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Statement by

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President, Federal Reserve Bank of Cleveland

before the

Subcommittee on Commerce, Consumer, and Monetary Affairs

of the

Committee on Government Operations

U.S. House of Representatives

April 3, 1985

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I am pleased to appear before the Commerce, Consumer, and Monetary Affairs Subcommittee to discuss the Federal Reserve's response to the recent problems experienced by thrifts insured by the Ohio Deposit Guarantee Fund. This morning I will be reviewing for you the response of the Federal Reserve Bank of Cleveland. Attached to my statement is a chronology that sets forth the Federal Reserve System's response to recent events in Ohio.

I would like to begin by stating that the role of the Federal Reserve Bank of Cleveland throughout this period has been to assist the State of Ohio and other Federal regulators in fashioning a solution. Our initial involvement was to insure that we could act quickly to provide liquidity assistance at the discount window and to make currency shipments -- first to Home State and subsequently to other institutions insured by the Ohio Deposit Guarantee Fund (ODGF). We have acted at the request of the State of Ohio, and throughout this period the Federal Reserve Bank of Cleveland and the Federal Home Loan Bank (FHLB) of Cincinnati have shared information and staff in a cooperative effort to deal with the problems and to fashion solutions. I would also like to recognize the substantial and supportive role of the correspondent banks in Cincinnati. I believe the Federal Reserve has been helpful, and we will continue to assist the State of Ohio and other Federal regulators until the problem is solved.

The Federal Reserve Bank of Cleveland first became aware of possible financial difficulties at Home State Savings Bank of Cincinnati, Ohio on March 4, 1985, when an official of Home State telephoned the Federal Reserve Bank of Cleveland to inquire about the procedures Home State should follow if it needed to borrow at the discount window. The Federal Reserve Bank of Cleveland did not have any financial information on Home

State. It is a state-chartered savings and loan association, regulated and examined by the Ohio Division of Savings and Loan Associations, and prior to this time it had never borrowed at the discount window. We did know that Home State's deposits were insured by the ODGF, but we did not have access to any financial reports on Home State. On March 5, the press reported that Home State might suffer a large loss in connection with the failure of E.S.M. Government Securities, Inc. (E.S.M.), a Florida-based broker-dealer in government securities. The Federal Reserve began an effort to gather information on Home State's situation. Discussions with the FHLB of Cincinnati confirmed that Home State was not a member of the FHLB and that the FHLB also had little financial information on Home State.

Reports from Cincinnati on Wednesday, March 6, indicated a large volume of depositor withdrawals at Home State. On that same day, Federal Reserve examiners entered Home State to examine available collateral in the event that it became necessary for Home State to borrow at the discount window. Depositor withdrawals on Wednesday and Thursday were funded with Home State's own liquidity and lending by the ODGF. The withdrawals on March 6 totaled \$55 million. On March 7, a meeting was held at the Cincinnati Branch of the Federal Reserve Bank of Cleveland with representatives from the State of Ohio, ODGF, and Home State to discuss liquidity assistance for Home State from the Federal Reserve Bank of Cleveland. Based on collateral judged to be acceptable by the Federal Reserve Bank, credit was extended on Friday, March 8, and arrangements were put in place to extend further credit. Depositor withdrawals had continued on March 7 and 8, reaching approximately \$100 million for those two days. On Saturday, March 9, Home State did not open for business.

Governor Celeste appointed a conservator for Home State and announced on Sunday night, March 10, that Home State would not reopen for business on Monday.

Although the problems at Home State were triggered by unique events growing out of its transactions with E.S.M., the severity of the public reaction made us concerned about possible deposit withdrawals at other ODGF insured institutions. As I mentioned earlier, deposits at Home State were insured by the ODGF, a private fund that also insured 70 other State-chartered thrift institutions in Ohio. According to State officials, the insurance fund had assets of about \$130 million prior to the run on Home State. Uncertainty regarding other ODGF insured institutions was increased by reports on the use of ODGF funds to deal with Home State's heavy deposit withdrawals. Financial information on all ODGF insured institutions was made available to the Federal Reserve Bank of Cleveland late Friday, March 8. Federal Reserve examiners and discount window staff reviewed and analyzed this information on Saturday and Sunday, March 9 and 10, with the assistance of senior examination personnel from the FHLB of Cincinnati.

