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U.S. DEPARTMENT OF THE TREASURY

PRESS RELEASES

TREASURY NEWS

partment of the Treasury • Washington, D.C. • Telephone 566-2041

CONTACT: Office of Financing
202/376-4350

FOR IMMEDIATE RELEASE
January 3, 1989

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,214 million of 13-week bills and for $7,212 million of 26-week bills, both to be issued on January 5, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing April 6, 1989			:	26-week bills maturing July 6, 1989		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	8.22%	8.51%	97.922	:	8.35% a/	8.84%	95.779
High	8.25%	8.54%	97.915	:	8.38%	8.87%	95.763
Average	8.24%	8.53%	97.917	:	8.37%	8.86%	95.769

a/ Excepting 1 tender of $2,000,000.

Tenders at the high discount rate for the 13-week bills were allotted 22%.
Tenders at the high discount rate for the 26-week bills were allotted 44%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 45,160	$ 44,850	:	$ 38,710	$ 38,710
New York	24,305,975	6,107,185	:	21,126,955	6,056,435
Philadelphia	35,295	35,295	:	25,210	25,210
Cleveland	39,395	39,395	:	40,840	40,660
Richmond	68,330	58,330	:	46,930	46,930
Atlanta	47,660	46,725	:	34,430	34,430
Chicago	2,314,260	175,860	:	944,025	206,825
St. Louis	66,635	45,350	:	44,675	39,405
Minneapolis	14,260	12,310	:	13,955	13,955
Kansas City	58,570	58,570	:	49,300	49,300
Dallas	42,890	32,890	:	31,195	21,195
San Francisco	1,572,310	109,655	:	1,355,690	186,690
Treasury	447,135	447,135	:	451,845	451,845
TOTALS	$29,057,875	$7,213,550	:	$24,203,760	$7,211,590
Type					
Competitive	$25,174,135	$3,329,810	:	$19,095,850	$2,103,680
Noncompetitive	1,314,755	1,314,755	:	1,109,960	1,109,960
Subtotal, Public	$26,488,890	$4,644,565	:	$20,205,810	$3,213,640
Federal Reserve	2,421,335	2,421,335	:	2,300,000	2,300,000
Foreign Official Institutions	147,650	147,650	:	1,697,950	1,697,950
TOTALS	$29,057,875	$7,213,550	:	$24,203,760	$7,211,590

An additional $19,350 thousand of 13-week bills and an additional $265,950 thousand of 26-week bills will be issued to foreign official institutions for new cash.

1/ Equivalent coupon-issue yield.

NB-96

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M.
January 3, 1989

CONTACT: Office of Financing
202/376-4350

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $14,400 million, to be issued January 12, 1989. This offering will provide about $ 350 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $14,051 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Standard time, Monday, January 9, 1989. The two series offered are as follows:

91-day bills (to maturity date) for approximately $ 7,200 million, representing an additional amount of bills dated April 14, 1988, and to mature April 13, 1989 (CUSIP No. 912794 RS 5), currently outstanding in the amount of $16,491 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $ 7,200 million, to be dated January 12, 1989, and to mature July 13, 1989 (CUSIP No. 912794 SQ 8).

The bills will be issued on a discount basis under competitive and noncompetitive bidding, and at maturity their par amount will be payable without interest. Both series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, on the records either of the Federal Reserve Banks and Branches, or of the Department of the Treasury.

The bills will be issued for cash and in exchange for Treasury bills maturing January 12, 1989. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rates of accepted competitive tenders. Additional amounts of the bills may be issued to Federal Reserve Banks, as agents for foreign and international monetary authorities, to the extent that the aggregate amount of tenders for such accounts exceeds the aggregate amount of maturing bills held by them. Federal Reserve Banks currently hold $ 1,808 million as agents for foreign and international monetary authorities, and $ 3,878 million for their own account. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 5176-1 (for 13-week series) or Form PD 5176-2 (for 26-week series).

Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. This information should reflect positions held as of one-half hour prior to the closing time for receipt of tenders on the day of the auction. Such positions would include bills acquired through "when issued" trading, and futures and forward transactions as well as holdings of outstanding bills with the same maturity date as the new offering, e.g., bills with three months to maturity previously offered as six-month bills. Dealers, who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities, when submitting tenders for customers, must submit a separate tender for each customer whose net long position in the bill being offered exceeds $200 million.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

Payment for the full par amount of the bills applied for must accompany all tenders submitted for bills to be maintained on the book-entry records of the Department of the Treasury. A cash adjustment will be made on all accepted tenders for the difference between the par payment submitted and the actual issue price as determined in the auction.

No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches. A deposit of 2 percent of the par amount of the bills applied for must accompany tenders for such bills from others, unless an express guaranty of payment by an incorporated bank or trust company accompanies the tenders.

Public announcement will be made by the Department of the Treasury of the amount and yield range of accepted bids. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. Subject to these reservations, noncompetitive tenders for each issue for $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. Cash adjustments will be made for differences between the par value of the maturing bills accepted in exchange and the issue price of the new bills. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

If a bill is purchased at issue, and is held to maturity, the amount of discount is reportable as ordinary income on the Federal income tax return of the owner for the year in which the bill matures. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, any gain in excess of the basis is treated as ordinary income.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76, 27-76, and 2-86, as applicable, Treasury's single bidder guidelines, and this notice prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars, guidelines, and tender forms may be obtained from any Federal Reserve Bank or Branch, or from the Bureau of the Public Debt.

10/87

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M.
January 4, 1989

CONTACT: Office of Financing
202/376-4350

TREASURY TO AUCTION $7,000 MILLION OF 7-YEAR NOTES

The Department of the Treasury will auction $7,000 million of 7-year notes to refund $3,296 million of 7-year notes maturing January 15, 1989, and to raise about $3,700 million new cash. The public holds $3,296 million of the maturing 7-year notes, including $535 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities.

The $7,000 million is being offered to the public, and any amounts tendered by Federal Reserve Banks as agents for foreign and international monetary authorities will be added to that amount. Tenders for such accounts will be accepted at the average price of accepted competitive tenders.

In addition to the public holdings, Government accounts and Federal Reserve Banks, for their own accounts, hold $212 million of the maturing securities that may be refunded by issuing additional amounts of the new notes at the average price of accepted competitive tenders.

Details about the new security are given in the attached highlights of the offering and in the official offering circular.

oOo

Attachment

NB-98

HIGHLIGHTS OF TREASURY
OFFERING TO THE PUBLIC
OF 7-YEAR NOTES
TO BE ISSUED JANUARY 17, 1989

January 4, 1989

Amount Offered:
To the public .... $7,000 million

Description of Security:
Term and type of security .... 7-year notes
Series and CUSIP designation E-1996
(CUSIP No. 912827 XB 3)
Maturity date .... January 15, 1996
Interest rate .... To be determined based on the average of accepted bids
Investment yield .... To be determined at auction
Premium or discount .... To be determined after auction
Interest payment dates .... July 15 and January 15
Minimum denomination available .. $1,000

Terms of Sale:
Method of sale .... Yield auction
Competitive tenders .... Must be expressed as an annual yield, with two decimals, e.g., 7.10%
Noncompetitive tenders .... Accepted in full at the average price up to $1,000,000
Accrued interest payable by investor .... None

Payment Terms:
Payment by non-institutional investors .... Full payment to be submitted with tender
Payment through Treasury Tax and Loan (TT&L) Note Accounts ... Acceptable for TT&L Note Option Depositaries
Deposit guarantee by designated institutions .... Acceptable

Key Dates:
Receipt of tenders .... Wednesday, January 11, 1989, prior to 1:00 p.m., EST
Settlement (final payment due from institutions):
a) funds immediately available to the Treasury .. Tuesday, January 17, 1989
b) readily-collectible check .. Thursday, January 12, 1989

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

CORRECTED COPY

FOR IMMEDIATE RELEASE
January 6, 1989

CONTACT: Office of Financing
202/376-4350

TREASURY'S 52-WEEK BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for approximately $9,000 million of 364-day Treasury bills to be dated January 19, 1989, and to mature January 18, 1990 (CUSIP No. 912794 TM 6). This issue will result in a paydown for the Treasury of about $425 million, as the maturing 52-week bill is outstanding in the amount of $9,437 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Standard time, Thursday, January 12, 1989.

The bills will be issued on a discount basis under competitive and noncompetitive bidding, and at maturity their par amount will be payable without interest. This series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, on the records either of the Federal Reserve Banks and Branches, or of the Department of the Treasury.

The bills will be issued for cash and in exchange for Treasury bills maturing January 19, 1989. In addition to the maturing 52-week bills, there are $13,791 million of maturing bills which were originally issued as 13-week and 26-week bills. The disposition of this latter amount will be announced next week. Federal Reserve Banks currently hold $2,229* million as agents for foreign and international monetary authorities, and $6,302 million for their own account. These amounts represent the combined holdings of such accounts for the three issues of maturing bills. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rate of accepted competitive tenders. Additional amounts of the bills may be issued to Federal Reserve Banks, as agents for foreign and international monetary authorities, to the extent that the aggregate amount of tenders for such accounts exceeds the aggregate amount of maturing bills held by them. For purposes of determining such additional amounts, foreign and international monetary authorities are considered to hold $ 380 million of the original 52-week issue. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 5176-3.

*NOTE: The original press release of 12:00 noon today misstated the amount held on behalf of foreign and international monetary authorities. The correct amount is $2,229 million. All other particulars of the original release remain the same.

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Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. This information should reflect positions held as of one-half hour prior to the closing time for receipt of tenders on the day of the auction. Such positions would include bills acquired through "when issued" trading, and futures and forward transactions as well as holdings of outstanding bills with the same maturity date as the new offering, e.g., bills with three months to maturity previously offered as six-month bills. Dealers, who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities, when submitting tenders for customers, must submit a separate tender for each customer whose net long position in the bill being offered exceeds $200 million.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

Payment for the full par amount of the bills applied for must accompany all tenders submitted for bills to be maintained on the book-entry records of the Department of the Treasury. A cash adjustment will be made on all accepted tenders for the difference between the par payment submitted and the actual issue price as determined in the auction.

No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches. A deposit of 2 percent of the par amount of the bills applied for must accompany tenders for such bills from others, unless an express guaranty of payment by an incorporated bank or trust company accompanies the tenders.

Public announcement will be made by the Department of the Treasury of the amount and yield range of accepted bids. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. Subject to these reservations, noncompetitive tenders for each issue for $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. Cash adjustments will be made for differences between the par value of the maturing bills accepted in exchange and the issue price of the new bills. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

If a bill is purchased at issue, and is held to maturity, the amount of discount is reportable as ordinary income on the Federal income tax return of the owner for the year in which the bill matures. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, any gain in excess of the basis is treated as ordinary income.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76, 27-76, and 2-86, as applicable, Treasury's single bidder guidelines, and this notice prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars, guidelines, and tender forms may be obtained from any Federal Reserve Bank or Branch, or from the Bureau of the Public Debt.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

Text As Prepared
Embargoed for Release
Upon Delivery Expected at 11:00 a.m. EST

Statement By
Secretary of the Treasury
Nicholas F. Brady
at the Press Briefing
On the Release of President Reagan's 1990 Budget
Monday, January 9, 1989

Good morning, ladies and gentlemen, and Happy New Year.

1988 was a year in which the longest peacetime economic expansion in recent U.S. history continued. It was a year of further constructive action in coordinating economic policies with our major trading partners; and it was a year in which we continued to attack the problem of our fiscal deficit.

Granting that there is always more to do, President Reagan's budget for 1990 provides a framework for continued progress. In particular, it provides a framework for reaching the Gramm-Rudman-Hollings (GRH) targets without resorting to increases in the taxes on the American people and outlines a plan to further reduce the fiscal deficit.

The progress we have made in 1988 is demonstrated in several ways. First, the economy has completed the 73rd month of economic expansion, with real economic growth averaging 4-1/4 percent annually since the expansion began late in 1982. In fact, the expansion continued in 1988 at an annual rate of 3.3 percent excluding the effects of the drought.

The vibrancy and strength of our economy helped once again to reduce unemployment rates to the lowest levels in over a decade as nonfarm payroll jobs increased more than 3.7 million in 1988. Perhaps as important, inflation has been held in check, at about the 1987 levels despite effects of the drought, with growth in the Consumer Price Index under 4-1/2 percent. It is no small achievement to sustain growth, check inflation, and provide more jobs for more people all at the same time.

NB-100

Economic Outlook

The economic progress we made in 1988 has favorable implications for the coming year. To briefly touch on the economic forecast, about which Beryl Sprinkel will speak in detail shortly, let me say this: We expect the current expansion -- the longest peacetime expansion in U.S. economic history -- to continue in 1989. However, to some small extent, the underlying rate of real economic growth, excluding the effects of the drought, is expected to moderate in the coming year.

Nonetheless, continued above-average growth of U.S. exports is expected to contribute significantly to economic expansion. This assumes a monetary policy that will remain supportive of sustainable economic growth, marked by further progress toward price stability.

External Imbalances and Economic Policy Coordination

A major element behind sustained economic growth during 1987 and 1988 was improvement in our trade balance. The strengthened U.S. competitive position, reinforced by stronger growth in our major trading partners, has generated a rise in U.S. exports of 28 percent in 1988, over three times the rate of increase of our imports. This has contributed to a reduction in the U.S. trade deficit of over $30 billion in 1988.

The improvement in our trade deficit reflected the efforts of the industrial nations to make further progress in coordinating their economic policies. During the course of 1988 the United States has -- in concert with our G-7 partners -- implemented economic measures that have resulted in a climate of relatively stable exchange markets and further improvements among the external imbalances in the major industrial countries.

Let me emphasize, however, that this is not the time to let up. These efforts must continue. The United States and our major trading partners must sustain our commitment to build on the progress we have made thus far. And the United States must do its part by continuing to reduce the fiscal deficit.

The 1990 Budget

Let me make only a few brief comments on President Reagan's FY 1990 budget, since the Director of OMB, Joe Wright, is here to provide a detailed outline.

To begin with, over recent years, progress has been made in addressing the Federal budget deficit, reducing it as a share of GNP from 6.3 percent in 1983 to 3.2 percent in FY 1988.

Further, President Reagan's budget presented today lays out a plan for reducing the FY 1990 deficit to $98.6 billion, without asset sales and $92.5 billion with asset sales, both below the $100 million GRH target.

This reduction is to be achieved without resort to new taxes and without touching social security. Rather the progress relies on a combination of growth in receipts and significant curbs in outlay growth. Growth of the economy accounts for a receipts increase of nearly $84 billion in FY 1990.

Finally, many of you are interested in knowing how President Reagan's budget relates to the budget plans of President-elect Bush. I would like to make a brief comment on that question.

First, the Reagan 1990 budget puts forward a reasoned, determined plan to reduce the deficit in a way that meets the GRH targets without new taxes. The twin goal -- meeting the GRH targets while avoiding new taxes -- is fully shared by President-elect Bush.

Second, work is actively underway on President-elect Bush's budget plans, which he has stated he will outline to Congress shortly after the Inauguration.

Third, although senior advisors to the President-elect are spending significant time on the matter, no final decisions have yet been made, and probably will not be made until after January 20. It is certainly possible that much of the current budget will remain on the table, although it is too early at this stage to offer more specific details.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

CONTACT: Office of Financing
202/376-4350

FOR IMMEDIATE RELEASE

January 9, 1989

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,220 million of 13-week bills and for $7,229 million of 26-week bills, both to be issued on January 12, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing April 13, 1989			:	26-week bills maturing July 13, 1989		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	8.34%	8.64%	97.892	:	8.46%	8.96%	95.723
High	8.36%	8.66%	97.887	:	8.48%	8.98%	95.713
Average	8.36%	8.66%	97.887	:	8.48%	8.98%	95.713

Tenders at the high discount rate for the 13-week bills were allotted 69%.
Tenders at the high discount rate for the 26-week bills were allotted 72%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 57,490	$ 57,465	:	$ 44,115	$ 44,115
New York	24,702,185	6,043,030	:	23,619,125	5,929,975
Philadelphia	38,845	38,845	:	24,830	24,270
Cleveland	75,605	73,485	:	43,355	43,355
Richmond	71,880	61,880	:	57,060	56,990
Atlanta	55,425	55,425	:	38,770	38,770
Chicago	1,366,325	98,610	:	1,127,515	119,125
St. Louis	82,130	42,130	:	62,375	34,375
Minneapolis	14,215	14,215	:	12,795	12,795
Kansas City	68,070	60,685	:	78,615	78,000
Dallas	50,615	40,615	:	42,495	32,495
San Francisco	1,839,205	110,050	:	1,624,715	293,715
Treasury	523,795	523,795	:	520,810	520,810
TOTALS	$28,945,785	$7,220,230	:	$27,296,575	$7,228,790
Type					
Competitive	$25,238,000	$3,512,445	:	$22,496,650	$2,428,865
Noncompetitive	1,627,555	1,627,555	:	1,303,525	1,303,525
Subtotal, Public	$26,865,555	$5,140,000	:	$23,800,175	$3,732,390
Federal Reserve	1,978,330	1,978,330	:	1,900,000	1,900,000
Foreign Official Institutions	101,900	101,900	:	1,596,400	1,596,400
TOTALS	$28,945,785	$7,220,230	:	$27,296,575	$7,228,790

An additional $30,800 thousand of 13-week bills and an additional $385,200 thousand of 26-week bills will be issued to foreign official institutions for new cash.

1/ Equivalent coupon-issue yield.

NB-101

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

<u>For Immediate Release</u>
January 9, 1989

Contact: Larry Batdorf
566-2041

TREASURY ASSESSES PENALTY AGAINST
UNITED ORIENT BANK, NEW YORK,
UNDER BANK SECRECY ACT

The Department of the Treasury on January 6th assessed a civil penalty of $250,000 against United Orient Bank, New York, based on in excess of 172 failures to file Currency Transaction Reports as required by the Bank Secrecy Act. The penalty was announced by Assistant Secretary for Enforcement Salvatore R. Martoche. Rudolph W. Giuliani, United States Attorney for the Southern District of New York, also announced that the bank, its President and two officers have entered pleas of guilty to related criminal violations of the Bank Secrecy Act. The bank also agreed to the imposition of criminal fines of $750,000.

This case was developed through an investigation conducted by the Criminal Investigation Division of the Internal Revenue Service. In connection with resolution of the criminal case, Treasury worked with the United States Attorney to resolve the question of the bank's corresponding civil liability for the criminal violations. Under the Bank Secrecy Act, criminal and civil sanctions are cumulative.

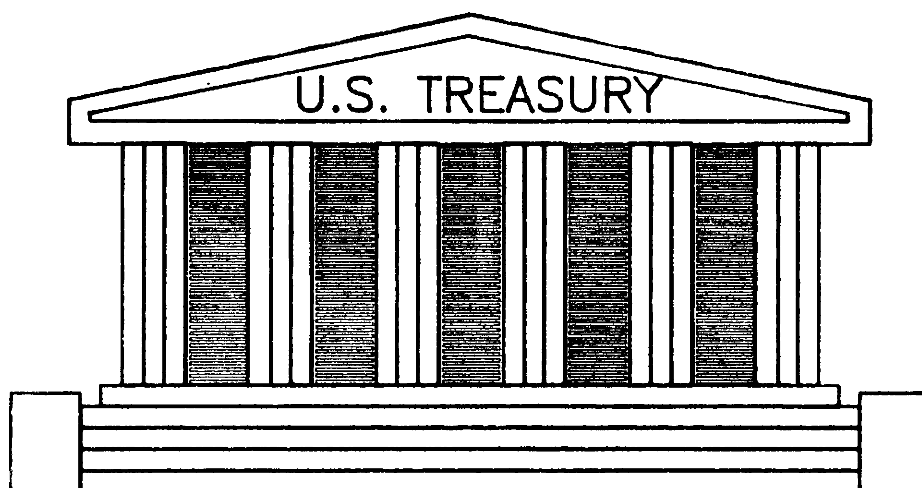
Martoche praised the fine investigative work of Mr. Giuliani and his staff and especially acknowledged the diligent work of the Internal Revenue Service Special Agents who worked on the case.

BUDGET-IN-BRIEF
FISCAL YEAR 1990

Department of the Treasury

January 1989

DEPARTMENT OF THE TREASURY
FISCAL YEAR 1990
BUDGET-IN-BRIEF



January 9, 1989

DEPARTMENT OF THE TREASURY
FY 1990 BUDGET-IN-BRIEF

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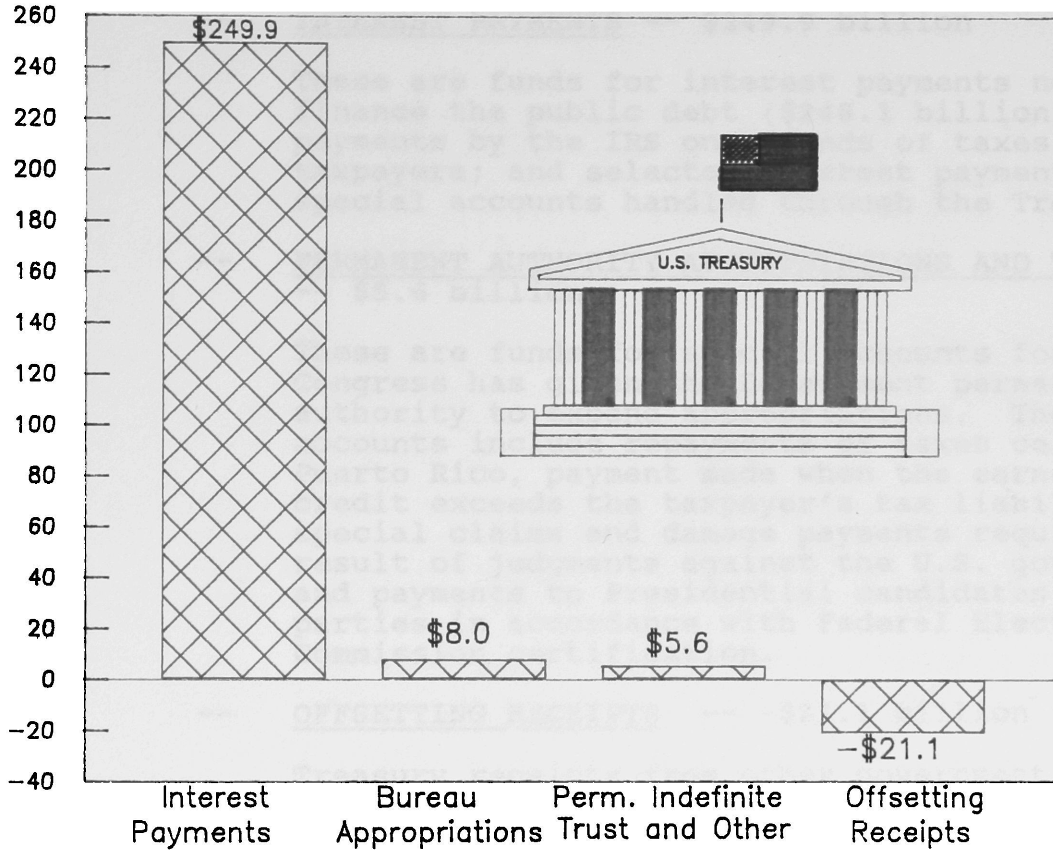
DEPARTMENT OF THE TREASURY
FUNDING LEVELS IN THE FY 1990 PRESIDENT'S BUDGET
(IN MILLIONS OF DOLLARS)

	FY 1988 ACTUALS	ESTIMATE 1989	ESTIMATE 1990	PERCENT INCREASE/ DECREASE
ANNUAL APPROPRIATIONS................	7,406.6	7,679.0	7,976.3	3.9%
UNDER PROPOSED LEGISLATION	0.0	0.0	4.3	N/A
INTEREST PAYMENTS....................	215,846.3	237,362.0	249,912.5	5.3%
o Interest on Public Debt	214,145.0	235,542.1	248,115.1	5.3%
o Interest on IRS Refunds	1,681.2	1,800.0	1,776.0	-1.3%
o Interest on Uninvested Funds	20.1	19.9	21.4	7.5%
TRUST FUNDS..........................	7.2	17.6	726.9	4030.1%
o Gifts and Bequests	0.8	0.3	0.5	66.7%
o Federal Financing Bank	0.0	0.0	708.9	N/A
o Miscellaneous Trust Funds	0.1	0.1	0.1	0.0%
o Ref, Tran & Exp Abandonded Goods	6.2	17.2	17.4	1.2%
OTHER................................	0.0	175.0	123.2	N/A
o Payments to Farm Credit System	0.0	175.0	123.2	N/A
PERMANENT AUTHORITY APPROPRIATIONS...	4,699.0	4,775.2	4,738.9	-0.8%
o Earned Income Credit	2,697.6	3,849.0	3,841.0	-0.2%
o Claims, Judgments & Relief	1,408.8	348.9	348.9	0.0%
o Customs Forfeiture Fund	0.0	20.0	20.0	0.0%
o Collection of Taxes for Puerto Rico by:				
ATF	257.5	230.0	230.0	0.0%
U.S. Customs	118.9	123.0	126.0	2.4%
o Coinage Profit Fund	58.6	43.3	6.4	-85.2%
o Pres. Election Campaign Fund	33.4	32.0	32.0	0.0%
o COBRA	107.2	111.0	116.6	5.0%
o Contrib. for Annuity Benefits	17.0	18.0	18.0	0.0%
OFFSETTING RECEIPTS..................	(23,837.9)	(22,706.0)	(21,126.0)	-7.0%
TOTAL, DEPARTMENT OF THE TREASURY....	204,121.2	227,302.8	242,356.1	6.6%
MULTILATERAL DEVELOPMENT BANKS.......	1,205.6	1,314.6	1,637.4	24.6%
INTERNATIONAL MONETARY FUND..........	0.0	0.0	150.0	N/A

Total Treasury Budget for 1990
$242.4 Billion

$ Billions



DEPARTMENT OF THE TREASURY

SUMMARY OF THE FY 1990 PRESIDENT'S BUDGET

TOTAL TREASURY BUDGET

- Treasury's FY 1990 budget request is for $242.4 billion and 155,594 total full-time equivalent (FTE) staff years and covers the following areas:

  -- INTEREST PAYMENTS -- $249.9 billion

  These are funds for interest payments needed to finance the public debt ($248.1 billion); interest payments by the IRS on refunds of taxes to taxpayers; and selected interest payments on special accounts handled through the Treasury.

  -- PERMANENT AUTHORITY APPROPRIATIONS AND TRUST FUNDS -- $5.6 billion

  These are funds for special accounts for which the Congress has given the Department permanent authority to expend appropriations. These accounts include repayments of taxes collected for Puerto Rico, payment made when the earned income credit exceeds the taxpayer's tax liability, special claims and damage payments required as a result of judgments against the U.S. government, and payments to Presidential candidates and their parties in accordance with Federal Election Commission certification.

  -- OFFSETTING RECEIPTS -- -$21.1 billion

  Treasury receipts from other government agencies and private sources are subtracted from the total Treasury budget as an offset.

  -- ANNUAL OPERATING APPROPRIATIONS [FUNDING FOR ALL TREASURY BUREAUS] -- $8.0 billion

  These are funds for the Treasury bureaus' activities. Details of bureau operating budgets are provided below.

OPERATING BUDGET [TREASURY BUREAUS]

- The Department's FY 1990 operating budget request is $8.0 billion and 155,594 total FTE, an increase of $301 million and 1,990 FTE compared to the FY 1989 enacted appropriation.

The FY 1990 budget has the following major objectives:

- OUR KEY PRIORITY IS TO MAINTAIN AN EFFECTIVE TAX ADMINISTRATION THROUGH CONTINUED SUPPORT OF TAX REFORM REQUIREMENTS AND THROUGH EFFECTIVE MODERNIZATION EFFORTS.

  - The Internal Revenue Service (IRS) budget addresses the natural growth in tax administration workload. It also includes further improvements to quality in tax returns processing, services to individuals and organizations, and in the conduct of internal investigations and research.

  - The IRS budget supports a continued major emphasis on redesigning the tax processing and administration system through the mid-1990s, largely funded through a prudent reordering of project priorities.

- OUR SECOND OBJECTIVE IS TO MAINTAIN THE ABILITY OF THE IRS TO PROMOTE TAX COMPLIANCE AND GENERATE REVENUE, WHILE ALSO SUPPORTING SPECIFIC AREAS OF IMPROVEMENT THAT REQUIRE A MODEST INVESTMENT OF NEW RESOURCES.

  - The Internal Revenue Service budget continues to support prior year enforcement revenue initiatives and augments efforts to reduce the backlog of delinquent tax accounts.

  - The budget reinforces several low cost, high yielding tax enforcement efforts that are conducted primarily at the ten IRS service centers, where some potential compliance problems can be addressed more advantageously.

- OUR THIRD BUDGET OBJECTIVE IS TO SUPPORT THE PRESIDENT'S WAR ON DRUGS.

  - The Customs Service will strengthen the President's War on Drugs through increased inspections of imports and operation of air interdiction assets acquired or modified in previous years. The budget seeks increased funding for drug interdiction over the FY 1989 enacted appropriation.

- FOURTH, WE INTEND TO MEET OUR OTHER LAW ENFORCEMENT AND PROTECTION RESPONSIBILITIES.

  -- The Federal Law Enforcement Training Center budget will fund the interagency training facility that provides basic and advanced law enforcement training for federal, state, and local agencies. It provides funds for a new dormitory to ease the current training capacity problem.

  -- The Customs Service budget will enforce the Nation's import and export laws and rapid clearance of passengers and cargo. It will support processing of 9.8 million formal merchandise entries, 115 million carriers, and 370 million passengers. The Administration will submit legislation to extend the passenger and merchandise processing user fees and to make the this fee consistent with the General Agreement on Tariffs and Trade.

  -- The Bureau of Alcohol, Tobacco and Firearms budget will provide for collection of all alcohol and tobacco excise taxes and programs to reduce the criminal use of firearms and explosives.

  -- The Secret Service budget will enhance security at the Vice President's residence, upgrade information and communications systems and improve administration.

- THE FIFTH OBJECTIVE IS TO SUPPLY THE RESOURCES NEEDED TO MANAGE THE NATION'S FINANCES AND SERVICE THE NATION'S DEBT.

  -- The budget for fiscal services, through the Bureau of the Public Debt and the Financial Management Service, continues the Administration's efforts to improve customer service to holders of government securities, cash management, debt collection and government-wide financial information systems.

- SIXTH, WE MUST PRODUCE ENOUGH CURRENCY AND COINAGE TO MEET THE NATION'S DEMANDS.

  -- The budget for the U.S. Mint will provide funding for an adequate level of coinage. We will also develop a more efficient coin materials handling system. The Bureau of Engraving and Printing does not require annual appropriations for currency production.

- SEVENTH, WE MUST PROVIDE POLICY FORMULATION AND MANAGEMENT OVERSIGHT OF DEPARTMENTAL OPERATIONS.

  -- The FY 1990 budget will permit the Department to develop and carry out the Nation's economic, financial, and tax policies. These responsibilities will be met through the budget for the Departmental Offices.

MULTILATERAL DEVELOPMENT BANKS

- The Multilateral Development Banks (MDBs) provide technical assistance and project financing on both near-market and concessional terms for development projects in less developed countries. Funding is provided by developed and some advanced developing nations through replenishment of resources and increases in capital.

INTERNATIONAL MONETARY FUND -- ENHANCED STRUCTURAL ADJUSTMENT FACILITY (ESAF)

- The Enhanced Structural Adjustment Facility (ESAF) was created in 1987 to enable the International Monetary Fund to provide balance of payments assistance on concessional terms to low-income developing countries with protracted payments problems which are prepared to adopt multi-year economic and structural reform programs.

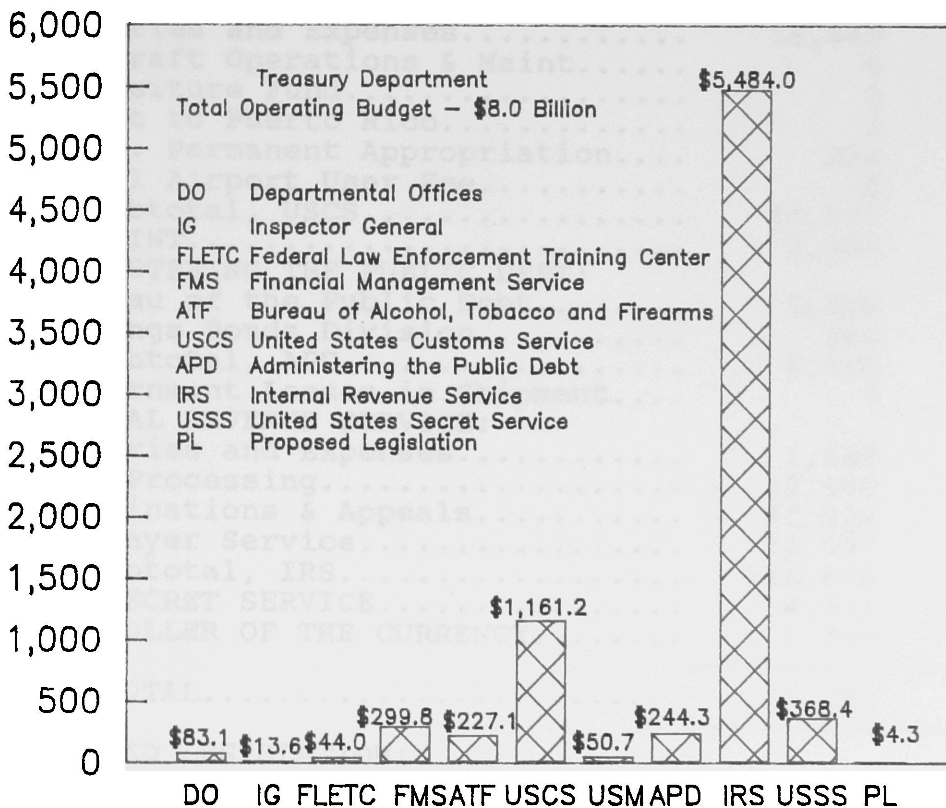
OPERATING
ACCOUNTS

DEPARTMENT OF THE TREASURY
COMPARISON OF APPROPRIATIONS AND ESTIMATES FOR TREASURY BUREAUS
(IN THOUSANDS OF DOLLARS)

APPROPRIATION	FY 1988 ENACTED	ESTIMATE FY 1989	ESTIMATE FY 1990
DEPARTMENTAL OFFICES...............	$78,803	$81,618	$83,091
OFFICE OF THE INSPECTOR GENERAL....	0		13,605
FED. LAW ENFORCEMENT TRN. CENTER...			
Salaries and Expenses............	28,672	34,664	34,158
Acquisition......................	0	20,000	9,880
FINANCIAL MANAGEMENT SERVICE:			
Salaries and Expenses............	265,000	277,230	289,695
St. Lawrence Seaway *	9,037	10,700	10,084
ALCOHOL, TOBACCO AND FIREARMS......	217,531	241,000	227,133
U.S. CUSTOMS SERVICE:			
Salaries and Expenses............	966,000	1,033,911	1,021,490
Aircraft Operations & Maint......	140,000	149,262	128,128
Forfeiture Fund..................	10,000	10,000	10,000
Grant to Puerto Rico.............	7,800	0	0
Small Airport User Fee...........	486	1,588	1,588
Subtotal, USCS.................	1,124,286	1,194,761	1,161,206
U.S. MINT..........................	42,000	47,000	50,735
ADMINISTERING THE PUBLIC DEBT:			
Bureau of the Public Debt........	195,200	199,850	225,312
Savings Bonds Division...........	19,800	18,880	19,004
Subtotal, APD..................	215,000	218,730	244,316
Government Losses in Shipment....	400	960	0
INTERNAL REVENUE SERVICE:			
Salaries and Expenses............	89,472	87,542	72,382
Tax Processing...................	1,706,666	1,795,339	1,940,640
Examinations & Appeals...........	1,796,814	1,794,818	1,898,515
Taxpayer Service.................	1,465,928	1,517,181	1,572,482
Subtotal, IRS..................	5,058,880	5,194,880	5,484,019
U.S. SECRET SERVICE................	367,000	357,500	368,401
SUBTOTAL.........................	7,406,609	7,679,043	7,976,323
PROPOSED LEGISLATION:			
CREDIT FINANCING SERVICE.........	0	0	4,326
U.S. MINT REVOLVING FUND.........	0	0	0
TOTAL, DEPARTMENT OF THE TREASURY..	7,406,609	7,679,043	7,980,649
MULTILATERAL DEVELOPMENT BANKS.....	1,205,571	1,314,630	1,637,384
INTERNATIONAL MONETARY FUND........	0	0	150,000

*Considered by Subcommittee on Transportation.

Department of the Treasury
FY 1990 Funding

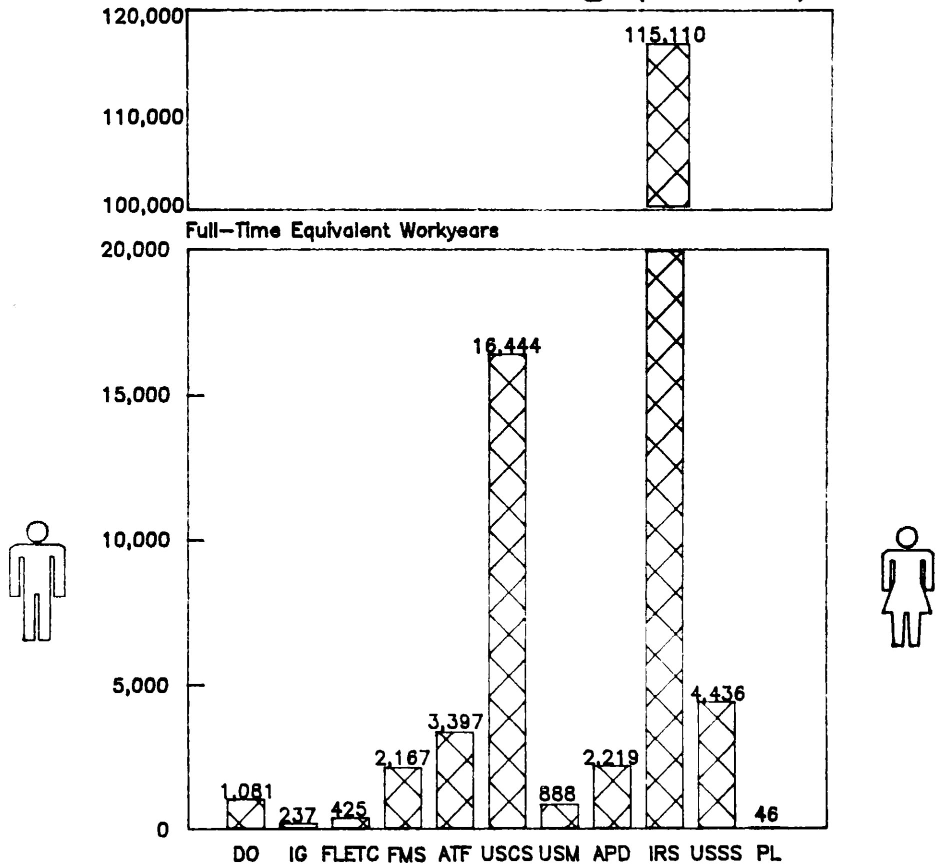


1/ Includes St. Lawrence Seaway ($10.1M).
2/ Proposed Legislation for Credit Financing Service ($4.3M).

DEPARTMENT OF THE TREASURY
TOTAL WORKYEARS (FTE) FOR TREASURY BUREAUS

APPROPRIATION	FY 1988 OMB CEILING	ESTIMATE FY 1989	ESTIMATE FY 1990
DEPARTMENTAL OFFICES...............	1,453	1,393	1,284
OFFICE OF THE INSPECTOR GENERAL....	0	0	242
FED. LAW ENFORCEMENT TRN. CENTER...	333	429	429
FINANCIAL MANAGEMENT SERVICE:			
Salaries and Expenses............	2,358	2,292	2,217
St. Lawrence Seaway..............	10	5	5
ENGRAVING AND PRINTING.............	2,190	2,310	2,346
ALCOHOL, TOBACCO AND FIREARMS......	3,467	3,717	3,541
U.S. CUSTOMS SERVICE:			
Salaries and Expenses............	16,669	17,329	17,238
Aircraft Operations & Maint......	0	0	0
Forfeiture Fund..................	0	0	0
Grant to Puerto Rico.............	0	0	0
Misc. Permanent Appropriation....	294	294	309
Small Airport User Fee...........	8	22	22
Subtotal, USCS.................	16,971	17,645	17,569
U.S. MINT..........................	2,452	2,306	1,050 1/
ADMINISTERING THE PUBLIC DEBT:			
Bureau of the Public Debt........	1,926	1,956	1,967
Savings Bonds Division...........	260	260	252
Subtotal, APD..................	2,186	2,216	2,219
Government Losses in Shipment....	0	0	0
INTERNAL REVENUE SERVICE:			
Salaries and Expenses............	1,669	1,650	1,018
Tax Processing...................	35,640	36,354	37,786
Examinations & Appeals...........	41,938	42,218	41,871
Taxpayer Service.................	33,583	33,525	35,194
Subtotal, IRS..................	112,830	113,747	115,869
U.S. SECRET SERVICE................	4,351	4,298	4,436
COMPTROLLER OF THE CURRENCY........	3,200	3,246	3,246
SUBTOTAL........................	151,801	153,604	154,453
PROPOSED LEGISLATION:			
CREDIT FINANCING SERVICE.........	0	0	46
U.S. MINT REVOLVING FUND.........	0	0	1,095
TOTAL, DEPARTMENT OF THE TREASURY..	151,801	153,604	155,594
MULTILATERAL DEVELOPMENT BANKS.....	0	0	0

1/ Total FTE request for the U.S. Mint is 2,145. See proposed legislation.

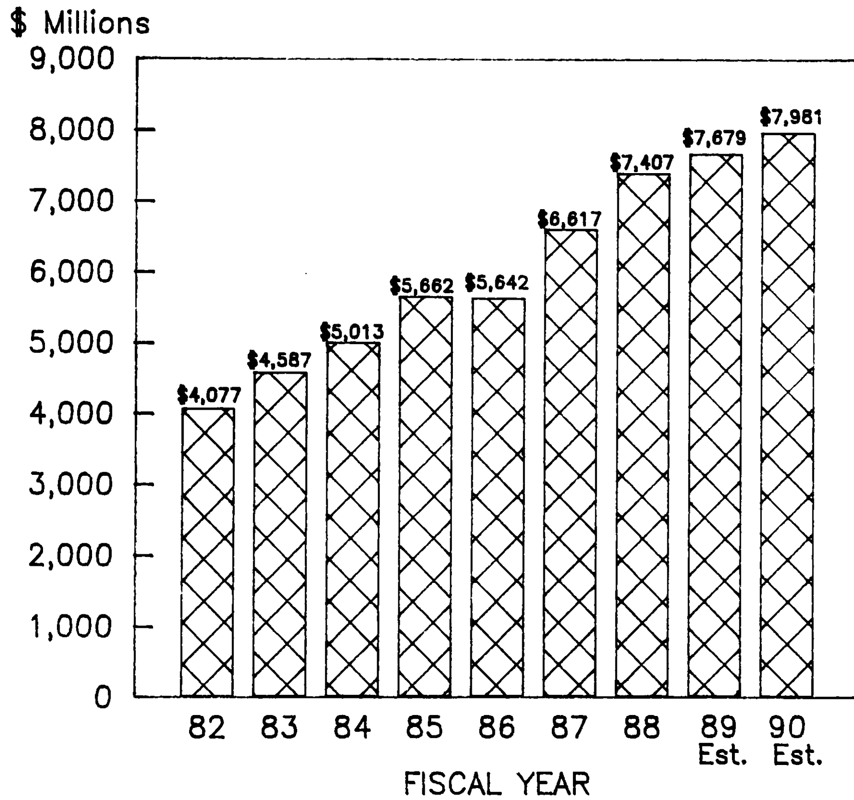


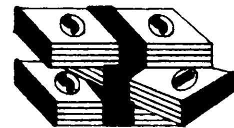
TREASURY DEPARTMENT
TOTAL DIRECT STAFFING – 146,450

DO Departmental Offices
IG Inspector General
FLETC Federal Law Enforcement Training Center
FMS Financial Management Service 1/
ATF Bureau of Alcohol, Tobacco and Firearms
USCS United States Customs Service
USM United States Mint
APD Administering the Public Debt
IRS Internal Revenue Service
USSS United States Secret Service
PL Proposed Legislation 2/

1/ Includes St. Lawrence Seaway (5 workyears).
2/ Includes Credit Financing Service (46 workyears).

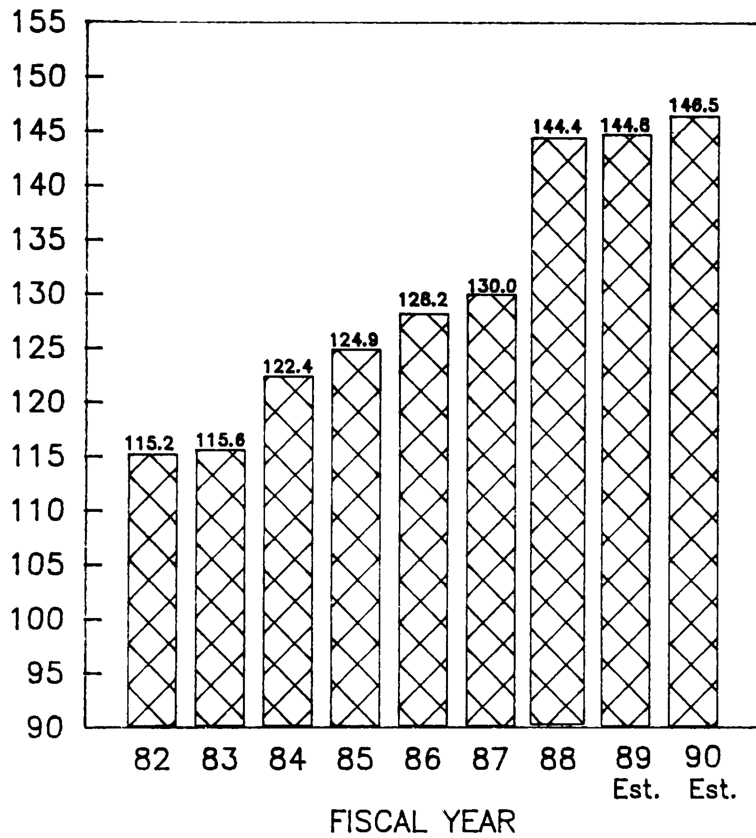
Department of the Treasury
Operating Budget
Funding History: FY 1982 – FY 1990

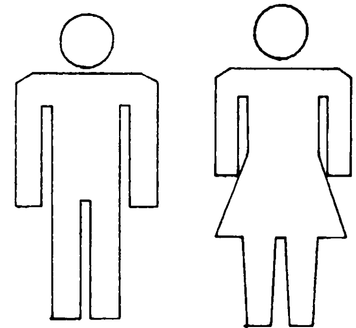




Department of the Treasury
Direct Staffing History: FY 1982 - FY 1990

Full-Time Equivalent Workyears in Thousands





DEPARTMENT OF THE TREASURY
SELECTED WORKLOAD MEASURES
(in Millions)

	FY 1988	FY 1989	FY 1990	CHANGE
o INTERNAL REVENUE SERVICE:				
TAX RETURNS FILED	194.3	202.3	208.3	3.0%
RETURNS EXAMINED	1.2	1.4	1.5	7.1%
SERVICE CENTER CONTACTS	0.6	0.7	0.9	28.6%
TAXPAYERS ASSISTED	67.3	55.7	68.4	22.8%
o U.S. CUSTOMS SERVICE:				
FORMAL ENTRIES OF MERCHANDISE PROCESSED	8.9	9.3	9.8	5.4%
ARRIVING PASSENGERS PROCESSED	345.2	357.9	370.2	3.4%
ARRIVING CARRIERS PROCESSED	106.9	111.1	115.6	4.1%
o U.S. MINT:				
COINS PRODUCED	14,705	18,000	19,500	8.3%
o BUREAU OF THE PUBLIC DEBT:				
SAVINGS-TYPE SECURITIES SOLD	95.1	100.0	109.0	9.0%
SAVINGS-TYPE SECURITIES REDEEMED	59.4	62.0	62.0	0.0%
o FINANCIAL MANAGEMENT SERVICE:				
TOTAL PAYMENTS MADE [CHECKS & ELECTRONIC FUNDS TRANSFERS]	751.7	759.9	771.4	1.5%
o BUREAU OF ENGRAVING & PRINTING:				
CURRENCY PRODUCED	6,013	6,329	6,600	4.3%
POSTAGE STAMPS PRODUCED	38,421	37,652	36,000	-4.4%

DEPARTMENT OF THE TREASURY
PROPOSED AUTHORIZED LEVEL FOR FY 1989 COMPARED TO FY 1990 REQUEST
(Dollars in Thousands)

	FTE Positions	Amount
FY 1989 APPROPRIATION (P.L. 100-440).	144,795	$7,679,043
PROPOSED FY 1989 LEVEL.	144,795	7,679,043
Changes Proposed for FY 1990:		
o PROPOSED PROGRAM INCREASES		
International Affairs Support	0	2,063
Accounting System Development	0	1,649
Budget and Finance Studies	0	550
AFMIS, Data Center Improvements	1	1,458
Revenue Estimating	7	300
Dormitory Construction	0	6,880
System 90	5	4,875
Electronic Certification	0	1,400
Financial Information Systems Improvements	3	1,050
Facilities Modernization	0	1,683
Image Processing	0	250
Contraband Examinations	396	21,000
Automated Enforcement Information System	0	5,000
P3 Aircraft Radar Spare Parts	0	800
Citation Aircraft Radar Spare Parts	0	1,100
Aerostats Operating Funds	0	19,917
Helicopter Operating Funds	0	6,176
Albuquerque Hangar Maintenance	0	165
Increased Production of Coins	56	1,505
Asbestos Abatement	0	385
Building Repairs/Replace Obsolete Equipment	0	2,135
Engineering and Support Personnel	4	131
Protection of Monetary Assets	0	25
E/EE Systems Redesign	18	1,059
State and Local Government Securities	0	329
Computer Processing Capacity Expansion	0	537
Federal Reserve Bank Reimbursement	0	23,410
Returns Processing	251	9,913
Improved Quality of Taxpayer Service	1,300	55,900
Tax Enforcement Enhancements	1,380	55,948
Internal Investigation and Research	34	5,994
Information Systems Modernization	260	102,343
Vice President's Residence Improvements	0	2,100
Van Ness International Drive	0	1,249
Technical/Protective Requirements	62	4,296
Uniformed Division	79	3,067
ADP/Communications Programs	0	260
HQ Consolidation	0	7,616
Subtotal.	3,856	354,518

DEPARTMENT OF THE TREASURY
PROPOSED AUTHORIZED LEVEL FOR FY 1989 COMPARED TO FY 1990 REQUEST
(Dollars in Thousands)

o WORKLOAD INCREASES.	849	42,945
o MAINTAIN CURRENT PROGRAM LEVELS		
Mandatory Cost Increases	1,011	170,967
January 1989 Pay Raise Annualization	0	88,289
Subtotal.	1,011	259,256
o REDUCTIONS, NONRECURRING COSTS AND SAVINGS. .	(3,486)	(290,476)
o TRANSFERS		
Statutory Inspector General (Non-Add)	237	13,605
Organized Crime Drug Enforcement Task Force	(614)	(37,485)
State Depart. Foreign Affrs. Admin. Support	0	1,470
Census Bureau	0	(585)
E2C Aircraft to Coast Guard	0	(10,400)
Subtotal.	(614)	(47,000)
o PROGRAM REDUCTIONS.	(7)	(21,963)
Total FY 1990 Changes.	1,609	297,280
FY 1990 PRESIDENT'S BUDGET	146,404	7,976,323
o PROPOSED LEGISLATION		
Credit Financing Service	46	4,326
U.S. Mint Revolving Fund	0	0
Subtotal.	46	4,326
TOTAL, DEPARTMENT OF THE TREASURY	146,450	$7,980,649

January 9, 1989

BUREAU
HIGHLIGHTS

DEPARTMENTAL OFFICES
SALARIES AND EXPENSES
Analysis of Fiscal Year 1990 President's Budget
(Dollars in Thousands)

	FTE Positions	Amount ($000's)
FY 1989 APPROPRIATION (P.L. 100-440). .	1,190	$81,618
PROPOSED FY 1989 LEVEL	1,190	81,618
Changes Proposed for FY 1990:		
o PROGRAM INCREASES	8	6,020
o MAINTAIN CURRENT PROGRAM LEVELS . . .	0	2,650
o REDUCTIONS, NONRECURRING COSTS, AND SAVINGS	---	(1,090)
o NET TRANSFERS	(117)	(5,506)
o PROGRAM REDUCTIONS.	---	(601)
Total FY 1990 Changes	(109)	1,473
FY 1990 PRESIDENT'S BUDGET	1,081	$83,091

Highlights of FY 1990 Budget Changes

	Change from Proposed FY 1989 Levels	
	FTE Positions	Amount ($000's)
Program Increases: Increases are requested to fund restoration of the International Affairs reduction taken in FY 1989 (0 FTE, $2,063), upgrade the Data Center (1 FTE, $1,308), develop a new financial management and accounting system (0 FTE, $1,649), upgrade the Automated Financial Management Information System (AFMIS) (0 FTE, $150), improve tax policy revenue estimates (7 FTE, $300), and contract costs for budget and finance studies (0 FTE, $550).	8	$6,020

	Change from Proposed FY 1989 Levels	
	FTE Positions	Amount ($000's)
Maintain Current Program Levels: An increase is requested for the costs of inflation, pay annualization, and other uncontrollable increases (e.g., benefits, contracts, equipment) ($2,049), and an FY 1990 pay comparability increase ($601).	---	$2,650
Reductions for Nonrecurring Costs and Savings: A decrease is requested for nonrecurring costs relating to completion of the annex move.	---	(1,090)
Net Transfers: The Departmental Offices is transferring resources to the Statutory Inspector General appropriation (-117 FTE, -$6,134). Further, funds have been transferred in from the State Department which reflect Treasury's share of expenses for overseas administrative support ($628).	(117)	(5,506)
Program Reductions: Reductions taken against travel, training, supplies, and other administrative support, to offset annualization of the January 1989 pay increase.	---	(601)

OFFICE OF INSPECTOR GENERAL
SALARIES AND EXPENSES
Analysis of Fiscal Year 1990 President's Budget
(Dollars in Thousands)

	FTE Positions	Amount ($000's)
FY 1989 APPROPRIATION (P.L. 100-440). .	---	---
PROPOSED FY 1989 LEVEL	---	---
Changes Proposed for FY 1990:		
o NET TRANSFERS	237	13,605
Total FY 1990 Changes	237	13,605
FY 1990 PRESIDENT'S BUDGET	237	$13,605

Highlights of FY 1990 Budget Changes

	Change from Proposed FY 1989 Levels	
	FTE Positions	Amount ($000's)
Net Transfers: Pursuant to Public Law 100-504, resources have been transferred from various Treasury bureaus to the Office of the Inspector General.	237	$13,605

FEDERAL LAW ENFORCEMENT TRAINING CENTER
SALARIES AND EXPENSES
Analysis of Fiscal Year 1990 President's Budget
(Dollars in Thousands)

	FTE Positions	Amount ($000's)
FY 1989 APPROPRIATION (P.L. 100-440). .	425	$34,664
PROPOSED FY 1989 LEVEL	425	34,664
Changes Proposed for FY 1990:		
o WORKLOAD INCREASES.	---	919
o MAINTAIN CURRENT PROGRAM LEVELS . . .	---	984
o REDUCTIONS, NONRECURRING COSTS AND SAVINGS	---	(2,409)
Total FY 1990 Changes	---	(506)
FY 1990 PRESIDENT'S BUDGET	425	$34,158

Highlights of FY 1990 Budget Changes

	Change from Proposed FY 1989 Levels	
	FTE Positions	Amount ($000's)
Workload Increases: An increase is requested to fund more rapid replacement of training equipment.	---	$919
Maintain Current Program Levels: An increase is requested for the costs of inflation and other uncontrollable increases (e.g., equipment, supplies) (0 FTE, $813) and annualization of the FY 1989 pay comparability increase (0 FTE, $171).	---	984
Reductions for Nonrecurring Costs and Savings: A decrease is requested for nonrecurring costs of Permanent Change of Station moves.	---	(2,409)

FEDERAL LAW ENFORCEMENT TRAINING CENTER
ACQUISITION, CONSTRUCTION, IMPROVEMENTS AND RELATED EXPENSES
Analysis of Fiscal Year 1990 President's Budget
(Dollars in Thousands)

	FTE Positions	Amount ($000's)
FY 1989 APPROPRIATION (P.L. 100-440). .	---	$20,000
PROPOSED FY 1989 LEVEL	---	20,000
Changes Proposed for FY 1990:		
o PROGRAM INCREASES	---	6,880
o REDUCTIONS, NONRECURRING COSTS AND SAVINGS	---	(17,000)
Total FY 1990 Changes	---	(10,120)
FY 1990 PRESIDENT'S BUDGET	---	$9,880

Highlights of FY 1990 Budget Changes

	Change from Proposed FY 1989 Levels	
	FTE Positions	Amount ($000's)
Proposed Program Increases: An increase is requested to fund construction of an additional dormitory (0 FTE, $6,400) and increased building maintenance (0 FTE, $480).	---	$6,880
Reductions for Nonrecurring Costs and Savings: A decrease is requested for nonrecurring construction costs of a driver training course (0 FTE, $1,500), a firearms range (0 FTE, $5,000), expanded physical training facilities (0 FTE, $1,600), expansion of the cafeteria (0 FTE, $1,300), dormitory preparations (0 FTE, $600) and the new Artesia training center (0 FTE, $7,000).	---	(17,000)

FINANCIAL MANAGEMENT SERVICE
SALARIES AND EXPENSES
Analysis of Fiscal Year 1990 President's Budget
(Dollars in Thousands)

	FTE Positions	Amount ($000's)
FY 1989 APPROPRIATION (P.L. 100-440). . .	2,240	$277,230
PROPOSED FY 1989 LEVEL	2,240	277,230
Changes Proposed for FY 1990:		
o PROGRAM INCREASES	8	9,258
o MAINTAIN CURRENT PROGRAM LEVELS	---	15,517
o REDUCTIONS, NONRECURRING COSTS, AND SAVINGS	(86)	(5,886)
o NET TRANSFERS	---	(200)
o PROGRAM REDUCTIONS.	---	(6,224)
Total FY 1990 Changes. . . .	(78)	12,465
FY 1990 PRESIDENT'S BUDGET	2,162	$289,695

Highlights of FY 1990 Budget Changes

	Change from Proposed FY 1989 Levels	
	FTE Positions	Amount ($000's)
Program Initiatives: An increase is requested to fund third year development of System 90 (5 FTE, $4,875), implementation of electronic certification ($1,400), and improved financial information systems (3 FTE, $1,050). Additional funds are requested for facilities modernization (0 FTE, $1,683) and development of image processing system for checks (0 FTE, $250).	8	9,258

	Change from Proposed FY 1989 Levels	
	. FTE Positions	Amount ($000's)
Maintain Current Program Levels: An increase is requested for the costs of inflation, pay annualization, and other uncontrollable increases (e.g., benefits, check supplies, equipment) ($8,307). The request also includes, for System 90, the restoration of base funding in FY 1990, and funds for hardware acquisition, reprogrammed in FY 1989 to cover the the FY 1988 postal rate increase ($7,210).	---	$15,517
Reductions for Nonrecurring Costs and Savings: A decrease is requested for nonrecurring costs, (e.g., contract support, furniture and equipment) (0 FTE, -$4,232), and productivity savings (-86 FTE, -$1,654).	(86)	(5,886)
Net transfers: A decrease is requested for the transfer of funds for the Statutory Inspector General.	---	(200)
Program Reductions: A decrease is requested for a projected reduction in the volume of check payments (0 FTE, -$3,224) and a phased reduction in Federal Tax Deposit fee payments through the TT&L program (0 FTE, -$3,000).	---	(6,224)

FINANCIAL MANAGEMENT SERVICE
ST. LAWRENCE SEAWAY TOLL REBATE PROGRAM
Analysis of Fiscal Year 1990 President's Budget
(Dollars in Thousands)

	FTE Positions	Amount ($000's)
FY 1989 APPROPRIATION (P.L. 100-440) . . .	5	$ 10,700
PROPOSED FY 1989 LEVEL	5	10,700
Changes Proposed for FY 1990:		
o MAINTAIN CURRENT PROGRAM LEVELS	---	8
o REDUCTIONS, NONRECURRING COSTS, AND SAVINGS	---	(124)
o PROGRAM REDUCTIONS.	---	(500)
Total FY 1990 Changes	---	(616)
FY 1990 PRESIDENT'S BUDGET	5	$10,084

Highlights of FY 1990 Budget Changes

	Change from Proposed FY 1989 Levels	
	FTE Positions	Amount ($000's)
Maintain Current Program Levels: An increase is requested for the costs of inflation, pay annualization, and other uncontrollable increases (e.g., benefits, contracts, services).	---	$8
Reductions for Nonrecurring Costs and Savings: A decrease is requested for non-recurring administrative and equipment costs.	---	(124)
Program Reductions: A decrease is requested for toll rebates based on revised projections.	---	(500)

BUREAU OF ALCOHOL, TOBACCO & FIREARMS
Analysis of Fiscal Year 1990 President's Budget
(Dollars in Thousands)

	FTE Positions	Amount ($000's)
FY 1989 APPROPRIATION (P.L. 100-440). .	3,701	$234,000
Anti-Drug Abuse Act (P.L. 100-690)	---	7,000
PROPOSED FY 1989 LEVEL	3,701	241,000
Changes Proposed for FY 1990:		
o MAINTAIN CURRENT PROGRAM LEVELS . . .	---	6,907
o REDUCTIONS, NONRECURRING COSTS, AND SAVINGS	(157)	(11,257)
o NET TRANSFERS	(147)	(9,517)
Total FY 1990 Changes	(304)	(13,867)
FY 1990 PRESIDENT'S BUDGET	3,397	$227,133

Highlights of FY 1990 Budget Changes

	Change from Proposed FY 1989 Levels	
	FTE Positions	Amount ($000's)
Maintain Current Program Levels: An increase is requested for the costs of inflation and other uncontrollable increases (e.g., benefits and equipment) ($5,479), and an FY 1990 pay comparability increase ($1,428).	---	$6,907
Reductions for Nonrecurring Costs and Savings: A decrease is requested for nonrecurring costs, (e.g., contract support and equipment) (-$3,030), A-76 study savings (-27 FTE, -$227) and reduction in the Alcohol Compliance Operations Program (-130 FTE, -$8,000).	(157)	(11,257)
Net Transfers: A decrease is requested for a transfer to the Statutory Inspector General (-19 FTE, -$905), and a transfer to the Department of Justice for the Organized Crime Drug Enforcement Task Force (-128 FTE, -$8,612).	(147)	(9,517)

U.S. CUSTOMS SERVICE
SALARIES AND EXPENSES
Analysis of Fiscal Year 1990 President's Budget
(Dollars in Thousands)

	FTE Positions	Amount ($000's)
FY 1989 APPROPRIATION (P.L. 100-440) .	16,739	$1,025,411
Anti-Drug Abuse Act (P.L. 100-690) . .	---	8,500
PROPOSED FY 1989 LEVEL	16,739	1,033,911
Changes Proposed for FY 1990:		
o PROGRAM INCREASES.	396	26,000
o MAINTAIN CURRENT PROGRAM LEVELS . .	---	20,418
o REDUCTIONS, NONRECURRING COSTS AND SAVINGS.	(396)	(32,893)
o NET TRANSFERS.	(317)	(19,642)
o PROGRAM REDUCTIONS	---	(6,304)
Total FY 1990 Changes . . .	(317)	(12,421)
FY 1990 PRESIDENT'S BUDGET	16,422	$1,021,490

Highlights of FY 1990 Budget Changes

	Change from Proposed FY 1989 Levels	
	FTE Positions	Amount ($000's)
Program Increases: An increase is requested to fund initiatives for increased contraband examinations of high-risk cargo (396 FTE, $21,000) and hardware purchases for an automated enforcement information system (0 FTE, $5,000).	396	$26,000
Maintain Current Program Levels: An increase is requested for the costs of inflation and other uncontrollable increases (e.g., equipment, supplies) ($14,114) and annualization of the FY 1989 pay comparability increase ($6,304).	---	20,418

	Change from Proposed FY 1989 Levels	
	FTE Positions	Amount ($000's)
Reductions for Nonrecurring Costs and Savings: A decrease is requested for nonrecurring costs, (e.g., Automated Commercial System and drug bill equipment purchases) (0 FTE, -$18,549), productivity savings attributable to the Automated Commercial System (-140 FTE, -$5,588), savings from A-76 studies to be conducted (-129 FTE, -$1,097) and a shortfall in use of the FY 1989 staffing add-on (-127 FTE, -$7,659).	(396)	(32,893)
Net Transfers: A decrease is requested for the net effect of transfers to the new Statutory Inspector General (-91 FTE, -$5,642), to the new Organized Crime Drug Enforcement Task Force account (-226 FTE, -$14,461) and from the State Department for Foreign Affairs administrative support (0 FTE, $461).	(317)	(19,642)
Program Reductions: A decrease is requested to offset the annualization of the January 1989 pay increase.	---	(6,304)

U.S. CUSTOMS SERVICE
AIRCRAFT OPERATIONS AND MAINTENANCE
Analysis of Fiscal Year 1990 President's Budget
(Dollars in Thousands)

	FTE Positions	Amount ($000's)
FY 1989 APPROPRIATION (P.L. 100-440). .	---	$142,262
Anti-Drug Abuse Act (P.L. 100-690)	---	7,000
PROPOSED FY 1989 LEVEL	---	149,262
Changes Proposed for FY 1990:		
o PROGRAM INCREASES	---	28,158
o MAINTAIN CURRENT PROGRAM LEVELS . . .	---	1,967
o REDUCTIONS, NONRECURRING COSTS AND SAVINGS	---	(40,859)
o NET TRANSFERS	---	(10,400)
Total FY 1990 Changes	---	(21,134)
FY 1990 PRESIDENT'S BUDGET	---	$128,128

Highlights of FY 1990 Budget Changes

	Change from Proposed FY 1989 Levels	
	FTE Positions	Amount ($000's)
Program Increases: An increase is requested to fund initiatives for radar spare parts for P3 aircraft (0 FTE, $800) and Citation aircraft (0 FTE, $1,100). Increases are also requested to provide operating funds for new aerostats (0 FTE, $19,917), additional operating funds for helicopters (0 FTE, $6,176) and additional maintenance funding for the Albuquerque hangar (0 FTE, $165).	---	28,158
Maintain Current Program Levels: An increase is requested for the costs of inflation and other uncontrollable increases (e.g., equipment, supplies).	---	1,967

	Change from Proposed FY 1989 Levels	
	FTE Positions	Amount ($000's)
Reductions for Nonrecurring Costs and Savings: A decrease is requested for nonrecurring costs of Citation aircraft modification (0 FTE, -$9,045), radar sensor spare parts (0 FTE, -$6,434), over-the-horizon radar (0 FTE, -$14,800), Albuquerque hangar construction (0 FTE, -$3,580) and drug bill equipment purchases (0 FTE, -$7,000).	---	(40,859)
Net Transfers: A decrease is requested for the transfer of operating costs for two E2C aircraft to the Coast Guard.	---	(10,400)

U.S. CUSTOMS SERVICE
FORFEITURE FUND
Analysis of Fiscal Year 1990 President's Budget
(Dollars in Thousands)

	FTE Positions	Amount ($000's)
FY 1989 APPROPRIATION (P.L. 100-440). .	---	$10,000
PROPOSED FY 1989 LEVEL	---	10,000
FY 1990 PRESIDENT'S BUDGET	---	$10,000

U.S. CUSTOMS SERVICE
SMALL AIRPORT USER FEE FUND
Analysis of Fiscal Year 1990 President's Budget
(Dollars in Thousands)

	FTE Positions	Amount ($000's)
FY 1989 APPROPRIATION (P.L. 100-440). .	22	$1,588
PROPOSED FY 1989 LEVEL	22	1,588
FY 1990 PRESIDENT'S BUDGET	22	$1,588

U.S. MINT
SALARIES & EXPENSES
Analysis of Fiscal Year 1990 President's Budget
(Dollars in Thousands)

	FTE Positions	Amount (000's)
FY 1989 APPROPRIATION (P.L. 100-440)	901	$47,000
PROPOSED FY 1989 LEVEL	901	47,000
Changes Proposed for FY 1990:		
o PROGRAM INCREASES	60	4,181
o MAINTAIN CURRENT PROGRAM LEVELS	---	1,729
o REDUCTIONS, NONRECURRING COSTS, AND SAVINGS	(73)	(1,808)
o NET TRANSFERS	---	(36)
o PROGRAM REDUCTIONS	---	(331)
Total FY 1990 Changes	(13)	3,735
FY 1990 PRESIDENT'S BUDGET	888	$50,735

Highlights of FY 1990 Budget Changes

	Change from Proposed FY 1989 Levels	
	FTE Positions	Amount (000's)
Program Increases: Increases are requested for increased production of 1.5 billion coins (56 FTE, $1,505) replacement of worn-out and obsolete equipment (0 FTE, $1,935) asbestos removal (0 FTE, $385) buildings and improvements (0 FTE, $200) engineering and support personnel (4 FTE, $131) and protection of monetary assets (0 FTE, $25).	60	4,181
Maintain Current Program Levels: An increase is requested for the costs of inflation (e.g., benefits, supplies, contracts, equipment) ($1,193) and annualization of the January 1989 pay increase ($536).	---	1,729

	Change from Proposed FY 1989 Levels	
	FTE Positions	Amount (000's)
Reductions for Nonrecurring Costs and Savings: A decrease is requested for productivity savings (-8 FTE, -$226) savings associated with an A-76 Security study (-63 FTE, -$537) and other A-76 studies (-2 FTE, -$380) and research and development costs (0 FTE, -$665).	(73)	($1,808)
Net Transfers: The Mint is transferring funds to the Statutory Inspector General.	---	(36)
Program Reductions: Reductions will be taken in the Equipment Activity to offset the annualization of the January 1989 pay increase.	---	(331)

BUREAU OF THE PUBLIC DEBT
ADMINISTERING THE PUBLIC DEBT
Analysis of Fiscal Year 1990 President's Budget
(Dollars in Thousands)

	FTE Positions	Amount ($000's)
FY 1989 APPROPRIATION (P.L. 100-440). . .	1,956	$200,550
Transfer to Natl. Economic Commission	---	(700)
PROPOSED FY 1989 LEVEL	1,956	199,850
Changes Proposed for FY 1990:		
o PROGRAM INCREASES	18	25,335
o WORKLOAD INCREASE	4	4,600
o MAINTAIN CURRENT PROGRAM LEVELS	---	5,725
o REDUCTIONS, NONRECURRING COSTS, AND SAVINGS	(9)	(4,429)
o NET TRANSFERS	(2)	(223)
o PROGRAM REDUCTIONS.	---	(5,546)
Total FY 1990 Changes	11	25,462
FY 1990 PRESIDENT'S BUDGET	1,967	$225,312

Highlights of FY 1990 Budget Changes

	Change from Proposed FY 1989 Levels	
	FTE Positions	Amount ($000's)
Program Increases: Increases are requested to fund new and improved systems that provide investor services (e.g., for savings bonds and state and local government securities), (18 FTE, $1,925) and to fully reimburse the Federal Reserve Banks for services performed for the Bureau (0 FTE, $23,410).	18	$25,335
Workload Increase: An increase is requested to handle anticipated sales of college savings bonds.	4	4,600

	Change from Proposed FY 1989 Levels	
	FTE Positions	Amount ($000's)
Maintain Current Program Levels: An increase is requested for the costs of inflation, pay annualization, and other uncontrollable increases (e.g., benefits, contracts, equipment).	---	5,725
Reductions for Nonrecurring Costs and Savings: A decrease is requested for nonrecurring costs (e.g., ADP equipment) (0 FTE, -$211), and productivity savings from EZ Clear and A-76 (-9 FTE, -4,218).	(9)	(4,429)
Net Transfers: A decrease is requested for the transfer of funds for the Statutory Inspector General.	(2)	(223)
Program Reductions: A decrease is requested to reflect revised savings bonds workload projections for FY 1990 (0 FTE, -$5,000) and pay-related program reductions to the marketable and savings securities programs (0 FTE, -$546).	---	(5,546)

SAVINGS BONDS DIVISION
ADMINISTERING THE PUBLIC DEBT
Analysis of Fiscal Year 1990 President's Budget
(Dollars in Thousands)

	FTE Positions	Amount ($000's)
FY 1989 APPROPRIATION (P.L. 100-440). . .	260	$ 18,880
PROPOSED FY 1989 LEVEL	260	18,880
Changes Proposed for FY 1990:		
o MAINTAIN CURRENT PROGRAM LEVELS	---	641
o REDUCTIONS, NONRECURRING COSTS, AND SAVINGS	(1)	(171)
o PROGRAM REDUCTIONS	(7)	(346)
Total FY 1990 Changes	(8)	124
FY 1990 PRESIDENT'S BUDGET	252	$19,004

Highlights of FY 1990 Budget Changes

	Change from Proposed FY 1989 Levels	
	FTE Positions	Amount ($000's)
Maintain Current Program Levels: An increase is requested for the costs of inflation, pay annualization, and other uncontrollable increases (e.g., benefits, contracts, services) ($641).	---	$641
Reductions for Nonrecurring Costs and Savings: A decrease is requested for A-76 productivity savings.	(1)	(171)
Program Reductions: A decrease is requested for a reduction in sales promotion staff (-7 FTE, -$235) and for pay-related reductions in the sales program (0 FTE, -$111).	(7)	(346)

INTERNAL REVENUE SERVICE
Analysis of Fiscal Year 1990 President's Budget
(Dollars in Thousands)

	FTE Positions	Amount ($000's)
FY 1989 APPROPRIATION (P.L. 100-440). . .	113,811	$5,194,880
Staffing Reduction To Support Pay Raise	(753)	---
PROPOSED FY 1989 LEVEL.	113,058	5,194,880
Changes Proposed for FY 1990:		
o PROPOSED PROGRAM INCREASES	3,225	230,080
o WORKLOAD INCREASE	845	37,426
o MAINTAIN CURRENT PROGRAM LEVELS	1,011	190,023
o REDUCTIONS, NONRECURRING COSTS AND SAVINGS	(2,764)	(153,409)
o NET TRANSFERS	(265)	(14,981)
Total FY 1990 Changes	2,052	289,139
FY 1990 PRESIDENT'S BUDGET	115,110	$5,484,019

Highlights of FY 1990 Budget Changes

	Change from Proposed FY 1989 Levels	
	FTE Positions	Amount ($000's)
Program Increases: Includes improvements to returns processing (251 FTE, $9,913, including wage report analysis, more taxpayer service support (1,300 FTE, $55,882), tax enforcement enhancements (1,380 FTE, $55,948), improved internal investigation and research capability (34 FTE, $5,994), and modernizing computerized information systems, especially in tax system redesign (260 FTE, $102,343).	3,225	$230,080
Workload Increase: Processing 5.2 million more tax returns and 0.8 million more supplemental documents, handling more tax forms and data requirements resulting from tax reform.	845	37,426

	Change from Proposed FY 1989 Levels	
	FTE Positions	Amount ($000's)
Maintain Current Program Levels: An increase is requested for the costs of inflation, project annualizations, and other uncontrollable increases (e.g., benefits, contracts, equipment) (1,011 FTE, $108,324) and completion of funding for the FY 1989 pay comparability increase (0 FTE, $81,699).	1,011	$190,023
Reductions for Nonrecurring Costs and Savings: A decrease is requested for nonrecurring costs and discontinued projects, primarily in automated systems (-959 FTE and -$132,793), contracted-out work and productivity savings (-1,805 FTE and -$20,616).	(2,764)	(153,409)
Transfers: To Justice Department (-260 FTE, -$14,413 to Organized Crime and Drug Enforcement Task Force), to Treasury Inspector General (-5 FTE, -$308) to Census Bureau (0 FTE, -$585); and from State Department (0 FTE and $325).	(265)	(14,981)

U.S. SECRET SERVICE
SALARIES AND EXPENSES
Analysis of Fiscal Year 1990 President's Budget
(Dollars in Thousands)

	FTE Positions	Amount ($000's)
FY 1989 APPROPRIATION (P.L. 100-440). .	4,468	$357,500
FTE Ceiling Adjustment	(170)	---
PROPOSED FY 1989 LEVEL.	4,298	357,500
Changes Proposed for FY 1990:		
o PROGRAM INCREASES	141	18,588
o MAINTAIN CURRENT PROGRAM LEVELS . . .	---	11,090
o REDUCTIONS, NONRECURRING COSTS, AND SAVINGS	---	(16,566)
o NET TRANSFERS	(3)	(100)
o PROGRAM REDUCTIONS.	---	(2,111)
Total FY 1990 Changes	138	10,901
FY 1990 PRESIDENT'S BUDGET	4,436	$368,401

Highlights of FY 1990 Budget Changes

	Change from Proposed FY 1989 Levels	
	FTE Positions	Amount ($000's)
Program Increases: An increase is requested to fund Enhancements to the Vice President's Residence (0 FTE, $2,100), Consolidated Building (0 FTE, $7,616), Technical Security Countermeasures (0 FTE, $1,480), Van Ness International Drive (0 FTE, $1,249), ADP Program (0 FTE, $160), Technical Security Program (0 FTE, $350), Communications (0 FTE, $100), Permanent Protection (55 FTE, $2,194), Uniformed Division (79 FTE, $3,067) and Protective Research (7 FTE, $272).	141	$18,588

	Change from Proposed FY 1989 Levels	
	FTE Positions	Amount ($000's)
Maintain Current Program Levels: An increase is requested for the costs of inflation, pay annualization, and other uncontrollable increases (e.g., benefits, supplies, equipment).	---	$11,090
Reductions for Nonrecurring Costs and Savings: A decrease is requested for nonrecurring costs, (e.g., Candidate Protection, WH South Barriers, Remote Delivery Site, MCI PCs/Peripherals, Intrusion System, WH Windows, WH Video System, Butler Storage Building, Fixed Site Security, Space Renovations, STU-III, WHCA (-$14,066) and construction at Rowley Training Center (-$2,500).	---	(16,566)
Net Transfers: A decrease is requested for the transfer to fund the Statutory Inspector General (-3 FTE, -$156) and an increase is requested for the State Department Foreign Affairs Administrative Support (0 FTE, $56) transfer.	(3)	(100)
Program Reductions: Reductions to offset the annualization of the January 1989 pay increase will be taken from equipment and travel.	---	(2,111)

OTHER
ACCOUNTS

DEPARTMENT OF THE TREASURY

DETAIL OF OTHER ACCOUNTS

INTEREST PAYMENTS

1. INTEREST ON THE PUBLIC DEBT:

The Government's current deficit and outstanding debt requirements are financed through borrowing; e.g., auctions of Treasury Bills, Notes, and Bonds. Funds paid to lenders for the use of their money is paid from the appropriation Interest on the Public Debt.

