

1988

Enhancing the Value of the Thrift Franchise: A Possible Solution for the Dilemma of the FSLIC?

C. Thomas Long

William J. Schilling

Carol R. Van Cleef

Follow this and additional works at: <https://scholarship.law.edu/lawreview>

Recommended Citation

C. Thomas Long, William J. Schilling & Carol R. Van Cleef, *Enhancing the Value of the Thrift Franchise: A Possible Solution for the Dilemma of the FSLIC?*, 37 Cath. U. L. Rev. 385 (1988).

Available at: <https://scholarship.law.edu/lawreview/vol37/iss2/5>

This Symposium is brought to you for free and open access by CUA Law Scholarship Repository. It has been accepted for inclusion in Catholic University Law Review by an authorized editor of CUA Law Scholarship Repository. For more information, please contact edinger@law.edu.

ENHANCING THE VALUE OF THE THRIFT FRANCHISE: A POSSIBLE SOLUTION FOR THE DILEMMA OF THE FSLIC?

C. Thomas Long,* William J. Schilling,** and Carol R. Van Cleef***

The plight of the nation's thrift industry¹ has been daily, and often front page news since the early 1980's when the devastating effects of a combination of external pressures and internal changes became evident. Plagued by extremes in economic conditions, beset by inconsistent governmental policies, and faced with increased competition and dwindling resources, the industry today struggles for its very survival. As the tumultuous decade of the 1980's nears an end, the industry has reached a critical juncture: Will it survive as a separate industry or will it be absorbed into another segment of the financial services industry?²

* Partner, Jones, Day, Reavis & Pogue.

** Of Counsel, Jones, Day, Reavis & Pogue.

*** Associate, Jones, Day, Reavis & Pogue. The authors would like to express their appreciation for the contribution of Lauren A. Mogensen.

1. The thrift industry is comprised of several distinct types of financial institutions including savings banks, credit unions, and savings and loan associations. Although each type of institution serves a different constituency and function, the underlying purpose of each is to encourage savings by the public. Savings banks were organized to encourage savings by the so-called "laboring poor." See C. GOLEMBE, H. CARTER & D. HOLLAND, *FEDERAL REGULATION OF BANKING*, 1986-87, at 9 (1986). Groups with a common bond, such as churches, established credit unions "to offer low income persons an alternative to usurious loan rates." *Id.* at 9-10. The most common form of thrift institution, the savings and loan association, was formed to facilitate the pooling of savings from which an individual member could borrow to finance the purchase of a home. FEDERAL HOME LOAN BANK BOARD, *A GUIDE TO THE FEDERAL HOME LOAN BANK SYSTEM 5* (1987) [hereinafter *FHLBB GUIDE*]. This Article principally focuses on savings and loan associations and savings banks insured by the Federal Savings and Loan Insurance Corporation (FSLIC).

2. Absorption of the thrift industry could occur in one of several ways. First, the current form of the savings and loan association may become a special type of bank, e.g., the consumer bank. See H.R. 3209, 100th Cong., 1st Sess., 133 CONG. REC. H7351, E3398 (daily ed. Aug. 7, 1987); *Deposit Insurance Reform and Related Supervisory Issues: Hearings Before the House Comm. on Banking, Housing, and Urban Affairs* (pt. 2), 99th Cong., 2d Sess. 117 (1986) [hereinafter *Deposit Insurance Reform Hearings*] (statement of George D. Gould, Undersecretary of Finance, U.S. Department of the Treasury). Second, the banking industry may absorb the savings and loan industry entirely into the banking industry either by conversion, merger, or purchase and assumption transactions or as the result of a merger of the FSLIC into the Federal Deposit Insurance Corporation (FDIC), the corporation responsible for insuring the de-

Regardless of how this question is answered, the thrift industry faces the task of recapitalizing itself.³ To remain viable, most stronger institutions require additional capital to sustain the risks of activities necessary to be competitive, while weaker members require capital infusions to support existing interest payments and other liabilities.⁴ Moreover, as the industry's financial condition has worsened, so has the condition of the Federal Savings and Loan Insurance Corporation (FSLIC), the federal entity responsible for insuring the deposits held by the thrift industry.⁵ Without additional sources of capital, the insurance fund cannot survive;⁶ the demise of the insurance fund would destroy depositor confidence and guarantee the elimination of the industry in its current form.⁷

The industry's current financial weakness is indisputable: the existing level of interest-bearing assets cannot support the extent of the industry's nonearning assets and exposure to interest-rate risk. Even the demise of a separate thrift industry structure, however, would not eliminate the need for new capital. The nearly \$1.2 trillion of assets and \$909 billion of deposits held in member thrifts simply will not vanish.⁸ Without additional sources of capital, the absorbing industry, regardless of whether it is the banking or

posits of commercial banks and certain other banking organizations. *See infra* notes 360-78 and accompanying text. Third, the savings and loan industry, as well as the commercial banking industry, may amalgamate with other financial service companies, including securities and insurance firms that offer similar financial products. *See* S. 1905, 100th Cong., 1st Sess., 133 CONG. REC. S16,857 (daily ed. Dec. 1, 1987); *see also* S. 1891, 100th Cong., 1st Sess. 2, 133 CONG. REC. S16,675-92 (daily ed. Nov. 20, 1987); E. CORRIGAN, FINANCIAL MARKET STRUCTURE: A LONGER VIEW 34 (1987); *Remarks by Secretary of Treasury, James A. Baker Before the Garn Institute*, Treasury News, Jan. 12, 1987, at 5-6.

3. *See infra* notes 272-91 and accompanying text.

4. *See infra* notes 241-46, 286-87 and accompanying text.

5. *See infra* notes 247-69 and accompanying text; *see also* S. REP. NO. 19, 100th Cong., 1st Sess. 18, *reprinted in* 1987 U.S. CODE CONG. & ADMIN. NEWS 489, 508; S. REP. NO. 536, 97th Cong., 2d Sess. 3-4, *reprinted in* 1982 U.S. CODE CONG. & ADMIN. NEWS 3054, 3057-58.

6. *See generally* U.S. GENERAL ACCOUNTING OFFICE (GAO), THRIFT INDUSTRY: COST TO FSLIC OF DELAYING ACTION ON INSOLVENT SAVINGS INSTITUTIONS (1986); GAO, FINANCIAL AUDIT: FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION'S 1986 AND 1985 FINANCIAL STATEMENTS (1987) [hereinafter FINANCIAL AUDIT].

7. Horvitz & Pettit, *Short Run Financial Solutions for Troubled Thrift Institutions*, in FUTURE OF THE THRIFT INDUSTRY 44, 65 (Federal Reserve Bank of Boston Conference Oct. 1981); Horvitz, *Merger May Be Wise in the Long Run But Won't Solve FSLIC's Woes*, Am. Banker, Apr. 10, 1987, at 10, col. 1; Day, *U.S. Aide Prods Congress on FSLIC*, Wash. Post, Jan. 22, 1987, at C1, col. 2; Easton, *Is a Separate Thrift Industry Really Necessary?*, Am. Banker, Jan. 5, 1987, at 9, col. 2.

8. Progress of the Recapitalization of the FSLIC: Hearings Before the Subcomm. on General Oversight and Investigations of the House Comm. on Banking, Housing, and Urban Affairs, 100th Cong., 2d Sess. chart 1 (Feb. 4, 1988) [hereinafter Progress of the Recapitalization of the FSLIC] (unpublished statement of M. Danny Wall, Chairman, Federal Home Loan Bank Board (FHLBB)).

an amalgamated financial services industry, will be required to make its own capital resources available.⁹

The use of the absorbing industry's capital presents several problems. First, the impact of the absorption on the market value of the acquirer affects the ability of the survivors, individually and collectively, to attract capital. Raising additional capital would most heavily burden industries that already suffer from declining profitability, such as the banking, the securities, and the insurance industries.¹⁰

Second, absorption by individual entities, especially within the banking industry, may face significant regulatory hurdles. Bank regulators scrutinizing the impact of the proposed absorption on the acquirer could deny a proposal if the capital of the surviving entity was insufficient or if the risks of absorption appeared excessive.¹¹ Alternatively, regulators could force the absorbing institution to limit the range of its operations until the institution restored appropriate capital levels.¹²

Finally, serious questions exist as to the financial condition of the Federal Deposit Insurance Corporation (FDIC), the insurance fund protecting commercial bank deposits.¹³ The FDIC possesses limited resources¹⁴ and could

9. See *supra* note 2.

10. See *infra* note 12. The steady decline in bank profitability during the 1980's is attributable to asset quality. The inability to improve return on equity, as well as uncertainty about asset values has complicated the efforts of banking institutions to raise additional capital. FDIC, MANDATE FOR CHANGE: RESTRUCTURING THE BANKING INDUSTRY 13 (1987). The securities and insurance industries also have experienced declining profitability during the 1980's. From 1981 to 1983, the pretax profit margin for the securities industry averaged 12%. This margin declined to less than 9% from 1984 through the first three quarters of 1987. *Securities Industry Still a Top-notch Performer*, P.R. Newswire, Dec. 3, 1987, at 1. See generally REPORT OF THE PRESIDENTIAL TASK FORCE ON MARKET MECHANISMS (1988) (Brady Commission Report). In 1986 the insurance industry had to enact rate increases of up to 500% in an effort to regain profitability. Abramowitz, *Coverage Set to Resume for Midwives*, Wash. Post, July 23, 1986, at G1, col. 2.

11. See 12 U.S.C. §§ 3707(b), 3909 (1982); 12 C.F.R. § 225, app. A (1987); *id.* § 325.3(c)(4) (1987); see also Nash, *Banking Plan Seen Impeding Mergers*, N.Y. Times, Feb. 1, 1988, at A1, col. 1.

12. See, e.g., 12 C.F.R. §§ 3.10, 325.3(d)(2) (1987); see also COMMITTEE ON GOVERNMENT OPERATIONS, MODERNIZATION OF THE FINANCIAL SERVICES INDUSTRY: A PLAN FOR CAPITAL MOBILITY WITHIN A FRAMEWORK OF SAFE AND SOUND BANKING, H.R. REP. NO. 324, 100th Cong., 1st Sess. 26, 72 (1987) [hereinafter MODERNIZATION OF THE FINANCIAL SERVICES INDUSTRY].

13. Bank failures among institutions insured by the FDIC currently are at record levels. In the 30 years between 1945 and 1975, only 165 FDIC-insured banks failed. An additional 64 FDIC-insured banks failed between 1976 and 1980. 1986 FDIC ANN. REP., 53 (1987). Since 1981, the number of failures has increased steadily. In 1981, 10 FDIC-insured banks with total assets of nearly \$5 billion were closed. *Id.* In 1983, that number climbed to 48 banks with total assets in excess of \$7 billion. *Id.* In 1986, the number of failed banks reached 138 with total assets of approximately \$7 billion. *Id.* In the same year, an additional seven banks received \$161 million in financial assistance to avert failures. FDIC, 1986 BANK FAILURES &

be imperiled if forced to assume the burdens of a weakened savings and loan industry.¹⁵

Ultimately, the most likely key to increased capital formation in the thrift industry will be the enhancement of the value of the thrift charter. This value, however, has suffered from many of the same problems contributing more generally to the industry's financial troubles, such as inconsistent governmental policies, an inappropriate mix of asset and liability powers, and increased competition.

This Article reviews the philosophical and statutory predicate for the thrift industry and examines the causes of some of the problems contributing to the industry's current plight. It also reviews previous legislative and regulatory attempts to address such problems, and then considers those elements of both statutory and regulatory policy that aggravated or perpetuated these problems. Finally, this Article suggests a number of steps that, individually and collectively, may serve to increase the value of the thrift franchise. Some of these suggestions may require congressional action, some may be accomplished through regulatory change, and some are attainable through industry initiative. In any case, the current condition of the thrift industry demands prompt attention to these and other proposals.

I. PHILOSOPHICAL AND STATUTORY PREDICATE FOR TODAY'S THRIFT INDUSTRY

Unquestionably, the United States' thrift industry is in a state of flux. As it has attempted to come to grips with the causes of its problems, the industry finds itself confronting the very philosophical and legal tenets that gave rise to its existence. These tenets, however, are proving to be a double-edged

ASSISTANCE TRANSACTIONS LISTING (1987). Another record was set in 1987 as 184 banks failed, and 19 banks in danger of failing received financial assistance. FDIC, Press Release No. PR-23-88 (Feb. 1, 1988). Although FDIC-insured banks historically have received annual credits against their premium payments, as provided for in the FDIC's statutory assessment formula, no assessment credit was allowable in 1985 and 1986. 1986 FDIC ANN. REP. x (1987); 1985 FDIC ANN. REP. iv (1986); see also *Financial Condition of Federally Insured Depository Institutions: Hearing Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 100th Cong., 1st Sess. 2 (1987) (statement of L. William Seidman, Chairman FDIC); *FDIC Faces First Loss Ever*, N.Y. Times, March 29, 1988 at 18, col. 6.

14. At year-end 1987, the FDIC insurance fund had an estimated \$18.3 billion in net worth, an amount that approximated net worth at year-end 1986. FDIC, Press Release No. PR-44-88 (Mar. 1, 1988).

15. FDIC Chairman L. William Seidman stated "the conversion of many [FSLIC-insured institutions] to FDIC insurance would most likely be another harmful move. It would further weaken [the] FSLIC by taking out the strongest and largest thrifts, and it would weaken [the] FDIC because your capital requirements [of FSLIC-insured institutions] are still so different from those required of banks." Remarks of L. William Seidman, Chairman, FDIC, Before the U.S. League of Savings Institutions (Nov. 9, 1987); see also 52 Fed. Reg. 21,736 (1987).

sword: they justify a separate financial structure while, at the same time, they hinder the evolution of an economically viable industry capable of providing competitive and quality services to its customers.

The savings and loan association charter¹⁶ was born of a need in the early 1800's to provide a group of individuals with the means to pool their savings through small, regular contributions, with the intent of providing each member with an opportunity to borrow from the pool to finance the purchase of a home.¹⁷ It has been estimated that between 1831, when the United States' first cooperative home-financing society formed, and 1932, savings and loan associations financed the purchase of more than three million homes.¹⁸

For nearly one hundred years, all savings and loan associations were chartered under state law¹⁹ because federal charters were not yet authorized.²⁰ In addition, most institutions were mutual in form during this period.²¹

The Depression decimated the industry.²² Many institutions closed,²³ and the unfavorable economic conditions discouraged the chartering of new institutions. As a result, the nation lost its traditional source of funds for mortgage loans, the home building industry collapsed, and many individu-

16. The term "savings and loan association" is generally used to refer to a number of types of institutions including building and loan associations, cooperative banks, homestead associations, building associations, and savings associations. See A. CARRON, *THE PLIGHT OF THE THRIFT INSTITUTIONS* 2 (1982). Originally, these institutions may have performed slightly different functions or may have been authorized to engage in different types of activities. Over time, however, many states eliminated separate charters for each type of institution, although existing institutions were grandfathered. See *id.*; see also IND. CODE ANN. §§ 28-1-21.2-1, 28-5-1-21 (Burns 1987); OHIO REV. CODE ANN. § 1151.01 (Anderson 1986).

17. FHLBB GUIDE, *supra* note 1, at 5; C. GOLEMBE, H. CARTER & D. HOLLAND, *supra* note 1, at 9.

18. See 78 CONG. REC. 12,588 (1932) (discussing the beginnings and subsequent growth of thrift institutions); see also FHLBB GUIDE, *supra* note 1, at 5-6.

19. See FHLBB, *AGENDA FOR REFORM: A REPORT ON DEPOSIT INSURANCE TO THE CONGRESS* 55 (1983) [hereinafter *AGENDA FOR REFORM*].

20. Federal charters were unavailable until the enactment of the Home Owners Loan Act of 1933, Pub. L. No. 73-43, 48 Stat. 128 (codified as amended at 12 U.S.C. §§ 1461-1470 (1982 & Supp. IV 1986) [hereinafter *HOLA*]). See *infra* notes 34-37 and accompanying text.

21. See FHLBB GUIDE, *supra* note 1, at 65. "Mutual institutions are mutually owned by all of the institution's savers and borrowers, who elect the institution's board of directors." *Id.* Each saver generally is entitled to vote in accordance with the size of his account. *Id.* Traditionally, mutual institutions have granted savers one vote for every \$100, or fraction thereof, held in savings in the institution up to a maximum limit. *Id.* A borrower may cast one vote. *Id.*

22. See FHLBB GUIDE, *supra* note 1, at 8.

23. In 1930, there were 11,777 savings and loan associations with total assets of \$8,829,000. FHLBB, *ASSET AND LIABILITY TRENDS* 1985, at 4 (1986). By 1932, the number had fallen to 10,915 with total assets of \$7,737,000. *Id.* By 1936, the number of institutions had declined further to 10,042 associations with total assets of \$5,772,000. *Id.*

als, unable to refinance their mortgages, lost their homes through foreclosure.²⁴ Responding to this crisis, Congress enacted legislation between December 1931 and May 1934 to create the savings and loan system that exists today.²⁵

President Herbert Hoover urged the first step—the creation of a central credit facility. President Hoover wrote to Congress that establishment of the Federal Home Loan Bank System was required immediately in order to revive employment by facilitating new home construction, to mitigate the difficulties of refinancing mortgages on homes and farms, and to encourage home ownership.²⁶ Responding to Hoover's directive, Congress enacted the Federal Home Loan Bank Act (FHLB Act),²⁷ authorizing the creation of the Federal Home Loan Bank Board (FHLBB) and eight to twelve federal home loan district banks to address the problems facing homeowners unable to refinance mortgage loans. The conference committee wrote:

This measure is an important and integral part of the comprehensive program for economic recovery undertaken by Congress. . . . [N]o consideration has [previously] been given to the home owner who, after all, is the backbone of our Nation. Mortgages have been foreclosed; families have lost their homes and the savings they have had in them, and many wage earners who own property are in want. A great injustice results if those who own their own homes are not given relief in the present emergency and provision made to prevent a recurrence of the present distress. The home loan bank system will serve the wage earner and people in the humbler walks of life, through serving those institutions which are devoted to helping them accumulate their savings for the "rainy day" and also helping them to own their own homes.²⁸

The federal home loan bank plan was a voluntary system allowing "[a]ny building and loan association, savings and loan association, cooperative bank, homestead association, insurance company, or savings bank" to be-

24. FHLBB GUIDE, *supra* note 1, at 9. "By 1933, 40% of the country's \$20 billion home mortgage debt was in default, and, through foreclosures, Americans were losing their homes at a rate of 26,000 per month." *Id.*

25. See National Housing Act, Pub. L. No. 73-479, 48 Stat. 1246 (1934) (codified as amended at 12 U.S.C. §§ 371, 1131g-1, 1422, 1426, 1430-1431, 1462-1463, 1701-1703, 1705-1742 (1982 & Supp. IV 1986)) [hereinafter NHA]; Federal Home Loan Bank Act, Pub. L. No. 72-304, 47 Stat. 725 (1932) (codified as amended at 12 U.S.C. §§ 1421-1449 (1982 & Supp. IV 1986)) [hereinafter FHLB Act]; HOLA, Pub. L. No. 73-43, 48 Stat. 128 (codified as amended at 12 U.S.C. §§ 1461-1468 (1982 & Supp. IV 1986)); 41 U.S.C. § 22 (1982), *amended by* 41 U.S.C.A. § 22 (West Supp. 1987).

26. 76 CONG. REC. 1263 (1932).

27. FHLB Act, Pub. L. No. 72-304, 47 Stat. 725 (1932) (codified as amended at 12 U.S.C. §§ 1421-1449 (1982 & Supp. IV 1986)).

28. H.R. REP. NO. 1418, 72d Cong., 1st Sess. 10-11 (1932).

come a member.²⁹ The privilege of membership was the right to borrow necessary funds from the federal home loan bank by placing mortgages with the bank to secure the loans.³⁰ Congress envisioned member institutions using the borrowed funds to refinance existing loans, carry worthy borrowers who were having difficulty meeting interest or installment payments, assist borrowers in paying taxes and insurance costs, and provide a source of funds to refinance short-term mortgages that were called for payment as a result of bank failures and financial institutions converting their resources into liquid funds.³¹ Permanent capital for the district banks was supplied by member institutions' subscriptions for district bank stock in an amount equal to one percent of the home mortgages such members held.³² The federal home loan banks raised additional funds by selling bonds.³³

One year later, Congress passed the Home Owners' Loan Act of 1933 (HOLA).³⁴ The preamble to the HOLA stated that the purpose of the statute was to authorize the FHLBB to charter *federal* savings and loan associations "[i]n order to provide *local* mutual thrift institutions in which people may invest their funds and in order to provide for the financing of homes."³⁵ The HOLA authorized the establishment of a federal savings and loan association in any community unless the establishment of such an institution would cause undue injury to existing local thrift and home financing institutions.³⁶ As Senator Robert Bulkley stated, "[t]hese associations [were] intended to be permanent associations to promote the thrift of the people in a cooperative manner, to finance their homes and the homes of their

29. FHLB Act, Pub. L. No. 72-304, 47 Stat. 725, 726 (codified at 12 U.S.C. § 1424(a) (1982)). In order to become a member of a federal home loan bank, an institution must: (1) [be] organized under the laws of any State or of the United States; (2) [be] subject to inspection and regulation under the banking laws, or under similar laws, of the State or of the United States; and (3) make[] such home mortgage loans as in the judgment of the [FHLBB], are long-term loans. . . . No institution shall be eligible to become a member . . . if, in the judgment of the [FHLBB], its financial condition is such that advances may not safely be made to such institution or the character of its management or its home-financing policy is inconsistent with sound and economical home financing, or with the purposes of this chapter.

Id.; see also 12 C.F.R. § 523 (1987).

30. H.R. REP. NO. 1418, 72d Cong., 1st Sess. 5 (1932).

31. 75 CONG. REC. 12,588 (statement of Rep. Reilly).

32. FHLB Act, Pub. L. No. 72-304, 47 Stat. 725, 727 (1932) (codified as amended at 12 U.S.C. § 1426(c)(1) (1982)). Today, "[t]he original stock subscription price of each institution eligible to become a member . . . shall be an amount equal to 1 per centum of the subscriber's aggregate unpaid loan principal, but not less than \$500." 12 U.S.C. § 1426(c)(1) (1982).

33. FHLB Act, Pub. L. No. 72-304, 47 Stat. 725, 729 (1932).

34. Pub. L. No. 73-43, 48 Stat. 128 (codified as amended at 12 U.S.C. §§ 1461-1468 (1982 & Supp. IV 1986)).

35. *Id.* at 132 (codified at 12 U.S.C. § 1464(a)(1) (1982)) (emphasis added).

36. *Id.* at 133 (codified at 12 U.S.C. § 1464(e) (1982)).

neighbors."³⁷

In 1934, Congress completed the savings and loan regulatory system by enacting the National Housing Act (NHA)³⁸ to provide a federal insurance umbrella for institutions belonging to the Federal Home Loan Bank System. The NHA created the FSLIC to provide federal deposit insurance coverage of up to \$5,000 per depositor³⁹ for money deposited in accounts held by federal savings and loan associations, state-chartered building and loans, savings and loan and homestead associations, and state-chartered cooperative banks.⁴⁰ Congress intended the insurance plan to afford "mutual and financial relief to 10,000,000 investors in building-and-loan associations through Federal cooperation in assuring them against losses through a cooperative insurance plan backed by the Government."⁴¹ Congress also expressed concern that without such insurance, savings and loan associations would be unable to compete with commercial and savings banks⁴² that had

37. 77 CONG. REC. 4974 (1933) (statement of Sen. Bulkley).

38. Pub. L. No. 73-479, 48 Stat. 1246 (1934) (codified as amended at 12 U.S.C. §§ 371, 1131g-1, 1422, 1426, 1430-1431, 1462-1463, 1701-1703, 1705-1742 (1982 & Supp. IV 1986) and 41 U.S.C. § 22 (1982), amended by 41 U.S.C.A. § 22 (West Supp. 1987)).

39. The amount of insurance coverage per depositor has steadily increased since 1934. In 1950, Congress increased coverage to \$10,000. Housing and Rent Act of 1950, Pub. L. No. 81-574, 64 Stat. 255, 259 (amended 1980). In 1966, coverage increased to \$15,000. Financial Institutions Supervisory Act of 1966, Pub. L. No. 89-695, 80 Stat. 1028, 1055 (amended 1980). In 1969, coverage increased to \$20,000. Act of Dec. 22, 1969, Pub. L. No. 91-151, 83 Stat. 371, 375 (amended 1980). In 1974, Congress increased coverage to \$40,000. Act of Oct. 28, 1974, Pub. L. No. 93-495, 88 Stat. 1500, 1503 (amended 1980). In 1980, coverage increased to the present level of \$100,000 per depositor. Depository Institutions and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132, 147 (codified as amended at 12 U.S.C. § 1728(a) (1982)) [hereinafter DIDMCA].

40. NHA, Pub. L. No. 73-479, 48 Stat. 1246, 1256-57 (1934) (codified as amended at 12 U.S.C. § 1725(a) (1982)). To obtain FSLIC insurance coverage, institutions must pay a premium charge for their insurance equal to a percentage of the total amount of all deposit accounts of the insured members of the institution plus any creditor obligation of the institution. See 12 U.S.C. § 1727(b)(1) (1982). In 1934, the insurance premium was equal to one-fourth of one percent of the total amount of all accounts of the insured members of such institution plus any creditor obligations of such institution. NHA, Pub. L. No. 73-479, 48 Stat. 1246, 1258 (1934) (codified as amended at 12 U.S.C. § 1727(b)(1) (1982)). The 1987 rate was one-twelfth of one percent of the total amount of all accounts of the insured members of the institution. 12 U.S.C. § 1727(b) (1982). The FSLIC also has the power to make supplemental assessments of up to one-eighth of one percent annually. *Id.* § 1727(c). Since March 1985, the FSLIC has exercised that power. See *infra* note 250. The FSLIC may also require insured institutions to deposit up to one percent of their assets in the FSLIC in an interest-bearing, deposit account repayable at the FSLIC's discretion. 12 U.S.C. § 1727(i)(1) (1982). This authority, which is intended to provide liquidity to the FSLIC, has never been invoked.

41. Statement of Objectives of the National Housing Bill, 78 CONG. REC. 12,014 (1934).

42. 78 CONG. REC. 11,196 (1934) (statement of Rep. Reilly). Rep. Reilly stated:

Notwithstanding the fact that these mutual institutions have a remarkable record for solvency and have stood up in many ways better than the banks, yet it would appear that the people are putting their money in banks instead of these cooperative home

been eligible for federal deposit insurance coverage since the enactment of the Federal Deposit Insurance Act in 1933.⁴³

With their accounts federally insured, individuals were expected to continue to save at savings and loan associations, thereby ensuring the survival of the country's main source for home financing.⁴⁴ The insurance program had an additional element: it established a method of exercising federal control over many state-chartered thrift institutions.⁴⁵

II. EVOLUTION

For approximately fifty years, the thrift industry dutifully complied with the mandate of Congress, as set forth in the FHLB Act, the HOLA, and the NHA, to serve as the primary source of locally based fixed-rate mortgages for the nation's homeowners. Indeed, until 1964,⁴⁶ thrifts could exercise only very limited powers beyond mortgage financing.⁴⁷ Long-term mortgages were financed primarily by passbook savings accounts.⁴⁸

Additional asset or liability powers were considered unnecessary for most

building institutions, and the object of this legislation is to make the savings of the people, that may be put in these home-building institutions, just as safe as if they were placed in the banks of the country.

Id.

43. Banking Act of 1933, Pub. L. No. 73-66, 48 Stat. 162, 168 (codified as amended at 12 U.S.C. §§ 1811-1832 (1982 & Supp. IV 1986)).

44. See AGENDA FOR REFORM, *supra* note 19, at 20. In 1940, savings and loan associations accounted for approximately 31.8% of all nonfarm home mortgages recorded. UNITED STATES SAVINGS AND LOAN LEAGUE, SAVINGS AND LOAN FACT BOOK 1955, at 27 (1956). Commercial banks accounted for 24%, insurance companies for 8.2%, mutual savings banks accounted for 4.2%, and individuals and others accounted for 30.7%. *Id.*

45. Congress made all FSLIC-insured institutions, including state-chartered institutions, subject to FHLBB regulation. See 12 U.S.C. § 1726(b) (1982 & Supp. IV 1986). Today, the FHLBB subjects state-chartered, FSLIC-insured institutions to a wide range of regulation. See, e.g., 12 C.F.R. § 563 (1987) (operations); *id.* § 563b (conversions from mutual to stock form); *id.* § 563c (accounting requirements); *id.* § 563d (securities of insured institutions); *id.* § 562e (community reinvestment); *id.* § 563f (management official interlocks); *id.* § 563g (securities offerings). Additionally, all insured institutions are subject to FHLBB enforcement powers and the FHLBB's authority to issue cease and desist orders to any institution that it has reasonable cause to believe is engaging in unsafe or unsound banking practices. 12 U.S.C. §§ 1464(d), 1730(f) (1982 & Supp. IV 1986).

