Suppose that you are a typical middle-class worker in New York in 1820. You work hard and earn fair wages as a craftsman. You are married and about to have a child, so you decide that you would like to own your own home. There are many commercial banks in the city, but as their name implies, these institutions exist to serve commerce, not the working class, because that is where the profits are. Where could you go to borrow the money to buy a home? Your options at that time would have been very limited. Later in the century, however, a new institution emerged that opened the possibility of home ownership to more than the very wealthy. That institution was the savings and loan association.

The middle class also had problems finding financial institutions willing to offer small consumer-type loans. Again, banks had determined that loans to these customers were not profitable. Another type of institution, the credit union, emerged at about the same time as savings and loans to service the borrowing needs of this segment of the economy.

In Chapters 17, 18, and 19 we discussed commercial banks, the largest of the depository institutions. Though smaller, savings and loan associations, mutual savings banks, and credit unions, collectively called thrift institutions or thrifts, are important to the servicing of consumer borrowing needs. Thrifts are primarily concerned with lending to individuals and households, as opposed to banks, which still tend to be more concerned with lending to businesses. We begin our discussion by reviewing the history of the thrift industry. We then describe the nature of the industry today and project where it might be in the future.
Mutual Savings Banks

The first pure savings banks were established by philanthropists in Scotland and England to encourage saving by the poor. The founders of the institutions would often provide subsidies that allowed the institution to pay interest rates above the current market level. Because of the nature of the savings banks' customers, the institutions were very conservative with their funds and placed most of them in commercial banks. The first savings banks in the United States were chartered by Congress and founded in the Northeast in 1816. These institutions quickly lost their distinction of being strictly for the poor and instead became a popular place for members of the middle class to store their excess money.

Savings banks were originally organized as mutual banks, meaning that the depositors were the owners of the firm. This form of ownership led to a conservative investment posture, which prevented many of the mutual savings banks from failing during the recession at the end of the nineteenth century or during the Great Depression in the 1930s. In fact, between 1930 and 1937, deposits in mutual savings banks grew while those in commercial banks actually shrank. Following World War II, savings banks made mortgage lending their primary business. This focus made them similar to savings and loans.

Mutual ownership means that no stock in the bank is issued or sold; the depositors own a share of the bank in proportion to their deposits. There are about 300 mutual savings banks, primarily concentrated on the eastern seaboard. Most are state chartered. (Federal chartering of savings banks did not begin until 1978.) Because they are state chartered, they are regulated and supervised by the state as well as the federal government.

The mutual form of ownership has both advantages and disadvantages. On the one hand, since the capital of the institution is contributed by the depositors, more capital is available because all deposits represent equity. This leads to greater safety in that mutual savings banks have far fewer liabilities than other banking organizations. On the other hand, the mutual form of ownership accentuates the principal–agent problem that exists in corporations. In corporations, managers are hired by the board of directors, who are in turn elected by the shareholders. Because most shareholders do not own a very large percentage of the firm, when there is a disagreement with management, it makes more sense to sell shares than to try to change policy. This problem also exists for the mutual form of ownership. Most depositors do not have a large enough stake in the firm to make it cost-effective for them to monitor the firm's managers closely.

The corporation, however, has alternative methods of aligning managers' goals with those of shareholders. For example, managers can be offered a stake in the firm, or stock options can be part of their compensation package. Similarly, managers of corporations are always under the threat of takeover by another firm if they fail to manage effectively. These alternatives are not available in the mutual form of ownership. As a result, there may be less control over management.

An advantage to the mutual form of ownership is that managers are more risk-averse than in the corporate form. This is because mutual managers gain nothing if the firm does very well, since they do not own a stake in the firm, but they lose everything if the firm fails. This incentive arrangement appeals to the very risk-averse investor, but its importance has diminished now that the government provides deposit insurance.
Savings and Loan Associations

In the early part of the nineteenth century, commercial banks focused on short-term loans to businesses, so it was very difficult for families to obtain loans for the purchase of a house. In 1816, Congress decided that home ownership was part of the American dream, and to make that possible, Congress passed regulations creating savings and loans and mutual savings institutions. Congress chartered the first savings and loans 15 years after the first mutual savings banks received their charters. The original mandate to the industry was to provide a source of funds for families wanting to buy a home.

These institutions were to aggregate depositors’ funds and use the money to make long-term mortgage loans. The institutions were not to take in demand deposits but instead were authorized to offer savings accounts that paid slightly higher interest than that offered by commercial banks.

There were about 12,000 savings and loans in operation by the 1920s. Mortgages accounted for about 85% of their total assets. The rest of their assets were usually deposited in commercial banks. One of every four mortgages in the country was held by a savings and loan institution, making S&Ls the single largest provider of mortgage loans in the country.

Despite the large number of separate savings and loan institutions, they were not an integrated industry. Each state regulated its own S&Ls, and regulations differed substantially from state to state. In 1913, Congress created the Federal Reserve System to regulate and help commercial banks. No such system existed for savings and loans.

Before any significant legislation could be passed, the Great Depression caused the failure of thousands of thrift institutions. In response to the problems facing the industry and to the loss of $200 million in savings, Congress passed the Federal Home Loan Bank Act of 1932. This act created the Federal Home Loan Bank Board (FHLBB) and a network of regional home loan banks, similar to the organization of the Federal Reserve System. The act gave thrifts the choice of being state or federally chartered. In 1934, Congress continued its efforts to support savings and loans by establishing the Federal Savings and Loan Insurance Corporation (FSLIC), which insured deposits in much the same way as the FDIC did for commercial banks.

Savings and loans were successful, low-risk businesses for many years following these regulatory changes (see Chapter 18). Their main source of funds was individual savings accounts, which tended to be stable and low-cost, and their primary assets (about 55% of their total assets) were mortgage loans (see Figure 25.1). Since real estate secured virtually all of these loans and since real estate values increased steadily through the mid-1970s, loan losses were very small. Thrifts provided the fuel for the home-building boom that for almost half a century, from 1934 to 1978, was the centerpiece of America’s domestic economy.

Mutual Savings Banks and Savings and Loans Compared

Mutual savings banks and savings and loan associations are similar in many ways; however, they do differ in ways other than ownership structure.

- Mutual savings banks are concentrated in the northeastern United States; savings and loans are located throughout the country.
• Mutual savings banks may insure their deposits with the state or with the Federal Deposit Insurance Corporation; S&Ls may not.
• Mutual savings banks are not as heavily concentrated in mortgages and have had more flexibility in their investing practices than savings and loans.

Because the similarities between mutual savings banks and savings and loans are more important than the differences, the focus of this chapter will be more on savings and loans.

