

TESTIMONY OF

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ON

APPROPRIATIONS TO COVER THE GUARANTEES AND
OBLIGATIONS OF THE FORMER FEDERAL SAVINGS
AND LOAN INSURANCE CORPORATION

BEFORE THE

SUBCOMMITTEE ON VA, HUD AND INDEPENDENT AGENCIES
COMMITTEE ON APPROPRIATIONS
UNITED STATES SENATE

10:00 AM
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138 DIRKSEN SENATE OFFICE BUILDING

Madam Chair and members of the Subcommittee, I am pleased to have the opportunity to address the fiscal year 1994 appropriation request of \$1.326 billion to meet the continuing obligations of the former Federal Savings and Loan Insurance Corporation (FSLIC). In addition, I will briefly highlight the progress the Resolution Trust Corporation has made toward realizing savings from expenditure of prior years' appropriations. I also will touch on aspects of the Federal Deposit Insurance Corporation Improvement Act that are subject to appropriation.

OVERVIEW

In order to manage the savings and loan crisis, the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), among many things, established the Resolution Trust Corporation (RTC), the FSLIC Resolution Fund (FRF) and the Savings Association Insurance Fund (SAIF). All assets and liabilities of the former FSLIC were transferred to the FSLIC Resolution Fund. This includes all liabilities arising under the financial assistance agreements and all FSLIC related litigation.

The government's obligation for future savings association failures was transferred to the RTC until September 30, 1993 and the RTC must terminate its operations on or before December 31, 1996. The SAIF was created to replace the FSLIC and will be

available to protect depositors in savings associations that fail after September 30, 1993.

The FSLIC Resolution Fund was established to cover the net liabilities of the old FSLIC. The appropriations we request are made solely to ensure that the obligations of the Federal Government, obligations that are now several years old, are met as they come due.

Operationally, the relationship of the FSLIC Resolution Fund to the Federal Deposit Insurance Corporation is unusual and complex. Under the law, the FDIC has responsibility for the fund but the Resolution Trust Corporation has the authority for renegotiating assistance agreements and notes that have come to be known as the "1988 deals."

All assistance agreements were entered into by the former FSLIC under Section 406(f) of the National Housing Act and were approved by the former Federal Home Loan Bank Board. Assistance transactions were done to facilitate the acquisition of failed or failing thrifts. The impetus for the Bank Board's use of assisted transactions was the lack of liquidity in the FSLIC insurance fund.

In sum, an assistance agreement is a contract between the FSLIC Resolution Fund, as successor to the FSLIC, and an acquirer which

specifies procedures and actions the acquirer must take prior to incurring major expenses or losses that are to be reimbursed by the FSLIC Resolution Fund. Typically, these agreements would include some, but not all, of the following provisions:

- o Payment in cash, or with a note, to cover all or a negotiated amount of the negative net worth of the failed institution(s);
- o Capital loss coverage which provides payment for the difference between book value and net sales proceeds on "covered assets." The amount and nature of covered assets is identified in each agreement;
- o Yield subsidies, which ensure a defined level of return on covered assets;
- o Indemnifications to the acquirer for legal expenses in connection with lawsuits against the failed institution or other contingencies;
- o Loss-sharing arrangements in which the acquirer bears a percentage of loss upon disposition of covered assets;
- o Gain-sharing arrangements, in which a percentage of gain realized on the sale of covered assets above some benchmark,

are provided as an incentive to the acquirer to obtain the maximum price for covered assets;

- o Tax benefit sharing provisions that arise from the acquirers' use of preacquisition net operating losses (NOLs) as well as other tax features of the agreements.
- o Buy out options under which the FDIC may elect to purchase covered assets;
- o Warrants which entitle the FSLIC Resolution Fund to share in any increase in value in the assisted thrift. In some instances, this also may include sharing in earnings;
- o Mark-to-market coverage which may reimburse the acquirer for the difference between book and fair market value of remaining covered assets when the agreement terminates or for goodwill established for assets that are not covered.

