CHAPTER 6

First RepublicBank Corporation

Name of Institution: First RepublicBank Corporation
Headquarters Location: Dallas, Texas

Date of Resolution: March 17, 1988
Resolution Method: Open Bank Assistance Transaction

Date of Resolution: July 29, 1988
Resolution Method: Bridge Bank

Date of Resolution: November 22, 1988
Resolution Method: Stock Purchase Transaction

Introduction

First RepublicBank Corporation (First Republic), with $33.4 billion in assets at the time of its resolution in July 1988, holds the dubious distinction of being the largest FDIC insured banking organization ever to fail.[1] First Republic, at an estimated cost to the FDIC of $3.9 billion, was also the most costly resolution the FDIC has ever completed.

First Republic's resolution was notable in other respects. First, the FDIC granted interim assistance in the form of a six-month note for $1 billion to First Republic's two lead banks in Dallas and Houston. The note was backed by the stock of all the solvent subsidiaries of First Republic, which was a condition of the interim assistance. The condition effectively functioned as a cross guarantee provision, allowing the FDIC to use value in the solvent banks in the holding company to offset some of the losses in the insolvent subsidiaries.

Second, for the first time since the FDIC assisted Continental Illinois National Bank and Trust Company (Continental), Chicago, Illinois, the FDIC explicitly assured all depositors and other general creditors of First Republic's banks that they would be fully protected against any loss.

Third, a bridge bank was formed for only the second time since the FDIC had obtained this authority.[2]

1. Continental Illinois National Bank and Trust Company (Continental), Chicago, Illinois, was slightly larger, but technically it did not fail. Refer to Chapter 4, Continental Illinois National Bank and Trust Company, for an explanation of the Continental case.

2. The FDIC used its bridge bank authority for the first time when Capital Bank & Trust Company, Baton Rouge, Louisiana, was closed on October 30, 1987. FDIC, *1987 Annual Report*, 6. See Part I, Resolution and Asset Disposition Practices, Chapter 6, Bridge Banks, for a full discussion of this subject.

Fourth, troubled loans and real estate properties from the failed banks were placed in a special asset pool that was owned and administered by the assuming bank; all costs of operation and all losses on assets were paid by the FDIC.

Fifth, the FDIC used special powers obtained in the Garn–St Germain Depository Institutions Act (Garn–St Germain) of 1982, which allowed an out-of-state bank holding company to be selected as the acquiring institution.

Finally, the bid submitted by the acquiring bank was high enough to be least costly to the FDIC because of two special letter rulings the bidder had received from the U.S. Internal Revenue Service (IRS); the other potential acquirers were not aware of those IRS rulings. The letter rulings allowed the acquirer to treat the acquisition as a tax-free reorganization and to carry forward losses from the failed banks to offset future income. The letter rulings were controversial after the fact and led to changes in the way the FDIC evaluates bids from potential acquirers.

General Description of the Corporation

On March 31, 1988, First Republic was the 14th largest bank holding company in the United States, with 40 subsidiary banks and more than 160 banking offices throughout Texas.[3] It was the largest banking organization headquartered in Texas and in the Southwest. First Republic also owned a credit card bank in Delaware. Most of the subsidiary banks had federal charters and were regulated by the Office of the Comptroller of the Currency (OCC). First Republic's subsidiary banks had a strong presence in the market areas of Austin, Dallas, Fort Worth, Houston, and San Antonio. The approximate share of bank deposits held by the First Republic banks on a city-wide basis, as of March 31, 1988, was as follows: Dallas, 34 percent; Austin, 29 percent; Fort Worth, 19 percent; San Antonio, 10 percent; and Houston, 8 percent. In total, the First Republic system had deposit accounts numbering approximately 2.2 million, of which 780,000 accounts were in the Dallas area banks.

The First Republic banks maintained major correspondent relationships with almost 1,100 banks across the United States, primarily in the Southwest. In its correspondent relationships, the First Republic banks acted as depositories for their correspondents and provided check clearing; wire transfers of funds; loan participations; and custodial, clearance, and investment advisory services.

In addition to maintaining deposit relationships, the First Republic system, as a whole, held 20 percent of the loans made by commercial banks in Texas. It also had approximately 125,000 loan customers and unfunded loan commitments of more than

3. House Committee on the Budget, *Report on FDIC Bailouts of First Republic and Mcorp Banks*, 99th Cong., 1st sess. (January 1991), 8.

$9.1 billion. The trust departments represented the largest trust operation in the Southwest, managing more than $50 billion in assets for more than 25,000 customers.

Background

First Republic was the result of a merger between two large bank holding companies, RepublicBank Corporation (RepublicBank), Dallas, Texas, with $20.9 billion in assets, and InterFirst Corporation (InterFirst), Dallas, Texas, with $18 billion in assets. At the time of the merger on June 6, 1987, RepublicBank and InterFirst were the second and third largest bank holding companies, respectively, in Texas. The merger that created First Republic, the largest bank holding company in the Southwest and the 11th largest banking group in the United States, was completed only nine months before First Republic obtained interim open bank assistance from the FDIC.[4]

RepublicBank began having difficulties in the mid-1980s because of the failing economy in the Southwest. The energy market declined, followed by the real estate and agriculture markets. The market declines severely affected the financial industry in Texas and the rest of the Southwest. During the mid-1980s, commercial real estate and the related construction industry were two of the weakest sectors of the Texas economy. At the end of 1987, Dallas and Houston had commercial office real estate vacancy rates of approximately 30 percent and, combined, had more than 87 million square feet in unoccupied office space. Real estate experts indicated that it would take four to five years to absorb the inventory of vacant office space. The residential real estate market in Texas was also weak.

The merger of the two bank holding companies was aimed primarily at assisting InterFirst, which had reported a net loss of $326.5 million for 1986. After the merger, however, it was discovered that RepublicBank's subsidiary banks were suffering, too, as a result of (1) poor management and inadequate supervision from their respective boards of directors, (2) inadequate accounting systems, (3) poor asset quality, (4) continuing deterioration of assets, (5) an inadequate internal problem loan identification process, (6) escalating loan losses, and (7) an inability to attract sufficient funding. Both RepublicBank and InterFirst had high concentrations of real estate loans; InterFirst had problem energy loans, as well. At year-end 1986, both institutions had more than 36 percent of their loan portfolios in real estate.

