



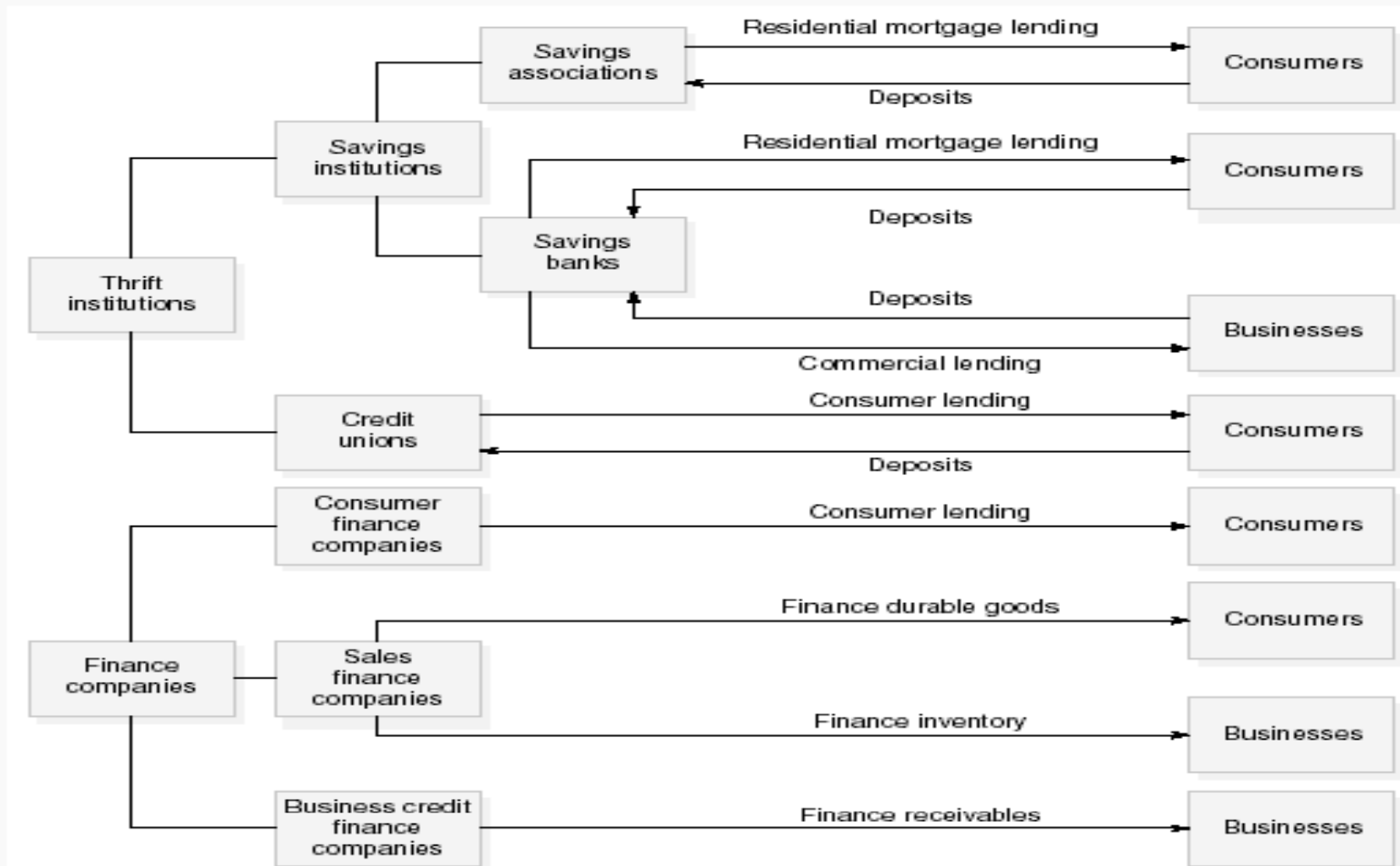
CHAPTER 17

**THRIFT INSTITUTIONS
AND FINANCE
COMPANIES**

Institutions Covered

- Thrift Institutions – thrifts are depository institutions. They take deposits and make loans. Originally the institutions were owned (mutually) by the depositors. Alternative for is stock holder owned.
 - Savings Associations (or S&Ls)
 - Historically focused on residential mortgage lending.
 - Savings Banks
 - Historically focused on both residential and commercial lending.
 - Credit Unions
 - Historically focused on consumer loans.
- Finance Companies – finance companies do not accept deposits. They borrow in order to make loans.
 - Historically focused on riskier types of consumer and commercial lending.

EXHIBIT 17.1
Types of Thrift Institutions and Finance Companies



Historical Origins of Thrifts

- Mutual Savings Banks - developed in 1800s because commercial banks did not serve needs of small savers.
 - Eventually invested most of deposits in mortgage loans.
- Mutual Savings and Loan Assoc and Building Societies (also 1800s)
 - People pooled savings so each would eventually be able to acquire house.
- Recent
 - Stockholder-owned savings and loan assoc relatively uncommon until 1970s.
 - Pressure to attract more capital encouraged S&Ls to convert to stock form.
 - S&Ls now dominate in terms of number and assets.
- What happened during late 1970s? Classic banking problem decimated industry.
 - Rising short-term rates forced thrifts to pay higher rates to depositors.
 - Rates earned on assets (mortgages loans) were fixed with long maturity.
 - Problems compounded by unsound lending practices and mismanagement
 - One solution: securitization. (One current problem: securitization)

