Gregory Gajewski and Deano Hagerman

Ailing Banks and S&L's Get Federal Help, But At What Risk?

In response to rising rates of bank and S&L failures, lawmakers and regulators have adopted a "wait and see" attitude, allowing many institutions with little or no equity left to remain open. The policy, known as forbearance, is supposed to limit the costs to the deposit insurance funds (FSLIC and FDIC) while preserving financial services in depressed areas, and areas, often rural, where past failures are concentrated. But the incentives for weak and insolvent institution managers to gamble with depositors' money for a return to health may well increase the long-term resolution costs, and not help their local communities.

Between 1983 and 1986, nearly 700 federally insured commercial banks and savings and loans (S&L's, or thrifts) failed. Roughly 40 percent were headquartered in rural counties and many of them specialized in financing agriculture. These failures have raised concerns about the financial system's stability, regional economic growth, and financial-service availability in affected areas. The types of institutions failing have also focused attention on the adequacy of credit for agriculture and other rural enterprises. All of these worries have been used to support "forbearance" policies, policies that allow institutions with little or no equity left to remain in business.

But more is at stake, because the costs of financial-service firms' problems, potentially borne by the taxpayers, are ballooning. As of July 1987, the Federal Savings and Loan Insurance Corporation (FSLIC) was operating in the red, and its losses growing by around $3.5 billion a year. The estimated $25-$45 billion it will cost to close insolvent S&L's makes the $6-billion line of credit the Federal Farm Credit System has requested from the U.S. Treasury look small by comparison. Commercial banks are better off than S&L's, and the Federal Deposit Insurance Corporation (FDIC), which insures bank deposits, has about $18 billion in reserves. But the FDIC expects losses to exceed income this year for the first time in recent history.

Meanwhile, over 1,400 weakened commercial banks and S&L's remain open, and about 35 percent of them are headquartered in rural counties. Roughly a third of the 1,400 are technically broke (see Definitions box) and are able to keep deposits only because of their Federal deposit insurance. S&L's are a disproportionate part of the problem: at the end of 1986 about 1,000 S&L's (a third of the industry) had negative or below-standard net worth. They held about $400 billion in assets. At yearend 1986, 420 commercial banks (3 percent of all banks) had negative equity or below-standard capital, and reported assets of about $40 billion.

The rural dimension mirrors the national picture. Less than 3 percent of the 7,554 rural banks reported negative equity or below-standard capital, but a third of the 1,024 rural S&L's had low or negative equity at the end of 1986.

The weak and ailing institutions are able to keep their doors open only because of regulators' "forbearance," the hope that things will improve and weak banks and S&L's will become healthy again. Such a policy was seldom used before the 1980's. Under the old rules, regulators would order banks and S&L's with low equity to raise new capital relatively quickly. The firm could do this, for example, by selling stock to the public, if it had good prospects. Otherwise, regulators would declare the institution insolvent and close it if its condition deteriorated and remaining equity was lost.

Figure 1
Bank and S&L failures in the 1980's are the highest since Federal deposit insurance began in the 1930's

