

**FDIC intervention, Investor reactions and Reported Bargain Purchase Gains
during the 2008 crisis**

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FDIC strategies, accounting representations and investor reactions during the financial crisis 2008-2009

Abstract:

The recent acquisition of Silicon Valley Bank by First Citizens Bank organized by the FDIC led to both a reported gain on acquisition and increased First Citizens stock price by 55%. This transaction mirrored FDIC actions during the 2008-2009 crisis when the FDIC offered considerable asset discounts, upfront cash payments and indemnification contracts against acquired loan defaults to incentivize acquirers. We compare (a) the use of fair value estimates which determined whether the merger led to an accounting gain; (b) investor reactions to mergers measured through short and long-term stock returns; and (c) the difference in these associations between accounting valuations and stock market returns based on whether the transaction was mediated by the FDIC. Our findings show that FDIC intervention was efficient in shoring up the banking industry both in terms of future accounting performance and stock market returns for the acquirer.

Keywords: financial institution; bargain purchase gain; ASC 805; fair value measurement; ASC 820; earnings management.

JEL Classification: G20, G28, G34, M41.

1. Introduction

The recent acquisitions of troubled regional banks such as Silicon Valley Bank and First Republic by First National and JP Morgan respectively were assisted by the FDIC.² Both acquisitions resulted in reported gains and an increase in the acquirers' stock price.³ During the 2008-2009 financial crisis, the FDIC assisted many such takeovers of failing banks by solvent banks that led to reported accounting profits.⁴ In order to facilitate takeovers, the FDIC entered into loss-sharing arrangements with the acquirer, where the agency agreed to partially reimburse incurred losses on "covered loans" (typically, 80% of the eventual losses). The issuance of ASC 805 (formally SFAS 141R) Business Combinations in December 2007, emphasizing the use of fair values for acquired assets including intangible ones, resulted in the recognition of a bargain purchase gains (hereafter, BPGs) from these mergers.

Our analysis examines whether the reported BPGs that constitute an increase in the reported equity of the acquirer reflect a real economic transfer both through investor reactions at the time of the merger, and as reflected in future performance. While earlier papers have examined the informational content of fair value measurements (Barth et al., 2015; Dechow et al., 2010; Song et al., 2010) and more specifically, the occurrence of BPGs in bank mergers (Dunn et. al. 2016), we offer a novel perspective on this issue through the lens of FDIC intervention and the institutional arrangements pertaining to indemnification contracts. First, this methodology allows

² FDIC insures individual accounts against bank failure. It is often in the FDIC (and consumer interest) to fold a failing bank into another bank so that depositors can continue to use their accounts with minimum disruption. Ideally, a failing bank closes on a Friday and resumes under new management the following Monday as happened in the First Republic JP Morgan takeover where First Republic was closed on April 28 and resumed business on May 1, 2023.

³ Under ASC 805, if the fair values of acquired assets exceeds the consideration paid, BPGs were recorded and credited to net income

⁴ However, unlike the current crisis, there was an additional problem in 2008-2009 concerning the quality of the receivables held by the failing banks which made healthy banks reluctant to participate in the merger. SVB's assets consisted of long-term treasury notes where the probability of default is zero. In contrast, many struggling banks in 2008-2009 held asset backed securities of dubious quality.

us to compare reported fair values in FDIC-assisted transactions with those reported in non-FDIC acquisitions. Second, the differences in reactions of investors to reported BPG acquisitions as opposed to Goodwill acquisitions can be examined across the whole sample of transactions. Lastly, we can compare differences in investor reaction to BPG and Goodwill transactions separately in the FDIC and non-FDIC subsamples and the difference in the differences across these two groups.⁵

Out of a total of 412 acquisitions over the period 2008 through 2012 resulting in day one gains as defined under ASC 805, 201 (roughly half) are in the financial industry. These 201 bargain purchase transactions in our sample constitute 12.15 percent of the 1,654 acquisitions performed by public financial institutions over this time period.⁶ This is unexpected since financial assets that are central to bank mergers typically specify future cash flows. Fair values and market values for clearly identified cash flows should not diverge substantially, at least in theory (though of course, they could both diverge from book values). However, the banking turmoil of 2007 led to such a loss of liquidity that market values fell below fair values. In turn, this fall in market values led to potential insolvency for a wide spectrum of banks forcing them to merge with other banks, either through choice or under duress. A significant portion of these transactions fell in the post-SFAS 141 R period which required fair value measurement of the acquired financial assets.

In acquisitions of financial institutions, the primary fair value estimate starts with the carrying amount of loans and mortgages transferred at date of acquisition. These loans are then written up (or down) to their fair value. After adjustments, the net value acquired is compared with the consideration paid and the difference booked either as goodwill or as BPGs. When indemnification agreements are present, the fair value of the expected reimbursement from the

⁵ In particular, this feature distinguishes our paper from Dunn (2016) which focuses on the earnings management aspect of BPGs within the sample of FDIC-assisted acquisitions.

⁶ We identify the 1,654 acquisitions from Compustat firms with acquisitions reported in the financial industry.

FDIC, typically 80% of all losses on the loans covered by the agreement, has to be booked as an intangible asset associated with the acquisition. Indemnification agreements, therefore, directly increase the net value of assets acquired. At least in theory, a competitive bidding process (as described in FDIC procedures) should increase the consideration paid by an equal amount, that is, the acquisition price through a competitive auction ought to have fully priced the indemnification arrangement resulting in a net zero BPG

Given this background, our primary research questions pertain to the interaction between SFAS 141-R and the provision of FDIC indemnification agreements:

- Do reported BPGs reflect the economic value associated with the acquisition by investors, and in particular, the value associated with an indemnification agreement, or, are BPGs “manufactured” using discretion in fair value estimates primarily for the purpose of increasing market valuations (Huizinga and Laeven 2012)?
- Are the loans acquired being overvalued in order to generate BPGs or undervalued in order to book a higher (contingent) receivable from the FDIC?
- Is the FDIC simply folding one failed bank into a healthier financial institution or is there some other strategy implicit in the FDIC contracts with the acquirer?

To answer these questions, we identify Form 10-K filings containing business acquisitions with BPGs by a keyword search on EDGAR Online I-Metrix. Each Form 10-K is reviewed over the period 2008-2012 to collect the fair value of assets acquired, liabilities assumed, and other acquisition deal characteristics. Missing financial information within Compustat, CRSP, and PrivCo for either the acquiring or target firm reduces the sample size to 201 BPG deals in the

financial industry.⁷ We identify a pair-match control group of 201 acquisitions with goodwill recognized at the acquisition date. With this sample, we examine cross-sectional differences across different “treatment” and “control” samples: (1) BPG transactions assisted by the FDIC compared with BPG transactions not assisted by the FDIC; (2) All BPG transactions compared with the matched goodwill sample; and (3) BPG and Goodwill acquisitions separately for FDIC and non-FDIC subsamples. These different comparisons provide a more nuanced picture of the way BPGs are determined and recorded as well as their effects on earnings management.

Consistent with earlier literature (Dechow et al., 2010 and Barth et al., 2015, Dunn et al. 2016), the empirical results show that acquirers with decline in earnings before the inclusion of BPGs are more likely to recognize BPGs. Furthermore, the magnitudes of BPGs are negatively related to changes in earnings before BPGs. However, these associations only exist in non-FDIC acquisitions. These conflicting findings suggest that the interpretation of BPGs as evidence of earnings management is too simplistic and that BPGs could, under the right circumstances, actually indicate mergers that strengthen the acquirer. We support our interpretation by documenting that we find a positive relationship between bargain purchase gains and Level-3 fair value estimates of loans (Martin et al. 2006, Ronen, 2008, Kolev 2009) in the non-FDIC subsample but not in the FDIC-assisted subsample. In other words, the (over)valuation of the acquired loans is an important component of BPGs for non-FDIC acquisitions but that the provision of indemnification asset counter-acts this tendency as an overestimate of collectability will weaken the case for an indemnification contract.

⁷ Untabulated statistics based on the sample banks reveal that approximately 77% of targets are private firms, so we obtain financial data for those private targets from PrivCo.

Next, we investigate market reactions and find that abnormal returns around acquisition completion dates are significantly positive for FDIC-assisted transactions, but not for non-FDIC-assisted transactions. Lastly, we show by controlling for the likelihood of an indemnification agreement, that the FDIC offered these contracts to offset potential losses in *weaker* acquisitions. Consequently, non-indemnified FDIC acquisitions were the ones that had genuine BPGs while the presence of indemnification increased the value of the weaker acquisitions. In summary, the availability of indemnification agreements ensured that all FDIC-assisted acquisitions were considered favorably by investors even though these acquisitions involved troubled targets.

