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Briefing Report to the Chairman, Committee on Banking, Housing, and Urban Affairs, United States Senate

May 1987

THRIFT INDUSTRY

Forbearance for Troubled Institutions 1982-1986

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The Honorable William Proxmire
Chairman, Committee on Banking,
Housing, and Urban Affairs
United States Senate

Dear Mr. Chairman:

You asked us to provide the Committee with information on the use of forbearance in the thrift industry. Stated simply, forbearance is the Federal Home Loan Bank Board (FHLBB) practice of giving a financially troubled thrift more time to work out its problems rather than closing or merging it. The FHLBB has offered this delay either because it believed the thrift to be capable of recovery or because the regulator desired to postpone using insurance fund reserves to absorb the losses of failing thrifts.

The Bank Board has extended forbearance to capital-deficient thrifts throughout the 1980s. By December 1982, at the height of the thrift crisis, there were 222 insolvent thrifts and 916 thrifts that were barely solvent (under generally accepted accounting standards (GAAP)). By September 1986, much of the thrift industry had prospered. Of the 222 thrifts that were insolvent in December 1982, however,

-- 77 had ceased to exist by either being liquidated, acquired, merged or reorganized;

-- 65 had attained positive net worth; and

-- 80 remained insolvent.

For the industry as a whole in September 1986, the number of insolvent thrifts had doubled to 445 and nearly 600 other thrifts were barely solvent. All of these thrifts that were operating with capital levels below the Bank Board's regulatory minimum of 3 percent were receiving forbearance.

In responding to your request, we had two primary objectives. First, we determined the extent and kinds of capital forbearance given to thrifts that became insolvent under GAAP at the height of the S&L crisis in 1982. Second, we present information on the capital and income status of these recipients of forbearance 4 years later and also briefly summarize the same type of information for weakly capitalized but not insolvent thrifts. The intervening period was one of falling interest rates, economic recovery from recession, and, during 1985 and 1986, profitability for most of the S&L industry. The information we provide includes the extent of recovery experienced as of September 1986 by thrifts that were insolvent in 1982. September 1986 represents the latest period for which thrift financial statements have been publicly released. More details on the scope of our analysis and the methods we used are included in the appendix.

In 1982, most troubled thrifts suffered from the sharp upsurge in interest rates. The cost of their borrowing had adjusted to the higher interest rates much faster than the return on their primary assets (mortgages). The best cure for problems caused by high interest rates is falling rates. Because interest rates tend to move in cycles, the Bank Board viewed forbearance, or delay, as a reasonable policy that afforded a good probability of eventual recovery for problem thrifts.

The principal form of forbearance practiced by the Bank Board in 1982 could be described as capital augmentation. A number of techniques were used by the Bank Board to increase capital as reported for regulatory purposes even though there was no change in the underlying condition of the institution. For example, net worth was "created" for low-net-worth thrifts through the net worth certificate program (NWC). In this case, the Federal Savings and Loan Insurance Corporation (FSLIC) provided thrifts with FSLIC notes in exchange for NWCs and allowed the thrifts to include the certificates as part of regulatory net worth even though they were not acceptable under GAAP.

Forbearance was exercised by the Bank Board throughout the period of our examination (December 1982 to September 1986). However, underlying conditions in the industry changed substantially over the period. By 1986, interest rates had fallen, the economy had recovered, and the thrift industry was relatively strong and profitable.

Nevertheless, some thrifts were still weak or insolvent. Their underlying problem was no longer high interest rates, however. According to Bank Board officials, virtually all the problems facing troubled thrifts today are caused by poor-quality assets in their portfolios.

In contrast to institutions with interest rate problems, thrifts holding too many bad assets are not necessarily helped by delaying regulatory action, i.e., by forbearance. Experience at FSLIC with institutions having asset-quality problems indicates that bad assets, particularly those in thrifts beset by bad management or fraud, are at least as likely to get worse as they are to get better. As evidenced by the number of capital-deficient thrifts that are still operating, forbearance continues to be used.

Forbearance for problem thrifts, however, may no longer be a matter of choice but a necessity. The financial condition of the Federal Savings and Loan Insurance (FSLIC) fund suggests one important explanation. Fund reserves have been falling steadily for several years, and preliminary results of our 1986 audit of FSLIC's financial statement show that the liabilities of the insurance fund exceed its assets by between \$3 and \$7 billion. Moreover, in testimony on April 23, 1987, before the Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce, the Chairman of the Bank Board said that FSLIC's holdings of cash and short-term securities had fallen below \$1 billion. Yet FSLIC insures about \$900 billion in deposits. Under these circumstances, continuing forbearance is due to the lack of sufficient FSLIC funds to absorb the losses associated with closing or merging failing thrift institutions.

Besides the change in the reason forbearance was used, the Bank Board also changed its preferred form of forbearance between 1982 and 1986. Rather than artificially augmenting the net worth of weak thrifts to bring them up to minimum standards, current policy is to exempt thrifts from the standards. For example, the Bank Board's recently announced policy on forbearance (February 25, 1987) did not change the official regulatory requirement of 3 percent capital for thrifts, but rather says that "the Bank Board is unlikely to take administrative action to enforce the minimum capital requirements" for thrifts that meet the conditions established by the forbearance policy.

In addition to examining the condition of thrifts that were insolvent in 1982, we also tracked, up through September 1986, the 916 barely solvent thrifts that existed in 1982. Of those thrifts, the September 1986 financial reports show that,

-- 170 had ceased to exist through liquidation, acquisition, merger, or reorganization;

-- 280 had attained strong capital levels above 3 percent;

-- 280 remained barely solvent; and

-- 186 had deteriorated into insolvency.

Conclusion

It is clear from the results to date that forbearance has had mixed success. Some thrifts have taken advantage of the time given them and improved their condition. Others have either remained in the same condition or worsened since the end of 1982. Of those that deteriorated, the capital position of some declined substantially as a result of their incurring heavy losses. When these institutions are insolvent, the losses may eventually fall on the FSLIC insurance fund.

Economic conditions during 1985 and 1986 were especially favorable for the recovery of thrifts that experienced difficulties early in the decade. In particular, interest rates and inflation fell sharply, making it easier for most thrifts to earn money on their traditional mortgage-lending operations. Even though thrifts generally responded to this beneficial environment and earned healthy profits, 13.5 percent of the industry is still insolvent. Given that today's insolvent thrifts are troubled because of bad assets, and the possibility that future changes in interest rates and inflation will be less favorable for profitability than those of the recent past, it is difficult to conclude that prospects are good for recovery of these institutions.

As requested by your office, we did not obtain official comments from the Bank Board. We have, however, discussed the report with its officials, who had no substantive disagreement with the information presented.

As arranged with your office, we are sending copies of this briefing report to the Bank Board and interested congressional committees. Copies will also be made available to others who request them. If you or your staff have any questions regarding this report, please contact Gillian G. Garcia of my staff on (202) 275-9856.

Sincerely yours,

Craig A. Simmons
Senior Associate Director

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FORBEARANCE IN THE THRIFT INDUSTRY

In February 1987, the Federal Home Loan Bank Board (FHLBB) announced a policy of capital forbearance for "savings institutions experiencing temporary financial difficulties due to distressed regional economies."

