View metadata, citation and similar papers at core.ac.uk

brought to you by CORE

provided by Fordham University School of Law

Fordham Law Review

Volume 59 | Issue 6 Article 4

1991

Thumbs on the Scale: The Role that Accounting Practices Played in the Savings and Loan Crisis

Richard C. Breeden

Follow this and additional works at: https://ir.lawnet.fordham.edu/flr

Part of the Law Commons

Recommended Citation

Richard C. Breeden, *Thumbs on the Scale: The Role that Accounting Practices Played in the Savings and Loan Crisis*, 59 Fordham L. Rev. S71 (1991).
Available at: https://ir.lawnet.fordham.edu/flr/vol59/iss6/4

This Article is brought to you for free and open access by FLASH: The Fordham Law Archive of Scholarship and History. It has been accepted for inclusion in Fordham Law Review by an authorized editor of FLASH: The Fordham Law Archive of Scholarship and History. For more information, please contact tmelnick@law.fordham.edu.

Thumbs on the Scale: The Role that Accounting Practices Played in the Savings and Loan Crisis

Cover Page Footnote
Phillip D. Parker, Associate General Counsel of the Commission, assisted in researching, drafting and revising this article. His contribution and counsel have been invaluable on this article and these issues.

This article is available in Fordham Law Review: https://ir.lawnet.fordham.edu/flr/vol59/iss6/4

THUMBS ON THE SCALE: THE ROLE THAT ACCOUNTING PRACTICES PLAYED IN THE SAVINGS AND LOAN CRISIS

*RICHARD C. BREEDEN**

INTRODUCTION

THE savings and loan crisis began because thrift institutions were poorly designed financial intermediaries that became increasingly vulnerable to competitive pressures, greater volatility in interest rates, and other changes in the economic environment in which they operated. Then, at a time when the thrift industry was economically insolvent, the Federal Home Loan Bank Board ("FHLBB") encouraged the industry to grow out of its problems, hoping that growth through the accumulation of higher yielding assets would offset losses on existing mortgage assets. By greatly reducing capital requirements and continuing to make under-priced federal deposit insurance available even to economically insolvent institutions, the regulators provided thrift owners with every incentive to engage in aggressive growth by speculating with taxpayer dollars. Besides causing the thrift industry to attract more than its share of fraudulent operators, this policy led to ruinous expansion which greatly increased the ultimate losses to the government.

Although a variety of economic, political, and regulatory forces contributed to the thrift crisis, this article will focus on the key role played by the misuse of accounting standards. In order to implement its policy of regulatory forbearance, the FHLBB sanctioned unsound accounting practices that operated to inflate the calculation of thrift capital and earnings. By creating the *appearance* that troubled thrift institutions were in compliance with capital requirements, these accounting standards concealed or minimized the magnitude of the problems facing the

* Mr. Breeden is the Chairman of the Securities and Exchange Commission.

Phillip D. Parker, Associate General Counsel of the Commission, assisted in researching, drafting and revising this article. His contribution and counsel have been invaluable on this article and these issues.

This speech was given by Chairman Breeden as part of the annual Financial Institutions and Regulation Symposium at the Fordham University School of Law.

The Commission, as a matter of policy, disclaims responsibility for any private publication or statement by any of its members or employees. The views expressed herein are those of the author and do not necessarily reflect the views of other members of the Commission or the staff.

industry. As a result, thinly capitalized or insolvent institutions were permitted to pay dividends out of capital, make acquisitions, pay lavish salaries and engage in aggressive growth.

It is doubtful that financial regulators should have permitted the continued operation of troubled thrift institutions. Far worse, however, was the decision of those regulators to foster accounting principles designed to allow deceptive measurements of net worth. The purpose of accounting standards is to assure that financial information is presented in a way that permits investors, creditors, and other users to make informed judgments. If we learn nothing else from the thrift crisis, it should cause us to recognize that accounting standards should never be subverted to accommodate the perceived needs of a particular industry. The accounting practices adopted by thrift regulators created the appearance that thrift institutions were operating on a safe and sound basis, but they did not—and could not—change the underlying business realities.

The first section of this article describes how the reduction of capital requirements and business expansion fueled the thrift crisis. Section II describes how improper accounting practices facilitated the policy of permitting thinly capitalized or insolvent institutions to expand. Section III discusses why financial regulators should not be responsible for administering the federal securities laws with respect to the financial institutions they regulate, and then briefly reviews current initiatives to mandate a broader use of market value accounting by financial institutions.

I. The Role of Capital Requirements and Business Expansion in the Thrift Crisis

A. *Setting the Stage for Growth*

The assets of savings and loan institutions traditionally were concentrated in long-term, residential mortgage loans at fixed rates of interest. These mortgage loans were largely funded by short-term deposits. Due to the fundamental maturity imbalance between their long-term assets and their short-term liabilities, thrift institutions were inherently vulnerable to interest rate fluctuations. For decades, the borrow short, lend long construct of the thrifts represented good politics, but not good economics or sound financial structure.

At the same time, federal law capped the rate of interest that could be paid on bank and thrift deposits. This made thrifts vulnerable to periodic bouts of disintermediation when market rates exceeded permissible interest rate ceilings. While the interest rate ceilings created periodic problems in funding new mortgage originations, they also acted like a governor that prevents an engine from running too fast and overheating. Because the limitation on interest rates made it difficult for institutions to grow rapidly in size, there was time for a slow regulatory system to discover and correct problem situations.

In the 1970s, extended periods of inflation and interest rate volatility

led to the development of consumer-oriented financial products, such as money market mutual funds, that paid market rates of interest.[1] This caused depository institutions to lose large volumes of their controlled-rate federally insured deposits, and they did not have the authority to offer comparable uninsured products.[2] In response to these developments, Congress enacted legislation in 1980 that authorized negotiable orders of withdrawal (NOW) accounts and established a schedule for the deregulation of interest rates paid to depositors.[3] The 1980 legislation also increased the amount of federal deposit insurance per account from $40,000 to $100,000.