46. Housing Act of 1964, Pub. L. No. 88-560, 78 Stat. 769, 805 (codified as amended at 12 U.S.C. § 1464(c) (1982 & Supp. IV 1986)).

47. Congress permitted federally chartered savings and loan associations to engage in mortgage financing and to invest only in United States obligations and federal home loan bank stocks and bonds. HOLA, Pub. L. No. 73-43, 48 Stat. 128, 132 (codified as amended at 12 U.S.C. §§ 1461-1468 (1982 & Supp. IV 1986)); see also FHLBB GUIDE, *supra* note 1, at 13. Although Congress broadened these powers several times between 1964 and 1980, see *infra* notes 86-89, 91 and accompanying text, it did not authorize substantial new asset powers for federally chartered institutions until 1980. See *infra* notes 111-17 and accompanying text.

48. 1985 FHLBB ANN. REP. 5 (1986).

of this period because the industry enjoyed substantial government protection⁴⁹ and operated in a relatively stable economic environment.⁵⁰ FSLIC receipts and expenditures between 1940 and 1960 reflected this stability. In 1940, the FSLIC collected \$6 million in premiums and other income and had no expenses.⁵¹ In 1950, the FSLIC collected \$13 million in premiums and other income, while it spent only \$3 million.⁵² In 1960, the amount of premiums and other income collected increased to \$54 million, while expenditures were only \$1 million.⁵³

During the mid-1960's, however, the thrift industry began to experience financial pressures as a result of disintermediation,⁵⁴ restrictive monetary policy, interest rate increases, and greater tax burdens.⁵⁵ During the period from 1966 to 1970, the FSLIC provided assistance to an increasing number of failing institutions and liquidated additional institutions.⁵⁶

When interest and inflation rates rose dramatically in the 1970's, the deterioration of the thrift industry's financial condition accelerated.⁵⁷ The rate of return on fixed-rate mortgages in thrift portfolios was significantly lower than the cost to retain or obtain new deposit liabilities.⁵⁸ The length of the

49. See, e.g., T. FRANKEL & A. YALIF, *FINANCIAL INSTITUTIONS, MARKETS AND THE LAW* 11-17 (1985).

50. See *AGENDA FOR REFORM*, *supra* note 19, at 20.

51. *Id.* at 22.

52. *Id.*

53. *Id.*

54. Disintermediation refers to the withdrawal of deposits from savings and loan associations, as well as other financial intermediaries, for investment directly in market instruments such as treasury bills, money market funds, and other financial institutions' deposit instruments. Hartzog, *The Money Market Certificate—An Anti-Disintermediation Instrument*, 11 FHLBB J., Aug. 1978, at 6, 6.

55. See FHLBB GUIDE, *supra* note 1, at 13; see also P. LOCKWOOD, *THE FEDERAL HOME LOAN BANK SYSTEM*, c-4/p-4 (FHLBB Pub. 5th ed. 1986) (draft).

56. See 1970 FHLBB ANN. REP. 60 (1971); 1969 FHLBB ANN. REP. 55 (1970); 1968 FHLBB ANN. REP. 57 (1969); 1967 FHLBB ANN. REP. 76 (1968); 1966 FHLBB ANN. REP. 62 (1967).

57. The thrift industry's aggregate net-worth ratio declined in the period from 1970 to 1979 from 7.66% of assets at the end of 1970 to 5.92% at the end of 1979. See FHLBB, *AN ANALYSIS OF PROPOSED CAPITAL REQUIREMENTS FOR THRIFT INSTITUTIONS* 21 (1986) (staff economic study, Office of Economic Policy and Research). Additionally, economic conditions in the 1970's and early 1980's led to an increased number of mergers between FHLBB members. The peak years for voluntary, supervisory, and FSLIC-assisted mergers were 1971-1972, 1975, and 1981-1982, each a period of economic recession. In 1971-1972, 220 mergers occurred; in 1975, 130 mergers occurred; between 1981-1982, 740 mergers occurred. Gould, *The Merging of the Savings and Loan Industry*, 16 FHLBB J., Jan. 1984, at 6, 6.

58. In 1976, the asset yield for savings and loan associations was 8.8% while the cost of funds was 6.38%. A. CARRON, *supra* note 16, at 5. By 1981, the situation had reversed; the asset yield for savings and loan associations was 10.11%, while the cost of funds had risen to 10.92%. *Id.* Although the asset yield had increased to 10.82% in 1982, the cost of funds had climbed to 11.30%. *Id.*

maturity of such loans made it impossible for institutions to restructure their portfolios quickly to correct the imbalance.⁵⁹ At the same time, increased competition from banking and nonbanking competitors began to squeeze profit margins in the industry's traditional lines of business.⁶⁰ Disintermediation, caused by increased rates and competition from money market mutual funds as well as traditional primary money market investments, resulted in substantial deposit outflows from the industry.⁶¹ Additionally, the industry began to encounter increased government regulation.⁶² To complicate these problems further, the growth in industry capital failed to match asset growth.⁶³

The financial crisis currently facing many of the nation's thrifts originated in the congruence of these economic and regulatory conditions.⁶⁴ Congress,

59. The average contractual length of all residential mortgage loans is 26 years, although mortgages are paid off in an average of seven years. Ross, *Accounting Change May Alter Rates*, Wash. Post, Dec. 31, 1986, at E1, col. 2.

60. See generally CHAIRMAN OF THE SUBCOMM. ON TELECOMMUNICATIONS, CONSUMER PROTECTION, AND FINANCE OF THE HOUSE COMM. ON ENERGY AND COMMERCE, REPORT ON RESTRUCTURING FINANCIAL MARKETS: THE MAJOR POLICY ISSUES, 99TH CONG., 2D SESS. (Comm. Print 1986) [hereinafter RESTRUCTURING FINANCIAL MARKETS]. Governor J. Charles Partee succinctly summarized the competitive pressures facing the thrift industry in 1980 testimony before a congressional committee:

Thrift institutions and many commercial banks are constrained in their capacity to pay market rates of return on all deposit liabilities because a substantial share of their assets, being long term in character, carry the lower interest rate returns of the past. Indeed, the increased attractiveness to depositors of market instruments, including the shares of money market mutual funds, has led banks and thrift institutions to promote aggressively the money market certificate. . . . This has increased markedly the average cost of deposits, so that many depository institutions—especially those with large mortgage portfolios—have been experiencing substantial downward pressure in their earnings margin.

Money Market Mutual Funds: Hearings Before the Subcomm. on Financial Institutions of the Senate Comm. on Banking, Housing, and Urban Affairs, 96th Cong., 2d Sess. 228 (1980) (statement of J. Charles Partee, Governor, Federal Reserve System); see also FHLBB GUIDE, *supra* note 1, at 15.

61. On March 31, 1979, FSLIC-insured thrift institutions held approximately \$130 billion in deposits in regular passbook accounts, club accounts, negotiable order of withdrawal accounts, demand accounts, and various miscellaneous accounts. Zabrenski, *Changes in S & L Deposit Account Structure: October 1980-March 1981*, 14 FHLB J., Aug. 1981, at 18. By March 31, 1980, that number had declined to approximately \$108 billion, and by March 31, 1981, it had fallen further to approximately \$101 billion. *Id.*; see also FHLBB GUIDE, *supra* note 1, at 15.

62. See FHLBB GUIDE, *supra* note 1, at 16.

63. See *supra* note 58.

64. Interest rate mismatches, which reduced spreads and produced lower income levels or losses, weakened the balance sheets of many FSLIC-insured institutions in the late 1970's and early 1980's. In 1981 and 1982, 331 FSLIC-insured thrift institutions closed. See 1985 FHLBB ANN. REP. 5 (1986). Most of the failures during the period reflected the effects of interest rate mismatches. *Id.* As interest rates declined in the mid 1980's, the principal source of problems for the industry shifted from asset and liability spread mismatches to poorly per-

the industry, and the regulators responded to the growing crisis in several ways. They made structural changes to facilitate the raising of new capital. Regulators granted enhanced powers to thrift institutions to enable them to be more competitive and profitable. Finally, the FHLBB modified regulatory and accounting policies to delay the impact of economic losses and provide the industry with additional time to work out its problems; in other words, the regulator was attempting "to buy time" for the endangered industry.

These actions were essential to remedy the problems facing the industry and the FSLIC. However, the actions were not always coordinated. Often they represented a response that was either too little or too late, and the results frequently gave rise to new problems.⁶⁵

A. Structural Changes

The traditional form of the savings and loan association was mutual.⁶⁶ In fact, prior to 1982, *all* newly chartered federal and most state savings and loan associations were mutuals.⁶⁷ Although the mutual form of organization encouraged a sense of cooperation, it hindered the ability of institutions to raise capital and precluded stockholder security in the institution's operations.⁶⁸

Conversions of federally chartered institutions from mutual to stock form began in 1948, after Congress amended the HOLA to allow federally chartered mutual institutions to convert to state-chartered associations.⁶⁹ Between 1948 and 1955, seventeen federally chartered mutual institutions relied upon this authority to convert to state-chartered stock associations.⁷⁰ In 1955, however, the FHLBB declared the first in a series of moratoria on mutual to stock conversions.⁷¹ A 1973 statute eventually extended these administratively imposed moratoria by prohibiting the FHLBB from approving conversions until June 30, 1974.⁷²

forming assets. *Id.* at 24. In 1984 and 1985, the predominant cause of thrift failure was characterized as poorly performing assets. *Id.*

65. See *infra* notes 121, 163-73 and accompanying text.

66. See *supra* note 21.

67. FHLBB GUIDE, *supra* note 1, at 65.

68. See AGENDA FOR REFORM, *supra* note 19, at 55.

69. Home Owners' Loan Act Amendments, Pub. L. No. 80-895, 62 Stat. 1239, 1239 (1948) (codified as amended at 12 U.S.C.A. § 1464(i) (West Supp. 1987)); see also S. REP. NO. 1392, 80th Cong., 2d Sess. 1, reprinted in 1948 U.S. CODE CONG. & ADMIN. NEWS 2315, 2315.

70. J. WILLIAMS, THRIFT ACQUISITIONS AND MERGERS: STATUTORY AND REGULATORY FRAMEWORK AND CURRENT ISSUES VIII-1 (Feb. 1987).

71. *Id.* at VIII-2.

72. Pub. L. No. 93-100, 87 Stat. 342 (1973).

In 1974, the Congress enacted the Depository Institutions-Insurance Act (DIIA).⁷³ The DIIA authorized the FHLBB to grant federal stock savings and loan charters to federal mutual savings and loan associations provided that either the state authorized its chartered savings and loans to operate in stock form in the state in which the federal institution was located or all the savings and loan associations in the state had federal charters. Although the DIIA generally did not permit such conversions until June 30, 1976,⁷⁴ the FHLBB had promulgated implementing regulations in 1974⁷⁵ to provide for an interim test program of a limited number of conversions.⁷⁶

In 1978, Congress took another step towards facilitating the conversion of mutual thrift institutions by enacting legislation to permit state-chartered mutual savings banks to convert to federal mutual thrift charters.⁷⁷ In 1980, Congress permitted state-chartered savings and loan associations that had existed in stock form for at least four years to convert to federal stock savings and loan associations.⁷⁸

Since 1980, the FHLBB has continued to modify its regulations to simplify and streamline the conversion process.⁷⁹ In 1983, it amended the con-

73. Pub. L. No. 93-495, 88 Stat. 1500 (1974) (codified as amended at 12 U.S.C. §§ 1813, 1817, 1818, 1821, 1828 (1982)) [hereinafter DIIA].

74. *Id.* at 1503 (codified as amended at 12 U.S.C. § 1828(c)(10) (1982)).

75. 39 Fed. Reg. 9142 (1974) (codified at 12 C.F.R. § 563b (1987)).

76. See S. REP. NO. 902, 93d Cong., 2d Sess. 2, reprinted in 1974 U.S. CODE CONG. & ADMIN. NEWS 6119, 6121. Between the enactment of the DIIA on Oct. 28, 1974 and June 30, 1976, the FHLBB permitted only the following institutions to convert: (a) institutions that had submitted applications to the FHLBB and given written notice to their accountholders prior to May 22, 1973; (b) 23 institutions located in 22 states that currently authorized such conversions; and (c) not more than 1% of the total number of institutions in any state which enacted legislation authorizing conversions subsequent to May 22, 1974. *Id.* The test period permitted a limited number of conversions in a controlled environment in order to learn as much as possible about the problems of conversions and the techniques available to deal with such problems. *Id.* The Conference Committee did not want to open the proverbial "flood gates," but at the same time did not want to prohibit all conversions. *Id.*

77. Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, 92 Stat. 3641, 3710 (codified as amended at 12 U.S.C. § 1464(i) (1982)), as amended in 12 U.S.C.A. § 1464(i) (West Supp. 1987). Converted state-chartered savings banks are permitted to retain FDIC-insurance coverage. See 12 U.S.C. § 1464(o) (1982), amended by 12 U.S.C.A. § 1464(o) (West Supp. 1987).

78. DIDMCA, Pub. L. No. 96-221, § 404, 94 Stat. 132, 158 (codified as amended at 12 U.S.C. § 1464(i) (1982), amended by 12 U.S.C.A. § 1464(i) (West Supp. 1987)). In 1982, Congress also authorized the chartering of de novo federal stock savings banks. See 12 U.S.C. § 1464(p) (1982), amended by 12 U.S.C.A. § 1464(p) (West Supp. 1987).

79. FHLBB regulations specify three types of "voluntary" conversion procedures for mutual thrifts, depending on the thrift's financial state. A standard conversion is available to all healthy mutual institutions. 12 C.F.R. § 563b.3-b.10 (1987). A voluntary supervisory conversion is available to a mutual whose liabilities exceed its assets under generally accepted accounting principals (GAAP). *Id.* § 563b.20-b.32 (1987). A modified conversion generally is available to a mutual that does not meet its regulatory capital requirements but has assets in

version regulations to permit the use of a summary proxy statement to reduce printing and mailing costs for converting institutions.⁸⁰ In 1985, the FHLBB further reduced the time and expense involved in the conversion process by permitting institutions to use valid perpetual proxies to vote in favor of a conversion unless members returned special proxies to vote against conversion.⁸¹ In 1986, the FHLBB modified the conversion procedures again,⁸² and simplified the process for supervisory conversions.⁸³

As of December 31, 1975, there were 4,078 FSLIC-insured institutions, of which 616 were stock institutions and 3,452 were mutual institutions.⁸⁴ Between the fourth quarters of 1975 and November 1987, 589 insured institutions converted from mutual to stock form, raising almost \$10 billion in new capital for the industry.⁸⁵

B. Enhanced Powers

The second major set of events in the evolution of the thrift industry was the authorization of new powers, on both the asset and liability sides of the thrift institution's balance sheet. The industry gained these new powers through an interplay of regulatory and legislative actions at both the federal and state levels.

1. Pre-1980 Powers

In 1964, Congress took the first steps towards expanding the powers of thrift institutions by enacting the Housing Act of 1964.⁸⁶ This law author-

excess of liabilities. *Id.* § 563b.34-b.41 (1987). A voluntary conversion is accomplished at the initiative of the thrift's board of directors. They are thereby distinguished from the involuntary procedures through which the FSLIC determines that a thrift is a supervisory case and sells it through a bidding process. 12 U.S.C. § 1730a(m) (1982), *amended by* 12 U.S.C.A. § 1730a(m) (West Supp. 1987).

80. 48 Fed. Reg. 7432 (1983) (codified at 12 C.F.R. § 563b.6(c)(2) (1987)).

81. 50 Fed. Reg. 20,555 (1985) (codified at 12 C.F.R. § 563b.5(d)(4) (1987)).

82. The basic steps in the conversion process today require (1) the adoption by the thrift institution of a plan of conversion, (2) the submission of an application for conversion to the FHLBB, (3) the holding of a special meeting of members of the institution to vote on the conversion plan, (4) the offering of pre-emptive subscription rights to acquire the common stock to members of the institution and (5) the sale of the remainder of the common stock in a public offering or direct community offering. *See generally* 12 C.F.R. § 563b (1987).

83. Conversions From Mutual to Stock Form and Acquisitions of Control of Insured Institutions, 51 Fed. Reg. 40,127 (1987) (codified in scattered parts of 12 C.F.R.).

84. 1975 FHLBB ANN. REP. 39 (1976).

85. Restrictions imposed on the ability of FSLIC-insured institutions to purchase stock of other institutions help ensure that funds generated by mutual to stock conversions represent an injection of new capital from outside the system. 12 U.S.C. § 1730a(e)(1)(A)(iii) (1982); *see also* 12 C.F.R. § 563.9-8(d)(3) (1987).

86. Pub. L. No. 88-560, 78 Stat. 769 (codified as amended in scattered sections of 12, 20, 38, 40 U.S.C.).

ized federal thrift institutions to offer personal loans for college or vocational purposes.⁸⁷ Between 1964 and 1980, Congress and federal regulators undertook additional efforts to broaden the powers and improve the competitive position of the thrift industry vis-a-vis other financial services providers,⁸⁸ even authorizing FSLIC-insured thrifts to pay depositors a slightly higher rate of interest than FDIC-insured banks were allowed to pay.⁸⁹ The states, however, often took the initiative by granting more expansive powers to state-chartered institutions than were currently available to federally chartered institutions.⁹⁰ Changes in federal law usually lagged.⁹¹

Some of the major developments before 1980 included the first efforts by several states to authorize substantial new asset powers for state-chartered institutions. For example, Maine allowed its state-chartered savings and

87. 12 U.S.C. § 1464(c)(3)(A) (1982); *see also* FHLBB GUIDE, *supra* note 1, at 13.

88. *See* Housing and Community Development Act of 1975, Pub. L. No. 93-383, 88 Stat. 633 (codified as amended in scattered sections of 5, 12, 20, 31, 40, 42 U.S.C.). The Housing and Community Development Act of 1974 liberalized lending powers for federally chartered associations by increasing the limitation on property improvement loans from \$5,000 to \$10,000, permitting savings and loan institutions to make line-of-credit construction loans not to exceed the greater of surplus, undivided profits and reserves, or 5% of assets; and increasing the limit on the amount of single-family dwelling loans from \$45,000 to \$55,000. 12 U.S.C. § 1464 (1982).

89. In 1966, Congress amended the authority of the Board of Governors of the Federal Reserve System (Federal Reserve Board) and the FDIC, and authorized the FHLBB to limit share or drawable accounts by regulating the rates of interest or dividends to be paid on deposits. *See* Interest Rate Adjustment Act of 1966, Pub. L. No. 89-597, 80 Stat. 824 (codified as amended at 12 U.S.C. § 371b (1982)). The law required consultation between the regulators before the exercise of the rate-making power. 12 U.S.C. § 461(b)(1)(F) (1982). In 1969, the Federal Reserve Board amended its regulations pertaining to interest on accounts to include interest-rate ceilings on time and savings deposits held by member banks. *See* Interests on Deposits, 34 Fed. Reg. 9702 (codified at 12 C.F.R. § 217 (1987)). The regulators then agreed that the ceiling for FSLIC-insured institutions would be set at a rate .25% higher than the ceiling rate to be determined by the Federal Reserve Board from time to time under regulation Q. *See* AGENDA FOR REFORM, *supra* note 19, at 35-36; *see also* C. GOLEMBE & R. HENGREN, FEDERAL REGULATION OF BANKING 1983-84, at 54-55 (1983).

90. Frequently, the states have served as laboratories for change in fostering many banking innovations, such as trust services, branching, interstate expansion, and NOW accounts. *See* U.S. TASK GROUP ON FINANCIAL SERVICES, BLUEPRINT FOR REFORM: THE REPORT OF THE PRESIDENTIAL TASK GROUP ON REGULATION OF FINANCIAL SERVICES 43-44 (1984) [hereinafter BLUEPRINT FOR REFORM]. For example, in 1979, the FHLBB permitted federal savings and loans to offer variable rate mortgages. Preceding the FHLBB's action, the agency implemented a test program for federally chartered institutions in California, *see* FHLBB GUIDE, *supra* note 1, at 16, where state-chartered institutions had been permitted to market such mortgages since 1975. *Id.* The state had permitted smaller, state-chartered institutions to offer such a product since 1961. *Id.* The states generally react more quickly to economic changes, developments in the marketplace, consumer demands, and the competitive challenges of nonregulated entities. *See* RESTRUCTURING FINANCIAL MARKETS, *supra* note 60, at 317-22. Such changes are often incorporated into federal legislation or regulation at a subsequent date. *See, e.g., infra* notes 94-101 and accompanying text.

91. *See, e.g., infra* notes 98-101 and accompanying text.

loan associations to make personal and consumer loans,⁹² and to purchase up to a seventy-five percent participation interest in any loan originated by a commercial bank authorized to do business in Maine.⁹³

On the liability side, the New England states gave birth to the negotiable order of withdrawal (NOW) account, the functional equivalent of a demand deposit or checking account, and the FHLBB gave insured institutions the opportunity to offer the first market-competitive, consumer deposit instrument. Massachusetts⁹⁴ and New Hampshire⁹⁵ authorized state-chartered depository institutions to offer NOW accounts in an effort to make these institutions more competitive with banks offering demand deposit accounts. By early 1973, approximately 44,300 NOW accounts in New Hampshire and Massachusetts held approximately \$45 million in deposits.⁹⁶ By the end of 1976, the four remaining New England states authorized their state-chartered institutions to offer NOW accounts.⁹⁷

Congress responded to the highly successful New England invention by authorizing most federally chartered institutions to offer NOW accounts, first in New Hampshire and Massachusetts⁹⁸ and later in the other New England states⁹⁹ and New York.¹⁰⁰ Finally, in 1980, Congress authorized federally insured depository institutions nationwide to offer NOW accounts.¹⁰¹

Interest rate increases in the late 1970's made uninsured money market fund accounts offered by unregulated entities an attractive alternative to

92. ME. REV. STAT. ANN. tit. 9-B, § 734 (1980).

93. *Id.* § 735(2)(A).

94. MASS. GEN. LAWS ANN. ch. 140E, § 1 (West Supp. 1987).

95. N.H. REV. STAT. ANN. ch. 394-A:11 (1985).

96. S. REP. NO. 368, 96th Cong., 2d Sess. 7, reprinted in 1980 U.S. CODE CONG. & ADMIN. NEWS 236, 243. By 1979, it was estimated that over one-half of the individual checking accounts in Massachusetts and three-quarters of the individual checking accounts in New Hampshire had converted to NOW accounts. *McKinney Urges Nationwide Now Accounts*, 12 FHLBB J., June 1979, at 7.

97. CONN. GEN. STAT. ANN. § 36-182(a) (West 1987); ME. REV. STAT. ANN. tit. 9-B, § 725 (1980); R.I. GEN. LAWS §§ 19-5-3, 19-23-15 (1986); VT. STAT. ANN. tit. 8, § 1971(a) (1984); see also S. REP. NO. 368, 96th Cong. 2d Sess. 7, reprinted in 1980 U.S. CODE CONG. & ADMIN. NEWS 236, 243. By 1980, approximately \$3.8 billion in deposits were held in 2.3 million NOW accounts. *Id.*, reprinted in 1980 U.S. CODE CONG. & ADMIN. NEWS 236, 243.

98. See Financial Institutions-Deposits-Interest-Investment, Pub. L. No. 93-100, § 2, 87 Stat. 342, 342 (1973) (codified as amended at 12 U.S.C. § 1813 (1982)).

99. See State Taxation of Depositories Act, Pub. L. 94-222, § 2, 90 Stat. 197, 197 (1976) (codified as amended at 12 U.S.C. § 548 (1982)).

100. See Financial Institutions Regulatory and Interest Control Act, Pub. L. No. 95-630, § 1301, 92 Stat. 3641, 3712 (1978) (codified as amended at 12 U.S.C. § 1832 (1982)).

101. DIDMCA, Pub. L. No. 96-221, § 303, 94 Stat. 142, 142 (codified as amended at 12 U.S.C. § 1832(a) (1982), amended by 12 U.S.C.A. § 1832(a) (West Supp. 1987)).

fixed-rate, low-yield thrift deposit accounts.¹⁰² In June 1978, the FHLBB responded by promulgating a regulation permitting insured institutions to offer, for the first time, six-month certificates of deposit paying market rates of interest.¹⁰³ The certificates, which had a \$10,000 minimum deposit requirement, were the first type of money-market accounts to be offered by a federally insured depository institution.¹⁰⁴ The consumer response to this innovative federally insured instrument was overwhelming. By March 31, 1979, FSLIC-insured institutions offering such accounts had received \$73.2 billion in new deposits. As of the end of March 1981, the amount of deposits had increased to \$197 billion, representing 38.7% of total deposits.¹⁰⁵

2. *Depository Institutions Deregulation and Monetary Control Act of 1980*

The evolutionary process received substantial impetus in 1980 with the enactment of the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA).¹⁰⁶ Recognizing the impact of inflation and the effects of disintermediation on federally regulated depository institutions, Congress enacted this legislation to "battle against inflation and for the stability of our institutions and our economy."¹⁰⁷ To improve the worsening financial condition and competitive position of the thrift industry, the bill broadened the scope of permissible powers of thrifts to enable them to offer new consumer products in order to become "real family financial service centers."¹⁰⁸

The deregulation of interest rate controls on deposit liabilities as mandated by DIDMCA had the most significant effect on the thrift industry. The legislation provided for a six-year phase-out of Regulation Q's controls¹⁰⁹ and created the Depository Institutions Deregulation Committee (DIDC), an interagency committee, for the purpose of ensuring an orderly phase-out over this period.¹¹⁰

102. See *infra* note 244 and accompanying text.

103. Limitations on Rate of Return, 43 Fed. Reg. 21,438 (1978).

104. See Hartzog, *supra* note 54, at 6.

105. Zabrenski, *supra* note 61, at 8.

106. Pub. L. No. 96-221, 94 Stat. 132 (codified as amended in scattered sections of 12 U.S.C.).

107. 126 CONG. REC. 6965 (1980) (statement of Rep. Reuss).

108. *Id.*

109. DIDMCA, Pub. L. No. 96-221, § 202, 94 Stat. 132, 142 (codified as amended at 12 U.S.C. § 3501(6) (1982)).

110. *Id.* § 203, 94 Stat. 132, 142 (codified as amended at 12 U.S.C. § 3502 (1982)). With the dramatic fall in interest rates after 1982, the Depository Institutions Deregulation Committee (DIDC) accomplished its task of an orderly phase-out in four years, two years less than allocated under DIDMCA. See Depository Institutions Deregulation Committee, 48 Fed.

In addition to interest rate deregulation, the DIDMCA granted several limited new powers to federally chartered thrift institutions. These powers included the permanent authority to establish remote service units,¹¹¹ exercise trust and fiduciary powers,¹¹² offer credit card services,¹¹³ and issue mutual capital certificates.¹¹⁴ New investment powers included the authority to invest up to twenty percent of assets in secured or unsecured consumer loans, commercial paper, and corporate debt securities.¹¹⁵ The DIDMCA also permitted institutions to invest in or hold shares of open-ended investment companies¹¹⁶ and to make acquisition, development, and construction loans.¹¹⁷

Although removal of Regulation Q's controls on interest rates enabled the thrift industry to begin paying more competitive rates to depositors, and the new powers provided the industry with greater flexibility, the DIDMCA did not eliminate all of the industry's problems. In fact, the DIDMCA presented the opportunity for a new set of problems to arise. Deposit funds continued to flow out of the industry.¹¹⁸ In addition, the traditional positive spread between rates paid to depositors and rates earned on loans, previously protected by Regulation Q and restrictive asset powers, had reversed.¹¹⁹ As a result, the industry suffered staggering losses in 1981 and 1982.¹²⁰

At the time of the DIDMCA's enactment, Congress recognized that its legislative efforts would not solve the industry's problems. Significant deregulation of liability powers had to be matched by far more extensive deregulation of asset powers if the institutions were to bear the cost of increasingly expensive liabilities. Therefore, immediately after the passage of the DIDMCA, Congress began work on legislative proposals to address these problems.¹²¹

Reg. 38,455 (1983) (removal of interest rates on time deposits), *repealed by*, Termination of Functions; Revocation of Regulations, 51 Fed. Reg. 9767 (1986) (termination of functions of DDC).

111. 12 U.S.C. § 1464(n)(1) (1982).

112. *Id.* § 1464(b)(1)(F) (1982), *amended by* 12 U.S.C.A. § 1464(b)(1)(F) (West Supp. 1987).