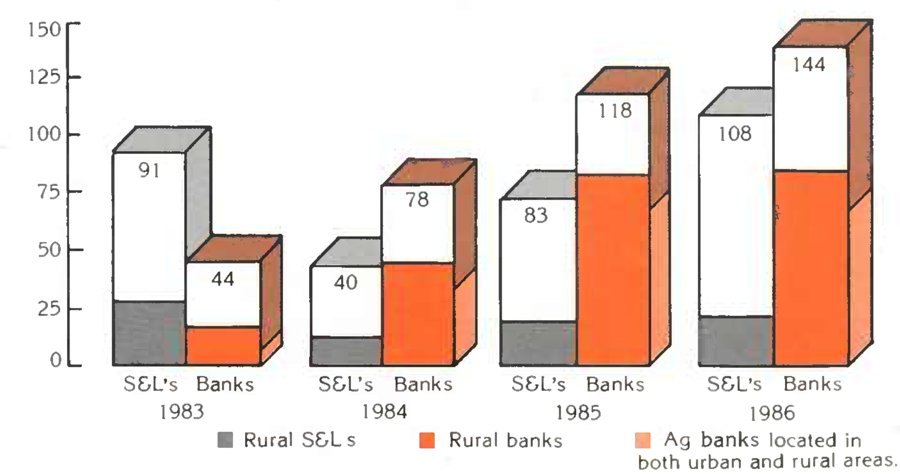
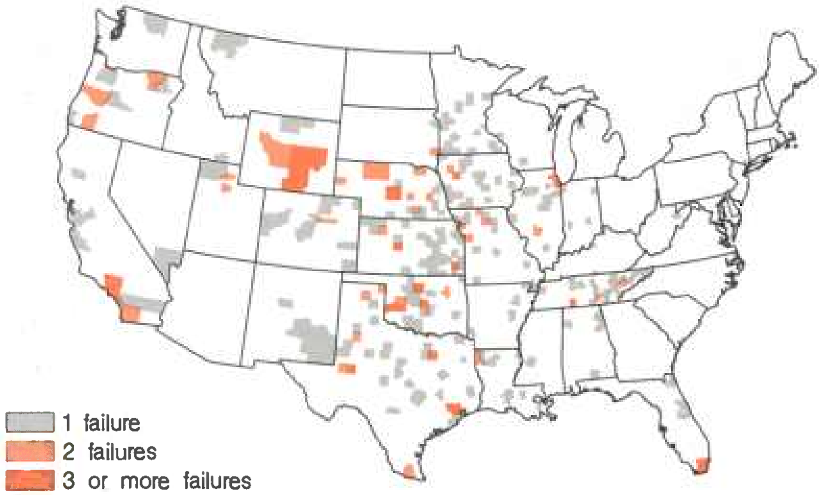


Photo provided by the author

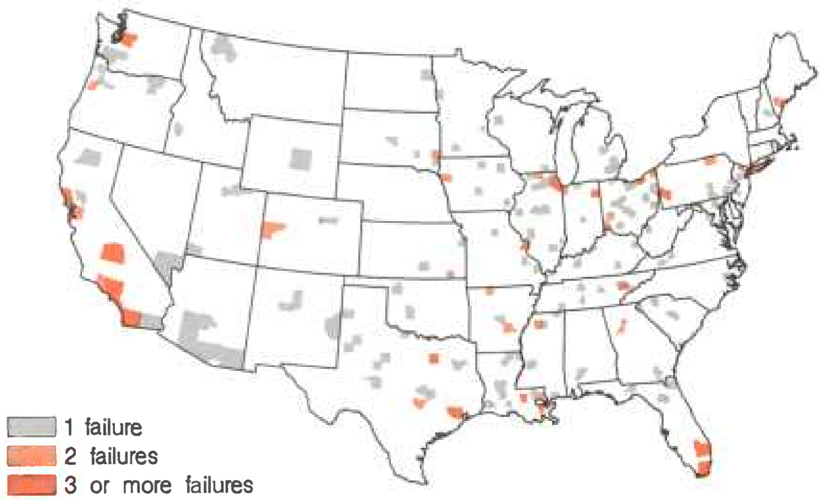
Rural Texas-based Vernon Savings and Loan was declared insolvent and closed by bank regulators in 1987. At the time of closing, 96 percent of its loans were delinquent, that is, past due at least 60 days. Regulators generally consider a loan delinquency rate of 4 percent as cause for serious alarm.

Gregory Gajewski and Deano Hagerman are financial economists with the Agriculture and Rural Economy Division, ERS, USDA. They thank David Hopkins and Brenda Sylvester of ERS' Data Services, who made possible the analysis of individual S&L-level data. The authors also thank Richard Brown of the Federal Home Loan Bank Board and Lynn Nejezchleb of the FDIC for comments on an earlier draft.

