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THE MODERN ROLE OF THRIFTS

Michael Roster*

With combined assets approaching $1 trillion (as compared to $2.3 trillion for all United States commercial banks), the role of thrift institutions in the American banking system is significant.¹ The chief problem posed by thrifts today is that they are doing exactly what they are supposed to do: they are the primary providers of mortgage finance in the United States.² Savings and loan associations developed in the late 1880's as mutual building societies for the purpose of providing mortgage financing, and this is the role the federal government has required that they play since passage of the Home Owner’s Loan Act of 1933³ and the Federal Savings and Loan Insurance Corporation (FSLIC) insurance provisions contained in the National Housing Act.⁴

I. FIXED-RATE MORTGAGE PORTFOLIOS

The fact that the thrift portfolios are largely comprised of residential mortgages is both good news and bad news for thrifts today. The good


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1. TASK GROUP ON REGULATION OF FINANCIAL SERVICES, BLUEPRINT FOR REFORM 100, 101 (1984).

2. By the end of 1982, residential mortgage portfolios (both single and multi-family) of thrifts totaled $513.7 billion as opposed to $193.0 billion for commercial banks and $35.6 billion for life insurance companies. See Hempel, Nonbank Financial Institutions, in HANDBOOK OF MODERN FINANCE 3-22 (D. Logue ed. 1984).


4. Pub. L. No. 479, 48 Stat. 1246, tit. 4 (codified as amended at 12 U.S.C. §§ 1724-1730 (1982)). Although mutual savings banks have a somewhat different history, savings and loans and savings banks today are virtually indistinguishable and, for lack of a better term, are both commonly referred to as thrifts.
news is that thrift portfolios in most cases comprise very sound assets. The purchase of a home is typically the most significant acquisition that a consumer will undertake in his or her lifetime, and the risk that the consumer will default on that home loan, assuming the loan was properly underwritten at the outset, is marginal. The problem, however, is that most mortgage loans that originated before the middle or late 1970's carried fixed rates of interest. In regions where houses are sold every seven to twelve years on the average, thrifts are able to obtain some yield improvements even where fixed-rate mortgages are involved. On the other hand, in certain areas of the country such as the East and the Midwest, where there may be less turnover in housing, thrifts are more likely to be burdened with large portfolios of below-market, fixed-rate loans. No doubt this is a primary factor underlying the thrift problems in New York, New England and the Chicago area. These problems were exacerbated by the rapid deregulation of deposit account rates that occurred between 1980 and 1984, which caused thrift liabilities to become highly volatile while their portfolios remained locked in largely fixed-rate loans.

The seriousness of the thrift problems was highlighted as the number of FSLIC and Federal Depository Insurance Corporation (FDIC) supervisory cases rose dramatically during the past six years. Even Congress was forced to recognize the seriousness of the situation and adopted a resolution indicating the federal government's willingness to back the federal insurance funds.

The regulatory and legislative responses to recent thrift problems have been multi-faceted. Thrifts and other mortgage lenders have been encouraged to shift to adjustable rate mortgages, and pressure has been exerted on thrifts to increase capital. Further, the powers of thrifts have been expanded in order to attract new capital into the thrift business and to allow diversification of existing thrift operations. Each of these three responses is discussed more fully below.

II. Adjustable Rate Lending

While many federal thrifts foresaw the problem of fixed-rate lending
and converted to adjustable rate mortgages as early as the 1960's, in
1972 the Federal Home Loan Bank Board (FHLBB) removed this au-
thority for federal savings and loan associations in response to congres-
sional pressure. Thus, at the time adjustable rate lending should have
been encouraged, it was outlawed. State chartered thrifts in states such
as California were not similarly restricted, and thus converted from
fixed-rate lending to adjustable rate lending in the 1970's. Many of
these companies now have portfolios in which approximately half of their
loans carry adjustable rates.

Today, providing adjustable rate mortgages has become more stan-
dard throughout the country, encouraged by the FHLBB's removal of its
earlier prohibitions and also by congressional preemption of conflicting
state laws through adoption of Title VIII of the Garn-St Germain Depos-
itory Institutions Act of 1982. Even adjustable rate mortgages present
problems, however. First, many adjustable rate mortgages are tied to
indices that are not sufficiently responsive to changes in market rates,
particularly in times of rapid rate increases. Second, in order to gain
borrower acceptance of adjustable rate mortgages, many lenders have
used "discounted" rates, either to make the adjustable rate loan attrac-
tive at the outset to borrowers or to help borrowers qualify for a loan.

