SAVINGS AND LOAN REPRISE

Some 50 specialists in financial services gathered at UCLA on Jan. 25 to assess the lessons of the 1980s S&L mess for financial institutions, markets and regulation in the years ahead. The give and take at the invitation-only meeting, co-hosted by the Milken Institute and UCLA's Anderson School of Management, reflected the diverse backgrounds of the participants. Some argued that today's financial markets are in much better shape than they were 20 years ago, while others asserted that not nearly enough has been done to prevent future problems.

The glass-is-half-full view was expressed most clearly by James Wilcox of the University of California's Haas School of Business. Among the lessons learned:

The value of diversification. We have seen what happens when institutions are not permitted to diversify their investments. Diversification across sectors, geographic regions and services, all make a difference

The need for risk management. We now have a much better understanding of how much interest rate and credit risk are in the system, and how these risks can be handled. Financial institutions have more latitude to hedge now than they did 20 years ago.

The imperative for closure. Instead of letting firms try to grow out of problems, we should opt for "reincarnation" – reorganizing struggling institutions, bringing them back with different managers, different owners and perhaps different balance sheets.

Other participants, including Susanne Trimbath of the Milken Institute, were less sanguine. In the long term, she noted, the share of U.S. financial assets held by banks and thrifts is falling. "We might well look to pension funds and mutual funds as the next set of institutions to become vulnerable if a conflict arises between asset classes and market conditions," she argued. A forced divestment of company stock from pension plans, for example, could leave those financial institutions vulnerable.

Susanne Trimbath speaking with Bruce Willison.

"Exactly the same things happened in Superior," a recently failed Chicago thrift, as happened in the 1980s, seconded George Kaufman of the Center for Financial Studies & Policy at Loyola University. Kaufman appends to Santayana's admonition that those who forget history are bound to repeat it. "What do those who do remember do? … they agonize first and then do it again."

To focus the discussion, the day included sessions on government policy, the public record, and the parallels in international banking. The final session summarized the day's discussion.

Participants

Bruce Willison Dean, Anderson School of Management, UCLA • **Michael Klowden** President and CEO, Milken Institute • **Timothy Anderson** Former banking consultant • **James Barth** Auburn University and Milken Institute; formerly Chief Economist, Office of Thrift Supervision and Federal Home Loan Bank Board • **Philip Bartholomew** International Monetary Fund; formerly Federal Home Loan Bank Board; U.S. House Banking Committee • **Gordon Bjork** Economics Department, Claremont McKenna College • **Elijah Brewer** Federal Reserve Bank of Chicago • **R. Dan Brumbaugh** Milken Institute; formerly Federal Home Loan Bank Board • **Charlotte Chamberlain** Jefferies & Company; formerly Federal Home Loan Bank Board • **Michael Darby** Anderson School of Management, UCLA; formerly Assistant Secretary, U.S. Treasury • **Mollie Dickenson** Author; *Worth* magazine • **Stephen Ege** Elias, Matz, Tiernan & Eric; formerly Special Assistant to the Chairman of the Federal Home Loan Bank Board • **Robert Eisenbeis** Director of Research, Federal Reserve Bank of Atlanta • **Peter Elmer** Director of Mortgage Analysis, Deloitte & Touche; formerly FDIC, RTC, FSLIC • **Catherine England** Department of Finance, Marymount University; formerly Cato Institute • **Ernest Fleischer** Blackwell Sanders Peper Martin; formerly Chairman, Franklin Savings • **James Freund** Director of Research, Research Institute for Housing America, Mortgage Bankers Association of America • **Catherine Galley** Cornerstone Research • **Peter Haje** Time Warner Inc.; formerly Paul, Weiss, Rifkind, Wharton & Garrison • **William Hamm** Law & Economics Consulting Group; formerly World Savings • **Jean Helwege** Max M. Fisher College of Business Ohio State University; formerly Federal Reserve Bank of New York • **Anne Henry** Farchmin, Ralls, Wagoner; Regulatory Watchdog; formerly Overland Park Savings & Loan • **Paul Horvitz** Department of Finance University of Houston; Shadow Financial Regulatory Committee; formerly Director of Research, FDIC; Director, Federal Home Loan Bank of Dallas • **Michael Intriligator** Burkle Center, UCLA; Milken Institute • **Edward Kane** Wallace E. Carroll School of Management, Boston College; past President of the American Finance Association • **George Kaufman** Center for Financial Studies & Policy, Loyola University; Shadow Financial Regulatory Committee • **J. Livingston Kosberg** Chairman, Remington Partners; formerly CEO Gibraltar Savings and First Texas Financial • **William Lang** Deputy Director, Office of the Comptroller of the Currency • **Arthur Leibold** Dechert Price & Rhoads; formerly General Counsel, Federal Home Loan Bank Board • **David Malmquist** Director of Economic Analysis, Office of Thrift Supervision • **Stephen Neal** Cooley Godward; formerly Kirkland & Ellis Richard Nelson Wells Fargo; formerly Chief Economist, Federal Home Loan Bank of San Francisco • **Gerald O'Driscoll** Director, Center for International Trade & Economics, Heritage Foundation; formerly Federal Reserve Bank of Dallas • **Peter Passell** Editor in Chief, *Milken Institute Review* • **Martin Regalia** Chief Economist, U.S. Chamber of Commerce; formerly Director of Research, Savings & Community Bankers of America • **Richard Roll** Anderson School of Management, UCLA; past President of the American Finance Association; formerly Director of Mortgage Securities Research, Goldman, Sachs & Co. • **Jeffrey Scott** Vice President, Wells Fargo Bank; formerly Federal Home Loan Bank of San Francisco • **William Shear** Assistant Director, Financial Markets and Community Investment, U.S. General Accounting Office • **Lewis Spellman** Department of Finance, University of Texas • **Kenneth Spong** Federal Reserve Bank of Kansas City • **Michael Staten** Director, Credit Research Center, McDonough School of Business, Georgetown University • **Kenneth Thygerson** Digital University, Inc.; formerly CEO, Imperial Corporation of America and Freddie Mac • **Susanne Trimbath** Research Economist, Milken Institute • **Robert van Order** Chief Economist, Freddie Mac • **Kevin Villani** Economist; formerly CFO, Imperial Corporation of America • **George Wang** Director, Market Research, Commodity Futures Trading Commission; formerly Federal Home Loan Bank Board • **Lawrence White** NYU Stern School of Business; formerly Board Member, Federal Home Loan Bank Board • **James Wilcox** Haas School of Business, University of California at Berkeley; formerly Chief Economist, Office of the Controller of the Currency. • **Glenn Yago** Director of Capital Studies, Milken Institute

