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Thrift Resolution Activity:
Historical Overview and Implications

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The Performance of Eleventh District Financial Institutions In the 1980s:
A Broader Perspective

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Between 1980 and 1988, the Federal Home Loan Bank Board (FHLBB) resolved more than 900 troubled thrift institutions using a variety of techniques, including supervisory merger, assisted merger, liquidation, and stabilization.[1] Of the 115 Texas resolutions, 81 were involved in transactions arranged as part of the Southwest Plan introduced by the FHLBB in 1988 to address the concentration of troubled thrifts in Texas.[2]

This article examines thrift resolutions completed during the 1980s and their implications for public policy. Evidence from the returns to the acquirers of failed thrifts during the 1980s indicates that the complex transactions negotiated by the FHLBB may have led to wealth transfers from both the Federal Savings and Loan Insurance Corporation (FSLIC) and the taxpayer to these acquirers.[3] This evidence suggests that greater reliance on simple *clean-bank* and *whole-bank* transactions for resolving troubled institutions is preferable to the more complex transactions implemented by the FHLBB during the 1980s.[4]

During 1989, the Federal Deposit Insurance Corporation (FDIC) placed an additional 317 thrifts into conservatorship or receivership. These institutions held more than $138 billion in assets. By the end of 1989, the Resolution Trust Corporation (RTC) had liquidated only thirty-seven of these thrifts. Inadequate resources slowed the RTC's pace in resolving the remaining 280 institutions, forcing the RTC to raise additional working capital to expedite the resolution process.[5]

The large number of thrifts that are awaiting resolution pose a major challenge to the regulatory agencies responsible for implementing resolution activities. Beyond the intervened thrifts that have already been placed into conservatorship or receivership, the FDIC has targeted more than 200 thrifts with more than $160 billion in assets for intervention during 1990. As many as 600

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[1] Cole (1990a) summarizes each of these resolution techniques.

[2] For a more complete assessment of the FHLBB's Southwest Plan, see Short and Gunther (1988).

[3] See Cole and Eisenbeis (1989), Cole, Eisenbeis, and McKenzie (1989), and Balbier, Judd, and Lindahl (1989).

[4] In a *clean-bank* deal, the insurer removes nonperforming assets from a failed depository's portfolio, replacing them with cash. This results in an essentially healthy institution that is then marketed. In a *whole-bank* deal, the failed depository is marketed as is, with potential acquirers bidding on the lump-sum cash payment that they will receive from the insurer. In the 1980s, the FDIC has used clean- and whole-bank transactions extensively to settle failed banks. The strategic plan for the Resolution Trust Corporation also favors this approach. Clean- and whole-bank deals contrast with the typical FHLBB deals, as exemplified by its Southwest Plan transactions, which involved the acquisition of one or more institutions marketed as is, but with complex and open-ended FSLIC assistance. This assistance typically provided an intermediate- to long-term note to cover the institutions' negative net worth. It also provided guarantees against capital losses and guaranteed yields on nonperforming assets. In some cases, the capital-loss provisions called for loss sharing or other incentives for the acquirer to minimize actual losses and/or for the yield maintenance to taper down over time. While such assistance packages allowed both for the FSLIC to economize on cash and for asset disposition to be regionally dispersed and conducted by the private sector, they also were most difficult to accurately value.

[5] To resolve troubled thrifts, the RTC initially needs more funds than it will ultimately spend. For example, in a liquidation the RTC must pay off all insured liabilities of a failed thrift upfront, but it can recover some percentage of this payout as it disposes of the thrift's assets. Much of the RTC's initial $20 billion allocation was used to replace high-cost brokered

additional thrifts may not meet the minimum capital standards mandated by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA).[6] These thrifts would face immediate restrictions on growth and dividend payments and could eventually face intervention.

To facilitate a better understanding of the pending thrift resolutions that will be implemented during the 1990s, it is important first to examine the thrift resolutions that were completed in the 1980s.