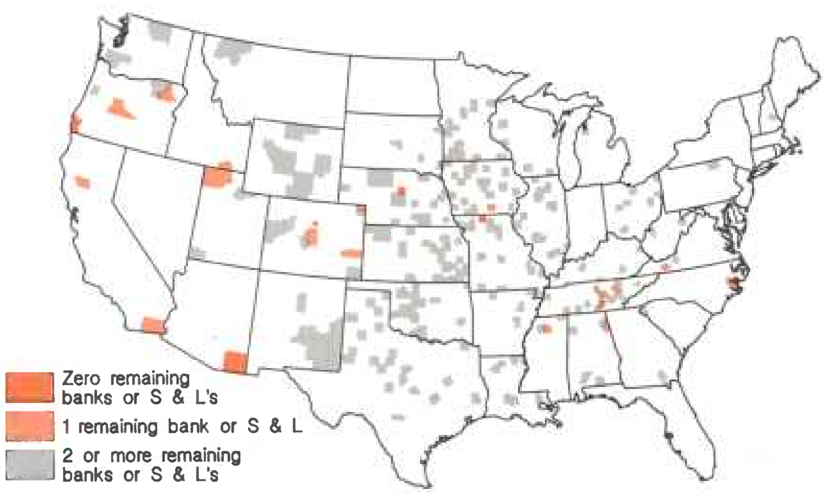
During 1983-86, commercial bank failures were concentrated in the Nation's heartland...



...S & L failures were more spreadout...



...and rural counties affected the most are scattered thoughout the country



Maps depict locations of headquarters offices only.

Today, at-risk institutions in formal forbearance programs are not required to raise new equity for several years, presumably when conditions improve. But de facto forbearance, where insolvent institutions are allowed by regulators to stay open indefinitely, is a growing problem, especially for FSLIC-insured thrifts. Those with below-standard capital not in a program or facing a regulatory action are also beneficiaries of informal forbearance. As of March 1987, about 90 banks and over 150 S&L's were in formal programs. That's a small share of the 1,400 weakened institutions still open.

Forbearance notwithstanding, most commercial banks are failed by regulators when they become insolvent, or soon after. S&L regulators, by contrast, have been unable to close S&L's that run out of equity because the FSLIC insurance fund, valued at a negative $6.5 billion in mid-1987, has been shrinking since 1981. So the FSLIC could not cover insured depositors if all insolvencies were closed at once.

Sixty commercial banks, with assets totaling $2.8 billion, reported negative equity capital at the end of 1986, and about half had failed by mid-May. But 461 insolvent S&L's with about $125 billion in assets were open at the end of 1986, up from 16 in 1980.

Supporters of forbearance policies claim that banks and S&L's weakened by temporary factors, such as a runup in interest rates or deteriorating local economic conditions brought on by slumps in the energy and farm sectors, for example, should be allowed the chance to recover. As the temporary problems go away, these banks and S&L's can use their new profits to build equity and reserves against future losses. Supporters also argue that keeping institutions open in depressed areas limits further declines in local economic activity by maintaining the availability of financial services. Residents in communities deprived of locally headquartered financial firms due to failures could have more trouble securing credit and may have to pay more for it, limiting future economic growth.

But forbearance is not justified for either banks or S&L's based on evidence of local economic effects or to maintain local financial-service availability. Only 7 of the 250 rural counties that experienced a bank or thrift failure in 1983-86 were left with no remaining local bank or S&L. And other research suggests that, while deteriorating local economies can contribute to failures, these failures induce little, if any, subsequent declines in local conditions. Because bank failures are concentrated in the heartland, forbearance policies may be more reasonable for weak banks than S&L's, to the extent it is justified at all. The case for S&L's would be more compelling if more of past failures were in depressed regions.