113. *Id.* § 1464(b)(4) (1982).

114. *Id.* § 1464(b)(5).

115. *Id.* § 1464(c)(2).

116. *Id.* § 1464(c)(1)(Q).

117. *Id.* § 1464(c)(3).

118. The combined deposit outflow for years 1981 and 1982 was \$31.8 billion. *See* 1985 FHLBB ANN. REP. 5 (1986).

119. *See supra* note 58.

120. In the two-year period, 1981-1982, the industry lost \$8.9 billion in net worth. 1985 FHLBB ANN. REP. 5-6 (1986). In the last half of 1981 and the first half of 1982, 80% of all FSLIC-insured institutions operated at a loss. *Id.*

121. *See generally* *Competition and Conditions in the Financial System: Hearings Before*

3. Garn-St Germain Depository Institutions Act of 1982

In the midst of the thrift crisis, and a little more than two years after the enactment of the DIDMCA, Congress approved "the most significant thrift legislation in half a century,"¹²² the Garn-St Germain Depository Institutions Act of 1982 (Garn-St Germain Act).¹²³ Although the Garn-St Germain Act is considered an omnibus banking bill because it affected various segments of the financial services industry, its preamble made clear that one of the principal purposes of the legislation was "to revitalize the housing industry by strengthening the financial stability of home mortgage lending institutions and ensuring the availability of home mortgage loans."¹²⁴

To accomplish this revitalization, one cornerstone¹²⁵ of the Garn-St

the Senate Comm. on Banking, Housing, and Urban Affairs (pt. 1), 97th Cong., 1st Sess. (1981); see also *id.* pt. 2; *Financial Institutions, Restructuring, and Services Act of 1981: Hearings on S. 1686, S. 1703, S. 1720, S. 1721 Before the Senate Comm. on Banking, Housing, and Urban Affairs* (pt. 1), 97th Cong. 1st Sess. (1981).

122. See FHLBB GUIDE, *supra* note 1, at 19.

123. Pub. L. No. 97-320, 96 Stat. 1469 (codified as amended in scattered sections of 12 U.S.C.).

124. H.R. CONF. REP. NO. 899, 97th Cong., 2d Sess. 1 (1982).

125. Other cornerstones of the thrift provisions were intended to provide regulators with additional flexibility to resolve industry problems. To alleviate some of the pressure on the resources of the FSLIC, the legislation attempted to broaden the scope of potential bidders for troubled thrifts. The FSLIC was authorized to preempt any state law or constitution or any federal statute to arrange emergency interstate and inter-industry acquisitions of failing thrifts whenever it determined that severe financial conditions threatened the stability of a significant number of insured institutions or of insured institutions possessing significant financial resources. 12 U.S.C. § 1730a(m) (1982), amended by 12 U.S.C.A. § 1730a(m) (West Supp. 1987). FHLBB Chairman Edwin J. Gray characterized this "enhanced elbowroom" for the FSLIC as "[p]erhaps the most important authority provided by the Garn-St Germain Act to help weakened thrifts." *Nonbank Banks: Hearings on H.R. 20 Before the Subcomm. on Financial Institutions Supervision, Regulation, and Insurance of the House Comm. on Banking, Finance, and Urban Affairs*, 99th Cong., 1st Sess. 205 (1985) (statement of Edwin J. Gray, Chairman, FHLBB) [hereinafter *Nonbank Banks Hearings*].

Yet another cornerstone of the Garn-St Germain Act provided the FHLBB and the FSLIC with new powers to assist financially troubled institutions. A program of low-cost capital assistance, aimed at depository institutions that had suffered earnings and capital losses primarily as a result of their mortgage lending activities, authorized the FSLIC to purchase "net-worth certificates," at its discretion, from qualified institutions in order to increase or maintain the capital of such institutions. 12 U.S.C. § 1729(f)(5) (1982), amended by 12 U.S.C.A. § 1729(f)(5) (West Supp. 1987). Net-worth certificates are capital instruments designed to provide payment of a percentage of later profits to the FSLIC. Net-worth certificates are considered capital under GAAP. Qualifying institutions were required to have a net worth of no more than 3% of its assets, losses during the previous two quarters, "a net worth of not less than one-half of one percentum of assets after" the FSLIC's purchase of its net-worth certificates, and "investments in residential mortgages or securities backed by such mortgages aggregating at least 20 percentum of its loans." *Id.* § 1729(f)(5)(B). Members of Congress linked the net-worth certificate program inextricably to the grant of a broader range of powers for thrift institutions. "To offer a net worth guarantee to the thrift institutions without simultane-

Germain Act provided the thrift industry with significant new asset powers.¹²⁶ One of the Act's floor managers summarized the importance of these assets powers:

If enacted this bill will help to stabilize our financial system. . . . All depository institutions have to have more flexibility in their operations. The bill provides this for banks and for thrifts. For the thrifts, new lending authority, including a limited basket of commercial lending authority, will provide them with the tools they need to restore their earnings and to weather business cycles.¹²⁷

With additional asset flexibility and earnings opportunities, Congress anticipated that the industry would be able "to improve their earnings and solidify their market positions in order to continue to provide financing for housing."¹²⁸

One of the Garn-St Germain Act's most important new powers for federally chartered thrifts was the authority to hold up to 5% of their assets in commercial, agricultural, and corporate loans.¹²⁹ This lending authority increased to ten percent in 1984.¹³⁰ The Act also granted federally chartered thrifts the authority to invest up to ten percent of their assets in any one issuer of state government securities,¹³¹ and allowed these thrifts to make loans secured by nonresidential real estate up to 40% of their assets.¹³² As a result, more than half of the assets of federally chartered thrifts could consist of previously forbidden investment vehicles.¹³³

ously allowing them broader lending power is to tie our guarantee power to a set of institutions which will not be able to earn their way out of their current problems." 128 CONG. REC. 27,349 (1982) (statement of Rep. Frank).

126. See 12 U.S.C. § 1464(c)(1)(B) (1982), amended by 12 U.S.C.A. § 1464(c)(1)(B) (West Supp. 1987) (real property loans); *id.* § 1464(c)(1)(H), (R) (1982), amended by 12 U.S.C.A. § 1464(c)(1)(H), (R) (West Supp. 1987) (government securities, commercial, and other loans); *id.* § 1464(c)(1)(O), amended by 12 U.S.C.A. § 1464(c)(1)(O) (West Supp. 1987) (housing and land development loans); Pub. L. 97-320, § 329, 96 Stat. 1502 (consumer loans); see also Implementation of New Powers; Limitation on Loans to One Borrower, 48 Fed. Reg. 23,032 (May 23, 1982).

127. 128 CONG. REC. 27,353 (statement of Rep. St Germain).

128. *Id.* 27,261 (statement of Rep. Wylie).

129. 12 U.S.C. § 1464(c)(1)(R) (1982), amended by 12 U.S.C.A. § 1464(c)(1)(R) (West Supp. 1987). Senator Paul Tsongas said, "[m]ost importantly for long-term health, the bill contains expanded commercial lending authority for thrifts. This is a major accomplishment. It is the key to allowing these institutions to make the management decisions necessary to find their niche in the changing financial marketplace." 128 CONG. REC. 27,148 (1982) (statement of Sen. Tsongas).

130. 12 U.S.C. § 1464(c)(1)(R) (1982), amended by 12 U.S.C.A. § 1464(c)(1)(R) (West Supp. 1987).

131. *Id.* § 1464(c)(1)(H), amended by 12 U.S.C.A. § 1464(c)(1)(H) (West Supp. 1987).

132. *Id.* § 1464(c)(1)(B), amended by 12 U.S.C.A. § 1464(c)(i)(B) (West Supp. 1987).

133. After passage of the Garn-St Germain Act, thrift institutions were authorized to invest in corporate debt securities (rated and unrated), commercial real estate loans, traditional

In addition, federally chartered thrifts gained additional liability powers, including the authority to accept demand deposits from commercial, corporate, and agricultural customers establishing loan relationships with the thrift.¹³⁴ The Act also eliminated the thirty-day notice period for withdrawal from a NOW account "in order to enable [savings and loan associations] to be more competitive with commercial banks with respect to this account."¹³⁵ Moreover, the Act authorized thrift institutions, as well as other federally insured depository institutions, to offer Money Market Demand Accounts to compete directly with money market mutual funds.¹³⁶ The Garn-St Germain Act further encouraged conversions from mutual to stock form¹³⁷ and authorized federal thrifts for the first time to issue capital stock to the general public.¹³⁸

In essence, the Garn-St Germain Act represented an effort to address the imbalance between the strict regulation of asset powers and the more liberal regulation of deposit interest rates.¹³⁹ However, the Act had the effect of further blurring the distinctions between the commercial banking and thrift industries because thrift institutions gained more traditional commercial bank powers.¹⁴⁰

commercial loans, commercial paper, and equipment leases. The ability of thrifts to take full advantage of these powers was traditionally limited by the requirement that a thrift maintain a certain portfolio mix in order to qualify as a domestic building and loan association eligible for favorable treatment of bad debt reserves equal to 50% of net income. See 26 U.S.C. § 7701(a)(19) (1982), amended by 26 U.S.C.A. § 7701 (a)(19) (West Supp. 1987). More recently, the flexibility gained by thrifts has been curtailed further by the requirements of the qualified thrift lender test. See *infra* notes 209-17 and accompanying text.

134. 12 U.S.C. § 1464(b)(1)(B) (1982), amended by 12 U.S.C.A. § 1464(b)(1)(B) (West Supp. 1987); see also 12 C.F.R. § 545.12 (1987).

135. *Summary of Depository Institutions Amendment of 1982*, 131 CONG. REC. 22,488 (1982).

136. 12 U.S.C. § 3503 (1982), amended by 12 U.S.C.A. § 3503 (West Supp. 1987).

137. *Id.* § 1464(i) (1982), amended by 12 U.S.C.A. § 1464(i) (West Supp. 1987); see also *supra* note 78.

138. 12 U.S.C.A. § 1464(i)(3)(B)(i) (West Supp. 1987).

139. See FHLBB GUIDE, *supra* note 1, at 19.

140. Former Comptroller of the Currency C. Todd Conover summed up the effect of this development when he stated "while the distinctions between banks and thrifts and between depository and nondepository institutions used to be clear, such institutional differences are disappearing. Different types of financial institutions increasingly offer similar products and services and compete in the same markets." *Bush Task Group Report on Regulation of Financial Services: Blueprint for Reform: Hearing Before the Subcomm. on Commerce, Consumer, and Monetary Affairs of the House Comm. on Government Operations* (pt. 1), 99th Cong., 1st Sess. 163 (1985) (statement by C. Todd Conover, Comptroller of the Currency); see also J. BARTH, D. BRUMBAUGH, JR., D. SAUERHAFT & G. WANG, THRIFT-INSTITUTION FAILURES: CAUSES AND POLICY ISSUES 33 (1985) (FHLBB, Office of Policy and Economic Research Working Paper No. 117, 1985) [hereinafter J. BARTH].

4. *Post-Garn-St Germain Act Developments*

Immediately following the enactment of the Garn-St Germain Act, a number of states began to consider legislation to expand further the powers of state-chartered thrifts.¹⁴¹ The premise of such legislation was essentially the same as the Garn-St Germain Act: to provide the tools necessary to restore the financial health of an industry severely affected by the economic conditions of the late 1970's and early 1980's and the deregulation of interest rates paid on deposit liabilities.¹⁴²

This new round of state legislation differed somewhat from earlier legislative efforts, however, because it granted thrifts powers to engage in activities far beyond the powers traditionally authorized for national banks or federally chartered thrifts. For example, California enacted a major bill to permit state-chartered thrifts to invest up to 100% of their assets in subsidiary service corporations, with no statutory limitations on the types of business in which the subsidiaries could engage. Additionally, California authorized its thrifts to invest directly in real estate development and syndication.¹⁴³

The new, unfettered investment powers of California thrifts, coupled with federal insurance regulations permitting a twenty year phase-in of the minimum capital requirements¹⁴⁴ and an unlimited ability to attract deposits, made state thrift charters highly desirable and succeeded in attracting new capital into the industry.¹⁴⁵ This capital, which entered the system through the chartering of new institutions and the acquisitions of existing institutions, was brought in by a class of less traditional and less risk averse investors as well as by individuals engaging in insider dealing, fraud, and abusive practices. Other states had the same experience.¹⁴⁶ The results fueled debates about the appropriate role of federal deposit insurance¹⁴⁷ and prompted the FHLBB to consider a variety of remedial efforts.¹⁴⁸

141. California, Texas and Florida expanded the powers of their state-chartered thrift institutions. *See infra* note 183.

142. RESTRUCTURING FINANCIAL MARKETS, *supra* note 60, at 319.

143. CAL. FIN. CODE § 7300 (West Supp. 1988).

144. *See infra* note 153.

145. *See* MODERNIZATION OF THE FINANCIAL SERVICES INDUSTRY, *supra* note 12, at 62-63.

146. *Id.*

147. *See Deposit Insurance Reform Hearings* (pt. 2), *supra* note 2, at 208, 218-19 (statement of Edwin J. Gray, Chairman, FHLBB); *id.* at 113, 157 (statement of George D. Gould, Undersecretary of Finance, Dep't of the Treasury). *See generally* BLUEPRINT FOR REFORM, *supra* note 90; Isaac, *International Deposit Insurance Systems*, ISSUES IN BANKING REGULATION 76 (Summer 1984); *Ex-Comptroller Urges Redefinition of the Role of Deposit Insurance*, *Am. Banker*, Sept. 21, 1984, at 7, col. 1.

148. *See infra* notes 307-315 and accompanying text.

C. Policy Changes

To cope with the continuing weakness and corresponding decline of capital within the industry,¹⁴⁹ the FHLBB lowered capital requirements and changed accounting techniques on several occasions. The FHLBB took most of these actions prior to 1985.¹⁵⁰

Between 1980 and 1982, the FHLBB lowered the capital requirements of the industry from 5% to 4%.¹⁵¹ In 1982, the FHLBB further lowered the requirements to 3%.¹⁵² Moreover, regulations permitted de novo institutions up to twenty years to achieve minimum capital, thereby providing an institution substantially greater leverage in the early years of its existence.¹⁵³

To provide institutions additional time and flexibility until interest rates fell or the institutions could earn their way out of net worth deficiencies, the FHLBB also encouraged the use of creative accounting devices.¹⁵⁴ These

149. Between 1979 and 1985, the GAAP net worth of the industry as a percentage of assets, fell from 2.4% to 1.8%. See J. BARTH, *supra* note 140, at app. 17.

150. In 1985, the industry reported its highest aggregate return on assets since 1979. Regulatory net worth also increased by 13%, although accounting principles in use overstated the increase. See *infra* note 154. At the same time, the FSLIC began to focus on the problems that had resulted from some of its earlier policy changes. See *Deposit Insurance Reform Hearings, supra* note 2, at 208-21 (statement of Edwin J. Gray, Chairman, FHLBB); see also *infra* note 311 and accompanying text.

151. Net Worth Amendments, 45 Fed. Reg. 76,111 (1980) (codified as amended at 12 C.F.R. § 563.13 (1987)).

152. Net Worth Amendments, 47 Fed. Reg. 3543 (1982) (codified as amended at 12 C.F.R. § 563.13 (1987)).

153. See Net Worth Requirements of Insured Institutions, 50 Fed. Reg. 6891, 6892 (1985) (codified as amended at 12 C.F.R. § 563.13 (1987)). The "twenty-year phase-in" period allowed institutions to phase in over 20 years required net worth by multiplying 3% of liabilities and assets, respectively, by a fraction, the numerator of which was the number of consecutive years of insurance and the denominator of which was 20. *Id.* In 1985, the FHLBB promulgated regulations eliminating the "twenty-year phase-in" method, and now requires institutions to calculate their minimum net-worth requirement at the end of each calendar quarter. *Id.*; see also *infra* notes 178, 323.

154. Among the accounting practices altered to accommodate the declining capital value of the industry were: the net-worth and income capital certificate programs, see *infra* notes 321-22 and accompanying text; see also GAO, REPORT TO THE CONGRESS OF THE UNITED STATES: THE FSLIC INSURANCE FUND—RECENT MANAGEMENT AND OUTLOOK FOR THE FUTURE 44 (1982); the use of deferred loan losses, see Accounting for Gains and Losses on the Sale or Other Disposition of Certain Assets, 48 Fed. Reg. 56,572 (1983); a one time reevaluation of capital assets in order to mark-up assets from historic to current market value, see Amendments to Net Worth and Statutory-Reserve Requirements, 47 Fed. Reg. 52,961 (1982); and the use of unusually aggressive purchase accounting techniques; see Information Disclosure Requirements in Connection with Conversions from the Mutual to Stock Form of Organization, 48 Fed. Reg. 31,614 (1983). In addition, some thrifts disguised investments in real estate as acquisition, development and construction loans. See Accounting Policy Relating to Acquisitions, Development and Construction Loans, 50 Fed. Reg. 18,233 (1985). Such actions permitted early income recognition. In 1986, the accounting profession finally began curtailing this practice.

devices enabled the industry and individual institutions to inflate current values of assets and defer recognition of losses, thereby postponing the potential consequences of weakened financial conditions.¹⁵⁵ In effect, these practices bolstered the paper net worth of an institution without any increase in the real equity of the institution.¹⁵⁶

D. Backlash

Although the Garn-St Germain Act represented a substantial step in the evolution of the thrift industry, the process was incomplete. Even the actions of the states and the efforts of the FHLBB could not reverse the industry's deepening crisis.

Although interest rates began to decline significantly during 1982,¹⁵⁷ over one-third of all FSLIC-insured institutions were losing money by the end of 1983.¹⁵⁸ As of the same date, more than one-fourth of all FSLIC-insured institutions had a regulatory net worth to total assets ratio of only 3% or less.¹⁵⁹ In 1984, deposits grew by 17% to \$784.7 billion and assets grew by 19% to \$978.5 billion, while FSLIC reserves, as a percent of savings deposits, dropped to 0.78%.¹⁶⁰ Although the operating results for 1985 improved,¹⁶¹ FSLIC reserves continued to dwindle. At the time, the projected cost of the current and future case load of insolvent institutions was expected to exceed the amount of FSLIC reserves.¹⁶² The FHLBB itself acknowl-

155. See *infra* note 303 and accompanying text.

156. This approach certainly is not without its critics. In debates on recent legislation that requires thrift institutions to begin abiding by GAAP within a five-year period, Rep. Parris characterized the existing regulatory accounting principles in the following manner:

Frankly, [regulatory accounting principles] had been used to hide the real trouble of the thrift industry. When thrifts got into trouble, the regulators invented a new scheme to make their balance sheets look better. If any one of us did it, it would be called fraud. It is nothing short of "cooking the books." I won't excuse the Congress from blame either. We have artificially inflated that [sic] net worths of thrifts through net worth and income capital certificates.

But the time has now come to correct that situation and to approve this change. We are past the thrift interest rate crunch period, when many of these accounting changes were deemed necessary to help an industry on the ropes. We must swallow hard and go back to GAAP accounting so that we no longer put a false face on the health of the industry.

133 CONG. REC. H6949 (daily ed. Aug. 3, 1987) (statement of Rep. Parris).

157. By the end of the first half of 1983, the industry's overall cost of funds had dropped to 9.81% while the average portfolio yield was 11.04%. 1984 FHLBB ANN. REP. 6 (1985).

158. *Id.*

159. *Id.* Accounting techniques used by the FHLBB during this period overstated the earnings and net worth figures of the industry when compared to earlier periods. See *infra* note 303.

160. See FHLBB GUIDE, *supra* note 1, at 21; see also 1985 FHLBB ANN. REP. 26 (1986).

161. See *infra* note 277 and accompanying text.

162. See *Deposit Insurance Reform Hearings, supra* note 2, at 209-10 (statement of Edwin

edged that "as dramatic and far-reaching as the Garn-St Germain Act was, it [was] doubtful this legislation alone could have saved the thrift industry."¹⁶³

By the middle of 1985, accumulating evidence suggested that newly gained asset powers and regulatory policy changes, coupled with the explosive growth of the liability base of the industry in recent years, exacerbated, rather than alleviated, a number of the problems facing the thrift industry.¹⁶⁴ First, an understaffed and unprepared regulatory system confronted the increasingly difficult task of dealing with the range of economic problems generally facing the industry.¹⁶⁵ Additionally, the Garn-St Germain Act and various state laws burdened the system with the problems resulting from substantial deregulation.¹⁶⁶ Second, the continued and significant relaxation of capital standards¹⁶⁷ enabled institutions to undertake explosive asset and liability growth without increasing the institution's capital base.¹⁶⁸ The development magnified the trend toward declining industry capitalization.

Third, it appears that the majority of the industry was convinced that it must "grow out" of its low-yield portfolio base. This belief was partially reinforced by the Garn-St Germain Act's emphasis on providing the industry with new asset powers to reduce dependency on mortgage lending.¹⁶⁹ Fourth, the industry, with its new powers, lacked experience to engage in those activities successfully.¹⁷⁰ This lack of experience was compounded by an impatience to increase yields to offset losses and nonearning assets by

J. Gray, Chairman, FHLBB); GAO, THRIFT INDUSTRY PROBLEMS: POTENTIAL DEMANDS ON THE FSLIC INSURANCE FUND 4-6 (1986).

163. 1984 FHLBB ANN. REP. 1 (1985).

164. See generally *Federal Regulation of Direct Investments By Savings and Loans and Banks: Hearings Before the Subcomm. on Commerce, Consumer, and Monetary Affairs of the House Comm. on Government Operations*, 99th Cong., 1st Sess. (1985); *The Federal Home Loan Bank Board's Proposed Direct Investment Regulation: Hearings Before the Subcomm. on Financial Institutions, Supervision, Regulation, and Insurance of the House Comm. on Banking, Housing, and Urban Affairs*, 99th Cong., 1st Sess. (1985).

165. See MODERNIZATION OF THE FINANCIAL SERVICES INDUSTRY, *supra* note 12, at 63.

166. See Schilling, *The Death of Discretion or Growing Pains?*, FINANCIAL LEADER 11 (Jan.-Feb. 1987); see also MODERNIZATION OF THE FINANCIAL SERVICES INDUSTRY, *supra* note 12, at 62.

167. See *supra* notes 151-52 and accompanying text.

168. See *supra* note 145; see also *Financial Condition of the Bank and Thrift Industries: Hearings Before the Subcomm. on Financial Institutions Supervision, Regulation, and Insurance of the House Comm. on Banking, Finance, and Urban Affairs* (pt. 1), 99th Cong., 1st Sess. 11 (1985) (statement of William Taylor, Director, Division of Banking Supervision and Regulation, Federal Reserve Board) [hereinafter *Financial Condition of the Bank and Thrift Industries*]; AGENDA FOR REFORM, *supra* note 19, at 73.

169. See *supra* notes 124, 126-28 and accompanying text.

170. See AGENDA FOR REFORM, *supra* note 19, at 99.

expanding into nontraditional activities and traditional activities in unfamiliar geographic areas.

Finally, the expanded powers of both federally and state-chartered institutions with substantial resources made the industry ripe for exploitation by cash-desperate entrepreneurs as well as certain criminal elements.¹⁷¹ Because of the low capital requirements, such individuals could acquire an institution by investing little or no capital. For these investors, there was "very little to lose if the speculation did not work out."¹⁷² In fact, it is estimated that between 1980 and 1983, misconduct by insiders was a major contributing factor in approximately 25% of all thrift failures.¹⁷³

The convergence of these factors threatened the very existence of the industry, and, in turn, subjected the thrift industry to increased regulatory and congressional scrutiny.¹⁷⁴ While the FHLBB responded with a number of often desperate regulatory initiatives, Congress debated the issues and considered various legislative proposals.¹⁷⁵ When Congress passed major banking legislation in 1987, it essentially reaffirmed the general trend of FHLBB regulation, although it offered no new bold solutions to remedy the thrift crisis.¹⁷⁶

To control the explosive growth within the thrift industry, the FHLBB entered a period of reregulation. Then-Chairman Edwin J. Gray characterized these actions as "historically unprecedented and critically important actions to reduce the risk exposure of the FSLIC by strengthening industry capital positions and providing for better monitoring of thrifts' conditions."¹⁷⁷ In 1985, the FHLBB issued regulations to slow the growth of deposits by correlating liability growth to net worth and requiring institu-

171. See generally HOUSE COMM. ON GOVERNMENT OPERATION, FEDERAL RESPONSE TO CRIMINAL MISCONDUCT AND INSIDER ABUSE IN THE NATION'S FINANCIAL INSTITUTIONS, H.R. REP. NO. 1137, 98th Cong., 2d Sess. 7 (1984) [hereinafter FEDERAL RESPONSE TO CRIMINAL MISCONDUCT AND INSIDER ABUSE].

172. See *id.*

173. MODERNIZATION OF THE FINANCIAL SERVICES INDUSTRY, *supra* note 12, at 62.

174. Some scrutiny could be anticipated, and was even planned for, in the passage of the Garn-St Germain Act. Section 712 of the Garn-St Germain Act, Pub. L. No. 97-320, 96 Stat. 1469, 1544 (1982), required both the FDIC and the FSLIC to conduct, within six months of enactment, a study of the current federal deposit insurance systems, the feasibility of additional insurance coverage and risk-based premiums, and consolidation of the insurance funds. *Id.* The FHLBB complied with the statute in March 1983, see AGENDA FOR REFORM, *supra* note 19, at 2-3, and the FDIC complied in April 1983. See generally FDIC, DEPOSIT INSURANCE IN A CHANGING ENVIRONMENT (1983).

175. See *supra* note 147.

176. See *infra* notes 185-223 and accompanying text.

177. *Deposit Insurance Reform Hearings*, *supra* note 2, at 215 (statement of Edwin J. Gray, Chairman, FHLBB).

tions to earn their growth.¹⁷⁸ In the same year, initiatives were taken to raise minimum capital requirements¹⁷⁹ and to correlate capital requirements with the degree of risk being undertaken by an institution.¹⁸⁰

The FHLBB also sought to limit the acquisition of brokered deposits,¹⁸¹ attempted to limit the direct investment authority of state-chartered thrifts,¹⁸² refused to process new insurance applications in certain states,¹⁸³ and sought to reclassify, as investments, transactions previously reported as loans.¹⁸⁴

E. Competitive Equality Banking Act of 1987

The enactment of the Competitive Equality Banking Act of 1987 (CEBA)¹⁸⁵ was a critical event in the evolution of the thrift industry. Although the final result constitutes a relatively moderate response to the problems of the industry, the CEBA does affect the industry in a number of important ways, including its ability to raise capital from outside sources.

A precise assessment of the legislation's impact on the industry is not a

178. *Id.*; see also FHLBB GUIDE, *supra* note 1, at 22; see also 50 Fed. Reg. 6891 (1985) (codified as amended at 12 C.F.R. §§ 561, 563, 570, 571, 584 (1987)).

179. See *infra* note 321.

180. 12 C.F.R. § 563.13 (1987). Even as Congress was enacting the Garn-St Germain Act to provide thrifts with greater asset powers, Congress had begun shifting its focus to the issue of reforming the deposit insurance system in light of the additional risk the insurance system assumed in a more deregulated environment. As part of the insurance study mandated by the Garn-St Germain Act, see AGENDA FOR REFORM, *supra* note 19, at 2-3, the FHLBB recommended maintenance of adequate capital by FSLIC-insured institutions to reduce the FSLIC's risk to a "prudent level." To this end, the FHLBB stated its belief that increased capital was necessary to provide a greater safeguard to the FSLIC and to ensure some management accountability for actions. Accordingly, it argued that thrift institutions should have the maximum ability to obtain new capital. *Id.* at 7; see also GAO, DEPOSIT INSURANCE: SUMMARY OF ANALYSIS OF REFORM PROPOSALS 9 (1986); BLUEPRINT FOR REFORM, *supra* note 90, at 83.

181. Brokered Deposits, Limitations on Deposit Insurance, 49 Fed. Reg. 13,003 (1984) (implementation enjoined in FAIC Securities, Inc. v. United States, No. 84-1136 (D.D.C. 1984), reprinted in 49 Fed. Reg. 27,294 (1984)).

182. Regulation of Direct Investment by Insured Institutions, 50 Fed. Reg. 6912 (1985) (codified as amended at 12 C.F.R. § 563.9 (1987)); H.R. Con. Res. 34, 131 CONG. REC. 828 (1985) (upheld in Lincoln Sav. & Loan Ass'n v. FHLBB, 670 F. Supp. 449 (D.D.C. 1987)).