As another section of Bank Board announcement emphasizes, forbearance is not new. The FHLBB has been delaying action against problem institutions, particularly since 1982, when it reduced its minimum regulatory net worth standard to 3 percent. Under the policy announced on February 25, 1987, basically sound, well-managed thrifts with regulatory capital above 0.5 percent and with capital deficiencies that are "largely the result of problems in the energy, agriculture, natural resources or other distressed sectors of the economy" may submit a written request to the Bank Board for forbearance.

A request for forbearance can be assumed to be granted unless the applicant is notified to the contrary. The Board can deny an application if an institution does not submit adequate operating and capital-rebuilding plans and progress reports, or if its problems derive from speculation or mismanagement. At its discretion, the Board can extend forbearance "in special circumstances to a thrift with a regulatory net worth level lower than 0.5 percent."

OBJECTIVES, SCOPE, AND METHODOLOGY

Senator Proxmire requested information on the extent and nature of forbearance in the thrift industry. In responding to his request, our objectives were to (1) determine the extent and kinds of forbearance given to thrifts that were insolvent (had negative net worth) under generally accepted accounting principles (GAAP) at the height of the S&L crisis early in 1982, and (2) obtain information on the capital and income status of these recipients of forbearance 4 years later. We compare the capital and income status to equivalent data for two other groups--weakly capitalized thrifts that had positive net worth below 3 percent and strongly capitalized S&Ls with net worth at or above 3 percent. The intervening period was one of falling interest rates, economic recovery from recession, and profitability for most of the S&L industry. The information we provide includes the extent of any recovery experienced as of September 1986 by thrifts that were insolvent in 1982. September 1986 represents the latest period for which thrift financial statements have been publicly released.

Information used in our analysis was collected from a number of sources. Data on the condition of thrifts were extracted from our data base of industry financial statements. These data were provided to us by the Bank Board from quarterly reports filed by thrift institutions with the FHLBB. We have not audited these data, the preparation of the financial statements, or their transcription to computerized format. Nevertheless, these data are the best publicly available on the thrift industry. Data identifying mergers and other FSLIC actions were provided to us separately by the Bank Board. Our work was done in accordance with generally accepted government auditing standards, between February and May 1987.

THE NATURE OF FORBEARANCE

In this section we discuss two aspects of the forbearance issue. First, we discuss the original basis for relaxation of financial reporting standards by the FHLBB in the early 1980s and show that while forbearance continues through the present, the reasons for its extension have changed. Second, we describe the extent and forms of forbearance that have been used by the Bank Board since 1982.

Reasons for Forbearance

The early 1980s were a period of crisis for the thrift industry. The rapid increase in interest rates of the late 1970s and early 1980s was the primary cause of the problem. Savings and loan institutions have always held assets with long maturities (mortgages) and liabilities with short maturities (deposits). Moreover, mortgages virtually always carried a fixed rate before the 1980s. Deposits, whose maximum rates were legally fixed, could be withdrawn with little or no notice when market yields rose above the highest rates that thrifts could pay. Consequently, rising interest rates led to massive deposit outflows from thrift institutions. As a result, Congress passed legislation (for example, the Depository Institutions Deregulation and Monetary Control Act of 1980) which allowed thrifts to pay competitive rates on deposits. However, because thrifts held long-term, fixed-rate mortgages, their new authority to offer variable market-based rates on deposits resulted in negative earnings. The industry's average cost of funds for deposits soon exceeded the average return on its long-term, low-yield mortgage holdings. The very large losses that ensued for the industry were accompanied by dramatically declining measures of net worth.

In the face of these problems, many thrift institutions disappeared, mostly through merger. Between the beginning of 1980 and the end of 1982, the number of FSLIC-insured institutions fell from 4,021 to 3,287. The number of institutions that were operating with GAAP net worth of zero or less increased over the same period from 16 to 222.

In 1982 Congress moved to deregulate the thrift industry by passing the Garn-St Germain Depository Institutions Act. This legislation was, in part, a response to the serious thrift crisis and granted thrifts additional powers and tools to enable them to diversify their asset portfolios as well as make the pricing of those assets more responsive to interest rate fluctuations in the hope that they would return to profitability.

Given the nature of the problems facing the industry at that time, a decision by the regulator to forbear on troubled thrift institutions was not unreasonable. Giving thrifts time for interest rates to fall, for mortgage portfolios to adjust, and for deregulation to take effect was an explicit choice on the part of both regulators and Congress.

Forbearance has continued for inadequately capitalized thrifts up to the present. However, both the cause of the thrifts' problems and the Bank Board's reason for exercising forbearance have changed. Because of the decline in interest rates from the double-digit levels of the early 1980s, thrifts no longer suffer from low or negative interest-rate spreads. According to Bank Board officials, thrift insolvencies today typically result from holding bad assets. That is, many thrifts are holding assets that are not producing income or are overvalued. This condition is more severe than interest rate problems because such assets have little potential to become productive.

Unlike the problems that were associated with rising interest rates, the potential for recovery for firms with bad assets is not obvious. Nor, even in those cases where recovery may occur, is it possible to predict the time lags that may exist. It is at least as likely that bad assets, particularly those due to fraud or mismanagement, will continue to decline in value over time as that they will improve. Therefore, the benefits to be gained from forbearance are unclear and their timing is uncertain. Nevertheless, out of necessity rather than choice, FHLBB and FSLIC continue to delay resolution of the problems being experienced by many thrifts that are unable to meet regulatory capital standards and for many thrifts that have no capital at all.[1]

The deteriorating financial condition of the insurance fund helps explain why forbearance continues to be extended to many thrifts today. FSLIC's total reserves have declined since 1980 and primary reserves have fallen rapidly since 1983 (see table I.1). In fact, preliminary results of our audit of FSLIC's 1986 financial condition suggest that, after necessary additions to the insurance fund's reserve for contingent liabilities, FSLIC may have a negative net worth of between $3 billion and $7 billion.

The data in table I.2 show that while 213 failed thrift institutions were resolved by merger or liquidation in 1982, only 70 were resolved in 1983. This number had dropped to 39 in 1984, despite the fact that the total number of insolvent institutions was rising. In 1986, only 43 cases were resolved. Between 1980 and 1986, the number of liquidations rose, while the number of mergers undertaken with supervisory encouragement or financial assistance from FSLIC fell.[2]

As an alternative to merging or liquidating insolvent thrifts, the FHLBB began placing thrifts into the management consignment program (MCP) in 1985. MCP institutions are those to which FSLIC has appointed a conservator or a receiver and replaced the old management in order to control FSLIC's potential losses. MCP institutions, including those in liquidating receiverships, continued to operate, although generally insolvent and unprofitable. Their problems, therefore, have not been resolved.

In addition to these developments, estimates of the likely demands facing FSLIC are rising. The average loss to FSLIC in

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[1]Resolutions occur when a thrift is liquidated or merged with another institution.