Forbearance is a gamble for the FSLIC and FDIC, and its long-term cost may be high. The most obvious risk is that depressed regions and sectors will remain stagnant, causing losses at weakened institutions to mount. But the biggest risk comes from the incentive it gives managers to "gamble for resurrection" by making large volumes of high-risk, potentially high-profit loans. If the loans make good, the institution reaps the profit, but if the loans sour and the lender goes broke, the Federal deposit insurer is liable for the losses, not the institution's owners. This incentive arises from the combination of deregulation, inadequate regulatory supervision, and deposit insurance premiums that are not based on risk; it is strongest when there is little equity left. So widespread forbearance may merely postpone failures and could result in bigger losses to the deposit insurance funds, the bank and S&L industry, and, ultimately, the taxpayers.

New Banking Bill Aids FSLIC, Requires Forbearance

A new banking bill, the Competitive Equality Banking Act of 1987, was signed into law by President Reagan on August 10. Intended to return the FSLIC to solvency and bolster public confidence in the S&L industry, it authorizes the FSLIC to raise $10.8 billion over 3 years by selling bonds on the open market. Interest on the FSLIC bonds will be paid from deposit insurance premiums charged federally insured thrifts. Moreover, the FSLIC cannot raise more than $3.75 billion in any 1 year. Even if all $10.8 billion were available immediately, most experts believe it would cover only about a quarter of the cost to close all the Nation's insolvent thrifts.

Two provisions of the new law deal directly with keeping weak institutions open. First, the Federal Home Loan Bank Board must extend its forbearance program to well-managed thrifts in areas where the real-estate markets are depressed by sector-specific problems such as the farm and energy sectors. S&L's in these areas with net worth as low as 0.5 percent of assets must be allowed to participate if no evidence of fraud or mismanagement is found. Second, commercial banks with less than $100 million in assets, more than 25 percent of their loans to agriculture, and headquartered in farm-dependent areas, are allowed to spread out their farm loan losses over 7 years instead of taking them the year they are incurred as is the usual practice. This provision could allow banks that have no capital left by normal accounting standards to remain in business.

Bank Failures Concentrated, Thrift Failures More Scattered

Over the 1983-86 period, 384 banks insured by the FDIC failed; 220 were headquartered in rural counties and 173 had above-average concentrations of farm loans. They were heavily concentrated in the Nation's heartland, with over 80 percent headquartered west of the Mississippi (see maps). More than half of the banks that failed in 1986 were in Colorado, Kansas, Louisiana, Oklahoma, and Texas. Those States together account for most of the U.S. "energy banks," specializing in financing oil and gas exploration and production. One percent of banks failed in 1986, setting a post-Depression high.

FSLIC-insured thrifts also failed in record numbers during the 1980's. Over the 1983-86 period, 312 S&L's failed. Seventy-nine of these were headquartered in rural counties, much less than the proportion of failed rural banks. Those figures may understate failed thrifts' importance in rural areas, however, because S&L's, more often than banks, can operate extensive branch-office networks (see Rural Financial Markets box). The extent of S&L lending to finance agricultural activity is unknown, but believed to be small. Federally chartered S&L's can make farm loans only up to 10 percent of their assets. S&L's chartered by some States (but federally insured) may, however, be able to specialize more in agricultural finance. Also, when farmers go broke, all their lenders (including S&L's that hold their home mortgages) suffer losses. Over 3 percent of S&L's failed in 1986; 3,242 remain open.

The pattern of failed S&L's over this 4-year period is diffuse, showing just a slight concentration in the rust-belt States around the Great Lakes (see maps). Less than half of failed S&L's were headquartered west of the Mississippi, substantially less than the proportion of western bank failures. Over 10 percent of S&L failures were in the Northeast, yet only three commercial banks failed in this region. But almost a third of 1986 S&L failures were in the five States with the most energy banks, suggesting that deteriorating regional economic conditions are also beginning to affect S&L failure patterns.

Rural Counties Still Well Served

Of the 696 bank and S&L failures in 1983-86, 299 were headquartered in 250 rural counties (see maps). Only seven of those counties, however, were bereft of any locally headquartered bank or S&L. Eighteen rural counties experiencing bank or S&L failures had only one main office left open at the end of 1986.