183. FSLIC insurance applications by thrifts chartered in California, Texas, and Florida were the primary targets of the FHLBB. See FHLBB to Give Insurance Review Priority to Applicants Committed to Home Lending, Wash. Fin. Rep. (BNA) at 607 (Oct. 24, 1983); Fitzgerald, Insurance Delays Irk California S & L's, Am. Banker, Nov. 10, 1983, at 3, col. 2; McCue, Bank Board Eyes Thrift Crackdown, Am. Banker, Oct. 13, 1983, at 1, col. 1; Satterfield, Giving Thrifts Room to Grow, Am. Banker, Nov. 4, 1985, at 16, col. 3.

184. Classification of Assets, 50 Fed. Reg. 53,275 (1985) (codified at 12 C.F.R. §§ 561.15-16c, 563.17-2, 571.1(a) (1987)).

185. Pub. L. No. 100-86, 101 Stat. 552 (1987) (to be codified in scattered sections of 12 U.S.C., 15 U.S.C., and 31 U.S.C.) [hereinafter CEBA].

simple task, however, for four reasons. First, the CEBA is truly an omnibus piece of legislation, containing twelve separate titles affecting many aspects of the financial services industry. Each title represents one or more separate legislative agendas.¹⁸⁶ Because Congress scattered the thrift provisions throughout these various titles, many of the provisions are subject to different, and often competing, agendas.¹⁸⁷

Second, implementation of new laws is always a time consuming task. That task is complicated by the sheer number of thrift provisions in the CEBA and the fact that one regulator has sole responsibility for implementing virtually all of those provisions. Although the FHLBB has done an admirable job, implementation has taxed the limits of the FHLBB's ability to process change.¹⁸⁸ Because implementation is incomplete, and will remain so in the immediate future, it may not be possible to measure the full extent of the legislation's impact for several years.

Third, because the CEBA emerged as a composite bill representing a number of smaller bills, there was little coordination from title to title of the various provisions and their effects. Consequently, a number of the CEBA's

186. *E.g.*, Title I-Financial Institutions Competitive Equality Act, *id.* §§ 101-111, 101 Stat. 554-81; Title II-Moratorium on Certain Nonbanking Activities, *id.* §§ 201-205, 101 Stat. 581-85; Title III-FSLIC Recapitalization, *id.* §§ 301-307, 101 Stat. 585-604; Title IV-Thrift Industry Recovery Provision, *id.* §§ 401-416, 101 Stat. 604-23; Title V-Financial Institutions Emergency Acquisitions, *id.* §§ 501-509, 101 Stat. 623-35; Title VI-Expedited Funds Availability, *id.* §§ 601-613, 101 Stat. 635-52; Title VII-Credit Union Amendments, *id.* §§ 701-716, 101 Stat. 652-56; Title VIII-Loan Loss Amortization, *id.* § 801, 101 Stat. 656-57; Title IX-Full Faith and Credit of Federally Insured Depository Institutions, *id.* § 901, 101 Stat. 657; Title X-Government Checks, *id.* §§ 1001-1006, 101 Stat. 657-60; Title XI-Interest to Certain Depositors, *id.* § 1101, 101 Stat. 660; Title XII-Miscellaneous Provisions, *id.* §§ 1201-1205, 101 Stat. 660-63. Title I, which alone would have constituted an omnibus bill, affects bank holding companies, savings and loan holding companies, securities activities of nonmember insured banks and FSLIC-insured institutions, leasing authority of national banks, NOW account authority for all financial institutions, and affiliate transactions for FSLIC- and FDIC-insured institutions. *Id.* §§ 101-111, 101 Stat. 554-81.

187. For example, the FHLBB lobbied principally for the FSLIC recapitalization provisions and for some modifications to the forbearance provision. *See* S. REP. NO. 19, 100th Cong., 1st Sess. 79-86, *reprinted in* 1987 U.S. CODE CONG. & ADMIN. NEWS 489, 568-75. The Federal Reserve Board focused principally on the title I provisions to close the nonbank bank loophole and the corresponding "unitary savings and loan holding company loophole" restrictions. *See id.* at 4, 7, *reprinted in* 1987 U.S. CODE CONG. & ADMIN. NEWS 489, 494, 497; *see also infra* note 217 and accompanying text. The FDIC focused on title V's emergency acquisition and bridge bank provisions. The consumer groups lobbied for the expedited funds availability provisions and the provision affecting cashing of government checks. *See id.* at 25-28, *reprinted in* 1987 U.S. CODE CONG. & ADMIN. NEWS 489, 515-18. Major segments of the banking industry were preoccupied by the title II moratorium on new bank and bank holding company powers. *See id.* at 93-96, *reprinted in* 1987 U.S. CODE CONG. & ADMIN. NEWS 489, 582-85.

188. Requirements of the Competitive Banking Equality Act of 1987, FHLBB Internal Memorandum, Fall 1987.

provisions cannot be interpreted easily or molded into an integrated regulatory scheme.¹⁸⁹

Fourth, the critical FSLIC recapitalization provision constituted a compromise many believed to be inadequate at best.¹⁹⁰ Moreover, certain provisions of the legislation may be transitory, applicable only until Congress can find a more lasting resolution of the industry's thrift problems.¹⁹¹

Although a full analysis of the CEBA is beyond the scope of this Article, a brief summary of the major thrift provisions is necessary to document fully its likely effect on the continuing evolution of the industry and its ability to attract new capital. The provisions specifically affecting thrifts may be divided into four basic categories.

The first includes provisions to recapitalize the FSLIC and preserve the integrity of the insurance fund and the recapitalization scheme during the process.¹⁹² These provisions, which are short-term remedies at best, seek to preserve the existence of a separately insured industry, at least until discovery of a more lasting solution.

Under the recapitalization plan, the FSLIC will receive an injection of \$10.8 billion, financed principally by securities issued by the Financing Corporation, an entity created by the CEBA for the sole purpose of facilitating the recapitalization plan.¹⁹³ The amount available to the FSLIC in any one

189. For example, the CEBA provided financial forbearance to certain thrifts at the same time it made accounting standards and capital requirements more restrictive for the industry. See *infra* notes 198, 200, 201-04 and accompanying text.

190. The conference committee adjourned on July 1, 1987. In a highly unusual move, the committee reconvened on July 29, 1987, to resolve serious political differences on the appropriate level of FSLIC recapitalization and to avoid a possible presidential veto. The elements of the compromise agreed to by the conferees included an increase in the amount of FSLIC recapitalization to \$10.8 billion, a sunset of some of the more controversial regulatory forbearance provisions "when the financing corporation makes its final net new borrowings," and a provision to permit "any financial or commercial concern to acquire an insolvent savings and loan association with assets of \$500 million or more." 133 CONG. REC. H6945 (daily ed. Aug. 3, 1987) (statement of Rep. Wylie); see also *id.* at H6947-49 (daily ed. Aug. 3, 1987) (statement of Rep. Parris).

191. See *infra* notes 195-96 and accompanying text.

192. CEBA, Pub. L. No. 100-86, §§ 302-307, 101 Stat. 585-604 (codified as amended at 12 U.S.C.A. §§ 1430, 1436, 1441, 1725, 1727, 1730 note and 31 U.S.C.A. § 9101 (West Supp. 1987)).

193. The CEBA requires each federal home loan bank to invest not more than the aggregate of its legal reserves and its undivided profits on December 31, 1985, and its legal reserves and undivided profits after December 31, 1985, in nonvoting capital stock of the Financing Corporation. 12 U.S.C.A. § 1441(d)(3) (West Supp. 1987). The CEBA limits the aggregate investment of all federal home loan banks to \$3 billion. *Id.* § 1441(d)(2). The Financing Corporation, which the FHLBB regulates, has congressional authorization to borrow from the capital markets by issuing debt. *Id.* § 1441(c)(3), (e). The Financing Corporation makes these funds available to the FSLIC by investing in FSLIC-issued securities. *Id.* § 1441(c)(2), (e)(3).

year under the plan is limited to \$3.75 billion.¹⁹⁴

Essential to the integrity of the recapitalization plan is the requirement that an exit fee be assessed against any institution terminating FSLIC insurance coverage.¹⁹⁵ Congress included this provision after a number of institutions announced their intentions to terminate coverage and several other institutions converted to, or were acquired by, FDIC-insured institutions. In addition to the exit fee requirement, the CEBA imposed a one-year moratorium to prevent institutions from voluntarily leaving the FSLIC.¹⁹⁶

The second group of provisions, which is included in the Thrift Industry Recovery Provisions, represents the culmination of congressional and industry frustration with FHLBB policies and practices.¹⁹⁷ In some cases, the statute reaffirms the general thrust of prior but yet unaccomplished FHLBB initiatives. For example, the CEBA requires the FHLBB to adopt regulations that will eventually apply generally accepted accounting principles (GAAP)¹⁹⁸ to all thrifts to the same degree that such standards apply to commercial banks.¹⁹⁹ The CEBA also directs the FSLIC to require all thrifts to achieve and maintain adequate capital "consistent with" the requirements established by the federal banking agencies.²⁰⁰

In an effort to encourage greater regulatory flexibility to aid the "capital recovery" of the industry, the CEBA also includes a provision calling for forbearance.²⁰¹ The intent of forbearance is to maximize the long-term viability of the thrift industry at the lowest cost to the FSLIC.²⁰² Accordingly, the CEBA directs the FHLBB to propose regulations for supervising and regulating "troubled but well-managed and viable" associations as an alter-

During the period of recapitalization, the Financing Corporation collects all insurance assessments due to the FSLIC. *Id.* § 1441(f).

194. *Id.* § 1441(e)(2). A restriction on the annual borrowing ability of the Financing Corporation imposes this limit. *Id.*

195. Pub. L. No. 100-86, § 302, 101 Stat. 552, 592 (1987); *see also infra* notes 337-40 and accompanying text.

196. 12 U.S.C.A. §§ 1727, 1730, 1730 note (West Supp. 1987).

197. *See* 133 CONG. REC. H6963 (daily ed. Aug. 3, 1987) ("The agency's controversial actions are the primary reason there is forbearance [sic] language in the bill.") (remarks of Rep. Dreier).

198. 12 U.S.C.A. §§ 1467(b) (West Supp. 1988); *See* Uniform Accounting Standards, 53 Fed. Reg. 324 (1988) (codified at 12 C.F.R. pt. 561, 563, 563(c) (1987)). These regulations do not prohibit thrifts from using subordinated debt to meet reserve and other regulatory requirements.

199. *See generally* 12 U.S.C.A. §§ 3901-09 (West Supp. 1988).

200. 12 U.S.C.A. § 1464(s)(1) (West Supp. 1987); *see also* Capital Forbearance, 53 Fed. Reg. 354 (1988) (to be codified at 12 C.F.R. pt. 563).

201. 12 U.S.C.A. § 1467a (West Supp. 1987).

202. *Id.*

native to closing the institutions.²⁰³ However, forbearance is *not* available when the weakened capital condition of an institution results from imprudent operating practices, insider abuses, excessive operating expenses, dividends, or actions taken solely for the purpose of qualifying for capital recovery.²⁰⁴ In addition, the CEBA formally revalidates the FHLBB's use of capital certificates for qualifying thrifts.²⁰⁵

Addressing concerns about prior regulatory abuse, the third set of thrift provisions target improvement of the regulatory procedures of the FHLBB. These provisions encourage the FHLBB to delegate more authority to district banks. They also encourage greater flexibility in applying the FHLBB regulations,²⁰⁶ but mandate the establishment of an informal and independent review of certain supervisory decisions, such as the appraisal of the value of loans or property serving as collateral, the classification by an examiner of any loan held by an association as substandard, doubtful, or lost, and the resulting imposition of a requirement on the association to establish or add to a reserve or allowance for possible loan losses.²⁰⁷ In addition, the CEBA requires the FHLBB to promulgate guidelines providing for automatic approval of applications submitted to the FHLBB at the end of a prescribed period unless the application has been approved or disapproved before the end of that period.²⁰⁸

The fourth set of thrift provisions limit the operation of thrifts or their holding companies and ultimately may serve to discourage much-needed capital investment from outside the thrift industry. One such provision reflects an effort to preserve the role of the savings and loan industry as principally home mortgage lenders by requiring thrifts to meet a qualified thrift lender (QTL) test.²⁰⁹ The conferees expressly noted that the CEBA imposed the QTL test for the purpose of "committing insured institutions to the

203. *Id.* The FHLBB will make capital forbearance available to institutions with a net worth of 0.5% or more whose weakened capital condition results primarily from (a) loan losses attributable to economic conditions in a designated economically depressed region or (b) loan losses made by a minority institution, 50% or more of whose loans are minority loans and 50% or more of whose loans are construction or permanent loans for one to four family residences. *Id.* § 1467a(b)(1)(A), (B).

204. *Id.* § 1467a(b)(2) notes 205-464.

205. *Id.* § 1725(b).

206. *Id.* § 1430 note.

207. *Id.* § 1442a; see Classification of Assets, 53 Fed. Reg. 338 (1988) (to be codified at 12 C.F.R. pts. 561, 563, 571); Appraisal Policies and Practices of Insured Institutions and Service Corporations, 53 Fed. Reg. 372 (1988) (to be codified at 12 C.F.R. pts. 563, 571).

208. 12 U.S.C.A. § 1437 note (West Supp. 1987). See Applications Processing Guidelines, 52 Fed. Reg. 39,064 (1987) (to be codified at 12 C.F.R. pt. 571).

209. 12 U.S.C.A. § 1730a(o) (West Supp. 1987); see also Qualified Thrift Lender Test; Savings and Loans Holding Company Amendments; Federal Home Loan Bank Advances, 53 Fed. Reg. 312 (1988) (to be codified at 12 C.F.R. pts. 525, 583, 584).

unique, congressionally defined role of providing housing finance."²¹⁰

The QTL test requires that an institution have, on average and in three out of every four quarters of two out of every three years, "qualified thrift investments" equal to at least sixty percent of its tangible assets.²¹¹ The institution must meet the QTL test by the end of the two year period beginning on August 10, 1987, or by the date on which a company receives approval to become a savings and loan holding company, whichever is later.²¹² Any insured institution failing to maintain its QTL status may not requalify as a QTL for five years.²¹³

Failure to meet the QTL has two consequences. First, an institution which is not a QTL has limited access to Federal Home Loan Bank advances.²¹⁴ Second, if the institution fails to meet the QTL test, the parent holding company may engage only in limited activities permissible for multiple savings and loan holding companies²¹⁵ or bank holding companies under section 4(c) of the Bank Holding Company Act (BHCA).²¹⁶ An additional

210. H.R. CONF. REP. NO. 261, 100th Cong., 1st Sess. 137 (1987).

211. 12 U.S.C.A. § 1730a(o) (West Supp. 1987). The CEBA defines a qualified thrift investment as "the sum of the aggregate amount of loans, equity positions or securities held by" an institution "which are related to domestic residential real estate or manufactured housing, the value of property used by such institution or subsidiary in the conduct of the business," "liquid assets of the type required to be maintained under § 5A of the FHLB Act," and "fifty percent of the dollar amount of the residential mortgage loans originated" and sold by the institution within ninety days of origination. CEBA, Pub. L. No. 100-86, § 104, 101 Stat. 552, 572.

212. FHLBB regulators deem an institution to have QTL status as of January 1, 1988. If the institution fails to meet the QTL test, it will not lose that status until June 30, 1989.

213. 12 U.S.C.A. § 1730a(o)(2), (4) (West Supp. 1987). The FHLBB may grant temporary exceptions from the QTL test when extraordinary circumstances exist, such as when high interest rates reduce mortgage demand to such a degree that an insured institution lacks sufficient opportunity to meet the asset requirements or to aid the FHLBB in facilitating acquisitions and mergers of troubled institutions. *Id.* § 1730a(o)(3).

214. *Id.* § 1430(e). The CEBA limits the institution's ability to borrow to an amount equal to the institution's otherwise existing eligibility for borrowing multiplied by its actual thrift investment percentage. *Id.* § 1430(e)(1).

215. Prior to the enactment of the CEBA, the industry referred to savings and loan holding companies as unitary and multiple. A unitary savings and loan holding company owned only one FSLIC-insured subsidiary and was subject to few restrictions on its activities. A multiple savings and loan holding company owned more than one FSLIC-insured institution and was subject to extensive restrictions on its activities. *See* 12 U.S.C. § 1730a(1)(E), (c)(2) (1982).

216. CEBA, Pub. L. No. 100-86, § 104, 101 Stat. 552, 568 (1987). A unitary savings and loan holding company formed before March 5, 1987 is exempt from the nonbanking restrictions of the CEBA, even if its subsidiary fails to meet the QTL test, if the holding company does not acquire additional banks or thrifts or increase the number of its subsidiary's business locations (other than by FSLIC-arranged or assisted acquisitions), or engage in any nonbanking activities except those existing on March 5, 1987. *Id.* at 570. However, its subsidiary must continue to meet the Internal Revenue Code asset test and must not incur any overdrafts at a Federal Reserve Bank. *Id.* The CEBA permits the FSLIC to eliminate such grandfathered

purpose of this restriction is to close the "nonthrift thrift" or unitary savings and loan holding company loophole in a manner consistent with the closing of the nonbank bank loophole.²¹⁷

The second provision limits the operating flexibility of a diversified savings and loan holding company.²¹⁸ The CEBA restricts the activities of a diversified savings and loan holding company by prohibiting its insured institution subsidiary from engaging in new joint marketing activities with any affiliate unless the activities of the affiliate are the same as those permitted of bank holding companies under the BHCA.²¹⁹ Joint marketing activities engaged in as of March 5, 1987 may be continued, however, in the same manner in which they were being offered or marketed on such date.²²⁰

A third provision extended the restrictions imposed by sections 20 and 32 of the Glass-Steagall Act²²¹ on FSLIC-insured thrifts until March 1, 1988.²²² Although limited in duration, the extension established a possible precedent for restricting the securities activities and affiliations of FSLIC-insured institutions that had not previously been subjected to such statutory limitations during the fifty-five year history of the Glass-Steagall Act. Under the CEBA, however, FSLIC-insured institutions enjoyed more flexibility than afforded FDIC-insured institutions by the Glass-Steagall Act's restrictions.²²³

rights "to prevent conflicts of interest, . . . unsound practices or" when otherwise required in the public interest. *Id.*

217. See generally *Nonbank Banks Hearings supra* note 125; see also *supra* note 187. A nonbank bank is a banking institution that was not a "bank," as the BHCA defined that term, prior to the enactment of the CEBA. See Board of Governors of the Fed. Reserve Sys. v. Dimension Fin. Corp., 974 U.S. 361, 363 (1985). Under the pre-CEBA definition, a "bank" was an institution that accepted deposits and made commercial loans. *Id.* Nonbank banks engaged in one or the other activity, but not both. See *id.* Owners of nonbank banks avoided regulation under the BHCA. *Id.* at 363-64; see also Florida Dep't of Banking & Fin. v. Board of Governors of the Fed. Reserve Sys., 760 F.2d 1135, 1142 (11th Cir. 1985), *vacated*, 474 U.S. 1098, *on remand* 850 F.2d 1543 (11th Cir. 1986), *cert. denied*, 107 S. Ct. 1887 (1987). Following the enactment of the CEBA and the redefinition of the term "bank," nonbanking companies that acquired nonbank banks prior to March 5, 1987 continue to be exempt from most provisions of the BHCA, subject to certain conditions. 12 U.S.C.A. § 1843(a)(2) (West Supp. 1987).

218. A diversified savings and loan holding company is a holding company whose thrift-related activities account for less than 50% of the thrift's net worth and net earnings. 12 U.S.C. § 1730a(a)(1)(F) (1982).

219. 12 U.S.C.A. § 1730a(p)(2)(A) (West Supp. 1987).

220. *Id.*

221. Pub. L. No. 73-66, 48 Stat. 162 (1933) (codified as amended at 12 U.S.C. §§ 24, 78, 377, 378 (1982 & Supp. IV 1986) and scattered sections of 18 U.S.C.).

222. 12 U.S.C.A. § 1730a note (West Supp. 1987); see also *infra* notes 379-81 and accompanying text.

223. See *infra* note 380. Under the CEBA, affiliations between FSLIC-insured institutions and securities firms that commenced prior to March 5, 1987 were grandfathered. Pub. L. No.

F. *A New Era for the FHLBB*

In May 1983, Edwin J. Gray, at the urging of the White House and the United States League of Savings Institutions,²²⁴ became the chairman of the FHLBB. During his tenure as chairman, one of the longest in the recent history of the agency and certainly one of its most controversial, Gray repeatedly confronted industry trade groups, thrift executives, and members of Congress who opposed his attempts to curb freewheeling industry practices that he deemed harmful to the industry's health.²²⁵

When he arrived, deregulation was well under way, especially in states such as California and Texas.²²⁶ However, problems for the FSLIC continued to mount. For example, in March 1984, Empire Savings and Loan of Mesquite, Texas became the largest thrift, as of that time, to be declared insolvent.²²⁷ A growing wave of thrift failures followed.

Gray's critics accused him of being incapable of handling the thrift crisis. One industry analyst noted: "[T]he last couple of years, we have had new problems and Gray is handling them in the old way. What we got was tinkering. Gray did not measure up to the structural changes affecting all thrifts."²²⁸

Gray's main response to the crisis was reregulation. Under his leadership, the FHLBB began promulgating new restrictions designed to curb industry growth and investments.²²⁹ Later in his term, Gray announced plans to publish proposed regulations that he apparently had no intention of adopting, solely to distract the industry from other regulations that he sought to adopt.²³⁰

Gray's relationship with Congress also was rocky. Members of the industry consistently complained about him to key congressional members. Mem-

100-86, §§ 104, 201, 101 Stat. 552, 570, 582 (1987) (codified as amended at 12 U.S.C.A. §§ 1730a, 1841 note (West Supp. 1987)).

224. McTague, *An Introspective Gray is Bloodied but Unbowed*, Am. Banker, June 25, 1987, at 24, col. 1.

225. *Id.* at 1, cols. 3, 4; see also *supra* note 164.

226. *Id.* at 24, col. 1

227. *Id.* at 23, col. 3.

228. *Id.* at 23, col. 2.

229. See *id.* at 1, col. 4, 24, col. 2. Examples of such regulations included a plan to limit insurance on brokered deposits, Brokered Deposits; Limitations on Deposit Insurance, 49 Fed. Reg. 13,003 (1984), and increased net-worth and liability regulations. Net Worth Requirements of Insured Institutions, 50 Fed. Reg. 6891 (codified as amended at 12 C.F.R. § 563.13(b) (1987)). A United States District Court subsequently overturned the brokered-deposit regulations as beyond the agency's statutory authority. See *FIAC Sec., Inc. v. United States*, 595 F. Supp. 73, 79 (D.D.C. 1984), *aff'd*, 768 F.2d 352 (D.C. Cir. 1985). Many members of the industry opposed both sets of regulations.

230. McTague, *supra* note 224, at 24, col. 2.

bers of the House Banking Committee criticized his handling of the Ohio savings and loan crisis, claiming his tardy offering of FSLIC coverage to privately insured Ohio thrifts exacerbated the crisis.²³¹ Moreover, Justice Department probes of his expense account and traveling expenditures, as well as an FBI investigation of his \$47,000 office renovation did little to enhance Gray's image among congressional members.²³²

In July 1987, M. Danny Wall, former majority and minority staff director of the Senate Banking, Housing, and Urban Affairs Committee replaced Gray as Chairman of the FHLBB.²³³ In one of his first public appearances as chairman, Wall expressed optimism about the future of the industry and his ability to resolve the crisis at the FSLIC: "This agency, this system and this industry are standing on the threshold of a new and brighter future."²³⁴ Wall announced that his agenda as chairman was to "reaffirm our commitment to the safety of deposits, to rebuild the agency and to resolve problems."²³⁵

Early in his administration, Wall's efforts began to produce visible results. Just forty-two days after he took office, Wall won respect and credibility from the industry for his handling of a "crisis" triggered by Texas Governor William Clements.²³⁶ He also developed new internal procedures for processing applications.²³⁷ Furthermore, Wall removed some of the controversial symbols of former Chairman Gray's administration such as the locked glass doors and the security guard posted outside the board members' offices.²³⁸

Chairman Wall, however, soon tempered his optimism. By November 1987, Wall had begun to express less enthusiastic predictions about a reasonable turn-around time for the industry. In a speech before the annual meeting of the United States League of Savings Institutions, Wall acknowledged that the bottom line for revitalizing the industry is the need for more

231. *Id.* at 23, col. 2.

232. *Id.* at 23, cols. 2, 3.

233. Speech by M. Danny Wall, Chairman, FHLBB, to the National Press Club 1 (Aug. 6, 1987).

234. *Id.* at 2.

235. *Id.* at 6.

236. McTague, *Three Take on Fate of Thrifts*, *Am. Banker*, Aug. 31, 1987, at 7, col. 2. Governor Clements had predicted that the FSLIC would not be able to pay off all of the fully insured depositors of Texas' failing institutions. *Id.* Wall responded by holding a press conference to rebut the Governor's claims and reaffirm the FSLIC's commitment to depositors. *Id.*

237. *See supra* note 208.

238. Telephone interview with Dolores Kelly, FHLBB Communications Office (May 2, 1988).

"human capital and financial capital."²³⁹ However, he asserted his objective for resolving FSLIC problem cases at a greatly accelerated pace, announcing: "[o]ur 1988 [sic] very conservative goal is [to close or merge] one [failed institution] a week, 52 institutions for 1988."²⁴⁰

III. THE CURRENT PROBLEMS OF THE THRIFT INDUSTRY

By the end of 1986, the savings and loan crisis worsened to such a point that it threatened the very existence of the FSLIC, if not the soundness of the financial structure of the country. This crisis did not originate solely from the mismatch of interest rates caused by the high period of inflation in the late 1970's and early 1980's or from the regulatory or legislative action or inaction discussed above.

Competitive factors also played several different, but significant roles in the evolution of the financial services industry. Technological innovations enabled institutions to provide a broader range of services to a more dispersed market at a lower cost, and erased many of the functional distinctions between different classes of financial services providers.²⁴¹ Advances in communications and computer technology also shattered the territorial security of traditional thrifts. Today, for example, a home buyer's realtor can "shop" for different rates and types of mortgages from institutions in distant cities and states rather than dealing only with the local lenders.

A second major competitive development has been the significant increase in product innovation. Since the 1970's, the financial services industry has created a wide variety of new financial instruments.²⁴²

At the same time these new products were being created, there was a cor-

239. Speech of M. Danny Wall, Chairman, FHLBB, before the Annual Meeting of the U.S. League of Savings Institutions 12 (Nov. 9, 1987).

240. *Id.* at 13.

241. *Financial Innovation and the Structure and Regulation of Financial Firms: Hearings Before the Subcomm. on Commerce, Consumer, and Monetary Affairs of the House Comm. on Government Operations*, 99th Cong., 2d Sess. 1 (1986) (statement by Rep. Barnard, Chairman); AGENDA FOR REFORM, *supra* note 19, at 70-72.

242. The variety of new products include new forms of mortgages such as variable, adjustable, and shared-appreciation mortgages, *see* 12 U.S.C. § 1464(c)(1)(O) (1982), *amended by* 12 U.S.C.A. § 1464(c)(1)(O) (West Supp. 1987); secondary mortgage market instruments, such as mortgage-backed bonds, mortgage pass-through certificates, collateralized mortgage obligations, *id.* § 1464(c)(1)(O) (1982), *amended by* 12 U.S.C.A. § 1464(c)(1)(O) (West Supp. 1987); credit and debit cards, *id.* § 1464(b)(4) (1982); securitized assets, including auto loans and credit-card receivables, *id.* § 1464(c)(2)(A) (1982), *amended by* 12 U.S.C.A. § 1464(c)(2)(A) (West Supp. 1987); variable annuities, money-market funds, and home equity loans, *id.* 3503(c)(1) (1982), *amended by* 12 U.S.C.A. § 3503(c)(1) (West Supp. 1987); *see also* AGENDA FOR REFORM, *supra* note 19, at 74; RESTRUCTURING FINANCIAL MARKETS, *supra* note 60, at 16, 285.

responding increase in consumer sophistication.²⁴³ Rate sensitivity to both deposit and loan products, awareness of fee structures, and demands for new, flexible products placed great demands on institutions and resulted in new competitive pressures. In particular, the thrift industry faced greatly increased competition in its traditional lines of business. Nonbank competitors successfully capitalized on increased consumer awareness of financial matters, capturing significant shares of consumer deposits and money market funds.²⁴⁴ Nonbank competitors also made use of the nonbank bank loophole to gain ownership of federally insured depository institutions with access to the payment systems.²⁴⁵ In addition, nonbank competitors actively began marketing credit and debit cards.²⁴⁶ Increasingly, the function of the banking system was split between commercial and consumer ventures.

