



ASSEMBLY OFFICE OF RESEARCH

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Established in 1966, the Assembly Office of Research (AOR) brings together legislators, scholars, research experts and interested parties from within and outside the legislature to conduct extensive studies regarding problems facing the state.

Under the director of the Assembly's bipartisan Committee on Policy Research, AOR investigates current state issues and publishes reports which include long-term policy recommendations. Such investigative projects often result in legislative action, usually in the form of bills.

AOR also processes research requests from Assemblymembers. Results of these short-term research projects are confidential unless the requesting legislators authorize their release.

MAJOR PROJECTS:

Mortgaging the Thrift Industry: A History of Savings and Loans (February 1990). This AOR report discusses the historical development of the thrift industry in the United States, emphasizing California's state-chartered savings and loans during the late 1970s and the 1980s; highlights the findings of federal and state regulators who examined insolvent savings and loan associations from the mid-1980s to the present; and offers policy options and recommendations to assist state legislators and other interested parties in addressing California's thrift problems.

According to the report, during the nineteenth century, the public's desire for institutions to finance home mortgages and provide safe depositories for personal savings led to the establishment of cooperative savings societies and mutual savings banks, the forerunners of today's savings and loan, or thrift, industry. There was no government support or supervision for these early savings and loans for more than a century. However, a number of unsound "national" savings and loans were formed in the late 1880s and early 1890s, leading to the creation of an industry organization to set standards. That organization is now known as the United States League of Savings Institutions. By 1928, some states had begun to regulate their savings and loans, resulting in an industry governed by a hodgepodge of state regulations.

Following the market crash of 1928 and the general economic collapse that followed, savings and loans found them-

selves with massive holdings of repossessed devalued property. Depositors lost faith in the system, and there were runs on both savings and loan associations and banks. Because there was no deposit insurance to protect savers and no system of home loan banks to provide emergency liquidity to thrifts, more than 1,700 failed, and depositors lost more than \$200 million.

Congress responded by approving three major acts: the Federal Home Loan Bank Act of 1932, the Home Owners' Loan Act of 1934, and the National Housing Act of 1934. Each of these acts was aimed at resuscitating the thrift industry, and each resulted in closer regulation of that industry.

During the period from 1947-60, total assets of the savings and loan industry grew from \$10 billion to more than \$60 billion. Interest rates paid to savings depositors in this post-war era were low, generally 2-2.5%, and mortgage interest was 5-5.5% and stable. In the 1960s, the industry experienced increased competition, higher interest rates, and declining earnings or return on assets. The 1970s brought inflation, as well as a significant increase in the number of rules governing savings and loan lending practices.

In California, perhaps the landmark action of the 1970s affecting the thrift industry was the 1978 state Supreme Court decision in *Wellenkamp v. Bank of America*. The court held that private lenders in California could not use "due-on-sale" clauses in loan agreements to prevent purchasers of residential real estate from assuming mortgages at old, low interest rates. The thrift industry complained that the decision bound them to old mortgages yielding 8-9% interest while the national prime lending rate was at its highest level in history. By the early 1980s, savings and loans had to pay depositors 16% or more to keep their money flowing into the industry.

In 1982, the United States Supreme Court held that *Wellenkamp* did not apply to federally-chartered thrifts. Later that same year, Congress gave both state-chartered financial institutions and private individuals the authority to enforce due-on-sale clauses. However, between 1978 and 1982, several hundred savings and loan institutions went out of business or merged with other institutions because they were caught in the interest rate squeeze.

Congress attempted to respond to this situation by passing the Depository Institutions Deregulation and Monetary Control Act of 1980. The Act (1) provided authority for all thrifts and

commercial banks to offer interest-bearing checking accounts; (2) allowed state-chartered thrifts to convert to federal charters; (3) raised the federal deposit insurance from \$40,000 per account per person or legal entity to \$100,000; and (4) eliminated the ceilings on interest rates that thrifts could pay depositors on various types of accounts. Acting on this last grant of authority, many thrifts paid depositors higher interest rates to keep them from withdrawing their savings to invest in more attractive financial instruments. However, because many of these thrifts were still locked into long-term, fixed rate mortgage loans that provided the thrifts with less income than they needed to pay depositors, almost 500 thrifts failed across the country between 1980 and 1983.