A Historical Overview of Thrift Resolution Activities in the 1980s

The thrift experience during the 1980s had two distinct phases. In the first phase, interest-rate spread problems caused by rising interest rates and the deregulation of deposit rates plagued the thrift industry. This combination left thrifts holding portfolios of mortgage assets that were earning substantially less than the interest cost of the deposit liabilities with which they were funded. In the second phase, asset quality problems caused by the FHLBB's policy of capital forbearance, deregulation, and asset growth as solutions to the earlier spread problems plagued the thrift industry. In the absence of deposit insurance reform, this combination created strong incentives for thrifts to adopt go-for-broke strategies because the owners of a depository institution with near-zero or negative net worth who are subject only to limited liability—meaning that they can lose only the amount of their investment—have incentive to undertake high-risk, high-return investments in an attempt to return their institution to solvency.[7] For a variety of reasons, including the declines in oil and real estate prices, problems in this second phase were concentrated in the Southwest, especially in Texas.

Thrift resolution activities reflect the two phases of the thrift experience during the 1980s. Chart 1 presents thrift case resolutions by year and by type. In this chart, two waves of resolutions are visible. The first wave peaks in 1982 with 247 resolutions, while the second wave peaks in 1988 with 229 resolutions. During the intervening trough years of 1983–87, less than 100 resolutions occurred in any one year.

The First Wave: Interest-Rate Spread Problems. In the first wave of resolutions, from 1980 to 1982, the FHLBB dealt with troubled institutions primarily by arranging supervisory mergers that entailed no explicit cost to the insurance fund. Supervisory mergers accounted for 181 of the 247 resolutions in 1982. In contrast, only one liquidation occurred in that year. Reliance on supervisory mergers allowed the FHLBB to conserve the dwindling liquidity of the FSLIC. The total cost of the 247 resolutions completed in 1982 was less than $1 billion.

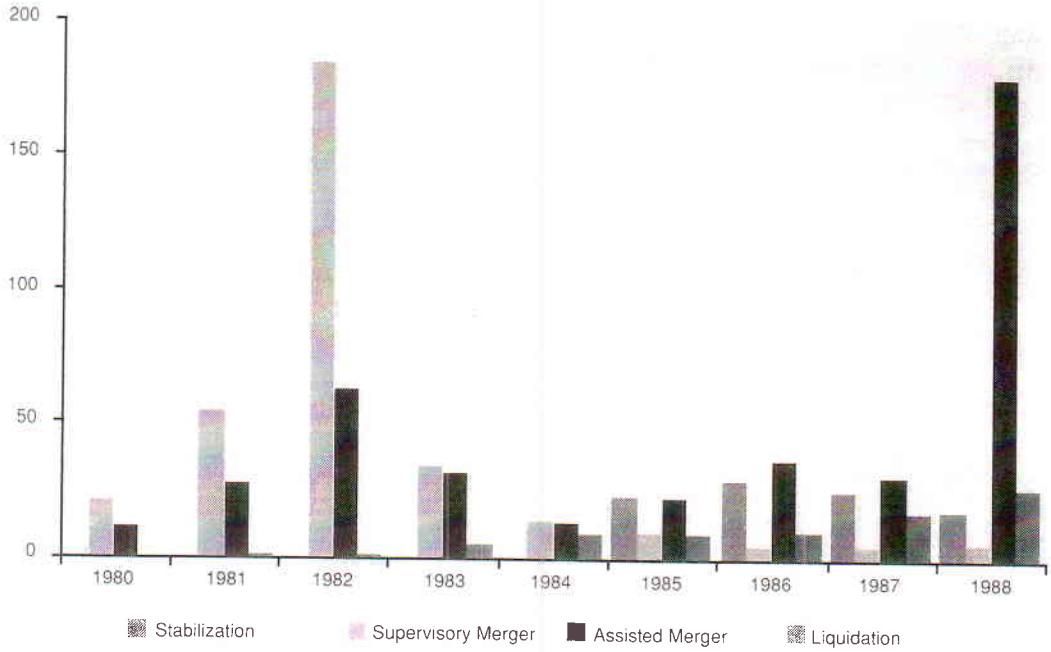
During this first wave, the FHLBB looked to regulatory forbearance and asset growth as substitutes for explicit assistance in attracting potential merger candidates. In effect, the FHLBB was anticipating that declining interest rates would eliminate the need for further action as institutions outgrew their spread problems. A fall in interest rates would appear on thrift balance sheets as an upward revaluation of *underwater*

deposits at conservatorship institutions to decrease the industry's cost of funds. FDIC Chairman William Seidman testified before the U.S. House Banking Committee that the RTC needed more than $50 billion in working capital to resolve thrifts during 1990 and that the shortage of working capital had seriously delayed resolution efforts. In February 1990, the U.S. Justice Department approved a plan by which the RTC would borrow short-term working capital from the Federal Financing Bank, an arm of the U.S. Treasury. Initially, $11 billion would be raised through the issuance of 90-day bonds at 12.5 basis points above the Treasury bill rate.

