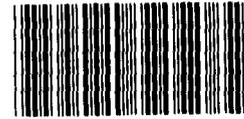


General Government Division

B-248681

May 26, 1992



146723

The Honorable Bill McCollum
Ranking Minority Member
Subcommittee on General Oversight
and Investigations
Committee on Banking, Finance and
Urban Affairs
House of Representatives

Dear Mr. McCollum:

The enclosed information on qualifying supervisory goodwill in the thrift industry is provided in response to your original request of March 24, 1992 and the subsequent agreement we reached with your staff to address the issues raised in the first two questions of the original request letter.

The information in the letter and the accompanying tables were generated using our data base consisting of the quarterly financial statements of all SAIF-insured institutions provided to us by the Office of Thrift Supervision. We did not audit the financial report data, the preparation of the financial statements, or their transcription to computerized format. We met with representatives of the Office of Thrift Supervision to discuss our methodology and the accuracy of our data and no disagreements surfaced. If you have any questions, please call me on 202-275-8678.

Sincerely yours,

Craig A. Simmons
Director, Financial Institutions
and Markets Issues

Enclosure

GAO/GGD-92-13R, Qualifying Supervisory Goodwill

054452/146723

QUALIFYING SUPERVISORY GOODWILL IN THE THRIFT INDUSTRY

QUESTION #1

Are there thrifts in the industry that would be closed down were it not for their supervisory goodwill, and would a 'buy-back' of their supervisory goodwill permit their operation to continue successfully? What is the comparative cost of buying back such thrifts versus resolving them through closure and subsequent sale of assets?

The Office of Thrift Supervision (OTS) defines supervisory goodwill as "goodwill resulting from the acquisition, merger, consolidation, purchase of assets, or other business combination that occurred on or before April 12, 1989 of: 1) A thrift where the fair market value of assets was less than the fair market value of liabilities at the acquisition date; or 2) A problem institution" (OTS Regulation 567.1 (ee)). The supervisory goodwill that OTS allows a thrift to count toward its capital adequacy is called qualifying supervisory goodwill.¹ Qualifying supervisory goodwill is of interest to regulators because it is a component of an institution's 'core capital.'² It should be noted that the total amount of supervisory goodwill in the industry exceeds the amount of qualifying supervisory goodwill. However, we cannot determine what this excess amount is because supervisory goodwill is not reported in the industry's quarterly financial report separately from other intangible assets.

Under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), thrifts must hold core capital equal to 3% of adjusted tangible assets.³ Qualifying supervisory goodwill, as a component of core capital, could not

¹ Qualifying supervisory goodwill is supervisory goodwill that thrifts are permitted by OTS Regulation 567.5(a)(2)(iii)(B) and as further outlined in the Thrift Financial Report Instruction Manual to include as part of their core capital requirement.

² Core capital in the thrift industry is composed of: Tangible Capital + Qualifying Supervisory Goodwill + Other Qualifying Intangible Assets.

³ Adjusted tangible assets equal total assets PLUS the thrift's pro rata share of assets of unconsolidated subsidiaries LESS the assets of nonincludable subsidiaries required to be deducted LESS goodwill and other intangible assets PLUS other qualifying intangible assets LESS nonqualifying purchased mortgage loan servicing.

supervisory goodwill included. The assets of this group are \$50.6 billion, or 6% of the total industry's assets. These thrifts account for \$580 million of qualifying supervisory goodwill, 15% of the qualifying supervisory goodwill of the industry.

We are not able to say which of the thrifts in the latter two categories would be transferred to RTC for resolution were it not for the supervisory goodwill that they are permitted to have on their books at this time. Clearly, the amortization of qualifying supervisory goodwill according to the schedule outlined above, means that, if nothing else changes, some thrifts may not be able to meet their core capital requirement as they reduce the qualifying supervisory goodwill on their books. Currently, however, OTS does not follow rigid rules in closing a thrift. The choice to close an institution is a discretionary administrative decision made on a case-by-case basis. This choice involves judgments about a thrift's ability to meet tangible, core and risk-based capital requirements, past and future projected earnings potential, its management ratings, OTS's assessment of the thrift's capital plan (if one was submitted), and OTS's assessment of the quality of the thrift's assets. Since meeting or not meeting a particular capital requirement does not necessarily mean that a thrift will be closed, we cannot predict what would happen to these thrifts once their qualifying supervisory goodwill is repurchased.