This study contributes to several streams of literature. First, it adds to the literature on the level of earnings management and over-optimism inherent to fair value estimates. Specifically, we show that in the presence of contractual agreements which provide insurance against incurred losses, measures of BPGs correspond more closely with real economic value. In contrast, when there is no insurance against bad acquisitions, BPGs are the more likely to reflect inflated fair values. In other words, the presence of BPGs should not automatically be taken as evidence for pervasive earnings management, an argument made forcefully in Ball (2013). Second, the results show that indemnification agreements transferred real economic value to acquiring banks, strengthening them in the long run. Lastly, our study shows that the use of these agreements by the FDIC was strategic in supporting weaker mergers and will lead to long-run benefits for the banking industry.

This paper calls for the users of financial statements to pay attention to nuances involved with the context of financial reports. The changes implemented in ASC 805 are motivated by a desire to improve the relevance of financial statements. However, many academic studies have argued that Level-3 valuations as described in SFAS 157 simply provide management with a tool

to manipulate earnings. This paper documents evidence that both these points of view have some validity and depend crucially on the reporting context. In FDIC-assisted transactions, regulatory monitoring and the discipline imposed by indemnification agreement results in BPGs reflecting underlying economics more accurately. However, in non-FDIC transactions, the BPGs seem to reflect management optimism rather than real economic value.

The remainder of this paper is organized as follows. The next section provides a background for bargain purchase acquisitions. Section 3 reviews the previous literature and develops testable hypotheses. Section 4 describes research design, and Section 5 shows the sample selection and data description. In Section 6, we show the empirical results. Section 7 and 8 discuss the conclusions and implications of our findings.

2. Understanding Bargain Purchase Acquisitions

In any acquisitions, the purchase price is allocated to assets and liabilities based on their estimated fair values as of the acquisition date. The acquiring management uses methodologies in accordance with SFAS 157 (September 2006) which “defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements.” The excess of fair value of the net assets acquired over the purchase price is recorded as a BPG and is shown as a separate component of earnings in the acquiring firm’s income statement.

SFAS 157 develops a 3-level fair value hierarchy to reflect the level of judgment involved in estimating fair values.⁸ This standard does not provide implementation guidance on how to

⁸ Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date... Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly... Level 3 inputs are unobservable inputs for the asset or liability...

incorporate management judgments in arriving at fair values. Absent clear rules, acquiring firms have subjectivity in fair value accounting and, thus, the recognition of BPGs. While transactions where the consideration paid is less than the fair value of net assets acquired should be rare exceptions, such transactions occurred frequently in the financial industry during the crisis and around 68% of such BPG acquisitions involved the assistance of the FDIC. Appendices A and B present examples of BPG acquisitions, the first without and the second with FDIC assistance.

2.1 Scenario A: Non-FDIC-assisted acquisition

On December 29, 2010, the merger of Northeast Bancorp and FHB Formation LLC (“FHB”) was completed. Northeast Bancorp has applied ASC 805 to this transaction. Northeast Bancorp recorded assets acquired and liabilities assumed at their respective fair values as of the transaction date but does not provide details in how to arrive at these fair values in the disclosure note of this transaction.

This transaction resulted in a BPG of \$15,441,000 because the fair value of total identifiable net assets is \$47,916,000, which is higher than the consideration paid of \$32,475,000. The magnitude of BPG is about 2.48 percent of prior year’s total assets. Even though Northeast Bancorp disclosed that it is the fair value of intangible assets, \$14,213,000, driving the recognition of BPGs, we have put the fair value estimate of loans in the spotlight. In this as in most other acquisitions, loans make up the largest portion of total assets acquired (\$369,605,000, or 58.52 percent) and their valuation is critical to whether the acquisition generates BPGs.

2.2 Scenario B: FDIC-assisted acquisition

unobservable inputs shall reflect the reporting entity’s own assumptions about the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk).” (SFAS 157, P.12 paragraph 3, 7; P.15 paragraph 2)

On June 19, 2009, First Bancorp had entered into a purchase and assumption agreement with the FDIC, as a receiver for Cooperative Bank, Wilmington, North Carolina. “According to the terms of the agreement, First Bank acquired all deposits (except certain brokered deposits) and borrowings, and substantially all the assets of Cooperative Bank and its subsidiary, Lumina Mortgage. The loans and foreclosed real estate purchased are covered by two loss share agreements. Under the[se] loss share agreements, the FDIC will cover 80% of covered loan and foreclosed real estate losses up to \$303 million and 95 percent of losses in excess of that amount. The term for loss sharing on residential real estate loans is ten years, while the term for loss sharing on non-residential real estate loans is five years in respect to losses and eight years in respect to loss recoveries. The reimbursable losses from the FDIC are based on the book value of the relevant loan as determined by the FDIC at the date of the transaction.” (First Bancorp 10-K, 2009).

As explained on the FDIC website,⁹ “The FDIC works cooperatively with the applicable chartering authorities and Federal regulators to expeditiously resolve failing banks in a least costly manner. The FDIC does not negotiate the proposed transactions terms with each potential bidder. Rather, the FDIC conducts a sealed bid process based on standard transaction terms. Bids are submitted to the FDIC electronically via a separate secured website to ensure confidentiality, and all bids must be submitted on the FDIC's standard forms. Failing institutions are usually closed within a few weeks after bids are submitted. The whole resolution process usually occurs over a two- to three-month period. The FDIC provides limited indemnification designed to protect the

⁹ https://www.fdic.gov/buying/FranchiseMarketing/marketing_process.html#processOverview

acquirer against liabilities created by the institution prior to the sale date that are not assumed by the acquirer.”¹⁰

As a result of this acquisition, First Bancorp reports \$916,048,000 in assets acquired and \$873,913,000 in liabilities assumed at fair value. First Bancorp wrote down Cooperative Bank’s book value of loans from \$828,957,000 to the estimated fair value \$601,104,000 and a fair value adjustment of \$185,112,000 for the FDIC loss share receivable, First Bancorp reports that differences in interest rates paid on their deposits and the acquired loans also affected fair value calculations and that the application of acquisition accounting results in a BPG of \$67,894,000, which is included in the Consolidated Statement of Operations for the year ended December 31, 2009.

3. Literature Review and Hypothesis Development

In this section, we review different streams of literature that are pertinent to our analysis.

3.1 Earnings Management

Managed earnings may be used to signal the quality of a business (Ronen and Sadan 1981; Demski, Pattell, and Wolfson 1984) or be used to prop up stock prices (Burgstahler and Diced 1997; Ahmed et al. 1999; Dechow et al. 2010), which is motivated by a desire to increase compensation tied to accounting benchmarks or stock prices (Healy 1985). However, it is also worth noting that Ball (2013) questions the overall prevalence of earnings management. Most acquiring firms in our sample (79.6%) are banks, and a reason for earnings management specific

¹⁰ We use the merger completion announcement date as the event date. There are small differences in the pre-merger disclosures depending on whether the merger was FDIC assisted or not, but the information across these groups of acquisitions is similar in our event period that surrounds the merger announcement date.

to the banking industry is to meet capital adequacy requirements regarding their reported regulatory capital (Moyer 1990; Collins et al. 1995; Beatty et al. 1995). The loan loss provision is typically the largest bank accrual (Beatty and Liao 2014) and discretion in the loan loss provision is an important tool for earnings management by banks (Beatty et al. 2002; Kanagaretnam et al. 2004; Anandarajan et al. 2007; Kilic et al. 2012). Other documented tools are the timing of securities gain and loss recognition (Beatty et al. 1995) and tax valuation allowances (Schrand and Wong 2003).

The main empirical method for establishing earnings management is to document a negative association between pre-managed earnings/earnings change and the discretionary accrual. Collins et al. (1995) finds such a negative relationship between securities gain and loss recognition and earnings, while Dechow et al. (2010) establish a similar result for securitizations. Dunn, Kohlbeck, and Smith (2016) document an analogous negative relationship between earnings change and BPGs in a sample of FDIC-assisted acquisitions. However, by studying the institutional arrangements surrounding FDIC assistance, we argue that the negative association disappears in this sample after controlling for other factors whereas it is manifested in non-FDIC-assisted BPG transactions (which were not analyzed in Dunn et al. 2016).

3.2 Fair Value Accounting

The debate over fair value accounting has focused on the tension between representational accuracy and timeliness. Proponents such as Barth et al. (1996) and Carroll et al. (2003) find evidence in support of fair-value relevance, whereas Nelson (1996) argue that the value relevance of reported fair values disappears after controlling for profitability and future growth. Opponents of fair value accounting argue that the reliability of fair value can be questionable, as managers have incentives and opportunities to bias reported values (Martin et al. 2006; Danbolt and Rees

2008). Level-2 and -3 fair values, where managerial inputs play a significant role, are considered less reliable than mark-to-market (Level-1) fair values (Kolev 2009). Song et al. (2010) also find that the value relevance of Level-3 fair values is significantly smaller than that of Level-1 and Level-2 but could be improved by strong corporate governance. Liao et al. (2010) shows that fair value accounting is associated with information asymmetry during the financial crisis period, while Riel and Seraphim (2011) document that financial institutions with more Level-3 financial assets exhibit a higher cost of capital due to uncertainty regarding their reported values. A recent summary of the conflicting literature may be found in Marra (2016).