Savings and Loans in Trouble: The Thrift Crisis

As part of the regulatory changes following the Great Depression, Congress imposed a cap on the rate of interest that savings and loans could pay on savings accounts. The theory was that if S&Ls obtained funds at a low cost, they could make loans to home borrowers at a low cost. The interest-rate caps became a serious problem for savings and loans in the 1970s when inflation rose. Chapters 17 and 19 provide an in-depth discussion of the capital adequacy and interest-rate problems depository institutions faced at that time.

By 1979, inflation was running at 13.3%, but savings and loans were restricted to paying a maximum of 5.5% on deposits. These rates did not even maintain depositors’ purchasing power with inflation running almost 8% higher than their interest return—in effect, the real interest rate they were earning was −7.8%. They were actually losing spending power leaving money in savings and loans.

At this same time, securities houses began offering a new product that circumvented interest-rate caps. Money market accounts paid market rates on short-term funds. Though not insured, the bulk of the cash placed in money market funds was in turn invested in low-risk securities such as Treasury securities or commercial paper. Because the customers of savings and loans were not satisfied with the low returns they were earning on their funds, they left S&Ls in droves for the high returns these money market accounts offered.

Financial innovation and deregulation in the permissive atmosphere of the 1980s led to expanded powers for the S&L industry that led to several problems.
First, many S&L managers did not have the required expertise to manage risk appropriately in these new lines of business. Second, the new expanded powers meant that there was a rapid growth in new lending, particularly to the real estate sector. Even if the required expertise was available initially, rapid credit growth might outstrip the available information resources of the banking institution, resulting in excessive risk taking. Third, these new powers of the S&Ls and the lending boom meant that their activities were expanding in scope and were becoming more complicated, requiring an expansion of regulatory resources to monitor these activities appropriately. Unfortunately, regulators of the S&Ls at the Federal Savings and Loan Insurance Corporation (FSLIC) had neither the expertise nor the resources that would have enabled them to monitor these new activities sufficiently. Given the lack of expertise in both the S&L industry and the FSLIC, the weakening of the regulatory apparatus, and the moral hazard incentives provided by deposit insurance, it is no surprise that S&Ls took on excessive risks, which led to huge losses on bad loans.

In addition, the incentives of moral hazard were increased dramatically by a historical accident: the combination of the sharp increases in interest rates from late 1979 until 1981 and a severe recession in 1981–1982, both of which were engineered by the Federal Reserve to bring down inflation. The sharp rises in interest rates produced rapidly rising costs of funds for the savings and loans that were not matched by higher earnings on the S&Ls’ principal asset, long-term residential mortgages (whose rates had been fixed at a time when interest rates were far lower). The 1981–1982 recession and a collapse in the prices of energy and farm products hit the economies of certain parts of the country, such as Texas, very hard. As a result, there were defaults on many S&Ls’ loans. Losses for savings and loan institutions mounted to $10 billion in 1981–1982, and by some estimates over half of the S&Ls in the United States had a negative net worth and were thus insolvent by the end of 1982.

Later Stages of the Crisis: Regulatory Forbearance

At this point, a logical step might have been for the S&L regulators—the Federal Home Loan Bank Board and its deposit insurance subsidiary, the Federal Savings and Loan Insurance Fund (FSLIC), both now abolished—to close the insolvent S&Ls. Instead, these regulators adopted a stance of regulatory forbearance: They refrained from exercising their regulatory right to put the insolvent S&Ls out of business. To sidestep their responsibility to close ailing S&Ls, they adopted irregular regulatory accounting principles that in effect substantially lowered capital requirements. For example, they allowed S&Ls to include in their capital calculations a high value for intangible capital, called goodwill.

There were three main reasons why the Federal Home Loan Bank Board and FSLIC opted for regulatory forbearance. First, the FSLIC did not have sufficient funds in its insurance fund to close the insolvent S&Ls and pay off their deposits. Second, the Federal Home Loan Bank Board was established to encourage the growth of the savings and loan industry, so the regulators were probably too close to the people they were supposed to be regulating. Third, because bureaucrats do not like to admit that their own agency is in trouble, the Federal Home Loan Bank Board and the FSLIC preferred to sweep their problems under the rug in the hope that they would go away.

Regulatory forbearance increases moral hazard dramatically because an operating but insolvent S&L (nicknamed a “zombie S&L” by Edward Kane of Ohio State University...
because it is the “living dead”) has almost nothing to lose by taking on great risk and “betting the bank”: If it gets lucky and its risky investments pay off, it gets out of insolvency. Unfortunately, if, as is likely, the risky investments don’t pay off, the zombie S&L’s losses will mount, and the deposit insurance agency will be left holding the bag.

This strategy is similar to the “long bomb” strategy in football. When a football team is almost hopelessly behind and time is running out, it often resorts to a high-risk play: the throwing of a long pass to try to score a touchdown. Of course, the long bomb is unlikely to be successful, but there is always a small chance that it will work. If it doesn’t, the team is no worse off, since it would have lost the game anyway.

Given the sequence of events we have discussed here, it should be no surprise that savings and loans began to take huge risks: They built shopping centers in the desert, bought manufacturing plants to convert manure to methane, and purchased billions of dollars of high-risk, high-yield junk bonds. The S&L industry was no longer the staid industry that once operated on the so-called 3–6–3 rule: You took in money at 3%, lent it at 6%, and played golf at 3 PM. Although many savings and loans were making money, losses at other S&Ls were colossal.

Another outcome of regulatory forbearance was that with little to lose, zombie S&Ls attracted deposits away from healthy S&Ls by offering higher interest rates. Because there were so many zombie S&Ls in Texas pursuing this strategy, above-market interest rates on deposits at Texas S&Ls were said to have a “Texas premium.” Potentially healthy S&Ls now found that to compete for deposits, they had to pay higher interest rates, which made their operations less profitable and frequently pushed them into the zombie category. Similarly, zombie S&Ls in pursuit of asset growth made loans at below-market interest rates, thereby lowering loan interest rates for healthy S&Ls, and again made them less profitable. The zombie S&Ls had actually taken on attributes of vampires—their willingness to pay above-market rates for deposits and take below-market interest rates on loans was sucking the lifeblood (profits) out of healthy S&Ls.

Competitive Equality in Banking Act of 1987

Toward the end of 1986, the growing losses in the savings and loan industry were bankrupting the insurance fund of the FSLIC. The Reagan administration sought $15 billion in funds for the FSLIC, a completely inadequate sum considering that many times this amount was needed to close down insolvent S&Ls. The legislation passed by Congress, the Competitive Equality in Banking Act (CEBA) of 1987, did not even meet the administration’s requests. It allowed the FSLIC to borrow only $10.8 billion through a subsidiary corporation called Financing Corporation (FICO) and, what was worse, included provisions that directed the Federal Home Loan Bank Board to continue to pursue regulatory forbearance (allow insolvent institutions to keep operating), particularly in economically depressed areas such as Texas.