[6] In addition to authorizing $50 billion to close insolvent thrifts, FIRREA established a three-tiered capital adequacy test for all remaining institutions. As of December 7, 1989, thrifts must hold 1.5 percent tangible capital, 3 percent core capital, and 6.4 percent risk-based capital. Supervisory goodwill and purchased mortgage servicing rights may be counted toward as much as half of the core capital requirement. The risk-based capital requirement rises to 7.2 percent on December 31, 1990, and to 8 percent on December 31, 1992.

[7] See Flannery (1982) for a discussion of this issue.

Chart 1
Thrift Case Resolutions, 1980–88
(Number of Resolutions)



Source: Federal Home Loan Bank Board

Table 1
Case Resolutions by Type and Year*

Year	Stabilization	Supervisory Merger	Assisted Merger	Liquidation	Total Closed	Total Insolvent
1980	0	21	11	0	32	48
1981	0	54	27	1	82	85
1982	0	184	62	1	247	237
1983	0	34	31	5	70	293
1984	0	14	13	9	36	445
1985	23	10	22	9	64*	470
1986	29	5	36	10	80*	471
1987	25	5	30	17	77*	515
1988	18	6	179	26	229*	364
TOTAL	95	333	411	78	917*	—

* These figures overstate the true total number of resolutions because many institutions were stabilized before final resolution. Virtually all stabilizations have appeared or will appear again as mergers or liquidations. In addition, several resolutions from the early 1980s reappeared in the latter years.

Sources: Analysis and Evaluation Division, Management Consignment Program Division, and Financial Assistance Division of the FSLIC

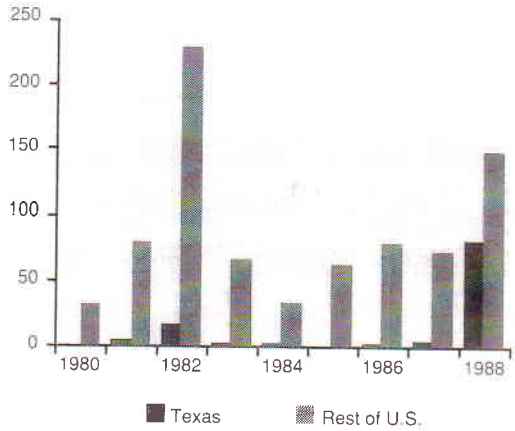
mortgage portfolios.[8] Asset growth would allow a thrift to make new investments earning returns greater than deposit costs. Newer assets earning positive spreads would offset the effect of older assets earning negative spreads. Together, the revaluations and growth effects would pull formerly insolvent thrifts into the black.

Although interest rates did indeed decline, regulators had not foreseen the unintended side effect of regulatory forbearance on incentives for risk-taking. In an attempt to outgrow their spread problems, hundreds of thrifts moved into high-risk, high-return investments in which they lacked the expertise of their competitors.[9] In so doing, they incurred huge credit risks that ultimately would swamp the beneficial effects of falling interest rates.

The Second Wave: Asset Quality Problems. The second wave of resolution activity came in the late 1980s. As Table 1 and Chart 1 show, resolutions rose from 64 thrifts in 1985 to 229 thrifts in 1988, and this second wave was characterized by the FHLBB's continuing policy of capital forbearance and increasing reliance upon assisted mergers. During 1988, the FHLBB engaged in 179 assisted mergers. Despite these efforts, 364 insolvent thrifts remained in operation at year-end.

Problems in this second wave were concentrated in the Southwest, and Table 2 and Charts 2–5 show how Texas resolutions compare to those in the rest of the nation. Chart 2 plots the number of case resolutions in Texas and the United States from 1980 to 1988. In 1983–87, only 13 of 327 resolutions

Chart 2
Thrift Case Resolutions, 1980–88
(Number of Resolutions)



Source: Federal Home Loan Bank Board

—less than 4 percent of the total—occurred in Texas. But, in 1988, 81 of the 229 resolutions—more than 35 percent of the total—occurred in Texas.

