How Are the Ex-ODGF Thrifts Doing?

by Paul R. Watro

Not long ago, excessive deposit withdrawals caused a moratorium on privately insured thrifts (savings and loan associations) in Ohio. On March 15, 1985, Governor Celestre closed all 70 ODGF institutions, consisting mostly of small and conservatively managed thrifts with assets under $500 million. The collapse of ODGF's largest member, Home State Savings Bank of Cincinnati (with assets of more than $1.4 billion), bankrupted the fund and led to large and increasing deposit withdrawals at many other ODGF institutions. Federal Reserve Bank of Cleveland, p. 15.

The collapse of ODGF's largest thrift, Home State Savings Bank of Cincinnati (with assets of more than $1.4 billion), bankrupted the fund and led to large and increasing deposit withdrawals at many other ODGF institutions. Federal Reserve Bank of Cleveland, p. 15.

To protect deposits, the state offered financial assistance for organizations to purchase financially troubled ODGF institutions. It also authorized out-of-state depository institutions to acquire these thrifts and to operate them either as thrifts or as commercial banks.

The thrifts that have survived the 1985 ODGF crisis as independent depository institutions have performed better than similar-sized thrifts in Ohio because they have been able to hold down costs and improve their net worth through higher earnings.

The remaining 26 thrifts were solvent according to generally accepted accounting principles but lacked sufficient capital to qualify immediately for federal deposit insurance. By April 1986, all ODGF institutions were fully open for business either as independent depository institutions or as offices or subsidiaries of larger depository organizations. Twenty-six institutions, including Home State Savings Bank, were merged into or acquired by other federally insured institutions and ceased to exist as independent thrift institutions. Two major acquirers were Chase Manhattan Corporation of New York and Home Savings of America, Los Angeles.
The 44 other ODGF institutions received approval for federal deposit insurance either from the Federal Deposit Insurance Corporation (FDIC) or from the Federal Savings and Loan Insurance Corporation (FSUC). Several of these institutions, including five of the ten ODGF institutions that became FDIC insured, were acquired by or merged with other depository institutions since 1985.

We examined the current financial condition of 26 surviving ODGF institutions that are operating today as FSUC-insured thrifts and are not subsidiaries of depository organizations.3 No doubt these thrifts came from the ODGF’s cream of the crop and were probably in better financial shape than the typical Ohio thrift when they obtained federal deposit insurance. However, the ODGF crisis could have had longer-term adverse effects on those institutions that were associated with the defunct insurance fund. If so, their current financial performance might be inferior to the performance of other federally insured thrifts in Ohio.

To minimize the potential impact of institutional size on thrift performance, we excluded from our analysis thrifts with deposits over $350 million, because the largest ex-ODGF institution had deposits of $356 million at year-end 1987. After this adjustment, we had 177 thrifts in our control group.

Performance was measured by capitalization and profitability using 1987 data. Performance differences were linked to variations in income and expenses, which in turn were related to differences in the composition of assets, loans, and deposits. For each of these measures, we calculated an average value for the ex-ODGF thrifts and an average value for all other thrifts. Ohio thrifts of similar size. Using a simple statistical method, we then tested to see if the averages were significantly different. The average performance values for the two groups of thrifts and the differences between them are presented in tables 1 and 2.

### Table 1: Thrift Performance

<table>
<thead>
<tr>
<th></th>
<th>Ex-ODGF</th>
<th>Other</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Earnings</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(percentage of average assets)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net income</td>
<td>0.83</td>
<td>0.44</td>
<td>0.39</td>
</tr>
<tr>
<td>Net interest margin</td>
<td>2.91</td>
<td>2.55</td>
<td>0.36</td>
</tr>
<tr>
<td>Net worth</td>
<td>7.55</td>
<td>5.64</td>
<td>1.91</td>
</tr>
</tbody>
</table>

- Significant at the 90 percent level.
- Significant at the 5 percent level.