[2]Here, liquidation does not necessarily mean that depositors are paid-off. Of late the FSLIC has increasingly transferred the deposits of a failed institution to newly created S&Ls that may be assigned to the MCP separately or in combination with other S&Ls in receivership. These deposits are often matched by transfers of assets, cash, notes, or some combination from FSLIC to the new institution.

Table I.1:

urance Fund Reserves
lions of dollars)
1980 - 1985

Secondary reserves[b]	Total reserves
0.79	6.46
0.60	6.30
0.61	6.30
0.66	6.42
0.72	5.61
0.77	4.55

ancial Statements of the Federal Home
d Related Agencies, GAO/AFMD-82-58,
-83-65, April 83; GAO/AFMD-84-47, May
, July 85; Financial Audit Federal
nsurance Corporation's 1985 and 1984
ts, GAO/AFMD-86-65, July 86.

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Table I 2

Disposition of Insolvent Institutions[a] 1980 - 1986

FSLIC Action	1980	1981	1982	1983	1984	1985	1986
Liquidations[b]	0	1	1	6	9	10[c]	21[d]
Supervisory Mergers[e]	21	56	166	31	13	11	4
FSLIC Mergers[f]	11	23	46	33	17	22	22
Total Resolutions	32	80	213	70	39	43	47
Allocations to MCP[g]	0	0	0	0	0	25	29 (17)[h]
Total Number of Insolvent Institutions[i]	16	53	222	281	434	449	445[j]

Source: FHLBB and FSLIC.

Notes [a]An insolvent institution is defined to have GAAP net worth less than or equal to zero.

[b]Liquidations include depositor pay-offs, and transfers of deposits backed by cash, FSLIC assets or notes, or a combination of these to other, often newly created, institutions.

[c]In two 1985 liquidations, assets in receivership were transferred to newly created S&Ls that became MCPs.

[d]Twelve institutions placed in liquidating receiverships in 1986 were actually transformed into newly created MCPs. Thus here and for two cases in 1985, the liquidating receivership was used, not to close institutions, but to create MCP institutions.

[e]In a supervisory merger, the Bank Board compels the institution to merge, typically without financial assistance, because the S&L failed to meet regulatory capital and other requirements.

[f]In a FSLIC merger, the insurance fund provides financial assistance as an inducement to the acquiring institution.

[g]Allocated initially to the management consignment program (MCP) in any given year

[h]The MCP definition was changed early in 1987. Seventeen institutions originally classified as MCP's in 1986, were declared to be non-MCPs as of December 31, 1986, because they had not gone through conservatorship or receivership These 17 institutions are not included in the 29 shown above as having been added to the program in 1986.

[i]At the end of the year, except 1986.

[j]By September 1986.

dealing with failed thrifts was 14.7 cents per dollar of assets in 1984. At that rate, it would have cost FSLIC $16.9 billion to liquidate or merge all GAAP insolvent thrifts in 1986 (see table I.3). It seems likely that the resolution cost per dollar of assets has risen since 1984.[3] Thus, while the dollar value of assets of insolvent thrifts has remained relatively constant recently, FSLIC's potential cost of resolving its problem caseload would seem to be rising. The FHLBB has estimated from its case files on problem institutions that the current cost to FSLIC of resolving already recognized problem cases is likely to be $23.5 billion. This is roughly equivalent to assuming an average loss of 20.8 percent in merging or liquidating all GAAP-insolvent thrifts.

The Forms and Extent of Forbearance

Forbearance can assume two general forms. In the first type, capital, as reported for regulatory purposes, is augmented through the use of various accounting and regulatory actions. In the second form of forbearance, institutions are, at least temporarily, exempted from regulatory capital requirements and are permitted to operate with regulatory net worth below the required minimum level. In addition to these two general forms of forbearance, Federal Home Loan Bank (FHLBank) advances to insolvent institutions may also be thought of as a kind of forbearance. Advances can be used as "lender of last resort" assistance for an institution experiencing deposit withdrawals that would otherwise force it to close.

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[3]We do not have firm figures on the average cost of resolution per dollar of assets since 1984. FSLIC can resolve a thrift's problems by liquidating it or merging it with a healthy institution. However, the cost to liquidate institutions has been rising fairly steadily, reaching 50 cents on the dollar in 1986. Since the proportion of cases resolved through liquidation is rising and liquidations typically cost more than mergers, it is reasonable to expect that the average cost for all FSLIC-assisted resolutions is also rising. One possible reason for the escalating cost of liquidation is that FSLIC, in order to conserve its reserves, is liquidating only those cases where action is unavoidable. These will usually be among the worst of the problem institutions. Thus, the average cost of liquidations may not be typical of the cost of resolving all currently troubled institutions.

Table I.3.

Estimates of FSLIC Losses on Insolvent Institutions' Asset Portfolios, 1980-1986[a]
(in billions of dollars)

December	Number of insolvent institutions	Total value of assets	Potential Dollar Losses to the FSLIC[b] 5 percent	15 percent	25 percent	35 percent
1980	16	$ 0.12	$0.01	$ 0.02	$ 0.03	$ 0.04
1981	53	11.82	0.59	1.77	2.96	4.14
1982	222	63.51	3.28	9.53	15.88	22.23
1983	281	77 76	3.89	11 66	19.44	27.21
1984	434	101.58	5.08	15.24	25.39	35.55
1985	449	112.93	5 65	16.94	28.23	39.52
1986[c]	445	112 76	5.64	16.91	28.19	39 47

Source: FHLBB Semiannual and Quarterly Financial Statements, 1980-1986.

Note [a]Insolvent institutions have zero or negative GAAP net worth We have calculated the GAAP net worth of institutions by subtracting from their reported regulatory net worth those items not consistent with GAAP. Industry participants have questioned some FHLBB regulations related to the valuation of assets and reserves that may be more rigorous than would be required under GAAP. To the extent this is true, our estimates of GAAP net worth may be understated and, thus, the number of institutions insolvent under GAAP, overstated Data to further refine our GAAP estimates are not collected by the Bank Board nor are they to our knowledge, available elsewhere. Such adjustments to GAAP net worth as may be appropriate, therefore, cannot currently be done. While further research may be necessary, the Bank Board has said that such adjustments would not substantially alter the picture of the industry provided by currently available information.

[b]Dollar losses to FSLIC assuming 5, 15, 25, and 35 percent losses on assets In 1984, the average cost to FSLIC of dealing with failed institutions was 14 7 percent of assets.

[c]Data are for September 1986.

Capital augmentation

The first general form of forbearance occurs when FSLIC increases the level of capital reported for regulatory purposes in the financial statements of a capital-deficient thrift without any accompanying real improvement in the underlying conditions of the institution. This assistance generally has involved either accounting changes or "created" capital in the form of capital certificates.