Although the expansion of deposit insurance coverage and the removal of interest rate limitations enabled thrift institutions to attract deposits, they continued to be vulnerable to interest rate risk caused by the concentration of their assets. The average cost of funds for thrift institutions rose from seven percent in 1978 to just over 11 percent in 1982, but the preponderance of long-term, fixed-rate mortgages in thrift portfolios prevented a corresponding increase in revenues.[4] In both 1981 and 1982, the average cost of funds actually exceeded the average return on mortgages. On a true market value basis, the thrift industry as a whole was probably insolvent as early as the mid-1970s. It has been estimated that, by 1981, the thrift industry was underwater on a mark-to-market basis by more than $100 billion.[5]

Thrift institutions also experienced new competition in their lending activities due to the growth of increasingly efficient secondary markets for mortgage-backed securities. Because the origination function often could be performed by mortgage bankers and others at lower cost, the thrift industry's share of new mortgage originations began to decline af-

---

1. The assets held by money market mutual funds grew from $10.9 billion in 1978 to $206.6 billion in 1982. *See* Investment Co. Inst., Mutual Fund Fact Book 78 (1990).

2. It should be noted that this loss of deposits was only partial. Money market funds purchased substantial volumes of certificates of deposit and other securities of banks, thereby returning these funds to the depository system.

3. *See* Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (1980) (codified as amended in scattered sections of 12 U.S.C.).

4. Thrifts were restrained from reducing their interest-rate vulnerability because the regulatory policies of the FHLBB, which were backed by strong Congressional support, did not authorize federally-chartered thrifts to offer adjustable rate mortgages during the late 1970s. These types of mortgages were not authorized for federal thrifts until June 1981. *See* Adjustable Mortgage Loan Instruments, 46 Fed. Reg. 24,148 (1981).

5. *See* E. Kane, The S&L Insurance Mess: How Did It Happen? 75 (1989). Kane estimates that in 1978, on a mark-to-market basis, the thrift industry had a negative net worth of between 6.87 percent ($35.1 billion) to 10.31 percent ($52.7 billion) of total industry assets. *See id.* Kane also estimates that by 1981, the negative net worth had increased to between 15.41 percent ($100.3 billion) and 23.12 percent ($150.5 billion) of assets. *See id.*; *see also* Statement of Richard T. Pratt before the House Comm. on Banking, Finance and Urban Affairs, 101st Cong., 2d Sess. 3-4 (October 1, 1990)[hereinafter Pratt Testimony]. Mr. Pratt, who was the Chairman of the FHLBB from April 1981 to April 1983, testified that it would have cost approximately $178 billion to liquidate the thrift industry in 1981. *See id.*

ter 1976.[6] In order to maintain its viability, the thrift industry pressed for an easing of restrictions on the types of investments and lines of business permitted for thrift institutions. In 1982, Congress enacted legislation that authorized federally-chartered thrifts to invest up to 40 percent of their assets in nonresidential real estate lending, and to invest as much as 30 percent of assets in consumer loans.[7] These changes in federal law allowing greater diversification by federally-chartered thrifts were modest compared to the actions of California, Texas and certain other states, which in the early 1980s essentially removed all portfolio or business activity limitations.[8] Thus, statutory change at both the state and federal level altered the lending activities and the overall risk pattern of the thrift industry.

If implemented in a prudent manner, the authority to diversify assets was a means to reduce, rather than increase, the risk structure of the thrifts. Indeed, Congressional action to reduce the dependency of thrifts on fixed-rate mortgage lending was long overdue by the early 1980s. Firms often incur heavy start-up losses, however, when they enter new lines of finance or other types of business without experience or market share. Moreover, because many thrifts were already economically insolvent, the owners of such institutions had no incentive to minimize the risks associated with their entry into new lines of business. Unfortunately, new thrift lending powers were not restricted to those institutions with high levels of tangible capital, or to capitalized holding company affiliates precluded from drawing on the capital or funding of the thrift itself. Such limitations could have significantly limited the risk to the deposit insurance fund resulting from otherwise sensible product diversification.

The legislative and regulatory changes effected during the early 1980's transformed an industry that had been characterized by slow growth due to limited funds availability into an industry that was capable of explosive growth.[9] There was no market discipline to control this growth because depositors protected by federal deposit insurance were indifferent to the financial health of the institutions to which they lent money. Indeed, the removal of interest rate ceilings led to the emergence of a brokered deposit business that directed funds toward institutions paying the highest rate of interest, which generally were the institutions in financial difficulty.

6. *See* L. White, The S&L Debacle 21 (1990)

7. Garn-St Germain Depository Institutions Act of 1982, Pub. L. 97-320, 96 Stat. 1469 (1982) (codified as amended in scattered sections of 12 U.S.C.).

8. *See, e.g.*, Cal. Fin. Code § 7250 (West 1989)(securities investment limitations and exceptions).

9. Another factor that contributed to growth was the liberalization of FHLBB regulations regarding the conversion of federally chartered institutions from mutual to stock organizations. Billions of dollars in proceeds from conversions were added to the capital of institutions which could then leverage those funds for rapid asset growth.

B. *Thrift Capital Levels*

Capital requirements are the most powerful source of discipline for financial institutions. When maintained at an appropriate level, capital requirements reduce the incentive to take excessive risks and provide a cushion against loss. A meaningful capital standard also serves as a check against uncontrolled growth, since the permissible level of investment is directly tied to capital requirements.

The thrift industry was permitted to engage in unchecked expansion because thrift regulators consistently acted in a manner that eroded the discipline of a capital standard during the period when it was most necessary. In response to widespread industry problems, the FHLBB first lowered its capital requirements from five percent to four percent in November 1980,[10] and then further reduced them to three percent in January 1982.[11] Thus, just as thrifts obtained vast new abilities to raise deposits, the regulatory agency acted to increase nominal industry leverage from 20:1 to over 33:1.

In practice, the discipline that might have been provided by capital requirements was significantly eroded by two other FHLBB regulations, known as the "five-year averaging" and "20-year phase-in" provisions. These provisions, which relaxed capital requirements for rapidly growing and newly-chartered thrifts, respectively, were originally designed to permit a gradual building of reserves and net worth by mutual institutions financing residential mortgages in local markets. They led to disastrous results, however, when used by institutions that could attract deposits on a nationwide basis and also engage in commercial and development lending and direct investments.

The "five-year averaging" provision was adopted by the FHLBB in December 1972.[12] This regulation permitted thrifts to base the calculation of their minimum net worth and reserve requirements on average liabilities and deposits over the five year period comprising the year of the calculation and the preceding four years, rather than on current liabilities and deposits.[13] This method of computation provided the greatest reduction of capital requirements for those thrifts that had expanded most aggressively.