Number and Assets of Thrift Institutions

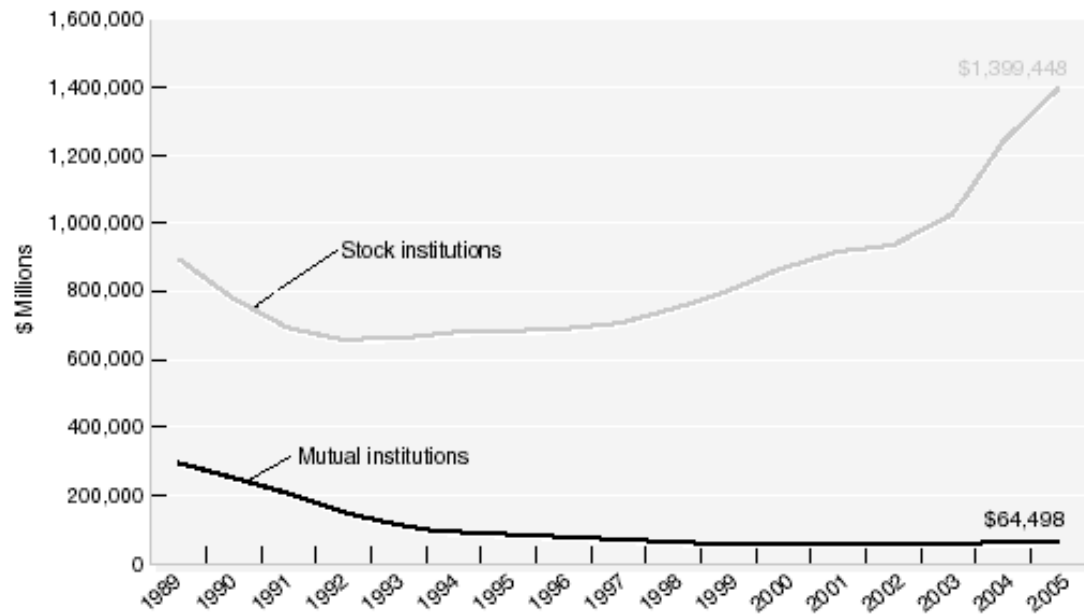