During the thrift crisis of the early 1980s, capital augmentation was the form of capital forbearance preferred by the Bank Board and FSLIC. The two most widely used types of capital certificates were net worth certificates and income capital certificates (ICC). NWCs, although relatively small in dollar terms were, perhaps, the best known of the various capital-augmentation techniques. A recent publication by the Federal Home Loan Bank System describes the NWC program and its purpose as follows:

> Finally, Garn-St Germain authorized a new capital assistance program for troubled institutions. Under this program--called the Net Worth Certificate Program--qualifying associations with less than 3 percent net worth were permitted to secure promissory notes from the FSLIC in exchange for instruments, issued by thrifts, called net worth certificates. Because the FSLIC's promissory notes guaranteed the notes' face amounts, thrifts could use them to raise their net worth to the required minimum, and thereby hold off a FSLIC takeover. [emphasis added]

According to the Bank Board, raising regulatory net worth to the required minimum in order to avoid a FSLIC takeover was a primary purpose of all the capital augmentation techniques used by the regulator.

Table I.4 shows the combined holdings of capital certificates among institutions that were GAAP insolvent in December 1982. Use of capital certificates peaked in the fourth quarter of 1985 at 0.71 percent of assets, but fell sharply during the third quarter of 1986. This reduction probably resulted from two unrelated occurrences. First, legislative authority for the NWC

Table I.4:

Components of Forbearance in the Regulatory Capital of Thrifts That Were GAAP Insolvent in December 1982 (as a percent of assets)

	Capital Components				Capital Concepts		
	Appraised equity capital[a]	Capital certificates[b]	Deferred net losses	Goodwill[c]	RAP	GAAP	TAP[d]
1977.2[e]	0.00	0.00	-0.03	0.01	4.77	4.80	4.79
1978.1	0.00	0.00	-0.09	0.01	4.71	4.80	4.79
2	0.00	0.00	-0.13	0.01	4.67	4.80	4.79
1979.1	0.00	0.00	-0.09	0.01	4.62	4.71	4.70
2	0.00	0.00	-0.06	0.01	4.61	4.67	4.66
1980.1	0.00	0.00	-0.06	0.01	4.30	4.36	4.35
2	0.00	0.00	-0.05	0.02	3.91	3.97	3.95
1981.1	0.00	0.00	-0.06	0.02	3.26	3.31	3.29
2	0.00	0.06	0.62	0.16	2.47	1.78	1.62
1982.1	0.00	0.30	1.74	2.01	1.53	-0.51	-2.52
2	0.23	0.43	3.86	4.11	1.18	-3.37	-7.48
1983.1	0.28	0.55	3.85	4.35	1.35	-3.35	-7.70
2	0.25	0.60	3.41	6.31	1.82	-2.54	-8.85
1984.1	0.23	0.42	3.34	5.24	2.39	-1.59	-6.83
2	0.22	0.41	3.50	5.06	2.38	-1.75	-6.81
3	0.21	0.43	3.51	5.31	2.61	-1.61	-6.92
4	0.19	0.50	3.34	5.19	2.85	-1.09	-6.28
1985.1	0.19	0.50	3.32	4.88	3.15	-0.81	-5.69
2	0.20	0.66	3.17	4.94	3.71	-0.14	-5.08
3	0.19	0.65	3.08	4.82	3.77	-0.01	-4.83
4	0.18	0.71	2.94	4.57	3.88	0.27	-4.30
1986.1	0.19	0.63	2.94	3.96	3.97	0.36	-3.60
2	0.18	0.61	2.79	3.88	3.97	0.53	-3.35
3	0.17	0.34	2.51	3.83	5.11	1.98	-1.85

Source: FHLBB Semiannual and Quarterly Financial Statements, 1980-1986.

Notes. [a]A one-time only adjustment to regulatory net worth to reflect the increased value of the thrifts' office buildings, land, and improvements above their original book value.

[b]Mutual capital certificates, income capital certificates, net worth certificates, and accrued net worth certificates that have been promised but not yet issued.

[c]Goodwill is an accounting concept that is acceptable under GAAP. It appears on the balance sheet as an asset, but it is not an earning asset to the firm. It became very important on the balance sheets of thrift institutions only after the Bank Board approved a change in accounting for thrift acquisitions in 1982.

[d]Tangible net worth (TAP) equals GAAP net worth less goodwill.

[e]Financial Statements were required of FSLIC-insured thrifts semiannually, at the end of June and December, through 1983. Starting in 1984, reports were filed at the end of each calendar quarter.

program expired. Second, the Financial Accounting Standards Board (FASB), which sets the nation's accounting standards, determined that ICCs were not to be included as part of net worth under GAAP, unless exchanged for cash.[4] Currently, FSLIC notes or other FSLIC assets are given as part of the process through which the deposits of a failed thrift are transferred to a newly created institution. In exchange, the assets of the failed institution, which are often of doubtful quality, are taken over by FSLIC as the receiver.

Another way of increasing the apparent value of thrift assets relative to liabilities is for the regulator to modify the rules used by thrifts to define their assets and net worth for regulatory purposes. For example, under RAP, thrifts were permitted to defer losses on assets sold where the losses resulted from adverse changes in interest rates. GAAP, in contrast, would have required the institutions to take the loss in the period incurred. The losses incurred but not taken under RAP appear as an asset on the institution's books, resulting in an overstatement of net worth. Deferred losses reached their highest percentage of assets (3.86 percent) during the second half of 1982.

Before 1982, net worth as measured under RAP and GAAP were essentially equal. Between then and 1985, the two measures diverged until average RAP net worth for the industry exceeded GAAP net worth by about 1 percentage point. More recently, the difference between RAP and GAAP net worth has begun to slowly diminish. This has been due to several factors. As a result of a change in FHLBB regulations in October 1984, use of deferred losses by insolvent S&Ls had declined to 2.51 percent of assets by the third quarter of 1986. The use of other accounting rules that allowed thrifts to augment their net worth for regulatory purposes has also been reduced by the Bank Board as part of a general move toward the use of GAAP in the industry.

Capital exemption

The second form of capital forbearance occurs when thrifts are allowed by the regulator to operate despite a continuing inability to meet minimum regulatory capital requirements. In effect, these thrifts are exempted from the capital standard. The

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[4]We include ICCs in net worth despite FASB's ruling because, from our data, we could not determine which ICCs were issued in exchange for cash and which for FSLIC notes. We chose to err on the side of overstating net worth, to avoid exaggerating the extent of industry problems.

current minimum regulatory net worth requirement established by the FHLBB is 3 percent. The Bank Board's recent policy statement on forbearance says that "the Board is unlikely to take administrative action to enforce minimum capital requirements . . . against a thrift whose regulatory net worth ratio declines below its minimum requirements to no less than 0.5 percent before December 31, 1987." As of September 30, 1986, 250 operating thrifts had regulatory net worth below 0.5 percent. Of these 250 institutions, 237 were insolvent under GAAP and 219 were insolvent under RAP. Table I.5 lists these under-capitalized institutions by state.