The "20-year phase-in" provision lowered capital requirements for a newly-chartered thrift by permitting it to determine its capital requirements by multiplying three percent of its liabilities by the fraction of twenty years that it had been covered by deposit insurance. Thus, a thrift in its first year of operations needed to have only one-twentieth of

10. *See* Net Worth Amendment, 45 Fed. Reg. 76,111 (1980).

11. *See* Net Worth Amendment, 47 Fed. Reg. 3,543 (1982).

12. *See* 37 Fed. Reg. 26,579 (1972). The original provision called for three-year averaging. *See* 36 Fed. Reg. 21,667 (1971).

13. The minimum net worth requirement was computed as a percentage of total liabilities, and the minimum statutory reserve requirement was computed as a percentage of insured deposits.

the normally required reserves and net worth. By permitting a debt-to-equity ratio as high as 666 to one, this provision essentially eliminated any meaningful capital restrictions on growth for the newest and most inexperienced thrifts trying to break into a volatile and changing industry. Prior to November 1983, when the FHLBB eliminated, for new but not existing institutions, use of the 20 year phase-in provision, a new institution could leverage $2 million in initial capital stock or pledged savings to support $1.3 billion in liabilities after the first year.[14]

The reduction of capital requirements, when combined with the accounting practices sanctioned by the FHLBB, permitted thrifts that had little or no capital base to engage in high-velocity expansion. Indeed, from year-end 1980 to year-end 1984, aggregate thrift assets grew from $618 billion to $979 billion. During the same period, aggregate industry tangible capital (*i.e.*, capital less goodwill and other intangible assets) fell from more than $32 billion to only $4 billion.[15] With virtually no tangible capital at risk, thrift operators had nothing to lose and everything to gain by adopting a strategy of rapid growth and enormous risk-taking. In fact, it was precisely those thrifts in the most precarious position that had the greatest incentive to engage in speculative business activities. In December 1983, at a time when thrift assets were approximately $820 billion, the Task Group on Regulation of Financial Services (Task Group), which was chaired by then-Vice President Bush and included the heads of all federal financial regulatory agencies, made an initial recommendation that the FHLBB be required to use the same capital standards (as well as the same accounting principles for determining such capital) as the Federal Deposit Insurance Corporation ("FDIC"). This recommendation was thereafter included in the final report issued by the Task Group in 1984.[16] Unfortunately, legislation to implement this recommendation was not enacted until the passage of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) in August 1989.[17] By that time, aggregate thrift assets had grown to approximately $1.25 trillion, an increase of roughly $430 billion from the level that existed when the Task Group made its initial recommendation to tighten thrift capital and accounting standards.

---

14. *See* Reserve Requirements and Policies Relating to Insurance of Accounts of de Novo Institutions, 48 Fed. Reg. 54,320, 54,324 (1983).

15. *See* R. Brumbaugh, Jr., Thrifts Under Siege: Restoring Order to American Banking 50-52 (1988).

16. *See* Blueprint for Reform: The Report of the Task Group on Regulation of Financial Services 82 (1984).

17. Pub. L. No. 101-73, 103 Stat. 183 (1989) (codified in scattered sections of 12 and 15 U.S.C.).

II. The Misuse of Accounting Standards to Conceal Industry Problems and Facilitate Expansion

A. *The Distinction Between RAP and GAAP*

Regulatory Accounting Principles (RAP) are accounting standards established by regulatory agencies to monitor compliance with statutory and administrative requirements. In the case of federally insured depository institutions, RAP govern the financial reports that are submitted to the relevant federal oversight agency. The appropriate use of RAP should require a regulated firm to calculate earnings and net worth on a basis that is more conservative than generally accepted accounting principles (GAAP) might be interpreted to permit.

By contrast, GAAP are established by private sector standard setters such as the Financial Accounting Standards Board ("FASB")[18] and the American Institute of Certified Public Accountants ("AICPA").[19] This development of standards by the professional accounting bodies takes place under oversight of the Securities and Exchange Commission ("SEC" or "Commission"). GAAP, including those principles that specifically address the financial services industries, provide the framework for the accounting measurements and disclosures that are required for the sale of securities and periodic financial reports under the federal securities laws.

During the early 1980s, thrift RAP were significantly more lenient than GAAP. For example, thrifts were permitted by RAP: (1) to amortize realized losses on assets sold over the remaining contractual life of the assets; (2) to record loan origination fees as income on a basis more liberal than that permitted by GAAP; and (3) to increase capital by the amount that certain assets had appreciated above recorded depreciated cost, without recognizing the decrease in value of other assets.

Thrift regulators also tolerated flawed interpretations of GAAP that enabled the regulated entities to comply with the lowered capital requirements. As a result, thrift institutions: (1) amortized acquisition costs in excess of net tangible assets over 40 years, while booking income on the discounted market value of the acquired assets over 10 years; (2) accelerated income on certain real estate investments; and (3) capitalized losses on speculative forward commitments.[20]

---

18. The FASB issues guidance in the form of Statements of Financial Accounting Standards ("FAS"), Interpretations, Technical Bulletins, Statements of Financial Accounting Concepts and minutes of The Emerging Issues Task Force.

19. The AICPA issues guidance in the form of Notices to Practitioners, Industry Audit and Accounting Guides, Statements of Position, Accounting Interpretations, Issue Papers and Accounting Standards Executive Committee ("AcSEC") Practice Bulletins.

20. While this article focuses on the impact of accounting standards sanctioned by the regulators, it is also fair to ask whether those standards were appropriately applied by financial institutions and accounting firms. As the numerous lawsuits against accounting firms suggest, there are substantial questions about whether accounting firms fulfilled their obligations.

The Commission's authority to regulate the disclosures made in registration statements and periodic financial reports includes publicly-held holding companies that own banks and savings and loan associations. Securities issued directly by depository institutions, however, are generally exempt from the registration requirements of the Securities Act of 1933 ("Securities Act").[21] Similarly, pursuant to Section 12(i) of the Securities Exchange Act of 1934 ("Exchange Act"),[22] the federal agencies that regulate depository institutions administer the disclosure provisions of that Act with respect to banks and thrifts. Thus, the securities laws, designed to protect investors, were interpreted and administered with respect to thrifts by the FHLBB, an agency primarily concerned with the financial health of thrifts, not their investors.