The Interest on the Public Debt appropriation is a permanent indefinite appropriation. This means that an annual appropriation request is not required to obtain this budget authority.

Interest on the Public Debt includes all interest paid on Treasury securities sold to the public (which includes foreign and domestic financial institutions, individuals, insurance companies, state and local governments, etc.) and to Federal Government trust funds, revolving funds and deposit funds.

Interest on the Public Debt is not the sole interest activity of the Federal Government. The Federal Government both pays and receives interest and in some cases pays itself. As a result, a better picture of the Federal Government's interest cost is seen in net interest outlay estimates. Essentially, these estimates are composed of:

-- Interest on the public debt, plus interest on tax collection refunds;

-- Interest collections from Federal agencies and the public (interest on loans to the Federal Financing Bank is the largest item of offsetting interest collections), and interest received by Federal trust funds for securities held by these funds.

2. INTEREST ON IRS REFUNDS:

Under certain conditions set forth in the tax law, IRS must pay interest on Internal Revenue collections which must be refunded -- amended returns, delayed refunds of more than 45 days from the due date of the return, corporation losses covering prior year returns, results of tax audits, etc. The rate of interest changes every three months to reflect the prime interest rate then in effect.

3. INTEREST ON UNINVESTED FUNDS:

Under select legislation, some trust accounts direct that the receipt account represents an outlay for the Treasury and is recorded under this heading. In FY 1990, it is estimated that the following accounts will receive payment:

Bequest of Gertrude M. Hubbard,
  Library of Congress
Library of Congress Trust Fund
National Gallery of Art Trust Fund
Education of the Blind
Soldiers' Home Permanent Fund
Immigration Bonds Deposit Fund
Oliver Wendell Holmes Deposit Fund

TRUST FUNDS AND OTHER

1. GIFTS AND BEQUESTS:

   The Secretary of the Treasury is authorized to accept, hold, administer and utilize gifts and bequests of property, both real and personal, for the purpose of aiding or facilitating the work of the Department of the Treasury. Property and proceeds thereof are used as nearly as possible in accordance with the terms of the gift or bequest.

2. MISCELLANEOUS TRUST FUNDS (FINANCIAL MANAGEMENT SERVICE):

   Consistent of expenses associated with three long-standing trust funds...

   Esther Cattell Schmitt Gift Fund -- Authorizes the acceptance of gifts made to the United States by the will of Esther Cattell Schmitt. The income received from the gift to the United States is paid by the Secretary of the Treasury to beneficiaries named in the provisions of the will.

   National Defense Conditional Gift Fund -- The Secretary of the Treasury accepts on behalf of the United States, "conditional" gifts of money and other intangible property to be used for a particular defense purpose. Intangibles other than money are converted at the best terms available. The moneys held in trust are paid to those appropriation accounts which best implement the intent of the donors.

   Pershing Hall Memorial Fund -- This fund was established to pay the American Legion for the maintenance of Pershing Hall in Paris, France, which honors veterans of World War I.

3. REFUNDS, TRANSFERS AND EXPENSES; UNCLAIMED, ABANDONED AND SEIZED GOODS:

   Unclaimed, abandoned or seized goods are held in storage under Customs Service's custody for one year from the date of impoundment or seizure. At the end of that period, all merchandise upon which duties, storage and other charges have not been paid is appraised and sold at public auction. The expenses shown in this fund represent the net expenses associated with holding this merchandise after receipts from public auction.

4. PAYMENTS TO FARM CREDIT SYSTEM:

The Agriculture Credit Act of 1987 (P.L. 100-233) authorized such sums as necessary to be appropriated to the Secretary of the Treasury for payments to the Farm Credit System Assistance Corporation. These payments reimburse the Assistance Corporation for interest expenses on U.S. guaranteed debt issued by the Corporation. The Assistance Corporation debt proceeds will be used to provide assistance to financially troubled institutions.

Beginning in FY 1989, Treasury will annually reimburse 100 percent of the Assistance Corporation interest expenses incurred between now and January 1993. Between January 1993 and the ensuing five years, Treasury will reimburse 50 percent of the Assistance Corporation's interest expense with the Systems Banks paying the balance. Thereafter, all Assistance corporation interest expense will be paid by the System Bank.

PERMANENT AUTHORITY APPROPRIATIONS

1. PAYMENT WHERE CREDIT EXCEEDS TAX LIABILITY (EARNED INCOME CREDIT):

   The earned income credit (originally authorized under the Tax Reduction Act of 1975) calls for absolute tax credits to low income taxpayers who meet certain qualifications. Only when the tax credit exceeds the taxpayer's total liability for taxes is this account used, and then, only by the amount that the tax liability is exceeded.

2. CLAIMS, JUDGMENTS AND RELIEF ACTS:

   Appropriations are made for payment of claims and interest for damages not chargeable to appropriations of individual agencies, and for payment of private and public relief acts. In FY 1988, $1,408.8 million in claims were paid as a result of such judgments; most of these judgments were handled through the Department of Justice.

3. CUSTOMS FORFEITURE FUND:

   The Anti-Drug Abuse Act of 1988 (P.L. 100-690) revised the treatment of the Customs Forfeiture Fund. A permanent appropriation was created for payment of the non-discretionary costs of seizing and maintaining assets from suspected criminal enterprises. A current definite appropriation is to be considered separately to pay for the discretionary costs associated with seizing these assets.

4. DUTIES, TAXES AND FEES (PUERTO RICO):

   Both the U.S. Customs Service and the Bureau of Alcohol, Tobacco and Firearms collect duties and excise taxes for Puerto Rico. These funds are deposited in a receipt account in the Treasury. After the bureaus deduct their cost of collecting these funds, the balance is refunded back to Puerto Rico through this account, which is shown as a Treasury outlay. In total, the activity (receipts/outlays) generally balances to zero, although the repayment is required to be included in total Treasury expenditures.

5. COINAGE PROFIT FUND:

This represents the portion of the gain from manufacturing coins that is used to cover wastage, recoinage losses incurred in minting coins, and the cost of distributing coins.

6. PRESIDENTIAL ELECTION CAMPAIGN FUND:

The fund represents payments to the candidates running for President during the primaries and the general election, as well as support of nominating conventions. Appropriations to the fund represent receipts from the Presidential Election check-off on taxpayers' income tax returns. Upon certification by the Federal Election Commission, payments are made for the above purposes. Major expenditures occur during the year of the Presidential election--appropriations shown represent collections from the check-off.

7. CONSOLIDATED OMNIBUS BUDGET RECONCILIATION ACT OF 1985 (COBRA):

COBRA established a user fee to cover the U.S. Customs Service's overtime cost for inspection. The fee is levied primarily as a $5 per passenger charge on those entering the country, but is also collected in varying amounts from different vessels and vehicles entering the United States. Fees are deposited in the Customs User Fee Account and are available without annual appropriation and apportionment limitation to reimburse the Customs Service's Salaries and Expenses appropriation.

8. CONTRIBUTION FOR ANNUITY BENEFITS:

This fund reimburses the District of Columbia for benefit payments made from the revenue of the District of Columbia to or for members of the Secret Service Uniform Division under the Policemen and Firemen's Retirement and Disability Act (4 D.C. Code 521).

OFFSETTING COLLECTIONS

In general, amounts collected by the Government are classified in two major categories:

Governmental receipts, which are compared with outlays in calculating the surplus or deficit.

Offsetting receipts, which are deducted from gross disbursements in calculating outlays.

These two types of collections are described below.

Governmental receipts - arise from the sovereign and regulatory powers unique to the Government. They consist primarily of tax receipts, but also include customs duties, court fines, certain licenses, etc. All governmental receipts are deposited into receipt accounts. These receipts are always reported in total (rather than as an offset to budget authority and outlays).

Offsetting receipts - are all collections that are offset against the budget authority and outlays of the collecting agency rather than reflected as governmental receipts in computing budget totals. Offsetting receipts are comprised of:

PROPRIETARY RECEIPTS - These receipts from the public are market-oriented and are derived from activities operated as business-type enterprises.

INTRAGOVERNMENTAL RECEIPTS - These are collections from other governmental accounts deposited in receipt accounts. These are further classified as follows:

1. Interfund Receipts - These are amounts derived from payments between Federal and trust funds.
2. Intrafund Receipts - These are amounts derived from payments within the same fund group (i.e., within the Federal fund group or within the trust fund group).

	($ in Millions)		
	FY 1988 ACTUAL	FY 1989 ESTIMATE	FY 1990 ESTIMATE
Proprietary	3.3	3.7	3.4
Interfund	1.5	1.6	.5
Intrafund	19.0	17.4	17.2
TOTAL	23.8	22.7	21.1

PROPOSED LEGISLATION

CREDIT FINANCING SERVICE:

To be created in the Department of the Treasury, the Credit Financing Service would be responsible for maintaining an accounting and control system to keep track of all loans in the Federal Credit Direct Loan Revolving Fund and the Federal Credit Guaranteed Loan Revolving Fund. The Service would calculate loan subsidies as the basis for agency loan subsidy appropriation requests, and provide oversight of agency loan servicing activities. To handle the projected workload, 46 FTE workyears and $4.3 million are requested in FY 1990.

U.S. MINT REVOLVING FUND:

Legislation will be proposed to create a public enterprise fund, the Mint Revolving Fund, to finance numismatic and bullion coin operations for the United States Mint beginning with FY 1990.

The Mint would retain profits for FY 1989 reimbursable programs to support start-up operations at October 1, 1990. During FY 1990 and thereafter, sales proceeds would be deposited into the revolving fund and operating and capital expenditures would be charged against the fund. At year's end, numismatic and bullion program net profits would be deposited into the General Fund of the Treasury, with exception of a stated amount of funding to be retained to finance start-up operations for the subsequent fiscal year.

MULTILATERAL
DEVELOPMENT BANKS

MULTILATERAL DEVELOPMENT BANKS

	FY 1988 Appropriation	FY 1989 Appropriation	FY 1990 Request
IBRD			
Paid-in	40,176,393	50,000,795	90,251,869
Callable	< 437,320,185 >	< 2,292,972,540 >	< 2,241,863,586 >
	477,496,578	2,342,973,335	2,332,115,455
IDA	915,000,000	995,000,000	965,000,000
IFC	20,300,000	4,891,528	114,936,472
MIGA			
Paid-in	44,403,116	0	0
Callable	< 177,612,464 >	< 0 >	< 0 >
	222,015,580	0	0
IDB			
Paid-in	31,600,000	0	31,617,983
Callable	< 119,403,576 >	< 0 >	< 0 >
	151,003,576	0	31,617,983
FSO	25,732,371	0	63,724,629
IIC	1,303,000	0	25,500,000
ADB			
Paid-in	15,057,220	0	0
Callable	< 276,503,941 >	< 0 >	< 0 >
	291,561,161	0	0
ADF	28,000,000	152,392,036	230,711,964
AFDB			
Paid-in	8,999,371	7,345,371	10,641,308
Callable	< 134,918,184 >	< 135,062,946 >	< 134,809,613 >
	143,917,555	142,408,317	145,450,921
AFDF	75,000,000	105,000,000	105,000,000
TOTAL MDBs	2,351,329,821	3,742,665,216	4,014,057,424
Budget Authority	1,205,571,471	1,314,629,730	1,637,384,225
Limitation	< 1,145,758,350 >	< 2,428,035,486 >	< 2,376,673,199 >

MULTILATERAL DEVELOPMENT BANKS

The Multilateral Development Banks (MDBs) provide technical assistance and project financing on both near-market and concessional terms for development projects in less developed countries. Funding is provided by developed and some advanced developing nations through replenishments of resources and increases in capital.

The soft-loan windows (the World Bank's International Development Association, the Asian Development Fund and the Inter-American Development Bank's Fund for Special Operations) make loans on concessional terms.

MDB hard-loan windows have two types of capital -- "paid-in" and "callable." In contrast to the soft-loan windows, where donor countries share the financial burden, the loans from the MDB hard-loan windows are largely financed by MDB borrowings from the private capital markets. These borrowings are backed by the capital subscriptions of the member governments of the Banks.

Callable capital is a pledge or subscription by member governments to meet a call if an MDB were to become unable to adequately service its financial market borrowings. It has never been necessary to call on member governments for their callable capital subscriptions, nor is any call envisioned in the future.

Program statements by institution are as follows:

I. The International Bank for Reconstruction and Development (IBRD) known as the World Bank, applies banking principles to the achievement of development goals. A major purpose of the Bank is to promote increased economic productivity and help developing economies meet more of the basic needs of their peoples. Cumulative lending since 1945 totaled $160.0 billion as of June 30, 1988.

The Bank's 1988 lending program included 118 loan commitments to 37 countries for a total of $14.7 billion. More than twice this amount was contributed to these projects by recipient countries, commercial lenders, and other multilateral or bilateral agencies.

For FY 1990, the Administration is requesting $90.3 million for paid-in capital subscriptions and $2,241.9 million in program limitations for callable capital subscriptions to the 1988 General Capital Increase.

II. The International Development Association (IDA) is the World Bank Group affiliate which provides development financing on highly concessional terms to the world's poorest nations - mainly those with an annual per capita gross national project of less than $400. IDA is the largest source of multilateral lending extended on concessional terms to developing countries. Projects have to meet the same economic and financial standards as other

World Bank projects. As of June 30, 1988, IDA had extended credits totaling $47.8 billion for development projects in 85 countries.

The Eighth Replenishment of IDA will provide resources of nearly $12.5 billion. The United States has pledged $2.875 billion to the replenishment and the $965.0 million requested in 1990 is to complete payment on that contribution.

III. The U.S. Contribution to Sub-Saharan Africa Facility supports the World Bank's Special Facility for Africa which was established in April 1985 to provide credits to IDA-eligible countries in Sub-Saharan Africa which have undertaken or are committed to undertake an appropriate medium-term program of policy reform. In FY 1987, Congress provided $64.8 million in a U.S. contribution to the Facility.

IV. The International Finance Corporation (IFC) a member of the World Bank Group, was established in 1956 to further economic development by encouraging the growth of private enterprise in developing countries. IFC provides and mobilizes loans and equity investments for promising ventures, and provides technical assistance. As of June 30, 1988, IFC had 133 member countries and had commitments of $4.5 billion, resulting from investments in over 450 enterprises in 78 countries. The FY 1990 request of $114.9 million is to complete payment toward the U.S. share of $175.0 million for the increase in IFC resources.

V. The Multilateral Investment Guarantee Agency (MIGA) is an international development institution which is designed to encourage the flow of investment to and among developing countries by: (1) issuing guarantees against non-commercial risks; (2) carrying out a wide range of investment promotional activities; and (3) encouraging sound investment policies in member countries.

The capital stock of the MIGA is $1.08 billion and the U.S. share is $222 million or 20.5 percent of the total. The U.S. subscription of $44.4 million to paid-in capital and $177.6 million to callable capital was provided in FY 1988.

VI. The Inter-American Development Bank (IDB) was established in 1959 to promote economic and social development in the developing countries in the Western Hemisphere by extending loans for specific development projects. Cumulative loan commitments from the capital window were $27.4 billion as of September 30, 1988. During FY 1988, 26 loans to 14 different countries were extended from the IDB's capital window for a total of $1.9 million.

- The Fund For Special Operation (FSO) is that part of the IDB which extends loans in circumstances where financing at near market rates of interest is not appropriate. FSO loans are made on concessional terms and are extended entirely

from contributions provided by the United States and other members of the Bank. The FSO was established in 1959 as an integral element in the Bank's lending operations.

As of September 30, 1988, cumulative loan commitments from the FSO totalled $9.7 billion. During FY 1988, 10 loans to 8 different countries were extended from the FSO for a total of $304.0 million.

- The Inter-American Investment Corporation (IIC) was designed to support private sector activities in Latin America through equity and loan investments that focus primarily on small-and medium-scale enterprises. During 1983 and 1984, the U.S. and the other interested member countries of the IDB worked out the creation of this new multilateral organization. The new organization, (IIC) is linked to the IDB, and was formally established in 1986.

The FY 1990 request for the IDB includes: (1) budget authority of $31.6 million for paid-in capital subscriptions to complete the U.S. share of the Sixth Replenishment of the Bank's capital; (2) budget authority of $63.7 million to complete the U.S. share of the current replenishment of the Fund for Special Operations; and (3) budget authority of $25.5 million to complete the U.S. share of the initial capitalization of the Inter-American Investment Corporation.

VII. The Asian Development Bank (ADB) is a multilateral organization whose capital stock is owned by its 47 member governments. It was established in 1966 and began ordinary capital lending operations in 1968. The ADB assists in the financing of economic development in Asia and the Pacific region. The Bank makes loans at near market interest rates from its ordinary capital resources. As of September 30, 1988, the ADB had cumulative ordinary capital loan commitments of $12.8 billion.

- The Asian Development Fund (ADF) extends loans at concessional rates from funds provided by ADB member governments, in addition to its ordinary lending operations. These special funds are used to finance priority economic development projects in the poorest ADB member countries. As of September 30, 1988 cumulative loan commitments from the Asian Development Fund (ADF) totaled $8.3 billion.

  In April 1986, negotiations were completed for the fourth ADF replenishment (ADF V), for an amount of $3.6 billion over the period 1987-1990. The U.S. share of the replenishment is 16.23 percent, or $584.28 million.

  In FY 1990, $230.7 million is being sought for payment toward the U.S. contribution to ADF V.

VIII. The African Development Bank (AFDB) was established in 1963 to make loans on near-market terms for the economic and social development of its fifty African members. Membership in the Bank was restricted to African nations until 1982. The United States became a member in 1983.

In 1986, agreement was reached on a $13.0 billion increase in AFDB capital. The U.S. share of the increase is $719.6 million of which $44.97 million would be paid-in over the FY 1988-92 period. A second installment on that subscription ($10.6 million of paid-in capital and $134.8 million for callable capital subscriptions) is being requested in FY 1990.

IX. African Development Fund (AFDF) was established in 1973 to complement the operations of the AFDB by providing concessional financing for high priority development projects in Africa. Fund lending is restricted to the poorest of its members with 80 percent going to countries with a per capita GNP of $510 or less. Fund membership includes 25 non-regional donor countries and the AFDB representing all of its African members. During FY 1988, the AFDF lent $605.0 million to 27 countries.

A fifth replenishment (AFDF V) was negotiated in 1987 to fund AFDF lending for 1988-90 and a target figure of $3.0 billion was established. The 1990 request for the AFDF is $105.0 million -- the second installment of the U.S. share of replenishment.

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

CONTACT: Office of Financing
202/376-4350

FOR RELEASE AT 4:00 P.M.

January 10, 1989

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $14,400 million, to be issued January 19, 1989. This offering will provide about $600 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $13,791 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Standard time, Tuesday, January 17, 1989. The two series offered are as follows:

91-day bills (to maturity date) for approximately $7,200 million, representing an additional amount of bills dated October 20, 1988, and to mature April 20, 1989 (CUSIP No. 912794 RU 0), currently outstanding in the amount of $14,418 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $7,200 million, to be dated January 19, 1989, and to mature July 20, 1989 (CUSIP No. 912794 SR 6).

The bills will be issued on a discount basis under competitive and noncompetitive bidding, and at maturity their par amount will be payable without interest. Both series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, on the records either of the Federal Reserve Banks and Branches, or of the Department of the Treasury.

The bills will be issued for cash and in exchange for Treasury bills maturing January 19, 1989. In addition to the maturing 13-week and 26-week bills, there are $9,437 million of maturing 52-week bills. The disposition of this latter amount was announced last week. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rates of accepted competitive tenders. Additional amounts of the bills may be issued to Federal Reserve Banks, as agents for foreign and international monetary authorities, to the extent that the aggregate amount of tenders for such accounts exceeds the aggregate amount of maturing bills held by them. For purposes of determining such additional amounts, foreign and international monetary authorities are considered to hold $1,767 million of the original 13-week and 26-week issues. Federal Reserve Banks currently hold $2,147 million as agents for foreign and international monetary authorities, and $6,302 million for their own account. These amounts represent the combined holdings of such accounts for the three issues of maturing bills. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 5176-1 (for 13-week series) or Form PD 5176-2 (for 26-week series).

Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. This information should reflect positions held as of one-half hour prior to the closing time for receipt of tenders on the day of the auction. Such positions would include bills acquired through "when issued" trading, and futures and forward transactions as well as holdings of outstanding bills with the same maturity date as the new offering, e.g., bills with three months to maturity previously offered as six-month bills. Dealers, who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities, when submitting tenders for customers, must submit a separate tender for each customer whose net long position in the bill being offered exceeds $200 million.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

Payment for the full par amount of the bills applied for must accompany all tenders submitted for bills to be maintained on the book-entry records of the Department of the Treasury. A cash adjustment will be made on all accepted tenders for the difference between the par payment submitted and the actual issue price as determined in the auction.

No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches. A deposit of 2 percent of the par amount of the bills applied for must accompany tenders for such bills from others, unless an express guaranty of payment by an incorporated bank or trust company accompanies the tenders.

Public announcement will be made by the Department of the Treasury of the amount and yield range of accepted bids. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. Subject to these reservations, noncompetitive tenders for each issue for $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. Cash adjustments will be made for differences between the par value of the maturing bills accepted in exchange and the issue price of the new bills. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

If a bill is purchased at issue, and is held to maturity, the amount of discount is reportable as ordinary income on the Federal income tax return of the owner for the year in which the bill matures. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, any gain in excess of the basis is treated as ordinary income.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76, 27-76, and 2-86, as applicable, Treasury's single bidder guidelines, and this notice prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars, guidelines, and tender forms may be obtained from any Federal Reserve Bank or Branch, or from the Bureau of the Public Debt.

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
January 11, 1989

CONTACT: Office of Financing
(202) 376-4350

RESULTS OF AUCTION OF 7-YEAR NOTES

The Department of the Treasury has accepted $7,021 million of $22,572 million of tenders received from the public for the 7-year notes, Series E-1996, auctioned today. The notes will be issued January 17, 1989, and mature January 15, 1996.

The interest rate on the notes will be 9-1/4%. The range of accepted competitive bids, and the corresponding prices at the 9-1/4% interest rate are as follows:

	Yield	Price
Low	9.29%*	99.798
High	9.30%	99.747
Average	9.30%	99.747

*Excepting 2 tenders totaling $101,000.

Tenders at the high yield were allotted 41%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 27,373	$ 27,373
New York	20,000,925	6,181,617
Philadelphia	11,117	11,117
Cleveland	25,790	25,790
Richmond	120,706	62,916
Atlanta	18,446	18,421
Chicago	1,423,803	387,973
St. Louis	42,020	19,020
Minneapolis	16,535	16,524
Kansas City	45,307	43,717
Dallas	14,710	14,710
San Francisco	822,950	209,423
Treasury	2,691	2,691
Totals	$22,572,373	$7,021,292

The $7,021 million of accepted tenders includes $647 million of noncompetitive tenders and $6,374 million of competitive tenders from the public.

In addition to the $7,021 million of tenders accepted in the auction process, $150 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $212 million of tenders was also accepted at the average price from Government accounts and Federal Reserve Banks for their own account in exchange for maturing securities.

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TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

CONTACT: Office of Financing
202/376-4350

FOR IMMEDIATE RELEASE

January 12, 1989

RESULTS OF TREASURY'S 52-WEEK BILL AUCTION

Tenders for $9,042 million of 52-week bills to be issued January 19, 1989, and to mature January 18, 1990, were accepted today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate (Equivalent Coupon-Issue Yield)	Price
Low -	8.43%	9.14%	91.476
High -	8.46%	9.17%	91.446
Average -	8.45%	9.16%	91.456

Tenders at the high discount rate were allotted 28%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted
Boston	$ 50,760	$ 50,760
New York	30,054,845	7,893,070
Philadelphia	49,770	49,770
Cleveland	72,180	71,080
Richmond	82,105	79,945
Atlanta	82,300	81,300
Chicago	2,297,045	189,395
St. Louis	70,855	54,855
Minneapolis	41,680	39,680
Kansas City	113,720	112,000
Dallas	37,480	37,480
San Francisco	1,968,815	179,775
Treasury	203,020	203,020
TOTALS	$35,124,575	$9,042,130
Type		
Competitive	$31,141,465	$5,059,020
Noncompetitive	1,573,110	1,573,110
Subtotal, Public	$32,714,575	$6,632,130
Federal Reserve	2,200,000	2,200,000
Foreign Official Institutions	210,000	210,000
TOTALS	$35,124,575	$9,042,130

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TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

January 12, 1989

MARK SULLIVAN III
GENERAL COUNSEL
TO LEAVE TREASURY

Secretary of the Treasury Nicholas F. Brady announced that Mark Sullivan III, General Counsel of the Treasury, will leave his post at the Treasury Department, effective February 10, 1989.

In announcing his departure, Secretary Brady commended Mark for his outstanding public service. "His service is characterized by high professional standards and dedication to the American people. Mark's many contributions to the Treasury are well known, and we wish him well in his future endeavors".

Mr. Sullivan was confirmed as General Counsel of the Treasury on March 23, 1988, where he serves as principal legal adviser to the Secretary, Deputy Secretary, and other senior officials. He supervises the Department's Legal Division, which comprises approximately 2000 attorneys in Washington and regional offices throughout the country. Mr. Sullivan's responsibilities center on the legal dimensions of banking, enforcement, trade, investment, economic sanctions, and tax matters before the Department. President Reagan also appointed Mr. Sullivan to be a member of the Board of Directors of the Federal Financing Bank on April 12, 1988.

Before assuming his duties as General Counsel of the Treasury, Mr. Sullivan served on the White House staff as the Associate Director of Presidential Personnel for Legal and Financial Affairs. In addition to his White House responsibilities, Mr. Sullivan was selected in 1986 by the President to be a Member of the Council of the Administrative Conference of the United States and serves on its Committee on Judicial Review and its Special Committee on Financial Services.

Prior to joining the Administration, Mr. Sullivan was a partner in the law firm of Baker & Hostetler from 1984 to 1985. Previously, he had been a partner with Hamel & Park from 1975-1984.

Mr. Sullivan graduated from Yale University (B.A. 1964) and the University of Virginia (LL.B. 1967). He resides in Bethesda, Maryland with his wife Susan and their two children, Jamie and Abby.

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TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

CONTACT: Office of Financing
202/376-4350

FOR IMMEDIATE RELEASE

January 17, 1989

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,202 million of 13-week bills and for $7,223 million of 26-week bills, both to be issued on January 19, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing April 20, 1989			:	26-week bills maturing July 20, 1989		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	8.28% a/	8.57%	97.907	:	8.33% b/	8.82%	95.789
High	8.31%	8.61%	97.899	:	8.35%	8.84%	95.779
Average	8.30%	8.60%	97.902	:	8.35%	8.84%	95.779

a/ Excepting 1 tender of $10,000.
b/ Excepting 3 tenders totaling $1,290,000.
Tenders at the high discount rate for the 13-week bills were allotted 82%.
Tenders at the high discount rate for the 26-week bills were allotted 58%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 50,415	$ 50,415	:	$ 47,060	$ 47,060
New York	20,737,410	5,982,020	:	19,842,580	6,190,080
Philadelphia	30,715	30,715	:	28,595	28,595
Cleveland	55,055	55,055	:	54,460	54,180
Richmond	58,525	58,525	:	57,225	57,225
Atlanta	47,385	47,385	:	58,910	58,910
Chicago	1,049,475	150,035	:	903,590	138,990
St. Louis	75,375	35,375	:	71,495	48,495
Minneapolis	11,900	11,900	:	14,725	14,725
Kansas City	62,885	61,960	:	69,880	69,880
Dallas	39,790	29,790	:	38,870	28,870
San Francisco	2,315,185	393,785	:	1,724,735	253,735
Treasury	295,190	295,190	:	231,935	231,935
TOTALS	$24,829,305	$7,202,150	:	$23,144,060	$7,222,680
Type					
Competitive	$21,091,465	$3,464,310	:	$18,497,170	$2,575,790
Noncompetitive	1,307,920	1,307,920	:	1,147,410	1,147,410
Subtotal, Public	$22,399,385	$4,772,230	:	$19,644,580	$3,723,200
Federal Reserve	2,302,000	2,302,000	:	1,800,000	1,800,000
Foreign Official Institutions	127,920	127,920	:	1,699,480	1,699,480
TOTALS	$24,829,305	$7,202,150	:	$23,144,060	$7,222,680

An additional $29,780 thousand of 13-week bills and an additional $333,720 thousand of 26-week bills will be issued to foreign official institutions for new cash.

1/ Equivalent coupon-issue yield.

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TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

CONTACT: Office of Financing
202/376-4350

FOR RELEASE AT 4:00 P.M.
January 17, 1989

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $14,400 million, to be issued January 26, 1989. This offering will provide about $ 50 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $ 14,349 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Standard time, Monday, January 23, 1989. The two series offered are as follows:

91-day bills (to maturity date) for approximately $ 7,200 million, representing an additional amount of bills dated October 27, 1988, and to mature April 27, 1989 (CUSIP No. 912794 RV 8), currently outstanding in the amount of $ 7,295 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $ 7,200 million, to be dated January 26, 1989, and to mature July 27, 1989 (CUSIP No. 912794 SS 4).

The bills will be issued on a discount basis under competitive and noncompetitive bidding, and at maturity their par amount will be payable without interest. Both series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, on the records either of the Federal Reserve Banks and Branches, or of the Department of the Treasury.

The bills will be issued for cash and in exchange for Treasury bills maturing January 26, 1989. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rates of accepted competitive tenders. Additional amounts of the bills may be issued to Federal Reserve Banks, as agents for foreign and international monetary authorities, to the extent that the aggregate amount of tenders for such accounts exceeds the aggregate amount of maturing bills held by them. Federal Reserve Banks currently hold $ 2,038 million as agents for foreign and international monetary authorities, and $ 3,723 million for their own account. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 5176-1 (for 13-week series) or Form PD 5176-2 (for 26-week series).

Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. This information should reflect positions held as of one-half hour prior to the closing time for receipt of tenders on the day of the auction. Such positions would include bills acquired through "when issued" trading, and futures and forward transactions as well as holdings of outstanding bills with the same maturity date as the new offering, e.g., bills with three months to maturity previously offered as six-month bills. Dealers, who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities, when submitting tenders for customers, must submit a separate tender for each customer whose net long position in the bill being offered exceeds $200 million.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

Payment for the full par amount of the bills applied for must accompany all tenders submitted for bills to be maintained on the book-entry records of the Department of the Treasury. A cash adjustment will be made on all accepted tenders for the difference between the par payment submitted and the actual issue price as determined in the auction.

No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches. A deposit of 2 percent of the par amount of the bills applied for must accompany tenders for such bills from others, unless an express guaranty of payment by an incorporated bank or trust company accompanies the tenders.

Public announcement will be made by the Department of the Treasury of the amount and yield range of accepted bids. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. Subject to these reservations, noncompetitive tenders for each issue for $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. Cash adjustments will be made for differences between the par value of the maturing bills accepted in exchange and the issue price of the new bills. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

If a bill is purchased at issue, and is held to maturity, the amount of discount is reportable as ordinary income on the Federal income tax return of the owner for the year in which the bill matures. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, any gain in excess of the basis is treated as ordinary income.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76, 27-76, and 2-86, as applicable, Treasury's single bidder guidelines, and this notice prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars, guidelines, and tender forms may be obtained from any Federal Reserve Bank or Branch, or from the Bureau of the Public Debt.

10/87

federal financing bank NEWS
WASHINGTON, D.C. 20220
Press 566-2041
FFB 566-2468

FOR IMMEDIATE RELEASE

January 18, 1989

FEDERAL FINANCING BANK ACTIVITY

Charles D. Haworth, Secretary, Federal Financing Bank (FFB), announced the following activity for the month of April 1988.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $150.0 billion on April 30, 1988, posting an increase of $0.3 billion from the level on March 31, 1988. This net change was the result of increases in holdings of agency debt of $156.2 million and agency-guaranteed debt of $166.5 million, and a decrease in holdings of agency assets of $0.4 million. FFB made 51 disbursements during April.

Attached to this release are tables presenting FFB April loan activity and FFB holdings as of April 30, 1988.

NB-109

FEDERAL FINANCING BANK

APRIL 1988 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
AGENCY DEBT					
NATIONAL CREDIT UNION ADMINISTRATION					
Central Liquidity Facility					
+Note #463	4/7	$ 16,625,000.00	7/8/88	6.435%	
+Note #464	4/27	5,000,000.00	5/27/88	6.198%	
TENNESSEE VALLEY AUTHORITY					
Advance #877	4/4	86,000,000.00	4/11/88	5.995%	
Advance #878	4/6	11,000,000.00	4/11/88	6.305%	
Advance #879	4/8	165,000,000.00	4/15/88	6.355%	
Advance #880	4/11	99,000,000.00	4/20/88	6.315%	
Advance #881	4/15	10,000,000.00	4/18/88	6.025%	
Advance #882	4/15	20,000,000.00	4/19/88	6.025%	
Advance #883	4/15	102,000,000.00	4/25/88	6.025%	
Advance #884	4/20	81,000,000.00	4/29/88	6.105%	
Advance #885	4/22	23,000,000.00	4/29/88	6.125%	
Advance #886	4/25	45,000,000.00	5/2/88	6.120%	
Advance #887	4/25	62,000,000.00	5/3/88	6.120%	
Advance #888	4/29	175,000,000.00	5/6/88	6.259%	
Advance #889	4/30	144,000,000.00	5/9/88	6.277%	
GOVERNMENT - GUARANTEED LOANS					
DEPARTMENT OF DEFENSE					
Foreign Military Sales					
Greece 16	4/6	6,080,965.40	9/1/13	8.955%	
Morocco 13	4/7	372,111.24	5/31/96	8.205%	
Greece 16	4/8	688,013.00	9/1/13	8.875%	
Philippines 11	4/8	27,703.49	9/12/96	7.765%	
Greece 16	4/13	200,419.39	9/1/13	8.855%	
Greece 17	4/13	9,344,940.65	8/25/14	8.807%	
Kenya 10	4/21	43,726.00	5/5/94	8.575%	
Greece 16	4/25	1,430,067.94	9/1/13	9.092%	
Greece 17	4/26	5,269,368.04	8/25/14	9.044%	

+rollover

FEDERAL FINANCING BANK

APRIL 1988 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
DEPARTMENT OF HOUSING & URBAN DEVELOPMENT					
Community Development					
*Fulton, GA	4/1	$ 600,000.00	4/1/91	7.549%	7.691% ann.
Toa Baja, PR	4/14	2,001,918.20	5/2/88	6.156%	
Lincoln, NE	4/19	35,000.00	11/1/88	6.672%	6.687% ann.
Ponce, PR	4/19	279,142.00	10/3/88	6.555%	
Lincoln, NE	4/21	30,000.00	10/3/88	6.599%	
Kansas City, MO	4/21	130,000.00	6/15/88	6.135%	
San Juan, PR	4/27	234,836.64	10/3/88	6.586%	
Rochester, NY	4/29	194,000.00	8/31/04	8.958%	9.159% ann.
RURAL ELECTRIFICATION ADMINISTRATION					
*Wabash Valley Power #206	4/4	12,107,000.00	4/4/90	7.535%	7.465% qtr.
*Wabash Valley Power #206	4/4	365,000.00	4/4/90	7.535%	7.465% qtr.
*Wolverine Power #182A	4/4	3,205,000.00	1/2/90	7.428%	7.360% qtr.
Colorado Ute-Electric #276	4/5	1,530,000.00	7/2/90	7.757%	7.683% qtr.
So. Miss. Elec. Power #90	4/7	10,000.00	12/31/12	8.750%	8.656% qtr.
*San Miguel Electric #110	4/8	7,269,000.00	12/31/15	8.853%	8.757% qtr.
*Wabash Valley Power #206	4/11	223,000.00	4/11/90	7.595%	7.524% qtr.
*Allegheny Electric #175A	4/11	2,632,000.00	7/2/90	7.637%	7.565% qtr.
*Wolverine Power #183A	4/11	1,271,000.00	1/2/90	7.510%	7.441% qtr.
*Wolverine Power #182A	4/11	1,011,000.00	1/2/90	7.510%	7.441% qtr.
*Wabash Valley Power #206	4/14	1,973,000.00	12/31/16	8.821%	8.726% qtr.
*Wabash Valley Power #104	4/14	6,237,000.00	12/31/16	8.821%	8.726% qtr.
*Colorado Ute-Electric #203A	4/18	1,376,000.00	7/2/90	7.777%	7.703% qtr.
Associated Electric #328	4/18	8,808,000.00	7/2/90	7.783%	7.709% qtr.
*Colorado Ute-Electric #168A	4/28	1,027,695.00	7/2/90	7.796%	7.721% qtr.
Oglethrope Power #320	4/28	8,696,000.00	7/2/90	7.803%	7.728% qtr.
SMALL BUSINESS ADMINISTRATION					
State & Local Development Company Debentures					
East Boston Local Dev Corp.	4/6	208,000.00	4/1/08	8.843%	
Metropolitan Growth & Dev Corp	4/6	227,000.00	4/1/08	8.843%	
TENNESSEE VALLEY AUTHORITY					
Seven States Energy Corporation					
Note A-88-07	4/29	674,455,867.69	7/29/88	6.173%	

*maturity extension

FEDERAL FINANCING BANK HOLDINGS
(in millions)

Program	April 30, 1988	March 31, 1988	Net Change 4/1/88-4/30/88	FY '88 Net Change 10/1/87-4/30/88
Agency Debt:				
Export-Import Bank	$ 11,488.5	$ 11,488.5	$ -0-	$ -975.0
NCUA-Central Liquidity Facility	114.6	119.4	-4.8	3.2
Tennessee Valley Authority	16,751.0	16,590.0	161.0	365.0
U.S. Postal Service	5,853.4	5,853.4	-0-	1,500.0
sub-total*	34,207.5	34,051.2	156.2	893.2
Agency Assets:				
Farmers Home Administration	59,674.0	59,674.0	-0-	-5,335.0
DHHS-Health Maintenance Org.	84.0	84.0	-0-	-0-
DHHS-Medical Facilities	102.2	102.2	-0-	-0-
Overseas Private Investment Corp.	-0-	-0-	-0-	-0.7
Rural Electrification Admin.-CBO	4,071.2	4,071.2	-0-	-170.0
Small Business Administration	17.2	17.6	-0.4	-2.4
sub-total*	63,948.6	63,949.0	-0.4	-5,508.0
Government-Guaranteed Lending:				
DOD-Foreign Military Sales	18,453.3	18,307.2	146.1	-710.6
DEd.-Student Loan Marketing Assn.	4,940.0	4,940.0	-0-	-0-
DHUD-Community Dev. Block Grant	321.7	319.8	1.8	-2.6
DHUD-New Communities	-0-	-0-	-0-	-30.6
DHUD-Public Housing Notes +	2,037.0	2,037.0	-0-	-37.3
General Services Administration +	391.6	391.6	-0-	-3.8
DOI-Guam Power Authority	32.6	32.6	-0-	-0.5
DOI-Virgin Islands	26.7	26.7	-0-	-0.4
NASA-Space Communications Co. +	949.4	949.4	-0-	140.8
DON-Ship Lease Financing	1,758.9	1,758.9	-0-	-29.4
Rural Electrification Administration	19,203.2	19,184.2	19.0	-1,993.7
SBA-Small Business Investment Cos.	703.3	711.8	-8.5	-37.3
SBA-State/Local Development Cos.	888.8	891.8	-2.9	-10.9
TVA-Seven States Energy Corp.	1,952.4	1,941.6	10.9	128.8
DOT-Section 511	51.2	51.2	-0-	-4.1
DOT-WMATA	177.0	177.0	-0-	-0-
sub-total*	51,887.4	51,720.9	166.5	-2,591.8
grand total*	$ 150,043.5	$ 149,721.2	$ 322.4	$ -7,206.6

*figures may not total due to rounding
+does not include capitalized interest

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M.
January 18, 1989

CONTACT: Office of Financing
202/376-4350

TREASURY TO AUCTION $9,250 MILLION OF 2-YEAR NOTES

The Department of the Treasury will auction $9,250 million of 2-year notes to refund $10,946 million of 2-year notes maturing January 31, 1989, and to pay down about $1,700 million. The public holds $10,946 million of the maturing 2-year notes, including $774 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities.

The $9,250 million is being offered to the public, and any amounts tendered by Federal Reserve Banks as agents for foreign and international monetary authorities will be added to that amount. Tenders for such accounts will be accepted at the average price of accepted competitive tenders.

In addition to the public holdings, Government accounts and Federal Reserve Banks, for their own accounts, hold $789 million of the maturing securities that may be refunded by issuing additional amounts of the new notes at the average price of accepted competitive tenders.

Details about the new security are given in the attached highlights of the offering and in the official offering circular.

oOo

Attachment

NB-110

HIGHLIGHTS OF TREASURY
OFFERING TO THE PUBLIC
OF 2-YEAR NOTES
TO BE ISSUED JANUARY 31, 1989

January 18, 1989

Amount Offered:
To the public .... $9,250 million

Description of Security:
Term and type of security .... 2-year notes
Series and CUSIP designation V-1991
(CUSIP No. 912827 XC 1)
Maturity date .... January 31, 1991
Interest rate .... To be determined based on the average of accepted bids
Investment yield .... To be determined at auction
Premium or discount .... To be determined after auction
Interest payment dates .... July 31 and January 31
Minimum denomination available .. $5,000

Terms of Sale:
Method of sale .... Yield auction
Competitive tenders .... Must be expressed as an annual yield, with two decimals, e.g., 7.10%
Noncompetitive tenders .... Accepted in full at the average price up to $1,000,000
Accrued interest payable by investor .... None

Payment Terms:
Payment by non-institutional investors .... Full payment to be submitted with tender
Payment through Treasury Tax and Loan (TT&L) Note Accounts ... Acceptable for TT&L Note Option Depositaries
Deposit guarantee by designated institutions .... Acceptable

Key Dates:
Receipt of tenders .... Wednesday, January 25, 1989, prior to 1:00 p.m., EST
Settlement (final payment due from institutions):
a) funds immediately available to the Treasury .. Tuesday, January 31, 1989
b) readily-collectible check .. Friday, January 27, 1989

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

For Immediate Release
January 19, 1989

Contact: Larry Batdorf
566-2041

TREASURY ASSESSES PENALTIES AGAINST
THE FIRST WOMEN'S BANK OF NEW YORK
UNDER THE BANK SECRECY ACT

The Department of the Treasury, on January 19, 1989, announced that The First Women's Bank of New York, New York, has agreed to pay penalties of $80,000 for failure to file thirty-five (35) currency transaction reports as required by the Bank Secrecy Act. The violations were discovered during a series of examinations by the Federal Deposit Insurance Corporation.

Salvatore R. Martoche, Assistant Secretary for Enforcement, who announced the penalties, said that the penalties represented a settlement of The First Women's Bank's civil liability under the Bank Secrecy Act. Martoche stated that the severity of the penalties imposed was the result of The First Women's Bank not voluntarily reporting the violations to the Department of the Treasury.

The Department of the Treasury has no evidence that The First Women's Bank engaged in any criminal activities in connection with these reporting violations.

Martoche stated that all of the reporting violations occurred prior to the installation of The First Women's Bank's present management and that the present bank management has cooperated fully with Treasury. No reporting violations have been discovered since the new management took over in 1986. Martoche added, "Based on the compliance procedures the bank has instituted and the attitude of the present bank management towards compliance, we look forward to full Bank Secrecy Act compliance by The First Women's Bank in the future."

NB-111

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
January 19, 1989

CONTACT: KENNETH W. BUTLER
(202) 376-4306

TREASURY APPROVES NEW DELIVERY SYSTEM FOR SAVINGS BONDS

The Treasury Department has announced that it will expand the use of a new system for issuing United States Savings Bonds. Recently tested in Ohio, as part of that effort, the Treasury's Bureau of the Public Debt and the Cleveland Federal Reserve Bank conducted a pilot in the State to test the feasibility of issuing savings bonds from regional offices rather than over-the-counter at 40,000 financial institutions. During the pilot, banks, savings and loan associations, and credit unions continued to receive bond purchase applications and payments from their customers. However, instead of each financial institution issuing bonds directly, the purchase information was forwarded to the Pittsburgh Federal Reserve Branch where the bonds were issued and then mailed to the customer. A certificate was provided to the bond buyer at the time of purchase which could be given to those who were to receive the bond as a gift when issued.

The results of the year-long test in Ohio clearly support the adoption of a regional delivery mechanism. During the pilot, over 500,000 Ohioans purchased bonds valued at $193.5 million. This is approximately the same level of bond sales as was recorded in Ohio immediately prior to the pilot. Before starting the pilot, Treasury stated that bonds would be mailed within three weeks from the time the customer submitted an application. This goal was consistently met or exceeded throughout the entire test. Since interest on the bonds begins on the first day of the month in which the customer submits an application, the new delivery system does not affect the earnings of bond purchasers.

Financial institutions in Ohio have responded very favorably to the new regional delivery system. They are still able to service their customers while no longer having the expense of maintaining and accounting for savings bond stock. Tellers are also able to complete bond purchase transactions more quickly. In addition, Treasury has found that there are significant cost savings and cash management benefits from the regional delivery system.

As a result of the success of the pilot, the regional delivery system will be continued in Ohio and will be implemented nationwide over the next few years. In 1989, Treasury and the Federal Reserve will expand the new system to include the rest of the Cleveland Federal Reserve District. Besides Ohio, this covers western Pennsylvania, eastern Kentucky and the northern panhandle of West Virginia.

NB-112

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

CONTACT: Office of Financing
202/376-4350

FOR IMMEDIATE RELEASE
January 23, 1989

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,211 million of 13-week bills and for $7,207 million of 26-week bills, both to be issued on January 26, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing April 27, 1989			:	26-week bills maturing July 27, 1989		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	8.22%	8.51%	97.922	:	8.29%	8.77%	95.809
High	8.27%	8.56%	97.910	:	8.31%	8.79%	95.799
Average	8.26%	8.55%	97.912	:	8.31%	8.79%	95.799

Tenders at the high discount rate for the 13-week bills were allotted 19%.
Tenders at the high discount rate for the 26-week bills were allotted 52%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 40,210	$ 40,210	:	$ 43,795	$ 43,795
New York	19,617,040	5,527,990	:	25,132,295	6,173,565
Philadelphia	42,630	42,630	:	27,265	26,305
Cleveland	48,560	48,440	:	49,275	49,275
Richmond	55,395	55,385	:	50,590	50,590
Atlanta	37,715	37,715	:	33,660	33,660
Chicago	1,176,020	203,710	:	924,985	49,505
St. Louis	53,090	33,090	:	39,005	31,005
Minneapolis	8,360	8,360	:	11,270	11,270
Kansas City	52,635	52,635	:	53,975	53,975
Dallas	34,605	25,555	:	31,515	21,465
San Francisco	1,911,145	619,045	:	1,781,960	129,860
Treasury	516,165	516,165	:	532,475	532,475
TOTALS	$23,593,570	$7,210,930	:	$28,712,065	$7,206,745
Type					
Competitive	$20,153,440	$4,070,800	:	$23,880,585	$2,675,265
Noncompetitive	1,316,500	1,316,500	:	1,225,450	1,225,450
Subtotal, Public	$21,469,940	$5,387,300	:	$25,106,035	$3,900,715
Federal Reserve	1,922,960	1,622,960	:	1,800,000	1,500,000
Foreign Official Institutions	200,670	200,670	:	1,806,030	1,806,030
TOTALS	$23,593,570	$7,210,930	:	$28,712,065	$7,206,745

An additional $26,430 thousand of 13-week bills and an additional $159,370 thousand of 26-week bills will be issued to foreign official institutions for new cash.

1/ Equivalent coupon-issue yield.

NB-113

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

Text as Prepared
Embargoed For Release Upon Delivery
Expected at 8:45 a.m., E.S.T.

Testimony By
The Secretary of the Treasury
Nicholas F. Brady
Before the Senate Finance Committee
Tuesday, January 24, 1989

Mr. Chairman and Members of the Committee:

It's a pleasure to be here today to discuss with you the growing phenomenon of Leveraged Buyouts (LBOs) and related transactions. The effect of LBOs on the American economy has become a matter of increasing concern both to Wall Street and Main Street as the size and number of LBOs have grown. One recent transaction approached $25 billion in size, suggesting that, if anything, the pace of LBO activity continues to accelerate. The business sections of our newspapers and nightly TV stock market reports abound with stories of the returns earned by investors in LBOs. As might be expected, that level of success attracts additional capital. There is now an estimated $30 billion in funds organized for equity investment in LBOs, which, when expanded by the associated debt, would support between $250 and $300 billion in future LBOs. The availability of such capital generates its own demand, as the pressure on managers to invest their assets spawns a search for new LBO candidates.

In examining the LBO phenomenon, we should not restrict our concern to LBOs alone. Just as investors pool their funds to create LBO equity funds, companies using the equity in their own operations leverage themselves up in order to engage in exactly the same activity. I call these transactions Leveraged Takeovers -- LTOs. As a matter of simplicity, in the course of my testimony I will address my remarks to LBOs, although they should be read to include LTOs as well.

NB-114

I. OVERVIEW

Competitiveness. Perhaps the issue that should guide our analysis of LBOs is the competitive position of the U.S. corporate sector. Increasingly we find ourselves in a global economy, with American businesses under pressure to compete and maintain the markets for their products. Their ability to remain competitive is, of course, central to our economic future. If we are competitive in the world economy, we will be able to provide the standard of living that our citizens desire and the jobs that they deserve. We ought, therefore, to focus on whether LBOs and the changes they produce in corporate financial structures hurt or improve our competitive position. That same standard should also be applied to measures which might be proposed to regulate LBOs in the future. Thus, even if we conclude that LBOs have adversely affected the corporate sector, we should weigh carefully whether proposals to restrict LBO activity will, in fact, aid American business, or only make more difficult the competitive challenges we face.

Need for More Data. The Committee will hear much testimony on the effects of LBOs. Some contend that LBOs reflect ordinary market forces and result in a more efficient corporate structure with improved investment of industrial resources. Others see a pattern of increasingly risky transactions, a sign that LBO activity, as with prior speculative markets, has begun to spiral out of control. They foretell a series of overpriced, overleveraged transactions, leaving the corporate sector increasingly vulnerable to an economic downturn.

These hearings will enable the Committee to get beyond much of the rhetoric that surrounds LBOs to examine and develop the data we need in order to reach an informed judgment on how LBOs have affected the American economy. Given what is at stake, we should proceed carefully through the evidence, and ensure thorough consideration of what is plainly a complex question.

II. BACKGROUND

LBO Structure. The typical LBO involves the acquisition of a public corporation by a small investor group, frequently including the target corporation's management and/or one of the LBO funds that pool capital for this purpose. The investors would ordinarily operate through a shell acquisition corporation, which would either merge with the target or make a tender offer for its stock. In either event, the target shareholders would surrender their equity, common stock, for cash and/or debt of the acquisition corporation.

The equity supplied by the investor group typically represents 15 percent of an LBO's total capitalization. Around one-third of an LBO's total capital would be subordinated debt, initially in the form of bridge loans which would later be replaced with so-called junk bonds. The bridge financing (roughly 30 percent) often comes from an investment bank, with the junk bonds purchased by pension funds, specialized limited partnerships, insurance companies, bank subsidiaries and tax-exempt institutions. The largest part (roughly 55 percent) of the total LBO financing would ordinarily be debt secured by the assets and receivables of the target corporation. This senior debt would typically come from a syndicate of banks, but may to a smaller extent involve insurance companies and specialized limited partnerships.

Corporate Trends. The surge in LBO activity in recent years can be seen as the convergence of two trends in the structure and capitalization of American corporations. The first, and more fundamental, is the replacement of corporate equity with debt and the consequent leveraging of corporate balance sheets. This trend is in part a product of LBOs and similar transactions such as LTOs. Independent of an acquisition, however, a corporation may repurchase its outstanding stock with indebtedness or with cash attributable to indebtedness. LBOs are, however, a principal occasion for corporations incurring new indebtedness, and many corporations that have issued debt to repurchase stock have done so as a defensive maneuver to head off a possible LBO or LTO.

The growing number of LBOs also represents a trend toward privatization of formerly public corporations. The movement by large U.S. corporations to operate privately rather than through public equity markets would not necessarily be a matter of concern. Private ownership frees a corporation from the pressures and the short-term perspective of the stock markets and may well be a prudent strategy, depending on a corporation's business and its need for investment capital.

III. LEVEL OF ACTIVITY

LBOs. The significance of the corporate trends toward additional leverage and private ownership is reflected in recent data concerning LBO activity. From 1978 to 1983, the total value of LBOs was around $11 billion dollars. In the five years since, LBOs totaled $160 billion, with 1988 alone accounting for over $60 billion.

The data also reveals a lesser trend of LBO activity concentrated in industries better able to support substantial leverage. Thus, a disproportionate share of LBOs have occurred in nondurables manufacturing, retailing, and services, all relatively noncyclical industries with characteristically strong cash flows.

Corporate Debt. An analysis of individual LBOs suggests that these transactions have introduced unprecedented levels of corporate leverage. Thus, the level of debt in some recent LBOs leaves the corporations unable to service their debt with existing cash flows. It is becoming apparent that many such transactions require immediate asset sales at higher prices in order to reduce the debt to a manageable level. In other cases, the corporation will be required to cut back on non-interest expenditures; for example, expenditures for research and development and replacement of capital goods, in order to provide an effective debt retirement schedule.

The extreme leverage in recent LBOs is only partly reflected in aggregate data concerning corporate debt. Most balance sheet measures of corporate debt indicate a significant increase in leverage over the past few years, with current levels at a historical high. Other measures, however, suggest more moderate increases in leverage. For instance, if debt and equity are taken at market rather than book value, current leverage ratios, although rising, remain well below the peak levels of the mid-1970s, and are in line with the average over the last fifteen years. This is consistent with the ratio of net interest expense to cash flow, perhaps the most accurate measure of a corporation's ability to service its debt. The ratio, although currently rising, remains below the peak levels reached in the early 1980s.

Ultimately, however, the significance of corporate leverage is a question of individual corporations' capacity to service their debt. Aggregate data concerning debt ratios reflect averages. And just as one may drown in water that averages two feet deep, average debt ratios cannot answer whether there are significant individual situations of dangerous overleverage. It is important to know whether individual cases of extreme leverage are isolated, and perhaps attributable to special circumstances, or reflect instead an accelerating trend in American industry.

Data addressing these and related questions is being developed at Treasury and by some in the private sector. We should recognize, however, that past experience is not a particularly good measure of the future prospects for a highly leveraged corporation. Existing LBOs have thrived in a period of extended economic expansion. They have not been subjected to the test of leaner times. It is certainly not the policy of the Bush Administration to arrange such a test. But how well these highly leveraged entities survive can not be answered by past data alone.

IV. CAUSES FOR CURRENT LEVEL OF LBO ACTIVITY

Some view LBOs as a rational strategy to maximize the value of corporations and their assets. Part of this strategy relates to the tax system and its discriminatory treatment of equity versus corporate debt. Since interest payments are deductible, but corporate dividends are not, there is a substantial tax advantage that accrues to LBOs and other transactions that effectively substitute corporate debt for equity. It should come as no surprise that removing the burden of a 34 percent tax rate from a corporation's income stream can arithmetically increase the value of a corporation's capitalization. The substitution of interest charges for pre-tax income is the mill in which the grist of takeover premiums is ground.

In addition, LBOs may generate new efficiencies in corporate management and financial structures. For corporations in mature industries, where cash flows are strong but opportunities for internal growth limited, an LBO may be a logical mechanism for distributing excess cash resources, allowing the market to reinvest the funds in more productive activities. Similarly, LBOs in some cases force corporate managers to abandon unproductive investments or extraneous lines of a corporation's business. Thus, some have seen in LBOs and the divestitures they trigger a process of corporate deconglomeration, reversing the conglomerate merger activity prevalent in the 1960s and early 1970s.

Although tax and efficiency considerations may be an important part of an LBO, they do not fully explain the extent and timing of LBO activity. The tax advantages of debt capitalization have existed for most of the history of the corporate income tax. Some analysts believe that the changes in the 1986 Tax Reform Act, including the reduction in the corporate tax rate and the elimination of the so-called General Utilities doctrine, may actually have diminished the tax benefits available from leveraged acquisitions.

Similarly, there does not appear to be anything in recent corporate management that would have suddenly made LBOs attractive. On the contrary, the corporate circumstances that arguably permit efficiency gains as a result of an LBO predate by a number of years the surge in LBO activity.

In sum, viewing LBOs as transactions that maximize shareholder value does not explain why it is only in the last few years that LBO activity has taken off. So what has happened? Our own analysis suggests that other factors have contributed importantly to the development of LBO activity at its current level. In part, these factors, which I will discuss here, have simply facilitated a market in which LBOs were made feasible.

<u>Junk Bond Market.</u> A key factor in the increase in LBO activity is the emergence of a junk bond market, which has supplied much of the debt capital on which LBOs are based. Prior to the late 1970s, junk bonds were generally fallen angels -- obligations that had been of investment grade when issued but were later downgraded because of problems that had arisen with the issuer's credit. More recently the junk bond market has developed into a market for corporate debt that, because of the debt's subordinated status and the corporation's substantial other indebtedness, is below investment grade when issued.

A central purpose of the present-day market for junk debt has been to facilitate directly LBOs and LTOs. The substantial leverage characteristic of LBOs dictates that much of the debt capital will necessarily be of an extremely junior grade. In the past, neither banks nor the traditional bond markets provided for such transactions and consequently, an alternative source of financing evolved. In sum, the junk bond market has vastly facilitated increased LBO and LTO activity.

<u>Arbitrageurs.</u> The current volume in LBOs is also partly attributable to the growth in arbitrage activity. Arbitrageurs purchase the stock of corporations thought to be acquisition candidates, hoping to sell the stock at a higher price if and when the acquisition is concluded. By definition, arbitrageurs are not long-term investors, and the nature of their activity and the demand for high rates of return on their available capital require that they turn over their investments in a reasonably short period of time. Because of arbitrage activity, the perception that a corporation is "in play" tends to become a self-fulfilling prophesy. Once arbitrageurs buy up the stock of a corporation, the willingness of the corporation's shareholders to sell is established, and management's ability to resist an acquisition is effectively reduced. The certain knowledge that arbitraguers own working control of the target company's stock in turn makes sure that the potential acquirers bidding for the corporation's stock will succeed.

<u>Bargain Stock Prices.</u> A third factor responsible for recent LBO activity is the perception that many stocks remain undervalued. As LBO and LTO operators have come to focus on the value placed on a corporation by the stock market, as compared with the replacement cost of its assets, and the higher sales values of component parts, the opportunity for bargain purchases has become apparent.

<u>Strong Economy/Speculative Returns.</u> Much of the current momentum behind LBO activity may simply reflect that, to this date, prior LBOs have largely been successful. Many have questioned whether the same pattern of success would have developed if the economy had been less robust in the last several years. At the moment, however, investors do not seem discouraged by such concerns, since they have rushed to get in on the spectacular returns that some prior LBOs have generated.

Advisory Fees. A final contributing factor in the proliferation of LBO activity is the ability of investment advisers, banks, underwriters and LBO fund managers to earn substantial up-front fees in the transactions. Such fees can total nearly 6 percent of the corporation's purchase price, and lend considerable momentum to LBO activity. These fees are earned up front, largely divorced from the long-term risks in the transaction. The LBO sponsor, investment banks, bond underwriters, syndicating bank and others earn substantial income if an LBO is completed, and thus have strong incentives to identify LBO candidates, arrange financing, and conclude transactions. Sadly these same parties may have relatively little, if any, investment in the long-term success of the new enterprise. Given this arrangement, it may very well be that the net effect of LBOs is a financial snipe-hunt, where the new long-term investors, flashlight in hand, are left holding the bag.

V. THE EFFECTS OF LBOs ON THE CORPORATE SECTOR

Corporate Management. LBOs have been defended by some as a positive check or discipline on corporate managers. In some cases, LBOs may well correct some of the deficiencies in the formal mechanisms of corporate governance. Our system of corporate democracy provides for a balance between continuity and change although it is viewed by some as exceedingly difficult for management of a public corporation to be removed by shareholder vote. Thus, management, once established, may pursue growth policies that aggrandize the corporation's position, but do not necessarily maximize the shareholders' investment. An LBO can be viewed as a sanction of such policies, since it replaces old management with a new team.

The entrenchment of corporate managers, free of effective control by the shareholders, may be a matter of legitimate concern. I find it difficult to accept, however, that LBOs and the psychology that feeds them are a sensible form of corporate governance. As the pace and scope of LBO activity have grown, I fear we are reaching a point where management is simply not disciplined toward more productive investment, but is robbed of any ability to pursue policies not in step with current market attitudes. In particular, to the extent markets become preoccupied with current earnings and cash flow, managers lose the flexibility to pursue long-term investment strategies. At a minimum, the corporate manager that pursues growth at the expense of short-term earnings may be threatened with the loss of his company.

We should not be surprised if corporate managers choose not to run that risk, and instead embrace what is currently fashionable, even though not in the long-term interest of their corporations. If that attitude becomes prevalent, we should be concerned whether U.S. corporations will make the commitment to research and development and other growth oriented strategies necessary to maintain their future competitiveness in a global economy.

We should also recognize that the plight of the corporate manager may not be relieved by privatization of the company. A buyout of a corporation's public shareholders does free it of stock market pressures, and thus in theory permits the corporation to pursue growth oriented policies without regard to the short-term effect on its earnings or stock price. As a practical matter, however, we are concerned that the financing in a typical LBO leaves management still focused on short-term performance, since substantial cash flow must be generated simply to meet debt service requirements.

Vulnerability to Business Cycle. The cash flow burdens of substantial leverage make a corporation more vulnerable to cyclical movements in the economy or to periods of slow economic growth. Debt service that may be manageable in periods of economic growth may become unmanageable if a corporation's revenues fall. Some argue that LBO debt can be restructured in the event of a downturn. Where a bankruptcy is forced, however, there may be significant costs in lost jobs, forced sales, and distraction of management. Moreover, the costs of bankruptcy may extend to the government, which effectively guarantees certain of a corporation's pension obligations for defined benefit plans through the Pension Benefit Guaranty Corporation.

Corporations and their lenders obviously take some account of bankruptcy potential, and what level of debt is prudent remains dependent on a particular corporation's situation. The many individual instances in which an LBO has dramatically increased a corporation's leverage, and the apparent market acceptance of these transactions, suggest that corporate managers and the financial markets have placed greater emphasis on the benefits than the risks of leverage. This attitude may be attributable to the sustained economic growth of the last six years, which has permitted the optimistic assumptions that appear to underlie some transactions to remain untested.

Risk to Banking System/Financial Institutions. The risks attributable to increased corporate debt fall also on investors. Some level of risk is inherent in all investment, and there would seem to be no reason for concern where individuals or business investors knowingly undertake the risks involved in acquiring LBO debt. However, much of the capital invested in LBOs comes from banks, savings and loans, pension funds, insurance companies and other institutional investors which are in effect investing on behalf of the individuals whose savings they control. It should be noted that depositors in banks and savings and loans and participants in defined benefit pension plans have the benefit of a federal guarantee of their deposits.

Many observers have questioned whether LBOs are appropriate investments for financial institutions, given the levels of risk involved. Although there is an understandable desire on the part of such institutions to maximize returns on their invested capital, such desires must be balanced against their fiduciary obligations to avoid substantial commitments of capital to high risk investments. This concern is sharpened by a history of overcommitment, driven by fees and fashion, to types of loans which subsequently proved to be problems.

In this regard, a number of state insurance regulators have proposed restrictions on the extent to which insurance companies can hold such debt. I am also encouraged to see that Chairman Greenspan of the Federal Reserve Board and Comptroller of the Currency Clarke have indicated their intent to review carefully the level of LBO investments by federally chartered banks.

Fairness to Shareholders. A concern expressed by some is whether LBOs permit Wall Street insiders and corporate managers to profit at the expense of ordinary investors. This is a legitimate concern, but one which was more relevant in the early days of LBO transactions.

More recently, however, we have seen that in most cases the market will operate to ensure that shareholders receive full value for their stock. As we have witnessed in recent transactions, a management initiated LBO may trigger offers from outside interests, with the ultimate price for the company's stock determined in an auction-like bidding process. This process works best to establish a fair price when all bidders have access to the relevant information concerning the corporation's business. And, corporate boards of directors, with the encouragement of the courts, have tended to insist that the corporation's books be opened to all potential bidders.

Other Constituencies. A final but important area of concern is the effect of LBOs on corporate constituencies other than the shareholders. In previous testimony to the Senate I have cautioned that we should be careful not to march to the drumbeat of single dimension philosophies. Thus, while shareholders may realize large premiums from an LBO, the corporation's employees, bondholders and the communities in which the corporation is located may all be adversely affected. Employees may lose their jobs if the corporation is forced to retrench or if divisions are sold in order to retire debt. Such job losses have significant collateral effects on the communities in which the employees work.

The clearest losers from a financial viewpoint in some LBOs are the corporation's pre-existing bondholders. The drop in the corporation's credit rating translates directly into a reduction in the value of their bonds. However, this is arguably a situation where the affected can take care of themselves, since a variety of contractual devices are available to protect bondholders in the event of an LBO or similar transaction affecting the corporation's credit rating.

VI. REMEDIAL MEASURES

A. Tax Proposals. As I indicated earlier, I do not believe the recent surge in LBOs should be seen as driven only by tax considerations. The tax incentives for debt capitalization are long standing, and recent legislative changes may have actually diminished the tax benefits available from leveraged acquisitions. However, tax considerations remain an important part of corporate financial planning, and we should be concerned about the tax system's bias against equity capitalization.

Because we subject income on corporate equity to double taxation, while interest payments, like wages, are taxed only once, a corporation throughout its existence is encouraged to raise capital in the form of debt rather then equity. The new corporation is encouraged to load its initial capital structure with debt; the growing corporation is encouraged to raise new capital through debt; and the mature corporation is encouraged to replace its existing stock with debt either through a stock buyback or LBO.

Dividend Relief. Many have concluded that the way to correct the tax bias for debt capitalization is to limit corporate interest deductions. This approach, however, would simply increase the cost of capital for American acquirers by effectively raising their interest rates on an after tax basis. Moreover, since such restrictions would not affect borrowing costs of foreign corporations, the net effect would be a competitive disadvantage for U.S. corporations. Finally, the long history of attempts to define problems out of existence has proved that the definees are more adept than the definors. Just as soon as new regulations are written, efforts are underway to render them irrelevant.

A more logical approach to the biases in our tax system would focus on our overtaxation of corporate equity. We stand virtually alone in the industrial world in the extent to which we apply a double tax regime to corporate income. Thus, although each of our major trading partners imposes a separate tax on corporate income, most also provide substantial relief from that tax when dividends are distributed. We should not ignore this fact as we are every day forced to compete in an increasingly global economy. Germany, Italy, Australia, and New Zealand allow shareholders full credit for the corporate tax paid. France provides full relief through the combination of a partial deduction for dividends paid and a partial shareholder credit. Other countries, including the United Kingdom, Japan and Canada, provide significant partial relief from double taxation.

The Treasury proposals for Tax Reform in 1984 and 1985 would have reduced the tax burden on corporate equity by permitting corporations to deduct a portion of the dividends they distribute. The House of Representatives included a scaled-back version of these proposals in its 1985 Tax Reform bill. Although dividend relief was eventually dropped in the final Tax Reform legislation, we should not accept this as the last word on the merits of such proposals. I well recognize that at this juncture revenue considerations limit our ability to provide fundamental relief from double taxation of corporate income. But the fact remains that market forces have created their own solution to the double taxation of dividends. At the same time, tax as well as economic policy would be ill served if we were to address the current imbalance in the taxation of debt and equity without seriously considering proposals to mitigate in some significant way the double tax on corporate equity income.

Revenue Effects. Part of the concern with the tax incentive for leveraged acquisitions and stock repurchases relates to possible revenue losses from a broad substitution of debt for existing corporate equity. A corporation replacing nondeductible dividend distributions with deductible interest payments will of course achieve a savings in its income tax liability for many years. If such substitution were to occur on a broad scale, there would be a correspondingly large reduction in corporate income tax receipts.

It is important to recognize, however, that LBOs and leveraged share buybacks typically generate three effects offsetting the increase in corporate interest deductions. An LBO or stock repurchase represents a taxable sale of stock for shareholders, generally at a substantial premium, and the gains recognized effectively accelerate income that might have been deferred for a number of years, or even exempted altogether if the shareholder held the stock until death. In addition, an LBO or substantial share repurchase would typically require taxable asset sales by the corporation in order to retire indebtedness. It is also important to recognize that to the extent that LBOs or other leveraged recapitalizations lead to a more efficient allocation of resources, the overall level of national income will be increased, and this will generate additional tax revenues which will further offset the adverse revenue impact of the substitution of debt for equity by those transactions.

B. Financial Institution Regulation. The substantial fees that banks can command for arranging LBO financing, as well as the higher interest rates they can charge, may lead some banks to commit an inappropriately large portion of their portfolios to LBO debt. Moreover, there is concern that some of the banks participating in a syndicate do not examine the loans carefully and simply rely on the judgment of the lead bank. Chairman Greenspan's recent warning to banks that they should examine closely the prospects of LBO loans under a wide range of economic and financial circumstances is thus particularly apt.

C. Securities Law. An additional and important source of regulation is the securities laws. In a recent testimony before the House Telecommunications and Finance Subcommittee, SEC Chairman David Ruder outlined several regulatory changes being considered by the SEC. Among the most important is a discussion of the rules governing so-called fairness opinions. In this regard, a standard practice that should receive scrutiny is linking the size of the fee paid for the opinion to successful completion of the transaction. Such linkage raises serious questions as to the objectivity of the opinion.

VII. CONCLUSION

My testimony has been necessarily general, but I admit that I have a growing feeling that we are headed in the wrong direction when so much of our young talent and the nation's financial resources are aimed at financial engineering while the rest of the world is laying the foundation for the future.

We have always done best in this country when our savings have been used to create new jobs, new products, and new services at lower prices. LBOs produce fundamental changes in the financial structures of this country's corporations. They, in turn, raise basic questions about our economic future, whether we will continue to grow and create jobs and whether we will remain competitive.

Mr. Chairman, I know you share my concerns. By holding this series of hearings, you have issued a call to the brightest minds in both government and the private sector to examine and evaluate this trend.

I commend your efforts and I would like to join you today in this endeavor, by issuing a challenge to those who make the financing decisions and the financial institutions which advise them -- to the gladiators in the arena.

I call on them to put the same intensity and effort into evaluating where we are going as they have into taking us there. Let them bring forward the evidence and make proposals about what should be done.

I think it is entirely appropriate that we together -- the Congress and the Administration -- call upon the private sector to take on this responsibility. It is in the finest tradition of our democratic system that government look first to the people themselves for solutions and only act when it is clear the people can not solve the problem themselves.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE January 24, 1989

Monthly Release of U.S. Reserve Assets

The Treasury Department today released U.S. reserve assets data for the month of December 1988.

As indicated in this table, U.S. reserve assets amounted to $47,802 million at the end of December, down from $48,944 million in November.

U.S. Reserve Assets
(in millions of dollars)

End of Month	Total Reserve Assets	Gold Stock 1/	Special Drawing Rights 2/3/	Foreign Currencies 4/	Reserve Position in IMF 2/
1988					
Nov.	48,944	11,059	9,785	17,997	10,103
Dec.	47,802	11,057	9,637	17,363	9,745

1/ Valued at $42.2222 per fine troy ounce.

2/ Beginning July 1974, the IMF adopted a technique for valuing the SDR based on a weighted average of exchange rates for the currencies of selected member countries. The U.S. SDR holdings and reserve position in the IMF also are valued on this basis beginning July 1974.

3/ Includes allocations of SDRs by the IMF plus transactions in SDRs.

4/ Valued at current market exchange rates.

NB-115

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

For Immediate Release
January 24, 1989

Contact: Larry Batdorf
566-2041

TREASURY REISSUES CURRENCY TRANSACTION REPORT FORM AND GIVES NOTICE TO FINANCIAL INSTITUTIONS THAT A NEW FORM WILL BE ISSUED

The Department of the Treasury announced today that it is reissuing the current Form 4789, the Currency Transaction Report, but will be publishing a revised form later this year. The form is used by financial institutions to report deposits, withdrawals, exchanges of currency, payments or other transfers of more than $10,000 in currency, as required by the Bank Secrecy Act.

The Office of Management and Budget extended use of the present form, originally set to expire on September 30, 1988, until January 31, 1989. The form is being reissued without change. Filers of the form may use the September 1988 version until the January version becomes available.

Filers should note that the reissued form will contain a December 31, 1989, expiration date. Treasury plans to introduce a revised Form 4789 by mid-year. Treasury will not require filers to use the revised form for six months from the date of issuance. This six-month lead time will allow both financial institutions and Treasury adequate time to adjust procedures to handle the revised form.

Those wishing additional information should contact Amelia Gomez, Deputy Director, Office of Financial Enforcement, Department of the Treasury, at (202) 566-8022.

NB-116

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

CONTACT: Office of Financing
202/376-4350

FOR RELEASE AT 4:00 P.M.
January 24, 1989

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $14,400 million, to be issued February 2, 1989. This offering will result in a paydown for the Treasury of about $ 250 million, as the maturing bills are outstanding in the amount of $14,641 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Standard time, Monday, January 30, 1989. The two series offered are as follows:

91-day bills (to maturity date) for approximately $ 7,200 million, representing an additional amount of bills dated November 3, 1988, and to mature May 4, 1989 (CUSIP No. 912794 RW 6), currently outstanding in the amount of $ 7,587 million, the additional and original bills to be freely interchangeable.

182-day bills (to maturity date) for approximately $ 7,200 million, representing an additional amount of bills dated August 4, 1988, and to mature August 3, 1989 (CUSIP No. 912794 SJ 4), currently outstanding in the amount of $ 9,287 million, the additional and original bills to be freely interchangeable.

The bills will be issued on a discount basis under competitive and noncompetitive bidding, and at maturity their par amount will be payable without interest. Both series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, on the records either of the Federal Reserve Banks and Branches, or of the Department of the Treasury.