Moreover, the nature of the problem confronting the FSLIC changed dramatically. Previously, the troubles of its insured thrifts largely resulted from disintermediation and/or losses on the spread between portfolio income and the increased interest costs of its liabilities. The explosive growth of thrifts discussed above, as well as the abuse and mismanagement by some of new powers, caused a shift in the problem. Now, instead of dealing with underwater, but still producing assets, the FSLIC has to deal with nonproducing assets that often have little or no marketability.

A. *The Financial Condition of the FSLIC*

The percentage ratio of FSLIC reserves to insured deposits has decreased steadily since 1969. In 1985, FSLIC's reserves were \$4.6 billion or .55% of insured savings deposits, down from 2.17% in 1969.²⁴⁷ This decrease in FSLIC reserves was due to the increased cost of this continuing, high level of

243. See generally *How the Financial System Can Best Be Shaped to Meet the Needs of the American People: Hearings on H.R. 5734 Before the House Comm. on Banking, Finance, and Urban Affairs*, 98th Cong., 2d Sess. (1984).

244. See *supra* note 60.

245. See *supra* note 217; see also *Comprehensive Reform in the Financial Services Industry: Hearings Before The House Comm. on Banking, Housing, and Urban Affairs*, 99th Cong., 1st Sess. 33 (1985) (statement of Paul A. Volcker, Chairman, Board of Governors of the Federal Reserve System); RESTRUCTURING FINANCIAL MARKETS, *supra* note 60, at 162-64; 133 CONG. REC. S11,210 (daily ed. Aug. 4, 1987) (statement of Sen. D'Amato); *id.* at H6948 (daily ed. Aug. 3, 1987) (statement of Rep. Parris); *id.* at S3800 (daily ed. Mar. 25, 1987) (statement of Sen. Proxmire); *id.* at S4058 (daily ed. Mar. 25, 1987) (statement of Sen. Glenn). See generally *Nonbank Banks Hearings*, *supra* note 125.

246. See Cocheo, *Bankcards at the Cross Roads*, ABA BANKING J. 66 (1987); Karmin, *Wait 'til Next Year*, U.S. NEWS & WORLD REP., Aug. 10, 1987, at 46; *Fed. Permits First Chicago Corp. to Acquire Beneficial's Nonbank Bank*, 48 Banking Rep. (BNA) 957 (June 1, 1987); *Researcher Says Optima on Target With Affluent Credit Card Customers*, Am. Banker, July 1, 1987, at 1, col. 2.

247. J. BARTH, *supra* note 140, at 42. By 1975, that figure decreased to 1.52%. *Id.* In

thrift failures.²⁴⁸

Beginning in March 1985, the FSLIC imposed a special quarterly assessment on insured institutions in an attempt to meet increased FSLIC losses and expenses of the dwindling insurance fund.²⁴⁹ As a result, on an annual basis since March 1985, the FSLIC has required institutions to pay as a special assessment, in addition to the regular one-twelfth of one percent premium,²⁵⁰ of one-eighth of one percent of deposits.²⁵¹

As the types of problems contributing to failures shifted from spread losses resulting from interest rate mismatches to asset problems, the FSLIC's cost of closing or merging insolvent thrifts rose dramatically. In 1980, the figure was estimated to be 7.2% of assets. That figure remained fairly constant until 1984, when it doubled to 14.7%. By 1986, the figure had risen to 23.5% of assets and in 1987 was estimated to be 34.0%.²⁵²

In addition to encouraging interstate mergers, one of the FSLIC's first steps to conserve cash when resolving problems of troubled institutions was to adopt the "Phoenix Plan" in 1983. The theory of the Phoenix Plan was to combine weak or insolvent thrifts into one institution where competent management could maximize economies of scale, cut expenses, eliminate overlapping branch networks and, over time, restore profitability.²⁵³

Despite disappointing results with the Phoenix Plan, the FHLBB officials attempted, in 1985, to respond to the increased onslaught of insolvent thrifts and the dwindling FSLIC resources by creating a similar program—the Management Consignment Program (MCP).²⁵⁴ The FHLBB designed MCP to put technically insolvent and severely troubled thrifts into a "holding pattern" under new management to avoid the expense of placing these institutions into receivership.²⁵⁵ The FHLBB expected new management of

1980, the percentage decreased further to 1.34%. *Id.* By 1984, the percentage was .82% and by 1985 the percentage fell to .55%. *Id.*; 1985 FHLBB ANN. REP. 26 (1986).

248. See 1986 FHLBB ANN. REP. 15 (1987); see also FHLBB GUIDE, *supra* note 1, at 21.
249. See *supra* note 40.

250. FSLIC Insurance Premium, 50 Fed. Reg. 51,948 (1985); FSLIC Insurance Premium, 51 Fed. Reg. 8894 (1986); FSLIC Insurance Premium, 51 Fed. Reg. 21,804 (1986); FSLIC Insurance Premium, 51 Fed. Reg. 32,686 (1986); FSLIC Insurance Premium, 51 Fed. Reg. 45,946 (1986); FSLIC Insurance Premium, 52 Fed. Reg. 9538 (1987); FSLIC Insurance Premium, 52 Fed. Reg. 21,738 (1987); FSLIC Insurance Premium, 52 Fed. Reg. 34,843 (1987); FSLIC Insurance Premium, 52 Fed. Reg. 48,575 (1987).

251. 12 U.S.C. § 1727(b)(1) (1982).

252. McTague, *Dealing with the Thrift Industry Blob*, *Am. Banker*, Jan. 22, 1988, at 5, col. 2 (citing R. Dan Brumbaugh, Jr., independent thrift economist).

253. See A. CARRON, *supra* note 16, at 30-31; see also Gould, *supra* note 57, at 11-12.

254. White, *Facing the Issues*, *OUTLOOK OF THE FEDERAL HOME LOAN BANK SYSTEM*, May-June 1987, at 24.

255. *Id.*

a MCP to stabilize the institution and cut operating expenses wherever possible.

Twenty-two institutions entered the MCP program in 1986, and twenty-five more institutions joined the program in 1987.²⁵⁶ It has been estimated that the cost to the FSLIC to resolve the financial problems of these institutions increases by \$6 million per day for each day these institutions remain in the program.²⁵⁷

Despite the FSLIC's efforts to generate income through special assessments and to cut costs by placing institutions in the MCP, losses continued and the General Accounting Office (GAO) declared the FSLIC to be technically insolvent following its 1986 year-end audit.²⁵⁸ As of December 31, 1986, the GAO found that FSLIC had \$10.8 billion in assets and \$17.2 billion in liabilities.²⁵⁹ Congress responded to the FSLIC's financial problem by passing the recapitalization plan in the CEBA.²⁶⁰

There is the increasing sentiment, however, that the CEBA recapitalization plan is an inadequate solution to the industry's problems. One of the industry's principal trade groups, which had originally supported a \$5 billion limit on the FSLIC recapitalization plan, has now acknowledged that such an amount could be inadequate to resolve the crisis.²⁶¹ Similar sentiments have been echoed throughout the industry. In fact, in November 1987, members of the Federal Savings and Loan Advisory Committee, an advisory body to the FHLBB, expressed concern that the industry may not exist as a separate industry in five years.²⁶²

Some members of Congress also have recognized that another solution may be necessary. At the time Congress enacted the CEBA, Representative Parris stated: "This Congress must in the near future search for alternative solutions for thrift problems. If the losses climb so high that the industry

256. FSLIC, 1987 Assisted Acquisitions and Mergers, (1988) (FHLBB Release).

257. *Federal Savings and Loan Insurance Corporation Recapitalization Act of 1987: Hearing Before the House Comm. on Banking, Finance, and Urban Affairs*, 100th Cong., 1st Sess. 55 (1987) (statement of Rep. Wylie) [hereinafter *FSLIC Recapitalization*].

258. FINANCIAL AUDIT, *supra* note 6, at 6.

259. *Id.* at 13.

260. *See supra* notes 192-94 and accompanying text.

261. *Official Talk of New Public FSLIC Bailout Spreads*, *Am. Banker*, Nov. 23, 1987, at 20, col. 2. At the United States League of Savings Institutions annual convention in New Orleans in November, 1987, League Chairman Theo H. Pitts, Jr. stated that "there is a limited amount of money that healthy thrifts can contribute to help the FSLIC liquidate the 20% of the industry that is dragging the rest of it down." *Id.* Former League Chairman Gerald Levy supported Pitts' position, stating that while the industry would pay its fair share, it was impossible for the industry to pay the whole bill. *Id.*

262. *Cf.* Minutes of the Meeting of the Federal Savings and Loan Advisory Council (No. 129) (Nov. 18-19, 1987) (discussing means to bolster the industry).

alone will not be able to rescue itself, then the Congress will be forced to address a comprehensive alternative."²⁶³

Additionally, the CEBA provisions adopted to bolster the FSLIC, for the most part, are stop-gap measures rather than a permanent solution to the thrift crisis.²⁶⁴ The moratorium to prevent FSLIC-insured institutions from leaving the FSLIC expires on August 10, 1988,²⁶⁵ and some question exists regarding whether the CEBA's exit fees will serve the purpose of discouraging healthy institutions from leaving the FSLIC.²⁶⁶

At the close of 1987, the FSLIC had a total caseload of 206 institutions, with aggregate total assets of approximately \$54.8 billion.²⁶⁷ The cost of resolving the problems by merging the insolvent federally insured thrifts out of existence is estimated at approximately \$45.6 billion.²⁶⁸ It also is estimated that as of year-end 1987, the FSLIC has approximately \$18 billion per year available to deal with problem institutions, including \$10.8 billion raised pursuant to the FSLIC recapitalization program.²⁶⁹

B. *The Financial Condition of the Industry*

As of December 31, 1987, the FSLIC insured deposits in 3,147 thrift institutions with \$1.25 trillion in assets.²⁷⁰ Of these institutions, 1,768 were federally chartered and 1,378 were state-chartered.²⁷¹

The net worth of the industry as of December 31, 1987 was \$47.5 billion, based on regulatory accounting principles (RAP), and \$35.1 billion based on GAAP.²⁷² Tangible net worth,²⁷³ however, was only \$9.9 billion.²⁷⁴

263. 133 CONG. REC. H6948 (daily ed. Aug. 3, 1987) (statement of Rep. Parris).

264. Even before the CEBA passed, Congress recognized that the level of funding to be provided by the FSLIC recapitalization provisions would probably not suffice to resolve the FSLIC's problems. After quoting statistics about the magnitude of the crisis facing the FSLIC—461 institutions that are GAAP insolvent with a total of \$125 billion in assets and 281 institutions that are not technically insolvent but have either negative earnings or earnings less than 0.5% and assets of \$146 billion—Rep. Parris said, "[a]s one can see, this is a significant crisis, that may require greater assistance than the industry alone can supply. I regret to say that we could well be back here asking for additional FSLIC borrowing authority in a year." *Id.* (statement of Rep. Parris).

265. *See supra* note 196 and accompanying text.

266. *See supra* note 195 and accompanying text; *see also* Saulsbury, *S & L's Costs of Conversion To FDIC Insurance*, FDIC, REGULATORY REV., June-May 1987, at 1.

267. Progress on the Recapitalization of the FSLIC, *supra* note 8, at 10.

268. McTague, *Fed. Proposal Imperils FSLIC v. U.S. League Savs.*, Am. Banker, Jan. 21, 1988, at 1, col. 2.

269. *Taxpayer Bailout of FSLIC is a Solution of Last Resort, FHLBB's Wall Insists*, 50 Banking Rep. (BNA) 448 (Mar. 14, 1988).

270. Telephone Interview with Betsy Greer, FHLBB Communications Office (Feb. 16, 1988).

271. Telephone Interview with Virginia Olin, FHLBB Statistics Office (Mar. 28, 1988).

272. *Id.*; *see also supra* note 198 and accompanying text.

Earnings weaknesses continue to plague the industry. In 1984, FSLIC-insured thrift institutions posted total earnings of approximately \$1.7 billion, representing a net return on assets of twelve basis points (0.12%).²⁷⁵ A substantial portion of this gain, however, could be attributed to the one-time dividend of participating preferred, nonvoting stock in the Federal Home Loan Mortgage Corporation that the agency distributed to Federal Home Loan Bank System member institutions during 1984.²⁷⁶

As interest rates declined in 1985, many institutions were able to restructure their portfolios to reduce their interest-rate risk and improve profitability. However, because a significant number of institutions continued to experience operating losses, the industry posted total earnings of approximately \$3.8 billion, representing an overall aggregate return on assets of only thirty-nine basis points (0.39%).²⁷⁷

The industry's 1986 earnings declined to \$0.9 billion and the aggregate return on assets was nine basis points (.09%).²⁷⁸ This decline could be attributed in large part to a decline in the quality of assets held in institutions.²⁷⁹ During 1987, the industry had earnings of negative \$6.8 billion.²⁸⁰ The return on assets was calculated as negative 1.02%.²⁸¹

The financial strength of the industry during these periods actually is overstated because of the regulatory accounting principles allowed by the FSLIC.²⁸² For example, if in 1984 the industry utilized GAAP rather than RAP, the number of problem cases would have increased from 877 to 1294.²⁸³ Only 17 institutions had both a zero GAAP and RAP net worth in 1980. By 1984, this number had risen to 71 based on RAP, but 434 based on GAAP.²⁸⁴ The number of institutions with a GAAP net worth as a percent of assets of only between 0% and 3% was 280 in 1980. The number had

273. Tangible net worth is defined to be GAAP net worth reduced by intangibles—primarily goodwill.

274. Telephone Interview with Virginia Olin, FHLBB Statistics Office (Mar. 28, 1988).

275. 1984 FHLBB ANN. REP. 7 (1985).

276. *Id.*

277. 1985 FHLBB ANN. REP. 7 (1986).

278. 1986 FHLBB ANN. REP. 5 (1987).

279. *Id.* at 7; J. BARTH, *supra* note 140, at 8.

280. Bailey & Hill, *Banks and S & L's Face New Wave of Failures As Regulators Goof Up*, Wall St. J., Mar. 25, 1988, at 1, col. 6.

281. Telephone Interview with Virginia Olin, FHLBB Statistics Office (Mar. 28, 1988).

282. *See supra* note 154.

283. *See* J. BARTH, *supra* note 140, at 8. Section 402 of the CEBA requires the FHLBB and the FSLIC to develop uniformly applicable accounting standards for all FSLIC-insured institutions consistent with GAAP. 12 U.S.C.A. § 226 note (West Supp. 1987); *see also supra* note 198 and accompanying text.

284. J. BARTH, *supra* note 140, at 7.

risen dramatically by the end of 1984 to 854 based on GAAP.²⁸⁵

As of December 31, 1987, 688 FSLIC-insured thrifts had a negative net worth on the basis of RAP.²⁸⁶ On a GAAP basis, 947 FSLIC-insured thrifts had a negative net worth.²⁸⁷

The steady decline in the financial health of the thrift industry is evidenced by another measure: the number of institutions that required FSLIC assistance to continue operations and the number of institutions that was merged out of existence or liquidated. Between January 1, 1984 and December 31, 1986, the number of federally insured thrifts requiring FSLIC assistance increased dramatically.²⁸⁸ In 1986, the FSLIC resolved a record forty-eight cases by merger, acquisition, or liquidation.²⁸⁹ During 1987, forty-eight institutions failed.²⁹⁰ Of these institutions, seventeen, with total assets of \$1.7 billion, were placed into FSLIC receivership for liquidation.²⁹¹

C. *The Role of Agency Conduct*

A contributing factor affecting the financial condition of the thrift industry and its ability to raise new capital has been the conduct of the agency principally responsible for regulating and insuring the industry. In recent history, the thrift industry has faced difficulty in medium- and long-term planning of its business opportunities because of inconsistent, unpredictable, and frequently changing regulatory approaches by successive administrations at the FHLBB. Attorneys for the industry blame the FHLBB's poor track record on an inexperienced and overworked legal staff, failure to pay attention to important procedural details, and, above all else, a tendency to overreach the agency's statutory authority, using rulemaking to resolve problems that Congress has failed to address.²⁹²

As the problems of the industry worsened during the early 1980's, the conduct of the FHLBB officials became more unpredictable. Congress criti-

285. Based on RAP, at year-end 1984, 806 institutions had a net worth of between 0% and 3%.

286. Telephone Interview with Martha Gravlee, FHLBB Communications Office (Mar. 28, 1988).

287. *Id.*

288. 1986 FHLBB ANN. REP. 28 (1987) (noting post-1980 upsurge in FSLIC assistance agreements).

289. *FHLBB News*, Jan. 15, 1988, at 2. The cost to the FSLIC of these resolutions was estimated to be \$3.7 billion in cash and notes. *Id.*

290. Telephone Interview with Betsy Greer, FHLBB Communications Office (Feb. 16, 1988).

291. FHLBB, 1987 FSLIC INSURANCE SETTLEMENTS 1-3 (Dec. 14, 1987).

292. See, e.g., *Recent Bank Board Legal Losses May Impose Burdensome Precedent*, 48 *Banking Rep.* (BNA) 319 (Feb. 16, 1987).

cized many regulatory actions,²⁹³ and the courts ultimately determined that a few of the FHLBB's actions were arbitrary and capricious or beyond its jurisdiction.²⁹⁴ Congressional reaction to, and monitoring of the agency's activities has intensified; hearings on several matters have convened in an effort to exercise some oversight and moderating influence,²⁹⁵ and, in some instances, Congress has passed legislation.²⁹⁶

The problems the industry has faced with its regulatory structure fall into four categories. The first category is vacillating agency policy positions. The second is the lack of experienced agency personnel who are able to confront and deal effectively with the changes affecting the industry, and thus the problems which confront the agency. The third is the tendency of the FHLBB to ignore its governing statutes and regulations when it deems actions as expedient or necessary. Fourth is the formulation and enforcement of agency policy positions as regulations, without regard to the procedures for promulgating regulations set forth in the Administrative Procedure Act.²⁹⁷

1. *Vacillating or Reversed Policy Positions*

The FHLBB's vacillation on a number of policy issues in the last decade has had a significant effect on the financial condition of the industry. Prior to 1980, the FHLBB's regulatory philosophy restricted the industry to offering very few asset and liability products and to operating within the simple mutual form of organization.²⁹⁸ In a short period of time, however, competitive pressures forced a relaxation of the restrictions on liability powers in order to prevent disintermediation.²⁹⁹

293. See, e.g., *supra* note 164.

294. See *infra* note 342.

295. See generally *Fraud and Abuse by Insiders: Hearings Before the Subcomm. on Commerce, Consumer, and Monetary Affairs of the House Comm. on Government Operations*, 100th Cong., 1st Sess. (1987); *FSLIC Recapitalization*, *supra* note 257; H.R. REP. NO. 1137, 98th Cong., 2d Sess. (1984).

296. See *supra* note 197 and accompanying text.

297. The Administrative Procedure Act, Pub. L. No. 404, 60 Stat 23 (1946) (codified as amended in scattered sections of 5 U.S.C.), has four main purposes:

- (1) To require agencies to keep the public currently informed of their organization, procedures and rules (sec. 3).
- (2) To provide for public participation in the rulemaking process (sec. 4).
- (3) To prescribe uniform standards for the conduct of formal rulemaking . . . i.e., proceedings which are required by statute to be made on the record after opportunity for an agency hearing (secs. 7 and 8).
- (4) To restate the law of judicial review (sec. 10).

DEP'T OF JUSTICE, ATTORNEY GENERAL'S MANUAL ON THE ADMINISTRATIVE PROCEDURE ACT 9 (1947).

298. See *supra* note 21.

299. See *supra* notes 61, 94-105 and accompanying text.

In order to deal with the mounting losses of the industry, the FHLBB, during the administration of Chairman Pratt, sought to encourage management initiatives by expanding permissible activities and reducing regulatory constraints.³⁰⁰ The purpose of these efforts was to give competent management the flexibility to deal with the increasingly complex economic environment as the industry consolidated. Although there was a recognition that the new openness would attract some undesirable elements, the belief prevailed that strict enforcement procedures could forestall the serious damage that might result from such elements and that good management could succeed.³⁰¹ This environment existed for about two years but was directly followed by the more restrictive regulatory philosophy of Chairman Gray's administration.³⁰² This philosophy reflected, in part, a recognition that neither the industry nor the agency was capable of adequately managing the recently authorized asset and liability powers.

The rapid changes in administration and philosophy of the FHLBB has resulted in varied, and in some cases inconsistent, directions and rules. Often the changes required fundamental alterations in business plans for management of institutions.

One such area of change involves the accounting procedures used by the industry. For example, the method for treating loan losses underwent several revisions in this period. In order to encourage the sale of underwater loans to facilitate the restructuring of loan portfolios, the FHLBB promulgated a regulation to allow institutions to postpone recognition of losses on asset sales by amortizing those losses over the anticipated remaining maturity of the loan.³⁰³ The FHLBB actively encouraged institutions to use this device to restructure their portfolios and reduce interest-rate risk. In 1987, however, the FHLBB proposed to end such loss deferral. Only after much protest from the industry did the FHLBB grandfather previously deferred losses.³⁰⁴

300. Wines, *S & L Rescue May Fall in the Face of Bickering Among Thrifts*, NAT'L J., Mar. 13, 1982, at 956; *Director of S & L Deposit Insurer Ponders Agency Future*, Am. Banker, Apr. 19, 1982, at 4, col. 2; Slaker, *Banking Committees Are Drafting New Reform Bill for This Fall*, Am. Banker, Sept. 16, 1981, at 1, col. 1.

301. See *Adequacy of Federal Home Loan Bank Board Supervision of Empire Savings and Loan Association: Hearings on H.R. 34-7650 Before the Subcomm. on Commerce, Consumer, and Monetary Affairs of the House Comm. on Government Operations*, 98th Cong., 2d Sess. 121-53 (1984) (statement of Edwin J. Gray, Chairman, FHLBB) [hereinafter *Empire Savings and Loan Association Hearings*].

302. See *supra* notes 177-84 and accompanying text.

303. Classification of Assets, 50 Fed. Reg. 53,275 (1985); see also *SEC and Corporate Audits: Hearings Before the Subcomm. on Oversight and Investigations of the House Comm. on Energy and Commerce*, 99th Cong., 2d Sess. (April 10, 24, 26, 1986).

304. Classification of Assets, 52 Fed. Reg. 18,369 (1987) (to be codified at 12 C.F.R. pts.

A second area involves the FHLBB's position on diversification of activities. During the early 1980's, the agency emphasized asset diversification. Thrift institutions were encouraged to diversify into new lines of business utilizing newly expanded asset powers granted to federal institutions by the Garn-St Germain Act and to state-chartered institutions by state law.³⁰⁵ Commercial lending, nonresidential real estate lending, real estate investment, and investment in equity securities were among the newly encouraged activities subsequently perceived as a cause of the industry's problems.³⁰⁶

Although the Garn-St Germain Act recognized the potential for problems in the exercise of expanded powers, the FHLBB's philosophy at that time was to permit the market to control the FSLIC's risk.³⁰⁷ The intent was to devise a scheme by which the management risk-taking could be controlled by market pressures, in both the capital and deposit markets, without direct regulatory constraints. The FHLBB first considered a risk-based premium system that would involve the assessment of variable rate insurance premiums by the FSLIC.³⁰⁸ Under such a system, aggressive, risk-taking institutions that posed significant risks for the FSLIC's insurance fund would pay larger insurance premiums than less aggressive institutions that pose fewer risks to the insuring agency.³⁰⁹

As congressional and regulatory deliberations on revamping the insurance system stalled and the chairman and other members of the FHLBB changed, the agency undertook other actions to reduce the insurance risk presented by expanded activities. The principal effort involved curtailment of institutional ability to engage in new activities the agency deemed excessively risky. This development was forecast by the earlier administration:

Although the deregulation of the last few years was a necessary response to market place innovations, it has substantially limited the ability of a regulatory agency to constrain the risk-taking of insured institutions. Moreover, this has occurred at a time when there are a number of insured institutions that are operating with impaired capital and have strong incentives to engage in very risky investments. In light of the competitive pressures that the industry will face within the next few years, this deregulation could result in substantial losses. If no attempt is made to deal with these poten-

561, 563, 571); Classification of Assets, 53 Fed. Reg. 338 (1988) (to be codified at 12 C.F.R. pts. 561, 563, 571). Section 402 of the CEBA reaffirmed the grandfather treatment accorded to previously deferred losses. 12 U.S.C.A. § 226 (West Supp. 1987).

305. See *supra* note 141 and accompanying text.

306. See *supra* notes 129-33 and accompanying text.

307. AGENDA FOR REFORM, *supra* note 19, at 9-10.

308. See Net Worth Requirements of Insured Institutions, 50 Fed. Reg. 6891 (1985) (codified at 12 C.F.R. §§ 561, 563, 570, 571, 584 (1987)).

309. AGENDA FOR REFORM, *supra* note 19, at 6, 83-100.

tial problems, there could be *substantial pressure for renewed regulation* of depository institutions.³¹⁰

To this end, the FHLBB proposed regulations in 1984 to limit the direct investments of FSLIC-insured, state-chartered institutions in real estate, equity securities, and service corporations.³¹¹ The regulation, finalized in 1985,³¹² imposed qualitative criteria for investments in equity securities and diversification requirements for investments in any security issue or real-estate project.³¹³ The regulations, scheduled to expire on January 1, 1987, were revised and extended until April 16, 1989.³¹⁴ The revised regulations link the ability of an institution to make direct investments, now expanded and referred to equity risk investment, to the level of the institution's capital.³¹⁵

Another important area where the regulatory system has changed frequently is the establishment and computation of capital requirements. In 1980, as the net worth of the industry declined,³¹⁶ the FHLBB lowered the net-worth requirements from 5% to 4% of liabilities.³¹⁷ In 1982, the

310. *Id.* at 41-42 (emphasis added).

311. Limitations on Direct Investments by Insured Institutions, 49 Fed. Reg. 20,719 (proposed May 16, 1984); Regulation of Direct Investment by Insured Institutions, 49 Fed. Reg. 48,743 (reproposed Dec. 14, 1984).

312. In response to industry protests, the regulations were subsequently modified. Regulation of Equity Risk Investments by Insured Institutions; Direct Investments, Certain Land Loans and Certain Nonresidential Construction Loans, 52 Fed. Reg. 23,787 (1987) (to be codified at 12 C.F.R. pt. 563); Regulation of Direct Investment by Insured Institutions, 52 Fed. Reg. 8188 (1987) (to be codified at 12 C.F.R. pt. 563); Regulation for Direct Investment by Insured Institutions, 52 Fed. Reg. 7821 (1987) (to be codified at 12 C.F.R. pt. 563); Regulation of Direct Investment by Insured Institutions, 51 Fed. Reg. 47,001 (1986) (to be codified at 12 C.F.R. pt. 563); Regulation of Direct Investment by Insured Institutions, 50 Fed. Reg. 6912 (1985) (codified at 12 C.F.R. § 563.13 (1987)). The United States District Court for the District of Columbia upheld the authority of the FHLBB to promulgate the direct investment regulations of state-chartered institutions, as well as the procedure utilized by the FHLBB to promulgate the regulations. *See Lincoln Sav. & Loan Ass'n v. FHLBB*, 670 F. Supp. 449, 452-54 (D.D.C. 1987).

313. Regulation of Direct Investment by Insured Institutions, 50 Fed. Reg. 6912 (1985) (codified at 12 C.F.R. § 563.13 (1987)).

314. 52 Fed. Reg. 23,787 (1987) (to be codified at 12 C.F.R. pt. 563).

315. Regulation of Direct Investment by Insured Institutions, 52 Fed. Reg. 8188 (1987) (to be codified at 12 C.F.R. pt. 563). The regulations have been the subject of serious congressional debate. *See supra* note 164. In the CEBA, Congress ordered the FHLBB to study the direct investment activities of FSLIC-insured thrifts and report its findings within 18 months after the enactment of the CEBA. 12 U.S.C.A. § 1437 note (West Supp. 1987). The FHLBB also must report any proposed action to repeal or modify the direct investment regulations not less than 90 days before the action becomes final. *Id.* § 3806.

316. *See supra* note 149.

317. Net Worth Amendments, 45 Fed. Reg. 76,111 (1980) (codified as amended at 12 C.F.R. § 563.13 (1987)). Additionally, the statutory reserve requirement was reduced from an amount equal to 5% of insured accounts to an amount equal to 4% of insured accounts.

FHLBB further lowered the net worth requirement to 3%.³¹⁸ At the same time, the FHLBB expanded the concept of RAP capital, including items such as deferred loan losses, which are not considered capital for GAAP purposes. Consequently, not only did the FHLBB reduce the required level of capital, but it also expanded the elements includable as capital.³¹⁹ The principal purpose of this adjustment, as noted before, was to provide troubled institutions time to work out their problems.³²⁰

By 1985, the FHLBB reversed this policy, making fundamental changes in its methods of determining the net-worth requirement.³²¹ Included in the revision was an increase in the amount of capital required, the component's of capital, and the calculation procedure.³²² A regulation was adopted in 1986 to create a 6% capital requirement on new liabilities.³²³ The regulation also requires an increase in capital for liabilities in existence as of December 31, 1986 over a period estimated to be twelve years based on the profitability of GAAP-solvent institutions.