The failure of Congress to deal with the savings and loan crisis was not going to make the problem go away, and consistent with our analysis, the situation deteriorated rapidly. Losses in the savings and loan industry surpassed $10 billion in 1988 and approached $20 billion in 1989. The crisis was reaching epidemic proportions. The collapse of the real estate market in the late 1980s led to additional huge loan losses that greatly exacerbated the problem.
Political Economy of the Savings and Loan Crisis

Although we now have a grasp of the regulatory and economic forces that created the S&L crisis, we still need to understand the political forces that produced the regulatory structure and activities that led to it. The key to understanding the political economy of the S&L crisis is to recognize that the relationship between voter-taxpayers and the regulators and politicians creates a particular type of moral hazard problem, discussed in Chapter 7, the principal–agent problem, which occurs when representatives (agents) such as managers have incentives that differ from those of their employer (the principal) and so act in their own interest rather than in the interest of the employer.

Principal–Agent Problem for Regulators and Politicians

Regulators and politicians are ultimately agents for voter-taxpayers (principals) because in the final analysis, taxpayers bear the cost of any losses by the deposit insurance agency. The principal–agent problem occurs because the agent (a politician or regulator) does not have the same incentives to minimize costs to the economy as the principal (the taxpayer).

To act in the taxpayer’s interest and lower costs to the deposit insurance agency, regulators have several tasks, as we have seen. They must do the following: (1) set tight restrictions on holding assets that are too risky, (2) impose high capital requirements, and (3) not adopt a stance of regulatory forbearance that allows insolvent institutions to continue to operate. However, because of the principal–agent problem, regulators have incentives to do the opposite. Indeed, as our sad saga of the S&L debacle indicates, regulators have at times loosened capital requirements and restrictions on risky asset holdings and pursued regulatory forbearance. One important incentive for regulators that explains this phenomenon is their desire to escape blame for poor performance by their agency. By loosening capital requirements and pursuing regulatory forbearance, regulators can hide the problem of an insolvent bank and hope that the situation will improve. Edward Kane characterizes such behavior on the part of regulators as “bureaucratic gambling.”

Another important incentive for regulators is that they want to protect their careers by acceding to pressures from the people who most influence their careers. These people are not the taxpayers but the politicians who try to keep regulators from imposing tough regulations on institutions that are major campaign contributors. Members of Congress have often lobbied regulators to ease up on a particular S&L that contributed large sums to their campaigns (as we see in the following case). Regulatory agencies that have little independence from the political process are more vulnerable to these pressures.

In addition, both Congress and the presidential administration promoted banking legislation in 1980 and 1982 that made it easier for savings and loans to engage in risk-taking activities. After the legislation passed, the need for monitoring the S&L industry increased because of the expansion of permissible activities. The S&L regulatory agencies needed more resources to carry out their monitoring activities properly, but Congress (successfully lobbied by the S&L industry) was unwilling to allocate the necessary funds. As a result, the S&L regulatory agencies became so
short staffed that they actually had to cut back on their on-site examinations just when these were needed most. In the period from January 1984 to July 1986, for example, several hundred S&Ls were not examined even once. Worse yet, spurred on by the intense lobbying efforts of the S&L industry, Congress passed the Competitive Equality in Banking Act of 1987, which provided inadequate funding to close down the insolvent S&Ls and also hampered the S&L regulators from doing their job properly by including provisions encouraging regulatory forbearance.

As these examples indicate, the structure of our political system has created a serious principal–agent problem: Politicians have strong incentives to act in their own interests rather than in the interests of taxpayers. Because of the high cost of running campaigns, American politicians must raise substantial contributions. This situation may provide lobbyists and other campaign contributors with the opportunity to influence politicians to act against the public interest, as we see in the following case.

**CASE**

**Principal–Agent Problem in Action: Charles Keating and the Lincoln Savings and Loan Scandal**

We see that the principal–agent problem for regulators and politicians creates incentives that may cause excessive risk taking on the part of banking institutions, which then causes substantial losses to the taxpayer. The scandal associated with Charles H. Keating Jr. and the Lincoln Savings and Loan Association provides a graphic example of the principal–agent problem at work. As Edwin Gray, a former chairman of the Federal Home Loan Bank Board, stated, “This is a story of incredible corruption. I can’t call it anything else.”

Charles Keating was allowed to acquire Lincoln Savings and Loan of Irvine, California, in early 1984, even though he had been accused of fraud by the SEC less than five years earlier. For Keating, whose construction firm, American Continental, planned to build huge real estate developments in Arizona, the S&L was a gold mine: In the lax regulatory atmosphere at the time, controlling the S&L gave his firm easy access to funds without being scrutinized by outside bankers. Within days of acquiring control, Keating got rid of Lincoln’s conservative lending officers and internal auditors, even though he had promised regulators he would keep them. Lincoln then plunged into high-risk investments such as currency futures, junk bonds, common stock, hotels, and vast tracts of desert land in Arizona.

Because of a shortage of savings and loan examiners at the time, Lincoln was able to escape a serious examination until 1986, whereupon examiners from the Federal Home Loan Bank of San Francisco discovered that Lincoln had exceeded the 10% limit on equity investments by $600 million. Because of these activities and some evidence that Lincoln was deliberately trying to mislead the examiners, the examiners recommended federal seizure of the bank and all its assets. Keating was not about to take this lying down; he engaged hordes of lawyers—eventually 77 law firms—and accused the bank examiners of bias. He also sued unsuccessfully to overturn the 10% equity limit. Keating is said to have bragged that he spent $50 million fighting regulators.

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Immediately after taking office, the Bush administration proposed new legislation to provide adequate funding to close down the insolvent S&Ls. The resulting legislation, the **Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA)**, was signed into law on August 9, 1989. It was the most significant legislation to affect the thrift industry since the 1930s. FIRREA's major provisions were as follows: The regulatory apparatus was significantly restructured without the Federal Home Loan Bank Board and the FSLIC, both of which had failed in their regulatory tasks. The regulatory role of the Federal Home Loan Bank Board was relegated to the Office of Thrift Supervision (OTS), a bureau within the U.S. Treasury Department, whose responsibilities are similar to those that the Office of the Comptroller of the Currency has over the national banks. The regulatory responsibilities of the FSLIC were given to the FDIC, and the FDIC became the sole administrator of the federal deposit insurance system with two separate insurance funds: the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF).