In this paper, our sample is comprised of acquisitions in the financial industry, where ASC 805 requires acquiring firms to recognize all assets acquired and liabilities assumed at their fair values. Any excess of amounts allocated to fair value of net assets over purchase price is recorded as BPGs (i.e., as income) whereas deficits are recognized as goodwill (i.e., as an asset). Almost all the assets acquired and liabilities assumed in acquisitions by financial institutions are estimated at Level-3. As discussed before, most BPG acquisitions in the financial industry are directed by the FDIC. Motivated by the critiques and concerns regarding fair value accounting, we investigate the impact of FDIC indemnification on fair value estimates and market perceptions of BPG acquisitions.

3.3 Market Acquisitions

Moeller, Schlingemann, and Stulz (2004) document that on average, acquisitions by large firms lost money over the 1980s and that these losses increased over the period 1998-2001. More recently, a report by AIG documented that 25% of insurance policies written on M&A deals of

more than \$1 billion ended in a claim.¹¹ Given the established literature on the topic, the probability of actually making an immediate profit on an acquisition may appear remote. Nevertheless, 201 firms reported day-1 BPGs over our sample period 2009-2012 in the financial services industry, while 211 firms reported such a gain in non-financial industries (Lilien Sarath and Yan 2019). During the financial crisis, traditional market pricing of risk collapsed and asset classes that were traditionally considered low risk, like commercial paper, suddenly dried up (Kasperczyk and Schnabl 2010). Therefore, it was more likely that assets were genuinely mispriced during this period and that at least some of these BPG acquisitions resulted in economic values for the acquirers. If this were the case, the market should also have viewed these acquisitions positively with positive returns around the acquisition date.

3.4 *Hypotheses Development*

Fair value measurements depend on projections of future cash flows. The need to project cash flows results naturally in opportunities for over-optimistic estimates. Prior literature (Barth et al. 1995, Dunn et al. 2016) argue that BPGs are associated with negative earnings changes before the effect of BPGs and infer that the use of BPGs is a mechanism for reversing this trend. We re-examine the inference that BPGs arise mainly from over-optimistic fair value estimates aimed at reversing a trend of earnings declines by comparing across FDIC and non-FDIC acquisitions. In particular, the association of BPGs with negative earnings changes may be part of an effort by the FDIC to strengthen acquiring banks by allowing them to acquire struggling banks at an advantageous price. To analyze this possibility rigorously, we first state two hypotheses analogous to these earlier studies that set up a baseline for our new findings and interpretations.

¹¹ marketwatch.com/story/mergers-and-acquisitions-are-getting-riskier-as-insurance-claims-rise-2017-04-20

H1: BPGs are more likely and larger in acquiring firms that have more negative changes in performance

The first hypothesis shows that the BPGs we analyze exhibit the same characteristics that earlier studies have characterized as an outcome of earnings management. This provides the starting point for our general theme that this inference may be justified for non-FDIC assisted acquisitions but that BPGs in FDIC-assisted acquisitions may reflect strategic *economic decisions* resulting in true economic value rather than *earnings management*. To this end, we next analyze the relationship between loan valuations and BPGs across these two samples. The fair-valuation of loans has a major impact on the reported consequences of banking acquisitions and could be a primary vehicle for generating BPGs. Therefore, we hypothesize next that this relationship will be stronger in non-FDIC acquisitions:

H2: BPGs are more strongly associated with loan values in non-FDIC acquisitions.

Having set up our two baseline hypotheses that support prior findings but also suggest that the inferences drawn from these findings may differ across FDIC and non-FDIC acquisitions, we move on to results that analyze differences in the characteristics of BPGs across these two subsamples of acquisitions. Before presenting our new hypotheses, we discuss the arrangement of loan indemnification that was provided by the FDIC in many acquisitions.

Given the crisis in the economy, acquiring banks were nervous about the potential loan-losses on acquisitions. The FDIC therefore offered insurance against potential defaults through indemnification agreements. The potential indemnification applied to a subset of the acquired loans (referred to in the agreement as “covered loans”) that were considered particularly risky. The inherent collectability risk led to a low valuation of the acquired loans offset by the indemnification agreements that compensated for incurred losses (almost always 80% of the incurred losses). These

contracts were not subject to any direct up-front premium from the acquirer. In other words, the acquiring banks identified the riskiest loans and estimated the potential losses on these loans to obtain insurance from the FDIC restricting their overall exposure to 20% of the incurred loss.

The presence of indemnification agreements created a potential incentive to overstate potential losses or to write-off loans prematurely and collect cash from the FDIC. To counter-act any potential moral-hazard in this regard, indemnification contracts contained a “true up” clause.¹² Under this clause, if write-offs are seen to be inaccurate ex-post, the acquiring firm might have to return money to the FDIC as well as face other penalties. The combined effect of the indemnification and true-up clauses forced the acquiring firm to report as accurate an assessment of their loan losses as is possible, since underestimates may dilute the insurance value whereas overestimates may lead to subsequent claw-backs (see Appendix B).

The relationship between indemnification contracts and BPGs is less clear. While no direct premium was charged, indemnification contracts should have had no effect on BPGs if their value was factored into the consideration paid for the acquisition. However, if the consideration paid did not reflect the full value of the indemnification agreement, there would be a value transfer to the acquirer. In general, if the FDIC adjusted the acquisition price in order to strengthen the position of the acquirer, BPGs in FDIC acquisitions are more likely to reflect a real economic value transfer. In summary, we hypothesize that FDIC acquisitions were favorable to the acquirer and that indemnification agreements played a role in this transfer of value.

¹² For example BNC records the following: BNC also has agreed to make a true-up payment to the FDIC 45 days after October 31, 2021 (or, if later, the time of disposition of all acquired assets pursuant to the loss-share agreements) equal to 50% of the excess, if any, of the following calculation: $A - (B + C + D)$, where (A) equals 20% of the intrinsic loss estimate of \$41.6 million; (B) equals the Net Loss Amount; (C) equals 25% of the asset (discount) bid or (\$4.4 million) and (D) equals 3.5% of total Shared Loss Assets at the inception of the related loss-share agreement of \$139.8 million. Based upon BNC’s estimate, as of December 31, 2011, no true-up payment will be required to be paid to the FDIC by BNC.

We test this hypothesis using investor reactions at the time of the merger announcement. At the time of acquisition, an 8-K giving considerable details about the acquisition is available to investors. Additional information as well as any required adjustments to the initial 8-K are made available in subsequent 8-Ks and 10-Ks. Therefore, our hypotheses concern the relationship between the partial public information and other private information available at the acquisition date with the valuation reported in detail in a subsequent 10-K. If the market were fully efficient, the later 10-K should be informationally redundant. Even if the market is only partially efficient, there should be a strong association between the initial returns at the time of the acquisition and the full details of the acquisition provided through accounting statements at a later date.

H3: Investors react more positively to FDIC-assisted BPG transactions than non-FDIC BPG transactions both at the time of the announcement and in the year after the merger.

We note that BPGs (or value transfers) do not arise directly from indemnification arrangements. The option to offer these contracts was available in all transactions and was only offered in transactions where the acquired loans were riskier. In addition, indemnification contracts were also offered in goodwill acquisitions. Since the acquirer still faced a 20% share of the incurred loan losses a larger expected indemnification asset also implied a larger potential risk for the acquirer. For this reason, investor reaction to indemnification arrangements involves opposing effects. If the FDIC chose *not* to offer indemnification, it is likely due to the high quality of the acquired loans and such acquisitions should be viewed most favorably by the market. In other words, the decision not to enter into an indemnification (or a smaller indemnification arrangement) could act as a signal of high-quality acquired loans. However, to the extent that the value of the indemnification contract was not fully factored into the acquisition price, it would have led to an economic value transfer to the acquirer.

The vast majority of FDIC acquisitions, whether they led to BPGs or not, involved indemnification contracts. This empirical fact results in a high correlation between 0-1 dummies for FDIC intervention and the provision of indemnification contracts. To avoid methodological issues, we use a two-stage procedure where at the first stage, we evaluate the economic value of the indemnification contract based on the observable characteristics of the target. That is, for each merger involving the FDIC, we estimate a “predicted indemnification amount” based on the quality of the acquisition. At the second stage, we regress the market reaction on this predicted asset. If a larger indemnification asset is predicted, that should imply a riskier acquisition and could have a negative effect on investor perceptions. However, if the majority of insurance value of the indemnification is transferred to the acquirer (through an acquisition price that does not reflect the insurance asset), the effect of a larger indemnification asset would be a positive effect on investor valuations. We therefore hypothesize a non-directional relationship on investor reactions.

