

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

9:30 AM  
APRIL 2, 1992  
116 DIRKSEN SENATE OFFICE BUILDING

Madam Chair and members of the Subcommittee, I am pleased to have the opportunity to address the fiscal year 1993 appropriation request of \$6.772 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 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 the receiver for 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, 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 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 subsequently assigned by the FDIC to the Resolution Trust Corporation since it was the RTC that was required by law to renegotiate many of these transactions.

We believe we have come a long way toward 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. Presently there remain 131 active assistance agreements. FSLIC notes have been reduced to approximately \$2.4 billion and covered assets to about \$14 billion as of December 31, 1991.

#### ASSETS IN LIQUIDATION

The FDIC also 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 \$8.9 billion as of December 31, 1991. The additional funds generated by FDIC asset sales, combined with assessment income from SAIF premiums, serve to reduce the size of the annual appropriation. However, SAIF premiums are no longer available to the FSLIC Resolution Fund after 1992.

#### 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 both fiscal years 1991 and 1992, the RTC implemented the cost-savings plan. We are pleased to report substantial progress. During fiscal year 1991 and through February 29 of fiscal year 1992 the RTC, on behalf of the FSLIC Resolution Fund, took the following cost-savings steps: 1) Prepaid notes aggregating \$16.0 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 \$4.2 billion in covered assets through December 31, 1991.

In addition, the RTC made significant progress in renegotiating the 96 separate assistance agreements for which the FSLIC Resolution Fund had a continuing obligation. Renegotiations have been completed on 43 agreements and another 19 agreements are in process. There were 24 agreements that expired according to their original terms and a final 10 remain to be addressed. Attached is a schedule which shows the outlays expended in these activities through February 29, 1992 together with estimates of the present value savings achieved to date.

These savings range from roughly \$1.2 billion to the government as a whole before tax benefits, to \$2.4 billion, assuming full use of tax benefits in the period generated.

The RTC also made substantial progress in its efforts to restructure or dispose of about \$1.1 billion of assistance transaction related capital instruments owned by the FSLIC Resolution Fund. These instruments took a variety of forms including preferred stock, subordinated debt, warrants and income capital and/or net worth certificates. Upon passage of FIRREA, these instruments no longer could be counted as core capital. As of December 1991, approximately 93% of these instruments have either been redeemed, restructured or written off. As a result, several large thrifts were able to have their capital plans approved by the Office of Thrift Supervision. This salvaged value for our investment and avoided potentially more exposure by reducing the possibility of failure of the institutions.

#### REMAINING FISCAL YEAR 1992 APPROPRIATION

For fiscal year 1992, the FSLIC Resolution Fund anticipates gross cash inflows of about \$19.0 billion. This will consist of fiscal year 1992 appropriations of \$15.9 billion and the collection proceeds from receivership assets, SAIF assessments and miscellaneous receipts of approximately \$1.8 billion, in

addition to a carryover of about \$1.3 billion in obligated appropriations from fiscal year 1991.

Payments required for contractual obligations from existing agreements and administrative costs are estimated at about \$4.8 billion. During fiscal year 1992 we have expended, or have committed to spend, about \$6.0 billion to renegotiate notes and agreements. Thus, as of February 29, 1992, there remains approximately \$7.0 billion in discretionary funds available through September 30, 1992 for continuing renegotiations, modifications and restructuring of the 1988-89 FSLIC Assistance Agreements. This total does not include approximately \$1.2 billion held in reserve for potential increases in contractual obligations during the remainder of the fiscal year. While it is necessary to keep plans fluid as renegotiations continue, the anticipated uses of funds are as follows:

- o \$3.4 billion for renegotiations;
- o \$2.5 billion for the termination of agreements with institutions under RTC control;
- o \$600 million (net) for New West intercompany note prepayments; and
- o \$500 million for further directed write-downs.

The \$2.5 billion estimate of the amount necessary to terminate the agreements with institutions under RTC control will not be spent in the current fiscal year if renegotiation savings can be achieved by accelerating obligations due at privately-held institutions. Any part of the 1992 appropriation which cannot be appropriately obligated will lapse.

FISCAL YEAR 1993 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.

The amount of appropriations requested in the President's budget for 1993 represents the upper end of a range of possibilities that depend on how events unfold in 1992. If particular obligations can be prepaid or renegotiated in 1992 they will not need funding in 1993. Unfortunately, successful renegotiations cannot be guaranteed and therefore funding must be sufficient to provide for these obligations in 1993 should it continue to be required.

For fiscal year 1993 we anticipate total cash needs of between \$5.2 billion and \$7.0 billion including a rollover of \$500 million from the previous year. The difference largely represents funds for termination of agreements with institutions controlled by the RTC if such agreements are not terminated in 1992. The base need of \$5.2 billion will provide for contractual obligations of ongoing agreements and optional note prepayments. We project non-appropriated cash receipts of approximately \$1.0 billion from the liquidation of assets and other sources in fiscal year 1993. This results in a projected shortfall ranging from \$4.2 billion to \$6.0 billion which will require appropriated funds. However, this estimate is highly dependent on real estate values and the general state of the economy. The Administration's request for an appropriation of \$6.772 billion would provide adequate funds for the FSLIC Resolution Fund under any scenario.