Under FIRREA, the physical assets acquired by FSLIC from the closure of failed thrifts were assigned to the FDIC for collection. In addition, the FDIC was assigned responsibility for the administration of 202 assistance agreements with operating institutions. The responsibility for administering the agreements was delegated by the FDIC to the Resolution Trust Corporation between January 1991 and October 1992 since the RTC

was required by law to renegotiate many of these transactions. With the virtual conclusion of the RTC's renegotiation efforts, the management of these functions was reassigned to the FDIC Division of Resolutions.

Considerable progress has been made in winding up the obligations and liquidating the assets inherited from the FSLIC. When we acquired responsibility for these assistance agreements in late 1989, there were 202 assistance agreements outstanding with FSLIC notes totalling nearly \$20 billion and covered assets totalling about \$58 billion. At fiscal year end 1992, 101 agreements remained with only 47 of these considered active. Within the 47 active cases, only \$9.3 billion of covered assets remained as of September 30, 1992. Through December 31, 1992, another \$1 billion in covered assets have been disposed of bringing the balance down to \$8.3 billion. During calendar year 1993, another 21 active agreements will be terminating according to their contractual terms. The remaining 54 inactive cases involve contractually required coverage of certain indemnifications (primarily litigation) provided in the original agreements.

ASSETS IN LIQUIDATION

The FDIC acquired from FSLIC roughly \$14 billion in assets resulting from failed savings and loans. The volume of FSLIC Resolution Fund assets held by the FDIC has been reduced from \$14

billion to about \$5.2 billion as of December 31, 1992. We estimate that approximately \$3 billion in cash generated by the sale of these assets will serve to reduce the amount of future appropriations.

ASSISTANCE AGREEMENTS WITH OPERATING INSTITUTIONS

In prior year's testimony, the RTC outlined several steps that could be taken in our efforts to lower the overall cost of the assistance agreements: (1) prepayment of FSLIC promissory notes; (2) renegotiation of the largest agreements where possible; (3) repurchase of covered assets and the placement of these assets with other managers where cost effective; (4) buyout of smaller agreements to save administrative costs; and (5) further note prepayments and covered asset write-downs with any remaining appropriated funds.

Through the appropriation of additional funds in fiscal years 1991 through 1993, the RTC implemented the cost-savings plan. We are pleased to report that the RTC has essentially completed its renegotiation efforts. During fiscal years 1991 and 1992 and through February 28 of fiscal year 1993, the RTC, on behalf of the FSLIC Resolution Fund, took the following cost-saving steps: 1) prepaid notes aggregating \$18.4 billion; 2) continued to prepay the New West/American Savings Bank intercompany note at

the earliest contractual opportunity; and 3) directed the write down of \$5.1 billion in covered assets.

In addition, the RTC made significant progress in renegotiating the 96 separate 1988 FSLIC assistance agreements for which the FSLIC Resolution Fund had a continuing obligation.

Renegotiations have been completed on all but one 1988 agreement. Attached is a schedule which shows the outlays expended in these activities through January 31, 1993 together with estimates of the present value savings achieved to date. These savings range from roughly \$1.4 billion to the government as a whole before tax benefits, to \$3.1 billion, assuming full use of tax benefits in the period generated.

Current efforts to reduce the cost of these assistance agreements include: facilitating terminations, resolving disputes with assisted institutions, effecting the final resolution of outstanding obligations of the inactive agreements, and continuing to monitor and meet the obligations of the remaining agreements at a minimum cost to the taxpayer. As the FRF obligations decline, so too does the cost associated with the FDIC's administrative responsibilities as they relate to this fund. Therefore, we anticipate reduced FRF administrative costs in the future.

REMAINING FISCAL YEAR 1993 APPROPRIATION

For fiscal year 1993, the FSLIC Resolution Fund anticipates gross cash disbursements of about \$5 billion. This will consist of fiscal year 1993 appropriations of \$2.622 billion and the collection proceeds from receivership assets and miscellaneous receipts of approximately \$966 billion, in addition to a carryover of about \$1.4 billion in obligated appropriations from fiscal year 1992.

