

FEDERAL HOME LOAN BANK BOARD

JOURNAL



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Conditioning for Regulatory Teamwork

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"You can tell people 'yes' or you can tell them 'no.' But you don't tell them 'we're looking into it' and keep telling them that for two years."
 —page 4



Page 6
**Dochow:
 Regulation Is Alive and Well**
 by Marc Adams

Conditioning for safety and soundness means that national policy is applied locally. Closer supervision, faster response, and better teamwork among the district banks are part of the plan

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Page 10
**Strategic Gridlock Spells
 Opportunity**
 by Erich W. Sippel

Many institutions will suffer as the forces of continuity meet the agents of change. Others will overcome their rigidities to outpace the competition

Page 15
How Deposit Insurance Went Awry
 by James R. Barth, Michael G. Bradley,
 and John J. Feid

The guarantee that all insured depositors will be fully protected generates problems not found with private insurance

Page 20
**Gramm: Full Faith
 and Credit Is a Fact**
 by DuPre Jones

The senator from Texas explains why the United States stands behind the obligations of the Federal Savings and Loan Insurance Corporation

.....
Buying and Selling Servicing
 Page 23

Buying Calls for Diligence
 by James T. Szymanski

Income will follow despite market fluctuations and rising interest rates

Page 24
Servicing Sellers Check Options
 by Michael K. Stamper

Sales proceeds are considered income on financial statements, whereas servicing income must be amortized

Page 26
**Freddie Mac Looks at Servicing
 Ability**
 by James Crum

Good servicers are reputable managers who improve troubled portfolios. They also show concern for the mortgage

.....

Scheduled Items	2
Letters to the Regulator	3
Prominent People	4
Turning Points	5
Statistical Series	insert
Out in Print	28
Regulatory Review.....	29
Enforcement Remedies.....	31
Followup Commentary.....	31

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Scheduled Items

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March 23, 1989

This is the last day for comments on the Bank Board's risk-based capital requirements proposal, which addresses two major issues: how much capital should be required for thrift institutions, and what should count as capital for thrifts. Like the rule previously proposed for commercial banks, the capital requirement would advance the effort of the Bank Board to distinguish among different risks. For example, thrifts without large amounts of collateralized borrowings would have a total capital requirement that, on average, is expected to equal 8 percent of risk-weighted assets. This requirement may be more or less stringent for a thrift than the present capital requirement, depending on the credit and interest rate risk in the institution's portfolio.

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March 31, 1989

Loan originations and purchases of mortgage and home improvement loans should be reported for the first time by certain thrift units if they have assets in excess of \$10 million and have an office in a metropolitan statistical area. The units include mortgage banking subsidiaries of thrift holding companies and thrift service corporations that are not majority-owned, which must report mortgage loans made on or after August 19, 1988. The new reporting requirement arises from amendments to the Home Mortgage Disclosure Act, which are implemented by a revised Regulation C adopted by the Board of Governors of the Federal Reserve System.

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April 1989

The Federal Home Loan Bank Board will compute and publish the so-called

April calculation of 1988 median return on assets of FSLIC-insured institutions. Institutions with liability-to-capital ratios of 3 percent or more—the standard group—will have to increase their ratios by 75 percent of the April calculation; those with liability-to-capital ratios of less than 3 percent—the lower group—will have to increase their ratios by 90 percent of the April calculation.

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April 16, 1989

The current regulation governing direct investment for FSLIC-insured savings institutions will expire. The rule, adopted by the Federal Home Loan Bank Board in 1987, sets limits within which federally insured thrifts may invest in equity securities, real estate, service corporations, and operating subsidiaries without prior review or approval from their principal supervisory agent.

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April 19-20, 1989

The Federal Savings and Loan Advisory Council (FSLAC) will hold its 133rd meeting in Washington, D.C. The 51-member council's four subcommittees—industry, legal issues, emerging issues, and investment banking—will meet in separate sessions, followed by a general session of the entire group. At its December meeting, the council discussed, among other items, the future role of thrifts as providers of housing credit; alternate plans for dealing with the caseload of insolvent institutions; how much public confidence in FSLIC has been lost because of publicity about insolvencies; the need for corporate governance regulations; and the amount of over-the-counter subordinated debt being issued by thrifts.

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May 31, 1989

This is the last day that the U.S. Department of the Treasury will send checks to financial institutions under its direct deposit program. Since the program began 10 years ago, institutions that wanted to participate but were unable to receive electronically transmitted funds

have been receiving Treasury checks for account holders desiring direct deposit. On June 1, 1989, institutions can receive government payments only via automated clearing houses (ACHs). Virtually all institutions in the direct deposit program now have an ACH connection.

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June 30, 1989

As of this date, a thrift institution may be considered a nonthrift by having less than 60 percent of its assets in mortgages and mortgage-related investments. Institutions that drop below the qualified thrift lender threshold will be able to receive only limited advances from federal home loan banks, and unitary thrift holding companies that are not qualified thrift lenders must refrain from engaging in certain activities.

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June 30, 1989

Maturity and yield/cost information—Section H of the thrift financial report—will be revised for the quarter ending this date. The first substantive revisions to this report section since its inception in 1984 are: addition of a three-months-or-less maturity column; segregation of nonperforming loans; division of first mortgage loans into fixed and adjustable; addition of loans serviced for others; division of investment securities into simple and complex varieties; disaggregation of hedging activities; and addition of noninterest-bearing deposits. Most of the changes to the Section H report reflect the growing complexity of financial instruments in the capital market.

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August 10, 1989

The moratorium on thrift exits from the Federal Savings and Loan Insurance Corporation will end—unless Congress extends it for a second time. The law prohibiting federally insured thrifts from dropping FSLIC insurance coverage in favor of coverage by the Federal Deposit Insurance Corporation was initially imposed by the Competitive Equality Banking Act of 1987. ♦

Letters to the Regulator

.....

Predation From Out of State

Recently, the Federal Savings and Loan Insurance Corporation (FSLIC) sold one of our local thrifts to a thrift that operates in two other states. The latter bought only the troubled institution's deposits and office space, not its loans. Furthermore, the acquiring thrift has indicated that it does not intend to lend in this state. This means that the acquirer has literally taken \$1 billion out of this state's already suffering economy—and the figure should grow.

The acquirer does not, as it does here, face restrictive usury laws in the other states where it does business. It can make consumer loans, home improvement loans, and second mortgages in its other-state locations at much higher rates than it could here. As a result, it can also afford to pay substantially higher rates for deposits than any other institution in this state.

In trying to solve one thrift's problem, FSLIC has created a situation that could be many times worse by forcing local institutions to compete at an unfair disadvantage. Unless something is done to remedy the problem, our state can only get poorer.

All savings institutions are subject to the Community Reinvestment Act, whereby the board of directors of every institution must adopt a statement of commitment to every community served. Thus, the law requires insured institutions to help meet the credit needs of their local communities.

The acquirer's branch network comprises more than 30 deposit offices and

1 lending office in more than 20 cities and towns in your state. Given this widespread presence, a large part of the state is being served by the acquirer under a Community Reinvestment Act statement.

Part of FSLIC's financial assistance to the acquirer was a note balancing the assets and liabilities of the acquirer. The note has a three-year term, with principal due in varying installment periods. The Federal Home Loan Bank System's examination staff will monitor the acquirer's performance to ensure that it abides by the Community Reinvestment Act.

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Nigerian Crime Network

Within the past 10 years, sophisticated organized crime against financial institutions has become a major problem. One of the worst offenders is the "Nigerian crime network." With major operations in New York City, Houston, and Los Angeles, this network also victimizes institutions in

Members of the crime network have become especially adept at bank, credit card, insurance, and entitlement fraud

Atlanta, New Orleans, Washington, and Baltimore.

Members of the Nigerian crime network have become especially adept at bank, credit card, insurance, and entitlement fraud. The gang is aided by effective intelligence operatives inside financial institutions and government agencies. With information gathered from these sources, forged documents, and a keen understanding of how an institution works, especially the rules created to protect consumers, the Nigerian network poses a far greater threat to financial institutions than the armed robbers of yesteryear.

The advent of the Expedited Funds Availability Act has exacerbated the situation. We asked regulators to avoid unwittingly and unnecessarily providing a game plane for those who would use the new rules to hide fraud and scams. No matter how carefully drawn, however, the new rules restrict the ability of financial institutions to impose holds. Therefore, the opportunities for those bent on defrauding institutions have ineluctably increased.

Two recommendations of the U.S. House of Representatives' permanent subcommittee on investigations should be acted on immediately. They are the creation of a central data base and the involvement of the U.S. Department of Justice, particularly the Federal Bureau of Investigation. The data base is essential to stopping the Nigerians, whose mobility and multiple identities seem to keep authorities a step behind them. The Immigration and Naturalization Service has begun such an effort, and private banking groups have increased their sharing of information, but greater amounts and coordination of data are required.

We at the Bank Board appreciate very much your informing us of these new patterns in organized crime. Too often, the thrift industry has been the victim of the fraud of both insiders and outsiders.

In 1985, the bank fraud working group was formed; since then, the Bank Board has worked closely with the U.S. Department of Justice and the Federal Bureau of Investigation in promoting the investigation and prosecution of those preying on the industry. I have directed that the information you have so thoughtfully brought to our attention be communicated to Justice through the working group. ◊

Letters and responses are edited, and the identities of the authors are kept confidential. Some letters have been directed to the Federal Home Loan Bank Board by the offices of other public officials.

Prominent People

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Taylor Takes Heat As FSLIC Referee

Throughout the mid-1980s, when thrift failures were beginning to peak, thousands of attorneys, brokers, and angry investors regularly called officials of the Federal Home Loan Bank Board and the Federal Savings and Loan Insurance Corporation to expound on the many things that bothered them.

But during the past 10 months or so, executives' phones have stopped ringing. The confused, the curious, and the malcontent now have Stillman K. Taylor Jr. to kick around.

In March 1988, Taylor was named ombudsman of the Federal Savings and Loan Insurance Corporation (FSLIC), a newly created position designed to screen and resolve questions and complaints. Since then, Taylor and his staff have managed to cool tempers throughout the industry by untying knots in the FSLIC bureaucracy.

"You can tell people 'yes' or you can tell them 'no,'" Taylor said. "But you don't tell them 'we're looking into it' and keep telling them that for two years. People don't deserve to be strung along."

The ombudsman's office was proposed by FSLIC Executive Director Stuart D. Root and Bank Board Executive Director James E. Boland Jr. because, as thrift failures mounted and rescue operations became more complex, complaints and inquiries soared. Legitimate complaints, as well as important contacts, were falling through the cracks—a problem that was intensified by a rash of negative publicity.

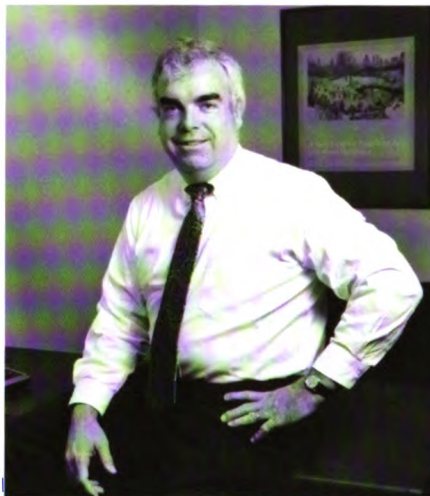
The idea was to bolster FSLIC's image as a responsive agency, and to relieve the Bank Board's Office of Communications, the traditional dumping ground for inquiries that other departments were

unwilling or unable to handle. Usually, by the time the complaint was plugged into the proper channel, the caller was boiling.

"It's really cut down on calls to senior management," said Mary Creedon, FSLIC's deputy director for operations, who helped develop the ombudsman position.

"Someone would call and say, 'I sold eight reams of paper to an institution that was just liquidated. Am I going to get paid?'" Creedon said. "By the time that call reached my level, the caller had been referred eight times, and would say, 'You people really have a messed up organization.'"

Now, such calls are referred to Taylor, a convivial, thick-set man who believes



that he was built for public service.

"Basically, I'm a computer person by trade," Taylor said. "In that respect, I've always been a problem-solver. And in terms of dealing with the public, you're either a helper, or you're not. I was born to help people. If the money weren't so bad in education, I'd probably be teaching third grade."

In prior positions as the Bank Board's chief of administrative systems and, subsequently, as deputy director of administrative services, responsible primarily for computer systems, contracting, and payroll, Taylor had gained a reputation as the Bank Board's resident trouble shooter. He also had helped establish the Bank Board's child care center, compiled the Bank Board's "flex-time" study to accommodate part-time employees, and served

on the federal women's programs committee.

"The computer background, with a step-to-step flow approach to problems, is really applicable to the [ombudsman's] position, especially if you have the right personality," Mary Creedon said.

Taylor said he was drawn to the job by prospects for national exposure and the opportunity to build his own staff, "which is rare in government service."

You don't want to respond with a letter that looks like three lawyers reviewed it. You want something that's written from the heart

"My attitude is that I can always find a solution, and my staff has to reflect the same approach," he said. "You get people who are upset, confused, and, in most cases, screaming their heads off because they think they've been done in. You have to remain calm and positive in those situations."

"I also wanted people on my staff who are good writers. When somebody sends you something written in crayon on the back of an envelope, you don't want to respond with a letter written in bureaucratese that looks like three lawyers reviewed it before it went out. You want something simple and clear, something that's written from the heart."

The office fields about 30 inquiries a day, mostly from investors seeking information on how to buy FSLIC assets. Other inquiries range from property management and participation loans to receiverships and automated teller machine transactions.

Taylor's four-member staff has had to develop a knack for fending off bargain-hunters angling for pressure from Wash-

ington on FSLIC field offices, where most assets are sold. There is also an art to deflecting occasional gadflies and cranks, such as the self-proclaimed Texas oil tycoon who casually offered \$3 billion in petroleum leases in exchange for 58 thrifts.

"I had a guy call me from a pay phone on Rodeo Drive in Beverly Hills, and ask me to send him a check for a zillion dollars," Taylor said. "I told him I didn't think I could do that. So he asked me who [Bank Board Chairman] Danny Wall's boss was. I told him Danny Wall's boss is Ronald Reagan. He said, 'Do you have his number?' So I gave him the number of the White House switchboard. He said, 'Oh, yeah. I have that number. I call it two or three times a day.'"

But the office provides more than a crisis hotline. For example, during a single month last fall, staff member Amy Plevin, an eight-year FSLIC veteran, researched the data needed to analyze the proposed minimum capital regulation. Lisa Felt, a former press aide for the City of Boston, helped settle a \$7 million asset sale in Atlanta, Georgia, while Missy Craig, formerly of FSLIC's analysis and evaluation division, coordinated orientation sessions for new FSLIC employees.

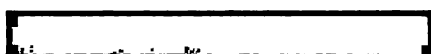
In addition, when he is not preparing Danny Wall's congressional testimony or lecturing foreign bankers, Taylor often is called upon to referee disputed thrift assistance agreements.

According to an internal staff report for the second quarter of 1988, all inquiries were acknowledged within 24 hours, and all but a few complex cases were resolved in less than a week. Some resolutions require no more than clarification, referral, or tactful commiseration.

"We don't have a backlog," Taylor boasted. "We have no unresolved cases. We're a dynamic office. We can handle anything. Our attitude here is that we either help the caller directly, or we make sure that the next person the caller talks to has the answer. For most of our callers, there is a solution. It may not be the best solution for them or for us—but it is a solution." ♦

Turning Points

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Conversions

The following savings institutions have recently completed voluntary mutual-to-stock conversions. Listed first is the name of the institution, followed by the amount of stock sold and the date the conversion was completed.

Midland Financial Savings & Loan Association, Des Moines, Iowa, \$25 million; December 31, 1988.

Wisconsin Savings Association, Tomah, Wisconsin, \$2.6 million; December 28, 1988.

Farmers' & Mechanics' Savings Bank, SLA, Burlington, New Jersey, \$9.9 million; December 21, 1988.

Port Washington Savings & Loan Association, Port Washington, Wisconsin, \$5.2 million; December 19, 1988.

Citizens Savings Bank, FSB, Concord, North Carolina, \$7.5 million; December 19, 1988.

Great Northwest Federal Savings & Loan Association, Bremerton, Washington, \$14.9 million; December 8, 1988.

Mergers

The following mergers have recently been approved by the Bank Board. Listed first is the acquired organization and its assets, followed by the acquiring savings institution, its assets, and type of acquisition.

Citizens Building & Loan Company, Jackson, Ohio, \$3.2 million; **McArthur Savings & Loan Company**, McArthur, Ohio, \$33.4 million; *voluntary*.

First Federal Savings & Loan Association of Kalamazoo, Kalamazoo, Michigan, \$628.9 million; **Standard Federal Bank**, Troy, Michigan, \$6.94 billion; *voluntary*.

Union Federal Savings & Loan Association of Shelbyville, Shelbyville, Indiana, \$15.9 million; **Union Federal Savings Bank**, Evansville, Indiana, \$303.2 million; *supervisory*.

Great Northern Savings Bank, Mundelein, Illinois, \$188.5 million; **The Talman Home Federal Savings & Loan Association of Illinois**, Chicago, Illinois, \$6.09 billion; *voluntary*.

Mendota Savings & Loan Association, Mendota, Illinois, \$23.2 million; **Eureka Savings & Loan Association of La Salle**, La Salle, Illinois, \$178.1 million; *voluntary*.

California Professional Savings & Loan Association, Beverly Hills, California, \$26.1 million; **Guardian Savings & Loan Association**, Houston, Texas, \$2.5 billion; *voluntary*.

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Holding Company Acquisitions

The Bank Board has given its approval for the following savings institutions to be acquired by holding companies. Listed first is the acquired thrift and its assets, followed by the acquiring holding company.

Gulf Federal Bank, A Federal Savings Bank, Mobile, Alabama, \$189.6 million; **Gulf Financial Holdings, Inc.**, Mobile, Alabama.

Atlantic Federal Savings & Loan Association, Fort Lauderdale, Florida, \$1.6 billion; **I.R.E. Financial Corporation**, Coral Gables, Florida.

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Service Corporation Activities

The Bank Board has given its approval for certain thrifts (listed below with assets) to have service corporations that offer, usually through contract with private firms, the activities also listed below.

First Indiana Bank, A Federal Savings Bank, Indianapolis, Indiana, \$864.4 million; *brokerage services*.

American Savings & Loan Association, A Federal Association, Salt Lake City, Utah, \$2.8 billion; *securities brokerage*. ♦

Dochow: Regulation is Alive and Well

During the past two years, as the condition of the Federal Savings and Loan Insurance Corporation has worsened, the Federal Home Loan Bank Board has proposed many new regulations—and adjusted many old ones—to prevent a recurring crisis. It has also adopted a new regulatory philosophy that seeks to help institutions better understand safety and soundness. The Office of Regulatory Activities is the division responsible for Bank System-wide examination and supervision. In an interview with the *Bank Board Journal*, Darrel W. Dochow, executive director of the Office of Regulatory Activities, discusses the new approach to regulation and what it should accomplish.

Journal: In what ways do you think regulation and supervision have changed the most?

Dochow: The entire effort that we are embarking on, and that the 12 [district] banks are joining us in, is a move to what we call regulation by safety and soundness. In the past, examiners walked into an institution and reviewed transactions primarily to determine if they complied with the law and with [Bank Board] regulations. If the institution was not in compliance, the examination report would list certain items as exceptions. It was only on occasion that an exam report would really contain comprehensive reporting of an institution's overall condition.

So the major change has been to position regulators properly—in such a way that examiners and supervisors will be exercising more judgment in evaluating insti-

The thrift industry's problems call for a new approach to ensuring safety and soundness. Closer supervision, faster response, and better coordination with district banks are part of the plan.

by Marc Adams

tutions. Is what the thrift is doing prudent? Is it good business practice? Is it safe, is it sound—rather than, does it comply with the regulation?

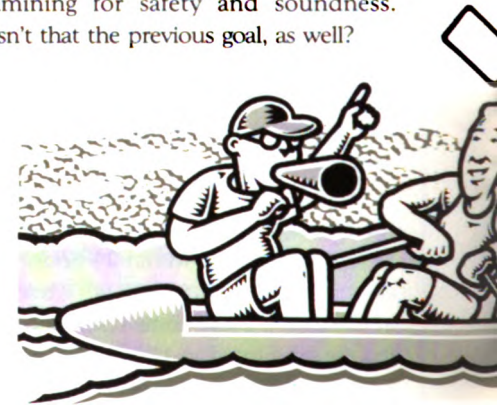
Let me give you another example. There's a regulation that says an institution shall not grow more than 12.5 percent in any two consecutive quarters without approval of the principal supervisory agent. The implication of that regulation is that it must be safe and sound to grow 12.49 percent, because the institution hasn't violated the 12.5 percent rule. That makes no sense from a regulatory viewpoint. If you're engaging in high-risk ventures, 1 percent growth may be unsafe and unsound.