### Table 2: Thrift Behavior

<table>
<thead>
<tr>
<th></th>
<th>Ex-ODGF</th>
<th>Other</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Asset structure</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(percentage of assets)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans</td>
<td>78.5</td>
<td>82.5</td>
<td>-4.0</td>
</tr>
<tr>
<td>Cash, deposits, and investments</td>
<td>19.3</td>
<td>16.2</td>
<td>3.1</td>
</tr>
<tr>
<td><strong>Loan composition</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(percentage of loans)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nonresidential mortgages</td>
<td>6.8</td>
<td>9.5</td>
<td>-2.7</td>
</tr>
<tr>
<td>Construction loans</td>
<td>2.4</td>
<td>5.6</td>
<td>-3.2</td>
</tr>
<tr>
<td>Nonmortgage loans</td>
<td>3.8</td>
<td>5.2</td>
<td>-1.4</td>
</tr>
<tr>
<td>Adjustable rate mortgages</td>
<td>51.4</td>
<td>45.8</td>
<td>5.6</td>
</tr>
<tr>
<td><strong>Revenue</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(average percentage yields)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mortgages</td>
<td>8.67</td>
<td>8.65</td>
<td>0.02</td>
</tr>
<tr>
<td>Loans</td>
<td>8.74</td>
<td>8.77</td>
<td>0.03</td>
</tr>
<tr>
<td><strong>Expenses</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(percentage of average assets)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Money</td>
<td>6.03</td>
<td>6.36</td>
<td>-0.33</td>
</tr>
<tr>
<td>General and administrative</td>
<td>2.05</td>
<td>2.45</td>
<td>-0.40</td>
</tr>
<tr>
<td>Nonmortgage</td>
<td>0.10</td>
<td>0.51</td>
<td>-0.41</td>
</tr>
<tr>
<td>Average deposit rate (%)</td>
<td>6.58</td>
<td>6.81</td>
<td>-0.23</td>
</tr>
<tr>
<td>(percent)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deposit composition</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(percentage of deposits)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transaction</td>
<td>6.0</td>
<td>4.3</td>
<td>1.7</td>
</tr>
<tr>
<td>Savings</td>
<td>40.7</td>
<td>29.6</td>
<td>11.1</td>
</tr>
<tr>
<td>Small time</td>
<td>49.4</td>
<td>61.0</td>
<td>-11.6</td>
</tr>
<tr>
<td>Large time</td>
<td>3.9</td>
<td>5.1</td>
<td>-1.2</td>
</tr>
</tbody>
</table>

- Significant at the 90 percent level.
- Significant at the 5 percent level.
- Significant at the 1 percent level.
- Significant at the 0.1 percent level.

### Notes

1. Net interest margin is the average percentage yield on mortgage loans minus the average interest cost of deposits.
2. The ODGF institutions portrayed a more conservative asset structure and loan portfolio than their counterparts, as shown in table 2. For example, as a percentage of assets, the ex-ODGF institutions made fewer loans, which are traditionally riskier than deposits and investments, particularly investments in government securities.
3. The ex-ODGF institutions also took less credit risk by making more residual mortgage loans and fewer commercial mortgages and construction loans. Nonresidential real estate loans and construction loans collectively accounted for 9.2 percent of the loans held by the ex-ODGF thrifts, compared with 13.1 percent of the loans held by the other thrifts. In addition, other thrifts held a larger share of higher-yielding nonmortgage loans such as consumer installment and business loans.

- Higher earnings by ex-ODGF institutions resulted not from taking greater risk or generating higher revenue, but from having a wider, or more favorable, interest-rate spread than the other thrifts.
- ODGF thrifts held a much larger share of government securities than their counterparts.

**Conclusion**

We might expect to find the cost of money to be higher at the ex-ODGF institutions. Before interest-rate deregulation, one advantage of being an ODGF institution was that deposit rates were generally more aggressive and more vulnerable to market forces. Accordingly, many of the ex-ODGF institutions probably were merged with or acquired by other institutions after the moratorium.

In any case, we found that the ex-ODGF institutions were paying higher overall deposit rates than their counterparts during 1987. On the contrary, the average cost of money and deposits was significantly lower at the ex-ODGF institutions. For example, these institutions’ average interest cost for deposits was 6.58 percent, compared with an average interest cost of 6.81 percent for deposits of other thrifts.

This difference can be explained to a large degree by differences in deposit composition. The ex-ODGF institutions held a much larger share of deposits in lower-paying transaction and savings accounts than did other thrifts. These deposits collectively accounted for 67 percent of the total deposits held by the ex-ODGF institutions, compared with 34 percent of such deposits held by other thrifts. In contrast, the ex-ODGF institutions had significantly fewer paying time deposits, including large deposits with balances over $100,000 that are uninsured.

In addition to lower funding cost, the ex-ODGF institutions also had much lower nonoperating expenses. The total cost involved with allocating money for bad loans and with selling assets at losses was five times lower at the ex-ODGF institutions than at the other thrifts.