8. For example, in the late 1960's and early 1970's some federal institutions in California
and elsewhere began their own versions of variable rate mortgage lending. Although there
were no reported statistics on these loans at that time, some of these programs became the
3d 540, 130 Cal. Rptr. 635 (1976); Vanguard Invs. v. Central Cal. Fed. Sav. and Loan Ass'n,
col. 3; Move on to Derail Calif. Mtge., Am. Banker, July 18, 1980, at 3, col. 1; Consumer
at 2, col. 3; VRM Lending is Growing at Federal S & L's in California but Several Problems
Remain, Am. Banker, Sept. 14, 1979, at 12, col. 1; Brouillette, Three Big Calif. Banks Doubt
11. See Thrift Vulnerability is Factor in Fed Monetary Policy, Martin Says, 44 WASH. FIN.
REP. 130 (1985).
25, 1985, at 18, col. 3; La Gesse, Pricing Model May Sour Investments in ARM's: Salomon
Banker, Dec. 21, 1984, at 3, col. 1; Deregulation has Potential for Consumer Confusion, Abuse,
15. See Oser, Financing is Available in a Variety of Forms, N.Y. Times, Oct. 28, 1984, § 12,
at 45, col. 1; de Courcy Hinds, Mortgage Rates Creep Toward 15%, N.Y. Times, June 10,
1984, § 8, at 1, col. 2; Cole, Sliding Rates Spur Activity in Mortgages, N.Y. Times, Jan. 17,
This has led to concern about the prospects of "payment shock" when sudden increases in loan payments occur due to rate changes, and particularly when the discounted rate jumps to the indexed rate.

Finally, even in those cases where there has been prudent underwriting and use of market-sensitive indices, there remains the risk of legislative action that would convert adjustable rate mortgages back to fixed-rate instruments. As indicated earlier, the purchase of a home is typically the largest transaction a consumer will make during his or her lifetime. During times of rapid interest rate increases, it is inevitable that voter pressure on public officials to control mortgage payment increases will mount, especially when the alternatives are loan delinquencies and foreclosures. Under these circumstances, Congress and even some state legislatures frequently seek ways to restrict interest rate increases or payment increases, including adoption of interest rate caps, as the Senate did in 1984.  

III. CAPITAL NEEDS

Another ongoing problem area facing thrifts is capital adequacy. In past years, the FHLBB required a minimum net worth of five percent. In the late 1970's and early 1980's, in view of the severe erosion of thrift earnings and other problems facing the industry, the FHLBB and most state regulatory agencies relaxed their capital requirements. Today the minimum capital requirement for FSLIC-insured thrifts is three percent, and even this amount typically involves intangibles such as good-

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16. See S. 2851, 98th Cong., 2d Sess. § 1010 (1984) (the Metzenbaum Amendment), which states:

(a) In connection with a residential mortgage transaction of less than $500,000, a creditor shall limit the total amount of increase in the interest rate on variable rate mortgages to not more than five percentage points above the initial rate over the term of the loan. As used in this section, the term "residential mortgage transaction" and "creditor" shall be the same as defined in section 103 of the Truth-in-Lending Act.

(b) The Board of Governors of the Federal Reserve Board [sic] shall prescribe regulations to carry out this section. Compliance with this section and such regulations shall be enforced as provided in Section 108 of the Truth-in-Lending Act.

(c) This section shall take effect on June 1, 1985.


18. On January 31, 1985, the Federal Home Loan Bank Board adopted a final rule pertaining to minimum net worth requirements of insured institutions. The rule imposes a minimum net worth requirement equal to a percentage of any increase in liabilities measured from the close of business on the last day of the preceding year. The percentage varies with the amount
will and "appraised equity capital." It has been estimated that the actual tangible capital in the thrift industry today is approximately .59%.  