#### FUTURE FRF APPROPRIATIONS

We anticipate the process of renegotiating the "1988 FSLIC deals" should be completed in fiscal year 1992. Although we cannot say with certainty, presently it appears the FSLIC Resolution Fund should be close to self-funding in fiscal year 1994. This depends 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. Nevertheless, any appropriations needed in fiscal year 1994 should be very modest in relation to past requests and the request before you for fiscal year 1993.

#### NEW PROVISIONS OF THE FDIC IMPROVEMENT ACT

We will comment briefly on the FDIC's plans for 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. Neither of these programs -- as provided for in section 241, FDIC Affordable Housing Program and section 231, Bank Enterprise Act, were proposed by the FDIC. However, we are evaluating approaches to implementing these programs in cooperation with the other agencies involved.

#### FDIC AFFORDABLE HOUSING

Full implementation of an affordable housing program, as envisioned by the statute, is subject to the availability of appropriated funds. The Act envisions a separate annual appropriation of \$30 million for "losses" under the affordable housing program. We expect that "losses" will be incurred primarily from the sale of multifamily properties and low-cost financing to be offered by the FDIC at its option, as provided for under the Act. Substantial losses on the sale of single family and condominium properties are not anticipated.

On March 1, 1992, the FDIC implemented an affordable housing program that complies with many of the provisions of section 241. The remaining provisions of the section 241 will require an appropriation to fully implement -- particularly provisions relating to multifamily properties. Once funds are appropriated, we anticipate little delay in implementing the balance of the program. The current estimated annual cost of personnel, and related training, travel, supplies and overhead is \$10 million.

The program we are implementing involves a dedicated staff to work closely with potential purchasers, national and state agencies and local groups to find financing, advertise our program, counsel buyers and qualify potential purchasers.

The program that became effective on March 1, 1992 includes:

1. Restricting for 180 days, the purchase of eligible single family and condominium housing to eligible individuals under the Act (except for current tenants).
2. Notifying state clearinghouses of the availability of single family properties as potential low-income housing.

3. Requiring a profit recapture on any resales within twelve months.
4. Notifying state clearinghouses of the availability of multifamily properties as potential low-income housing.
5. Contacting other agencies to learn of potential financing programs and specifics of their affordable housing programs.

#### 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 provisions of section 231 authorizing these programs do not take effect until appropriations are provided. Although the data are not sufficient to permit a precise estimate of the

costs of these programs, it may be worthwhile to illustrate how the costs may vary depending on response by consumers and depository institutions to these programs.

Approximately \$2.6 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 \$60 million per year, based on the current deposit insurance premium of 23 basis points. With a 50 percent assessment credit, the cost of each one percent deposit share amounts to \$30 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 low and moderate income borrowers in 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 or not an institution meets the criteria to qualify as a community development organization. Without such qualification, the assessment credit is equal to 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 is 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.

Deposit insurance assessment credits could be powerful incentives in the early period of this program. In addition to the normal interest and fees charged, a bank could receive an additional 5 to 15 percent of the loan in the form of an assessment credit. For example, a bank that qualified as a community development organization would 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 would receive an additional credit of another \$15,000. No program in the past has provided similar incentives to depository institutions and the impact could be substantial. In fact, the limits imposed on total assessment credits would likely function as the binding constraint.

The FDIC is identifying needed regulatory and administrative changes so that we are positioned to move quickly should appropriations be made available for the Bank Enterprise Act. We believe that if appropriations were made by mid-year, we would be positioned to have these programs fully implemented for the first deposit insurance premium assessment period of 1993.

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

FY91 and YTD FY92 ACTIVITY  
 1988-89 FSLIC ASSISTANCE AGREEMENTS  
 SUMMARY OF CASH EXPENDED AND SAVINGS ACHIEVED  
 (\$MILLIONS)

Report Date: February 29, 1992

Action Taken	Cash Outlay	Present Value Estimated Cost Savings	
		Minimum*	Maximum**
<b>FSLIC Note Prepayments</b>			
Investor-Owned	7,092.9	503.9	1,057.7
Government-Controlled	4,363.6	N/A	N/A
<b>Covered Asset Write-downs</b>			
Investor-Owned	3,985.8	218.8	400.9
Government-Controlled	249.4	N/A	N/A
<b>Renegotiations</b>			
Investor-Owned	3,148.5	172.0	609.0
Government-Controlled	0.0	N/A	N/A
<b>Settlements</b>			
Investor-Owned	458.6	20.3	29.3
Government-Controlled	2,372.6	N/A	N/A
<b>Other Activities</b>			
Investor-Owned	1,680.9	259.6	333.3
Government-Controlled	0.0	N/A	N/A
<b>Totals</b>			
Investor-Owned	16,366.7	1,174.5	2,430.2
Government-Controlled	6,985.5	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.