H4: FDIC-assisted acquisitions that incorporate indemnification agreements have a different CAR relative to FDIC-assisted acquisitions without indemnification agreements at the time of the acquisition.

4. Sample Selection and Summary Statistics

4.1 Sample

The revised FASB ASC 805 became effective for acquisitions completed during annual reporting periods that begin on or after December 15, 2008. Therefore, our sample begins with all bargain purchase acquisitions completed between December 15, 2008 and December 31, 2012. We use I-Metrix by Edgar Online to search for the keywords “bargain purchase”, “gain from

acquisition”, or “gain on acquisition” to identify Form 10-k reporting bargain purchase acquisitions. We read disclosure notes for acquisitions in each Form 10-k and hand collect deal characteristics including the announcement date of acquisition completion, the amount of BPGs realized, the fair value estimates of assets acquired and liabilities assumed, and the purchase consideration paid. We collect acquiring firms’ stock and financial data from The Center for Research in Security Prices (CRSP) and Compustat.

Table 1, Panel A reports the sample selection and Panel B reports the distribution of bargain purchase acquisitions by industry. In total, we identify 412 bargain purchase acquisitions from 2008 to 2012. Acquisitions in the financial industry, where the use of fair value accounting is much more prevalent than other industries, takes the largest proportion (56.43%). To investigate the role of FDIC, we limit the sample to FDIC-regulated financial industry (depository institutions). As a result, our sample includes 134 bargain purchase transactions taken by depository institutions with two-digit SIC code 60. Panel C describes the distribution of bargain purchase acquisitions by calendar year. The occurrence of bargain purchase acquisitions is spread evenly over the sample period after 2008, with a slightly higher concentration in 2010 (32.84%).

To construct a control group, we collect data on goodwill acquisitions from Thomson’s SDC Platinum database. We match each deal to a bargain purchase acquisition using acquiring firm’s size, SIC code, and acquisition year, and include stock and financial data from CRSP and Compustat. Our requirements yield a control sample of 122 goodwill acquisitions.

4.2 Summary Statistics

Table 2 shows the acquiring firm, target, and deal characteristics for bargain purchase acquisitions and matched goodwill acquisitions. All continuous variables are winsorized at the top and bottom one percent levels. Panel A shows that, for bargain purchase acquisitions, the mean

BPGs (*ACQBPG*) recognized by acquiring firms is 0.70% of total assets. For goodwill acquisitions, this variable is denoted as zero. We find that around 47.01% of BPG acquirers would experience a decline in earnings without BPGs, while only 16.39% of GDWL acquirers report an earnings decline (*DECLINE*). Moreover, we define $\Delta ROABB$ as the change in income before BPGs deflated by total assets. The mean (median) $\Delta ROABB$ is 0.0002 (0.0011) for BPG group, and 0.0053 (0.0034) for GDWL group. We also calculate acquiring firms' Altman z-score and find that *ALTMAN* is lower for BPG group, indicating a higher probability of bankruptcy. Overall, the univariate comparisons suggest that firms in the BPG and GW samples are comparable in most dimensions but firms with much lower earnings performance are involved in BPG transactions.

We also provide information on deal characteristics. *FDIC* is an indicator variable that equals one for acquisitions directed by the FDIC, and zero otherwise. Around 81.34% of bargain purchase acquisitions are assisted by the FDIC and 16.95% are non-FDIC whereas only 22.95% of matched goodwill acquisitions are directed by the FDIC while 77.04% are non-FDIC. This is a notable difference and suggests that FDIC arranged better value for the acquirers when they were directly involved. However, the average BPG is only 0.7% of the acquisition value and this raises the question of whether this will have a significant effect on investor reactions.

We also find that loans acquired represents a significant portion of total assets (*ACQLOAN*) acquired both for bargain purchase acquisitions (57.66%) and goodwill acquisitions (52.09%). In addition, only 17.91% of acquiring firms in bargain purchase acquisitions pay cash, while the proportion is 63.11% for goodwill acquisitions (*PAYMENT*). This finding is consistent with the fact that most BPG acquirers receive cash and indemnification assets from the FDIC instead of paying cash because of the poor financial condition of failed targets.

Panel B presents the BPG and Goodwill samples separately across the FDIC and non-FDIC groups. The disproportionate representation of FDIC intervention in the BPG and Goodwill samples makes it difficult to make univariate comparisons of the differences between the BPG and Goodwill firms separately across the FDIC and non-FDIC groups and we delay the discussion of these differences to Tables 4 and 5 that involve multi-variate tests. However, we note that BPG acquirors assisted by the FDIC report indemnification asset value of 17.15% of the total assets while the Goodwill sample also displays a similar indemnification asset of 16.56%. The comparability of these two proportions suggests that if the indemnification asset is valued by investors, the effect on the BPG and Goodwill samples would be similar.

Table 3 reports the correlations between key variables in the full sample. Almost all correlation coefficients for control variables are lower than 0.40, which is below the threshold of potential multi-collinearity as in Gujarati (2003). One exception that should be noted is the significant correlation of 0.72 between the FDIC dummy (*FDIC*) and the percentage of value represented by the indemnification asset (*ACQFDIC*). This high correlation affects our choice of a two-stage test where we drop *FDIC* and use only *ACQFDIC*.

5. Empirical Results

5.1 The Association between BPGs and Earnings Measures

To test H1, we first employ the following model to predict the probability of BPG recognition in an acquisition:

$$\begin{aligned}
 Prob(DBPG_{i,t}) = & \beta_0 + \beta_1 DECLINE_{i,t} + \beta_2 SIZE_{i,t-1} + \beta_3 MULTI_{i,t} + \beta_4 Q4_{i,t} + \beta_5 CAPR_{i,t-1} \\
 & + \beta_6 ALTMAN_{i,t-1} + \beta_7 TARSIZE_{i,t-1} + \beta_8 ACQFDIC_{i,t} + \beta_9 ACQDEP_{i,t}
 \end{aligned}$$

$$+ \beta_{10}PAYMENT_{i,t} + YEAR\ FIXED\ EFFECT + \varepsilon_{i,t} \quad (1)$$

where $DBPG_{i,t}$ is an indicator variable that equals one if the acquirer recognizes BPGs in year t . The variable of interest is $DECLINE_{i,t}$, which equals one if the acquirer would experience a decline in earnings without the effect of BPGs.

We include common controls for the recognition of BPGs. First, Beatty et al. (2002) argue that larger firms are often subject to more scrutiny from investors, which may decrease firms' likelihood of BPG recognition if it is driven by the purpose of earnings management. Therefore, we control for acquiring firm size before the transaction ($SIZE_{i,t-1}$). Second, Dunn et al. (2016) document that firms are more likely to report BPGs if they undertake multiple acquisitions. As a result, we include an indicator variable that equals one if the firm acquires more than one targets in year t ($MULTI_{i,t}$). We also follow Dunn et al. (2016) to control for the quarter of BPG recognition ($Q4_{i,t}$) and acquirer's capital adequacy ratio ($CAPR_{i,t-1}$). Third, we include acquiring firms' Altman z-score in the year preceding the transactions ($ALTMAN_{i,t-1}$) as firms that face higher risk may wish to paint an optimistic picture of the acquisition. Fourth, Hayward and Hambrick (1997) finds that target firm size is a potential factor driving the acquisition price, so we control for target firm size in the year before the acquisition ($TARSIZE_{i,t-1}$). In addition, we follow Dunn et al. (2016) to include the FDIC indemnification assets recognized in the acquisition ($ACQFDIC_{i,t}$) and deposits acquired ($ACQDEP_{i,t}$). We also control for the payment method with an indicator variable for whether cash is paid ($PAYMENT_{i,t}$). Finally, we include year fixed effect and cluster standard errors are clustered at the firm level to correct for serial correlation within firm groupings. Appendix C provides a detailed description of variable definitions.

Table 4, column (1) reports the estimation results in the full sample. We find a positive and significant coefficient on $DECLINE$ (coefficient = 1.1414, z-statistic = 2.55), suggesting that

acquiring firms are more likely to recognize BPGs if they would experience a decline in earnings without the effect of BPGs. We further explore the role of the FDIC by splitting the full sample into FDIC-assisted acquisitions and non-FDIC-assisted acquisitions. Column (2) shows that the coefficient on *DECLINE* becomes insignificant when the FDIC is involved (coefficient = 0.1061, z-statistic = 0.19), while we find the same coefficient remains positive and significant for non-FDIC acquisitions in column (3) (coefficient = 2.4156, z-statistic = 3.26). Dunn et al. (2016) document that acquiring firms in FDIC transactions utilize BPGs to boost earnings. In contrast, our results indicate that the assistance and monitoring of the FDIC reduce acquiring firms' incentives to manage earnings with the recognition of BPGs.