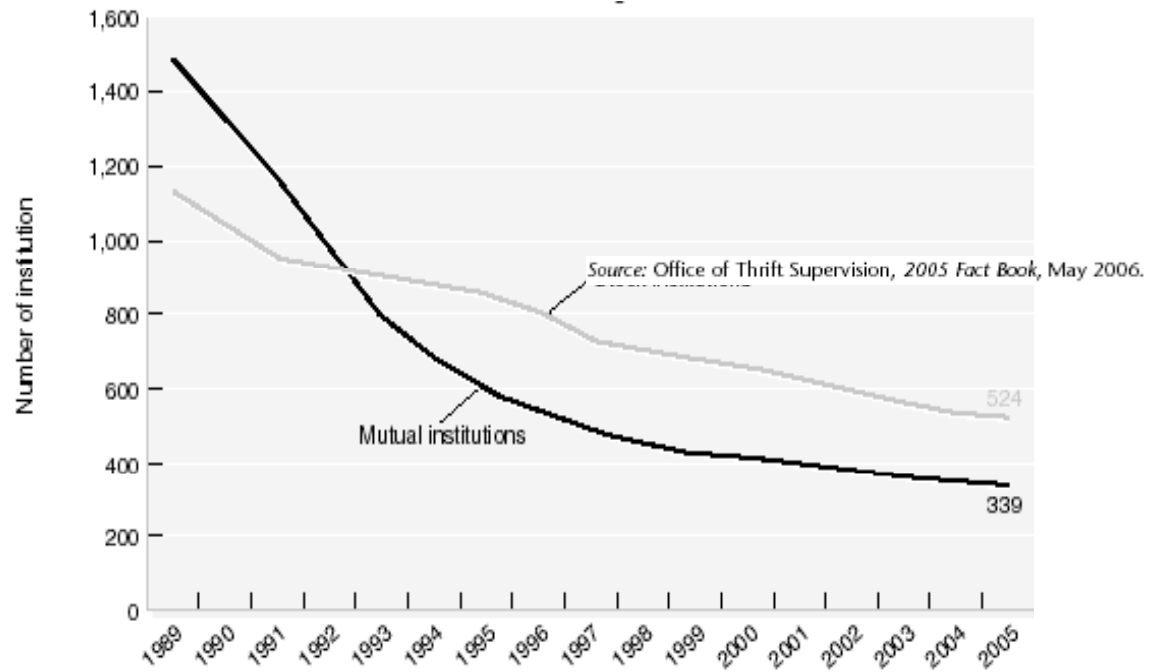
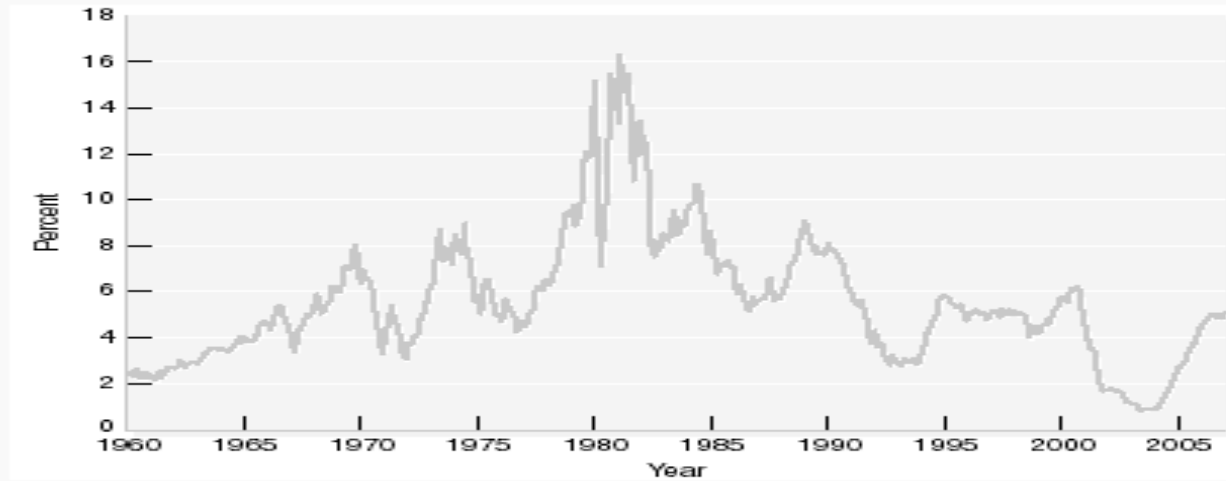