A variety of congressional acts during the early 1980s resulted in the substantial deregulation of federal-chartered thrifts. As a result, large numbers of California's state-chartered thrifts began converting to federal charters. To stem the tide of such conversions, the California League of Savings Institutions, then the California Savings and Loan League, asked for legislative action. In 1982, the state legislature removed most investment restrictions on state-chartered thrifts.

The new investment powers and deregulation measures at both the federal and state levels had an immediate impact on the industry nationwide, and they proved to be a very mixed blessing. Thrifts using the new powers prospered if they employed experienced managers familiar with the risks and benefits of commercial real estate lending, investment in commercial and residential property, equity securities, consumer loans, and a variety of financial instruments available in the secondary market. But the thrifts with inexperienced or shortsighted managers who did not understand either the inherent risks or the sophisticated and often high-risk devices used to hedge against those risks did not fare well.

Beginning in the mid-1980s, California began to stiffen its regulatory authority over savings and loans, and rigorous new financial standards have recently been imposed by federal legislation. However, serious damage has already occurred. By January 1989, an estimated 500 of the nation's 3,000 savings and loans were considered insolvent. The Federal Savings and Loan Insurance Corporation's (FSLIC) insurance fund went broke in 1986 bailing out these insolvent thrifts.

In August 1989, the Financial



Institutions Reform, Recovery and Enhancement Act (FIRREA) was enacted to re-fund the insolvent FSLIC. This legislation also raises capital requirements, gives federal regulators broader authority over state-chartered thrifts, and restricts direct real estate and equity investments by the state-chartered portion of the industry. (See CRLR Vol. 9, No. 4 (Fall 1989) pp. 99-100 for background information.)

AOR's report noted that the most common problems facing insolvent or poorly capitalized savings and loan institutions today can be placed into the following categories: (1) bad loans; (2) overreliance on volatile funding in the form of large brokered deposits; (3) insider abuse and fraud; (4) failure of management to correct problems identified by the regulators; and (5) poor recordkeeping that often masks risky deals.

In response to these problems and in light of current re-regulation of the industry, AOR made the following recommendations:

- the state legislature should set loan-to-value ratios for real estate loans secured by unimproved real property;

- the state legislature should amend existing law to require a thrift to inspect any property for which a savings and loan institution proposes to originate a loan of \$1 million or more;

- the legislature should amend the California Financial Code to restrict transactions among savings and loans, their holding companies, subsidiaries, and affiliates;

- the California Savings and Loan Commissioner should be required to report by March 1, 1991, on whether the FIRREA's exceptions to national bank lending restrictions provide adequate protections to state-chartered savings and loan depositors and shareholders;

- the legislature should restrict the use of brokered deposits by state-chartered savings and loans; and

- the legislature should reinstate a multiple stockholder requirement for new state-chartered savings and loans in California, together with a share percentage limit for any single stockholder.

Return of the Medfly: The Battles Continues (March 1990). According to this AOR report, in the early 1980s, the crop-destroying Mediterranean fruit fly (Medfly) caused a major infestation in northern California, particularly in Santa Clara County. In response, the California Department of Food and Agriculture (CDFA) attacked the pest with limited pesticide applications from the ground, removal of potentially infested backyard fruit, and release of

millions of sterile Medflies. Despite such efforts, the infestation worsened. Aerial spraying of the infested area with the pesticide malathion began in July 1981 and was completed in September 1982. About 900,000 acres in 44 cities within 8 counties were sprayed with malathion. The cost of the 1981-82 Medfly eradication program was approximately \$96 million.

According to the report, CDFA acknowledges that the state found at least one Medfly every year after this major infestation, except in 1983 and 1985. In 1987, 44 adult Medflies were found in Los Angeles County, compared to 4 adult Medflies found in the same county in 1980. Because of the increasing number of Medflies discovered within the state during the late 1980s, the report criticized CDFA for not responding more quickly to address and prevent the potentially serious problem of reinfestation.