Growing concern that other ODGF institutions might confront problems on Monday led us on Saturday, March 9, to develop a plan to monitor and deal with deposit withdrawals at other ODGF institutions, should they occur. The plan had several dimensions: 1) having a timely and effective mechanism for sensing unusually heavy deposit withdrawals; 2) informing ODGF institutions of collateral and other requirements for borrowing at the discount window; and 3) planning and putting into place the logistics necessary to deliver currency, evaluate collateral, and obtain documents for borrowing at the discount window. The large number of ODGF

institutions and the need for prompt and effective action, if action were required, made it imperative that we be prepared to deal with the problem by Monday, March 11, when the ODGF institutions opened. We were fortunate in being able to draw upon staff from other Federal Reserve Banks to assist in the contingency planning and logistics. The weekend planning effort concluded with meetings at 10:00 p.m. on Sunday, March 10, in both Cleveland and Cincinnati to brief Federal Reserve examiners on their role in the contingency plans. These plans called for examiners to be strategically placed near ODGF institutions throughout the State prepared to deliver borrowing documents upon request.

Also, late Sunday evening, March 10, following the Governor's announcement that Home State would not reopen on Monday, the Cleveland Federal Reserve Bank publicly restated its discount window policy: "State-chartered savings and loans and savings banks, like all depository institutions, are eligible for liquidity assistance through the discount window...under normal terms and conditions." Our weekend efforts had made it possible to implement the policy, to monitor deposit flows, to lend at the discount window, and to ship cash throughout the weeks that followed to a large number of institutions, most of which had not dealt with our discount window and which normally received their currency from other sources.

Public confidence in ODGF institutions continued to decline. As financial institutions opened on Monday, March 11, the evidence of the loss in depositors' confidence was almost immediate. At first the loss of confidence was largely confined to Cincinnati, where Home State is located. As the week progressed, the number of ODGF institutions suffering heavy cash drains increased, and the volume of withdrawals rose

sharply. On Thursday, March 14, for example, the seven most affected institutions in the Cincinnati area lost more than \$60 million in deposits -- almost triple the amount withdrawn on Wednesday. Several institutions had lost one-fifth of their deposits between Monday morning and Thursday night, and there was clear evidence that the crisis was spreading to ODGF insured institutions in other cities. The more public confidence fell, the more serious the problem became. Federal Reserve examiners were sent upon request to many institutions to begin reviewing collateral as deposit withdrawals and the potential for borrowing at the discount window increased. The Federal Reserve and other commercial banks shipped currency to institutions that were experiencing heavy withdrawals, but cash alone was not enough to restore confidence; without confidence even the strongest financial institution can be severely impacted.

Our active and visible role was to provide liquidity assistance to ODGF institutions at the discount window. In performing this function, the Federal Reserve Bank of Cleveland has not modified the normal eligibility requirements for discount window assistance in any way. The Monetary Control Act of 1980 made the discount window of the Federal Reserve Bank available to any depository institution that holds transactions accounts or nonpersonal time deposits. Regulation A of the Board of Governors, which prescribes standards for the operation of the discount window, provides for lending to eligible depository institutions under two basic programs. One is the adjustment credit program; the other supplies credit for seasonal and other limited purposes for more extended periods. Adjustment credit is available on a short-term basis to assist

borrowers in meeting temporary requirements for funds while an orderly adjustment is being made in their assets and deposit liabilities.

All Federal Reserve advances must be secured to the satisfaction of the Reserve Bank providing the credit. Satisfactory collateral includes securities of the U.S. government and of federal agencies, and, if of acceptable quality, residential mortgage notes and other assets.

Although collateral is generally held in safekeeping at the Federal Reserve Banks or acceptable third-party custodians, in this instance, field warehouses were set up in most ODGF institutions where collateral was identified, evaluated, and earmarked for possible use in securing discount window borrowings.

The Federal Reserve played another very important role during the ODGF savings and loan problem -- we served as a facilitator. During the early morning hours of Friday, March 15, when the full dimensions of the problem became clear, Governor Celeste decided to close all ODGF member institutions for a three-day period. Following that decision, the Governor requested that the Federal Reserve assist him in calling a meeting of large Ohio banking and thrift institutions to discuss the situation with them and propose a solution to the problem. A meeting with representatives of thirteen Ohio depository institutions -- banks and S&Ls -- was convened that morning at the Federal Reserve Bank of Cleveland. At that meeting Governor Celeste explained his decision to close the ODGF institutions and discussed a legislative proposal that would require the ODGF institutions to obtain federal insurance before reopening. He also presented a proposal for dealing with the ODGF institutions that would not qualify for federal insurance. The State subsequently decided it would be useful to discuss the situation with

out-of-state banks, and two meetings were held with out-of-state institutions at the Federal Reserve Bank of Cleveland--one on Saturday, March 16, at 9:00 p.m. and another on Sunday, March 17, at 11:00 a.m.