EXHIBIT 17.2**Three-Month Treasury Bill Rates (June, 1960–February, 2007)**

When interest rates spiked in the late 1970s, most mortgage-oriented savings institutions suffered large losses because they were forced to pay higher rates to retain deposits but did not earn additional interest on their loan portfolio.

Source: Federal Reserve Board of Governors, H15 Statistical Release.

EXHIBIT 17.4**Contraction of OTS-Regulated Private Sector Savings Institutions as a Result of Failures, Mergers, and Conversion to Bank Charters**

	1989	1990	1991	1992	1993	1994	1995	1996–2000	2001–2003
Exits									
Failures	320	213	147	61	8	2	2	3	3
Voluntary dissolutions	0	0	6	8	10	3	5	15	66
Charter conversions	2	16	43	108	116	66	29	135	76
Mergers and acquisitions	46	48	57	71	79	78	93	374	132
Total Exits	368	277	253	248	213	149	129	527	277
Entrants	15	24	6	6	15	11	23	156	72
Net Change (Exits)	353	253	247	242	198	138	106	371	205

In the late 1980s and early 1990s, the major reasons for savings association exit were failures, mergers, and conversions to savings bank or commercial bank charters. In recent years, mergers and charter conversions have been the primary reasons for contraction.

Source: Office of Thrift Supervision, *2005 Fact Book*, May 2006.

Regulation of Thrifts

- **Savings bank regulators—**
 - Federal regulator: Office of Thrift Supervision
 - Insurer: FDIC
- **Savings association (S&L) regulators—**
 - Federal regulator: Office of Thrift Supervision
 - Insurer: FDIC
- **State regulators** also charter and supervise thrifts
- **Federal Home Loan Banks: (FHLB)** – 12 regional FHLB empowered to borrow in capital markets and make loans (“advances”) to thrifts in their regions.
 - FHLB Board was regulator prior to 1989, but was abolished.
 - Regulatory powers mostly transferred to OTS.
 - FHL Banks still in place.

Balance Sheet of Thrifts

- Assets
 - Residential mortgages still main asset because of tax break
 - Other loan types better represented now due of deregulation
 - Liquidity management comparable to commercial banks
 - “**OREO**”— Other Real Estate Owned—acquired in foreclosures

- Liabilities
 - Deposits are key, but deposit types are much more varied today
 - Advances from FHLB are most important nondeposit source of funds
 - Fed funds less important as either source or use compared to banks

- Capital Accounts
 - Standards & Terms analogous to banks
 - Tier 1/ Tier 2
 - Risk-weighting of assets
 - Minimum ratios

EXHIBIT 17.5

Assets of Thrift Institutions (December 31, 2005)

Asset Accounts	All Insured Thrift Institutions ^a		Small Savings Institutions ^b	Medium-Size Savings Institutions ^c	Large Savings Institutions ^d
	Millions	Percent ^e	(Percent ^e)	(Percent ^e)	(Percent ^e)
Cash and due from depository institutions	\$35,091	2	7	4	2
Securities, total	320,906	17	20	23	17
Federal funds sold and securities purchased under repurchase agreements	20,577	1	2	1	1
Loans and leases, total	1,327,455	72	66	67	73
Loans secured by real estate, total	1,153,975	63	60	61	63
Construction and land development	57,251	3	4	7	3
1-4 family residential	919,208	50	46	39	52
Multifamily residential	90,175	5	2	4	5
Commercial	87,083	5	7	11	4
Commercial and industrial loans	65,990	4	3	3	4
Loans to individuals	111,054	6	3	3	7
Other loans	5,093	0	0	0	0
Less allowance for loan losses	8,683	0	1	1	0
Trading account assets	13,430	1	0	0	1
Bank premises and fixed assets	14,779	1	2	2	1
Other real estate owned	1,137	0	0	0	0
Goodwill and other intangible assets	41,664	2	0	1	3
Other assets	62,889	3	3	3	3
Total assets	\$1,837,927	100	100	100	100