The significant policy changes and reversals of the FHLBB over a relatively short period, such as the treatment of deferred loan losses and regulation of direct investments, seriously affect the managerial decisionmaking process over long periods. Similarly, certain changes impose different short- and long-term goals on management. It is possible that one philosophical approach, if consistently pursued with sufficient resources, could have succeeded. In juxtaposition, however, failure of these shifting regulatory policies was almost inevitable in the short term.

2. Agency Personnel

In the highly protective environment of prior years, when institutions operated under constraints on asset and liability powers, the demands placed on the regulators were minimal and could be accomplished with a relatively small number of highly specialized individuals concentrated in a few areas. However, as deregulation proceeded in the early 1980's, an understaffed and underprepared FHLBB staff confronted the effects of a less restrictive regu-

318. See *supra* note 152; see also Net Worth Amendments, 47 Fed. Reg. 3543 (1982) (codified as amended at 12 C.F.R. § 563 (1987)). The FHLBB again reduced the statutory reserve requirement to an amount equal to 3% of insured accounts.

319. Net Worth Amendments, 47 Fed. Reg. 3543 (1982) (codified as amended at 12 C.F.R. § 563 (1987)).

320. *Id.*

321. Net Worth Requirements of Insured Institutions, 50 Fed. Reg. 6891 (1985) (codified as amended at 12 C.F.R. §§ 561, 563, 570, 571, 584 (1987)).

322. *Id.*

323. Regulatory Capital (Net Worth) Requirements of Insured Institutions, 51 Fed. Reg. 33,565 (1986) (codified at 12 C.F.R. § 563.13 (1987)).

latory environment.³²⁴

The enormous growth of the industry following substantial deregulation and severe financial strain, first from the interest rate spread problems and later by problem assets,³²⁵ taxed the ability of the FHLBB's regulatory staff.³²⁶ In the wake of considerable criticism, the human response was two-fold: reregulation and a call for rapid increase in the number of agency personnel available to implement the new policies.³²⁷ Between July 1985 and December 1986, the Office of Examinations and Supervision grew from 747 examiners to 1,524.³²⁸ Further, between 1984 and 1986, the enforcement staff almost tripled.³²⁹

The consequence of such dramatic expansion was the presence of a new corps of mostly inexperienced personnel. It can be argued that, in some areas, the agency is now over-staffed, resulting in bureaucratic excess as each employee seeks to justify his or her position. This problem has been compounded by the decentralized regulatory system that could result in the same policy being executed in twelve different ways by the different federal home loan banks.³³⁰

3. *Failure to Observe Statutes and Regulations*

The FHLBB has lost credibility in some quarters by disregarding both the statutes and the regulations that it is charged with enforcing. The unpredictability of the agency has taken a variety of forms: in some cases, the agency has imposed restrictions despite a lack of statutory authority; in others, it has adopted regulations either in violation of required procedures or in excess of statutory jurisdiction; in still others, it has enforced policies as regulations without compliance with procedural rulemaking requirements; and finally, the agency has ignored procedures specified in regulations. The reputation of the FHLBB for such unpredictability, even where the motives for its actions are well-intended, has had adverse effects on industry morale and capital formation.

Two important actions of the FHLBB illustrate the tendency of the FHLBB to impose restrictions without statutory authority. On September 22, 1983, the Chairman of the FHLBB issued a press release announcing that the agency would not act on a number of proposals by investment bank-

324. *Empire Savings and Loan Association Hearings*, *supra* note 301, at 76-77 (statement of Edwin J. Gray, Chairman, FHLBB); *see also* Schilling, *supra* note 166, at 11.

325. *See supra* notes 64, 164.

326. *Cf. Empire Savings and Loan Association Hearings*, *supra* note 301, at 76.

327. *Cf.* 1986 FHLBB ANN. REP. 13-14 (1987).

328. *Id.* at 37.

329. *Id.*

330. *See* Schilling, *supra* note 166, at 18.

ing firms to acquire thrift institutions because the applications presented complex policy issues.³³¹ The effect of the press release, therefore, was to impose on FSLIC-insured institutions the same type of restrictions that sections 20 and 32 of the Glass-Steagall Act impose on member banks, although the Glass-Steagall Act does not prohibit an investment banking firm from owning, being owned by, or being an affiliate of a savings and loan association.³³² Only section 21 of the Glass-Steagall Act applies to FSLIC-insured institutions.³³³ In addition, such affiliations already existed within the industry prior to issuance of the press release. Judicial decree has also affirmed this reading of the statute.³³⁴

The most publicized use of the policy enunciated in the press release was made in connection with an application filed by John Hancock Mutual Life Insurance Company to acquire Buckeye Savings and Loan Association of Ohio. At the time of the application, Hancock owned Tucker Anthony & Co., an investment banking firm that accounted for less than one-half of one percent of Hancock's income. Despite protracted efforts to negotiate acceptable terms for the acquisition with the FHLBB, Hancock finally abandoned its efforts.³³⁵

The FHLBB took another step to institutionalize the prohibition against affiliations between thrifts and investment banking firms. It has required, as a condition of approval, would-be acquirers of thrifts to submit a certification that they are not and will not affiliate with a market-maker or underwriter.³³⁶

Perhaps the most notorious example of the FHLBB's extra-legal conduct was its effort to extract a substantial "exit fee" from institutions seeking to become, or be acquired by, FDIC-insured institutions.³³⁷ Prior to the

331. *FHLBB News*, Sept. 22, 1983, reprinted in *The Glass-Steagall Act-Banks and Securities Business*, PRACTISING LAW INSTITUTE 155 (1985) (corporate law and practice).

332. See *infra* note 379.

333. 12 U.S.C. § 378 (1982).

334. *Securities Indus. Ass'n v. FHLBB*, 588 F. Supp. 749, 762-64 (D.D.C. 1984).

335. See *John Hancock Drops S & L Acquisition after Wait for Regulatory Nod*, *Fin. Serv. Week*, Sept. 21, 1985, at 1; *John Hancock Drops Plans to Buy Buckeye*, *Am. Banker*, Aug. 29, 1985, at 12, col. 4.

336. FHLBB, Office of Examinations and Supervision, Memorandum SP-51, Dec. 12, 1984. The CEBA extended the scope of §§ 20 and 32 of the Glass-Steagall Act to include FSLIC-insured thrifts from the date of enactment to Mar. 1, 1988. 12 U.S.C.A. §§ 619, 619 note, 1828 (West Supp. 1987). See *supra* note 222 and accompanying text. Following the expiration of the moratorium, the FHLBB approved an application by a securities firm to acquire four troubled thrifts. *S&L's Bank Board Permits Iowa Securities Firm to Acquire Four Troubled Thrifts*, 50 *Daily Rep. for Executives (BNA) A-7* (Mar. 15, 1988); *Sale of S & L's to Insurance Firm Marks Bank Board Policy Switch*, *Am. Banker*, Mar. 15, 1988, at 1, col. 2; *Florida, Iowa, Acquisition Achieves Bank Board Goal*, FHLBB Press Release (Mar. 11, 1988).

337. The FHLBB justified its actions by claiming that a mass exodus from the FSLIC

CEBA, the only statutory requirement for a payment by an institution leaving the FSLIC insurance system was a provision requiring institutions voluntarily terminating insurance coverage to pay, as a premium, two times the insurance premium the institution paid during the past year.³³⁸ Beginning in 1986, however, the FSLIC required from several institutions seeking to leave the system a payment of approximately five and one-half times the amount of both the premium and the additional special assessments paid during the immediately preceding year.³³⁹ One federal judge described this requirement as "extortion," and determined that the FHLBB had no statutory authority to make such an assessment.³⁴⁰

To support its actions and prevent additional institutions from leaving the FSLIC, the FHLBB issued an "interpretive ruling" to clarify that a previously adopted regulation required the filing of certain applications and FHLBB approval in such cases.³⁴¹ A court reviewing the FHLBB's regulatory action termed it "the most high-handed, arbitrary, bureaucratic thing that's ever happened in this country. This looks like . . . big father is now saying this is the way you are going to operate because this is the way we want to do it and we're going to bail out the FSLIC."³⁴² The court decided the FHLBB had engaged in a legislative function subject to the APA.³⁴³

In the CEBA, Congress addressed both the Glass-Steagall Act and the

system would endanger the success of the proposed plan to recapitalize the FSLIC. *See Bank Board Asserts Authority to Stop Healthy Thrifts from Leaving FSLIC*, 47 Wash. Fin. Rep. (BNA) at 348 (Sept. 9, 1986); *Bank Board Asserts New Authority Over Thrift Conversions to Banks*, Am. Banker, Sept. 3, 1986, at 1, col. 2; Easton, *Not Many Bargains Left for Banks*, Am. Banker, Aug. 18, 1986, at 10, col. 2.

338. 12 U.S.C. § 1730(d) (1982).

339. *See FSLIC Charges AmeriTrust Highest Exit Fee Yet in Acquisition of Eagle S & L*, Wash. Fin. Rep. (BNA) at 927 (Dec. 15, 1986); Faust, *Barnett Banks of Florida Thrift Sue Bank Board over Agency Attempt to Regulate Acquisition*, Am. Banker, Nov. 6, 1986, at 3, col. 1.

340. *See United First Fed. Sav. & Loan Ass'n v. FHLBB*, No. 86-661-Civ-J-16 (M.D. Fla. Dec. 19, 1986). In recognition of the fact that the FHLBB lacked statutory authority prior to enactment of the CEBA, institutions that paid an exit fee prior to the enactment of the CEBA were entitled to a refund of the amount of the fee paid in excess to the congressionally mandated fee. *See* Pub. L. No. 100-86, § 302, 101 Stat. 552, 593.

341. Sale of Branches, 48 Fed. Reg. 21,302 (1983) (codified as amended at 12 C.F.R. §§ 563, 571 (1987)); Transfer of Assets of Insured Institutions, 51 Fed. Reg. 36,528 (1986) (codified as amended at 12 C.F.R. § 571 (1987)). The filing of an application gave the FHLBB leverage over the applicant that it might not have otherwise. If an applicant would not agree to pay the exit fee, the FHLBB could simply deny the application or indefinitely delay action. 12 C.F.R. § 571.5 (1987).

342. *United First Fed. Sav. & Loan Ass'n v. FHLBB*, No. 86-661-Civ-J-16, at 37 (M.D. Fla. Dec. 19, 1986).

343. Following the court's decision, the FHLBB reissued the interpretive ruling in full compliance with the requirements of the APA. *Federal Savings and Loan Insurance Corporation, Transfers of Assets of Insured Institutions*, 52 Fed. Reg. 5782 (1987) (to be codified at 12

exit issues, although, for the most part, on a temporary basis.³⁴⁴ Nonetheless, imposition of both the Glass-Steagall-like restrictions and the exit fee have had a severe impact on the credibility of the FHLBB and have deterred investment in the industry.

Examples of the second group of problems—failure to observe existing regulations—include the refusal of the agency to process applications for FSLIC insurance in California and Texas for more than a year,³⁴⁵ long delays and uneven standards applied in reviewing applications to exceed the regulatory limit on growth by insured institutions,³⁴⁶ and protracted delays in processing applications for holding companies' indebtedness.³⁴⁷

The lack of predictability in application processing has proven a serious problem for industry executives and applicants seeking to acquire institutions or expand their activities. However, because the FHLBB in many cases imposed its decision by refusing to act on an application, the action that was the subject of the application was often precluded. In addition, judicial review of agency action could not be sought since there was no "agency action" to serve as the subject of judicial review.³⁴⁸

The CEBA attempted to address some of these problems. For example, it imposed a requirement that the agency act upon holding company indebtedness applications within sixty days.³⁴⁹ In addition, it required the FHLBB to adopt guidelines specifying processing times for all applications.³⁵⁰

The agency's procedures for adopting regulations also has been the subject of criticism. In 1984, both the FSLIC and the FDIC acted to prevent insured institutions from soliciting deposits through brokers by promulgating regulations pursuant to which such deposits would not qualify for federal deposit insurance coverage.³⁵¹ The regulations were challenged, and the United States Court of Appeals for the District of Columbia Circuit held

C.F.R. § 571); Transfer Assets of Insured Institutions, 52 Fed. Reg. 23,937 (1987) (to be codified at 12 C.F.R. § 571).

344. See *supra* notes 195, 222 and accompanying text.

345. See *supra* note 183.

346. Where applications were acted upon, it often was impossible to rationalize the decisions made. Richard K. Kneipper, Attorney, Jones, Day, Reavis & Pogue, Public Comment Letter on FHLBB Proposal to Defer Expiration Date of 12 C.F.R. § 593.9-8, Regulation of Direct Investment by Insured Institutions 4-5 (Jan. 29, 1987). As a result of the delays, many applications ultimately were withdrawn.

347. The CEBA addressed this issue by providing that any application for debt issue be deemed approved if not disapproved by the FHLBB within 60 days from the date of filing. 12 U.S.C.A. § 1730a(g) (West Supp. 1987).

348. 5 U.S.C. § 704 (1982); 12 U.S.C. §§ 1464d(1), 1730(j), 1730a(k) (1982).

349. See *supra* note 347.

350. *Id.*

351. Brokered Deposits; Limitations on Deposit Insurance, 49 Fed. Reg. 13,003 (1984) (codified as amended at 12 C.F.R. §§ 561, 564 (1987)).

that both agencies lacked statutory authority to adopt the rule.³⁵²

In a lesser-known case, an administrative law judge determined that the FSLIC had exceeded its authority and violated its own rules, as well as the APA, when it adopted a rule that had the effect of preventing an institution from converting to stock form of ownership in a transaction.³⁵³ The transaction, as proposed, resembled a leveraged buy-out and would have resulted in the vesting of control of the institution in a single family. The agency subsequently withdrew the regulation and, despite the FHLBB's efforts to protect the "ownership" rights of the depositors, the parties consummated the transaction.³⁵⁴

Finally, the agency has for years issued "memoranda" to provide guidance on regulatory, accounting, and other issues. From time to time, agency personnel have applied these memoranda uniformly as if the agency had adopted these regulations in conformity with the APA.³⁵⁵ Such application, however, is not proper and has been the subject of judicial review.³⁵⁶

The agency's record for complying with regulatory procedures has had a negative impact on both industry performance and capital formation. This remains true even with well-founded actions. Despite the regulatory motives, the inability of the private sector to rely on established procedures has had a negative effect.

IV. POSSIBLE RESPONSES TO THE THRIFT CRISIS

Resolution of the current thrift crisis demands strong leadership. No resolution will be found, however, until the nation's leadership is willing to develop a clear position on certain significant national policies directly impacting the thrift industry.

Finding concise answers to the following questions should help our leader-

352. FAIC Sec., Inc. v. United States, 768 F.2d 352, 364 (D.C. Cir. 1985).

353. *In re First Fed. Sav. & Loan Ass'n of Philadelphia*, FHLBB No. 85-287, at 8-10 (FHLBB Apr. 16, 1986).

354. See Fromson, *How to Steal an S & L—Legally*, FORTUNE, Oct. 2, 1987, at 57; see also 12 C.F.R. § 563b.1(a)(2) (1987); Conversions from Mutual to Stock Form, 44 Fed. Reg. 18,881 (1979) (codified as amended at 12 C.F.R. § 563b (1987)); Conversion from Mutual to Stock Form, 48 Fed. Reg. 15,601 (1983) (codified as amended at 12 C.F.R. § 563b.1 (1987)); Conversion to Stock Form; Liquidation Accounts, 49 Fed. Reg. 19,002 (1984) (codified as amended at 12 C.F.R. § 563b.1 (1987)).

355. See *supra* note 297.

356. One court held the application of appraisal guidelines (memorandum R-41b) to be invalid. *Haralson v. FHLBB*, 655 F. Supp. 1550, 1561 (D.D.C.), *vacated*, 678 F. Supp. 925 (D.D.C. 1987). However, upon defendant's motion for reconsideration, which asserted facts not previously before the court, the court vacated its earlier order and held that the FHLBB's continued reliance on its appraisal standards set out in the guidelines was a logical outgrowth of the rulemaking process. *Haralson v. FHLBB*, 678 F. Supp. 925 (D.D.C. 1987).

ship determine the future of the industry and shape the appropriate policy responses: Should national policy foster and promote individual home ownership?³⁵⁷ If so, should the agency provide incentives to promote this policy through the support and maintenance of a separate sector of the financial services industry specializing in home financing and consumer lending?³⁵⁸ Depending upon the answers to the first two questions, the next question is whether the United States should retain separate deposit insurance funds for different types of depository institutions or one single fund for all depository institutions.³⁵⁹ Finally, should a federal deposit insurance fund be backed by the full faith and credit of the United States?

A. Merge the Insurance Funds

A single insurance fund alternative would seem more likely if a decision is made not to foster a separate type of depository (i.e., thrifts) for home financing and other consumer lending. Such a decision would allow the competitive evolution of financial services to continue to blur the distinctions which have traditionally existed between savings associations and other kinds of financial institutions.³⁶⁰

A merger of the federal insurance funds would provide consumers with a single, presumably strong, federally backed insurance fund. In addition, a merger would alleviate the competitive imbalance occasioned by public perception of the relative strengths of the various federal deposit insurance programs.³⁶¹

A merger of the insurance funds of the FSLIC, the FDIC, and the National Credit Union Administration (NCUA) was considered by the FDIC and the FHLBB in their reports submitted to Congress in 1983.³⁶² While

357. See *supra* notes 17, 26, 28-31, 35-37, 44 and accompanying text.

358. The Bush Task Force Report cited as one of its goals maintenance of a separate industry. BLUEPRINT FOR REFORM, *supra* note 90, at 62. More recently, the 1986 Economic Report of the President questioned the continuance of that goal. ECONOMIC REPORT OF THE PRESIDENT 212 (1986).

359. See *infra* notes 360-78 and accompanying text.

360. See *supra* notes 241-46 and accompanying text.

361. One example of how public perception affects the competitive balance can be seen in a comparison of the average costs of savings liabilities that FSLIC-insured institutions must pay over what FDIC-insured banks must pay. In California and Texas, FSLIC-insured institutions have been required to pay 150 and 200 basis points higher, respectively, for savings deposits than FDIC-insured banks located in the same state. See *Earle Named to Head FSLIC Restructuring Plan*, UPI, Mar. 10, 1988; Smith, *California Thrifts Buoyed by Interest Forecasts*, Reuters, Jan. 29, 1988; see also *Dallas FHLBank Proposes New Plan To Combat High Cost Of Funds in Region*, 50 Banking Rep. (BNA) 202 (Feb. 8, 1988). This rate disparity was attributable in large part to depositor concern over the condition of the thrift industry and the attendant weakness of its insurer, the FSLIC.

362. See *supra* note 174. The possibility of combining the insurance funds had actually

the FHLBB's report called for the maintenance of separate insurance funds,³⁶³ the FDIC's report stated that the consolidation of the FDIC and the FHLBB was feasible and eminently desirable.³⁶⁴ The report went further to state:

It is difficult to agree that the insurance funds of the FDIC and FSLIC should be separately maintained when the functions of thrift institutions and commercial banks are so similar that virtually the only distinction that can be found in present law between the two types of institutions is in the nature of the insurance attached to the liabilities of each. Not only are the depository institutions involved now almost indistinguishable in the powers they possess, but they are also beginning to come together, in some instances, in larger financial organizations, a trend that doubtless will accelerate in the future.³⁶⁵

A merger of the insurance funds was again considered in 1984 by the Task Group on Regulation of Financial Services, chaired by Vice President George Bush (Bush Task Force). The Bush Task Force ultimately recommended that the insurance funds remain separate, noting however that this recommendation was based on the fact that a proposal to merge the funds "would be premature at [the] time, in light of the continued differences in both financial condition and the nature of insured risk among the different types of insured organizations."³⁶⁶

The possibility of a merger of the funds was revisited in late 1985. The House Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the House Committee on Banking, Finance, and Urban Affairs and the Senate Committee on Banking, Housing, and Urban Affairs began a series of hearings to review various deposit insurance reform proposals.³⁶⁷

been considered as early as 1971. The 1971 Report of the President's Commission on Financial Structure and Regulation recommended that a new agency, the Federal Deposit Guarantee Administration, be established to incorporate the administrative functions of the FDIC, the FSLIC, and the National Credit Union Share Fund while maintaining three separate insurance funds. THE REPORT OF THE PRESIDENT'S COMMISSION ON FINANCIAL STRUCTURE AND REGULATION 87-88 (1971) [hereinafter HUNT COMMISSION]. The discussion principals for a 1975 House Banking, Currency, and Housing Committee Study on Financial Institutions and the Nation's Economy called for combining the agencies that provide federal insurance to depository institutions into a single newly created agency, the Federal Depository Institutions Commission. HOUSE BANKING, CURRENCY, AND HOUSING COMM., STUDY ON FINANCIAL INSTITUTIONS AND THE NATION'S ECONOMY, 94th Cong., 2d Sess. tit. IV, at 3 (1975) [hereinafter FINE REPORT].

363. AGENDA FOR REFORM, *supra* note 19, at 23-24.

364. FDIC, DEPOSIT INSURANCE IN A CHANGING ENVIRONMENT at xx (1983).

365. *Id.* at xxi.

366. BLUEPRINT FOR REFORM, *supra* note 90, at 82.

367. See generally *Deposit Insurance Reform and Related Supervisory Issues: Hearings Before the Senate Comm. on Banking, Housing, and Urban Affairs* (pts. 1-2), 99th Cong., 1st

At those hearings, Paul Volcker, then-Chairman of the Federal Reserve Board, and William Isaac, then-Chairman of the FDIC, both testified as to the feasibility of such a merger.³⁶⁸ While Volcker stressed the need for the regulatory agencies to agree on uniform regulatory and supervisory procedures before such a merger could be effective,³⁶⁹ Isaac supported outright a merger of the funds, stating: “[T]he FDIC believes that a merger of the FDIC and FSLIC would create a stronger insurance system with greater resources, a larger income stream and a more diversified risk base. It would also facilitate interindustry takeovers of founding institutions and unify the procedures for handling insurance claims.”³⁷⁰

Although the subcommittee failed to propose merger legislation in 1985, the issue did not die. In early 1987, during debates on the FSLIC recapitalization plan and at a time when the consensus on a specific approach on an appropriate recapitalization plan had broken down, the United States League of Savings Institutions, a traditional foe of a merger, indicated it would move to consider a merger of the FDIC and the FSLIC insurance funds if Congress passed a plan for a \$15 billion recapitalization plan proposed by the United States Treasury Department.³⁷¹ Treasury Undersecretary of Finance George Gould also suggested that the Treasury would consider a merger of the insurance funds in the event congressional efforts to recapitalize the FSLIC proved unsuccessful.³⁷² To this end, Gould presented an outline of a plan to accomplish such a merger, which, at least at

Sess. (1985) [hereinafter *Deposit Insurance Reform*]; *Financial Condition of the Bank and Thrift Industries* (pts. 1-3), *supra* note 168.

368. Edwin Gray, as Chairman of the FHLBB, also testified at the hearings, but did not discuss a merger of the funds. Instead, Chairman Gray advocated the collection of supplementary premiums and the pricing of such supplementary premiums commensurately with the risk of loss to the FSLIC as the means necessary to bolster the fund. *Financial Condition of the Bank and Thrift Industries* (pt. 1), *supra* note 168, at 1494 (statement of Edwin J. Gray, Chairman, FHLBB).

369. Volcker said: “In principle, [the merger of the funds] would appear appropriate if and as these depository institutions are required to adhere to equivalent regulatory and supervisory standards, and particularly if their powers broadly coincide. There has been some movement in those directions, but there also remains a good ways to go.” *Deposit Insurance Reform* (pt. 1), *supra* note 367, at 1278 (1985) (statement of Paul A. Volcker, Chairman, Board of Governors of the Federal Reserve System).

370. *Financial Condition of the Bank and Thrift Industries* (pt. 2), *supra* note 168, at 1470 (appendix to statement of William M. Isaac, Chairman, FDIC). Isaac also made several statements to the press regarding a merger of the insurance funds. In one article, he was quoted as saying: “I believe the FSLIC is going to need help, and the most logical place to get it is to merge the two insurance funds. It will be costly. But I believe [the FDIC] has the strength to deal with it.” *Insurance Funds’ Fate Debated*, *Am. Banker*, Apr. 29, 1985, at 15, col. 1.

371. Day, *U.S. Aide Prods Congress on FSLIC*, *Wash. Post*, Jan. 22, 1987, at C1, col. 2; Garsson, *Thrift Group Urges Its Own FSLIC Scheme*, *Am. Banker*, Jan. 21, 1987, at 2, col. 1.

372. *FSLIC Recapitalization*, *supra* note 257, at 414-15 (statement of George D. Gould, Undersecretary of Finance, U.S. Department of the Treasury).

first, would be only a merger of the administrative functions of the funds, not the actual balances of the fund.³⁷³

Following the eventual enactment of the recapitalization plan in the CEBA,³⁷⁴ the House Banking Committee announced plans to "explore a possible merger of the federal deposit insurance funds" by the March 1, 1988-end of the CEBA moratorium on new bank and bank holding company powers.³⁷⁵ Merger discussions also have been on the agendas of the FDIC, the Federal Reserve Board, the American Bankers Association, and the National Council of Savings Institutions.³⁷⁶ At the request of several members of the House Banking, Finance, and Urban Affairs Committee, the GAO is also exploring options including merger.³⁷⁷ In addition, on February 18, 1988, Congressman Gerald D. Kleczka introduced legislation proposing a merger of the funds.³⁷⁸

While it appears that current congressional sentiment supports maintenance of separate insurance funds as long as the depositories retain their separate and distinct identities, a merger would remove the cost of funds differential resulting from public concern over the strength of the FSLIC and distinguishing the thrift industry from the banking industry. It is unlikely, however, that the resources of a combined insurance fund would be adequate to deal with the commitments of both the thrift and banking industries without an infusion of additional resources. Notwithstanding popular beliefs to the contrary, it is simply unrealistic to assume that sufficient additional re-

373. *Id.* (statement of George D. Gould, Undersecretary of Finance, U.S. Department of the Treasury).

374. 12 U.S.C.A. §§ 226 note, 1441 (West Supp. 1987).

375. *Rep. St Germain Sets Agenda, Including Action on Industry Restructuring Legislation*, 190 Daily Rep. for Executives (BNA) A-8 (Oct. 2, 1987).

376. See Rehm, *Is Fund Merger Talk Only That?*, Am. Banker, Mar. 14, 1988, at 14, col. 2; Rehm, *Their Last Shot at New Powers*, Am. Banker, Dec. 21, 1987, at 7, col. 1; Trigaux, *FDIC Memo Says FSLIC Rescue Likely, Taxpayer Bailout of FSLIC May Be Needed*, Am. Banker, July 20, 1987, at 5, col. 1; Rehm, *Regulators Find Benefits in One Insurance Fund*, Am. Banker, June 19, 1987, at 15, col. 3; Rehm, *Debate on New Powers Group*, Am. Banker, Nov. 30, 1986, at 6, col. 1. On March 2, 1988, the National Council of Savings Institutions unveiled a proposed contingency plan if the Congress eventually decides to merge the insurance funds of the FDIC and the FSLIC. The plan proposes that all FSLIC-insured institutions join the fund, but that the FHLBB continue to be the chief regulator of the thrifts. It also calls for the FDIC to devote up to \$10 billion of its primary capital to bail out the FSLIC. *Thrift Trade Group Proposes Contingency Plan for Merger of FSLIC and FDIC Funds*, 50 Banking Rep. (BNA) 386 (Mar. 7, 1988).

377. The GAO is preparing a report analyzing the issues raised by a merger of the insurance funds to be submitted to Congress by October, 1988. Rehm, *Proxmire Foresees Bailout of FSLIC and FDIC*, Am. Banker, Mar. 9, 1988, at 4, col. 1; see also *GAO Official Says Agency Not Likely to Recommend Merger of FSLIC and FDIC*, 50 Banking Rep. (BNA) 450 (Mar. 14, 1988).

378. H.R. 3970, 100th Cong., 2d Sess., 135 CONG. REC. H425 (daily ed. Feb. 18, 1988).

sources can be provided by the two industries. Consequently, the necessary funds will ultimately have to be provided from other sources. Although it is beyond the scope of this Article to suggest a formula for a recapitalization plan, it can be noted that it is not unlikely that taxpayer funds ultimately will, in one form or another, be required. Because bolstering the public's confidence in the FSLIC (and the FDIC) can be accomplished only by an infusion of capital from previously untapped sources, the question of a merger of the funds should be resolved not on economic grounds but on the answer to the question of whether separate industries should be maintained for the provision of commercial and retail, including both housing and consumer finance, banking services.