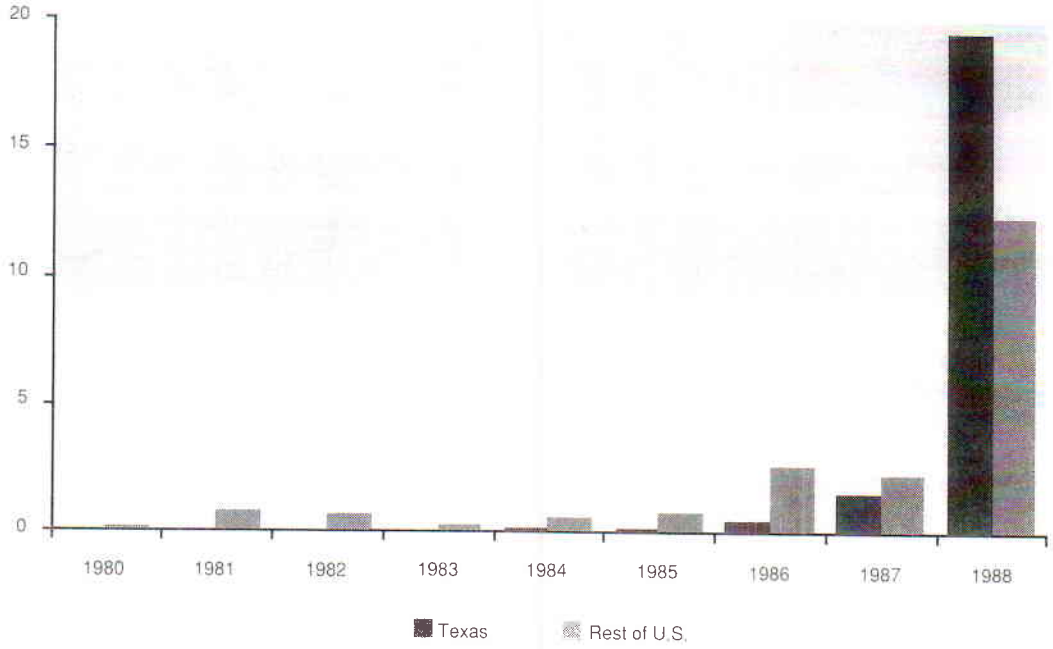
Chart 3 plots the cost of resolutions during 1980–88. From 1985 to 1988, Texas resolutions accounted for a growing fraction of the total U.S. cost. In 1988, Texas closures cost more than $19 billion, nearly two-thirds of the $32 billion national total. Nationally, resolution costs in 1988 were more than three times the spending for the entire 1980–87 period, which is strong evidence that forbearance was the FHLBB's preferred remedy during the 1980s.

Charts 4 and 5 identify thrift insolvencies by year for both Texas and the United States. Chart 4 shows the percentages of insolvent thrifts, while Chart 5 shows the actual number of insolvencies. The number of insolvencies, excluding resolutions, increased in each of these years, both in Texas and in the nation. In 1983, 7 percent of the 268 Texas thrifts were insolvent, while nationally 9 percent of the 3,146 thrifts were insolvent. Texas thrift insolvencies peaked at 56 percent in 1988. Nationally, insolvencies peaked in 1987 at 16 percent, declining in 1988 to 12 percent as a record 229 thrifts were resolved.

[8] Underwater mortgages refer to mortgages whose market value is less than their face value because of a rise in interest rates since the time the mortgage was issued. Such discounts are not recognized on the books of thrifts.

[9] Many spread cases rode out the interest-rate peaks of the early 1980s and returned to solvency and profitability in the falling-interest-rate environment of the mid-1980s. These thrifts primarily made traditional housing-related investments rather than moving into more speculative commercial lending and direct investment activities. See Rudolph (1989).