In the past two weeks, some elements of a solution have fallen into place. Each ODGF institution was examined on a case-by-case basis to determine its financial condition and the likelihood of its qualifying for federal insurance. The State Superintendent of Savings and Loan Associations requested assistance from the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and the Ohio Division of Banks in conducting these examinations. This process began on Saturday, March 16, with examiners provided by the Federal Reserve Bank of Cleveland and, eventually, by every other Federal Reserve Bank. Examiners were assigned to each of the ODGF institutions. Virtually all examinations were completed on Sunday, March 17, enabling us to conduct a preliminary review of the condition of each institution to supplement and update the information obtained the previous Friday from the State. The results of the preliminary examinations made it clear that a large number of these institutions were well-managed, in sound financial condition, and, consequently, viable candidates for federal deposit insurance. Others, for a variety of reasons, would have difficulty qualifying for federal deposit insurance. The FHLB Board agreed to review on an expedited basis the Federal Savings and Loan Insurance Corporation (FSLIC) insurance applications of ODGF member institutions. Under this arrangement, FSLIC qualification examinations were expedited, using the resources of the FHLB System and the Federal Reserve. The Federal Reserve offered its assistance to help complete the FSLIC examinations as rapidly as possible. We believed we could facilitate this process because our

examiners were already in place at the ODGF institutions and had gained familiarity with these institutions through the just completed examinations conducted on March 16 and 17.

As of Friday, March 29, according to the State of Ohio, 26 of the former ODGF institutions have been reopened for the full range of banking functions, most with federal insurance. Confidence in these institutions seems to have been fully restored. There has been no evidence of unusual withdrawals or need for assistance through either the credit facilities of the FHLB of Cincinnati or the Federal Reserve discount window. The federal deposit insurance applications of some ODGF institutions are still being considered. Other ODGF institutions have been informed of the changes and improvements that will be necessary to enable them to obtain federal insurance.

The State of Ohio is making intense efforts to develop an orderly plan for those institutions that might not qualify for federal insurance. It is my understanding that a final outline of such a plan is not yet complete. A solution may have to involve the sale of some ODGF institutions to other Ohio financial institutions and, perhaps, also to out-of-state institutions. The Federal Reserve Bank of Cleveland has not participated in the discussions involving plans for any single institution except those for which Federal Reserve regulatory approval was required, such as the sale of Metropolitan Savings Bank of Youngstown to FNB Corporation, a Pennsylvania bank holding company, and the conversion of Scioto Savings Association into a state-chartered FDIC insured commercial bank under the continuing ownership of its parent company, Society Corporation, an Ohio bank holding company.

While this process is underway, the State has authorized the ODGF institutions not yet qualified to reopen for full business to open for the limited purposes of giving each depositor access to a maximum of \$750 per month and pledging assets to and borrowing from correspondent banks or the Federal Reserve discount window to fund the limited deposit withdrawals. Complete confidence in the ODGF institutions has not been restored, but the atmosphere is much calmer than it was two weeks ago.

## CHRONOLOGY OF FEDERAL RESERVE RESPONSE TO OHIO S & L SITUATION

(\* indicates events not part of the Federal Reserve response but which are important to that day's chronology.)

### Monday, March 4

\* A receiver is appointed for ESM at the request of the S.E.C.

The Cleveland Reserve Bank's Loan and Discount Department receives what appears to be a routine telephone call from Home State inquiring whether its borrowing documents were in order.

### Tuesday, March 5

Cleveland Reserve Bank makes initial inquiries about Home State to the Federal Home Loan Bank of Cincinnati ("FHLB Cincinnati") and the Ohio Deposit Guarantee Fund ("ODGF").

Home State's correspondent bank meets with Cincinnati branch of the Cleveland Reserve Bank ("Cincinnati branch") to discuss Home State situation.

Cincinnati branch makes arrangements for emergency cash shipments to Home State.

### Wednesday, March 6

Cleveland Reserve Bank sends examination personnel to Home State and they begin to review collateral.

Home State has estimated deposit outflows of \$55 million.

Cincinnati branch makes 39 special cash shipments to various Home State offices.

### Thursday, March 7

Meeting at Cincinnati branch is held with representatives of the State, ODGF, Home State, and the Cleveland Reserve Bank to discuss possible discount window loan. Examiners continue reviewing collateral.

Governor Richard Celeste telephones President Karen Horn to discuss Home State matter and to learn what assistance might be available from Federal Reserve.

Cincinnati branch makes 59 special cash shipments to various Home State offices.

Home State has estimated deposit outflows of \$45 million.