Not only was RepublicBank's subsidiary banks' management slow to recognize its problems and write off nonperforming loans, it also used a variety of techniques to prop up the value of its real estate loan portfolio. For example, it did not keep its appraisals current, even though real estate values were falling 10 percent to 15 percent a year. That meant that the file appraisals did not reflect any loss in value. In addition, the banks'

4. James R. Kraus, "The First Republic Rescue," *American Banker* (August 2, 1998), 3.

management used above-market rents, below-average vacancy rates, and low discount rates to generate false future cash flow projections. Both InterFirst and RepublicBank's subsidiary banks advanced additional funds to troubled borrowers to pay interest and keep loans current.

By the end of 1987, barely six months after the merger, regulators required the First Republic banks to recognize their troubled loans. In late January 1988, First Republic disclosed that the company would suffer a net loss of $657 million in 1987, primarily as a result of deterioration in the Texas real estate market and the establishment of significant reserves on loans to less developed countries. The company announced that $3.9 billion, or 16 percent of the loans in the First Republic system, were nonperforming as of year-end 1987. Nonperforming real estate loans totaled $2.08 billion.[5]

The bad news significantly affected the company's funding. First Republic's overseas sources of funds evaporated. The lead banks in Dallas and Houston encountered significant funding problems and were forced to receive funds from other banks in the First Republic system to continue operating. Also, the First Republic banks were experiencing a decline in depositor confidence, and the banks suffered heavy losses of both demand deposit and correspondent business.

From December 1987 through early March 1988, the First Republic banks lost more than $1.8 billion in deposits, thus creating a liquidity crisis. By March 15, 1988, First RepublicBank–Dallas, N.A. was forced to borrow $2.6 billion from the Federal Reserve Bank of Dallas (Federal Reserve) and was on the verge of failure. Even worse, more than $6 billion of affiliated bank funds were at risk in the Dallas bank; the failure of the Dallas bank would have forced a failure of a substantial number of affiliate banks. Any discontinuation of services for that many First Republic banks had the potential of seriously disrupting the Texas and Southwest financial market.

On March 16, 1988, because it was on the verge of failure, First Republic formally sought the FDIC's assistance. Customers were withdrawing funds, compounding a liquidity crisis for the bank. The withdrawals created an "electronic run" on First Republic.[6]

The Resolution—March 17, 1988

On March 17, 1988, the FDIC announced an interim assistance plan for First Republic.[7] The plan had two components. First, the FDIC issued a statement worded almost exactly like the statement issued for Continental, announcing that the FDIC assured

5. Kraus, "The First Republic Rescue," 3.

6. The term "electronic run" refers to heavy customer withdrawals of funds by means other than going to the bank in person for the money. Wire transfers and withdrawals at automatic teller machines are two ways this can happen.

7. FDIC News Release, "FDIC Approves Assistance for Subsidiary Banks of First RepublicBank Corp., Dallas, Texas," PR-57-88 (March 17, 1988).

that "all depositors and other general creditors of First Republic's banks [would be] fully protected and service to the banks' customers [would] not be interrupted."[8] The statement specifically provided no assurance to creditors of the holding company and made no guarantee of interbank funding.[9]

Second, the FDIC provided a $1 billion six-month loan to the Dallas and Houston banks in the First Republic system. The loan was subordinated to the claims of depositors and general creditors of the banks and bore interest at the six-month Treasury bill rate plus 50 basis points. The note was guaranteed by First RepublicBank Corporation and by the other First Republic banks. The loan was further collateralized by a pledge of First Republic Bancorporation's shares of stock in 30 of its bank subsidiaries.[10] The Federal Reserve Board also pledged to provide interim liquidity support as the resolution process developed.

Then-FDIC Chairman William L. Seidman later explained in his book *Full Faith and Credit* why the loan was given to the First Republic banks and not to the holding company, as had been done when the FDIC assisted Continental in 1984. "This difference was of great significance," he wrote. "It removed the safety net from the billions of dollars of holding company debt. It reduced our insurance losses, disciplined the creditors of the holding company for their bad investment, and stabilized the banking system."[11]

After the assistance agreement, Albert V. Casey became the new chairman and chief executive of First RepublicBank Corporation. Casey had extensive experience as a newspaper executive, chairman of American Airlines, and U.S. Postmaster General. He had also served as a director of Republic Bank[12,13]

The assistance plan slowed the withdrawal rate on deposit accounts, but the condition of the First Republic banks continued to deteriorate. In the first two quarters of 1988, the company reported a total loss of $2.3 billion; common stockholders' equity decreased from $1.2 billion at year-end 1987 to a negative $1.1 billion at June 30, 1988.[14]

After providing the interim assistance, the FDIC began contacting financial entities and individuals regarding their interest in an assisted transaction or restructuring of First Republic, on either an open bank or closed bank basis.[15] Several of the entities the

8. FDIC News Release, PR-57-88.

9. The statement issued by the FDIC in the Continental transaction did not protect the creditors of the holding company. They were protected indirectly because of the structure of the assistance transaction.

10. FDIC, *1988 Annual Report,* 9-10.

11. L. William Seidman, *Full Faith and Credit: The Great S&L Debacle and Other Washington Sagas* (New York: Times Books, 1993), 150.

12. Seidman, *Full Faith and Credit: The Great S&L Debacle and Other Washington Sagas*, 151.

13. Albert V. Casey became the first President of the Resolution Trust Corporation (RTC) in October 1991, and was named the RTC's Chief Executive Officer on February 1, 1992.

14. Kraus, "The First Republic Rescue," 3.

15. Refer to Part I, Resolution and Asset Disposition Practices, Chapter 3, Evolution of the FDIC, for a discussion of the various closed bank and open bank transactions.

FDIC approached were major bank holding companies. Some potential bidders contacted the FDIC on their own. The FDIC never issued a formal solicitation for potentially interested bidders.[16] The publicity generated by the assistance agreement, however, made it clear to all banking entities that the FDIC would be accepting bids. [17] Among the bidders were Citicorp, New York, New York; Wells Fargo & Co., San Francisco, California; and NCNB Corporation (NCNB), Charlotte, North Carolina.

In April 1988, the FDIC received a proposal from NCNB for the restructuring and acquisition of First Republic's bank subsidiaries. The proposal suggested that the FDIC establish a bridge bank for all the First Republic subsidiary banks, and then engage NCNB to manage the bridge bank. NCNB's proposal also included a capital injection for the banks from NCNB, along with other funds to be provided by the FDIC. Although the FDIC Board of Directors rejected NCNB's proposal, they continued negotiations with the company.