Chart 3
Thrift Case Resolution Costs, 1980–88
(Billions of Dollars)



Source: Federal Home Loan Bank Board

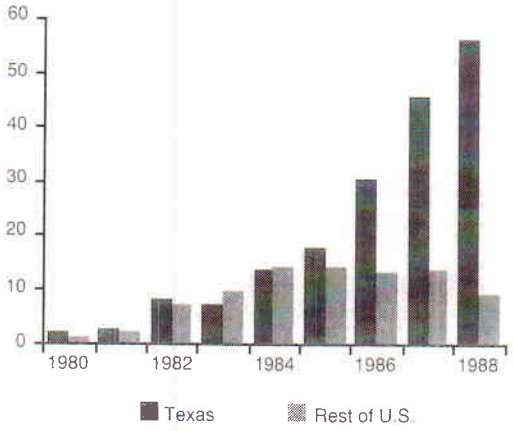
Table 2
Assisted Case Resolutions in Texas and the United States*

Year	Texas Closed	Total Closed	Texas Cost (Billions of dollars)	Total Cost (Billions of dollars)	Texas Insolvent	Total Insolvent
1980	0	32	0.000	0.167	7	48
1981	4	82	0.001	0.759	8	85
1982	17	247	0.078	0.803	23	237
1983	3	70	0.000	0.275	19	293
1984	3	36	0.164	0.743	36	445
1985	1	64*	0.155	0.979	48	470
1986	2	80*	0.493	3.065	85	471
1987	4	77*	1.504	3.704	128	515
1988	81	229*	19.491	31.792	114	364
TOTAL	115	917*	21.886	42.286	—	—

* These figures overstate the true total number of resolutions because many institutions were stabilized before final resolution. Virtually all stabilizations have appeared or will appear again as mergers or liquidations. In addition, several resolutions from the early 1980s reappeared in the latter years.

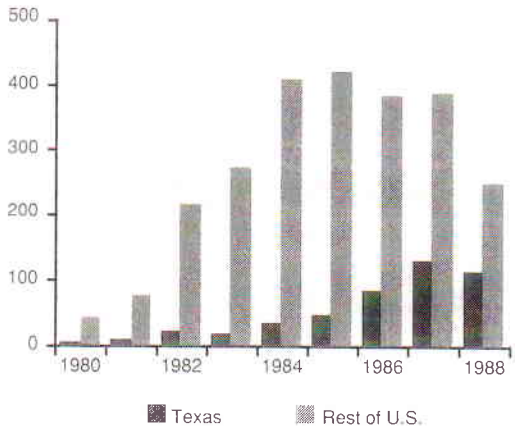
Sources: Analysis and Evaluation Division, Management Consignment Program Division, and Financial Assistance Division of the FSLIC

Chart 4
Percentage of Insolvent Thrifts, 1980–88



Source: Federal Home Loan Bank Board

Chart 5
Number of Insolvent Thrifts, 1980–88



Source: Federal Home Loan Bank Board

In this second wave of thrift resolutions, supervisory mergers all but disappeared as healthy thrifts were increasingly unwilling to assume the burden of working out problem assets of an insolvent institution as a means of growth. As an alternative to supervisory mergers, the FHLBB began a strategy designed to stabilize insolvent thrifts by instituting its Management Consignment Program (MCP) in 1985. In an MCP action, the FHLBB placed an institution into conservatorship or receivership and usually replaced the thrift managers responsible for insolvency with managers of its own choosing. The FHLBB aimed this program at extinguishing shareholders' claims while conserving the institution's franchise value until a suitable merger partner could be found. This was the FHLBB's way of dealing with a shortage of reserves in the thrift deposit insurance fund. By placing institutions into the MCP, the FHLBB made progress in dealing with problem insolvencies while conserving the liquidity that remained in the FSLIC.

To deal with the regional concentration of troubled thrifts in Texas, the FHLBB instituted its Southwest Plan in 1988. As Charts 4 and 5 show, insolvencies in Texas in 1988 were more than five times the national average and represented nearly one-third of the national total. The Southwest Plan sought economies of scale by merging many small insolvent thrifts into larger entities that were then marketed to potential buyers. Consolidations were intended to lead to economies in operating costs through the elimination of redundant branches, making the packages more attractive to potential bidders. Overall, eighty-one Texas thrifts were closed in 1988 under the Southwest Plan at a cost of more than $19 billion. But these actions were not sufficient to completely restore the thrift industry to financial health. As fast as the FHLBB completed transactions, new insolvencies occurred, and existing insolvencies grew more costly to resolve.