According to the FHLBB's recently released policy on forbearance for thrifts, capital exemption has replaced capital augmentation as the preferred form of forbearance. It says,

> The implementation of the Board's capital forbearance policy has no effect on balance sheet or income statement items reported in reports or other financial statements, nor does it allow thrifts to report, as assets, loans (or portions thereof) considered losses. On the contrary, the policy retains existing financial presentation rules and creates no inconsistencies with generally accepted accounting principles. The Board believes that maintaining the integrity of financial statements is vital to assuring confidence in the thrift system. [emphasis added]

FHLBank advances

Virtually all thrift institutions belong to the Federal Home Loan Bank System. One of the advantages of membership is the ability to borrow from the district Federal Home Loan Bank. Such loans are called advances and can be used to make new mortgages, purchase other assets, or replace deposit outflows. Advances may involve varying maturities up to several years and, generally, they are heavily collateralized, similar to loans made to commercial banks by the Federal Reserve. For troubled thrifts with inadequate collateral, however, the FHLBB has allowed FSLIC

APPENDIX I

Table I.5:

State Distribution of S&Ls Having Regulatory Net Worth Below One Half Percent in September 1986

State[a]	Number with RAP Net Worth below 0.5 Percent	Number RAP Insolvent	Number GAAP Insolvent	Total assets of institutions with RAP net worth below 0.5 percent (in millions of dollars)
Alabama	2	1	2	781.1
Arkansas	10	10	10	3,270.9
Arizona	1	1	1	1,121.1
California	28	25	26	13,081.8
Colorado	4	4	4	254.9
Connecticut	1	1	1	155.9
Florida	14	13	14	6,389.5
Georgia	3	3	3	128.1
Hawaii	1	0	0	1,676.4
Idaho	3	3	3	655.7
Illinois	19	15	18	4,367.5
Indiana	6	6	6	850.5
Iowa	5	5	5	568.9
Kansas	3	3	3	402.9
Kentucky	2	2	2	556.2
Louisiana	17	15	16	3,311.7
Maryland	2	1	2	152.0
Michigan	5	4	5	1,676.4
Minnesota	6	5	6	1,002.5
Missouri	5	3	5	1,420.2
Mississippi	3	3	3	92.2
North Carolina	1	1	1	136.6
Nebraska	4	3	3	845.8
New Jersey	6	4	4	1,975.0
New Mexico	1	1	1	214.4
Ohio	4	4	4	739.9
Oklahoma	11	9	10	1,397.4
Oregon	8	7	8	1,581.5
South Carolina	1	1	1	79.2
South Dakota	1	1	1	111.9
Tennessee	4	4	4	198.9
Texas	53	45	49	18,651.1
Utah	3	3	3	799.8
Virginia	3	3	3	315.0
Washington	4	4	4	376.5
Wisconsin	2	2	2	297.9
West Virginia	2	2	2	239.6
Wyoming	2	2	2	308.5
Total[b]	250	219	237	70,185.4

Source: FHLBB Quarterly Financial Statement, September 1986.

Notes: [a]Some states do not appear on the list because they do not have any S&Ls with regulatory net worth below 0.5 percent.

[b]There were 445 GAAP insolvent institutions in September 1986. Two hundred and eight do not appear here because they had RAP net worth above 0.5 percent.

to act as guarantor for the advances.[5] These advances, while not increasing net worth, do provide liquidity to the troubled thrifts. This source may be particularly important if the institution is threatened with deposit outflows. A run on an S&L, whether the institution is insolvent or solvent, may force FSLIC to close the institution. Thus, FHLBank advances can be considered an element of forbearance when provided to insolvent institutions.

Advances may also constitute a low-cost, subsidized source of funds to problem S&Ls. The financial strength of the combined FHLBanks allows the system to raise funds at low rates. When these rates are passed on to a troubled thrift, they may represent a cost-of-funds considerably below that available to the problem thrift in the market.

Table I.6 compares the degree of reliance placed on advances by three groups of thrifts. For the industry as a whole, usage of FHLBank advances rose only moderately from December 1982 to September 1986, when it reached 8.02 percent of assets. At this date, thrifts that were insolvent in December 1982 and remained insolvent 4 years later were more dependent on advances. These capital-deficient thrifts used advances to fund 11.33 percent of their assets. Thrifts that were initially insolvent but had recovered by September 1986 were more reliant on advances than the industry but less than the long-term insolvents, holding advances equal to 8.76 percent of assets.

CONCLUSION

The data show that thrifts that were insolvent in December 1982 have received significant amounts of forbearance since 1981. The use of some forbearance techniques, most importantly NWCs, ICCs, and other regulatory accounting techniques, has leveled off or declined recently. Exemptions from regulatory capital standards, however, together with advances, have continued to increase as the condition of weak thrifts has deteriorated.

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[5] We do not have data that distinguishes FSLIC-guaranteed advances from regularly collateralized advances.

Table I.6:

FHLBank Advances 1982-1986
(as a percent of assets)

	All industry	Institutions that were insolvent in December 1982 and still insolvent in September 1986[a]	Institutions that were insolvent in December 1982 but solvent in September 1986[b]
1982.2[c]	9.30	9.81	11.33
1983.1	7.66	8.80	10.30
2	7.03	7.32	9.17
1984.1	6.54	6.79	8.38
2	7.00	6.87	8.46
3	7.48	6.67	8.63
4	7.33	8.44	7.92
1985.1	7.22	8.82	7.41
2	7.50	9.67	8.05
3	7.82	10.17	8.00
4	7.89	10.33	8.96
1986.1	7.57	10.53	8.84
2	7.90	11.34	8.68
3	8.02	11.33	8.76

Source: FHLBB Semiannual and Quarterly Financial Statements, December 1982 and September 1986.

Notes: [a]There were 80 institutions that were insolvent at both the beginning and the end of the period.

[b]There were 65 institutions that were insolvent at the beginning of the period (December 1982) but had returned to solvency by September 1986.

[c]Financial Statements were required of FSLIC-insured thrifts semiannually, at the end of June and December, through 1983. Starting in 1984, reports were filed at the end of each calendar quarter.

STATUS OF INSOLVENT THRIFTS
RECEIVING FORBEARANCE SINCE 1982

In earlier, more normal times such as the 1970s, the Bank Board acted quickly to resolve the problems of a thrift that fell below minimum regulatory capital standards, which then stood at 5 percent.[6]

In the 1980s, the Bank Board has been unable to maintain its strict regulatory policy. In December 1982, at the depth of the economic recession and the height of the S&L crisis, 222 S&Ls had negative GAAP net worth. These institutions, therefore, were receiving forbearance. We tracked what happened to these firms to determine whether forbearance has been successful.

Measures of Success

Success may be measured against a three-part hierachy of progressively more stringent criteria. Did forbearance allow S&Ls to: (1) survive the high interest rates that weakened the industry in 1981 and 1982, (2) continue in operation and show an improvement, if not an actual return to full viability, and (3) recover fully by achieving capital levels exceeding 3 percent and profitability as of September 1986? In 1983 and 1984, as interest rates fell from earlier high levels, the economy and the S&L industry began to recover. The years 1985 and 1986 were very good years for the economy and for much of the thrift industry. By 1986 the economic environment was conducive to recovery by S&Ls that had become insolvent as a result of their earlier problems with interest rates.