There are significant problems concerning how new capital can be raised. A wave of conversions from mutual to stock form occurred in 1983. The FHLBB approved over 100 conversion applications of FSLIC-insured institutions, resulting in the infusion of over $3.3 billion in new capital. These conversions occurred, however, when the market was particularly attractive for thrift stocks, and most of the conversions involved larger companies that had greater appeal to the national investment community. Today approximately 2300 institutions remain in mutual form, and the average assets of these institutions amount to only $215 million.

In some instances, these institutions may be able to offer stock through community offerings, that is, conversions to stock form where the stock is purchased primarily by local residents. The difficulty inherent in a community offering is finding the expertise to conduct such an offering, particularly since the capital amounts to be raised in any single issue are relatively small. Moreover, many communities simply do not have the investment capital available even if residents are otherwise interested. The irony is that in these instances, the capital may be drawn from savings accounts of the very mutual institutions that are undergoing the conversions.

The capital problem is further complicated by the emergence of the so-called nonbank banks. At least some of the persons and companies that might have acquired thrifts to diversify their financial services activities can now do so far more cheaply, and with fewer regulatory hurdles, by forming or acquiring nonbank banks.

To the extent that interest rates remain low, thrifts have greater attractiveness in the equity markets, and thus 1985 may be a particularly good year for conversions. Whether the FHLBB develops a means to
make such conversions easier to accomplish remains to be seen. One recent regulatory proposal which would help to simplify the conversion process would be to allow the use of existing general proxies in individual cases where a member fails to respond to a special proxy solicitation for a stock conversion.23

Another recent regulatory change is the anti-takeover restriction that the FHLBB has imposed on savings institutions that have recently converted to stock form.24 This regulation prohibits any person from acquiring more than ten percent of the stock of a federally-insured institution that converted to stock form between March 1, 1983 and February 29, 1984 unless prior written approval of the FHLBB is obtained. The anti-takeover restriction for these institutions expires August 1, 1985. In addition, for institutions converting to the stock form of ownership after February 29, 1984, the same anti-takeover restriction applies for a period of three years following the institution's conversion. The stock of newly-converted entities may be less attractive to potential investors as a result of this restriction, particularly if the investors hope to ultimately acquire control. Nonetheless, the protection period may encourage management officials to undertake the monetary costs and other risks associated with a stock conversion without concern for hostile takeover offers, and management can focus on restructuring the newly-converted thrift through use of its new capital.

IV. DIVERSIFICATION

In order to help make thrifts a more attractive investment and to allow them to diversify their operations, Congress, various state legislatures and appropriate federal and state regulatory agencies recently expanded thrift powers. The changes included allowing consumer and commercial lending, leasing and similar activities. On the state level, changes also involved greatly expanding service corporation and real estate development powers.25

Typical thrift operations today can be placed in four general categories: "traditional," "retail," "wholesale" and "diversified." The bulk of the industry remains traditional, notwithstanding the expanded powers

25. See Real Estate is Focus of Regulators, BANKING EXPANSION REP., Feb. 15, 1985, at 1.
described above. Included in this category are the so-called “mom and pop” mutual savings and loan associations, which typically are federally chartered, are based in a single community and function today largely as they functioned in the early 1930's.

The retail model typifies most of the large thrifts, especially those located in the more competitive states. These are entities, typically stock rather than mutual in form, which compete head-on with commercial banks and consumer finance companies for the retail banking customer. Most of these larger companies are using their new powers very selectively. These thrifts are branched statewide, and many now are interstate as well. The aggressive retail thrifts seek economies of scale and are likely to be among the “survivors” of the shakeouts anticipated during the remainder of this decade. Many will remain independent, while others likely will become elements of multi-faceted financial services companies or be acquired by diversified conglomerates or even bank holding companies.

The third type of operation is the wholesale thrift. Included in this group are both large and small thrifts that have decided that rather than developing or retaining large branch networks and offering a broad range of retail products, their niche in the market will be to raise funds from a small branch system, and far more importantly, through brokered deposits. On the lending side, comparable emphasis is on wholesale functions such as mortgage banking (where the thrift originates loans and then typically sells them in the secondary market while retaining the rights to service the loans); residential and commercial construction lending; and real estate development, often through joint ventures with developers. A number of thrifts specializing in retail operations may also include in their operation a wholesale component.