The FHLBB's Resolution Strategies. Through both waves of resolutions, the FHLBB sought to merge insolvent thrifts with healthy institutions, either with or without FSLIC assistance. If a troubled thrift retained franchise value in excess of its negative net worth, then a merger was often accomplished at no explicit cost to the FSLIC in a *supervisory* merger.[iv] While supervisory mergers involved no explicit costs to the FSLIC, they always entailed implicit costs of regulatory forbearance.

including reduced capital requirements, waived interstate branching restrictions, and the potential for reemergence as a problem institution. A major point of contention over the recent implementation of stricter capital requirements for thrifts, some of which exclude supervisory goodwill, was the loss of forbearance.[11] Acquiring institutions booked large amounts of goodwill in supervisory mergers and were allowed to count this goodwill toward regulatory capital. This type of forbearance saved the FSLIC the considerable cash outlays necessary to resolve these institutions by other methods.

When no supervisory merger partners could be found, the FHLBB was forced to grant assistance to the acquirer at a positive explicit cost to the thrift insurance fund in an *assisted* merger. In addition to implicit costs associated with supervisory mergers, assisted mergers also carried explicit costs, usually incurred in the form of cash or notes in the amount of the institution's negative net worth, indemnification for capital losses incurred on the sale of covered nonperforming assets, and yield subsidies on nonperforming assets to compensate acquirers for accepting a below-market return on these assets.

The open-ended nature of assisted mergers made them the most difficult type of resolution for the FSLIC to value. Many of the costs attributable to explicit assistance depended on future events. Lower-than-expected returns and disposition prices on covered assets have significantly increased the costs of the majority of FSLIC-assisted transactions. The resulting increase in assistance increased the acquirers' tax shelter.[12]

Evidence on Abnormal Returns and Sources of Value in Thrift Resolutions

Congressional hearings on the thrift crisis focused new attention on how the FHLBB conducted case resolutions and how it structured FSLIC assistance packages. In a properly structured assistance agreement, the value of assistance provided would be sufficient to compensate the acquiring institution for assumed risks, and thus would yield no wealth transfer from the deposit insurance fund to the acquirer. If, on the other hand, the assistance package overcompensated the acquirer, then wealth transfers from the deposit insurance fund to shareholders of the acquiring institution would occur. These transfers should be observable through abnormally large returns on the acquirers' publicly traded equities.

Evidence from several studies confirms the existence of such returns.[13] When FSLIC-assisted thrift mergers were publicly announced, they led to positive abnormal returns on the acquirers' stocks. When voluntary thrift mergers were announced, no such positive abnormal returns were observed. These findings suggest that the FHLBB overcompensated acquirers of failing thrifts.

While the abnormal returns were statistically significant, their economic significance is less certain. Abnormal returns observed in assisted mergers averaged about 2 percent of the acquiring firm's market value, which is small relative to the amounts of assistance granted. While wealth transfers appear to have occurred, they were not a very large

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[11] Franchise value refers to intangibles such as long-term customer relationships that are of value to financial institutions.

[12] Several thrifts have filed suit for breach of contract over this issue.

[13] All FSLIC assistance was exempt from federal taxation until 1989, when tax benefits were cut in half. Losses on the sale of nonperforming assets were deductible, even as FSLIC indemnification for such capital losses was tax-exempt. Hence, the tax shelter increased with the amount of assistance. For thrift acquirers only, accumulated net operating losses from the failing thrift could also be used for tax shelter. Both Kormendi, Pirrong, and Snyder (1989) and Cole, Eisenbeis, and McKenzie (1989) find evidence that the FSLIC did not adequately value these tax benefits as part of its assistance packages. This oversight may have biased case resolutions away from liquidations toward mergers by understating the full costs of these mergers.

[14] Cole and Eisenbeis (1989), Cole, Eisenbeis, and McKenzie (1989), and Balbier, Judd, and Lindahl (1989) report such results.

part of the total resolution costs incurred in these transactions.[14]

More interesting than the existence of positive abnormal returns are the potential sources of these returns. If abnormal returns can be attributed to the ways in which the FHLBB conducted case resolutions, then it may be possible to eliminate these sources of value in future resolutions by altering the methods used by the FHLBB. Hence, identification of the sources of value in past assisted acquisitions may lead to significant economies in the hundreds of resolutions that the RTC has yet to conduct.

Analysis of potential sources of abnormal returns in FSLIC-assisted mergers provides evidence that three factors—capital forbearance granted by regulators, underestimation of assistance costs by regulators, and superior information held by acquirers relative to regulators—led to positive abnormal returns and wealth transfers from the FSLIC and the Treasury to the thrift acquirers.[15] Other potential sources of value, including core deposits, relative size, and geographic diversification through interstate acquisitions, were also examined but were not found to be significant in explaining abnormal returns. Table 3 summarizes these findings.