### Friday, March 8

Home State's liquidity position declines throughout the day. Cleveland Reserve Bank monitors the situation with Home State's correspondent bank. Frequent discussions are held by Federal Reserve officials in Cincinnati, Cleveland, and Washington regarding liquidity needs of Home State.

A Cleveland Reserve Bank official attends a meeting in Columbus called by the Superintendent to discuss possible solutions to Home State situation.

Friday, March 8 (Continued)

In late afternoon, Home State directors sign a note to borrow from the Cleveland Reserve Bank. Collateral is segregated by examiners and shipped to the Cincinnati branch. At 4:00 p.m., a discount window loan is made to Home State.

Cincinnati branch makes 76 separate cash shipments to various Home State offices.

Home State has estimated deposit outflows of \$54.2 million.

At the Cleveland Reserve Bank's request, the Superintendent agrees to provide financial information for all ODGF institutions in anticipation of borrowing requests from these institutions.

\* In late evening, Home State management announces that Home State will be closed on Saturday.

Saturday, March 9

Concerned about the potential spillover effects of the Home State closing, Cleveland Reserve Bank officials begin internal logistical planning for possible cash deliveries and borrowing arrangements for other ODGF institutions.

Cleveland Reserve Bank examination personnel begin analyzing the financial data of all ODGF member institutions for possible borrowings at the discount window. Three representatives from the FHLB Cincinnati assist in this process.

\* A conservator, Arlo Smith, is appointed by Governor Celeste to direct the affairs of Home State.

The Superintendent convenes a meeting at a Cleveland bank at 6:00 p.m. with several large bank holding companies in Ohio to discuss the proposed sale of Home State. Representatives from the Federal Reserve are in attendance as observers.

Sunday, March 10

\* Governor Celeste announces that Home State will not open on Monday.

Cleveland Reserve Bank issues a statement to the press indicating that state-chartered savings and loans, like all depository institutions, are eligible for liquidity assistance through the discount window under normal terms and conditions.

At the Cleveland Reserve Bank, contingency planning continues and officials from other Reserve Banks arrive to assist.

Monday, March 11

Cleveland Reserve Bank examiners are placed strategically throughout the state and are prepared to deliver borrowing documents to any ODGF institution that requests such information.

Cincinnati Branch officials discuss the Home State situation with local banks.

Estimated net deposit outflows of \$6.0 million at ODGF institutions.

Tuesday, March 12

Conservator Smith repays loan from Cleveland Reserve Bank.

Activity at ODFG institutions remains relatively calm. Estimated net deposit outflows for the day approximate \$13.4 million at ODFG institutions. Borrowing documents are delivered by Cleveland Reserve Bank examiners upon request.

Wednesday, March 13

Estimated net deposit outflows for the day of \$23.4 million at ODFG institutions.

Officials from four ODFG institutions experiencing heavy deposit withdrawals go to Washington, D.C., to meet with members of Congress and officials of the Federal Reserve and the FHLBB.

Several meetings are held at the Cincinnati Branch with individual institutions to discuss borrowing documents.

Thursday, March 14

Major runs occur at six ODFG institutions and cash shipments to these institutions accelerate.

Estimated net deposit outflows of all open ODFG institutions for day approximate \$63.9 million.

Seven special cash shipments to five different ODFG institutions by the Cleveland Reserve Bank.

Friday, March 15

At 7:30 a.m. in Cincinnati, Governor Celeste holds a press conference to declare a three-day holiday for the ODFG institutions. President Horn indicates that the Cleveland Reserve Bank stands ready to supply liquidity through the discount window under normal conditions when the institutions reopen.

At 11:45 a.m., a meeting at the Cleveland Reserve Bank is convened at the request of the Governor with representatives of 13 Ohio financial institutions. The Governor requests the institutions to join together to develop a rescue package for those ODFG institutions that would not qualify for federal insurance.

Fifteen special cash shipments are made to 12 institutions.

Saturday, March 16

At 9:00 a.m., a second meeting is held at the Cleveland Reserve Bank with the Ohio financial institutions.

The State also requests Federal Reserve assistance in discussing this situation with out-of-state financial institutions. Two meetings with out-of-state institutions are then scheduled at the Cleveland Reserve Bank--one on Saturday night at 9:00 p.m. and another for Sunday at 11:00 a.m. Representatives from the State requested out-of-state banks to consider acquiring some or all of those ODFG institutions that would not qualify for federal insurance.

Saturday, March 16 (Continued)

Examiners are present at every ODGF institution to review collateral. Examiners from other Reserve Banks arrive to assist. The Superintendent of Savings and Loan Associations requests the Federal Reserve, the FDIC, and the Ohio Division of Banks to assist in learning the current financial condition of all the ODGF institutions. Examinations are then commenced for this purpose.