The fourth type of operation is the very modern but also nontraditional thrift. This type of thrift exists in states such as California, Texas and Florida, where thrift statutory powers have been dramatically expanded to the point where critics complain that almost “anything goes.” Included in this group are several thrifts that have been acquired or formed by real estate developers who expect to do most, if not all, of their development through the thrift itself, using federally insured deposits to fund development projects. This group also includes companies that once were traditional in operation but have adopted a high-growth strategy as a means to “grown out” of their older, more traditional port-

folios. To accomplish a high-growth strategy, these companies typically rely on brokered deposits, may become involved in nonresidential lending activities, may speculate in equity securities and typically undertake a wide range of nontraditional service corporation activities, including such publicized investments as wind farms and hamburger chains.

From a legislative and regulatory perspective, the retail and wholesale models cause the least concern. The problem is that the bulk of the industry remains in the traditional model, which does not involve any significant entrepreneurial risk but nevertheless incurs severe losses from low, fixed-rate mortgage loans. In contrast, the nontraditional model involves a small number of entities but entails, at least according to the regulators, the greatest near-term risk.

The broad powers that thrifts have been granted by legislation, combined with the perceived benefits of using federally insured deposits to undertake businesses through the thrift that a potential thrift acquiror may presently do in a more traditional company, has caused many consultants throughout the nation to promote thrifts aggressively—and sometimes too aggressively. Often new acquirors have an overly optimistic view concerning what can be done with a thrift, both directly and through its subsidiaries. Typically, these acquirors are unaware of the restrictions and delays that are associated with operating in a highly regulated environment (even after so-called “deregulation”), particularly when transactions with affiliated companies are involved.

V. FROM DEREGULATION TO REREGULATION

The federal response to some of the publicized, nontraditional thrift activities has been reregulation. Bills were pending in the previous session of Congress, and several have already been introduced in the current session, which would make major changes affecting the powers of federally insured depositories and their affiliates. While there are variations among the bills, certain common threads run through them all.

One common thread is the proposed adoption of a “thrift test.” The purpose of the test is to require that a minimum percentage of assets of a thrift be invested in residential mortgage loans and certain other qualifying assets. An institution that fails to meet the thrift test faces, among other things, regulation as a commercial bank, restriction of its holding company activities to those permissible for bank holding companies, and

loss of the right to branch interstate. The institution could also lose the right to make commercial loans, and its powers could be restricted to those permissible for federal thrifts.

A second common threat in the pending federal legislation concerns those sections of the Banking Act of 1933 that are popularly known as the Glass-Steagall Act. Glass-Steagall restricts or prohibits altogether affiliations between certain depositories (particularly those that are members of the Federal Reserve System) and persons or companies engaged in the underwriting of securities. The general consensus among lawyers who have considered the issue is that thrifts currently are not subject to Glass-Steagall, or if they are, that their affiliates are not. The proposed legislation, however, would likely Glass-Steagall prohibitions on all banks and thrifts alike. This would create particular problems for thrifts to the extent they underwrite mortgage-related securities (including selling mortgage loans with recourse), have insurance affiliates that sell universal life or variable annuities, are involved in real estate syndications, or are owned by companies that have captive finance subsidiaries that help distribute commercial paper or other securities of the parent and its affiliates. Assuming that Congress desires to create a barrier between all depositories and companies engaged in securities activities, at least some exemptions for the previously listed activities nevertheless will be necessary for thrifts.

A third common thread in the legislation concerns exemption for unitary thrift holding companies. When Congress adopted the Bank Holding Company Act of 1956 (BHCA), as amended, it distinguished between companies owning only one bank and those owning more than one bank. This distinction was eliminated in 1970. When thrift holding companies first came under Congress' scrutiny in 1967, a similar distinction was made between what informally are called unitary thrift holding companies, i.e., companies that own only one thrift subsidiary, and multiple thrift holding companies. Although the distinction between unitary and multiple charter ownership was eliminated on the commer-


cial bank side, no similar action was taken on the thrift side. Thus, a multiple thrift holding company today is restricted to certain enumerated activities, which are generally related to financial, real estate or insurance activities. In contrast, a unitary thrift holding company can engage in any activity without any regulatory approval. The result is that many companies in the United States that want to offer financial services through federally-insured depositories have acquired thrift subsidiaries, yet still may engage in the broad range of commercial enterprises in which they traditionally engaged. These companies include Sears Roebuck and Company, National Intergroup (the successor to National Steel) and Household International.