B. *RAP That Inflated Reported Capital*

1. Deferral of Losses on the Sale of Assets

The FHLBB's most indefensible use of RAP was a regulation designed to encourage thrift institutions to liquidate long-term mortgage loans that could be sold only at a substantial discount in the high-interest rate environment of the early 1980s. Both GAAP and RAP allowed such loans to be carried at cost, without reflecting the dramatic loss in market value that had occurred. Although this failure to reflect economic reality had the effect of significantly overstating earnings and net worth, GAAP at least required immediate recognition of a loss the event that any such assets were sold.

To encourage portfolio restructuring, the FHLBB made an offer to thrift institutions that many could not refuse. A regulation adopted in 1981 permitted thrifts to book the entire amount of losses realized on the sale of mortgage loans as an *asset* for RAP purposes. This accumulated loss could then be amortized over the remaining contractual life of the assets sold.[23] For example, if a thrift sold a portfolio of mortgages with a $500 million face amount for $350 million, it could treat the realized loss of $150 million as an asset included in net worth. This meant that the thrift could maintain its current level of activity without injecting new capital, notwithstanding a $150 million reduction in the real value of the enterprise. The thrift also received a tax benefit from the transaction, since the sale resulted in the recognition of a $150 million loss for tax purposes.

One can argue that financial institutions should be allowed to carry

21. *See, e.g.*, Act of May 27, 1933, ch. 38, tit. I, 48 Stat. 74, § 3(a)(2) (codified as amended at 15 U.S.C. § 77c(a)(2) (1988))(banks); *id.* § 3(a)(5) (codified as amended at 15 U.S.C. § 77(a)(5) (1988))(savings and loans).

22. *See* ch. 404, 48 Stat. 881, § 12(i) (codified as amended at 15 U.S.C. § 78*l*(i) (1988)).

23. *See* Treatment of Gains and Losses on the Sale or Other Disposition of Mortgage Assets, Mortgage-Related Securities, and Debt Securities; Republication of Reserve Requirements, 46 Fed. Reg. 50,048 (1981).

assets at their historical cost on the assumption that they will be held to maturity. However, the loss deferral rule essentially permitted thrift institutions to carry assets at historical cost even *after* they had been sold, a result that Alice would have found outlandish even by the standards of Wonderland. The release issued by the FHLBB in adopting this rule stated that its purpose was to assist institutions that were "inhibited" from undertaking mortgage disposition programs because GAAP required immediate recognition of a loss. As discussed in Section III of this article, the use of mark-to-market accounting would eliminate any incentive to hold assets that can be sold only at a discount from book value.

The deferral of losses on assets sold created a major divergence between GAAP and RAP measures of net worth. Deferred losses exceeded $6.3 billion, or thirteen percent of reported regulatory net worth, as of December 31, 1985.[24] Under the FHLBB's capital levels at the time, this $6.3 billion in accumulated losses was sufficient to support $207.9 billion in loans.

2. Loan Origination Fees

Beginning in 1979, thrifts were allowed to recognize income from construction loan origination fees on a basis more liberal than that permitted by GAAP. For purposes of computing regulatory net worth, thrifts were allowed to recognize income from construction loan fees equal to 2.5 percent of the loan amount, immediately upon origination of a loan.[25] Thus, for a $20 million construction loan, RAP would allow a thrift to record $500,000 in loan fee income ($20 million x .025) on the day of closing. By contrast, GAAP allows immediate recognition of loan fee income only to the extent of costs incurred in originating loans, which in this example might reasonably have been $100,000 or less. The remainder of the fees are taken into income ratably over the life of the loan if it remains current, or upon sale.

For RAP purposes, the earnings arising from loan fees were greatest for those thrifts with significant construction loan volume. This almost certainly induced many institutions to enter into additional construction loans (however risky) in order to generate immediate income. A thrift making $1 billion per year in new construction loans, for example, could report $25 million per year in income from loan origination fees, even though the loans might be extraordinarily speculative and unlikely to be repaid.

Thrifts had a particularly strong incentive to promote rapid growth in

---

24. *See* Brumbaugh, *supra* note 15, at 44.

25. *See* Insurance of Accounts, Amendments Relating to Acquisition Credit Subject to Deferral, 44 Fed. Reg. 76,567 (1979). With respect to loans other than construction loans, thrifts could recognize income equal to two percent of the loan amount, plus $400 if the institution's employees performed appraisal, attorney, or loan closing services for which no escrow fee was charged.

deposits that could be lent out on those projects paying the highest "points", or origination fees. Due to the operation of the "five-year averaging" and 20-year phase-in provisions, the amount that a thrift accepting $1 billion in new deposits would have to increase its capital could be less than $10 million. At the same time, the thrift could generate as much as $25 million in income by using the deposits to fund construction loans. This may explain why annual growth rates of 1,000% or more were not uncommon in the thrift industry.

3. Appraised Equity Capital

Beginning in late 1982, the FHLBB permitted thrift institutions to include an item called "appraised equity capital" when computing their regulatory net worth. Appraised equity capital represented the amount that certain capital assets (*e.g.*, property and equipment) had appreciated above their recorded depreciated cost.[26] The rule permitted thrift institutions to recognize appreciation in the value of buildings even where those assets had not been sold, with a corresponding increase in net worth for RAP purposes.

Although a market value approach to accounting generally should measure an entity's net worth more accurately than an historical cost accounting approach, the thrifts were permitted to reflect market value on a totally selective basis. Only those adjustments that increased the value of certain assets were made, and there was no obligation to recognize the far greater decrease in value of other assets. Moreover, each dollar of capital that a thrift created by reappraising its assets permitted it to raise at least $33 by offering insured deposits to the public.

The release issued by the FHLBB when adopting this rule frankly acknowledged that it was a departure from GAAP that was intended "to maintain public confidence in the industry during this period of financial and operational transition."[27] The FHLBB also noted that, because the use of financial statements that depart from GAAP "may raise questions" under the antifraud provisions of the federal securities laws, thrift institutions "subject to such limitations" should refrain from disseminating financial statements that included appraised equity capital.[28] It should be noted that the FHLBB, while engaging in this effort to prop up the thrift industry, was also responsible for reviewing the disclosure documents of thrifts that were offering shares to the public, a blatant conflict of interest.