Neither we nor, in reality, anyone can predict the long run viability of any depository institution no matter how well-capitalized it might be. For this reason, buying back qualifying supervisory goodwill does not ensure that a thrift will be viable. For this reason also, it is not meaningful to compare the cost of buying a thrift's qualifying supervisory goodwill with the cost of resolving the same thrift through closure and subsequent sale of assets, since a thrift whose qualifying supervisory goodwill is bought back may still be closed and impose further costs on the government.

You noted in your letter of March 24, 1992, that the Resolution Trust Corporation's (RTC) past average expected cost of resolution has been 15% to 25% of asset value. However, this range of average costs may not be relevant for this particular class of thrifts at this time. To arrive at an estimated cost of resolution, we think that it would be more appropriate to consider the condition of each thrift individually rather than to use RTC's average historical experience which reflects a wide range of institutions' financial conditions under different circumstances.

Further information about the qualifying supervisory goodwill in the thrift industry as of December 1991, compiled from the quarterly financial reports filed by thrifts with OTS, is

exceed 1.5% of tangible assets prior to January 1, 1992.⁴ FIRREA mandates that the amount of qualifying supervisory goodwill be reduced to zero by January 1, 1995. This write-down allows qualifying supervisory goodwill to be 1.5% of tangible assets before January 1, 1992, decreasing to 1%, .75%, .375%, and 0% at the start of each successive calendar year.

As of December 1991, of the 2,096 thrifts in the industry, 1,848 held no qualifying supervisory goodwill. These thrifts accounted for \$463.6 billion of assets or 53% of the industry's assets. The remaining 248 thrifts (12%) held a total of approximately \$3.9 billion in qualifying supervisory goodwill on their books.⁵ These institutions held \$412.4 billion of assets, or 47% of the thrift industry assets.

Thrifts with qualifying supervisory goodwill may be divided into three categories: 1) Institutions which meet the core capital requirement even if qualifying supervisory goodwill is excluded, 2) Institutions that meet the core capital requirement only if such goodwill is included, and 3) Institutions that fail the core capital requirement even with qualifying supervisory goodwill included.

We expect that your interest lies in the last two groups since they are more likely to contain thrifts which are most likely to fail to meet, or continue to fail to meet, core capital requirements as qualifying supervisory goodwill is amortized in accordance with the FIRREA schedule. Thirty-three thrifts, or 13% of the thrifts with qualifying supervisory goodwill, fall into the second category, thrifts that meet the core capital requirements if qualifying supervisory goodwill is included in their core capital, but fail this capital requirement when such goodwill is removed. The assets of this group are \$86.5 billion, 10% of the total industry's assets. Together they account for \$1.2 billion of qualifying supervisory goodwill, or 31% of the qualifying supervisory goodwill of the industry.

Thirty-one thrifts, or 12.5% of the thrifts with qualifying supervisory goodwill, fall into the third category, thrifts which fail the core capital requirements even with qualifying

⁴ Tangible assets equal total assets PLUS the thrift's pro rata share of assets of unconsolidated subsidiaries LESS the assets of nonincludable subsidiaries required to be deducted LESS goodwill and other intangible assets LESS nonqualifying purchased mortgage loan servicing.

⁵ These numbers and the analysis that follows includes all OTS regulated, SAIF-insured thrifts in the industry. The analysis does not include the 91 thrifts in conservatorship as of December 1991.

QUESTION #2

What has been the rate of closure of thrifts in the past year, and how many of these closures involved thrifts with supervisory goodwill? In particular, how many institutions with supervisory goodwill have been closed from November 1, 1991 to March 24, 1992?⁶

We received the following information in a timely fashion from OTS in response to this question.