Another new agency, the **Resolution Trust Corporation (RTC)**, was established to manage and resolve insolvent thrifts placed in conservatorship or receivership. It was made responsible for selling more than $450 billion of real estate owned by failed institutions. After seizing the assets of about 750 insolvent S&Ls, over 25% of the industry, the RTC sold over 95% of them, with a recovery rate of over 85%. After this success, the RTC went out of business on December 31, 1995. Similarly, the regulatory responsibilities formerly held by the OTS were transferred to the Office

Lawyers were not Keating’s only tactic for keeping regulators off his back. After receiving $1.3 million of contributions to their campaigns from Keating, five senators—Dennis De Concini and John McCain of Arizona, Alan Cranston of California, John Glenn of Ohio, and Donald Riegle of Michigan (subsequently nicknamed the “Keating Five”)—met with Edwin Gray, the chairman of the Federal Home Loan Board, and later with four top regulators from San Francisco in April 1987. They complained that the regulators were being too tough on Lincoln and urged the regulators to quit dragging out the investigation. After Gray was replaced by M. Danny Wall, Wall took the unprecedented step of removing the San Francisco examiners from the case in September 1987 and transferred the investigation to the bank board’s headquarters in Washington. No examiners called on Lincoln for the next 10 months, and as one of the San Francisco examiners described it, Lincoln dropped into a “regulatory black hole.”

Lincoln Savings and Loan finally failed in April 1989, with estimated costs to taxpayers of $2.6 billion, making it possibly the most costly S&L failure in history. Keating was convicted for abuses (such as having Lincoln pay him and his family $34 million), but after serving four and a half years in jail, his conviction was overturned in 1996. Wall was forced to resign as head of the Office of Thrift Supervision because of his involvement in the Keating scandal. As a result of their activities on behalf of Keating, the Keating Five senators were made the object of a congressional ethics investigation, but given Congress’s propensity to protect its own, they were subjected only to minor sanctions.
Thrifts are now prohibited from accepting brokered deposits, short-term large-denomination deposits placed in thrifts by funds managers. Brokered deposits are discussed further in Chapter 20.

Initially, the total cost of the bailout was estimated to be $159 billion over the 10-year period through 1999, but more recent estimates indicated that the cost would be far higher. Indeed, the General Accounting Office placed a cost for the bailout at more than $500 billion over 40 years. However, as pointed out in Chapter 3, this estimate was misleading because, for example, the value of a payment 30 years from now is worth much less in today’s dollars. The present value of the bailout cost actually ended up being on the order of $150 billion. The funding for the bailout came partly from capital in the Federal Home Loan Banks (owned by the S&L industry) but mostly from the sale of government debt by both the Treasury and the Resolution Funding Corporation (RefCorp).

To replenish the reserves of the Savings Association Insurance Fund, insurance premiums for S&Ls were increased from 20.8 cents per $100 of deposits to 23 cents and can rise as high as 32.5 cents. Premiums for banks immediately rose from 8.3 cents to 15 cents per $100 of deposits and were raised further to 23 cents in 1991.

FIRREA also imposed new restrictions on thrift activities that in essence reeregulated the S&L industry to the asset choices it had before 1982. S&Ls can no longer purchase junk bonds and had to sell their holdings by 1994. Commercial real estate loans are restricted to four times capital rather than the previous limit of 40% of assets, and so this new restriction is a reduction for all institutions whose capital is less than 10% of assets. S&Ls must also hold at least 70%—up from 60%—of their assets in investments that are primarily housing-related. Among the most important provisions of FIRREA was the increase in the core capital leverage requirement from 3% to 8% and the eventual adherence to the same risk-based capital standards imposed on commercial banks.1

1Thrifts are now prohibited from accepting brokered deposits, short-term large-denomination deposits placed in thrifts by funds managers. Brokered deposits are discussed further in Chapter 20.
FIRREA also enhanced the enforcement powers of thrift regulators by making it easier for them to remove managers, issue cease-and-desist orders, and impose civil penalties. The Justice Department was also given $75 million per year for three years to uncover and prosecute fraud in the banking industry, and maximum fines rose substantially.

As a result of the failure of savings and loans and the passage of FIRREA, the total assets of savings and loans fell between 1988 and 1998. Figure 25.2 shows the total assets of savings and loans between 1979 and 2010; note the rapid decrease between 1988 and 1992 and between 2007 and the present.

The Savings and Loan Industry Today

Despite the problems and turmoil surrounding the industry in the 1980s, the savings and loan industry managed to survive, although somewhat changed. In this section we review the current state of the industry.

Number of Institutions

The savings and loan industry has witnessed a substantial reduction in the number of institutions. Many failed or were taken over by the RTC; others merged with stronger institutions to avoid failure. The number of S&Ls declined by nearly two-thirds between the end of 1986, when there were 3,600 of them, and the end of 2009, when there were only 1,173. As shown in Figure 25.3, the number of savings institutions continues to decline. Although new S&Ls continue to open, existing ones convert to commercial banks or credit unions or merge with other savings banks. It is interesting to note that consolidation in the savings industry has not been as dramatic as in commercial banking in recent years.

S&L Size

Figure 25.4 shows the average total assets for savings and loans since 1984. When viewed along with Figure 25.3, the graph indicates that the industry has consolidated in recent years. Between 1988 and 1991, the average size of S&Ls fell. This was likely due to the 1989 passage of FIRREA, which required S&Ls to increase their capital-to-asset ratio. Many institutions met the new standard by decreasing their assets rather than by increasing their capital. From 1992 to 2006, total S&L assets generally increased, even though the number of institutions decreased. From 2006 to 2010 both the total assets and the average assets declined due to losses encountered with the mortgage crisis.

S&L Assets

Table 25.1 provides a consolidated balance sheet for the savings and loan industry. Let us first discuss the assets side.

The 1982 reforms allowed S&Ls to make consumer and commercial loans. The intent of this legislation was to give S&Ls a source of assets with short maturities. The problem was that commercial loans are far riskier and require lending expertise that many S&Ls did not possess. FIRREA severely curtailed S&Ls' commercial lending. In the four years following passage of the law, the number of loans made for commercial purposes dropped by about 50%. Currently, nearly 70% of all S&L loans are secured by real estate. Clearly, the industry has returned to its original mandate of financing home ownership.
Savings and loans are subject to reserve requirements, just like banks. Recall from Chapter 17 that reserve requirements are cash deposits that must be held in the vault or at the Federal Reserve in interest-bearing accounts. The purpose of reserve requirements is to limit the expansion of the money supply and to ensure adequate liquidity for the institutions. About 4% of total S&L assets are kept in cash.

In addition to cash, savings and loans hold securities, such as corporate, Treasury, and government agency bonds. Unlike reserve deposits, these assets earn interest. The 1982 legislation allowed savings and loans to hold up to 11% of their assets in junk bonds. S&Ls were a major source of funds during the mid-1980s for corporations looking for capital to use in acquiring other firms. In 1989, the FIRREA required that savings and loans divest themselves of these high-risk securities. Currently, only relatively safe securities can be purchased.