Survival or elimination

Of the 222 institutions that were insolvent in December 1982, 145 met at least the weakest of our three criteria--survival (see table I.7). The remaining 77 institutions, more than one-third of the thrifts that were insolvent in December 1982, had either been

[6]During the period before 1982 there was little difference between GAAP and RAP measures of capital.

liquidated, acquired, merged, or reorganized 4 years later. In September 1986, 65 of the remaining 145 (29.3 percent of the 222 initially insolvent) had attained positive levels of GAAP capital. The other 80 (36.0 percent of the original 222) remained insolvent.

Forbearance failures

We define a forbearance failure as an unprofitable thrift having capital below minus 3 percent. Twenty-four institutions had deteriorated in capital position from between -3 to 0 percent to below -3 percent. Of these, 8 were profitable and 16 incurred losses in 1986. In total, by September 1986, 32 thrifts, or 14.4 percent of those insolvent in December 1982, were both deeply insolvent and unprofitable (51 with net worth below -3 percent, less 19 that were profitable).

Improvement

We present data on two aspects of improvement in the economic condition of an insolvent institution--capital and profits.

By September 1986, 73 of the 145 still existing thrifts that were insolvent in 1982 had improved their capital position by moving from one net worth category shown in table I.7 to a higher category. Of these institutions, 62 were also profitable during the first three quarters of 1986. In addition, of the 48 firms that retained the same capital position, 30 were profitable. Of the 24 whose capital position worsened, 8 were profitable.

Full recovery

Table I.7 shows that 25 thrifts had regained solvency and profitability by September 1986; that is, they had "fully recovered." We consider an institution fully recovered if it had GAAP net worth above 3 percent of assets in September 1986 and was profitable during the first three quarters of that year. Thirty institutions, or 13.5 percent of those initially insolvent, had net worth above 3 percent. Most (25) of these institutions were also profitable through the first 9 months of 1986. Thus, 11.3 percent (25) of the 222 institutions that were insolvent at the end of 1982 had fully recovered 4 years later.

Table I.7:

Progress of Insolvent Thrifts 1982 - 1986

Net Worth Dec. 82	below -3%	-3% to 0%	0% to 3%	above 3%	No longer in Existence	Number	Percent
	Number and percentage of S&Ls insolvent in 1982 GAAP Net Worth Category in September 1986[a]					Total 1982 Institutions	
below -3%	27	8	7	8	25	75	2.3%
row percentage	(36.0)	(10.7)	(9.3)	(10.7)	(33.3)	(100%)	
number profitable[b]	11	8	7	7		33	
-3% to 0%	24	21	28	22	52	147	4.5%
row percentage	(16.3)	(14.3)	(19.0)	(15.0)	(35.4)	(100%)	
number profitable[b]	8	19	22	18		67	
- - - - -							
Total[c] all insolvent	51	29	35	30	77	222	6.8%
row percentage	(23.0)	(13.1)	(15.8)	(13.5)	(34.7)	(100%)	
number profitable	19	27	29	25		100	

Source: FHLBB Semiannual and Quarterly Financial Statements, December 1982 and September 1986.

Notes: [a]Net Worth categories are defined as a percentage of assets under GAAP.
[b]Institutions that had positive net profits during the first three quarters of 1986.
[c]The total is the sum of the first two rows. It shows the change in the condition of all thrifts that were GAAP insolvent in December 1982.

Other Aspects of Forbearance for Insolvent Institutions

Table I.8 summarizes the 1986 capital position of thrifts that were insolvent in December 1982. While 25 had fully recovered, others still had serious capital deficiencies. For example, 17 had net worth below minus 10 percent and all but 1 of these were unprofitable. Eleven of these 17 had capital below minus 12 percent and were incurring losses at an 11.30 percent annual rate. In 1982 only 2 of the 145 insolvent thrifts that were to survive had net worth below minus 12 percent. They were both unprofitable at that time.

Changes in Capital Composition of Thrifts Insolvent in 1982

In the previous section we discussed the improvement that thrifts had made in their GAAP capital-to-assets ratios. Here we present other information on changes in the capital position of institutions insolvent in December 1982.

There have been three elements of change in capital composition among insolvent S&Ls since 1982. First, as a group their reliance on the creative capital components included in regulatory net worth--appraised equity capital, capital certificates, deferred net losses, and goodwill--was reduced in all cases as compared to the situation earlier in the decade (see table I.4).[7] This is evidenced by a narrowing of the differential between regulatory accounting (RAP) net worth and both GAAP and tangible (TAP) net worth.[8] Nevertheless, the differences between RAP, GAAP, and TAP measures of net worth for institutions that were insolvent in 1982 remain much larger than those for the entire industry.

Second, despite the reduced use of creative net worth components, table I.9 shows that by 1986, RAP net worth for those

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[7]Early in the decade, thrifts were allowed to increase the book value of their assets and net worth by raising the value of some real assets from their initial levels to market values. The addition was called appraised equity capital. Many industry analysts regard goodwill as a creative capital component, although it is eligible under GAAP, because the asset has no direct earnings.

[8]Tangible net worth consists of GAAP net worth less goodwill.

Table I.8:

Capital and Income Condition in September 1986 of Thrifts That Were Insolvent in December 1982

GAAP Net Worth Category	Number of Thrifts	Number of Profitable Thrifts[a]	Percent of Profitable Thrifts	Average GAAP Net Worth	Return on Assets in 1986[b]
GAAP <= -12%	11	1	9.09	-26.55	-11.30
-12% < GAAP <= -11%	4	0	0.00	-11.44	- 4.72
-11% < GAAP <= -10%	2	0	0.00	-10.16	- 1.44
-10% < GAAP <= - 9%	2	1	50.00	- 9.78	- 0.87
- 9% < GAAP <= - 8%	3	1	33.33	- 8.69	0.21
- 8% < GAAP <= - 7%	3	2	66.67	- 7.55	1.05
- 7% < GAAP <= - 6%	3	1	33.33	- 6.81	1.09
- 6% < GAAP <= - 5%	6	2	33.33	- 5.51	- 1.69
- 5% < GAAP <= - 4%	5	3	60.00	- 4.68	0.27
- 4% < GAAP <= - 3%	12	8	66.67	- 3.30	0.10
- 3% < GAAP <= - 2%	6	6	100.00	- 2.43	0.48
- 2% < GAAP <= - 1%	9	9	100.00	- 1.66	0.60
- 1% < GAAP <= - 0%	14	12	85.71	- 0.37	0.84
0% < GAAP <= 1%	19	16	84.21	0.66	1.03
1% < GAAP <= 2%	8	7	87.50	1.31	0.98
2% < GAAP <= 3%	8	6	75.00	2.23	1.77
3% < GAAP <= 4%	10	9	90.00	3.22	0.54
4% < GAAP <= 5%	6	5	83.33	4.19	0.83
5% < GAAP <= 6%	5	4	80.00	5.52	0.78
6% < GAAP <= 7%	2	2	100.00	6.56	2.10
7% < GAAP <= 8%	0	0	N/A	N/A	N/A
8% < GAAP <= 9%	1	1	100.00	8.43	1.79
9% < GAAP <= 10%	1	1	100.00	9.45	4.41
10% < GAAP <= 11%	1	1	100.00	10.15	5.80
11% < GAAP <= 12%	0	0	N/A	N/A	N/A
12% < GAAP <= 12%	4	2	50.00	18.99	0.30
Total	145	100	70.0		

Source: FHLBB Quarterly Financial Statements, September 1986.