So the new focus is to get the examiners to report, "This growth is highly speculative; this growth is potentially unsafe and unsound because you don't have the management in place, the procedures in place, or the controls in place." What it amounts to is a more tailored approach—that is, tailored to the risk inherent in those institutions.

I guess another area of change is that we're trying to improve the overall quality and judgment of the regulatory force. That's been done through the national mandatory core curriculum that all new examiners and supervisors have to take,

which essentially is a program of accreditation. The idea is that all [district bank] officers must make sure that their banks have quality controls in place.

Journal: You cite the ultimate goal of examining for safety and soundness. Wasn't that the previous goal, as well?



Dochow: I don't think so. The previous goal was to make sure an institution was complying with laws and with Bank Board rules and regulations; and when they weren't complying, to take prompt enforcement action to make them comply. I think that's a very different goal from examining for safety and soundness. When you examine for safety and soundness, you have a stake in how well that institution does. Not that regulators can prevent all

Marc Adams, a former associate editor of the *Bank Board Journal*, is in the Office of Communications, Federal Home Loan Bank Board.

failures, but we can put things in motion, take an active interest, and ensure that the institution operates profitably, competitively, and in a safe and sound fashion.

Therefore, we're more likely to change the management, change the board of directors, take initiatives sooner than if we were simply waiting for the institution to violate something. Not having a strategic corporate plan can make an institution unsafe and unsound, yet it could be in total compliance with all the rules and regulations. So we're changing an attitude.

Journal: You've heard it said that among the root causes of the thrift crisis were lack of regulation and, subsequently, a failure to increase supervision.

Dochow: Some of that's true.

Journal: So, is the primary goal of this regulatory evolution to avert another crisis?

Dochow: Absolutely. Each district bank has a set of goals. We in Washington, with the district banks, monitor those goals on a quarterly basis. We also have a set of goals that we call a business plan. Among the goals in the business plan is to prevent a recurrence of the problems that we've experienced in the past. And if we can't rep-

resent that we have a system in place that maintains the safety and soundness of the industry as a whole—excepting some isolated institutions that will still fail because of fraud or mismanagement—if we can't represent that we have that system in place, then why do you need us?

I view examinations and supervision as a service to the public and to the industry. It serves the public by helping to pro-

protect the public good, by ensuring that the industry stays safe and sound—that it provides home financing, a sound place to put your savings, a reasonable rate of return, and fair treatment across the board. It provides service to the industry in much the same way, by ensuring that those individuals that are abusing their authority or acting inappropriately are not damaging the overall industry—that institutions are not pricing up the cost of funds, or mispricing their adjustable-rate mortgage teaser rates to the

One of the subtle movements that's occurred is the development of consistency among the districts

extent that they're causing harm to the industry. If they are, it's our responsibility to stop them. To the extent that they're causing harm to themselves, it's our responsibility to remove them from the industry.

[accreditation] come out of Washington, so that an examiner will be not an accredited examiner in the 12th district, for example, but an accredited national thrift examiner. One of the subtle movements that's occurred, especially in the last year, is the development of a national focus, a consistency among the districts—the fact that no district can stand by itself and issue its own policy. We must be working as a system. That means that the Office of Regulatory Activities has taken a very active role in laying down what is mandatory, and what is optional.

Journal: Was this something [Bank Board Chairman M. Danny] Wall specifically set out to accomplish as part of his program?

Dochow: Danny basically wanted a couple of things in place. He wanted to ensure that the regulatory apparatus fully used the resources and talents of the district banks. I took his direction to mean that the banks are a very valuable part of the Bank System. We saw in the past that you can't do national supervision from Washington. You've got to supervise on a local basis. So the national policies and procedures that we implement have to focus on the real strength of the Bank System—the talent in the banks.

Journal: You mentioned accreditation and training programs. Who is sponsoring these programs, and by whom will the examiners be accredited?

Dochow: I expect to have national examiner accreditation standards set by this office, and then each district will be responsible for certifying that accreditation. I personally think it's a good idea to have the

A second major focus was that the thrift regulatory process needed to be better than the process that existed anywhere else. Quite frankly, I took that to mean that we need to be better than the banking agencies.

Journal: In view of the work you've done thus far, what do you see as the biggest regulatory problem facing you and the

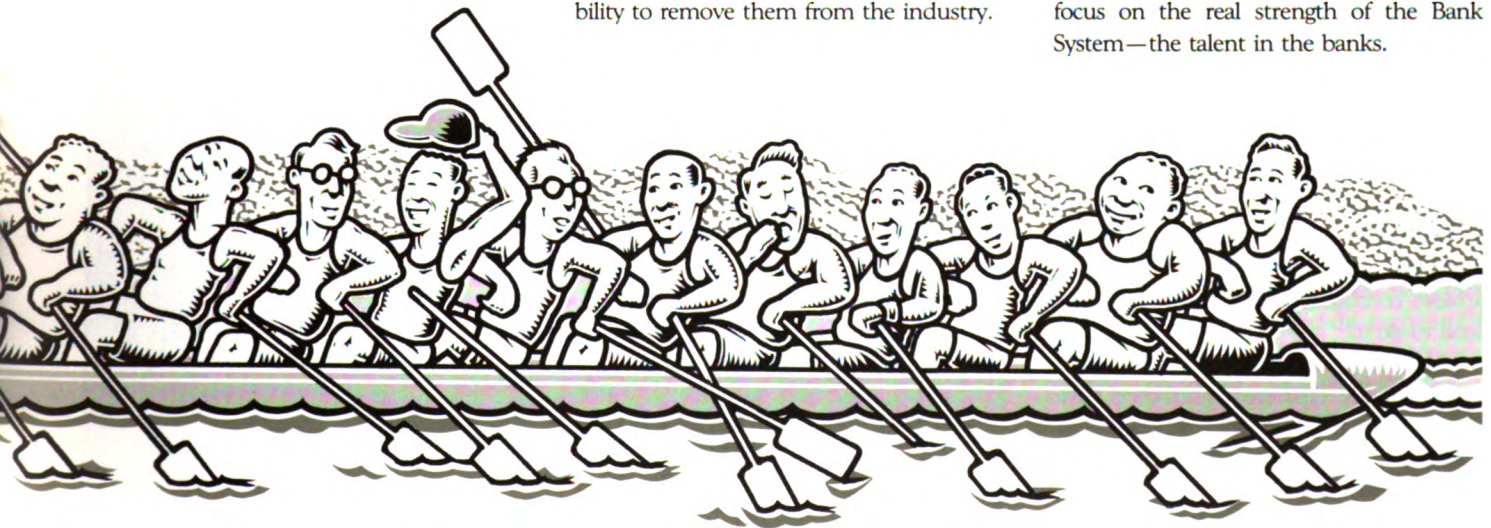


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entire Office of Regulatory Activities today?

Dochow: I don't think of them as problems; I think of them more as challenges. One challenge is what I refer to as organizational. How do we solidify the relationships between the 12 banks and the Office of Regulatory Activities so that we work as one system? We've come a long way in that regard. The officers [of the district banks] have done tremendous things. They're involved in almost every major project that's been under way in the last year, such as writing the new examination handbooks. So I view that as a system-wide effort, and I think that's a challenge that we will face through rest of the 1980s.

A second challenge is what I refer to as a supervisory challenge: to do everything we can to ensure that the middle group of institutions—those that can be salvaged—are salvaged. And that's very much an activity that falls directly to the district banks because they do the day-to-day supervision—but we have to support them strongly by ensuring that they have the necessary tools, motivation, talent, and national resources.

The third major challenge is to put in place a mechanism by which FSLIC case resolutions are examined and supervised in a fashion that ensures their success. And a fourth major challenge is to move regulations beyond "crossing the t's and dotting the i's"—broad-brushed regulations with too many specifics—and back into a format that deals with key areas but allows for differences among institutions.

Journal: Why is it so difficult to achieve consistency, and how do you intend to do it?

Dochow: There are 12 banks. They're independently chartered, and they have had their own supervisory functions for many, many years. In July 1985, they took over direct responsibility for examinations. But, historically, none of the banks had a strong Washington office to look to. So they created their own approaches, techniques, procedures, and policies. They recognized that they needed national direction, but it really wasn't forthcoming. So only in the last year or two have they received much more direction, and that's why they've been so highly supportive.

Consistency becomes critical as you look at changes in the industry. Some

The Lap-Top PC In Action

How do thrift examiners in the field feel about using the personal computer (PC)? Pretty good, according to several examiners contacted at random by the *Bank Board Journal*. Here is what two district bank examiners—John H. Vance of the Federal Home Loan Bank of Atlanta and Jon Johnson of the Federal Home Loan Bank of Chicago—had to say about the influence of the lap-top computer on the examination process.

Vance: The lap-top computer is helpful in many ways. At the beginning of the exam, examiners set up the computer to bring in over the phone lines all the necessary report pages and financial information that provide the basis for the examination.

Later, as examiners review different areas, they develop work report comments and other information that should be placed in the report. The lap-top comes in handy here primarily for word processing—that is, for writing and editing report comments—and the computer is used a lot once the exam reaches its latter stages and most of the review is done. Then, when the exam is over, instead of having to lug the results around, examiners transmit the information from the site.

Johnson: At the beginning, I think there was a little hesitation by examiners about taking this technology under their wing. But now that they use it day in and day out for their reports, work

papers, and whatnot, they turn to it more and more often—knowing that it will go straight into the [central] computer in final form.

Vance: The introduction of the PC has improved the quality of the examination in two ways. Previously, examiners had to write out all the report pages and report comments by hand, or use a typewriter we borrowed from the institution; now, word-processing capability reduces the amount of time it takes to write and edit comments.

Although getting access to the report-of-examination template from the Bank Board offices in Washington and transmitting it to the district banks takes time (and sometimes there are transmission problems), I'm convinced it's better than the old system.

Johnson: The tools they're coming out with are increasingly helpful. The automated handbooks, for example, are just fantastic. No more carrying around seven or eight books; you've got all the information right at your fingertips.

The software is also very useful for securities analysis by special examiners. It gives us access to data on securities on both the mainframe and the PC.

Vance: The word-processing functions significantly reduce the amount of examination time. I feel very positive about the PC. It could be even better if we'd get a few more applications, such as some spreadsheet-type software. We could use that too. ♦

thrifts now operate in more than one district. So, if you're doing asset classification in one of those institutions, and you classify a loan substandard in one district, and in a different district classify it doubtful, and in a third district don't classify it at all, you end up with major practical and logistical problems.

Here's another example. A "1-rated" institution in the Northeast might be just perfect in every respect. A "1-rated" institu-

tion in Texas might have the characteristics that a "3-rated" institution might have in Boston. Well, that's intolerable. You can't have that situation, because if one is trying to make national policy, or if the Bank Board is trying to assess the size of the industry's problem, they need to know that the information they're getting is evaluated the same way.

I also believe that examiners and supervisors ought to rotate between districts.

If an examiner develops a career only within a given district, he or she won't have the same experience and expertise as if they'd been in two or three different districts, or in Washington, during part of their careers. It's a rounding-out process, like management training.

Journal: You say that the districts are receptive to this symmetry. But these are fundamental changes in approach, and the districts have been operating on their own for a long time. How comfortable do you think these changes have been for them?

Dochow: I guess one way of looking at that is, have we received input from districts that would give us pause? The answer is no. Understand the composition of the districts today versus three years ago. The 12 federal home loan bank districts probably have the finest staff of regulatory functions personnel in existence. And I think we have a staff in the Office of Regulatory Activities that now equals what you see in the banking agencies. Many of those staff members have a very thorough understanding of how the Bank System works, as well as how the banking agencies work.

So, if you consider people like Angelo Vigna, or Larry Muldoon, or Don Wentz [from the federal home loan banks of New York, Cincinnati, and Des Moines, respectively], who have been with the Bank System for quite some time, and mesh them with people like John Downey, Jack Ryan, or Mike Patriarca [from the banks of Indianapolis, Boston, and San Francisco], what you end up with is a system that has brought in the best of all talents—the best of the Bank System and the best of the banking agencies. Then we've added the talents of people from the private sector, such as Tommie Thompson in Topeka, from a Big Eight accounting firm, and Stuart Brafman in Chicago, who came from the Mortgage Guaranty Insurance Corporation. So we've now got a system that isn't all home grown. These people have brought with them an emphasis on management evaluation, more emphasis on policies, and more emphasis on looking at an institution for safety and soundness and moving away from detailed regulations.

So I don't see resistance, quite frankly. If we were talking about recentralizing examinations and supervision, there would be resistance, but we're not

talking about that. We're talking about national policy and standards.

Journal: How much has the Office of Regulatory Activities increased its staff in the past year or so?

Dochow: When the Office of Regulatory Activities was created in October 1986, it had 66 employees. Of those 66 employees, most were from the Bank Board's former Office of Examination and Supervision. We have moved up to approximately 150 people today. And most of the new people have come either from

If we are talking about recentralizing examinations and supervision, there would be resistance, but we're not talking about that. We're talking about national standards

the banking agencies, from other governmental agencies, such as the Office of Management and Budget, or from advanced degree programs in colleges and universities, from the thrift industry, or from related financial services industries.

We have a ceiling of 175 people, and we intend to be there as soon as possible—probably by the end of 1989's first quarter. As part of that staffing effort, we have a need to rotate our Washington people out to the district banks, because some of our own people need career development too, and it's beneficial to have worked in a district bank, just as I expect the district bank people to come here.

Journal: How have you attracted these people?

Dochow: Primarily, it's the challenge. The condition of FSLIC includes a perception that this industry's terrible, when in fact people don't understand how good this industry really is. We've given these people opportunities to make a change, to make a difference. This is the hottest thing

in town, and if you're good, if you have a lot of drive, you come to where the action is, and the action is here.

And so, they're able to work on things like risk-based capital, net worth policies, and interest rate risk policies. And if you're a very experienced supervisor, you're monitoring holding companies that run major homebuilding concerns, or insurance companies, or, in some of the more recent cases, there are retail outlets that own thrifts. And what are the thrifts doing? The thrifts are investing in equities and securities; they're doing direct investments and real estate development. We don't have much investment in windmill farms and shrunken head museums anymore.

Journal: Even the name of this division has changed several times in the recent past. What significance does that hold?

Dochow: It holds more significance than people may think. When the office was called Examinations and Supervision, it really tried to do direct supervision and examinations out of Washington, and failed, in my opinion. When [former Bank Board chairman] Ed Gray, with the help of [Board member] Don Hovde, finally got the examiners transferred to the district banks, the Washington office was changed to provide oversight, policy, and some supervision. That's why it was called ORPOS—Office of Regulatory Policy, Oversight and Supervision. That name tried to capture what the new mission was supposed to be.

When we later changed the name to Office of Regulatory Activities, we could just as easily have changed the name to Office of Supervision. But supervision was always considered just one small piece of regulatory activities. And we don't do day-to-day supervision out of Washington, with some minor exceptions. Our role really is oversight, policy, and some supervision.

So when we changed to the Office of Regulatory Activities, I was trying to do some fine-tuning, to show that we're not just examiners and supervisors—we're national regulators. We're trying to make the system more homogeneous, and the name change was part of that effort.

And, quite frankly, the other reason for changing our name was that we had

trouble answering the phones. It's pretty hard to answer the phone, "ORPOS." People would say, "What?"

Journal: What about enforcement—the point at which you must take some action. Has that changed in much the same way?

Dochow: I think it has changed, but you need to understand that enforcement action remains with each of the district banks, with the support and oversight of the Office of Enforcement under [director] Rosemary Stewart, and of the Enforcement Review Committee.

The Enforcement Review Committee is a relatively new mechanism. The committee, with responsibility delegated from the Bank Board, now approves many final enforcement actions. The idea is to propose to the Bank Board consistent national policies in enforcement; to speed up final Bank Board enforcement actions; and to leave day-to-day enforcement in the hands of professionals, instead of in the hands of the Bank Board. Let the Bank Board set policy, and let the professionals implement it.

We used to treat enforcement as sort of a score card. You had an enforcement action, you were satisfied, and that's all you needed to do. What we're trying to do is change that—to focus on whether we're getting the desired action from an institution.

For example, an institution might have poor underwriting. Just taking an enforcement action that says "all underwriting shall be well-documented and done appropriately" doesn't mean you've changed the institution's behavior. So now we're trying to focus more on "is the behavior modified such that we're comfortable that the institution is operating safely and soundly?"

Maybe it involves enforcement action, and maybe it involves removing management. You can never stop a failure. You can protect the overall safety and soundness of the industry, but you can't stop individual failures—and what causes failures is mismanagement, in most cases. So what you need to be doing as a supervisor, from a national policy perspective, is to ensure that you have the very best management possible. If you don't have that, then you need to change the management. ♦

Strategic Gridlock Spells Opportunity

Forces for continuity have met agents of change, creating strategic gridlock. Many institutions will suffer from such circumstances—others will overcome their rigidities and take advantage of their competitors' slow and timid responses.

by Erich W. Sippel

The woes of the thrift industry are certainly well known to everyone in it. Less well known, but equally significant, is the thrift industry's part in a larger pattern of shifting demand in the financial intermediation business in the United States—a pattern that has affected banks and insurance companies as well as thrifts. Simply put, there are now good substitutes for the services and products traditionally provided by thrifts and other intermediaries. These substitutes have surfaced because technology, and in some cases changes in lifestyle, have made it possible to satisfy market needs at lower costs to intermediary and customer.

Sources of Revenue

The most critical decisions managers of a financial firm make are in choosing its products and services. It's helpful to analyze these options with a matrix that arrays the sources of revenues in the business (table 1, vertical elements) against the values obtained by customers when they

purchase a financial product or service. Any financial product can be plotted on this matrix; some occupy only one cell, while others occupy several. An important assumption implicit in the matrix is that the sources of revenue in financial services, and the customer's perception of value in a financial product, are independent of the legal form of the intermediary. Sources of revenue are:

- ◆ Bearing risk—pooling and sometimes redistributing contingency risk. Risk-bearing services include pure risk insurance and reinsurance.

- ◆ Managing the spread—profiting from the spreads between the cost of funds and the charges for putting the money to use. The spread can arise from differences in credit ratings as well as from the time value of money. Spread management supports traditional lending, the investment elements of nonvariable life insurance products, and certain investment banking activities, such as bridge financing.

- ◆ Aggregating funds—without assuming investment risk, investing, or lending on behalf of investors. Aggregator services include mutual fund sponsorship and the investment elements of variable life insurance products.

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◆ Processing information—without assuming risk, providing financial information to others. Dow Jones, Reuters, A.M. Best Co., Standard & Poors, and the Insurance Services Office, as well as actuarial firms and managers of captive insurance companies, are information processors.

◆ Distributing—selling financial services and products on behalf of a firm. Although some distributors receive fees from end customers, they are generally compensated by commission or commission plus base salary, plus a variety of bonuses that are contingent on reaching certain sales and quality goals.

Meeting Needs

The source of revenues is only half the story of financial services—the supply half. It is too frequently forgotten that customers do not necessarily buy what firms make. Say that a bank makes money on the spread between the cost and the use of

◆ Advice—guidance concerning financial goals and the means of reaching them. Investment and insurance counseling are included, as well as advice on how to expedite—for example, on how a customer might cut red tape in dealing with an intermediary.

◆ Record-keeping—providing purely administrative services such as financial statements, claims paying, and billing and collecting.

◆ Access to capital—providing debt capital for interest charges and investment banking fees, making equity capital available for fees, and improving cash flow for fees and interest charges. Reducing a firm's business line, for example, would qualify for this category in that it provides capital by freeing cash.

Legal Forms

Historically the legal form of a financial services firm determined its economic

historically managed spreads, increasingly make their money by securitizing loans—that is, by aggregating.

Managers of thrifts will come to appreciate, if they have not already, two important facts about disappearing specialization. First, the various sources of revenues have various capital requirements. Second, any two products or services meeting identical needs are interchangeable in the eyes of the customer. An example of both points is the replacement of traditional checking accounts by money market mutual funds. Checking accounts historically gave banks two sources of revenues—access to a low-cost source of funds, thus allowing them to make more money on the spread, and fees for information processing. The value they offered customers was record-keeping.