FISCAL YEAR 1994 APPROPRIATION

Appropriations for the FSLIC Resolution Fund, unlike most, are not composed of specific line items subject to separate analysis and funding decisions. Rather, the request calls for a single line item driven by economic estimates, and a pace of doing business by, and with, holders of major assistance agreements. The required funding is the difference between other FSLIC Resolution Fund funding sources, principally collections from the sale of the Fund's assets, and the obligations due for payment during the fiscal year.

Because the renegotiation process will be completed before fiscal 1994, the timing of the remaining contractual obligations of FRF should not significantly change. There are however, variables within assistance agreements that may cause future payments to

vary from present estimates. The amount of payments may vary as the result of interest rates changes, the loss on covered assets and other similar variables that impact the liability of the FRF. In addition, the outcome in 1993 of the remaining renegotiation may impact the amount and timing of the payments on FRF's present obligations.

Based on our current estimates, FRF will need fiscal year 1994 appropriations of \$1.326 billion. This is down considerably from our 1992 and 1993 appropriation requests of \$15.9 and \$2.6 billion respectively. We anticipate total cash needs of approximately \$2.3 billion for fiscal year 1994. This will be covered by cash receipts of approximately \$776 million from the liquidation of assets and other sources in fiscal year 1994, our appropriation request \$1.326 billion and the carry over of obligations of about \$300 million from fiscal 1993 appropriations.

In our fiscal year 1993 appropriation hearings, we indicated that FRF could be close to self funding in fiscal year 1994. However, we also indicated that our analysis depended on factors that are not totally within our control -- such as the strength of the economy and the market value and liquidity of FSLIC Resolution Fund receivership assets. In addition, that premise was built on the basis of our appropriation request of \$15.9 billion for fiscal year 1992 and a request of \$6.7 billion for fiscal year

1993. These requests were based on the expected timing of certain large FRF obligations. In fiscal year 1992, we had hoped to be able to prepay the "New West Note" and had requested \$6.5 billion for that purpose. Negotiations were protracted and extended beyond fiscal year 1992. Instead of prepaying the New West note, the RTC was able to pay off three smaller notes. These notes did not require the full \$6.5 billion that was planned and as a result \$1.6 billion of our fiscal year 1992 appropriations lapsed.

The New West negotiations are continuing and were again planned for in fiscal year 1993. At the time, after the maximum payments allowed under the note were made, the anticipated funding necessary to prepay was about \$4 billion. Negotiations did not result in accelerated prepayment rights subsequent to our testimony last year and our actual 1993 appropriation was reduced to \$2.6 billion. The New West obligation must still be paid in subsequent years, giving rise to our modest appropriations request for fiscal year 1994.

PROVISIONS OF THE FDIC IMPROVEMENT ACT

We will comment briefly on the FDIC's progress in implementing two programs created by the House Banking Committee and authorized by the Federal Deposit Insurance Corporation

Improvement Act of 1991. Both programs are subject to appropriations.

FDIC AFFORDABLE HOUSING

As you are aware, the FDIC Improvement Act of 1991 required the Corporation to implement an Affordable Housing Program upon appropriation of funds by Congress. This legislation authorized appropriations of up to \$30 million to reimburse the FDIC for losses on properties with additional funds available for any additional administrative expenses associated with running the program. For fiscal year 1993, \$5 million was appropriated.

In spite of limited funding, we have made a substantial effort to comply with the letter and spirit of the law and accommodate low- and moderate-income purchasers of our properties. Over the last year, we have succeeded in implementing a nationwide program and have worked effectively with state and federal agencies, non-profits and financing sources such as banks. Notably, the FDIC worked with a consortium of New England banks, coordinated by the Massachusetts Banking Association, to conduct three affordable housing auctions. The consortium banks provided financing on many FDIC sales.

The success of the program was, in large part, made possible by the Congress allowing the FDIC to modify the statutory program to

allow a more cost-effective administration of the program. Without this discretion, the FDIC had projected administrative costs for the program to run as high as \$6.5 million. Under the current program, only \$2 million is anticipated to be spent on administration of this nationwide program.