Real estate lending, especially for residential properties, dominates savings institutions' asset portfolios.

^a This group consists of 1,307 insured savings institutions.

^b This group consists of the country's 405 smallest savings institutions. These institutions have assets of less than \$100 million.

EXHIBIT 17.6

Liabilities and Capital Accounts of Saving Institutions (December 31, 2005)

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Liabilities and Capital Accounts	All Insured Thrift Institutions ^a		Small Savings Institutions ^b	Medium-Size Savings Institutions ^c	Large Savings Institutions ^d
	Millions	Percent ^e	(Percent ^e)	(Percent ^e)	(Percent ^e)
Liabilities					
Deposits	\$1,068,176	58	77	75	55
Borrowed funds, total	522,564	28	7	13	31
Federal funds purchased and securities sold under repurchase agreements	93,380	5	0	1	6
Other borrowed money	429,184	23	7	12	25
Subordinated notes and debentures	9,192	1	0	0	1
Trading liabilities	40	0	0	0	0
All other liabilities	31,647	2	1	1	2
Total liabilities	\$1,631,618	89	86	89	89
Capital accounts					
Common and preferred stock	1,457	0	1	0	0
Surplus	76,992	4	9	7	4
Undivided profits	127,860	7	4	3	8
Total equity capital	\$206,309	11	14	11	11
Total liabilities and equity capital	\$1,837,927	100	100	100	100

Deposits are the largest source of funds for most savings institutions, but they are a much more important source for small and medium-sized institutions. Borrowed funds are a more important source of funds for large banks. Other borrowed money consists largely of FHLB advances.

^a This group consists of 1,307 insured savings institutions.

^b This group consists of the country's 405 smallest savings institutions. These institutions have assets of less than \$100 million.

^c This group consists of the country's 747 medium-size savings institutions. These institutions have assets between \$100 million

EXHIBIT 17.7**Trends in Capital Adequacy, Problem Assets, and Savings Institution Earnings**

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Year-End	1989	1991	1996	1997	2000	2003
Capital Adequacy Ratios for OTS-Supervised Savings Institutions						
Average Tier-I leverage ratio	3.83%	5.27%	7.38%	7.59%	7.39%	8.15%
Average (total) risk-based capital ratio	7.19	10.16	14.53	14.59	13.32	13.98
Problem Assets of OTS-Regulated Savings Institutions						
Total troubled assets as a percentage of assets	NA	3.80%	1.13%	1.00%	0.60%	0.59%
Noncurrent loans as a percentage of assets	NA	1.87	0.85	0.77	0.5	0.59
Noncurrent 1–4 family loans ^a	NA	1.85	1.21	1.11	0.67	0.5
Noncurrent multifamily loans ^a	NA	—	1.45	0.79	0.15	0.16
Noncurrent commercial loans ^a	NA	5.98	1.38	1.1	1.52	1.1
Noncurrent consumer loans ^a	NA	1.32	0.89	0.97	0.81	0.63
Return on Assets (ROA) for OTS-Regulated Savings Institutions						
Average ROA for savings institutions	-0.41%	0.13%	0.89%	0.84%	0.90%	1.18%
Average ROE for savings institutions	0.97	1.88	11.15	10.44	11.61	12.9

After weak savings institutions were liquidated by the RTC in the early 1990s, savings institutions' assets fell, but capital ratios, earnings, and troubled asset ratios improved. Commercial loans and multifamily loans showed the greatest improvement.