Then, along came money market funds. By charging fees for aggregating rather than trying to make money from the

Table 1

<i>Customers' Financial Needs and Firms' Sources of Revenue</i>						
Customer needs:	Reduction in uncertainty		Advice on		Record-keeping	Access to capital
	Known/unknown loss	Optimal risk/return ratio	Goals	Means		Cash flow Debt/equity
Sources of revenue:						
Bearing risk						
Managing spread					Checking account	
Aggregating funds					Money market mutual funds	Money market mutual funds
Processing information					Checking account	
Distributing						

money. That's good for the bank, but it isn't what attracts the customer. Customer needs (table 1, horizontal elements) are:

◆ Reduction in uncertainty—sometimes, the exchange of a known loss of a known size at a certain time for an uncertain loss of unknown size at an uncertain time (insurance); at other times, an optimal risk/return tradeoff (an investment). Successful investments offer greater returns than competing products with the same risk, or the same return with lower risks, and thereby reduce uncertainty.

specialization: insurance companies were risk bearers; banks and thrifts, spread managers; mutual funds, aggregators; credit rating bureaus, information processors; and insurance agents, distributors. However, that pattern of specialization is rapidly disappearing as financial services firms find that additional functions are critical to profitability. For example, the insurance industry—both life and property/casualty—is earning less of its profits from risk-bearing, and more from spread management (investments). Banks, which have

spread, these funds satisfied the same customer need for record-keeping, offered higher interest rates on deposits to these customers, and were still profitable because they required lower reserves and capital than a bank's checking account. Thus, money market mutual funds caused the disintermediation of large amounts of money from banks and thrifts.

Replacement is a recurrent phenomenon in the financial services marketplace. Currently, for example, the market is replacing the traditional mortgage with

mortgage-backed securities. Since 1975, mortgage-backed securities outstanding as a percentage of all residential mortgages have increased from about 5 percent to more than 25 percent. As intermediaries in the securitization process, firms still give the customer access to capital, but spread management is no longer the primary source of revenues. That's become the role of fees for aggregating and information processing. Such fee income from originating and servicing loans would seem preferable, at most thrifts, to warehousing a mismatched portfolio. Besides, aggregating and distributing do not require as much capital as managing the spread. In other words, if thrifts are capitalized to make money on the spread, they are overcapitalized, and are forced to depend on off-balance-sheet fee income to produce an acceptable return on excess capital.

In too many cases, there are no remedies—there are only losses, and the losses are staggering. The Federal Savings and Loan Insurance Corporation is at least \$40 billion short of what it would need to liquidate troubled thrifts. Consequently, recent restructurings are more rescues than orderly liquidations. With capital locked into many losing situations, neither politicians nor regulators can allow the wholesale failure of thrift institutions.

But the phenomena of replacement and a locked-in supply leading to overcapacity and poor financial results is not limited to the thrift industry. In commercial banking, junk bonds and commercial paper substitute for traditional lending; in property/casualty insurance, alternative approaches to risk management, such as captives and risk retention groups, substitute for coverage traditionally provided by carriers; and in life insurance, mutual funds, home equity loans, individual retirement accounts, and 401(k) plans substitute for the traditional savings element, while working spouses and increased health consciousness substitute for pure mortality protection.

In each of these industries, supply (capital multiplied by the appropriate leverage ratio) is locked in by some combination of regulation, legal structure, and management skills, even as substitution reduces demand and decreases the capital required to meet customer needs. The

problem is bigger than Texas, and it's even bigger than the thrift industry—it encompasses America's entire system of financial intermediation.

Strategic Options

Unless financial managers can develop and execute strategies that can overcome such adverse conditions as the replacement of thrifts' traditional products and roles, their firms will suffer decline and even failure.

Over the years, most managers in traditional financial intermediaries have not shown themselves to be effective strategists. After all, they didn't have to be; all their stable businesses required were effective operations. But that is no longer

The roles of various legally defined components of the industry won't revert to former patterns

enough. Today, managers should be fully aware of all the options. The options are few; traditional intermediation comprises only six archetypal strategies:

- ◆ Cost reduction—lowering costs, thus benefiting the firm through higher returns, greater market share, or both. Results can be achieved through downsizing (including divestment and reductions in workforce) and through organizational simplification.

- ◆ Differentiation—distinguishing a product or its distribution from its competitors. This may be accomplished by getting customers to recognize a product's superiority, or it may be achieved through synergy, the auspicious combination of two products customarily considered dissimilar. Merrill Lynch's cash management account is quintessential financial-product synergy.

- ◆ Niching—concentrating on a segment of a market in which competition is less intense. A niche may be an opportunity abandoned or overlooked by competitors, an area not subject to a general de-

cline, or an emerging and as yet unrecognized market.

- ◆ Diversification—adding to a firm's core businesses, thereby reducing risks or raising revenues. An example: Prudential Insurance Company's acquisition of Bache Securities.

- ◆ Resistance—refusing to give in to apparently strong reasons for change. Naive resisters deny the importance, or even the existence, of the changes; sophisticated resisters believe that they will benefit from the eventual consolidation of a troubled industry and set about acquiring assets cheaply and making plans to dominate a declining market.

- ◆ Acceptance of greater risk—taking advantage of a market's inefficiencies to produce returns that outweigh the risks of involvement. Such a strategy might dictate the purchase of junk bonds, the holding of riskier loans, more liberal approaches to underwriting or pricing, or more risky capital structures. Such tactics are particularly tempting for banks and thrifts, whose deposit insurance premiums are not adjusted for risk.

Because the pace of change in financial services has been heady, managers of thrifts should consider these strategic options thoroughly. Choosing the most productive options is the most important task of management.

Forces of Continuity

It is inconceivable that the favorable, stable economics of the thrift industry of the 1950s can be reestablished. The industry has permanently changed, and that change, driven by economics, also includes more than economics. The roles of the various legally defined components of the financial services industry will never revert to their former patterns, nor will the technological genie that created products that have changed the industry go back into the bottle.

Thrifts are in a situation similar to that described and analyzed by George Ainsworth Land, who has developed concepts of life cycles in the context of general systems theory. According to Land, any living system goes through three phases in its life cycle (chart). The first involves establishing connections between the system and its environment. Once it has found

ways to connect, the system enters a period of rapid and possibly prolonged growth. In this second phase, the emphasis is on replicating the successful approach or strategy developed in the first phase. Inevitably, however, all systems eventually decline and die because the environment

pared with the old. Thus, change is often fiercely resisted.

In the foregoing terms, the traditional connections between thrifts and their environment are coming unraveled, and thrifts in many cases are clinging to what they were as if it were life itself. Nine factors

of automated teller machines, they continue to rely primarily on the branch system developed in the 1920s and 1930s. The only significant exception is the success of Citibank and a few others in distributing credit cards by direct mail. The few experiments in alternative distribution, such as videotex, have not led to the adoption of new systems.

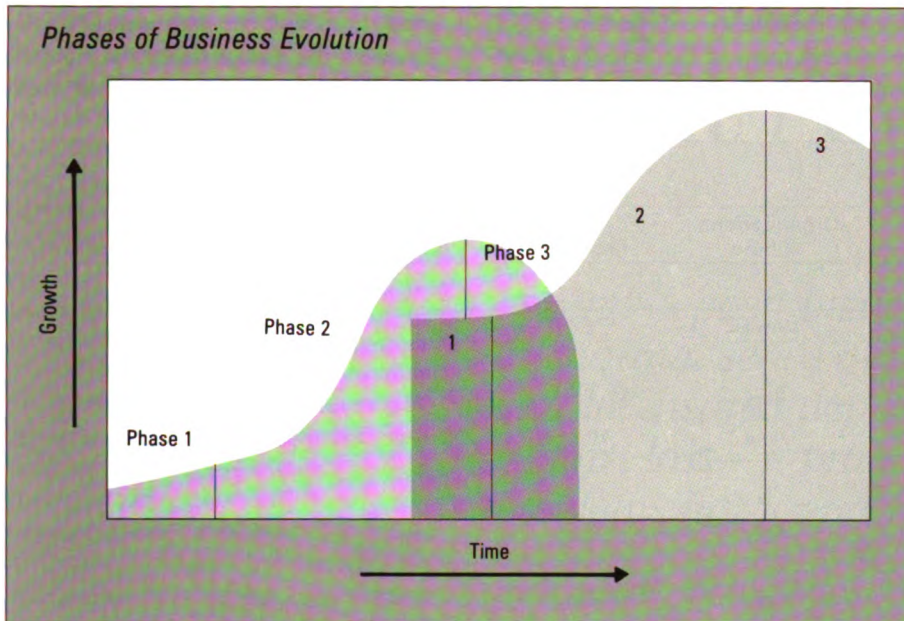
- ◆ Beliefs. Experience and common sense suggest that beliefs have not changed much. For example, most companies continue to emphasize management of assets, or supply, rather than that of liabilities, or demand. Overcapacity and poor profitability mean that attention must be paid to management of demand—marketing—beyond giving away toasters to people who open a new account. Although there has been some improvement, not enough financial institutions meaningfully research the market, segment it, target it, and identify heavy users; that is, few engage in state-of-the-art marketing.

- ◆ Regulation. Although considerable deregulation has occurred, the regulatory structure still strikingly lags the market.

- ◆ Organizational designs. Traditional banks and thrifts, generally rigidly hierarchical and bureaucratic, are characterized by diffused decision-making. Profit centers are usually established geographically, branch by branch, occasionally with an overlay of product-line management (retail vs. wholesale). Sometimes, organizations simply follow the legal distinctions among firms. Virtually no thrift or other financial services firm is organized along potentially more effective lines, such as by customer need or source of revenues.

- ◆ Organizational culture. In most traditional thrifts and banks, the culture remains risk-averse and nonentrepreneurial. Studies show that corporate cultures in the financial services industry have remained stable over time, and that organizational vitality is low.

- ◆ Products. At first glance, there appears to have been a great deal of product innovation in the financial services industry, such as adjustable rate mortgages and universal life insurance. These are, indeed, significant innovations. Most important product innovations in financial services, however, have not been developed by traditional intermediaries. Salomon Brothers



changes, the food supply is consumed, or the limits of technology are reached. This decline is the third phase, and the only escape from it is through discontinuity: the system must find a new way of connecting in order to begin the growth process all over again. This process (represented in the chart by the dotted line) is always difficult.

There are obviously affinities between such a view, the product life cycle notion, and certain concepts of innovation, such as those of Richard Foster in his book, *Innovation*. Foster argues that a technology follows an S-curve in its development. The technology is created (Land's phase 1), its potential is developed and applied (Land's phase 2), and eventually its limits are reached (Land's phase 3). At that point, a discontinuous jump to a new technology is the only answer; for example, steam replaces sail, jets replace propeller-driven aircraft. This replacement of one technology by another is no small matter—look at the resistance to nuclear power today. People have vested interests in the old; the new creates a new set of winners and losers; the new is unknown; and inevitably the new is somewhat crude and undeveloped com-

have been stable for so long that they have inculcated a strong sense of continuity on thrift managers: economics, technology, institutional characteristics, products, distribution systems, beliefs, regulation, organizational designs, and organizational culture. In the 1970s, however, technological, economic, and institutional factors introduced chaos into the thrifts' traditional world (table 2). These changes have changed the environment to such an extent that thrifts have been thrust into Land's phase 3.

Fighting For Continuity

Faced with new conditions, the thrift industry has not yet made the transition to a new growth curve. Despite major change in three of the components of the industry's structure, managers have changed little and grudgingly with respect to the other six. Distribution systems, beliefs, regulation, organizational designs, organizational culture, and products exhibit more continuity than change, despite the probability that major changes in the industry will require major adjustment:

- ◆ Distribution systems. Although thrifts and banks have installed thousands

pioneered securitization, Merrill Lynch created the cash management account, E. F. Hutton was the first to market universal life insurance, and Drexel Burnham Lambert developed the junk bond market. No similar list could be created for thrifts, banks, and insurers.

Shouldn't economic change cause rational managers of profit-seeking organizations to adjust to the new reality? Not doing so obviously hurts a firm in a num-

Table 2

<i>Rigidities Versus Strategies</i>						
Rigidities:	Organizational designs	Organizational culture	Regulation	Beliefs	Distribution systems	Products
Strategies:						
Cost reduction	Medium	Medium	Easy	Easy	Medium	Medium
Differentiation:						
leadership	Hard	Hard	Easy	Easy	Hard	Hard
synergy	Hard	Hard	Medium	Hard	Hard	Hard
Nicheing:						
overlooked/ abandoned	Easy	Easy	Easy	Easy	Medium	Medium/hard
immune to general decline	Easy	Easy	Easy	Easy	Easy	Easy
emerging	Hard	Hard	Easy	Hard	Medium	Medium
Diversification	Hard	Hard	Medium	Hard	Hard	Medium
Resistance:						
naive	Easy	Easy	Easy	Easy	Easy	Easy
sophisticated	Easy	Easy	Medium	Medium	Medium	Easy
Acceptance of greater risk:						
underwriting	Medium	Medium/hard	Medium/hard	Hard	Medium/hard	Hard
investments	Easy	Medium/hard	Medium/hard	Hard	Easy	Easy
capital structure	Easy	Easy	Hard	Hard	Easy	Easy

economic and political interests, slowness in decision-making, and the inertia of any large organization, and it is no surprise that many aspects of the financial services industry persist relatively unchanged.

The result? Strategic gridlock. The industry's economics, technology, and institutional framework have permanently evolved; meanwhile, organizational rigidities prevent many of the industry's members from following. Resistant forces, carry-

against the change-resistant rigidities (table 2). Implementation of each strategy places different pressure on each of the rigidities. The matrix can yield an estimate of how difficult it would be for a traditional firm (or a traditional competitor) to overcome rigidity and implement a strategy.

Any estimate, of course, will be greatly simplified, because the matrix is designed for the average traditional intermediary. A thrift using this diagnostic tech-

ber of ways and opens it to attack by opportunistic competitors.

Why is response slow or nonexistent? The answers lie with Land's S-curve. First, nearly all thrift managers have experienced nothing in their careers except phase 2. Asking them to leap to a new way of connecting with the world is asking them to be conversant with something for which they do not even have a language. Second, phase 3 is stressful, and, when people are placed under stress, they more often than not revert to whatever has worked for them in the past. Accepting the new and untried only increases the stress. Add to these factors the normal defense of vested

ing a heavy load of intellectual and psychological freight, block the way—with self-defeating implications.

Competitive Advantage

Despite all its drawbacks for the industry as a whole, this gridlock creates opportunities. The more difficult it is for a competitor to duplicate a strategy, the greater its payoff to a firm that can successfully make the change. Even competitors potentially capable of duplicating the strategy often do not do so. The forces for continuity often make them unwilling, even when they would appear able.

Strategic options may be arrayed

nique should adapt its method to each circumstance, and it should consider the specific actions dictated by each strategy, as well as the interrelationships among the rigidities.

Despite its simplified nature, however, important conclusions can be drawn from the matrix. First, the strategic options that offer the highest payoff are not those that most firms in the industry are pursuing. Consulting experience suggests that the most frequently adopted strategies among traditional thrifts are naive resistance and cost reduction through downsizing. These present competitors with very low response barriers. Cost reduction

through downsizing places a certain amount of pressure on the organization, but is well within the experience of virtually every firm. No unusual barriers must be overcome to implement it. Both cost reduction through downsizing and naive resistance offer few opportunities to exploit competitors' response barriers.

But the strategy of differentiation through synergy has high potential, because rigidities in every area will slow competitors' responses. Organizational rigidities arise from issues of cross-subsidies between profit centers. Cultural differences often exist. Belief barriers are buttressed by widespread skepticism regarding the strategy. Depending on how the strategy is implemented, distributional and product barriers will probably also crop up.

Because its competitors face numerous strong rigidities, a firm successfully implementing this strategy can expect superior results. An example of the big payoffs possible in this area is Merrill Lynch's cash management account.

Most thrifts may find that soft areas, such as organizational design and culture, as well as belief, are readier sources of competitive advantage than the harder elements, such as products and distribution systems. The competitive implications of the soft areas are not obvious; consequently, few firms manage them with awareness of their possibilities.

Self-Diagnosis

The catch to all this is that a competitor's rigidities are likely to resemble those of one's own firm. Thus, managers of an institution should diagnose their own ability to implement strategies that exploit response lags. Moreover, they should choose strategies that competitors cannot implement as easily.

Most thrifts will find, however, that strategies difficult for their competitors are likely to be difficult for them. Rewards, for the most part, will come only to traditional thrifts that conduct their strategic check-ups in a clear-eyed manner and work hard to overcome the rigidities their competitors face. The good news is that an institution need not strive for excellence to take advantage of the rigidities of competitors. Merely being better will be enough in the 1990s. ◊

How Deposit Insurance Went Awry

Federal deposit insurance is not insurance in the normal sense of the word. It is a guarantee that all insured depositors will be fully protected against loss—a promise that generates problems not found with private insurance.

by James R. Barth, Michael G. Bradley, and John J. Feid

The federal deposit insurance system, established in the 1930s, is not insurance in the normal sense of the word. It is a guarantee that all insured depositors will be fully protected against loss, even when a crisis swamps the insurance fund. Unlike a private insurer, a deposit insurance fund cannot simply declare itself bankrupt and pay off insured depositors on a pro rata basis. The more the deposit insurer's practices diverge from those of a private insurer, the more the guarantee aspect of federal deposit insurance becomes important.

Because federal deposit insurance practices diverge significantly from private insurance practices, there should be a rule by which the guarantee to cover all insured deposits is to be implemented when an insurance fund is overwhelmed by catastrophic losses. The absence of such a rule generates substantial uncertainty and con-

troversy, and has permitted insolvent thrift institutions to remain open. The very poor performance of these institutions in recent years has skewed measures of aggregate thrift performance, masking the performance of solvent institutions. The ensuing debate on the cost of resolving troubled thrifts and whether healthy thrifts can pay these costs has drawn attention from the potential value of the thrift charter in an increasingly competitive financial services market.

Normal Practices Set Aside

From its inception, federal deposit insurance was characterized by practices different from those of private insurers, especially in the way that rules pertaining to deposit insurance provided perverse incentives on the part of insured institutions. As Luther A. Harr and W. Carlton Harris pointed out more than 50 years ago:

Under the guarantee fund, all banks, good and bad, are taxed on the same basis Insurance principles dictate that the element of risk must be guarded against and this is done by

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differential rates, depending upon the circumstances surrounding each particular case.

The Federal Deposit Insurance Corporation (FDIC) was created by the Banking Act of 1933. The Federal Savings and Loan Insurance Corporation (FSLIC) was created by the National Housing Act of 1934 and placed under the aegis of the

The assessments did not reflect either the costs incurred by the fund or the extent of coverage

Federal Home Loan Bank Board. To establish their reserve funds, the FDIC and the FSLIC were empowered to levy annual insurance assessments (tables 1 and 2).

In response to FDIC chairman Leo Crowley's testimony in February 1935 before the House Committee on Banking and Currency, the Banking Act of 1935 changed the insurance premium for commercial banks and increased the assessment base to total domestic deposits. Crowley presented historical data on the losses to depositors resulting from commercial bank failures for the period following the development of the national banking system in July 1864 through June 1934. The data showed that the average loss per total domestic deposit dollar was approximately $\frac{1}{3}$ of 1 percent (32 basis points) for this 70-year period. If, however, periods of episodic crisis (1873-1878, 1892-1897, and 1931-1934) were removed from the data, the average loss per dollar of total domestic deposits declined to $\frac{1}{8}$ of 1 percent (12.5 basis points).

Relying on these data, Congress lowered the insurance premium to $\frac{1}{12}$ of 1 percent for banks, although it was clear that this premium would not have covered the historic losses even when abnormally high-loss years were omitted. Congress apparently accepted Crowley's argument that strict enforcement and regulation could be used to reduce the probability of failure and thereby avoid large losses to the insurance fund.

Table 1

FSLIC Deposit Insurance Premiums and Coverage

June 27, 1934 National Housing Act	Annual premium set at $\frac{1}{4}$ of 1 percent of the total amount of all accounts at insured institutions plus any creditor obligations. Premium to be assessed annually until a reserve fund equal to 5 percent of all accounts plus creditor obligations is established. Emergency assessment of an additional $\frac{1}{4}$ of 1 percent per annum available to meet the expenses of the corporation. Basic coverage is set at \$5,000 per depositor per insured institution.
May 28, 1935 An Act to Provide Additional Home-Mortgage Relief	Premium is reduced to $\frac{1}{8}$ of 1 percent. Maximum special assessment is reduced to $\frac{1}{8}$ of 1 percent.
June 27, 1950 Amendment to the National Housing Act	Premium is reduced to $\frac{1}{12}$ of 1 percent. Elimination of the special assessment is proposed; however, maximum special assessment remains $\frac{1}{8}$ of 1 percent. Line of credit with the Treasury is established, the maximum amount borrowable in an emergency is \$750 million. Basic insurance coverage is set at \$10,000 per individual depositor.
September 8, 1961 Amendment to the National Housing Act	Establishment of the secondary reserve, a prepayment reserve with a 2 percent annual assessment on anticipated net increases in total deposits.
October 16, 1966 Financial Institutions Supervisory Act	Basic insurance coverage raised to \$15,000 per depositor.
December 23, 1969 Credit Control Act	Basic insurance coverage raised to \$20,000 per individual depositor.
August 16, 1973 Amendment to the National Housing Act	Eliminates payments into the prepayment reserve, the secondary reserve.
October 28, 1974 Act of October 28, 1974	Basic insurance coverage raised to \$40,000 per individual depositor.
March 31, 1980 Depository Institutions Deregulation and Monetary Control Act	Basic insurance coverage raised to \$100,000 per depositor.
March 31, 1985	The Bank Board levied a special assessment ($\frac{1}{8}$ of 1 percent annually) against FSLIC-insured institutions for the first time.