The 79 failed rural S&L's were headquartered in 72 counties, 29 of which had no surviving local S&L, but only two of which had no local banks left either. Over half of the 250 rural counties experiencing local bank or S&L failures had at least five locally headquartered financial institutions still in business.

Rural counties hurt the most are scattered throughout the Nation. The 25 rural counties with none or only one institution remaining are in 16 States, ranging from Alaska to North Carolina. Some of them are in Colorado, but affected rural counties in the other four States with the most energy banks all had at least two local institutions left at the end of 1986.

These findings do not present a complete picture of financial-service markets in affected counties. Almost all services available at headquarters offices are also provided by branches, and branching systems are not reviewed here. Examining only headquarters locations leaves out two types of effects. First, counties with branches of failed firms headquartered in another county may lose services. Second, banks and S&L's acquiring failed institutions in a different county will sometimes reopen them using the failed firm's building, but as a branch office. So the affected county has lost a locally headquartered institution, but still has local access to financial services.

Information on remaining local institutions suggests that rural areas still have reasonable access to financial services and do not need to run the risks of supporting weak or insolvent banks and S&L's. In addition, only about a third of failed rural banks reopened between 1983 and 1985 became branches of banks headquartered in a different county. Loss of branches belonging to failed firms headquartered in a distant county is also likely to be small, because failed banks and S&L's had below-average numbers of branch offices.

More worrisome for rural areas than the failures is the rising trend of liquidating failed rural banks. When the FDIC cannot find a healthy bank to purchase and reopen a failed bank, it pays off the bank's insured depositors and dissolves the bank. There were seven liquidations in 1983, but over 20 each in 1985 and 1986. They have been disproportionately rural. Of the 54 banks dissolved between 1983 and 1986, 70 percent have been rural and 50 percent agricultural. Rural counties in Oregon, Nebraska, Colorado, and Missouri have seen their local banks fail and disappear this way.

The most severe disruptions can occur when the only bank in town is liquidated. For 1985 and most of 1986, bank liquidations left 19 rural towns without banks. These towns tended to be very small, according to Emanuel Melichar, an economist with the Federal Reserve Board of Governors. Most had between 80 and 600 residents and only two had populations greater than 1,000. Yet, in one case he investigated, another bank opened a new branch in the town shortly after the failed bank was liquidated. So the problem may be less severe than the data indicate, because this may have happened in the other towns as well. Or banks in other towns may be close enough to serve.

Liquidated S&L's are also up, both in number and as a proportion of all S&L failures. But they have less effect on rural communities. Of the 46 liquidated in the 4 years studied here, only 10 were headquartered in rural counties.

Forbearance policies are not the best tools available to preserve financial services in towns where the only institution is failing. Regulators could subsidize the failing

Definitions and Data

An insolvent bank or S&L has liabilities worth more than assets, and its owners' equity is negative. Without Federal deposit insurance, depositors of firms becoming insolvent would withdraw their deposits, and together with other creditors, force the firms into bankruptcy. The decision to fail a federally insured (FDIC or FSLIC) bank or S&L, however, rests with its chartering authority: the Comptroller of the Currency for banks with national charters, the Federal Home Loan Bank Board for federally chartered S&L's, and the State banking agencies for State-chartered banks or S&L's. While chartering authorities may fail an institution if it violates certain banking statutes, almost all are failed due to insolvency. Not all institutions that are actually insolvent are formally recognized as broke by the authorities, so many insolvencies remain open.

When an institution is declared insolvent by its chartering authority, the Federal deposit insurance agency as receiver is notified. For commercial banks, the FDIC can liquidate the bank, transfer its deposits to another bank, arrange its acquisition by a healthy bank, or provide open bank assistance. The FSLIC faces similar options for S&L's, but has added flexibility to provide assistance or put the failed institution under the management of the FSLIC's own agents.

For this article, an institution was counted as a failure any time regulators acted to resolve the firm's stressed situation, defined as all of the above-mentioned acts by the FDIC and the FSLIC. Some failures were omitted: FDIC-insured mutual savings banks, institutions headquartered in U.S. possessions and territories, and State-insured S&L's (notably those in Ohio and Maryland).