At about the same time, the FDIC was notified that First Republic was developing its own recapitalization plan, with the assistance of Drexel Burnham Lambert, Inc. The First Republic proposal would have allowed First Republic to operate as an independent, Texas-owned institution, supported with an advance from the FDIC. The plan was to rescue the entire First Republic holding company, plus the banks, by raising new capital from outside investors.[18] On July 20, 1988, Casey, First Republic's new chairman, told a reporter from *The Dallas Morning News*, "We had hoped for a favorable decision on our plan by now, but the FDIC has required additional time to study all available options. We remain confident that the First RepublicBank plan is the most viable of these options and will ultimately be accepted."[19]

After receiving several bids, the FDIC went through a two-step process to evaluate the bids. First, it determined which bids were viable. Second, each viable bid was analyzed by determining and evaluating its effect on the banking system, its cost to the FDIC insurance fund, and the capabilities of the bidding institution's management. In July 1988, the FDIC Board of Directors reviewed details of bids submitted to date. The FDIC selected July 25, 1988, as the date for submission of final bids.

During the bid submission period, NCNB requested and received two private letter rulings from the IRS. The rulings would result in NCNB's receiving an estimated $1 billion in tax benefits if it acquired the First Republic banks. The first ruling was applied for on May 30, 1988, and issued June 10, 1988. After the first ruling was issued, NCNB applied for a supplemental ruling that was issued on July 28, 1988, the eve of the FDIC's selection of NCNB as the acquirer of the First Republic banks. The two tax rul-

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16. House Committee on the Budget, *Report on FDIC Bailouts of First Republic and MCorp Banks*, 99th Cong., 1st sess. (1991); James E. Heath, FDIC Division of Research and Statistics, *Bank Failures (Texas)*, working paper (1997), 35.

17. David LaGesse, "First Republic Decision Awaited," *The Dallas Morning News* (July 18,1988), 1D.

18. Seidman, *Full Faith and Credit: The Great S&L Debacle and Other Washington Sagas*, 152.

19. Jim Mitchell, "Losses Plague Bank," *The Dallas Morning News* (July 20, 1988), 1D.

ings indicated that, should NCNB acquire the First Republic banks, it would be able to treat the transaction as a tax-free reorganization and carry forward the losses from the failed First Republic banks to offset future income.[20] The rulings allowed NCNB to offer the FDIC a higher premium for the First Republic banks because the tax savings represented an "asset" that the other bidders had not recognized. On July 27, 1988, FDIC staff reported to the board of directors that an analysis of the NCNB bid estimated costs of $1.4 billion to $2.6 billion to the FDIC. The FDIC selected NCNB's bid because it was the least costly to the deposit insurance fund of all the proposals received.

The rulings issued to NCNB by the IRS were known to the FDIC, but not to the other bidders. A discussion emerged at the FDIC about whether to treat the NCNB letter rulings as proprietary information or to disclose them to other bidders. It was decided not to disclose them, because the FDIC keeps all bidders' information confidential.[21]

The FDIC also did not discount the value of the tax benefits in weighing the competing bids. The tax savings to NCNB represented money foregone by the U.S. Treasury, and were, therefore, a cost to the government. That was a significant issue, especially in light of what was taking place in the Federal Savings and Loan Insurance Corporation (FSLIC) in 1988. Because the FSLIC's deposit insurance fund was insolvent, all costs in its transactions for resolving the failed savings and loans came from the government. Under provisions of the Federal Deposit Insurance Act, the FDIC was not obligated to estimate the cost of its options from a taxpayer's perspective. Instead, the FDIC was required only to consider costs to the insurance fund. On that basis, the FDIC evaluated the NCNB offer as the least costly to its insurance fund.[22] Therefore, the potential tax benefit to NCNB permitted NCNB to be the high bidder; the letter rulings played a significant, if not critical, role in NCNB's successful bid for the First Republic banks.[23]

Out-of-state bank holding companies normally would not have been eligible to acquire Texas banks because of then existing state statutory restrictions on interstate branching. The federal Garn–St Germain Act, however, provided the FDIC with the authority to permit out-of-state bidders to be eligible to purchase First Republic, which the FDIC Board of Directors approved on July 29, 1988.[24]

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20. *Report on FDIC Bailouts of First Republic and MCorp Banks,* 13-14, 21-24, 51-52; Heath, *Bank Failures (Texas),* 35-36.

21. *Report on FDIC Bailouts of First Republic and MCorp Banks,* 23.

22. *Report on FDIC Bailouts of First Republic and MCorp Banks,* 16.

23. *Report on FDIC Bailouts of First Republic and MCorp Banks,* 54; Heath, *Bank Failures (Texas),* 37.

24. To qualify under the Emergency Interstate Acquisition provisions, a bank had to be a closed bank (with the FDIC as receiver) with total assets of $500 million or more; or it had to be a bridge bank that had assumed deposits in one or more closed banks that had total assets aggregating $500 million or more.

The Resolution—July 29, 1988

On July 29, 1988, the FDIC notified the OCC that its $1 billion loan to two of the First Republic banks would not be renewed. The OCC notified the Federal Reserve Bank that First RepublicBank-Dallas, N.A., was no longer viable, and the Federal Reserve then requested repayment of the Dallas bank's borrowings. When the bank was unable to pay, it was declared insolvent and closed by the OCC. The closing of the Dallas bank was an event of default under the open bank assistance terms, and the FDIC demanded immediate repayment of its $1 billion interim loan that had been made in March and had been guaranteed by the other First Republic banks. The amount of the banks' guarantee was charged against their capital accounts. That charge, along with losses on interbank funding, rendered the other banks in the First Republic system insolvent, and they, too, were ordered closed.[25] Only First Republic's credit card subsidiary bank, First RepublicBank Delaware, remained open and under the control of the holding company.[26]

The FDIC approved the assisted acquisition by NCNB of the First Republic banks. It announced NCNB's bid as the most effective, most viable, and least costly approach for preserving existing banking services in the affected communities and as for providing stability to the Texas banking system.[27] The FDIC and NCNB entered into an agreement in principle on July 29, 1988, for the purchase of the First Republic banks by NCNB. The FDIC decided to use authority granted to it by the Competitive Equality Banking Act (CEBA) of 1987 to create a bridge bank, called NCNB Texas National Bank (NCNB-TNB), which NCNB agreed to manage until the transaction could be finalized.[28] The bridge bank purchased all assets and assumed all deposits and certain other nondeposit liabilities from the failed banks. The FDIC agreed that the assurances given in March—that the depositors and other general creditors of the First Republic banks would be fully protected—would remain in force.