The bills will be issued for cash and in exchange for Treasury bills maturing February 2, 1989. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rates of accepted competitive tenders. Additional amounts of the bills may be issued to Federal Reserve Banks, as agents for foreign and international monetary authorities, to the extent that the aggregate amount of tenders for such accounts exceeds the aggregate amount of maturing bills held by them. Federal Reserve Banks currently hold $ 1,854 million as agents for foreign and international monetary authorities, and $3,987 million for their own account. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 5176-1 (for 13-week series) or Form PD 5176-2 (for 26-week series).

Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. This information should reflect positions held as of one-half hour prior to the closing time for receipt of tenders on the day of the auction. Such positions would include bills acquired through "when issued" trading, and futures and forward transactions as well as holdings of outstanding bills with the same maturity date as the new offering, e.g., bills with three months to maturity previously offered as six-month bills. Dealers, who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities, when submitting tenders for customers, must submit a separate tender for each customer whose net long position in the bill being offered exceeds $200 million.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

Payment for the full par amount of the bills applied for must accompany all tenders submitted for bills to be maintained on the book-entry records of the Department of the Treasury. A cash adjustment will be made on all accepted tenders for the difference between the par payment submitted and the actual issue price as determined in the auction.

No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches. A deposit of 2 percent of the par amount of the bills applied for must accompany tenders for such bills from others, unless an express guaranty of payment by an incorporated bank or trust company accompanies the tenders.

Public announcement will be made by the Department of the Treasury of the amount and yield range of accepted bids. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. Subject to these reservations, noncompetitive tenders for each issue for $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. Cash adjustments will be made for differences between the par value of the maturing bills accepted in exchange and the issue price of the new bills. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

If a bill is purchased at issue, and is held to maturity, the amount of discount is reportable as ordinary income on the Federal income tax return of the owner for the year in which the bill matures. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, any gain in excess of the basis is treated as ordinary income.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76, 27-76, and 2-86, as applicable, Treasury's single bidder guidelines, and this notice prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars, guidelines, and tender forms may be obtained from any Federal Reserve Bank or Branch, or from the Bureau of the Public Debt.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
January 25, 1989

CONTACT: Office of Financing
202/376-4350

RESULTS OF AUCTION OF 2-YEAR NOTES

The Department of the Treasury has accepted $9,289 million of $25,976 million of tenders received from the public for the 2-year notes, Series V-1991, auctioned today. The notes will be issued January 31, 1989, and mature January 31, 1991.

The interest rate on the notes will be 9%. The range of accepted competitive bids, and the corresponding prices at the 9% rate are as follows:

	Yield	Price
Low	9.06%*	99.892
High	9.08%	99.857
Average	9.08%	99.857

*Excepting 1 tender of $25,000.

Tenders at the high yield were allotted 79%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 81,435	$ 81,335
New York	20,866,290	6,753,800
Philadelphia	74,655	74,655
Cleveland	120,255	120,255
Richmond	544,700	385,780
Atlanta	91,550	88,340
Chicago	2,211,200	928,875
St. Louis	155,290	115,765
Minneapolis	59,895	59,895
Kansas City	221,905	220,695
Dallas	54,060	48,010
San Francisco	1,482,045	398,875
Treasury	12,465	12,465
Totals	$25,975,745	$9,288,745

The $9,289 million of accepted tenders includes $1,992 million of noncompetitive tenders and $7,297 million of competitive tenders from the public.

In addition to the $9,289 million of tenders accepted in the auction process, $860 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $789 million of tenders was also accepted at the average price from Government accounts and Federal Reserve Banks for their own account in exchange for maturing securities.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

CONTACT: Office of Financing
202/376-4350

FOR IMMEDIATE RELEASE
January 30, 1989

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $ 7,207 million of 13-week bills and for $ 7,232 million of 26-week bills, both to be issued on February 2, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing May 4, 1989			:	26-week bills maturing August 3, 1989		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	8.29%	8.59%	97.904	:	8.36%	8.85%	95.774
High	8.34%	8.64%	97.892	:	8.39%	8.88%	95.758
Average	8.33%	8.63%	97.894	:	8.39%	8.88%	95.758

Tenders at the high discount rate for the 13-week bills were allotted 75%.
Tenders at the high discount rate for the 26-week bills were allotted 61%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 45,905	$ 45,905	:	$ 38,700	$ 38,700
New York	20,006,565	5,073,315	:	23,247,205	6,137,015
Philadelphia	33,340	33,340	:	25,870	25,870
Cleveland	55,735	55,735	:	53,080	49,240
Richmond	65,835	65,835	:	55,375	55,365
Atlanta	42,975	42,775	:	44,060	43,380
Chicago	1,522,750	720,250	:	858,925	82,645
St. Louis	61,800	51,800	:	44,335	36,335
Minneapolis	11,795	11,795	:	11,970	11,970
Kansas City	48,315	48,315	:	60,900	60,900
Dallas	39,420	29,410	:	38,095	28,095
San Francisco	1,827,005	562,985	:	1,678,815	145,120
Treasury	465,985	465,985	:	517,440	517,440
TOTALS	$24,227,425	$7,207,445	:	$26,674,770	$7,232,075
Type					
Competitive	$20,588,915	$3,868,935	:	$21,845,735	$2,703,040
Noncompetitive	1,375,275	1,375,275	:	1,265,945	1,265,945
Subtotal, Public	$21,964,190	$5,244,210	:	$23,111,680	$3,968,985
Federal Reserve	2,086,625	1,786,625	:	1,900,000	1,600,000
Foreign Official Institutions	176,610	176,610	:	1,663,090	1,663,090
TOTALS	$24,227,425	$7,207,445	:	$26,674,770	$7,232,075

An additional $6,390 thousand of 13-week bills and an additional $ 54,310 thousand of 26-week bills will be issued to foreign official institutions for new cash.

1/ Equivalent coupon-issue yield.

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TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FEB
1989

Text as Prepared
Embargoed for Release Upon Delivery
Expected at 10 a.m., EST

Testimony By
The Secretary of the Treasury
Nicholas F. Brady
Before the Committee on Ways & Means
of the U.S. House of Representatives
Tuesday, January 31, 1989

Mr. Chairman and Members of the Committee:

It's a pleasure to be here today to discuss with you the growing phenomenon of Leveraged Buyouts (LBOs) and related transactions. The effect of LBOs on the American economy has become a matter of increasing concern both to Wall Street and Main Street as the size and number of LBOs have grown. One recent transaction approached $25 billion in size, suggesting that, if anything, the pace of LBO activity continues to accelerate. The business sections of our newspapers and nightly TV stock market reports abound with stories of the returns earned by investors in LBOs. As might be expected, that level of success attracts additional capital. There is now an estimated $30 billion in funds organized for equity investment in LBOs, which, when expanded by the associated debt, would support between $250 and $300 billion in future LBOs. The availability of such capital generates its own demand, as the pressure on managers to invest their assets spawns a search for new LBO candidates.

In examining the LBO phenomenon, we should not restrict our concern to LBOs alone. Just as investors pool their funds to create LBO equity funds, companies using the equity in their own operations leverage themselves up in order to engage in exactly the same activity. I call these transactions Leveraged Takeovers -- LTOs. As a matter of simplicity, in the course of my testimony I will address my remarks to LBOs, although they should be read to include LTOs as well.

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I. OVERVIEW

Competitiveness. Perhaps the issue that should guide our analysis of LBOs is the competitive position of the U.S. corporate sector. Increasingly we find ourselves in a global economy, with American businesses under pressure to compete and maintain the markets for their products. Their ability to remain competitive is, of course, central to our economic future. If we are competitive in the world economy, we will be able to provide the standard of living that our citizens desire and the jobs that they deserve. We ought, therefore, to focus on whether LBOs and the changes they produce in corporate financial structures hurt or improve our competitive position. That same standard should also be applied to measures which might be proposed to regulate LBOs in the future. Thus, even if we conclude that LBOs have adversely affected the corporate sector, we should weigh carefully whether proposals to restrict LBO activity will, in fact, aid American business, or only make more difficult the competitive challenges we face.

Need for More Data. The Committee will hear much testimony on the effects of LBOs. Some contend that LBOs reflect ordinary market forces and result in a more efficient corporate structure with improved investment of industrial resources. Others see a pattern of increasingly risky transactions, a sign that LBO activity, as with prior speculative markets, has begun to spiral out of control. They foretell a series of overpriced, overleveraged transactions, leaving the corporate sector increasingly vulnerable to an economic downturn.

These hearings will enable the Committee to get beyond much of the rhetoric that surrounds LBOs to examine and develop the data we need in order to reach an informed judgment on how LBOs have affected the American economy. Given what is at stake, we should proceed carefully through the evidence, and ensure thorough consideration of what is plainly a complex question.

II. BACKGROUND

LBO Structure. The typical LBO involves the acquisition of a public corporation by a small investor group, frequently including the target corporation's management and/or one of the LBO funds that pool capital for this purpose. The investors would ordinarily operate through a shell acquisition corporation, which would either merge with the target or make a tender offer for its stock. In either event, the target shareholders would surrender their equity, common stock, for cash and/or debt of the acquisition corporation.

The equity supplied by the investor group typically represents 15 percent of an LBO's total capitalization. Around one-third of an LBO's total capital would be subordinated debt, initially in the form of bridge loans which would later be replaced with so-called junk bonds. The bridge financing (roughly 30 percent) often comes from an investment bank, with the junk bonds purchased by pension funds, specialized limited partnerships, insurance companies, bank subsidiaries and tax-exempt institutions. The largest part (roughly 55 percent) of the total LBO financing would ordinarily be debt secured by the assets and receivables of the target corporation. This senior debt would typically come from a syndicate of banks, but may to a smaller extent involve insurance companies and specialized limited partnerships.

Corporate Trends. The surge in LBO activity in recent years can be seen as the convergence of two trends in the structure and capitalization of American corporations. The first, and more fundamental, is the replacement of corporate equity with debt and the consequent leveraging of corporate balance sheets. This trend is in part a product of LBOs and similar transactions such as LTOs. Independent of an acquisition, however, a corporation may repurchase its outstanding stock with indebtedness or with cash attributable to indebtedness. LBOs are, however, a principal occasion for corporations incurring new indebtedness, and many corporations that have issued debt to repurchase stock have done so as a defensive maneuver to head off a possible LBO or LTO.

The growing number of LBOs also represents a trend toward privatization of formerly public corporations. The movement by large U.S. corporations to operate privately rather than through public equity markets would not necessarily be a matter of concern. Private ownership frees a corporation from the pressures and the short-term perspective of the stock markets and may well be a prudent strategy, depending on a corporation's business and its need for investment capital.

III. LEVEL OF ACTIVITY

LBOs. The significance of the corporate trends toward additional leverage and private ownership is reflected in recent data concerning LBO activity. From 1978 to 1983, the total value of LBOs was around $11 billion dollars. In the five years since, LBOs totaled $160 billion, with 1988 alone accounting for over $60 billion.

The data also reveals a lesser trend of LBO activity concentrated in industries better able to support substantial leverage. Thus, a disproportionate share of LBOs have occurred in nondurables manufacturing, retailing, and services, all relatively noncyclical industries with characteristically strong cash flows.

Corporate Debt. An analysis of individual LBOs suggests that these transactions have introduced unprecedented levels of corporate leverage. Thus, the level of debt in some recent LBOs leaves the corporations unable to service their debt with existing cash flows. It is becoming apparent that many such transactions require immediate asset sales at higher prices in order to reduce the debt to a manageable level. In other cases, the corporation will be required to cut back on non-interest expenditures; for example, expenditures for research and development and replacement of capital goods, in order to provide an effective debt retirement schedule.

The extreme leverage in recent LBOs is only partly reflected in aggregate data concerning corporate debt. Most balance sheet measures of corporate debt indicate a significant increase in leverage over the past few years, with current levels at a historical high. Other measures, however, suggest more moderate increases in leverage. For instance, if debt and equity are taken at market rather than book value, current leverage ratios, although rising, remain well below the peak levels of the mid-1970s, and are in line with the average over the last fifteen years. This is consistent with the ratio of net interest expense to cash flow, perhaps the most accurate measure of a corporation's ability to service its debt. The ratio, although currently rising, remains below the peak levels reached in the early 1980s.

Ultimately, however, the significance of corporate leverage is a question of individual corporations' capacity to service their debt. Aggregate data concerning debt ratios reflect averages. And just as one may drown in water that averages two feet deep, average debt ratios cannot answer whether there are significant individual situations of dangerous overleverage. It is important to know whether individual cases of extreme leverage are isolated, and perhaps attributable to special circumstances, or reflect instead an accelerating trend in American industry.

Data addressing these and related questions is being developed at Treasury and by some in the private sector. We should recognize, however, that past experience is not a particularly good measure of the future prospects for a highly leveraged corporation. Existing LBOs have thrived in a period of extended economic expansion. They have not been subjected to the test of leaner times. It is certainly not the policy of the Bush Administration to arrange such a test. But how well these highly leveraged entities survive can not be answered by past data alone.

IV. CAUSES FOR CURRENT LEVEL OF LBO ACTIVITY

Some view LBOs as a rational strategy to maximize the value of corporations and their assets. Part of this strategy relates to the tax system and its discriminatory treatment of equity versus corporate debt. Since interest payments are deductible, but corporate dividends are not, there is a substantial tax advantage that accrues to LBOs and other transactions that effectively substitute corporate debt for equity. It should come as no surprise that removing the burden of a 34 percent tax rate from a corporation's income stream can arithmetically increase the value of a corporation's capitalization. The substitution of interest charges for pre-tax income is the mill in which the grist of takeover premiums is ground.

In addition, LBOs may generate new efficiencies in corporate management and financial structures. For corporations in mature industries, where cash flows are strong but opportunities for internal growth limited, an LBO may be a logical mechanism for distributing excess cash resources, allowing the market to reinvest the funds in more productive activities. Similarly, LBOs in some cases force corporate managers to abandon unproductive investments or extraneous lines of a corporation's business. Thus, some have seen in LBOs and the divestitures they trigger a process of corporate deconglomeration, reversing the conglomerate merger activity prevalent in the 1960s and early 1970s.

Although tax and efficiency considerations may be an important part of an LBO, they do not fully explain the extent and timing of LBO activity. The tax advantages of debt capitalization have existed for most of the history of the corporate income tax. Some analysts believe that the changes in the 1986 Tax Reform Act, including the reduction in the corporate tax rate and the elimination of the so-called *General Utilities* doctrine, may actually have diminished the tax benefits available from leveraged acquisitions.

Similarly, there does not appear to be anything in recent corporate management that would have suddenly made LBOs attractive. On the contrary, the corporate circumstances that arguably permit efficiency gains as a result of an LBO predate by a number of years the surge in LBO activity.

In sum, viewing LBOs as transactions that maximize shareholder value does not explain why it is only in the last few years that LBO activity has taken off. So what has happened? Our own analysis suggests that other factors have contributed importantly to the development of LBO activity at its current level. In part, these factors, which I will discuss here, have simply facilitated a market in which LBOs were made feasible.

Junk Bond Market. A key factor in the increase in LBO activity is the emergence of a junk bond market, which has supplied much of the debt capital on which LBOs are based. Prior to the late 1970s, junk bonds were generally fallen angels -- obligations that had been of investment grade when issued but were later downgraded because of problems that had arisen with the issuer's credit. More recently the junk bond market has developed into a market for corporate debt that, because of the debt's subordinated status and the corporation's substantial other indebtedness, is below investment grade when issued.

A central purpose of the present-day market for junk debt has been to facilitate directly LBOs and LTOs. The substantial leverage characteristic of LBOs dictates that much of the debt capital will necessarily be of an extremely junior grade. In the past, neither banks nor the traditional bond markets provided for such transactions and consequently, an alternative source of financing evolved. In sum, the junk bond market has vastly facilitated increased LBO and LTO activity.

Arbitrageurs. The current volume in LBOs is also partly attributable to the growth in arbitrage activity. Arbitrageurs purchase the stock of corporations thought to be acquisition candidates, hoping to sell the stock at a higher price if and when the acquisition is concluded. By definition, arbitrageurs are not long-term investors, and the nature of their activity and the demand for high rates of return on their available capital require that they turn over their investments in a reasonably short period of time. Because of arbitrage activity, the perception that a corporation is "in play" tends to become a self-fulfilling prophesy. Once arbitrageurs buy up the stock of a corporation, the willingness of the corporation's shareholders to sell is established, and management's ability to resist an acquisition is effectively reduced. The certain knowledge that arbitraguers own working control of the target company's stock in turn makes sure that the potential acquirers bidding for the corporation's stock will succeed.

Bargain Stock Prices. A third factor responsible for recent LBO activity is the perception that many stocks remain undervalued. As LBO and LTO operators have come to focus on the value placed on a corporation by the stock market, as compared with the replacement cost of its assets, and the higher sales values of component parts, the opportunity for bargain purchases has become apparent.

Strong Economy/Speculative Returns. Much of the current momentum behind LBO activity may simply reflect that, to this date, prior LBOs have largely been successful. Many have questioned whether the same pattern of success would have developed if the economy had been less robust in the last several years. At the moment, however, investors do not seem discouraged by such concerns, since they have rushed to get in on the spectacular returns that some prior LBOs have generated.

Advisory Fees. A final contributing factor in the proliferation of LBO activity is the ability of investment advisers, banks, underwriters and LBO fund managers to earn substantial up-front fees in the transactions. Such fees can total nearly 6 percent of the corporation's purchase price, and lend considerable momentum to LBO activity. These fees are earned up front, largely divorced from the long-term risks in the transaction. The LBO sponsor, investment banks, bond underwriters, syndicating bank and others earn substantial income if an LBO is completed, and thus have strong incentives to identify LBO candidates, arrange financing, and conclude transactions. Sadly these same parties may have relatively little, if any, investment in the long-term success of the new enterprise. Given this arrangement, it may very well be that the net effect of LBOs is a financial snipe-hunt, where the new long-term investors, flashlight in hand, are left holding the bag.

V. THE EFFECTS OF LBOs ON THE CORPORATE SECTOR

Corporate Management. LBOs have been defended by some as a positive check or discipline on corporate managers. In some cases, LBOs may well correct some of the deficiencies in the formal mechanisms of corporate governance. Our system of corporate democracy provides for a balance between continuity and change although it is viewed by some as exceedingly difficult for management of a public corporation to be removed by shareholder vote. Thus, management, once established, may pursue growth policies that aggrandize the corporation's position, but do not necessarily maximize the shareholders' investment. An LBO can be viewed as a sanction of such policies, since it replaces old management with a new team.

The entrenchment of corporate managers, free of effective control by the shareholders, may be a matter of legitimate concern. I find it difficult to accept, however, that LBOs and the psychology that feeds them are a sensible form of corporate governance. As the pace and scope of LBO activity have grown, I fear we are reaching a point where management is simply not disciplined toward more productive investment, but is robbed of any ability to pursue policies not in step with current market attitudes. In particular, to the extent markets become preoccupied with current earnings and cash flow, managers lose the flexibility to pursue long-term investment strategies. At a minimum, the corporate manager that pursues growth at the expense of short-term earnings may be threatened with the loss of his company.

We should not be surprised if corporate managers choose not to run that risk, and instead embrace what is currently fashionable, even though not in the long-term interest of their corporations. If that attitude becomes prevalent, we should be concerned whether U.S. corporations will make the commitment to research and development and other growth oriented strategies necessary to maintain their future competitiveness in a global economy.

We should also recognize that the plight of the corporate manager may not be relieved by privatization of the company. A buyout of a corporation's public shareholders does free it of stock market pressures, and thus in theory permits the corporation to pursue growth oriented policies without regard to the short-term effect on its earnings or stock price. As a practical matter, however, we are concerned that the financing in a typical LBO leaves management still focused on short-term performance, since substantial cash flow must be generated simply to meet debt service requirements.

Vulnerability to Business Cycle. The cash flow burdens of substantial leverage make a corporation more vulnerable to cyclical movements in the economy or to periods of slow economic growth. Debt service that may be manageable in periods of economic growth may become unmanageable if a corporation's revenues fall. Some argue that LBO debt can be restructured in the event of a downturn. Where a bankruptcy is forced, however, there may be significant costs in lost jobs, forced sales, and distraction of management. Moreover, the costs of bankruptcy may extend to the government, which effectively guarantees certain of a corporation's pension obligations for defined benefit plans through the Pension Benefit Guaranty Corporation.

Corporations and their lenders obviously take some account of bankruptcy potential, and what level of debt is prudent remains dependent on a particular corporation's situation. The many individual instances in which an LBO has dramatically increased a corporation's leverage, and the apparent market acceptance of these transactions, suggest that corporate managers and the financial markets have placed greater emphasis on the benefits than the risks of leverage. This attitude may be attributable to the sustained economic growth of the last six years, which has permitted the optimistic assumptions that appear to underlie some transactions to remain untested.

Risk to Banking System/Financial Institutions. The risks attributable to increased corporate debt fall also on investors. Some level of risk is inherent in all investment, and there would seem to be no reason for concern where individuals or business investors knowingly undertake the risks involved in acquiring LBO debt. However, much of the capital invested in LBOs comes from banks, savings and loans, pension funds, insurance companies and other institutional investors which are in effect investing on behalf of the individuals whose savings they control. It should be noted that depositors in banks and savings and loans and participants in defined benefit pension plans have the benefit of a federal guarantee of their deposits.

Many observers have questioned whether LBOs are appropriate investments for financial institutions, given the levels of risk involved. Although there is an understandable desire on the part of such institutions to maximize returns on their invested capital, such desires must be balanced against their fiduciary obligations to avoid substantial commitments of capital to high risk investments. This concern is sharpened by a history of overcommitment, driven by fees and fashion, to types of loans which subsequently proved to be problems.

In this regard, a number of state insurance regulators have proposed restrictions on the extent to which insurance companies can hold such debt. I am also encouraged to see that Chairman Greenspan of the Federal Reserve Board and Comptroller of the Currency Clarke have indicated their intent to review carefully the level of LBO investments by federally chartered banks.

Fairness to Shareholders. A concern expressed by some is whether LBOs permit Wall Street insiders and corporate managers to profit at the expense of ordinary investors. This is a legitimate concern, but one which was more relevant in the early days of LBO transactions.

More recently, however, we have seen that in most cases the market will operate to ensure that shareholders receive full value for their stock. As we have witnessed in recent transactions, a management initiated LBO may trigger offers from outside interests, with the ultimate price for the company's stock determined in an auction-like bidding process. This process works best to establish a fair price when all bidders have access to the relevant information concerning the corporation's business. And, corporate boards of directors, with the encouragement of the courts, have tended to insist that the corporation's books be opened to all potential bidders.

Other Constituencies. A final but important area of concern is the effect of LBOs on corporate constituencies other than the shareholders. In previous testimony to the Senate I have cautioned that we should be careful not to march to the drumbeat of single dimension philosophies. Thus, while shareholders may realize large premiums from an LBO, the corporation's employees, bondholders and the communities in which the corporation is located may all be adversely affected. Employees may lose their jobs if the corporation is forced to retrench or if divisions are sold in order to retire debt. Such job losses have significant collateral effects on the communities in which the employees work.

The clearest losers from a financial viewpoint in some LBOs are the corporation's pre-existing bondholders. The drop in the corporation's credit rating translates directly into a reduction in the value of their bonds. However, this is arguably a situation where the affected can take care of themselves, since a variety of contractual devices are available to protect bondholders in the event of an LBO or similar transaction affecting the corporation's credit rating.

VI. REMEDIAL MEASURES

A. Tax Proposals. As I indicated earlier, I do not believe the recent surge in LBOs should be seen as driven only by tax considerations. The tax incentives for debt capitalization are long standing, and recent legislative changes may have actually diminished the tax benefits available from leveraged acquisitions. However, tax considerations remain an important part of corporate financial planning, and we should be concerned about the tax system's bias against equity capitalization.

Because we subject income on corporate equity to double taxation, while interest payments, like wages, are taxed only once, a corporation throughout its existence is encouraged to raise capital in the form of debt rather then equity. The new corporation is encouraged to load its initial capital structure with debt; the growing corporation is encouraged to raise new capital through debt; and the mature corporation is encouraged to replace its existing stock with debt either through a stock buyback or LBO.

Dividend Relief. Many have concluded that the way to correct the tax bias for debt capitalization is to limit corporate interest deductions. This approach, however, would simply increase the cost of capital for American acquirers by effectively raising their interest rates on an after tax basis. Moreover, since such restrictions would not affect borrowing costs of foreign corporations, the net effect would be a competitive disadvantage for U.S. corporations. Finally, the long history of attempts to define problems out of existence has proved that the definees are more adept than the definors. Just as soon as new regulations are written, efforts are underway to render them irrelevant.

A more logical approach to the biases in our tax system would focus on our overtaxation of corporate equity. We stand virtually alone in the industrial world in the extent to which we apply a double tax regime to corporate income. Thus, although each of our major trading partners imposes a separate tax on corporate income, most also provide substantial relief from that tax when dividends are distributed. We should not ignore this fact as we are every day forced to compete in an increasingly global economy. Germany, Italy, Australia, and New Zealand allow shareholders full credit for the corporate tax paid. France provides full relief through the combination of a partial deduction for dividends paid and a partial shareholder credit. Other countries, including the United Kingdom, Japan and Canada, provide significant partial relief from double taxation.

The Treasury proposals for Tax Reform in 1984 and 1985 would have reduced the tax burden on corporate equity by permitting corporations to deduct a portion of the dividends they distribute. The House of Representatives included a scaled-back version of these proposals in its 1985 Tax Reform bill. Although dividend relief was eventually dropped in the final Tax Reform legislation, we should not accept this as the last word on the merits of such proposals. I well recognize that at this juncture revenue considerations limit our ability to provide fundamental relief from double taxation of corporate income. But the fact remains that market forces have created their own solution to the double taxation of dividends. At the same time, tax as well as economic policy would be ill served if we were to address the current imbalance in the taxation of debt and equity without seriously considering proposals to mitigate in some significant way the double tax on corporate equity income.

Revenue Effects. Part of the concern with the tax incentive for leveraged acquisitions and stock repurchases relates to possible revenue losses from a broad substitution of debt for existing corporate equity. A corporation replacing nondeductible dividend distributions with deductible interest payments will of course achieve a savings in its income tax liability for many years. If such substitution were to occur on a broad scale, there would be a correspondingly large reduction in corporate income tax receipts.

It is important to recognize, however, that LBOs and leveraged share buybacks typically generate three effects offsetting the increase in corporate interest deductions. An LBO or stock repurchase represents a taxable sale of stock for shareholders, generally at a substantial premium, and the gains recognized effectively accelerate income that might have been deferred for a number of years, or even exempted altogether if the shareholder held the stock until death. In addition, an LBO or substantial share repurchase would typically require taxable asset sales by the corporation in order to retire indebtedness. It is also important to recognize that to the extent that LBOs or other leveraged recapitalizations lead to a more efficient allocation of resources, the overall level of national income will be increased, and this will generate additional tax revenues which will further offset the adverse revenue impact of the substitution of debt for equity by those transactions.

B. Financial Institution Regulation. The substantial fees that banks can command for arranging LBO financing, as well as the higher interest rates they can charge, may lead some banks to commit an inappropriately large portion of their portfolios to LBO debt. Moreover, there is concern that some of the banks participating in a syndicate do not examine the loans carefully and simply rely on the judgment of the lead bank. Chairman Greenspan's recent warning to banks that they should examine closely the prospects of LBO loans under a wide range of economic and financial circumstances is thus particularly apt.

C. Securities Law. An additional and important source of regulation is the securities laws. In a recent testimony before the House Telecommunications and Finance Subcommittee, SEC Chairman David Ruder outlined several regulatory changes being considered by the SEC. Among the most important is a discussion of the rules governing so-called fairness opinions. In this regard, a standard practice that should receive scrutiny is linking the size of the fee paid for the opinion to successful completion of the transaction. Such linkage raises serious questions as to the objectivity of the opinion.

VII. CONCLUSION

My testimony has been necessarily general, but I admit that I have a growing feeling that we are headed in the wrong direction when so much of our young talent and the nation's financial resources are aimed at financial engineering while the rest of the world is laying the foundation for the future.

We have always done best in this country when our savings have been used to create new jobs, new products, and new services at lower prices. LBOs produce fundamental changes in the financial structures of this country's corporations. They, in turn, raise basic questions about our economic future, whether we will continue to grow and create jobs and whether we will remain competitive.

Mr. Chairman, I know you share my concerns. By holding this series of hearings, you have issued a call to the brightest minds in both government and the private sector to examine and evaluate this trend.

I commend your efforts and I would like to join you today in this endeavor, by issuing a challenge to those who make the financing decisions and the financial institutions which advise them -- to the gladiators in the arena.

I call on them to put the same intensity and effort into evaluating where we are going as they have into taking us there. Let them bring forward the evidence and make proposals about what should be done.

I think it is entirely appropriate that we together -- the Congress and the Administration -- call upon the private sector to take on this responsibility. It is in the finest tradition of our democratic system that government look first to the people themselves for solutions and only act when it is clear the people can not solve the problem themselves.

TREASURY NEWS

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January 31, 1989

O. DONALDSON CHAPOTON
ASSISTANT SECRETARY (TAX POLICY)
TO LEAVE TREASURY

O. Donaldson Chapoton, Assistant Secretary (Tax Policy) will leave the Treasury Department to rejoin, on February 1, the Houston-based law firm of Baker & Botts. Mr. Chapoton will be the partner-in-charge of the firm's Washington office.

In announcing Mr. Chapoton's upcoming departure, Secretary of the Treasury Nicholas F. Brady noted, "Don has been a tremendous asset to the Department. His tax knowledge and experience have been invaluable in the important area of Tax Policy and we wish him well."

As Assistant Secretary for Tax Policy, Mr. Chapoton has served as the chief Treasury spokesman and advisor to the Secretary in the formulation and execution of domestic and international tax policies and programs.

Mr. Chapoton joined the Treasury Department in May of 1986. Prior to that time, he was a Senior Partner with the law firm of Baker & Botts in Houston specializing in the areas of corporate reorganizations, acquisitions and liquidations, oil and gas and partnership tax law, and tax aspects of foreign investment in the United States. From 1961-63, Mr. Chapoton served in the Judge Advocate General's Corps, U.S. Army. He also served as a law clerk to Judge John R. Brown, Fifth Circuit Court of Appeals, Houston, Texas, after receiving his LL.B. from the University of Texas School of Law in 1960.

Mr. Chapoton, a native of Houston, Texas, is married to the former Mary Jo Kelley of San Antonio. They have two children, a daughter Kelley, age 13, and a son Hunt, age 10.

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TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M.
January 31, 1989

CONTACT: Office of Financing
202/376-4350

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $14,400 million, to be issued February 9, 1989. This offering will result in a paydown for the Treasury of about $225 million, as the maturing bills are outstanding in the amount of $14,635 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Standard time, Monday, February 6, 1989. The two series offered are as follows:

91-day bills (to maturity date) for approximately $7,200 million, representing an additional amount of bills dated May 12, 1988, and to mature May 11, 1989 (CUSIP No. 912794 RX 4), currently outstanding in the amount of $16,324 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $7,200 million, to be dated February 9, 1989, and to mature August 10, 1989 (CUSIP No. 912794 ST 2).

The bills will be issued on a discount basis under competitive and noncompetitive bidding, and at maturity their par amount will be payable without interest. Both series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, on the records either of the Federal Reserve Banks and Branches, or of the Department of the Treasury.

The bills will be issued for cash and in exchange for Treasury bills maturing February 9, 1989. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rates of accepted competitive tenders. Additional amounts of the bills may be issued to Federal Reserve Banks, as agents for foreign and international monetary authorities, to the extent that the aggregate amount of tenders for such accounts exceeds the aggregate amount of maturing bills held by them. Federal Reserve Banks currently hold $1,922 million as agents for foreign and international monetary authorities, and $4,362 million for their own account. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 5176-1 (for 13-week series) or Form PD 5176-2 (for 26-week series).

NB-122

Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. This information should reflect positions held as of one-half hour prior to the closing time for receipt of tenders on the day of the auction. Such positions would include bills acquired through "when issued" trading, and futures and forward transactions as well as holdings of outstanding bills with the same maturity date as the new offering, e.g., bills with three months to maturity previously offered as six-month bills. Dealers, who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities, when submitting tenders for customers, must submit a separate tender for each customer whose net long position in the bill being offered exceeds $200 million.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

Payment for the full par amount of the bills applied for must accompany all tenders submitted for bills to be maintained on the book-entry records of the Department of the Treasury. A cash adjustment will be made on all accepted tenders for the difference between the par payment submitted and the actual issue price as determined in the auction.

No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches. A deposit of 2 percent of the par amount of the bills applied for must accompany tenders for such bills from others, unless an express guaranty of payment by an incorporated bank or trust company accompanies the tenders.

Public announcement will be made by the Department of the Treasury of the amount and yield range of accepted bids. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. Subject to these reservations, noncompetitive tenders for each issue for $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. Cash adjustments will be made for differences between the par value of the maturing bills accepted in exchange and the issue price of the new bills. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

If a bill is purchased at issue, and is held to maturity, the amount of discount is reportable as ordinary income on the Federal income tax return of the owner for the year in which the bill matures. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, any gain in excess of the basis is treated as ordinary income.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76, 27-76, and 2-86, as applicable, Treasury's single bidder guidelines, and this notice prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars, guidelines, and tender forms may be obtained from any Federal Reserve Bank or Branch, or from the Bureau of the Public Debt.

Final 1/27/89*

Opening Statements by
M. Peter McPherson
Deputy Secretary of the Treasury
and
David Walker
Assistant Secretary, Pension and Welfare Benefits Administration
Department of Labor
at the Press Briefing on ERISA and Takeovers
Monday, January 30, 1989

DEPUTY SECRETARY MCPHERSON: Due to the Secretary of the Treasury's role as chief economic adviser to the President and our responsibility for certain ERISA rules, Treasury has received a number of questions lately about what ERISA rules require or permit pension plan fiduciaries to do with regard to tender offers, takeovers, and mergers. In brief, there is some confusion about these matters so we spoke to officials of the Department of Labor. The Department of Labor has primary responsibility for the relevant ERISA rules. They had recently received many of the same questions; so we agreed that it would be useful to clear up this confusion today. So that he can do so, I will now turn the podium over to Assistant Secretary of Labor David Walker, who heads the Pension and Welfare Benefits Administration.

ASSISTANT SECRETARY WALKER: We are here today to clear up certain misperceptions regarding ERISA's requirements as they relate to tender offers including cash offers at premiums above the market and merger proposals.

Given the size and growth of pension plan assets over the past 15 years, pension plans are playing an ever increasing role in the capital markets. In addition, whether they want to be or not, they are major players in tender offer and proxy contests.

Some have asserted that ERISA requires plan fiduciaries to accept any tender offers that involve a premium over the prevailing market price. This is not the case. While ERISA does require that fiduciaries manage plan investments prudently and solely in the interest of plan participants and beneficiaries, it does not mandate that plan fiduciaries automatically tender shares held by the plan in order to capture any premium represented by the tender offer.

Rather than an automatic tender mandate, ERISA requires plan fiduciaries to make investment decisions, including tender offer decisions, based on the facts and circumstances applicable to the investment and the plan. Fiduciaries are required to take the course of action that is in the economic best interest of the pension plan, recognizing the pension trust as a separate legal

entity designed to provide retirement income. Plan fiduciaries are not required to take the "quick buck" if they believe, based on an appropriate and objective analysis, the plan can achieve a higher economic value by holding the shares than by tendering the shares and re-investing the proceeds. For example, in making such an investment decision, plan fiduciaries may weigh, among other things, the long-term value of the target company. In making that determination, the long-term business plan of the target company's management would be relevant. A similar analysis would be involved in evaluating whether to support or oppose a merger offering the possibility of an immediate gain.

Given the size and growth of pension plan assets and their related equity holdings, it is clear they will continue to play a significant role in contests for corporate control. The Department of Labor will continue to monitor plan fiduciaries, corporate management, and other interested parties to assure they do not violate ERISA's requirements and are aware of the liability that can result from any such violations.

We are sensitive to the need to assure that government policies and actions do not prevent the huge pools of capital represented by pension plans to be invested in manners that will facilitate our continued economic growth, provide corporate accountability, and enhance our nation's competitiveness. At the same time, we must not lose sight of the fact that pension plans are established and maintained for the purpose of providing retirement income. We will, therefore, continue to vigorously enforce ERISA's fiduciary requirements. This is essential if we are to maintain the credibility and ensure the security of our voluntary private pension system, on which millions of Americans rely.

DEPUTY SECRETARY MCPHERSON: Thank you, Dave. These issues are complex and precision is important so the Departments have prepared a longer written statement which should answer most questions relating to these matters. Assistant Secretary Walker, Michael Darby, Assistant Secretary of the Treasury for Economic Policy, and I will be glad to handle any technical questions you may have regarding the statement.

Thank you for your time and interest in this matter.

Final 1/27/89

Joint Department of Labor/Department
of Treasury Statement on Pension Investments

Questions have recently been raised with the Departments of Labor and Treasury as to the duties of pension fund fiduciaries with respect to tender offers including cash offers at premiums above the market and merger proposals. Given the size and growth of private pension fund equity portfolios in the past 15 years, the significant role that they play in the capital markets, and the recent increase in public attention accorded to related pension investment issues, the Departments would like to reiterate the duties of fiduciaries of pension plans covered by the Employee Retirement Income Security Act of 1974 (ERISA) with respect to tender offers and merger proposals.[1]

Assertions have been made that because a tender offer represents a premium over the prevailing market price for shares of the target company's stock, the fiduciary responsibility provisions of ERISA require that pension fund fiduciaries

[1]Under ERISA, every plan is required to provide for a "named fiduciary" who has the authority to control and manage the operation and administration of the plan. This named fiduciary may be a person or persons such as corporate directors and officers who can have other relationships to the plan sponsor (e.g., corporate officers, directors). In acting as a named fiduciary, however, they are not representing the sponsor or any other organization, but rather are subject to provisions of ERISA, including the requirement that they act solely in the interest of plan participants and beneficiaries.

automatically tender their shares. This is not the case. ERISA does require that fiduciaries manage plan investments prudently and solely in the interest of plan participants and beneficiaries. It does not, however, mandate that the plan fiduciary automatically tender shares held by the plan to capture the premium over market represented by the tender offer.

The Department of Labor defines prudence under ERISA with reference to what is in the economic best interest of a plan's participants and beneficiaries, in their capacity as participants and beneficiaries of the plan. Therefore, such decisions must be based on what is in the economic interest of the pension plan, recognizing that the pension trust is a separate legal entity designed to provide retirement income. ERISA's prudence rule also requires fiduciaries to make investment decisions, including tender offer decisions, based on the facts and circumstances applicable to a particular plan. Thus, in evaluating a tender offer, a fiduciary would have to evaluate it on its merits. In doing so, among other things, it would be appropriate to weigh a tender offer against the underlying intrinsic value of the target company, and the likelihood of that value being realized by current management or by a possible subsequent tender offer. It would also be proper to weigh the long-term value of the company against the value presented by the tender offer and the ability to invest the proceeds elsewhere. In making these determinations, the long-term business plan of the target company's

management would be relevant. A similar process should lead to the fund's decision to support or oppose a proposed merger.

The Department of Labor has been and will continue to be particularly watchful for attempts by corporate management to utilize the assets of their own plans either as an offensive or defensive tool in battles for corporate control. The Department wishes to reiterate that any such actions would violate both the requirement that pension funds be managed solely in the interest of plan participants and beneficiaries and the prohibited transaction provisions of ERISA.

In conclusion, the Department of Labor will continue to monitor plan fiduciaries, corporate management, and other interested parties to assure they do not violate ERISA's requirements governing pension plans and are aware of the potential liability for any related violations. The Departments are sensitive to the need to ensure that government policies and actions do not prevent the huge pools of capital represented by private pension plans from being invested in manners that will facilitate our continued economic growth, provide corporate accountability, and enhance our nation's competitiveness. We will insist that plan fiduciaries adhere to ERISA's fiduciary standards and prohibited transaction rules. This is essential if we are to assure the credibility of the private pension system and safeguard the benefit security for the millions of Americans

who will rely on their private pension benefit during their retirement years.

federal financing bank NEWS
WASHINGTON, D.C. 20220
Press 566-2041
FFB 566-2468

FOR IMMEDIATE RELEASE February 1, 1989

FEDERAL FINANCING BANK ACTIVITY

Charles D. Haworth, Secretary, Federal Financing Bank (FFB), announced the following activity for the month of May 1988.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $150.0 billion on May 31, 1988, posting a decrease of $0.1 billion from the level on April 30, 1988. This net change was the result of decreases in holdings of agency debt of $252.3 million and in agency assets of $0.5 million. Agency-guaranteed debt increased by $194.8 million. FFB made 52 disbursements during May.

Attached to this release are tables presenting FFB May loan activity and FFB holdings as of May 31, 1988.

NB-123

FEDERAL FINANCING BANK

MAY 1988 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
AGENCY DEBT					
NATIONAL CREDIT UNION ADMINISTRATION					
Central Liquidity Facility					
+Note #465	5/4	$ 10,200,000.00	8/4/88	6.438%	
+Note #466	5/19	9,640,000.00	8/18/88	6.522%	
TENNESSEE VALLEY AUTHORITY					
Advance #890	5/3	37,000,000.00	5/9/88	6.380%	
Advance #891	5/6	209,000,000.00	5/13/88	6.489%	
Advance #892	5/9	26,000,000.00	5/16/88	6.601%	
Advance #893	5/9	55,000,000.00	5/19/88	6.601%	
Advance #894	5/13	10,000,000.00	5/18/88	6.525%	
Advance #895	5/13	319,000,000.00	5/19/88	6.525%	
Advance #896	5/17	26,000,000.00	5/24/88	6.506%	
Advance #897	5/19	5,000,000.00	5/23/88	6.522%	
Advance #898	5/19	100,000,000.00	5/24/88	6.522%	
Advance #899	5/19	65,000,000.00	5/27/88	6.522%	
Advance #900	5/20	21,000,000.00	5/27/88	6.458%	
Advance #901	5/24	118,000,000.00	5/30/88	6.558%	
Advance #902	5/30	112,000,000.00	6/6/88	6.756%	
Advance #903	5/31	131,000,000.00	6/8/88	6.756%	
Power Bond 1988-B	5/19	200,000,000.00	11/15/02	9.280%	
GOVERNMENT - GUARANTEED LOANS					
DEPARTMENT OF DEFENSE					
Foreign Military Sales					
Greece 17	5/6	5,136,977.00	8/25/14	9.162%	
Greece 15	5/12	556,013.72	6/15/12	9.329%	
Niger 2	5/13	33,017.02	10/15/90	8.173%	
Niger 3	5/13	124,760.44	5/15/95	8.957%	

+rollover

FEDERAL FINANCING BANK

MAY 1988 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
GOVERNMENT - GUARANTEED LOANS (Cont'd.)					
Greece 15	5/17	$ 556,013.72	6/15/12	9.236%	
Israel 17	5/18	147,016,575.45	8/25/14	9.335%	
Greece 15	5/18	249,878.14	6/15/12	9.336%	
Morocco 13	5/18	7,752.24	5/31/96	8.697%	
Greece 16	5/23	1,964,025.70	9/1/13	9.435%	
Greece 17	5/23	30,039,991.13	8/25/14	9.419%	
Israel 17	5/24	8,771,777.19	8/25/14	9.480%	
Greece 17	5/24	863,933.80	8/25/14	9.439%	
DEPARTMENT OF ENERGY					
Geothermal Loan Guarantees					
Ormesa-Geothermal	5/20	49,980,00.00	5/19/08	9.300%	
DEPARTMENT OF HOUSING & URBAN DEVELOPMENT					
Community Development					
*Toa Baja, PR	5/2	2,742,000.00	5/1/93	8.212%	8.381% ann.
Rochester, NY	5/2	70,889.00	8/15/88	6.400%	
*Montgomery Cty., PA	5/16	2,000,001.00	5/15/96	7.088%	7.152% ann.
Newport News, VA	5/17	10,000.00	2/15/89	7.197%	7.283% ann.
Kansas City, MO	5/24	470,000.00	6/15/88	6.558%	
Ponce, PR	5/24	345,148.08	10/3/88	6.860%	
RURAL ELECTRIFICATION ADMINISTRATION					
*Tex-La Electric Coop #208A	5/2	1,056,000.00	1/3/17	9.157%	9.055% qtr.
*Northwest Electric Power #176	5/2	915,000.00	1/3/17	9.153%	9.051% qtr.
Brazos Electric #333	5/6	2,500,000.00	12/31/21	9.210%	9.106% qtr.
*Wolverine Power #182A	5/11	1,750,000.00	1/2/90	7.988%	7.910% qtr.
*Wolverine Power #183A	5/11	2,336,000.00	1/2/90	7.988%	7.910% qtr.
*Allegheny Electric Coop #175A	5/11	3,255,000.00	7/2/90	8.146%	8.065% qtr.
*Wabash Valley Power #104	5/12	2,526,000.00	1/3/17	9.285%	9.180% qtr.
*Wabash Valley Power #206	5/12	846,000.00	1/3/17	9.285%	9.180% qtr.
*Wabash Valley Power #206	5/12	203,000.00	5/14/90	8.075%	7.995% qtr.
*Colorado Ute-Electric #203A	5/19	3,364,000.00	7/2/90	8.186%	8.104% qtr.
New Hampshire Electric #270	5/20	1,968,000.00	1/2/18	9.379%	9.272% qtr.

*maturity extension

FEDERAL FINANCING BANK

MAY 1988 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
RURAL ELECTRIFICATION ADMINISTRATION (Cont'd.)					
Oglethorpe Power #320	5/26	$ 9,728,000.00	7/2/90	8.313%	8.228%
Alaska Electric #310	5/31	294,000.00	1/3/17	9.415%	9.307%
SMALL BUSINESS ADMINISTRATION					
State & Local Development Company Debentures					
Crossroads Econ. Dev. Corp.	5/4	71,000.00	5/1/08	9.101%	
Columbus Citywide Dev. Corp.	5/4	239,000.00	5/1/13	9.177%	
TENNESSEE VALLEY AUTHORITY					
Seven States Energy Corporation					
Note #A-88-08	5/31	657,457,234.04	8/31/88	6.786%	

FEDERAL FINANCING BANK HOLDINGS
(in millions)

Program	May 31, 1988	April 30, 1988	Net Change 5/1/88-5/31/88	FY '88 Net Change 10/1/87-5/31/88
Agency Debt:				
Export-Import Bank	$ 11,488.5	$ 11,488.5	$ -0-	$ -975.0
NCUA-Central Liquidity Facility	106.5	114.6	-8.1	-4.9
Tennessee Valley Authority	16,768.0	16,751.0	17.0	382.0
U.S. Postal Service	5,592.2	5,853.4	-261.2	1,238.0
sub-total*	33,955.1	34,207.5	-252.3	640.9
Agency Assets:				
Farmers Home Administration	59,674.0	59,674.0	-0-	-5,335.0
DHHS-Health Maintenance Org.	84.0	84.0	-0-	-0-
DHHS-Medical Facilities	102.2	102.2	-0-	-0-
Overseas Private Investment Corp.	-0-	-0-	-0-	-0.7
Rural Electrification Admin.-CBO	4,071.2	4,071.2	-0-	-170.0
Small Business Administration	16.8	17.2	-0.5	-2.8
sub-total*	63,948.2	63,948.6	-0.5	-5,508.5
Government-Guaranteed Lending:				
DOD-Foreign Military Sales	18,588.6	18,453.3	135.3	-575.4
DEd.-Student Loan Marketing Assn.	4,940.0	4,940.0	-0-	-0-
DOE-Geothermal Loan Guarantees	50.0	-0-	50.0	50.0
DHUD-Community Dev. Block Grant	320.7	321.7	-1.0	-3.5
DHUD-New Communities	-0-	-0-	-0-	-30.6
DHUD-Public Housing Notes +	2,037.0	2,037.0	-0-	-37.3
General Services Administration +	390.7	391.6	-0.9	-4.8
DOI-Guam Power Authority	32.6	32.6	-0-	-0.5
DOI-Virgin Islands	26.7	26.7	-0-	-0.4
NASA-Space Communications Co. +	949.4	949.4	-0-	140.8
DON-Ship Lease Financing	1,758.9	1,758.9	-0-	-29.4
Rural Electrification Administration	19,217.7	19,203.2	14.5	-1,979.2
SBA-Small Business Investment Cos.	693.1	703.3	-10.2	-47.5
SBA-State/Local Development Cos.	885.8	888.8	-3.0	-14.0
TVA-Seven States Energy Corp.	1,965.4	1,952.5	12.9	141.7
DOT-Section 511	48.5	51.2	-2.7	-6.8
DOT-WMATA	177.0	177.0	-0-	-0-
sub-total*	52,082.3	51,887.4	194.8	-2,396.9
grand total*	$ 149,985.6	$ 150,043.5	$ -58.0	$ -7,264.5

*figures may not total due to rounding
+does not include capitalized interest

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE WHEN AUTHORIZED AT PRESS CONFERENCE
February 1, 1989

CONTACT: Office of Financing
202/376-4350

TREASURY FEBRUARY QUARTERLY FINANCING

The Treasury will raise about $13,625 million of new cash and refund $15,130 million of securities maturing February 15, 1989, by issuing $9,750 million of 3-year notes, $9,500 million of 10-year notes, and $9,500 million of 30-year bonds. The $15,130 million of maturing securities are those held by the public, including $678 million held, as of today, by Federal Reserve Banks as agents for foreign and international monetary authorities.

The three issues totaling $28,750 million are being offered to the public, and any amounts tendered by Federal Reserve Banks as agents for foreign and international monetary authorities will be added to that amount. Tenders for such accounts will be accepted at the average prices of accepted competitive tenders.

In addition to the public holdings, Federal Reserve Banks hold $1,411 million of the maturing securities for their own accounts, which may be refunded by issuing additional amounts of the new securities at the average prices of accepted competitive tenders.

The 10-year note and 30-year bond being offered today will be eligible for the STRIPS program.

Details about each of the new securities are given in the attached highlights of the offering and in the official offering circulars.

oOo

Attachment

NB-124

HIGHLIGHTS OF TREASURY OFFERINGS TO THE PUBLIC
FEBRUARY 1989 QUARTERLY FINANCING

February 1, 1989

Amount Offered to the Public.....	$9,750 million	$9,500 million	$9,500 million
<u>Description of Security</u>:			
Term and type of security........	3-year notes	10-year notes	30-year bonds
Series and CUSIP designation.....	Series R-1992 (CUSIP No. 912827 XD 9)	Series A-1999 (CUSIP No. 912827 XE 7)	Bonds of 2019 (CUSIP No. 912810 EC 8)
CUSIP Nos. for STRIPS Components.	Not applicable	Listed in Attachment A of offering circular	Listed in Attachment A of offering circular
Issue date	February 15, 1989	February 15, 1989	February 15, 1989
Maturity date....................	February 15, 1992	February 15, 1999	February 15, 2019
Interest rate....................	To be determined based on the average of accepted bids	To be determined based on the average of accepted bids	To be determined based on the average of accepted bids
Investment yield.................	To be determined at auction	To be determined at auction	To be determined at auction
Premium or discount..............	To be determined after auction	To be determined after auction	To be determined after auction
Interest payment dates...........	August 15 and February 15	August 15 and February 15	August 15 and February 15
Minimum denomination available...	$5,000	$1,000	$1,000
Amount required for STRIPS.......	Not applicable	To be determined after auction	To be determined after auction
<u>Terms of Sale</u>:			
Method of sale...................	Yield auction	Yield auction	Yield auction
Competitive tenders..............	Must be expressed as an annual yield with two decimals, e.g., 7.10%	Must be expressed as an annual yield with two decimals, e.g., 7.10%	Must be expressed as an annual yield with two decimals, e.g., 7.10%
Noncompetitive tenders...........	Accepted in full at the average price up to $1,000,000	Accepted in full at the average price up to $1,000,000	Accepted in full at the average price up to $1,000,000
Accrued interest payable by investor.............	None	None	None
<u>Payment Terms</u>:			
Payment by non-institutional i[illegible]	Full payment to be submitted with tender	Full payment to be submitted with tender	Full payment to be submitted with tender
P[illegible]ugh Treasury Tax a[illegible]&L) Note Accounts....	Acceptable for TT&L Note Option Depositaries	Acceptable for TT&L Note Option Depositaries	Acceptable for TT&L Note Option Depositaries
D[illegible]antee by d[illegible]nstitutions..........	Acceptable	Acceptable	Acceptable
<u>K[illegible]</u>			
R[illegible]enders...............	Tuesday, February 7, 1989, prior to 1:00 p.m., EST	Wednesday, February 8, 1989, prior to 1:00 p.m., EST	Thursday, February 9, 1989, prior to 1:00 p.m., EST
S[illegible] (final payment d[illegible]stitutions):			
a) [illegible]mediately available to the Treasury.....	Wednesday, February 15, 1989	Wednesday, February 15, 1989	Wednesday, February 15, 1939
b) readily-collectible check.....	Monday, February 13, 1989	Monday, February 13, 1989	Monday, Februar[illegible] 13, 1989

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE February 1, 1989

PETER T. MADIGAN LEAVES TREASURY TO BECOME DEPUTY ASSISTANT SECRETARY OF STATE

Secretary of the Treasury Nicholas F. Brady announced today that Deputy Assistant Secretary of Legislative Affairs, Peter T. Madigan, is leaving the Department to assume a similar position at the State Department in the Bush Administration, Principal Deputy Assistant Secretary of State for Legislative Affairs.

Secretary Brady said, "Peter has made many valuable contributions to the Treasury Department and will be missed". He was deeply involved with the passage of the 1986 Tax Reform Act, the creation of the Financial Working Group on the Stock Market Break, the negotiations on the 1988 Trade Bill and the Bipartisan Budget Summit Agreements, and with Savings and Loan reform. "Peter will be a major asset to the Bush Administration," Secretary Brady added.

Mr. Madigan has served as Principal Deputy Assistant Secretary for Legislative Affairs for the last year. Prior to that he was Special Assistant to the Assistant Secretary of the Treasury for Legislative Affairs. From 1984 to 1985 he was Legislative Director of the National Association of Realtors. From 1983-1985 he served in the Reagan Administration in a number of legislative posts, including Special Assistant to the Assistant Secretary of Health and Human Services and Legislative Assistant to the Director of the Office of Management and Budget.

Prior to joining the Reagan Administration, Mr. Madigan served as Floor Assistant to the House Republican Chief Deputy Whip.

Mr. Madigan received his Bachelor of Arts degree in Broadcasting & Political Science from the University of Maine at Orono in 1981. A native of Maine, he now resides in the District of Columbia.

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TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

CONTACT: Office of Financing
202/376-4350

FOR RELEASE AT 12:00 NOON
February 3, 1989

TREASURY'S 52-WEEK BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for approximately $9,000 million of 364-day Treasury bills to be dated February 16, 1989, and to mature February 15, 1990 (CUSIP No. 912794 TR 5). This issue will result in a paydown for the Treasury of about $900 million, as the maturing 52-week bill is outstanding in the amount of $9,907 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Standard time, Tuesday, February 14, 1989.

The bills will be issued on a discount basis under competitive and noncompetitive bidding, and at maturity their par amount will be payable without interest. This series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, on the records either of the Federal Reserve Banks and Branches, or of the Department of the Treasury.

The bills will be issued for cash and in exchange for Treasury bills maturing February 16, 1989. In addition to the maturing 52-week bills, there are $14,639 million of maturing bills which were originally issued as 13-week and 26-week bills. The disposition of this latter amount will be announced next week. Federal Reserve Banks currently hold $2,371 million as agents for foreign and international monetary authorities, and $7,963 million for their own account. These amounts represent the combined holdings of such accounts for the three issues of maturing bills. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rate of accepted competitive tenders. Additional amounts of the bills may be issued to Federal Reserve Banks, as agents for foreign and international monetary authorities, to the extent that the aggregate amount of tenders for such accounts exceeds the aggregate amount of maturing bills held by them. For purposes of determining such additional amounts, foreign and international monetary authorities are considered to hold $880 million of the original 52-week issue. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 5176-3.

Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. This information should reflect positions held as of one-half hour prior to the closing time for receipt of tenders on the day of the auction. Such positions would include bills acquired through "when issued" trading, and futures and forward transactions as well as holdings of outstanding bills with the same maturity date as the new offering, e.g., bills with three months to maturity previously offered as six-month bills. Dealers, who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities, when submitting tenders for customers, must submit a separate tender for each customer whose net long position in the bill being offered exceeds $200 million.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

Payment for the full par amount of the bills applied for must accompany all tenders submitted for bills to be maintained on the book-entry records of the Department of the Treasury. A cash adjustment will be made on all accepted tenders for the difference between the par payment submitted and the actual issue price as determined in the auction.

No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches. A deposit of 2 percent of the par amount of the bills applied for must accompany tenders for such bills from others, unless an express guaranty of payment by an incorporated bank or trust company accompanies the tenders.

Public announcement will be made by the Department of the Treasury of the amount and yield range of accepted bids. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. Subject to these reservations, noncompetitive tenders for each issue for $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. Cash adjustments will be made for differences between the par value of the maturing bills accepted in exchange and the issue price of the new bills. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

If a bill is purchased at issue, and is held to maturity, the amount of discount is reportable as ordinary income on the Federal income tax return of the owner for the year in which the bill matures. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, any gain in excess of the basis is treated as ordinary income.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76, 27-76, and 2-86, as applicable, Treasury's single bidder guidelines, and this notice prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars, guidelines, and tender forms may be obtained from any Federal Reserve Bank or Branch, or from the Bureau of the Public Debt.

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

CONTACT: Office of Financing
202/376-4350

FOR IMMEDIATE RELEASE
February 6, 1989

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,205 million of 13-week bills and for $7,210 million of 26-week bills, both to be issued on February 9, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing May 11, 1989			:	26-week bills maturing August 10, 1989		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	8.53% a/	8.84%	97.844	:	8.51%	9.02%	95.698
High	8.58%	8.89%	97.831	:	8.54%	9.05%	95.683
Average	8.57%	8.88%	97.834	:	8.53%	9.04%	95.688

a/ Excepting 1 tender of $200,000.

Tenders at the high discount rate for the 13-week bills were allotted 51%.
Tenders at the high discount rate for the 26-week bills were allotted 7%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 44,895	$ 44,895	:	$ 33,760	$ 33,760
New York	19,767,980	5,937,330	:	20,101,490	5,940,840
Philadelphia	29,260	29,260	:	24,980	24,980
Cleveland	54,205	54,205	:	44,220	44,220
Richmond	63,425	63,425	:	58,265	58,265
Atlanta	45,505	45,505	:	43,180	43,180
Chicago	1,187,725	163,725	:	1,134,405	219,905
St. Louis	39,560	39,560	:	36,335	36,335
Minneapolis	12,260	12,260	:	14,435	14,435
Kansas City	45,535	45,535	:	64,270	64,260
Dallas	36,180	31,180	:	36,145	31,145
San Francisco	2,067,545	263,545	:	1,573,615	173,115
Treasury	474,580	474,580	:	525,790	525,790
TOTALS	$23,868,655	$7,205,005	:	$23,690,890	$7,210,230
Type					
Competitive	$20,191,660	$3,828,010	:	$18,468,805	$2,288,145
Noncompetitive	1,364,320	1,364,320	:	1,301,345	1,301,345
Subtotal, Public	$21,555,980	$5,192,330	:	$19,770,150	$3,589,490
Federal Reserve	2,200,415	1,900,415	:	2,162,000	1,862,000
Foreign Official Institutions	112,260	112,260	:	1,758,740	1,758,740
TOTALS	$23,868,655	$7,205,005	:	$23,690,890	$7,210,230

An additional $33,540 thousand of 13-week bills and an additional $341,860 thousand of 26-week bills will be issued to foreign official institutions for new cash.

1/ Equivalent coupon-issue yield.

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TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 3:00 PM
February 6, 1989

Contact: Peter Hollenbach
(202) 376-4302

TREASURY ANNOUNCES ACTIVITY IN SECURITIES IN THE STRIPS PROGRAM FOR JANUARY 1989

The Department of the Treasury announced activity figures for the month of January 1989 of securities within the Separate Trading of Registered Interest and Principal of Securities program, (STRIPS). The principal outstanding for eligible securities was $307,630,412,000 with $234,223,102,000 held in unstripped form and $73,407,310,000 held in stripped form. The gross amount reconstituted through January was $17,170,680,000. The attached table gives a breakdown of STRIPS activity by individual loan description.

These monthly figures are included in Table VI of the Monthly Statement of the Public Debt, entitled "Holdings of Treasury Securities in Stripped Form." These can also be obtained through a recorded message on (202) 447-9873.

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TABLE VI—HOLDINGS OF TREASURY SECURITIES IN STRIPPED FORM, JANUARY 31, 1989
(In thousands)

Loan Description	Maturity Date	Principal Amount Outstanding			Gross Amount Reconstituted to Date
		Total	Portion Held in Unstripped Form[1]	Portion Held in Stripped Form[1]	
11-5/8% Note C-1994	11/15/94	$6,658,554	$5,498,554	$1,160,000	$2,256,00
11-1/4% Note A-1995	2/15/95	6,933,861	6,269,381	664,480	948,96
11-1/4% Note B-1995	5/15/95	7,127,086	5,448,846	1,678,240	910,40
10-1/2% Note C-1995	8/15/95	7,955,901	7,005,101	950,800	628,00
9-1/2% Note D-1995	11/15/95	7,318,550	6,792,550	526,000	893,60
8-7/8% Note A-1996	2/15/96	8,410,929	8,140,529	270,400	9,60
7-3/8% Note C-1996	5/15/96	20,085,643	19,959,243	126,400	—0—
7-1/4% Note D-1996	11/15/96	20,258,810	19,918,810	340,000	—0—
8-1/2% Note A-1997	5/15/97	9,921,237	9,776,037	145,200	—0—
8-5/8% Note B-1997	8/15/97	9,362,836	9,362,836	—0—	—0—
8-7/8% Note C-1997	11/15/97	9,808,329	9,718,729	89,600	—0—
8-1/8% Note A-1998	2/15/98	9,159,068	9,159,068	—0—	—0—
9% Note B-1998	5/15/98	9,165,387	9,165,387	—0—	—0—
9-1/4% Note C-1998	8/15/98	11,342,646	11,342,646	—0—	—0—
8-7/8% Note D-1998	11/15/98	9,902,835	9,902,835	—0—	—0—
11-5/8% Bond 2004	11/15/04	8,301,806	2,692,206	5,609,600	1,143,200
12% Bond 2005	5/15/05	4,260,758	1,725,608	2,535,150	129,400
10-3/4% Bond 2005	8/15/05	9,269,713	6,245,713	3,024,000	876,000
9-3/8% Bond 2006	2/15/06	4,755,916	4,755,916	—0—	—0—
11-3/4% Bond 2009-14	11/15/14	6,005,584	1,475,184	4,530,400	1,222,400
11-1/4% Bond 2015	2/15/15	12,667,799	2,713,719	9,954,080	401,440
10-5/8% Bond 2015	8/15/15	7,149,916	1,946,716	5,203,200	429,760
9-7/8% Bond 2015	11/15/15	6,899,859	3,263,059	3,636,800	281,600
9-1/4% Bond 2016	2/15/16	7,266,854	5,158,854	2,108,000	554,400
7-1/4% Bond 2016	5/15/16	18,823,551	13,559,551	5,264,000	2,496,800
7-1/2% Bond 2016	11/15/16	18,864,448	10,309,088	8,555,360	2,756,640
8-3/4% Bond 2017	5/15/17	18,194,169	8,489,369	9,704,800	945,280
8-7/8% Bond 2017	8/15/17	14,016,858	10,349,658	3,667,200	169,600
9-1/8% Bond 2018	5/15/18	8,708,639	5,941,439	2,767,200	67,200
9% Bond 2018	11/15/18	9,032,870	8,136,470	896,400	50,400
Total		307,630,412	234,223,102	73,407,310	17,170,680

[1] Effective May 1, 1987, securities held in stripped form were eligible for reconstitution to their unstripped form. The amounts in this column represent the net affect of stripping and reconstituting securities.

Note: On the 4th workday of each month a recording of Table VI will be available after 3:00 pm. The telephone number is (202) 447-9873.
The balances in this table are subject to audit and subsequent adjustments.

GPO 83[illegible]

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
February 6, 1989

Statement by
The Secretary of the Treasury
Nicholas F. Brady
Regarding the President's Savings and Loan Reform Program

Thank you, Mr. President.

From the day five months ago that I was sworn in as Secretary of the Treasury, achieving a sound, responsible resolution to the savings and loan crisis has been a top priority. As the President has said, there are no simple or painless solutions to this problem. When he took office eighteen days ago, the President reaffirmed our commitment to fix it now, fix it right, and fix it for good. He also directed me to consult with Congress, and we have done so.

Two watch words guided us as we undertook to solve this problem--NEVER AGAIN.

- o Never again should we allow a federal insurance fund that protects depositors to become insolvent.
- o Never again should we allow insolvent federally insured deposit institutions to remain open and operate without sufficient private capital at risk.
- o Never again should we allow risky activities permitted by the states to put the federal deposit insurance fund in jeopardy.
- o Never again should we allow fraud committed against financial institutions or depositors to be anything but a serious white collar crime.

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The plan I am about to describe to you meets all these requirements. It is a blueprint for comprehensive reform and financing. It is supported by all the federal bank regulators -- the Federal Reserve, the Comptroller of the Currency, the Federal Home Loan Bank Board and the Federal Deposit Insurance Corporation. I will first describe the crucial reform program, then turn to the financing structure.

But before I begin, let me stress that insured depositors need not worry. Insured deposits are as safe today as they were yesterday, regardless of whether these savings are in savings and loans or commercial banks; savers with insured accounts will continue to be protected in the future. The banks that are open today will be open tomorrow. Our aim is to ensure that there will be no disruption of services in local communities. Above all, federally insured savings are, and will remain, backed by the full faith and credit of the federal government.

Now for the reform program. The current organization of the thrift system dates to the New Deal era. As the events of the 1980s have demonstrated, this system is antiquated. The Federal Home Loan Bank Board, under the leadership of Chairman M. Danny Wall, has addressed this crisis in an expedited manner under extremely difficult circumstances--with inadequate funding and limited staff. The men and women who work at the Bank Board and the FSLIC deserve our thanks for their tireless efforts. But, to correct long-term structural problems, we propose the creation of an independent insurance agency to protect depositors. FSLIC will be consolidated with the FDIC. The existing expertise and manpower of FSLIC will be incorporated into the FDIC. However, and I stress this point, two separate insurance funds, with separate premium streams, one for S&Ls and one for banks, will be maintained. The two separate funds cannot be commingled.

In conjunction with this step, we propose to reorganize the existing regulatory structure to ensure the availability of home financing in the future. The entire supervisory structure will be accountable to the Chairman of the Federal Home Loan Bank System, instead of to the industry they regulate. And the Chairman of the revitalized Federal Home Loan Bank System, like the Comptroller of the Currency, will report to the Secretary of the Treasury.

In a further measure to put our financial institutions on a sound footing, we will require that the level of private capital be uniform for all banks and S&Ls in adequate quantities to act as a buffer to the deposit insurance funds. Therefore, by June 1, 1991, all insured institutions must meet the uniform capital standards applicable to FDIC-insured banks. For the savings and loans this will mean roughly doubling the required

savings and loans this will mean roughly doubling the required capital.

We are upgrading safety and soundness measures. If this plan is enacted, in the future depositors will be protected through a range of new measures, including:

- A capital requirement that will be pegged to the risk of S&L investments;
- Stricter standards for granting insurance;
- Prohibitions and restrictions on growth and risk-taking by undercapitalized institutions;
- And, where risky activities authorized by the states pose a threat to the insurance fund, federal deposit insurance standards will prevail.

Requirements for receiving federal deposit insurance will be determined by the FDIC. There will be no more windmill farms financed by federally guaranteed deposits; and new uniform accounting, supervisory and disclosure standards will help enforce these measures.

Lest anyone have any doubts about how serious we are about cleaning up the thrift industry and keeping it clean, we are upgrading enforcement and increasing penalties to make fraud against financial institutions and depositors a most serious white collar crime. Under our plan, the maximum civil penalty will be increased from the current $1,000 per day to $100,000 per day. Under our plan, the U.S. government will make every effort to recover squandered funds by increasing funding for enforcement.

These reform measures are vitally important to the future of the thrift industry. Without them, we will not have a healthy private savings and loan industry to provide home financing for Americans. But as we are all acutely aware, reform and a financial solution to the problems of the current system go hand in hand. When combined with the $40 billion already spent, the $50 billion in new funds provided by this program will bring to $90 billion the total amount available to address the problems of insolvent S&Ls.

We believe it is essential that we resolve, with all deliberate speed, the cases of the insolvent S&Ls. We will do so through the creation of the Resolution Trust Corporation (the RTC). It will be a corporation whose function is to isolate insolvent S&Ls from healthy ones and resolve them in an orderly

fashion. The RTC mechanism will allow one consolidated resolution process where accounting for -- and controlling the funds will be a clear and straightforward process. In short, strict accountability will be ensured. The RTC will not have a large staff and the FDIC will manage the resolutions. The work of the RTC will be overseen by a board consisting of the Secretary of the Treasury, Chairman of the Federal Reserve, and the Comptroller General. A funding corporation will sell $50 billion in bonds over the next three years to finance the resolutions.

Our plan for financing the recovery and restructuring of the S&L industry uses both private and public funds to resolve insolvent thrifts. This plan is on-budget, in other words, every cent of additional public funds spent counts as an increase in budget outlays. Funds for the payment of principal will come from S&L industry sources.

In all, this plan provides funds for three purposes. First, S&L industry and Treasury funds are used to finance the RTC's resolution of insolvent thrifts. Second, S&L insurance premiums are used to create an insurance fund for healthy S&Ls. Third, increased commercial bank insurance premiums help bring the FDIC insurance fund for commercial banks up to a fully funded level. But let me reiterate, no commercial bank insurance premiums are used to resolve insolvent S&Ls or go into the S&L insurance fund.

The S&L industry financing comes from three sources: retained earnings of the Federal Home Loan Banks, funds from the disposal of assets received by the insurance fund from insolvent S&Ls, and deposit insurance premiums charged to individual S&Ls.

Commercial bank resources required to bring the FDIC fund up to a fully funded level will also come from an increase in insurance premiums. The FDIC will reduce insurance premiums to both commercial banks and S&Ls, once it determines that their respective funds are fully financed and pegged to a more historical reserve-to-deposit ratio of 1.25 percent.

The FSLIC and FDIC will immediately begin a joint supervisory program with personnel also contributed by the Federal Reserve and Office of the Comptroller of the Currency. Over the next several weeks FDIC personnel will assume supervisory control of insolvent S&Ls to protect depositors. This program will stabilize these institutions by curbing losses and will give a head start for the tough job ahead.

This, then, is the Bush Administration's solution to the savings and loan crisis. If enacted by Congress in a timely manner, it will provide a sound, long-term solution to the S&L

crisis. I call on Congress to work with us to turn this plan into law as soon as is possible. Working together, we can recreate and rejuvenate the vital thrift industry which served our country so well in the past.

* * * * * * * *

THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release February 6, 1989

STATEMENT BY THE PRESIDENT

For more than a half century, the United States has operated a deposit insurance program that provides direct government protection to the savings of our citizens. This program has enabled tens of millions of Americans to save with confidence. In all the time since creation of deposit insurance, savers have not lost one dollar of insured deposits. I am determined that they never will.

Deposit insurance has always been intended to be self-funded. This means that the banks, savings and loans and credit unions that are insured pay a small portion of their assets each year into a fund that is used to protect depositors. In every case these funds are spent to protect the depositors, not the institutions that fail.

For the last twenty years, conditions in our financial markets have grown steadily more complex, and a portion of the savings and loan industry has encountered steadily growing problems. These financial difficulties have led to a continuous erosion of the strength of the Federal Savings and Loan Insurance Corporation. Economic conditions have played a major role in this situation. However, unconscionable risk-taking, fraud, and outright criminality have also been factors. Congress, previous Administrations, the regulators and the industry were not prepared to be tough on those who risked the public's money or abused the system.

Because of the accumulation of losses at hundreds of thrift institutions, additional resources must be devoted to cleaning up this problem. We intend to restore our entire deposit insurance system to complete health.

While the issues are complex, and the difficulties manifold, we will make the hard choices, not run from them. We will see that the guarantee to depositors is forever honored, and we will see to it that the system is reformed comprehensively so that this situation is not repeated ever again.

To do this, I am today announcing a comprehensive and wide-ranging set of proposals. The Secretary of the Treasury Nicholas Brady will describe these proposals to you in detail in a few minutes. However, I think it is important to summarize the major points.

The proposals include four major elements. First, currently insolvent savings institutions will be placed under the joint management of the FDIC and FSLIC pursuant to existing law. This will enable us to control future risk-taking, and to begin reducing ongoing losses.

Second, the regulatory mechanism will be substantially overhauled to enable it to more effectively limit risk-taking. The FDIC would become the insurance administrator for both banks and thrifts under this system. These funds will not be commingled. The insurer will have the authority to set minimum standards for capital and accounting. Uniform disclosure standards would also be implemented. The chartering agency for thrifts would come under the general oversight of the Secretary of the Treasury.

Third, we will create a financing corporation to issue $50 billion in bonds to finance the cost of resolving failed institutions, which will supplement approximately $40 billion that has already been spent.

All of the principal of these bonds, and a portion of the interest on them, will be paid from industry sources. However, the balance would be paid from on-budget outlays of general revenues. Hopefully some of these revenues will be recovered in the future through sales of assets and recovery of funds from wrongdoers.

Fourth, we plan to increase the budget of the Justice Department by approximately $50 million per year to enable it to create a nationwide program to seek out and punish those that have committed wrongdoing in the management of the failed institutions. These funds will result in almost doubling the personnel devoted to the apprehension and prosecution of individuals committing fraud in our financial markets.

As you can see, these proposals are based upon several overriding principles:

First, I will not support any new fee on depositors.

Second, we should preserve the overall federal budget structure, and not allow the misdeeds and wrongdoing of savings and loan executives and the inadequacy of their regulation to significantly alter our overall budget priorities.

Third, I have concluded that this proposal, if promptly enacted, will enable our system to prevent any repetition of this situation.

Fourth, I have decided to attack this problem head-on, with every available resource of this government. Because it is a national problem, I have directed that the combined resources of our federal agencies be brought together in a team effort to resolve the problem.

Fifth, I believe that banks and thrifts should pay the real cost of providing the deposit insurance protection. The price the FDIC charges banks for their insurance has not been increased since 1935. We propose to increase the bank insurance premium by less than seven cents per $100 of insurance protection they receive. Every penny collected would be used to strengthen the FDIC so that the taxpayers will not be called on to rescue it a few years from now.

I make to you a solemn pledge that we will make every effort to recover assets diverted from these institutions, and to place behind bars those who have caused losses through criminal behavior. Let those who would take advantage of the public trust and put at risk the savings of American families anticipate that we will seek them out, pursue them relentlessly and demand the most severe penalties.

In closing, I wish to speak to the small savers of America. Across this great land families and individuals work and save, and we hope to encourage even greater rates of savings to promote a brighter future for our children. Your government has stood behind the safety of insured deposits before, it does today, and it will do so at all times in the future. Every insured deposit will be backed by the full faith and credit of the United States of America, which means that it will absolutely be protected.

For the future, we will seek to achieve a safe, sound and profitable banking system. However, integrity and prudence must share an equal position with competition in our financial markets. Clean markets are an absolute prerequisite to a free economy, and to the public confidence that is its most important ingredient.

I have determined to face this problem squarely, and to ask for your support in putting it behind us. I have ordered that the resources of the Executive Branch be brought to bear on cleaning up this problem. I have personally met with the leadership of the Congress on this issue. My Administration will work cooperatively with Congress as the legislation we will submit in a few days time is considered. I call on Congress to join me in a determined effort to resolve this threat to the American financial system permanently, and to do so without delay.

# # #

THE WHITE HOUSE
OFFICE OF THE PRESS SECRETARY

FOR IMMEDIATE RELEASE February 6, 1989

FACT SHEET

THE PRESIDENT'S REFORM PLAN
FOR THE SAVINGS AND LOAN INDUSTRY

President Bush announced that he will send Congress a major reform and financing initiative to resolve the nation's savings and loan industry problems. The President emphasized that all insured savings and loan and bank deposits are and will continue to be backed by the full faith and credit of the federal government.