In 1985, the FHLBB extended the "sunset" date of the appraised equity capital rule for another year. At the time, the FHLBB noted that appraised equity capital represented a "real, though unrealized" equity value that, in case of merger or liquidation, would serve to protect the

26. Amendments to Net Worth and Statutory Reserve Requirements, 47 Fed. Reg. 52,961 (1982).
27. *Id.* at 52,962.
28. *Id.* at 52,964.

interests of the insurance fund just as much as "more traditional" forms of capital.[29] The appraised equity capital rule resulted in an estimated increase to reported regulatory net worth of $2.2 billion as of December 31, 1986, when the rule became ineffective.[30]

C. *Accounting Interpretations*

1. Purchase and Goodwill Accounting

While the preceding examples involved the promulgation of RAP that departed from the requirements of GAAP, the deception sponsored by thrift regulators also extended to the misapplication of GAAP. The most egregious distortions of GAAP involved treatments of goodwill that were designed to make the acquisition of troubled thrifts (thrifts whose liabilities exceeded the market value of their assets) more attractive.

The concept of goodwill is based on a premise that, when a business is acquired in an arms-length transaction for an amount that exceeds the aggregate book value of its assets, there must be an intangible asset that accounts for the difference. The concept assumes, in other words, that a buyer will not overpay for the acquired assets. This basic premise was questionable in the case of many thrift acquisitions, however, in which the buyer assumed the excess liabilities of a thrift that was incurring substantial losses. In fact, many thrift acquisitions took place only because the FHLBB interpreted GAAP in a manner that enabled the buyer of an insolvent thrift to generate immediate accounting profits.

When a troubled thrift was acquired, its assets (mostly long-term mortgages which had depreciated in value as a result of changes in interest rates) were recorded on the buyer's books at fair market value in accordance with GAAP. The "discount," or difference between the original book value and the fair market value, was booked as income over the estimated life of the assets on an interest-method basis. The net liabilities (*i.e.*, the fair value of total liabilities less the fair value of the assets acquired) were recorded as goodwill and expended on a straight-line basis over an amortization period.

GAAP recognize that there is considerable judgment to be applied in determining the appropriate amortization period for goodwill, specifying only that the goodwill be amortized over the period benefited, not to exceed 40 years. If a thrift used the maximum 40-year period, the yearly "expense" for goodwill would be one-fortieth of the total amount. Because the typical life of the purchased assets usually averaged about 10 years, however, this would mean that the "discount" was recorded as income over a shorter period. Thus, the income from amortizing the purchase discount would exceed the expense from goodwill, and the acquiring thrift would generate net income during the first 10 years after the acquisition. Because the amount of these paper profits immediately

---

29. Appraised Equity Capital, 50 Fed. Reg. 45,988 (1985).
30. *See* Brumbaugh, *supra* note 15, at 44.

following the acquisition was directly tied to the amount of goodwill amortized over a longer period, the biggest boost to profits was realized by the buyers who acquired the weakest thrifts.[31]

The distortions caused by goodwill accounting were clearly understood by the FHLBB. From 1974 to 1981, in fact, FHLBB guidance required thrifts to amortize goodwill over no more than 10 years.[32] In 1980, the FHLBB proposed a regulation to codify this guidance and to require that a goodwill amortization period be matched with the accretion of discounts on acquired assets, stating that "[t]he use of different accounting periods in this instance may give rise to distortions in net worth levels and computations."[33]

In August 1981, however, the FHLBB reversed course and directed its staff to eliminate this restriction on the acceptable goodwill amortization period.[34] The FHLBB's release withdrawing the proposed regulation stated that "[u]pon further consideration, the Board has determined to allow the application of generally accepted accounting principles in this area without regulatory restriction."[35] Ironically, this release was issued

---

31. The impact of this provision can be seen in the treatment of an acquisition of a troubled thrift whose assets had lost $1 billion in actual value from a face amount of $3 billion. In this circumstance, a buyer that assumed the net assets would have recorded liabilities of $3 billion, loans of $2 billion and goodwill of $1 billion. Absent payment defaults, in subsequent years the loan balance would be gradually increased to correspond to the principal payments of $3 billion. These increases would result directly in additions to interest income of $1 billion. Assuming the loans have an average estimated maturity of ten years, and that the income is recognized on a straight-line basis, income will be increased by $100 million in the first year solely as a result of this amortization practice. Assuming the goodwill is amortized over 40 years, the goodwill expense will be $25 million in the first year, resulting in a net increase to net worth of $75 million (before tax) after one year and $750 million after 10 years. Further, since GAAP require amortization of loan discounts using the interest method, the enhancement of income in the earlier years is amplified.

32. *See* FHLBB Memorandum R-31a (March 8, 1974).

33. 45 Fed. Reg. 72,661, 72,662 (1980).

34. *See* Treatment of Goodwill Acquired in Mergers, 46 Fed. Reg. 42,274 (1981).

35. While this accounting treatment of goodwill purportedly was based on GAAP, the SEC refused to allow thrift holding companies reporting to the Commission to amortize goodwill over a period longer than 25 years. Shorter periods were required when the transaction involved a troubled institution. This position was embodied in Staff Accounting Bulletin ("SAB") No. 42, an interpretative release issued in 1981. The FASB ultimately adopted the general concepts of this interpretive position as an industry-specific GAAP, *see* Statement of Concepts No. 72, Accounting for Certain Acquisitions of Banking or Thrift Institutions (Fin. Accounting Standards Board 1983), issued in February 1983. FAS No. 72 requires that goodwill, to the extent that it results from the assumption of excess liabilities, be amortized on an interest method over the life of the interest bearing assets acquired. It also requires that regulatory assistance be netted against goodwill.

SAB No. 42A was issued in December 1985 to deal with issues relating to the formation of thrift holding companies that become Commission registrants. This SAB indicated that the use by such companies of the long goodwill amortization periods permitted in their filings with the FHLBB would not be acceptable in Commission filings. It further noted concerns with the use in Commission filings of purchase accounting (with 40-year goodwill) for mergers of failing institutions.

on the same day that the FHLBB proposed a regulation that diverged from GAAP by permitting the deferral of losses on assets sold, based on a concern that thrift institutions contemplating asset disposition programs were "inhibited" by GAAP.