Although none of the federal legislation currently pending proposes to eliminate the unitary thrift holding company exemption outright, most of the bills do impose a "qualified thrift" test as a condition to retaining the exemption. However, if Congress eliminates nonbank banks and tries again to distinguish between financial service companies and those involved in manufacturing or investment banking, then the exemption for qualified thrifts likewise could come under legislative pressure. On the other hand, if Congress ratifies the existence of nonbank banks as specialized banks, particularly in the consumer area, then the pressure on the legislative exemption for unitary thrift holding companies will be greatly diminished. Additionally, holding companies owning thrifts and those owning nonbank banks, at least over time, will likely be regulated in largely the same manner.

On the regulatory side, one area of concern has involved direct investments. Thrifts, unlike banks, have broad power to engage in service corporation activities. Although federal associations may invest an amount equal to only two to three percent of their assets in service corporations (plus additional amounts for conforming loans) and although those activities are generally limited by regulation to thrift-related endeavors, service corporations of federal thrifts still have much broader powers than commercial bank service corporations. Even more dramatic

33. Id. at § 1730a(c)(2).
34. Note, however, that there are limits on borrowing. See 12 U.S.C. § 1730a(n) (1982), which provides:
   A savings and loan holding company, or any subsidiary thereof which is not an insured institution, whose subsidiary insured institution fails to qualify as a domestic building and loan association under section 7701(a)(19) of title 26 [Internal Revenue Code of 1954], may not commence, or continue for more than three years after such failure, any business activity other than those specified for multiple savings and loan holding companies and their subsidiaries under subsection (c)(2) of this section.
are the powers of state thrifts, since several states permit thrifts to invest in virtually any type of subsidiary, and often without any statutory limitations. California, for example, has no statutory limitation on the percentage of assets that may be invested in service corporations, nor is there any statutory limitation on service corporation activities. The California Savings and Loan Commissioner generally limits total investments in service corporations to ten percent of the thrift’s assets, absent a business plan that demonstrably supports a higher percentage. But if a thrift can make a reasonable argument concerning why the ownership of such diverse entities as medical care centers or restaurants constitutes an appropriate part of a thrift business plan, it is conceivable that state approval could be obtained for such enterprises.

Federal regulators are not as sanguine about some of these diversified activities, especially since the ultimate risk insurers are the FSLIC and the FDIC. Federal officials also are sensitive to the potential congressional backlash that could develop from some of these state activities. Accordingly, the FHLBB has adopted regulations that would restrict service corporation investments to ten percent of assets or twice net worth, whichever is greater, unless prior approval is obtained. The FHLBB also has imposed higher reserves for investments in service corporations and equity securities and has limited the types of equity securities in which thrifts or their service corporations may invest.

VI. THRIFT AND BANK CROSSOVER

Whether there will remain a difference between commercial banks and thrifts is uncertain. If the legislative and regulatory changes described above are adopted, thrifts will likely remain primarily mortgage lenders. In that case, the potential crossover of thrifts and commercial banks will occur in one of two ways: companies will be permitted to own both types of charters, or companies will convert from one type of charter to the other.

With regard to acquisitions, the Federal Reserve’s approval of a series of Citicorp acquisitions of thrifts is the only recent instance where a commercial bank holding company has acquired thrifts and continues to

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37. "[A]n association may, without limit, . . . invest in the capital stock, obligations, or other securities of service corporations." CAL. FIN. CODE § 7252(a) (West 1977).
operate both types of charters. These Citicorp acquisitions all involved supervisory cases. Some bills proposed in Congress, however, in both the last and current sessions, would allow banks or their holding companies to acquire thrifts in non-supervisory cases and likewise would allow thrifts or their holding companies to acquire full-service banks. Such acquisitions would be subject to existing statutes limiting the interstate operations of thrift and bank holding companies, and thus a bank holding company still could not own thrifts with principal offices in more than one state. Likewise, an enterprise that owned both a bank and a thrift could be far more restricted in its real estate, insurance, securities and other activities than if it only owned a thrift. A bank holding company could, however, acquire a thrift in its home state. If that thrift already were branched into other states, or had the power to do so, then its multi-state presence would not be an impediment to the acquisition, and the acquisition of a thrift that is interstate in operation could be attractive to some banks. However, the attraction for thrifts or their holding companies to acquire banks is quite limited, unless the thrift wants to gain more rapid entry into commercial lending, or if the thrift seeks an anti-takeover device.