NA = not available.

^a As a percentage of the loan type.

Source: Office of Thrift Supervision, 2005 Fact Book, May 2006.

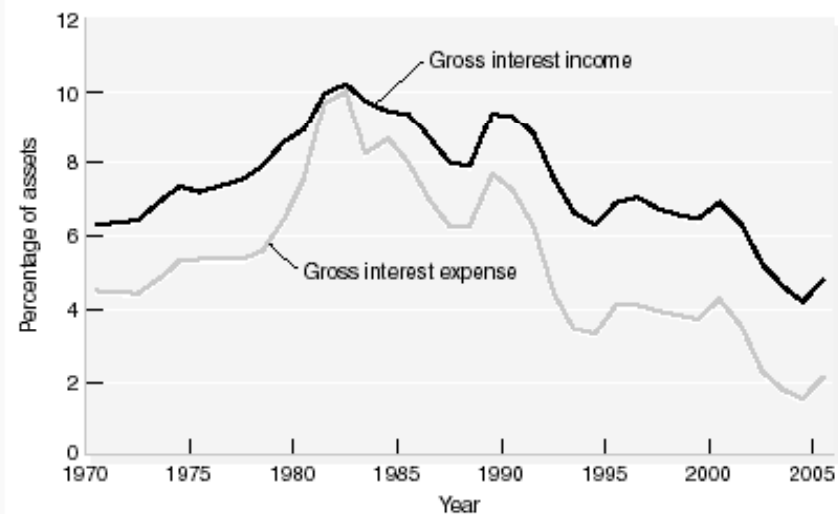
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Income, Expenses, & Performance

- Structure of income statement comparable to banks
- Net Interest Margin about 3%
 - deposit rates have fallen more rapidly than mortgage rates
 - institutions take much less interest rate risk than they used to
- Provision for loan losses reflects sounder lending practices
- Industry ROAA averages around 1.2%; ROAE around 13%.

- Late 1970's – early 1980s
 - Shrinking loan margins
 - Increasing bad loans.

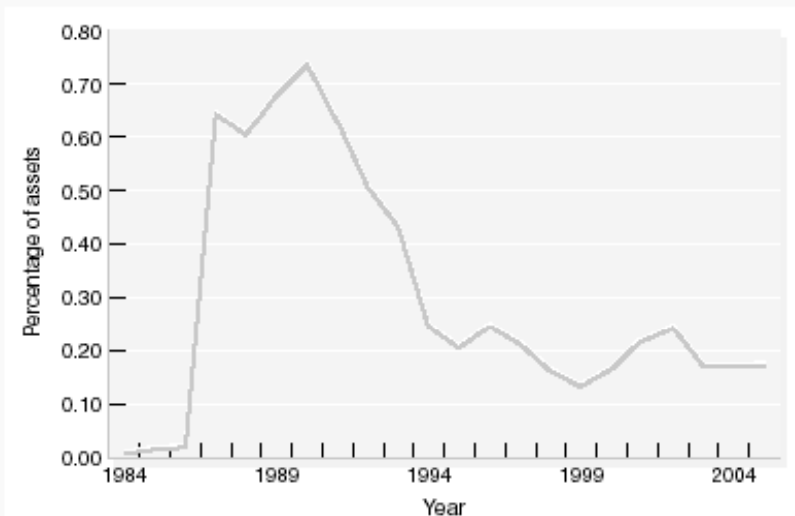
EXHIBIT 17.8
Net Interest Margin of Savings Institutions (1970–2005)



In the late 1970s and early 1980s, savings institutions' net interest margins shrank to almost nothing. In the 1990s, however, savings institutions' net interest margins grew as interest rates declined. Margins have remained relatively stable since then.