First Republic Chairman and Chief Executive Casey expressed his feelings about the FDIC's rejection of First Republic's open bank assistance proposal: "We are extremely disappointed that our plan was not accepted, …but we wish NCNB every success and pledge our complete cooperation."[29]

Two aspects of the First Republic transaction deserve mention. First, the closing of the 40 First Republic banks comprised the largest number of banks ever closed in one

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25. "Regulators Spell Out Terms of the Recapitalization," *American Banker* (August 2, 1988), 16.

26. The Delaware bank was closed on August 2, 1988, and the FDIC placed it in a separate bridge bank.

27. FDIC, OCC, and FRS Joint News Release, "Regulators Announce Approval of Acquisition of Subsidiary Banks of First RepublicBank Corporation, Dallas, Texas, by NCNB Corporation, Charlotte, North Carolina," PR-148-88 (July 29, 1988), 1.

28. For a complete description of this subject, see Part I, Resolution and Asset Disposition Practices, Chapter 6, Bridge Banks.

29. David LaGesse, "NCNB Acquiring First Republic," *The Dallas Morning News* (July 30, 1988), 1A.

day. Second, because each bank was an individual institution, the FDIC had to prepare closing and sale (bridge bank) documents for all 40 institutions. Organizing the 40 closings represented an enormous task, and the FDIC staff numbered in the hundreds.

The actions of declaring the First Republic banks insolvent and forming a bridge bank meant that the stockholders and bondholders of First Republic were essentially "wiped out."[30] The FDIC's newly acquired bridge bank authority allowed it to avoid the undesirable features of open bank assistance including the time-consuming process of accepting proposed rescue plans that would require resolving large banks by obtaining the approval of stockholders and bondholders. The bridge bank authority was important because "[t]he FDIC wrestled with those parties at length in securing the $1.5 billion rescue of First City Bancorporation of Texas, Inc. . . " the previous April.[31]

Joseph M. "Jody" Grant, then the chairman and chief executive officer of Texas American Bancshares, Inc., recalls speaking with former FDIC Chairman William M. Isaac in March 1988, when the FDIC had given its $1 billion loan to the First Republic banks. (Mr. Isaac had left the FDIC before that date.)

> Bill Isaac had told the . . . working group at the meeting on March 14 that he had urged the First Republic management not to accept the FDIC's $1 billion loan and not to pledge the stock of all the solvent subsidiary banks as security for the loan. The disastrous consequence of their failure to follow his advice was now evident. Demanding payment of the $1 billion note, which was guaranteed by the solvent subsidiaries, was a critical element in the sequence of steps in the takeover by the FDIC, as it triggered the insolvency of all the subsidiaries.[32]

The July 29, 1988, agreement in principle was finalized on November 22, 1988, in a stock purchase transaction. Before final resolution, the bridge bank was converted to stock ownership form, and the capital stock of the bridge bank was "issued" under the terms of the assistance agreement dated November 22, 1988. The new holding company, NCNB Texas Bancorporation, purchased 2 million shares of common stock, and the FDIC purchased 8 million shares of Class B nonvoting common stock. At the same time, the FDIC and NCNB entered into a shareholders agreement that, among other things, granted NCNB the exclusive right for a period of five years to purchase any or all of the FDIC's shares.

Because the transaction was completed within the bridge bank structure, the bridge bank continued to exist until NCNB purchased the FDIC's equity position. The bridge

30. LaGesse, "NCNB Acquiring First Republic," 1A.

31. LaGesse, "First Republic Decision Awaited," 1D

32. Joseph M. Grant, *The Great Texas Banking Crash: An Insider's Account* (Austin: University of Texas Press, 1996), 145.

bank, operating under the control of NCNB, lasted for a little more than a year, from July 29, 1988, to August 9, 1989.

On November 22, 1988, the FDIC, NCNB, NCNB Texas Bancorporation, and NCNB-TNB entered into a financial assistance agreement designed to capitalize and stabilize the new bank. Major elements of the transaction were as follows:[33]

- Approximately $24.7 billion in assets and $19.5 billion in liabilities were acquired by the new bank, NCNB-TNB.[34]

- As part of the initial capitalization, the FDIC purchased 100 percent (8 million shares) of NCNB-TNB nonvoting common stock for $840 million. NCNB Texas Bancorporation (100 percent owned by NCNB) purchased 100 percent (2 million shares) of NCNB-TNB voting common stock for $210 million. Thus, the FDIC retained an 80 percent equity, 100 percent nonvoting interest in the bank. The total equity infusion of $1.05 billion provided the new bank a minimum of 6 percent primary capital.

- NCNB Texas Bancorporation received an exclusive, nontransferable option, exercisable at any time during the first five years, to purchase the FDIC's 80 percent equity interest. NCNB Texas Bancorporation agreed to pay the FDIC a premium over the book value of the bank's stock when purchased. During the first three years, the exercise price per share was the amount of the FDIC's original investment per share plus 115 percent of the net increase in book value per share. The premium increased to 120 percent in the fourth year of the option and to 125 percent in the fifth year.

- NCNB-TNB took on the ownership of and responsibility for administering and collecting the problem assets; it segregated into a separate asset pool approximately $9.2 billion of troubled loans, real estate properties, and other distressed assets. The segregated pool's assets were written down to market value. NCNB-TNB assigned a full-time, dedicated management team to collect and liquidate the assets in the special asset pool.

- The FDIC funded the negative equity that resulted from the writedown to market value of assumed assets and liabilities. To accomplish that funding, the FDIC assumed $1 billion of the bridge bank's debt to the Federal Reserve. The FDIC also forgave $131.8 million of the bridge bank's $300 million debt to the FDIC under a revolving credit agreement. NCNB-TNB paid the balance of that debt on January 11, 1990. The FDIC's initial outlay as of November 22, 1988, was $2.1 billion, including the $1 billion loaned to First Republic in March of that same year.

33. Major elements of the financial assistance agreement are taken from FDIC, *1988 Annual Report,* 48-50.

34. The name of the bridge bank, NCNB Texas National Bank, was not changed until August 1989, when NCNB completed the purchase of the FDIC's stock.