Total expenses would have been even lower at theex-ODGF institutions, but their operations were more costly than those at other thrifts. Higher salaries and other operating costs caused the ex-ODGF institutions
The 44 other ODGF institutions received approval for federal deposit insurance either from the Federal Deposit Insurance Corporation (FDIC) or from the Federal Savings and Loan Insurance Corporation (FSIC). Several of these institutions, including five of the ten ODGF institutions that became FDIC insured, were acquired or merged with other depository institutions since 1985. We examined the current financial condition of 26 surviving ODGF institutions that are operating today as FSIC-insured thrifts and are not subsidiaries of depository organizations. No doubt these thrifts came from the FDIC's cream of the crop and were probably in better financial shape than the typical Ohio thrift when they obtained federal deposit insurance. However, the ODGF crisis could have longer-term adverse effects on those institutions that were associated with the defunct insurance fund. If so, their current financial performance might be inferior to the performance of other federally insured thrifts in Ohio.

To minimize the potential impact of institutional size on thrift performance, we excluded from our analysis thrifts with deposits over $550 million, because the largest ex-ODGF institution had deposits of $556 million at year-end 1987. After this adjustment, we had 177 thrifts in our control group.

Performance was measured by capitalization and profitability using 1987 data. Performance differences were limited to variations in income and expenses, which in turn were related to differences in the composition of assets, loans, and deposits. For each of these measures, we calculated an average value for the ex-ODGF thrifts and for all other federally insured thrifts in Ohio of similar size. Using a simple statistical method, we then tested to see if the averages were significantly different. The average values for the two groups of thrifts and the differences between them are presented in tables 1 and 2.

**Performance**

The ex-ODGF thrifts clearly outperformed their counterparts, as shown in table 1. On average, the ex-ODGF institutions are much better capitalized, earn higher returns on assets, and have wider interest rate margins than other thrifts.

In 1985, the average net worth-to-asset ratio for FSIC-insured thrifts in Ohio stood at less than 5 percent. A few years before the ODGF crisis, federal thrift regulators had reduced the minimum capital guidelines for existing FSIC-insured thrifts from 6 percent of assets to 3 percent because of the financial plight of the thrift industry.

Although the FSIC and FDIC accelerated the procedure for ODGF institutions to qualify for federal deposit insurance, they did not reduce the thrifts' capital requirements. Like any other depository institution applying for federal deposit insurance, the ODGF thrifts had to have net worth equivalent to at least 6 percent of their assets. Consequently, the ODGF institutions that did qualify for federal deposit insurance were better capitalized than many other federally insured thrifts.

After becoming federally insured, the surviving ODGF institutions also significantly enhanced their net worth. At year-end 1987, they had an average net worth-to-asset ratio of 7.6 percent, compared to a 5.6 percent capital ratio for similar-sized thrifts.

The ex-ODGF thrifts earned 0.83 percent on average assets—nearly twice the level of their counterparts. These higher returns can be attributed largely to having a wider, or more favorable, spread between the cost of money and the interest earned on that money. As a percentage of assets, this spread, known as the net-interest margin, was 56 basis points higher at the ex-ODGF institutions than at the other thrifts.

**Behavior**

Despite higher earnings, the ex-ODGF institutions portrayed a more conservative asset structure and loan portfolio than their counterparts, as shown in table 2. For example, as a percentage of assets, the ex-ODGF institutions made fewer loans, which are traditionally riskier than deposits and investments, particularly investments in government securities.

- **Table 1: Thrift Performance**
  - **Earnings (percentage of average assets)**
    - Net income: 0.83 0.44 0.394
    - Net interest margin: 2.91 2.55 0.303
    - Net worth: 7.55 5.64 1.913
  - **Significant at the 90 percent level.
  - **Significant at the 95 percent level.
  - **Net worth is based on generally accepted accounting principles.

- **Table 2: Thrift Behavior**
  - **Net income**
    - Mortgage: 8.67 8.56 0.02
    - Loans: 8.74 8.77 0.03
  - **Expenses (percentage of average assets)**
    - Nonresidential mortgages: 6.8 9.5 2.79
    - Construction loans: 2.4 3.6 1.24
    - Nonmortgage loans: 3.8 5.2 1.4
    - Adjustable rate mortgages: 51.4 45.8 5.6
  - **Average deposit rate (percent)**
    - Money: 6.03 6.36 0.33
    - General and administrative: 2.05 2.45 0.4
    - Nonoperating: 0.10 0.51 0.41
  - **Net worth**
    - Money: 6.58 6.81 0.23
  - **Deposit composition (percentage of deposits)**
    - Money: 60 4.3 1.7
    - Savings: 40.7 29.6 11.1
    - Small time: 49.4 61.0 11.6
    - Large time: 39.5 51 1.2

- **Significant at the 90 percent level.
- **Significant at the 95 percent level.
- **Significant at the 90 percent level.