Quarterly Transfers (March 1991 - December 1991)

<u>QUARTER</u>	<u>NUMBER TRANSFERRED</u>	<u>INSTITUTIONS WITH QUALIFYING SUPERVISORY GOODWILL</u>	
		Number	Percent of Closures
March 91	47	17	36%
June 91	45	18	40%
September 91	38	7	18%
December 91	17	6	35%

Transfer Data (November 1, 1991 - March 24, 1992)

<u>MONTH</u>	<u>NUMBER TRANSFERRED</u>	<u>INSTITUTIONS WITH QUALIFYING SUPERVISORY GOODWILL</u>	
		Number	Percent of Closures
November 91	7	2	29%
December 91	1	1	100%
January 92	7	5*	71%
February 92	5	0	0
March 24, 92	3	0	0
Total	<u>23</u>	<u>8</u>	<u>35%</u>

* Includes Crossland Savings, a BIF association.

⁶ We are defining 'closed' as 'transferred to RTC.'

contained in the attached tables following our response to question #2. In those tables, the word "goodwill" refers to "qualifying supervisory goodwill."

Table 2: Institutions With Qualifying Supervisory Goodwill
as of December 1991
(Dollar Amounts in Millions)

<u>Qualifying Supervisory Goodwill Category</u>	<u>Number</u>	<u>Assets</u>	<u>Percent of Industry Assets</u>	<u>Qualifying Supervisory Goodwill</u>	<u>Percent of Industry Goodwill</u>
Institutions Which Meet Core Capital Requirement Even if Goodwill Excluded	184	\$275,311.6	31.4	\$2,156.6	54.6
Institutions Which Meet Core Capital Requirement Only With Goodwill Included	33	\$86,486.5	9.9	\$1,212.8	30.7
Institutions Which Fail Core Capital Requirement Even With Goodwill Included	31	\$50,642.5	5.8	\$580.1	14.7
TOTAL	248	\$412,440.6	47.1	\$3,949.5	100

Source: OTS Quarterly Thrift Financial Report.

Table 1: Qualifying Supervisory Goodwill in the Thrift Industry
as of December 1991
(Dollar Amounts in Millions)

<u>Industry Totals</u>	<u>Whole Industry</u>	<u>Institutions With Qualifying Supervisory Goodwill</u>	<u>Institutions With Zero Qualifying Supervisory Goodwill</u>
Number of Firms	2,096	248	1,848
Total Assets	\$876,015.5	\$412,440.6	\$463,574.8
Net Income	\$858.6	\$219.0	\$639.6
Qualifying Supervisory Goodwill	\$3,949.5	\$3,949.5	0
Core Capital	\$47,394.0	\$19,749.8	\$27,644.3
Core Capital Without Goodwill	\$43,444.6	\$15,800.3	\$27,644.3
Average Goodwill to Assets (Percent)	.1	.9	0
Average Goodwill to Core Capital (Percent)	2.9	25.3	0
Average Core Capital to Assets (Percent)	7.0	5.2	7.3
Average Core Capital Without Goodwill to Assets (Percent)	6.9	4.3	0

Note: Percents are calculated as weighted averages of the item in the denominator.

Source: OTS Quarterly Thrift Financial Report.

Table 3B: Profile of Thrift Institutions With Qualifying Supervisory Goodwill as of December 1991

Institutions Which Meet Core Capital Requirement Only With Goodwill Included
(Dollar Amounts in Millions)

	<u>Institutions With Positive Net Income for Quarter</u>	<u>Institutions With Negative Net Income for Quarter</u>	<u>Total for Both Groups</u>
Number of Firms	28	5	33
Total Assets	\$66,479.6	\$20,006.9	\$86,486.5
Net Income	\$104.5	\$-80.3	\$24.2
Qualifying Supervisory Goodwill	\$914.3	\$298.5	\$1,212.8
Total Core Capital	\$2,414.5	\$804.0	\$3,218.5
Required Core Capital	\$1,978.9	\$599.0	\$2,577.9
Core Capital Without Goodwill	\$1,500.3	\$505.6	\$2,005.9
Core DEFICIT Without Goodwill	\$-478.6	\$-93.4	\$-572.0
Average Goodwill to Assets (Percent)	1.3	1.4	1.3
Average Goodwill to Core Capital (Percent)	35.2	38.3	35.9
Average Core Capital to Assets (Percent)	3.6	3.7	3.6
Average Core Capital Without Goodwill to Assets (Percent)	2.4	2.3	2.4

Note: Percents are calculated as weighted averages of the item in the denominator.