Whatever the ultimate decision on a merger, a clear exposition of national policy on this issue would facilitate personal planning, capital formation, regulation, and corporate management. The new administration should recognize the political as well as economic risks associated with deferring decisions on recapitalizing the FSLIC and preserving distinctions between retail and commercial banking activities. Accordingly, these issues should be made priority items to be acted upon during the "honeymoon" period that the next administration will enjoy early in its term, in recognition of the fact that any action during this period will probably encounter less resistance than at any other time. In such an environment, the new administration could provide the leadership needed to permit reasoned decision making by investors, consumers, and managers.

B. Short-Term Enhancement of the Thrift Charter

If Congress decides that the promotion of home ownership remains a national priority, and that the thrift or consumer banking industry, which is becoming diversified but is still devoted to providing home financing, should continue as a separate industry in order to meet that priority, a number of initiatives could enhance the value of a thrift charter and thereby attract new capital and managerial talent into the industry. These initiatives range from major national policy changes to minor regulatory adjustments. Some will require significant legislative initiatives, while others amount to little more than house-cleaning efforts within the FHLBB.

Adoption of these changes should follow a careful review of the unwelcomed and unwanted results of prior legislative and regulatory initiatives. Any relaxation or realignment of current restrictions and regulatory procedures or the grant of additional authorities requires significant supervisory oversight to minimize potential abusive practices or the likelihood of regulatory policy reversals due to unexpected results and must be taken only after clear exposition of the fundamental policies underlying the specific

changes. In addition, the regulatory structure must have sufficient, qualified personnel with powers to implement and appropriately monitor the changes.

The following are some suggested legislative and regulatory actions that could enhance the value of a thrift charter. This discussion is not intended to be exhaustive, but it is hoped that it will form the basis of a meaningful program to address the issues.

1. *Legislative Initiatives*

a. *Continue to Permit Thrift Affiliates to Engage in Securities Activities*

Glass-Steagall-like prohibitions against affiliations between FSLIC-insured institutions and securities underwriters and market-makers were imposed upon savings associations as a matter of regulatory policy rather than law until the enactment of the CEBA.³⁷⁹ The CEBA extended the applicability of sections 20 and 32 of the Glass-Steagall Act to FSLIC-insured institutions, but only until March 1, 1988.³⁸⁰ This moratorium was part of an integrated scheme to freeze the securities, real estate, and insurance powers activities of federally insured depository institutions until Congress could act to resolve the debate on whether the "barrier between banking and commerce," which it legislatively mandated during the Great Depression, is war-

379. Historically, no federal statutory restriction prohibited securities firms and thrifts from being affiliated, although for a brief period policy restrictions were imposed. See *supra* notes 331-36 and accompanying text. The prohibition of §§ 20 and 32 of the Glass-Steagall Act apply only to banks that are members of the Federal Reserve System. 12 U.S.C. §§ 78, 377 (1982).

380. 12 U.S.C.A. § 1841 note (West Supp. 1987). Section 20 of the Glass-Steagall Act prohibits member banks from being affiliated in any manner with any organization engaged principally in the issue, floatation, underwriting, public sale, or distribution, at wholesale or retail or through syndicate participation of stocks, bonds, debentures, note or other securities. *Id.* § 377. Section 32 of the Glass-Steagall Act prohibits any officer, director, or employee of a corporation, or partner or employee of a partnership or any individual primarily engaged in the issue, floatation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, debentures, notes, or other securities from serving at the same time as an officer, director, or employee of any member bank. *Id.* § 78. The CEBA, however, applied these restrictions to FSLIC-insured institutions to the same extent that such restrictions apply to member banks, although the restrictions expired on March 1, 1988. 12 U.S.C.A. § 1730a (West Supp. 1987). During the moratorium period, the CEBA provided exemptions from the restrictions to permit affiliation between a thrift and a securities firm that commenced prior to March 5, 1987, and affiliations resulting from emergency acquisitions of institutions that have total assets of more than \$500 million. *Id.* § 1730a(m). The restriction also did not apply to affiliations between thrifts and those firms that engage principally in the underwriting or distribution of (1) interests in real estate or real estate loans; (2) securities representing interests in partnerships formed to own, operate, manage, or invest in real estate; (3) insurance products deemed to be securities; (4) securities of an investment company; or (5) securities whose underwriting or distribution is permitted for national banks. *Id.*

ranted today.³⁸¹

Despite the fact that FSLIC-insured institutions were permitted to, and did, affiliate with securities firms since 1933, there is no apparent evidence of any detrimental effect on the industry or specific institutions.³⁸² Permitting affiliates of securities firms to acquire thrift institutions increases the pool of available capital on which the industry can potentially draw.³⁸³

A number of congressional and industry leaders, including the chairman and ranking member of the Senate Banking Committee, have endorsed legislation that would repeal or substantially modify the Glass-Steagall Act. On March 30, 1988, the Senate approved a bill that would phase-out several of the Glass-Steagall Act's restrictions over a three-year period.³⁸⁴

In most of the current legislative proposals, including the Senate bill, the restriction on the ability of banking organizations to underwrite securities would be relaxed to permit separate affiliates to conduct such activities. Those proposals do not deal with FSLIC-insured institutions, thereby effectively permitting them to maintain the pre-CEBA status quo, where the affiliations of FSLIC-insured institutions with securities firms are unrestrictive. Congress should preserve this status quo and, in no case, prohibit FSLIC-insured institutions from exercising at least the same powers as banking organizations.

b. Grant Additional Tax Benefits for Savings and Loans

While the industry currently enjoys a number of tax benefits, the Tax Reform Act of 1986 reduced many benefits.³⁸⁵ These recent changes were a

381. *Id.* §§ 1841, 1841 note, 3106; *see also* H.R. REP. NO. 261, 100th Cong., 1st Sess. 150 (1987).

382. *See supra* note 336.

383. *See, e.g., S & L's Bank Board Permits Iowa Securities Firm to Acquire Four Troubled Thrifts*, 50 Daily Rep. for Executives (BNA) A-7 (Mar. 15, 1988).

384. *See generally* S. 1886, 100th Cong., 2d Sess., 134 CONG. REC. 3360 (1988); S. REP. NO. 305, 100th Cong., 2d Sess. (1988).

385. In 1986, the Congress completed a substantial reform of the Internal Revenue Code. Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (codified in scattered sections of 26 U.S.C.). With the passage of the Tax Reform Act of 1986 (TRA), taxation of all areas of the economy changed, including the taxation of thrift institutions.

Prior tax law allowed thrift institutions to use either the specific charge-off method or the percentage of taxable income method in computing their deduction for bad debts for income tax purposes. 26 U.S.C. § 593 (1982 & Supp. II 1984), *amended by* 26 U.S.C.A. § 593(b)(2) (West Supp. 1987). The TRA retained this deduction for thrifts, but reduced the percentage of the deduction from 40% to 8%. Furthermore, the TRA allows the deduction only if the thrift institution meets a 60% qualified-asset test, defined to be "housing related investments." 26 U.S.C.A. § 593(a)(2) (West Supp. 1987). Failure to meet the 60% qualified-asset test results in taxation of the thrift as a commercial bank, which may require it to recapture its bad debt reserves for income tax purposes. *Id.* § 585.

The TRA also repealed the provision permitting thrifts to carry their net operating losses

part of overall tax reform, however, rather than the result of congressional consideration of a national priority for the promotion of home ownership. If Congress decides to promote the thrift industry as a specialized vehicle for home and consumer finance, it should reconsider current tax provisions and provide additional tax relief.

Enhancement of the value of the thrift charter would result from a reduction of taxation of interest income and consideration of additional tax incentives for individual depositors. Currently, tax laws provide tax relief to a home buyer through a deduction for interest on a home mortgage. This is a healthy incentive for consumption, but there are few incentives to encourage savings. One major consideration which should be reviewed, therefore, is the removal or reduction of taxation of interest income on savings deposits. Such a tax savings incentive would have the additional benefit of providing thrifts with a more stable source of deposits and lower costs for liabilities, resulting in a protected position in the financial services industry.

A tax-induced incentive is not without precedent. A number of the United States' industrialized allies provide significant tax incentive for savings by individual consumers. In addition, current law includes some tax-exempt deposit opportunities.³⁸⁶ Moreover, Congress has previously enacted temporary tax deductions for deposit instruments.³⁸⁷ By and large, however, the Internal Revenue Code has always taxed interest on savings deposits as ordinary income with only a small allowable deduction.

c. Relax and Simplify the Affiliated-Transaction Provisions

Until the enactment of the CEBA, most transactions between FSLIC-insured institutions and their holding-company affiliates were expressly pro-

(NOLs) back 10 taxable years and forward five taxable years. *Id.* § 172(b)(1)(M) (repealing 26 U.S.C. § 172(b)(1)(F) (1982)). Under the TRA, NOLs incurred by a financial institution in taxable years after December 31, 1986 are allowed to be carried back three taxable years and carried forward 15 taxable years. *Id.* § 172(b)(1)(A), (B). A special rule applies to thrifts that experienced a NOL after December 31, 1981 and before January 1, 1986 to allow any NOL incurred during this period to be carried back 10 prior taxable years or carried forward eight taxable years. *Id.* § 172(b)(1)(M). The Internal Revenue Service also contemplates special tax treatment for defaulted thrift institutions that are placed into receivership as part of the Management Consignment Program. I.R.S. Notice 88-7, 1988-4 I.R.B. 20.

In addition, the TRA repeals, effective December 31, 1988, special rules exempting the acquisition of financially troubled thrifts from certain requirements for qualification as a tax-free bankruptcy reorganization. 26 U.S.C.A. § 368 (West Supp. 1987). These rules also govern the survival of NOLs following a merger and the exemption of certain payments from the FSLIC from the determination of the thrifts "income" for tax purposes.

386. 26 U.S.C.A. §§ 219, 408 (West Supp. 1988) (individual retirement accounts).

387. 26 U.S.C. § 128 (1982) (all-savers certificates), *repealed by* Pub. L. No. 98-369, § 16(a), 98 Stat. 505 (1984).

hibited.³⁸⁸ The CEBA created an exemption for transactions between an insured institution owned by a holding company and those affiliates that engage only in the limited activities permissible for bank holding companies under section 4(c) of the BHCA.³⁸⁹ Now such transactions are subject to the same restrictions imposed on affiliated transactions of FDIC-insured banks by sections 23A and 23B of the Federal Reserve Act (FRA).³⁹⁰ While this is a proper step, it is too limited and the effect of the specific statutory provisions creates unforeseen anomalies and confusion.

As a first step towards furthering the relaxation of the affiliated-transactions prohibition, the FHLBB, which has authority to prescribe regulations for the purpose of defining and clarifying the applicability of the FRA limitations,³⁹¹ should issue regulations allowing thrift institutions maximum flexibility within the statutory limitations. In addition, Congress could consider broadening the scope of the statute to permit transactions between the FSLIC-insured institution and all affiliates subject only to necessary and appropriate safety and soundness limitations.³⁹²

d. Eliminate the Requirement of Prior Approval for Debt Issues by Nondiversified Holding Companies

Currently, nondiversified savings and loan holding companies are restricted in the amount of debt securities that they can issue without prior approval of the FSLIC.³⁹³ The restriction, which does not apply to diversified savings and loan holding companies, limits the amount of debt issuable without prior approval to not more than 15% of the consolidated net worth of the holding company and the subsidiary association, as computed at the end of the preceding year.³⁹⁴ Although the statute and the regulation set forth the procedure to be utilized to obtain the FSLIC approval for the issu-

388. 12 U.S.C. § 1730a(d) (1982).

389. 12 U.S.C. § 1730a(d); 12 U.S.C.A. §§ 1730a, 1730a note (West Supp. 1987); *see also id.* §§ 24, 1832, 1842 (West Supp. 1987).

390. 12 U.S.C. §§ 221-462 (1982 & Supp. IV 1986); 12 U.S.C.A. §§ 371c-1, 1730a, 1730a notes (West Supp. 1987). Section 23A allows affiliated transactions of up to 10% of the bank's capital and surplus for transactions with any one affiliate and up to 20% for transactions with all affiliates. 12 U.S.C. § 371(c)(1982). Section 23B subjects these and other transactions to certain additional restrictions, such as the requirement that the transaction be on the same terms and under the same circumstances as would apply to nonaffiliated companies. 12 U.S.C.A. § 371c-1 (West Supp. 1987).

391. 12 U.S.C.A. § 1430 (West Supp. 1987) [hereinafter FRA].

392. *See generally* The Thrift Charter Enhancement Act of 1988, S. 2073, 100th Cong., 2d Sess. (1988) [hereinafter S. 2073]. Hearings on S. 2073 were held by the Senate Committee on Banking, Housing, and Urban Affairs on April 27, 1988.

393. 12 U.S.C. § 1730a(g) (1982); 12 C.F.R. § 584.6(c) (1987).

394. 12 C.F.R. § 584.6(a)(2) (1987).

ance of debt,³⁹⁵ this process can be extremely slow and cumbersome at times.

It is uncertain why this limitation should be imposed on nondiversified savings and loan holding companies. The BHCA imposes no similar restriction on bank holding companies. Moreover, a savings and loan holding company's inability to issue debt may limit the opportunities for the thrift subsidiary to receive infusions of capital and may pose a risk in the event that the holding company cannot meet its own cash flow needs without the issuance of debt. Therefore, absent a clear and convincing showing of a justification for treating differently nondiversified holding companies, Congress should eliminate or, at the very least, substantially relax the debt issuance restriction.

e. Increase Commercial and Consumer Lending Authority for Federal Associations

Current law limits the commercial and consumer lending authority of federally chartered thrifts to 10% and 30% of assets, respectively.³⁹⁶ Congress could amend the HOLA to permit a federal thrift to increase its commercial loan portfolio to 20% or 25% of assets and its consumer loan portfolio to 50% of assets.³⁹⁷ Such an increase should be conditioned upon maintenance of certain required regulatory capital levels.³⁹⁸ The QTL test (which should either be reduced from 60% to 50% of assets or amended to include some or all consumer loans as qualifying assets) would continue to ensure the institution's principal focus is on home finance, while the change would allow greater diversification by savings institutions into commercial and consumer lending.³⁹⁹

f. Increase Allowable Investment in Service Corporations

FSLIC-insured, state-chartered thrifts are allowed, to the extent permitted under state law, to invest up to twice the amount of their tangible capital in a service corporation depending upon the amount of the institution's tangible capital.⁴⁰⁰ Federally chartered associations, on the other hand, may not invest not more than 2% of their assets in service corporations, plus an additional 1% if they invest funds in community development or inner-city

395. 12 U.S.C. § 1730a(g) (1982); 12 C.F.R. § 584.6(d), (e) (1987).

396. 12 U.S.C. § 1464(c)(R) (1982).

397. See, e.g., S. 2073, *supra* note 392, § 101.

398. The Thrift Charter Enhancement Act, S. 2073, proposes to increase the commercial loan limit to 20% of assets on the condition that the institution maintain capital equal to or above the FHLBB's minimum capital requirements. *Id.*

399. See *supra* notes 209-12 and accompanying text.

400. 12 C.F.R. § 563.9-8(c)(2)(i) (1987).

improvements.⁴⁰¹ The statutory limit for federally chartered institutions and the regulatory limit for state-chartered associations are both low and inconsistent.

Congress should raise the standard for investment to 5% or 10% for all thrifts, and provide the FHLBB with discretionary authority to impose lower limits if an institution does not meet its regulatory capital requirement or is subject to enforcement proceedings or a supervisory agreement.⁴⁰² The FHLBB also should have the flexibility to approve applications for higher limits where a thrift exceeds its regulatory capital requirements.

g. Reduce Restrictions on Holding Company Activities

Although holding company activities were reviewed during the recent debates on the CEBA,⁴⁰³ several restrictions imposed by that legislation should be reevaluated with the purpose of enhancing the value of the thrift charter. The most significant restriction is the differing treatment of multiple and unitary savings and loan holding companies.⁴⁰⁴ A holding company with a single, insured subsidiary expanding into new states via mergers of other institutions into its single thrift subsidiary, retains the broad powers of a unitary holding company.⁴⁰⁵ On the other hand, if the same holding company acquires additional healthy thrifts interstate and continues to operate

401. 12 U.S.C. § 1464(c)(4)(B) (1982).

402. See, e.g., S. 2073, *supra* note 392, § 102. The Thrift Charter Enhancement Act of 1988 (TCEA) proposes to increase the total investment in service corporations from 3% to 5% of assets. Additional flexibility would be granted if the institution or its holding company acquired a failed thrift. Federally chartered institutions would also be permitted to invest up to 1% of the institution's assets or 5% of capital and surplus in small business investment companies. *Id.* at 3.

403. See *supra* notes 216-18 and accompanying text.

404. See *supra* note 216 and accompanying text.

405. See *supra* note 216. In contrast to the restriction imposed on national bank branching across state lines, 12 U.S.C. § 36(c) (1982), no federal statute prohibits federally chartered or federally insured thrift institutions from branching across state lines. Although the FHLBB has adopted a policy statement that generally restricts a federal institution to operating within the state where its home office is located, see 12 C.F.R. § 556.5(a)(2) (1987), the FHLBB permits a federally chartered institution to establish or operate a branch in a state other than its home office if (1) the law of the state in which the federal institution's home office is located permits the establishment of such a branch by a state chartered association, and (2) the law of the state where the branch is to be located permits such a branch by an association chartered by the home state of the federal association. *Id.* § 556.5(a)(3)(i)(a)(1) (1987). The FHLBB also grants interstate branching rights in up to three states as inducement for investors bidding on FSLIC-assisted transactions. State law controls branching of state-chartered institutions on an interstate basis. A number of states have enacted such statutes. See, e.g., ARIZ. REV. STAT. ANN. §§ 6-322, 6-323 (1956); CONN. GEN. STAT. ANN. § 36-180 (West 1987); N.Y. BANKING LAW § 396 (McKinney 1987). The most common form of interstate acquisition statute permits branching on a regional, reciprocal basis. State-chartered institutions also may branch without specific state authorization by acquiring troubled thrifts pursuant to the emer-

them as independent subsidiaries of the holding company, it would then be subject to the greater restrictions applicable to a multiple holding company.⁴⁰⁶

In reality, the operational and economic impact of the interstate expansion of both entities are largely the same. To enhance the value of the thrift charter, this distinction should be eliminated.

A similar restriction on activities of the holding company is imposed if the insured institution's subsidiary fails to meet the QTL test.⁴⁰⁷ The QTL test is too inflexible, and Congress should relax it either to reduce from 60% to 50% the required amount of qualified assets or to permit the inclusion of other consumer loans, such as credit card receivables, as qualified assets.⁴⁰⁸ This reform would ensure that thrift institutions remain principally oriented towards serving the American family, while permitting more latitude for institutions and their holding companies to operate profitably.

h. Reduce Restrictions on Cross Marketing

In an effort to establish parity in the regulation of companies owning non-bank banks and companies owning only one FSLIC-insured thrift,⁴⁰⁹ Congress enacted a restriction on cross marketing of products and services within a diversified savings and loan holding company. In particular, only thrifts and affiliates engaged in an activity permissible for bank holding companies may cross market products and services.⁴¹⁰ At a time when efforts are made to attract additional capital into the FSLIC system, this type of a

agency provisions of the Garn-St Germain Act. 12 U.S.C. § 1730a(m) (1982); *see supra* note 125.

406. Until recently, multiple savings and loan holding companies were generally prohibited from acquiring or controlling FSLIC-insured institutions in more than one state, although Congress permitted an exemption from this prohibition for emergency acquisitions of troubled thrifts pursuant to § 408(m) of the NHA, 12 U.S.C. § 1730(m) (1982), *amended by* CEBA, Pub. L. No. 100-86, § 104, 101 Stat. 552, 574. The CEBA relaxed the restriction by enacting a "Douglas-type amendment" that governs interstate acquisitions by bank holding companies. *See* 12 U.S.C. § 1842(d) (1982) (permitting multiple savings and loan holding companies to acquire insured institutions in more than one state if state law where the acquired insured institution is located expressly authorizes acquisition by a state-chartered insured institution in the state where the acquiring company is located); *see also* CEBA, Pub. L. No. 100-86, § 104, 101 Stat. 552, 574. Both in anticipation of and following enactment of the CEBA, states enacted laws permitting acquisitions of savings and loan associations, either on a nationwide or reciprocal regional basis. *See, e.g.,* CAL. FIN. CODE § 10,002 (West 1988).

407. *See supra* note 216 and accompanying text.

408. The TCEA proposes to amend the QTL test to increase the dollar amount of residential mortgage loans originated by an insured institution that qualify as qualified thrift investments from 50% to 100% and to include as qualified thrift investments other assets that have been rated investment grade. *See* S. 2073, *supra* note 392, § 206.

409. *See supra* notes 217-20 and accompanying text.

410. *See supra* note 219; *see also* 12 U.S.C.A. §§ 1730a, 1730a note (West Supp. 1987).

restriction significantly deters investment in thrifts by any entity in a well-capitalized industry if the company engages in activities not otherwise permissible for bank holding companies.⁴¹¹

i. Redefine "Control" and "Holding Company"

Current definitions of "control" and "holding company" in the NHA have impeded significantly ownership by complex, multi-tiered entities.⁴¹² Under these definitions, companies or individuals separated in the corporate structure by several tiers of intervening companies from the direct operation of the subsidiary thrift may nonetheless be deemed to "be in control" or "to be holding companies." Thus, as a result, they become subject to the application requirements and regulations imposed on holding companies while, in reality, they are not intimately involved in the thrift's operations or management. In turn, these companies or individuals incur significant costs in making appropriate filings with the regulatory agencies.

Potential investors are often discouraged by the amount of disclosure that must be made by such remote parties. In addition, the level of required disclosure rarely enhances the ability of the regulator to perform its responsibilities. If Congress amends the Savings and Loan Holding Company Act and the Change in Savings and Loan Control Acts to permit the agency to waive compliance for remote parties while reserving jurisdiction to deal with deliberate attempts at evasion, it could alleviate much of the unnecessary delay and expense imposed on both the applicant and the agency.

j. Eliminate Director Interlock Provisions Between Banks and Thrifts

If it is decided that the maintenance of a distinct and separate industry is necessary for the promotion of home financing or desirable for retail banking, and that the attendant tax and operational differences between that industry and the commercial banking and other financial industries should be preserved, Congress should consider eliminating provisions that prohibit interlocking directorates of banks and thrift institutions.⁴¹³ Assuming the separate industries are preserved, cross-pollinization between the banking and thrift industries may indeed benefit both industries.⁴¹⁴ Any anticompetitive

The Act grandfathered products offered or marketed with or by nonqualified affiliates as of March 5, 1987. See 12 U.S.C.A. §§ 1730a, 1730a note (West Supp. 1987).

411. The TCEA would eliminate the CEBA cross-marketing restrictions, but continue to subject the holding company and its affiliates to the limitations of §§ 23A and 23B of the FRA Act. S. 2073, *supra* note 392, § 206.

412. 12 U.S.C. §§ 1730(g)(8)(B); 1730a(a)(1)(D)-(F) (1982).

413. See 12 U.S.C. §§ 3201-3203 (1982).

414. The TCEA would create an exception for any savings and loan association acquired pursuant to the emergency acquisition provisions of the Garn-St Germain Act, 12 U.S.C.

effects of such relationships could be dealt with explicitly by statute.

k. Remove Barriers to Exit

In the CEBA, Congress erected the barriers to block or deter FSLIC-insured institutions from leaving the FSLIC system. The one-year moratorium on exits and the exit fee imposed by the CEBA may serve a short-term goal of retaining thrifts within the system. However, these barriers have potentially significant long-term ramifications: investors hesitate to commit financial resources if their opportunities to sell freely or otherwise dispose of the thrift are complicated unduly.⁴¹⁵ Therefore, Congress should resist all efforts to extend the moratorium or increase exit fees.

2. Regulatory Actions

a. Permit Bank Holding Companies to Acquire Healthy Thrifts

Although not prohibited by statute, the Federal Reserve Board generally has refused to permit bank holding companies to acquire FSLIC-insured or federally chartered thrifts.⁴¹⁶ The Federal Reserve Board has determined that a bank holding company's operation of a thrift is not so closely related to banking as to be a proper incident thereto.⁴¹⁷

The Federal Reserve Board has created an exemption to this general regulatory prohibition by allowing bank holding companies to acquire federally chartered *and* state-chartered thrifts that have encountered financial difficulty.⁴¹⁸ However, acquisitions made under this exception remain subject to numerous restrictions, which, in part, prevent bank holding companies that acquire thrift institutions from circumventing federal limitations on bank branching and interstate expansion and nonbanking activities of bank holding companies.⁴¹⁹ Those restrictions have, in effect, deprived the thrift char-

§ 1730a(m) (1982). S. 2073, *supra* note 392, § 301. It also authorizes the federal regulators to make other exceptions upon a finding that the proposed interlock would not result in a substantial lessening of competition or substantial conflicts of interest. *See id.*

415. *See supra* notes 195-96.

416. *See* D.H. Baldwin, 63 Fed. Res. Bull. 280 (1977).

417. *Id.* at 280.

418. *See, e.g.,* Citicorp (Nat'l Permanent), 72 Fed. Res. Bull. 724 (1986); Rainer Bancorporation (Lincoln), 72 Fed. Res. Bull. 666 (1986).

419. *See* 12 U.S.C. §§ 36, 1842(d) (1982). These restrictions include: (i) allowing the thrift to engage only in those activities that are permitted for federally chartered thrifts *and* bank holding companies; (ii) allowing the thrift to establish or operate branches only at locations permissible for national or state-chartered banks located in that state; (iii) requiring that the thrift be operated as a separate, independent, profit-oriented corporate entity; and (iv) prohibiting the thrift from changing its name if the public might be confused about the status of the thrift as a nonbanking institution. *See, e.g.,* Citicorp (Nat'l Permanent), 72 Fed. Res. Bull. 724 (1986); Baltimore Bancorp (Charles Street), 71 Fed. Res. Bull. 901, 903 (1985).

ter of any special franchise value and, as a result, deterred many potential bank holding company buyers from considering an acquisition.⁴²⁰

In 1987, the Federal Reserve Board solicited comments as to whether, in light of changing economic and regulatory circumstances, it should determine generally that the acquisition and operation of thrift institutions by bank holding companies is a permissible activity.⁴²¹ It proposed to amend the Federal Reserve Board's regulation to add to the list of permissible bank holding company activities the "acquiring and operating of thrift institutions, including savings and loan associations, building and loan associations, and FSLIC-insured savings banks, so long as the institution is not a bank."⁴²² As part of the proposal, it raised the question of whether any or all of the restrictions should be removed.

Removal of the restrictions imposed on thrift activities as a condition of acquisition by a bank holding company would represent a substantial step towards enhancing the value of the thrift charter. Permitting the acquisition of nonfailing thrifts by bank holding companies also would encourage a significant new infusion of capital into the thrift industry.⁴²³ The banking industry, which may ultimately be required to bear a substantial burden of the thrift crisis through a merger of the insurance funds, would have an opportunity to be a voluntary part of the solution during an intermediate period. In addition, an increasingly attractive thrift charter may have the effect of encouraging bank holding companies to retain such charters and continue to make payments into the FSLIC fund.

b. Continue Current FHLBB Regulatory Initiatives

Much of the loss in value of the thrift franchise in recent history has been due to the lack of certainty, efficiency, and continuity in the policies and procedures of the dominant regulatory authority for the industry. As dis-

420. See Bank Holding Companies and Change in Bank Control; Board Policy Regarding the Acquisition and Operation of Thrift Institutions by Bank Holding Companies, 52 Fed. Reg. 36,041 (1987).

421. *Id.*

422. *Id.* at 36,045.

423. The banking industry generally supports the Federal Reserve Board's proposed regulation. See, e.g., Comment Letters on FRB proposal from Am. Bankers Ass'n, N.Y. Clearing House, Mellon Bankcorp., Marine Midland Banks, Inc., Citicorp (available in Office of Freedom of Information, Federal Reserve Board). The proposal is opposed by the U.S. League of Savings and several key members of Congress. See Comment Letters on FRB Proposed Regulation from U.S. League, Rep. Ferdinand St Germain, Rep. Bruce F. Vento, Rep. Frank Annuzio, Sen. William Proxmire (available in Office of Freedom of Information, Federal Reserve Board); see also *Industry Groups Divided Over FED's Proposed Amendments to Regulation Y*, 49 Banking Rep. (BNA) 901 (Nov. 30, 1987).

cussed above, abrupt shifts in policy⁴²⁴ and an ineffective and painfully slow procedural morass have combined with economic conditions to make it difficult to acquire a thrift and operate it profitably.