Prior to receiving the fiscal year 1993 appropriation, the FDIC voluntarily implemented a limited program on March 31, 1992, restricting the sale of eligible single-family and condominium property for 180 days to households with incomes less than 115% of the area's median income as adjusted for family size. Non-profits and government agencies were also eligible to purchase these properties if they would use the purchased properties as affordable housing. Since no funds were appropriated, the program was run on a cost neutral basis. In calendar year 1992, under the voluntary program, the FDIC sold 705 housing units to qualified purchasers for \$20.8 million.

In October 1992, Congress appropriated \$5 million for losses and administrative expenses associated with the program. Because the funding was less than originally anticipated, the funding legislation allowed the FDIC to modify the program in a manner which would best utilize the limited amount of funds. The modified program is, in most respects, similar to the voluntary program implemented in March. The primary difference in the appropriated program is that the FDIC provides rebates or

discounts in an amount of up to ten percent of the sales price as assistance to qualified purchasers. This subsidy can be used in a number of ways: (1) two-to-one matching of down payment money (e.g., a buyer who can contribute \$1,500 would be eligible for an additional \$3,000 from the FDIC to be applied to the down payment.); (2) to cover necessary rehabilitation; (3) to buy down mortgage points and to cover closing cost; (4) to cover costs for any required buyer counseling; or (5) for direct discounts on purchases.

As of February 29, 1993, under the appropriated program, the FDIC has sold an additional 468 housing units to qualified purchasers consisting of 268 1-4 family residences and 200 units in a single room occupancy facility. \$1.1 million in rebates and discounts are committed for these sales. Given these results, we anticipate that the FDIC can provide assistance on the sale of over 700 housing units, representing sales of about \$30 million, during fiscal year 1993.

The FDIC can effectively utilize any funds, up to the authorized \$30 million, appropriated for the upcoming 1994 fiscal year. Additional money could be used for sales of multi-family properties which cannot be supported under current appropriations levels. The discounts associated with a multi-family program could easily meet or exceed the \$30 million authorized for the program. Also, additional subsidies could be used to provide

more assistance to low-and moderate-income purchasers of single family properties. Assuming that the FDIC can retain the flexibility to modify the program, any level of funding up to the authorized amount could be used effectively.

BANK ENTERPRISE ACT

Section 231 of the FDIC Improvement Act of 1991, termed the "Bank Enterprise Act", is designed to encourage insured depository institutions to provide deposit and loan services to economically disadvantaged borrowers and communities through reductions in FDIC insurance premiums. The specific programs authorized are: (1) reduced assessment rates for insured depository institutions offering "lifeline" accounts; and, (2) community enterprise assessment credits ("CEACs") towards deposit insurance premiums for insured depository institutions making loans and taking deposits in distressed communities.

The FDIC does not have sufficient data to permit a precise estimate of the costs of these programs because the cost would vary depending on the response by consumers and depository institutions to these programs. To illustrate this, approximately \$3.2 trillion is held in domestic deposits at FDIC-insured institutions, including both commercial banks and thrift institutions. For each one percent of deposits attributed to lifeline accounts, the assessments amount to \$74 million per

year, based on a deposit insurance premium of 23 basis points. With a 50 percent assessment credit, the cost of each one percent deposit share amounts to \$37 million per year. Consumer use of lifeline accounts will depend on how the accounts are defined and whether the reduced assessment is sufficient to make offering such accounts cost effective.

Community Enterprise Assessment Credits are generated from increases in loans made to distressed communities. Furthermore, institutions with branches in distressed communities can earn credits for increases in any deposits taken, and any loans or other investments made within distressed communities by those branches. The amount of this credit varies depending on whether an institution meets the criteria to qualify as a community development organization. Without such qualification, the assessment credit can be as high as 5 percent of the increase in loans made plus the increase in deposits taken, except deposits that exceed the volume of loans made are not counted. The credit can be as high as 15 percent for institutions that qualify as community development organizations. The total credit for an institution is subject to a cap of 20 percent of total assessments or 50 percent of total assessments for a qualified community development organization.

For example, a bank that qualified as a community development organization could receive a \$15,000 credit for each \$100,000

increase in qualifying loans. If the bank also increased qualifying deposits by the same amount it could receive an additional credit of another \$15,000. The impact of these incentives could be substantial with the limits imposed on total assessment credits being the binding constraint.