Note: [a]Profit, measured at an annual rate, is defined as total income less total expenses after taxes for the first three quarters of 1986.

[b]The return on assets is calcuated for the first 3 quarters of 1986.

Table I.9:

Net Worth of Thrifts That Were Insolvent in December 1982[a]
(As a Percentage of Total Assets, 1977-1986)

	Traditional Capital			Capital Concepts		
	Stock and paid-in surplus	Reserves	Undivided profits[c]	RAP	GAAP[d]	TAP[e]
1977.2[b]	0.10	3.25	1.42	4.77	4.80	4.79
1978.1	0.10	3.07	1.54	4.71	4.80	4.79
2	0.10	3.18	1.40	4.67	4.80	4.79
1979.1	0.10	3.06	1.47	4.62	4.71	4.70
2	0.09	3.18	1.34	4.61	4.67	4.66
1980.1	0.08	3.07	1.14	4.30	4.36	4.35
2	0.09	2.81	1.02	3.91	3.97	3.95
1981.1	0.08	2.53	0.64	3.26	3.31	3.29
2	0.08	2.24	0.09	2.47	1.78	1.62
1982.1	0.10	1.86	-0.74	1.53	-0.51	-2.52
2	0.09	1.52	-1.13	1.18	-3.37	-7.48
1983.1	0.09	1.31	-0.89	1.35	-3.35	-7.70
2	0.33	1.33	-0.79	1.82	-2.54	-8.85
1984.1	0.63	1.25	-0.45	2.39	-1.59	-6.83
2	0.61	1.18	-0.37	2.38	-1.75	-6.81
3	0.53	1.17	-0.13	2.61	-1.61	-6.92
4	0.73	1.05	0.05	2.85	-1.09	-6.28
1985.1	1.07	1.04	0.02	3.15	-0.81	-5.69
2	1.33	1.03	0.14	3.71	-0.14	-5.08
3	1.37	1.00	0.19	3.77	-0.01	-4.83
4	1.37	0.97	0.26	3.88	0.27	-4.30
1986.1	1.36	0.97	0.45	3.97	0.36	-3.60
2	1.40	0.96	0.47	3.97	0.53	-3.35
3	2.26	1.35	0.64	5.11	1.98	-1.85

Source: FHLBB Semiannual and Quarterly Financial Statements, 1977-1986.

Notes: [a]GAAP Net Worth (including ICCs) in December 1982 at 0 percent or below defines insolvency.
[b]Financial Statements were required of FSLIC-insured thrifts semiannually, at the end of June and December, through 1983. Starting in 1984, reports were filed at the end of each calendar quarter.
[c]Undivided Profits (Retained Earnings) and Net Undistributed Income.
[d]GAAP net worth equals RAP net worth less appraised equity capital, net worth and accrued net worth certificates, qualifying mutual capital certificates and subordinated debt, and deferred net losses on loans and other assets sold.
[e]Tangible net worth (TAP) equals GAAP net worth less goodwill.

remaining from the group of 1982 insolvents had increased from 1.18 percent in the second half of 1982 to a level of 5.11 percent, above the regulatory required minimum of 3 percent. Similarly, GAAP net worth (which excludes the first three creative components listed above) had returned to positive values in 1985 and had risen to 1.98 percent in September 1986. In addition, tangible net worth, which unlike GAAP also excludes goodwill, had risen, but still remained negative at -1.85 percent at the end of the period.

Third, among the individual components of net worth, the insolvent group's reserves and undistributed profits had risen somewhat but continued to demonstrate weakness. However, substantial amounts of new capital had been raised and amounted to 2.26 percent of assets by the end of September 1986. The raising of new capital is an important prerequisite to recovery for problem thrifts.

STATUS OF WEAKLY CAPITALIZED THRIFTS AS A CONSEQUENCE OF FORBEARANCE SINCE 1982

At the end of 1982, 916 S&Ls were solvent but weakly capitalized with net worth below 3 percent (see table I.10). Allowing these institutions to continue in operation, in fact, constituted forbearance relative to the strict capital standards enforced in the 1970s.

Survival or Elimination

Four years later, 746 of these initially weakly capitalized thrifts continued in operation; that is, they had survived. Two hundred and eighty (30.6 percent) remained in the same capital category; of these, 81.4 percent were profitable. One hundred and seventy (18.6 percent) had ceased to exist.

Deterioration

One hundred and eighty-six thrifts (20.3 percent of the initial low capital group) had deteriorated into insolvency. Almost half of these declining thrifts had become deeply insolvent with capital below minus 3 percent. Seventy-four of those that had become deeply insolvent were also unprofitable. These 74 represent 8.1 percent of the initial set of 916 weakly capitalized thrifts that had joined the ranks of the very seriously troubled thrifts, which can, on the basis of our definition, be regarded as forbearance failures.

Table I.10:

Progress of Solvent and Insolvent Thrifts 1982-1986

	Number and percentage of 1982 S&Ls by GAAP Net Worth Category in September 1986[a]					Total 1982 Institutions	
Net Worth Dec. 82	below -3%	-3% to 0%	0% to 3%	above 3%	No longer in Existence	Number	Percent
All insolvent[b]	51	29	35	30	77	222	6.8%
row percentage	(23.0)	(13.1)	(15.8)	(13.5)	(34.7)	(100%)	
number profitable[c]	19	27	29	25		100	
0% to 3%	90	96	280	280	170	916	27.9%
row percentage	(9.8)	(10.5)	(30.6)	(30.6)	(18.6)	(100%)	
number profitable[c]	16	53	228	255		552	
above 3%	80	70	266	1566	167	2149	65.4%
row percentage	(3.7)	(3.3)	(12.4)	(72.9)	(7.2)	(100%)	
number profitable[c]	7	39	173	1480		1699	
Total	221	195	581	1876	414	3287	100.0%
row percentage	(6.7)	(5.9)	(17.7)	(57.1)	(12.6)		
number profitable[c]	42	119	430	1760		2351	

Source: FHLBB Semiannual and Quarterly Financial Statements, December 1982 and September 1986.

Notes: [a]Net Worth categories are defined as a percentage of assets under GAAP.

[b]All insolvent is equal to the "Total" on table I.7. It includes all thrifts that were insolvent under GAAP in December 1982.

[c]Institutions that had positive net profits during the first three quarters of 1986.

Improvement and Full Recovery

Another two hundred and eighty (30.6 percent) of those weakly capitalized in 1982 had attained strong capital levels above 3 percent. Of these, 255, or 27.8 percent of the low-capital-in-1982 group, had fully recovered with strong capital and positive profits.