**S&L Liabilities and Net Worth**

Now let’s look at the right-hand side of the balance sheet in Table 25.1. The primary liabilities of savings and loans are deposits and borrowed funds.

The largest liability of savings and loans are customer funds held on deposit. In the past, the bulk of the deposits were from *passbook savings accounts,*
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**FIGURE 25.4** Average Assets per Savings and Loan Association, 1984–2010


**TABLE 25.1** Consolidated Balance Sheet for Savings and Loan Associations ($ billions, fourth quarter, 2010)

<table>
<thead>
<tr>
<th>Savings and Loan Associations</th>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and reserves</td>
<td>50.0</td>
<td>Deposits</td>
</tr>
<tr>
<td>Securities</td>
<td>217.6</td>
<td>Other borrowed funds</td>
</tr>
<tr>
<td>Mortgage loans</td>
<td>633.3</td>
<td>All other liabilities</td>
</tr>
<tr>
<td>Commercial loans</td>
<td>178.1</td>
<td>Equity</td>
</tr>
<tr>
<td>Consumer credit</td>
<td>77.5</td>
<td>Total liabilities and equities</td>
</tr>
<tr>
<td>Corporate equities</td>
<td>22.2</td>
<td></td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>75.0</td>
<td></td>
</tr>
<tr>
<td>Total assets</td>
<td>1,253.7</td>
<td></td>
</tr>
</tbody>
</table>

Sources: Flow of Funds, Table L114 and [www.federalreserve.gov/releases/z1](http://www.federalreserve.gov/releases/z1).
interest-bearing savings accounts. At one time, banks issued small books to savers to use for keeping track of their savings balances. The customer would present this book to the teller every time a deposit or withdrawal was made, and the teller would validate the entry. The physical passbook has been phased out over the years and replaced with computerized record keeping.

The second major liability is **borrowings**, funds obtained in either the money or capital markets. Since savings and loan deposits are typically short-term, one way to lengthen their average maturity is to borrow long-term funds. Borrowed funds are currently only a small portion of S&L liabilities.

**Capital**

The capital of financial institutions is often measured by the **net worth ratio**, total equity (also known as **net worth**) divided by total assets. This figure is closely watched by regulators for indications that a financial institution may be under-capitalized. The average net worth-to-assets ratio was about 3% in 1984. Many institutions had a negative net worth at this time. Since 1989, the average net worth ratio has improved. At the end of 2003, it stood at 7.6%. This is now about the same as the 10% average net worth ratio for commercial banks. One reason for the improvement in the capital of savings and loans is that FIRREA mandated that it be increased. (We discussed the importance of capital in the functioning of a financial institution in Chapter 17.)

The accounting for savings and loans permitted extensive use of goodwill, an asset account on the balance sheet that supposedly reflects the value of a firm’s good name and reputation. For example, in 1987, goodwill accounted for $29.6 billion of savings and loan assets. This represented more than half of the $53.8 billion in total capital. If we removed goodwill from capital before calculating the net worth-to-assets ratio in 1987, we find that the ratio is only 1.6%, not the 3.7% it was when including goodwill. The value of goodwill fell steadily since its high that year. Listing large amounts of goodwill as an asset was another way that savings and loans were able to hide the fact that they were insolvent.

**Profitability and Health**

Though the S&L industry suffered losses between 1987 and 1990, it had returned to health by 2001 and posted steady profits through 2007. At this point it suffered mortgage loan losses, along with the rest of the banking industry. In 2008 S&Ls posted a $10.7 billion loss for the year. Though overall the industry posted a small profit in 2009, fully 30% were listed by the FDIC as unprofitable and 20 failed in that year alone. This is about the same percentage of unprofitable commercial institutions (29%). See Figure 25.5 for a graph of net income over time for the industry. A more telling indication of continuing problems is found by reviewing the S&L industry balance sheet and noting the increase in Other Real Estate Owned (OREO). When a mortgage loan defaults and the lender forecloses, the property pledged as collateral becomes OREO. The amount of OREO held by the industry increased from about $1.6 billion in 2006 to over $6.1 billion by 2010. These are non-income-producing assets. As long as defaults and foreclosures continue, the industry will have difficulty returning to its former profitability. This is unlikely to happen until the housing market recovers.
The Future of the Savings and Loan Industry

One issue that has received considerable attention in recent years is whether the savings and loan industry is still needed. Observers who favor eliminating S&L charters altogether point out that there is now a large number of alternative mortgage loan outlets available for home buyers. In Chapter 14 we introduced the securitized mortgage. This new instrument has provided the majority of the funds needed by the mortgage market. A reasonable question to ask is whether there is a need for an industry dedicated exclusively to providing a service efficiently provided elsewhere in the financial system.
Let us review the history of the savings and loan industry for a moment. S&Ls were established to provide mortgages to home buyers. The industry was healthy until interest rates increased and they were stuck holding low-interest fixed-rate mortgages financed with high-cost funds. Congress attempted to provide relief by giving S&Ls a great deal of flexibility in their capital structure and lending functions. Due to abuses, poor market conditions, inadequate supervision by FSLIC, and fraud, tremendous losses accrued. Finally, Congress reregulated the industry and again required that its primary business be mortgage lending. While S&Ls continued to make primarily mortgage loans, they strayed from standard lending practices in the 2005–2010 period. They are likely to eventually return to normal profitability once the real estate market recovers. The only trouble now is that mortgage loans are available from many other sources (see Chapter 14).

Just as efficient markets develop new securities and services when the need for them arises, efficient markets should eliminate unneeded institutions when they are no longer required. Many industry analysts expect the savings and loan industry to disappear, perhaps by existing savings and loans being acquired by other institutions or by commercial banks. It is likely that both the number and total assets held by S&Ls will continue to decline. Competition from banks and other mortgage lending sources will continue. However, there is no reason this decline should accelerate.

### Credit Unions

The third type of thrift institution is the **credit union**, a financial institution that focuses on servicing the banking and lending needs of its members. These institutions are also designed to service the needs of consumers, not businesses, and are distinguished by their ownership structure and their “common bond” membership requirement. Most credit unions are relatively small.
History and Organization

In the early 1900s, commercial banks focused most of their attention on the business borrower. This left the small consumer without a ready source of funds. Because Congress was concerned that commercial banks were not meeting the needs of consumers, it established savings banks and savings and loan associations to help consumers obtain mortgage loans. In the early 1900s, the credit union was established to help consumers with other types of loans. A secondary purpose was to provide a place for small investors to place their savings.

The concept behind credit unions originated in Germany in the nineteenth century. A group of consumers would pool their assets as collateral for a loan from a bank. The funds so raised were then loaned to the members of the group, and each member of the group was personally liable for repayment of the loan. Defaults were very rare because members knew one another well.