After implementation of the final agreement and while NCNB was still a minority owner, it managed the bridge bank substantially as if it were an NCNB subsidiary. Under the agreement, however, NCNB was required to consult with the FDIC regarding decisions on business operations and strategies and provide certain reports to the FDIC. The overall transaction was very profitable for NCNB. Although other banking entities had equal opportunity to bid on the First Republic banks and to purchase them, critics have called the FDIC's agreement with NCNB the "deal of the century."[35] NCNB's chairman, Hugh L. McColl, Jr., apparently considered the terms of its agreement with the FDIC so generous that he reportedly boasted, "Candidly, I think we paid zero for First Republic."[36]

The transaction created enormous profitability for NCNB-TNB. It was estimated that NCNB would receive tax savings of $700 million. For year-end 1989, NCNB-TNB reported net income of $308.8 million, or 50 percent of NCNB's total earnings. On the day the First Republic transaction was announced, NCNB's stock was trading at $23.375 per share; one year later, the stock had more than doubled to $53 per share. Those profits propped up NCNB at a time when the performance of NCNB as a whole was slumping.

The First Republic transaction and its resulting profits for NCNB had a tremendous impact on the Texas banking industry. Because NCNB's profits were largely shielded from taxes, NCNB could afford to pay higher interest rates on deposits and charge lower rates for loans. NCNB's market dominance in Texas grew considerably, at the expense of other struggling banks in Texas. "The government has created a monster," said Chris Williston, then the president of the Texas Independent Bankers Association. He further stated that the "tax breaks allow NCNB to engage in predatory pricing, and it is having anticompetitive effects in Texas."[37]

NCNB did not assume any obligations of the failed banks' holding company. The obligations of the failed banks' parent companies, First Republic and 1FRB Corporation (the parent of InterFirst), included approximately $1.2 billion in debt and preferred stock. Use of the bridge bank structure separated the obligations of the failed banks' holding company from the debts of the banks. Because the First Republic banks were closed and placed in receiverships, no claims could be presented against the bridge bank. Had the FDIC provided open bank assistance to First Republic, as its management team had requested, it might have been necessary to pass any operating profits to the parent companies to service the parent companies' debt.

First Republic and 1FRB Corporation filed Chapter 11 bankruptcy on July 31, 1988, seeking to shield the companies' remaining assets from creditors, including their bondholders. First Republic indicated that it might emerge with a plan to repay its

35. *Report on FDIC Bailouts of First Republic and MCorp Banks,* 2.

36. *Report on FDIC Bailouts of First Republic and MCorp Banks,* 2; Heath, *Bank Failures (Texas),* 40.

37. Steve Klinkerman, "Tax Breaks Seen Giving NCNB an Unfair Edge in Texas Market," *American Banker* (July 24, 1990), 16; Heath, *Bank Failures (Texas),* 43-44.

debts, but First Republic chairman and chief executive Casey downplayed the probability of that: "There will be so many claims against the company, I just can't say if there'll be anything left."[38] At the time of the bankruptcy filing, First Republic still retained First RepublicBank Delaware, which had not been closed by the state of Delaware. That institution subsequently was closed by the state on August 2, 1988, and placed in a bridge bank by the FDIC. The Delaware bridge bank was sold to Citibank (Delaware), New Castle, Delaware, on September 9, 1988, and not to NCNB because First Republic had arranged the sale to Citibank before the failure of the banks.[39]

The tax breaks resulting from the IRS letter rulings created an incentive for investment in NCNB; those investments then attracted additional investors. The increased investment enabled NCNB to buy out the FDIC's ownership interest during the first year of its five-year exclusive option. In April 1989, NCNB purchased 29 percent of the FDIC's nonvoting stock in NCNB-TNB, which increased NCNB's ownership interest to 49 percent. On August 9, 1989, NCNB purchased the remaining 51 percent interest in NCNB-TNB from the FDIC. In the end, NCNB paid the FDIC a total of $1.1 billion for all the stock, which resulted in a gain of $275 million for the FDIC.[40]

Before NCNB's acquisition of the First Republic banks, NCNB was ranked as the 18th largest banking organization in the nation, with $26.8 billion in assets.[41] With the completion of the Texas acquisition, NCNB Corporation nearly doubled in size to become the nation's 10th largest bank holding company, with total assets of $55 billion.[42]

The Liquidation

The amount of adversely classified assets initially included in the special asset pool had an estimated market value of $6.1 billion, which was reflective of a 33 percent markdown from the 1988 year-end book value of $9.1 billion.[43] In addition, the agreement allowed NCNB-TNB to return an unlimited amount of the failed banks' assets during 1989 and a maximum of $750 million in 1990.[44] The additional assets transferred into the pool over the two-year "put" period had a total book value of $1.9 billion and an estimated market value of $1.6 billion. Together with the original transfer of $9.1 billion in book value, that $11 billion in assets represented approximately one-third of the

38. David LaGesse, "First Republic Announces Chapter 11 Filing," *The Dallas Morning News* (August 2, 1988), 1D.

39. FDIC, *1988 Annual Report*, 10.

40. FDIC, *1989 Annual Report*, 90.

41. David LaGesse, "Fate of First Republic to Be Decided," *The Dallas Morning News* (July 29, 1988), 1A.

42. LaGesse, "NCNB Acquiring First Republic," 1A.

43. FDIC, *The Cost of Large Resolution Transactions* (March 12, 1996).

44. *Report on FDIC Bailouts of First Republic and MCorp Banks*, 27.

First Republic banks' assets before failure and, at that time, was equal to nearly 40 percent of the total liquidation assets owned by the FDIC.

NCNB-TNB owned the assets in the pool and retained management and administrative responsibility for the pool. Management and employees of NCNB-TNB's Special Asset Division worked those loans exclusively and had no other bank-related duties.[45] The FDIC retained responsibility for market value declines and for NCNB-TNB's servicing expenses, incurring a significant financial stake in the operations of the asset pool. Termination of the asset pool settlement was set to occur after five years, on November 22, 1993. The FDIC had agreed to purchase the remaining unliquidated assets in the pool at fair market value and settle with NCNB for asset pool administration costs.