We also employ the following Tobit model to examine the association between the magnitude of BPGs and acquirers' changes in earnings before the effect of BPGs:

$$\begin{aligned}
ACQBPG_{i,t} = & \beta_0 + \beta_{1i} \Delta ROABB_{i,t} + \beta_2 SIZE_{i,t-1} + \beta_3 MULTI_{i,t} + \beta_4 Q4_{i,t} + \beta_5 CAPR_{i,t-1} \\
& + \beta_6 ALTMAN_{i,t-1} + \beta_7 TARSIZE_{i,t-1} + \beta_8 ACQFDIC_{i,t} + \beta_9 ACQLOAN_{i,t} \\
& + \beta_{10} ACQOREO_{i,t} + \beta_{11} ACQINV_{i,t} + \beta_{12} ACQPPE_{i,t} + \beta_{13} ACQINTAN_{i,t} \\
& + \beta_{14} ACQDEP_{i,t} + \beta_{15} PAYMENT_{i,t} + YEAR\ FIXED\ EFFECT + \varepsilon_{i,t} \quad (2)
\end{aligned}$$

We use a Tobit model because goodwill acquisitions have zero effect on income. In addition to control variables in model (1), we further control for the fair value estimates of all major assets (loans, other real estate owned, inventory, PP&E, intangible assets) and liabilities assumed (deposits).

Table 5, column (1) reports the estimation result in full sample. We find that the coefficient on $\Delta ROABB$ is negative but insignificant (coefficient = -0.0781, t-statistics = -0.50). In columns (2) and (3), we split the full sample into FDIC-assisted and non-FDIC-assisted acquisitions. We find that the coefficient on $\Delta ROABB$ is negative and significant only in non-FDIC assisted

transactions (coefficient = -0.3746, t-statistics = -3.31), suggesting that BPGs are larger when acquirers experience a larger decline in earnings without BPGs. These results provide supplemental evidence that acquiring firms are motivated to avoid earnings declines with the recognition of BPGs. However, the involvement of the FDIC prohibits acquiring firms from boosting earnings and avoiding earnings declines with the recognition of BPGs.¹³

5.2 The Association between BPGs and Loan Values

The results in Table 5 also provide evidence on the association between the size of BPGs and the level-3 fair value estimates of loans acquired. As discussed earlier, we include the fair value measures of all major assets acquired and liabilities assumed. Column (1) shows that, in the full sample, the coefficient on *ACQLOAN* is insignificant (coefficient = -0.0008, t-statistic = -0.19). When we split the full sample into FDIC and non-FDIC transactions, the coefficient on *ACQLOAN* is positive and significant only in the non-FDIC sample (coefficient = 0.0203, t-statistic = 3.29). These results provide supporting evidence for H2 that BPGs in non-FDIC acquisitions may be driven by acquirers' opportunistic fair value estimates of loans, while BPGs in FDIC-assisted acquisitions may reflect strategic economic decisions resulting in true economic value rather than earnings management.

5.3 The Association between the FDIC Assistance and Announcement Returns

To test H3, we estimate acquirers' value-weighted cumulative abnormal returns in the (-1, +1) window around the acquisition completion announcement date (*CAR*). Table 6, Panel A

¹³ In this paper, we follow Dechow et al. (2010) and Barth et al. (2015) to assume that firms use earnings in the prior year as a benchmark for earnings management. Previous literature also suggests that managers may have incentives to meet or beat analyst forecast (Brown and Caylor, 2003). In untabulated analyses, we also use analyst forecast as a benchmark and arrive at similar inferences: the magnitude of BPGs is negatively related to by how much an acquiring firm's earnings before BPGs miss the I/B/E/S consensus forecast estimate.

presents how market reactions differ between FDIC and non-FDIC bargain purchase acquisitions. We find that, on average, $CAR(-1, +1)$ is positive and significant for FDIC-assisted transactions, but insignificant for non-FDIC-assisted acquisitions. The difference across two groups is significant at the one percent level.¹⁴ We also report the summary statistics for our sample of announcement returns in Panel B and the regression results of $CAR(-1, +1)$ on the indicator variable of FDIC assistance in Panel C. In Panel C, we find that the coefficient on FDIC is positive and significant (coefficient = 0.0129, t-statistic = 2.10), suggesting that the assistance of the FDIC in bargain purchase acquisitions is positively associated with announcement returns. However, as noted earlier, the CAR on goodwill acquisitions assisted by the FDIC is also positive though it is not significant at the five percent level.¹⁵ As noted earlier, goodwill acquisitions were also offered roughly the same level of indemnification as BPG acquisitions. In other words, the acquisition discount combined with the risk reduction effected by the indemnification contract resulted in a net gain for the acquirers.

5.4 The Association between the FDIC Indemnification Assets and Announcement Returns

To test H4, we limit the sample to FDIC-assisted bargain purchase acquisitions and use a two-stage procedure. Since nearly 80% of all FDIC assisted acquisitions involve indemnification arrangements and, in addition, 81% of the BPG contracts were FDIC-assisted, there are methodological issues in isolating the effects of the indemnification contract from the more general

¹⁴ One point should be noted here. While information for FDIC assisted acquisitions is at least partially available on the FDIC website including information about covered loans, the 8-K statement associated with a non-FDIC acquisition may not be available for four days after the acquisition. For this reason, we also examined a (-1 +5) window, but it was not substantially similar to the (-1, +1)-window.

¹⁵ The FDIC Goodwill sample was small (28 data points). Although the event CAR 's in the FDIC Goodwill sample were large (4.34%) they were not significant at the 5% level (T-stat 1.75). In addition, unlike the BPG sample, the long-term CAR 's over a 30-day window were insignificant. For these reasons, we do not tabulate the results for the FDIC goodwill sample. However, we note that the difference in CAR 's between the FDIC and non-FDIC Goodwill samples was significant at the 5% level.

effects of FDIC intervention. We adopt a two-stage approach where in the first stage, we predict the probability of the FDIC offering an indemnification asset based on fair values of other major assets acquired and liabilities assumed. Table 7, Panel A reports the estimation results. We find a negative and significant coefficient on *ACQLOAN* (coefficient = -2.4672, z-statistics = -2.18). In other words, the FDIC is more likely to offer a loan loss sharing contract when the FV of acquired loans is lower, that is, the higher the estimated probability of indemnification, the lower the quality of the acquired loans. However, the actual provision of indemnification mitigates the risk of the acquired loans. The joint effect of these two forces affect investor perceptions regarding the value of the acquisition.

In the second stage, we regress the announcement CAR on the probability of FDIC offering indemnification. We find a negative and significant coefficient on *FDIC Indemnification* (probability: coefficient = -0.0502, t-statistic = -2.10), suggesting that the provision of indemnification by the FDIC was truly for high-risk loans as assessed by investors. As 20% residual loan losses will be borne by the acquirer, higher potential losses will result both in a greater probability of being offered indemnification and reduced CAR's in the market. This finding again suggests that the provision of indemnification by the FDIC was closely related to the risk assessments of investors and that the provision of indemnification contracts was efficient from an economic perspective.

6. Conclusions

Fair value assessments switch the accountants focus to contingent future cash flows rather than documented past transactions. As such, this viewpoint coincides with asset valuations made by investors that is also based on expected future cash flows. We examine the relationship between

investor assessments and accounting assessments in the context of bank-mergers conducted in the crisis period of 2008-2009.

The focus on this period is motivated by two institutional details: (i) bank mergers were often overseen by the FDIC and (ii) mergers often resulted in BPGs where the (accounting) fair value of the assets acquired exceeded the fair value of the consideration paid. Earlier studies have documented that discretion with regard to Level-3 valuations is used by management to smooth a declining earnings trend, and, in particular, that day one bargain purchase gains (BPGs) are a powerful tool for disguising earnings declines. We provide evidence that BPGs reflect real economic value in FDIC-assisted transactions and that the link between BPGs and earnings management is valid only for non-FDIC transactions. Specifically, we show that abnormal returns at the time of the merger and future performance are higher for BPG acquisitions in FDIC-assisted mergers but not for non-FDIC-assisted acquisitions.

A caveat to our study is that the high correlation between FDIC involvement and the provision of indemnification contracts makes it difficult to separate out other features of FDIC involvement that are not related to the provision of loss indemnification. To address this issue, we conduct a two-stage analysis where the first stage measures the probability of an indemnification agreement. We find that the FDIC offers indemnification agreements for more risky acquisitions reflected through lower CARs at the time of the merger. This finding leads us to conclude that indemnification contracts were an important mechanism to protect depositors, and that the accounting BPG resulting from the use of these contracts were associated with a real economic value transfer that protected the depositors (who now became clients of the acquirer). This value transfer resulted in CAR's both at the time of the merger announcement and over the succeeding year.