Source: FDIC, *Statistics on Banking*, December 31, 2005.

EXHIBIT 17.9
Provision for Loan Losses for Savings institutions (1984–2005)



The provision for loan losses at thrift institutions increased substantially in the late 1980s as many savings institutions struggled to absorb losses on their lending portfolio, especially those loans made in oil-producing states such as Texas, Oklahoma, and Louisiana.

Source: FDIC, *Statistics on Banking*, December 31, 2005.

Credit Unions

- Credit Union - Mutual institutions organized much like a club with each member (share owner) having a vote to elect the board of directors.
 - Membership requires common bond (same employer, church, trade assoc).
 - Credit Union Assets have grown steadily in recent years.

- Crucial characteristics of credit unions - always and strictly mutually owned; organized like clubs
 - Common-bond membership/exemption from antitrust constraints.
 - Most common bonds are occupational.
 - Others are associational/fraternal or residential
 - Not-for-profit and therefore tax-exempt
 - Expected to concentrate on smaller consumer loans

- Credit Union regulation
 - Regulated by the National Credit Union Administration (NUCA).
 - Deposits insured by National Credit Union Share Insurance Fund (NCUSIF).
 - Liquidity is provided by the Credit Liquidity Facility (CLF).

Credit Union Balance Sheet

- Credit Union assets
 - Credit union member loans constitute bulk of CU assets.
 - Other assets include cash and investments.

- Credit Union liabilities
 - Regular Share Accounts are like savings accounts
 - Share certificates are time deposits like CDs, and have become more important source of funds
 - Share drafts are CU interest-bearing checking accounts.
 - Notes Payable/Certificates of Indebtedness
 - Net worth includes reserves and undivided earnings.

- Credit Union developments
 - Small credit unions are merging or liquidating
 - Credit unions, especially larger ones, adopting new technologies.
 - Funds flows are becoming increasingly coordinated
 - Corporate central credit unions - correspondent banking for credit unions
 - Powerful trade associations/lobbying groups -CUNA - NAFCU

Finance Companies

- Finance companies – make loans to businesses and consumers who are typically higher risk borrowers. Source of funds is loans, rarely deposits!
 - Most larger finance companies are now subsidiaries of bank and financial holding companies.
 - Many "nonbank" banks or consumer banks are similar to finance co.
 - Finance companies are diverse and adaptive to changing needs.

- Recent developments
 - Securitization
 - Shift toward business credit
 - Shift toward second mortgage lending
 - Growth of leasing
 - Growth of home equity credit lines
 - Decline in small finance companies

Finance Company

- Assets
 - Investment securities, real assets, cash, and deposits represent a small percent of assets.
 - Consumer receivables (loans)
 - Personal loans; Automobile credit; Mobile home credit.
 - Revolving Consumer Installment Credit.
 - Other Consumer Installment Credit.
 - Real Estate Lending (second mortgages)
 - fastest growing area of finance company lending.
 - Business credit -- area of growth in recent years
 - Wholesale paper - loans to finance inventories. "Floor plan" is a type of wholesale paper.
 - Retail paper -- purchase of consumer sales (loan) contracts from retailers.
 - Lease paper -- leasing business equipment and consumer durables.
 - Commercial accounts receivable financing.
 - Factoring -- the purchase of accounts receivables.

Liabilities and Net Worth

- Net worth: highly leveraged.
 - Net worth level directly related to riskiness of loan portfolio.
 - But cannot neglect N/W; borrowing ability depends on credit rating.

- Debt:
 - Bank debt
 - Commercial paper – about 20% of funds
 - Transfer credit from parent companies – about 7% of funds.
 - Long-term debt when rates are low - about 40% of funds

- Regulation – mostly focuses on consumer protection, rather than safety and soundness.
 - Interest rate ceilings on loans, but phased out in most states
 - Debt collection practices
 - Branching, chartering, and merger restrictions
 - Truth-in-lending
 - Bankruptcy protections