The first two credit unions in the United States were established in Massachusetts in 1910. The Massachusetts Credit Union (MCU) was organized in 1914 as a functioning credit union but with the additional purpose of encouraging the formation of additional credit unions. The MCU evolved into a kind of central credit union facility. In 1921, the MCU was reorganized as the Credit Union National Extension Bureau (CUNEB), which worked to have credit unions established in every state. In 1935, CUNEB was replaced by the Credit Union National Association (CUNA).

In 1934, Congress passed the Federal Credit Union Act, which allowed federal chartering of credit unions in all states. Prior to this, most credit unions were chartered by the state in which they operated. Currently, about 40% of credit unions have state charters and 60% have federal charters.

One reason for the growth of credit unions has been the support they received from employers. They realized that employee morale could be raised and time saved if banking-type facilities were readily available. In many cases, employers donated space on business property for the credit union to operate. The convenience of this institution soon attracted a large number of customers.

Mutual Ownership

Credit unions are organized as *mutuals*; that is, they are owned by their depositors. A customer receives shares when a deposit is made. Rather than earning interest on deposited funds, the customer earns dividends. The amount of the dividend is not guaranteed, like the interest rate earned on accounts at banks. Instead, the amount of the dividend is estimated in advance and is paid if at all possible.

Each depositor has one vote, regardless how much money he or she may have with the institution. Depositors vote for directors, who in turn hire managers to run the credit union.

Because credit unions are cooperative businesses, they are managed somewhat differently from other businesses. For example, many credit unions make extensive use of volunteer help to reduce their costs. Since any cost reductions are passed on to the depositors, volunteers feel that they are working for the common good. Similarly, as noted, operating facilities may be donated.

Common Bond Membership

The single most important feature of credit unions that distinguishes them from other depository institutions is the common bond member rule. The idea behind *common bond membership* is that only members of a particular association, occupation, or geographic region are permitted to join the credit union. A credit union’s common bonds define its field of membership.

The most frequent type of common bond applies to employees of a single occupation or employer. For example, most state employees are eligible to join their state
credit union. Similarly, the Navy Credit Union is open to all U.S. Navy personnel. Other credit unions accept members from the same religious or professional background.

One problem with the common bond membership rule is that it prevents credit unions from diversifying their risk. If most of a credit union's members are employed by one business and that business is forced to lay off workers, it is likely that the credit union will have high default rates on loans. A recent trend among credit unions has been for several to merge, a move that helps reduce the risk of having all members linked by a single bond. To make mergers easier, regulators have interpreted the common bond requirement less strictly. For example, most credit unions now let members of the immediate family of an eligible member join, and many credit unions have adopted a “once a member, always a member” policy. In 1982, regulators ruled that credit unions could accept members from several employee groups instead of just one. In 1988, regulators determined that the bond between members of the American Association of Retired People was sufficient and authorized the organization to open its own credit union. The American Automobile Association, however, was rejected.

The commercial bank lobby violently disagrees with relaxed membership rules for credit unions that in some instances have allowed them to admit virtually everyone in a community. Commercial banks view credit unions as unfair competitors due to the government support they receive in the form of tax advantages (to be discussed shortly). Many bankers feel that the threat posed by credit unions could cause more vulnerable banks to fail.

To curb this threat, a group of Tennessee bankers sued to change the regulators' stance that federal law allows multiple occupational groups, each of which independently shares a common bond, to join a single credit union. In April 1997, an appeals court ruled in favor of the bankers, saying that the restrictions on common bond membership should be left intact.

On February 24, 1997, the U.S. Supreme Court reviewed a different lower court ruling on the AT&T Family Federal Credit Union that placed sharp limits on membership in federally chartered credit unions. It ruled that bankers have the right to sue about the field-of-membership issue and that the credit union regulator, the National Credit Union Administration, can no longer allow federal credit unions to expand outside of their original memberships.

This ruling resulted in intense congressional lobbying by credit union supporters that led to the passage of the Credit Union Membership Access Act on August 7, 1998. The intent of this law was to preserve the right of all consumers to choose the credit union alternative. It maintains the concept of common bond membership but allows for the combining of groups with different common bonds in a single credit union. This act became effective on January 1, 1999.

**Nonprofit, Tax-Exempt Status** The Federal Credit Union Act of 1934 contained the provision that credit unions were to be nonprofit and consequently exempt from federal taxation. All of the income earned by the institutions is to be spent on their members. Credit unions are currently the only financial institutions that are tax-exempt. This makes it easier for them to accumulate retained earnings than it is for other institutions. Banks and S&Ls are questioning this tax-exempt status as credit unions become larger and more significant competitors. Savings and loans lost their tax-exempt status in 1951. The American Bankers Association estimates that the subsidy reduces the cost of funds to credit unions by almost 2.5% and gives them a cost advantage of $1 billion per year. The credit unions dispute this number and assign their cost advantage to their use of volunteer help. It remains a question how long the favorable tax treatment for credit unions can be maintained.
Partly as a result of being nonprofit and partly due to the cost advantage of being tax-exempt, credit union fees tend to be lower than those of banks.

**Regulation and Insurance** The **National Credit Union Act of 1970** established the **National Credit Union Administration (NCUA)**. This independent federal agency is charged with the task of regulating and supervising federally chartered credit unions and state-chartered credit unions that receive federal deposit insurance. The remaining credit unions are regulated by state credit union or banking departments, which generally follow federal practices.

The National Credit Union Act of 1970 also established the **National Credit Union Share Insurance Fund (NCUSIF)**, to be controlled by the NCUA. This fund insures the deposits of all nationally chartered credit unions and most state-chartered credit unions for up to $100,000 per account. The remaining state-chartered credit unions are insured by one of the state insurance systems. Since the savings and loan crisis, most states are eager to get out of the insurance business. It is likely that in the future, all credit union deposit insurance will be provided by the NCUSIF.

**Central Credit Unions** Because many credit unions are small and have very little diversification, they are often susceptible to seasonal cash flow problems. Most credit unions also lack the size needed to support large administrative staffs. One way they overcome these problems is with “state central” or “corporate” credit unions, which service the credit unions in their area by providing computer and financial assistance. There are currently 44 state central credit unions, which provide a number of valuable services, including:

- They may help with member institutions’ credit needs. The state central can invest excess funds and make loans to cover short-term shortages.
- They can invest excess funds with the **U.S. Central Credit Union**, which in turn can invest in the financial markets.
- They can hold clearing balances.
- They can provide educational services.