Since mid-1989, and possibly due to CDFA's inaction, the state has been fighting another Medfly war, this time in southern California. (See CRLR Vol. 10, No. 1 (Winter 1990) pp. 118-19 for background information.) During the summer of 1989, CDFA captured 40 Medflies in the Los Angeles area. In August, CDFA applied a single aerial spraying of malathion to the area and, several days later, released sterile Medflies. In September, CDFA claimed that eradication was complete.

However, since that time, 249 adult Medflies and an unknown number of Medfly larvae at 27 sites have been captured in 45 cities in southern California. Aerial spraying of malathion has escalated to an area in excess of 500 square miles in southern California.

Following the first infestation, then-Governor Edmund Brown established a Pest Response Task Force, to ensure that critical lessons learned during the 1980-82 Medfly infestation were not forgotten and to guarantee prompt control of future emergency pest problems. The task force recommended that California's defense lines be strengthened, that exclusion and prevention be an ongoing priority, and that a systematic and ongoing program of research support be established to aid in the battle.

According to AOR, however, Californians may not have learned this lesson. Research projects to fill Medfly biology and ecology data gaps are not being funded. CDFA has failed to fund important Medfly research projects. Instead of heeding the task force recommendations, CDFA appears to focus funding on research to build a better Medfly trap or to better eradicate the

Medfly once it is found in the state. A review of CDFA budget data for the period 1980-81 through 1990-91 reveals that eradication programs have received far more resources than prevention programs, receiving funding approximately 225-650% higher than prevention programs.

According to AOR, an emphasis on prevention programs over eradication programs would alleviate the adverse effects that many eradication pesticides cause. Malathion, for example, may produce the following reactions in humans: skin rashes, irritation of the eyes, nose, or throat, or a flare-up of asthma in known asthmatics.

AOR recommends that California reorganize existing governmental research activities and abolish the existing Medfly/exotic pest Science Advisory Panel within CDFA, and that the legislature create an independent Institute for Exotic Pest Research. In conjunction with the creation of this Institute, the legislature should do the following:

- set a research agenda which focuses on prevention, but not to the exclusion of exploring better methods of eradication as well;

- appropriate all state funds currently appropriated to CDFA and the University of California for exotic pest-related research to the Institute for research projects;

- provide advice to CDFA, county agricultural commissioners, and farmers regarding exotic pest prevention and detection activities; and

- direct the Institute to prepare regularly scheduled reports to the Governor and the legislature on the status of state-funded exotic pest research efforts.

A Closer Look At The Doggie In The Window: A Survey of Pet Stores and Veterinarians in California (April 1990) presents statistical information regarding the number and origin of puppies transported into California for sale by pet stores, as well as information regarding those pet shop puppies in need of medical attention following purchase. Bills introduced during recent legislative sessions have attempted to place controls on the interstate shipment of puppies into California. Debate on these bills has focused on the conditions under which puppies are bred and transported to California, and the resultant incidence of allegedly sick and genetically defective puppies being sold by pet stores.

In preparing this report, AOR sent questionnaires to 1,252 veterinarians in 26 cities, as well as 268 pet stores in those same cities. However, only 175 valid veterinarian surveys were returned



to AOR, and only 54 pet stores served as the pet store data base. Also, district attorneys representing each of the 26 cities, humane societies, and better business bureaus were contacted and asked to enumerate complaints they had received or actions they had taken related to pet stores selling sick puppies.

Results of the surveys include the following:

- Veterinarians responding to the questionnaire indicated that during 1988, 8,988 pet store puppies received treatment after purchase.

- The most common ailments among pet store-purchased puppies were upper respiratory disease and gastrointestinal parasitism.

- Of the puppies treated, 48.6% were identified as incubating a disease or sick at the time of purchase.

- Over half (52%) of the puppies treated incurred \$50-\$150 in treatment costs, and 26.7% of the puppies treated incurred \$151-\$300 in treatment costs.

- Although 51 of the 54 pet stores responding indicated that puppies were sold under warranty, approximately 39% of veterinarians responding to the survey noted that none of the costs for treating pet store purchased puppies were covered by warranties from pet stores.