In summary, our research provides new insights regarding fair value estimates by looking at differences across BPG and Goodwill acquisitions as well as across FDIC-assisted and non-FDIC-assisted transactions. We find that accounting BPGs are associated with real economic value only in FDIC-assisted transactions where the availability of indemnification contracts ensured that the acquiring bank profited through the transaction. However, in non-FDIC transactions, BPGs are not related to investor valuations and reflect managerial opportunism as argued in prior research.

Appendix A: A Non-FDIC-assisted Bargain Purchase Acquisition

The Business Combination Disclosure in Northeast Bancorp 10-K Annual Report for the Fiscal Year Ended June 30, 2011

Consideration Paid:

(Dollars in Thousands)

FHB investors' purchase of 937,933 existing Northeast shares, at \$13.93 per Surviving Company share	\$	13,065
Existing Northeast shareholders' retention of shares in Surviving Company, 1,393,399 shares at \$13.93 per share		19,410
Total consideration paid:	\$	32,475

Net Assets Acquired:

(Dollars in Thousands)

Assets:

Cash and short-term investments	\$	58,598
Available-for-sale securities		153,315
Loans		369,605
Premises and equipment		7,909
Bank-owned life insurance		13,536
Core deposit intangible		6,348
Other identifiable intangibles		7,865
Other assets		14,409
	\$	631,585

Liabilities and Preferred Equity:

Deposits	\$	378,523
Overnight borrowings		63,043
Term borrowings		125,627
Jr. subordinated debentures issued to affiliated trusts		7,889
Other liabilities		4,492
Preferred stock		4,095
	\$	583,669
Total identifiable net assets	\$	47,916
Consideration paid	\$	32,475
Bargain purchase gain recorded in income	\$	15,441

Appendix B: A FDIC-assisted Bargain Purchase Acquisition

The Business Combination Disclosure in First Bancorp (FBNC) 10-K Annual Report for the
Fiscal Year Ending December 31, 2009

(\$ in thousands)	As Recorded by Cooperative Bank	Fair Value Adjustments	As Recorded by the Company
Assets			
Cash and cash equivalents	\$ 66,096	–	66,096
Securities	40,189	–	40,189
Presold mortgages	3,249	–	3,249
Loans	828,958	(227,854) (a)	601,104
Core deposit intangible	–	3,798 (b)	3,798
FDIC loss share receivable	–	185,112 (c)	185,112
Foreclosed properties	15,993	(3,534) (d)	12,459
Other assets	4,178	(137) (e)	4,041
Total	<u>958,663</u>	<u>(42,615)</u>	<u>916,048</u>
Liabilities			
Deposits	\$ 706,139	5,922 (f)	712,061
Borrowings	153,056	6,409 (g)	159,465
Other	2,227	160 (e)	2,387
Total	<u>861,422</u>	<u>12,491</u>	<u>873,913</u>
Excess of assets received over liabilities	97,241	(55,106)	42,135
Less: Asset discount	(123,000)		
Cash received from FDIC at closing	25,759		<u>25,759</u>
Total gain recorded			<u>\$ 67,894</u>

Explanation of Fair Value Adjustments

- (f) This estimated fair value adjustment was recorded because the weighted average interest rate of Cooperative Bank's time deposits exceeded the cost of similar wholesale funding at the time of the acquisition. This amount will be amortized to reduce interest expense on a declining basis over the average life of the portfolio of approximately 15 months.
- (g) This estimated fair value adjustment was recorded because the interest rates of Cooperative Bank's fixed rate borrowings exceeded current interest rates on similar borrowings. This amount was realized shortly after the acquisition by prepaying the borrowings at a premium, and thus there will be no future amortization related to this adjustment.

Appendix C. Variable Definitions

<i>DBPG</i>	An indicator variable equal to one if an acquirer report bargain purchase gains in year t .
<i>ACQBPG</i>	Acquirer's bargain purchase gains in year t scaled by lagged total assets.
<i>DECLINE</i>	An indicator variable equal to one if an acquirer will experience a loss in income before interests, taxes, and bargain purchase gains in year t .
<i>ΔROABB</i>	Acquirer's change in income before interests, taxes and bargain purchase gains in year t scaled by lagged total assets.
<i>SIZE</i>	Natural logarithm of acquirer's total assets in year $t-1$.
<i>MULTI</i>	An indicator variable equal to one if the acquirer completes more than one acquisition in year t .
<i>Q4</i>	An indicator variable equal to one if the acquisition is completed in the fourth quarter of year t .
<i>CAPR</i>	Acquirer's Tier 1 capital ratio in year $t-1$.
<i>ALTMAN</i>	Acquirer's Altman z-score in year $t-1$.
<i>TARSIZE</i>	Natural logarithm of target's total assets in year $t-1$.
<i>FDIC</i>	An indicator variable equal to one if the acquisition is assisted by the FDIC, and zero otherwise.
<i>ACQFDIC</i>	The level-3 fair value estimate of FDIC indemnification assets acquired over the total assets acquired.
<i>ACQLOAN</i>	The level-3 fair value estimate of loans acquired over the total assets acquired.
<i>ACQOREO</i>	The fair value estimate of other real estate owned acquired over the total assets acquired.
<i>ACQINV</i>	The fair value estimate of inventories acquired over the total assets acquired.
<i>ACQPPE</i>	The fair value estimate of property, plant, and equipment acquired over the total assets acquired.
<i>ACQINTAN</i>	The fair value estimate of intangible assets acquired over the total assets acquired.
<i>ACQDEP</i>	The fair value estimate of deposits acquired over the total assets acquired.

<i>PAYMENT</i>	An indicator variable equal to one if cash is paid, and zero otherwise.
<i>CAR</i>	Cumulative abnormal return surrounding an acquirer's announcement of completion.
<i>LEV</i>	Acquirer's total debt scaled by total equity.
<i>OCF</i>	Acquirer's operational cash flows scaled by lagged total assets.

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Table 1
Sample Selection and Distribution of Bargain Purchase Acquisitions

Panel A: Sample Selection

	Number of Observations
Bargain purchase acquisitions completed over fiscal years 2008 to 2012	412
Drop bargain purchase acquisitions in industries that are not regulated by the FDIC	-252
Drop bargain purchase acquisitions with missing data	-26
Main Sample	134

Panel B: Distribution of Bargain Purchase Acquisitions by Industry

Industry	Two-digit SIC Codes	Number of Observations	Frequency
FDIC-regulated Financial Industries	60	134	47.86%
Non-FDIC-regulated Financial Industries	61, 62, 63, 65, 67	24	8.57%
Non-Financial Industries	All Others	122	43.57%
Total		280	100.00%

Panel C: Distribution of Bargain Purchase Acquisitions by Fiscal Year

Fiscal Year	Number of Observations
2009	27
2010	44
2011	37
2012	26
Total	134

Notes: This table reports sample selection procedures in Panel A, sample distribution by industry in Panel B, and sample distribution by fiscal year in Panel C. The sample spans from 2009 to 2012.

Table 2
Descriptive Statistics

Panel A: Differences across Bargain Purchase Acquisitions and Goodwill Acquisitions

	Bargain Purchase Acquisitions (DBPG = 1)				Matched Goodwill Acquisitions (DBPG = 0)				Mean Diff
	N	Mean	Median	SD	N	Mean	Median	SD	
<i>ACQBPG</i>	134	0.0070	0.0026	0.0113	122	0.0000	0.0000	0.0000	0.0070***
<i>DECLINE</i>	134	0.4701	0.0000	0.5009	122	0.1639	0.0000	0.3717	0.3062***
<i>AROABB</i>	134	0.0002	0.0011	0.0193	122	0.0053	0.0034	0.0083	-0.0051***
<i>SIZE</i>	134	8.0936	7.9565	1.1061	122	8.3189	8.2358	1.2306	-0.2253
<i>MULTI</i>	134	0.5597	1.0000	0.4982	122	0.4918	0.0000	0.5019	0.0679
<i>Q4</i>	134	0.2985	0.0000	0.4593	122	0.2869	0.0000	0.4542	0.0116
<i>CAPR</i>	134	0.1400	0.1296	0.0361	122	0.1416	0.1328	0.0356	-0.0016
<i>ALTMAN</i>	134	3.5909	3.5630	0.1472	122	3.6242	3.6441	0.1711	-0.0333*
<i>TARSIZE</i>	134	5.7446	5.6468	1.0716	122	5.9215	5.9825	1.8907	-0.1769
<i>FDIC</i>	134	0.8134	1.0000	0.3910	122	0.2295	0.0000	0.4223	0.5839***
<i>ACQFDIC</i>	134	0.1395	0.1365	0.1228	122	0.0380	0.0000	0.0854	0.1015***
<i>ACQLOAN</i>	134	0.5766	0.6168	0.2096	122	0.5209	0.6087	0.2666	0.0557*
<i>ACQOREO</i>	134	0.0212	0.0105	0.0232	122	0.0058	0.0000	0.0137	0.0154***
<i>ACQINV</i>	134	0.0847	0.0561	0.0893	122	0.0942	0.0668	0.1015	-0.0095
<i>ACQPPE</i>	134	0.0019	0.0000	0.0065	122	0.0085	0.0017	0.0111	-0.0066***
<i>ACQINTAN</i>	134	0.0055	0.0032	0.0099	122	0.0117	0.0055	0.0187	-0.0062***
<i>ACQDEP</i>	134	0.8519	0.9701	0.3962	122	0.7729	0.8667	0.3682	0.0790
<i>PAYMENT</i>	134	0.1791	0.0000	0.3848	122	0.6311	1.0000	0.4845	-0.4520***