SOURCE FOR TABLES: *Federal Banking Law Report*, Commerce Clearing House, Chicago, 1988.

Assessments and Coverage

The FSLIC-insured institutions have paid a higher effective insurance assessment than commercial banks since the inception of deposit insurance. The assessments levied by FSLIC, however, did not reflect either the costs incurred by the insurance fund or the extent of coverage. In particular, when FSLIC losses increased—slightly in the late 1960s and markedly in the early 1980s—the premium was not immediately increased. The effective premium levied by the FDIC was adjusted more rapidly to changes in cost experience.

The premium levied by the FDIC was increased in the early 1980s as the FDIC sharply reduced the rebate it paid to insured institutions.

The coverage ratio, reserves divided by insured deposits, has been much more variable at FSLIC than at the FDIC (chart 1). Prior to the 1980s, losses per dollar of total deposits remained flat for both insurance funds, and their coverage ratios were driven largely by legislative actions and deposit growth. The greater variability of FSLIC's coverage ratio is attributable, in large part, to the establishment of a sec-

Table 2

<i>FDIC Insurance Premiums and Coverage</i>	
June 16, 1933 Banking Act of 1933	Premium set at ½ of 1 percent of total insured deposits. One half of total assessment to be paid in full upon admission to the fund, the remainder subject to call. The ability to assess an emergency sum not to exceed the amount already paid in for that year, for a possible maximum special assessment of ½ of 1 percent of total insured deposits. Basic coverage set at \$2,500 per depositor per insured institution.
August 23, 1935 Banking Act of 1935	Premium assessed on total domestic deposits and reduced to ½ of 1 percent per annum. Maximum emergency borrowings from Treasury are \$975 million, and emergency assessment rights are eliminated.
August 5, 1947 Banking Act of 1935	Line of credit at Treasury is increased to \$3 billion.
September 21, 1950 The Federal Deposit Insurance Act	Premium rebates equal to 60 percent of net assessment income are established. Basic insurance coverage raised to \$10,000 per individual depositor.
July 14, 1960 Amendment to the Federal Deposit Insurance Act	Rebates increased to 66.6 percent of net assessment income.
October 16, 1966 Financial Institutions Supervisory Act	Basic insurance coverage raised to \$15,000 per individual depositor.
December 23, 1969 Credit Control Act	Basic insurance coverage raised to \$20,000 per individual depositor.
October 28, 1974 Act of October 28, 1974	Basic insurance coverage raised to \$40,000 per individual depositor. Insurance limit for time and savings accounts held by state and political subdivisions increased to \$100,000.
November 10, 1978 Financial Institutions Regulatory and Interest Rate Act of 1978	Insurance limit for Individual Retirement (IRA) and Keogh accounts raised to \$100,000.
March 31, 1980 Depository Institutions Deregulation and Monetary Control Act	Rebates decreased to 60 percent of net assessment income. Basic insurance coverage is raised to \$100,000 per individual depositor.

ondary reserve in the early 1960s, and to the greater volatility in deposit growth at FSLIC-insured institutions. Moreover, compared with commercial banks, deposits grew at a much greater pace at FSLIC-insured institutions during the 1970s and 1980s.

Rapid deposit growth combined with extremely high losses to the FSLIC fund in recent years have greatly reduced FSLIC's coverage ratio. Had a 32-basis-point premium been assessed on FSLIC-insured institutions, instead of the historic premiums, FSLIC's reserve position would be much different today (chart 2). Although one cannot say with certainty that FSLIC

would have been solvent at the end of 1987 had a 32-basis-point assessment been levied, the funds available for the resolution of insolvent institutions would certainly have been far greater than under the historic premiums. Additional funds would have enabled FSLIC to resolve insolvent institutions in a more timely fashion, eliminating losses that occurred when institutions that should have been resolved remained open. The FDIC's rebate system apparently has been somewhat more successful in stabilizing the coverage ratio than FSLIC's use of the secondary reserve or special assessment. Unlike FSLIC, however, the FDIC has not been required to book

contingent liabilities for troubled institutions likely to require financial assistance.

Insurer Actions

A private insurer implements changes immediately when something happens to affect its reserves. First, it collects new data to determine if the actuarial basis for its pricing system should be changed; then, if it remains profitable, it offers insurance. Second, it reexamines the behavior of those insured to determine if insurance should be limited or denied. Third, the risk characteristics insured are reassessed, and a new deductible and premium are established for each segment if appropriate. Fourth, coinsurance and reinsurance, if not

Federal insurers took or were required to take actions opposite to those that would have been taken by a private insurer

already in place, are reevaluated for possible implementation. Fifth, and more generally, the insurer is usually relatively free to establish new rules for those insured.

The federal deposit insurers have been either unwilling or unable to take any of these actions when faced with the severe problems experienced by the institutions whose deposits they insure in the 1980s. In fact, in some important ways the federal insurers took or were required to take actions directly opposite to those that would have been taken by a private insurer.

Examiners collect data for the federal insurers. Supervisory personnel use the examination report and other information to analyze the safety and soundness of an institution's activities, and take action to prevent or to contain trouble. Relative to total industry assets, the number of Bank Board and home loan bank examination and supervisory personnel declined substantially

between 1979 and 1984. The budget for the examination function increased only slightly during these years, and the Bank Board found it increasingly difficult to hire and maintain qualified examiners. In response, in July 1985, the Bank Board transferred the examination function to the district banks. Still, the staffing levels remained low, particularly in regions with a disproportionate number of insolvent institutions.

Although the deposit insurance system does establish some rules for the institutions that are covered, enforcing such rules is often difficult. Many of the Bank Board's regulatory and enforcement options are ineffective with recalcitrant

State-chartered institutions . . . may be granted wider powers than federally chartered institutions, creating possible conflicts between the insurer and the chartering authority

boards and management. State-chartered institutions, moreover, may be granted wider powers than federally chartered institutions, creating possible conflicts between the insurer and the chartering authority. Termination of insurance may be useful as a threat, but its implementation may cause a run on deposits. Furthermore, determining when an institution is unsafe and unsound requires accurate financial information and the legal ability to act upon such information.

The federal deposit insurers are permitted neither to base premiums on risk characteristics nor to provide less than 100 percent coverage. Congress has insisted throughout the history of federal deposit insurance, moreover, that the insurer

Chart 1

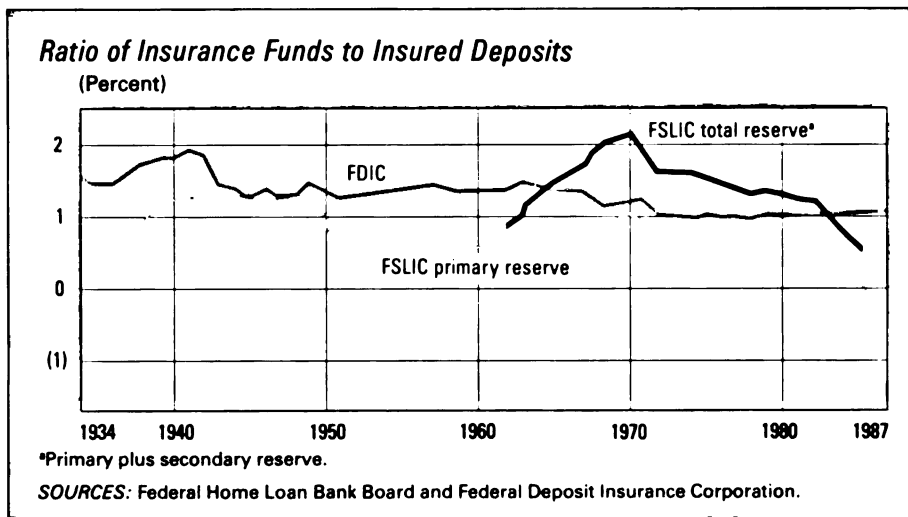


Chart 2

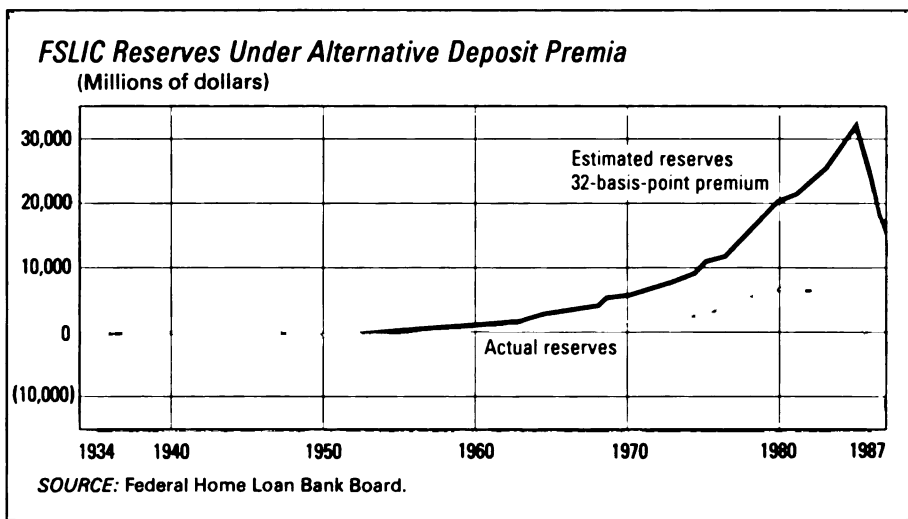
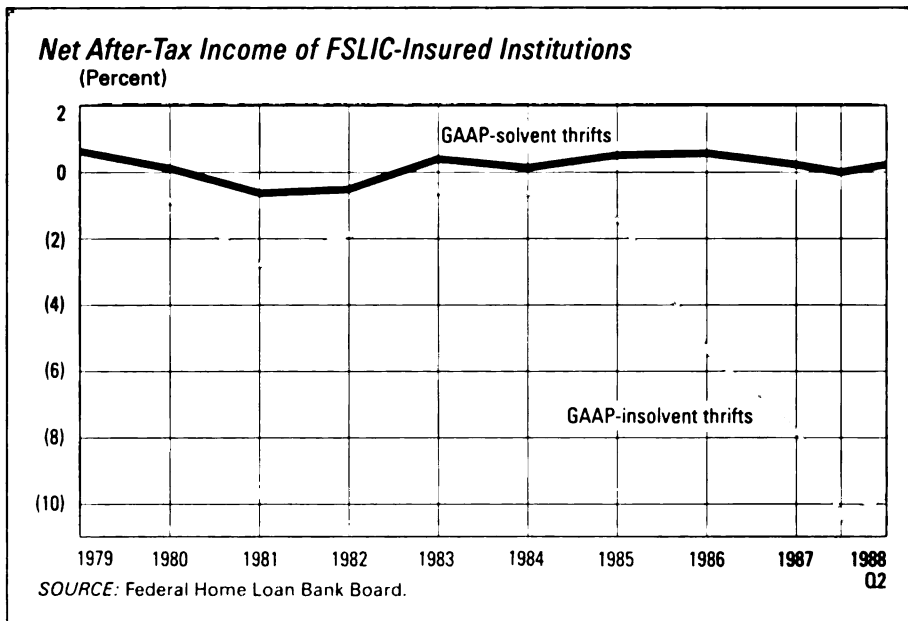


Chart 3



ance premium be linked to an insured financial institution's total domestic deposits.

Although thrift institutions were operating in an increasingly risky and competitive economic environment following deregulation, both the Bank Board and Congress took actions to reduce the capital (deductible) required of insured institutions, actions that have subsequently been reversed.

Consignment Program Begun

Because the Bank Board, as operating head of FSLIC, could not take many of the actions that a private insurer would have taken to protect its reserve fund, it has attempted to mimic such actions. For example, the Management Consignment Program, established in April 1985, permits FSLIC to take operating control of insolvent institutions that pose the greatest threat of further deterioration. Instead of immediately closing an insolvent institution, FSLIC allows it to continue operations under a new board of directors and new management. Furthermore, the Bank Board began to tighten regulation of the industry in 1984 as evidence accumulated that the asset quality at an increasing number of thrift institutions was deteriorating rapidly.

But as long as federal insurance practices are not identical to those of private insurers, the guarantee aspect of federal deposit insurance will be extremely important, even though there is currently no rule stipulating how this guarantee is to be honored when an insurance fund is totally depleted. All FSLIC is legally permitted to do to obtain additional resources for resolving troubled thrifts is to issue notes and guarantees that will be repaid out of its present and future premium income. No rule exists regarding a funding source in the event this income is insufficient.

Thrift Performance

Deregulation was expected to cause some institutions to fail as relatively inefficient firms were eliminated. Between January 1980 and December 1987, 804 thrifts and 657 banks failed as a result of insolvency, some being closed (management or ownership changed through liquidation or merger) and others still operating. Roughly

70 percent of all thrift institution failures in the 1980s occurred before 1984, what might be reasonably referred to as the transition period to a deregulated environment. Moreover, 46 percent of the 496 institutions that were insolvent according to generally accepted accounting principles (GAAP-insolvent) in June 1988 first reported being tangibly insolvent five or more years ago, indicating that the current losses being reported are largely embedded losses that reflect actions taken years earlier. The inability of FSLIC to take action

The continuation of the special assessment and a higher capital requirement could adversely affect competitiveness unless other financial firms are subjected to similar constraints

against all institutions when they became insolvent has distorted the aggregate performance of the thrift industry in recent years. A comparison of the net after-tax income of solvent and insolvent institutions reveals that these groups have performed far differently (chart 3). Recent aggregate data for the industry have been dominated by the huge losses of insolvent institutions, and mask the far healthier performance of most solvent institutions.

Thrift Charter Value

To adapt to evolving technological and other market developments, the financial services firm should have the choice of offering a wide array of financial services. A basic premise of deregulation is that individual institutions should be permitted to diversify into areas consistent with their business objectives and management capa-

bilities, provided that competition is not impaired. The thrift charter is potentially quite valuable because of the generally great powers it provides to thrift institutions.

Federally chartered thrift institutions have asset and liability powers comparable with those of commercial banks. In addition, relative to commercial banks, thrift institutions receive favorable tax treatment, can get lower-cost advances, and have greater branching powers, lower capital requirements, and greater service corporation powers. Thrift institutions, moreover, can be owned by any type of business and maintain broad powers, provided that the subsidiary thrift institution is a qualified thrift lender.

During the 1980s, although it has been relatively more variable, the return on equity (ROE) at GAAP-solvent thrift institutions has generally exceeded the ROE at banks, suggesting that both industries, in the aggregate, are potentially viable. Equity capital is a scarce resource allocated by the capital markets to those sectors of the economy where investors believe they can earn the highest after-tax risk-adjusted return. Industries yielding a relatively high after-tax risk-adjusted ROE expand as equity capital flows into these sectors. Industries yielding a low after-tax risk-adjusted ROE decline.

Reflecting the relatively high ROE at GAAP-solvent institutions since 1983, thrift institutions have been able to raise more than \$10 billion in new equity capital. Years of heavy equity offerings correspond to years in which the industry earned a relatively high ROE. That the industry continues to attract new equity capital indicates that it remains competitive. However, the continuation of the special assessment and the movement toward a higher minimum capital requirement could adversely affect thrift competitiveness unless other financial service firms are subjected to similar constraints. In any event, the potential value of the thrift charter remains quite high, which may be overlooked when one focuses only on the cost of resolving troubled thrifts and who will bear this cost. Reforming federal deposit insurance, not eliminating the thrift charter, should be the focus of the current debate. ♦

Gramm: Full Faith and Credit Is a Fact

With FSLIC notes already counted as an outlay of the government, says the Texas senator, we already have the burden. We may as well obtain the market benefits by granting explicit full faith and credit.

by DuPre Jones

Senator Phil Gramm (R-Texas), a member of the Banking, Finance, and Urban Affairs Committee, has become recognized as one of Capitol Hill's leading authorities on federal deposit insurance. "Savings and loans," he admits, "is a subject with which I am, sadly, familiar." The *Bank Board Journal* asked Gramm for his views on the doctrine of full faith and credit in light of recent developments in the industry.

Journal: Let me ask you first as a scholar, what are the meanings and origins of the phrase, "full faith and credit?"

Gramm: I think the meaning of the term is that if a financial instrument has the full faith and credit of the United States Government, that simply implies that the federal government stands behind that financial instrument and, if necessary, would use its power to print money—which is the ultimate financial power—to discharge any obligations related to it.

The term, of course, dates back to the Renaissance, when the use of the term "full faith and credit" related to the issuance of financial instruments by governments that backed those instruments with taxing or money-printing power.

Journal: It sounds as if it's more of a

reassuring axiom than a legal obligation.

Gramm: You might debate what the ultimate policy of printing money to discharge financial instruments might be for the country and the economy. But there can be no doubt that the government has the power to do that, and therefore a financial instrument backed by the full faith and credit of the United States government has always been viewed as the most secure financial instrument that the world can provide.

Journal: So it means that the government must honor FSLIC notes, no matter what?

Gramm: If they were granted the full faith and credit of the United States. There is, of course, a debate about the degree to which they currently have full faith and credit. As you will recall, in the most recent recap[italization] bill, Congress passed a resolution that said "it is the sense of the Congress that it should reaffirm that deposits up to the statutorily prescribed amount in federally insured depository institutions are backed by the full faith and credit of the United States."

Of course, a "sense of the Congress" resolution is not binding on the federal government. I think what is more relevant is the full faith and credit issue concerning

FSLIC notes, and certainly FSLIC notes are treated by the federal government as if they were backed by full faith and credit, because FSLIC notes count as an outlay of the Treasury; for budget purposes they are scored as an outlay of the Treasury, and to my mind that is the clearest signal that they are full-faith-and-credit notes. In my opinion, however, there is no sense leaving any doubt about the fact that there is full faith and credit backing for FSLIC notes and that the Congress ought to go ahead and adopt a law affirming full faith and credit.

Journal: Why are professional accountants the most unaccepting of groups who doubt that full faith and credit exists for FSLIC notes?

Gramm: They get paid to be doubters. Again, I think it's a perfectly legitimate concern for people that are investing their money, and we have found it in our interest in the past and in other areas not to leave any doubt about it. Accountants do not get paid for faith, they get paid for fact. I've also become totally convinced that we've got to come up with an accounting system that takes market values into account. That's another area that accountants are right about: our bookkeeping system in savings and loans is just not workable.

Journal: I think what many people are worrying about currently is that the idea of full faith and credit is being used to bail out fraudulent or inept institutions.

Gramm: Any idea that the Federal Home Loan Bank Board is bailing out institutions is simply a misuse of the term. They are bailing out FSLIC, which is a federal institution, but there is no effort to protect the stockholder, and the stockholder almost uniformly is walking away from this naked and broke. I have no doubt that we will have a followup and that we will have some people indicted and sent to prison for wrongdoing, so they're certainly not being bailed out. But it's the depositor who put money into these institutions—and those deposits are guaranteed by FSLIC—that we have to be concerned about.

Journal: So you think it's inevitable that there will be some institutions that, at least in the public perception, are not being managed well but are nevertheless going to have to come under the protective rubric . . .

Gramm: In the ones that are not being managed well, the existing management and ownership are being wiped out. Then the question is, what do you want to do? Do you want to close the institution, try to sell off its assets, try to pay off its depositors? Or do you want to do a cash-assisted transfer that puts in good management and brings in new capital? My view is that it is much cheaper to do cash-assisted transfers in most cases than to simply liquidate the institution.

Journal: Still, nobody likes to see these kinds of ill-run institutions. Are there preventive measures?