The U.S. Central Credit Union was organized in 1974 to act as a central bank for credit unions. It is chartered as a commercial bank in Kansas, and its primary function is to provide banking services to the 44 state central credit unions. It allows these institutions access to the money markets and to long-term capital markets. Most individual credit unions and even most state central credit unions lack sufficient size and transaction volume to operate efficiently in these wholesale markets.

In 1978, the **Financial Institutions Reform Act** created the **Central Liquidity Facility (CLF)** as the lender of last resort for credit unions. This agency provides many of the same functions for credit unions that the Federal Reserve provides for commercial banks. Although most day-to-day liquidity needs of credit unions are met by the state central organizations, in the event of a national liquidity crisis, a federal agency can raise far more funds. For example, in a crisis, the CLF can borrow directly from the Federal Reserve.

Membership in the CLF is voluntary, and any state or federally chartered credit union may join the CLF by pledging 0.5% of capital. Most of the funds in the CLF are borrowed from the federal government.

**Credit Union Size** Credit unions are small relative to other depository financial institutions. The industry accounts for only about 10% of all consumer deposits and about 15% of all consumer loans. One reason for credit unions’ limited size is the common
bond restraint. Because credit unions can enroll only members who satisfy the common bond, their growth potential is severely restricted. Nevertheless, some credit unions have grown quite large. The Navy Credit Union dwarfs the others, with over $36 billion in total assets. However, most credit unions are small. 82% have total assets less than $100 million. Table 25.2 lists the largest credit unions.

As discussed earlier, mergers between credit unions help them capture economies of scale and diversify their risk. This trend has resulted in fewer but larger credit unions. Figure 25.7 reports the number of credit unions active from 1933 to 2009. The number has fallen steadily since 1970 as credit unions merged.

**Trade Associations** Because credit unions are so small, they often lack the economies of scale necessary to service their customers at competitive costs. For example, a credit union with only $5 million of deposits cannot afford the costs of maintaining a computer center for processing checks and sending out statements. Similarly, most credit unions cannot afford to maintain their own automated teller machine network. One solution to this problem is the use of **trade associations**, groups of credit unions that have organized together. These associations provide services to large numbers of credit unions.

The largest of the trade associations is the Credit Union National Association. CUNA has a number of affiliations that provide specific services:

- CUNA Service Group provides new products for credit unions.
- CUNA Supply, Inc., provides for bulk purchases of supplies to lower supply costs.
- ICU Services, Inc., provides various investment management services.
- CUNA Mortgage provides a liquidity facility for mortgage lending by credit unions.

In addition to using trade associations, many credit unions contract with commercial banks for data-processing services. Checks written by credit union customers

### Table 25.2 Ten Largest Federally Insured Credit Unions, December 31, 2008

<table>
<thead>
<tr>
<th>Current Rank</th>
<th>Name of Credit Union</th>
<th>Rank 1 Year Ago</th>
<th>City</th>
<th>State</th>
<th>Year Chartered</th>
<th>Assets (billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Navy</td>
<td>1</td>
<td>Merrifield</td>
<td>VA</td>
<td>1947</td>
<td>36.4</td>
</tr>
<tr>
<td>2</td>
<td>State Employees’</td>
<td>2</td>
<td>Raleigh</td>
<td>NC</td>
<td>1937</td>
<td>13.9</td>
</tr>
<tr>
<td>3</td>
<td>Pentagon</td>
<td>3</td>
<td>Alexandria</td>
<td>VA</td>
<td>1935</td>
<td>9.3</td>
</tr>
<tr>
<td>4</td>
<td>Boeing Employees</td>
<td>4</td>
<td>Tukwila</td>
<td>WA</td>
<td>1935</td>
<td>8.6</td>
</tr>
<tr>
<td>5</td>
<td>Schoolsfirst</td>
<td>5</td>
<td>Santa Ana</td>
<td>CA</td>
<td>1934</td>
<td>6.8</td>
</tr>
<tr>
<td>6</td>
<td>The Golden 1</td>
<td>6</td>
<td>Sacramento</td>
<td>CA</td>
<td>1933</td>
<td>6.0</td>
</tr>
<tr>
<td>7</td>
<td>Alliant</td>
<td>7</td>
<td>Tampa</td>
<td>FL</td>
<td>1978</td>
<td>5.9</td>
</tr>
<tr>
<td>8</td>
<td>Suncoast Schools</td>
<td>8</td>
<td>Chicago</td>
<td>IL</td>
<td>1935</td>
<td>5.9</td>
</tr>
<tr>
<td>9</td>
<td>American Airlines</td>
<td>9</td>
<td>Ft. Worth</td>
<td>TX</td>
<td>1982</td>
<td>5.3</td>
</tr>
<tr>
<td>10</td>
<td>Security Service</td>
<td>10</td>
<td>San Antonio</td>
<td>TX</td>
<td>1956</td>
<td>5.1</td>
</tr>
</tbody>
</table>

are automatically routed to the bank, which takes the funds out of a credit union account. The bank then provides a transaction history in electronic form that is given to the credit union. The tie-in with the servicing bank may be so close that the credit union’s teller terminals are linked to the bank’s computer system, just like the bank’s own teller terminals. The credit union customer may never be aware that a separate commercial bank is involved in the process.

**Sources of Funds**

Over 71% of credit union funds come from customer savings and share draft accounts. Unlike commercial banks, credit unions seldom purchase funds in the capital or money markets. Four main types of accounts are offered by credit unions: regular share accounts, share certificates, share draft accounts, and money market accounts. Figure 25.8 shows the distribution of funds among the share accounts.

**Regular Share Accounts** Regular share accounts are savings accounts. Customers cannot write checks against these accounts, although they can withdraw funds without giving prior notice or incurring any penalties. These accounts make up about 27% of total deposits. Customers do not receive interest on these accounts. Instead they receive dividends that are not guaranteed in advance but are estimated. The credit union tries to pay the estimated amount.

**Share Certificates** Share certificates are comparable to CDs offered by commercial banks. The customer agrees to leave the funds on deposit with the credit union for a specified length of time and in exchange receives a higher return.

**Share Draft Accounts** Share drafts were first developed in 1974 and made legal nationally in 1980. They are virtually identical to the checks written by customers of commercial banks. Share draft accounts usually pay interest and permit depositors to write share drafts against them. These accounts represent about 11% of credit union liabilities.
Capital
Credit union capital cannot be measured in the usual way because credit union share accounts are in fact equity accounts. A more meaningful approach is to measure capital as the difference between total assets and total liabilities, where liabilities include all share accounts. Using this approach, the average capital-to-asset ratio was 9.9% in March 2010. One reason for this strong capital position is that regulations require a capital-to-loan ratio of at least 10% for credit unions. Recent downturns in CU profitability have caused some to fall below this threshold.