All institutions reported here as insolvent had liabilities greater than assets, according to Generally Accepted Accounting Principles (GAAP). Under other methods of asset valuation, many more would be insolvent. Weak firms include insolvencies and those with below-regulator-standard equity or primary capital (equity plus loan loss reserves). Banks must have primary capital equaling 5.5 percent of assets to meet current standards. S&L's with net worth below 3 percent of assets were counted as substandard. Not all of these are necessarily considered substandard by the S&L regulators; they use different (and more liberal) accounting principles with their 3-percent standard.

A commercial bank or S&L is classified rural if its headquarters is in a nonmetropolitan county. Agricultural banks are those with above-average concentrations of farm loans in their loan portfolios. At the end of 1986, the average farm loan ratio (as a percent) was 15.78 for all banks. Banks and S&L's reporting zero assets, loans, or deposits were excluded. In December 1986, there were 14,008 commercial banks; 7,554 were rural. Of the 4,690 agricultural banks, 4,125 were also rural. Out of 3,242 S&L's insured by the FSLIC at the end of 1986, 1,024 were rural. The number involved heavily in agricultural finance is unknown, but believed to be small.

Data for individual banks, from quarterly Reports of Condition and Income, were provided by the Federal Reserve Board of Governors. Bank failure data were provided by the FDIC. Analogous data on S&L's were provided by the Federal Home Loan Bank Board. Wherever possible, we used data from December reports.

firm's acquisition by a healthy bank or S&L. The FDIC is experimenting with this, and several failing rural banks were replaced this way in 1986. Another solution is for FDIC and FSLIC to replace the failing institution's managers with their own agents, and force the stockholders to take losses as if the firm were shut down. S&L regulators have done this on occasion. The key is to prevent managers with little equity left to lose from offering high interest rates and investing deposits in high-risk ventures, where it's "heads we win, tails the FSLIC or FDIC loses."

How Does A Failure Affect the Community?

Researchers have been unable to quantify the effects financial institution failures have had on their communities. One study found that bank failures led to declines in farm output a year later, but the methods used are being disputed. Two other studies could not isolate significant local effects of bank failures in Tennessee, Kansas, or Nebraska. Overall, the effects on local economies seem to have been negligible.

There are, nonetheless, some believable ways that the failure of a local bank or thrift could hurt its community. Because farms and rural businesses that rely on local financing are small, it is costly for distant lenders to gather information necessary to judge their creditworthiness. When a local institution disappears, its former customers may have difficulty securing credit, and may pay more for it.

Local failures could prompt healthy surviving banks and S&L's to make fewer local loans if local borrowers are viewed as higher credit risks. Concern about unexpected deposit withdrawals may induce these institutions to boost cash on hand and other short-term liquid assets, so as to appear safer. That makes less funds available for lending. Credible Federal deposit insurance eliminates the risk of such deposit runs, but the well-publicized insolvency of the FSLIC has made it more of an issue for healthy S&L's.

Local depositors risk losing uninsured balances (that is, deposits greater than $100,000) if the institution is liquidated. But debtors with troubled loans held by failed banks and S&L's are probably hurt the most. The Federal deposit insurance agencies are often left to administer them. And these agencies tend to be strict with problem debtors, since their legal responsibilities are to the failed institution's depositors, bondholders, and stockholders.

Failures Due to Declining Local Economies, Deregulation, Fraud

Up to now the focus has been on how failures affect the communities. But the contractions in the farm and oil sectors that depressed many local economies also hurt local financial institutions, pushing some closer to failure. So bad local conditions have contributed to some bank and S&L failures. On the other hand, the financial-services industry has undergone massive deregulation, substantial technological advances, and abrupt interest-rate changes. Proponents of widespread forbearance claim that victims of the agricultural and oil crunches, as well as those hurt by the runup in rates, should be given more time to recover. No one argues for relief of banks or S&L's that cannot survive deregulation or technological change.