The President's proposal has the support of all the federal agencies that regulate financial institutions: the Federal Reserve Board, the Comptroller of the Currency, the Federal Home Loan Bank Board and the Federal Deposit Insurance Corporation.

The President's proposal contains these elements:

- The plan will fundamentally restructure the way the savings and loan industry is regulated and insured to prevent such a situation from ever reoccurring.
- It will improve supervisory controls so that regulators will be able to prevent future abuses.
- It will increase the financial integrity of the federal deposit insurance funds for the future.
- It will enhance enforcement and increase penalties aimed at fraud against financial institutions.
- It will create and fund a new corporation to pay the cost of closing all insolvent savings and loan institutions. I have rejected any new fee on deposits as part of this program.
- It will begin placing these institutions under the control of the federal government in an orderly manner.

Structural Reform

The Federal Savings and Loan Insurance Corporation (FSLIC) will be separated from the Federal Home Loan Bank Board and attached administratively to the Federal Deposit Insurance Corporation (FDIC). This will create one strong independent insurer with an overriding mission of providing insurance to protect depositors and maintaining the security of the deposit insurance fund. The considerable expertise of the two corporations will be available to deal with financial insurance and regulatory issues. However, while a single agency will be created, separate insurance funds will be maintained for commercial banks and for S&Ls. The separate insurance funds will

not be commingled, and premiums from each industry will be used only for its own insurance fund.

The current Federal Home Loan Bank Board (FHLBB) will be renamed the Federal Home Loan Bank System (FHLBS). Its current board will be replaced by a single chairman. The Chairman of the FHLBS will be subject to the general oversight of the Secretary of the Treasury in the same manner as the Comptroller of the Currency, who regulates national banks. The system of 12 Federal Home Loan Banks will be maintained to support housing finance. However, supervisory responsibilities will be strengthened, current pay standards for supervisory personnel of the FHLBB will not be altered.

By separating the insurer from the chartering agency, more serious disciplinary standards are likely to be maintained in the future. In addition, by subjecting the actions of the FHLBS to oversight by the Treasury department, the interests of the taxpayers can be more fully and consistently protected. This Treasury oversight has existed for national banks since the Administration of President Abraham Lincoln. These steps will create a system of checks and balances for savings and loans that more closely parallels that for commercial banks.

Improved Supervisory Controls

The President's plan will increase safety and soundness standards for savings and loan institutions. In effect, these institutions will be brought up to commercial bank standards over a two-year period.

All S&Ls will be required to meet the capital requirements applicable to FDIC-insured banks by June 1, 1991. That is, their capital must be increased to approximately six percent of assets, almost double the current capital requirement. Risk-based capital standards would be utilized. The increase of private capital will stand ahead of the government's guarantee of deposits, giving taxpayers an enhanced level of protection.

The FDIC will be given enhanced authority to set insurance standards for all S&Ls, both federal and state-chartered. It will be able to restrict risky activities that have been authorized by some states in the past. In addition, the FDIC would be authorized to take appropriate measures on an expedited basis when unsound practices are found.

Financial Integrity

The President's plan will require increased insurance premiums to put federal deposit insurance on a sound financial basis for the future, funded by the industry.

It will recapitalize the deposit insurance fund for S&Ls, with S&L premium income of a billion dollars a year beginning in

1991. The annual premium rate payable to the FDIC by S&Ls will be increased to 0.23 percent of deposits (from 0.208 percent) from 1991 until 1994, when it will decline to 0.18 percent.

The plan also will require increased premiums for commercial banks to bring the separate FDIC fund more in line with its own historic reserve-to-deposit ratio. When a target reserves level of 1.25 percent of total insured deposits is achieved, excess net premium income will be rebated. The FDIC premium paid by commercial banks will increase to 0.12 percent (from 0.083 percent) in 1990, the first year and to 0.15 percent in succeeding years. Commercial bank premiums will not be used to resolve insolvent S&Ls or to shore up the S&L insurance fund.

Enhanced Enforcement

The President's plan will add new enforcement authorities, increase penalties for fraud, and increase funding to provide for dramatically increased law enforcement staff and prosecutions.

The scope of federal regulators' enforcement authority will be broadened to include all insiders, in addition to those directly involved in running an institution. It will give regulators broader power to impose temporary cease-and-desist orders.

It will increase maximum civil penalties to $1,000,000 per day, and maximum criminal penalties to 20 years or more, with new sentencing minimums. It will provide authority for regulatory agencies to pay rewards to informants.

Most importantly, approximately $50 million per year will be provided from the proceeds of the funding program to the Justice Department to fund a new national program to attack financial institution fraud. This program will include new investigators, auditors, analysts, and prosecutors. Indeed, the number of personnel devoted to investigating and prosecuting bank and thrift fraud will be approximately doubled.

Resolution of Remaining Insolvents

The President's plan will create a new Resolution Trust Corporation to resolve currently insolvent S&Ls in an orderly fashion. The creation of this new private corporation is proposed for practical business reasons. It will allow isolation of insolvent S&Ls during the resolution process, and will facilitate a full and precise accounting of all funds that are used.

The RTC will have an Oversight Board comprised of the Secretary of the Treasury, the Chairman of the Federal Reserve Board and the Comptroller General of the United States. It will not have a large staff of its own, but will contract with FDIC to manage the insolvent institutions. The RTC would seek to

complete the resolution or other disposition of all institutions and their assets over a period of five years.

The RTC will require $50 billion in funding to resolve the remaining insolvent S&Ls. Another $40 billion has already been committed in past FSLIC resolutions. Much of the funding required will come from S&L industry sources, but general revenues will also be required. All Treasury funds will be counted on-budget.

A separate Resolution Funding Corporation ("REFCO") will be authorized to issue $50 billion in 30-year bonds. The principal will be repaid entirely with S&L industry funds, and taxpayer funds or guarantees or commercial bank funds will not be required for repayment of the principal of the REFCO bonds. Approximately $5-6 billion of existing S&L industry funds, retained earnings of the Federal Home Loan Banks and special assessment premiums will be used to purchase zero coupon Treasury securities, which when they mature in 30 years will pay off the $50 billion in principal of the REFCO bonds.

Ongoing REFCO bond interest payments and payments on the $40 billion previously committed will be covered first by S&L industry funds with the shortfall made up by Treasury funds. The Treasury funds will increase budget outlays as they are spent, but the outlays were anticipated in President Reagan's FY 1990 budget.

Immediate Joint Supervisory Cooperation

The President announced that the FDIC and FSLIC immediately will begin joint supervisory cooperation to bring the expertise of the FDIC as well as the FSLIC to bear on the effort to address the expensive problem of resolving insolvent S&Ls.

The FSLIC and FDIC will immediately begin a joint supervisory program with personnel also contributed by the Federal Reserve and Office of the Comptroller of the Currency. Over the next several weeks FDIC personnel will assume supervisory control of insolvent S&Ls to protect depositors. This program will stabilize these institutions by curbing losses and it will provide a head start for the tough job ahead.

THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release February 6, 1989

PRESS BRIEFING
BY
SECRETARY OF TREASURY NICHOLAS BRADY;
DIRECTOR OF THE OFFICE OF MANAGEMENT AND BUDGET RICHARD DARMAN;
ATTORNEY GENERAL RICHARD THORNBURGH;
CHAIRMAN OF THE FEDERAL RESERVE ALAN GREENSPAN;
CHAIRMAN OF FEDERAL HOME LOAN BANK BOARD DANNY WALL;
HEAD OF FEDERAL DEPOSIT INSURANCE CORPORATION WILLIAM SEIDMAN;
COMPTROLLER OF CURRENCY

Room 450
Old Executive Office Building

4:35 P.M. EST

Q What's this going to cost the taxpayers?

SECRETARY BRADY: Thank you, Mr. President.

From the day five months ago that I was sworn in as Secretary of the Treasury, achieving a sound and responsible resolution to the savings and loan crisis has been a top priority. As the President has said, there are no simple or painless solutions to the problem. When he took office just 18 days ago, the President reaffirmed our commitment to fix it now, fix it right, and fix it for good. He also directed us to consult with Congress, and this we have done.

Two watch words guided us as we undertook to solve this problem: never again. Never again should we allow a federal insurance fund that protects depositors to become insolvent. Never again should we allow insolvent federally insured deposit institutions to remain open and operate without sufficient private capital at risk. Never again should we allow risky activities permitted by the states to put the Federal Deposit Insurance Fund in jeopardy. Never again should we allow fraud committed against financial institutions or depositors to be anything but a serious white collar crime. We're going to find the wrongdoers, as the President said, recover the assets they've stolen, and put them in jail for a very long time.

The plan I'm about to describe to you meets all of these requirements. It is a blueprint for comprehensive reform and financing. It is supported by all the federal bank regulators -- the Federal Reserve, the Comptroller of the Currency, the Federal Home Loan Bank Board, and the Federal Deposit Insurance Corporation.

I will first describe the reform program and then turn to the financing structure. But before I begin, let me stress that insured depositors need not worry. Insured deposits are as safe today as they were yesterday, regardless of whether these savings are in savings and loans or commercial banks. Savers with insured accounts will continue to be protected in the future. The banks that are open today will be open tomorrow. Our aim is to ensure that there will be no disruption of services in local communities. Above all, federally insured savings are and will remain backed by the full faith and credit of the federal government.

Now for the reform program. The current organization of the thrift system dates back to the New Deal era. However, as the events of the 1980s have demonstrated, this system is antiquated.

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The Federal Home Loan Bank Board, under the leadership of Chairman Danny Wall, has addressed this crisis in an expedited manner, under extremely difficult circumstances, with very low funding, and a limited staff. The men and women who work at the Bank Board and the FSLIC deserve our thanks for this tireless effort under difficult circumstances.

But to correct the long-term structural problems inherent, we proposed the creation of an independent insurance agency to protect depositors. FSLIC will be consolidated with the FDIC. The existing expertise and manpower of the FSLIC will be incorporated into the FDIC. However -- and I stress this point -- two separate insurance funds, with separate premium screens, one for the S&Ls and one for the commercial banks, will be maintained. The two separate funds cannot be comingled.

In conjunction with this step, we propose to reorganize the existing regulatory structure to ensure the availability of home financing in the future. The entire supervisory structure will be accountable to the Chairman of the Federal Home Loan Bank System instead of to the industry they regulate. And the Chairman of the revitalized Federal Home Loan Bank System, like the Comptroller of the Currency, will report to the Secretary of the Treasury.

In a further measure to put our financial institutions on a sound footing, we will require that the level of private capital be uniform for all banks and S&Ls in adequate quantities to act as a buffer to the federally insured deposit funds. Therefore, by June 1, 1991, all insured institutions must meet the uniform capital standards applicable to FDIC insured banks. For the savings and loans, this will mean roughly doubling the required capital.

Further, we are upgrading safety and soundness measures. If this plan is enacted, in the future, depositors will be protected through a range of new measures, including a capital requirement that will be pegged to the risk of the S&L investments; stricter standards for granting insurance, prohibitions in restrictions on growth and risk-taking by undercapitalized institutions; and where risky activities authorized by the states pose a threat to the insurance fund, federal deposit insurance standards will prevail.

Requirements for receiving federal deposit insurance will be determined by the FDIC. There will be no more windmill farms, no prize cattle herds financed by federally guaranteed deposits. And the new uniform accounting, supervisory and disclosure methods will help enforce these measures.

Lest anyone have any doubts about how serious we are about cleaning up the thrift industry and keeping it clean, we are upgrading enforcement and increasing penalties to make fraud against the financial institutions and depositors a most serious white collar crime. Under our plan, the maximum civil penalty will be increased from the current $1,000 per day to $100,000 per day. Under our plan, the U.S. government will make every effort to recover the squandered funds by increasing funds available for enforcement.

These reform measures are vitally important to the future of the thrift industry. Without them we will not have a healthy private savings and loan industry to provide home financing to Americans. But, as you all are acutely aware, reform and a financial solution to the problems of the current system go hand in hand. When combined with the $40 billion already spent, the $50 billion of new funds provided by this program will bring to $90 billion the total amount available to address the problems of insolvent S&Ls.

We believe it is essential that we resolve with all deliberate speed the cases of the insolvent S&Ls you've all read about. We will do so through the creation of a new organization called the Resolution Trust Company, the RTC. It will be a corporation whose function is to isolate insolvent S&Ls, separate

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them from healthy ones, and resolve them in an orderly fashion. The RTC mechanism will allow one consolidated resolution process where accounting for and controlling the funds will be a clear and straightforward process.

In short, strict accountability will be ensured. The RTC will not have a big staff and the FDIC will manage the resolutions. The work of the RTC will be overseen by a board consisting of the Secretary of the Treasury, the Chairman of the Federal Reserve, and the Comptroller General. And a funding corporation will sell $50 billion in bonds over the next three years to finance the resolutions.

Our plan for refinancing the recovery and restructuring of the S&L industry uses both private and public funds to resolve insolvent thrifts. This plan is on budget. In other words, every set of additional public funds spent counts as an increase in budget outlays. Funds for the payment of principal will come from the S&L industry itself.

In all, this plan provides funds for three purposes. First, S&L industry and Treasury funds are used to finance the RTC's resolution of the insolvent thrifts. Second, S&L insurance premiums are used to create an insurance fund for healthy S&Ls. And third, increase commercial bank insurance premiums help bring the FDIC insurance fund for commercial banks up to a fully funded level. But let me reiterate, no commercial bank insurance premiums are used to resolve insolvent S&Ls or to go into the S&L insurance fund.

The S&L industry financing comes from three sources -- retained earnings of the Federal Home Loan Banks, funds from the disposal of assets received by the insurance fund from insolvent S&Ls, and deposit insurance premiums charged to individual S&Ls. Commercial bank resources required to bring the FDIC fund up to a fully funded level will also come from an increase in insurance premiums. The FDIC will reduce insurance premiums to both commercial banks and S&Ls once it determines that their respective funds are fully financed and pegged to the more historical reserve-to-deposit ratio of 1.25 percent.

FSLIC and the FDIC will immediately begin a joint supervisory program -- by "immediately," I mean tomorrow -- with personnel also contributed by the Federal Reserve and the officer of the Comptroller of the Currency. Over the next several weeks, FDIC personnel will assume supervisory control of insolvent S&Ls to protect depositors. This program will stabilize these institutions by curbing losses and will give a head start for the tough job ahead.

This then is the administration's solution to the savings and loan crisis. If enacted by Congress in a timely manner, it will provide a sound, long-term solution to the S&L problem. I join the President's call on Congress to work with us to turn this plan into law as soon as possible. Working together, we can recreate and rejuvenate the vital thrift industry which has served our country so long and so well in the past.

Q How much is it going to cost?

Q How much money do you think it's going to cost the taxpayers? I mean, we know about the $90 billion. If you could give us an idea of what it's actually going to cost out of our pockets.

SECRETARY BRADY: Well, $90 billion is both -- it counts for money that's been spent and the $50 billion that will be spent. Our best estimates in the first 10 years is that it will come roughly half from the industry and half from the taxpayers.

Q Is that all the money that it's going to cost us -- $90 billion?

SECRETARY BRADY: That's what we think. We think the problem -- the size of the problem is $90 billion. Actually there is a slight reserve in there so that if there are any unforeseen unpleasant circumstances that show up, we've got some room in there to take care of it.

Q Let me make certain I understand that. If it's half from the taxpayers and half from the S&Ls, that's $45 billion from the taxpayers and over 10 years it's $4.5 billion a year?

SECRETARY BRADY: That's about right.

Q Mr. Secretary, there -- in the fact sheets we were given, it says there is -- of the $40 billion already committed that the S&L industry will pick up part of that and that Treasury the rest. I don't understand how you get the $40 billion.

SECRETARY BRADY: I'm going to let Dick Darman comment on that. (Laughter.)

Q Can you explain the relationship of the $45 billion to the estimate here that there was a $40 billion already committed and that Treasury will pick up the rest of that?

DIRECTOR DARMAN: You people are too tall for me.

Let me try to give you a more detailed breakdown. In Fiscal Year '90, the net budget outlays associated with this, everything considered, the new element that has to go to cover some interest and Treasury contribution to some funding of the old piece which is still left over for funding, which is what I think you are referring to, would be $1.9 billion for Fiscal Year '90, $6.0 billion for '91, $3.8 billion for '92, $3.7 billion for '93, $1.5 billion for '94. That's a total of, if you add $11.1 for Fiscal Year '89, which deals with some of what has already happened -- a good deal of what has already happened -- that's not new -- the total for '89 through '94 would be $28.1 billion. I think you may have that in the fact sheet. I haven't seen the latest version.

The number for '89 to '99 -- comparable number -- would actually be $39.9 billion on our estimates.

Q I take it you're estimating the funds -- a couple of funds will be capitalized by that? Is that the reason, and that the premiums would decline or what? Or that the amount -- the contributions would decline?

DIRECTOR DARMAN: No. These numbers bounce around for a variety of reasons, and -- you mean, over time? All that's left to pay for as you move out is the -- or, the main thing left to pay for is the Treasury contribution to interest. It's offset by some other things that are happening -- some asset sales along the way, some premiums coming in, things going out. There are a lot of flows, but the nets are the ones that I gave you. We can give you a more detailed backup if you'd like to see it all the way across.

The Treasury payments for the bond interest itself -- and then I'll retire from the podium and let it get back to substance, not numbers -- for the bond interest itself, those numbers go in Fiscal Year '91, .4; '91, 1.6; '92, 0.9; '93, 0.8; '94, 1.1; and the five-year total for that component is $6.3 billion. So that is part of the 28 billion.

Q And that is taxpayer payments to help pay for the bond interest? That's separate and beyond what the savings and loans have contributed?

DIRECTOR DARMAN: It is in addition to what they will have contributed. Let me just clarify one thing. There is zero Treasury or public or taxpayer -- whatever label you want to use --

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money that is involved with respect to the principal of these bonds. Those are covered entirely and in advance by private sources. There is, however, a shortage when it comes to servicing the interest, a projected shortage, when it comes to serving the interest on these bonds. And to make sure that the bonds can be sold at a low cost in the market, the Treasury is saying it will cover the difference between what will be covered by the premium flow for that interest and the total interest burden. That's the number that I gave you for interest. And it's only the interest that is the public money. Indeed, it's not all of the interest, as your question suggests. It's only a portion of the interest, and it's none of the principal -- zero on the principal.

Q I take it that number is the 39.9 -- that's the taxpayers number? Not 45, it's 39.9?

DIRECTOR DARMAN: The 39.9 is the total net of everything over a 10-year period, that's correct. And it bounces around year to year.

Q Secretary Brady, President Bush said that he did not know -- said there was no guarantees that this higher cost for bailing out the S&Ls would be passed on to the consumer. Do you have any concern at all about the recent trend towards higher interest rates in the United States and the affect that has on the dollar?

SECRETARY BRADY: Well, to get to President Bush's question, it was asked first of all, there's no way of knowing that'll be passed on to the depositor. But competition is a very hard force in this country, and perhaps those who pass it on won't get the deposits; the guys that might absorb it will get the deposits. So I don't think there's any way of saying whether it will or won't be passed on until we see how it works. My own private opinion is competition will take over and the guys that don't pass it on are -- will be able to give the depositors more money.

Q Are you concerned about interest rate levels at present, though? The trend towards higher rates?

SECRETARY BRADY: I think you better wait until Chairman Greenspan gets up here. I don't want to comment on that.

Q You said that $40 billion has already been spent. But $40 billion has been committed, at least the way I understand this. Can you explain why you're only having to raise $50 billion?

SECRETARY BRADY: Well, the problem is somewhere between $80 billion and $90 billion big. When people say that, and all the estimates that you've been reading over the past months, they also include in that figure that amount of resolutions that have already been taken care of by Danny Wall and FSLIC. So you shouldn't add that to the total. You add the 40 that's been in the past and what we say is some 40 to 50 to go, and that gets to the 80 and the 90.

Q But the money -- what has been committed in the future, but that money hasn't already been laid out by the government.

SECRETARY BRADY: Well, in a sense, it has been laid out by the government because it's been committed in bonds and resolvements that the FSLIC has made. So someday you've got to pay those off, so it's committed.

Q But there will be adequate funds in the FSLIC to --

SECRETARY BRADY: There are adequate funds in this program to pay off not only what has been committed before December 31st, 1988 and what we are proposing from here on.

Q How much of this will require congressional

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legislation and how much of it can be done administratively without Congress' approval?

SECRETARY BRADY: In terms of congressional legislation, all the first part of what I mentioned to you this afternoon, which is the creation of the Resolution Trust Company and certainly all of the reforms that go along with that -- increasing the penalties and the like, take congressional action. But starting tomorrow morning, Chairman Wall and Chairman Seidman have said that they're going to put the two funds together -- FSLIC from an administrative standpoint will start to go into FDIC, although the two funds will remain separate.

Q Mr. Secretary, I'm puzzled by the fact that the fact sheet there's a small, only 10-percent increase in the insurance premium to be paid by the S&Ls and an increase of nearly 50 percent to be paid by the banks. Since you're saying that these premiums are not going to be comingled, why are the bank proportionately taking a much bigger hit than the S&Ls?

SECRETARY BRADY: Well, to start off with, the banks come from a much lower level and the funds that are generated out of the bank premiums to take a fund which is at a historical low level compared to what it should be and bring it back up. And you can't do that in one year; it takes some time.

Q If I may follow up, what are some of the problems that have accrued apparently in recent years with the banks that require a virtual doubling of the bank's insurance premium?

SECRETARY BRADY: Well, we can get into that a little bit later; Bill Seidman can tell you. But the same problems that the banks have had -- I mean the same problems that the S&L industry have had, the bank industry has also had. It isn't just particular to the S&L industry.

Q Mr. Secretary, when you reorganize the Bank Board, do you anticipate Mr. Wall will remain as Chairman?

SECRETARY BRADY: He will remain as Chairman.

Q Mr. Secretary, I know when you fellows start talking about a billion here and a billion there, to paraphrase Ev Dirksen, you're not yet talking about real money. But I need the difference between the $39.9 billion that Dick Darman talked about and the $45 billion that you talked about clarified, please.

SECRETARY BRADY: Dick?

Q Is that just difference in estimates or is that part of round figuring the other more precise figure?

DIRECTOR DARMAN: I think the Secretary was rounding, if I'm correct.

SECRETARY BRADY: Correct.

Q Is that right, Mr. Secretary?

Q Could we get the total figure that the taxpayer is going to have to pay? Mr. Darman only gave us the five-year figure. What is the total amount?

DIRECTOR DARMAN: I gave you a five-year figure of $28.1 billion and a 10-year figure of $39.9. I don't have the figure over the whole life, but the proportion of the interest that is covered by the public sector rises as you go beyond 10 years. But the present value of that is an extremely small number because, obviously, you're talking about 20, 30 years from now.

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Overall, just to give you a rough feel, if you looked at the total expenditures involved and you said, what percent is public? In five years it's about 25 percent. Over the 10-year period it's about 42 percent. Over the 30-year period, in nominal terms, it's about 54 percent. That is not the correct way to look at this. If you looked at it in present value terms, the public share would be substantially smaller. But if you looked at it the way people ordinarily look at it, you would say over the 30-year life, it would be about half and half.

Q Dick, in terms of your short-term problem and what the President has to do on February 9th, this will require a line for additional outlays in the Fiscal '90 budget, is that correct?

DIRECTOR DARMAN: This will be included in the February 9th presentation with, I hope, exactly the numbers I've read to you now. And we will, I hope, still meet the Gramm-Rudman-Hollings targets.

Q So to be specific, that means $1.9 billion additional in Fiscal '90?

DIRECTOR DARMAN: Obviously, if you're going to spend this money and it's treated as outlays and you're going to budget it, then it means it's got to be in the budget. It will be in the budget and I would hope and expect we will still meet the Gramm-Rudman-Hollins targets.

That said, I might note that the baseline estimates that have been done prior to our doing this analysis presumed that there would be about this level of expenditure required. So it is not something which suddenly shows budget planning way off. It fits roughly within the funds that have been allocated.

Q But to be specific, that's $1.9 billion over and above what the Reagan administration left you?

DIRECTOR DARMAN: No, that's incorrect. No, it's $1.9 billion in '90 period. In fact, in the Reagan budget, that number was $2.1 billion. So it's slight -- it's almost the same as in the Reagan budget.

Q To follow that, the Reagan budget also had $10 billion for '89 and you've got $11.1 billion. So you've dumped some of your current costs that went over it, you dumped it back into the past.

DIRECTOR DARMAN: Rich, if you'll pardon my saying so, the word "dump" is not really appropriate. (Laughter.) The November estimates were done before the December action. When we put out our budget, you will see that we take account of the December action. And because the December action was taken after the November estimates, it wasn't in those estimates, but it will be in our estimates. We haven't dumped anything. We will properly account for what has already been done.

Q Mr. Brady, the competitive implications of requiring the S&Ls to be brought up to a standard of financial management that banks meet is likely to produce fewer of the benefits that bring deposits to them in the first place. Has this contingency been taken into effect in assessing future ability to contribute to this deposit premium fund?

SECRETARY BRADY: Yes. I think that the fact that we're requiring more capital in the system and that the whole system is sounder will, in effect, reduce the amount of money they have to pay for their deposits. It should come down.

Q Do you expect them to -- there be a failure rate as they try to bring themselves --

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SECRETARY BRADY: Well, there may be some, but in the long run we'll have a much sounder and safer system. We've got some assumptions for institutions not being able to stand the competitive climate in our assumptions. It's accounted for in the figures. But I don't think it's going to be all that big.

Q Sir, are you anticipating to continue the moratorium on S&Ls and the banks going from one fund to the other, or --

SECRETARY BRADY: We are -- that moratorium, if the legislation is enacted, will be part of the legislation.

Mr. Attorney General, they want to ask you a question.

ATTORNEY GENERAL THORNBURGH: There are really two important roles that the law enforcement community can play here. One is the obvious prosecution of those persons who have violated the laws in connection with failures and shortfalls in the system as it presently exists. The other is to provide some suggestions for remediation as we develop these cases and uncover patterns that can be dealt with better within the regulatory structure.

The review of the Department of Justice activities in this area began shortly after I assumed office, and we are able to be fairly precise about where the needs are and how we can utilize the figure that has been announced today as a goal for increased resources for the Department of Justice. The $50 million will be allocated to increasing our investigative capability through the Federal Bureau of Investigation, providing more prosecutors and more support personnel in the areas in which these problems exist. And in addition to resources, the increased civil and criminal penalties which Secretary Brady spoke about, the addition of new seizure and forfeiture language which will enable us to recoup some of the resources that have been diverted out of the system all provide a package that we are, I think, confident will greatly enhance the ability to contribute to restoring the credibility and integrity of the system as a whole.

Q Are those, sir, who mismanaged in the past, largely beyond your reach?

ATTORNEY GENERAL THORNBURGH: We have a number of indictments that have resulted in convictions thus far, a number awaiting trial, and a number of investigations in various stages. It's been clear, however, that lack of resources has been a major problem in providing the deterrent capability that we ought to have in our law enforcement operations.

Q Since about half, or 40 percent or half of these frauds or collapses have occurred in Texas, do you plan to allocate about 40 percent or half of the enforcement resources to Texas, too?

ATTORNEY GENERAL THORNBURGH: Well, as you know, we already have a substantial commitment to the Dallas task force and we will be looking at ways in which to bring that up to the level necessary to pursue every allegation within that jurisdiction, but we have the advantage there of not only having a head start in terms of the placement of resources, but a laboratory within which this special effort has been undertaken that can be used in replicating in other districts across the country.

Q If I could ask Secretary Brady -- President Bush in his opening remarks said that broader factors in the economy figured into the S&L crisis that we have now. Many people feel that this proposal will be simply throwing good money after bad unless some more steps are taken to deal with the highly-leveraged position that the overall economy is in. That is, the creation of unsecured notes, the junk bonds that are used in leveraged buyouts, and so forth, which they believe has actually contributed to the condition that the

S&Ls find themselves in now.

SECRETARY BRADY: Well, I don't really think that's what caused the problem in the S&L industry. The S&L industry problem was caused by mismanagement to some extent, fraud to some extent, but also some severe depressions in some of the industries that these people did business in.

Also, it's a mistake, we have found out, to federally insure one side of the balance sheet and on the other side of the balance sheet let the institutions who can go and get federally insured funds invest in any kind of activity that they want. So the main stem of this program is to make sure that two things happen -- if people want to do that, they've got an awful lot more of their own money at risk first so that the federal government has some cushion there before they have to come up with their guarantees, but also to make sure that the type of investments that these people can get into is severely restricted from what they were.

Q How about the LBOs? Do you think that there should be any actions taken to divert the level of activity that's going on now?

SECRETARY BRADY: We've had extensive hearings on this subject. I'm sure you read about the results of those hearings -- Chairman Greenspan testified, I testified. I think the general conclusion, not only from the people in Congress who listened, but to those of us that testified, is that this is a trend that we should watch very closely, that some of the reasons that we should be concerned about it are more philosophical reasons, which are that so much of our talent and expertise in this country is used to come up with financial engineering when the rest of the world is setting long term plans. But for a fix right now, I think the general conclusion so far, from the people that I've talked to that come out of those hearings, is people want to watch and wait some more.

We'll just take a couple more questions. We're going to -- we have a complete briefing for those who want to stay and some fact sheets to hand out, but why don't we take two or three more questions.

Q Mr. Secretary, can we go back to the $40 billion? As I understand it, is the amount of notes that were issued under Mr. Wall's resolution -- right?

SECRETARY BRADY: I'm going to let Mr. Darman come up here and repeat what he said before to you.

Q How is that going to be repaid?

DIRECTOR DARMAN: It's the -- the $40 billion is not the amount of the notes. About 20 is the amount of the notes, and the remainder is an estimate of the value of the yield maintenance agreements that are associated with those notes, and other costs associated with those deals. The notes -- the roughly $20 billion in notes have already been scored as outlays in the federal budget. The remaining portion has not yet been scored because in most cases the remaining portion has not yet been paid. The deals have been concluded, the obligations are there, but the additional funds are paid over time and it's a projection as to what those expenses will be. So some of those are costs that continue into the future even though these deals have already been concluded and the $40 billion has already been committed.

Some of that continuing stream can be funded from the S&L premiums, but that -- when you add up everything that has to be funded, with the premium structure that is projected, you still come up short by the amount that I indicated over the period. So part of the amount that I indicated you could think of -- and I identified it specifically -- as paying the interest. The remainder is filling a

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gap which exists above and beyond the interest in part from the expenses -- future expenses associated with deals already done.

Q So what you're saying is that the principle -- no principle will be repaid, that's limited to the $50 billion in bonds? There is a portion of those notes and deals that you will have to cover out of general revenue funds?

DIRECTOR DARMAN: Well, this takes all of that into account. The 30 year cost, the 10 year, 15 -- all of that takes fully into account a presumption as to what the repayment schedule and how that's going to be financed and so on. And I think that will all be laid out in the detailed fact sheets you'll get.

SECRETARY BRADY: We're going to take one more question from this lady here. But I just want to comment on one thing. The $50 billion that's going to be raised by the Resolution Trust Company is coming all from S&L industry funds, that is not coming from the taxpayers.

Q I have a two-part question. First of all, I just want to understand -- the $40 billion that Danny Wall committed last year, the GAO estimates that the Bank Board is going to have a short fall of about $26 billion. Is that what you're saying you have included in your estimate?

DIRECTOR DARMAN: No, we don't have exactly the same estimate, but we have a little bit different estimate than was used, I think, by Danny Wall, and we are taking our revised estimate into account. But what you say is the amount of the shortfall depends on where you say your allocating what's coming in. What's coming in --

Q They said over ten years -- the GAO said over 10 years --

DIRECTOR DARMAN: I understand, but there's a question of whether -- what you assume else is being paid for with the stream of money coming in. What you'll see, I think, in the sheets that we'll hand out is an easier way to look at it. Just separate out the pieces, look at all collections coming in, all obligations for things going out, and you can see what the gap is there and which portion is paid publically and which is --

Q But regardless of what the short fall is, you're saying it will only be interest rates --

DIRECTOR DARMAN: No, --

Q That the taxpayers will only pay --

DIRECTOR DARMAN: No, that's with respect to the $50 billion that Secretary Brady has correctly said will be raised, and the principle of -- with that $50 billion, the principle obligation -- $50 billion -- will be covered entirely and in advance by private sources. It's not dependent on any future stream because it will be covered, if I might say, it would be covered by the purchase of zero coupon bonds immediately from private sources, from industry sources. And those zeros mature and fully cover the $50 billion. This isn't some promise dependent upon a future income stream.

Q Well, what about the $40 billion? We understand that for the 50, but the 40 --

DIRECTOR DARMAN: Some of that is not adequately covered and a portion --

Q How much?

DIRECTOR DARMAN: Well the difference, roughly speaking, the net amount that isn't covered is the difference between the

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number I gave you for the interest portion and the bottom line for total outlays.

Q Can you give us a number? How much are taxpayers going to have to pay of the $40 billion?

DIRECTOR DARMAN: I can't break it up that way for you. I gave you the amount that really matters which is how much the taxpayers are going to have to pay, period.

Q And second, the follow-up question on that is, when you talk about a $90 billion problem, that's on principle, that doesn't count the interest payments, correct?

DIRECTOR DARMAN: That is a way of putting it that would be correct. If you looked at the total debt servicing associated with it, the number would be larger than 90, which is why some of these numbers we've been using here don't correctly add.

Q What's the number if you add the total amount --

SECRETARY BRADY: Let me just say, you know, that is a way to look at it, but it -- I mean if you buy a house and the person sells it to you for $100,000 you don't -- and somebody asks you how much it cost, you don't say $100,000 plus all the interest that it cost you.

Q I do when I'm thinking about tax dollars.

SECRETARY BRADY: Well, you know, when we account for an aircraft carrier or some capital item in the budget we don't -- we say what the thing cost when you buy it from the guy that sells it to you and not what the financing charges are and the portion of the deficit over --

Q Just humor me, how much is the total payment, principle and interest?

Q Can somebody else ask a question.

Q Yes, please.

DIRECTOR DARMAN: Maybe this would humor you. I have already given you that. The total I gave you is for all of the above, it is the way you would want it, not the small way. If we wanted to give it the way people normally think about a house, the number would be lower.

SECRETARY BRADY: We're going to -- thank you all very much. We've got Richard Breeden and Bob Glauber here who have got fact sheets and all of the backups and we urge you to stay here and work with them and get the subject cleared up.

END 5:15 P.M. EST

THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release February 6, 1989

NEWS CONFERENCE OF THE PRESIDENT

Room 450
Old Executive Office Building

4:10 P.M. EST

THE PRESIDENT: Well, for the more than half a century, the U.S. has operated a deposit insurance program that provides direct government protection to the savings of our citizens. This program has enabled tens of millions of Americans to save with confidence. In all the time since creation of the deposit insurance, savers have not lost one dollar of insured deposits. And I am determined that they never will.

Deposit insurance has always been intended to be self-funded. And this means that the banks, the savings and loans and credit unions that are insured pay a small amount of their assets each year into a fund that's used to protect depositors. In every case these funds are spent to protect the depositors, not the institutions that fail.

For the last twenty years, conditions in our financial markets have grown steadily more complex, and a portion of the savings and loan industry has encountered steadily growing problems. These financial difficulties have led to a continuous erosion of the strength of the Federal Savings and Loan Insurance Corporation -- FSLIC. Economic conditions have played a major role in this situation. However, unconscionable risk-taking, fraud, and outright criminality have also been factors.

Because of the accumulation of losses at hundreds of these thrift institutions, additional resources must be devoted to cleaning up this problem. We intend to restore our entire deposit insurance system to complete health.

While the issues are complex, and the difficulties manifold, we will make the hard choices, not run from them. We will see that the guarantee to depositors is forever honored, and we will see to it that the system is reformed comprehensively so that the situation is not repeated again.

To do this, I am today announcing a comprehensive and wide-ranging set of proposals. The Secretary of the Treasury, Nicholas Brady, will describe these proposals to you in detail in a few minutes. However, I think it's important to summarize some of the major points.

The proposals include four major elements. First, currently insolvent savings institutions will be placed under the joint management of the FDIC and FSLIC pursuant to existing law. This will enable us to control future risk-taking and to begin reducing ongoing losses.

Second, the regulatory mechanism will be substantially overhauled to enable it to more effectively limit risk-taking. The FDIC would become the insurance agency for both banks and thrifts under this system, although there's no commingling of funds. The insurer will have the authority to set minimum standards for capital and accounting. Uniform disclosure standards will also be implemented. The chartering agency for thrifts would come under the general oversight of the Secretary of the Treasury.

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Third, we will create a financing corporation to issue $50 billion in bonds to finance the cost of resolving failed institutions, which will supplement approximately $40 billion that has already been spent.

All of the principal of these bonds, and a portion of the interest on them, will be paid from industry sources. However, the balance would be paid from on-budget outlays of general revenues. Hopefully, some of these revenues will be recovered in the future through sale of assets and recovery of funds from the wrongdoers.

Fourth, we plan to increase the budget of the Justice Department by approximately $50 million to enable it to create a nationwide program to seek out and punish those that have committed wrongdoing in the management of these failed institutions. These funds will result in almost doubling the personnel devoted to the apprehension and prosecution of individuals committing fraud in our financial markets.

As you can see, these proposals are based upon several overriding principles.

First, I will not support any new fee on depositors.

Second, we should preserve the overall federal budget structure, and not allow the misdeeds and the wrongdoings of savings and loan executives and the inadequacy of their regulation to significantly alter our overall budget priorities.

And third, I have concluded that this proposal, if promptly enacted, will enable our system to prevent any repetition of this situation.

And fourth, I have decided to attack this problem head-on, with every available resource of our government because it is a national problem. I have directed that the combined resources of our federal agencies be brought together in a team effort to resolve the problem.

And fifth, I believe that banks and thrifts should pay the real cost of providing the deposit insurance protection. The price the FDIC charges banks for their insurance has not been increased since 1935. We propose to increase the bank insurance premium by less than seven cents per $100 of insurance protection that they receive. Every penny collected would be used to strengthen the FDIC so that the taxpayers will not be called on to rescue it a few years from now.

And I make you a solemn pledge that we will make every effort to recover assets diverted from these institutions, and to place behind bars those who have caused losses through criminal behavior. Let those who would take advantage of the public trust and put at risk the savings of American families anticipate that we will seek them out, pursue them and demand the most severe penalties.

In closing, I want to just say a word to the small savers of America. Across this great land families and individuals work and save, and we hope to encourage even greater rates of savings to promote a brighter future for our children. Your government has stood behind the safety of insured deposits before, it does today, and it will do so at all times in the future. Every insured deposit will be backed by the full faith and credit of the United States of America, which means that it will be absolutely protected.

For the future, we will seek to achieve a safe, sound and profitable banking system. However, integrity and prudence must share an equal position with competition in our financial markets. Clean markets are an absolute prerequisite to a free economy, and to the public confidence that is the most -- that is its most important ingredient.

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I've determined to face this problem squarely, and to ask for you support in putting it behind us. I have ordered that the resources of the Executive Branch be brought to bear on cleaning up this problem. I have personally met with the leadership of Congress on this issue. My administration will work cooperatively with Congress as the legislation that we will submit in a few days' time is considered. I call on the Congress to join me in a determined effort to resolve this threat to the American financial system permanently, and to do so without the delay.

I welcome the leaders that are with me here on this platform. I think their support says a lot about the efficacy of our proposal. And now I propose to take just a few questions. On the technical aspects, I will defer to these people, and then I'll be glad to turn this over to Secretary Brady. I believe we start with Helen and then Terry and then get going --

Q Mr. President, are you guaranteeing that the extra costs -- premiums, increases and so forth -- will not be past on to the depositors and taxpayers? And also, what is your responsibility in this debacle -- I mean, the Reagan-Bush zeal for deregulation of business and banking?

THE PRESIDENT: On the first place, we're not guaranteeing that. I would hope that wouldn't happen, but there is no guarantee what the institutions will do. Secondly, there is enough to be said for everybody in this together trying to solve this problem, so I can't equate any personal -- not inclined to go into any personal blame, simply to say that we've got to solve this problem and we're on the path to doing that.

Q Mr. President, the House votes tomorrow on that controversial pay raise plan, and the Senate has already voted against it. Would you sign a bill that vetoes the pay raise, not only for the members of Congress, but also for federal judges and other high officials in the government?

THE PRESIDENT: I've said I support it.

Q Mr. President, there is a feeling that part of this problem is attributable to deregulation of the financial industry. In retrospect, do you think that deregulation might have gone too far in the last ten years or so? And in the future, is your marching order to your administration to be a little more careful in regulating this particular industry?

THE PRESIDENT: Jerry, I don't know the answer. I'd be most interested to know what our experts here feel about whether -- how much of the problem could be attributed to deregulation. I just don't know the answer to your question, so I can't reply.

Q Mr. President, you have placed considerable stress in these early days of your presidency on ethics and propriety, yet in recent days there has been controversy on Capitol Hill concerning the propriety of some of Tower's alleged behavior, questions raised over the weekend about the financial investments on the private funds of the man in charge of ethics, your counsel, Boyden Gray, and other questions involving members of the administration -- or members-to-be of the administration. And I wonder, sir, what has happened here? Is it too harsh behavior on our part, too lax behavior on your part? What?

THE PRESIDENT: I don't think anything has happened. I learned long ago in public life not to make judgments based on allegations. But having said that, I want to have my administration aspire to the highest possible ethical standards. And we have appointed a commission to go out there now and try to detail what these standards should be. And we are in a new era on these matters. Matters that might have been approved and looked at one way, may have

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a different perception today. And so what I want to do is finalize our standards and then urge everybody in all branches of government to aspire to those standards. But I do think, Brit, that it's fair that we not reach judgment on Senate hearings before the Senate hearings are concluded because it's very hard to filter out fact from fiction, spurious allegations from fact. And I am not about to make a judgment based on a sensationalized newspaper story. I'm simply not going to do that. That wouldn't be fair and I'm not sure how ethical it would be. So let's wait and see this -- you're referring to the Tower matter up there -- that matter has been looked at by the FBI, the committee now has that, they have the responsibility to make determinations, and I'll be very interested to see what they say. But I am not going to make -- jump to conclusions based on stories that may or may not have any validity at all.

Q Mr. President, even if, as your spokesman says you do, you continue to back Senator Tower for the position, there are those you've heard who say that the best thing he could do for you is to step aside because even if confirmed he then would become damaged goods, weaker in administering a very, very tough job on your behalf. How do you respond to that suggestion?

THE PRESIDENT: Well, I think people would not want a person to step aside in a rumor, particularly if the rumor is baseless. And the process -- what the problem is -- the process is taking a little longer than I would like, and yet I think the Senate has got to do what they're doing -- looking at these allegations very carefully. But you know, as I said here at this same podium a while back, the American people are basically fair. And if these allegations prove to be allegations, without fact behind them, I think the people are going to say wait a minute, what went on here, how come it was all this -- we read this one day and then kind of a puff of smoke the next. And so, I don't think in your substantive question though, that if it proves -- if the Senate committee gives its endorsement to the Senator, particularly after all of these allegations, that there is any danger at all of damage to his credibility or his ability to do the job.

Q Mr. President, there are new and substantive allegations that Senator Tower lost control over the highly classified security documents and computer disks that were used in Geneva under his watch. If those allegations prove to be founded, would you then withdraw his nomination?

THE PRESIDENT: I would not answer hypothetical questions of that nature. You're telling me something that I haven't heard before. And we did have access to FBI reports. So if this matter is now before the Congress, let them investigate it. But I can't go into a hypothesis. All I would be doing would be adding to I think speculation that is not helpful at this juncture.

Q But, sir, will you pursue these allegations in the Executive Branch? Are you going to track what the FBI is looking into? Are you going to personally surveil these kinds of allegations yourself?

THE PRESIDENT: Every rumor and every innuendo, no. But if you're making -- if there's some substantive allegation of this nature, of course it would concern me.

Q Mr. President, back to S&Ls if we might, millions of -- (laughter) -- millions of Americans save alternatively. That is they save in mutual funds, stocks, and that kind of thing. As I read it, you've now outlined a plan that places a lot of the S&L bailout on the backs of the general treasury. How fair is that?

THE PRESIDENT: We've got a major problem and something has to be done. And this is the fairest system that the best minds in this administration can come up with. And so I again would ask you to ask the specifics of the treasury burden, to the Chairman of

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the Federal Reserve, or the Secretary of the Treasury, ask how they see that. But look, as I've said, there is no easy answer to this. All I want to do is make a sound proposal, work to put it into effect, and have that proposal such that the country won't have to face this problem again.

Q Mr. President, you said you dropped the deposit fee idea, but this plan you've given us has an increase in premiums that may be paid by consumers, as well as a large amount of taxpayers funds. Isn't that the same thing -- consumers and taxpayers are still going to have to pay the price for this?

THE PRESIDENT: Well, as I indicated earlier on, there is no guarantee of passing this on to the consumer, nor is there a guarantee it won't be passed on. But this arrangement has been there since -- for 50 years, and you might argue whether it's been passed on or not. I just don't know, I haven't seen the flow through in the industry. But nothing is without pain when you come to solve a problem of this magnitude.

Q Mr. President, you've talked to several members of Congress in various receptions and dinners and personal conversations over the past couple of weeks, and in many of them you have discussed this -- your plan for this problem. What is your feeling of the reception that it's going to get on Capitol Hill and of the selling job that awaits you now to get it passed?

THE PRESIDENT: We may have a big selling job, but I've been encouraged so far with the spirit epitomized by the members of Congress, particularly at the joint leadership meeting the other day. We didn't go into every detail of this. These plans were still being formulated and I wanted to get their views. I was encouraged by what Bill Seidman told me earlier on about how he -- what he felt the receptivity of the plan will be. But I don't think it's fair to the Congress to say that they have signaled to me that they are going to be enthusiastic on this plan, although I hope they are.

Q Mr. President --

THE PRESIDENT: I'm going to take about three more and then turn this over to these gentlemen here who are prepared to go into as much detail as you want.

Q Mr. President, these allegations that surround Tower now, at least variations on the theme, surfaced early in the transition -- allegations of womanizing and taking money from defense contractors -- that sort of thing. Have you satisfied yourself that he is still the nominee you want? Can you give us at this time a full-hearted endorsement of Tower?

THE PRESIDENT: Yes, I can and I will right now because some of the very same allegations that were floated that long ago apparently have been looked at and examined by the best possible examiners -- and I'm talking about the FBI -- and found to be groundless. So therefore I'm not about to change my view. If somebody comes up with facts, I hope I'm not narrow-minded enough that I wouldn't take a look. But I am not going to deal in the kinds of rumors that I've seen reported and then knocked down and then reported and then knocked down.

Q Mr. President --

THE PRESIDENT: One -- two to go.

Q There have been hints that Gorbachev may propose steps to diffuse the situation in Central America. I wonder if you see the possibility of superpower deals in Central America, and if so, what -- if you could suggest what would be acceptable for you?

THE PRESIDENT: I don't know about a deal, but I can see

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a possibility of cooperation in Central America because I would like the Soviets to understand that we have very special interests in this hemisphere, particularly in Central America, and that our commitment to democracy and to freedom and free elections and these principles is unshakeable, and I don't think they really have substantive interests in this part of the world -- certainly none that rival ours. So I would like to think they would understand that and there are so many areas where we could demonstrate a new spirit of cooperation, and this would clearly be one of them. So I'd like to think that is the way that the matter would be approached by the Soviets.

Yes, follow-up.

Q If I could follow up and ask you whether an understanding on Central America -- whether you'd be willing to include abandonment of aid to the Contras as part of such an understanding?

THE PRESIDENT: I wouldn't make a deal on that with the Soviets, nor would that come up. I don't believe we'd ever have a -- I can't see a situation of that nature arising, knowing as I do what will be negotiated and discussed with the -- so I think that's so hypothetical as to not even be a possibility of any kind.

Yes, Charles. And then I do have to run.

Q Mr. President, we still don't know what the taxpayers' burden is in here. Out of this $40 billion, it says first from S&L funds and the shortfall from Treasury funds. How big is it, and have you, in going through your budget had to knock out some things to pay for this?

THE PRESIDENT: We've had to knock out a lot of things on the overall budget for a lot of different reasons. But I'd like to leave this for Dick, for the questioning, to give the specific amounts. It is shared, as I've indicated, and he can give you the amounts that are involved.

Listen, thank you all very much, and now I'm going to turn this over to Secretary Brady. And then in order I guess they'll refer to each of these others.

Q Mr. President, one more word for the small --

Q -- seats back here, Mr. President?

THE PRESIDENT: What was that substantive question? (Laughter.)

Q In the back -- we didn't see you get back in this area.

THE PRESIDENT: We didn't get that far back, no, but if there's been an egregious offense to those in the back benches, I will take one parting question. And inasmuch as you raised it, fire away.

Q Thank you very much, sir. Back on the ethics issue, a couple of --

THE PRESIDENT: Mindful that the last questions always does get you in great trouble -- (laughter) -- go ahead.

Q Your perspective nominees -- one of your perspective nominees and your counsel have just recently changed their minds on matters that would have violated the ethics rules under the Reagan administration. Did you have difficulty in getting the word out that times would be tougher under your administration?

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THE PRESIDENT: No, I don't think so. For example, if you're referring to the Boyden Gray matter, which I think you are, that matter was reviewed every single year by the Office of Government Ethics, and he was deemed in compliance every single year. But now we've got a new ballgame here. He's the General Counsel here in the White House and I'm the President, and I've set out rhetorically the highest possible standards and we're trying to back that up by findings from this commission. And so I do think that we've got to be very careful about perceptions of impropriety when it comes to conflict of interest. Not rumors or innuendos of one sort or another. I don't think you can -- I should deal in those things. But when it comes to perceived conflicts of interest, I'd like our people to bend over backwards.

And I think that's what has happened in both the question of Lou Sullivan, whether he's entitled to -- all he did was ask, am I entitled to continue these arrangements with this small university. And all Boyden did, in my view now, is to try to go a step beyond what the government ethics office has said to avoid the perception of impropriety. But -- so I think it might be different now. I have to approach it differently as President. Not that you have lower standards, but I just think that again this whole question of perception we've got to look at it very, very carefully. But I want to be fair. I do not want to have the loudest charge, no matter how irresponsible, be that that sets the standards. We've got to achieve more objective standards. And that's why I'm putting a lot of faith in the -- hope to put a lot of faith in the findings of Judge Wilkey and former Attorney General Griffin Bell. And they will be looking at all these matters in terms of reality, and then, to some degree I'm sure, in terms of perception. So what might be legal and might be perfectly sound ethically might have to be altered given this new approach because of perception. It's a delicate one. I don't want to have the standards set in such an irresponsible way that good people just throw up their hands and say, look, who needs that kind of grief, who needs it, why should I have to give up all my whatever it is -- a health plan from the XYZ company. And yet, on the other hand, we're in a different time now. We're in a time when we've got to try to set these standards as high as possible. So I think Dr. Sullivan did the right thing in asking what was proper. I think Boyden Gray did the correct thing every year in asking what was proper and reviewing his own personal holdings in a family company with the Ethics Office, but now taking another step because of perception in this case.

So we've got to reach -- we've got to work with these individuals to find the proper answer and we've got to work with the commission to try to codify these standards.

Q Sir, by following, you said during the campaign very clearly that your staffers would not take outside income. I wonder why they need a legal opinion to understand that?

THE PRESIDENT: They had a legal opinion saying it was perfectly proper from this family company, and so now we're changing that and saying, look, there is this different perception problem here in this new era, so let's bend over as far backwards as we possibly can to -- you know, to recognize that.

Thank you all very much.

Q What about leveraged buy-outs, Mr. President?

THE PRESIDENT: There's your LBO man right there.

THE PRESS: Thank you.

END 4:35 P.M. EST

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
February 7, 1989

CONTACT: Office of Financing
202/376-4350

RESULTS OF AUCTION OF 3-YEAR NOTES

The Department of the Treasury has accepted $9,761 million of $31,264 million of tenders received from the public for the 3-year notes, Series R-1992, auctioned today. The notes will be issued February 15, 1989, and mature February 15, 1992.

The interest rate on the notes will be 9-1/8%. The range of accepted competitive bids, and the corresponding prices at the 9-1/8% rate are as follows:

	Yield	Price
Low	9.17%*	99.884
High	9.19%	99.833
Average	9.18%	99.859

*Excepting 1 tender of $10,000.

Tenders at the high yield were allotted 26%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 61,855	$ 61,855
New York	27,434,830	8,410,835
Philadelphia	53,895	53,895
Cleveland	114,265	114,260
Richmond	85,980	84,500
Atlanta	81,170	78,590
Chicago	1,733,045	359,545
St. Louis	108,310	88,310
Minneapolis	63,070	63,070
Kansas City	189,170	189,160
Dallas	51,650	47,950
San Francisco	1,277,770	199,310
Treasury	9,410	9,410
Totals	$31,264,420	$9,760,690

The $9,761 million of accepted tenders includes $1,750 million of noncompetitive tenders and $8,011 million of competitive tenders from the public.

In addition to the $9,761 million of tenders accepted in the auction process, $465 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $1,111 million of tenders was also accepted at the average price from Government accounts and Federal Reserve Banks for their own account in exchange for maturing securities.

NB-130

// TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M.

CONTACT: Office of Financing
202/376-4350

February 7, 1989

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $14,400 million, to be issued February 16, 1989. This offering will result in a paydown for the Treasury of about $ 250 million, as the maturing bills are outstanding in the amount of $ 14,639 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Standard time, Monday, February 13, 1989. The two series offered are as follows:

91-day bills (to maturity date) for approximately $7,200 million, representing an additional amount of bills dated November 17, 1988, and to mature May 18, 1989 (CUSIP No. 912794 RZ 9), currently outstanding in the amount of $7,800 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $ 7,200 million, to be dated February 16, 1989, and to mature August 17, 1989 (CUSIP No. 912794 SU 9).

The bills will be issued on a discount basis under competitive and noncompetitive bidding, and at maturity their par amount will be payable without interest. Both series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, on the records either of the Federal Reserve Banks and Branches, or of the Department of the Treasury.

The bills will be issued for cash and in exchange for Treasury bills maturing February 16, 1989. In addition to the maturing 13-week and 26-week bills, there are $ 9,907 million of maturing 52-week bills. The disposition of this latter amount was announced last week. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rates of accepted competitive tenders. Additional amounts of the bills may be issued to Federal Reserve Banks, as agents for foreign and international monetary authorities, to the extent that the aggregate amount of tenders for such accounts exceeds the aggregate amount of maturing bills held by them. For purposes of determining such additional amounts, foreign and international monetary authorities are considered to hold $1,488 million of the original 13-week and 26-week issues. Federal Reserve Banks currently hold $ 2,368 million as agents for foreign and international monetary authorities, and $7,884 million for their own account. These amounts represent the combined holdings of such accounts for the three issues of maturing bills. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 5176-1 (for 13-week series) or Form PD 5176-2 (for 26-week series).

Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. This information should reflect positions held as of one-half hour prior to the closing time for receipt of tenders on the day of the auction. Such positions would include bills acquired through "when issued" trading, and futures and forward transactions as well as holdings of outstanding bills with the same maturity date as the new offering, e.g., bills with three months to maturity previously offered as six-month bills. Dealers, who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities, when submitting tenders for customers, must submit a separate tender for each customer whose net long position in the bill being offered exceeds $200 million.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

Payment for the full par amount of the bills applied for must accompany all tenders submitted for bills to be maintained on the book-entry records of the Department of the Treasury. A cash adjustment will be made on all accepted tenders for the difference between the par payment submitted and the actual issue price as determined in the auction.

No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches. A deposit of 2 percent of the par amount of the bills applied for must accompany tenders for such bills from others, unless an express guaranty of payment by an incorporated bank or trust company accompanies the tenders.

Public announcement will be made by the Department of the Treasury of the amount and yield range of accepted bids. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. Subject to these reservations, noncompetitive tenders for each issue for $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. Cash adjustments will be made for differences between the par value of the maturing bills accepted in exchange and the issue price of the new bills. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

If a bill is purchased at issue, and is held to maturity, the amount of discount is reportable as ordinary income on the Federal income tax return of the owner for the year in which the bill matures. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, any gain in excess of the basis is treated as ordinary income.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76, 27-76, and 2-86, as applicable, Treasury's single bidder guidelines, and this notice prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars, guidelines, and tender forms may be obtained from any Federal Reserve Bank or Branch, or from the Bureau of the Public Debt.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
February 8, 1989

CONTACT: Office of Financing
202/376-4350

RESULTS OF AUCTION OF 10-YEAR NOTES

The Department of the Treasury has accepted $9,502 million of $22,740 million of tenders received from the public for the 10-year notes, Series A-1999, auctioned today. The notes will be issued February 15, 1989, and mature February 15, 1999.

The interest rate on the notes will be 8-7/8%. 1/ The range of accepted competitive bids, and the corresponding prices at the 8-7/8% interest rate are as follows:

	Yield	Price
Low	8.90%	99.837
High	8.92%	99.706
Average	8.91%	99.771

Tenders at the high yield were allotted 76%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 20,633	$ 20,633
New York	20,196,324	8,775,444
Philadelphia	5,805	5,805
Cleveland	11,277	11,277
Richmond	14,056	13,910
Atlanta	10,402	10,182
Chicago	1,412,913	574,963
St. Louis	28,460	12,425
Minneapolis	8,216	8,216
Kansas City	12,920	12,900
Dallas	10,484	6,474
San Francisco	1,006,362	47,962
Treasury	1,841	1,841
Totals	$22,739,693	$9,502,032

The $9,502 million of accepted tenders includes $522 million of noncompetitive tenders and $8,980 million of competitive tenders from the public.

In addition to the $9,502 million of tenders accepted in the auction process, $200 million of tenders was also accepted at the average price from Federal Reserve Banks for their own account in exchange for maturing securities.

1/ The minimum par amount required for STRIPS is $1,600,000. Larger amounts must be in multiples of that amount.

NB-132

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

For Release Upon Delivery
Expected at 10:00 a.m., E.S.T.
February 9, 1989

FEB 1
DEPAR

STATEMENT OF
DANA L. TRIER
TAX LEGISLATIVE COUNSEL
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON LABOR
FOR THE
COMMITTEE ON LABOR AND HUMAN RESOURCES
UNITED STATES SENATE

Mr. Chairman and Members of the Subcommittee:

I am here today at your request to present the Treasury Department's views regarding an employer's ability to recover assets from a terminated defined benefit plan. The Department continues to believe that an employer who terminates a defined benefit plan should be entitled to receive any assets remaining in the trust related to the plan after the satisfaction of all plan liabilities ("excess assets") as specified under law. The ability of an employer to recover excess assets upon termination of a plan should be preserved in order to ensure sound funding of pension plans and, ultimately, to protect employees' retirement security.

Background

A fundamental principle of the tax law applicable to pension plans is that plan assets must be used for the exclusive benefit of plan participants and their beneficiaries prior to the satisfaction of all plan liabilities. The term "liabilities" includes both the fixed and contingent liabilities that are provided under a plan. Generally, fixed liabilities are the vested benefits accrued under the plan benefit formula as of the date of plan termination, taking into account current salary and years of service. Contingent liabilities include those benefits for which the vesting requirements have not been satisfied as of the date of plan termination.

If a pension plan is terminated, plan assets must first be applied to satisfy plan liabilities. Upon the satisfaction of such liabilities, plan assets remaining in the trust related to

the plan may be distributed to the employer. The ability of an employer to recover excess assets has long been the law. During its deliberations prior to the enactment of the Employee Retirement Income Security Act of 1974 ("ERISA"), Congress rejected proposals to prevent or limit an employer's ability to recover excess assets. In fact, Title IV of ERISA specifically provides that an employer may recover excess assets if all plan liabilities have been satisfied and certain conditions are satisfied.

Excess assets may arise upon termination of a defined benefit plan because of changes in interest rates and investment performance and because of the actuarial nature of plan funding. In determining the amount of contributions that may be made to a plan, an actuary makes certain assumptions regarding the rate of return on plan investments, salary increases until participants' projected retirements, the rate of employee turnover and mortality and other factors, which may prove to be untrue. Moreover, these assumptions are made on the basis of an ongoing plan. Thus, the anticipated expense of benefits that the actuary projects to be earned by participants is not incurred when a plan is terminated. Furthermore, the funding methods that may be used for budgeting the cost of projected benefits generally require minimum contributions that exceed the accrued benefits under the plan. For example, if a level funding method is adopted by an employer, the employer makes contributions to the plan over the working lives of its employees in such a manner that the employer may avoid large increases in annual costs. An employer contributing to a plan under a level funding method typically contributes more in each of the plan's early years than the value of the benefits earned in each such year. In sum, when a plan is terminated, excess assets may exist because (i) the actual experience of the plan may be different from the assumptions made by the actuary, (ii) the accrued benefits, both fixed and contingent, are less than those projected to be earned upon participants' retirements, and (iii) the funding method adopted by the employer generally would have required prefunding of those projected benefits.

Treasury regulations published prior to the enactment of ERISA provide that an employer may reserve the right to receive any excess assets if they are due to erroneous actuarial computations. Excess assets are due to erroneous actuarial computations if the liabilities under the plan upon its termination are less than the projected plan liabilities determined by a competent actuary using reasonable assumptions. If any excess assets are the result of decreases in benefits earned under plan or changes to vesting requirements for such benefits, the assets are not considered attributable to erroneous actuarial computations. Thus, excess assets due to such amendments may not be distributed to an employer. The only other constraint on reversions of excess assets is the requirement that excess assets attributable to employee contributions be returned to participants.

Recent Legislation

The concept of excess assets attributable to erroneous actuarial computations as set forth in the regulations has not been changed over the years. In fact, Congress has reaffirmed an employer's right to recover excess assets upon plan termination several times during its deliberations of recent tax bills.

Congress recognized this right in the Tax Reform Act of 1986 ("TRA '86") when it imposed a 10% nondeductible excise tax upon reversions received by employers. See Senate Report No. 99-313. The Conference Committee Report to the Pension Protection Act (Omnibus Budget Reconciliation Act of 1987 (OBRA '87), Title IX, Part II) states that present law permits an employer to recover excess assets if such excess is due to actuarial error and to the extent such excess is not attributable to employee contributions. The Senate Finance Committee Report relating to the Pension Protection Act states that the terms of the plan document determine whether an employer has the right to recover excess plan assets or is required to share the excess assets with plan participants. The Report concludes that present law standards regarding reversions and the 10% excise tax on reversions are the appropriate rules for addressing the issue of employer access to excess plan assets. The Technical and Miscellaneous Revenue Act of 1988 increased the excise tax from 10% to 15%.

The Pension Protection Act affected reversions in two ways. First, the Act imposed an additional limit on deductible contributions to a defined benefit plan. Under this limit, an employer may not deduct contributions to the extent they result in plan assets exceeding 150% of a plan's current liabilities. Current liabilities are those fixed and contingent liabilities that must be satisfied upon plan termination. Since this limit on deductible contributions is based on liabilities earned to date, an employer's ability to contribute on a deductible basis to a plan based on benefits to be provided upon employees' projected retirement may be curtailed significantly. Moreover, because this limitation restricts an employer's ability to prefund its future liabilities under a level funding method, the amount of excess assets upon plan terminations occurring in the future will be reduced.

Second, Congress amended Title IV of ERISA to provide that any plan amendment providing for a reversion or increasing the amount of the reversion is not effective for five years. If a plan is terminated within the five year period following an amendment to permit a reversion, the excess assets must be distributed to participants and their beneficiaries. This provision was intended to prevent an employer from amending its plan prior to termination to obtain a reversion.

Treasury Department Position Regarding Reversions

The Treasury Department believes that current law correctly permits an employer to recover excess assets upon plan termination. If reversions were precluded and an employer followed a prudent method of funding on a level basis for projected benefits, the employer's actual cost could increase significantly on plan termination beyond the effect of vesting upon termination because the employer would be obligated to provide employees with larger benefits than earned under the plan. Such a result is inappropriate when the employer is assuming the ultimate risk for funding the plan. Moreover, the incentive of an employer to fund a plan adequately and to cause its investment earnings to be maximized would be decreased by a rule requiring that excess assets be used to fund extra benefits for its employees.

In a letter to Senator Byrd dated June 29, 1988, former Secretary of Treasury James A. Baker III and former Secretary of Labor Ann McLaughlin urged Congress to delete a provision from the Labor-HHS-Education Appropriations Bill requiring a moratorium on asset reversions. Secretaries Baker and McLaughlin stated that the moratorium was intended to force Congress to reconsider legislation requiring employers who terminate overfunded plans to pay greater benefits to participants than were promised. The Secretaries pointed out that this proposal was opposed by the Reagan Administration and rejected by Congress during consideration of OBRA '87. The letter warned that such legislation would deter sound pension funding, decrease employees' retirement income security, discourage employers from establishing and maintaining defined benefit plans and pose serious risks to the Pension Benefit Guaranty Corporation's financial security. The Treasury Department continues to adhere to the policy position stated in the June 29, 1988 letter of former Secretaries Baker and McLaughlin.

Current law strikes a delicate balance among the various goals of pension policy, i.e., to protect employees' retirement income security, to encourage the sound funding of plans and to encourage employers to establish and maintain pension plans for their employees. We believe it is premature to take additional steps restricting an employer's ability to recover excess assets; the effects of the recent tax law changes cannot yet be determined. The 10% nondeductible excise tax on reversions was enacted to recapture the tax benefit received by an employer recovering plan assets that were not used to provide retirement benefits to plan participants. This tax was increased to 15% only a few months ago. The new limitations on deductible contributions have only been effective for one year and, in fact, not all employers have made contributions under the new limitation. Finally, the limitation on plan amendments to increase reversions was also recently enacted.

Sound public policy should encourage the optimal funding of defined benefit plans. Any further restrictions on an employer's ability to fund its plan or recover excess assets due to the prior funding of its plan may jeopardize the sound funding of defined benefit plans. Promoting the sound funding of plans is the most desirable way to ensure employees' retirement income security under a voluntary, private pension system.

This concludes my prepared remarks. I would be pleased to respond to your questions.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
February 9, 1989

CONTACT: Office of Financing
202/376-4350

RESULTS OF AUCTION OF 30-YEAR BONDS

The Department of the Treasury has accepted $9,508 million of $17,163 million of tenders received from the public for the 30-year Bonds auctioned today. The bonds will be issued February 15, 1989, and mature February 15, 2019.

The interest rate on the bonds will be 8-7/8%.1/ The range of accepted competitive bids, and the corresponding prices at the 8-7/8% interest rate are as follows:

	Yield	Price
Low	8.90%	99.740
High	8.95%	99.223
Average	8.91%	99.636

Tenders at the high yield were allotted 12%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

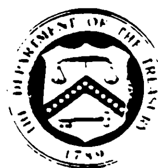
Location	Received	Accepted
Boston	$ 1,002	$ 1,002
New York	15,229,896	9,011,656
Philadelphia	1,459	1,134
Cleveland	939	939
Richmond	12,194	12,164
Atlanta	4,745	4,725
Chicago	1,143,168	455,168
St. Louis	13,993	5,993
Minneapolis	3,577	3,327
Kansas City	2,830	2,810
Dallas	2,602	2,602
San Francisco	746,253	6,128
Treasury	246	246
Totals	$17,162,904	$9,507,894

The $9,508 million of accepted tenders includes $307 million of noncompetitive tenders and $9,201 million of competitive tenders from the public.

In addition to the $9,508 million of tenders accepted in the auction process, $100 million of tenders was also accepted at the average price from Federal Reserve Banks for their own account in exchange for maturing securities.

1/ The minimum par amount required for STRIPS is $1,600,000. Larger amounts must be in multiples of that amount.

General Explanations
of the
President's Budget Proposals
Affecting Receipts



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February 1989

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CAPITAL GAINS TAX RATE REDUCTION FOR INDIVIDUALS

Current Law

Under current law, capital gains of individuals are taxed at the same rates as ordinary income. Thus, capital gains are subject to a 15 percent, 28 percent, or 33 percent marginal rate, although the overall rate on all income cannot exceed 28 percent. Prior to the Tax Reform Act of 1986 (the "1986 Act"), the tax code provided an exclusion for capital gains. The elimination of the capital gains exclusion had the effect of increasing the rate of tax on capital gains. While the 1986 Act eliminated the capital gains exclusion, it did not eliminate the legal distinction between capital gains and ordinary income. Thus, the tax code retains most of the pre-1987 structure that implemented the capital gains tax rate differential.

Gains or losses from the sale or exchange of capital assets held for more than one year are treated as long-term capital gains or losses. A taxpayer determines net capital gain by first netting long-term capital gain against long-term capital loss and short-term capital gain against short-term capital loss. The excess of any net long-term capital gain over any net short-term capital loss equals net capital gain. Individuals with an excess net capital loss may generally take up to $3,000 of such loss as a deduction against ordinary income. A net capital loss in excess of the deduction limitations may be carried forward indefinitely, retaining its character in the carryover year as either a short-term or long-term loss. Special rules allow individuals to treat losses with respect to a limited amount of stock in certain small business corporations as ordinary losses rather than as capital losses.

A capital asset is defined generally as property held by a taxpayer other than (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business; (2) depreciable or real property used in the taxpayer's trade or business; (3) rights to literary or artistic works held by the creator of such works, or acquired from the creator in certain tax-free transactions; (4) accounts and notes receivable; and (5) certain publications of the government.

Special rules apply to gains and losses with respect to "section 1231 property." Section 1231 property is defined as (1) depreciable or real property held for more than 6 months and used in a taxpayer's trade or business, but not includable in inventory or held primarily for sale in the ordinary course of a trade or business; (2) certain property subject to compulsory or involuntary conversion; and (3) special 1231 property, including certain interests in timber, coal, domestic iron ore, certain livestock, and certain unharvested crops. Gains and losses from all transactions involving section 1231 property are netted for

each taxable year. Only gains that are not subject to recapture as ordinary income are included in the netting. If there is a net gain from section 1231 property, all gains and losses from section 1231 property are treated as long-term capital gains and losses and are combined with the taxpayer's other capital gains and losses. If there is a net loss from section 1231 property, all transactions in section 1231 property produce ordinary income and ordinary loss. However, net gain from section 1231 property is converted into ordinary income to the extent net losses from section 1231 property in the previous 5 years were treated as ordinary losses.

Depreciation recapture rules recharacterize a portion of gain realized upon the disposition of depreciable property as ordinary income. These rules vary with respect to the type of depreciable property. Under ACRS, for all personal and nonresidential rental real property, all previously allowed depreciation, not in excess of total realized gain, is recaptured as ordinary income. However, if a taxpayer elects straight-line depreciation over a longer recovery period, there is no depreciation recapture upon disposition of the asset. With respect to residential rental property, only the excess of ACRS deductions over the straight-line method is recaptured as ordinary income. Depreciation recapture also is imputed to a partner who sells a partnership interest if recapture would have been imposed upon disposition by the partnership of depreciable property. There are also recapture rules applicable to depletable property.

Capital gains and losses are generally taken into account when "realized" upon sale, exchange, or other disposition of the property. Certain dispositions of capital assets, such as transfers by gift, are not generally realization events for tax purposes. Thus, in general, in the case of gifts, the donor does not realize gain or loss and the donor's basis in the property carries over into the hands of the donee. In certain circumstances, such as the gift of a bond with accrued market discount or of property that is subject to indebtedness in excess of the donor's basis, the donor may recognize ordinary income upon making a gift. Gain or loss also is not realized on a transfer at death.

The amount of a seller's gain or loss is equal to the difference between the amount realized by the seller and the seller's adjusted basis (i.e., the cost or other original basis adjusted for items chargeable against or added to basis). Under various nonrecognition provisions, however, realized gains and losses in certain transactions are deferred for tax purposes. Examples of such nonrecognition transactions include certain like-kind exchanges of property, involuntary conversions followed by an acquisition of replacement property, corporate reorganizations, and the sale of a principal residence. Generally, nonrecognition treatment defers gain or loss for tax purposes by providing for a substitution of basis from the old

property to the new or for a carryover basis from the old holder to the new holder.

Reasons for Change

Restoring a capital gains tax rate differential is essential to promote savings, entrepreneurial activity, and risk-taking investments in new products, processes, and industries that will help keep America competitive and economically strong. At the same time, investors should be encouraged to extend their horizons and search for investments with long-term growth potential. The future competitiveness of this country requires a sustained flow of capital to innovative, technologically advanced activities that may generate minimal short-term earnings but promise strong future profitability. A preferential tax rate limited to long-term commitments of capital will encourage investment patterns that favor innovations and long-term growth over short-term profitability.

A capital gains differential will also provide a rough adjustment for taxing inflationary gains that do not represent any increase in real income. In addition, the Administration believes it is appropriate to provide further capital gains benefit to low and moderate income individuals, who less frequently make direct investments in capital assets and whose capital gains tend to be disproportionately attributable to inflation.

Long-range Investment and Competitiveness. The Administration is committed to maintaining and enhancing American leadership in employment growth and entrepreneurial activity. A great strength of the American economy has been the rate of new business formation, product and process innovation, and leadership in new and emerging technologies. This has led to record new job creation this decade, a period for which most other major industrial economies have suffered stagnant employment.

By reducing the top individual income tax rate to its lowest level in more than half a century and by introducing the lowest marginal tax rates among the major industrial economies of the world, the 1986 Act created strong incentives for individual work, savings, and investment that will lead to long-term economic growth. These low tax rates are now being emulated by our major trading partners -- including especially Canada, the United Kingdom, Germany, and Japan -- who wish to get back in step with the United States. While low marginal tax rates were an enormous step forward, the Tax Reform Act of 1986 also raised the rate of tax on capital gains. In this area, our major competitors now have the upper hand: none of them taxes long-term capital gains in full. Restoring a tax differential for capital gains will solidify the favorable tax position of the

United States relative to the major industrial nations of the world.

Some of the soundest investments in America's future do not have immediate payoffs. Thus, it is important to the future competitive position of this country that investors look beyond short-run profit to an investment's long-term potential. Consequently, restoration of a capital gains tax rate differential should be tailored to encourage sound, long-term investments that require multi-year commitments of capital. Moreover, a tax rate differential will promote personal savings to finance long-term investment and will ameliorate the built-in bias of the income tax against corporate equity financing.

Inflationary Gains. Although inflation has been kept low under policies of the past eight years, even low rates of inflation mean that individuals who sell capital assets at a nominal profit are paying tax on a "fictional" element of profit represented by inflation. High rates of inflation, such as those that existed in the mid and late 1970s, exacerbate the problem. An income tax should consider only "real" changes in the value of capital assets -- after adjusting for inflation -- in order to avoid unintended high effective rates of tax that actually lower the real after-tax value of assets. Current law taxation of nominal capital gains in full has the perverse result that real gains are overstated (and taxed too highly) and real losses are understated and, in some cases, actually converted for tax purposes from losses to gains. A partial exclusion for long-term capital gains provides a rough adjustment for the inflationary element of capital gains without creating the complexities and additional record-keeping that a precise inflation adjustment would require.

Low and Moderate Income Taxpayers. Low and moderate income individuals typically do not directly realize capital gains as frequently as those with higher incomes. In 1985, the latest year for which detailed tax return data are available, nearly 60 percent of all returns reported adjusted gross incomes less than $20,000, but, as shown on table 1, only 30 percent of the returns with net long-term capital gains fell into this group, and their gains were only 11.4 percent of the total dollar value of gains realized that year. Economic studies of the behavioral reactions of individuals to changes in the taxation of capital gains suggest that lower income individuals are much less responsive than higher income taxpayers to capital gains tax rate changes, thus an extra measure of incentive is required to encourage lower income individuals to make direct capital investment in America's future. Further, analysis of capital gains realized by individuals at different income levels shows that lower income individuals are much more likely than higher income individuals to have large fractions of their gains represented by inflation. For these two reasons -- targeted extra incentive and fairness --

it is appropriate to provide special capital gains tax relief for lower income taxpayers.

<u>Collectibles</u>. Investment in so-called collectibles, which include works of art, stamp and coin collections, antiques, valuable rugs, and similar items does relatively little to enhance the nation's economic growth or productivity. For this reason collectibles do not warrant the preferential treatment accorded other capital investments.

<u>Treatment of Gain on Depreciable and Depletable Assets</u>. Gains and losses from sales or other dispositions of depreciable and depletable property should be treated in the same manner as other business income or loss and gains or losses from sales of other business property (<u>e.g.</u>, inventory). The asymmetrical treatment of gains and losses from such depreciable or depletable property provided by pre-1987 law, <u>i.e.</u>, the availability of capital gain treatment for gains and ordinary loss treatment for losses, is without justification as a matter of tax policy.