Gramm: Yeah! The preventive medicine is to strengthen our regulatory process to assure that in the future we never allow these institutions to act irresponsibly, without sufficient oversight. It's very interesting to me that Congress has been very critical of the Federal Home Loan Bank Board, when Congress more than any other public institution has been irresponsible on this issue. Congress prevented the Bank Board from intervening by not providing funds for recapitalization. For two years, Congress fooled around on this issue while the problem got worse. So I'm not saying the Federal Home Loan Bank Board is not due some criticism in some areas. I'm just saying that Congress does not have much standing in criticizing.

Journal: Apart from the funding issue, in terms of supervision that could encourage better management, do you think there are statutory solutions there?

Gramm: I think this problem built for a long time. It certainly dates back to the period in which we had high short-term rates in the market and low interest rates on the long-term mortgages in thrifts' portfolios. Savings and loans were in deep trouble. Congress responded by granting savings and loans broad new powers.

The Federal Home Loan Bank Board was sort of a sleepy little institution that was regulating makers of home mortgages—and in an inflationary era only an idiot could lose money on a home mortgage—and then, suddenly, we had savings and loans in the fried chicken business. Residual earners in the fried chicken business! I think it is clear that the Bank Board did not have the resources to do that regulatory job, and once they realized

that things were out of control, they didn't have the money to do it. We could spend lots of time pointing fingers back and forth, but the critical thing is to get on with the solution.

Journal: Could you be more specific about what the solution should be, and are you suggesting legislation yourself?

Gramm: Well, I think the approach has got to be that you set guidelines, that you have enough resources in FSLIC so that if an institution violates your capital requirements you step in and put the institution on the block, and you have enough capital to have a cash-assisted transfer if needed, and you put that management out on the street.

Journal: Which is what they're doing now . . .

Gramm: Which is what they're doing now, but they could not do that two years ago because they did not have the money. So we were losing a million dollars a day or more because of the inability of the Bank Board to close institutions. To have closed them would have required money and they didn't have the money, that's right.

Journal: Are you finding that there are different concerns, which are not reconcilable, between the savings and loan industry and individual institutions on one hand, and the depositor on the other?

Gramm: I think it's pretty remarkable that the depositor does not show more signs of concern. Clearly, over the years we have convinced the American people that deposit insurance works and that it's reliable. There's no other explanation for depositor behavior. I think that in some cases the natural disciplining device has been eliminated because of the success of our deposit insurance.

Journal: Is that altogether healthy, though?

Gramm: I'm not saying it doesn't have plusses and minuses . . .

Journal: . . . because the everyday depositor is saying, "it doesn't matter where I put my money because it's insured by FSLIC."

Gramm: That's right, and that means that the institutions that have long ago stopped worrying about the bottom line and are simply worried about keeping the door open, don't have to worry about what kind of interest rates they pay. That's why

acting quickly and getting institutions into the hands of those who are worried about the bottom line is so critically important.

Today's savings and loan is not predominantly an issuer of mortgages in an inflationary era. One, there isn't high inflation, and two, savings and loans are doing a lot of other things besides home mortgages. So they require a different kind of regulation, and I think we are moving towards that very rapidly.

The remaining question as I see it is: who is going to pay to fix FSLIC? As usual there are not a lot of people who want to pick up the tab. I look at the fact that 90 percent of the industry is solvent by some definitions and about 60 percent is profitable, and I see no possibility that they're going to walk off and leave the rest of society holding the bag alone. This is a bad situation. It's not a question of right or wrong, it's a question of who has to come in and pick up the pieces, and the industry itself still holds the principal contingent liability for FSLIC. And that's a reality.

Journal: You suggested that different solutions might be inappropriate during a noninflationary period. But that could change.

Gramm: I'm just saying that the reality of the regulation of savings and loans in the early 1970s was that savings and loans were predominantly making home mortgages in an era where the value of the home in the period of time between the closing and somebody making the first payment grew enough to cover the closing cost. So it was very difficult to lose money on a mortgage loan in the early 1970s. That situation has changed since 1982, when we stopped the inflation—as is obvious by the fact that HUD [U.S. Department of Housing and Urban Development] and lots of other people have a lot of real estate that they are now the proud owners of (well, not such proud owners of). So you've got to take that into account in your regulatory process—that mortgage lending has risk today that it did not have in 1972.

Journal: But a new inflationary period would change the equation?

Gramm: Well, it would, yeah. But I don't foresee it. I'm dedicated to it not happening. I don't want to try to solve this problem by creating a bigger problem, all right? ◊

As the structure of the mortgage market has changed, and as tax and accounting regulations have evolved, many financial firms have entered the loan-servicing business. Each has faced the difficult task of figuring out how servicing fit into its overall business strategy.

There are many reasons a servicing portfolio might be offered by one firm and bid on by another. The seller might consider itself too small to manage servicing profitably. Or the decision may rest with something more subtle: a difference in the two firms' evaluations of prepayment risk, for example. Or the decision to buy or sell may be dictated by the balance sheet or income statement: the seller may desire immediate income; the buyer may be looking for long-term income flow. Such complementary evaluations make the sale of servicing not only possible, but very often mutually profitable.

The key to a successful transfer of servicing is the effect that it has on the portfolio's value, a consideration crucial not only to the buyer and the seller of the portfolio, but to the investor—the secondary mortgage market agency—as well. To protect that value, the agencies have established stringent requirements for those who purchase servicing through them.

Before a firm gets involved in either buying or selling servicing, it should know as much as possible about the opportunities, the risks, and the rules. Three industry experts offer their insights to the Bank Board Journal in the next five pages.



ILLUSTRATION BY BRIAN JAMES WALKER

Buying Servicing Calls For Diligence

Servicing provides income opportunities that are less dependent than other investments on market fluctuations. And it provides a hedge against rising interest rates.

by James T. Szymanski

The decision of a savings institution—or any other firm—to pursue loan servicing should only follow an evaluation of its overall business strategy. Many thrift managers recognize that servicing can become a major source of long-term income and cash flow; moreover, they know that a servicing portfolio can improve the institution's hedging ability and the level of its overall service to borrowers.

However, a partial commitment to servicing may be ill-advised. The potential for profit in servicing is predicated on high volume, and a large servicing portfolio allows an institution to make confident long-term predictions about cash and income flows. Economies of scale, affording control over the costs per loan serviced, grant a thrift greater operational efficiency. In addition, high volume enables a thrift to automate loan servicing to an extent that would have been prohibitive on a smaller portfolio.

These aren't the only advantages of large-scale servicing. Servicing provides income that is less dependent than other investments on market fluctuations. And it provides a hedge against rising interest

rates. With escrow deposits, interest expense does not rise with interest rates; meanwhile, such deposits earn for the institution at current yields. What's more, servicing rights have historically increased in value during periods of rising interest rates.

Evaluating Portfolios

In evaluating a portfolio for possible acquisition, a thrift should ask three important questions. What are the interest rates on the loans in the portfolio? These yield an estimate of the long-term income flow and the potential runoff of a portfolio. What will be the overall servicing fee and ancillary income? And what will be the operational costs incurred in servicing the portfolio?

Such an evaluation requires both subjective and objective analyses of the portfolio and the thrift's ability to service it. By considering geographical locations, types of loan servicing, delinquencies, and investor requirements, an institution can develop an overall incremental cost of servicing any portfolio. Once a thrift knows its strengths and weaknesses in handling various types of servicing portfolios, it will find that it can handle some portfolios more efficiently than others. These records of efficiency can help to produce an estimate of the cost, on an annualized basis, of loans serviced.

Bids and Contracts

If a portfolio meets an institution's tests, the transfer process begins. Although all the decision-making and evaluating are intended to minimize risk, the execution of the transfer is where the greatest risks occur. An efficient transfer of the portfolio doesn't interfere with the needs of either the borrower or the investor. Upon smooth execution of a servicing transfer rest all the assumptions made in evaluating the portfolio. This test of reality is often the hardest.

The transfer takes place in stages, each with its own risks. In the initial stage, a thrift develops and submits a financial bid to the offering party. At this point, an institution runs the risk of making fallacious assumptions about its ability to service the portfolio. If successful, a bidder contacts the seller to discuss a contract to purchase the servicing rights on its portfolio. Along with the negotiation, there should also be a due diligence review on site. Initially, a due diligence review should verify the existence of the portfolio characteristics placed in the bid offering. Is it the portfolio the thrift

A large servicing portfolio allows an institution to make confident long-term income predictions

thought it bought? Is the portfolio relatively clean? Or is it being sold because it has problems?

Then the review should confirm the seller's conformity with investor guidelines. Because most investors require the buyer of the servicing to maintain all origination and servicing warranties, it is important to ensure that the seller has originated and serviced the loans according to these guidelines.

The buyer should also identify the ways in which the loan portfolio will be serviced differently after the transfer. There are many ways to service a loan according to the guidelines, and these ways differ in approach as well as result. By identifying these differences and thus smoothing the

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transfer, a buyer benefits both investors and borrowers.

From due diligence are developed the items that are incorporated in the contract covering all risk, passback, and recourse obligations. A critical part of the contract negotiations is deciding which risks will travel with the purchase and which will be retained by the seller.

Transfer Details

The transfer is a very complex procedure. A buyer must:

- ◆ Obtain from the seller computer records and reports to help the buyer service the new loans;
- ◆ Notify all customers;
- ◆ See that the funds are transferred;
- ◆ Match the investor cycle so that data continue to flow smoothly;
- ◆ Ensure that the loans can be loaded on the buyer's system in time to make the transition dates; and
- ◆ Carry enough staff to answer questions from borrowers.

In addition, the buyer should keep detailed schedules and checklists to obtain information, and should evaluate the portfolio continually until its transfer.

Both the investor and the borrower need assurance that, no later than the effective date of transfer, the buyer will be able to service the loans as effectively and completely as the previous servicer, while meeting all contract obligations. The buyer should bear in mind that its relationship with its new customers will largely be set at the moment of transfer. If the cross-selling of services is an objective, an institution's future business is at risk if it makes sad work of the transfer.

As a safeguard, the institution should maintain communication with the seller of servicing from the date of bidding until long after the transfer has been accomplished. Indeed, post-transaction communications with the previous servicer and investors will probably be required to work out confusion regarding characteristics of the previous servicing and the originations. Structure such activities as carefully as the execution of the transfer and assign the followup to specific groups.

The transfer is not truly accomplished until the borrowers and the investors are satisfied with its success. ◊

Sellers of Servicing Check the Options

An institution may not wish to service everything it originates; proceeds from a sale of servicing are considered income on financial statements, whereas servicing income must be amortized.

by Michael K. Stamper

A few years ago, mortgage banks sold everything they originated and savings institutions kept everything they originated. The same sort of division is taking place now in servicing. Some firms would no more consider retaining servicing than a mortgage banker would consider retaining a mortgage. Others may either retain servicing or sell it when the price is right.

There are primarily two kinds of sellers of servicing: one that sells "flow servicing" and another that sells a servicing portfolio. The former, selling servicing rights as the loans are produced, originates a loan, sells the loan, and sells the servicing, thus taking itself out of the loop altogether. The latter markets a servicing portfolio, or a portion thereof, and views servicing as an asset to be managed. By altering the composition of a portfolio, such a firm seeks to upgrade the value of a portfolio and then to sell at a profit. This is easier said than done; opinions of the value of a portfolio may vary depending on a firm's treatment of prepayment assumptions, discount rates, foreclosure incidence and costs, and

the actual costs of the servicing. The difference between a seller of flow servicing and a seller of portfolios is comparable to that between a mortgage banker who sells all loans and a portfolio lender who sells only when the opportunity presents itself.

What drives the decision to sell flow servicing, as opposed to an enhanced portfolio? Some sellers, wishing to position themselves as loan brokers, have neither the capability nor the desire to service loans in general. Some sellers may not wish, or be able, to service a particular type of loan. Many sellers of the latter type were drawn into the market when the Federal Housing Administration (FHA) went through a period in which it changed its maximum mortgage interest rates quickly in a fast-moving market. In the scramble, some firms found that they couldn't originate enough of any one coupon to form a Government National Mortgage Association (Ginnie Mae) pool of \$1 million. Some larger originators, recognizing the opportunity, offered to buy the odd lots (say, \$400,000 of FHA/Veterans Administration loans servicing-released) of the smaller originators, and, before long, it became a mode of doing business. Subsequently, some loan originators with more than enough loans to form a Ginnie Mae pool

Michael K. Stamper is general manager of the security sales and trading group at the Federal Home Loan Mortgage Corporation.

figured that selling servicing-released might be less trouble and expense, for them, than forming the pool and servicing the loans.

Using a similar rationale, some big wholesalers saw that, by selling off a small number of loans at a time, they could avoid carrying sizable inventory for the length of time required to build a million-dollar pool. Even if interest rates were stable and they knew that eventually they'd get a pool together, why take the risk that prices might turn against them? Instead, they could sell a few loans at a time, get their money out of the deal, and know that they had come out ahead.

Now that transfers of servicing are relatively commonplace, thrifts often sell simply because they don't want to handle a particular product. Say that a thrift is helping a customer get an FHA or VA loan, but that the thrift doesn't want to be stuck with servicing it. The solution? The firm processes the loan up front and sells it servicing-released.

Another example: a few years ago, when all those exotic adjustable-rate loans came along, mortgage bankers found that their production offices wanted to originate as many adjustables as possible. Their servicing staffs, on the other hand, were generally opposed to working with these complex and troublesome instruments. The mortgage bankers compromised by selling the loans servicing-released.

The Business of Servicing

What was evolving was a sense of the servicing portfolio as a business entity separate from the loan origination process, and the realization that a firm doesn't have to service everything it originates or to originate everything it services. Today, if a firm's servicers want to concentrate in 30-year fixed-rate loans, but the originators want to offer a hundred different products, including adjustable-rate mortgages, there is a way to deal with that. Keep the servicing on all those 30-year fixed-rate loans; buy 30-year fixed-rate-loan servicing in the market, if that fits the business plan; and sell the servicing originated on anything else.

As a result of such activities, thrifts are moving closer to mortgage banking. If an institution is unable to originate loans that fit its portfolio, it simply sells the loans it

originates and doesn't want, and it buys the loans that it couldn't originate. As a consequence of this new way of doing business, firms have come to recognize servicing as a liquid asset.

Accounting Considerations

Another reason to sell servicing is the accounting treatment it gets. For example, the sale of servicing can produce an immediate increase in earnings for sellers pressed to show earnings. Sellers may simply want to show income on their profit and loss statements. If loans have an excess servicing fee, the fee can be capitalized and taken as income.

If servicing is not sold, it can have a negative effect on the financial statement. Say that a thrift originates a loan that has no excess servicing fee. Although the ser-

If an institution is unable to originate loans that fit its portfolio, it sells what it originates and doesn't want, and buys the loans it couldn't originate

ving has value, it can't be capitalized. Suppose that in a perfectly efficient market the institution originates a loan disbursing 100 cents on the dollar, and that it then sells that loan in the secondary market for 99 cents. Although there appears to be a 1 cent loss, the thrift also has a servicing contract worth 1 cent. If this is a perfectly competitive environment, then nobody has made any money: the thrift has lost 1 cent up front and gained a servicing asset worth 1 cent.

That is not how the transaction will appear on the institution's financial statement, however. There, the transaction will show a loss of 1 cent, with a footnote about the servicing. The value of that servicing as income will not appear. The income state-

ment will declare only income earned from servicing that year.

There is a way for a thrift to put its financial statements back in balance, however. That is by selling the servicing, whereupon the income statement will show the thrift breaking even. It would disburse 100 cents on the dollar in originating the loan, sell the loan for 99 cents, and sell the servicing for a penny: a breakeven deal. In other words, although both holding and selling servicing break even economically, only selling reflects the equation on the income statement.

Cost of Selling

There are some significant transactions costs involved in selling that both buyers and sellers should consider. These include administrative costs, fees, and the costs of controlling quality.

For example, buyers or sellers must typically pay a broker's fee to arrange a sale. (Although the fee can be avoided by not using a broker, the cost of searching for aggressive counterparts usually exceeds the broker's fee.) In addition, the cost of moving the loan file and setting it up on a new servicing system often represents considerable administrative expense.

The adverse selection and quality control expenses arise because the seller knows a lot more about what is being sold than the buyer does. Under such circumstances, it's important for the buyer to have quality control, and this results in some underwriting costs. It's important to keep in mind that most investors, including Freddie Mac, require the new servicer to assume the warrants provided by the loan originator relating to the quality of the loan. Firms will have to reunderwrite some or all of the loans; this will involve their reviewing the credit packages and evaluating the appraisals. If the buyer does not do so, it will expose itself to the excessive costs of servicing low-quality loans and to the potential losses arising from selling warranty violations.

Such costs, as important as they are to consider, should not keep a firm from entering the secondary market for servicing. The benefits derived from an institution's ability to choose the servicing strategy most appropriate to it far outweigh the costs. ◊

Freddie Mac Looks at Servicing Ability

*What are some signs of a good servicer?
Strong, reputable, and reliable managers.
The ability to price accurately and improve
unusual or troubled portfolios. Concern for
the mortgagor.*

by James Crum

The first concern of any secondary mortgage market agency with a buyer of loan servicing is the buyer's managerial ability. The agency takes measures to ensure that the firm is fully capable of the job before it. What must a buyer do to be approved?

Initially, the firm looking to take on a new servicing portfolio must agree to accept the responsibilities of the underlying purchase contract. That may not seem like much, but the agreement cannot be taken lightly. Some special servicing obligations may be involved, particularly with some of the newer, more unusual products.

For example, the agency and the seller may have agreed to change the reporting schedule or the timing of the remittance of cash. And some extraordinary provisions, such as limited or full recourse, may be attached to the purchase contract. The prospective servicer must be prepared to honor these provisions.

James Crum is regional director of loan servicing at the Federal Home Loan Mortgage Corporation.

The Inquiring Agency

The prospective buyer of servicing must not only be willing; it must also pass muster with the secondary mortgage market agency. The Federal Home Loan Mortgage Corporation (Freddie Mac) looks at how well the firm has managed its portfolio in the past. Before the transfer agreement is executed, the agency's regional office evaluates the servicer by a number of general criteria. The servicer must be approved for the types of loans that are being transferred—home mortgages, second mortgages, or multifamily mortgages—and the firm must have the financial strength to meet its responsibilities.

The components of Freddie Mac's screens for buyers are established, quantifiable criteria such as default rates, the number of repurchases, and the number of times reports or cash remittances are late. The agency's subjective view of the customer is also important. How responsive is the institution to new requirements? How good is the managers' attitude toward taking on more obligations? When there's a problem, do the managers work well with

the agency to solve it? There's no way to quantify such evaluations. Their outcomes depend on how well the investor knows the institution and what it thinks of the managers.

The servicer should have a good, strong management team. In addition, the firm should have the financial strength to keep operating in the bad times as well as the good. The firm should have controls in place to make sure that money and reporting aren't falling through the cracks. Moreover, the investor can't look just at an isolated portfolio of acquired servicing; it needs the whole picture. If a firm has made three or four acquisitions in the past year, will the next troublesome increment be the one to push it into substandard performance?

Freddie Mac wants to be sure that the buyer's acquisition of a new servicing portfolio will not permanently impair its ability to service the portfolio it already has. This is especially important now, when many institutions are receiving troubled portfolios as a result of consolidations within the industry. Given a reasonable length of time, an institution should be able to absorb even a troubled portfolio and bring its performance close to the level of its current portfolios.

A servicer that fails through good management eventually to reconcile an acquired servicing portfolio with its base portfolio runs the risk of weakening its relationship with the investor. That is, such a servicer endangers its claim to special negotiating waivers and pricing considerations. On the other hand, the agency has the obligation to consider the extenuating circumstances of a given portfolio's performance. That is, it should recognize the higher risks of an acquired loan portfolio compared with an originated one.

Warranties and Risks

Both Freddie Mac and the Federal National Mortgage Association require a buyer to meet other responsibilities, as well, such as maintaining selling warranties. Freddie Mac's contract states that buyers of servicing must agree to take over the selling warranties, along with any other special terms and conditions inserted in Freddie Mac's purchase contract. If a buyer takes on a portfolio with a higher instance of re-

purchase, the institution must be able to bear the additional risk and the greater-than-usual due diligence required.

This takes time and attention: it's one thing to price a portfolio simply on the basis of expected cash flows and default ratios; it's another to price a portfolio with broad quality risk. Investors require buyers to assume such terms, conditions, and risks because they don't want to have to chase a loan from institution to institution to resolve a problem. Freddie Mac wants to deal with the servicer, and only with the servicer. So the firm must have, among other qualities, the strength to buy back these loans, if necessary.