Banks headquartered in oil- and gas-dependent counties had significantly higher probabilities of closure in 1986. Banks headquartered in farming-dependent counties also had higher odds of failure, but a bank's aggressiveness and degree of farm loan specialization were more important determinants. The inability or unwillingness of many rural and agricultural banks to diversify tied their fate more closely to local conditions.

S&L's have historically specialized in home mortgages, and their initial problems arose from this tradition. Unexpectedly, interest rates more than doubled between 1978 and 1982. S&L's were caught with long-term, low-rate mortgages as the costs of their primarily short-term funds (deposits and other borrowings) skyrocketed. Losses mounted and hundreds of S&L's failed or lost most of their equity. Initially, many S&L's also lost deposits because the maximum rate they could pay depositors was fixed by law.

Congress responded to these problems by deregulating. It phased out the deposit-rate ceilings for banks and S&L's, and allowed S&L's to finance activities outside of homeownership. The intent was to assure adequate deposits and allow S&L's to diversify away from home mortgages so they could protect against losses caused by volatile rates and housing market downturns. After interest rates peaked in 1982, many S&L's had little or no equity left, but greatly expanded lending powers and the ability to attract large deposits by offering to pay above-market rates. This set the stage for the "resurrection-gamblers." Risk-loving owners and managers, with little of their own on the line, often bought failing S&L's to play this game.

The problem arose because Federal deposit insurance costs banks and S&L's a flat-rate premium not adjusted for risk. Not charging more for risk-taking encourages all institutions to take on more risk, but the temptation is greatest when the owners have little left to lose.

Since 1982, when interest rates began falling, most S&L failures and insolvencies have been attributed to bad loans. Also, only 11 percent of 1982 S&L forbearance participants had met net worth standards and returned to profitability by late 1986. Participants should have performed better, according to the arguments of those advocating forbearance, because most initially suffered from rising interest rates, a temporary condition that has since been reversed.

Commercial banks face the same incentives as S&L's, but their situation is somewhat different. Because they deal more in short-term loans, they were not hit as hard by spiking interest rates. Their portfolios were better diversified, and their lending powers were not expanded as much by deregulation. Fewer were in weak condition in 1982, so the magnitude of the "resurrection gambler" problem was much smaller. Moreover, commercial banks are monitored and supervised more closely than S&L's, dampening the tactics of the most aggressive bank managers.

The new financial environment has expanded opportunities for fraud and insider abuse. Because the line between fraud and a poor judgment of credit-quality is difficult to draw, fraud's importance as a cause of failure is debatable. Some studies have reported it as the dominant factor in a third of bank failures and the main cause of S&L failures in some States.

In short, declining local economies have contributed to many failures, though the connection is easier to make for commercial banks than for S&L's. Certainly the sharp declines in farm- and energy-

Rural Financial Markets

Federally insured commercial banks and S&L's are the most important providers of financial services to rural communities because they are the most decentralized and ubiquitous. Life insurance companies, investment banks, mortgage companies, and other suppliers of financial services are more concentrated in urban areas. At the end of 1986, 2,119 rural counties had their own local bank, leaving only 252 without a bank headquarters. Commercial banks headquartered in rural areas outnumber urban-based banks by a slim margin; 7,554 of the 14,008 U.S. banks are based in nonmetro communities. But they hold less than 12 percent of all bank assets.

There are fewer S&L's, and a smaller proportion of them are based in rural counties. Found in 762 rural counties, about a third of the 3,242 S&L's in the U.S. had a rural headquarters office at the end of 1986. Like the rural banks, rural S&L's are smaller, holding a little more than 10 percent of S&L industry assets. As a whole, the S&L industry, with just over a trillion dollars in assets, is smaller than the banking industry. As of December 1986, commercial banks reported assets of about $3 trillion.