Historically, the availability of capital gain treatment for gains from sales of depreciable assets stems from the implementation of excess profits taxes during World War II. Many depreciable assets, including manufacturing plants and transportation equipment, had appreciated substantially in value when they became subject to condemnation or requisition for military use. Congress determined that it was unfair to tax the entire appreciation at the high rates applicable to wartime profits. Accordingly, gains from wartime involuntary conversions were taxed as capital gains. The provision was extended to voluntary dispositions of assets because it was not practical to distinguish condemnations and involuntary dispositions from sales forced upon taxpayers by the implicit threat of condemnation or wartime shortages and restrictions. These historical circumstances offer no justification for returning to the pre-1987 treatment of depletable or depreciable assets used in a trade or business, given the absence of exceptional wartime gains and the low, historically unprecedented (in the post-World War II era) statutory tax rates.

The timing of sales of depreciable or depletable business assets is more likely to be determined by the condition of the particular asset or by routine business cycles of replacement than would be true of capital assets held by investors. As a consequence, taxation of gains on sales of depreciable or depletable business assets at ordinary rates is less likely to affect taxpayer decisions about sales and reinvestment. Conversely, taxation of gains on sales of depreciable or depletable assets at preferential rates would create an undesirable bias toward certain sources of business income.

Depletion and depreciation deductions provide a current benefit in the years in which they are claimed. The effect of the recapture rules may be to offset this benefit, in whole or in

part, by preventing the conversion of ordinary income into capital gain, which was a significant issue under pre-1987 law. Such rules are complex, however, and one of the significant policy advantages of current law is the greatly reduced significance of recapture rules. Excluding gains on depletable and depreciable business property from preferential treatment would preserve the limited significance of current recapture rules.

Finally, the availability of a capital gain preference prior to 1987 for depreciable and depletable business property contributed significantly to tax shelter activity. Although the passive loss rules adopted in the 1986 Act have limited tax shelter benefits, restoration of a capital gain preference for depreciable and depletable business property would make tax shelter investments more attractive.

Treatment of Gain on Special Section 1231 Property. Under pre-1987 law, gains on dispositions of certain interests in timber, coal, iron ore, livestock and unharvested crops, were eligible for favorable capital gain treatment without regard to whether the property was held for sale in the ordinary course of the taxpayer's business. This special treatment violated the distinction, which is inherent in the definition of a capital asset, between investment property and business property. Business income, whether derived from the sale of property used in a trade or business or from the sale of property to customers in the ordinary course of business, should be taxed as ordinary income. The preferential tax rate on capital gains should apply only to investment assets. Gains from dispositions of interests in certain natural and agricultural resources should be taxed in accordance with these generally applicable rules.

Description of Proposal

General Rule. An exclusion would be allowed to individuals for 45 percent of the gain realized upon the disposition of qualified capital assets. The maximum tax rate applicable to any gains on qualified assets would be 15 percent. A qualified asset would generally be defined as any asset that qualifies as a capital asset under current law and satisfies the phased-in holding periods. For example, assuming the holding period is satisfied, an individual's residence would be a qualified asset and gain on its disposition would be eligible for the lower capital gains rate proposed by the budget (and continued rollover of gain and the $125,000 one-time exclusion). Disposition of a qualified asset by an RIC, REIT, partnership, or other passthrough entity would continue to be treated as capital gain under the budget proposal and would be eligible for the exclusion in the hands of individual investors.

Holding Period and Effective Date. To be treated as qualified assets eligible for the lower capital gains rate, assets will need to satisfy the following holding periods: more than 12 months for assets sold in 1989, 1990, 1991, and 1992; more than 24 months for assets sold in 1993 and 1994; and more than 36 months for assets sold in 1995 and thereafter.

The proposal would be effective generally for dispositions of qualified assets after June 30, 1989. Dispositions of qualified assets after that date would be fully protected by the exclusion or maximum rate -- that is, there would be no blended rate for gains realized in 1989 after June 30. Conversely, gains realized on or before June 30, 1989, would not be eligible for the exclusion, maximum rate, or any of the other provisions of the proposal and would be taxable under current law.

15 Percent Maximum Rate. A 15 percent maximum tax rate would apply to capital gains on qualified assets. This maximum rate would apply for purposes of both regular and minimum tax. Thus while a taxpayer's ordinary income may be subject to a 33 percent marginal rate (due to phase-out of the 15 percent rate or personal exemptions), capital gains would not be subject to a marginal rate exceeding 15 percent. In some cases, the application of a 45 percent exclusion would result in an effective tax rate lower than 15 percent; for example, if the taxpayer's marginal rate is 15 percent, a 45 percent exclusion would result in an effective tax rate of 8.25 percent.

100 Percent Exclusion for Certain Taxpayers. A taxpayer would be eligible for a 100 percent exclusion on sales of qualified assets if the taxpayer's adjusted gross income is less than $20,000 and the taxpayer is not subject to the alternative minimum tax. The $20,000 amount wouldbe calculated taking the 45 percent capital gains exclusion into account. Thus, if a taxpayer's adjusted gross income is $22,000 (including the full amount of gains realized on capital assets), and a 45 percent exclusion on capital gains would reduce the taxpayer's taxable income to less than $20,000, the taxpayer would be eligible for the 100 percent exclusion.

The $20,000 figure applies to married taxpayers filing jointly and heads of households. Single taxpayers and married taxpayers filing separately would be eligible for the 100 percent exclusion if their adjusted gross incomes are less than $10,000.

Taxpayers who are subject to the alternative minimum tax would not be eligible for the 100 percent exclusion. In making this determination, a taxpayer's tentative minimum tax would be compared with his regular tax computed using a 45 percent exclusion. If the tentative minimum tax exceeds the regular tax, the taxpayer has liability under the alternative minimum tax and would not be eligible for the 100 percent exclusion. The ineligibility for the 100 percent rate would have no other effect on the taxpayer. Consideration will given to the need for other

rules to restrict the 100 percent exclusion to true low-income families.

Collectibles Not Treated as Qualified Assets. The budget proposal would deny capital gain treatment for gains realized upon the disposition of collectibles, as defined under the individual retirement account (IRA) rules. These rules prohibit investments by IRAs in collectibles, which are defined to include works of art, rugs, antiques, metals, gems, stamps, alcoholic beverages, and most coins. The Secretary of the Treasury is also given authority to specify other tangible personal property to be treated as collectibles. Proposed regulations define collectibles to include musical instruments and historical objects. Consideration would also be given to rules denying the capital gains preference to sales of corporate stock to the extent collectibles had been contributed to the corporation by the selling shareholders.

Definition of Capital Asset and Treatment of Assets Used in a Trade or Business. The budget proposal would not alter the definition of a capital asset; however, gain from the sale, exchange, or other disposition of depreciable or depletable property used in a trade or business would not be treated as gain eligible for the lower capital gains rates. For this purpose, depreciable property refers to any property which is of a character subject to an allowance under Code sections 167 or 168. Thus, gains realized on the disposition of intangible property, the cost of which may be recovered through amortization deductions (see section 1.167(a)-3), such as sports player contracts, would be treated as ordinary income if the intangible property is used in the taxpayer's trade or business. The fact that cost recovery of an intangible asset may be referred to as "amortization" would not prevent its being treated as depreciable property under this provision. Depletable property refers to any property of a character that is subject to an allowance for depletion, whether cost or percentage depletion.

Under current law, gains on dispositions of special section 1231 assets, which include certain interests in timber, coal, iron ore, livestock, and unharvested crops, are eligible for capital gain treatment regardless of whether the property is held for investment or used in the ordinary course of the taxpayer's trade or business. Under the budget proposal, gains from such assets would not automatically be treated as capital gain eligible for the lower rate. Instead, the character of gain upon the sale, exchange, or other disposition of such assets would depend on generally applicable principles.

Gains on nondepreciable property that is used in a trade or business and is not held for sale in the ordinary course of business would be eligible for the lower capital gains rates. Losses on such property would also be treated as capital losses. Thus, for example, gain or loss realized on the disposition of

land that is used in a trade or business and is not held for sale to customers would be treated as capital gain or loss.

Effects of Proposal

The proposal would restore incentives for investment and risk taking that may have been discouraged by elimination of a capital gains tax differential in the Tax Reform Act of 1986. The proposal would especially encourage long-run investments, which would lead to new jobs, the creation of new technologies, and economic growth. By more narrowly defining assets eligible for preferential treatment and by lengthening the prior-law holding period to 3 years, the proposal targets tax benefits to assets which are most responsive to a change in tax rate.

Under the proposal most taxpayers would be eligible for the 45 percent or 100 percent exclusions; however, most gains would be taxed at the alternate 15 percent rate. The following examples illustrate how the proposal would effect typical taxpayers. (Taxes have been computed using current law rates and other provisions applicable to 1989.)

Example A. Taxpayer A is a single individual earning $16,000. For some years he has been making modest investments in a mutual fund that in 1990 reports his share of long-term capital gain to be $750.

Under current law his tax on the $750 capital gain would be 15% of the full $750 gain, or $112.50.

Under the proposed general 45 percent exclusion his tax on the gain would be 15 percent of $412.50 (after excluding $337.50), or $61.88; however because Taxpayer A has adjusted gross income that is less then $20,000, he is eligible for the special 100 percent long-term capital gains exclusion, resulting in a tax of zero, a 100 percent reduction from current law tax.

Example B. Couple B both work and earn $90,000 between them. They also have interest income of $3,200 and dividend income of $1,800. They have two dependent children and have itemized deductions of $7,000.

In 1995 they sell corporate stock, realizing an $1,800 capital gain on stock held 15 months and a $3,700 capital gain on stock held 38 months.

Under current law both gains are subject to full taxation at the 33 percent effective marginal tax rate. Tax on the $1,800 gain would be $594, and tax on the $3,700 gain would be $1,221, for a combined tax of $1,815. Under the proposal, the gain from the 1995 sale of stock held 15 months will be short-term capital gain taxable at ordinary income rates, but

the gain from the sale of stock held 38 months is subject to the 15 percent maximum alternate capital gains tax rate (which for them is more beneficial than the 45 percent exclusion). Their tax on the latter gain will be $555.00, representing a reduction from current law of $666, or 55 percent.

Example C. Taxpayer C is a widow with dividend income of $23,000 and $7,000 of taxable pension income. In 1993 she sells corporate stock she had purchased over a number of years. The most recent purchase had been made more than 2 years previously. Her realized capital gains total $18,000.

Under current law her tax on that gain would be $5,040 (28 percent of $18,000). Under the proposal, the 15 percent rate cap will lower this capital gains tax to $2,700, a reduction of $2,340, or 46 percent.

Revenue Estimate

The effect on Federal tax revenues of changes in capital gains tax rates is controversial. Studies using different data, different explanatory variables, and different statistical methodologies have reached opposite conclusions on the effect of capital gain rate reductions on Federal revenues.

The Treasury Department estimates that the revenue effect of the President's proposal will be positive during the budget period, as well as in the long-run, after the phase-in of the three-year holding period requirement. The methodology used for these estimates is described below in more detail than usual since the President's proposal is different from proposals previously evaluated and generalizing from previous proposals can be misleading.

The revenue estimate for the budget proposal is generally consistent with the Treasury Department's estimate of the capital gains tax changes included in the 1986 Act; however, the proposal differs significantly from a simple reversal of the general increase in capital gains tax rates in the 1986 Act: (1) The proposal excludes gains on certain assets whose realizations are less responsive to changes in capital gains tax rates; (2) the proposal requires a longer holding period for gains to benefit from the lower rates; and (3) the proposal has a different time pattern between the announcement and effective date. Most importantly, in terms of its impact on revenues, the proposal creates a much smaller differential between the tax rate on capital gains and the tax rate on ordinary income than existed prior to the 1986 Act.

As described below, the Treasury revenue estimates assume significant behavioral effects as taxpayers adjust their capital

gain realizations, their financial portfolios and income sources, and the timing of their realizations to the new tax rules. These behavioral effects are the subject of continued empirical research. Studies will differ on the magnitude of these behavioral effects, in part due to the scarcity of data on timing and on the ultimate conversion of ordinary income to capital gain income, and in part due to the responsiveness of taxpayers' capital gains realizations to influences other than tax rates. The Office of Tax Analysis incorporates all effects believed to be important and presents its best estimate of the expected effects.

Table 2 shows the separate revenue effects of the various elements of the capital gains proposal. In addition, it shows the "static" and behavioral effects incorporated in the estimate. Additional revenues resulting from positive macroeconomic effects of the proposal are not included in the revenue estimate. It is useful to describe the different effects incorporated in the revenue estimate before considering the targeting and growth-oriented features that distinguish the budget proposal. The revenue estimate is broken into seven different elements.

Effect of Tax Rate Reduction on the Level of Current Law Realizations. First, a tax loss results from reducing tax rates on capital gains that would be realized at current law tax rates; *i.e.*, realizations that would have occurred regardless of a reduction in tax rates. This is what the "static" revenue estimate would be.

Effect of Increased Realizations. Second, lower tax rates will increase taxes due to additional realizations that would not otherwise occur in the current year. These "induced" gains are accelerated from realizations in future years, are due to portfolio shifting to capital gain assets from fully taxable income sources, or are taxable realizations that would otherwise have been tax-exempt because they would have been held until death, donated to charities, or realized but not reported.

The estimate is based on a responsiveness by taxpayers which results in additional revenue from induced gains more than sufficient to offset the revenue loss from lower rates on current gains. The responsiveness of capital gains realizations to changes in tax rates is one of the most important revenue estimating issues. The estimate of induced realizations is based on a survey of academic and government studies that examine taxpayers as a group over a number of years and other studies that examine individual tax returns over several years. With respect to the assumed degree of responsiveness of realizations to changes in the tax rate, the estimate takes a conservative position; there are studies that show both lower responses as well as higher ones. The response is greater in the initial years than in the long run due to the unlocking of gains accrued before the effective date.

The responsiveness of capital gains realizations to a general 45 percent exclusion from current law would be lower than that used to estimate the effect of the 1986 Act, where the top effective tax rate on capital gains increased from 20 percent to 33 percent. Most empirical studies have found that responsiveness decreases at lower marginal tax rates.

Effect of Deferring Gains Until After Effective Date. Third, the proposal will induce some taxpayers to defer realizations in the first half of 1989 until after the effective date of the proposal. With the announcement of the proposal in February and the assumed enactment and effective date of July 1, 1989, some realizations that otherwise would occur between the announcement date and the effective date will be delayed in order to benefit from the lower tax rate. The estimate predicts that revenue will be lost only over the fiscal year 1989-1990 period due to realizations deferred until the effective date.

Effect of Conversion of Ordinary Income to Capital Gain Income. Fourth, the proposal will induce taxpayers to realize additional capital gains currently and will encourage taxpayers to earn income in the form of lower taxed capital gains. Since the advent of preferential tax rates on capital gains in 1922, taxpayers have found various ways to convert ordinary taxable income into capital gains. Many of the most obvious conversion techniques have been stopped, but a capital gains tax rate differential will encourage taxpayers to shift to sources of income with lower tax rates.

Methods of converting ordinary income to capital gain income include shifting away from wages and salaries to deferred compensation, such as incentive stock options; shifting out of fully taxable assets, such as certificates of deposits, to assets yielding capital gains; shifting away from current yield assets to growth assets, including corporations reducing their dividend payout ratios; and investing in tax shelter activities. It is assumed that the conversion of ordinary income to capital gain income will occur gradually, increasing over the first 5 years.

The capital gains estimate for the 1986 Act included a large revenue gain from stopping the conversion of ordinary income to capital gain income by elimination of the differential. In fact, most of the revenue gain from reduced income shifting resulted from the drop in the top ordinary income tax rate from 50 percent to 28 percent. Before the 1986 Act, a 30 percentage point differential existed between the top ordinary tax rate and the top capital gains tax rate. Under the President's proposal, only a 13 percentage point differential will separate the 15 percent maximum rate on capital gains and the top 28 percent statutory marginal tax rate on ordinary income and only an 18 percentage point differential using the 33 percent effective marginal tax rate that applies to certain higher income taxpayers.

Effect of Excluding Depreciable Assets and Collectibles. The revenue estimate of the proposal is significantly affected by the exclusion of depreciable assets and collectibles from the lower rate. The 1985 Office of Tax Analysis study of capital gains found the responsiveness of capital gain realizations from assets other than corporate shares to be relatively low. That is, for some classes of assets the additional tax from induced realizations will not offset the tax loss from lower tax rates on gains that would occur under current law on such assets. By restricting the lower rates to more responsive assets, the proposal raises an incremental amount of additional net revenue.

Effect of Phasing In the 3-Year Holding Period Requirement. The 3-year holding period requirement is phased in gradually beginning in 1993. Any holding period encourages taxpayers to defer realizations until they are eligible for the lower rate. During the transition to the 3-year holding period, a one-time revenue loss will occur as realizations are deferred. After the transition is completed, the 3-year holding period raises revenue because it, like the depreciable asset exclusion, tends to limit the lower rate to assets more responsive to changes in capital gains tax rates. Assets sold after only 1 or 2 years for consumption or other purposes, rather than deferred to 3 years, would generally be less responsive to lower tax rates.

The phase-in of the 3-year holding period will encourage many taxpayers to defer realizations that would otherwise occur after 1 or 2 years until they become eligible for the lower tax rates. In addition, the phase-in will provide an incentive during the transition for some taxpayers to accelerate the realization of some gains. For instance, taxpayers who might realize gains held for 18 months in early 1993 might choose to accelerate those gains into calendar year 1992 to be eligible for the lower rate as 1-year assets. Thus, the phase-in will increase realizations in 1992 and revenues in fiscal years 1992 and 1993. Due to the two-step phase-in (the jump to 2 years in 1993 and to 3 years in 1995), the revenue pattern creates temporary incremental revenue losses in fiscal years 1994 and 1996.

Effect of 100 Percent Exclusion for Low-Income Taxpayers. The additional provision to exclude all qualified capital gain realizations from tax for taxpayers with low incomes will lose approximately $0.3 billion annually. In 1985, taxpayers with adjusted gross incomes of less than $20,000 accounted for 11.4 percent of net long-term capital gain realizations. Some of these taxpayers, however, were taxpayers with low adjusted gross income due to large tax preferences. The potential cost of this feature is reduced by limiting the zero tax rate to individuals who are not subject to the alternative minimum tax rate. The provision is considered after the initial 45 percent exclusion so the revenue loss is due only to the rate reduction from 8.25 percent (55 percent times 15 percent) to zero, not the full reduction from 15 percent to zero.

Total Effect of the Proposal. The President's proposal is estimated to increase Federal revenues in fiscal years 1989 through 1993 due to the large induced realizations in the initial years from the unlocking of previously accrued gains. During fiscal years 1994 through 1996, a one-time revenue loss will occur as the 3-year holding period requirement is phased in, causing taxpayers to defer short-term realizations. After fiscal year 1996, the proposal will increase Federal receipts between $1 and $2 billion annually.

These estimates do not include potential increases in the rate of macroeconomic growth expected from a lower capital gains tax rate. This conforms to the general budget practice of including macroeconomic effects of revenue and spending proposals in the underlying economic forecast and hence the budget revenue and outlay totals but excluding such estimates from budget lines showing revenue impacts of any particular proposal. In the case of the proposed lower capital gains tax rate, the investment, savings, and national income growth will be most significant over the longer term. Although not yet estimated, it is likely that positive revenues from macroeconomic improvements will be significant in the long run.

Office of Tax Policy

Table 1

Distribution of Net Long Term Capital Gains For Returns With Long Term Capital Gains in 1985

(In Percent)

Adjusted Gross Income Class	Distribution of Returns With Long Term Gains	Distribution of Long Term Gains	Percentage of Total Returns With Long Term Gains
Less than $10,000	14.6%	8.0%	4.4%
$10,000 to $19,999	15.6	3.4	6.2
$20,000 to $29,999	15.6	3.7	9.6
$30,000 to $49,999	24.9	8.3	13.7
$50,000 to $99,999	21.3	16.1	31.2
$100,000 to $199,999	5.5	14.1	61.1
$200,000 or more	2.4	46.4	80.7
TOTAL	100.0%	100.0%	9.9%

Department of the Treasury
Office of Tax Analysis

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Source: 1985 IRS Statistics of Income

Table 2

Revenue Effects of The President's Capital Gains Proposal
Fiscal Years 1989–1999

Effects of Proposal	Fiscal Years ($billions)										
	Budget Period						Longer Run*				
	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Effect of Tax Rate Reduction on Existing Gains Projected For Current Law Realizations	-1.6	-11.9	-17.6	-19.1	-20.2	-21.0	-21.5	-22.0	-22.5	-23.0	-23.5
Effect of Increased Realizations	2.4	17.1	21.8	21.8	21.5	22.3	22.3	22.9	23.4	23.9	24.5
Effect of Delaying Gains Until the Effective Date	-0.2	-1.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Effect of Conversion of Ordinary Income to Capital Gain Income	0.0	-0.1	-0.6	-1.3	-1.9	-2.5	-2.5	-2.6	-2.6	-2.7	-2.8
Effect of Excluding Depreciable Assets and Collectibles	0.2	1.2	1.7	1.9	2.1	2.1	2.3	2.4	2.4	2.5	2.5
Effect of Phased in Three Year Holding Period	0.0	0.0	0.0	0.4	1.0	-7.4	-2.3	-11.7	-0.1	1.5	1.5
Effect of 100% Exclusion for Certain Low Income Taxpayers	-0.0	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
TOTAL REVENUE EFFECT OF PROPOSAL	0.7	4.8	4.9	3.5	2.2	-6.8	-2.0	-11.3	0.2	1.8	1.8

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Notes:

These estimates include changes in taxpayer behavior but do not include potential increases in the level of macroeconomic growth.
Details may not add due to rounding.
Disaggregated effects are stacked in sequence.
* *Longer run estimates assume 1994 growth extends past the budget forecast period.*

PERMANENT RESEARCH AND EXPERIMENTATION TAX CREDIT

Current Law

Present law allows a 20 percent tax credit for a certain portion of a taxpayer's "qualified research expenses." The portion of qualified research expenses that is eligible for the credit is the increase in the current year's qualified research expenses over the base amount. The base amount is the taxpayer's average annual amount of qualified research and experimentation (R&E) expenditures over the prior three years (or if the taxpayer has not been in existence for three years, the average of the expenditures for its years in existence). This base, however, is subject to the limitation that it can never be less than 50 percent of current qualified expenditures.

In general, qualified expenditures consist of (1) "in-house" expenditures for wages and supplies used in research; (2) 65 percent of amounts paid by the taxpayer for contract research conducted on the taxpayer's behalf; and (3) certain time-sharing costs for computers used in research. Restrictions further limit the credit to expenditures for research that is technological in nature and that will be useful in developing a new or improved business component. In addition, certain research is specifically excluded from the credit, including research performed outside the United States, research relating to style, taste, cosmetic, or seasonal design factors, research conducted after the beginning of commercial production, research in the social sciences, arts, or humanities, and research funded by persons other than the taxpayer.

The credit is available only for research expenditures paid or incurred in carrying on a trade or business of the taxpayer. With one exception, relating to certain research joint ventures, the "trade or business test" for purposes of the credit is the same as for purposes of the business deduction provisions of section 162. As a result, new corporations and corporations entering a new line of business cannot claim the credit for qualified R&E expenses until the expenses relate to an ongoing trade or business.

Present law also provides a separate 20 percent tax credit ("the University Basic Research Credit") for corporate funding of basic research through grants to universities and other qualified organizations performing basic research. The University Basic Research Credit is measured by the increase in spending from certain prior years. This basic research credit applies to the excess of (1) 100 percent of corporate cash expenditures (including grants or contributions) paid for university basic research over (2) the sum of a fixed research floor plus an amount reflecting any decrease in nonresearch giving to

universities by the corporation as compared to such giving during a fixed base period (adjusted for inflation). A grant is tested first to see if it constitutes a basic research payment; if not, it may be tested as a qualified research expenditure under the general R&E credit.

The R&E credit is aggregated with certain other business credits and made subject to a limitation based on tax liability. The sum of these credits may reduce the first $25,000 of regular tax liability without limitation, but may offset only 75 percent of any additional tax liability. Taxpayers may carry credits not usable in the current year back three years and forward fifteen.

The amount of any deduction for research expenses is reduced by 50 percent of the amount of the tax credit taken for that year.

The research credit (including the University Basic Research Credit) expires on December 31, 1989.

Reasons for Change

The tax credit for research is intended to create an incentive for technological innovation. Although the benefit to the country from such innovation is unquestioned, the market rewards to those who take the risk of research and experimentation are not sufficient to support the level of research activity that is socially desirable. The credit is intended to reward those engaged in research and experimentation of unproven technologies.

The credit cannot induce additional R&E expenditures unless it is available at the time firms are planning R&E projects and projecting costs. R&E activity, by its nature, is long-term, and taxpayers should be able to plan their research activity knowing whether the credit will be available. Thus, if the credit is to have the intended incentive effect, the R&E credit should be made permanent.

It is now widely acknowledged that the present incremental credit with a base equal to a moving average of previous expenditures amounts to an effective rate of credit which is much lower than the 20 percent statutory rate. (A credit's effective rate is the effective reduction in price for an additional expenditure undertaken by a firm and is a measure of the credit's incentive effect.) The credit's low effective rate is primarily attributable to the moving base, since additional R&E in one year increases the base and thereby decreases the credit in subsequent years. Thus, R&E generating one dollar of credit in the first

year will cause a 33.3 cent reduction in credit in each of the following three years, so that the credit's only benefit to a firm is a deferral rather than a reduction in taxes.

In some situations the moving base can actually turn the effective rate of credit negative, so that the credit encourages a firm to reduce R&E expenditures. This occurs both when a firm is growing slowly and current R&E expenditures are below the base and when a firm is growing quickly and is subject to the 50 percent base limitation. For firms with R&E expenditures below the base, negative effective rates of credit result because increases in R&E expenditures yield no current credit but reduce credits in future years. For firms subject to the base limitation, negative effective rates of credit result because each 50 cents of credit earned in the current year is followed by 33.3 cents less credit in each of the following three years.

Under the current credit structure, the availability of the credit, the amount of credit, and the revenue loss from the credit are positively related to the rate of inflation. High rates of R&E growth in the early 1980s (due both to real growth and to inflation) minimized the problem of the limited availability of the current credit to firms performing R&E, because inflation kept many slow-growing firms from falling below the base. A slowdown in R&E growth in the late 1980s, however, has made it increasingly apparent that an increase in the availability of the credit would improve its effectiveness.

Under current law, a new firm or a firm entering a new line of business may not earn credits until qualified expenses are incurred "in carrying on" a trade or business. Since it may be several years between initial research expenditures and the sale of products resulting from such expenditures, the tax system puts start-up firms at a competitive disadvantage vis-a-vis established firms who are already "carrying on" a trade or business.

Under present law, alternative sources of Federal government support for research receive different tax treatment. A tax credit is economically equivalent to a grant (but administered through the tax system). However, a firm's research costs funded through grants are not deductible while 50 percent of research costs offset by credits are deductible. Grants and tax credits should receive similar tax treatment.

Description of Proposal

The proposed R&E credit would retain the incremental feature of the present credit and its 20 percent rate, but would make the credit permanent and modify calculation of the base amount. The new base would be a fixed historical base equal to the average of

the firm's qualified R&E expenditures for the years 1983 through 1987, and would be indexed annually by the average increase in gross national product (GNP). Firms also would have the option of a separate seven percent credit for expenditures which exceed 75 percent of the base amount. In addition, for the first year the base would receive a one-time upward adjustment of two percent. As with current law, all firms would be subject to a 50 percent base limitation.

Under the proposal, the "trade or business" test would be made less stringent so that new firms and firms entering new lines of business could claim the credit without regard to the trade or business test if the taxpayer intended to use the results of the research in the active conduct of a present or future trade or business. The credit would not be available, however, for research undertaken for investment rather than business purposes. Thus, research intended solely to be licensed to unrelated parties for use in their businesses would not be eligible for the credit. In addition, the liberalized trade or business rules would apply only to in-house research and not to research contracted out to unrelated parties.

Finally, a taxpayer's section 174 research deductions would be reduced by the total amount of credit taken.

The proposal would apply to expenditures for research and experimentation on or after January 1, 1990.

Effects of Proposal

The proposed credit has the following advantages: (1) it makes the credit permanent; (2) it increases the incentive of the R&E credit; (3) it increases the percentage of R&E-performing firms that are eligible for the credit; (4) it eliminates the relationship between the availability of the credit and the rate of inflation; (5) it extends to new firms R&E incentives which had previously been available only to established firms; and (6) it rationalizes the tax treatment of alternative funding sources for research.

Stable tax laws that encourage research allow taxpayers to undertake research with greater assurance of tax consequences. A permanent R&E credit (including the University Basic Research Credit) permits taxpayers to establish and expand research facilities without the fear that tax rules will suddenly change.

The proposal would increase the credit's incentive effect by replacing the current credit's moving-base with a fixed-base structure. The critical feature of this "fixed" base is that a firm's current spending will have no effect on future credits. Thus, unlike the current credit, a dollar of credit earned in the current year does not reduce credits in the following year.

The proposal would also significantly increase the percentage of R&E-performing firms eligible for the credit. This increase is achieved through the design of the primary and alternative bases, which results in a larger number of firms with R&E expenditures above the base. Since the credit base is indexed to GNP, the amount of the credit allowable to any firm and the cost of the credit to the government no longer depends on the rate of inflation. In this way, the credit is provided only for real increases in R&E spending.

The proposal greatly expands the number of firms eligible for the credit by allowing new firms and firms beginning a new line of business to claim the credit for qualified R&E expenses that relate to the active conduct of a present or future trade or business. The proposal would allow expenditures of new firms and firms entering new lines of business to claim the credit without regard to the trade or business test if the taxpayer intends to use the results of the research in the active conduct of a present or future trade or business. Thus, a firm that intends merely to lease or license the results of research would continue to be ineligible for the credit.

Finally, the proposal disallows a deduction for R&E expenses to the extent of R&E credits taken. Disallowing a deduction for R&E expenses to the extent of R&E credits would provide similar tax treatment for all sources of Federal support for R&E. For example, assume Firm A conducts $100 in qualifying research and receives $20 from the government as a 20 percent matching grant. Under current law, Firm A is entitled to deduct only the $80 R&E expenses it actually incurred. By contrast, Firm B conducts $100 of research and receives $20 of tax credit rather than a $20 grant. Under current law, Firm B is entitled to deduct $90 of R&E expense ($100 expenditure minus 50 percent of the R&E credit) even though the $20 tax credit to Firm B is equivalent to $20 grant received by Firm A. Under the proposal, Firm B would be allowed to deduct $80, the same amount as firm A.

Revenue Estimate

Fiscal Years			
1990	1991	1992	1993
($ billions)			
-0.4	-0.7	-1.0	-1.2

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R&E EXPENSE ALLOCATION RULES

Current Law

Research and experimentation (R&E) allocation rules generally expired on May 1, 1988. Under those rules, U.S. firms were allowed to deduct 64 percent of their expenses for R&E performed in the United States from their U.S. income. (The technical terminology is that 64 percent of the expenses were allocated to U.S. source income.) The remaining 36 percent of expenses were allocated between U.S. and foreign source income on the basis of either gross sales or gross income. (The amount allocated to foreign source income on the basis of gross income had to be at least 30 percent of the amount allocated to foreign source income on the basis of gross sales.)

Since expiration of the R&E allocation rules, R&E expenses have been allocated between U.S. and foreign source income under detailed 1977 Treasury regulations, which were designed to match R&E expenses with the foreign and domestic source income related to the expenses.

Reasons for Change

The current allocation regulations do not provide sufficient incentives for U.S.-based research activity. In fact, a return to the 1977 Treasury regulations might actually reduce R&E expenditures in the United States from their current levels and might shift some research from the United States to overseas. To encourage U.S.-based R&E, more favorable allocation rules are needed.

The Tax Reform Act of 1986 increased the significance of the allocation rules for many taxpayers by expanding the number of U.S. firms that have excess foreign tax credits and by increasing the size of such excess credits. Firms derive greater tax benefits by using these credits to offset their current U.S. tax liability rather than carrying them forward or deducting them. Firms can use more of their foreign tax credits to offset their U.S. tax liability to the extent that R&E expenses are allocated to U.S. source income rather than to foreign source income. The proposal would allow more R&E expenses to be allocated to U.S. source income.

The new rules should be made permanent because after more than 10 years of instability, taxpayers need certainty. Temporary rules for allocating R&E expenses were passed in 1981, 1984, 1985, 1986, and 1988. U.S. firms need permanent rules so they can be certain of the long-term tax ramifications of their R&E expenses. Stable tax laws would encourage growth in U.S. research activity.

Description of Proposal

The proposal would permit 67 percent of R&E expenses to be allocated to U.S. source income. The remaining 33 percent would be allocated on the basis of either gross sales or gross income. No limitation would be placed on the allocation to U.S. source income under the gross income method.

The proposal would apply retroactively to the expiration of the earlier rules, generally May 1, 1988.

Effects of Proposal

The proposal would result in greater tax savings than current law for U.S. firms from their U.S.-based R&E expenses. Current law allocates more R&E expenses to foreign source income and less to U.S. source income than the proposal. The higher allocation to foreign source income under current law reduces the amount of foreign tax credits that firms can use to offset their U.S. tax liability. Because many firms have excess foreign tax credits, the existing allocation regulations can reduce firms' U.S.-based R&E expenditures.

The difference in the effects of the current regulations and the proposal is best illustrated by an example. Assume that before deductions a firm has $1,075 in U.S. source income and $1,075 in foreign source income. Assume also that the firm has $100 in R&E expenses and $500 in foreign tax credits. Assume under current law, $25 of expenses are allocated to U.S. source income and $75 to foreign source income. Thus, for U.S. tax purposes, the firm is considered to have $1,050 ($1,075 - $25) in U.S. source income and $1,000 ($1,075 - $75) in foreign source income. Assuming the firm pays tax at a 34-percent rate, the firm would have a U.S. tax liability of $697 [($1,050 + $1,000) * .34]. But the firm can offset $340 ($1,000 * .34) of its U.S. tax liability by using its foreign tax credits. Thus, the firm would have to pay U.S. tax of $357 ($697 - $340). The firm could carryover the remaining $160 ($500 - $340) in foreign tax credits.

Under the proposal, $75 of R&E expenses would be allocated to U.S. source income and $25 to foreign source income. (The example assumes that the amount of foreign tax paid is unaffected by changes in U.S. allocation rules.) Thus, for U.S. tax purposes, the firm would be considered to have $1,000 ($1,075 - $75) in U.S. source income and $1,050 ($1,075 - $25) in foreign source income. The firm would still have a U.S. tax liability of $697 [($1,000 + $1,050) * .34]. But the firm would now be able to offset $357 ($1,050 * .34) of its U.S. tax liability by using its foreign tax credits. Thus, the firm would only have to pay U.S. tax of $340 ($697 - $357). The firm would carryover the remaining $143 ($500 - $357) in foreign tax credits.

The net result is that the proposal would reduce the amount of U.S. tax that the firm must pay by $17.

Revenue Estimate

Fiscal Years			
1990	1991	1992	1993
($ billions)			
-1.7*	-0.7	-0.8	-0.9

*The FY 1990 revenue loss includes the retroactive application of this proposal.

Office of Tax Policy

ENERGY TAX INCENTIVES

Current Law

Summary. Current law provides incentives for domestic oil and gas exploration and production by allowing the expensing of intangible drilling costs ("IDCs") and the use of percentage depletion. These two incentives are subject to certain limitations and their benefits are included as preferences in the alternative minimum tax ("AMT"). Current law does not provide any further tax incentives for either exploratory drilling or tertiary enhanced recovery techniques.

Exploratory Drilling vs. Development Drilling. The search for new oil and gas reserves typically begins with certain preliminary tests (e.g., geological and geophysical tests) designed to determine the likelihood of discovering commercial quantities of hydrocarbons. If such tests suggest that oil and gas may be present, further tests may be conducted. New oil and gas reserves, however, are typically identified only by exploratory drilling (i.e., drilling in a property not previously drilled and not located next to another producing property). About 55 percent of exploratory well drilling expenditures result in dry holes. A dry hole results if commercially recoverable oil and gas is not found. A taxpayer is allowed to expense all costs of a dry hole upon abandonment of the dry hole. If exploratory drilling is successful in locating oil and gas in commercial quantities, additional drilling, termed development drilling, is done to recover the maximum amount of oil and gas. Current law does not provide any special incentive for exploratory drilling.

Tertiary Enhanced Recovery Techniques. Tertiary enhanced recovery techniques increase available reserves by producing oil and gas that cannot be recovered economically with conventional pumping or water flooding. Tertiary enhanced recovery projects use steam, CO_2, or chemical injectants. Current law does not provide any special incentive for these projects.

Intangible Drilling Costs (IDCs). Current law generally requires the capitalization of expenditures for permanent improvements or betterments made to increase the value of any property. An exception to the capitalization requirement permits the expensing of IDCs paid in connection with the drilling of oil, gas, and geothermal wells. IDCs include amounts paid for labor, fuel, repairs, and site preparation. IDCs do not include geological and geophysical costs ("G&G costs") and surface casing costs (e.g., the cost of casings, valves, pipelines, and other facilities required to control, transport, or store the oil and gas). Costs that do not qualify as IDCs must be capitalized and recovered through depreciation or depletion.

Percentage Depletion. Cost recovery with respect to oil and gas properties is allowed by means of depletion deductions. The depletion deduction may be calculated under the cost depletion method or, with significant restrictions, under the generally more favorable percentage depletion method. Under cost depletion, the amount of the depletion deduction is equal to the portion of the taxpayer's basis equal to the percentage of total oil or gas reserves produced during the year. Cost depletion deductions may not exceed the taxpayer's basis in the property.

Under percentage depletion, the amount of the depletion deduction is equal to a statutory percentage of gross income from the property (15 percent in the case of oil and gas production). Percentage depletion deductions over the life of a property may exceed the cost of the property. Independent producers and royalty owners may use percentage depletion, but only with respect to 1,000 barrels of production per day. Percentage depletion with respect to oil and gas is not permitted for retailers or refiners of oil or gas products. Percentage depletion is also unavailable for oil and gas properties that have been transferred after they have been "proven" (i.e., shown to have oil or gas reserves). The percentage depletion deduction may not exceed either 50 percent of the taxpayer's net income from the property or 65 percent of the taxpayer's net taxable income for the year.

Alternative Minimum Tax (AMT). An alternative minimum tax is imposed on certain taxpayers. This tax is calculated with respect to alternative minimum taxable income ("AMTI"), which is calculated by making certain adjustments and adding tax preference items to regular taxable income. Both IDCs and percentage depletion deductions are preference items for both corporate and non-corporate taxpayers, and thus are included in AMTI.

The percentage depletion tax preference item is the amount by which the depletion deduction claimed for regular tax purposes exceeds the taxpayer's basis in the property at the end of the taxable year (disregarding the depletion deduction for the year). Treating such amounts as a preference item in computing AMTI may reduce or eliminate the benefit of permitting percentage depletion for certain taxpayers.

The IDC tax preference is the amount by which a taxpayer's "excess IDCs" claimed with respect to successful wells exceed 65 percent of his net income from oil, gas, or geothermal properties. The "excess IDCs" are the amount by which the IDC deductions claimed for the year exceed the deductions that would have been claimed had the IDCs been capitalized and either amortized over 120 months or recovered through cost depletion. Thus, for AMT purposes, the IDC deduction for incremental IDC expenditures in excess of the net income limit is reduced to zero.

Reasons for Change

The sharp reduction in world oil prices and the increasing levels of oil imports may raise both energy security and national security concerns. Our increased dependence on foreign oil may leave the nation vulnerable to potential foreign supply disruptions. The Administration supports an energy policy that is designed to address these concerns by improving our long-term energy security and strengthening the domestic oil industry.

An increase in domestic oil and gas reserves would improve our energy security. The level of proven domestic reserves is closely related to the level of domestic exploratory drilling. The level of domestic exploratory drilling, however, has fallen by 70 percent from recent levels, largely due to uncertainty concerning low world oil prices. In addition, over the same time period, development drilling has increased 20 percent, resulting in a substantial decline in domestic oil and gas reserves. Special tax incentives are appropriate to encourage higher levels of exploratory drilling which may lead to increased domestic reserves.

Current law limits the incentive effects of IDC expensing and percentage depletion, particularly for independent producers, which have historically drilled a majority of our exploratory wells. Current rules for the use of percentage depletion by independent producers limit the use to properties acquired by or transferred to an independent producer before the property is shown to have oil or gas reserves (the "transfer rule"). The transfer rule discourages the transfer of producing wells that are uneconomic in the hands of current owners to owners that may be more efficient, more willing to bear current losses, or better able to use the tax benefits of current depletion. Repeal of the transfer rule would encourage the continued operation of such properties by small producers with lower overhead. By keeping marginal wells in production, U.S. oil production would be maintained without additional drilling costs. Current law also provides that percentage depletion may not exceed 50 percent of the net income of a property calculated before depletion. At current oil and gas prices, the 50 percent net income limitation may significantly reduce the benefits of percentage depletion for production from properties generating a small amount of net income. Raising the net income limitation to 100 percent would allow some oil producers to claim greater depletion deductions, thus encouraging them to operate marginal properties. Moreover, raising the limit might also encourage added investment in exploratory drilling projects. In addition, the current alternative minimum tax (AMT) severely limits the incentive effects of IDC expensing, particularly for independent producers.

The level of exploratory drilling and domestic reserves would be increased by providing a program of temporary IDC credits, less restrictive rules for the use of percentage depletion, and AMT relief, all targeted to exploratory drilling in general and

to independent producers in particular. A temporary tax credit for new tertiary enhanced recovery projects would encourage the recovery of known energy deposits that are currently too costly to produce.

Description of Proposal

Four incentives are proposed to encourage exploration for new oil and gas fields and the reclamation of old fields. Two proposals would provide temporary tax credits. The temporary tax credits would be phased out if the average daily U.S. wellhead price of oil is at or above $21 per barrel for a calendar year.

First, a temporary 10 percent tax credit would be allowed for the first $10 million of expenditures (per year per company) on exploratory intangible drilling costs and a 5 percent credit would be allowed for the balance effective January 1, 1990. Second, a temporary 10 percent tax credit, effective January 1, 1990, will be allowed for all capital expenditures on new tertiary enhanced recovery projects (i.e., projects that represent the initial application of tertiary enhanced recovery to a property).

These tax credits could be applied against both the regular tax and the alternative minimum tax. However, the credits, in conjunction with all other credits and net operating loss carryforwards, could not eliminate more than 80 percent of the tentative minimum tax in any year. Unused credits could be carried forward.

Third, the proposal would eliminate the "transfer rule," which discourages the transfer of proven properties to independent producers and royalty owners, and would increase the percentage depletion deduction limit for independent producers to 100 percent of the net income of each property. These changes would increase the availability to independent producers of the percentage depletion tax incentive. The proposed effective date of each change would be January 1, 1990.

Fourth, the proposal would eliminate 80 percent of current AMT preference items generated by exploratory IDCs incurred by independent producers effective January 1, 1990. Thus, independent producers would be allowed to deduct 80 percent (rather than zero, as under current law) of exploratory excess IDCs in excess of the net income limit for purposes of the AMT. As under current law, the net income limit would be equal to 65 percent of oil and gas net income determined without regard to excess IDC deductions.

Effects of Proposal

The proposed new incentive program for the oil and gas industry would encourage exploration for new oil and gas fields and the reclamation of old fields. The incentives would strengthen the financial health of the smaller independent producers in particular. The incentives would help the nation achieve greater energy independence and greater national security.

Revenue Estimate

	Fiscal Years			
	1990	1991	1992	1993
	($ billions)			
10 percent credit for exploratory drilling	-0.2	-0.3	-0.3	-0.4
10 percent credit for tertiary enhanced recovery	*	*	*	*
Eliminate the transfer rule and increase the net income allowance to 100 percent for percentage depletion by independent producers and royalty owners	*	*	*	*
Eliminate 80 percent of exploratory IDC tax preferences from minimum tax for independent producers	-0.1	-0.1	-0.1	-0.1

*-$50 million or less.

Office of Tax Policy

ENTERPRISE ZONE TAX INCENTIVES

Current Law

Existing Federal tax incentives generally are not targeted to benefit specific geographic areas. Although the Federal tax law contains incentives that may encourage economic development in economically distressed areas, they are not limited to use with respect to such areas.

Among the existing general tax incentives that aid economically distressed areas is the targeted jobs tax credit. This credit, which provides an incentive to employers to hire economically disadvantaged workers, often is available to firms locating in economically distressed areas. An investment credit also is allowed for certain investment in low-income housing or the rehabilitation of certain structures. Another type of tax incentive permits the deferral of capital gains taxation upon certain transfers of low-income housing and certain exchanges of business or investment property for property of the same kind. As a final example of a general tax incentive benefitting economically distressed areas, state and local governments are permitted to issue a limited number of tax-exempt private activity bonds that provide low-cost financing for businesses to begin or expand their ventures.

Reasons for Change

Despite sustained national prosperity and growth, certain areas have not kept pace. To help these areas share in the benefits of continued economic growth, this Administration proposes enterprise zones to stimulate local government and private sector revitalization of economically distressed areas.

Enterprise zones would encourage private industry investment and job creation in economically distressed areas by removing regulatory and other barriers inhibiting growth. They would also promote growth through selected tax incentives to reduce the risks and costs of expanding in severely depressed areas. Enterprise zones would let business and innovation bloom in places where there has been little hope and little opportunity.

A new era of public/private partnerships is needed to help distressed cities and rural areas help themselves. The enterprise zone initiative will help determine the effectiveness of selected Federal tax incentives and reduced Federal regulations in stimulating the private and local public investment needed to revitalize economically deprived areas.

Description of Proposal

The proposed enterprise zone initiative would include selected Federal employment and investment tax credits. These tax credits will be offered in conjunction with Federal, state, and local regulatory relief. Up to 70 zones will be selected between 1990 and 1993.

There would be both capital-based and employment-based tax credits, although the details of the tax credits have not been specified. The extent of the tax subsidies will vary, with larger subsidies in the early years that decline over time. Total Federal revenue losses will gradually rise, however, as more zones are designated.

The willingness of states and localities to "match" Federal incentives will be considered in selecting the special enterprise zones to receive these additional Federal incentives.

Revenue Estimate

Fiscal Years ($ millions)			
1990	1991	1992	1993
-150	-200	-300	-400

Office of Tax Policy

PROPOSED CHILD TAX CREDIT AND REFUNDABLE CHILD AND DEPENDENT CARE TAX CREDIT

Current Law

The Internal Revenue Code provides assistance to low-income working parents through both the earned income tax credit (EITC) and the child and dependent care tax credit.

Earned Income Tax Credit. Low-income workers with minor dependents may be eligible for a refundable income tax credit of up to 14 percent of the first $6,500 in earned income. The maximum amount of the EITC is $910. The credit is reduced by an amount equal to 10 percent of the excess of adjusted gross income (AGI) or earned income (whichever is greater) over $10,240. The credit is not available to taxpayers with AGI over $19,340. Both the maximum amount of earnings on which the credit may be taken and the income level at which the phase-out region begins are adjusted for inflation (1989 levels are shown).

Earned income eligible for the credit includes wages, salaries, tips and other employee compensation, plus the amount of the taxpayer's net earnings from self-employment. Eligible individuals may receive the benefit of the credit in their paychecks throughout the year by electing advance payments.

Child and Dependent Care Credit. Taxpayers may also be eligible for a nonrefundable income tax credit if they incur expenses for the care of a qualifying individual in order to work. A qualifying individual is (1) a dependent who is under the age of 13 for whom the taxpayer can claim a dependency exemption; (2) the spouse of the taxpayer if the spouse is physically or mentally incapable of caring for himself or herself; or (3) a dependent of the taxpayer who is physically or mentally incapacitated and for whom the taxpayer can claim a dependency exemption or could claim as a dependent except that he or she has more than $1,500 in income.

To claim the child and dependent care credit, taxpayers must be married and filing a joint return or be a head of household. Two-parent households, with only one earner, do not qualify for the credit unless the non-working spouse is disabled or a full-time student.

The amount of employment-related expenses that is eligible for the credit is subject to both a dollar limit and an earned income limit. Employment-related expenses are limited to $2,400 for one qualifying individual and $4,800 for two or more qualifying individuals. Further, employment-related expenses cannot exceed the earned income of the taxpayer, if single, or for married couples, the earned income of the spouse with the lower earnings.

Taxpayers with AGI of $10,000 or less are allowed a credit equal to 30 percent of eligible employment-related expenses. For taxpayers with AGI of $10,000 to $28,000, the credit is reduced by one percentage point for each $2,000, or fraction thereof, above $10,000. The credit is limited to 20 percent of employment-related dependent care expenses for taxpayers with AGI above $28,000.

Reasons for Change

Current law does not adequately provide for the child care needs of low-income working families. Many low-income families do not incur a federal income tax liability and as a consequence are unable to claim the child and dependent care credit. Further, many low-income families rely on relatives and neighbors to provide care for their children, and thus these families can not claim the child and dependent care credit. The EITC, while refundable, does not adjust for differences among working families in the costs of providing care according to the age of the dependent child. Pre-school children generally require more extensive care than older children who may be in a school setting for much of the day.

Description of Proposal

Proposed Child Tax Credit. Low-income families, containing at least one worker, would be entitled to take a new tax credit of up to $1,000 for each dependent child under age four. For each child under the age of four, families could receive a credit equal to 14 percent of earned income, with a maximum credit equal to $1,000 per child. Initially, the credit would be reduced by an amount equal to 20 percent of the excess of AGI or earned income (whichever is greater) over $8,000. As a consequence, the credit would not be available to families with AGI or earned income greater than $13,000. In subsequent years, both the starting and end-points of the phase-out range would be increased by $1,000 increments. In 1994, credit would phase-out between $15,000 and $20,000.

The credit would be refundable and would be effective for tax years beginning January 1, 1990. Families would have the option of receiving the refund in advance through a payment added to their paycheck.

Refundable Child and Dependent Care Credit. The existing child and dependent care tax credit would be made refundable. Families could not claim both the new child credit and the child and dependent care credit with respect to the same child but could choose the larger of the two credits. The refundable child and dependent care credit would be effective for tax years beginning January 1, 1990.

Effects of the Proposal

The proposal would increase the resources available to low-income families, better enabling them to choose the child-care arrangements which best suit their needs and correspond to their personal values. About 2.5 million working families with children under the age of four will initially be eligible for the new child tax credit. When the proposal is fully implemented, eligibility will be expanded to approximately 1 million additional families. These families will also have the option of claiming the refundable child and dependent care credit, although they will not be able to claim both credits with respect to the same child. In addition, low-income parents of children between the ages of four and twelve would benefit from the refundabilty of the child and dependent care credit if they incur child-care expenses in order to work.

Consider, for example, a single working mother of two children, ages three and six years old. The mother earns $10,000 a year and has no other sources of taxable income. She pays a neighbor $20 a week to care for her younger child. Her older child is enrolled in a latchkey program during the school year and a neighborhood park program during the summer at a total cost of $500 per year. In total, she spends $1,540 a year for child care in order to work. Under current law, she is not entitled to claim the child and dependent care credit. At a 30 percent credit rate on dependent care expenses, the credit would be $462. However, she has no tax liability as a consequence of the standard deduction and personal exemptions, and therefore cannot claim the credit.

Under the proposal, the mother would be able to claim the proposed child tax credit. In 1990, she would be entitled to a credit equal to $600. (A mother in similar circumstances in 1992 would be entitled to the full $1,000 credit.) In addition, the mother would be able to claim the child and dependent care tax credit of $150 based on the expenses associated with the day care of her older child. In total, she would be entitled to a refund of $750.

Revenue Estimate

	Fiscal Years			
	1990	1991	1992	1993
	($ billions)			
Revenue loss	*	*	*	.1
Outlays[1]	.2	1.8	2.2	2.4

* $50 million or less.

[1] Increased outlays attributable to refunds payable to eligible individuals with no tax liability.

Office of Tax Policy

DEDUCTION FOR SPECIAL NEEDS ADOPTIONS

Current Law

Expenses associated with the adoption of children are not deductible under current law. However, expenses associated with the adoption of special needs children are reimbursable under the Federal-State Adoption Assistance Program (Title IV-E of the Social Security Act). Special needs children are those who by virtue of special conditions such as age, physical or mental handicap, or combination of circumstances, are difficult to place for adoption. The Adoption Assistance Program includes several components. One of these components requires states to reimburse families for costs associated with the process of adopting special needs children. The Federal government shares 50 percent of these costs up to a maximum Federal share of $1,000 per child. Reimbursable expenses include those associated directly with the adoption process such as legal costs, social service review, and transportation costs. Some children are also eligible for continuing Federal-State assistance under Title IV-E of the Social Security Act. This assistance includes Medicaid. Other children may be eligible for continuing assistance under State-only programs.

Reasons for Change

The Tax Reform Act of 1986 (the "1986 Act") repealed the deduction for adoption expenses associated with special needs children. Under prior law, a deduction of up to $1,500 of expenses associated with the adoption of special needs children was allowed. The 1986 Act provided for a new outlay program under the existing Adoption Assistance Program to reimburse expenses associated with the adoption process of these children. The group of children covered under the outlay program is somewhat broader than the group covered by the prior deduction. The prior law deduction was available only for special needs children assisted under Federal welfare programs. Aid to Families with Dependent Children (AFDC), Title IV-E Foster Care, or Supplemental Security Income (SSI). The current adoption assistance outlay program provides assistance for adoption expenses for these special needs children as well as special needs children in private and State-only programs.

Repeal of the special needs adoption deduction may have appeared to some as a lessening of the Federal concern for the adoption of special needs children.

An important purpose of the Adoption Assistance Program is to enable families in modest circumstances to adopt special needs children. In a number of cases the children are in foster care with the prospective adoptive parents. The prospective parents would like to formally adopt the child but find that to do so would impose a financial hardship on the entire family.

While the majority of eligible expenses are expected to be reimbursed under the continuing expenditure program, the Administration is concerned that in some cases the limits may be set below actual cost in high cost areas or in special circumstances. Moreover, inclusion in the tax code of a deduction for special needs children may alert families who are hoping to adopt a child to the many forms of assistance provided to families adopting a child with special needs.

Description of Proposal

The proposal would permit the deduction from income of expenses incurred associated with the adoption of special needs children up to a maximum of $3,000 per child. Eligible expenses would be limited to those directly associated with the adoption process that are eligible for reimbursement under the Adoption Assistance Program. These include court costs, legal expenses, social service review, and transportation costs. Only expenses for adopting children defined as eligible under the rules of the Adoption Assistance Program would be allowed. Expenses which were deducted and reimbursed would be included in income in the year in which the reimbursement occurred.

Effects of Proposal

The proposal when combined with the current outlay program would assure that reasonable expenses associated with the process of adopting a special needs child do not cause financial hardship for the adoptive parents. The proposed deduction would supplement the current Federal outlay program. In addition, the proposal highlights the Administration's concern that adoption of these children be specially encouraged and may call to the attention of families interested in adoption the various programs which help families adopting children with special needs.

There is currently uncertainty regarding whether Federal and State reimbursements are income to the adopting families. The proposal would clarify the treatment of reimbursements by making them includable in income but also deductible, up to $3,000 of eligible expenses per child. Additionally, qualified expenses up to this limit would be deductible even though not reimbursed.

While the costs of adoption of a special needs child are only a small part of the total costs associated with adoption of these children, the Administration believes that it is important to remove this small one-time cost barrier that might leave any of these children without a permanent family.

Revenue Estimate

Fiscal Years
($ millions)

1990	1991	1992	1993
-*	-3	-3	-3

* less than $500,000

Office of Tax Policy

MEDICARE HOSPITAL INSURANCE (HI) FOR STATE AND LOCAL EMPLOYEES

Current Law

State and local government employees hired on or after April 1, 1986, are covered by Medicare Hospital Insurance and their wages are subject to the Medicare tax (1.45 percent on both employers and employees). Employees hired prior to April 1, 1986, are not covered by Medicare Hospital Insurance nor are they subject to the tax.

Reasons for Change

State and local government employees are the only major group of employees not assured Medicare coverage. A quarter of state and local government employees are not covered by voluntary agreements nor by law. However, eighty-five percent of these employees receive full Medicare benefits through their spouse or because of prior work in covered employment. Over their working lives, they contribute only half as much tax as is paid by workers in the private sector. Extending coverage would assure that the remaining 15 percent have access to Medicare and would eliminate the inequity and the drain on the Medicare trust fund caused by those who receive Medicare without fully contributing.

Description of Proposal

As of October 1, 1989, all state and local government employees would be covered by Medicare Hospital Insurance.

Effects of Proposal

An additional 2 million state and local government employees would be contributing to Medicare. Of these, roughly 300,000 employees would become newly eligible to receive Medicare benefits subject to satisfying the minimum 40 quarters of covered employment.

Revenue Estimate[1]

Fiscal Years				
1990	1991	1992	1993	1994
($ billions)				
1.8	1.9	1.9	1.9	1.9

[1]Net of income tax offset.

Office of Tax Policy

REPEAL OF THE AIRPORT AND AIRWAY TRUST FUND TAX TRIGGER

Current Law

The Airport and Airway Safety and Capacity Expansion Act of 1987 established a trigger that would reduce by 50 percent several of the airport and airway trust fund taxes. The trigger would take effect in calendar year 1990 if the 1988 and 1989 appropriations for the capital programs funded by these taxes were less than 85 percent of authorizations. The trigger would reduce by 50 percent the 8 percent air passenger tax, the 5 percent air freight tax, and the 14 cents per gallon noncommercial aviation fuels tax. It would also substantially reduce the aviation gasoline tax.

Reasons for Change

Given congressional action for 1988 and 1989, the trigger would take effect and reduce by 50 percent these airport and airway trust fund taxes. The receipts from these taxes are required to modernize airport and airway facilities in the United States in the early 1990s.

Description of Proposal

The proposal would repeal the tax reduction trigger, resulting in increased airport and airway trust fund receipts of $1.2 billion in 1990 and increased governmental receipts (net of income and employment tax offsets) of $0.9 billion.

Effects of Proposal

Repealing the trigger is required for the accumulation of funds for the modernization of airport and airway facilities in the United States in the early 1990s.

Revenue Estimate[1]

Fiscal Years			
1990	1991	1992	1993
($ billions)			
0.9	1.6	1.7	1.8

[1] Net of income tax offsets. The estimates shown are relative to current services receipts which assume continuation of trigger rates through 1994.

Office of Tax Policy

EXTENSION OF THE COMMUNICATIONS (TELEPHONE) EXCISE TAX

Current Law

The Omnibus Budget Reconciliation Act of 1987 extended the communications excise tax until the end of 1990. The tax is imposed at a rate of three percent on local and toll (long-distance) telephone service and on teletypewriter exchange service.

Reasons for Change

The communications excise tax was originally enacted in 1914 and has been imposed continuously since 1932, even though it has been scheduled to expire continuously since 1959. Allowing the tax to expire would reduce Federal tax receipts by approximately $2.5 billion annually.

Description of Proposal

The proposal would permanently extend the three percent Federal communications excise tax. The tax rate is substantially less than the ten percent rate that was in effect between 1954 and 1972, and as low or lower than the rate in effect for any year since 1932 (except for 1980-82). The base of the tax would not be broadened.

Effects of Proposal

Extension of the communications excise tax would maintain a revenue source that has been in existence continuously since 1932, and would avoid the disruption that would occur if the tax were allowed to expire and then were reenacted.

Revenue Estimate[1]

Fiscal Years 1990	1991	1992	1993
	($ billions)		
0	1.6	2.6	2.8

[1] Net of income tax offset.

Office of Tax Policy

MISCELLANEOUS PROPOSALS AFFECTING RECEIPTS

Current Law

Internal Revenue Service (IRS) Enforcement Initiative. IRS currently allocates some of its funding for tax law enforcement.

Increase Nuclear Regulatory Commission (NRC) User Fees. The proportion of the NRC's costs incurred in regulating nuclear power plants will decline from 45 percent in 1989 to 33 percent in 1990.

Initiate Federal Emergency Management Agency (FEMA) User Fees. The costs that FEMA incurs as NRC's agent in regulating the evacuation plans of nuclear power plants are financed through general revenues.

Increase District of Columbia (D.C.) Employer Contributions to the Civil Service Retirement System (CSRS). The D.C. government contributes 7 percent of wages and salaries to CSRS and D.C. employees contribute an additional 7 percent.

Initiate Federal Marine Fishing Licenses and Fees. The costs of Federal efforts to conserve and manage the Nation's marine fishery resources are financed through general revenues.

Extend Reimbursable Status to Amtrak. The Technical and Miscellaneous Revenue Act of 1988 exempts public commuter railroads from paying the full railroad unemployment tax rate in 1989 and 1990 and permits them to reimburse the unemployment fund for the actual costs of their employees. The exemption does not extend to Amtrak.

Eliminate Superfund Petroleum Tax Differentials. The superfund petroleum tax is 8.2 cents per barrel for domestic crude oil and 11.7 cents per barrel for imported products.

Other Proposals. Pay raise proposals; extending customs processing fee; establish a fee for U.S. Travel and Tourism Administration; user fee on taxpayer telephone information services.

Reasons for Change

Internal Revenue Service (IRS) Enforcement Initiative. The gap between taxes owed and taxes voluntarily paid contributes to the Federal deficit and undermines the system of voluntary compliance.

Increase NRC User Fees. Costs of regulating the nuclear power industry should be fully borne by the users of the services.

Initiate FEMA User Fees. Costs of regulating the evacuation plans of the nuclear power industry should be borne by the users of the services, as are the general regulatory costs.

Increase D.C. Employer Contributions to CSRS. Retirement costs exceed the current combined contributions of the employer and employee. The excess costs should be financed by the D.C. government.

Initiate Federal Marine Fishing Licenses and Fees. The costs of Federal conservation and management of marine fishery resources should be paid by the commercial fishermen who directly benefit from the services.

Extend Reimbursable Status to Amtrak. The reimbursement arrangement ensures that commuter railroads use the public subsidies they receive to hold down fares rather than paying for the high unemployment costs of private freight railroads. Amtrak is in much the same position as the commuter railroads.

Eliminate Superfund Petroleum Tax Differentials. The current tax differential could subject the United States to retaliation or possible compensatory damage payments under the General Agreement on Tariffs and Trade (GATT).

Description of Proposal

IRS Enforcement Initiative. Increase IRS funding for tax law enforcement.

Increase NRC User Fees. Increase fees to cover 100 percent of NRC's regulatory costs, effective October 1, 1989.

Initiate FEMA User Fees. Recover 100 percent of regulatory costs through user fees, effective October 1, 1989.

Increase D.C. Employer Contributions to CSRS. The D.C. government will pay retirement cost-of-living adjustments (COLAs) to its retirees and their survivors. The initial annual payment would begin in 1991 because of a proposed budget COLA freeze for government annuitants in 1990.

Initiate Federal Marine Fishing Licenses and Fees. Establish a permit and an ad valorem fee on commercial sales, effective January 1, 1990. Applicable only to fishermen who fish in the fishery conservation zone (3 to 200 miles offshore) or who fish for federally managed species.

Extend Reimbursable Status to Amtrak. Require Amtrak to reimburse the unemployment fund for actual costs of their employees rather than paying the full railroad industry unemployment tax.

Eliminate Superfund Petroleum Tax Differentials. Equalize the excise taxes through a slight increase in the tax rate on domestic crude oil and a slight decrease in the rate on imported petroleum products.

Other Proposals. Additional changes affecting receipts include the Administration's pay raise proposals; extension of the customs processing fee, which is scheduled to expire September 30, 1990, at current rates; and the establishment of a fee for the U.S. Travel and Tourism Administration (USTTA). A user fee on taxpayer telephone information services is proposed for 1991; a design evaluation will be conducted in 1989 and 1990 that will include an actual demonstration of the technologies and systems capabilities.

Effects of Proposal

IRS Enforcement Initiative. Ensure that taxpayers correctly report their income for tax purposes and improve collection of past due taxes.

Increase NRC User Fees. Users of NRC regulatory services pay the full costs of regulation.

Initiate FEMA User Fees. Users of FEMA regulatory services pay the full costs of regulation.

Increase D.C. Employer Contributions to CSRS. Requires the D.C. government to bear more of the retirement costs of its employees.

Initiate Federal Marine Fishing Licenses and Fees. Requires users of Federal fishery research, conservation, and management services to pay the costs of the services.

Extend Reimbursable Status to Amtrak. Helps to reduce the Amtrak operating deficiency and prevents public funds intended to subsidize public commuter railroad fares from unintentionally cross-subsidizing high unemployment freight railroads.

Eliminate Superfund Petroleum Tax Differentials. Achieves a system of excise taxes on petroleum that is consistent with GATT.

Revenue Estimates

	1990	Fiscal Years 1991	1992 ($ billions)	1993
IRS Enforcement Initiative	0.3	0.6	0.7	0.7
Increase NRC User Fees	0.3	0.3	0.3	0.3
Initiate FEMA User Fees	*	*	*	*
Increase D.C. Government CSRS Contributions	0.0	*	*	*
Initiate Federal Marine Fishing Licenses and Fees	*	0.1	0.1	0.1
Extend Reimbursable Status to Amtrak	- *	- *	*	*
Eliminate Superfund Petroleum Differential	0.0	0.0	0.0	0.0
Other Proposals	- 0.1	0.1	0.1	0.2

* $50 million or less.

Office of Tax Policy

REVENUE EFFECTS OF PROPOSED LEGISLATION

REVENUE EFFECTS OF PROPOSED LEGISLATION

PROPOSAL	Fiscal Years ($ billions)				
	1989	1990	1991	1992	1993
Capital Gains Tax Rate Reduction for Individuals	0.7	4.8	4.9	3.5	2.2
Permanent Research and Experimentation Tax Credit	--	-0.4	-0.7	-1.0	-1.2
R&E Expense Allocation Rules	--	-1.7	-0.7	-0.8	-0.9
Energy Tax Incentives	--	-0.3	-0.4	-0.4	-0.5
Enterprise Zone Tax Incentives	--	-0.2	-0.2	-0.3	-0.4
Proposed Child Tax Credit and Refundable Child and Dependent Care Tax Credit 1/	--	-*	-*	-*	-0.1
Deduction for Special Needs Adoption	--	-*	-*	-*	-*
Medical Hospital Insurance (HI) for State and Local Employees	--	1.8	1.9	1.9	1.9
Repeal of the Airport and Airway Trust Fund Tax Trigger	--	0.9	1.6	1.7	1.8
Extension of the Communication (Telephone) Excise Tax	--	--	1.6	2.6	2.8
Miscellaneous Proposals Affecting Receipts	-*	0.6	1.2	1.2	1.0
TOTAL REVENUE EFFECTS OF PROPOSALS	0.7	5.6	9.0	8.3	6.7

Department of the Treasury
Office of Tax Analysis

February 9, 1989

* = less than $50 million

1/ Refundable tax credits involving refunds which exceed tax liability are shown as increased outlays. Outlays will increase by $0.2 billion in FY90, $1.8 billion in FY91, $2.2 billion in FY92, $2.4 billion in FY93, and $2.8 billion in FY94.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

CONTACT: Office of Financing
202/376-4350

FOR IMMEDIATE RELEASE
February 13, 1989

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,205 million of 13-week bills and for $7,213 million of 26-week bills, both to be issued on February 16, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing May 18, 1989			26-week bills maturing August 17, 1989		
	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/	Price
Low	8.47%	8.78%	97.859	8.52%a/	9.03%	95.693
High	8.49%	8.80%	97.854	8.55%	9.06%	95.678
Average	8.49%	8.80%	97.854	8.54%	9.05%	95.683

a/ Excepting 1 tender of $10,000.

Tenders at the high discount rate for the 13-week bills were allotted 77%.
Tenders at the high discount rate for the 26-week bills were allotted 6%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	Received	Accepted
Boston	$ 53,570	$ 53,440	$ 44,660	$ 44,660
New York	24,792,980	5,879,005	20,224,145	5,875,905
Philadelphia	27,850	27,850	22,735	22,735
Cleveland	61,165	61,150	57,060	57,015
Richmond	65,380	65,380	52,915	52,915
Atlanta	62,730	62,300	49,230	49,230
Chicago	1,457,505	286,955	1,113,420	394,020
St. Louis	74,295	39,295	44,305	36,425
Minneapolis	12,730	12,730	12,180	12,180
Kansas City	64,980	64,980	63,005	63,005
Dallas	49,850	39,850	40,845	35,845
San Francisco	1,721,935	118,935	1,699,565	101,565
Treasury	493,020	493,020	467,900	467,900
TOTALS	$28,937,990	$7,204,890	$23,891,965	$7,213,400
Type				
Competitive	$24,762,125	$3,229,025	$18,828,135	$2,349,570
Noncompetitive	1,576,970	1,576,970	1,290,225	1,290,225
Subtotal, Public	$26,339,095	$4,805,995	$20,118,360	$3,639,795
Federal Reserve	2,584,010	2,384,010	2,300,000	2,100,000
Foreign Official Institutions	14,885	14,885	1,473,605	1,473,605
TOTALS	$28,937,990	$7,204,890	$23,891,965	$7,213,400

An additional $15,515 thousand of 13-week bills and an additional $787,895 thousand of 26-week bills will be issued to foreign official institutions for new cash.

1/ Equivalent coupon-issue yield.

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TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
February 14, 1989

CONTACT: LARRY BATDORF
(202) 566-2041

U.S.-PORTUGAL INCOME TAX TREATY

The Treasury Department today announced that negotiations of a proposed income tax treaty between the United States and Portugal are scheduled to take place in Washington during the week of April 3-7, 1989.

There is not now an income tax treaty in effect between the United States and Portugal. The negotiations will take as their starting point the model draft texts published by the United States and the Organization for Economic Cooperation and Development. They will also take into account the U.S. Tax Reform Act of 1986 and recent treaties concluded by each country. The issues to be discussed include the taxation of income from business, investment, and employment derived in one country by residents of the other, provisions to ensure nondiscrimination and the avoidance of double taxation, and provisions for administrative cooperation between the tax authorities of the two countries.

Interested persons are invited to send written comments concerning the forthcoming negotiations to Leonard Terr, International Tax Counsel, U.S. Treasury, Room 3064, Washington, D.C. 20220.

This notice will appear in the Federal Register on February 14, 1989.

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TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

CONTACT: Office of Financing
202/376-4350

FOR RELEASE AT 4:00 P.M.
February 14, 1989

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $14,400 million, to be issued February 23, 1989. This offering will result in a paydown for the Treasury of about $ 325 million, as the maturing bills are outstanding in the amount of $ 14,720 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Standard time, Tuesday, February 21, 1989. The two series offered are as follows:

91-day bills (to maturity date) for approximately $ 7,200 million, representing an additional amount of bills dated November 25, 1988, and to mature May 25, 1989 (CUSIP No. 912794 SA 3), currently outstanding in the amount of $ 7,650 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $ 7,200 million, to be dated February 23, 1989, and to mature August 24, 1989 (CUSIP No. 912794 SV 7).

The bills will be issued on a discount basis under competitive and noncompetitive bidding, and at maturity their par amount will be payable without interest. Both series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, on the records either of the Federal Reserve Banks and Branches, or of the Department of the Treasury.

The bills will be issued for cash and in exchange for Treasury bills maturing February 23, 1989. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rates of accepted competitive tenders. Additional amounts of the bills may be issued to Federal Reserve Banks, as agents for foreign and international monetary authorities, to the extent that the aggregate amount of tenders for such accounts exceeds the aggregate amount of maturing bills held by them. Federal Reserve Banks currently hold $ 2,746 million as agents for foreign and international monetary authorities, and $ 4,480 million for their own account. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 5176-1 (for 13-week series) or Form PD 5176-2 (for 26-week series).

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Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. This information should reflect positions held as of one-half hour prior to the closing time for receipt of tenders on the day of the auction. Such positions would include bills acquired through "when issued" trading, and futures and forward transactions as well as holdings of outstanding bills with the same maturity date as the new offering, e.g., bills with three months to maturity previously offered as six-month bills. Dealers, who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities, when submitting tenders for customers, must submit a separate tender for each customer whose net long position in the bill being offered exceeds $200 million.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

Payment for the full par amount of the bills applied for must accompany all tenders submitted for bills to be maintained on the book-entry records of the Department of the Treasury. A cash adjustment will be made on all accepted tenders for the difference between the par payment submitted and the actual issue price as determined in the auction.

No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches. A deposit of 2 percent of the par amount of the bills applied for must accompany tenders for such bills from others, unless an express guaranty of payment by an incorporated bank or trust company accompanies the tenders.

Public announcement will be made by the Department of the Treasury of the amount and yield range of accepted bids. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. Subject to these reservations, noncompetitive tenders for each issue for $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. Cash adjustments will be made for differences between the par value of the maturing bills accepted in exchange and the issue price of the new bills. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

If a bill is purchased at issue, and is held to maturity, the amount of discount is reportable as ordinary income on the Federal income tax return of the owner for the year in which the bill matures. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, any gain in excess of the basis is treated as ordinary income.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76, 27-76, and 2-86, as applicable, Treasury's single bidder guidelines, and this notice prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars, guidelines, and tender forms may be obtained from any Federal Reserve Bank or Branch, or from the Bureau of the Public Debt.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

CONTACT: Office of Financing
202/376-4350

FOR IMMEDIATE RELEASE
February 14, 1989

RESULTS OF TREASURY'S 52-WEEK BILL AUCTION

Tenders for $9,032 million of 52-week bills to be issued February 16, 1989, and to mature February 15, 1990, were accepted today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate (Equivalent Coupon-Issue Yield)	Price
Low -	8.54% a/	9.26%	91.365
High -	8.59%	9.32%	91.315
Average -	8.59%	9.32%	91.315

a/ Excepting 1 tender of $10,000.
Tenders at the high discount rate were allotted 78%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted
Boston	$ 52,695	$ 52,695
New York	23,899,200	7,770,790
Philadelphia	42,255	42,255
Cleveland	69,270	69,270
Richmond	78,100	78,100
Atlanta	54,930	54,930
Chicago	1,265,420	263,365
St. Louis	53,265	43,265
Minneapolis	31,090	31,090
Kansas City	92,935	92,665
Dallas	49,580	43,455
San Francisco	1,783,800	225,100
Treasury	264,790	264,790
TOTALS	$27,737,330	$9,031,770
Type		
Competitive	$23,040,670	$4,335,110
Noncompetitive	1,436,660	1,436,660
Subtotal, Public	$24,477,330	$5,771,770
Federal Reserve	3,000,000	3,000,000
Foreign Official Institutions	260,000	260,000
TOTALS	$27,737,330	$9,031,770

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February 14, 1989

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989

I. Consolidating the FSLIC with the FDIC; Separate Insurance Pools.

A. The FSLIC would be consolidated with the FDIC for insurance and case resolution purposes. The FDIC would maintain the existing FDIC and the FSLIC funds as separate insurance pools that could not be commingled.

B. As insurer of a new category of depository institutions, the FDIC would be provided with new supervisory and regulatory authority to deal with these responsibilities:

1. Setting Insurance Premiums

The FDIC Board would have specific authority to set insurance premiums as set forth in Section II to put the funds on a sound financial basis for the future.

2. Denial or Revocation of Insurance

The FDIC Board would be entitled to deny initial insurance coverage or revoke insurance for any S&L institution, state or federal.

3. Examination Authority

The FDIC Board would receive copies of all examination reports prepared or filed with the Federal Home Loan Bank System (FHLBS) as restructured in Section III. The FDIC also would have the right:

(a) to examine, after notification to the FHLBS, institutions insured by it (whether state or federally-chartered) that in the view of the FDIC are troubled, as well as a reasonable sample of non-troubled institutions; and

(b) to accompany the FHLBS on other examinations of non-troubled insured institutions.

4. Enforcement Authority of the FDIC

(a) The FDIC Board would have authority, subject to an expedited hearing procedure, to

terminate insurance for both state and federally chartered savings and loan institutions engaging in significant unsafe or unsound practices, operating in an unsafe or unsound condition, or otherwise posing undue risks to the insurance fund. Such termination proceedings would be handled under an expedited hearing procedure that would permit revocation (e.g., within 90 days) of the filing of a notice of intent to terminate. Following revocation of insurance eligibility, new insured deposits could not be accepted, but insurance already in effect would remain in force to protect depositors for a minimum of six months following the date of insurance revocation. Existing long term deposits would maintain insurance.

(b) The FDIC would have the authority to request the FHLBS or any state supervisory authority to take any other enforcement action applicable to any insured thrift, or its officers and directors. Where the FHLBS or any state supervisory authority declines to take such action or fails to correct the problem within a reasonable time period, the FDIC would be entitled to initiate such action independently if the FDIC Board of Directors, based upon an examination of any such savings and loan, determines such action to be necessary under statutory standards.