SUMMARY OF THE RESULTS

The pattern of progress for both insolvent and weakly capitalized thrifts receiving forbearance is mixed. For example, forbearance for insolvent thrifts over the 4-year period December 1982 through September 1986, produced full recovery (to profitability and capital above 3 percent) for 25 thrifts (11.3 percent). An additional 29 S&Ls (13.2 percent of those initially insolvent) became profitable and solvent but were weakly capitalized with net worth below 3 percent. Recovery or improvement did not occur for all insolvent thrifts, however. Seventy-seven ceased to exit. By September 1986, 32 initially insolvent thrifts had achieved the opposite of full recovery; that is, capital levels below minus 3 percent and unprofitability.

A similar mixed set of results is apparent for 916 thrifts that were weakly capitalized in 1982. Two hundred and fifty-five (27.8 percent) recovered fully, 280 stayed in the same capital category, and 186 (20.3 percent) deteriorated to a lower, insolvent level of capital. Seventy-four (8.1 percent) of the initially weakly capitalized thrifts became forbearance failures--unprofitable with capital below minus 3 percent.

GLOSSARY

Accrued Net Worth Certificates	Capital certificates that will be issued by the institution to FSLIC at the end of the current reporting period. Only those institutions that have received written assurance of Net Worth Certificates purchases from their Supervisory Agent may make such accruals.
Advances	Loans or discounts, with terms of as long as twenty years, issued by the regional Federal Home Loan Banks to member institutions. These loans are for the purpose of offsetting deposit outflows or promoting local housing markets.
Appraised Equity Capital	The excess of appraised value over book value of office land, buildings, and improvements of the insured institution or of any of its subsidiaries. The appraisal is a "one time only" appraisal as permitted by the institution's principal regulator.
Assets	Total savings and loan assets consist of mortgage loans and contracts, nonmortgage loans, repossessed real estate investments, liquid assets, fixed assets, and "other" assets.
Assisted Merger	The takeover of one thrift by another with assistance from FSLIC in the form of indemnification against certain liabilities, infusion of capital, and/or assumption of certain assets by FSLIC.
Book Value	The value of assets and liabilities as they are recorded in the S&Ls financial statements to the Bank Board, usually the value at acquisition of any asset or liability.

Conservator/Receiver	An individual or institution appointed by the Bank Board to oversee the assets of a failing institution to facilitate liquidation, merger, or replacement of management (see Management Consignment Program). A receivership eliminates any stockholder claims against the institution's assets while they are preserved under conservatorship.
Credit Risk	The potential for a borrower to default on all or part of a loan, and, consequently, the potential for the value of the loan held by a thrift to fall.
Deferred Losses	An FHLBB regulation permits FSLIC-insured institutions to defer over time part of the losses (or gains) incurred on the sale of assets.
Expense	FLSIC-insured institutions report their expenditures either as operating expense, interest charges, or nonoperating expense.
Forbearance	Delay by FSLIC in dealing with thrifts that do not meet regulatory capital requirements through (1) the provision of capital assistance to augment reported regulatory capital and/or (2) the exemption of thrifts from minimum regulatory capital requirements. Thrifts receiving forbearance may utilize Federal Home Loan Bank Board Advances.
GAAP Net Worth	The sum of preferred stock; permanent, reserve, or guaranty stock; paid-in surplus; income capital certificates; reserves; retained earnings; and net undistributed income less deferred net losses (gains) on loans and other assets sold. These items are recognized under the Generally Accepted Accounting Principles defined by the Financial Accounting Standards Board.

Goodwill and Other Intangible Assets	The premium over book value of an institution's assets that an acquiring institution pays during a merger or acquisition. See "Purchase Accounting."
Income	FSLIC-insured institutions report their earnings as operating or nonoperating income.
Income Capital Certificates	Certificates issued to the FSLIC by institutions seeking supplementary net worth. A regulatory program conceived and operated by FSLIC.
Insolvent	A condition in which the value of liabilities exceeds the value of assets according to some accounting standard such as regulatory accounting standards (RAP), generally accepted accounting principles (GAAP), or some other measure. That is, net worth (or capital) is negative.
Liabilities	Claims, held by others against the institutions, consisting of deposits, borrowings, and other liabilities.
Liquidation	The closure of a thrift by paying the claims of insured depositors and other secured creditors.
Low Net Worth	Net worth, assets minus liabilities, between 0 and 3 percent of total assets.
Management Consignment Program (MCP)	A program established by the Bank Board where by the day-to-day operations of a thrift are overseen by an outside supervisor, usually another thrift. Thrifts enter the program through either conservatorship or receivership.

Mortgage Loans	Loans that are secured by property, specifically residential property. Typically the principal asset of a thrift; they may be guaranteed by the Federal Housing Administration or the Veterans Administration. Where not guaranteed they are called "conventional loans."
Mutual Capital	A regulatory creation of FHLBB allowing mutual institutions to increase their regulatory net worth
Net Worth	Created by the Garn-St Germain Certificates Depository Institutions' Act, these certificates are issued by a qualified FSLIC-insured institution to FSLIC for the purpose of increasing the institution's regulatory net worth.
Net Undistributed Income	Profit earned but not distributed to stockholders
Nonoperating Expense	The provision for losses on the sale of real estate, investment securities, loans, and other assets.
Nonoperating Income	Profit earned from the sale of real estate, investment securities, loans, and other assets.
Operating Expense	Directors' fees; officers' and employees' compensation; legal expenses; directors' officers', and employees' expenses; office occupancy expenses; furniture, fixtures, equipment, and automobile expenses; advertising; commissions and fees paid; amortization of goodwill and of deferred losses; and other operating expenses.

Operating Income	Consists of interest earned, fees received, amortized deferred gains, and net income received from real estate owned, from service corporations and subsidiaries, and from leasing operations.
Permanent, Reserve, or Guaranty Stock	Par value of common stock outstanding.
Purchase Accounting	As purchase method accounting for a business combination as the acquisition of one enterprise (thrift institution) by another. The acquiring corporation (thrift institution) records as its cost the acquired assets less liabilities assumed. A difference between the cost of an acquired enterprise (thrift institution) and the sum of the fair values of tangible and intangible assets less liabilities is recorded as goodwill.
Qualifying Subordinated Debt	Subordinated debt determined by FHLBB regulation as qualifying for inclusion in net worth.
Regulatory Net Worth (RAP)	The sum of preferred stock; permanent, reserve, or guaranty stock; paid-in surplus; qualifying mutual capital certificates; qualifying subordinated debentures; appraised equity capital; net worth certificates; accrued net worth certificates; income capital certificates; reserves; undivided profits (retained earnings); and net undistributed income.
Reserves	Moneys set aside, either voluntarily or required by audit,to absorb losses or contingencies that have not yet occurred but are foreseen.

Retained Earnings	All unallocated profits from the current and previous report periods.
Subordinated Debentures	Subordinated debt may or may not qualify as net worth under FHLBB regulation. Reported as "borrowings" where their remaining period to maturity is less than 1 year and not qualifying as net worth.
Supervisory Merger	The takeover of one thrift by another with Bank Board oversight but without financial assistance.
Tangible Net Worth	Equals GAAP net worth (see above) less goodwill and other intangible assets.
Undistributed Profits	All unallocated profits from the current and previous report periods.
Undivided Profits	All unallocated profits from the current and previous report periods.