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OTS 97-56 - What Do Highly Profitable Thrifts Do? OTS Finds They Do Traditional Mortgages

Office of Thrift Supervision

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WHAT DO HIGHLY PROFITABLE THRIFTS DO? OTS FINDS THEY DO TRADITIONAL MORTGAGES

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WASHINGTON, D.C., Aug. 20, 1997 -- What makes a thrift institution not only profitable, but highly profitable? That's what the Office of Thrift Supervision (OTS) wanted to find out in a study of thrift performance over the past three years.

Some of the initial findings aren't surprising. Highly profitable thrifts (HPTs) are more efficient, maintain higher asset quality and generate more fee and interest income than other thrifts. But the OTS study also produced some surprises, the most significant being that the HPTs were heavily concentrated in fixed-rate, single-family mortgages. The high yields from the fixed-rate mortgages boosted the HPTs' profits substantially.

"The thrift industry overall has done well over the last three years," OTS Director Nicolas Retsinas said. "But the performance of the HPTs has been outstanding. Our initial findings clearly show that a residential mortgage specialist that does its job well can make an excellent profit."

OTS identified a group of 102 institutions that performed well above the average of the 1,300-institution industry. The OTS Industry Analysis staff used a return on average assets (ROA) of 100 or more basis points -- often considered a measure of high profitability in banking -- to identify the select group. A thrift made the highly profitable group only if its ROA exceeded 100 basis points in each quarter studied from 1994 through the first quarter of 1997. The anomalous third quarter of 1996 was excluded because of the industry loss resulting from the one-time special premium assessment to capitalize the thrift insurance fund.

The HPTs averaged a "remarkably" high ROA of 168 basis points versus the industry average of 73 basis points over the three-year period. The actual quarterly ROA range for the HPTs was from 150 basis points to a high of 185 basis points, with some individual institutions' ROA exceeding 200 basis points.

Significantly, the study shows that the HPTs are predominantly community-based lenders, with heavy concentration in single-family mortgages, plus consumer, commercial and small business loans. The only exceptions were two institutions among the HPTs that are mainly credit card lenders.

At the end of March 1997, the HPTs held nearly 40 percent of their assets in fixed-rate mortgages and mortgage-backed securities, compared with 21.5 percent for the industry. Conversely, the HPTs held just 20.5 percent in ARMs to 40.5 percent for the industry. With their higher average interest rates, the fixed-rate mortgages yielded a greater return than the adjustable rate mortgages (ARMs). Kenneth Ryder, OTS executive director for research and analysis who oversaw the study, said that although the HPTs' concentration in fixed-rate mortgages carried a higher interest-rate risk, they more than offset that by maintaining capital levels substantially greater than the industry average. As a result, their interest rate exposure as measured by the OTS interest rate model was actually less than the industry's exposure. The HPTs' ratio of capital to assets at the end of March was 10.2 percent, 30 percent higher than the industry average.

Among other key characteristics of the HPTs are these:

- They ranged in asset size from \$22 million to \$6 billion, averaging \$600 million as of March 31, 1997. Their combined assets totaled \$61 billion, or 8 percent of industry assets.
- Stock HPTs outnumbered mutuals 65 to 37.
- More than half the HPTs are in the OTS Southeast and Central regions, which include 14 states in the South and Great Lakes area. The West region, with most of the 10 largest thrifts, had the lowest percentage of HPTs -- under 8 percent, reflecting the lagging economy over the three years in California.
- The HPTs' operating efficiency and asset quality were superior to the industry average.

The study of HPTs will continue. OTS analysts noted that the initial study covers a period during which the underlying economic conditions, especially the relatively low and stable interest rates and strong economic growth, created a favorable environment for the "traditional portfolio lender" strategy of the HPTs. Now they will extend the study to include a longer period with more variable economic conditions. In addition, they will look more in depth at the typical business strategies being pursued by the HPTs.

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The Office of Thrift Supervision (OTS), a bureau of the U.S. Treasury, regulates and supervises the nation's thrift industry. OTS' mission is to ensure the safety and soundness of thrift institutions and to support their role as home mortgage lenders and providers of other community credit and financial services.