Pending legislation would allow cross-ownership of banks and thrifts in two ways. First, an amendment to the BHCA has been proposed that provides specifically that ownership of thrifts is a permissible bank holding company activity. Even if this provision does not survive the legislative process, however, a second pending statutory change could have the same effect. That change would amend the test of permissible activities under BHCA section 4(c)(8).

At present, the activities permissible under section 4(c)(8) must be

43. S. 2851, 98th Cong., 2d Sess. §§ 104(d), 107(b) (1984).
45. The provisions of § 4 of the BHCA set forth the extent to which bank holding companies engage in non-banking activities. According to § 4, and its implementing regulations, bank holding companies are generally limited to those activities that are "closely related to banking." Thus a broad range of activities in which unitary thrift holding companies many engage would not be permitted for bank holding companies. See 12 U.S.C. § 1843 (1982); 12 C.F.R. § 225 (1984).
both "closely related" to banking and "a proper incident thereto." Under various bills currently pending in Congress, the "proper incident" test would be eliminated, and a bank holding company instead would be allowed to engage in activities "of a financial nature." Since the "proper incident" language is the language upon which the Federal Reserve has relied when denying bank acquisitions of healthy thrifts, this legislative change alone, even without explicit authorization for bank holding companies to acquire thrifts, could be sufficient in future years to permit a crossover between banks and thrifts.

The crossover between banks and thrifts is likely to occur in another way as well—through conversions from one type of charter to another. During the last two years, for example, several reorganizations have resulted in FDIC-insured commercial banks converting to thrift charters. There are several reasons why a bank might undertake such a conversion. First, the unrestricted activities of a unitary thrift holding company hold considerable attraction to any banker who otherwise is subject to the restrictions of the BHCA and the policies of the Federal Reserve which administers that Act. Second, because many thrift charters today permit most of the activities in which a commercial bank may engage, a charter conversion may have little business impact on the bank—depending, of course, on its level of mortgage and consumer lending as opposed to such activities as commercial lending and municipal bond underwriting. Third, because a thrift has powers to engage in securities, real estate and insurance activities, a bank that is looking for a broader range of financial products may find that the thrift charter better accomplishes its business strategy than its existing bank charter. Fourth, there is no legislation for thrifts comparable to the McFadden Act of 1927 or the Douglas Amendment to the Bank Holding Company Act of 1956 that restricts branching. Federal thrifts, for example, are not limited by statute to operating in a single state; rather, policies of the FHLBB determine whether or not interstate operations are permitted. Because the FSLIC requires lower capital ratios than the FDIC, still another reason for a commercial bank to consider converting is that it can obtain greater leverage on its capital through a thrift charter than a bank charter. Finally, there is a perception by at least some bankers that thrift regulators are more supportive of the thrift industry than bank regulators are of the banking industry. This is not to say that thrift regulators do not impose some rather stringent and unpopular requirements on their regulated

constituents, but at least some bankers perceive that thrift regulators work more harmoniously with the industry to find common solutions.

Whether the rest of this decade will see an increasing number of bank-to-thrift conversions is uncertain. To undertake a conversion, a bank must in large part look like a thrift even before it changes its charter. For example, because a bank would have to meet a qualified thrift test, if not at the outset, then at least within a few years from the date of conversion, a bank that has few residential mortgage loans in its portfolio would have great difficulty converting. On the other hand, a company, such as the Old Stone Bank of Rhode Island, which started in 1819 as a mutual savings bank and converted to a commercial bank in 1973 and then back to a thrift in 1984, made the 1984 conversion with little material change in its operations. Many independent community banks are significant mortgage lenders in their market areas, and these entities thus may be prime candidates for conversions from bank to thrift charters. Indeed, if the trend of converting small banks to thrifts were to gain momentum, it would likely give impetus to reorganizing the bank regulatory agencies according to size and function rather than type of charter. The large money center banks probably would be regulated as true commercial banks and international lenders, whereas the existing thrifts and the smaller banks that convert to thrift charters likely would be regulated by an agency more attuned to mortgage lending and consumer needs.