5. <u>Applications for Insurance</u>

(a) The FDIC Board would have authority to review and to deny any application for a federal savings and loan charter that would result in eligibility for federal insurance. The FHLBS would be required to furnish a copy of the individual application to the FDIC for its review. In reviewing any such application for insurance, the FDIC would be limited to consideration of the following factors: 1) financial history and condition; 2) capital adequacy; 3) future earnings prospects; 4) character and experience of management; and 5) risk to the insurance fund.

(b) The FHLBS would advise the FDIC of its determination regarding such factors, and in

the normal course the FDIC would rely on such determination. In any event where the FDIC Board of Directors does not concur in any such determination by the FHLBS, it would be required to advise the FHLBS promptly that it intends to decline to provide insurance coverage.

(c) State-chartered thrifts must apply directly to the FDIC for insurance. In reviewing any such application, the FDIC shall establish governing procedures and shall include the criteria in the FDI Act, including the factors listed I.B.5.a.

6. Issuing Regulations

(a) The FDIC would have authority to issue regulations governing (i) all aspects of the provision, rates, cancellation, and payment of insurance for thrifts formerly insured by FSLIC, (ii) thrifts' actions that pose a serious threat to the insurance fund, and (iii) internal operations of the RTC and the functions and activities transferred to the FDIC by the FSLIC.

(b) The power to issue regulations governing thrifts' actions that pose a serious threat to the insurance fund would not preclude the FHLBS from issuing regulations to promote safety and soundness or to enforce compliance with other laws, but would specifically include the power to issue regulations (i) setting minimum capital requirements below which a thrift could be declared to be operating per se in an unsafe and unsound condition and, therefore, subject to appointment of a receiver or conservator, (ii) powers that a State-chartered thrift would be prohibited from exercising while enjoying insured status, and (iii) capital levels below which the FDIC would impose higher premium charges than those otherwise specified under section II (c) hereunder.

D. The FDIC would be required to prohibit or restrict any growth of assets by any savings and loan institution that does not meet minimum capital standards established by the FDIC for such institutions.

E. 1. Within 3 months after enactment, the FHLBS shall establish capital standards for savings and loan institutions that shall be not less stringent than capital standards applicable to national banks.

2. The capital standards required pursuant to paragraph E.(1) shall be phased-in according to a schedule determined by the FHLBS. Such capital standards shall be fully implemented not later than June 1, 1991.

3. From the date of enactment to June 1, 1991, the Chairman of the Federal Home Loan Bank System shall restrict the growth of any formerly FSLIC-insured savings and loan which does not meet applicable capital standards.

F. All appropriate administrative functions of the FSLIC and all insurance-related personnel would be transferred to the FDIC.

G. The FDIC's financial operating plans (including estimates of actual and future spending, with consideration of financial commitments, guarantees and other forms of contingent liabilities) must be reported to the Secretary of the Treasury. Estimates of actual and future non-cash obligations must be included in the operating plan. Conditions would be placed on the FDIC's ability to issue notes or similar debt obligations in an aggregate amount outstanding at any one time.

H. The FDIC Board would have the power to determine that certain activities pose an undue risk to the insurance fund and to require that a savings and loan institution cease conducting such activities.

II. Organization of the FDIC.

A. The FDIC would have an integrated management structure, with an agency staff reporting to the Chairman and the Board of Directors. The FDIC Board of Directors would be expanded to include five members. These would include the Comptroller of the Currency, the Chairman of the Federal Home Loan Bank System and three public members, of which no more than two can be of the same political party.

B. Notwithstanding the single agency, two separate insurance pools would be maintained, with the current reserves of the FDIC and FSLIC being transferred to the respective FDIC and FSLIC pools. The two separate pools could not be commingled.

C. The insurance premium base payable by any insured institution would be as set forth below:

1.

	FDIC-Pool	FSLIC-Pool
1990	12 BP	20.8 BP
1991	15	23
1992	15	23
1993	15	23
1994 and later	15	18

2. The premium would be assessed against a base of total domestic deposits and collateralized borrowings (collateralized borrowing does not include retail or wholesale repurchase agreements). This change would be phased-in over five years.

   (a) The insurance premiums set forth in II.C.1 will remain in effect until each fund reaches a "target reserve level" of 1.25 to insured deposits.

   (b) The new FDIC would have authority to raise the premium for institutions in either pool if: (i) a fund has aggregate reserves of less than a specified minimum level of deposits (e.g. 1.20) and collateralized borrowings, in effect at any time (the "target reserve level"); or (ii) extraordinary circumstances exist that raise a reasonable risk of serious future losses in the opinion of the Board of Directors. Any annual increase in premiums charged could not exceed 50 percent, and in no event could the maximum premium exceed 75 basis points.

D. To the degree that the funds of either insurance pool exceeded the target reserve level plus specific contingency reserves established by the Board, annual net premium income of each such pool, after expenses and expenditures, would be rebated to participants of such pool in accordance with current law.

E. Accounting for all the federal deposit insurance funds would be on comparable terms. Over an 8 year

transition period, credit unions would be required to expense the one-percent of deposits that federally-chartered credit unions maintain with the NCUSIF. The existing statutory 1/12 of one-percent premium would remain unchanged. The NCUSIF would have comparable authority set forth in II.C.2.b.

F. The FDIC would report annually to the President and the Congress on its status and condition and would continue to be subject to any applicable reporting requirements of the Government Corporation Control Act.

III. Organization and Functions of the FHLBS.

A. Basic Structure and Authority

The FHLBB would be renamed the Federal Home Loan Bank System ("FHLBS"). The Board of the FHLBB would be dissolved and replaced by a single Chairman of the Federal Home Loan Bank System. The FHLBS would remain the chartering authority for all federal S&Ls and primary federal supervisor for all federal and state-chartered S&Ls and their holding companies. The Chairman would be subjected to Senate confirmation, would have a fixed 5 year term of office, and would not be subject to removal except for cause or misconduct. The Chairman of the FHLBB would be subject to the general oversight of the Secretary of the Treasury to the same degree as is currently true for the Comptroller of the Currency who regulates national banks.

(1) Qualifying S&Ls (as defined in the Competitive Equality Banking Act) would retain their current powers, existing tax treatment, and access to FHLBank advances to finance housing.

(2) The Chairman of the Federal Home Loan Bank System would be the regulator of the FHLBank System. The FHLBS shall have the authority to limit or prohibit growth by savings and loan institutions that are taking excessive risks or are paying excessive rates for deposits.

(3) Wherever current law mandates promotion of home financing, such requirement would be amended to make it consistent with standards of safety and soundness for the institutions supervised.

(4) The FHLBS shall require all savings and loan institutions to conform to accounting and

disclosure standards applicable to banks and shall apply equivalent supervisory policies as are applicable to banks.

(5) The FHLBS would have authority to issue regulations (i) governing its own internal operations, (ii) implementing federal statutes providing for the chartering, safe and sound operation, and appointment of receivers and conservators of all federally-insured state and federally chartered thrifts, (iii) implementing federal laws providing for the regulation of savings and loan holding companies, and (iv) implementing the Federal Home Loan Bank Act, as it is to be amended.

(6) The FHLBS would have full enforcement authority, as currently provided to be combined FHLBB and FSLIC, over state and federal thrifts, their holding companies, affiliates, officers, directors, employees, agents, and persons participating in the conduct of their affairs.

B. FHLBank System Functions

The FHLBank System would remain in place to support housing finance by providing liquidity (advances). The aggregate amount of consolidated obligations would be determined by the Chairman of the Federal Home Loan Bank System.

C. FHLBank Boards of Directors

FHLBank directors would be modeled after the Federal Reserve System.

(1) Instead of the current typical regional FHLBank board of directors (14 members, 8 of whom are selected by the S&L industry), the Federal Reserve model would apply.

(2) The FHLBank board of directors would consist of 9 board members of 3 different types classifications:

-- Class A: 3 members from the savings industry;

-- Class B: 3 public members representing the housing industry (chosen by Class A and C directors); and

-- Class C: 3 public members chosen by the Chairman of the FHLBS (cannot be from the savings industry).

-- The Chairman of the FHLBS designates the Chairman and Deputy Chairman from the Class C public members (not a savings industry representative).

D. Pricing of FHLBank Services

Explicit pricing of FHLBank services, comparable to Federal Reserve pricing (Federal Reserve Act, Section 11A) would be required within six months after the date of enactment.

E. Separate Supervisory Structure

The senior supervisory employee of the FHLBank would report directly to the chief supervisory official of the FHLBS and could be removed for cause by the Chairman.

F. Transition Requirement for Non-Qualified Thrifts

Non-qualified S&Ls would be treated in all respects as banks with an appropriate transition period. That is, they could only engage in activities permissible for banks, would be subject to bank capital standards, would be subject to bank regulations, and company owners would become bank holding companies. There would be no diminution of insurance premiums or FDIC enforcement or supervisory powers during the transition period.

G. Affiliate and Insider Rules

S&Ls would be subject to Section 23A, Section 23B, and Section 22H (insider lending) of the Federal Reserve Act as if they were banks.

H. Examination Staff

Staff compensation of the FHLBS and the OCC shall be competitive with compensation established by the other federal bank regulators. The FHLBS and the OCC shall have flexibility to establish compensation levels,

including granting of regional pay differentials, hiring at any step within a given grade and using their own competitive hiring registers. There would be no exemption to the President's authority to control personnel levels.

I. Freddie Mac

The Federal Home Loan Mortgage Corporation remains in place. [Freddie Mac board to be determined.]

J. FHLBS adjudicatory and enforcement decisions pertaining to specific institutions would not be subject to review or alteration by the Treasury Department.

IV. Additional Insurance Rules

A. When deposit insurance is granted automatically as a result of actions by the Comptroller of the Currency and the Federal Reserve (e.g., granting a national bank charter or membership in the Federal Reserve System), the FDIC must be notified and given an opportunity to comment regarding risk to the insurance fund, prior to such action.

B. Movement between funds would be permitted for FSLIC-insured institutions 5 years after the date of enactment upon payment of an appropriate exit fee as determined by the Secretary of the Treasury. The FDIC would have discretionary authority to establish an appropriate entrance fee to preclude excessive dilution of the fund.

C. All insured depository institutions owned by a holding company will guarantee the insurer against loss in the event of failure of any other insured institutions owned by such holding company.

D. Logos, properly representing the facts, to be determined.

V. Resolution of Currently Insolvent Thrifts through a new Resolution Trust Corporation (RTC).

A. The Resolution Trust Corporation (RTC) would be created and managed by the FDIC. The RTC would be charged with assuming responsibility for managing the orderly resolution of all insolvent thrift institutions formerly insured by the FSLIC. In its resolution activities, the RTC would be authorized to take warrants, equity, or other participation in resolved

institutions. The RTC would manage the resolution of all additional FSLIC-insured institutions that become capital insolvent as defined by FDIC within three years of enactment. RTC would assume management and authority over all existing FSLIC cases, and all assets owned by FSLIC, as of the date of enactment. FADA would be wound down and eliminated over a 6 month period.

B. Organization of the RTC

1. The RTC Oversight Board, comprised of the Secretary of the Treasury (Chairman), the Chairman of the Federal Reserve Board, and the Comptroller General of the United States, would be created to review the work and progress of the RTC. The RTC would be authorized to employ such staff as may be necessary.

2. The RTC Oversight Board would be authorized to review, and with the vote of the Chairman and one other board member would be authorized to disapprove, any purchase and assumption agreement, merger agreement or other transaction in which any person or entity acquires a failed savings and loan institution under management by RTC.

3. Funding would be provided directly to the RTC to resolve currently insolvent institutions under the review of the Oversight Board.

4. The RTC would contract with the new FDIC and private sources to provide management of the institutions (and their assets) conveyed to RTC or RTC's portfolio. All institutions managed by the RTC would be subject to legal restrictions on all growth, lending activities and asset acquisition (except as necessary to serve the existing customer base with residential mortgage or consumer loans), use of brokered deposits without specific approval, and payment of deposit rates beyond ceilings established by the RTC Oversight Board. Any institution taking insured deposits would remain subject to the normal supervision by the FHLBS and the FDIC.

5. The RTC would be authorized to analyze any FSLIC resolutions completed since January 1, 1988, and report its conclusions to the Secretary of the Treasury. The RTC would actively review all means by which it can reduce costs under existing FSLIC

agreements, including through the exercise of rights to restructure such agreements, subject only to monitoring by the Oversight Board.

6. The RTC would sunset five years after the date of enactment. All remaining assets and liabilities after the date of sunset, if any, would be managed by the FDIC. Net proceeds, if any, would go first to repay Treasury expenditures to REFCORP and the RTC, and then into the FSLIC pool.

7. All RTC case resolutions shall be considered in light of the statutory cost test in the FDI Act, which would be amended to include immediate and long term expenditures, contingent liabilities, and tax revenues foregone.

C. Funding for Case Resolution

1. A new entity, the Resolution Funding Corporation (REFCORP), would be created to finance the additional funds necessary for case resolution.

2. This separate entity would be patterned after the Financing Corporation created by Congress in the Competitive Equality Banking Act.

VI. Enhanced Acquisition of Thrift Institutions

A. Barriers to entry of traditional financial services companies and other sources of private capital would be lifted.

(1) Sec. 4(c)(8) of the Bank Holding Company Act would be amended to permit, effective 2 years after the date of enactment, the acquisition not only of failed or failing S&Ls by a bank holding company as provided under present law and Federal Reserve policy, but also healthy institutions as well, and without tandem operations restrictions.

(2) The cross-marketing restrictions in the Competitive Equality Banking Act would be repealed.

(3) Savings and loan holding companies would be authorized to acquire up to five percent of the outstanding shares of an unaffiliated federally insured thrift or savings and loan holding company

on the same conditions that bank holding companies can acquire such interests. Current law prohibits any such ownership other than a controlling interest.

(4) Provisions in the National Housing Act concerning management interlocks would be repealed, thereby eliminating a redundancy created by the passage of the Management Interlocks Act of 1978.

VII. Enhanced Enforcement Authorities and Penalties.

A. New enforcement authorities and significant penalties would be added.

(1) The scope of the federal regulators' authority over individuals would reach all insiders, as well as all directors, officers, employees, agents, and others participating in the conduct of the affairs of the regulated financial institution.

(2) Temporary cease-and-desist orders would be allowed without requiring a showing that the activities in question threaten the institution or depositors. Regulators would be permitted to issue such orders against institutions whose books and records are so incomplete or inaccurate that the regulators cannot determine the institution's financial condition.

(3) An individual suspended or removed from an institution would be prohibited from participating in any other insured financial institution or any affiliate of an insured institutions, rather than from only the institution involved.

(4) Enforcement authority would specifically reach those who resign or otherwise leave an institution before initiation of an enforcement action.

(5) Civil penalties would be raised for violations of laws, regulations, cease and desist orders, and reporting requirements. Civil money penalties would also be assessed against individuals for unsafe and unsound banking practices or breaches of fiduciary duty. Proportionality based on loss to the institution or gain to the individual would apply to the application of such penalties.

(a) Maximum civil penalties of $1,000,000, per day, would be added in cases of reckless disregard.

(b) Other violations would be subject to a maximum civil penalty of $25,000 per day or $250,000, whichever is greater.

B. <u>Civil Penalties for Willful Violations</u>

(1) Civil penalties, parallel to banking crime provisions (fraud, embezzlement and misapplication, bribery, false entries, false statements) would be added for violations made with reckless disregard.

(a) These civil penalties could be imposed by the appropriate regulatory agency or by the Attorney General following a criminal investigation or proceeding.

(b) Civil penalties and criminal sanctions would be cumulative.

C. <u>Civil and Criminal Seizure and Forfeiture Authority</u>

(1) Civil and criminal seizure and forfeiture authority would apply in banking crime (fraud, embezzlement, and misapplication, bribery, false entries, false statements) cases and parallel civil penalty cases. (At the point there was probable cause for a violation, the Attorney General could move forward to seize assets.)

(2) Following conviction of a bank crime, criminal forfeiture would be required. Unlike victim restitution, forfeiture would not be discretionary with the court.

(3) The law would require forfeited property (both civil and criminal) to be transferred to the Treasury where an institution is insolvent and otherwise, to the institution as restitution, where appropriate. The agencies pursuing such cases would be able to recover their expenses.

(a) The amount paid the institution would be set off against any amount later recovered as compensatory damages in a private action

under State or Federal law or as restitution in any subsequent action by the deposit insurer.

(b) Forfeiture must be satisfied before a criminal fine or civil penalty is paid. (Criminal and civil fines are credited to the general fund.)

(4) Both civil and criminal forfeiture would include the tracing of funds to all property purchased with the proceeds of the activity (substitute assets) by the wrongdoer.

D. Informant's Rewards and Employee Protection

(1) Authority for regulatory agencies to pay informant's rewards to any person who provides original information leading to a recovery of a criminal fine, civil penalty or forfeiture would be added.

(2) Employees who provide information would be protected (*e.g.*, if wrongfully discharged because of actions, the person would be able to seek an administrative remedy from the regulatory agency or reinstatement with back pay or the right to three years salary).

E. Other Criminal Enhancements

(1) Maximum terms for most bank crimes would be increased to 20 years or more, with new sentencing minimums.

(2) Financial institution misapplication and fraud would be added as RICO predicates.

(3) The statute of limitations for financial institution crimes would be extended to ten years.

F. More Resources for Enforcement

$50 million per year would be provided in budget authority from the general fund of the Treasury to the Justice Department to fund a new national Financial Institution Strike Team.

VIII. Review of Broader Deposit Insurance and Banking Regulation Issues.

A. Study: The Secretary of the Treasury, in consultation with the federal financial regulators, shall review the deposit insurance system, including an appropriate structure for the offering of competitive products and services consistent with safety and soundness considerations. The Secretary shall make any recommendations for change to Congress within 18 months of enactment.

B. Topics will include (but not be limited to): the risk and rate structure with deposit insurance; incentives for market discipline; methods to reduce the scope of deposit insurance coverage and resulting liability of the insurance fund; the feasibility of market value accounting, assessments on foreign deposits, and limitations on brokered deposits and multiple insured accounts; policies to be followed regarding the recapitalization or closure of insured depositories whose capital is depleted to, or near the point of, insolvency; and the efficiency of housing subsidies through FHLB System.

IX. Publicly Offered Securities of Banks and Thrifts

The registration requirements of the Securities Act of 1933 would be made applicable to publicly offered securities of banks and thrifts (but not deposit instruments), and the administration and enforcement of disclosure and other requirements of the Securities Exchange Act of 1934 for bank and thrift securities would be transferred from the bank and thrift regulatory agencies to the SEC, as is currently the case for securities of all other types of companies (including bank and thrift holding companies). This provision would be submitted as separate legislation.

February 14, 1989

S & L RESOLUTION FUNDING PLAN

- Provides $50 billion in new funds for resolving the remaining insolvent thrifts. To date, FSLIC has resolved approximately $40 billion in insolvent S&Ls and an additional $50 billion should be more than adequate for resolving the remaining institutions. Of the additional funds, an estimated $10 billion would be spent in FY 89, $25 billion in FY 90 and $15 billion in FY 91.

- The plan provides funding both to resolve all insolvent S&Ls and to establish viable, on-going insurance funds in the future. S&L industry and Treasury funds are applied to cleaning up the current S&L problem. Industry insurance premiums are raised to put federal deposit insurance on a sound financial basis for the future.

Resolution Trust Corporation (RTC) Financing

- S&L Resolution Financing. The $50 billion in bonds are to be issued by a new entity, the Resolution Funding Corporation (REFCORP) to finance the proposed Resolution Trust Corporation (RTC) -- the separate corporation charged with the responsibility of resolving all currently insolvent S&Ls and those which become insolvent during the 3 years after enactment.

  -- The Resolution Funding Corporation is an entity patterned after the Financing Corporation created by Congress in the Competitive Equality Banking Act of 1987.

REFCORP Bond Principal

- The $50 billion principal of REFCORP bonds will be paid with S&L industry funds. Roughly $5-6 billion of S&L industry funds (FHLBank retained earnings plus S&L assessment premiums) would be used to buy long-term zero coupon Treasury obligations, which, when they mature, would pay-off (defease) the $50 billion principal. No taxpayer funds or guarantees will be involved in the payment of REFCORP bond principal.

REFCORP Bond Interest

- Proceeds from new S&L liquidations, and additional FHLBank retained earnings would be first used to pay the interest on REFCORP bonds with Treasury funds making up the shortfall. Treasury funds used to service REFCORP bond interest would be scored for budget purposes in the year

expended. The proceeds, if any, from the sale of warrants or other equity participations acquired in RTC case resolutions will be used to repay Treasury for REFCORP interest expenditures.

REFCORP Bond Financing Cost

- REFCORP bonds are similar to existing FICO bonds, but would have a lower financing cost. The RTC financing mechanism would be similar to FSLIC's Financing Corporation (FICO), established in the Competitive Equality Banking Act of 1987. However, because no Treasury funds or guarantees were involved in FICO, the interest cost on FICO bonds was 3/4% to 1% higher than direct Treasury financing. REFCORP bond interest cost should be only marginally higher than direct Treasury borrowing cost because Treasury funds would pay any shortfall in interest not available from industry funds, and the principal would be fully collateralized by Treasury bonds purchased with S&L industry funds. S&L industry funds used to pay interest effectively offset any incremental cost REFCORP financing over direct Treasury financing.

- This separate funding mechanism segregates S&L resolution financing, allowing a clear and tractable accounting of all public and private funds employed in resolving the S&L problem.

Servicing Past FSLIC Resolutions

- Treasury funds would also be required to service past FSLIC resolutions. Any shortfall in FSLIC resources needed to pay past FSLIC resolutions would be paid with Treasury funds. Existing FSLIC resources would be applied to servicing the $40 billion in past FSLIC resolutions. These resources include S&L assessments premiums (net of funds used for REFCORP principal defeasance and payments to a new S&L insurance fund), proceeds from remaining FICO bond issuance authority, proceeds from liquidation of past resolutions, and other miscellaneous FSLIC income.

Recapitalization of Deposit Insurance Funds

- Establishes a sound S&L insurance fund for the future. S&L premium income would be used to build a new deposit insurance fund to protect currently healthy thrifts that choose to remain primarily mortgage lenders.

- <u>Shores up commercial bank insurance fund</u>. A higher commercial bank deposit insurance premium would increase the level of the FDIC fund to bring it back in line with its historical reserve-to-deposit ratio to protect depositors and taxpayers. Deposit insurance premiums would be reduced when the FDIC fund exceeds a reserve to deposit ratio of 1.25 percent. Commercial bank insurance premiums would be available for use only to resolve FDIC member institutions. <u>No commercial bank insurance premiums would be used in any S&L resolution or recapitalization of the S&L insurance fund</u>.

<u>Budget Impact of Financing Plan</u>

- Total budget outlays under this plan for 1990 and near term out-years will not exceed those projected for FSLIC in the Reagan 1990 budget.

- The outlays called for in the plan should not interfere with the Administration's commitment to meet G-R-H targets.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

For Immediate Release
February 15, 1989

Contact: Larry Batdorf
566-2041

TREASURY ASSESSES PENALTY AGAINST PONCE FEDERAL BANK, F.S.B., PONCE, PUERTO RICO UNDER THE BANK SECRECY ACT

The Department of the Treasury on February 9, 1989, assessed a civil penalty of $500,000 against Ponce Federal Bank, F.S.B., formerly known as the Ponce Federal Savings and Loan Association of Puerto Rico, Ponce, Puerto Rico, based on in excess of 50 failures to file Currency Transaction Reports as required by the Bank Secrecy Act. The civil penalty was announced by Assistant Secretary for Enforcement Salvatore R. Martoche. This is the largest civil penalty for violations of the Bank Secrecy Act assessed against a savings institution.

These unreported transactions involved the purchase by customers of the bank of bearer certificates of deposit with cash, the failure of the bank to maintain a confidential list with the true identities of the owners of the bearer certificates of deposit, and the borrowing of cash by the bank from its own clients. The Bank Secrecy Act regulations require that deposits, withdrawals, and exchanges of currency in excess of $10,000 be reported by the financial institution involved in the transaction.

On February 13, 1989, the bank entered pleas of guilty to five related criminal violations of the Bank Secrecy Act. The District Court for the District of Puerto Rico, in its discretion, imposed a criminal fine of $500,000 on each count for a total criminal fine of $2,500,000. Under the Bank Secrecy Act, criminal and civil sanctions are cumulative.

This case was developed through an investigation conducted by Special Agents of the Internal Revenue Service assigned to Assistant Commissioner (International), Criminal Investigation Division, working with the Operation Greenback task force of the Justice Department in San Juan, Puerto Rico. In connection with resolution of the criminal case, Treasury worked with the Justice Department to resolve the question of the bank's corresponding civil liability for the criminal violations.

NB-139

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M.
February 15, 1989

CONTACT: Office of Financing
202/376-4350

TREASURY TO AUCTION 2-YEAR AND 5-YEAR 2-MONTH NOTES TOTALING $17,000 MILLION

The Treasury will raise about $6,375 million of new cash by issuing $9,250 million of 2-year notes and $7,750 million of 5-year 2-month notes. This offering will also refund $10,626 million of 2-year notes maturing February 28, 1989. The $10,626 million of maturing 2-year notes are those held by the public, including $971 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities.

The $17,000 million is being offered to the public, and any amounts tendered by Federal Reserve Banks as agents for foreign and international monetary authorities will be added to that amount. Tenders for such accounts will be accepted at the average price of accepted competitive tenders.

In addition to the public holdings, Federal Reserve Banks for their own accounts hold $897 million of the maturing securities that may be refunded by issuing additional amounts of the new notes at the average price of accepted competitive tenders.

Details about each of the new securities are given in the attached highlights of the offerings and in the official offering circulars.

oOo

Attachment

NB-140

HIGHLIGHTS OF TREASURY OFFERINGS TO THE PUBLIC OF 2-YEAR AND 5-YEAR 2-MONTH NOTES

February 15, 1989

Amount Offered to the Public ...	$9,250 million	$7,750 million
Description of Security:		
Term and type of security	2-year notes	5-year 2-month notes
Series and CUSIP designation ...	Series W-1991 (CUSIP No. 912827 XF 4)	Series J-1994 (CUSIP No. 912827 XG 2)
Issue date	February 28, 1989	March 3, 1989
Maturity date	February 28, 1991	May 15, 1994
Interest rate	To be determined based on the average of accepted bids	To be determined based on the average of accepted bids
Investment yield	To be determined at auction	To be determined at auction
Premium or discount	To be determined after auction	To be determined after auction
Interest payment dates	August 31 and February 28	November 15 and May 15 (first payment on November 15, 1989)
Minimum denomination available .	$5,000	$1,000
Terms of Sale:		
Method of sale	Yield auction	Yield auction
Competitive tenders	Must be expressed as an annual yield, with two decimals, e.g., 7.10%	Must be expressed as an annual yield, with two decimals, e.g., 7.10%
Noncompetitive tenders	Accepted in full at the average price up to $1,000,000	Accepted in full at the average price up to $1,000,000
Accrued interest payable by investor	None	None
Payment Terms:		
Payment by non-institutional investors	Full payment to be submitted with tender	Full payment to be submitted with tender
Payment through Treasury Tax and Loan (TT&L) Note Accounts ..	Acceptable for TT&L Note Option Depositaries	Acceptable for TT&L Note Option Depositaries
Deposit guarantee by designated institutions	Acceptable	Acceptable
Key Dates:		
Receipt of tenders	Wednesday, February 22, 1989, prior to 1:00 p.m., EST	Thursday, February 23, 1989, prior to 1:00 p.m., EST
Settlement (final payment due from institutions):		
a) funds immediately available to the Treasury ...	Tuesday, February 28, 1989	Friday, March 3, 1989
b) readily-collectible check ...	Friday, February 24, 1989	Wednesday, March 1, 1989

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

February 16, 1989

TREASURY DEPARTMENT DECISION
ON THE CLASSIFICATION OF SPORT UTILITY VEHICLES AND VANS

I. SUMMARY

The Treasury Department has made the following determinations on the tariff classification of imported sport-utility vehicles and vans:

-- Two-door sport-utility vehicles generally will now be classified as "motor vehicles for the transport of goods", which are dutiable at 25 percent.

-- Four-door sport-utility vehicles generally will now be classified as "motor vehicles principally designed for the transport of persons", dutiable at 2.5 percent.

-- Vans with side windows and rear seats to accommodate at least two persons generally will continue to be classified as motor vehicles designed for the transport of persons, dutiable at 2.5 percent. This was basically the manner in which they were classified in 1988 and for many years prior to 1988.

These determinations result from the Treasury Department's application of the relevant language of the Harmonized Tariff Schedule of the United States (HTSUS), which went into effect on January 1, 1989. Treasury's approach was to make a technical and legal classification decision.

In 1988, approximately 239,000 imported sport-utility vehicles and vans entered the United States. In 1988, under the previous tariff schedule, approximately 44 percent of the vehicles were classified at the 25 percent rate and approximately 56 percent were classified at the 2.5 percent rate. Were these same vehicles to be classified under the principles announced today, approximately 62 percent would be classified at the 25 percent rate, and approximately 38 percent would be classified at the 2.5 percent rate. These percentages are based on a static analysis; actual quantities of vehicles entered in 1989 at the higher rate may be smaller.

NB-141

II. BACKGROUND

The classification principles announced today result from an intensive six-week review by Treasury Department officials. That review, which was focused on the legal classification issues, included meetings with representatives of the importers, domestic manufacturers, and automobile dealers. All of these representatives were invited to submit legal arguments and technical information pertaining to the tariff classification issues at stake. Treasury officials also examined the vehicles in question at the port of Baltimore, at an importer's facility near the port, in dealers' showrooms, and during a technical session held in Detroit with engineers and other staff of the domestic automakers.

The Harmonized Tariff Schedule of the United States (HTSUS) became effective this year as a result of the enactment of the Omnibus Trade and Competitiveness Act of 1988. Under this Act, the United States became a contracting party to an international convention that brings under a common system, or "harmonizes", the commodity descriptions that govern classification of merchandise under the various tariff schedules of the world's major trading countries.

In 1988, under the previous U.S. tariff schedule, the U.S. Customs Service had been reviewing its criteria for classifying sport-utility vehicles and vans. However, after the enactment of the law implementing the new tariff schedule, the Customs Service discontinued that review and began a study of the proper tariff classification of the vehicles in question under the new tariff system.

On January 4, 1989, the Customs Service issued a ruling letter (the "Suzuki ruling") classifying the Suzuki Samurai, the Suzuki Sidekick and the GEO Tracker as motor vehicles for the transport of goods dutiable at 25 percent. Upon issuing the ruling, Customs announced that all other imported sport-utility vehicles and most small vans would also be classified under this provision and therefore be subject to the 25 percent rate.

The Treasury Department began its legal review immediately after the Customs announcement. Treasury officials arranged the meetings described above in response to expressed concerns that the Suzuki ruling was not legally and technically correct and that there had not been sufficient opportunity for input by the affected parties.

III. <u>THE TREASURY DEPARTMENT'S REVIEW OF THE CUSTOMS SERVICE DECISION</u>

The Treasury Department has concluded its review of the Suzuki ruling and also has reached conclusions on the proper tariff classification of the other imported vehicles at issue. The vehicles in question are as follows:

<u>Sport-utility vehicles</u>:

Dodge Raider
GEO Tracker
Isuzu Trooper and Trooper II
Mitsubishi Montero
Nissan Pathfinder
Range Rover
Suzuki Samurai
Suzuki Sidekick
Toyota 4Runner
Toyota Land Cruiser

<u>Vans</u>:

Mazda MPV
Mitsubishi Wagon and Van
Nissan Van
Toyota Van
Volkswagon Vanagon

<u>Other</u>:

Nissan Stanza Wagon
Plymouth/Dodge Colt Vista Wagon

The tariff provisions at issue are as follows:

<u>Heading 8703:</u>	<u>Applicable Duty Rate</u>
"Motor cars and other motor vehicles principally designed for the transport of persons (other than those of heading 8702), including station wagons and racing cars"	2.5 percent *ad valorem*
<u>Heading 8704</u>:	
"Motor vehicles for the transport of goods"	25 percent *ad valorem*

The Treasury Department has concluded that the two-door sport-utility vehicles at issue should be classified under heading 8704, at 25 percent. All of these vehicles have designs that are either derived directly from pick-up trucks or that incorporate design features of cargo vehicles, including flat floors in the rear portion of the interior, rear doors or tailgates that are large enough to facilitate the loading and unloading of cargo, and chassis and suspension designs that are more rugged than those found on ordinary passenger vehicles of the same general size. In brief, the integral design features of these two-door sport-utility vehicles compel a conclusion that cargo transport was a high priority in their design and that they are not principally designed to transport persons. In accordance with this conclusion, the Treasury Department has decided that the Customs Service was correct in its determination that the Suzuki Samurai, Suzuki Sidekick, and the GEO Tracker, which are two-door sport-utility vehicles, should generally be classified under heading 8704 and therefore subject to the 25 percent rate of duty.

Upon review, Treasury has reached a different conclusion regarding the four-door sport-utility vehicles in question. These vehicles should be classifiable under heading 8703 at 2.5 percent duty because their design features, particularly the presence of rear passenger access doors, favor the transport of persons. Unlike the two-door sport-utility vehicles, the four-door sport-utility vehicles generally are not direct derivatives of pick-up truck designs. As a matter of basic structure, the body style of these vehicles is one for which the transport of persons was a principal design consideration. Therefore, four-door sport-utility vehicles generally will be classified as motor vehicles principally designed for the transport of persons under heading 8703, at a duty rate of 2.5 percent.

With respect to vans, Treasury has examined the relevant design features of vans and has concluded that many of the relevant design features are equally well suited for the transport of passengers or goods. The basic physical structure of these vehicles, consisting of a box-like body and a chassis configuration for which compact exterior dimensions and the highly efficient use of space are principal design considerations, is one that is advantageous and readily adaptable for both a cargo-carrying and a passenger-carrying function. Manufacturers add other features to this basic structure in designing a vehicle principally for the transport of persons. Such a design

will have large windows around the rear compartment, for example, whereas a van for the transport of goods may or may not have such windows. In addition, vans designed principally for passenger use will always be fitted with one or more rows of additional seats behind the front seats and will frequently have other passenger amenities as well. When configured in passenger form, even a small van (or "minivan", as a vehicle of this type is often called) can carry up to seven persons with spacious interior accommodations.

For these reasons, Treasury has concluded that vans with seating for two or more passengers behind the front seat area, one or more rear side doors, windows on the rear side door(s) and on the side panels of both sides of the vehicle, should be classified as motor vehicles principally designed for the transport of persons, subject to a duty of 2.5 percent. A van without all of these design features should be classified as a motor vehicle for the transport of goods under heading 8704, at 25 percent duty.

IV. SUMMARY OF THE TREASURY DEPARTMENT'S CONCLUSIONS

Of the vehicles mentioned above, the following sport-utility vehicles, which are two-door models, generally will be classified under heading 8704 at 25 percent duty:

Dodge Raider
GEO Tracker
Isuzu Trooper and Trooper II, two-door models
Mitsubishi Montero, two-door models
Nissan Pathfinder
Suzuki Samurai
Suzuki Sidekick
Toyota 4Runner

The following sport-utility vehicles, which are four-door models, generally will be classified under heading 8703, at 2.5 percent duty:

Isuzu Trooper and Trooper II, four-door models
Mitsubishi Montero, four-door models
Range Rover
Toyota Land Cruiser

The following vans will be classified under heading 8703, at 2.5 percent duty, when entered with rear seating for two or more persons, at least one rear side door, and windows on the rear side door(s) and on the side panels on both sides of the vehicle:

Mazda MPV
Mitsubishi Wagon
Nissan Van
Toyota Van
Volkswagon Vanagon

The following vehicles technically are neither sport-utility vehicles nor vans. Under the principles discussed above, they will be classified under heading 8703:

Nissan Stanza Wagon
Plymouth/Dodge Colt Vista Wagon

The percentages of vehicles entered under the two relevant tariff provisions, as set forth on page 1, were calculated based only on the sport-utility vehicles and vans listed above. Certain sport-utility vehicles assembled in North America are not included for purposes of this analysis because, although imports in a technical sense, they contain a high percentage of domestic content.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

Embargoed For Release Until Delivery
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STATEMENT BY
FRANK VUKMANIC
DIRECTOR OF THE OFFICE OF
MULTILATERAL DEVELOPMENT BANKS
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON FOREIGN OPERATIONS
COMMITTEE ON APPROPRIATIONS
U.S. HOUSE OF REPRESENTATIVES
FEBRUARY 21, 1989

Mr. Chairman:

It is a pleasure to participate in this series of panels on Global Climate Change. My statement this morning will deal with the activities of the multilateral development banks (MDBs) and how we have been attempting through our participation in these institutions to address environmental issues including those that have implications for global warming.

As members of this subcommittee are aware, we already have extensive legislation in place directing us to seek very specific environmental reforms in the multilateral development banks. The reforms that we have been seeking include: restructuring and strengthening of environmental units; hiring of environmentally-qualified staff; greater emphasis on staff training on environmental implications of development; increased coordination with non-governmental groups affected by development projects in borrowing countries; and the preparation of additional projects that will have a positive and beneficial effect on the environment in general. We have also sought to protect fragile eco-systems such as tropical moist forests and wetlands that may be at risk from specific development projects and to encourage programs for energy efficiency and conservation. Last year, this subcommittee developed legislation directing us to instruct U.S. Executive Directors to promote and encourage energy conservation measures. Last week we submitted to the Congress a report setting out in more detail the progress we have made in implementing legislative provisions over the past year.

It is fair to say that a great deal has been accomplished in the MDBs particularly with regard to organizational changes, staffing, training, and in the preparation of more environmentally-beneficial projects. Additional reforms still need to be made, however, and we will be pressing the banks to improve their performance in these areas and in other areas. For example, we recognize that the MDBs need to strengthen their assessment of environmental impact, review their information policies with a view to providing more and earlier access to relevant information, cooperate and coordinate more with non-governmental organizations in borrowing countries, and promote energy efficiency and conservation programs.

DESTRUCTION OF TROPICAL FORESTS

There has been mounting concern in recent years over the destruction of tropical rain forests, particularly those in the Amazon Basin of South America. It is estimated that up to ten percent of the increases in greenhouse gases are the result of deforestation in this and other regions.

The multilateral development banks inadvertently contributed to this problem in the past by funding electric power projects and penetration roads in these regions without securing adequate environmental safeguards. The banks have been moving, however, to correct those particular problems. They have financed subsequent projects designed to protect forests and to replant depleted areas. In 1987 and 1988, projects were initiated in the Ivory Coast, Costa Rica, and Nepal to replant and improve the management of large areas of tropical forest. I believe the banks have come to realize the importance of following sustainable strategies for development of forest regions and of protecting forests from the detrimental effects of development projects. Therefore, we must continue to press in the MDBs, in our bilateral contacts, and in other multilateral fora for an increased awareness of the severity of the problems and the need to address them. The ultimate key to solving these problems is for borrowing countries to realize that it is in their own long-term interest to do so.

U.S. STANDARDS FOR EVALUATING MDB PROJECTS

Last year we took significant steps that should help us achieve these goals, developing U.S. standards to evaluate environmental aspects of MDB projects that may adversely affect tropical moist forests. Those standards were

undertaken at the initiative of Secretary Baker when he was at Treasury. They have the full support of many environmental groups in this country. Indeed, in drafting the standards, we worked very closely with the Tropical Forest Working Group, which included representatives from over fifty groups in this country. I would like to provide a set of the standards for the record.

I want to emphasize that these are standards for U.S. evaluation of MDB projects. They were adopted in April, 1988, and made available immediately to management and staff in all of the multilateral development banks. The U.S. Executive Directors in all of the banks have been instructed to use the standards in their evaluations of projects.

The standards have also been distributed to governments of other countries in order to promote greater international support for measures to protect tropical moist forests. In May, the standards were tabled at an ad hoc meeting of experts held under the auspices of the Organization for Economic Cooperation and Development (OECD). The meeting was called at our initiative to draft an environmental checklist for multilateral and bilateral assistance decision-makers, including executive directors from OECD countries at the MDBs. Following adoption of the checklist, we sought to get wider acceptance of our standards. We continued this initiative at a working group of the OECD's Development Assistance Committee in December, 1988, and we are now hopeful that it will be taken up at a June, 1989, meeting of that working group.

I should also mention that we have adopted U.S. standards for evaluating MDB projects that may adversely affect wetlands and Sub-Saharan savannas. We are now working with a special committee chaired by the Natural Resources Defense Council to perfect standards for projects affecting marine areas. Our overall objective is to use these standards to achieve a broad international consensus on guidelines to help protect all sensitive eco-systems that may be threatened by development projects.

ENERGY EFFICIENCY AND CONSERVATION

A second major initiative that we have taken is in the area of energy efficiency and conservation. As I mentioned, we have a strong mandate from Congress and from this subcommittee, in particular, to encourage greater emphasis on projects of this type and to make provision for least-cost analysis in choosing among alternative technologies.

The multilateral development banks have already taken several steps to improve their performance in this area. Their efforts to promote more realistic tariff schedules and to rehabilitate transmission and distribution systems, lowering physical losses and losses from theft, are two important examples I can cite that will increase efficiency. However, the banks have not always been successful in securing agreement on adequate tariffs and the benefits from rehabilitation have frequently been lost over time as a result of mismanagement and inadequate maintenance.

The World Bank also reports that it is carrying out energy-related preinvestment activities in more than 50 countries and is providing institutional and policy guidance on energy matters to decision-makers in developing countries. These activities span a wide spectrum including studies of energy investment priorities and energy efficiency assessments both on the supply side and in end uses in households and industries.

We would like the Bank to put more emphasis on these types of activities. It should play a more innovative and catalytic role in searching out new and wider opportunities for investments in energy conservation and efficiency, including renewable energy particularly where it is the least cost alternative.

Internally, we are working to develop practical initiatives in this area that we can pursue in the MDBs. Treasury, in September, 1988, proposed the establishment of an informal working group on energy efficiency and conservation, to be composed of experts from the Departments of Treasury and Energy, EPA, AID, and environmental groups. The mandate of the group is to consider what specific steps the U.S. might take to advance the case for energy efficiency and conservation in all of the MDBs. The first meeting of the group, held in October, amounted to a preliminary exchange of views on how we might proceed. A second meeting of the group was held last week to air in more detail the views of some of the non-governmental organizations.

MONTREAL PROTOCOL

A third initiative I want to mention concerns U.S. obligations under the Montreal Protocol and the international effort to cut back on CFCs and halons. Up to twenty percent of the increase in greenhouse gases is thought to be due to CFCs. Since the Montreal Protocol came into effect on January 1, 1989, representatives from Treasury, State, and

EPA have met with World Bank staff on two occasions to discuss ways in which the Bank can promote uses of alternative technologies and substitute products as well as ensure that it does not provide inadvertent assistance for programs that would aid production of CFCs or halon. The initial response from Bank staff has been positive. They have expressed interest in the possibility of providing financing for retro-fitting of manufacturing facilities in the Bank's borrowing countries. There is also an obligation to refrain from financing projects that would assist in the production of CFCs or halons. Bank staff reported that the IFC had turned down a proposal in the early 1980's specifically because it would have contributed to the production of CFCs. Our objective is to strengthen Bank practice in this area and to work for a policy that would clearly preclude any such financing.

The World Bank itself is not a signatory to the Montreal Protocol. However, most of its developed member countries have ratified the protocol and a number of its developing member countries have become signatories. We will strongly encourage our protocol partners to work with us in helping to develop a work program in the World Bank. The next meeting of participants to report on measures to implement the protocol will take place in May.

The World Bank also participated as an observer at a working group meeting earlier this month of the Inter-Governmental Panel on Climate Change. The Bank should continue to participate in the panel's work over the next eighteen months in areas that are appropriate to its expertise. We will strongly suggest through our executive directors that the regional MDBs be invited to participate as well.

In conclusion, Mr. Chairman, I want to reiterate that the multilateral development banks can make important contributions to our efforts to address the complicated issues of global climate change. The most important of these contributions is to take steps early in the project cycle to mitigate or eliminate environmentally-adverse effects of projects and to take the initiative in financing environmentally-beneficial projects, particularly those that will protect tropical moist forests, and promote greater reliance on energy efficiency and conservation. There is widespread agreement in the scientific community that these are two critical areas in which we can begin to make important progress now. We see that we need to work constructively within the MDBs to bring about the changes

that we seek. We also believe that we have to enlist support from other member countries through our bilateral contacts and work in other multilateral fora in order to gain wider acceptance of our ideas.

Thank you.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

February 17, 1989

JOHN K. MEAGHER
ASSISTANT SECRETARY (LEGISLATIVE AFFAIRS)
TO LEAVE TREASURY

Assistant Treasury Secretary for Legislative Affairs John K. Meagher announced today that he will leave the department around April 1, 1989 to practice law in Washington.

Secretary of the Treasury Nicholas F. Brady commended Mr. Meagher for his dedication and abilities. "John informed me in November of his desire to return to the private sector but agreed to stay at his post through the transition," he said. "I am personally grateful for his help during this period. He has been a tremendous asset, and I wish him well."

Mr. Meagher became Assistant Secretary for Legislative Affairs on October 2, 1987, and has been responsible since that time for the smooth coordination between the Department and Congress.

Before assuming his post at Treasury, Mr. Meagher served as Vice President - Government Relations for The LTV Corporation since 1981. He also served as Chairman of the Basic Industries Coalition, Inc. (BIC), a trade association of large American corporations.

Prior to joining The LTV Corporation, Mr. Meagher served as minority counsel of the Committee of Ways and Means of the U. S. House of Representatives.

A native of Syracuse, New York, Mr. Meagher is a graduate of William and Mary College and its law school.

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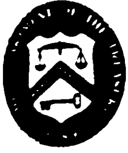


THE SECRETARY OF THE TREASURY
WASHINGTON

February 16, 1989

Dear Congressman:

We note with concern that a House vote has been scheduled on H.R. 5, the "Foreign Ownership Disclosure Act of 1989", which would mandate registration and disclosure of foreign investment in the United States. It goes to the floor without hearings or mark up in this Congress.

This legislation would not contribute in any meaningful way to our ability to determine the extent and effects of foreign investment in the United States. Virtually all the data which the legislation would require are already collected by the Department of Commerce. The data are voluminous and are adequate for statistical and policy analysis.

H.R. 5 would impose registration and disclosure requirements and potential penalties on foreign direct investors that are not imposed on domestic investors. The disclosure requirements in H.R. 5 would be tantamount to public disclosure. Singling out foreign direct investors constitutes a sharp change in U.S. policy from one of open investment to one of discrimination. This shift in policy would discourage foreign direct investment in the United States resulting in slower economic growth, productivity and job creation and triggering higher interest rates that could hurt a wide range of Americans, including homebuyers and farmers.

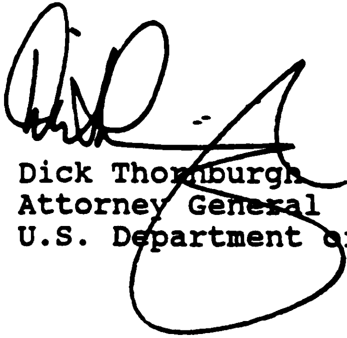
It is noteworthy that none of the other major industrialized countries finds it necessary or desirable to require disclosure of foreign direct investment as required by H.R. 5. Passage of H.R. 5 would run counter to our longstanding efforts to encourage freer investment practices in other countries.

If foreign registration and disclosure legislation such as H.R. 5 is presented to the President, we will recommend that he veto it.

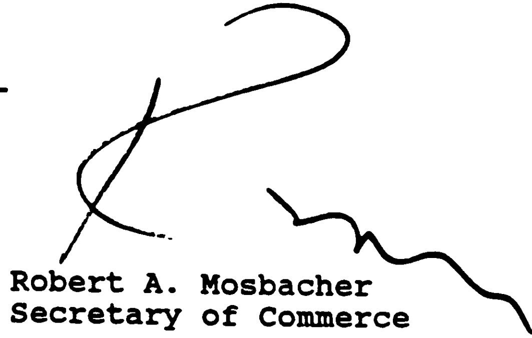
Sincerely,

Nicholas F. Brady
Secretary of Treasury

James A. Baker, III
Secretary of State



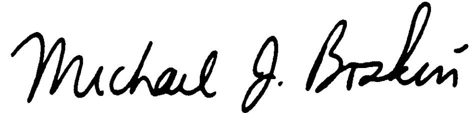
Dick Thornburgh
Attorney General
U.S. Department of Justice



Robert A. Mosbacher
Secretary of Commerce

Carla A. Hills
U.S. Trade Representative

Richard G. Darman, Director
Office of Management and Budget



Michael J. Boskin, Chairman
Council of Economic Advisers

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

CONTACT: Office of Financing
202/376-4350

FOR IMMEDIATE RELEASE
February 21, 1989

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,213 million of 13-week bills and for $7,209 million of 26-week bills, both to be issued on February 23, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing May 25, 1989			:	26-week bills maturing August 24, 1989		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	8.49%	8.80%	97.854	:	8.48%	8.98%	95.713
High	8.52%	8.83%	97.846	:	8.51%	9.02%	95.698
Average	8.51%	8.82%	97.849	:	8.50%	9.00%	95.703

Tenders at the high discount rate for the 13-week bills were allotted 26%.
Tenders at the high discount rate for the 26-week bills were allotted 69%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 43,170	$ 43,170	:	$ 34,225	$ 34,225
New York	21,985,255	6,091,335	:	18,888,680	5,840,550
Philadelphia	23,340	23,340	:	17,780	17,780
Cleveland	43,045	43,045	:	41,055	41,055
Richmond	63,690	63,680	:	50,365	50,365
Atlanta	44,750	42,485	:	43,650	43,650
Chicago	1,243,765	104,555	:	1,390,795	376,845
St. Louis	53,675	33,305	:	47,625	45,005
Minneapolis	9,455	9,455	:	9,395	9,395
Kansas City	42,240	42,240	:	58,595	58,595
Dallas	46,225	36,225	:	36,650	31,650
San Francisco	1,883,695	214,295	:	1,740,110	155,110
Treasury	465,520	465,520	:	504,825	504,825
TOTALS	$25,947,825	$7,212,650	:	$22,863,750	$7,209,050
Type					
Competitive	$22,213,150	$3,477,975	:	$17,385,440	$1,730,740
Noncompetitive	1,387,990	1,387,990	:	1,210,710	1,210,710
Subtotal, Public	$23,601,140	$4,865,965	:	$18,596,150	$2,941,450
Federal Reserve	2,279,785	2,279,785	:	2,200,000	2,200,000
Foreign Official Institutions	66,900	66,900	:	2,067,600	2,067,600
TOTALS	$25,947,825	$7,212,650	:	$22,863,750	$7,209,050

1/ Equivalent coupon-issue yield.

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TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

CONTACT: Office of Financing
202/376-4350

FOR RELEASE AT 4:00 P.M.
February 21, 1989

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $14,400 million, to be issued March 2, 1989. This offering will result in a paydown for the Treasury of about $ 250 million, as the maturing bills are outstanding in the amount of $ 14,644 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Standard time, February 27, 1989. The two series offered are as follows:

91-day bills (to maturity date) for approximately $ 7,200 million, representing an additional amount of bills dated December 1, 1988, and to mature June 1, 1989 (CUSIP No. 912794 SB 1), currently outstanding in the amount of $ 7,467 million, the additional and original bills to be freely interchangeable.

182-day bills (to maturity date) for approximately $ 7,200 million, representing an additional amount of bills dated September 1, 1988, and to mature August 31, 1989 (CUSIP No. 912794 SK 1), currently outstanding in the amount of $ 9,211 million, the additional and original bills to be freely interchangeable.

The bills will be issued on a discount basis under competitive and noncompetitive bidding, and at maturity their par amount will be payable without interest. Both series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, on the records either of the Federal Reserve Banks and Branches, or of the Department of the Treasury.

The bills will be issued for cash and in exchange for Treasury bills maturing March 2, 1989. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rates of accepted competitive tenders. Additional amounts of the bills may be issued to Federal Reserve Banks, as agents for foreign and international monetary authorities, to the extent that the aggregate amount of tenders for such accounts exceeds the aggregate amount of maturing bills held by them. Federal Reserve Banks currently hold $2,251 million as agents for foreign and international monetary authorities, and $4,289 million for their own account. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 5176-1 (for 13-week series) or Form PD 5176-2 (for 26-week series).

Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. This information should reflect positions held as of one-half hour prior to the closing time for receipt of tenders on the day of the auction. Such positions would include bills acquired through "when issued" trading, and futures and forward transactions as well as holdings of outstanding bills with the same maturity date as the new offering, e.g., bills with three months to maturity previously offered as six-month bills. Dealers, who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities, when submitting tenders for customers, must submit a separate tender for each customer whose net long position in the bill being offered exceeds $200 million.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

Payment for the full par amount of the bills applied for must accompany all tenders submitted for bills to be maintained on the book-entry records of the Department of the Treasury. A cash adjustment will be made on all accepted tenders for the difference between the par payment submitted and the actual issue price as determined in the auction.

No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches. A deposit of 2 percent of the par amount of the bills applied for must accompany tenders for such bills from others, unless an express guaranty of payment by an incorporated bank or trust company accompanies the tenders.

Public announcement will be made by the Department of the Treasury of the amount and yield range of accepted bids. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. Subject to these reservations, noncompetitive tenders for each issue for $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. Cash adjustments will be made for differences between the par value of the maturing bills accepted in exchange and the issue price of the new bills. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

If a bill is purchased at issue, and is held to maturity, the amount of discount is reportable as ordinary income on the Federal income tax return of the owner for the year in which the bill matures. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, any gain in excess of the basis is treated as ordinary income.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76, 27-76, and 2-86, as applicable, Treasury's single bidder guidelines, and this notice prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars, guidelines, and tender forms may be obtained from any Federal Reserve Bank or Branch, or from the Bureau of the Public Debt.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

Text as Prepared
Embargoed for Release Upon Delivery
Expected at 10 a.m., EST

TESTIMONY OF THE HONORABLE
NICHOLAS F. BRADY
SECRETARY OF THE DEPARTMENT OF THE TREASURY
BEFORE THE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE
WEDNESDAY, FEBRUARY 22, 1989

INTRODUCTION

Mr. Chairman, Senator Garn, and Members of the Committee.

From the day when I was sworn in as Secretary of the Treasury, a top priority has been to achieve a sound, responsible response to the savings and loan crisis. President Bush is correct: No simple or painless solution to this problem exists. Only eighteen days after he was inaugurated, however, he announced the Administration's plan. In doing so, President Bush reaffirmed our commitment to fix it now, fix it right, and fix it once and for all.

Two watch words guided us as we prepared a plan to solve this problem--NEVER AGAIN.

- Never again should a federal insurance fund that protects depositors become insolvent.
- Never again should insolvent federally-insured depository institutions remain open and operate without sufficient private risk capital.
- Never again should risky activities permitted by individual states put the federal deposit insurance fund in jeopardy.
- Never again should fraud committed against financial institutions or depositors be punished as if it were a victimless white-collar crime.
- Never again should the nation's savings and loan system, which is important to our commitment to available, affordable housing, be put in jeopardy.

The Administration plan meets these standards. It serves as a blueprint for comprehensive reform and sound financing. It assures the emergence of a healthy and strong S&L industry and for this reason is pro-industry -- both for S&Ls and for the housing industry they serve. Moreover, it has the strong support of the federal regulators -- the Federal Reserve Board (Federal Reserve), the Federal Deposit Insurance Corporation (FDIC), the Federal Home Loan Bank Board (Bank Board), and the Comptroller of the Currency (OCC).

When the President announced his plan, he also called on Congress to join him -- with all possible speed -- to solve the savings and loan crisis. Today I can report to you that a key part of the administrative reform is already underway.

On February 7, the day after the President announced his plan, the Federal Savings and Loan Insurance Corporation (FSLIC), FDIC, OCC, and the Federal Reserve worked together to stabilize control of the remaining insolvent institutions and impede them from enlarging the S&L deficit. By that action we should begin to reduce the cost of funds over time -- for banks, as well as for savings and loans -- and to control the losses in the insolvent S&Ls. Moreover, our quick action will give us a head start on consummating the resolutions, which will be executed as soon as Congress provides the necessary financing.

This joint supervisory operation was designed with several purposes in mind: first, to conserve the assets of troubled savings institutions; and second, to preserve day-to-day banking services for the public until a permanent resolution of the institutions' problems can be put in place.

Our objectives are to minimize operating losses, restrict unwarranted or unsound growth, eliminate speculative activities and destructive competition in deposit rates, and to get rid of waste, fraud, and insider abuse wherever it exists.

I would like to emphasize that during this interim period, insured depositors remain fully protected, basic customer services will not change, and each institution's employees will continue to conduct the normal day-to-day operations of the institution. These institutions are open, with deposits backed by the federal government, and ready to do business with their customers.

The supervisory and resolution personnel of the FDIC and the other agencies are preparing for resolutions and are in a good position to act swiftly once the legislation is in place. This early start on the cooperative supervisory process saves us both time and money. Fast action by all parties -- the

Administration, the regulators, and the Congress -- will help reduce the industry's cost of funds by getting the insolvent institutions resolved, out of the marketplace, and out of the business of needlessly bidding up interest rates.

Given the magnitude of the problems we face, expedited and stabilizing action provides an orderly transition to the new regulatory structure we propose. We now need legislative action by the Congress to put the reform and financing plan into place to finish the job.

In short, we have proposed a blueprint for reform. We now need your help to build a solid structure for the savings and loan industry to ensure a strong foundation for housing finance in the future. The President has asked me to deliver to the bipartisan leadership of this Committee our comprehensive plan. We respectfully request that you introduce it today. In his budget message to the joint session of Congress on February 9, President Bush called on the Congress to deliver a reform package to him in 45 days. Once Congress acts, we will be ready to move to stem the hemorrhaging.

This is a tall order, but I pledge to you the full cooperation of the Administration. Cooperative and expedited action by the Congress and the Executive branch will help to reassure the millions of American savers, who rely on deposit insurance protection, that we indeed have a safe and sound financial system that will continue to meet their saving and borrowing needs in the future.

THE SAVINGS AND LOAN PROBLEM

Our plan attempts to right the wrongs of the past. Consequently, an understanding of how the current problem arose will not only place our plan in the proper context, but also explain why we have come forward with the detailed package we present to you today.

Causes of the Problem

Inflation, Interest Rates, and Regulation Q. In the middle 1960s, savings and loans began experiencing liquidity and earnings problems caused by increased inflation and the resulting high, volatile interest rates. Mainly to protect these institutions from the effects of rising interest rates and excessive competition for funds from commercial banks, Congress, in 1966, placed commercial banks, mutual savings banks and savings and loans under deposit interest rate regulation (Regulation Q).

Consumer Demands for Market Rates. In the late 1970s, when rising inflation and interest rates exceeded Regulation Q ceilings, many savers became unwilling to limit themselves to the returns allowed under these artificially low interest rate ceilings. These savers withdrew their deposits from traditional savings accounts -- a process called disintermediation -- and invested them in newly-emerging, uninsured money market mutual funds. As a result of market forces, both consumers and depository institutions pressured Congress to remove the Regulation Q ceilings, which it did in the Depository Institutions Deregulation and Monetary Control Act of 1980.

Changes in Technology. Starting in the 1970s, the development of electronic technologies made it possible for funds to be withdrawn or shifted between institutions and across geographic boundaries instantaneously. Devices such as repurchase agreements for securities and certificates of deposit, marketed aggressively through brokers and underwriters, made it possible for institutions to draw depositors from a broad geographic base. They also enable depositors to withdraw their money from those institutions very quickly, thus permitting funds to flow to the highest bidder.

Furthermore, technological innovations made possible the securitization of mortgage loans. This development has allowed thrifts and non-thrifts to originate mortgages and sell them in the broader capital markets to investors such as insurance companies and pension funds. This, in turn, has increased competition and reduced the interest rate spreads and profit margins at banks and savings and loans.

Spread Problem. The high, short-term cost of deposits and lower embedded fixed rates on mortgages produced losses and drained capital from the S&L industry during the late 1970s and early 1980s. The industry's tangible capital fell from $28 billion in 1978 to $4 billion in 1982, a reduction of 85 percent.

Broadened Powers. In 1982, responding to the interest rate problems of thrifts, Congress passed the Garn-St Germain Depository Institutions Act. This law gave the Federal Home Loan Bank Board authority to substantially broaden the powers of Federally chartered thrift institutions. Subsequently, the Bank Board relaxed controls on consumer and commercial real estate lending.

Direct Investments. In response to the reduced spreads available in mortgage lending, some states permitted state-chartered savings and loans to diversify their asset portfolios. That change pulled capital away from residential mortgage loans and into significant amounts of direct investment in real estate and equity securities not permitted to federally-chartered

institutions. State-chartered savings and loans that took advantage of these investments were still insured by the FSLIC, even though many of their investments extended beyond traditional home financing and were riskier than the activities Congress has authorized for federally-chartered institutions.

In the new regulatory environment, some institutions moved too quickly into activities for which they were unprepared. Regulators at all levels were slow to strengthen their supervision and enforcement capabilities. Diversification can be a healthy business practice, but proper supervisory practices are also required.

Inadequate Supervision Exacerbated by Deregulation. Supervisory and regulatory laxity in oversight also contributed to the current FSLIC problem. Inadequate capital requirements allowed thrifts to grow quickly with almost no "at-risk" capital. Low equity, in turn, encouraged greater risk taking. Belated authorization to issue adjustable rate mortgages prevented savings and loans from properly adjusting the maturity gap between deposits and mortgage loans. High turnover of the supervisory and examination personnel reduced the number and experience of much-needed industry watchdogs. And perhaps most disturbingly, the agency regulating the industry faced the often conflicting statutory goals of supervising, advocating, and insuring depository institutions in the name of promoting a stable housing finance market.

Imprudent Managers and Fraud. Compounding these problems has been the entry of some imprudent operators into the savings and loan industry. Managers used S&Ls and their authority to further their own business and other interests and not to foster traditional home financing.

Moreover, many of these "high fliers" used their institutions to finance lavish lifestyles and to engage in speculative and fraudulent business activities. Testimony to this effect was prepared by the Bank Board for presentation to the House Financial Institutions Subcommittee on June 9, 1987. An excellent report has been prepared by the House Government Operations Subcommittee chaired by Representative Doug Barnard.

The Justice Department continues to conduct large scale criminal investigations of financial institution fraud and embezzlement. As of September 30, 1988, 7,385 such investigations were open. Of these, 3,446 involved losses to institutions of $100,000 or more.

Attorney General Richard Thornburgh already has testified on the fraud problem confronting us. Estimates by the General Accounting Office (GAO) and others reveal that fraud may account

for more than one-third of the failures in the S&L industry that we must now finance. The Federal Home Loan Bank Board's list of "significant" fraud cases turned over to the Justice Department involve institutions with total assets of $160 billion.

Economic Downturn in the Southwest. Finally, the economic downturn and general price deflation in the agricultural, real estate, and oil and gas sectors of the economy have created serious problems in the Southwest. Even well-managed thrift institutions in the Southwest now face widespread non-accruing loans, collateralized, in many cases, with non-salable properties.

Summary. In sum, consumer demand for increasing market interest rates on deposits, combined with both technological changes as well as high and volatile interest rates, resulted in negative interest rate spreads in the late 1970s and early 1980s. This, in turn, drastically reduced the industry's aggregate capital-to-asset ratio from 5.6 percent in 1979 to 2.9 percent in 1982. Once market interest rates declined, most institutions became profitable again. They started to rebuild their capital holdings. Other institutions, however, took advantage of the expanded state-authorized asset powers, the low capital requirements, and inadequate examination and supervision. The resulting problem portfolios were characterized by excessive risk and poor asset quality due to rapid growth. The economic downturn in the Southwest quickly reduced such portfolios to collections of non-earning assets.

OBJECTIVES OF THE ADMINISTRATION'S PLAN

To ensure that the tremendous losses in the industry never happen again and to minimize the total cost of resolving the problem, the Administration plan makes structural reforms a prerequisite for the use of any taxpayer funds and provides for the necessary funding to solve the problem now. The following Administration objectives guided the development of our plan:

- Reform -- a prerequisite to additional funding;
- A flexible financing plan of sufficient capacity to repair the damage;
- Institutional arrangements that lessen the disruption in the industry and avoid creating new government bureaucracies;
- Utilizing a fair level of S&L industry sources of funds before using taxpayer funds;

- Precise and trackable accounting for all public and private funds employed in resolving the S&L problem;
- Structural reforms that are sound, but practical enough to accommodate the market-driven changes that develop in any competitive industry;
- Funding for an adequate, on-going, self-financed savings association insurance fund, so that Treasury funds will not be needed again to bolster the deposit insurance funds;
- Protecting American taxpayers by assuring full financial and regulatory accountability through Treasury oversight; and
- Finally, sufficient private capital and industry-financed insurance funds standing between financial institution failures and the taxpayers.

OUTLINE OF THE PLAN

Let me summarize the Administration's comprehensive reform proposal in the following manner: first, by delineating the major structural reforms we seek; second, by providing an overview of the other reforms we propose; and, finally, by explaining how the resolution of the remaining insolvent institutions, which we have already begun, will be financed. The President's legislative package and the section-by-section analysis to be provided later give you all of the necessary details.

Structural Reforms

One Strong, Independent Insurance Administrator. The current organization of the thrift system dates from the New Deal. As the events of the 1980s have demonstrated, this system is antiquated. Furthermore, the goals of the regulator as an industry advocate and insurer are inherently in conflict. To correct this systemic problem, the FSLIC will be separated from the Bank Board and attached administratively to the FDIC (see Chart 1). This will create a strong, independent insurer with the over-arching mission to protect depositors and to maintain the integrity of the deposit insurance fund.

The considerable administrative expertise of the two corporations will be available to manage financial, insurance, and regulatory issues. While a single agency will be created, however, separate insurance funds will be maintained for

commercial banks and for savings and loans. The separate insurance funds will not be commingled, and premiums from each industry will be used only for its own insurance fund.

The FDIC Board will be expanded from three to five members. Three members, including the Chairman, will be private citizens appointed by the President and confirmed by the Senate. The two remaining members will be the Comptroller of the Currency and the Chairman of the newly-renamed Federal Home Loan Bank System (FHLBS).

The Chairman of the FHLBS will continue to be the chartering authority for federal savings and loan associations and mutual savings banks, will supervise the Federal Home Loan Mortgage Corporation, and it will be the primary federal supervisor of savings and loans (see Chart 1). The current board will be replaced by a single chairman. The Chairman of the FHLBS will be subject to the general direction of the Secretary of the Treasury in the same manner as the Comptroller of the Currency. The new FHLBS Chairman will also be the head of the system of 12 Federal Home Loan Banks (FHLBanks), which currently make loans to member institutions and supervise and examine them as well. The chief supervisory employee of each FHLBank will report directly to the chief supervisory officer in Washington.

By separating the insurer from the chartering agency, more serious disciplinary standards designed to protect the integrity of federally-insured deposits can be maintained. In addition, by subjecting the actions of the FHLBS to oversight by the Treasury Department, the interests of the taxpayers can be more fully and consistently protected. This Treasury oversight has existed for national banks since the Administration of President Abraham Lincoln. These steps will create a system of checks and balances for savings and loans that more closely parallels that for commercial banks.

Some observers have already expressed reservations about Treasury oversight of the primary thrift supervisor in a manner that parallels our authority over national banks. Let me assure the Committee that we do not intend to micro-manage the revitalized Federal Home Loan Bank System. That concern led to our designating a chairman who would serve and function as a chief executive officer.

It is critical, however, that we exercise the proper degree of oversight. The reason is clear: Treasury funds are being used for the first time as part of the clean-up operation. Treasury oversight is essential to ensure that these problems and the strain they place on our financial system do not occur again. Treasury oversight is essential to ensure a strong and safe system for readily available home financing.

Enhanced Safety and Soundness Standards

Capital Requirements. We are experiencing the results today of an industry that collectively has not been adequately capitalized. We have learned a valuable lesson: Deposit insurance simply will not work without sufficient private capital at risk and up front.

The Administration plan will increase safety and soundness standards for savings and loan institutions by requiring these institutions to meet standards equivalent to commercial bank capital and regulatory standards within a two-year period. This is consistent with the on-going efforts of all the federal financial regulators, including the current Bank Board, to implement risk-based capital to ensure that sufficient private capital is at risk ahead of the deposit insurance fund. Again, private capital is the best assurance that the federal insurance of deposits will not be exposed to undue risk and imprudent investment behavior.

All savings and loans will be required to meet capital requirements equivalent to those for national banks by June 1, 1991. Some 1,240 savings and loans with total assets of $319 billion already meet this capital requirement, while the remaining 1,368 solvent institutions will be expected to raise the necessary capital internally or externally or by merging with stronger institutions.

The Chairman of the FHLBS will oversee and manage this transition period. When S&L capital standards become equivalent with those for banks, S&Ls could have a 50 percent break in the amount of required capital because of the treatment of home mortgage assets under the Basle capital agreement. Moreover, S&Ls will be given 10 years to amortize the goodwill on their balance sheets.

Some stockholders may suffer dilution of their holdings, but appropriately we are achieving a safer and stronger system where private capital stands ahead of the government's insurance of deposits, giving taxpayers enhanced protection. At the same time, we expect a lower cost of funds for the solvent portion of the industry once unfair competition from insolvent institutions is removed.

Incentives for New Capital. Incentives for attracting new capital will further increase the amount of private capital protecting depositors. Several barriers to the entry of traditional financial services companies will be eliminated. For example, bank holding companies will be permitted to acquire a

failed or failing savings and loan without the existing cross-marketing and tandem restrictions. After two years, bank holding companies will be able to acquire <u>any</u> savings and loan <u>without</u> these restrictions.

<u>Additional Supervisory Powers</u>. The FDIC will be given enhanced authority to set insurance standards for all savings and loans, both federal and state-chartered. It will be able to restrict risky activities that have been authorized by some states in the past. The FDIC also would have a "fast whistle" to halt unsafe and unsound practices, while still protecting insured depositors. Furthermore, all insured depository institutions within holding companies would guarantee the insurance fund against loss in the event of the failure of any insured depository institution owned by the same holding company.

<u>Putting Deposit Insurance on a Sound Financial Basis for the Future</u>

There is a fundamental requirement that the federal deposit insurance funds are put on a sound financial basis. This can be accomplished by reestablishing the basic principle of industry-financed deposit insurance funds standing between any future industry problems and the taxpayer.

The cost of the S&L solution underscores the importance of requiring all federal deposit funds to be adequately capitalized. Consistent with this mandate is the creation of a sound savings association insurance fund, not just after-the-fact financing for insolvent S&Ls. It is equally important that we shore up the commercial bank insurance fund. The FDIC insurance fund's reserve-to-insured deposit ratio has fallen to an estimated all-time low of 0.83 percent from its historical average of 1.40 percent.

We propose increasing commercial bank premiums to bring the FDIC fund back in line with its historical reserve-to-deposit ratio to protect depositors and taxpayers. Specifically, we propose a gradual rise in the deposit insurance premiums paid by commercial banks from $.08 per $100 in deposits to $.15 per $100 in deposits by 1991. Premiums would be rebated when the bank insurance fund is in excess of a 1.25 percent reserve-to-deposit ratio.

It is important to point out that this is the first statutory increase in the FDIC's deposit insurance premium since 1935. During the intervening years, the amount of deposits insured per depositor in any one institution has increased from $2,500 in 1933 to the current level of $100,000.

Let me emphasize, however, that all of the increased premium revenue paid by commercial banks will go to the FDIC insurance fund; not one penny from commercial banks will go to any S&L resolution or to the new savings association insurance fund.

Emergency special assessment authority will be granted to the FDIC. The FDIC will be permitted to raise the overall premium level when the fund is too low, as well as to lower premiums when it is fully funded. Thus, risk-based capital and experience cost-based premiums will ensure that the costs to the funds are covered. The maximum cap on the premiums paid by commercial banks or S&Ls would be 35 basis points.

The Administration's reform plan also proposes to strengthen the National Credit Union Share Insurance Fund (NCUSIF) by having it use accounting procedures comparable to those used by the FDIC and FSLIC. The NCUSIF is currently structured such that each insured credit union places and maintains one percent of its shares on deposit in the fund and treats the contribution as an asset on its balance sheet. This contrasts with the practices of both the FSLIC and the FDIC in which insured institutions treat their premium contributions as expenses. As long as credit unions consider their contributions as assets, they will resist the using of these assets to cover insurance losses.

Therefore, we recommend that credit unions be required to expense the one percent of deposits they maintain at the NCUSIF over an 8-year transition period. During this transition period, no additional premiums would be collected. At the end of 8 years, the NCUSIF would avail itself of its existing statutory authority to collect a 1/12 of one percent premium.

Enhanced Enforcement Authority

As part of the comprehensive reform package, we must ensure that fraud and financial institution crimes are pursued and punished as befitting their grave societal costs. The fraud and abuse are widespread and well-known to the American public through news accounts. Our proposal will add new enforcement authorities, increase penalties for fraud, and increase funding to provide for dramatically increased law enforcement staff and prosecutions. The scope of federal regulators' enforcement authority will be broadened to include all insiders, in addition to the managers of an institution. It will also grant regulators broader power to impose temporary cease-and-desist orders.

We have borrowed a page from the Administration's war on drugs and drug money laundering in drafting our new enforcement authority. Maximum civil penalties will be raised to $1,000,000 per day, and maximum criminal penalties to 20 years, with

mandatory minimum sentencing. Authority will also be provided for regulatory agencies to pay rewards to informants. Civil penalty authority will be given to the Justice Department for the first time. These civil penalties will be cumulative to criminal sanctions. Also, we propose to add civil and criminal seizure and forfeiture authority similar to the forfeiture authority for drug and drug money laundering.

Most importantly, approximately $50 million per year would be authorized for three years for the Justice Department to fund a new national program to search out financial institution fraud. This program will include new investigators, auditors, analysts, and prosecutors trained in specialized and sophisticated methods of financial institution fraud. Indeed, the number of personnel devoted to investigating and prosecuting bank and thrift fraud will be approximately doubled.

A Revitalized Housing Finance System

Today, as in the past, the S&L industry plays an important role in housing finance. The S&L industry's problems do not stem fundamentally from their traditional business of mortgage financing. Nonetheless, problems in the S&L industry are a threat to the viability of our housing finance system.

The Administration's plan is designed explicitly to promote housing finance by revitalizing the S&L industry and the FHLBS. The regulatory reforms outlined earlier as well as oversight by Treasury of the FHLBS help insure a financially viable S&L industry to serve housing finance. We believe the best thing for housing finance in this country is a strong and sound S&L industry.

Moreover, the plan provides for explicit representation for the housing industry on the boards of directors of the regional Federal Home Loan Banks. The objective is to ensure that the concerns of the housing industry play a direct role in the policies and practices of these government sponsored enterprises.

Finally, the plan provides funding not just to resolve insolvent S&Ls, but also includes funding to establish a new S&L insurance fund for the future. The majority of future S&L insurance premiums are allocated to this insurance fund; none pay for REFCORP interest. And Treasury funds are allocated to the insurance fund as well, giving tangible proof of our commitment to the future of the S&L industry as a provider of housing finance.

Restoring the Industry to Financial Health

During 1988, the Bank Board resolved 205 institutions and stabilized 17 others. But the factors I have outlined combined to create such a problem that there still remain a total of about 350 S&Ls insolvent according to generally accepted accounting principles, or GAAP, and an additional roughly 150 which, while GAAP solvent, have negative tangible net worth. These institutions held about $265 billion in assets and had negative net worth on the order of $18 billion as of September 1988, the latest available figures.

Let me describe in some detail the Administration plan for restoring the S&L industry to financial health. It has three components. The first $50 billion is to resolve currently insolvent institutions and any other marginally solvent institutions which may become insolvent over the next several years. Secondly, the plan ensures adequate servicing of the $40 billion in past FSLIC obligations. And third, and perhaps most important, the plan provides $33 billion in financial resources necessary to put S&L deposit insurance on a sound financial basis for the future.

At the heart of our plan is the creation of a Resolution Trust Corporation (RTC), for which the FDIC will be the primary manager directed to resolve all S&Ls which are now GAAP insolvent or become so over the next three years (see chart 2). The creation of this new corporation will serve several practical business purposes: it will allow the isolation and containment of all insolvent S&Ls during the three-year resolution process and will facilitate a full and precise accounting of all the funds that are used. The RTC will seek to complete the resolution or other disposition of all insolvent institutions and their assets over a period of five years. An Oversight Board consisting of the Secretary of the Treasury, the Chairman of the Federal Reserve Board of Governors, and the Attorney General will monitor all RTC activities to ensure the most effective use of both private and public financial resources.