The servicing agreement was administered and monitored under the guidance of an on-site FDIC oversight committee, which consisted of two senior representatives of the FDIC and one senior member of NCNB-TNB. The committee had unlimited asset disposition authority, and although the Special Asset Division had been delegated the authority to resolve assets of less than $5 million in book value, the oversight committee still retained the authority over approximately 75 percent of the dollar volume of all asset disposition decisions. The FDIC conducted financial compliance reviews on the servicer to ensure its compliance with the FDIC's policies and procedures.

The expenses covered by the FDIC included the costs of managing and administering the special asset pool, allocated overhead expenses of NCNB-TNB, and the cost of funding the assets, according to NCNB-TNB's average cost of interest-bearing funds. Those asset funding costs alone during the 21-month period from January 1, 1989, through September 30, 1990, were $660.8 million. In addition, during 1989, the FDIC paid approximately $248 million in overhead expenses for the servicing of those assets.[46] The servicing agreement proved to be a major source of income for NCNB-TNB, which created an incentive for the bank to hold the assets in anticipation of a market upturn rather than liquidate them. In October 1989, the FDIC's independent auditor reviewed the expenses associated with the pool. The auditor concluded that the arrangement provided no incentive for NCNB-TNB to control its expenses because it was fully reimbursed for them.[47]

NCNB-TNB's management incentive fee was tied to gross collections on the pool and limited to $48 million for the five-year term of the contract; that cap was achieved after only two years. The servicing contract that the FDIC renegotiated in July 1990 included provisions to align the interests of the bank more closely with those of the FDIC. The new formula for the incentive fees was based on net, rather than gross, collections, with net collections defined as gross collections less allowable expenses. Under the new formula, NCNB-TNB received one-half of 1 percent of gross collections, plus a sliding

45. *Report on FDIC Bailouts of First Republic and MCorp Banks,* 27, 29.

46. *Report on FDIC Bailouts of First Republic and MCorp Banks,* 3, 29.

47. *Report on FDIC Bailouts of First Republic and MCorp Banks,* 3-4; Heath, *Bank Failures (Texas),* 41-42.

fee of 3 percent to 7 percent of net collections, which discouraged speculative holding of the assets and minimized expenses.[48] Because of the nature of the assets remaining in the pool, the termination date was moved up by two years to November 22, 1991.

In November 1991, NCNB exercised its option for the FDIC to repurchase the remaining assets in the pool for $2.5 billion. The assets consisted of an adjusted pool value of $1.9 billion for the assets, and a deferred settlement account of $600 million for expenses and compensation. Over the life of the contract, gross collections were $8.6 billion, and net collections were $7.1 billion. As of December 31, 1996, the FDIC had terminated 33 of First Republic's 41 receiverships.

Shareholder Litigation

After the banks failed, First Republic's bondholders immediately filed court challenges against the FDIC. The suit alleged that both the March 1988 interim assistance transaction and the July 1988 bridge bank transaction exceeded the FDIC's statutory authority. The suit sought, among other things, to prevent the FDIC from pursuing, in First Republic's bankruptcy, its claim for the $1 billion loan; to void guarantees of the loan by the holding company; and to recover the value of the First Republic subsidiary banks whose assets were transferred to NCNB-TNB.[49]

The litigation further challenged the FDIC's ability to fully protect third-party creditors of a failed bank without treating affiliated creditors equally. In the case of First Republic, the FDIC arranged a resolution transaction whereby all depositors and third-party creditors received all their funds; however, the recovery on the loans from the affiliated banks to the failed lead bank was limited to their pro rata interests in the failed bank's receivership estate. The FDIC estimated that interest to be about 78 percent of the full amount those banks were owed.

Similar suits subsequently were filed against the FDIC by creditors of MCorp and Texas American Bancshares, Inc. (TAB).[50] The court in the MCorp and TAB suits initially ruled against the FDIC, but the court in the First Republic case did not rule on the claims. It merely noted that, notwithstanding the decisions in the other two cases, the FDIC's arguments had "considerable force."[51]

The issue was directly appealed by the FDIC to the Fifth Circuit Court, which reversed the ruling of the lower court. The court expressly held that the FDIC is obligated to pay creditors only the amount realized in liquidation, and that additional pay-

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48. *Report on FDIC Bailouts of First Republic and MCorp Banks,* 32.

49. FDIC, *1988 Annual Report,* 22.

50. MCorp, Dallas, Texas, failed on March 28, 1989. Texas American Bancshares, Inc., Fort Worth, Texas, failed on July 20, 1989.

51. FDIC, *1990 Annual Report,* 28-29.

ments from the insurance fund can be preferred among creditors at the FDIC's discretion. Congress subsequently enacted the intent of that ruling into the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) of 1989.

The First Republic bankruptcy was resolved in late 1990. The FDIC recovered approximately $158.7 million, plus interest, for its claims on the $1 billion loan and the guarantees of the other banks in the First Republic system.[52]

The Stock Transactions

On November 22, 1988, to help capitalize the new institution, the FDIC purchased 8 million shares (100 percent) of NCNB-TNB nonvoting common stock for $840 million (about $105 per share). In April 1989, NCNB purchased 2.9 million shares of the FDIC's nonvoting stock in NCNB-TNB, at approximately $107 per share, for a total of $309.7 million, which represented a gain to the FDIC of $5.1 million. In August 1989, NCNB purchased the remaining 5.1 million shares of the FDIC's stock for $800 million, or about $157 per share, which represented a gain to the FDIC of $264.5 million. NCNB paid the FDIC $480 million in cash and gave a note in the amount of $320 million for the balance. The note was paid in full in January 1990. On January 31, 1991, the FDIC received prior years' dividends of $4.7 million for the period during which it held the stock. In all, NCNB paid the FDIC a total of $1.115 billion for all the stock, producing (with the dividends) a total gain of $275 million for the FDIC. A summary of the stock transactions is shown in table II.6-1.

FDIC Resolution Costs

The First RepublicBank transaction was the most costly bank failure ever handled by the FDIC. As of December 31, 1995, the total cost of that transaction was approximately $3.86 billion. Much of that cost was due to the poor condition of the bank's assets and the ongoing weakness in the Texas economy. Of the $33.4 billion in total assets at failure, approximately $12 billion in problem assets were assigned to the pool and managed by NCNB-TNB.