VII. The Future

What is the future for thrifts? The answer to this question depends far more on interest rates than on any other single factor. Assuming rates remain low for the next year or more, thrifts will have some preciously needed time to continue to restructure their balance sheets and to implement business plans that help them diversify into new and hopefully profitable lines of financial services.

In addition to interest rates, there are several other factors that influence the future for thrifts. First, the FSLIC continues to face problem situations that can have a severe impact on its reserves. Higher premiums are likely, and there is even the possibility of variable premiums. Unless the FSLIC can resolve its problem cases more effectively and with greater cost benefits than in the past, it is conceivable that pressure will build to merge the FSLIC and the FDIC.

A second item on the horizon concerns capital. If conversions of

51. La Gesse, Old Stone Completes End Run, Am. Banker, Sept. 21, 1984, at 1, col. 2.
mutual companies to stock form again become more attractive, this could have significant impact on the thrift system. Absent that consideration, however, the federal government will continue to face some very difficult questions concerning treatment of federally-insured depositories that are severely undercapitalized. One possibility may be to allow an orderly liquidation of these companies, whereby a federally-related corporation would acquire the underwater assets and the companies would start over with a "clean slate."

Companies that are released from the burden of their old fixed-rate portfolios might indeed be viable competitors in their local markets, particularly in the consumer and home finance areas. Whether they can attract the necessary management, support systems and other components necessary in a highly competitive deregulated market remains to be seen.

In this regard, two concepts that are likely to emerge will be franchising and specialization. The neighborhood "mom and pop" grocery store of yesterday is today's 7-Eleven franchise or neighborhood specialty food store. A similar concept is likely to occur in financial services. As companies develop a truly interstate presence and also expand into diversified financial products, the huge financial conglomerates will obviously achieve significant economies of scale, ranging from data processing to national advertising, much like their chain grocery store counterparts. This does not mean, however, that the local savings and loan cannot be viable. The thrift manager who knows the local community and can be selective in the products offered will be able to provide greater personalized service and respond rapidly to changing markets without dealing with committees and complex corporate hierarchies. In addition, he or she could establish a special market niche and could thus be far more profitable than the giant financial conglomerates with which the local thrift competes. The important issue will be whether the local thrift can obtain necessary national marketing as well as necessary support services. Such marketing and support services are precisely what franchised systems can offer, allowing the managing officer to concentrate on localized service and the institution's particular specialities.

The third item that exerts significant impact on the future is whether nonbank banks, operating as consumer banks, will be permitted. If so, then most of the nation's bank holding companies as well as other financial services companies will be truly interstate in their activities. Thus, the advantage that thrifts can expand interstate more readily than commercial banks will no longer exist. Likewise, the market for existing thrifts will be severely diminished, in that anyone interested in owning a
depository institution will likely find the organization of a new nonbank far easier than the acquisition of an existing (and possibly older, more traditional) thrift. Indeed, consumer banks will likely be mirror-images of thrifts. Thus the once proposed conversion of the FHLBB into an agency specializing in smaller banks and consumer finance companies may be resurrected.

Whether or not nonbank banks are allowed to continue, interstate expansion is likely to be a fourth major development for thrifts. Pending federal legislation would allow regional compacts for thrifts and banks alike. Even without this legislation, the FHLBB will continue to promote interstate expansion in supervisory cases. Moreover, if nonbank banks are allowed to operate, there will be considerable pressure on the FHLBB to lift its regulatory restrictions and allow interstate expansion, even in non-supervisory cases. One application for nationwide expansion by a federal thrift is already pending.53

In summary, the future of the thrift industry depends upon a number of variables, many of which are outside the control of any given company. Whether inflation can be held in check, how the capital markets respond to thrift securities offerings, how the federal insurance funds deal with pending losses, and how Congress handles interstate branching and proliferation of nonbank banks all will have a dramatic impact on thrifts through the remainder of this decade.