Fifteen special cash shipments are made to 11 ODGF institutions.

Sunday, March 17

A meeting is held at 11:00 a.m. at the Cleveland Reserve Bank with a second group of eleven out-of-state bank holding companies. (This meeting is also attended by some representatives from the previous meeting.)

Examinations conducted at the State's request are concluded at virtually all ODGF institutions by examiners from the Federal Reserve. Summary results from these examinations are compiled and reviewed.

Monday, March 18

\* Governor Celeste signs an executive order requiring ODGF institutions to remain closed for an additional 48 hours.

Examiners insure execution of borrowing documents and control of adequate collateral for all ODGF institutions.

An evening meeting is held at the Cleveland Reserve Bank with officials from the Federal Home Loan Bank System to discuss possible assistance by the Federal Reserve with FSLIC qualification insurance examinations for ODGF institutions.

Eight special cash shipments are made to 7 institutions.

Tuesday, March 19

A second meeting is held at the Cleveland Reserve Bank with officials from the Federal Home Loan Bank System. The Federal Home Loan Bank Board officials accept an offer from the Federal Reserve to assist in qualification examinations.

Governor Celeste meets separately in Washington, D.C., with Chairman Volcker and Chairman Gray. Governor Celeste is assured of expedited processing by FHLBB of FSLIC insurance applications.

As provided in the Cleveland Reserve Bank's check collection operating letter, the Bank sends notice and begins returning checks drawn on the closed ODGF institutions with the stamp "not presentable at this time."

FSLIC qualification examinations begin at ODGF institutions with the assistance of Federal Reserve examiners already present at these institutions.

Two special cash shipments are made to 2 institutions.

Wednesday, March 20

\* The State of Ohio legislature approves legislation requiring federal insurance and permitting partial withdrawals (\$750 per depositor each 30 day period) for ODGF institutions.

Wednesday, March 20 (Continued)

The availability of discount window assistance to reopened ODGF institutions was restated by Chairman Volcker.

Two special cash shipments are made to 2 institutions.

Thursday, March 21

The conversion of Scioto Savings Association into a commercial bank is approved by the State of Ohio, the FDIC, and the Board of Governors of the Federal Reserve System.

Friday, March 22

A task force is established in Columbus at the office of the Superintendent of Savings and Loan Associations to coordinate communications between the Superintendent, Cleveland Reserve Bank, and the FHLB-Cincinnati.

An application by F.N.B. Corporation in Hermitage, Pa., to acquire Metropolitan Savings Bank in Youngstown, Ohio, is processed and approved on an emergency basis by the Board of Governors of the Federal Reserve System.

Saturday, March 23

As ODGF institutions reopen for limited withdrawal purposes, cash demands are placed on the Cleveland Federal Reserve Bank.

FSLIC qualification examinations continue. In addition, Federal Reserve examiners continue their presence in ODGF institutions to monitor cash situations, and to secure collateral for borrowings where necessary. Staff remains on duty at the Cleveland Reserve Bank to provide assistance and discount window borrowings, answering questions regarding check collection and manage the large numbers of examiners from outside the Fourth Federal Reserve District.

Seven special cash shipments are made to 4 institutions.

Estimated net deposit outflows (aggregate) - \$5.4 million.

Sunday, March 24

FSLIC qualification examinations continue.

Monday, March 25

The Cleveland Reserve Bank issues notice that it is presenting checks to those institutions that are fully open.

Six special cash shipments are made to 5 institutions.

Estimated net deposit outflows (aggregate) - \$7.7 million.

Tuesday, March 26

Eighteen institutions are now open on a full-service basis. Liquidity and cash situations in these institutions continue to be monitored by Federal Reserve examiners in the field as well as the Cleveland Reserve Bank staff in Cleveland, Cincinnati, and Columbus.

Tuesday, March 26 (Continued)

Five special cash shipments to 2 institutions.

Estimated net deposit outflows (aggregate) - \$3.9 million.

Wednesday, March 27

Six special cash shipments to 4 institutions.

Estimated net deposit outflows (aggregate) - \$2.9 million.

Thursday, March 28

One special cash shipment.

Estimated net deposit outflows (aggregate) - \$4.4 million.

Friday, March 29

Twenty-six institutions are now open on a full-service basis.

FSLIC qualification examinations continue.

Three special cash shipments to 3 institutions.

Estimated net deposit outflows (aggregate) - \$2.8 million.

Saturday, March 30

Estimated net deposit outflows (aggregate) - \$1.3 million.