In total, more than $2.2 billion of the total resolution cost were spent to reimburse NCNB-TNB for the initial and subsequent writedowns to market value. Another $1.9 billion were spent on expenses and compensation pertaining to the asset management contract. Finally, approximately $113 million in additional losses on the assets from the special asset pool subsequently were purchased by the FDIC, and about $40 million were expensed for litigation, interest, indemnification, and other expenses. In all, those

52. FDIC, *1990 Annual Report*, 28-29.

Table II.6-1

A Summary of the FDIC's Stock Transactions in the Resolution of the First Republic Subsidiary Banks
($ in Thousands)

Date	Trans action	Beginning Number of Shares	Shares Sold, Written Down, Converted	FDIC Stock/ Equity Investment	FDIC Proceeds from Sales	FDIC Book Value of Transaction	Gain or Loss on Transaction	FDIC Dividend Income
				Nonvoting Common Stock				
11/22/88	Original purchase	8,000,000		$840,000				
04/29/89	Sale to NCNB		(2,900,000)		$309,682	$304,500	$5,182	
08/09/89	Sale to NCNB		(5,100,000)		800,000	535,500	264,500	
01/31/91	Prior years' dividends through 1990							$4,736
	Totals	**8,000,000**	**(8,000,000)**	**$840,000**	**$1,109,682**	**$840,000**	**$269,682**	**$4,736**

Source: FDIC, *Equity Investment Portfolio, Bank Insurance Fund,* December 31, 1993.

expenses totaled approximately $4.3 billion. Offsetting the expenses were recoveries to the FDIC of approximately $420 million, including $275 million in gains from the sale of the FDIC's equity in NCNB-TNB. While that gain was a significant return on the FDIC's equity position, it was still a relatively small return when compared to the FDIC's overall expenses on the transaction. The total cost to the FDIC for the First Republic resolution is shown in table II.6-2.

The federal government also incurred other costs over and above those incurred by the FDIC. Those costs resulted from the favorable tax treatment that NCNB-TNB received, which resulted in sizeable tax savings. The tax savings represented money foregone by the U.S. Treasury and were, therefore, a cost to the federal government.

Issues and Lessons Learned

The FDIC learned several positive lessons from the First Republic resolution. First, the FDIC's relatively new bridge bank authority proved to be extremely helpful in providing a mechanism for dealing with a large failing institution. The formation of a bridge bank for First Republic enabled the FDIC to proceed to resolution quickly. The FDIC had

Table II.6-2

First RepublicBank Corporation Resolution Costs
($ in Millions)

FDIC's Expenses		
Funding for mark-to-market valuations	$2,232	
Special asset pool costs and deferred settlement costs	1,887	
Loss on corporate purchase of special asset pool assets	113	
Indemnification, litigation, and other costs	42	
Total Expense		$4,274
FDIC's Recoveries		
Stock purchase gains	$275	
Delaware claim recovery	143	
Total FDIC Recovery		$418
FDIC's Total Resolution Costs		**$3,856**

Sources: FDIC, *The Cost of Large Resolution Transactions* (March 12, 1996); FDIC Division of Finance; FDIC Division of Research and Statistics.

struggled for more than seven months to put together an open bank assistance transaction for the subsidiaries of First City Bancorporation of Texas, Inc., and did not want to go through negotiations of that type again.[53]

Second, the interstate acquisition provisions allowed by the Garn–St Germain legislation once again proved their value. Few banks in Texas had the ability to acquire banks the size of First Republic. Nationwide competition was needed to ensure the presence of multiple bidders.

Third, the financial benefit associated with taking an equity position was shown when the FDIC realized a $275 million gain on its NCNB-TNB stock. That point should not be overstated, though, because the overall resolution, of which this was just one part, was the costliest in the FDIC's history.

Fourth, some evidence indicated that market discipline still existed in the post-Continental banking industry. When First Republic's losses began to grow, deposits began a rapid exodus from the banks. That suggests that, although the typical failed bank resolution involved full protection of all depositors and other general creditors, there was not enough certainty of that result for complacency to exist among those who were uninsured.

53. See Chapter 5, First City Bancorporation of Texas, Inc.

Fifth, the structure of the earlier interim assistance resulted in all the banks in the holding company providing support to the insolvent banks. The failure of the lead bank in Dallas was an event of default under the terms of the interim assistance, and the FDIC called the guarantees, but the banks were unable to pay. Those banks were, in turn, declared insolvent and closed. Because all the banks in the holding company became insolvent when the guarantee was called, it was doubtful that solvent affiliated institutions would sign such a guarantee in the future. Therefore, the cross guarantee authority granted by FIRREA in 1989 was a critical provision for the FDIC to recover some of its costs for failing banks from other banks in the same holding company.

Some of the other results from the First Republic transaction were not as favorable. First, the transaction was extremely costly for the FDIC. Much of the cost was inherent in the banks' poor condition and ongoing economic weakness in Texas. Some parts of the transaction, however, could have been structured better. For example, because of the FDIC's liquidity concerns, NCNB funded the bad assets with reimbursement from the FDIC. The problem was that NCNB had a higher cost of funds than did the FDIC. The difference raised the overall cost of the transaction. While the FDIC's liquidity concerns perhaps necessitated the structure as originally designed, the result provides support for the view that a deposit insurance fund needs adequate sources of liquidity to enable it to focus on minimizing costs. Also, the asset management contract proved to have some room for improvement. The asset manager did not have sufficient incentives built into the contract to control costs or to liquidate the assets. Eventually, that contract was restructured to address those issues, and subsequent contracts were designed to better align the interests of the servicers with the interests of the FDIC.

Second, substantial additional costs to the federal government exceeded those incurred by the FDIC. Those costs came from the favorable tax treatment received by NCNB. Under then existing law, the FDIC was required only to consider costs to the deposit insurance fund. That policy was changed with the passage of FIRREA in 1989. The FDIC is now required to offset taxes foregone by the U.S. Treasury in determining the least costly resolution.

Third, the FDIC's authority to treat creditors in like classes differently was unclear, leading to costly litigation. In the First Republic transaction, the FDIC provided full protection to all depositors and other third-party general creditors, but did not provide similar protection to the affiliated banks that lent funds within the holding company. The FDIC's position was that affiliated banks that lent funds to the failed lead bank should receive at least, but not more than, their pro rata shares of receivership proceeds.

Litigation on that issue in the First Republic transaction was resolved favorably for the FDIC, and unfavorable rulings in the litigation arising from the MCorp and the TAB resolutions were overturned on appeal. In 1989, FIRREA included a provision ratifying the FDIC's position by stating that an unsecured creditor was entitled to receive no more than its pro rata share of receivership proceeds, and that the FDIC had the discretion to pay more to some creditors from the FDIC's own funds. Table II.6-3 lists all the banks in First Republic's chain.