To accomplish its task, the RTC will have available $50 billion in new funding, which is provided by the Administration plan. The plan also provides funds to pay for the $40 billion that already has been committed in past FSLIC resolutions. Finally, the plan will provide additional funds for handling insolvencies in the post-RTC period from 1992 to 1999, as well as to help build an insurance fund for the healthy S&Ls -- the Savings Association Insurance Fund (SAIF) -- which will be operating during this period.

Let me discuss now some specifics of the financing of the various component parts of our plan. Further details are contained in the Appendix to my testimony which includes materials provided to this Committee by the Office of Management and Budget.

To provide the $50 billion to the RTC, we will create a new, separate, privately-owned corporation, the Resolution Funding Corporation (REFCORP), which will issue $50 billion in long-term bonds to raise the needed funds. REFCORP will purchase zero-coupon, long-term Treasury securities whose maturity value will be $50 billion -- growing through compound interest -- to assure the repayment of the principal of the bonds issued by REFCORP. Funds to purchase these zero-coupon bonds will come exclusively from private sources (see Chart 2):

- o The FHLBanks will contribute about $2 billion of their retained earnings -- which are currently allocated to, but not needed by, the existing Financing Corporation (FICO) -- plus approximately 20% of their annual earnings, or $300 million, in 1989, 1990 and 1991;

- o The S&Ls will contribute a portion of their insurance premiums; and

- o If necessary, proceeds from the sale of FSLIC receivership assets will be used.

No Treasury funds or guarantees will be used to repay any REFCORP principal.

Interest payments on the REFCORP bonds will come from a combination of private and taxpayer sources:

- o The FHLBanks, beginning in 1992, will contribute $300 million a year;

- o The RTC will contribute a portion of the proceeds generated from the sale of receivership assets, and proceeds from warrants and equity participations taken in resolutions; and

- o Treasury funds will make up any shortfall.

All Treasury funds used to service REFCORP interest will be scored for budget purposes in the year expended.

Funds for the second component of our plan -- servicing the cost of the $40 billion in resolutions already completed by FSLIC -- also will come from a combination of S&L industry and taxpayer sources:

- FICO will issue bonds under its remaining authority and contribute the proceeds;

- The S&Ls will contribute a portion of their insurance premiums;

- FSLIC will contribute the proceeds realized from the sale of receivership assets taken in already completed resolutions, as well as miscellaneous income; and

- Treasury funds will be used to make up any shortfall.

The final component of the plan -- managing future S&L insolvencies and building SAIF, the new S&L insurance fund, during the post-RTC period -- is funded again from a combination of S&L industry and taxpayer sources:

- The S&Ls contribute a portion of their insurance premiums; and

- Treasury will contribute funds as needed.

These sources together provide about $3 billion per year to handle any insolvencies which occur in the 1992-99 period and in addition contribute at least $1 billion per year to building the new Savings Association Insurance Fund. Assuming that $24 billion is used for post-RTC resolutions, by 1999 the SAIF fund will still contain just under $9 billion at a minimum to support the healthy S&Ls. Overall the plan contains $33 billion in post-RTC funds from 1992 to 1999 to manage future insolvencies and contribute to building a healthy new S&L insurance fund. Found in the appendix are a chart (Chart 3) and a listing of sources and uses of funds.

Throughout the plan, all Treasury funds used are fully scored for budget purposes and increase budget outlays as expended. The level of expected outlays falls within the margin provided for in President Reagan's FY 1990 budget and should not interfere with President Bush's commitment to meet the Gramm-Rudman deficit reduction goals in future years. Over the 1989-1999 period, we estimate the net increase in the deficit to be roughly $40 billion.

The S&L industry will be a major beneficiary of restoring its own financial health. From the outset, the Administration has stated that the S&L industry must therefore contribute its fair share -- before the Federal government makes good on its pledge to protect insured depositors. As you can see, the plan requires a combination of private industry and public sources throughout. We believe that the share demanded of the industry

is indeed fair, but not so great as to jeopardize the viability of the healthy S&L industry which will emerge from the RTC resolution process. And it will indeed be a healthy industry that emerges -- one with an attractive and viable charter, with a clean insurance fund, and one prepared to provide its traditional support for home financing.

Is the capacity of the Administration's plan sufficient to resolve those S&Ls presently insolvent and those marginal institutions which will become insolvent? The answer is surely yes.

To address the immediate problem, the Bank Board has already handled about 222 institutions in 1988. Funding for the estimated cost -- about $40 billion -- is contained in our plan.

What remains to resolve in the near future is the roughly 350 institutions which are insolvent by GAAP measures and about 150 additional institutions which, while GAAP solvent, have negative tangible net worth. These 500 institutions have about $18 billion of negative net worth and about $265 billion of assets. Importantly, the problems are concentrated in a relatively few institutions -- over 80% of the negative net worth is held in the most troubled 100 institutions.

How much will it cost assuming all of this caseload of 500 institutions have to be resolved? That, of course, depends on a number of factors -- future interest rates, real estate prices and the speed with which the FDIC can get to work on the job. Under likely scenarios, we estimate the size of the immediate problem at well under the $50 billion available to the RTC to handle it. To get our estimate, we start with the $18 billion of negative tangible net worth. To that cost we add some fraction of the assets which will be lost in the process of liquidation or merger. Our present estimate of the total cost is about $40 billion. Even under less likely scenarios which would make the problem worse, it is within the $50 billion available to the RTC.

Our best estimate of the size of the current problem -- $40 billion for the resolutions completed by the Bank Board last year plus something under $50 billion for the current caseload, a total of about $90 billion -- is in line with estimates from the FDIC, GAO, Federal Reserve, and the Bank Board.

What happens if in the future even more that 350 GAAP insolvent and 150 GAAP solvent and tangible with negative tangible net worth must be resolved, as a number of commentators have suggested? Our plan already contains a substantial amount of funds to support the S&L industry during the post-RTC period,

1992-99. A total of about $24 billion will be available during this period to resolve any S&Ls which become insolvent. This amount is in addition to about $9 billion which is allocated by the plan to building a new insurance fund for the healthy S&Ls.

Should a presently implausible economic scenario occur which markedly increases the cost of the RTC resolution task -- either by increasing the cost of resolving the roughly 500 institutions with negative tangible net worth or by adding a large number of presently solvent institutions to its caseload -- some portion of the additional $24 billion capacity could be used. If they are not needed for resolutions, these funds will be available for use in further building the new S&L insurance fund.

CONCLUSION

The Administration's activity of the past few weeks should illustrate clearly our commitment to a long-lasting resolution of the S&L crisis. We have presented a structurally sound plan. We have delivered to you a balanced financing package that requires contributions from the S&L industry and also lives within the government's means. If there is one recurring theme that I hear from my G-7 finance colleagues, it is this: They -- like all investors in our capital markets -- are closely watching our commitment to budget discipline and financial responsibility. Our expedited action will enhance financial stability both now and in the future.

In conclusion, the President's comprehensive solution to the savings and loan crisis -- if enacted by Congress in a timely manner -- will provide a sound, long-term answer to the savings and loan problem. We already have made a head start. The time to act is now.

The cooperative supervisory action already being implemented by the FSLIC and the FDIC paves the way to begin case resolutions immediately once the Congress acts. We stand ready and eager to work with the Members of this Committee and others to enact this plan into law as soon as possible. Working together, we can recreate and rejuvenate the vital savings and loan industry, which has served the nation's home owners so well in the past.

I will be happy to answer any questions the Members of the Committee may have.

# # # # #

Priority of Sources of Funds

1. Commercial bank premiums:

    1) Bank Insurance Fund (Old FDIC fund)

2. Savings and Loan premiums:

    1) Interest on FICO bonds
    2) Principal for REFCORP bonds
    3) FSLIC Resolution Fund (Old FSLIC assets and liabilities)*
    4) Savings Association Insurance Fund*
    * 3 and 4 above switch to 4 and 3 in 1992

3. Old Receivership Proceeds:

    1) Principal for REFCORP
    2) Interest on FICO bonds
    3) FSLIC Resolution Fund

4. New Receivership Proceeds:

    1) Interest on REFCORP bonds

5. Warrants and Participations:

    1) Interest on REFCORP bonds

6. Miscellaneous FSLIC Income:

    1) FSLIC Resolution Fund

7. FHLBank Retained Earnings and $300 million in FHLBank Profits:

    1) Principal on FICO bonds
    2) Principal on REFCORP bonds
    3) Interest on REFCORP bonds

8. Treasury funds:

    1) Interest on REFCORP bonds
    2) FSLIC Resolution Fund
    3) Savings Association Insurance Fund (Schedule of estimated resolution costs plus $1 billion starting in 1991 until earlier of 1999 or reaching 1.25 ratio)

9. REFCORP Proceeds

    1) Resolution Trust Corporation (RTC)

Priority of Uses of Funds

1. FDIC -- Bank Insurance Fund:

    1) Commercial bank premiums

2. FDIC -- Savings Association Insurance Fund:

    1) Savings and Loan premiums
    2) Treasury funds
    3) Offices and office supplies of FSLIC Resolution Fund (upon dissolution)

3. FSLIC Resolution Fund:

    1) Miscellaneous FSLIC income
    2) Proceeds of FICO bonds
    3) Old receivership proceeds
    4) S&L premiums
    5) Treasury funds

4. FICO Principal:

    1) FHLBank Retained Earnings and $300 million in FHLBank Profits

5. FICO Interest:

    1) S&L premiums
    2) Old receivership proceeds

6. REFCORP Principal:

    1) FHLBank Retained Earnings and $300 million in FHLBank Profits
    2) S&L premiums
    3) Old receivership proceeds

7. REFCORP Interest:

    1) New receivership proceeds
    2) Warrants and Participations
    3) FHLBank Retained Earnings and Profits
    4) Treasury funds

8. Resolution Trust Corporation (RTC):

    1) REFCORP proceeds ($50 billion)

9. Treasury:

    1) FSLIC Resolution Fund proceeds upon dissolution (net of offices and office supplies)
    2) REFCORP proceeds upon dissolution

Chart 1

General Organizational Structure

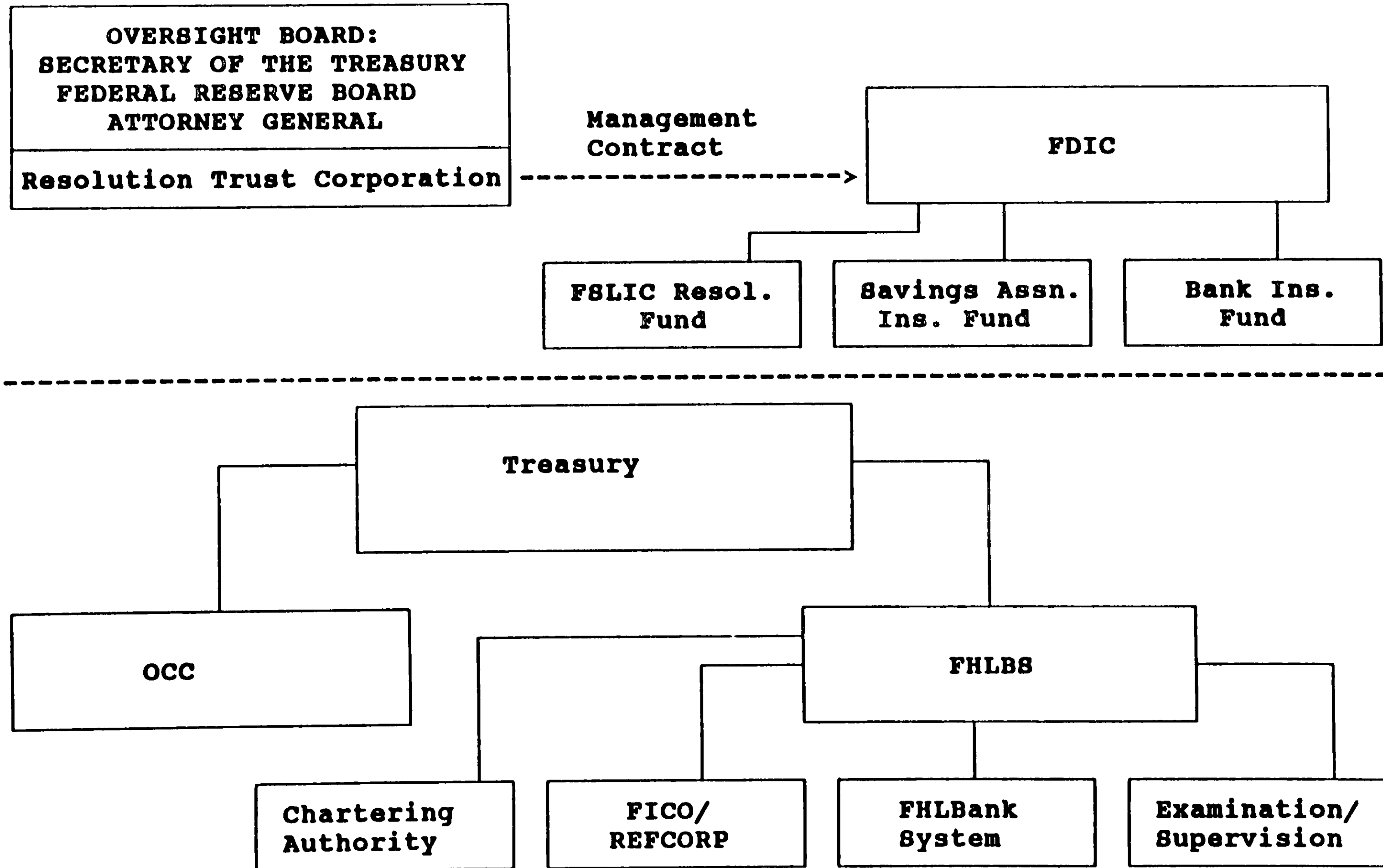
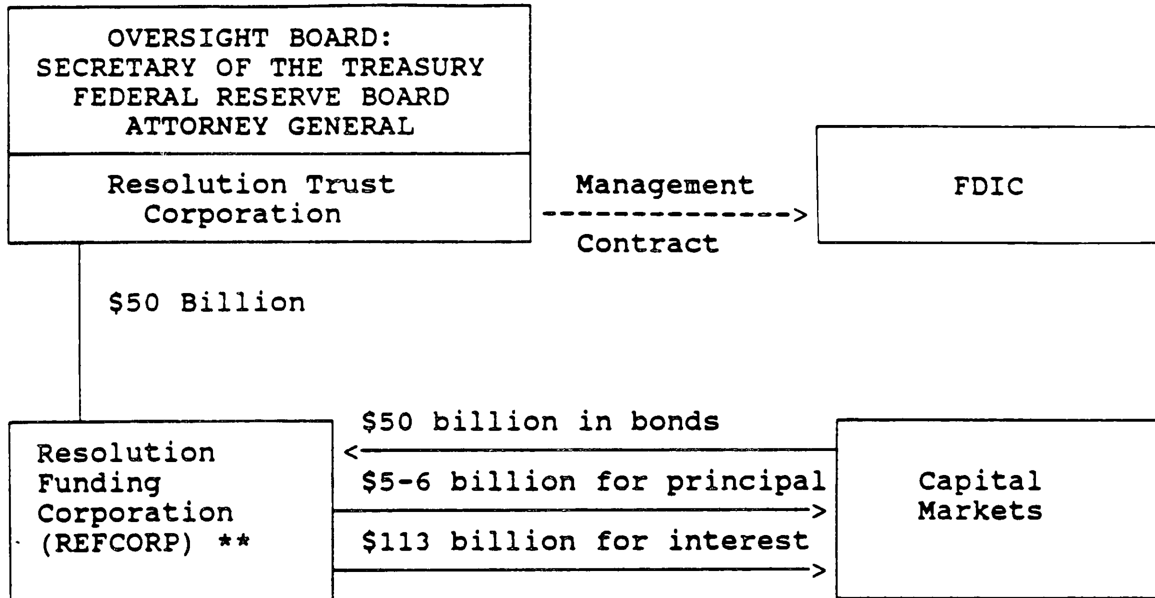


Chart 2

Insurance and Financing Structure

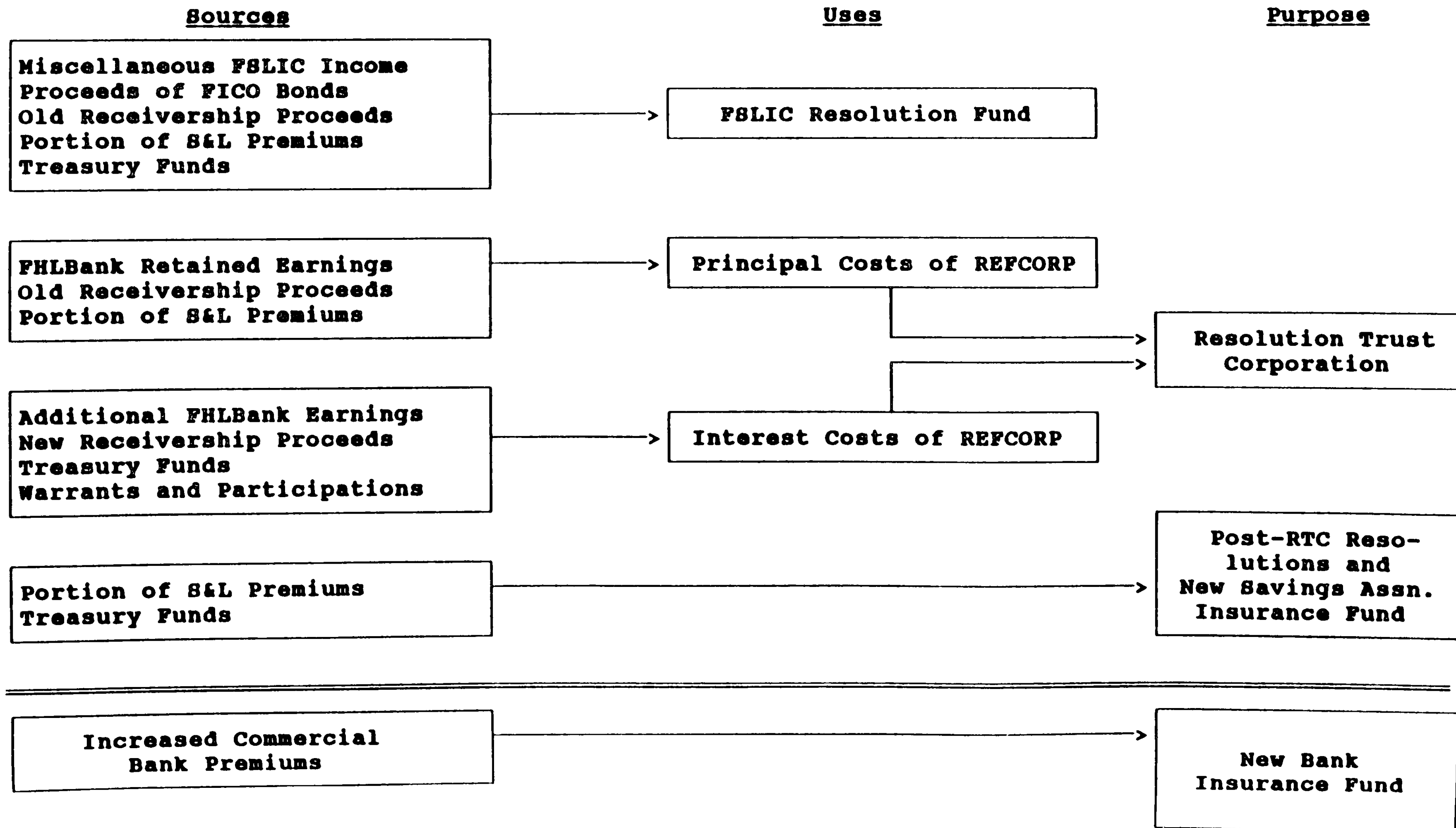


* The RTC will resolve all GAAP-insolvent S&Ls over a three-year period and will sunset after five years. NOTE: Although the RTC will contract with the FDIC, it will be subject to an Oversight Board composed of the Treasury Secretary, the Federal Reserve Chairman, and the Attorney General.

** The REFCORP will raise $50 billion in the capital markets, transfer that sum to the RTC for resolution costs for GAAP-insolvent S&Ls, and repay the principal and interest costs on the $50 billion.

Chart 3

SOURCES AND USES OF FUNDS
Resolution Trust Corporation * and
Resolution Funding Corporation (REFCORP) **



* The Resolution Trust Corporation will resolve GAAP insolvent savings and loans.

Administration Proposal: Cash Flow for Government
($ in billions)

2/15/89

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94	89-94	89-99
Cash Inflows (-):								
FSLIC/RTC collections from FICO	-3.8	-3.3					-7.1	-7.1
FSLIC/RTC collections from REFCORP	-10.0	-25.0	-15.0				-50.0	-50.0
S&L Premiums and other FSLIC Collections	-3.3	-1.5	-1.5	-3.2	-3.6	-3.5	-16.4	-31.2
Additional Collections to FDIC	0.0	-0.8	-1.6	-1.7	-1.8	-1.9	-7.9	-19.9
TOTAL CASH INFLOWS	-17.0	-30.6	-18.1	-4.9	-5.4	-5.5	-81.4	-108.2
Cash Outflows:								
Old Cases and administrative expenses -- cash	8.3	6.5	5.6	5.4	5.7	3.8	35.3	61.6
RTC cases	10.0	25.0	15.0				50.0	50.0
Post-RTC Cases			2.0	2.4	3.6	2.0	10.0	24.0
Contribution to REFCORP interest costs	0.5	1.4	1.6	0.9	0.8	1.1	6.3	22.0
TOTAL CASH OUTFLOWS	18.8	32.9	24.2	8.7	10.1	7.0	101.7	157.6
Net cash outflows	1.8	2.3	6.1	3.9	4.8	1.5	20.2	49.3
Debt transaction adjustments:								
New FSLIC debt issued	9.7	0.0	0.0	0.0	0.0	0.0	9.7	9.7
Redemption of FSLIC debt	-0.4	-0.3	-0.1	0.0	-1.1	0.0	-1.9	-19.2
NET COST TO GOVERNMENT (Budget Outlays)	11.1	1.9	6.0	3.8	3.7	1.5	28.1	39.9

FUNDING SUMMARY
($ in billions)

2/20/89

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94	89-94	89-99
FSLIC/RTC								
Disbursements	27.7	31.2	22.5	7.8	8.3	5.8	103.2	126.2
Old Cases & Other Expenses	17.7	6.2	5.5	5.4	4.7	3.8	43.2	52.2
New Cases	10.0	25.0	17.0	2.4	3.6	2.0	60.0	74.0
Collections (-)	-17.0	-29.8	-16.5	-3.2	-3.6	-3.5	-73.5	-88.3
New FICO(REFCORP) Bonds	-10.0	-25.0	-15.0				-50.0	-50.0
Old Premiums (Net)	-1.4	0.4	0.3	-1.5	-1.5	-2.0	-5.6	-19.0
Additional Premium 1/			-0.3	-0.3	-0.3	0.4	-0.4	2.1
Other Old Collections	-5.6	-5.2	-1.6	-1.4	-1.8	-1.9	-17.5	-21.4
FSLIC/RTC Net Outlays	10.7	1.4	6.0	4.6	4.7	2.3	29.7	37.9
Treasury Payments for Bond (REFCORP) Interest	0.5	1.4	1.6	0.9	0.8	1.1	6.3	22.0
Add'l FDIC Collections	0.0	-0.8	-1.6	-1.7	-1.8	-1.9	-7.9	-19.9
TOTAL BUDGET OUTLAYS	11.1	1.9	6.0	3.8	3.7	1.5	28.1	39.9

1/ A (-) indicates increase in premiums, a (+) indicates a decrease.

FEB 20 1989

02/20/89

NEW FICO (REFCORP) FINANCING
($ in billions)

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94	89-94	89-99
NEW FICO (REFCORP) 1/								
PRINCIPAL covered by zeros paid with private funds:								
FHLB Retained Earnings	0.8	1.1	0.8	0.0	0.0	0.0	2.7	2.7
S&L Insurance Premiums	0.0	1.7	1.7	0.0	0.0	0.0	3.3	3.3
TOTAL DEFEASANCE	0.8	2.8	2.5	0.0	0.0	0.0	6.0	6.0
INTEREST covered by private & public funds:								
FHLB future income	0.0	0.0	0.0	0.3	0.3	0.3	0.9	2.4
Receivership Proceeds	0.0	0.5	1.8	2.6	2.7	2.4	10.0	12.0
Treasury funds	0.5	1.4	1.6	0.9	0.8	1.1	6.3	22.0
TOTAL INTEREST	0.5	1.9	3.4	3.8	3.8	3.8	17.2	36.4

1/ Sells long-term bonds: $10B in FY 89, $25B in FY 90, $15B in FY 91.

FEB 23 1989

2/15/89

($ in billions)

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94	89-94	89-99
FSLIC & RTC ACCOUNT								
DISBURSEMENTS								
Old Cases & Other Expenses								
Admin and misc exp	0.3	0.3	0.3	0.3	0.3	0.2	1.6	2.8
Notes Issued	9.7						9.7	9.7
Interest on Notes Outstanding	1.4	1.5	1.1	0.9	0.8	0.7	6.4	9.2
Repay notes issued prior to FY 87	0.0	0.0	0.2	0.0	0.2	0.0	0.5	0.5
Assistance Payments	5.2	4.4	3.8	4.2	3.4	2.9	24.0	28.8
Liquidations	1.0						1.0	1.0
Total Old Cases and Other Exp	17.7	6.2	5.5	5.4	4.7	3.8	43.2	52.2
New Cases								
Assisted Mergers	5.0	12.5	8.5	1.2	1.8	1.0	30.0	44.0
Liquidations	5.0	12.5	8.5	1.2	1.8	1.0	30.0	30.0
Total New Cases	10.0	25.0	17.0	2.4	3.6	2.0	60.0	74.0
TOTAL DISBURSEMENTS	27.7	31.2	22.5	7.8	8.3	5.8	103.2	126.2
COLLECTIONS (-)								
FICO proceeds (CEBA) (-)	-3.8	-3.3					-7.1	-7.1
New REFCORP Proceeds (-)	-10.0	-25.0	-15.0				-50.0	-50.0
Insurance Premiums before deductions (-)	-2.1	-2.3	-2.7	-2.9	-3.1	-2.6	-15.6	-31.6
Deduct (+):								
FICO (CEBA) Interest	0.6	0.9	1.0	1.0	1.0	1.0	5.5	10.7
Sec. Reserve Credit	0.1	0.1	[illegible]	0.1	0.3	0.0	0.7	0.7
Defease New Bond Principal		1.7	1.7				3.3	3.3
Net Premium Income (-)	-1.4	0.4	0.1	-1.8	-1.7	-1.6	-6.0	-16.9
Proceeds from Receivers and Corporate-held Assets (old cases) (-)	-1.4	-1.4	-1.2	-1.0	-1.4	-1.5	-7.8	-9.7
Income on invest bal (-)	-0.1	0.0	0.0	0.0	-0.1	-0.1	-0.4	-1.1
Other Collections (-)	-0.4	-0.4	-0.4	-0.3	-0.3	-0.4	-2.1	-3.5
TOTAL COLLECTIONS	-17.0	-29.8	-16.5	-3.2	-3.6	-3.5	-73.5	-88.3
FSLIC/RTC NET OUTLAYS	10.7	1.4	6.0	4.6	4.7	2.3	29.7	37.9
Repayment of Notes Issued after FY 86	0.4	0.3	0.1	0.0	1.1	0.0	1.9	19.2
Balance of FSLIC Notes Outstanding (end-yr)	19.2	18.9	18.6	18.5	17.3	17.3	17.3	0.0
FSLIC/RTC Cash/Investment end-yr balances (9/30/88=81.9B)								
balance for cases:	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.5
balance for new fund:	0.0	0.0	0.0	1.0	2.1	3.2	3.2	8.8
SUMMARY OF ACCOUNTS AFFECTED								
FSLIC/RTC Net Outlays	10.7	1.4	6.0	4.6	4.7	2.3	29.7	37.9
Treasury Contribution to REFCORP Interest	0.5	1.4	1.6	0.9	0.8	1.1	6.3	22.0
Add'l FDIC Collections	0.0	0.8	1.6	1.7	-1.8	1.9	7.9	19.9
TOTAL BUDGET OUTLAYS	11.1	1.9	6.0	3.8	3.7	1.5	20.1	39.9

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Assumptions	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94	
FICO (CEBA) Rates	9.8%	8.6%			wtd avg (88-90):		9.5%
REFCORP Rates	9.1%	7.9%	6.5%		wtd avg (89-91):		7.7%
Int Rate on LT Treasuries	8.8%	7.6%	6.2%		wtd avg (89-91):		7.4%
Discount on zeros	8.8%	7.6%	6.2%		wtd avg (89-91):		7.4%
Int Rate on FSLIC Notes	9.5%	7.8%	6.1%	4.9%	4.3%	4.0%	
FSLIC Deposit Base							
($ in trillions)	1.0	1.1	1.2	1.2	1.3	1.4	
1989-99 Growth Rate	7.2%						
FDIC Deposit Base							
($ in trillions)	2.1	2.3	2.4	2.6	2.8	2.9	
1989-99 Growth Rate	6.9%						

Recovery on receivership assets (new cases):
40 cents on each dollar over the 4 years subsequent to liquidation

TREASURY NEWS

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FOR IMMEDIATE RELEASE
February 22, 1989

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DEPARTMENT OF THE TREASURY

CONTACT: LARRY BATDORF
(202) 566-2041

PROTOCOL TO U.S.-FRANCE INCOME TAX TREATY RATIFIED

The Treasury Department today announced that ratification procedures have been completed of the Protocol to the U.S.-France income tax treaty, which was signed on June 16, 1988 ("the Protocol"). The Protocol amends the Convention between the United States of America and the French Republic with Respect to Taxes on Income and Property of July 28, 1967, as previously amended by Protocols of October 12, 1970, November 24, 1978, and January 17, 1984.

The Protocol was ratified on December 29, 1988 and entered into force on that day. Its provisions apply:

a) with respect to taxes withheld at the source, to amounts payable on or after February 1, 1989;

b) with respect to taxes referred to in paragraph 2 of Article 13 (Branch Profits), as added by Article VIII of the Protocol, to profits realized in any taxable year ending on or after December 29, 1988;

c) with respect to subparagraphs (c), (d) and (e) of paragraph 2(a)(ii) and subparagraph (e) of paragraph 2 of Article 23 (Relief from Double Taxation), as added by Article IX of the Protocol, to income described therein derived on or after January 1, 1988; and

d) with respect to all other modifications made by the Protocol, for taxable years beginning on or after December 29, 1988.

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DEPARTMENT OF THE TREASURY

C. EUGENE STEUERLE
DEPUTY ASSISTANT SECRETARY (TAX ANALYSIS)
LEAVES TREASURY

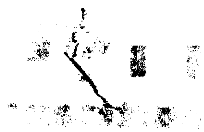
C. Eugene Steuerle, Deputy Assistant Secretary of the Treasury for Tax Analysis, has left the Treasury Department to become President of the Government Finance and Budget Institute and to write a column in conjunction with work with Tax Analysts, a non-profit organization located in Arlington, Virginia.

As Deputy Assistant Secretary for Tax Analysis, Mr. Steuerle served as the principal deputy on economic matters to the Assistant Secretary for Tax Policy. He directed the activities of the Office of Tax Analysis, which included economic analyses of tax proposals, preparation of approximately 25 mandated studies for the President and the Congress, and estimation of receipts for the U.S. Budget. He also represented the department on numerous issues related to revenue bills and proposals, as well as to tax components of catastrophic health, welfare, environmental and other bills.

Before accepting the appointment as Deputy Assistant Secretary for Tax Analysis, Mr. Steuerle was Director of Finance and Taxation Projects and a Resident Fellow at the American Enterprise Institute for Public Policy Research. During a previous Treasury tenure, he had also served as Economic Staff Coordinator for the Treasury's Project for Fundamental Tax Reform, and was the original organizer and a principal designer of the Treasury Department's 1984-86 tax reform effort.

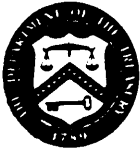
Mr. Steuerle is the author of over 50 books, articles and reports on public finance and taxation. He holds a doctorate in economics (with distinction in public finance) and two masters degrees from the University of Wisconsin. His bachelor's degree is from the University of Dayton, where he was named the outstanding graduate of the College of Arts and Sciences. He and his wife and two children reside in Alexandria, Virginia.

NB-148



Report to Congress
on the
Taxation of Income Earned by Members of Insurance or Reinsurance Syndicates

Department of the Treasury
February 1989



DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

FEB 22 1990

The Honorable Dan Rostenkowski
Chairman, Committee on Ways and Means
U. S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Enclosed is a Report to Congress on the taxation of income earned by members of insurance or reinsurance syndicates. The Report was mandated by Section 10244 of the Omnibus Budget Reconciliation Act of 1987.

As you know, the Treasury Department was requested to make the study because of Congressional concern that a 1980 closing agreement between the Internal Revenue Service and underwriters at Lloyd's, London may require revision to account for changes in the U.S. taxation of insurance income since 1980. Congress was also concerned about the possibility that the closing agreement might create an inappropriate disparity between the taxation of underwriters at Lloyd's of London and U.S. underwriters who are members of Lloyd's-type syndicates formed in the United States.

As a result of the study, we have concluded that the 1980 closing agreement with the underwriters at Lloyd's of London should be revised and we have begun discussions with their counsel on a new agreement. We will keep you informed of further developments.

Similar letters and copies of the Report are being sent to the Honorable Bill Archer, ranking minority member of your committee, the Honorable Lloyd Bentsen, Chairman, Senate Finance Committee, and the Honorable Bob Packwood, ranking minority member of the latter committee. If you have any questions about the Report, we would be pleased to answer them.

Sincerely,

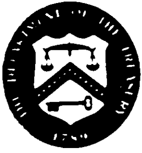
Dennis E. Ross
Acting Assistant Secretary (Tax Policy)

Enclosures

cc: Ronald A. Pearlman
Chief of Staff
The Joint Committee on Taxation

Report to Congress on the Taxation of Income Earned by Members of Insurance or Reinsurance Syndicates

Department of the Treasury
February 1989



DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

FEB 22 1989

The Honorable Lloyd Bentsen
Chairman, Senate Finance Committee
United States Senate
Washington, D.C. 20510

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Sincerely,

Dennis E. Ross
Acting Assistant Secretary (Tax Policy)

Enclosures

cc: Ronald A. Pearlman
Chief of Staff
The Joint Committee on Taxation

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REPORT TO CONGRESS

on the

TAXATION OF INCOME EARNED BY MEMBERS
OF INSURANCE OR REINSURANCE SYNDICATES

Section 10244 of the Omnibus Budget Reconciliation Act of 1987 directed the Secretary of the Treasury (or his delegate) to conduct a study of the proper federal income tax treatment of income earned by members of insurance or reinsurance syndicates. The study was requested because of Congressional concern that a closing agreement executed in 1980 between the Internal Revenue Service and underwriters at Lloyd's, London (hereafter referred to as "Lloyd's of London") may require revision to account for changes in the taxation of insurance income since 1980. Congress also wanted Treasury to consider whether U.S. underwriters who are members of Lloyd's of London and U.S. underwriters who are members of Lloyd's-type syndicates formed in the United States are similarly situated, and, if so, whether the 1980 agreement, which imposes only one level of tax on underwriters at Lloyd's of London, creates an inappropriate disparity between the two groups of U.S. underwriters. The Treasury Department agreed with Congress that the 1980 agreement should be revisited and is pleased to submit this report.

I. INTRODUCTION

Lloyd's of London is a 300-year-old insurance market, based in London, in which insurance and reinsurance is purchased for risks located around the world and in space. As described in more detail below, the more than 30,000 underwriters who are members of Lloyd's of London, participating through one or more syndicates, accept shares in insured risks and pledge all of their personal assets as security. Underwriters at Lloyd's of London have insured risks arising in the United States since at least 1892.

The Internal Revenue Service's study of the appropriate taxation of income (including both underwriting income and investment income) earned by underwriters at Lloyd's of London dates back at least to the 1930s. In 1968, the IRS and the underwriters at Lloyd's of London entered into a closing agreement that provided certain guidelines for the taxation of income earned by the underwriters from their U.S. insurance activities. The 1968 closing agreement was revised in 1980 and this second agreement remains in effect. A companion agreement signed in 1981 provides rules for taxing income that is subject to the U.S. excise tax on insurance premiums paid to foreign insurers. The current agreements, in brief, provide as follows:

-- Underwriters at Lloyd's of London are to be taxed as individuals.

-- Individual underwriters (both U.S. and foreign) are deemed to have a "permanent establishment" in the U.S., which means that the income attributable thereto (both underwriting income and investment income) is subject to income tax on a net basis. There is only one level of U.S. tax imposed.

- All U.S. source investment income earned from premiums placed in U.S.-based trust accounts is taxed annually to each underwriter; underwriting profit and losses are taxed using the so-called 3-year accounting method applied to Lloyd's of London underwriters under British law.

-- Under source rules agreed to in the closing agreement, some premiums paid in U.S. dollars (as the currency of convenience between the parties) are deemed to be for U.S. insurance (and subject to net-basis taxation under the agreement) even though the risk is not located in the U.S. and the insurance income would not otherwise be subject to U.S. tax. Conversely, a small amount of business written in currencies other than the U.S. dollar is exempted from tax, even though it involves U.S. situs risks.

-- U.S. dollar premiums paid for U.S. reinsurance placed without the use of a U.S. broker are deemed not to be earned through a U.S. permanent establishment and are subject instead to the gross-basis insurance premium excise tax imposed under section 4371 of the Internal Revenue Code of 1986. (The U.S./U.K. income tax treaty relieves British residents from the excise tax, however.) All such reinsurance premiums are placed in a U.S. trust fund, and investment income earned by the premiums is subject to U.S. taxation under a formula set forth in the closing agreement. In addition, excise tax is collected on certain reinsurance policies obtained by underwriters at Lloyd's of London for reinsurance of U.S. risks.

Prior to enactment of the Omnibus Budget Reconciliation Act of 1987, counsel for Lloyd's, U.S. (hereafter referred to as "Lloyd's (U.S.)"), a U.S.-based insurance exchange organized under Texas law and patterned after Lloyd's of London, urged the Treasury Department and Congress to revise the 1980 closing agreement with underwriters at Lloyd's of London on the ground that the 1980 agreement provided underwriters at Lloyd's of London a competitive advantage. As described more fully below, underwriters at Lloyd's (U.S.) are subject to two levels of tax on their insurance income: corporate tax treatment under subchapter L of the Code and taxation at the "shareholder" level on net profits. Both the underwriting and investment income are determined annually at the corporate level, and the net profits are deemed immediately distributed to the individual underwriter.

The underwriters at Lloyd's (U.S.) would prefer to be taxed only once, like underwriters at Lloyd's of London; as a secondary solution, Lloyd's (U.S.) urges that the 1980 closing agreement should be revised to subject underwriters at Lloyd's of London to two levels of tax, with both investment income and underwriting income determined on an annual basis (rather than using a 3-year accounting method for underwriting income). Lloyd's (U.S.) continued to press its position as this study progressed. Both before and after enactment of the 1987 legislation, Lloyd's of London has maintained that the 1980 closing agreement represents an appropriate compromise for the U.S. taxation of its underwriters and should be retained, although it has expressed throughout a willingness to consider modifying the agreement.

Both Lloyd's of London and Lloyd's (U.S.) provided substantial assistance to the Treasury Department in conducting this study. Lloyd's (U.S.) is not the only Lloyd's-type plan operating in the United States, and we invited other U.S.-based Lloyd's-type insurance plans to submit comments. No other group chose to participate.

Lloyd's of London has not challenged the current tax treatment of Lloyd's (U.S.) or changes in that treatment that Lloyd's (U.S.) has sought for itself; rather, Lloyd's of London generally has limited its submissions to an explanation and justification of the tax treatment its underwriters receive under the 1980 closing agreement. Nonetheless, it is important to note that Lloyd's of London and Lloyd's (U.S.) agree on very little regarding each other's operations, except in one respect. Each group asserts that its underwriters should be subject to one -- and only one -- level of tax on their insurance income; they both assert that, since insurance is a risk business, this tax should be computed on the basis of accounting principles that permit the establishment of reasonable reserves. Beyond this common goal, the differences between them on issues of both fact and law are marked. For instance, they disagree as to:

-- Whether the structure and operation of Lloyd's (U.S.) and those of Lloyd's of London are so different as to warrant the imposition of different tax regimes.

  - Lloyd's (U.S.) contends that its structure and operations are substantially indistinguishable from those of Lloyd's of London. Lloyd's of London responds that its operation and structure differ substantially from that of Lloyd's (U.S.), and these differences explain any differences in taxation.

-- Whether nonresident alien underwriters at Lloyd's of London conduct insurance operations through a permanent establishment in the U.S., absent the application of the closing agreement, and the extent to which underwriting

profit or loss and investment income is attributable to such a permanent establishment.

- Lloyd's of London asserts that, with possible minor exceptions, it does not conduct its U.S. insurance operations through a permanent establishment. Lloyd's (U.S.) asserts that Lloyd's of London clearly has a permanent establishment in the United States to which most, and possibly all, of its U.S. income is attributable.

-- Whether the Lloyd's of London accounting method results in a competitive advantage.

- Lloyd's (U.S.) argues that the 3-year accounting method for underwriting profits and losses used by underwriters at Lloyd's of London provides those underwriters a substantial competitive advantage. Lloyd's of London responds that the 3-year method usually operates to defer underwriting losses, so that tax collections are accelerated and its underwriters are often disadvantaged economically by this method of accounting; Lloyd's of London adheres to the 3-year method because it must use that method for U.K. regulatory and tax purposes and because it believes that method more clearly reflects income.

-- Whether current law is consistent with imposing a single level of tax on the underwriters at Lloyd's of London.

- Lloyd's of London asserts that its underwriters do business as individuals, lack corporate characteristics, and do not utilize subchapter L of the Code, and thus should not be subject to two levels of tax. Lloyd's (U.S.) agrees that, as a conceptual matter, individuals engaged in the insurance business should be subject to only one level of tax; but, it argues that under current law as applied by the IRS even an individual is effectively subject to two levels of tax on income earned through an insurance operation.

In this study, we have not sought to reconcile each of the differences of opinion on factual and legal issues between Lloyd's of London and Lloyd's (U.S.). Nor have we attempted to determine with finality the appropriate taxation of underwriters at either Lloyd's of London or Lloyd's (U.S.). To do so would require the resolution of factual questions to which the answers may change over time and which, in any event, should be left to the Internal Revenue Service to resolve on audit. Rather, we have tried to examine -- in light of the factual patterns presented by the operations of Lloyd's of London and Lloyd's (U.S.) -- the question posed by Congress: under current law,

what is the appropriate U.S. tax treatment of members of insurance (or reinsurance) syndicates such as underwriters at Lloyd's of London who insure U.S. risks?

In examining this question, we have considered three major issues:

1. What is the appropriate taxable entity for a Lloyd's-type insurance group: (a) the individuals who accept the risks; (b) the syndicates through which specific risks are insured or accounted for; or (c) the umbrella group that provides the marketplace (such as the entire membership of Lloyd's of London or Lloyd's (U.S.))?

2. What are the tax accounting rules that should apply to participants in a Lloyd's-type program?

3. Absent a closing agreement, would the underwriters at Lloyd's of London be subject to U.S. net-basis taxation? Do the underwriters have a permanent establishment in the United States? If so, what are the tax consequences? If not, what are the tax consequences? What is the significance of tax treaties between the United States and some of the countries in which underwriters at Lloyd's of London are residents?

SUMMARY

The CONCLUSIONS to this report (see page 58) provide a brief summary of findings.

II. OPERATION OF LLOYD'S OF LONDON

A. History and Development

Lloyd's of London is an insurance marketplace in which more than 30,000 individual underwriters carry on the business of underwriting insurance. It is not an insurance company. It traces its roots to 1688 when Edward Lloyd's coffeehouse in London became a center for marine underwriters and shipowners wishing to insure their vessels and cargoes. Because it often was not economical for an individual underwriter to assume 100 percent of a particular risk, the practice developed whereby more than one underwriter would assume parts of a single risk. From these activities, a society of underwriters developed, known collectively as Lloyd's. Over the years, Lloyd's of London has evolved into a major insurance institution in the United Kingdom and throughout the world.

The present structure and operation of Lloyd's of London is set out in British legislation, particularly the Lloyd's Act of 1982, which requires that underwriting at Lloyd's of London be by individuals, trading each for his own account. As described more

fully below, individual underwriters who are members of Lloyd's of London select a member's agent and, through that agent, one or more managing agents who operate insurance "syndicates"; a syndicate may include hundreds of underwriters, or only a few. The managing agent for a syndicate (who may further delegate authority to one or more underwriting agents) has authority to bind each underwriting member of the syndicate to a risk; each underwriting member has unlimited liability, but only for his own account, that is, there is several, not joint, liability. An individual underwriter's percentage of the risks insured by a syndicate to which he or she belongs is fixed at the beginning of the "year of account" (which is the calendar year), according to the portion of the underwriter's premium limit that he or she allocates to the syndicate; the percentage applies to every risk insured through the syndicate during the year and generally does not change during the year. Lloyd's of London has grown in capacity by admitting additional underwriters, whose capital expand the market's total premium income limits.

After 1850, the Lloyd's of London business expanded beyond marine insurance. By 1900, Lloyd's of London had evolved into a sophisticated insurance market, and the early years of this century were marked by rapidly increasing regulation and improved procedures. In 1902, Lloyd's of London began requiring deposits or guarantees from members. In 1903, the Committee of Lloyd's began requiring each new underwriter to put a portion of his premium income and investment yield in irrevocable 3-year trusts for the payment of underwriting liabilities and to assure the protection of policyholders. About 1908, Lloyd's of London began requiring audits of all syndicate accounts by an approved independent auditor. In 1909, the British Parliament enacted the Assurance Companies Act, which required deposits of money to be set aside by insurance companies and by every individual underwriter in relation to the amount of the risks underwritten. The Lloyd's Committee obtained an exemption from the deposit requirement for any underwriter who could produce a certificate of solvency and had provided the Committee with a deposit or guarantee equal to a year's premium income. This is the origin of the "means" test for qualification as a Lloyd's underwriter and of the deposit requirement that new members must satisfy; the "means" test and deposit requirement are more fully explained below.

Underwriters at Lloyd's of London began insuring U.S. risks at least by 1892. In 1939, the Committee of Lloyd's established the Lloyd's American Trust Funds ("LATF"), maintained by Citibank as trustee, into which all dollar premiums must be paid. The assets of the trust fund currently exceed $8 billion.

Originally, Lloyd's of London syndicates tended to be small; in 1856, most of the syndicates had no more than three members with the largest having approximately six members. In 1952, sixteen syndicates had 100 members or more, and one syndicate had 300 members. Syndicates have continued to grow in number and

size; for 1988 there were 376 syndicates, some of which included more than 1,000 members. Approximately 10 percent of the more than 33,500 Lloyd's of London underwriters in 1988 were U.S. residents or citizens.

B. Lloyd's of London Today

The Corporation of Lloyd's provides facilities and services to assist underwriters in carrying on their business. This Corporation does not underwrite any insurance. It acts within limits established by a Council composed of twelve active underwriting members of Lloyd's of London, eight nonworking members of Lloyd's and eight nonmembers of Lloyd's of London approved by the Governor of the Bank of England. The 1982 Lloyd's Act empowered the Council to control the admission and discipline of members; to set the members' reserve requirements beyond the amounts in the premiums trust funds1/ (*i.e.*, the Deposit Guaranty Funds, and the Central Fund); to set the fees and deposits required; to control and provide central accounting, claims adjustment, collections, and special services; to set restrictions on and standards for brokers, managing agents, and underwriters; to check for conformity and process all policies; and to have the power of general assessment on its members. The 1982 Act does not authorize the Council to direct the day-to-day insurance business transacted at Lloyd's of London.

Each member of Lloyd's of London must select a member's agent who assists the underwriter in selecting one or more managing agents; each managing agent directs the operation of one or more syndicates. Through agency agreements, the member grants authority for underwriting activities to be conducted on his behalf. Members cannot conduct their insurance business directly. It is typical for a member to join a number of syndicates, which can vary from year to year, in order to spread his risks.

To obtain insurance at Lloyd's of London, a potential insured or his broker must contact a broker in London who is authorized by Lloyd's of London to place business at Lloyd's of London, or contact a broker outside London to whom, through an authorized London broker, certain Lloyd's of London underwriters have given written binding authority.

To be eligible to underwrite insurance at Lloyd's of London, an individual must apply and be sponsored by an existing member. The applicant must meet a "means" or net worth test to ensure that he will have sufficient assets to satisfy possible claims and to provide a basis for setting the member's premium limit.

1/ These reserves are not reserves for tax purposes, but amounts required by Lloyd's of London to be set aside as security to ensure the payment of claims.

After acceptance to membership, a member has an affirmative obligation to notify Lloyd's of London of any material change in his financial position that affects his declared means. An applicant chooses a member's agent who will help with the application process and advise the new member on the available syndicates. A new member of Lloyd's of London pays a nonrefundable entrance fee and must pay an annual subscription that is used to meet expenses of the Corporation of Lloyd's. A new member must also make certain deposits with Lloyd's of London; the amount of the deposit as well as the member's means determines the member's premium limit.

All premiums received by underwriters and all investment income earned on the premiums are required by British law to be placed initially in premiums trust funds. Funds in the trust may be used solely to pay claims and underwriting expenses. Members' agents control all reserves and premium trusts, subject to guidelines established by the Corporation of Lloyd's. Profits are released to underwriters only after the three-year period of account is concluded and reinsurance is obtained to cover all future claims. A member may deposit all or part of his profits in a Personal or Special Reserve Fund to cover ascertained losses or estimated deficiencies on his underwriting account. Such deposits are not deductible for U.S. tax purposes (although deposits to the Special Reserve Fund are deductible to a limited extent for purposes of U.K. tax).

Each member is required to contribute annually, by means of a levy on premium income, to a Central Fund. This Fund, which exists for the protection of all policyholders, is held and administered under a Trust Deed by the Corporation of Lloyd's. The purpose of the Central Fund is to meet underwriting liabilities of any member in the event that his deposits and personal assets are insufficient to meet his underwriting commitments.

Investment of premiums and investment income is made under guidelines set by the Council of Lloyd's. These guidelines, which are basically standards of prudence, require generally that investments be in government securities, "AA"-rated corporate bonds, prime commercial paper, or cash. Members' agents control the investment of these funds and authorize all releases of amounts to pay claims, expenses, reinsurance or net profits to members.

Under British law, the Lloyd's of London accounting system must use a three-year period. Each calendar year is a separate "year of account" for each syndicate; underwriting profit or loss with respect to a year of account normally is determined after the end of the third year. At that time, a syndicate's entire portfolio of insurance is reinsured to cover future claims that may be made against the reinsured syndicate's year of account. This is almost always accomplished by transferring the entire remaining underwriting portfolio to a reconstituted syndicate by

means of reinsurance, a process known as obtaining "reinsurance to close." The ceding syndicate's year of account is then closed and underwriting profit or loss is ascertained. The reinsuring syndicate -- which generally is a successor to the closing syndicate and includes many of the same underwriting members2/ -- receives reinsurance premium income, salvages, reinsurance recoveries, and late-arriving direct insurance premiums, and assumes liability for all subsequent claims and expenses.

C. **The 1968 Closing Agreement**

Prior to 1968, premiums paid to Lloyd's of London underwriters attributable to insurance policies on U.S. risks were subject to the insurance premium excise tax imposed by section 4371 of the Internal Revenue Code. Withholding tax was imposed on the U.S.-source, non-effectively connected investment income of the trust funds (i.e., the premium trust funds of the members insuring U.S. and U.S.-dollar risks) and net-basis income tax was imposed on the underwriting profits and losses from Illinois and Kentucky, the only states in which the Lloyd's of London underwriters were licensed to do business and the only U.S. business with respect to which the IRS considered the underwriters at Lloyd's of London to have permanent establishments. The members of Lloyd's of London were not otherwise subject to U.S. income tax, because all (or almost all) members before 1968 were nonresident aliens who were considered by the IRS not to be engaged in a trade or business in the U.S. through a permanent establishment, except in Illinois and Kentucky.

In 1966, negotiations began that culminated in a 1968 closing agreement between the Underwriters at Lloyd's of London and the Commissioner of the IRS. The U.S. Treasury Department and the U.K. Inland Revenue were closely involved. Under the closing agreement, the underwriters agreed to be taxed as if they conducted their U.S. situs business through a permanent establishment located in the United States, and they agreed on a set of rules to determine what income would be attributble thereto. Thus, the nonresident alien underwriters became subject to the graduated U.S. net-basis income tax on their underwriting profits and losses and on the related premiums trust fund investment income attributable to the United States permanent establishment (as defined by formula in the closing agreement). The nonresident underwriters remained liable for withholding tax on U.S.-source investment income not attributable to the permanent establishment and hence not effectively connected;

2/ Members may underwrite a different proportion of the total risks in the two years of account; in addition, members resign or die, and new members often join. The reinsurance to close has the effect of reinsuring each member's initial liability with all members of the syndicate in the earliest open succeeding year of account.

reinsurance premiums paid to the underwriters were subject to the insurance premium excise tax only if those premiums for reinsurance were placed without the intervention of a U.S. broker, because those reinsurance premiums were deemed not to be attributable to the U.S. permanent establishment.

The 1968 closing agreement resulted from ruling requests (dated November 15, 1966 and December 15, 1966) that the underwriters at Lloyd's of London made through their U.S. attorneys. These ruling requests were prompted by the 1966 Supplementary Protocol to the United States/United Kingdom Tax Convention. T.D. 5569, 1947-2 C.B. 100; T.D. 6898, 1966-2 C.B. 567. It was in part the uncertainty of Lloyd's of London as to the effect of these treaty changes that caused the underwriters to request rulings and a closing agreement. At the time of the ruling requests (and at the time the 1968 closing agreement was entered into), the vast majority of the 6,000 underwriters who conducted business at Lloyd's of London were British persons entitled to benefits under the U.S./U.K. treaty and few if any of the underwriters were U.S. citizens or residents.

The relevant portions of the U.S./U.K. Tax Convention as amended by the 1966 Supplementary Protocol that were in effect at the time of the ruling requests are as follows. Article III(1) of the Convention provided that industrial and commercial profits of an enterprise of one of the Contracting Parties would be exempt from tax by the other Party unless the enterprise was engaged in a trade or business in the territory of the other Party through a permanent establishment situated therein. If such enterprise was so engaged, tax could be imposed by such other Party on the industrial or commercial profits of the enterprise but only on so much of them as were directly or indirectly attributable to the permanent establishment.

Article VI of the Convention provided that the rate of U.S. tax on dividends beneficially owned by a U.K. resident which were derived by such resident from a U.S. corporation would not exceed 15 percent of the gross amount of the dividends unless the individual receiving the dividends had a permanent establishment in the U.S. and the holding giving rise to the dividends was effectively connected with such permanent establishment.

Article VII of the Convention provided that interest derived and benefically owned by a U.K. resident would be exempt from tax by the U.S. unless the recipient of the interest had a permanent establishment in the U.S. and the indebtedness giving rise to the interest was effectively connected with the permanent establishment.

During its consideration of the Lloyd's of London ruling requests, the IRS concluded that, rather than imposing the excise tax on the premiums paid to underwriters at Lloyd's of London, it was preferable to view all of the Lloyd's of London members who underwrite insurance placed in the Lloyd's market through U.S.

brokers as being engaged in the conduct of a trade or business in the U.S. and as having U.S. permanent establishments. It was noted at the time that choosing one approach over the other would not substantially affect tax revenues. During the period from 1955 through 1965, excise taxes of approximately $66.2 million were imposed on premiums paid to Lloyd's of London underwriters; income tax on Illinois and Kentucky underwriting profits and the investment income of the New York trust fund during this period totaled approximately $18.6 million, for a total tax burden of approximately $84.8 million. It was estimated that if the underwriters had been subject to net-basis federal income tax, their tax liability would have been approximately $82.6 million.

D. The 1980 Closing Agreement

The 1968 closing agreement was renegotiated in 1980. One reason for the renegotiation was the uncertainty caused by the enactment of section 861(a)(7) of the Code by the Tax Reform Act of 1976, P.L. 94-455, § 1036(a). Section 861(a)(7) provides that "[a]mounts received as underwriting income (as defined in section 832(b)(3)) derived from the insurance of United States risks (as defined in section 953(a))" shall be treated as income from sources within the U.S. Other changes also had occurred since 1968 that spurred interest in renegotiation, including proposed amendment of the U.S./U.K. tax treaty to exclude certain insurance premiums from liability for the insurance premium excise tax, uncertainty about treatment under the 1968 agreement of reinsurance to close, and the addition of U.S. residents and citizens as members of Lloyd's of London. (As noted above, in 1968 there were few if any U.S. residents or citizens who were members of Lloyd's of London and there was some question whether the 1968 agreement applied to U.S. residents or citizens.)

The 1980 closing agreement is summarized in the Introduction. It applies to all Lloyd's of London underwriters, including U.S. citizens or residents. In the agreement, it was agreed that the underwriters at Lloyd's of London are taxable as individuals and, for purposes of U.S. income and excise taxes, that neither the members nor their premiums trust funds constitute "insurance companies" for purposes of subchapter L of the Internal Revenue Code. The underwriters and the IRS agreed that the underwriters' U.S.-source underwriting profit or loss (as defined in the closing agreement) and related investment income (as determined under the closing agreement) would be taxed as if it were attributable to a U.S. permanent establishment. The 1980 closing agreement accepts, for determining underwriting profit or loss, the three-year accounting method required of Lloyd's of London members for U.K. regulatory and tax purposes: underwriting profit or loss is determined after the end of the three-year period of account. Investment income in the premiums trust funds continued to be taxed annually. In determining underwriting profit or loss, a reasonable deduction for reinsurance premiums to close out a year of account is expressly allowed to the underwriters on the ceding syndicate and the closing reinsurance premiums are

includible as income in the computation of profit by the underwriters on the assuming syndicate. The closing agreement may be terminated with six months' notice.

The 1980 closing agreement was reexamined by the IRS, in consultation with Lloyd's of London, in 1984-85; a decision was made not to reopen the agreement at that time.

III. OPERATION OF LLOYD'S (U.S.)

A. General

Lloyd's (U.S.), like its U.K. counterpart, is an insurance marketplace that brings together individual underwriters who agree to insure specific portions of a stated risk. It was organized in 1983 under the laws of Texas, pursuant to a Texas statute authorizing "Lloyd's-plan" insurance arrangements. (A substantial number of the Lloyd's-plan insurance groups in the United States are located in Texas, where certain pricing rules that apply to insurance companies do not, under Texas law, apply to Lloyd's plans.) Lloyd's (U.S.) differs from virtually every other Lloyd's-plan insurer in Texas or elsewhere in the United States in that it is not owned or controlled by a stock or mutual insurance company. Its underwriting members, who currently number approximately 30, are all individuals. The annual premium volume for underwriters at Lloyd's (U.S.) is currently about $15 million.

Underwriters at Lloyd's (U.S.) must sign Articles of Agreement, which are drafted to bring the plan within the scope of the applicable Texas statute. The underwriters share a common attorney-in-fact, known as Lloyd's, U.S. Corporation, which provides central services for all underwriters, including bookkeeping and issuing policies. The attorney-in-fact does not subscribe to a portion of any risk and is compensated solely by service fees.

Members of Lloyd's (U.S.), unlike underwriters at Lloyd's of London, do not operate through formal syndicates. When a risk is presented by a broker, each member underwriter assesses the risk either directly or through his appointed agent and determines how much, if any, of the risk he is willing to assume. Some underwriters assess risks themselves; others have designated one or more agents to make underwriting decisions. Informal syndicates may arise, because a group of underwriters may designate a single agent to assess risks or may tend to take similar positions for specific kinds of risks. But it is also possible for a single risk to be insured by a group of underwriters that do not subscribe to any other risk together.

When an underwriter agrees to assume a portion of a risk, the attorney-in-fact issues the policy in the name of Lloyd's (U.S.) and invoices, collects and holds the entire premium in trust. If

one or more members desire to reinsure part of a particular risk, they may do so provided the reinsurance meets the requirements of state legislation. The cost of such reinsurance is not paid from the initial premium, which remains in trust.

In practice, each member of Lloyd's (U.S.) makes individual and disparate underwriting decisions, either personally or through his agent(s). For example, there are two members who specialize in certain types of property and liability insurance and who regularly assume risks which the other members do not. Conversely, there are certain risks presented to the underwriters that tend to be underwritten by a majority of the members of Lloyd's (U.S.), albeit in different amounts.

Texas law provides that an underwriter in a Lloyd's plan, by making certain deposits, can obtain limited liability for his insurance business. Lloyd's (U.S.) states that its underwriters presently do not secure limited liability under this law, because the deposit requirements are considered too onerous; thus, the underwriters presently each have unlimited personal liability. Lloyd's (U.S.) submitted a letter from Texas counsel supporting its statement. Lloyd's of London submitted letters from Texas counsel opining that underwriters at Lloyd's (U.S.) do indeed have limited liability. We have not attempted to resolve this legal matter.

B. Deposits and Premiums

In order to become an underwriter at Lloyd's (U.S.), an individual must post with the attorney-in-fact 100 percent of his "underwriting position" in liquid assets, such as cash, publicly traded stocks and bonds. The "underwriting position" determines the underwriter's capacity. The underwriter's capacity generally is limited to risks for which the premiums do not exceed three times the amount of the deposit. The attorney-in-fact is the custodian of the deposited funds and the deposited funds of all member underwriters are available as security to guarantee payment of policy claims of any underwriter in the event the underwriter's account (consisting of premiums received and investment income) is insufficient to pay claims. (If the security deposits of other members are used to pay policyholder claims against a member, the other members may later seek indemnification.)

Once an individual is admitted as an underwriter at Lloyd's (U.S.), the individual must adhere to the restrictions applicable to all members, such as the ratio of premiums written to his deposited funds and the percentage of capital that may be committed to a single risk.

In accordance with Texas law, the attorney-in-fact determines annually the necessary reserves (in accordance with state regulations generally applicable to all insurers) for claims made and for incurred but not reported losses. The net of earned

premiums less loss reserves is deemed to be each member's net underwriting profit. For insurance purposes, this amount is deemed to be surplus against which the member may write new business. If the amount is not withdrawn, this additional deemed surplus will permit the underwriter to write additional business. Investment income derived from each underwriter's deposited funds belongs to the individual; the underwriter is taxed on this amount annually and may withdraw the income or leave it on deposit to increase his premium writing capacity.

Under current law, each member of Lloyd's (U.S.) is deemed to be an insurance company taxable under subchapter L of the Internal Revenue Code. The member's taxable income is computed annually, using the accounting principles applicable to all insurance companies, including deductions for reserves. The net income is subject to a corporate-level tax, and then, because it is deemed distributed immediately to the individual, the distributable profits are subject to individual taxation.

IV. QUESTION ONE: WHAT IS THE APPROPRIATE TAXABLE ENTITY?

A. Background

The starting point in evaluating the proper taxation of income from the insurance activities of either underwriters at Lloyd's of London or those participating in Lloyd's-type plans is to determine the individual or organization that is properly treated as earning the income, or bearing the loss, from such insurance transactions. This determination is made difficult by the fact that both Lloyd's of London and Lloyd's (U.S.) consist of several separate levels of persons, organizations, or arrangements. Although significant differences exist between Lloyd's of London and Lloyd's (U.S.), in each case, the following five levels can be identified: (1) the individuals 3/ who bear the ultimate economic risk (limited or unlimited) with respect to some portion of the insurance underwritten through the plans (the "members"); (2) the trust funds or accounts maintained with respect to each member that receive, hold, and invest premium and investment receipts; (3) the groups of members who, by sharing a common agent or other arrangement, underwrite insurance risks in a coordinated manner for some period of time (the "syndicates"); (4) the group of all members (the "Membership"); and (5) the incorporated entity that provides services in connection with the underwriting of insurance.

3/ Although Texas law permits individuals, partnerships, or unincorporated associations of individuals to be underwriters in a Lloyd's plan, we understand that all members of Lloyd's (U.S.) are individuals.

Each of these five levels of individuals, organizations, or arrangements could conceivably be regarded, in the case of either Lloyd's of London or Lloyd's (U.S.), as the person or persons appropriately taxed on the income from insurance activities. The determination of who is the proper taxpayer requires resolution of the following three interrelated questions. (Because of differences between the operation of Lloyd's of London and of Lloyd's (U.S.), such determination must be made independently for each group, and the analysis will not necessarily be the same.) First, which of the different levels of individuals, organizations, or arrangements that comprise a Lloyd's-type plan should be given effect (i.e., treated as a potential taxpayer) for federal income tax purposes? Second, which of those persons that are given effect for tax purposes are actually engaged in the activity of underwriting insurance? Third, are such persons properly classified as individuals, partnerships, trusts, or corporations for federal income tax purposes?

Resolution of these questions is difficult, particularly in the case of Lloyd's of London. With respect to each question, difficult conceptual issues are raised and there is little guidance directly on point. As a result, while we express our view as to how these questions would be resolved in the absence of a closing agreement, we caution that this resolution is uncertain. Bearing this caution in mind, we will proceed by analyzing separately each of the different levels of individuals, organizations, or arrangements that comprise Lloyd's of London and Lloyd's (U.S.).

B. Lloyd's of London

1. Corporation of Lloyd's. The Corporation of Lloyd's (the "U.K. Corporation") is a nonprofit, nonstock corporate entity financed by annual subscriptions from the members of Lloyd's of London. It provides premises, administrative staff, and services that enable insurance business to be transacted in London at Lloyd's of London. In addition, the U.K. Corporation implements the rules and regulations established by the Council of Lloyd's. It underwrites no insurance (and is not empowered to do so under British law) and it conducts no business operations in the United States. For U.K. tax purposes, the U.K. Corporation is not taxed on subscription income and may not deduct expenditures made with respect to the insurance market.

In the case of the U.K. Corporation, answers to the first and third questions raised above are easily answered. The U.K. Corporation is an organization that should be given effect for federal income tax purposes, and it would properly be classified as an association taxable as a corporation if it were a taxable entity in the United States. The more important question, however, is whether the U.K. Corporation is engaged in the activity of underwriting insurance, and therefore is the entity

properly taxed on the income or loss from the insurance activities of Lloyd's of London.

Several factors may be viewed as supporting the proposition that the U.K. Corporation is engaged in an insurance underwriting activity. First, the U.K. Corporation implements the rules and framework required under British law for undertaking the insurance underwriting activities of Lloyd's of London. Second, through its centralized services, it arguably plays a significant role in the insurance transactions. Third, the Central Fund, which it administers, stands as security for the payment of claims on insurance underwritten at Lloyd's of London, and the U.K. Corporation is empowered (but not obligated) to pledge its substantial assets as additional security for the payment of claims.

We do not believe that these facts support a conclusion that the U.K. Corporation is engaged in an insurance underwriting activity or that it bears the benefits or burdens associated with such activity. Although the U.K. Corporation performs significant regulatory and administrative services, it performs them in the capacity of an agent acting on behalf of other persons, rather than as a principal. Although the Central Fund (and, at least potentially, its own assets) is ultimately available to pay claims of policyholders, this occurs only in unusual circumstances and the Central Fund becomes subrogated to the claims of the policyholders against the defaulting member or members. Thus, it appears that the U.K. Corporation has only an indirect risk of loss with respect to the insurance underwritten at Lloyd's of London. Moreover, the U.K. Corporation has no direct interest in the profits from such insurance. The absence of any interest in the potential profits, or any substantial risk of loss, from the insurance underwritten at Lloyd's of London is convincing evidence that the U.K. Corporation is not appropriately taxed on this income.

2. Lloyd's of London Membership. The members of Lloyd's of London form a membership organization, the Society of Lloyd's (the "U.K. Membership"). Under U.K. law, the U.K. Membership is not a corporation, partnership, or other juridical entity. Nonetheless, the U.K. Membership is an identifiable organization, with well-established operating rules and bylaws. The central question regarding the U.K. Membership is whether this organization should be given effect for tax purposes.

The factors that were cited as supporting the proposition that the U.K. Corporation should be taxed on the insurance activities of Lloyd's of London also support (with somewhat greater force) the proposition that the U.K. Membership should be treated as a taxpayer subject to tax on this income. The U.K. Membership, through the Council of Lloyd's, exercises overall responsibility for and control over the affairs of the Lloyd's market, including the regulation of the business of insurance at Lloyd's, the election of new members, and the approval of those

wishing to act as agents or Lloyd's brokers. Moreover, the U.K. Membership has established the Central Fund, administered by the U.K. Corporation, which exists for the purpose of meeting the underwriting obligations of members who fail to meet their own policy obligations. Although the Central Fund becomes subrogated to the claims of the policyholders against the defaulting member or members upon payment of a claim, the Central Fund has in some instances paid claims and not obtained reimbursement from a defaulting member. In these instances, the Central Fund can be viewed as having effected a sharing of the losses among all of the members of Lloyd's of London.

Although some underwriting losses are shared among members through the operation of the Central Fund, representatives of Lloyd's of London have provided materials indicating that this occurs rarely. The materials indicate further that the Central Fund generally has failed to obtain reimbursement only in those cases in which the member has exhausted all his personal assets (or all except those he is permitted to retain for humanitarian reasons). The materials include specific examples of cases in which substantially all personal assets of members have been seized by the Central Fund.4/ It thus appears that any sharing of losses among members occurs not as a result of local law but rather as a result of a defaulted obligation.

Apart from the quite limited sharing of loss resulting from the operation of the Central Fund, there is no sharing of profits or losses among the U.K. Membership as a whole. As discussed more fully in the following section, one of the identifying characteristics of a partnership is a contemplated sharing of profits by two or more persons. This requirement distinguishes a partnership from an arrangement merely to share expenses. See Reg. sec. 301.7701-3(a). Similarly, the existence of associates and an objective to carry on business for joint profit are essential characteristics of an association. See Reg. sec. 301.7701-2(a)(2). We believe that the absence of an objective to carry on business for the joint profit of the U.K. Membership as a whole makes it inappropriate to treat the U.K. Membership as an

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4/ Although we have no reason to question this information, we note that we have not attempted independently to verify information provided by interested parties to us, and representatives of Lloyd's (U.S.) have expressed doubt regarding the practice of the Central Fund to recover losses from the personal assets of members.

entity taxable on the insurance underwritten at Lloyd's of London.5/

3. Syndicates. Unlike the U.K. Membership, smaller groups of members who underwrite insurance risks in a coordinated manner for some period of time through a syndicate do share severally, although not jointly, in the profits and losses of the insurance underwritten at Lloyd's of London. There appears to be a strong argument that the syndicates, although not juridical entities under U.K. law, are organizations that should be given effect for federal income tax purposes. If this is the answer to the first of the three questions listed at the outset of this section, we believe it is clear that the answers to the second and third questions would be that the syndicates are engaged in the activity of underwriting insurance and that, under the general entity classification rules, they should be classified as partnerships. If syndicates are treated as partnerships under the general classification rules, it is unclear whether the syndicates should be treated as "insurance companies" within the meaning of section 7701(a)(3), and hence taxed as corporations.

Determining the tax status of a syndicate presents the issue of whether a syndicate is a partnership or merely a cluster of agent-principal relationships. One treatise states that "the boundary between partnerships and arrangements lacking sufficient 'jointness' to be classified as partnerships is a shifting no-man's land." McKee, Nelson, Whitmire, Federal Taxation of Partnerships and Partners, 3-6 (1977).

Syndicates are not, under U.K. law, partnerships or other juridical entities. This is not, however, required for classification as a partnership for federal income tax purposes. See, e.g., Hect v. Malley, 265 U.S. 144 (1924). Rather, the definition of a partnership is very broad. Reg. sec. 301.7701-3(a) provides that "the term 'partnership' includes a syndicate, group, pool, joint venture, or other unincorporated

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5/ There is some authority supporting the proposition that an organization the owners of which have separate interests in different activities conducted by the organization may be treated as a single taxable entity. See Union Trusteed Funds v. Commissioner, 8 T.C. 1133 (1947); Maxwell Hardware Co. v. Commissioner, 343 F.2d 713 (9th Cir. 1965). We do not believe this authority should apply in this context. Whatever reluctance existed in the Union Trusteed case to subdivide a single state law corporate entity should not exist in the case of an unincorporated, non-juridical organization such as the U.K. Membership. In addition, attempting to treat the U.K. Membership as a single taxable entity would produce the inappropriate tax result of shifting of tax benefits and detriments among the members. Similar concerns led to the overturning of the Union Trusteed case through enactment of section 851(h) of the Code.

organization through or by means of which any business, financial operation, or venture is carried on, and which is not a corporation or a trust or estate . . . ."

Three requirements for classification of an arrangement as a partnership have been identified. First, the arrangement must be formed for the purpose of producing profits. The syndicates have a profit motive and thus satisfy this requirement. Second, the arrangement must contemplate the sharing of profits by two or more persons. This requirement distinguishes a partnership from an arrangement "merely to share expenses." See Reg. sec. 1.761-1(a); Reg. sec. 301.7701-3(a). Unlike the U.K. Membership, it appears that the syndicates meet this requirement since the syndicates contemplate the earning and sharing of a single profit. With respect to the sharing of profits, as opposed to losses, we do not believe there is any meaningful distinction between sharing severally and sharing jointly. The third requirement is that two or more of the persons sharing the profits must do so as proprietors. This requirement distinguishes a partnership from other investment arrangements, such as the co-ownership of property, in which the participants have retained the right to make separate decisions with respect to the property. Although the answer is not clear, we believe this requirement is satisfied by the syndicates.

Several factors that have been regarded as relevant in distinguishing a partnership from other arrangements for the division of profits are the following: (1) whether the parties intend to be treated as, or represent to others that they are, partners or joint venturers; (2) whether the parties divide the net income generated by the activity; (3) whether the parties have an obligation to share losses; (4) the extent of the parties' control over income and capital and the right of each to make withdrawals; (5) whether business is conducted in the joint names of the parties; (6) whether separate books of account are maintained for the activity; and (7) whether the parties exercise mutual control over and assume mutual responsibilities for the activity. See, e.g., Luna v. Commissioner, 42 T.C. 1067 (1964).

In the case of the syndicates, there are some indications of an absence of partnership status. First, it appears that the members do not intend to be treated as partners or joint venturers. Section 8(2) of the 1982 Lloyd's Act mandates that each member underwrite insurance for his own account and not for another. Materials provided to prospective members state that "A member (Name) underwrites for his own account on a syndicate: he is not in partnership and does not have any joint liability with any other members underwriting on that syndicate." Second, it is arguable the members do not assume mutual responsibility for the underwriting activity. This factor is somewhat in doubt, however, because of the contribution by all members to the Central Fund and the assurance to policyholders that all valid claims have in the past been and in the future will be paid,

regardless of the solvency of any particular member.6/ Third, the members have several, rather than joint, liability for losses and expenses.

It is this third factor of unlimited several liability that is relied upon by Lloyd's of London as conclusive support for the proposition that the syndicates should not be recognized for federal income tax purposes. The courts have in several cases characterized arrangements in which the participants had several rather than joint liability as mere co-ownership arrangements. In these cases, however, both the holdings and the basis for the holdings are unclear.

C. A. Everts, et al., Jamison Lease Syndicate v. Commissioner, 38 B.T.A. 1039 (1938), and T. A. Johnston, Trustee, Victory Lease v. Commissioner, 38 B.T.A. 1199 (1938), addressed the classification of fractional undivided interests in oil and gas leases. In holding that the interests were co-ownership interests in the leases, rather than associations taxable as corporations, the courts cited the fact that the leaseholders had unlimited proportionate liability. On the other hand, the courts also noted as significant the fact that the leaseholders, as a group, had no form of organization. Moreover, the courts did not address the issue of whether the interests might be classified as partnerships. Similarly, in Commissioner v. Gerstle, 95 F. 2d 587 (9th Cir. 1938), the court held that several real estate syndicates, the members of which had unlimited proportionate personal liability for losses, represented co-ownership arrangements (although the court also referred to them as joint ventures).

Nonetheless, the courts have not viewed any one factor distinguishing partnerships from other arrangements as conclusive. For example, in Luna, the court stated that a number of factors "none of which is conclusive, bear on the issue." 42 T.C. at 1077. Moreover, courts have held that a partnership can exist even where there is no risk of loss shared by a particular partner. For example, in Wheeler v. Commissioner, 37 T.C.M. 883 (1978), a "service partner" and a "money partner" joined together to develop real property; losses were allocated entirely to the "money partner" until operation of the venture resulted in a cumulative profit.