There are special risks in taking on unusual product types, and buyers should be aware of them. For example, suppose a buyer wants to acquire monthly cost-of-funds-indexed adjustable-rate mortgages. Can the institution monitor the rate adjustments and calculate the payment changes? Can it notify the borrower of these changes? Can it explain to the borrower how the loan is operating? Can it re-

It's one thing to price a portfolio on the basis of cash flows and default ratios; it's another to price a portfolio with quality risk

port the related cash flows to the investor? The more complex the product line, the more difficult and costly it is to manage, and a buyer has to recognize and accept the financial and credit risks, as well as the burden of more complicated processing and customer service.

Transfer Restrictions

If the prospective servicer is approved, the investor then examines the form of the transfer. Freddie Mac ensures that the transaction is complete, meaning that the agency retains all rights to the servicing income and all of the implicit protections. Coupon stripping is not permit-

ted. An institution may want to sell a servicing portfolio worth $\frac{3}{8}$ of a basis point to a firm willing to service it for $\frac{1}{4}$ of a point, so that the seller can retain the extra $\frac{1}{8}$ of a point, but Freddie Mac won't go along with that kind of transaction. Buyers can expect that, in general, issuers of mortgage-backed securities will ensure that transfers are whole transfers—with the entire income from the servicing fee moving to the servicer—and that the old servicer does not retain any residual direct claims on the loans or the servicing fee generated by them.

Prohibitions on pledging and transferring servicing are consistent with Freddie Mac's idea of the value of servicing. The agency claims full right to the servicing spread as a reward for services performed under a contract. No other party may encumber the investor's ability to use the value of that servicing spread as a tool of portfolio management. What's more, the investor should have the flexibility to move any portfolio, free from the snagging claims of third parties.

Borrower's Concerns Prevail

Although such restrictions are for the investor's protection, they also protect the borrower. Consumers may be more price-conscious today than they were years ago, but once they choose the firm they're going to do business with, they expect—and they're entitled to—a certain continuity. If an investor transfers New York loans to a California servicer, it's not unreasonable for the borrowers to expect to be well-treated by that transfer. They shouldn't have to pay \$4 per minute in telephone charges at midday in order to reach a servicer because the firm is open for only three hours in the borrower's time zone.

Communication should be the strong point in any relationship between servicer and borrower. It's advisable that servicers provide a local, toll-free telephone number for borrowers. The number of incoming lines should be sufficient to handle the average volume of calls, which will undoubtedly be heaviest after a servicing portfolio is transferred. When servicers receive complaints, they should acknowledge them promptly and provide continuous followup until the problems are completely resolved.

Everyone should be sensitive to the needs of the borrower. If borrowers lose interest in the loan, they're more likely to default. If that happens, they're less likely to recover. They figure that, if the financial system doesn't care about them, why should they work to solve the problem. They're more likely to give up and walk away.

Borrowers should have the opportunity, by asking questions, to satisfy themselves of the transaction's legitimacy

Good relations with the mortgagor are important to preserving the timely payment of a loan. Freddie Mac sets day-to-day standards for dealing with the mortgagor. Moreover, the agency offers some general rules concerning the administration of the loan, the servicing of delinquent loans, and the timing of both mortgage insurance cancellations and waivers of escrow requirements. These guidelines give the agency some assurance that servicers will treat borrowers equitably throughout the routine servicing of the loan.

Recently, a change in Freddie Mac's *Sellers and Servicers Guide* established new requirements for consumer notification. These guidelines, which facilitate the early disclosure to consumers of information concerning a transfer, lower the risks that a transfer will meet strong resistance. As soon as possible, borrowers should be introduced to the firm they're going to be dealing with and should have the opportunity, by asking questions, to satisfy themselves of the transaction's legitimacy. Moreover, early transfers of information allow buyers of servicing more time to remedy any problems in managing the overall transfer. Remember that the smoothness of this transfer sets the tone for the long-term relationship between the borrower, the new servicer, and the investor. ◊

Out In Print

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The Wealth of the Nation: An Economic History of the United States

by **Stuart Bruchey**

Harper & Row, Publishers, New York,
New York, 1988. 232 pages. \$18.95.

In 1775, on the eve of the American Revolution, England was on the verge of accepting the colonists' proposal for an independent union. If only emissary Benjamin Franklin would strike the clause permitting the establishment of unrestricted manufacturing companies, British negotiators said, Parliament likely would approve the colonies' plan.

But independent manufacturing was important to the development of inland communities. Colonial recalcitrance in that regard spurred Britain to station 10,000 troops on American soil—at colonial expense—to enforce more rigorously the Acts of Trade and Navigation, igniting armed revolt.

According to author Stuart Bruchey, the founding fathers' concept of freedom was based on the Lockean principle equating liberty with financial independence and property rights. With the American Revolution as his backdrop, Bruchey has produced an absorbing, highly readable account of how the American economy and its flaws and excesses have affected historical events.

Some historians take the view that America's economy was shaped by the nation's social and political structure. To Bruchey, the reverse is true. In 232 pages, the author whisks the reader through an economic examination and evaluation of every war, of every major financial, industrial, and agricultural development, and of nearly every presidential administration in the nation's 200-year existence.

The book is a tightly written overview

that gives the reader almost a sense of cramming for an examination. But the author's panoramic descriptions of westward migration, emerging cattle empires, and ruthless financiers add the flavor of a good, long yarn.

Bruchey's chronicle delineates not only past economic crises but also modern corporate structure, business ethics, and government intervention. The author dispels several myths, and he has thrown what for some will be a fresh perspective on how America's wealth was accumulated.

For example, in a pattern of growth driven by mechanization, the number of farms in the Dakota Territory alone increased from 17,435 in 1878 to 95,204 in 1887. Steel production vaulted from 70,000 tons in 1880 to 1.3 million tons in 1890. Bruchey's depiction of the accompanying social upheaval brings the industrial revolution to life.



Businesses trying to cope with the effects of a severe depression in the 1870s and another in the 1890s created "pool" agreements, informally known as price-fixing. Meanwhile, in 1890, beef tycoons Gustavus and Edwin Swift fought local butchers' unions by instituting a nationwide distribution system controlled by a central marketing office in the nation's first vertically integrated company.

Several years later, oil magnate John D. Rockefeller, evading laws against voting trusts, gained control of the nation's oil refineries by creating the holding company—a mechanism that played a major role in the merger wave that rolled over the American economy from 1895 to 1904, spawning American Tobacco Company, International Harvester Inc., and United States Steel Corp., history's first billion-dollar corporation. In 1899 alone, 1,028 firms disappeared into conglomerations. Today's merger activity pales by comparison.

Central to Bruchey's theory are key decisions in the 1800s by the U.S. Supreme Court, which, the author claims, made possible the fitful, explosive development of national markets. The courts of chief justices John Marshall and Roger B. Taney gave rise to freewheeling enterprise by repeatedly ruling against attempts by state legislatures to pass arbitrary trade and contract laws that favored local interests. Taney in particular is praised for liberating private business from the shackles of local government. Taney reasoned that "corporate egalitarianism" served the public welfare by opening new areas of enterprise to free competition and the application of the latest technology.

Bruchey seems to favor federalism, or, as he calls it, "democratized capitalism," as the only way to guarantee free trade. He views as an aberration the former world economic superiority of the United States. But the author, a professor of American economic history at Columbia University, sees some disturbing trends. Today's corporate managers have abandoned research and innovation for tax avoidance and manipulation of assets. Higher premiums are placed on expertise in law and finance than on expertise in science and engineering. His solution is a national industrial policy.

Bruchey is not the first economist to recommend such reform. But his book is required reading for anyone seeking a compact account of the nation's early economic system and its development.

—Marc Adams

Office of Communications
Federal Home Loan Bank Board

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Controlling Corporate Illegality: The Regulatory Justice System

by Nancy Frank and Michael Lombness
Anderson Publishing Company, Cincinnati, Ohio, 1988. 147 pages. \$14.95.

From the title, the reader might expect a discourse on the corporate justice system, replete with examples of how to catch white-collar criminals. But it is not until the end of chapter two that the authors make clear their aim: to describe how the regulatory justice system works, and why it works the way it does. The idea is that regulation cannot be controlled unless it is understood.

The book is based on two assumptions: regulations are here to stay, and regulations can be greatly improved. The authors focus on some of the important legal features of the regulatory system, as well as on the social forces that mold it.

Four models are explored: the justice model, whereby regulation is viewed as a social control; the rational-legal model, which contends that law provides a rational and definitive solution to social problems; the economic model, which views regulation in terms of the overall efficiency of the economy and seeks to enact regulations that maximize social benefits and minimize social costs; and the conflict model, which holds that regulation is a political tool for assigning rights and responsibilities.

The authors note that the regulatory justice system has created a new variety of law—administrative law, which defines the powers of regulatory agencies and the procedures they must follow. Within constitutional and statutory constraints, regulatory agencies create several types of rules: those that specify regulatory requirements; those that set standards for what is fair, efficient, and safe; and those that clarify the limits of corporate conduct.

Once regulations are established, they must be enforced. So the authors discuss investigation processes, and how they may differ. Is the investigation reactive or proactive? When rules are so broad that regulations must be interpreted in light of spe-

cific circumstances, how is judgment exercised? The authors posit—not surprisingly—that some agencies use vague rules as an opportunity to expand their authority; that some back away from investigation and enforcement of marginal cases; and that the direction an agency takes is likely to depend on the political climate.

Lack of money and staff affect the regulatory process. Because it is unlikely that these shortages soon will be remedied, limited resources must be used in the most efficient ways. Thus, the cooperation of regulated entities must be sought.

To a great extent, regulatory investigation relies on the regulated to provide voluntarily the information and access to facilities necessary to discover violations. The cooperation and compliance of regulated firms depend upon the regulating agency's ability to communicate the reasonableness of its intentions. A captured agency—that is, one whose political environment is dominated, if not monopolized, by industry groups promoting unobtrusive regulation—will be completely ineffective if it cannot institute a program of voluntary compliance.

Even then, if the regulations for which it seeks voluntary compliance are weak, corresponding to the industry's own voluntary—thereby, acceptable—standards, the industry will win almost every time, and the agency cannot effectively mediate between the interests of the public, which are to be protected through regulation, and the interests of the regulated industry. The authors contend that this is the dominant pattern in regulatory agencies. They note, however, that capture can be stopped, or at least tempered, by statutory limits on regulatory discretion, professionalization of regulatory personnel, and diffusion of regulatory authority.

The authors do not expect the regulatory system ever to please everyone. It cannot, if it is to be effective. But they believe the system can be improved, with their book as a platform for the discussion of reforms. ◊

—Diana Garmus
Office of Regulatory Activities
Federal Home Loan Bank System

Regulatory Review

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What is the proper interpretation of the term "advisory or honorary director," as defined in the Depository Institutions Management Interlocks Act of 1978? Under what circumstances may directors be exempt from that statute's proscriptions?

Only a director who is truly a mere figurehead is exempt from the definition of a "management official" contained in the Depository Institutions Management Interlocks Act (DIMIA). The determinative consideration is whether a director gives advice or participates in any way in the management of the unaffiliated entity.

The DIMIA does not allow a management official of a depository institution or a depository holding company to serve as a management official of any other unaffiliated depository institution or depository holding company if the two institutions are located within a certain distance of one another.

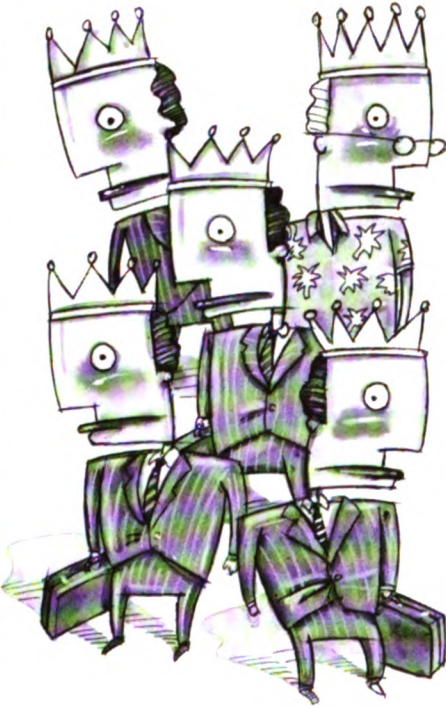
Regardless of its geographic location, if a depository institution or depository holding company has total assets exceeding \$1 billion, a management official of that institution or any of its affiliates may not serve as a management official of any other unaffiliated depository institution, depository holding company, or any of their affiliates having total assets exceeding \$500 million. The term "management official" includes an advisory or honorary director. The term "advisory or honorary director" is not further defined in DIMIA, however.

Congress clearly intended DIMIA to reduce potentially anticompetitive consequences that could result from interlocking relationships. Moreover, there is nothing in the act's legislative history to suggest that Congress intended to preclude its application to advisory or honorary direc-

Regulatory Review

tors. The United States Court of Appeals for the Ninth Circuit cited DIMIA's use of the term "honorary director" as an indication that Congress understood the significance of labeling a position "honorary," and thus expressly intended that those holding such a title be covered by the statute.

A recent letter to the Bank Board notes that, under Pennsylvania law, an "advisory or honorary director emeritus" has "little or no authority" and "shall not have any



responsibilities or be subject to any liability." The letter implies that these directors should always be exempt from the prescriptions of DIMIA.

That view is too expansive. DIMIA's parenthetical inclusion of "advisory or honorary director" was clearly intended to cover all directors of an unaffiliated depository institution, holding company, or affiliate—no matter how thin their responsibilities or how nominal their titles—to avoid the potential anticompetitive consequences proscribed in the statute.

REFERENCE: Letter from general counsel, Federal Home Loan Bank Board, October 4, 1988 (88/RL-50)

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Is the finance leasing of real property, secured by the property, a permissible method of real estate lending by a federally chartered thrift institution?

The loan is permissible under the following conditions: A federally chartered stock thrift intends to make a mortgage loan, which must be arranged so that the institution acquires fee simple title to the real estate that will serve as collateral. The borrower leases the real estate from the thrift under terms that make it clear that it is a "finance lease," not a true lease.

Further, in the event of a default, provisions of the lease permit the lending institution—in its role as "landlord"—to foreclose upon the real estate as if the lease were a mortgage or deed of trust. The "rental" under the lease will be the payments required under the loan, and—in addition to principal and interest—may include an equity kicker or other feature of a participating mortgage.

Under the Home Owners' Loan Act of 1933 as amended, a federal institution is authorized to invest in loans on the security of liens upon residential or nonresidential real property, provided that the loans and investments in nonresidential real property do not exceed 40 percent of assets.

Section 545.53, Title 12, of the Code of Federal Regulations provides that a federal thrift may acquire "real property for the purpose of leasing such property . . . and may incur obligations incidental to its position as the legal or beneficial owner and lessor of the leased property," provided that certain conditions are met. The lease must be a net lease, precluding the thrift from becoming obligated—directly or indirectly—to repair or maintain the property, purchase parts or accessories, lend or replace substitute property, purchase insurance for the lessee, or renew any license, registration, or filing required for the property.

The regulation also permits the lessee to recover its investment in the property, plus the cost of financing it over the lease term,

from rental payments, estimated tax benefits, and the estimated residual value at the expiration of the lease (provided the amount of recovery derived from the residual value of the leased real property does not exceed 20 percent). Thrifts must liquidate their interest in the property as soon as they can upon expiration of the lease.

A finance leasing transaction that meets the requirements of section 545.53 is, therefore, the functional equivalent of a real estate loan, and must comply with the requirements imposed on real estate loans made by FSLIC-insured institutions. These include loans-to-one-borrower limitations, appraisal restrictions, record-keeping requirements, and conflict-of-interest regulations.

Further, when a federal association makes a loan secured by property that is a leasehold or other interest for a period of years, the term of the interest must be subject to extension or renewal at the option of the institution for a term of at least five years after the loan matures. Also, no transaction is permitted that is inconsistent with safe and sound operations, even if it does not violate a specific regulation.

A final consideration in the proposed finance leasing transaction is the matter of an equity kicker or other feature of a participating mortgage. As part of the 1983 revisions to its real estate lending regulations, the Bank Board clarified the extent to which a federal institution may participate with a borrower in the income generated by security property. With limited exceptions, a federal institution lacks statutory authority to acquire an equity interest in real estate or in a corporation. The regulation does, however, permit an association to receive a share of the income from the property securing a real estate loan, regardless of the method of calculating the share, if the income "in substance constitutes no more than a part of the compensation received for the use of the association's funds."

REFERENCE: Letter from deputy general counsel, Federal Home Loan Bank Board, August 31, 1988 (88/RL-46) ♦

Enforcement Remedies

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Off-the-Books Trading

A former officer of a state-chartered stock thrift traded securities off the institution's books—and concealed the losses by converting funds from various sources. After a thorough investigation, accountants hired by the thrift estimated the losses from this unauthorized trading at \$26 million.

The former officer's conduct thus gave rise to unsafe and unsound practices and breaches of fiduciary duty that resulted in substantial financial losses to the institution. The Bank Board issued a final order in December that prohibited the former officer from participating in any manner in the conduct of the affairs of the institution, or voting for directors or serving or acting as an officer, director, or employee of any institution insured by the Federal Savings and Loan Insurance Corporation (FSLIC).

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Manage Better or Else

General ledger problems and a lack of policies and procedures for financial transactions have forced a state-chartered savings and loan association to operate under a cease-and-desist order issued by the Bank Board in November. The order, which binds not only the association but also its directors, its major stockholder, and two of its officers, requires the thrift to correct the ledger problems, submit revised business and management plans, hire qualified managers with banking experience, and establish policies and procedures for its financial transactions. If the order is violated, the supervisory agent may request the resignation or termination of any members of the thrift's management or board. ◊

Followup Commentary

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In the Washington Times of November 8, 1988, an editorial placed primary blame for thrift losses on the perverse effect of federal deposit insurance on deregulation: "Unscrupulous thrift managers were unchained from federal regulations governing their behavior, but protected from losses by taxpayer-subsidized insurance." (True enough, except that no subsidy has yet passed from taxpayer to insurance fund.) The editorial dismisses the argument that thrifts' losses were caused largely by the poor timing and execution of deregulation. The main problem is not with the way thrifts have been handled, we are told, but with their special character—that is, with the federal guarantee behind their deposits and with the nation's "blind devotion" to such a pledge. The editorial's central question is: why should the guarantee persist?

The editorial indicts for some degree of venality or negligence nearly every group associated with thrifts: managers, regulators, and (selected) politicians. It's quite unremitting. Indeed, if such a recitation of abuses amounts to the best knowledge regarding the thrift industry, then even institutions taking only nominal risks haven't a prayer of holding onto federal deposit insurance.

But thrifts do have a prayer of sorts—a couple of requests, anyway: may the dire harmonics of editorials not smother, as if it were discord, the news of redemptive developments in the thrift industry; and may those who decide the future of deposit insurance be circumspect.

People will make judgments of the Federal Home Loan Bank Board's ability to forestall a repetition of the Federal Savings and Loan Insurance Corporation's (FSLIC's) past decade of trouble. A positive

judgment should require no great leap of faith. The public and its representatives should not have to search for reasons for maintaining the federal government's longstanding and still valuable commitment to housing via the thrift industry. Among the most important of these reasons should be regulatory changes at the Bank Board that both strengthen FSLIC's defenses against, and lower the likelihood of, financial extremity among large numbers of thrifts.

A broad initiative will raise what Bank Board member Lawrence J. White has called the thrift industry's deductible. By requiring a thrift to hold more capital—the owners' stake in the business—the Bank Board lessens the likelihood of losses ever reaching FSLIC. With each increase in the required level of capital, the federal insurance fund is better immunized. Moreover, as a hostage of sorts against failure, capital is also a psychological deterrent. As the owners' capital in a thrift increases, so does their regard for the welfare of the institution.

For three years, the Bank Board has had a rule that gradually raises thrifts' capital requirements relative to total assets. With the latest round of proposals, the goal is raised to an average of 8 percent in 1993. As this broad program has proceeded, capital rules with special applications have also been promulgated. A regulation (563.14) of early 1988 provided for higher requirements for selected thrifts: "Increased individual minimum capital requirements may be established upon a determination that the insured institution's capital is or may become inadequate in view of its circumstances." Such circumstances include the regulators' expectation of financial trouble at a thrift, high exposure to certain risks, illiquidity, problems at an affiliate or subsidiary that may affect the thrift, and poor underwriting controls. The Bank Board may never know how successfully certain principles of good management have been communicated to thrift owners and managers, but requiring additional capital should unstopper all ears.

Regulations requiring thrifts to capitalize their weaknesses are being reconciled with the international risk-based capital requirements adopted by the banking agencies. Under the modified proposal,

Followup Commentary

which was put out for comment in December, the capital of every thrift will be required to reflect the institution's credit risk and interest rate risk (a model developed by the Bank Board will calculate the latter for each institution).