Panel B: Differences across FDIC Acquisitions and Non-FDIC Acquisitions

	Bargain Purchase Acquisitions					Matched Goodwill Acquisitions				
	FDIC		Non-FDIC		Mean Diff	FDIC		Non-FDIC		Mean Diff
	N	Mean	N	Mean		N	Mean	N	Mean	
<i>ACQBPG</i>	109	0.0069	25	0.0074	-0.0005	28	0.0000	94	0.0000	0.0000
<i>DECLINE</i>	109	0.4403	25	0.6000	-0.1597	28	0.2857	94	0.1277	0.1580**
<i>ΔROABB</i>	109	0.0014	25	-0.0051	0.0065	28	0.0074	94	0.0046	0.0028
<i>SIZE</i>	109	8.1857	25	7.6919	0.4938**	28	8.6369	94	8.2243	0.4126
<i>MULTI</i>	109	0.5779	25	0.4800	0.0979	28	0.7143	94	0.4255	0.2888***
<i>Q4</i>	109	0.2752	25	0.4000	-0.1248	28	0.2500	94	0.2979	-0.0479
<i>CAPR</i>	109	0.1425	25	0.1290	0.0135*	28	0.1446	94	0.1407	0.0039
<i>ALTMAN</i>	109	3.5981	25	3.5594	0.0387	28	3.4939	94	3.6631	-0.1692***
<i>TARSIZE</i>	109	5.7587	25	5.6832	0.0755	28	6.5074	94	5.7470	0.7604*
<i>ACQFDIC</i>	109	0.1715	25	0.0000	0.1715***	28	0.1656	94	0.0000	0.1656***
<i>ACQLOAN</i>	109	0.5901	25	0.5179	0.0722	28	0.5731	94	0.5055	0.0676
<i>ACQOREO</i>	109	0.0249	25	0.0052	0.0197***	28	0.0205	94	0.0015	0.0190***
<i>ACQINV</i>	109	0.0805	25	0.1027	-0.0222	28	0.0892	94	0.0957	-0.0065
<i>ACQPPE</i>	109	0.0004	25	0.0083	-0.0079***	28	0.0030	94	0.0101	-0.0071***
<i>ACQINTAN</i>	109	0.0047	25	0.0086	-0.0039*	28	0.0049	94	0.0137	-0.0088**
<i>ACQDEP</i>	109	0.8952	25	0.6633	0.2319***	28	0.9678	94	0.7148	0.2530***
<i>PAYMENT</i>	109	0.0734	25	0.6400	-0.5666***	28	0.3571	94	0.7128	-0.3557***

Notes: This table reports the summary statistics of key variables for the full sample of bargain purchase acquisitions and matched goodwill acquisitions. Panel A displays the differences between bargain purchase acquisitions and goodwill acquisitions. Panel B displays differences between FDIC acquisitions and non-FDIC acquisitions. All continuous variables are winsorized at the 1% and 99% percent levels. Variable definitions are presented in Appendix C. ***, **, and * denote the difference is significant at 1%, 5%, and 10% levels, respectively.

Table 3
Pearson and Spearman Correlations between Variables

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)
(1) <i>ACQBPG</i>		0.44	-0.32	-0.19	0.03	0.04	-0.03	-0.13	-0.01	0.53	0.40	0.07	0.33	0.02	-0.34	-0.19	0.16	-0.44
(2) <i>DECLINE</i>	0.30		-0.81	-0.06	-0.06	0.10	-0.02	0.14	-0.02	0.19	0.11	-0.06	0.11	0.01	-0.10	-0.03	0.06	-0.23
(3) <i>ΔROABB</i>	-0.25	-0.67		0.07	0.15	-0.11	0.05	-0.25	0.05	-0.02	0.06	0.02	0.03	0.01	0.01	0.01	0.02	0.12
(4) <i>SIZE</i>	-0.22	-0.07	0.03		0.09	-0.15	-0.23	0.01	0.31	0.05	0.08	0.01	-0.08	-0.11	-0.09	-0.23	-0.18	-0.02
(5) <i>MULTI</i>	-0.02	-0.06	0.16	0.06		-0.06	0.22	-0.02	-0.13	0.17	0.16	-0.10	0.11	-0.11	-0.15	-0.14	0.08	-0.08
(6) <i>Q4</i>	0.00	0.10	-0.11	-0.14	-0.06		0.05	0.01	0.07	0.05	0.05	0.12	0.00	0.04	0.07	0.04	0.04	0.09
(7) <i>CAPR</i>	-0.03	-0.00	0.08	-0.28	0.23	0.10		0.18	0.02	0.05	0.03	-0.07	0.13	0.01	0.04	0.19	0.13	-0.05
(8) <i>ALTMAN</i>	-0.07	0.12	-0.12	-0.00	-0.02	0.02	0.15		-0.00	-0.24	-0.25	-0.23	-0.17	0.03	0.18	0.07	-0.11	0.15
(9) <i>TARSIZE</i>	0.13	-0.02	-0.01	0.31	-0.09	-0.08	0.02	-0.02		0.01	0.02	0.11	-0.00	0.21	0.14	0.01	-0.07	0.00
(10) <i>FDIC</i>	0.22	0.19	0.00	0.07	0.16	-0.05	0.06	-0.20	0.06		0.80	0.13	0.53	0.01	-0.48	-0.23	0.43	0.57
(11) <i>ACQFDIC</i>	0.12	0.11	0.06	0.12	0.18	-0.06	0.05	-0.18	0.05	0.72		0.21	0.59	0.08	0.41	0.15	0.52	0.39
(12) <i>ACQLOAN</i>	0.04	-0.09	0.03	0.01	-0.07	-0.06	-0.01	-0.18	0.21	0.16	0.26		0.08	0.02	0.03	0.04	0.20	0.06
(13) <i>ACQOREO</i>	0.05	0.11	0.10	-0.02	0.13	-0.01	0.11	-0.10	-0.04	0.52	0.61	0.11		0.29	-0.20	0.01	0.47	-0.22
(14) <i>ACQINV</i>	-0.02	0.02	0.01	-0.04	-0.09	0.01	-0.02	0.09	0.19	-0.08	0.00	0.10	0.13		0.21	0.24	0.21	0.14
(15) <i>ACQPPE</i>	-0.13	-0.11	0.06	-0.12	-0.14	0.10	0.04	0.14	-0.05	-0.46	-0.36	-0.03	-0.23	0.12		0.36	-0.08	0.39
(16) <i>ACQINTAN</i>	-0.09	0.03	-0.01	-0.08	-0.05	0.03	0.07	0.08	-0.38	-0.26	-0.18	-0.27	-0.11	-0.09	0.21		0.07	0.21
(17) <i>ACQDEP</i>	0.03	0.02	0.04	-0.18	-0.03	0.01	0.18	-0.04	0.16	0.27	0.32	0.45	0.36	0.29	-0.02	-0.22		-0.34
(18) <i>PAYMENT</i>	-0.23	-0.23	0.09	-0.02	-0.08	0.09	-0.05	0.13	-0.08	-0.58	-0.35	0.02	-0.24	0.16	0.41	0.23	-0.21	

Notes: This table reports Pearson (lower left) and Spearman (upper right) correlations among main variables in the full sample. Variable definitions are presented in Appendix C. Bold figures indicate significant levels of less than 1%.