GOVERNMENT POLICY: WERE THERE UNINTENDED CONSEQUENCES?

Government policy left S&Ls vulnerable to shifting market forces, including interest rate volatility, deteriorating asset quality and increasing industry competition. "Public policy at the time included a rigid institutional design," explained Glenn Yago, director of capital studies at the Milken Institute. "That design inhibited the ability of S&Ls to adapt to technological developments, federal and state deregulation that came after the industry was in serious trouble, and tax law changes that weakened the financial condition of savings and loan institutions by adversely affecting real estate values."

PUBLIC RECORD: WAS THERE FAIR AND ACCURATE COVERAGE?

News coverage mediates society's understanding of events and often becomes the accepted history. The media frames the coverage, promoting certain issues as problematic, certain outcomes as undesirable, and certain strategies as inappropriate. In representing the S&L industry in the 1980s, it generally failed to go beyond terms like "crisis" and "bailout," which fit into 30-second sound bites. "Catch a crook" attracted more attention than how thrifts could fulfill their historical mission to "build a house."

Martin Regalia of the U.S. Chamber of Commerce reminded the conferees that "for the most part, newspapers are not the guardians or watchdogs of our society, but just another business trying to make a buck. And that is not all bad."

U.S. S&L EXPERIENCE: ARE THERE PARALLELS IN OTHER COUNTRIES?

The problems of financial institutions in the 1980s anticipated or paralleled those of other countries. When problems occur here, U.S. analysts prefer to look to unique circumstances or the failings of individuals. When problems occur elsewhere, they find systemic causes with simple solutions.

But what happened to the S&Ls was not so different from financial disruptions that occurred overseas both before and after the 1980s. For example, James Barth of the Milken Institute points out that "S&Ls were essentially directed toward the politically motivated investments in residential real estate." Equivalent policy-directed investments are common in other countries with state-owned or controlled financial systems.

SUMMING UP: DO S&LS PROVIDE A USEFUL PERSPECTIVE?

The 1980s witnessed the collision of vulnerable financial institutions with frenetic regulatory policy. An examination of the portfolios of institutions that invested in similar assets shows that the S&Ls were treated differently in a systematic way. Banks were underwater at the same time as thrifts, yet the banks were not closed. The seizure of S&L assets amounted to an extraordinarily large – perhaps the largest ever – nationalization of private assets.

The S&L case was more visible than other examples of policy mixing poorly with markets because government deposit insurance put the S&Ls in a very visible position. Government-insured institutions were naturally subject to political competition over who was to blame for their demise. But looking below the surface, the similarities in these conflicts generally exceed the differences.

Future roundtables in the series will focus on different forms of financial institutions and different types of asset classes. The conferences will be represented in a book series from Kluwer Academic Publishers, the Milken Institute Series on Financial Innovation and Economic Growth.