositors lost faith. Now they had good reason, no question about that and it was internal, domestic reasons, not international reasons why that occurred. I have to say I didn't take anyone seriously who thought that about the Kuwait investments. Now there is a lot of money, but I don't think that was an aspect of it at all. Because we are a debtor nation in this situation, whether you're talking about a debtor nation in the private sector sense or a debtor nation in our government sense, we are looking to other countries to invest in this country and to continue doing so or there is going to be a lot of hurt here.