- Puppies from out of state accounted for the single largest source of sick puppies—4,046 (45%) of the 8,988 sick puppies treated for illness by veterinarians.

- The pet shops surveyed noted that 69.8% of puppies sold are acquired from out-of-state breeders.

California Children, California Families: Educating Minority Students in California (April 1990) addresses ways in which California can reform and/or restructure its educational system to respond more effectively to the needs of its minority students. The report develops an academic profile of those schools principally serving minority students, examines factors contributing to the differences in achievement between low- and high-performing schools, addresses issues of resource allocation, and makes several policy recommendations for addressing some of the more critical issues highlighted by the study.

The report noted that gains have been made in the achievement of black and Hispanic students since the implementation of various educational reform efforts five years ago. However, there continues to be a persistent and significant gap between the performance of white and Asian students and the performance of black and Hispanic students in California public schools. The differ-

ences are extremely acute when comparing the performance of schools serving predominantly black and/or Hispanic students with schools serving predominantly white students.

Also, schools serving high percentages of black and Hispanic students have significantly larger average enrollments than schools serving high percentages of white students. This is particularly true for Hispanic students at all grade levels.

AOR noted that current statewide practice requires that fiscal data be collected using the school district as the unit of analysis rather than the individual school site. Therefore, it is not possible to determine whether actual resource differences exist among schools serving primarily black and Hispanic students as compared to schools serving primarily white students.

Finally, AOR found that no overwhelming quantitative data exist which demonstrate the factors contributing to the differences between the highest- and lowest-performing schools serving predominantly minority students.

As recommendations, AOR first suggested that policies for improving low-performing schools serving primarily black and Hispanic students should include reducing the size of the school unit. This could be accomplished either by designing smaller individual schools or adopting a "school within a school" concept.

AOR next recommended that expenditure data be collected so it is possible to determine per pupil expenditures by school site. The data to be collected should be standardized statewide, using expenditure categories which are easily understood by the public. The actual design of the school level data system should consider input from a group of local administrator and teacher groups. School personnel at the school site level should receive training and assistance from the school district in order to ensure that data collection is uniform and does not pose an excessive burden on site personnel.

Finally, AOR noted that continued investigation is needed to assist schools serving minority students in identifying the critical factors involved in making significant improvements in student performance. A number of projects designed to assist such schools are currently underway. Issues such as teacher collegiality, community support services, student participation levels, staff development, partnerships with private industry and institutions of higher education, decisionmaking models, and incentives for innovative strategies

should be considered when examining schools which are making significant improvements in minority student achievement.

SENATE OFFICE OF RESEARCH

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Established and directed by the Senate Committee on Rules, the Senate Office of Research (SOR) serves as the bipartisan, strategic research and planning unit for the Senate. SOR produces major policy reports, issue briefs, background information on legislation and, occasionally, sponsors symposia and conferences.

Any Senator or Senate committee may request SOR's research, briefing and consulting services. Resulting reports are not always released to the public.

MAJOR PROJECTS:

Regulation vs. Practice: A Review of the California Department of Food and Agriculture's Pesticide Registration Process (February 1990). SOR reviewed the California Department of Food and Agriculture's (CDFA) analysis of pesticide products registered for sale in 1987. The review indicates severe problems with the current registration process, with the following principal findings:

- numerous pesticide products lacking adequate warnings for consumers have been registered for sale in California;

- recommendations by CDFA's scientists questioning the safety of pesticide products have been repeatedly disregarded over the last four years, and CDFA scientists have accused non-scientists of altering documents, disregarding policies, and distorting legal mandates; and

- CDFA has adopted policies and practices circumventing regulatory requirements that require full testing for acute health effects of pesticides.

CDFA is charged with protecting Californians from the toxic properties of pesticide products. In order to accomplish this task, pesticides must be registered by CDFA before they may be sold in the state. SOR reviewed CDFA's registration of pesticide products between March and December 1987. This report documents that during this time twenty products were approved for sale without regard for the recommendations of CDFA scientists. This number represents 14% of the products evaluated by CDFA's Medical Toxicology Branch