The current Chairman of the FHLBB has undertaken to improve the operations of the agency and has announced that one of his primary goals is the enhancement of the thrift charter's value: "To make thrifts attractive to a broader range of investors the FHLBB will seek to demonstrate 'that as a regulatory and supervisory entity, we're going to be more responsive and prompt with decisions.'"⁴²⁵ To this end, the Chairman has increased the size of the FHLBB's Washington staff, which had proven, during the last decade, to be far too small and inexperienced to handle the major crises and change in the industry.⁴²⁶ The Chairman also has imposed deadlines for the processing most applications and has delegated the responsibility for processing of a number of types of applications to the twelve regional federal home loan banks.⁴²⁷ These initiatives are to be applauded, but additional work remains to be done to eliminate unnecessary applications and information contained in applications and to ensure uniform and speedy action by the regional banks.

c. Expedite the Acquisition of Failing Thrifts

i. Facilitate Unassisted Acquisitions of Failing Institutions

Currently, the FHLBB has no uniform application procedures to deal with the ever increasing number of failing thrifts. Insolvent thrifts are subject to a loosely structured bidding process with no clear guidelines as to who may bid or how to negotiate the bids. Some procedures, however, are in place for the acquisition of troubled thrifts, when FSLIC financial assistance is not required and a receivership is not involved. The application and approval procedures are generally the same as those for the acquisition of healthy thrifts.⁴²⁸ Traditionally, however, the FHLBB has responded very

424. See *supra* notes 298-323 and accompanying text.

425. *FHLBB Chief Vows to Seek Expanded Thrift Powers, Coax Healthy Institutions to Remain with the FSLIC*, 49 Banking Rep. (BNA) 451 (Sept. 14, 1987).

426. See *supra* notes 324-30 and accompanying text.

427. Application Processing Guidelines, 52 Fed. Reg. 39,064 (1987) (to be codified at 12 C.F.R. pt. 571).

428. Mutual thrift institutions must proceed through a two step process before they can be acquired. First, the mutual institution must be converted into stock form prior to its acquisition. Conversion can take place voluntarily at the initiative of the board of directors or involuntarily if the FHLBB determines that the thrift is a supervisory case and sells it. 12 C.F.R. § 563b (1987). See *supra* note 79. Once the institution is in stock form, acquiring institutions must apply for acquisition approval from the FHLBB. Criteria that the FHLBB uses to judge the application include (1) the acquirer's financial condition, (2) the competence, experience and integrity of its managers, and (3) the future prospects of the thrift. The proposed acquisi-

slowly in the processing of these types of applications.⁴²⁹ In the case of failing thrifts, this delay has often had detrimental effects. During the processing period, the financial condition of the thrift continues to deteriorate, making it less attractive to potential acquirers. Such delays also have caused some potential acquirers to abandon their applications either in frustration or because of the thrift's deteriorated condition.

In addition, the FHLBB has frequently discouraged acquirers by placing conditions upon the approval of acquisition applications. For example, it normally requires that the savings and loan holding company maintain the thrift's net worth at an agreed level. At a minimum, this level, required by regulation, is usually 3% of liabilities, although it may be set at an even higher level.⁴³⁰ In addition, the FHLBB has required the holding company to covenant that dividends paid by the thrift will not exceed 50% of net income per year. If the thrift fails to meet its minimal capital requirements, the FHLBB prohibits the payment of a dividend.⁴³¹

Recently, however, the FHLBB has begun to consider alternatives to the standard application procedures and covenants previously required. One alternative the FHLBB is experimenting with involves the relaxation of the traditional net-worth maintenance guarantees.⁴³² In a recent acquisition, the acquisition agreement required the acquirer to maintain the acquired institution's capital at a specified level.⁴³³ If the institution's capital drops below that level, but remains above 3% of assets, the thrift will be considered a "Supervisory Case" and be subject to operating restrictions and other supervisory directives usually employed against thrifts which fail to meet this required regulatory capital level. If the thrift's capital level drops below 3%, the FHLBB can automatically take possession and control of the thrift and replace its management.⁴³⁴ The modified arrangements have two principal

tion of the thrift cannot harm the thrift or its depositors, nor can it pose an insurance risk to the FSLIC. *Id.* § 574.7.

429. The application processing guidelines promulgated by the FHLBB pursuant to the congressional mandate in the CEBA, require the FHLBB to speed up its processing time. *See supra* note 208.

430. *See* Brokered Deposits; Limitations Applicable to Institutions With Low Net Worth, 50 Fed. Reg. 5232, 5233 (1985) (codified at 12 C.F.R. §§ 561, 563 (1987)); 12 C.F.R. § 574.8(a)(iv)(B) (1987).

431. 12 C.F.R. § 574.8(a)(iv)(B) (1987).

432. *See supra* note 323.

433. *See* White, *Facing the Issues*, OUTLOOK, May-June 1987, at 25.

434. In a recent decision, the FHLBB further modified its regulatory capital maintenance requirements. In approving an application by Temple-Inland, Inc., to acquire Texas-based Kilgore Federal Savings and Loan Association, the FHLBB limited Temple-Inland's capital obligation to an amount equal to Kilgore's regulatory capital requirement at the close of the quarter preceding consummation of the transaction. Additionally, if Kilgore's ratio of capital to total liabilities falls below 2% and Temple-Inland is unwilling to infuse sufficient capital to

benefits: they permit the FHLBB to intervene long before the thrift becomes insolvent and they lessen the burden and stigma attached to an absolute, net-worth maintenance agreement.

Other alternatives are available to the FHLBB. In particular, Congress could adopt the CEBA proposal for dealing with failing FDIC-insured banks as a procedure for handling thrift institutions before they fail.

The CEBA provides for the creation of a bridge bank, which is a new national bank that is established by the FDIC for the purpose of assuming the assets and liabilities of a failed bank and carrying on the business of the failed bank for a limited period of time.⁴³⁵ The bridge bank, which is in essence owned by the FDIC, is insured from the time of its organization and has all the powers of and is subject to the same legal provisions as a national bank. The FDIC must dispose of the stock of a bridge bank within two years from its chartering unless the FDIC decides that an extension of time is in the best interests of the depositors.⁴³⁶ If the FDIC makes such a finding, the FDIC can extend the authorization of the bridge bank for a period not to exceed an additional year.⁴³⁷

Expediting the processing of unassisted supervisory acquisitions and imposing only necessary and reasonable conditions could dramatically reduce the cost of resolution for problem cases. These steps require FHLBB action to ensure proper policies are uniformly applied in each case.

ii. Specify Bidding Procedures for FSLIC-Assisted Acquisitions

The FHLBB must refine its internal procedure for processing and accepting offers for FSLIC-assisted acquisitions of failed institutions. Currently, the FHLBB uses a bidding procedure that is notorious for long delays, frequent rebidding, the reopening of the bid process to new bidders after the deadlines for bids has passed, and the renegotiation of proposals after apparent conclusion of agreements. A number of bidders, frustrated by inordinate delays and uncertainties, have withdrawn from the bid process

restore the ratio, the FSLIC will then have the right to vote and to dispose of the Kilgore securities held by Temple-Inland. See FHLBB May Allow Some Variations in Holding Company Capital Rules, FHLBB Press Release, Jan. 21, 1988.

435. 12 U.S.C.A. § 1821(h)-(i) (West Supp. 1987). The FDIC can establish a bridge bank only if: (i) the amount which is reasonably necessary to organize and operate a bridge bank does not exceed the amount which is reasonably necessary to save the cost of liquidating the bank, including paying the insured accounts of the closed bank; (ii) the continued operation of the insured bank or banks is essential to provide adequate banking services to the community; or (iii) the continued operation of the insured bank or banks is in the best interests of the depositors of the closed bank and the public. *Id.*

436. *Id.* § 1821(i)(10).

437. *Id.*

entirely. To resolve these problems, the FHLBB must establish new, defined procedures that will balance its desire to obtain the best possible deal from a bidder with the need to avoid the additional cost of not closing the failed institution promptly.

When accepting interstate and interindustry bids for a failing thrift, the Garn-St Germain Act requires the FSLIC to prioritize the bids received based upon statutory priorities as to the type of acquirer and then consider both the bidder's priority and the net cost of the bids in determining which bid to accept.⁴³⁸ Failure to consider applicable priorities and to allow rebidding when required may result in the reversal of the FSLIC bid approvals.⁴³⁹ However, the Garn-St Germain Act priorities provide only minimal guidance for the bid process.

In actual application, the FSLIC's bid process has developed a mystique of its own and has caused substantial uncertainty for bidders. Negotiations can be extended for a year or more, and a final negotiated agreement may vary radically from any of the initial proposals.⁴⁴⁰

A number of previously successful, and some frustrated bidders, have suggested improvements in the process that would include:

(a) Publishing Guidelines

(i) Parameters for qualification as a bidder for a FSLIC-assisted case and a clear definition of circumstances in which bidders would be offered an opportunity to bid should be established. Currently, there appears to be no consistent process to identify who is or is not invited to a bidder's conference.

(ii) Written schedules should be established and adhered to for the submission of a bid as well as for the evaluation of bids by the FSLIC.

(b) Adopting a New Policy for the Negotiation of a Final Agreement

If, upon initial evaluation of the bids received for a particular institution, the FSLIC determines that none of the bids are acceptable without *substantial* modifications, the FSLIC should offer the three (or another predetermined number of) *best* bidders an opportunity to rebid within clearly defined time frames. If, on the other hand, the FSLIC determines that it could accept one or perhaps two of the submitted bids

438. 12 U.S.C. § 1730a(m)(3)(B) (1982).

439. See, e.g., *Getty v. Federal Sav. & Loan Ins. Corp.*, 805 F.2d 1050, 1055 (D.C. Cir. 1986).

440. McTague, *Panel to Investigate Bank Board's Efforts to Assist Ailing FCA*, Am. Banker, Feb. 8, 1988, at 1, col. 4; Stevenson, *Talks Set on Savings Unit Breakup*, N.Y. Times, Feb. 8, 1988, at D1, col. 3.

with some minor modification, those bidders would enter into negotiation with the FSLIC. The FSLIC could notify all other bidders in writing of the rejection of their bids.

The procedure could add a new degree of certainty to the bidding process. Bidders would still have an incentive to submit the best bid in the first round, because the FSLIC would enter into negotiations with, or rebid to, only the best bids in the first round. The proposed procedure also would avoid the current practice of protracted discussions with only one first round bidder, a practice that frequently results ultimately in *no* acceptable solution or a complete rebidding. Similarly, notification to losing bidders would lessen the likelihood that they would continue to expend funds unnecessarily on the possible transaction and would free them to pursue alternative acquisitions.

(c) Granting More Authority to District Banks

The Federal home loan district banks should possess additional authority to negotiate FSLIC-assisted transactions with minimal involvement of the FHLBB's Washington staff. The district banks are, in most instances, more familiar with the distressed institution and with many of the potential bidders. Thus, the banks should serve as the focal point for initial negotiations relating to a distressed institution.

d. Further Streamline Application Procedures

In the past several years, and particularly since July 1985 when Congress transferred the FHLBB's examination function to the Federal home loan district banks, the staff responsible for examination, supervision, review, and approval of applications has increased by nearly 100%.⁴⁴¹ The enlarged staff clearly can operate to enhance the value of a thrift charter *if* the agency applies the additional workforce and talent to ensure the quick review and approval of applications, the rapid resolution of supervisory problems, and the efficient and timely use of examination and supervision powers to prevent thrifts from posing potential problems to the insurance fund or to the industry. The increased staffing should provide sufficient resources for the safe supervision of new powers and authorities available under the thrift charter.

This tremendous increase in personnel, however, may have a negative effect. This rapid increase in staffing creates the potential for the imposition of *overly* burdensome regulation on the industry.⁴⁴² Great care must be taken that this enlarged staff focuses its attention on real threats to the safety and

441. Kuttner, *Banking*, BUS. WEEK, Feb. 17, 1986, at 45.

442. See *supra* note 330 and accompanying text.

soundness of the system and on the enhancement and improvement of the thrift industry in general. The expanded regulatory system must not become parasitic by dwelling upon minutia, requiring production of irrelevant information, or make stifling requests for unneeded data or unnecessary action. The goal must be *streamlining* the regulatory process and reducing the regulatory burden for well-managed thrifts, expediting the entry into the system of new capital, and focusing the system's workforce on the elimination of *real* problems—before they grow out of control.

e. Enhance Supervisory Personnel's Contact with and Understanding of the Thrift Industry

The efforts initiated under the past FHLBB administration and continuing under the chairmanship of Mr. Wall to enhance both the number and quality of supervisory personnel⁴⁴³ are to be applauded. However, as noted above, it is important that the focus and attitude of new personnel be in keeping with the goals of enhancing the value of the thrift charter and the promotion of home ownership.

In this regard, the exchange of personnel between the regulators and the regulatees on a regular basis should be encouraged. The possibility of industry personnel serving in fellowship capacities in the Federal home loan banks and, likewise, supervisory personnel serving in insured institutions is worthy of consideration.⁴⁴⁴

Obviously this type of program poses potential questions relating to conflicts of interest and potential access to inside information concerning competitors. A well-structured program, however, could lead to a better understanding between the regulated industry and its regulators.

f. Relax Stock Transfer Limitations

The FHLBB restricts the free transferability of a FSLIC-insured institution's equity for a period of three years following the completion of a conversion from mutual to stock form.⁴⁴⁵ During this period no person may offer to acquire directly or indirectly more than a 10% beneficial ownership interest of any class of equity stock offered by the institution.⁴⁴⁶ If a person does acquire more than a 10% ownership interest, the additional shares cannot be

443. See *supra* note 441 and accompanying text.

444. An example of such an exchange, which has been highly successful, is the FHLBB's Accounting Fellow Program. Under this program, certified public accountants from large accounting firms spend one year to two years at the FHLBB dealing with thrift industry accounting issues. At the end of the fellowship they return to the same accounting firm.

445. 12 C.F.R. § 563b.3(i)(3) (1987).

446. *Id.*

voted or counted as voting shares in connection with any matter submitted to the stockholders in a vote.⁴⁴⁷ The purpose of this rule is to protect against takeovers designed to gain control of a converting institution's conversion proceeds and to foster the integrity and objectives of the conversion process.⁴⁴⁸ Waiver of the nontransferability requirement may be obtained,⁴⁴⁹ but processing of the waiver can be subject to delay. Such delays, however, have discouraged, and will continue to discourage, acquisitions. At the very least, the FHLBB should relax the prohibition to permit thrifts' shareholders to elect promptly after conversion whether they want to impose such a restriction on share transferability.⁴⁵⁰

g. Encourage Indemnification of Officers and Directors

Because of the impact of the economic crisis suffered by thrifts during the past decade, as well as the damage caused by a number of less than scrupulous individuals who came into control of thrifts during that period of time,⁴⁵¹ director and officer liability insurance is very difficult to obtain for some institutions.⁴⁵² Moreover, the insurance coverage that is available is extraordinarily limited in scope and extremely expensive. In addition, as a result of increased civil and criminal litigation against former officers and directors both by the regulatory authorities and by private individuals, many institutions find it very difficult to attract qualified and experienced individuals to serve as directors.

The FHLBB should establish policies and procedures that would allow, and encourage, well-run institutions to establish and fund indemnification programs, including the set aside of significant amounts of assets, in order to attract talented directors. Obviously, institutions should not indemnify against liabilities for criminal activity or willful neglect. However, in the face of increasing litigation, the FHLBB must take effective steps to provide resources for the defense and protection of management and directors who have performed their duties honorably and diligently, but who may also have been the victims of poor business judgment or unforeseen economic circumstances.

Clear enunciations of the policy to be followed by the FSLIC in commenc-

447. *Id.*

448. Conversions from Mutual to Stock Form, 49 Fed. Reg. 7356 (1984) (codified at 12 C.F.R. § 563b (1987)).

449. 12 C.F.R. § 563b.3(i)(3) (1987).

450. *See, e.g.*, N.Y. COMP. CODES R. & REGS. tit. 3, § 86.10 (1983).

451. *See supra* note 171 and accompanying text.

452. *See U.S. League Launches Insurance Captive With Initial Capital of \$33 Million*, 48 Banking Rep. (BNA) 349 (Feb. 23, 1987).

ing litigation would also be helpful. Obviously, the standard should differ from that used by "strike-suit" plaintiffs (i.e. settlement value).

h. Expand Use of the "No Action" Interpretative Process

In the past, the typical regulatory response of the FHLBB on any given issue has been the issuance of regulations or guidelines applicable to all insured institutions.⁴⁵³ Unfortunately, such an approach has had the effect of regulating institutions to the lowest common denominator within the industry, and is one that is not amenable to being tailored to specific needs of individual institutions.

Consideration should be given to adopting a formal interpretative letter process pursuant to which the FHLBB would issue a "no action" letter for special circumstances not intended to have general applicability within the industry. This method would streamline consideration of issues before the regulator, conserving time and staff resources.⁴⁵⁴ Although the process is currently used on a limited basis by the FHLBB's Office of General Counsel, a more formal and expanded procedure would be beneficial.

i. Realign the Role of the FHLBB Washington Office Vis-a-Vis the Federal Home Loan Banks

As additional responsibilities are delegated to the federal home loan district banks for supervision, examination, application approval, and negotiation of mergers and acquisitions, the role of the Washington bureaucracy should shift from one of application approval and active involvement in negotiations to a new role of quality control, appeal, and policy formulation.⁴⁵⁵ The oversight responsibility for assuring consistency among the districts, effective implementation of the FHLBB's policies, monitoring of district bank activities, and the expeditious resolution of appeals from disputed district bank decisions should be vested in the Washington staff. This change would depart substantially from the traditional procedure of requiring approval at two levels, first at the district bank and then at the Washington staff level. The elimination of this two-step process and the utilization of the Washington staff to assure compliance with decision time lines and policy guidelines should enhance the value of a thrift charter.

453. See *supra* notes 355-56 and accompanying text.

454. A similar approach was adopted by the Office of the Comptroller of the Currency in 1985.

455. See, e.g., 12 U.S.C.A. §§ 1457, 1468 (West Supp. 1987); Office of the Comptroller of the Currency, OCC Staff No-Objection Positions, Banking Circular No. 205 (July 26, 1985).

j. Stabilize Management of the FHLBB

In recent history, a change in administration has inevitably led to a change not only in the membership and chairmanship of the FHLBB, but also in the management of most of the senior divisions of the FHLBB itself. This experience differs substantially from the experience of the Federal Reserve Board where the managers of supervisory, examination, and enforcement divisions occupy career positions that do not automatically change with a change in the chairmanship or composition of the board.

The constant change of senior positions within the FHLBB has had a negative impact upon staff morale, has prevented the development of an experienced administrative leadership, has impeded the continuity of management policies and procedures, and, in general, has led to a high degree of inefficiency. While it is clear that leadership of the FHLBB must change periodically as the priorities of the nation's leadership change, the establishment of a career-based structure for examination, supervision, and enforcement would greatly increase FHLBB efficiency. Certainty and continuity would provide the management of thrifts with a more stable environment and would provide the membership of the FHLBB with a solid foundation of experience to provide insight with regard to the FHLBB's proposed changes in policy and direction. The wild gyrations in policy direction that have occurred at the FHLBB in the course of the past several years could be ameliorated and, while still allowing for changes in policy, a certain degree of stability could be added to the regulatory environment and procedures of the FHLBB.

k. Confirm Credit Card Powers For Federally Chartered Thrifts

The value of a thrift charter could increase significantly by the promulgation of a rule that would resolve existing legal issues regarding the implementation of section 522 of the DIDMCA, which governs the rates of interest a FSLIC-insured institution may charge on any loan.⁴⁵⁶ Presently, the ability of thrift institutions to develop nationwide credit card lending programs, for example, is impeded by the existence of a number of legal issues that create an uncomfortable level of uncertainty for potential credit card issuers. This uncertainty arises from the fact that although section 522 is very similar to section 85 of title 12 of the United States Code,⁴⁵⁷ which governs the ability of national banks to export interest rates and other fees to residents of other states, there is substantial material interpreting section

456. 12 U.S.C. § 1730g (1982); *see also* 12 C.F.R. § 570.11 (1987).

457. 12 U.S.C. § 85 (1982).

85,⁴⁵⁸ while a more limited body of interpretation exists for section 552.

An appropriate rule, promulgated by the FHLBB, would provide a clear statement of the purpose by recognizing that the congressional intent of section 522 was to achieve competitive equality between FSLIC-insured thrifts and national banks by granting FSLIC-insured thrifts the same authority granted to national banks pursuant to section 85 of title 12. Such a rule would clarify this purpose by explicitly recognizing that, as interpreted by the United States Supreme Court, section 85 includes two doctrines: the "most favored lender" doctrine⁴⁵⁹ and the "exportation" doctrine.⁴⁶⁰ By reiterating the congressional desire to affirm the principle that thrift and bank institutions offering similar products should be subject to similar rules, an FHLBB rule would lay the groundwork for statutory construction in the thrift context.

Lending under the "most favored lender" doctrine or under the "exportation" doctrine raises an issue regarding the extent to which state law must be "borrowed" or "incorporated." A FHLBB rule should resolve the issue with respect to the most favored lender doctrine by subjecting insured institutions to only those provisions of state law that are material to the determination of the interest rate for a specified class of loans. This resolution would be consistent with current interpretations of the most favored lender doctrine and could adopt the terminology developed in those interpretations.⁴⁶¹

The issue of where an institution is located, which determines which state law section 522 incorporates under the "exportation" doctrine, may be resolved by a regulation clarifying the location of an institution for purposes of the doctrine. A FHLBB rule could provide that an insured institution is located, for purposes of the "exportation" doctrine, in the state in which the institution's designated home office is located. Such a rule, consistent with prior authority under section 94 of title 12,⁴⁶² could also recognize and permit other definitions of location to apply as may be necessary in different contexts.

The legal issue of the exportation of interest rates into states that have opted out of section 522 may be resolved by clarifying when and where a loan is made for purposes of the exportation doctrine and section 525 of the

458. See *infra* notes 459-60 and accompanying text.

459. *Tiffany v. Nat'l Bank of Missouri*, 85 U.S. (18 Wall.) 409, 412 (1875).

460. *Marquette Nat'l Bank v. First Serv. Corp.*, 439 U.S. 299, 318 (1978).

461. See 12 C.F.R. § 7.7310 (1987).

462. See *Helco, Inc. v. First Nat'l City Bank*, 470 F.2d 883, 884 (3d Cir. 1972); *Buffum v. Chase Nat'l Bank*, 192 F.2d 58, 61 (7th Cir. 1951), *cert. denied*, 342 U.S. 944 (1952); *National City Bank v. Domenech*, 71 F.2d 13, 16 (1st Cir. 1934), *aff'd*, 294 U.S. 199 (1935).

DIDMCA.⁴⁶³ A FHLBB rule could resolve this issue by stating that insured institutions may export interest rates into states that have opted out of section 522, provided that the loan is not made in the opt-out state. Such a rule should further provide that a loan is made for purposes of the exportation doctrine in the state where the insured institution approves the credit and commits to extend the credit. This would remove any ambiguity as to the jurisdiction in which an insured institution made a loan.

Another legal issue, which arises under the exportation doctrine and is similar to that which arises under the most favored lender doctrine, relates to the scope of the state law incorporated into section 522. This issue would be appropriately resolved by identifying the scope or parameters of the concept of "rate" in the exportation doctrine context. A FHLBB rule could provide that the rate exported by a thrift must include any state law provision that is material to the determination of the interest rate. The use of a "material to the determination of the interest rate" standard builds upon existing interpretation and construction by administrative and judicial authorities. Such a standard would avoid the problem of expedient labeling and would recognize the weight of judicial authority holding that the relevant statutes contemplate more than a rate expressed simply as a multiplier.⁴⁶⁴

Having clarified the scope of state law to be borrowed under the most favored lender doctrine and incorporated under the exportation doctrine, an issue remains as to what precisely is material to the determination of the interest rate; that is, what should be considered an essential part of the rate borrowed or incorporated? The FHLBB could resolve this issue by distilling current authority in a FHLBB rule that would provide a description of provisions meeting that standard. The description should state that a provision of state law is material to the determination of the interest rate if the provision establishes the characteristics of a loan for which the rate of interest may be charged, or constitutes an element of or affects the total anticipated monetary return to the lender. This formulation would recognize that interest rates are set in relation to particular types of loans and that "interest" and competition among lenders in the making of loans involves more than the common use of a numerical rate expressed simply as a multiplier.

By describing provisions that are material to the determination of the interest rate, a FHLBB rule would avoid the problems involved in attempting

463. Section 525 of DIDMCA provides that § 522 applies to loans made in states where the voters of have *not* opted out of the provisions of § 522. 12 U.S.C. § 1730g (1982).

464. See 12 C.F.R. § 7.7310 (1987); *see also* First Nat'l Bank v. Nowlin, 509 F.2d 872, 876 (8th Cir. 1975); Attorney General v. Equitable Trust Co., 450 A.2d 1273, 1291-92 (Ct. App. Md. 1982).

to define what may constitute "interest," meaning the compensation allowed by law for the use or forbearance of money in the modern lending context. A FHLBB rule would clarify the relationship between rates of interest and the type of loan made by providing that the characteristics of a loan include amount, term to maturity, type of collateral, and class of borrowers to whom the loan is made. It also should define the elements of total anticipated monetary return to include provisions governing the calculation, assessment, or timing of charges related to the origination, maintenance, renewal, servicing, or collection of the extension of credit to the borrower. Under such a rule, provisions of law that affect these elements also would be defined as material.

The FHLBB's adoption of a rule containing provisions such as those suggested above would resolve the basic legal issues that presently impede the use of thrift charters for national lending programs such as those involving credit cards. Such a rule would build upon and clarify existing judicial precedent, authority, and interpretation and would allow thrifts to realize the equality with national banks intended by section 522 of the DIDMCA. Clarification of this authority would increase significantly the value of thrift charters by presenting an opportunity for credit card lending to an extent not otherwise possible. Indeed, when combined with other authority granted under the HOLA, thrift charters could become superior vehicles for credit card lending on a nationwide basis.

V. CONCLUSION

The thrift industry has seen a number of economic, technological, and regulatory changes in the past decade. Although the industry has traditionally been a significant source of stability to the nation through its fostering of home ownership and promotion of community savings, its future is now shrouded in a cloak of uncertainty. Resting upon a diminished capital foundation, protected by a severely weakened insurance fund, beset by new and unrelenting competitors, and grappling with uncertainty about its specialized role in the financial community, the industry is at a crossroads, desperately requiring serious decisions concerning its future in light of the nation's priorities.

A growing consensus inside and outside the industry is that only a merger into the FDIC can resolve the financial crisis of the FSLIC. It is not clear that such a merger is, in fact, a viable economic solution to the problem, however. In addition, any merger would undoubtedly involve a transition period, and the ultimate result most likely would be elimination of an independent and discernible thrift industry. This would occur at a time when

the nation faces a crisis with respect to home ownership.⁴⁶⁵ The debate, therefore, will focus upon the appropriate role of a separate thrift industry in supporting that policy. As an alternative the value of the thrift franchise could be enhanced concurrent with the recapitalization of the insurance fund to permit the industry to survive as a retail consumer finance industry with a concentration, but not an exclusive focus, on housing finances.

If the ultimate solution is continued maintenance of a separate thrift industry, policymakers will have to decide whether the industry will be supported by the private or public sector. If the burden falls on the public sector, the taxpayer will have to provide the additional capital necessary to preserve the viability of the industry. If Congress selects a private sector solution, there must be an incentive to encourage investment of new capital. That incentive can only be accomplished through a more attractive thrift charter. If the thrift charter is not made more attractive, the industry will not entice necessary capital.

Therefore, if the leadership of the nation determines that home ownership remains a national goal and that the thrift industry should continue to play a significant role in supporting that priority (either as a dominant service or one of several retail services), steps can and must be taken to enhance the thrift charter. Congress can provide additional tax incentives and charter authorities to make thrifts profitable and a source of low-cost home financing. In the interim, the principal financial regulator of the industry, the FHLBB, can take steps including those described in this Article to improve the efficiency of its operations, provide continuity of leadership and policy, and increase the value of the thrift charter.

465. See Kuttner, *A Blueprint for Affordable Housing*, BUS. WEEK, Aug. 3, 1987, at 18; Boles, *Affordable Homes With Lots of Help*, N.Y. Times, Feb. 25, 1988, at C1, col. 1; Mauno, *Low-Income Residents Go Further Out*, Wash. Post, Feb. 20, 1988, at E1, col. 5; McQueen, *A Dream Deferred*, Wall St. J., Feb. 5, 1988, at 1, col. 6.