Table II.6-3

First RepublicBank Corporation Subsidiary Banks as of July 29, 1988

($ in Thousands)

	Bank Name, City, State	Resolution Assets	Resolution Deposits	Resolution Cost	Assets Passed	FDIC Assets	Resolution Cost / Resolution Assets (%)
1	First RepublicBank-Clifton, Clifton, TX	$77,693	$77,698	$22,321	$77,693	$0	28.73
2	First RepublicBank-Forney, Forney, TX	50,994	51,424	15,944	50,994	0	31.27
3	First RepublicBank-Temple, N.A., Temple, TX	163,400	152,221	13,552	163,400	0	8.29
4	First RepublicBank-Abilene, N.A., Abilene, TX	214,305	204,343	50,820	214,305	0	23.71
5	First RepublicBank-Austin, N.A., Austin, TX	1,734,407	1,275,677	44,642	1,734,407	0	2.57
6	First RepublicBank-Brownwood, N.A., Brownwood, TX	124,218	120,821	27,702	124,218	0	22.30
7	First RepublicBank-Conroe, N.A., Conroe, TX	206,393	203,730	47,432	206,393	0	22.98
8	First RepublicBank-Corsicana, N.A., Corsicana, TX	198,593	189,533	15,545	198,593	0	7.83
9	First RepublicBank-Dallas, N.A., Dallas, TX	18,162,609	6,899,561	1,962,069	18,162,609	0	10.80
10	First RepublicBank-Denison, N.A., Denison, TX	141,514	138,942	28,300	141,514	0	20.00
11	First RepublicBank-Ennis, N.A., Ennis, TX	96,137	90,650	20,727	96,137	0	21.56
12	First RepublicBank-Ft. Worth, N.A., Ft. Worth, TX	1,905,148	1,513,693	150,867	1,905,148	0	7.92
13	First RepublicBank-Galveston, N.A., Galveston, TX	261,089	248,605	13,552	261,089	0	5.19
14	First RepublicBank-Greenville, N.A., Greenville, TX	82,781	81,012	15,744	82,781	0	19.02
15	First RepublicBank-Harlingen, N.A., Harlingen, TX	208,383	196,990	46,037	208,383	0	22.09

Table II.6-3

First RepublicBank Corporation Subsidiary Banks as of July 29, 1988

($ in Thousands)

Continued

	Bank Name, City, State	Resolution Assets	Resolution Deposits	Resolution Cost	Assets Passed	FDIC Assets	Resolution Cost / Resolution Assets (%)
16	First RepublicBank-Henderson, N.A., Henderson, TX	$120,083	$119,496	$35,873	$120,083	$0	29.87
17	First RepublicBank-Houston, N.A., Houston, TX	2,886,126	2,236,058	536,306	2,886,126	0	18.58
18	First RepublicBank-Lubbock, N.A., Lubbock, TX	496,207	448,420	1,594	496,207	0	0.32
19	First RepublicBank-Mineral Wells, N.A., Mineral Wells, TX	167,841	169,986	51,618	167,841	0	30.75
20	First RepublicBank-Mt. Pleasant, N.A., Mt. Pleasant, TX	142,692	140,471	31,887	142,692	0	22.35
21	First RepublicBank-Odessa, N.A., Odessa, TX	167,958	163,573	37,069	167,958	0	22.07
22	First RepublicBank-Plano, N.A., Plano, TX	183,784	179,170	36,471	183,784	0	19.84
23	First RepublicBank-Richmond, N.A., Richmond, TX	94,945	91,504	28,499	94,945	0	30.02
24	National Bank of Ft. Sam Houston, Ft. Sam Houston, TX	614,155	510,064	94,267	614,155	0	15.35
25	First RepublicBank-Stephenville, N.A., Stephenville, TX	119,699	117,390	19,132	119,699	0	15.98
26	First RepublicBank-Tyler, N.A., Tyler, TX	600,406	549,262	65,768	600,406	0	10.95
27	First RepublicBank-Waco, N.A., Waco, TX	703,104	615,344	57,397	703,104	0	8.16
28	First RepublicBank-Wichita Falls, N.A., Wichita Falls, TX	287,558	271,546	41,254	287,558	0	14.35
29	First RepublicBank-Lufkin, Lufkin, TX	218,720	193,869	20,926	218,720	0	9.57
30	First RepublicBank-Cleburne, N.A., Cleburne, TX	114,816	111,062	14,150	114,816	0	12.32

Table II.6-3

First RepublicBank Corporation Subsidiary Banks as of July 29, 1988

($ in Thousands)

Continued

	Bank Name, City, State	Resolution Assets	Resolution Deposits	Resolution Cost	Assets Passed	FDIC Assets	Resolution Cost/ Resolution Assets (%)
31	First RepublicBank-San Antonio, N.A., San Antonio, TX	$743,428	$680,155	$55,803	$743,428	$0	7.51
32	First RepublicBank-Hillsboro, Hillsboro, TX	63,530	63,356	20,328	63,530	0	32.00
33	First RepublicBank-Malakoff, Malakoff, TX	47,978	48,912	16,143	47,978	0	33.65
34	First RepublicBank-Jefferson County, Beaumont, TX	221,573	217,100	45,639	221,573	0	20.60
35	First RepublicBank-Victoria, Victoria, TX	173,057	163,551	20,926	173,057	0	12.09
36	First RepublicBank-A&M, College Station, TX	92,090	88,599	11,360	92,090	0	12.34
37	First RepublicBank-Paris, Paris, TX	77,906	77,504	19,930	77,906	0	25.58
38	First RepublicBank-El Paso, N.A., El Paso, TX	212,114	206,932	34,080	212,114	0	16.07
39	First RepublicBank-Williamson County, N.A., Austin, TX	41,681	42,431	14,150	41,681	0	33.95
40	First RepublicBank-Midland, N.A., Midland, TX	616,165	577,549	70,750	616,165	0	11.48
41	First RepublicBank-Delaware, Newark, DE	612,745	211,500	249	0	612,745	0.04
	Totals	**$33,448,025**	**$19,739,704**	**$3,856,826**	**$32,835,279**	**$612,746**	**11.53**

Source: FDIC, *1988 Annual Report.*

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