In each assisted merger, the FHLBB granted regulatory capital forbearance to the acquiring thrift. Forbearance is most valuable to acquirers with low or negative net worth because it protects them from being seized by regulators for deficient capital. Evidence suggests that shareholders of acquirers with low or negative tangible net worth realized an increase in value from the regulatory capital forbearance that accompanied their firm's initial assisted acquisition.

In all of its deals, the FHLBB has been criticized for underestimating the true costs of the open-ended assistance granted to acquirers. If shareholders perceived that the FHLBB was undervaluing the assistance packages, then abnormal returns should be positively related to the estimated value of FSLIC assistance.

To test two variants of this criticism, researchers examined both the ratio of assistance to acquired assets and the absolute amount of assistance as potential sources of value. If systematic underestimation of the assistance cost was a source of excess returns, then the assistance-to-assets ratio should be positively related to abnormal returns. As this ratio increased, so did the potential for measurement error. Hence, the larger this ratio is, the larger the potential abnormal returns become.

However, if measurement errors were small, but tax benefits to acquirers were not included in the assistance cost estimates, then abnormal returns should be positively related to the absolute amount of assistance. Abnormal returns would depend only on the tax benefits, which are proportional to the dollar value of assistance granted. Abnormal returns would not depend upon the size of the acquired firm. In this latter case, the acquirer would receive wealth transfers from the taxpayer rather than from the FSLIC insurance fund. Evidence supports only the latter criticism that the FHLBB did not adequately value the tax benefits granted to acquirers. This finding suggests that acquirers received wealth transfers from the taxpayer rather than from the FSLIC insurance fund.

Concerns were expressed that cash and personnel constraints placed the FHLBB at a disadvantage to acquirers in assessing the market value of assets held by troubled thrifts. Such asymmetric information could lead acquirers to ask for more assistance than necessary to compensate them for the risk involved in the acquisition. If successful, the acquirer would reap a wealth transfer from both the FSLIC insurance fund and the taxpayer. Results of the analysis strongly support this informational asymmetry hypothesis. Specifically, acquirers appear to have more accurately assessed the market value of the mortgage-backed securities

[14] Abnormal returns also averaged about 2 percent of resolution costs, but with considerable variation.
[15] See Cole, Eisenbeis, and McKenzie (1989).

Table 3
Sources of Value in FSLIC-Assisted Acquisitions

Source of Value	Expected Sign	Actual Sign	Significance*
Capital Forbearance	+	+	< 10
Underestimation of Costs	+	+	< 5
Informational Asymetries	+	+	<.01
Interstate Merger	+	+	> 10
Core Deposits	+	+	> 10
Relative Size of Frims	−	−	> 10
1988 Deals	+	+	> 10

*Probability (in percent) of rejecting the hypothesis that the variable in not a source of value when, in fact, it is not.
Source: Cole, Eisenbeis, and McKenzie (1989).

held by the thrifts upon which they were bidding, and this superior information appears to have enabled them to reap windfall gains in these transactions.

In summary, analysis of voluntary and FSLIC-assisted thrift mergers reveals that acquirers earned positive abnormal returns from assisted transactions that were not present in voluntary mergers. Further analysis of potential sources of value in these assisted mergers shows that three factors—regulatory capital forbearance, underestimation of assistance costs, and superior information held by acquirers relative to the FSLIC—were significant in explaining the positive abnormal returns. These results have important policy implications for the FDIC, the RTC, and the Office of Thrift Supervision (OTS) as they continue to deal with the thrift crisis. FIRREA has appropriated funds for the RTC to begin case resolutions and has granted regulators important new tools in an attempt to prevent a recurrence of the systemic failures. Still, it is the FDIC, RTC, and OTS that must implement the actual cleanup. In the next section, the public policy implications of these findings are examined.

Policy Implications from FSLIC-Assisted Case Resolutions

To assess the policy implications from the evidence on FSLIC-assisted resolutions, one must remember the political and financial constraints under which they were conducted. The FHLBB had to regulate an industry whose market value was negative throughout the 1980s. It simply lacked the personnel resources to adequately monitor the troubled segment of the industry, and it lacked the monetary resources to close the insolvent segment of the industry. In this second-best world, the evidence that acquirers earned positive abnormal returns averaging 2 percent of their market value is not surprising. Under the circumstances, this is not an unduly large margin of error. However, the evidence on sources of the abnormal returns offers some guidance on how to make margins of error even narrower in future case resolutions.