Source: OTS Quarterly Thrift Financial Report.

Table 3A: Profile of Thrift Institutions With Qualifying Supervisory
Goodwill as of December 1991

Institutions Which Meet Core Capital Requirement Even if Goodwill Excluded
(Dollar Amounts in Millions)

	<u>Institutions With Positive Net Income for Quarter</u>	<u>Institutions With Negative Net Income for Quarter</u>	<u>Total for Both Groups</u>
Number of Firms	160	24	184
Total Assets	\$223,023.2	\$52,288.4	\$275,311.6
Net Income	\$509.0	\$-225.4	\$283.6
Qualifying Supervisory Goodwill	\$1,827.8	\$328.8	\$2,156.6
Total Core Capital	\$13,342.1	\$3,370.8	\$16,712.9
Required Core Capital	\$6,851.3	\$1,542.0	\$8,393.3
Core Capital Without Goodwill	\$11,514.3	\$3,042.0	\$14,556.3
Average Goodwill to Assets (Percent)	.8	.8	.8
Average Goodwill to Core Capital (Percent)	13.4	15.6	13.8
Average Core Capital to Assets (Percent)	6.5	5.5	6.3
Average Core Capital Without Goodwill to Assets (Percent)	5.7	4.7	5.5

Note: Percents are calculated as weighted averages of the item in the denominator.

Source: OTS Quarterly Thrift Financial Report.

Table 4A: Regional Profile of the Thrift Industry for Thrifts
 With Qualifying Supervisory Goodwill
 (Dollars in Millions)

MIDWEST

<u>Qualifying Supervisory Goodwill Category</u>	<u>Number</u>	<u>Total Assets</u>	<u>Net Income</u>	<u>Qualifying Supervisory Goodwill</u>	<u>Core Capital</u>	<u>Average Core Capital Without Goodwill to Assets</u>
Have Goodwill, Meet Core Capital Requirement Without it	36	\$46,392.9	\$29.1	\$261.6	\$2,278.2	4.9%
Meet Core Capital Requirement With Goodwill, Fail Core Capital Requirement Without Goodwill	9	\$14,098.2	\$42.1	\$173.1	\$540.1	2.6%
Fail Core Capital Requirement With Goodwill	5	\$3,105.6	\$-8.8	\$33.9	\$-231.1	N/A

Note: Percents are calculated as an asset weighted average.

Source: OTS Quarterly Thrift Financial Report.

Table 3C: Profile of Thrift Institutions With Qualifying Supervisory
Goodwill as of December 1991

Institutions Which Fail Core Capital Requirement Even With Goodwill Included
(Dollar Amounts in Millions)

	<u>Institutions With Positive Net Income for Quarter</u>	<u>Institutions With Negative Net Income for Quarter</u>	<u>Total for Both Groups</u>
Number of Firms	16	15	31
Total Assets	\$34,004.2	\$16,638.3	\$50,642.5
Net Income	\$81.0	\$-169.8	\$-88.8
Qualifying Supervisory Goodwill	\$409.5	\$170.6	\$580.1
Total Core Capital	\$-.6	\$-181.1	\$-181.7
Required Core Capital	\$1,110.2	\$489.7	\$1,599.9
Core DEFICIT With Goodwill	\$-1,110.8	\$-670.8	\$-1,781.6
Core Capital Without Goodwill	\$-410.1	\$-351.7	\$-761.8
Core DEFICIT Without Goodwill	\$-1,520.3	\$-841.4	\$-2,361.7
Average Goodwill to Core Capital (Percent)	179.0 ^a	51.1 ^a	137.0 ^a
Average Core Capital to Assets (Percent)	.4	N/A	N/A
Average Core Capital Without Goodwill to Assets (Percent)	N/A	N/A	N/A

Note: Percents are calculated as weighted averages of the item in the denominator.

^aExcludes firms with core capital ≤ 0 .