In placing all assets on one of six steps of risk, the credit risk proposal gives special treatment to equity risk investments (ERIs)—a primary agent of catastrophe in the early 1980s. Regulations governing these investments were toughened in 1985, and the proposal is even stricter. Under current regulations, such investments may be weighted by as much as 267 percent: if a thrift with average amounts of capital and equity risk investments invests \$100,000 in an ERI, it might be required to secure the investment with capital of approximately \$15,000 (\$100,000 times the 5 percent capital requirement, plus an additional 10 percent for credit risk).

Under the primary credit risk proposal (to be phased in with the overall capital requirement in 1991 and 1993), the

maximum weighting is 300 percent, and the average institution would be required to hold as much as \$24,000 (\$100,000 times the 6 percent capital requirement, times 300 percent for credit risk weighting, or \$18,000, plus an interest-rate-risk component of 2 percent of risk-weighted

The Bank Board has been hampered by its inability to redirect the fortunes of a thrift headed for insolvency until it was too late

assets, or \$6,000). This is six times the capital the proposal requires of the same institution on a one- to four-family residential mortgage of equal size (\$100,000 times 6 percent, times the 50 percent credit risk weighting, or \$3,000, plus 1 percent of risk-weighted assets, or \$1,000,

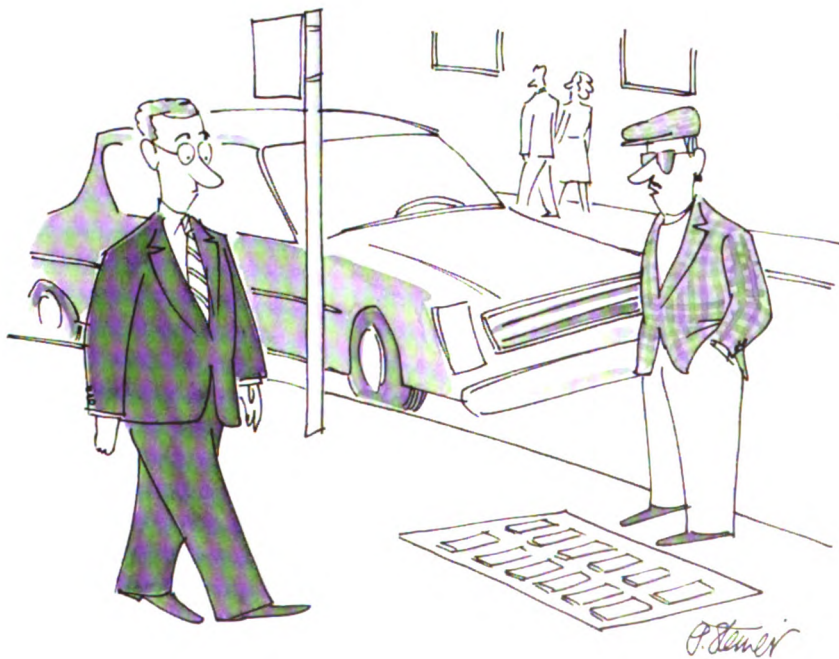
for a total of \$4,000). Moreover, the sum is 15 times the capital required on a mortgage-related security guaranteed by the U.S. government (\$100,000 times 6 percent, times a 20 percent credit risk weighting, plus 1 percent of risk-weighted assets, or \$400, for a total of \$1,600). An exclusionary approach is also out for comment; in effect, this approach would relegate ERIs to thrifts' subsidiaries.

A proposal to empower the Bank Board to intervene before a thrift's net worth reaches zero, if adopted, would also improve considerably the Bank Board's ability to protect FSLIC against loss. The Bank Board has been hampered by its inability to redirect the fortunes of a thrift headed for insolvency until it was too late. In many cases, the managers and directors of a hopeless institution aggravated its losses severely in their efforts to recover net worth. Meanwhile, regulators had to look helplessly on, prevented from doing what was necessary until an institution's net worth had hit zero and had fallen into the netherworld.

Early intervention would place the fate of a thrift with core equity capital of 1.5 percent or less in the hands of the Bank Board. The regulator could remove its managers, arrange a merger, or appoint a conservator or receiver to oversee operations. This proposal was put comment in January.

If the risk-based capital revision and the early intervention plan become regulation, the Bank Board will have prepared the thrift industry and FSLIC for the possibility of future adversity, provided that present adversity can be overcome. The regulators have learned much from everyone's mistakes, including their own. Some commentators, on the other hand, seem to have little taste for accomplishments. Even old bad news is better than new good news. In the aftermath of catastrophes, some never tire of sitting around bemoaning the losses, the inadequacy of the old safeguards, the looting, and the jadedness of official response. There's been a lot to complain about, but give credit to those busy rebuilding. ♦

—Frank Dwyer



"Yo! Mortgages. Check 'em out."

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Statistical Series

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Table 1

Selected Balance Sheet Data

FSLIC-Insured Thrift Institutions

Assets

Millions of Dollars

End of Period	Number of institutions	Mortgages and mortgage-backed securities outstanding ^a				Nonmortgage loans outstanding ^a			Cash deposits, investment securities	Other assets	Total assets	Memo: Assets eligible for regulatory liquidity
		Net total	Construction loans	Permanent loans	Mortgage-backed securities	Net total	Consumer loans	Commercial loans				
1983	3,183	612,210	46,353	497,001	90,902	28,337	26,380	3,532	109,923	68,698	819,168	84,958
1984	3,167	705,720	64,169	574,730	112,686	44,983	34,719	11,960	136,745	90,003	977,451	104,558
1985	3,246	761,023	63,976	626,741	115,525	60,712	45,809	17,424	143,538	104,739	1,070,012	107,339
1986	3,220	813,845	58,349	639,102	158,193	72,264	51,622	23,683	164,844	112,898	1,163,851	119,057
1987	3,147	881,077	52,825	668,768	201,828	77,598	57,902	23,163	169,717	122,462	1,250,855	100,310
1987												
Nov	3,168	876,576	53,254	664,679	200,039	77,327	57,465	23,294	170,713	122,367	1,246,983	98,774
Dec	3,147	881,077	52,825	668,768	201,828	77,598	57,902	23,163	169,717	122,462	1,250,855	100,310
1988												
Jan	3,135	883,385	51,976	670,968	201,732	78,300	58,342	23,538	169,953	123,247	1,254,885	100,142
Feb	3,126	880,831	51,523	672,333	197,811	78,503	58,687	23,340	174,106	124,025	1,257,466	104,271
Mar	3,118	882,246	51,536	674,089	197,889	78,766	58,390	24,004	176,386	124,184	1,261,581	103,313
Apr ^r	3,112	892,392	51,890	677,093	202,767	79,852	59,120	24,243	177,955	124,284	1,274,483	101,535
May ^r	3,094	898,836	52,003	681,544	205,053	81,058	60,250	24,201	179,506	125,939	1,285,339	101,495
Jun ^r	3,092	904,465	52,333	684,566	207,744	82,318	61,151	24,672	177,536	125,815	1,290,134	98,485
Jul ^r	3,083	911,437	52,130	691,009	208,533	83,152	61,568	24,962	178,442	126,526	1,299,557	96,912
Aug ^r	3,045	923,037	52,300	699,175	210,598	84,366	62,414	25,096	175,995	128,392	1,311,789	90,963
Sep ^r	3,025	927,486	52,022	702,636	211,223	83,630	61,789	24,893	183,080	130,000	1,324,196	95,178
Oct ^r	3,007	934,848	51,908	709,135	212,001	83,661	61,317	25,265	184,727	129,998	1,333,233	96,179
Nov ^p	3,001	938,619	51,741	711,833	212,703	84,294	61,812	25,411	180,072	130,705	1,333,691	94,435

Liabilities and Capital

Millions of Dollars

End of Period	Liabilities										Total liabilities & capital	
	Deposits				Borrowings ^b							
	Total	\$100,000 or less	More than \$100,000	Memo: IRA-Keogh	Total	FHLB advances	Reverse repurchase agreements	Other	Other liabilities	Total liabilities		Capital ^c
1983	671,058	590,545	80,512	N.A.	98,511	57,253	27,313	13,945	16,619	786,188	32,980	819,168
1984	784,468	671,069	113,399	39,961	137,945	71,741	46,128	20,076	17,876	940,290	37,162	977,451
1985	843,932	735,454	108,478	52,789	157,667	84,390	44,260	29,016	21,756	1,023,354	46,657	1,070,012
1986	890,664	773,997	116,667	63,522	196,930	100,025	58,584	38,321	23,975	1,111,569	52,282	1,163,851
1987	932,616	808,274	124,342	70,382	249,916	116,363	84,723	48,831	21,941	1,204,473	46,382	1,250,855
1987												
Nov	922,340	803,930	118,410	69,041	247,462	111,283	87,100	49,078	27,404	1,197,206	49,777	1,246,983
Dec	932,616	808,274	124,342	70,382	249,916	116,363	84,723	48,831	21,941	1,204,473	46,382	1,250,855
1988												
Jan	939,080	814,301	124,779	70,833	246,087	114,053	84,222	47,813	23,873	1,209,040	45,845	1,254,885
Feb	946,790	822,544	124,246	71,679	239,452	112,725	77,863	48,864	25,818	1,212,059	45,406	1,257,466
Mar	958,471	832,238	126,233	73,402	237,663	112,389	76,917	48,357	22,555	1,218,689	42,892	1,261,581
Apr ^r	962,304	834,643	127,661	74,699	244,990	113,029	80,180	51,781	24,618	1,231,912	42,570	1,274,483
May ^r	963,761	836,186	127,575	74,804	250,697	114,994	83,802	51,901	27,161	1,241,618	43,720	1,285,339
Jun ^r	966,756	838,549	128,207	76,114	257,120	117,281	87,243	52,595	24,562	1,248,438	41,697	1,290,134
Jul ^r	968,218	839,476	128,742	76,312	262,733	118,207	90,333	54,193	27,105	1,258,056	41,502	1,299,557
Aug ^r	968,297	838,243	130,053	76,399	266,724	120,671	91,496	54,557	28,898	1,263,919	47,871	1,311,789
Sep ^r	973,732	841,968	131,764	77,425	273,642	123,430	93,275	56,937	25,991	1,273,365	50,830	1,324,196
Oct ^r	976,168	843,627	132,541	77,554	278,288	124,362	97,097	56,829	27,547	1,282,003	51,230	1,333,233
Nov ^p	972,028	840,707	131,320	77,558	281,154	127,640	97,417	56,098	29,125	1,282,307	51,384	1,333,691

- a. Net total is after deduction of contra-assets. Detail is shown gross, before deduction of contra-assets.
b. Prior to 1987, reverse repurchase agreements are included in other borrowings.
c. Includes all items qualifying as regulatory capital except general loss reserves.
p. Preliminary.
r. Revised.

Table 2

Sources and Uses of Funds

FSLIC-Insured Thrift Institutions

Sources of Funds

Millions of Dollars

Period	Total sources of funds	Net new deposit receipts ^a			Borrowings			Other liabilities			Total liabilities	Capital
		Total	Over \$100,000	Other	Total	FHLB advances	Other	Total	Interest credited	Other		
1983	119,271	63,224	24,734	38,490	575	(6,699)	7,274	48,275	46,990	1,285	112,074	7,197
1984	155,853	57,181	27,662	29,519	39,155	15,074	24,080	55,672	53,895	1,777	152,008	3,845
1985	84,709	(4,602)	(5,595)	993	20,176	13,203	6,972	60,420	56,968	3,452	75,990	8,715
1986	97,743	(3,344)	8,396	(11,740)	40,105	16,468	23,638	55,674	53,458	2,216	92,435	5,308
1987	91,689	(1,815)	8,101	(9,914)	54,275	17,519	36,760	46,239	48,182	(1,943)	98,701	(7,011)
1987												
Nov	7,047	3,176	(1,965)	5,142	1,407	1,861	(453)	2,958	2,612	346	7,541	(494)
Dec	3,878	2,571	5,947	(3,376)	2,500	5,126	(2,625)	2,259	7,717	(5,458)	7,330	(3,451)
1988												
Jan	6,319	5,452	486	4,966	(3,240)	(1,763)	(1,477)	4,548	2,578	1,970	6,760	(441)
Feb	2,719	5,271	(523)	5,795	(6,618)	(1,311)	(5,308)	4,494	2,549	1,945	3,147	(428)
Mar	3,924	4,301	1,976	2,325	(1,708)	(253)	(1,455)	4,094	7,349	(3,255)	6,687	(2,763)
Apr ^r	12,878	1,179	1,433	(254)	7,327	640	6,687	4,700	2,637	(2,062)	13,206	(328)
May ^r	10,868	(1,113)	(53)	(1,061)	5,726	1,971	3,754	5,200	2,660	2,540	9,813	1,055
Jun ^r	5,345	(3,274)	673	(3,947)	6,460	2,281	4,179	5,034	7,621	(2,587)	8,221	(2,876)
Jul ^r	10,113	(357)	570	(927)	5,707	1,011	4,696	5,245	2,685	2,560	10,595	(482)
Aug ^r	12,233	(2,629)	1,314	(3,943)	3,986	2,457	1,529	4,544	2,753	1,791	5,900	6,333
Sep ^r	12,684	(1,891)	1,738	(3,628)	6,977	2,805	4,173	4,672	7,574	(2,902)	9,759	2,925
Oct ^r	9,257	(131)	783	(913)	4,712	995	3,718	4,331	2,766	1,566	8,913	344
Nov ^p	179	(7,009)	(1,212)	(5,797)	2,926	3,337	(410)	4,408	2,821	1,587	325	(146)

Uses of Funds

Millions of Dollars

Period	Total uses of funds	Mortgage loans and mortgage-backed securities						Nonmortgage loans			Cash deposits & investment securities	Other assets	
		Total	Loans closed	Net purchases	Cash repayments	Mortgage-backed securities	Other ^b	Total	Consumer	Commercial			Other ^b
1983	119,271	72,259	151,073	(9,600)	71,342	27,990	(25,862)	7,948	5,864	2,724	(640)	25,243	13,821
1984	155,853	93,148	181,302	341	81,455	16,738	(23,778)	17,243	9,027	8,298	(82)	25,123	20,340
1985	84,709	49,914	196,750	(35,346)	108,527	2,103	(5,066)	15,302	10,792	5,337	(827)	5,711	13,777
1986	97,743	57,538	265,512	(100,701)	162,208	43,496	11,439	11,386	6,482	6,220	(1,316)	20,933	7,886
1987	91,689	72,903	253,407	(58,921)	148,303	44,391	(17,672)	5,729	6,465	(240)	(493)	4,365	8,692
1987													
Nov	7,047	8,853	16,875	(1,138)	9,246	3,048	(686)	993	939	118	(64)	(2,596)	(203)
Dec	3,878	4,588	21,524	(4,573)	10,799	1,788	(3,353)	273	438	(130)	(35)	(1,148)	165
1988													
Jan	6,319	4,246	13,077	(1,078)	7,886	24	109	883	599	401	(116)	345	844
Feb	2,719	(2,439)	13,664	(3,620)	8,149	(3,920)	(414)	215	357	(198)	56	4,160	783
Mar	3,924	1,373	18,378	(4,827)	10,063	28	(2,144)	277	(274)	698	(147)	2,125	149
Apr ^r	12,878	10,130	19,078	(4,300)	10,151	4,878	624	1,085	729	239	117	1,564	99
May ^r	10,868	6,486	21,237	(4,110)	11,258	2,284	(1,666)	1,238	1,180	(37)	95	1,477	1,668
Jun ^r	5,345	5,725	25,565	(6,193)	13,394	2,713	(2,965)	1,317	904	583	(169)	(1,913)	216
Jul ^r	10,113	7,220	21,681	(3,784)	11,491	794	19	917	496	310	112	1,334	642
Aug ^r	12,233	11,653	24,654	(3,018)	11,706	2,066	(342)	1,217	846	135	236	(2,525)	1,888
Sep ^r	12,684	4,677	23,343	(5,996)	11,708	634	(1,597)	(718)	(609)	(200)	91	7,077	1,648
Oct ^r	9,257	7,466	19,722	(2,601)	10,187	792	(260)	41	(468)	381	128	1,680	70
Nov ^p	179	3,376	18,092	(5,148)	9,868	717	(417)	634	489	157	(12)	(4,612)	782

Note: Where sources and uses are based on net changes in balance sheet items, the effect of such structural changes as mergers or other acquisitions, conversions, newly insured or chartered institutions, liquidations, or terminations of insurance are excluded. Figures given in parentheses are negative.

- a. New deposits received less deposits withdrawn.
 b. Includes primarily changes in contra-asset items.
 p. Preliminary.
 r. Revised.

Table 3

Net New Deposit Receipts

FSLIC-Insured Thrift Institutions

Millions of Dollars

End of Period	United States	Federal home loan bank district											
		Boston	New York	Pittsburgh	Atlanta	Cincinnati	Indianapolis	Chicago	Des Moines	Dallas	Topeka	San Francisco	Seattle
1983	110,212	1,536	7,181	2,830	13,913	5,659	3,597	6,606	4,064	16,236	4,219	40,746	3,625
1984	59,787	(184)	1,813	662	6,676	(425)	351	403	510	16,209	2,540	31,104	128
1985	(2,697)	(40)	(689)	476	(839)	(1,797)	(909)	(2,059)	(869)	7,634	637	(2,779)	(1,463)
1986	3,247	565	(148)	670	(1,435)	(1,798)	(577)	(1,704)	(2,011)	3,512	548	7,052	(1,427)
1987	(1,785)	1,449	(1,283)	(1,027)	(1,748)	(1,976)	(998)	(2,918)	(2,330)	(421)	(38)	10,715	(1,210)
1987													
Nov	3,177	202	386	51	716	0	(186)	(154)	(135)	759	(69)	1,667	(60)
Dec	2,571	(115)	121	166	779	187	(120)	(151)	(129)	178	(68)	1,671	52
1988													
Jan	5,453	36	(14)	345	798	(37)	(19)	132	(43)	993	729	2,624	(91)
Feb	5,268	34	431	405	989	305	37	123	96	985	533	1,195	135
Mar	4,301	197	368	299	887	183	(47)	250	107	569	(59)	1,349	198
Apr ^r	1,180	119	(146)	27	404	70	(22)	70	(105)	(271)	(58)	1,221	(129)
May ^r	(1,115)	179	215	(105)	(198)	(48)	(48)	(130)	(125)	(365)	(216)	(214)	(60)
Jun ^r	(3,270)	200	(237)	(156)	(331)	(242)	(268)	(281)	(307)	(85)	(169)	(1,158)	(236)
Jul ^r	(360)	136	8	(42)	294	(86)	19	(114)	(178)	(1,021)	169	547	(92)
Aug ^r	(2,631)	11	(413)	(280)	(528)	(394)	(207)	(766)	(390)	(542)	(301)	1,151	28
Sep ^r	(1,893)	(150)	(389)	60	(37)	(141)	350	(286)	(195)	(400)	(246)	(450)	(9)
Oct ^r	(131)	(111)	(373)	16	(58)	(143)	(102)	(225)	(100)	(1,178)	(160)	2,366	(63)
Nov ^p	(7,008)	(408)	(212)	54	(907)	(311)	(294)	(384)	(310)	(1,896)	(569)	(1,485)	(286)

Note: "Net new deposit receipts" are new deposits received less deposits withdrawn. Figures given in parentheses are negative.

p. Preliminary.

r. Revised.

Table 4

Mortgage Loans Closed

FSLIC-Insured Thrift Institutions

Millions of Dollars

Period	United States	Federal home loan bank district											
		Boston	New York	Pittsburgh	Atlanta	Cincinnati	Indianapolis	Chicago	Des Moines	Dallas	Topeka	San Francisco	Seattle
1983	138,200	2,995	6,700	3,629	21,567	6,910	3,700	6,018	3,278	26,607	6,087	45,412	5,297
1984	169,921	3,877	9,122	4,114	26,766	7,518	3,678	8,447	4,189	30,031	6,132	59,775	6,272
1985	189,478	6,424	13,119	4,324	31,421	10,620	4,763	9,264	4,429	31,588	5,916	60,952	6,658
1986	265,276	10,558	23,917	7,298	43,251	15,057	8,334	15,415	6,125	28,613	7,537	89,909	9,262
1987	253,059	9,290	26,132	7,796	41,274	14,608	8,210	13,198	5,762	17,065	5,846	95,818	8,060
1987													
Nov	16,875	602	1,758	523	2,631	888	483	904	358	868	360	7,027	473
Dec	21,523	592	2,048	565	3,216	1,017	543	871	558	1,303	462	9,711	637
1988													
Jan	13,077	448	1,453	425	2,194	702	289	556	255	828	241	5,266	421
Feb	13,664	396	1,286	420	2,198	691	340	591	285	962	250	5,822	421
Mar	18,378	480	1,835	512	2,993	985	458	743	332	1,145	370	7,910	615
Apr	19,078	630	1,803	537	3,043	1,069	499	847	393	1,317	349	7,915	675
May ^r	21,237	664	2,175	687	3,468	1,221	689	1,032	498	1,202	438	8,449	713
Jun ^r	25,565	703	2,382	777	4,009	1,506	764	1,267	513	1,800	478	10,599	767
Jul ^r	21,681	550	1,936	699	3,234	1,239	681	1,086	415	1,345	385	9,453	659
Aug ^r	24,654	649	2,278	758	3,572	1,310	694	1,201	503	1,343	410	11,231	706
Sep ^r	23,343	472	1,896	712	3,281	1,271	669	1,091	448	1,222	380	11,222	679
Oct ^r	19,722	446	1,750	527	2,971	1,102	579	974	320	985	308	9,164	595
Nov ^p	18,092	415	1,663	480	2,568	924	543	884	303	876	286	8,570	581

Note: These data include all mortgage loans closed in the name of the institution.

p. Preliminary.

r. Revised.