We might expect to find the cost of money to be higher at the ex-ODGF institutions. Before interest-rate deregulation, one advantage of being an ODGF institution was that deposit rate ceilings applied only to federally insured institutions. Prior to the moratorium, eight ODGF institutions were paying interest rates between 8 percent and 10 percent on passbook savings accounts. These rates were substantially above the maximum permitted rate of 5.5 percent for FSIC-insured institutions. Moreover, 33 of these institutions were paying at least 5.75 percent for savings deposits.

Although we do not have savings-rate data for individual institutions, we can infer that the higher-paying institutions were generally more aggressive and more vulnerable to financial distress. Accordingly, many of the ODGF institutions probably were merged or acquired by other institutions after the moratorium.

In any case, we found that the ex-ODGF institutions were not paying higher overall deposit rates than their counterparts during 1987. On the contrary, the average cost of money and deposits was significantly lower at the ex-ODGF institutions.

- **Examples**: For example, these institutions' average interest cost for deposits was 6.58 percent, compared with an average interest cost of 6.81 percent for deposits of other thrifts.

This differentiation can be explained to a large degree by differences in deposit composition. The ex-ODGF institutions held a much larger share of deposits in lower-paying transaction and savings accounts than did other thrifts. These deposits collectively accounted for 67 percent of the total deposits held by the ex-ODGF institutions, compared with 34 percent of such deposits held by other thrifts. In contrast, the ex-ODGF institutions had significantly fewer higher-paying time deposits, including large deposits with balances over $100,000 that are uninsured.

In addition to lower funding cost, the ex-ODGF institutions also had much lower nonoperating expenses. The total cost of nonoperating expenses for ex-ODGF thrifts was 1.7 percent lower than for other thrifts. Higher salaries and other operating costs caused the ex-ODGF institutions...
How Are the Ex-ODGF Thrifts Doing?

by Paul R. Watro

Not long ago, excessive deposit withdrawals caused a moratorium on privately insured thrifts (savings and loan associations) in Ohio. On March 15, 1985, Governor Celebrezze closed all 70 state-chartered savings and loan associations insured by the Ohio Deposit Guarantee Fund (ODGF), a private insurance fund. ODGF was funded by deposits from member institutions, consisting mostly of small and conservatively managed thrifts with assets under $50 million. The collapse of ODGF’s largest member, Home State Savings Bank of Cincinnati (with assets of more than $1.4 billion), bankrupted the fund and led to large and increasing deposit withdrawals at many other ODGF institutions. Eight federal deposit insured institutions were closed for five days to stop deposit runs. This action also gave time for state and federal officials to assess the severity of the situation and for state legislators to pass emergency legislation dealing with the crisis.

The closed institutions were allowed to reopen on a case-by-case basis depending on their financial condition. Deposit withdrawals, however, were limited until these institutions qualified for federal deposit insurance. To protect deposits, the state offered financial assistance for organizations to purchase financially troubled ODGF institutions. It also authorized out-of-state depository institutions to acquire these thrifts and to operate them either as thrifts or as commercial banks.

Contrary to common belief, the crisis did not seriously impact the financial health and performance of all 70 ODGF thrifts. Those that were better managed and more capitalized obtained federal deposit insurance and resumed operations as independent depository institutions.

In this Economic Commentary, we discuss briefly what happened to the ODGF thrifts. We then examine the current financial condition of the surviving ODGF thrifts by comparing their performance to the performance of other similar-sized thrifts in Ohio.

Survivors

Within two weeks of the moratorium, state and federal examiners determined that 26 ODGF institutions would qualify for federal deposit insurance with minor adjustments. These thrifts were fundamentally sound and could have viable futures. In contrast, 18 ODGF institutions were initially insolvent, that is, their liabilities were greater than their assets.

The remaining 26 thrifts were solvent according to generally accepted accounting principles but lacked sufficient capital to qualify immediately for federal deposit insurance. By April 1986, all ODGF institutions were fully open for business either as independent depository institutions or as offices of subsidiaries of larger depository organizations. Twenty-six institutions, including Home State Savings Bank, were merged into or acquired by other federally insured institutions and ceased to exist as independent thrift institutions. Two major acquirers were Chase Manhattan Corporation of New York and Home Savings of America, Los Angeles.