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OTS 96-13 - OTS Research Studies Failure Rates of Mortgage Specialists, 1984-1995

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OTS RESEARCH STUDIES FAILURE RATES OF MORTGAGE SPECIALISTS-1984-1995

WASHINGTON, D.C., Feb. 29, 1996 -- A research report issued today by the Office of Thrift Supervision compares the failure rates and insurance costs of mortgage specialist thrifts with those of other federally insured depository institutions.
The study was prompted by the need to understand the strengths and/or weaknesses of mortgage specialists in view of the conclusion by some observers that the thrift debacle of the 1980s demonstrates that thrifts are "failure prone."

"We believe the findings of the study should provide additional, important insight into the deposit insurance risks imposed by mortgage specialists as the charter issue is debated," said Jonathan Fiechter, acting director of OTS.

The study's author, OTS Senior Economist Eric Hirschhorn, analyzed insurance costs, failure rates and other factors for three groups: mortgage specialist thrifts, all other thrifts and commercial banks. Based on an analysis of the thrift and bank failures from 1985 through 1995, the study made these key findings:

- Thrifts that focused on home mortgage lending imposed far lower losses on the deposit insurance system than thrifts that ventured into other lending and investment activities during the 11-year period.
- The failure rate of these mortgage specialists was slightly higher than banks, but the cost of resolution was lower than for commercial banks.

Hirschhorn said the era studied "represents a strong test case for these issues, because these years were clearly the worst experienced by the thrift industry."

The mortgage specialists that survived the era comprise today's financially sound thrift industry, Fiechter said, noting that many thrifts failed "because they were allowed to expand into high risk activities in an effort to grow out of their financial problems without having the underlying capital to back their expansion." The Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) of 1989 put an end to those practices.

Among Hirschhorn's specific findings are the following:

- Mortgage specialist thrifts, those that met key asset tests applicable today to federal thrifts, had an average annual failure rate between 1985 and 1995 that was about one-fourth the rate of other thrifts -- 2.4 percent of total assets versus 8.5 percent for other thrifts.
- The cost of closing those mortgage-specialist thrifts that did fail was less than half that for other failed thrifts. Over the 11 years, the loss rate was 13.1 percent for mortgage specialists compared with 30.8 percent for all other thrifts. Loss rate is the ratio of failure-resolution costs to failed-thrift assets.
- Annual insurance losses for all mortgage specialists, including many thrift institutions that in 1985 were significantly undercapitalized, averaged 28.2 basis points over the 11-year period. Other thrifts had an annual average insurance loss of 187.2 basis points, more than 6 times greater. Annual insurance losses are equal to annual failure rates times loss rates per failure.
- Annual insurance losses for mortgage specialists with capital comparable to commercial banks averaged 7.8 basis points compared with 8.9 basis points for banks.

(The attached chart shows the comparison of the annual insurance costs for all thrifts, mortgage specialist thrifts and banks for the period 1984 through 1995).

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