On October 6, 1992, Congress provided \$1 million in appropriations to cover fiscal year 1993 costs incurred by the FDIC and other designated government agencies for beginning preliminary study, design and development for programs authorized by the Bank Enterprise Act (BEA).

Specifically, the funding was to cover estimated administrative expenses for issuing minimum requirements and guidelines for the two BEA programs. The appropriation did not provide funding to offset assessment credits to depository institutions offering lifeline accounts or increased lending to distressed communities. The funds were provided to the FDIC only because the CEAC Board had not been organized and the FDIC along with the Federal Reserve Board are responsible for developing the lifeline account concept.

In the interim, the FDIC has established a billing system to capture BEA-related costs incurred by staff at the FDIC and other Federal agencies who are identifying and studying relevant

issues. Reimbursement will be limited to \$1 million in fiscal year 1993. However, no funds have been disbursed yet.

The BEA established the CEAC Board and charged it with issuing guidelines that would permit the prompt commencement of program operations should Congress provide funding in future years for reduced deposit insurance assessments and assessment credits.

The CEAC Board is to be comprised of the Secretary of the Department of Housing and Urban Development and the Chairman of the FDIC, plus two Presidential appointees representing community organizations, and chaired by the Secretary of the Treasury. The FDIC has written to the Secretary of the Treasury to request the expeditious organization of the CEAC Board. However, the Presidential appointments have not yet been made.

In the meantime, the FDIC established an interagency working group to discuss and identify issues which could be affected by the legislation. The group met with Congressional staff on several occasions to correct deficiencies in the original language and discussed going ahead with working on related projects to the extent it could without a CEAC Board. However, action on assessment credits for qualifying activities relating to distressed communities cannot go forward until the CEAC Board is established and functioning.

The definition, guidelines and policies with regard to lifeline accounts are being formulated now and should be ready for Federal Reserve System and FDIC Board review by early May. A 60-day comment period is proposed before finalizing the requirements.

Madam Chair, this concludes my prepared statement. I would be happy to respond to any questions that you may have.

Monthly Activity Report
1988-89 FSLIC Assistance Agreements
Summary of Cash Expended and Savings Achieved
(\$Millions)

Exhibit 1.

Report Date: January 31, 1993

Action Taken	MONTHLY ACTIVITY			FY91, FY 92 and YTD FY 93 ACTIVITY		
	Cash Outlay	Present Value		Cash Outlay	Present Value	
		Estimated Cost Savings	Minimum * Maximum **		Estimated Cost Savings	Minimum * Maximum **
FSLIC Note Prepayments						
Investor-Owned	193.9	15.7	25.7	7,297.0	519.5	1,083.6
Government-Controlled	0.0	N/A	N/A	4,363.6	N/A	N/A
Covered Asset Write-downs						
Investor-Owned	0.0	0.0	0.0	4,874.4	280.5	501.1
Government-Controlled	0.0	N/A	N/A	249.4	N/A	N/A
Covered Asset Purchases						
Investor-Owned	0.0	0.0	0.0	0.0	0.0	0.0
Government-Controlled	0.0	N/A	N/A	0.0	N/A	N/A
Renegotiations						
Investor-Owned	357.5	10.0	10.0	6,490.9	133.8	848.4
Government-Controlled	0.0	N/A	N/A	0.0	N/A	N/A
Settlements						
Investor-Owned	0.0	0.0	0.0	461.7	20.7	29.7
Government-Controlled	0.7	N/A	N/A	4,813.7	N/A	N/A
Other Activities						
Investor-Owned	0.0	0.0	0.0	2,251.6	424.5	534.0
Government-Controlled	0.0	N/A	N/A	0.0	N/A	N/A
Totals						
Investor-Owned	551.3	25.7	35.7	21,375.5	1,379.0	2,996.8
Government-Controlled	0.7	N/A	N/A	9,426.7	N/A	N/A

- * Minimum Cost Savings is the present value cost savings to the Federal Government, as a whole, assuming no tax benefits utilized.
- ** Maximum Cost Savings is the present value cost savings to the Federal Government, as a whole, assuming full use of tax benefits in the period generated.