The ability to extend the amortization of goodwill had the effect of increasing the apparent profitability of acquiring institutions, as well as increasing the overall capital of the thrift industry by eliminating the capital shortage of the insolvent thrifts. In 1982 alone, over $15 billion in goodwill was created in purchase transactions, thereby enabling thrifts to maintain approximately $500 billion in deposits and to make an equivalent volume of loans without a single dollar of tangible capital investment. In that year, goodwill as a percentage of total industry GAAP capital rose from six percent to approximately eighty-two percent.[36]

The distortions created by goodwill accounting reached their zenith in what were referred to as "Phoenix" transactions. When it became too difficult to solicit financially sound buyers, the regulators would select several thrifts, usually all of which were insolvent, and designate one of the insolvent thrifts as the purchaser of the others. By applying purchase accounting and goodwill concepts, the new thrift formed by the combination immediately generated reported profits and positive net worth.

2. Acquisition, Development and Construction Loans

During the 1980s, many thrift institutions engaged in types of transactions involving the funding of real estate development that were mischaracterized as lending activity. The structure of these acquisition, development, and construction ("ADC") loans typically gave the financial institution the risks and rewards of investor participation, rather than a lender's normal return of principal and market rate of interest. Because GAAP require that accounting treatments reflect the substance of transactions rather than their form, these ostensible "loans" should have been accounted for as joint venture transactions.

Financial institutions had an incentive to characterize these transactions as loans because it enabled them to inflate reported income. When a $10 million mortgage at twelve percent is legitimately structured as a loan, for example, a lender may normally recognize interest income of at least $1.2 million per year.[37] By contrast, it is inappropriate to accrue interest when a transaction should be accounted for as a joint venture.[38]

36. Black, *Ending Our Forebearers' Forbearance: FIRREA and Supervisory Goodwill*, Stanford L. & Pol'y Rev. 102, 106 (Spr. 1990)(citing Brumbaugh, *supra* note 15, at 40-41, 50).

37. As noted earlier, RAP treatment of loan fees resulted in substantial additional income in the period that the loan was made.

38. Where the transaction is accounted for as a joint venture, the financial institution might be able to capitalize the interest payment, which would increase the carrying amount of the asset. The benefit to the financial institution of this accounting treatment, however, would be less than the benefit of including interest income.

ADC loans proved to be a major problem area, as thrifts suffered large losses from high risk investments improperly accounted for as loans.[39] Given the judgmental nature of the accounting requirements in this area, and the temptation to report investments as loans (thereby obtaining up-front fee income and accelerated recognition of interest), unequivocal guidance and strict enforcement were essential. The FHLBB, however, failed to prevent abuses in many cases.

To assist institutions and auditors in evaluating the substance of ADC transactions, the AICPA published a series of guidelines beginning in 1983.[40] In October 1984, the FHLBB proposed to adopt a statement of policy concerning the regulatory accounting for certain real estate activities.[41] This policy, which was intended to be consistent with the AICPA's guidelines, was not adopted until April 1985, and was applicable only to transactions occurring after that date.[42]

3. Repurchase Transactions

During the mid-1980s, some financial institutions engaged in certain speculative forward commitment transactions, known as "dollar-rolls," that were accounted for as borrowing/lending (financing) arrangements. The effect of accounting for these transactions as financing was to defer loss (or gain) recognition.

The most significant example of this practice involved Financial Corporation of America ("FCA"), a public holding company. FCA had total assets of $10.7 billion and stockholders' equity of $219 million by June 30, 1983. During the third quarter of 1983, FCA acquired American Savings & Loan Association, which approximately doubled FCA's asset base, initiated a program of purchases of securities financed by repurchase agreements and aggressively sought brokered deposits. By September 1984, FCA's assets had more than tripled to $32.4 billion, and repurchase obligations represented approximately twenty-two percent ($7 billion) of total assets.

In mid-1984, the Commission concluded that FCA's investment and repurchase transactions were, in substance, forward commitments to

---

39. *See, e.g.*, Federal Home Loan Bank Board's Supervision and Failure of Empire Savings and Loan Association of Mesquite, Texas, House Comm. on Government Operations, H.R. Rep. No. 953, 98th Cong., 2d Sess. 32 (1984)(discussing impact of high-risk investments in Empire failure).

40. *See, e.g.*, Notice to Practitioners, "Certain Real Estate Lending Activities of Financial Institutions" (November 1983)(AIPCA guidelines); Notice to Practitioners, "ADC Loans" (November 1984)(same). In February 1986, the AICPA issued new and expanded guidance which encompassed the earlier notices. *See* Notice to Practitioners, "ADC Arrangements" (November 1986). The guidance was generally consistent with how the Commission staff applied the accounting literature.

41. *See* 49 Fed. Reg. 43,557 (1984).

42. *See* Statement of Policy, Accounting for Acquisition, Development and Construction Loans, 50 Fed. Reg. 18,233 (1985). Even then, however, the adopting release stated that "classification of ADC transactions is best left to the insured institution and its independent public accountant." *Id.* at 18,235 (1985).

purchase securities. Because such commitments are speculative transactions rather than leveraged investments, they must be marked-to-market under GAAP. When the Commission required FCA to restate its financial statements and recognize a loss of $155 million on the forward commitment transactions, American Savings and Loan Association depositors withdrew $6.84 billion of deposits during a single quarter. Ultimately, FCA became insolvent, resulting in a loss to the public of billions of dollars.

III. Proposals for Reform

The enactment of FIRREA, by mandating higher capital levels and restricting the use of RAP by thrift regulators, has eliminated most of the abuses discussed in this article. Two additional measures are necessary, however, in order to assure the integrity and relevance of financial statements disseminated to the public by banks and thrifts. First, the registration requirements of the Securities Act should be made applicable to publicly-offered securities of banks and thrifts, and the administration and enforcement of Exchange Act disclosure requirements for banks and thrifts should be transferred from the bank and thrift regulatory agencies to the SEC. Second, there should be a movement towards a greater use of market value accounting in the financial reports that are publicly disseminated by banks and thrifts.

A. *Functional Regulation*

Banks and thrifts that are not part of a holding company are exempted from the uniform application of the Securities Act and the Exchange Act. The Securities Act has, since its inception, exempted financial institutions from its registration requirements for public offerings of securities. With respect to the Exchange Act, Section 12(i) provides that the bank and thrift regulatory authorities shall have the authority "to administer and enforce" the registration requirements of Section 12, the periodic reporting requirements of Section 13, the proxy and tender offer provisions of Section 14, and the insider reporting and trading liability provisions of Section 16.[43]

Our experience with the savings and loan industry illustrates why it is bad policy to exempt banks and thrifts from the uniform application of the federal securities laws. The FHLBB, throughout the period in which it permitted the use of unsound accounting practices, was responsible for protecting the federal deposit insurance fund. At the same time, it was also responsible for reviewing thrift financial statements that were disseminated to public investors. This dual responsibility represented a serious conflict, since every dollar of equity that the thrifts could raise from

43. Exchange Act, *supra* note 22, § 12(i) (codified as amended at 15 U.S.C. § 78*l*(i) (1988)).

public investors benefitted the Federal Savings and Loan Insurance Corporation (FSLIC).