A reason why there are fewer S&L's than banks has to do with differing laws on branching activity. State-chartered institutions must abide by State regulations; commercial banks with National charters must also follow their home-State's laws. But federally chartered S&L's that keep at least 60 percent of their assets for financing homeownership are exempt from State branching restrictions. They do not face Federal interstate branching restrictions either, although the Federal Home Loan Bank Board usually allows interstate branching only to facilitate acquisition of a failing S&L. Many States that restrict or prohibit bank branch offices allow their S&L's more freedom to open branches. So there are fewer S&L's, with more branch offices, than banks in many States.

dependent real estate markets caught some S&L's at a time when they had been weakened by interest rate swings and had often just increased their risk-exposure due to deregulation, inadequate supervision, and mispriced deposit insurance. But problems in the local economy alone do not explain the problems faced by S&L's. Similarly, many banks with high probabilities of failure exhibit resurrection-gambler symptoms: low capital, dependence on high-cost and brokered deposits, high delinquent loan rates, and high loan-asset ratios.

What It Means For Rural Development

If the current system is not changed, losses at weak and insolvent institutions will mount. Because Federal deposit insurance is funded through premiums paid by banks and S&L's, these costs will initially be covered by remaining healthy institutions. But the costs facing the troubled FSLIC are rapidly approaching a magnitude that remaining healthy S&L's will be unable to pay. Fear of spiraling FSLIC-insurance costs are driving the healthiest S&L's to seek FDIC coverage instead. If the costs must be covered by Federal outlays, either taxes will rise or less Federal funds will be available for other nondefense activities, including programs for rural areas and agriculture.

Aside from the cost issues, rural communities are better served if insolvent firms are closed and replaced with healthy ones. USDA's Farmers Home Administration, cooperating with the FDIC, runs a small program aiding stressed farm borrowers of failed farm banks; more programs like this would help rural communities adjust to bank and thrift failures. Even a more conservative but healthy bank or S&L might promote steady long-term community growth better than a troubled institution that continues to make unsound, often nonlocal, loans.

A financial system with a small but growing number of weak firms will not allocate resources efficiently; too many high-risk ventures will begin, while more cost-effective projects will remain on the drawing boards.

Forbearance may be reasonable in some instances for institutions carefully chosen and closely monitored by regulators. But it is not a cure-all and can be counterproductive if applied indiscriminately. The pressures on managers of insolvent or nearly insolvent institutions to gamble, to try to grow out of their problems, may be too powerful to control. The FSLIC-recapitalization bill signed into law this August requires forbearance for S&L's in economically troubled regions. Mandating such policies is probably expensive, because it prevents regulators from closing ill-managed institutions in those areas. If there is a reluctance to close insolvent institutions, a policy of replacing their managers with agents of the deposit insurance funds, as the FSLIC is now doing on a limited scale, is one way of limiting public exposure to more losses and avoids immediate outlays.

Widespread forbearance sets a bad precedent. Bank and S&L managers will take on even higher risks in the future, knowing that regulators and lawmakers will accommodate them if the risks don't pan out. Many analysts believe that the booms in agriculture, oil, and some real-estate markets were inflated by excessive credit availability; widespread forbearance plants the seeds for this to be repeated in sectors experiencing the next boom. Also, the weaknesses in the current financial system, combined with forbearance, raise serious questions about the wisdom of granting even more powers to banks and S&L's at this time.

Other policies, such as capital requirements based on risk, or variable-rate deposit insurance premiums, along with enhanced supervision, are needed to treat the underlying problems facing federally insured banks and thrifts. More research is needed on the links between local conditions and financial firm performance, but the evidence so far suggests that depressed local economies alone do not justify widespread use of forbearance.

For Additional Reading...

James R. Barth and Martin A. Regalia, "The Evolving Role of Regulation in the Savings and Loan Industry," Presented at the 5th Annual Monetary Policy Conference, Washington, DC, CATO Institute, Feb. 1987.

U.S. General Accounting Office, "Thrift Industry: Forbearance for Troubled Institutions, 1982-1986," Briefing Report to the Chairman of the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Report No. B-226353, May 1987.