Table 5

Income and Expenses

FSLIC-Insured Thrift Institutions

Amounts

Millions of Dollars

Period	Operating income and expense					Nonoperating income and expense					Net income before taxes ^b	Income taxes	Net income after taxes
	Operating income		Operating expenses			Nonoperating income		Nonoperating expense					
	Net operating income	Interest income	Other operating income	Interest expense ^a	Other operating expense	Net non-operating income	Total	Profit on sale of assets	Total	Provision for & loss on sale of assets			
1983	(32)	75,527	6,473	69,549	12,483	2,627	4,232	3,614	1,605	1,116	2,595	592	2,005
1984	990	92,455	8,738	85,128	15,076	796	3,919	3,392	3,123	2,585	1,786	764	1,022
1985	3,597	101,135	9,502	87,852	19,188	2,215	7,121	6,465	4,906	4,117	5,815	2,087	3,728
1986	4,556	100,577	10,234	83,640	22,615	(1,290)	8,704	8,038	9,994	8,559	3,272	3,141	131
1987	2,850	99,551	7,964	80,642	24,022	(7,930)	5,848	5,126	13,778	11,781	(5,079)	2,699	(7,779)
1987													
Q 3	624	24,991	1,956	20,388	5,936	(2,042)	1,089	884	3,131	2,740	(1,418)	571	(1,989)
Q 4	(427)	25,842	1,553	21,517	6,305	(3,177)	1,268	1,033	4,446	4,154	(3,604)	398	(4,003)
1988													
Q 1 ^r	(281)	26,021	1,508	21,886	5,936	(3,167)	1,163	1,061	4,331	4,041	(3,449)	490	(3,938)
Q 2 ^r	224	26,573	1,745	22,054	6,057	(3,582)	1,093	939	4,675	4,423	(3,358)	545	(3,902)
Q 3	378	26,881	1,765	22,383	5,897	(1,418)	1,222	989	2,640	2,460	(1,040)	582	(1,622)

Percentage of Average Assets

Annual Rates

Period	Operating income and expense					Nonoperating income and expense					Net income before taxes ^b	Income taxes	Net income after taxes
	Operating income		Operating expenses			Nonoperating income		Nonoperating expense					
	Net operating income	Interest income	Other operating income	Interest expense ^a	Other operating expense	Net non-operating income	Total	Profit on sale of assets	Total	Provision for & loss on sale of assets			
1983	0.00	10.05	0.86	9.25	1.66	0.35	0.56	0.48	0.21	0.15	0.35	0.08	0.27
1984	0.11	10.31	0.97	9.49	1.68	0.09	0.44	0.38	0.35	0.29	0.20	0.09	0.11
1985	0.35	9.93	0.93	8.63	1.88	0.22	0.70	0.63	0.48	0.40	0.57	0.20	0.37
1986	0.41	9.00	0.92	7.48	2.02	(0.12)	0.78	0.72	0.89	0.77	0.29	0.28	0.01
1987	0.24	8.30	0.67	6.72	2.00	(0.65)	0.49	0.43	1.14	0.98	(0.41)	0.23	(0.64)
1987													
Q 3	0.21	8.26	0.65	6.74	1.96	(0.68)	0.36	0.29	1.04	0.91	(0.47)	0.19	(0.66)
Q 4	(0.14)	8.38	0.50	6.98	2.04	(1.03)	0.41	0.33	1.44	1.35	(1.17)	0.13	(1.30)
1988													
Q 1 ^r	(0.09)	8.30	0.48	6.98	1.89	(1.01)	0.37	0.34	1.38	1.29	(1.10)	0.16	(1.26)
Q 2 ^r	0.07	8.33	0.55	6.92	1.90	(1.12)	0.34	0.29	1.47	1.39	(1.05)	0.17	(1.22)
Q 3	0.12	8.23	0.54	6.85	1.81	(0.43)	0.37	0.30	0.81	0.75	(0.32)	0.18	(0.50)

Note: Figures given in parentheses are negative.

a. Interest accrued on deposits, borrowings, and escrow accounts less capitalized interest charges.

b. Net operating income plus net nonoperating income.

r. Revised.

Table 6

Mortgage Loans Held, Delinquencies, and Foreclosures

FSLIC-Insured Thrift Institutions

Millions of Dollars or Annualized Percentage Rates

Period	Mortgage loans held ^a						Mortgage delinquency rates ^b				Mortgage foreclosure rates ^c			
	Construction		Permanent				Construction and land	Home	Other	All types	Construction and land	Home	Other	
	Residential	Nonresidential	Residential	Nonresidential	Land	Other								Total
1983	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	548,879	N.A.	N.A.	N.A.	0.736	N.A.	N.A.	N.A.
1984	64,169 ^d	N.A.	567,186 ^d	N.A.	N.A.	N.A.	631,355	N.A.	N.A.	N.A.	0.970	N.A.	N.A.	N.A.
1985	34,639	29,337	511,934	72,797	31,857	1,334	681,898	N.A.	N.A.	N.A.	1.409	N.A.	N.A.	N.A.
1986	35,067	23,282	514,161	81,848	31,762	1,871	687,991	N.A.	N.A.	N.A.	2.140	N.A.	N.A.	N.A.
1987	33,739	19,087	539,800	88,514	27,559	2,915	711,614	16.86	2.02	8.96	2.798	8.420	1.260	3.793
1987														
Q 3	33,734	20,471	526,475	87,163	27,779	2,709	698,331	17.91	2.13	9.27	2.895	9.660	1.294	3.370
Q 4	33,739	19,087	539,800	88,514	27,559	2,915	711,614	16.86	2.02	8.96	3.090	8.444	1.260	5.056
1988														
Q 1'	33,240	18,296	544,923	89,305	27,258	3,062	716,084	17.07	1.96	8.93	2.588	7.461	1.034	4.199
Q 2'	34,323	18,011	556,509	89,351	26,489	3,352	728,035	15.95	1.80	9.11	2.849	8.184	1.137	4.771
Q 3	35,018	17,025	573,474	90,009	26,405	3,710	745,641	14.73	1.65	8.60	2.549	7.934	0.939	4.358

Note: "N.A." signifies that these data are not available

a. Amounts are shown gross, before deduction of contra-assets

b. Construction and land loans and all other permanent loans are reported as delinquent when a payment is past due. Permanent loans secured by 1-4 dwelling unit properties reported as delinquent when a payment is 60 days or more past due. Rate represents dollar amount of delinquent loans as a percent of the dollar amount of gross mortgage loans (excluding mortgage-backed securities) outstanding at end of period.

c. Rate represents dollar amount of such loans foreclosed during the period as a percent of the average dollar amount of gross mortgage loans (excluding mortgage-backed securities) outstanding during the period, calculated as an annual percentage rate.

d. Breakdown by property type not available; these figures represent totals for the residential and permanent categories.

r. Revised.

Table 7

Effective Interest Rates on Conventional Home Mortgages

Major Lenders

U.S. Averages in Percent

Period	Commitment rates ^a			Rates on loans closed ^b							Memo: portion closed with adjustable rates ^c	
	Adjustable-rate loans			All major lenders								
	Fixed-rate loans	With limited rate change	With unlimited rate change	Loan purpose				Loan type		FSLIC-insured thrifts: all loans	Major lenders	FSLIC thrits
				All loans	Purchasing newly built home	Purchasing previously built home	Fixed rate	Adjustable rate				
1983	N.A.	N.A.	N.A.	12.73	12.57	12.75	12.98	12.33	12.75	40	42	
1984	14.38	12.34	12.66	12.48	12.38	12.49	13.18	12.05	12.44	62	68	
1985	12.99	11.02	10.96	11.64	11.55	11.64	12.43	10.87	11.65	51	54	
1986	10.73	9.45	9.15	10.18	10.17	10.18	10.50	9.42	10.14	30	38	
1987	10.51	8.69	8.36	9.30	9.31	9.28	9.90	8.51	9.16	43	56	
1987												
Nov	11.19	8.98	8.57	9.31	9.30	9.25	10.57	8.59	9.10	64	74	
Dec	11.07	8.97	8.53	9.21	9.15	9.20	10.43	8.67	9.13	69	78	
1988												
Jan	10.97	8.98	8.46	9.24	9.10	9.24	10.43	8.58	9.01	65	78	
Feb	10.48	8.72	8.33	9.16	9.12	9.16	10.24	8.55	9.02	64	76	
Mar	10.33	8.64	8.19	9.14	9.15	9.14	10.03	8.38	8.91	54	69	
Apr	10.48	8.61	8.24	9.21	9.13	9.21	10.12	8.27	8.95	49	65	
May	10.65	8.63	8.33	9.19	8.95	9.22	10.17	8.31	9.01	53	64	
Jun	10.78	8.80	8.42	9.28	9.26	9.28	10.35	8.39	9.04	54	66	
Jul	10.73	8.86	8.42	9.29	9.17	9.32	10.50	8.44	9.10	59	68	
Aug	10.84	9.04	8.67	9.28	9.06	9.32	10.56	8.47	9.09	61	72	
Sep	10.95	9.19	8.75	9.30	9.26	9.30	10.64	8.51	9.10	63	74	
Oct	10.82	9.13	8.78	9.36	9.10	9.41	10.69	8.58	9.17	63	72	
Nov	10.70	9.26	8.78	9.47	9.43	9.48	10.54	8.76	9.24	60	74	

a. Weighted average effective interest rates offered by major lenders for conventional mortgages with a loan-to-price ratio of 75 percent and a term to maturity of 15 years or longer. The effective interest rate includes the contract interest rate plus fees and charges amortized over a ten-year period.

b. Weighted average effective interest rates on loans closed during the period.

c. The estimated number of loans closed with adjustable rates as a percent of the total number of loans closed (also estimated)

Table 9

Selected Operating Factors

Federal Home Loan Banks

Month	Number of borrowers (end of month)	Average cost consolidated obligation bonds ^a		Average rate on FHLB advances ^b	
		Out-standing (end of month) ^c	Issued (during month) ^d	Out-standing (end of month) ^c	Made (during month) ^d
Percent per annum					
Dec					
1983	1,904	12.16	12.15	11.30	10.64
1984	1,902	11.96	10.62	11.43	9.87
1985	1,840	10.91	8.04	10.36	9.09
1986	1,908	9.40	6.92	9.37	9.39
1987					
Nov	2,150	8.75	8.22	8.64	8.00
Dec	2,204	8.73	8.22	8.66	8.23

Month	Number of borrowers (end of month)	Average cost consolidated obligation bonds ^a		Average rate on FHLB advances ^b	
		Out-standing (end of month) ^c	Issued (during month) ^d	Out-standing (end of month) ^c	Made (during month) ^d
Percent per annum					
1988					
Jan	2,158	7.70	7.76	8.59	7.65
Feb	2,103	8.67	7.46	8.57	7.35
Mar	2,077	8.62	7.42	8.52	8.53
Apr	2,075	8.58	7.68	8.50	7.56
May	2,093	8.58	8.32	8.52	7.99
Jun	2,040	8.57	8.15	8.55	8.19
Jul	2,124	8.58	8.33	8.58	8.35
Aug	2,161	8.59	8.82	8.67	8.82
Sep	2,221	8.60	8.67	8.76	8.93
Oct	2,144	8.59	8.63	8.76	8.84
Nov	2,115	8.60	8.93	8.77	9.05

Note. For purposes of the Net Worth Certificate Program, the standardized financing cost of Federal Home Loan Bank System obligations was 9.10 percent as of November 30, 1988.

a. Includes selling costs and passsthroughs to the Federal Home Loan Mortgage Corporation.

b. Excludes advances to the Federal Home Loan Mortgage Corporation.

c. Weighted by amount outstanding of each rate.

d. Weighted by amount issued or made at each rate. Advances made exclude renewals and conversions and the averages shown reflect changes in the types of advances being made as well as changes in rates on specific types of advances.

Table 10

Number and Types of Members

Federal Home Loan Bank System

as of November 30, 1988^p

District Banks	Total number of members	Member S&LAs	Savings and loan associations			Savings banks			Memo: S&LAs and savings banks by type of organization	
			Federal	State-chartered		FSLIC-insured	Other	Insurance companies	Stock	Mutual
				FSLIC-insured	Other					
All Banks	3,311	2,478	1,160	1,252	66	587	239	7	1,415	1,889
Boston	315	107	30	28	49	32	176	—	130	185
New York	273	183	59	122	2	47	43	—	84	189
Pittsburgh	203	176	67	98	11	21	6	—	48	155
Atlanta	601	427	272	155	—	172	1	1	305	295
Cincinnati	351	297	151	143	3	53	—	1	111	239
Indianapolis	161	86	65	21	—	69	1	5	48	108
Chicago	325	290	134	156	—	35	—	—	57	268
Des Moines	178	143	75	67	1	35	—	—	35	143
Dallas	427	365	124	251	—	62	—	—	279	148
Topeka	157	134	78	56	—	22	—	—	82	75
San Francisco	211	193	53	140	—	17	—	—	184	27
Seattle	109	77	52	25	—	22	12	—	52	57

p. Preliminary.

Table 8

Combined Statement of Condition

Federal Home Loan Banks

Millions of Dollars

End of Period	Assets				Total assets; total liabilities and capital accounts ^b	Liabilities			Capital accounts	
	Cash	Investments	Advances ^a	Other		Deposits and borrowings	Consolidated obligations ^c	Other ^d	Capital stock	Retained earnings
1976	164	6,079	15,862	376	22,481	14,024	14,620	313	2,889	635
1977	134	3,749	20,173	510	24,566	4,286	16,009	296	3,295	680
1978	201	3,414	32,670	482	36,767	6,243	25,109	459	4,120	836
1979	251	3,693	41,838	646	46,428	9,368	30,372	596	5,149	943
1980	304	4,328	48,963	752	54,347	10,147	37,268	903	5,160	869
1981	395	8,157	65,194	934	74,680	12,185	54,131	1,563	5,827	974
1982	358	12,575	66,001	1,328	80,262	15,155	55,967	1,727	6,269	1,144
1983	556	9,841	58,978	3,115	72,490	14,153	48,930	1,672	6,395	1,340
1984	1,128	17,584	74,616	3,664	96,992	21,024	65,085	2,179	7,200	1,504
1985	799	19,243	88,835	3,275	112,152	25,215	74,447	2,383	8,313	1,794
1986	2,607	17,388	108,645	2,787	131,427	28,030	88,752	2,900	9,485	2,260
1987										
Nov	1,408	17,385	127,056	2,465	148,314	20,701	111,185	2,713	10,961	2,754
Dec	1,587	16,538	133,058	2,921	154,104	21,624	115,725	2,897	11,281	2,577
1988										
Jan	1,394	21,271	130,914	2,790	156,369	23,099	116,374	2,796	11,402	2,698
Feb	1,159	27,515	129,585	2,538	160,797	26,005	117,569	2,787	11,625	2,811
Mar	1,353	27,706	129,506	1,353	161,154	25,460	118,250	2,876	11,879	2,689
Apr	1,324	24,524	130,241	2,843	158,932	23,206	118,153	2,947	11,874	2,752
May	1,384	22,708	132,121	2,653	158,866	23,288	117,864	2,924	11,922	3,868
Jun	1,140	18,329	134,835	2,626	156,930	21,359	117,773	2,847	12,205	2,746
Jul	1,369	17,846	135,762	2,861	157,838	20,416	119,409	2,890	12,304	2,819
Aug	1,420	16,676	137,957	2,648	158,701	19,167	121,266	2,953	12,372	2,943
Sep	1,301	19,308	141,562	2,703	164,874	20,581	126,014	2,836	12,636	2,807
Oct	1,329	20,525	142,265	2,701	166,820	21,219	127,113	2,943	12,638	2,907
Nov	1,329	19,711	145,775	2,731	169,546	20,277	130,630	2,859	12,747	3,033

a. Advances outstanding net of deferred hedge gains (losses) and unamortized commitment fees.

b. Figures may vary from other published data on the Banks due to rounding and other reclassification of accounts.

c. Represents Banks' participation exclusive of passthroughs to the Federal Home Loan Mortgage Corporation.

d. Represents capital distribution to Financing Corporation and other liabilities.

Table 11

Advances Outstanding

Federal Home Loan Bank System

Millions of Dollars

End of Period	All Districts	Federal home loan banks											
		Boston	New York	Pitts- burgh	Atlanta	Cincin- nati	Indian- apolis	Chicago	Des Moines	Dallas	Topeka	San Francisco	Seattle
1978	32,670	842	2,578	1,283	4,223	2,574	1,105	2,807	2,537	2,345	2,060	7,972	2,344
1979	41,838	1,150	3,678	1,658	5,459	3,209	1,437	3,357	3,193	3,017	2,608	10,126	2,946
1980	48,963	1,171	4,536	1,672	6,480	3,403	1,478	3,209	3,431	3,262	2,903	14,138	3,279
1981	65,194	1,229	5,969	1,994	9,517	4,031	1,778	3,750	3,785	4,359	3,472	20,574	4,726
1982	66,011	1,475	5,803	1,662	8,714	3,807	2,764	3,520	4,204	3,990	3,578	20,586	5,908
1983	58,978	1,351	5,553	1,401	7,255	3,284	3,752	2,766	3,097	3,813	3,589	17,583	5,538
1984	74,622	2,311	5,924	1,951	9,947	3,246	4,382	2,897	4,192	5,882	4,021	23,902	5,966
1985	88,852	3,560	7,097	2,515	11,620	3,217	5,023	2,781	4,200	8,803	4,478	28,863	6,694
1986	108,668	5,728	10,549	3,544	13,309	3,660	6,222	3,350	5,286	11,138	6,041	32,582	7,259
1987													
Nov	127,065	9,996	15,789	4,977	16,209	4,102	7,454	3,718	5,466	12,617	7,585	30,808	8,344
Dec	133,054	10,348	16,244	5,230	16,885	4,308	7,441	3,872	5,989	13,746	7,774	32,496	8,721
1988													
Jan	130,910	10,216	16,244	4,919	16,787	4,113	7,392	3,731	5,885	13,658	8,169	31,166	8,630
Feb	129,582	10,072	16,564	4,596	16,622	4,049	7,384	3,594	5,678	13,240	8,277	31,108	8,396
Mar	129,503	10,159	16,552	4,369	16,520	3,998	7,344	3,550	5,623	13,167	8,397	31,269	8,554
Apr	130,238	10,208	16,443	4,551	16,801	4,093	7,293	3,424	5,618	13,471	8,743	30,957	8,634
May	132,118	10,239	16,472	4,551	17,061	4,080	7,381	3,435	5,802	13,730	8,985	31,750	8,632
Jun	134,832	10,442	16,362	4,443	17,506	4,172	7,466	3,488	5,880	14,335	9,184	32,645	8,909
Jul	135,759	10,315	16,395	4,555	17,613	4,209	7,407	3,470	6,028	15,178	9,300	32,339	8,950
Aug	137,953	10,259	16,349	4,594	17,930	4,165	7,554	3,513	6,118	16,002	9,357	33,129	8,983
Sep	141,562	10,611	16,411	5,190	18,310	4,223	7,571	3,853	6,238	16,621	9,491	34,161	9,151
Oct	142,260	10,583	16,378	5,192	18,416	4,209	7,549	3,507	6,146	17,442	9,571	34,177	9,090
Nov	145,771	10,823	16,424	5,030	18,462	4,200	7,601	3,380	6,307	18,902	9,667	35,853	9,123

Note: Detail may not add to total because of rounding.

DEPOSIT
JUN 21 1989
SHIPPED