The FHLBB consistently resolved this conflict in favor of the chronically underfunded FSLIC. As former FHLBB Chairman Richard Pratt recently testified before Congress, in defending the FHLBB treatment of goodwill:

> The Bank Board was caught between a rock and a hard place. While it did not have sufficient resources to close all insolvent institutions, at the same time, it had to consolidate the industry, move weaker institutions into stronger hands, and do everything possible to minimize losses during the transition period. Goodwill was an indispensable tool in performing this task.[44]

Because the FHLBB was preoccupied with minimizing losses to FSLIC, it evaluated accounting standards by how well they performed that task. The FHLBB treatment of goodwill was relaxed in order to make it a better "tool." At the same time, when GAAP proved to be an "inhibition" against mortgage disposition programs, the FHLBB adopted its loss deferral regulation.[45]

In order for financial statements to be useful, they must be credible and neutral measurements of business reality. It is therefore essential that accounting principles be established through a standard-setting and review process, overseen by a single agency, that is immune from tampering by a failed industry or its regulators. If financial regulators are permitted to determine how the activities of regulated institutions will be measured and reported to the public, the danger of thumbs on the scale will always be present.

Uniform administration of the federal securities laws is also necessary to ensure investor confidence. Although the federal deposit insurance system protects insured depositors, and has often been administered in a manner that protects uninsured depositors and even general creditors, it affords no protection to common shareholders. The losses suffered by shareholders as a result of bank and thrift failures over the past five years exceed $10 billion.

The low price/earnings multiples of many money center banks may reflect the fact that investors view their financial reports with skepticism. This lack of confidence affects the entire industry, and raises the cost of capital for the strong institutions as well as the weak.

---

44. Pratt Testimony, *supra* note 5, at 81.

45. Martin Mayer's recent book on the savings and loan crisis describes how Pratt, in urging the FASB to endorse the loss deferral rule, argued that it was necessary in light of the industry's desperate condition. The FASB refused to do so. As Donald Kirk, the former Chairman of the FASB, stated: "FASB took the position, 'You can be tolerant, but stop monkeying with the balance sheet.' If you want to set capital requirements at one percent, or minus one percent, do it. You have the legal right to do it, but stop concealing the condition of the institution." M. Mayer, The Greatest-Ever Bank Robbery, 73 (1990).

The SEC has long advocated repeal of Exchange Act Section 12(i) and modification of Securities Act Sections 3(a)(2) and 3(a)(5). In 1984, the Task Group on Regulation of Financial Services recommended such changes as a means of providing better and more consistent protection to investors at lower cost. The Department of the Treasury has recently included the same recommendation in its report on the federal deposit insurance system.[46]

B. *Market Value Accounting*

The nation's experience with the savings and loan industry demonstrates the substantial danger of a reporting system for financial institutions that is premised on historical cost accounting principles.[47] Because GAAP failed to reflect massive unrealized losses in savings and loan portfolios, institutions that were deeply insolvent on an economic basis continued to operate and to report a positive net worth. Besides tending to legitimize a policy of regulatory forbearance, the absence of adequate market-based information made it difficult for investors to make a meaningful assessment of the real economic value and risk exposure of a depository institution. We should therefore explore the extent to which the relevance and credibility of bank and thrift financial statements can be enhanced by a broader application of market value accounting.

Under the most comprehensive application of market value accounting, depository institutions would be required to reflect in their financial reports the fair market value of their assets, liabilities, and off-balance sheet items. This would enable regulators and investors to assess more precisely the true economic value and risk exposure of a depository institution. Besides facilitating more timely corrective action by regulators, this approach would also aid private sector discipline by making the managers of depository institutions more accountable for their investment and business decisions.

While the benefits of market value accounting would be substantial, the approach raises complex valuation and auditing issues that must be resolved before any decision is made to implement it on a comprehensive basis.[48] In particular, additional work is needed to develop reasonably accurate and verifiable valuation techniques for assets, liabilities, and off-

---

46. *See* Dep't of Treasury, *Modernizing the Financial System: Recommendations for Safer, More Competitive Banks* ch. IX (Feb. 1991)[hereinafter Treasury Report].

47. Under the historical cost model, most assets are recorded at their acquisition price, which is presumed to be more objective. Departing from the historical cost rule (*i.e.*, using the lower of cost or market, or "LOCOM") is generally done only when the future utility (or revenue-producing ability) of an asset is less than its cost. Such differences should be recorded in the period in which they occur. *See, e.g.*, Statement of Concepts No. 5, Recognition and Measurement in Financial Statements of Business Enterprises ¶¶ 67-69 (Fin. Accounting Standards Board Dec. 1984); Accounting Research Bulletin No. 43, ch. 4, ¶¶ 8, 9 (Accounting Principles Board).

48. For an examination of the issues raised by market value accounting, along with a list of reference materials, see Treasury Report, *supra* note 46, ch. XI.

balance sheet commitments that do not trade in active markets. For banks and thrifts, the most obvious illiquid assets are loans; everyone agrees that market value accounting for these assets would be difficult and perhaps impossible. There should also be an assurance that the preparation and auditing costs associated with a comprehensive application of market value accounting do not exceed the anticipated benefits.

Since May 1986, the FASB has been reexamining the standards for recognition and measurement of financial instruments and transactions. As part of this project, the FASB is assessing whether to expand the use of market value data in financial statements and related disclosures. Due to the complexity of the recognition and measurement issues, the FASB determined that new disclosure standards should be issued as an intermediate step in the process. The most recent FASB proposal would require all entities to disclose, either in the body of the financial statements or in the accompanying notes, the market value of financial instruments for which it is practicable to estimate that value.[49]

1. Accounting for Investment Securities

As noted above, the FASB's development of standards for increased disclosure of market value information is part of a larger examination of the manner in which financial instruments should be recognized and measured. In November 1990, at the request of the AICPA, the FASB voted to accelerate a separate portion of the financial instruments project to consider market value accounting for debt securities held as assets. Thus, it is possible that the use of market value accounting will be mandated for investment securities held by financial institutions.