Regulatory forbearance provides positive abnormal returns to acquirers, which is consistent with other work on forbearance demonstrating that resolution costs increased if a thrift continued to operate while insolvent.[16] To stanch the financial hemorrhaging of insolvent depository institutions, regulators should follow a policy of prompt closure for undercapitalized institutions. Unfortunately, as both the FHLBB and the RTC have found, liquidity constraints may force regulators to delay resolution actions until Congress can provide adequate funding.

[16] Cole (1990b) reports that the 769 failed thrifts he examined were insolvent, on average, for more than three years, and that the length of insolvency was statistically significant in explaining resolution costs.

The positive influence of the dollar value of FSLIC assistance provides evidence that the FSLIC underestimated the true value of the tax breaks it was granting to acquirers. This finding suggests that the use of tax breaks to augment assistance packages is inefficient; therefore, future resolutions should be explicitly funded from deposit insurance reserves.

Strong evidence exists of informational asymmetries between regulators and acquirers. Regulators should explore ways to improve their informational endowment. Performance of due diligence reviews on all failed institutions before marketing is one avenue by which to remedy this informational problem. Assistance cost savings from information thus acquired should easily offset the costs of the reviews.

Taken as a whole, the evidence suggests that future case resolutions should follow the FDIC's lead in moving away from complex deals involving open-ended assistance and moving toward simpler clean-bank and whole-bank deals, where bidders ask for a one-time lump sum payment from the insurance fund in exchange for taking over a troubled thrift. Once the regulator has performed a due diligence review and marked assets to market value, there is much less chance for underestimating the ultimate costs of cash assistance. By reducing the potential for underestimation of the cost of assistance, regulators can ultimately reduce the actual assistance costs.

The advantages of clean- and whole-bank transactions derive from the simplicity in estimating the costs to the deposit insurance fund. Bidders calculate how large of a single payment they would require to take over the troubled thrift. Hence, regulators can readily compare the impact of alternative bids on the deposit insurance fund.

In contrast, estimation of the costs of a transaction involving open-ended assistance are subject to large errors because of the long-term nature of the assistance and the uncertain value of the covered assets and the tax shelter granted to the acquirer. If interest rates or asset market conditions change from those assumed in the costing scenarios, the ultimate costs to the insurance fund can vary greatly from the assumed costs.

These results also suggest that the RTC should investigate the possibility of exercising call options on covered assets included in past deals.[17] The FHLBB wrote into many deals options that allow the government to buy back covered assets at book value. Such buybacks hold the promise of considerable cost savings for deals where guaranteed yields on nonperforming assets are above the RTC's cost of funds.

Conclusions

This historical overview of thrift resolutions in the 1980s may show how to reduce the costs of resolutions in the 1990s. As an unprecedented number of institutions are to be dealt with in a short time, evidence from FSLIC case resolutions offers the following insights.

Costs may be reduced by striving to eliminate potential informational asymmetries between regulators and potential acquirers through the collection of asset-specific information on the market values of thrifts that are to be resolved. To accomplish this, more resources may need to be directed at current thrift resolution efforts to ensure that cash and personnel constraints do not hinder these efforts.

Furthermore, the structure of assistance agreements has a major effect on resolution costs. The use of implicit assistance such as capital forbearance and tax benefits as substitutes for explicit assistance payments appears to be less efficient than direct cash assistance because implicit assistance is more difficult to value.

Based on the experience in the 1980s, the resolution policies of the FDIC and RTC

[17] FIRREA explicitly requires regulators to reexamine all 1988 FSLIC-assisted transactions to identify if cost savings could be achieved by renegotiating the deals.

appear preferable to those of the FSLIC. Simple whole-bank and clean-bank transactions decrease resolution costs relative to the more complex mergers involving open-ended assistance by reducing the potential for underestimating the final dollar cost of the assistance. Despite this advantage, even these simply structured assisted resolutions may not adequately account for the competitive impact that the newly created institutions have on their nonintervened competitors, banks and thrifts alike. Because of the large number of thrift institutions that will require resolution during the next few years, the unassisted competitors of the resolved institutions will grow more concerned with this issue, meriting additional study of this subject.