Source: OTS Quarterly Thrift Financial Report.

Table 4C: Regional Profile of the Thrift Industry for Thrifts
 With Qualifying Supervisory Goodwill
 (Dollars in Millions)

NORTHEAST

<u>Qualifying Supervisory Goodwill Category</u>	<u>Number</u>	<u>Total Assets</u>	<u>Net Income</u>	<u>Qualifying Supervisory Goodwill</u>	<u>Core Capital</u>	<u>Average Core Capital Without Goodwill to Assets</u>
Have Goodwill, Meet Core Capital Requirement Without it	21	\$17,516.1	\$27.6	\$149.6	\$1,069.5	5.7%
Meet Core Capital Requirement With Goodwill, Fail Core Capital Requirement Without Goodwill	5	\$12,268.1	\$13.9	\$174.3	\$404.9	2.1%
Fail Core Capital Requirement With Goodwill	8	\$10,625.4	\$-.7	\$115.4	\$45.2	N/A

Note: Percents are calculated as an asset weighted average.

Source: OTS Quarterly Thrift Financial Report.

Table 4B: Regional Profile of the Thrift Industry for Thrifts
 With Qualifying Supervisory Goodwill
 (Dollars in Millions)

SOUTHEAST

<u>Qualifying Supervisory Goodwill Category</u>	<u>Number</u>	<u>Total Assets</u>	<u>Net Income</u>	<u>Qualifying Supervisory Goodwill</u>	<u>Core Capital</u>	<u>Average Core Capital Without Goodwill to Assets</u>
Have Goodwill, Meet Core Capital Requirement Without it	35	\$31,392.0	\$24.8	\$279.9	\$1,911.3	5.5%
Meet Core Capital Requirement With Goodwill, Fail Core Capital Requirement Without Goodwill	7	\$12,548.4	\$15.9	\$172.0	\$416.6	2.0%
Fail Core Capital Requirement With Goodwill	10	\$11,152.5	\$-36.7	\$128.8	\$-71.1	N/A

Note: Percents are calculated as an asset weighted average.

Source: OTS Quarterly Thrift Financial Report.

Table 4E: Regional Profile of the Thrift Industry for Thrifts
 With Qualifying Supervisory Goodwill
 (Dollars in Millions)

WEST

<u>Qualifying Supervisory Goodwill Category</u>	<u>Number</u>	<u>Total Assets</u>	<u>Net Income</u>	<u>Qualifying Supervisory Goodwill</u>	<u>Core Capital</u>	<u>Average Core Capital Without Goodwill to Assets</u>
Have Goodwill, Meet Core Capital Requirement Without it	22	\$128,797.7	\$128.2	\$1,021.3	\$8,426.4	6.1%
Meet Core Capital Requirement With Goodwill, Fail Core Capital Requirement Without Goodwill	3	\$41,414.6	\$-50.1	\$624.7	\$1,635.2	2.5%
Fail Core Capital Requirement With Goodwill	3	\$16,368.4	\$12.6	\$169.4	\$25.9	N/A

Note: Percents are calculated as an asset weighted average.

Source: OTS Quarterly Thrift Financial Report.

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Table 4D: Regional Profile of the Thrift Industry for Thrifts
 With Qualifying Supervisory Goodwill
 (Dollars in Millions)

CENTRAL

<u>Qualifying Supervisory Goodwill Category</u>	<u>Number</u>	<u>Total Assets</u>	<u>Net Income</u>	<u>Qualifying Supervisory Goodwill</u>	<u>Core Capital</u>	<u>Average Core Capital Without Goodwill to Assets</u>
Have Goodwill, Meet Core Capital Requirement Without it	70	\$51,212.9	\$73.9	\$451.3	\$3,027.5	5.9%
Meet Core Capital Requirement With Goodwill, Fail Core Capital Requirement Without Goodwill	9	\$6,157.2	\$2.3	\$68.5	221.8	2.5%
Fail Core Capital Requirement With Goodwill	5	\$9,390.7	\$-55.2	\$132.7	\$49.4	N/A

Note: Percents are calculated as an asset weighted average.

Source: OTS Quarterly Thrift Financial Report.