GAAP currently permit a financial institution to classify its holdings of securities into either a "trading" portfolio or an "investment" portfolio. Securities in the trading portfolio must be reported at their current market value. Securities classified as "investments", however, are carried at cost (less provision for credit losses), unless it can be shown that the institution does not have either the intent or the ability to hold the securities. As a result, what may be material fluctuations in the current market value of investment securities are concealed in the institution's public financial statements.

The accounting treatment currently accorded to investment securities is based on the rationale that fluctuations in market value are irrelevant if an institution professes an intent to hold an instrument to maturity, when it may be redeemed at its face amount. It is questionable whether management's current intent should ever dictate future business decisions, however, as management has a continuing obligation to reassess the most productive use of its assets. Moreover, the economic environment in which financial institutions now operate has led to sophisticated

49. Proposed Statement of Financial Accounting Standards, "Disclosures about Market Value of Financial Instruments," (Fin. Accounting Standards Board Dec. 31, 1991).

asset-liability management strategies, which undermine the presumption that investment securities will be held to maturity.

In practice, management's intent to hold the securities is virtually impossible for auditors and others to validate, giving rise to an abusive practice referred to as "gains trading". Simply put, institutions may sell those "investment" securities that have risen in value, taking the profits immediately into income, while continuing to hold and carry at cost those securities that have fallen in value. Gains trading will continue to be a problem so long as bank and thrift managers can generate income by cherry-picking the bond portfolio without having to recognize losses on the remaining securities that are not yet realized. The use of market value accounting would eliminate any incentive to sell or retain investments for reasons of accounting treatment rather than business utility.

In response to gains trading abuses and other concerns, the AICPA attempted to prepare and issue guidance on reporting by financial institutions for debt securities held as assets. In May 1990, the AICPA published for comment proposed rules intended to provide practical guidelines for evaluating the intent and ability of an entity to hold securities to maturity.[50] Because the comments on this proposal were generally negative, the AICPA ultimately concluded that it should no longer continue attempts to clarify the meaning of existing guidance on the intent and ability to hold. The AICPA then requested the FASB to consider whether an objective standard, such as one based on market value measurements, would be more appropriate in order to gain consistent application.[51]

2. Opposition to Market Value Accounting

Banks have generally opposed the proposed use of market value accounting for investment securities. They have been joined in this opposition, for the most part, by depository institution regulators. In reviewing the debate over this proposal, it is important to distinguish what may be referred to as "accounting issues" from policy objectives that are unrelated to the fair presentation of financial information.

It has been suggested, for example, that market valuation of investment securities may cause banks and thrifts to reduce their holdings of government securities, thereby sacrificing liquidity and asset quality, merely in order to avoid reporting unrealized losses. This concern should not influence the debate, however, as accounting standards should not be used to motivate business decisions. The depository institution regulators have ample authority to require appropriate levels of portfolio liquidity to satisfy prudential concerns, and institutions that place themselves into an illiquid condition would also be subject to market disci-

50. AICPA Exposure Draft of Proposed Statement of Position, "Reporting by Financial Institutions of Debt Securities Held as Assets" (May 25, 1990).

51. *See* "Text of CPA's Request to Accounting Standards Board," Am. Banker (Nov. 2, 1990).

pline. Accordingly, the sole focus should be on the relevance and materiality of market value information to a fair presentation of a firm's financial condition.

In contrast to this type of concern, a relevant accounting issue that should be considered is whether marking investment securities to market, while continuing to measure other assets (such as real estate loans) and other liabilities (such as deposits) at historical cost, could lead to volatility in reported earnings and capital that would not be indicative of a depository institution's true financial condition. This distortion could potentially result because, to the extent that depository institutions engage in hedging strategies to minimize interest rate sensitivity, a partial approach to market value accounting might require some gains and losses to be recognized while not acknowledging offsetting changes in the value of other assets, liabilities, or off-balance sheet items.

The FASB will consider this issue as part of its current project, and it may ultimately conclude that "related liabilities" should be marked to market in tandem with investment securities. The concern that a partial approach to market value accounting would lead to distortion may, however, be overstated. Since many bank and thrift liabilities reprice within one year, the divergence between their book value and their market value should not be as great as that for investment securities with longer average maturities. Accordingly, the use of market value accounting for investment securities alone could lead to financial statements more accurate than those used today, even if they did not attain theoretical perfection.

CONCLUSION

The purpose of accounting standards is to assure that financial information is presented in a manner that permits public and private decisionmakers to make informed judgments. In order to fulfill their purpose, accounting standards must lead to financial information that is neutral and reliable. Neutral information is that which objectively measures economic activity, without seeking to influence behavior in any particular direction.

The accounting practices used in the thrift industry during the past decade demonstrate the danger of using accounting standards to implement policy objectives unrelated to the fair and accurate presentation of financial information. Accounting standards were manipulated not only to obscure the magnitude of the industry's problems, but also to facilitate the growth of troubled thrifts. The thrift regulators viewed accounting standards not as a means of objectively measuring economic reality, but as a "tool" for implementing regulatory policy.

In this context, RAP became the financial equivalent of the Stealth technology. Accounting standards were used to justify regulatory forbearance by making it impossible for creditors, investors and the public

to be able to measure the size of the problems facing the industry. Sadly, we discovered that encouraging the growth of insolvent firms led to lending practices that government supervision was unable to control. Because the accounting practices sanctioned by the regulators delayed the public recognition that was essential to developing adequate funding and other necessary responses to thrift insolvencies, the ultimate losses to the government were greatly increased.

Although the worst abuses that characterized the accounting practices of the thrift industry have been curbed by passage of FIRREA, preserving the neutrality of financial information continues to be critical. So long as public policy and resource allocation decisions are influenced by the presentation of financial information, there will always be parties who urge the adoption of accounting standards that present such information in the manner that best serves their particular interests. That is exactly the foundation for the banking industry's resistance to an accounting standard that would require banks to reflect fully losses that they have incurred in their securities portfolios. It is therefore essential that accounting standards be developed by an independent body that will responsibly seek to ensure that the public receives, as Sergeant Friday would have said, "Just the facts, ma'am."