Uses of Funds
In March 2010, 63% of credit union assets were invested in loans. Most credit union loans are relatively small; a large percentage of the loans are for autos, credit cards, and home improvements. This is in keeping with the mission of credit unions to provide loans to small borrowers. Credit union loan losses are usually quite small. The average ratio of delinquent loans to total loans was under 1.0% in 2010. This compares closely to the loan loss ratio for commercial banks.

The mix of loans made by credit unions demonstrates that credit unions are indeed providing a service directed at consumers. Figure 25.9 shows the loan distribution of the industry. We see that auto loans make up about 31% of the total loans volume.

The balance of credit union assets are in cash, government securities, deposits at other institutions, and fixed assets. Credit unions tend not to make risky investments and are limited by regulations to certain types of investment securities that assure low risk.

Advantages and Disadvantages of Credit Unions
Figure 25.10 traces the membership in credit unions from 1933 to 2009. The steady increase is expected to continue because credit unions enjoy several advantages over other depository institutions. These advantages have contributed toward their growth and popularity.

- Employer support. Many employers recognize that it is in their own best interest to help their employees manage their funds. This motivates the firm
to support the employee credit union. Businesses will frequently provide free office space, utilities, and other help to the credit unions.

- **Tax advantage.** Because credit unions are exempt from paying taxes by federal regulation, this savings can be passed on to the members in the form of higher dividends or lower account-servicing costs.

- **Strong trade associations.** Credit unions have formed many trade associations, which lower their costs and provide the means to offer services the institutions could not otherwise offer.

**FIGURE 25.9** Loan Distribution


**FIGURE 25.10** Credit Union Membership, 1933–2008

The main disadvantage of credit unions is that the common bond requirement keeps many of them very small. The cost disadvantage can prevent them from offering the range of services available from larger institutions. This disadvantage is not entirely equalized by the use of trade associations.

**The Future of Credit Unions**

Credit unions are well positioned to continue their growth as a significant provider of financial services to consumers. Figure 25.11 shows that credit union assets increased from $282 billion in 1993 to $896.8 billion by the end of 2009, a 7.5% compounded annual growth rate. Though credit unions are likely to remain small compared to other financial institutions, their cost advantages give them a competitive edge that will continue to attract consumer business.

![Figure 25.11: Credit Union Assets, 1993–2009](http://www.ncua.gov/Resources/Reports/statistics/Yearend2009.pdf)

SUMMARY

1. Congress mandated that savings and loans and mutual savings banks provide mortgage loan opportunities for consumers. For most of the twentieth century, they profitably satisfied this need.

2. In the late 1970s and the 1980s, savings and loans lost money because interest rates on their deposits rose while the return on their mortgage portfolios was fixed. These losses initially led to deregulation. Savings and loans continued to lose money despite regulatory reform.

3. Due to mounting losses among savings and loans the industry was reregulated in 1987. It has since recovered in terms of both profitability and net worth, despite the setback caused by the real estate crisis in 2008. The industry continues to consolidate, though total assets are remaining about constant. It is too early to determine whether the industry will simply merge with commercial banks or remain independent.

4. Credit unions were established to serve the public’s demand for consumer-type loans. They are unique because members must satisfy a common bond requirement to join. This common bond requirement has restricted the growth of credit unions. Most are small compared to savings and loans and commercial banks.

5. Because of their small size, credit unions have benefited by forming cooperative organizations. These co-ops, such as CUNA, provide technical, liquidity, mortgage, and insurance services that would be impossible for the individual credit unions to have otherwise.

6. Credit unions enjoy several advantages that should keep them viable in the future. First, as nonprofit organizations, they are exempt from federal taxation. Second, many have strong support from a sponsoring company or business, which lowers the operating cost of the institution. The use of volunteers also helps keep costs low.

KEY TERMS

Central Liquidity Facility (CLF), p. W-19
common bond membership, p. W-17
credit union, p. W-16
Credit Union National Association (CUNA), p. W-17
Credit Union National Extension Bureau (CUNEB), p. W-17
Federal Credit Union Act, p. W-17
Federal Home Loan Bank Act of 1932, p. W-3
Federal Home Loan Bank Board (FHLBB), p. W-3
Financial Institutions Reform Act, p. W-19
Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), p. W-9
mutual banks, p. W-2
National Credit Union Act of 1970, p. W-19
National Credit Union Administration (NCUA), p. W-19
National Credit Union Share Insurance Fund (NCUSIF), p. W-19
passbook savings accounts, p. W-12
regulatory forbearance, p. W-5
Resolution Trust Corporation (RTC), p. W-9
trade associations, p. W-20
U.S. Central Credit Union, p. W-19

QUESTIONS

1. How does the mutual form of ownership differ from the typical corporate form of ownership?

2. What is the primary disadvantage of the mutual form of ownership?

3. What are the primary assets of savings and loan institutions?

4. Name three factors that led to the thrift crisis.

5. Why did depositors not object to the risky loans and investments made by savings and loans in the early and mid-1980s?

6. How was the thrift crisis ended?

7. What is the most common measure of the capital adequacy of a financial institution?

8. What has been the trend in S&L net income since the mid-1990s?
9. What type of customers are credit unions focused on servicing?

10. What is the purpose of the Credit Union National Association (CUNA)?

11. Describe the common bond membership rule.

12. Why does the commercial banking lobby object to the nonprofit, tax-exempt status enjoyed by credit unions?

13. Are most credit unions larger or smaller than commercial banks? Why?

14. What are share accounts, share certificates, and share drafts?

15. What are the primary advantages enjoyed by credit unions?

16. Why is regulatory forbearance a dangerous strategy for a deposit insurance agency?

17. Why did the S&L crisis not occur until the 1980s?

18. The FIRREA legislation in 1989 is the most comprehensive thrift legislation since the 1930s. Describe its major features.

19. Some advocates of campaign finance reform believe that government funding of political campaigns and restrictions on campaign financing might reduce the principal–agent problem in our political system. Do you agree?

20. How can the S&L crisis be blamed on the principal–agent problem?

WEB EXERCISES

Savings Associations and Credit Unions

1. Like banks, thrifts provide a great deal of summary information to the public. One of the most extensive sites for thrift information is at http://www.ots.treas.gov/. Select “Industry Performance” under “Data and Research” on the left margin of the site. Now go to “Thrift Industry Selected Indicators” on the site to answer the following questions.

a. What is the return on average assets for the most recent time period?

b. What is the return on average equity for the most recent time period?

c. How many thrift institutions are reporting to the OTS during the most recent time period?

2. Go to http://www.ncua.gov/. This is the home page of the National Credit Union Administration. Click on “About NCUA” on the left margin of the site, and then click on History of Credit Unions.

a. According to the NCUA, what features define a credit union?

b. What was the name of the first credit union opened in the United States in 1909?

c. In what year was the Federal Credit Union Act signed into law?