Table 4
Logistic Regression of the Probability of Recognizing Bargain Purchase Gains

	Dependent Variable = <i>DBPG</i>					
	(1)		(2)		(3)	
	Full Sample		FDIC Acquisitions		Non-FDIC Acquisitions	
	Coefficient	z-statistic	Coefficient	z-statistic	Coefficient	z-statistic
<i>DECLINE</i>	1.1414**	2.55	0.1061	0.19	2.4156***	3.26
<i>SIZE</i>	-0.4304**	-2.13	-0.4183	-1.36	-0.6093*	-1.82
<i>MULTI</i>	0.1320	0.38	-1.4262**	-2.25	0.9822	1.16
<i>Q4</i>	0.2683	0.65	0.3308	0.56	0.3661	0.46
<i>CAPR</i>	-0.0749	-1.42	-0.1049	-1.15	-0.2692**	-2.28
<i>ALTMAN</i>	-0.1496	-0.12	6.2348***	2.62	-5.5543**	-2.57
<i>TARSIZE</i>	-0.0721	-0.62	-0.3516	-1.43	0.2118	0.75
<i>ACQFDIC</i>	8.6939***	3.68	5.5005**	2.14		
<i>ACQDEP</i>	-0.6849	-0.97	-1.6193	-1.48	0.2557	0.22
<i>PAYMENT</i>	-1.7386***	-5.17	-1.7617***	-2.97	0.5129	0.89
Intercept	6.2043	1.28	-12.4051	-1.37	26.7018***	3.09
Year Fixed Effects	Yes		Yes		Yes	
Total N	256		137		119	
Pseudo R ²	0.3240		0.2909		0.3886	
Wald χ^2	75.48		49.79		26.21	

Notes: This table reports the results of predicting the probability of recognizing bargain purchase gains in the full sample, the FDIC sample, and the non-FDIC sample in columns (1), (2), and (3), respectively. Year fixed effects are included in each model. Standard errors are clustered at the firm level. All continuous variables are winsorized at the 1% and 99% levels. Variable definitions are presented in Appendix C. ***, **, and * indicate statistical significance based on two-tailed t-tests at the 1%, 5%, and 10% levels, respectively.

Table 5
Tobit Regression of the Relation between the Size of Bargain Purchase Gain and Earnings Changes
Dependent Variable = *ACQBP*G

	(1) Full Sample		(2) FDIC Acquisitions		(3) Non-FDIC Acquisitions	
	Coefficient	t-statistic	Coefficient	t-statistic	Coefficient	t-statistic
<i>AROABB</i>	-0.0781	-0.50	-0.0317	-0.21	-0.3746**	-3.31
<i>SIZE</i>	-0.0048***	-2.82	-0.0066***	-3.55	-0.0014	-1.53
<i>MULTI</i>	0.0008	0.39	0.0048	1.60	0.0007	0.36
<i>Q4</i>	-0.0021	-1.14	-0.0032**	-2.26	0.0069**	3.31
<i>CAPR</i>	-0.0005	-1.26	-0.0006	-1.54	0.0012*	2.14
<i>ALTMAN</i>	-0.0029	-0.27	-0.0011	-0.10	-0.0060	-0.91
<i>TAR</i> SIZE	0.0046**	2.30	0.0073***	3.01	-0.0015	-1.67
<i>ACQFDIC</i>	0.0035	0.50	-0.0018	-0.29		
<i>ACQLOAN</i>	-0.0008	-0.19	0.0028	0.73	0.0203**	3.29
<i>ACQOREO</i>	-0.0168	-0.46	-0.0060	-0.15	-0.0570	-1.24
<i>ACQINV</i>	0.0023	0.33	-0.0084	-1.09	0.0152	1.55
<i>ACQPPE</i>	0.1173	0.82	-0.0314	-0.18	0.1276	1.81
<i>ACQINTAN</i>	-0.0905	-1.38	0.0552	-0.91	0.1686**	2.43
<i>ACQDEP</i>	-0.0017	-0.84	-0.0004	-0.19	-0.0363***	-7.79
<i>PAYMENT</i>	-0.0035	-1.52	-0.0077*	-1.88	-0.0109***	-3.81
Intercept	0.0384	1.20	0.0297	0.81	0.0368	1.68
Year Fixed Effects	Yes		Yes		Yes	
Total N	134		109		25	
R ²	-0.0676		-0.0986		-0.3008	

Notes: This table reports the results of estimating the association between the magnitude of bargain purchase gains and acquirers' income before the effect of bargain purchase gains in the full sample, the FDIC sample, and the non-FDIC sample in columns (1), (2), and (3), respectively. Year fixed effects are included in each model. Standard errors are clustered at the firm level. All continuous variables are winsorized at the 1% and 99% levels. Variable definitions are presented in Appendix C. ***, **, and * indicate statistical significance based on two-tailed t-tests at the 1%, 5%, and 10% levels, respectively.

Table 6**Regression of the Relation between the Acquisition Completion Returns and FDIC Assistance****Panel A: Difference across FDIC Acquisitions and Non-FDIC Acquisitions**

	FDIC	Non-FDIC	Difference
<i>CAR (-1, +1)</i>	1.93%***	0.81%	1.12%***
t-statistic	7.06	1.82	5.25
N	128	83	

Panel B: Difference across FDIC and non-FDIC BPG Acquisitions

	FDIC BPG	Non-FDIC BPG	Difference
<i>CAR (-1, +1)</i>	3.32%***	1.14%	2.18%*
t-statistic	4.80	1.06	1.65
N	112	40	
<i>CAR (+1, +30)</i>	4.34%***	3.37%	0.96%
t-statistic	3.60	1.43	0.39
N	112	40	
<i>CAR (+1m, +12m)</i>	8.62%***	-0.55%	9.17%**
t-statistic	2.61	-0.05	2.65
N	115	39	

Panel C: Descriptive Statistics

	N	Mean	Median
<i>CAR (-1, +1)</i>	211	0.0149	0.0101
<i>FDIC</i>	211	0.6066	1
<i>SIZE</i>	211	8.1903	7.997
<i>LEV</i>	211	7.9439	7.9988
<i>ALTMAN</i>	211	3.6036	3.5988
<i>CAPR</i>	211	0.1406	0.126
<i>TAR SIZE</i>	211	5.7671	5.6399
<i>MULTI</i>	211	0.5308	1
<i>Q4</i>	211	0.2891	0
<i>PAYMENT</i>	211	0.3602	0

Panel D: OLS Regression Results

	Dependent Variable = <i>CAR (-1, +1)</i>	
	Coefficient	t-statistic
<i>FDIC</i>	0.0129**	2.1
<i>SIZE</i>	-0.0058***	-3.01
<i>LEV</i>	-0.0013	-1.21
<i>ALTMAN</i>	-0.012	-1.09
<i>CAPR</i>	-0.0007	-1.11
<i>TAR SIZE</i>	0.0048***	3.01
<i>MULTI</i>	0.0082*	1.83

<i>Q4</i>	0	0
<i>PAYMENT</i>	0.0008	0.13
Intercept	0.0972**	2.02
Year Fixed Effects	Yes	
Total N	211	
Adjusted R ²	0.1683	

Notes: This table reports cumulative abnormal returns for FDIC and non-FDIC acquisitions in Panel A and for FDIC and non-FDIC bargain purchase acquisitions in Panel B. Panel C reports the results of estimating the association between cumulative abnormal returns and FDIC assistance. Year fixed effects are included in each model. Standard errors are clustered at the firm level. All continuous variables are winsorized at the 1% and 99% levels. Variable definitions are presented in Appendix C. ***, **, and * indicate statistical significance based on two-tailed t-tests at the 1%, 5%, and 10% levels, respectively.

Table 7
Two-Stage Least Squares Regression of the Relation between the Acquisition Completion Returns and FDIC Indemnification

Panel A: Probit Regression Results on Probability of FDIC Indemnification

	Dependent Variable = <i>FDIC Indemnification</i>	
	Coefficient	z-statistic
<i>ACQLOAN</i>	-2.4672**	-2.18
<i>ACQOREO</i>	8.9921	1.09
<i>ACQINV</i>	-2.5206	-0.89
<i>ACQPPE</i>	27.1594	1.00
<i>ACQINTAN</i>	42.7547	1.13
<i>ACQDEP</i>	-2.2279	-1.38
Intercept	4.2492***	2.77
Year Fixed Effects		Yes
Total N		123
Pseudo R ²		0.1885

Panel B: OLS Regression Results on the Association between Acquisition Completion Returns and FDIC Indemnification

	Dependent Variable = <i>CAR (-1, +1)</i>	
	Coefficient	t-statistic
<i>FDIC Indemnification</i>	-0.0502**	-2.10
<i>SIZE</i>	-0.0108***	-4.22
<i>OCF</i>	-0.0209	-1.38
<i>ALTMAN</i>	-0.0030	-0.13
<i>CAPR</i>	-0.0005	-0.85
<i>TARSIZE</i>	0.0112***	4.60
<i>MULTI</i>	0.0133**	2.29
<i>Q4</i>	-0.0017	-0.26
<i>PAYMENT</i>	-0.0051	-0.48
Intercept	0.1089	1.42
Year Fixed Effects		Yes
Total N		103
Adjusted R ²		0.2407

Notes: This table reports the results of estimating a two-stage least squares regression. Panel A reports the results of predicting the probability of FDIC indemnification. Panel B reports the results of estimating the association between cumulative abnormal returns and predicted FDIC indemnification. Year fixed effects are included in each model. Standard errors are clustered at the firm level. All continuous variables are winsorized at the 1% and 99% levels. Variable definitions are presented in Appendix C. ***, **, and * indicate statistical significance based on two-tailed t-tests at the 1%, 5%, and 10% levels, respectively.