6/ The relevance of the Central Fund in determining whether members in a particular syndicate are joint venturers may be questioned in light of the fact that all members, not just those in a particular syndicate, contribute to the Central Fund. We believe, however, that in evaluating the status of a syndicate the actions of the Membership as a whole are relevant, notwithstanding that each syndicate is only a subset of the larger U.K. Membership.

The absence of an intention to be treated as joint venturers, the absence of an assumption of substantial mutual responsibilities, and the existence of unlimited several liability of members are significant factors weighing against classification of the syndicates as partnerships. Balanced against these factors, however, are other factors indicative of partnership classification. The strongest of these is the fact that the members have joined in an organization with a well established set of rules and regulations. (As indicated earlier, we believe it is proper to view this as mutual action by members of syndicates notwithstanding that each syndicate is only a subset of the larger U.K. Membership.) Second, each syndicate exists for a significant period of time (one year in which it assumes direct risks and two additional years in which it pays claims and assumes and purchases reinsurance) and actively engages in a substantial number of separate insurance transactions. Third, each member of a syndicate is entitled to his proportionate share of the aggregate net income. As indicated earlier, we see no meaningful distinction between sharing profits severally and sharing profits jointly. Fourth, the activities of the syndicate are conducted in the name of the syndicate rather than in the names of the individual members. (It should be noted, however, that each policy states that it is written by the members of the syndicate "each for his own part and not one for another," and litigation on claims proceeds against the members individually in the name of a representative.) Finally, the ability of members to withdraw their capital (e.g., their required minimum deposits) is controlled by the rules and regulations of the Council of Lloyd's. On the whole, we believe that the factors indicative of partnership status outweigh the factors indicative of the absence of partnership status.

Section 761 and the regulations thereunder permit certain unincorporated organizations, at the election of all of the members of the organization and provided that the income of the members may be adequately determined, to be excluded from the application of all or part of subchapter K of the Code. This election applies only if the organization is availed of (1) for investment purposes only and not for the active conduct of a business, (2) for the joint production, extraction, or use of property, but not for the purpose of selling services or property produced or extracted, or (3) by dealers in securities for a short period for the purpose of underwriting, selling, or distributing a particular issue of securities. None of these potential exceptions would be applicable to a syndicate.

If each syndicate is a partnership for federal income tax purposes, the further issue is presented whether the syndicate is an "insurance company" within the meaning of section 7701(a)(3)

of the Code. Section 7701(a)(3) defines the term "corporation" to include "associations, joint-stock companies, and insurance companies."7/ Rev. Rul. 83-132, 1983-2 C.B. 270, considered the classification of an unincorporated business entity that was engaged in the business of issuing insurance contracts through an insurance exchange. Under applicable state law, insurers not organized in corporate form, including partnerships and individuals, were permitted to operate on the exchange, and were subject to basic accounting rules imposed on all insurers under state law. The ruling held that a business entity that is primarily engaged in the business of issuing insurance contracts (and hence meets the definition of an insurance company in Reg. sec. 1.801-3(a)(1)) is an insurance company, and therefore is a corporation under section 7701(a)(3).

The terms of section 7701(a)(3) and Rev. Rul. 83-132 support the view that the term "insurance company" as used in section 7701(a)(3) may include unincorporated business entities such as partnerships. We recognize however, that both the legislative history and judicial interpretations of the statutory precursors to section 7701(a)(3) contemplate that the term "insurance company" refers to an entity that is organized under federal or state law. See Flint v. Stone Tracy Co., 220 U.S. 107 (1911); Eliot v. Freeman, 220 U.S. 178 (1911). In the case of an organization that is not a juridical entity, is not subject to basic accounting rules imposed on all insurers under the applicable law, and does not seek to benefit from the favorable tax rules applied to insurance companies under subchapter L of the Code, we think it is questionable whether section 7701(a)(3) is applicable. In other words, it may be appropriate to characterize a syndicate as a partnership that is not an insurance company within the meaning of section 7701(a)(3) or subchapter L of the Code.

4. **Members**. The proper tax treatment of the members of Lloyd's of London in the absence of a closing agreement depends largely on the characterization of the syndicates. If, as we believe most likely, the syndicates were characterized as partnerships in the absence of a closing agreement, the members would be treated as partners and, by virtue of the rules of subchapter K, would be required to include in computing their taxable income their distributive share of the syndicate's items of income, gain, loss, deduction, or credit.

Alternatively, if the syndicates were treated as insurance companies, and hence as corporations, under section 7701(a)(3) and Rev. Rul. 83-132, the members would be treated as shareholders of such corporations. As a third alternative, if the syndicates were characterized as mere co-ownership arrangements, the members would be treated as conducting the

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7/ Although not discussed herein, we do not believe that the syndicates have sufficient corporate characteristics to be classified as associations within the meaning of section 7701 of the Code. See Reg. sec. 301.7701-2(a).

insurance underwriting activities directly. This would present the issue of whether the individual members are "insurance companies," and hence taxable as corporations. As discussed above in connection with the syndicates, although Rev. Rul. 83-132 would support such a result, application of section 7701(a)(3) to a person who is not a juridical entity, is not subject to basic accounting rules imposed on all insurers under local law, and does not seek to benefit from the favorable tax rules applicable to insurance companies under subchapter L of the Code is questionable.

5. Premiums Trust Funds. During the three-year accounting period that is utilized by Lloyd's of London, premium and investment receipts with respect to each member are received, held, and invested by, and claims are paid from, a separate Premiums Trust Fund. The Closing Agreement "deems" each Premiums Trust Fund to be a grantor trust, the owner of which is the member. Lloyd's of London asserts, however, that absent the Closing Agreement these funds would not be treated as grantor trusts "since the Underwriters have none of the rights, benefits or powers enumerated in sections 673 through 677 of the Code." Lloyd's of London further asserts that, while premium and investment receipts that are received prior to the expiration of the three-year accounting period are receipts of the Premiums Trust Fund, rather than of the member, these receipts do not constitute taxable income to the Fund.

In our view, it is quite clear that the Premiums Trust Funds are properly treated as grantor trusts, the owners of which are the respective members (either in their individual capacities or, if the syndicates are treated as partnerships, in their capacity as partners). Accordingly, under section 671 of the Code, all of the items of income, deduction, and credit of the Funds are taken into account in computing the taxable income of the members.

This conclusion is based on section 677(a), which provides, in part, that "the grantor shall be treated as the owner of any portion of a trust . . . whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be--(1) distributed to the grantor . . . ." Reg. sec. 1.677(a)-(1)(d) provides that "under section 677 a grantor is, in general, treated as the owner of a portion of a trust whose income is, or in the discretion of the grantor or an nonadverse party, or both, may be applied in discharge of a legal obligation of the grantor . . . ." The trustees of the Premiums Trust Funds do not have a substantial beneficial interest in the trusts, and hence are not "adverse parties" as defined in section 672(a) of the Code.

The Premiums Trust Funds are established to hold assets of the members, earn investment income for the benefit of the members, discharge liabilities of the members, and at the end of the three-year accounting period distribute any remaining assets to the members. Lloyd's of London asserts that the Premiums

Trust Funds exist solely for the benefit of the policyholders. There is no doubt that the Funds provide security to assure the payment of claims. No policyholder is entitled to any distribution from the Funds, however, except in payment of a claim. The members have full personal liability to policyholders for their shares of claims. Thus, payment of a claim out of a Premiums Trust Fund discharges the legal liability of the member on a dollar-for-dollar basis. Moreover, in the event of a claim, payment is unrelated to the amount of assets of the Fund; no claims have ever gone unpaid.

The characterization of a trust established for similar purposes was considered in Rev. Rul. 85-158, 1985-2 C.B. 175. This ruling involved a commodity futures exchange clearing organization that guaranteed payment to exchange customers in the event of a default by exchange members on exchange-traded contracts. To "meet this legal obligation, protect investors, and promote public confidence," the clearing organization created a trust which would "provide funds to be used solely for the purpose of preventing or mitigating losses of public customers having claims against defaulting clearing members" (and hence against the clearing organization). The ruling held that "because [the trust's] income and corpus may be used to discharge [the clearing organization's] legal obligations arising out of the purchase or sale of any trade cleared and the trustee is not an adverse party, [the clearing organization] is considered to be the owner of the entire trust under section 677(a) of the Code." _See also_, _Douglas v. Willcuts_, 296 U.S. 1 (1935); _Helvering v. Stuart_, 317 U.S. 154 (1942).

Treatment of the Premiums Trust Funds as grantor trusts is also supported by recent legislation. Section 468B(g) of the Code, as amended by the Technical and Miscellaneous Revenue Act of 1988, provides as follows:

> Nothing in any provision of law shall be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income taxation. The Secretary shall prescribe regulations providing for the taxation of any such account or fund whether as a grantor trust or otherwise.

C. Lloyd's (U.S.)

1. _Corporation of Lloyd's_. Administrative and other services to facilitate the underwriting of insurance at Lloyd's (U.S.) are provided by the Lloyd's, U.S. Corporation (the "U.S. Corporation"). As in the case of the U.K. Corporation, the U.S. Corporation does not have an economic interest in the profits or losses from the insurance underwriting it facilitates. Moreover, the U.S. Corporation is a for-profit corporation the stock of which is not owned by the members of Lloyd's (U.S.). For both of these reasons, it is clear that the U.S. Corporation is not

properly taxable on the income from insurance underwritten at Lloyd's (U.S).

2. Lloyd's (U.S.) Membership. In the case of Lloyd's of London, this study concludes that the U.K. Membership, considered as a group, lacks sufficient "jointness" to be properly treated as a partnership or association. In the case of Lloyd's (U.S.), we believe that the facts are sufficiently different to justify, at least as a theoretical matter, treatment of the U.S. Membership as a corporation. The proper treatment of the U.S. Membership is, however, subject to significant doubt, and corporate treatment would create certain practical and conceptual problems.

The members of Lloyd's (U.S.) have executed Articles of Agreement under Texas law. The Articles of Agreement purport not to create a corporation, partnership, or other joint business association. Article I states that:

> It is expressly agreed and hereby declared that it is not the purpose of the individuals subscribing to these Articles of Agreement . . . to form or to assume the powers of a partnership, limited or otherwise, a joint stock company, a corporation or quasi-corporation; that there shall be no joint funds or capital stock and that no joint rights or obligations shall be planned, claimed, or created . . .

As discussed earlier, the declaration of an intention not to create a partnership or association, although a factor to be taken into account, is not controlling for federal tax purposes.

Based on the facts provided to us, which in several respects do not enable us to make a definitive determination, it appears that the U.S. Membership constitutes an organization that could properly be given effect for tax purposes. The key factor in this determination is the apparent objective of the U.S. Membership to carry on business for joint profit. Materials submitted by Lloyd's (U.S.) state that "pursuant to Texas law, the sum total of all Underwriters' security deposits lodged with the corporate attorney-in-fact are available to pay claims against any single Underwriter." This joint liability, resulting under state law, is distinct from the joint liability resulting from the failure of defaulting members of Lloyd's of London to repay debts to the Central Fund of Lloyd's of London.

Treating the U.S. Membership as a separate entity is consistent with various authorities recognizing Lloyd's-type plans formed under Texas law to be separate from their constituent members for purposes other than federal income tax. *See, e.g.*, *Gaunt v. Lloyds America of San Antonio*, 11 F. Supp. 787, 790 (W.D. Tex. 1935) (Lloyds America is an association constituting a "legal entity not only provided for and recognized

by, but licensed under, the state laws," and may be sued like any other association); In re Lloyds of Texas, 43 F.2d 383 (N.D. Tex. 1930) (Lloyd's plan held to be an "insurance corporation" under the Bankruptcy Code); Tex. Att'y Gen. Op. No. 2897 (9/23/32) (Lloyd's insurance associations constitute insurance companies subject to gross premiums tax). One decision concluded that a Lloyd's-type plan was not a corporation, but it is not clear whether the court rejected partnership classification. Harris v. Prince, 121 S.W.2d 983, 985 (Comm'n App. Tex. 1938) ("Properly speaking," defendant was not a stockholder, but rather an individual underwriter; under the statute and the articles of association, the underwriters merely pool their individual liability for convenience in making contracts).

If the members of Lloyd's (U.S.) are viewed as associates having an objective to carry on business for joint profit, the U.S. Membership would be classified as an association taxable as a corporation if the Membership possesses a majority of the four corporate characteristics set forth in Reg. sec. 301.7701-2(a). These corporate characteristics are limited liability, centralization of management, free transferability of interests, and continuity of life.

It is unclear whether the U.S. Membership has the corporate characteristic of limited liability. Texas law provides the members of Lloyd's (U.S.) with the opportunity to obtain limited liability. Article IV of the Articles of Agreement states that "The total liability of each Underwriter shall not be greater than the total of his contributions to the guaranty deposit fund plus his additional contributions, financial guarantees, and his share of profits or undivided surplus." Lloyd's (U.S.) has suggested, however, that this appearance of limited liability is misleading, because the cost of achieving limited liability is too high. They state that Texas law "gives underwriters in a Texas Lloyd's-plan insurer the option to limit their liability by depositing one-half of their capital in a Guarantee Fund under the custody of the State. Lloyd's, U.S. has not elected that option . . . ." Lloyd's (U.S.) has submitted an opinion of Texas counsel supporting their position. Lloyd's of London has disputed the assertions of Lloyd's (U.S.). Counsel for the Lloyd's of London underwriters point out that membership solicitation materials that have been used by Lloyd's (U.S.) in the past make representations to the contrary, and have obtained opinion letters from Texas counsel supporting their position.

Second, Reg. sec. 301.7701-2(c)(1) provides that "An organization has centralized management if any person (or any group of persons which does not include all the members) has continuing exclusive authority to make the management decisions necessary to the conduct of the business for which the organization was formed." Under the Articles of Agreement of

Lloyd's (U.S.), the Attorney-in-Fact has authority to make the management decisions necessary to the conduct of the business. Under Article V, the actions of the Attorney-in-Fact are supervised by the "Committee of Lloyd's, U.S.", a group consisting of no more than 10 persons, no more than eight of whom are members. Under Article XII, however, the Attorney-in-Fact may not be removed, except that if the Attorney-in-Fact is "adjudged in any suit, action, or proceeding liable for its own gross negligence, bad faith, fraudulent intent or willful malfeasance," then the Attorney-in-Fact may be removed by members holding not less than 75 percent of the aggregate guaranty fund. We believe that these facts indicate that the U.S. Membership has centralized management.

Third, Reg. sec. 301.7701-2(e)(1) provides that "An organization has the corporate characteristic of free transferability of interests if each of its members or those members owning substantially all of the interests in the organization have the power, without the consent of other members, to substitute for themselves in the same organization a person who is not a member of the organization." Members of Lloyd's (U.S.) do not appear to have the power to substitute others for themselves without the consent of other members. Article XV states that "Any underwriter may also sell his insurance business, provided the purchaser is acceptable to the Committee of Lloyd's . . . " Moreover, such sales are subject to certain restrictions imposed under Texas law. Accordingly, it appears that the U.S. Membership does not have the corporate characteristic of free transferability of interests.

Fourth, Reg. sec. 301.7701-2(b)(1) provides that an organization has the characteristic of continuity of life "if the death, insanity, bankruptcy, retirement, resignation, or expulsion of any member will not cause a dissolution of the organization." Under Article XIII, it appears that a dissolution of the Membership will not be caused by these events.

Depending on whether the U.S. Membership has limited liability under Texas law, the Membership appears to have either three of the four corporate characteristics (and therefore to be properly classified as an association), or only two of the four corporate characteristics (and therefore to be properly classified as a partnership). If the U.S. Membership is properly classified as a partnership, it might nonetheless be treated as

an insurance company that is taxable as a corporation under section 7701(a)(3). 8/

Classification of the U.S. Membership as a corporation is, thus, possible, although rendered doubtful by uncertainties regarding the extent of personal liability of members of Lloyd's (U.S.) under Texas law and the scope of section 7701(a)(3). Moreover, a conclusion that the U.S. Membership is properly taxable as a corporation is inconsistent with the current treatment of the organization and its members. Currently, in reliance on Rev. Rul. 83-132, the U.S. Membership is not recognized for federal income tax purposes; rather, each member is taxed as a separate corporation.

Treating the U.S. Membership as an organization that is not recognized for tax purposes has certain practical and conceptual advantages. The interests of the members are joint, but only to a limited degree. Among the members, different members or groups of members have differing interests in different underwriting activities. Treating the U.S. Membership as a single corporation would create an undesirable shifting of tax benefits and detriments among members. For example, taxable income that is economically attributable to one member would be offset by taxable losses economically attributable to another member. Because the Membership would be taxed as a corporation rather than a partnership, special allocations of income and deduction items could not be utilized to achieve consistency between the tax attributes and the underlying economic results. As noted earlier, similar concerns in the case of "series" mutual funds led to the enactment of section 851(h) of the Code.

In light of the significant doubt regarding the proper treatment of the U.S. Membership and the practical and conceptual problems that would result from treating the U.S. Membership as a single corporation, we believe that, as in the case of Lloyd's of London, it is appropriate to continue to ignore the existence of the U.S. Membership for federal tax purposes.

8/ Classification of the U.S. Membership as a corporation is consistent with an early court decision holding a Lloyd's-type plan formed under Texas law to be an association taxable as a corporation for tax purposes. See Harris v. United States, 51 F.2d 382 (S.D. Tex. 1931). Incidentally, one Lloyd's-type plan which elected to file corporate tax returns was ruled eligible to participate in a tax-free corporate reorganization. Rev. Rul. 58-218, 1958-1 C.B. 185. But see Liberty Lloyd's v. United States, 49-2 U.S.T.C. 9424 (N.D. Tex. 1949) (Guarantee Fund interest is directly taxable to each underwriter).

3. Syndicates. In the case of Lloyd's of London, this study concludes that, in the absence of a closing agreement, the syndicates probably would be treated as taxable entities. Among the factors that supported this conclusion were the formalized operating rules and sustained period of existence of particular syndicates. The syndicates formed by the members of Lloyd's (U.S.) appear to be rather informal and transitory, often changing composition on a transaction-by-transaction basis. At least at the present time (and assuming that the U.S. Membership is not treated as a taxable entity), the syndicates more closely resemble clusters of agent-principal relationships than partnerships or associations. This conclusion could change if the syndicates become more formalized and stable in the future.

4. Members. As discussed above, at the present time, each member of Lloyd's (U.S.) is treated as a separate corporation. In light of the practical and conceptual problems that would result from treating the U.S. Membership as a single corporation, we believe that such treatment of the members is appropriate. Moreover, in light of the facts that the members are subject to basic accounting rules imposed on all insurers under local law and seek to benefit from the favorable tax rules applicable to insurance companies under subchapter L of the Code, it appears that the members are properly treated as corporations under Rev. Rul. 83-132.

5. Underwriting Account. Under Article VI of the Articles of Agreement of Lloyd's (U.S.), a separate Underwriting Account is maintained with respect to each member. The Underwriting Account is credited with all premium and investment receipts, and is charged with all losses and expenses, with respect to the member. Under Article X, profits may be withdrawn from the Underwriting Account "on such occasions and in such amounts as shall be determined by a majority vote of the Committee of Lloyd's . . . ." For the reasons discussed above with regard to the Lloyd's of London Premiums Trust Funds, we believe it is clear that these Underwriting Accounts are grantor trusts, the owners of which are the members.

V. QUESTION TWO: WHAT TAX ACCOUNTING RULES SHOULD BE APPLIED TO MEMBERS OF INSURANCE SYNDICATES?

A. Timing of Income Recognition.

The closing agreement permits use of the so-called three-year accounting method for underwriting income.9/ Lloyd's of London asserts that use of the three-year accounting method is proper because (i) its use is required for regulatory and tax purposes under British law, (ii) it has been accepted by the Internal Revenue Service for almost fifty years, and (iii) "it is the only method which clearly reflects the income of individuals writing insurance with unlimited liability because it reflects the earliest time at which true economic profit or loss is determinable."

The fact that a method of accounting is permissible or required for regulatory purposes does not give rise to a presumption that the method clearly reflects income for federal income tax purposes. See Thor Power Tool Co. v. Commissioner, 439 U.S. 522 (1979). Nor is the fact that the Service has accepted the three-year accounting method in the past conclusive; the purpose of this study is to examine whether prior conclusions should be modified. Thus, we are left with the issue of whether the three-year accounting method clearly reflects income.

Representatives of Lloyd's of London make several related arguments in support of the position that income of the members can be clearly reflected only through use of the three-year accounting method. First, they argue that the members, as individuals using the cash receipts and disbursements method, cannot be taxed on income before it is actually or constructively received. They claim that the members do not actually or constructively receive premium or investment income before the end of the three-year accounting period because the members "have no beneficial interest either in the premiums or in the earnings thereon until, by its term, the trust is released following the final claim payment or the final provision for incurred but unreported losses . . . at the end of the year of account." As

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9/ Although tax on the income from premiums received in the first year of the account is deferred for three years, there is a lesser amount of deferral, or no deferral, with respect to other income. Under the closing agreement, all U.S. source investment income, whether or not effectively connected, is taxed annually. Premiums from reinsurance to close transactions are received in the third year of the account. Accordingly, there is only a one-year deferral in reporting this income. Although varying by syndicate, the premiums on reinsurance to close transactions are, on average, over 50 percent of the total effectively connected premiums received. It should be further noted that not all of the other premium income would be received in the first calendar year of the account.

discussed above, we believe it is clear that the Premiums Trust Funds are grantor trusts the owners of which are the members. Under the grantor trust rules, the members would be treated as receiving the premiums and investment income at the time they are received by the trust.

A related argument of Lloyd's of London is that the premium and investment receipts are not "income" in the year of receipt because these amounts are being held for the benefit of the policyholders. In support of this argument, Lloyd's of London cites Seven-Up Co. v. Commissioner, 14 T.C. 965 (1950), acq. in result only, Rev. Rul. 74-318, 1974-2 C.B. 15, and its progeny. The Internal Revenue Service has not acquiesced in the theory of these cases. Even if these cases are assumed to be correct, however, they do not support the argument of Lloyd's of London.

In Seven-Up Co., the taxpayer received funds from 7-Up bottlers for use in conducting a national advertising campaign. The court held that the receipts were not income to the taxpayer on the ground that "it was the intention of all of the parties concerned that these contributions were to be used to acquire national advertising for the 7-Up bottled beverage and for that purpose only, and that petitioner was to be a conduit for passing on the funds contributed to the advertising agency . . . ." 14 T.C. at 977. Similarly, in Broadcast Measurement Bureau, Inc. v. Commissioner, 16 T.C. 988 (1951), the court held that a corporation formed to contract for radio audience survey studies was not taxed on the receipt of subscription fees where the corporation "was obligated to return to subscribers either as a refund or as a credit on future studies, any excess of fees over the actual cost" of the study. 16 T.C. at 997. See also Dri-Powr Distributors Association Trust v. Commissioner, 54 T.C. 460 (1970).

Illinois Power Co. v. Commissioner, 792 F.2d 683 (7th Cir. 1986), addressed the treatment of amounts received by a public utility pursuant to a rate surcharge the purpose of which was to encourage energy conservation. At the time of ordering the surcharge, the utility regulatory commission made clear that the utility would not be able to keep the money collected. On the basis of this fact, the court held the amounts were not includible in income, stating that "it was apparent back when the order was issued that the company would not be able to profit from the higher rates. The company was to be a custodian, a tax collector, with no greater beneficial interest in the revenues collected than a bank has in the money deposited with it." Id., at 688, 689. The court further stated that, "Where, unlike the case of a trustee or a collection agent or a borrower, the taxpayer's obligation to refund or rebate or otherwise repay money that he has received is contingent, the money is taxable as income to him." Id., at 689.

In the case of Lloyd's of London, a member is in no sense a mere conduit, collection agent, or borrower. The assets held in the Premiums Trust Fund will be paid to policyholders only to the extent of their claims. Any excess amounts will be paid to the member. Indeed, the only reason for the member to enter into an underwriting transaction is the hope that the assets in the Fund will exceed the claims. Applying the standard of the Illinois Power court, the member's obligation to repay money held in the Premiums Trust Fund is contingent on the claims of policyholders. Accordingly this money is not excludable from gross income.

The income received from underwriting insurance policies is "pre-paid" income, in that many of the expenses associated with the earning of that income may be paid in a later taxable year. Taxable income is, however, calculated on an annual basis. Except in the case of certain financial products, taxpayers are generally not permitted to defer recognition of prepaid income. Automobile Club of Michigan v. Commissioner, 353 U.S. 180 (1957); American Automobile Association v. United States, 367 U.S. 687 (1961); Schlude v. Commissioner, 367 U.S. 911 (1961). Deferral of prepaid income for services is permitted only in the "specified and limited circumstances" described in Rev. Proc. 71-21, 1971-2 C.B. 549. The circumstances of Lloyd's of London are not among those described in Rev. Proc. 71-21.

In recognition of the fact that, under the annual accounting system, the difference in timing between the receipt of premium income and the payment of claims produces a mismatching of income and deduction items, insurance companies are allowed a deduction for additions to a reserve for incurred losses. Such reserve deductions are allowed, however, only if the taxpayer is an insurance company subject to tax under subchapter L of the Internal Revenue Code.

B. Tax Accounting for Future Benefit Claims

The preceding section suggests that, absent the closing agreement, and assuming they would not be treated as insurance companies, the members of Lloyd's of London would be required to include premiums in taxable income when received and would not be permitted to deduct benefit claims until paid. This section discusses whether such a result is appropriate as a matter of tax policy. The basic issue raised is the proper method of accounting for benefit claims and future costs, a subject that has received substantial attention in recent years. Five alternative methods of accounting for future costs can be identified. As will be demonstrated, the approaches differ in the extent to which investment income on the assets used to fund the future cost is subject to tax.

Each of the approaches is illustrated using an example that assumes the following facts:

(i) X receives premiums of $100 on the last day of year 1;

(ii) X incurs in year 1 a liability to make (and ultimately does make) a $121 payment on the last day of year 3;

(iii) X has a pre-tax rate of return on its investment assets of 10 percent;

(iv) X is subject to income tax at a marginal rate of 34 percent and can fully utilize any deductible losses realized with respect to the insurance activity; and

(v) any tax liability or benefit is paid or received on the last day of the taxable year to which it relates.

It should be emphasized that these examples do not take account of underwriting and related expenses.

1. Undiscounted current deduction. The first method is to allow a current deduction equal to the undiscounted estimated amount of the future benefit payments. Prior to the 1986 Act, property and casualty insurance companies accounted for incurred losses using this method. Under this method, the cash flows of X would be as follows:

Undiscounted Current Deduction
(cash flows in **bold**)

	Year 1	Year 2	Year 3
Premiums	**$100**	**0**	**0**
Investment Income	**0**	**10.71**	**11.42**
Reserve (Increase)	(121)	0	121
Claims (Paid)	0	0	**(121)**
Taxable Income	(21)	10.71	11.42
Tax (Paid)	**7.14**	**(3.64)**	**(3.88)**
Net Portfolio Assets	**$107.14**	**$114.21**	**$ 0.75**

The effect of allowing a current undiscounted deduction for a future benefit payment is to tax the investment income on the assets funding the liability at a negative rate. While the investment income earned by X is subject to tax, an offsetting deduction for the future cost is allowed. The deduction ($121) is equal to the sum of the initial payment ($100) plus the pre-tax investment income earned during the two-year period prior to payment of the cost ($21). The negative tax rate results from the accelerated allowance in year 1 of a deduction for the $21 of investment income to be earned in years 2 and 3, which produces a tax deferral in year 1 of $7.14. (An "extra" tax of $3.40 (34 percent of $10) is paid in year 2 as a result of the acceleration of the deduction from year 2 to year 1.) The after-tax investment income earned on the year 1 tax saving (reduced by the extra tax paid in year 2) is $0.75, the amount of X's ending assets. If the undiscounted method of accounting for future benefit payments applies, the issuer would be able to charge a premium less than $100.

2. Pre-tax discounting. The second method of accounting for future benefit payments is to allow a current deduction equal to the present value of the future payment, calculated using a discount rate equal to a pre-tax rate of investment return. Additional deductions are allowed in future years in an amount equal to the annual growth in this present value. Following the 1986 Act, property and casualty insurance companies account for incurred but unpaid losses under a pre-tax discounting method. Under this method, the cash flows of X would be as follows:

Pre-Tax Discounting
(cash flows in **bold**)

	Year 1	Year 2	Year 3
Premiums	**$100**	**0**	**0**
Investment Income	**0**	**10**	**11**
Reserve (Increase)	(100)	(10)	110
Claims (Paid)	**0**	**0**	**(121)**
Taxable Income	0	0	0
Tax (Liability)	**0**	**0**	**0**
Net Portfolio Assets	**$100**	**$110**	**0**

The effect of the pre-tax discounting method of accounting for benefit payments is to attribute the insurer's portfolio income to the insured. This method provides a true accrual: each period's investment income in the accounts of the insurer exactly matches the accrual of the insurer's benefit payment liability, and, hence, is not an accretion to the insurer's net worth, i.e., not a measure of its income. Indeed, the interest rate which generates the investment income is precisely the discount rate used to determine the $100 premium the insured would have to pay.

No practical way has been devised to attribute and tax the portfolio investment income to insured parties, however. Thus, application of the pre-tax discounting method to insurers effectively exempts from tax the investment income on the assets funding the future benefit claim during the period prior to the payment.

3. After-tax discounting. The third method is to allow a current deduction equal to the present value of the future liability, calculated using a discount rate equal to the after-tax rate of investment return. No additional deductions are allowed in future years for the increase in the present value of the liability. Thus, the taxpayer is allowed a deduction equal to the amount that would have to be set aside to grow (after taxes) to satisfy the future liability. An after-tax discounting method applies to nuclear decommissioning funds under section 468A. In addition, an after-tax discounting method was proposed for property and casualty insurance companies in the President's Tax Proposals to the Congress for Fairness, Growth, and Simplicity (May 1985) in order to ensure that the investment income was subject to one level of tax. Under an after-tax discounting method, the cash flows of X would be as follows:

After-Tax Discounting
(cash flows in bold)

	Year 1	Year 2	Year 3
Premiums	**$100**	**0**	**0**
Investment Income	**0**	**10.22**	**10.89**
Reserve (Increase)	(106.48)	(7.03)	121
Claims (Paid)	**0**	**0**	**(121)**
Taxable Income	(6.48)	10.22	10.89
Tax (Paid)	**2.20**	**(3.47)**	**3.70**
Net Portfolio Assets	**$102.20**	**$108.95**	**($ 4.86)**

The effect of the after-tax discounting method is that the investment income used to fund the future benefit payment liability is taxed at the marginal tax rate of X. The deduction allowed to X for the future payment does not offset the investment income earned by X. If an after-tax discounting method is applied, X presumably will have to increase the amount of the premium charged to assume the liability to make a future payment of $121. In order to have sufficient funds to pay the future liability, X should demand a premium of at least $106.48. This is the amount that will grow in two years at an after-tax rate of return of 6.6 percent to $121.10/

4. Deferral of deduction. The fourth method is to defer allowance of a deduction until the liability is actually paid. This approach applies to taxpayers using the cash method of accounting and, following the enactment of section 461(h) in 1984, generally also applies to accrual method taxpayers. Section 461(h) does not apply to items with respect to which the Code specifically allows a deduction for estimated expenses (e.g., insurance reserves specifically allowed under subchapter L). Under this approach, the cash flows of X would be as follows:

Deferral of Deduction
(cash flows in **bold**)

	Year 1	Year 2	Year 3
Premium Income	**$100**	0	0
Investment Income	0	6.60	**7.04**
Claims (Paid)	0	0	**121**
Taxable Income	100	6.60	(113.96)
Tax (Paid)	**(34)**	**(2.24)**	**38.75**
Net Portfolio Assets	$ 66	$ 70.36	**($ 4.85)**

10/ Just as the pre-tax discounting method yields a precise measure of the insurer's and insured party's economic income, the after-tax discounting method yields precise measures in the case of prepaid expenses. In the cases of expected underwriting expenses such as brokers', legal, administrative and litigation costs to be incurred, the "premium load" will be determined as the present value of the expected future cost stream. An after-tax discount rate is appropriate because the portfolio funded by the "load", and its cumulated after-tax earnings, must be sufficient to pay the costs as they occur over the term of the insurance contract.

The effect of the deduction deferral method, like the after-tax discounting method, is to tax the investment income used to fund the future cost at the marginal tax rate of X. As illustrated by the amount of ending assets, the overall effect of the after-tax discounting method and the deduction deferral method is the same. Although the timing and amount of the allowed deductions differ, they are the same in present value terms. As under the after-tax discounting method, X presumably will increase the premium charged to assume the liability to make a future payment of $121 from $100 to $106.48.11/

5. Lloyd's of London's three-year accounting method. Under the method of accounting used by Lloyd's of London pursuant to the closing agreement, premium income and benefit payment deductions are accounted for in the year after the third year of a three-year accounting period. Investment income is reported as it is earned. Under this method, the cash flows of X would be as follows:

Lloyd's Three-Year Accounting Method
(cash flows in **bold**)

	Year 1	Year 2	Year 3	Year 4
Premiums	**$100**	**0**	**0**	**0**
Investment Income	**0**	**10**	**10.66**	**0**
Claims (Paid)	**0**	**0**	**(121)**	**0**
Taxable Income	0	10	10.66	(21)
Tax (Paid)	**(0)**	**(3.40)**	**(3.62)**	**7.14**
Net Portfolio Assets	**$100**	**$106.60**	**($ 7.36)**	**($0.22)**12/

11/ The deferral of deduction method (section 461(h)) is algebraically equivalent to the previously described after-tax discounting method. It therefore yields precise measures of periodic income, but only for pre-paid costs of service.

12/ This example is not directly comparable to the previous examples, since it continues through year 4 and investment income for year 4 (which would be negative) is not taken into account. The example can be compared to the previous examples by adding to the net cash at the end of year 3 the present value of the year 4 tax savings, $6.70 ($7.14/1.066). Thus, the value of X's assets at the end of year 3 is negative $0.66.

On these facts, the three-year accounting method is less advantageous than the undiscounted current deduction and pre-tax discounting methods, but significantly more advantageous than the after-tax discounting and deduction deferral methods. Because the three-year accounting method affects the timing of income, as well as loss, recognition, the relative advantage of the method would, on other facts, vary. For example, the three-year accounting method would be relatively more favorable if benefit claims were more favorable than expected as reflected in premium income and would be relatively less favorable if loss claims were greater than expected, particularly if the claims were paid before the final year of the accounting period. Moreover, closing reinsurance transactions (the premiums for which are calculated on an undiscounted basis) may, in situations where the memberships of the ceding and assuming syndicates substantially overlap, have the effect of allowing in the final year of the accounting period a current undiscounted reserve deduction for future claims.

In summary, under the after-tax discounting and the deferred deduction methods, investment income earned on the assets used to fund a future benefit claim is, during the period prior to payment, taxed to the person liable to make the payment. In contrast, this investment income is taxed at a negative rate under the current undiscounted deduction method, taxed at a zero rate under the pre-tax discounting method, and, in general, only partially taxed under the three-year accounting method. Under none of the methods is the investment income taxed currently to any other person (i.e., the person from whom the liability was assumed).

Although it is clear that the latter three methods fail to impose a current tax on the investment income earned in an insurance transaction, it is less clear that this investment income should be taxed to the insurer. It may be argued that in an insurance transaction the insurer invests premium income for the benefit of the insureds and receives no economic benefit itself from the anticipated investment income that is taken into account in setting the premium. Under this argument, the insurer, like a bank, should be allowed the economic equivalent of an interest deduction, leaving it taxed only on the spread between the investment income earned and the amount needed to fund the future cost.

Absent the taxation of investment income at the policyholder level, we cannot accept this argument. We believe that the failure to impose a current tax on investment income earned in insurance transactions is inconsistent with basic income tax principles. This investment income cannot as a matter of practicality be taxed to the insured party. In contrast, the income can as a matter of practicality be taxed to the insurer. Unlike the indebtedness that exists between a bank and a depositor, an insurer has no fixed obligation to return to insurers the premiums it receives. The existence of a fixed

obligation between a bank and a depositor justifies the accrual of a deduction to the bank and income to the depositor. Conversely, we believe that the absence of a fixed liability between an insurer and insured justifies denial of a deduction to the insurer and failure to accrue income to the insured.

C. Subchapter S Treatment for Individual Insurance Underwriters

An individual underwriter of insurance may account for insurance losses under a pre-tax discounting method if the underwriter is, as provided in Rev. Rul. 83-132, treated as an insurance company under subchapter L of the Code. Such treatment carries with it, however, the disadvantage of a corporate level tax. Although corporations owned by a single individual generally may elect to be taxed under the pass-through rules of subchapter S, section 1361(b)(2)(C) provides that an insurance company subject to tax under subchapter L is ineligible for subchapter S status. This restriction was adopted in 1982 on the ground that insurance companies "are entitled to certain deductions not generally allowed to individuals." S. Rept. No. 97-640, 97th Cong. 2d Sess. 9 (1982).

One reason for denying access to subchapter S to insurance companies and other corporations entitled to special deductions not allowed individuals is the concern that corporate level losses attributable to the allowance of such deductions would be passed through to individuals and used to shelter from tax income from unrelated investments or personal services. This concern has, to a substantial extent, been addressed by the adoption in 1986 of the passive activity loss rules. It can therefore be argued that Congress should reconsider the issue of whether insurance companies and other currently ineligible corporations may qualify as S corporations.

We believe, however, that a second reason exists for denying insurance companies access to subchapter S -- the concern that the insurance company tax rules fail to tax properly all of the income earned by the parties to an insurance transaction. As discussed in the previous section, the rules for taxing property and casualty insurance companies have the effect of exempting certain investment income from tax. We believe that it would be inappropriate to extend access to these favorable rules by permitting them to be used at the individual level. Accordingly, despite the enactment of the passive loss rules, we believe that insurance companies should continue to be ineligible for S corporation status.

Although we do not favor expanding access to the favorable rules of subchapter L, individual underwriters of insurance would have a strong basis to object if they were taxed on a less favorable basis than other insurers. We believe that applying cash method or section 461(h) rules to an insurer would result in proper taxation of the insurance transaction in cases of prepaid expenses and where the investment income is not taxed to the

policyholders. The current rules of subchapter L that permit the deduction of reserves are more favorable, however, and individual underwriters of insurance should not be placed at a competitive disadvantage to other insurers by being denied access to the tax rules that govern their competitors. If other insurers are permitted to claim reserve deductions under subchapter L, we believe that individual underwriters should be permitted to achieve similar treatment. As discussed above, Rev. Rul. 83-132 allows individual underwriters access to these rules. It does not follow, however, that individual underwriters are entitled to more favorable treatment than other insurers. That is, if on grounds of fairness individual underwriters should be allowed access to the favorable tax rules of subchapter L, we believe they should also be subject to a corporate level tax or its equivalent.

D. Application of Passive Activity Loss Rules

The enactment of the passive activity loss rules, contained in section 469 of the Code, is one of the most significant changes in the U.S. tax laws that has occurred since the negotiation of the 1980 closing agreement. A number of issues are raised by the application of these rules to members of Lloyd's of London. The purpose of this section is not to analyze the application of these rules in the absence of a closing agreement but rather to note certain issues and discuss how they should be addressed in any renegotiated closing agreement.

The passive activity loss rules apply to members of Lloyd's of London who are U.S. residents or who otherwise have effectively-connected U.S. trade or business income from their Lloyd's insurance operations. A typical member's insurance operations constitute a passive activity because insuring risks is a trade or business and the typical member does not materially participate in the conduct of that trade or business. The passive activity rules are designed to prevent individuals from deducting tax losses from passive activities, except to the extent of income from passive activities in the same year. Any excess net passive activity loss may be carried forward subject to the same rules. Because Congress did not intend to deny true economic losses incurred in closed and completed transactions, the taxpayer may deduct any remaining suspended passive loss from an activity at the time he disposes of his entire interest in the activity to an unrelated party in a taxable transaction.

1. Treatment of investment income. The passive loss rules prohibit an individual from reducing "nonpassive" income by passive activity losses. For this purpose, "nonpassive" income includes (a) income from a trade or business in which the taxpayer materially participates, and (b) portfolio income, such as interest, dividends, and gains from the sale of property held for investment that are not derived in the ordinary course of a trade or business.

Investment income earned on "working capital" generally is treated as portfolio income, notwithstanding that the capital may be needed to conduct a trade or business. Thus, a taxpayer generally is unable to use a passive loss from a trade or business in which he does not materially participate to offset investment income from working capital used in that trade or business. Regulations interpreting the passive loss rules, however, contain a special rule for the investment income of insurance businesses. Specifically, the regulations treat as trade or business income (rather than as portfolio income) "[i]ncome from investments made in the ordinary course of a trade or business of furnishing insurance or annuity contracts or reinsuring risks underwritten by insurance companies . . . ." Temp. Reg. sec. 1.469-2T(c)(3)(ii)(C). Thus, investment income from an insurance business may be treated as passive income that may be offset by underwriting losses.

In the case of the members of Lloyd's of London, this treatment appears to be appropriate with respect to income earned from the investment of policyholder premiums. This investment income is an indivisible part of an insurance transaction. The treatment might not be appropriate, however, with respect to income earned from the investment of capital provided by a member. U.S. members may have an incentive to increase the amount of capital used in or otherwise characterized as part of an insurance activity in order to change the nature of the income generated by that capital from portfolio to passive. We understand that most, if not all, of the capital deposited by U.S. members with Lloyd's of London at the present time is in the form of letters of credit. Thus, it appears that a problem does not exist at the present time. Nonetheless, the issue should be addressed in a renegotiated closing agreement.

2. Disposition of activity. As discussed earlier, upon disposition of his entire interest in a passive activity to an unrelated party in a fully taxable transaction, a taxpayer may deduct any remaining suspended passive losses from the activity. In the case of the members of Lloyd's of London, it is unclear whether entry into a closing reinsurance transaction should be treated as a disposition of the member's entire interest in an activity in a taxable transaction with an unrelated party. For example, the closing reinsurance transaction might not be viewed as a disposition of the entire interest in the activity, the transaction might not be viewed as a taxable transaction to the extent the members of the reinsuring syndicate are not required to include the reinsurance premiums in taxable income in the year of the transaction, and the transaction might not be viewed as a disposition to an unrelated party if the member of the reinsured syndicate also holds an interest in the reinsuring syndicate.

The Conference Committee Report to the 1986 Act contains the following statement on the disposition issue:

> "Certain insurance transactions. -- Clarification is provided with respect to certain transactions involving dispositions of interests in syndicates that insure U.S. risks. Generally, when an owner of an interest in such a syndicate that is treated as a passive activity enters into a transaction whereby he disposes of his interest in the syndicate in a fully taxable closing transaction, he is treated as having made a disposition of his interest in the passive activity."

H.R. Rept. 841 (Vol. II), 99th Cong., 2d Sess. II-143 (9/18/86).

In light of this legislative history, we believe that any renegotiated closing agreement should clarify that any suspended passive losses attributable to an interest in a particular syndicate generally should be "freed-up" upon entry into a closing reinsurance transaction, regardless of whether the member continues to hold interests in other syndicates and regardless of the method of accounting used by the reinsurer. Any renegotiated closing agreement should also address whether this general rule should apply if the member of the reinsured syndicate (or a related party) is a member of the reinsuring syndicate. The freeing up of suspended losses in the latter situation would appear to be inconsistent with the statutory requirements that the disposition be complete and that it involve a transaction with an unrelated party.

3. Straddle transactions. Some practitioners have suggested that taxpayers may avoid the effect of the passive loss rules by engaging in so-called "straddle" transactions. These are passive activities in which income and losses are mismatched -- passive income (which can be offset by otherwise unusable passive losses) is generated in one year and passive losses are generated in a later year in which the activity is disposed of. The tax accounting rules under the closing agreement have the effect of creating a straddle for members of Lloyd's of London. Under the closing agreement, investment income is taxed currently, while underwriting income or loss is determined in the year following the third year of the accounting cycle. Thus, with respect to any single three-year accounting cycle, members will always have positive income in the first three years. Any loss will occur only in the fourth year.

The Treasury Department has explicit regulatory authority to prevent abuses resulting from straddle transactions. Independent of any exercise of this regulatory authority, however, we believe that any renegotiated closing agreement should ensure that the tax accounting rules applied to members of Lloyd's of London do not create an opportunity to avoid the effect of the passive loss rules.

VI. QUESTION THREE: DO THE NONRESIDENT UNDERWRITERS AT LLOYD'S OF LONDON HAVE A U.S. PERMANENT ESTABLISHMENT?

A. General

Under U.S. tax law, the taxation of income earned by a foreign person turns in part on whether the income is "effectively connected with the conduct of a trade or business within the United States." A foreign person is subject to a gross-basis withholding tax on "fixed or determinable annual or periodical gains, profits and income," such as dividends, interest, wages and annuities, but only to the extent the amount so received is not effectively connected with the conduct of a U.S. trade or business. If a foreign person is engaged in a U.S. trade or business, that person is subject to income tax on a net basis, at graduated rates, with respect to all the income effectively connected. Business profits (i.e., income that is not "fixed or determinable annual or periodical" income) are not subject to U.S. tax if the profits are not effectively connected with the conduct of a U.S. trade or business.

A special rule applies to premiums paid to foreign insurers and reinsurers; under section 4371, a gross-basis excise tax is imposed at the rate of (1) 4 cents on each dollar (or fraction thereof) of the premium paid on a policy of casualty insurance or indemnity bond; (2) 1 cent on each dollar (or fraction thereof) of the premium paid on a policy of life, sickness or accident insurance, or annuity contract on the life or hazards to the person of a U.S. citizen or resident, unless the insurer is subject to tax under section 842(b) (relating to the taxation of foreign insurance companies); and (3) 1 cent on each dollar (or fraction thereof) of the premium paid on a policy of reinsurance covering any of the contracts taxable under (1) or (2).

Prior to December 1988, premiums were exempt from this excise tax if the policy, indemnity bond or annuity contract was signed or countersigned by an officer or agent of the insurer in a State, or in the District of Columbia, where the insurer was authorized to do business. This exemption was intended to coordinate the gross-basis excise tax with the net-basis income tax imposed on foreign insurers engaged in the conduct of a U.S. trade or business. But see Neptune Mutual Association, Ltd. vs. United States, 13 Cl.Ct. 309 (1987) (providing a different coordination rule), aff'd in part and rev'd in part, 862 F.2d 1546 (Fed. Cir., 1988). Under that prior rule, however, there was a possibility that both taxes would be imposed -- or neither -- because the signing or countersigning of a policy in the U.S. did not determine whether the issuer was engaged in the conduct of a U.S. trade or business. The Technical and Miscellanous Revenue Act of 1988 ("TAMRA") contained a provision, effective December 1988, that ensures appropriate coordination in the future between the insurance premium excise tax and the regular U.S. net-basis income tax on nonresidents engaged in the conduct

of a U.S. trade or business. The new rule, amending Code section 4373(1), provides that the insurance premium excise tax will not apply to "[a]ny amount which is effectively connected with the conduct of a trade or business within the United States unless such amount is exempt from [net-basis tax] pursuant to a treaty obligation of the United States." TAMRA of 1988, Section 1012(q)(13)(A).

The United States often changes the tax rules applicable under the Code by using a bilateral income tax treaty. In particular,

-- Treaties usually provide that business profits of a foreign person will be subject to tax in the United States only if that person has a "permanent establishment" in the U.S. and the profits are "attributable to" the permanent establishment. The permanent establishment test provides a more certain -- and generally more demanding -- standard for determining whether a foreign corporation is subject to U.S. net-basis tax than the statutory standard of "effectively connected with the conduct of a trade or business."

-- Some treaties, such as the treaty between the United States and the United Kingdom, waive the insurance premium excise tax under certain circumstances.

-- Treaties usually reduce the rate of tax on actual or deemed distributions of dividends, interest, and other periodical income.

B. Application of Treaties

The U.S./U.K. income tax treaty, consistent with most U.S. tax treaties, provides that business profits earned by a U.K. resident are subject to U.S. tax only if the profits are attributable to a permanent establishment in the United States. As noted, the insurance premium excise tax is waived on payments made to a U.K. resident entitled to the benefits of the treaty. Thus, for an underwriter at Lloyd's of London who is a U.K. resident (and not a U.S. citizen), the question whether the underwriter has a U.S. permanent establishment is pivotal.

Under the 1980 closing agreement, all underwriters at Lloyd's of London are taxed by the United States on their Lloyd's insurance income in the same manner. In the absence of a closing agreement, that would not be the case. There are several different categories of underwriters, each of which could be subject to different tax rules:

1. U.S. citizens and resident aliens would be subject to tax on their worldwide income in every case. The tax accounting rules for determining the insurance income and tax are discussed at pp. 30-39.

2. U.K. residents and residents of some other countries with which the U.S. has tax treaties are entitled to the benefits of a "standard" permanent establishment clause, so that business profits would be taxed only if there is a permanent establishment.

There would be significant differences for underwriters from different countries, however, even if each treaty has a permanent establishment clause. In some cases (such as the U.K.), the treaty waives the insurance premium excise tax; in other cases, the treaty does not. Thus, for income that is not subject to net-basis taxation (because there is no permanent establishment), there may or may not be an excise tax imposed.

In addition, treaties differ in whether they permit a branch profits tax or a second withholding tax to be imposed on income effectively connected with a U.S. trade or business when that income is deemed distributed to the foreign person. The U.S./U.K. treaty, for instance, prohibits imposition of a branch profits or second-tier withholding tax; other treaties permit application of a branch tax or a second withholding tax on dividends, at varying rates.

3. Some U.S. treaties include a permanent establishment clause but have special rules that may be relevant. In most U.S. treaties, for instance, a foreign person will not be deemed to be conducting business in the United States through a permanent establishment if the business is concluded by an independent agent. The U.S. treaty with Belgium, however, to take one example, has an exception for insurance companies, if the independent agent "has, and habitually exercises, an authority to conclude contracts." Thus, a Belgian resident who conducts business through an agent such as the brokers who hold binding authorities from underwriters at Lloyd's of London may have a U.S. permanent establishment, even though the same broker/agent would not constitute a permanent establishment for a resident of another country with a different treaty. (The Belgium treaty has an exception to the special rule for reinsurance, which is the principal business conducted by Lloyd's of London; under the treaty, an insurance company writing reinsurance contracts in the other State through an independent agent will not, for that reason alone, be treated as having a permanent establishment.)

The underwriters at Lloyd's of London include residents from more than 80 countries, including most of the jurisdictions with which the U.S. has treaties, so the nuances of each separate treaty would have to be considered in determining the appropriate tax treatment of underwriters.

4. Some Lloyd's of London underwriters would not be entitled to the benefits of any treaty with the U.S. These underwriters would be subject to net-basis U.S. tax on their effectively connected business profits if they are "engaged in the conduct of a U.S. trade or business." There is no bright line for

determining when a taxpayer meets this standard, nor is the relationship between this test and the permanent establishment test entirely clear. But it is possible that an underwriter from a non-treaty jurisdiction would be subject to U.S. net-basis taxation on some income because he would be engaged in the conduct of a U.S. trade or business with respect to that income, even though other underwriters in the same syndicate (and thus conducting business in exactly the same way) who are residents of treaty countries would not be subject to net-basis tax because they would not have U.S. permanent establishments. In addition, if underwriters at Lloyd's of London are deemed to be doing business in the United States as corporations, underwriters from non-treaty jurisdictions that earn income subject to net-basis taxation would be subject to the U.S. branch profits tax on deemed remittances of their U.S. income.

In a letter to the IRS dated December 10, 1984, which was resubmitted in connection with this study, counsel for Lloyd's of London stated that placement of insurance with Lloyd's of London through licensed agents in Illinois and Kentucky "clearly rises to the level of being engaged in trade or business in the U.S., and the I.R.S. has so ruled." Letter to IRS from counsel for Lloyd's of London dated December 10, 1984, p. 42. In the same letter, counsel concedes that some other activities of underwriters at Lloyd's of London in the U.S. may constitute a "trade or business." At the same time, counsel argues that underwriters at Lloyd's of London do not have a U.S. permanent establishment. Thus, diverse tax treatment of underwriters in a single syndicate earning income from a single risk could well occur.

If an underwriter in a non-treaty jurisdiction earned income that was not subject to U.S. tax on a net basis (because the income was not effectively connected with the conduct of a U.S. trade or business), the underwriter would be subject to gross-basis tax on that income through the insurance premium excise tax imposed by section 4371.

C. Context in Which the Issue Must Be Considered

Lloyd's of London argues vigorously that its underwriters do not conduct business through a U.S. permanent establishment, at least as that term is defined for purposes of the U.S./U.K. treaty. Lloyd's (U.S.) asserts with equal vigor that the underwriters at Lloyd's of London do have a permanent establishment in the U.S. The issue is crucial, and the answer is not certain.

Before examining the specific factors that may (or may not) cause underwriters at Lloyd's of London to have a permanent establishment, it is important to consider the context in which this question must be considered.

1. In the 1980 closing agreement -- as in the 1968 agreement -- the underwriters at Lloyd's of London agreed that they would be deemed to have a U.S. permanent establishment. However, Lloyd's of London argues persuasively that this concession was solely for purposes of negotiating those closing agreements and is not relevant in determining whether, absent a closing agreement, the underwriters have a U.S. permanent establishment.

In 1968, the U.S./U.K. treaty did not waive the U.S. excise tax on insurance premiums. Thus, a U.K. citizen who was an underwriter at Lloyd's of London was subject to either the gross-basis excise tax or a net-basis income tax on business profits. The burden of a gross-basis tax will exceed the burden of a net-basis tax in years of loss or low profits; in the insurance industry, loss years are not uncommon, because of the cyclical nature of the business. (In profitable years, of course, a net-basis tax may exceed a gross-basis tax.) It was not unreasonable for the underwriters at Lloyd's of London to agree to a U.S. permanent establishment -- and thus subject themselves to net-basis income tax in all years -- whether or not that was in fact the case.

In 1980, when the closing agreement was revised, the U.S./U.K. treaty provided for a waiver of the excise tax. However, in view of (1) the earlier agreement to be taxed on the basis of a permanent establishment; (2) the possibility that at least some underwriters at Lloyd's of London did indeed have a U.S. permanent establishment to which at least some of their U.S. income was attributable; (3) the fact that not all Lloyd's of London underwriters qualify for taxation under the U.K. treaty and there are strong administrative advantages to providing a single U.S. tax regime for all underwriters; and (4) other advantages offered by continuation of the closing agreement with relatively few changes (including certainty of tax treatment and IRS acceptance of the special accounting rules imposed by U.K. law), it was not unreasonable for underwriters at Lloyd's of London to agree to be taxed as though they operated through a permanent establishment and thus were subject to a net-basis income tax.

2. The United States is a strong proponent of a high standard for determining whether a taxpayer has a permanent establishment. Because the U.S. favors a free flow of capital investment and U.S.-owned businesses traditionally have had greater sales and investments in other countries than foreign-owned businesses have had in this country, the U.S. has resisted efforts by some countries to erode the protection that is provided foreign taxpayers by means of a permanent establishment test. Although treaty differences in the permanent establishment test are not great, there is some variance in the standards. The U.S./U.K. treaty, reflecting the U.S. (and U.K.) view of permanent establishments, adopts a more rigorous version of the test than is used in some U.S. treaties.

3. If it is determined that underwriters at Lloyd's of London do not have a permanent establishment in the United States, the U.S. situs business conducted in this country by Lloyd's of London -- with an annual gross premium volume estimated by Lloyd's of London of more than $3 billion -- would probably represent the largest single bilateral business activity in the world conducted without a permanent establishment. On the other hand, because of the nature of the insurance business and the widespread reliance on brokers, U.S. and foreign insurers often conduct substantial business activities in other countries without operating through a permanent establishment.13/

D. Factors that May Cause Nonresident Underwriters at Lloyd's of London to Have a U.S. Permanent Establishment

The U.S./U.K. treaty, as is common, defines a permanent establishment as "a fixed place of business through which the business of an enterprise is carried on." The treaty states that the term shall include especially "a branch, an office, a factory, a workshop, a mine . . . or a building or construction or installation project which exists for more than 12 months." Certain fixed sites are excluded from the definition, particularly sites used solely for storage of goods or for activities of a "preparatory or auxiliary character."

In addition, the U.S./U.K. treaty provides that a person acting in one contracting State on behalf of an enterprise in the other contracting State generally shall be deemed to be a permanent establishment if that person has, and habitually exercises, an authority to conclude contracts in the name of the enterprise unless the person so acting is a "broker, general commission agent or any other agent of independent status, where such persons are acting in the ordinary course of their business."

With the possible exception of the operations in Kentucky and Illinois, the underwriters at Lloyd's of London do not operate from a "fixed place of business" in the United States, at least in the sense of a specific office building or other business location. Rather, as described above, underwriters at Lloyd's of London obtain business through several thousand brokers and agents. If underwriters at Lloyd's of London do have a permanent establishment (or permanent establishments) in the United States through which they earn some or all of their business income, we believe it will be for one or both of the following reasons:

13/ The ability of insurers to conduct large-scale operations without creating a permanent establishment has resulted in some international tax treaties (including some U.S. agreements) providing special permanent establishment rules for insurance activities. See the Commentary to the OECD Model Double Taxation Convention, Art. 5, Para. 38; discussion of U.S. treaties at p.45, supra, and p.56, infra.

1. The Illinois and Kentucky operations are determined to be permanent establishments and the operations in other states are sufficiently related to those operations that some or all of the income from other states is "attributable to" the Illinois and Kentucky permanent establishments. (Gross premium income directly attributable to Illinois and Kentucky business currently is about seven percent of the U.S. business, within the meaning of the 1980 closing agreement, conducted by underwriters at Lloyd's of London.)

2. One or more of the agents or brokers with binding authority for underwriters at Lloyd's of London is a "dependent agent" that constitutes a permanent establishment, rather than an "independent agent" acting in the ordinary course of its business. (Gross premium income directly attributable to binding authority business currently is about 12 percent of the U.S. business, within the meaning of the 1980 closing agreement, conducted by underwriters at Lloyd's of London.)

Although Lloyd's (U.S.) urged us to conclude definitively that Lloyd's of London does have a permanent establishment in the U.S. -- and underwriters at Lloyd's of London urged us with equal vigor to conclude that they do not -- we believe resolution of this inherently factual issue, if necessary, should be made by the Internal Revenue Service and the courts. Nonetheless, we want to discuss the factors that could result in a conclusion that underwriters at Lloyd's of London have a permanent establishment in the U.S.

1. Illinois and Kentucky. As discussed above, underwriters at Lloyd's of London are licensed to do business in Kentucky and Illinois. Their presence in these states results from historical business interests: Lloyd's of London is a leader in insuring race horses, for which Kentucky is the most important location; likewise, Lloyd's of London is a major marine insurer and Chicago is a principal port for ships operating on the Great Lakes.

Two sets of issues are raised in connection with the Lloyd's of London operations in Illinois and Kentucky:

-- Are these permanent establishments? And, if so, do they constitute a permanent establishment for each underwriter at Lloyd's of London?

-- If the Illinois and Kentucky operations are permanent establishments, is income earned in other states "attributable to" those permanent establishments?

a. **Do the underwriters have permanent establishments in Illinois and Kentucky?**

The IRS examined the presence of Lloyd's of London in Illinois and Kentucky during the 1930s and concluded in private letter rulings that the operations constituted permanent establishments. Lloyd's of London has not challenged the validity of these conclusions, because the rulings are not relevant so long as tax is imposed pursuant to a closing agreement. However, Lloyd's of London does not concede that these rulings are still correct and has reserved the right to reexamine whether it has permanent establishments in Illinois and Kentucky if the issue is relevant in the future.14/

Underwriters at Lloyd's of London maintain attorneys-in-fact in Illinois and Kentucky who function as agents for service of process, process policy documentation, and handle the accounting and annual statement filings for the licensed business written in those two states. The attorneys-in-fact do not underwrite insurance. The insurance operations of the Lloyd's of London underwriters in Kentucky and Illinois are similar to their operations elsewhere; the business generally is provided to the underwriters though brokers, and a majority of the business consists of reinsurance or surplus lines. However, the underwriters at Lloyd's of London are fully licensed in these two states, which permits the underwriters to write direct insurance and not limit their policies to reinsurance or surplus lines coverage. The licenses for Illinois and Kentucky are, in effect, group licenses for all underwriters at Lloyd's of London; individual underwriters are not required to obtain separate licenses and the two states do not even know the identities of the underwriters.

14/ It should be noted that in a letter dated December 17, 1984, which was resubmitted in connection with this study, counsel for Lloyd's of London stated that the Illinois and Kentucky operations constituted permanent establishments: "Were it not for the Closing Agreement, none of those U.K. resident Underwriters would have a 'permanent establishment' in the U.S. . . . except to the limited extent that an Underwriter accepts risks on licensed business in Illinois and Kentucky, the only two states in which Underwriters at Lloyd's are licensed and maintain attorneys-in-fact and deposits." Letter to the IRS from counsel for Lloyd's of London dated December 17, 1984, p.2. In the same letter, at page 3, counsel describes certain U.S. income and states ". . . nor would such income be attributable to Underwriters' Illinois and Kentucky establishments." See also, same letter p. 7.

Lloyd's of London states that "[t]he existence of an attorney-in-fact solely for purposes of service of process does not constitute a permanent establishment." Letter of April 15, 1988, at page 13 n.16. That statement, while possibly correct, does not answer the question whether underwriters at Lloyd's of London in fact have a permanent establishment in Illinois or Kentucky.

There is no single test for determining whether activities constitute a "permanent establishment" and resolution of this issue, if necessary, should be left to the Internal Revenue Service and the courts. However, it is certainly possible that Lloyd's of London has permanent establishments in Illinois and Kentucky. The language of the U.S./U.K. treaty and the technical explanation of the treaty provide some guidance in determining what is meant by a "permanent establishment"; in addition, the "permanent establishment" provision of the U.S./U.K. treaty is similar to that provision in the OECD Model Double Taxation Convention and the OECD commentaries are useful on this issue. From these sources, it can be noted:

-- The attorney-in-fact may constitute a "fixed place of business" for the underwriters at Lloyd's of London; providing an agent and address for service of process is one function of the attorneys-in-fact.

-- A "fixed place of business" will not constitute a permanent establishment if the activities at that place are merely "preparatory or auxiliary" to the enterprise. The services provided by the attorneys-in-fact may not be "auxiliary" if they are regular and on-going and are essential to the continuing legal right of Lloyd's of London to operate as a licensed insurance entity in Illinois and Kentucky.

-- Even if Lloyd's of London does not have a fixed place of business in Illinois or Kentucky, it could have permanent establishments in those states if the attorneys-in-fact are considered to be "dependent agents."

In sum, there is reason to conclude that -- as the IRS held fifty years ago and as Lloyd's of London seemingly conceded four years ago (and, by implication, this year) -- the Lloyd's of London operations in Illinois and Kentucky are "permanent establishments" as that term is used in the U.S./U.K. treaty.

b. Is income earned by nonresident underwriters outside Illinois and Kentucky "attributable to" the permanent establishments in those states?

If the Illinois and Kentucky operations are permanent establishments, then most (or all) of the income earned by Lloyd's of London from operations in those states would be "attributable to" those permanent establishments. A second question is whether income earned elsewhere in the United States is "attributable to" those permanent establishments. Lloyd's of London argues that such other income would not be attributable to the two permanent establishments, and, on balance, that argument is probably correct. But there is at least a question presented which merits exploration.

Until the 1960s, the United States and most other nations followed a "force of attraction" theory for purposes of taxing business profits that arose in a country. Under this approach, if a taxpayer had a permanent establishment (or, in a non-treaty situation, engaged in a trade or business) in a jurisdiction for any of its business, all other income of that entity was deemed "attracted" to that permanent establishment (or trade or business) and subjected to net-basis income tax. The "force of attraction" theory is no longer applicable, and the test today is whether the business profits are "attributable" to the permanent establishment (in the presence of a treaty) or "effectively connected" to the trade or business (in the absence of a treaty.) Under this approach, a taxpayer may be found to have a permanent establishment (or a trade or business) for some lines or types of business activity, but not for others. See, e.g., Rev. Rul. 84-17, 1984-1 C.B. 308; Rev. Rul. 83-144, 1983-2 C.B. 295; Rev. Rul. 81-78, 1981-1 C.B. 604.

The Illinois and Kentucky insurance operations generally are operated independently of the other Lloyd's of London insurance businesses in the United States; there are separate books and records, separate trust funds, and some separate product lines. In Illinois and Kentucky, Lloyd's of London underwriters write some direct insurance, whereas the business in other states is limited to surplus lines insurance and reinsurance. Thus, it would appear that business profits arising outside Illinois and Kentucky generally should not be deemed to be "attributable to" the permanent establishments in those states.

The issue is clouded, however, by the question whether the the licenses in Illinois and Kentucky are material in enabling underwriters at Lloyd's of London to compete for business elsewhere. In one submission, counsel for Lloyd's of London explained the historical reasons for the operations in Illinois and Kentucky as follows:

> Many states' "credit for reinsurance" provisions require a reinsurer to be licensed in at least one U.S. jurisdiction in order for its cedents to be able to take

> credit on their annual statements for that reinsurance. It is for this reason that Underwriters [at Lloyd's of London] have maintained a licensed status in Illinois and Kentucky.

Letter of February 18, 1988, Attachment 8, p. 1. Unless an insurer qualifies for a "credit for reinsurance" for reinsurance placed with another insurer, the initial insurer must set aside reserves for claims notwithstanding the reinsurance agreement. This nullifies much of the advantage of reinsurance to the initial insurer and, as a practical matter, an insurer generally will not place reinsurance unless the reinsurance will be "credited" by state regulators. Thus, based on this statement by Lloyd's of London, it could be argued that the Illinois and Kentucky operations are a linchpin for income derived by Lloyd's of London in other states.

Subsequently, underwriters at Lloyd's of London provided information that (i) every state will allow a non-admitted insurer to qualify for a "credit for reinsurance" by posting a sufficient letter of credit, or other security device, in lieu of evidence that it is admitted in another state, and (ii) every state but two will allow a non-admitted insurer to provide surplus lines coverage by posting a sufficient letter of credit, or other security device, in lieu of evidence that it is admitted in another state. Thus, the U.S. trust funds may provide a sufficient basis for the Lloyd's of London underwriters to qualify to write reinsurance and surplus lines coverage in the various states, without regard to whether they are admitted in Illinois or Kentucky. In addition, the underwriters at Lloyd's of London argued that it is not sufficient that the permanent establishment be a "material factor" in earning the income for the income to be "attributable to" the permanent establishment; rather, the income must also be realized in the course of business carried on through that office -- and business outside of Illinois and Kentucky is not carried on by the offices in those states. These arguments have merit. Nonetheless, Lloyd's of London underwriters historically have used their admissions in Illinois and Kentucky to qualify to offer reinsurance and surplus lines coverage in other states and there is a non-frivolous argument that at least some income earned by the underwriters outside Illinois and Kentucky is "attributable to" the operations in those states.

2. <u>Dependent Agents</u>. Lloyd's of London argues that all its U.S. business is conducted through independent agents acting in the ordinary course of their business. Indeed, it is clear that independent agents -- independent in the sense they are insurance brokers who are permitted to place policies with many insurance companies -- are extensively involved in placing U.S. business with underwriters at Lloyd's of London and handling claims from that business. Well-known insurance brokerage firms are included among, and according to Lloyd's of London, constitute the majority of, the approximately 1,000 "coverholders" empowered to

bind underwriters at Lloyd's of London on risks. Other U.S. insurance brokers, with less authority than "coverholders," also assist insureds in placing insurance for U.S. risks with Lloyd's of London underwriters.

Lloyd's (U.S.) argues, however, that some of the "independent agents" engaged in business with Lloyd's of London underwriters are, in fact, not-so-independent agents. On this issue, as on so many, Lloyd's (U.S.) and Lloyd's of London hold dramatically different views. For instance, they disagree on the following points:

-- Whether any binding authority coverholders operate exclusively as agents for underwriters at Lloyd's of London.

- Lloyd's (U.S.) asserts that some binding authority coverholders for Lloyd's of London operate exclusively, or almost exclusively, as agents for Lloyd's of London and have no significant base of business independent of that work. Counsel for Lloyd's of London contends that in no instance is any coverholder restricted to placing business with underwriters at Lloyd's of London and states that it is unaware of any U.S. coverholder, of whatever size, who uses Lloyd's of London exclusively.

-- The scope of the authority of such coverholders to bind underwriters on risks and to settle claims.

- Lloyd's (U.S.) asserts that coverholders for Lloyd's of London have authority to conclude contracts in the name of Lloyd's of London on certain kinds of risks, up to certain limits, without review in London; after a policy is submitted to London, a U.K. agent may reject a contract, but the agreement is binding for any claim that arises prior to the rejection. Counsel for Lloyd's of London asserts that the scope of authority for a coverholder to bind underwriters is closely limited; in any event, coverholders do not have authority to prepare or issue policies. Counsel for Lloyd's of London notes that coverholders typically have similar authority to bind other foreign insurers to policies and such authority generally has not been deemed to be sufficient to cause those foreign insurers to have a permanent establishment in the United States.

-- The significance of the net accounting procedures used by brokers and the underwriters at Lloyd's of London.

- Lloyd's (U.S.) asserts that coverholders have authority, in some cases, to disburse funds on behalf of Lloyd's of London to settle claims, without prior review or approval by Lloyd's of London; brokers may retain premium payments for a period, invest them in

> short-term accounts, use the premiums to settle claims, and remit only a net balance to the Lloyd's of London trust fund. Counsel for Lloyd's of London responds that the settlement authority of coverholders is closely limited; underwriters may override the coverholder in the adjustment and settlement of any claim. Moreover, remitting only net premiums is typical for the industry.

There is, of course, no bright-line test for when an agent is a dependent agent (so that he may constitute a permanent establishment) and when an agent is an independent agent. It is not necessary for a person to be an employee of an enterprise in order to be a dependent agent; likewise, the fact that a person operates his own business (such as an insurance brokerage firm) does not guarantee that he will be an independent agent for a company that he represents.

Neither the text nor the technical explanation of the U.S./U.K. treaty provides useful guidance on the distinction between a dependent and an independent agent. The commentary to the OECD model convention -- the text of which is substantially identical on this point to the text of the U.S./U.K. treaty -- is helpful, but not determinative. The commentary states, in part:

> A person will come within the scope of paragraph 6 -- i.e., he will not constitute a permanent establishment of the enterprise on whose behalf he acts -- only if
>
> (a) he is independent of the enterprise both legally and economically, and
>
> (b) he acts in the ordinary course of his business when acting on behalf of the enterprise.
>
> Whether a person is independent of the enterprise represented depends on the extent of the obligations which this person has vis-a-vis the enterprise. Where the person's commercial activities for the enterprise are subject to detailed instructions or to comprehensive control by it, such person cannot be regarded as independent of the enterprise.

Lloyd's of London argues that this language compels a conclusion that the U.S. coverholders are independent agents. It asserts that most coverholders are large insurance brokerage firms that carry on business for many companies in addition to underwriters at Lloyd's of London; thus, the coverholders are not economically dependent on Lloyd's of London. In addition, the instructions to and control of coverholders provided by underwriters at Lloyd's of London is typical of the industry and not equivalent to the control exerted over an employee.

Lloyd's of London also raises two other arguments in support of its conclusion that its business operations should not be deemed to constitute a permanent establishment within the meaning of the U.S./U.K. treaty:

1. Other U.S. treaties, such as those with Belgium and France, have special terms applicable to the permanent establishments of insurance companies that lower the threshold for certain insurance income to be taxable on a net basis. There is no such special term in the U.S./U.K. treaty.

2. The OECD commentary recognizes that an insurance enterprise may have extensive operations in another country without creating a permanent establishment. The OECD commentary notes that countries may wish to alter their treaties to prevent this result. The U.S./U.K. treaty, which took effect after the OECD commentary was published, does not have a special insurance provision in the permanent establishment article.

Lloyd's of London argues that, by not providing special rules for insurance agent binding authorities, the U.S./U.K. treaty intended to treat this type of agent as an independent agent that would not create a permanent establishment.

The assertions by Lloyd's of London may be correct, but that is not clear. There is a dearth of useful guidance on the distinction between independent and dependent agents, and, ultimately, the distinction is so bound by facts and circumstances that the conclusions to be drawn for a particular taxpayer often could only be resolved by a court. Nonetheless, in response to the arguments advanced by the underwriters at Lloyd's of London, we note:

1. The absence of a special insurance provision in the U.S./U.K. treaty could have resulted, in part, from the fact that Lloyd's of London -- the most significant British insurance enterprise active in insuring U.S. risks -- was subject to a specially negotiated taxing regime under a closing agreement.

2. Reg. sec. 1.864-7(d)(3), which was cited by Lloyd's of London and which attempts to distinguish dependent agents from independent agents, states:

> Exclusive agents. Where an agent who is otherwise an independent agent within the meaning of subdivision (i) of this subparagraph acts in such capacity exclusively, or almost exclusively, for one principal who is a nonresident alien individual or a foreign corporation, the facts and circumstances of a particular case shall be taken into account in determining whether the agent, while acting in that capacity, may be classified as an independent agent.

Lloyd's (U.S.) asserted that at least some individual U.S. agents for Lloyd's of London work, as a practical matter, "almost exclusively" for underwriters at Lloyd's of London.15/ Counsel for the underwriters at Lloyd's of London expressed doubt about this assertion, but could not, of course, refute it. (The underwriters at Lloyd's of London would have no basis for knowing whether a U.S. broker with binding authority has discontinued its work for non-Lloyd's of London underwriters.)

3. The fact that an individual operates, at times, as an independent agent does not prevent a conclusion that other actions can cause the individual to be deemed to be a dependent agent who will give rise to a finding that his foreign principal has a permanent establishment. See, e.g., OECD Commentary to the Model Double Taxation Convention, Art. 5, Para. 37 (1977).

In sum, the issue whether some or all of the U.S. coverholders (and other agents) for the underwriters at Lloyd's of London are dependent agents is not clear. But it appears, on balance, that there is a reasonable argument that (i) the degree of control exercised by Lloyd's of London over the coverholders; (ii) the scope of authority (to conclude contracts and settle claims) exercised by some coverholders; (iii) the economic interdependence that some coverholders may have upon the Lloyd's of London market; and (iv) the frequent and sustained nature of some coverholders' actions on behalf of underwriters at Lloyd's of London in the United States supports a conclusion that the underwriters at Lloyd's of London have a permanent establishment (or establishments) in the United States.

Assuming that at least some of the U.S. agents are dependent agents, an extremely difficult issue would arise as to how to determine what U.S. insurance income is "attributable to" the permanent establishment. A thorough analysis would require a determination of the status of each U.S. agent (as a dependent or independent agent) for purposes of each individual transaction. Such an analysis would, of course, be virtually impossible. The difficulty presented, however, does not eliminate the fact that, for at least certain transactions, we believe it is likely that some of the U.S. insurance income earned by nonresident underwriters of Lloyd's of London is earned through a permanent establishment.

15/ The regulation could be read to mean that, because numerous individual underwriters at Lloyd's of London subscribe to each risk, no U.S. coverholder could ever work "exclusively or almost exclusively" for one principal. We do not believe that is a proper reading of the regulation in the context of an entity structured like Lloyd's of London.

E. Reexamination of the U.S./U.K. Treaty

If the analysis above is incorrect -- so that underwriters at Lloyd's of London do not have a permanent establishment (or establishments) in the U.S. -- and an appropriate closing agreement is not reached with the underwriters, the Treasury Department and Congress would need to reexamine the terms of the U.S./U.K. tax treaty. We do not make this statement lightly, nor is it intended as a threat; indeed, the underwriters at Lloyd's of London repeatedly have stated their willingness to enter into a reasonable closing agreement. Nonetheless, it is important to acknowledge that we would necessarily be required to consider whether the treaty strikes an appropriate division of taxing authority if an estimated $3 billion in insurance premiums for U.S. situs business were paid annually to U.K. underwriters (and deducted, for the most part, by U.S. taxpayers) without collection of either a net-basis income tax or an excise tax by the United States.

As a general matter, the U.S. historically has favored (i) a high threshold for determining when a nonresident entity is subject to net-basis tax (i.e., a high threshold for finding there is a permanent establishment) and (ii) no special taxing regimes on insurance companies. These positions reflect the fact that (i) the U.S. tends to have more direct investment abroad than foreign investors have in the U.S., and (ii) U.S. insurance entities tend to insure more foreign risks than foreign entities insure U.S. risks. More generally, the U.S. favors tax rules that encourage the free flow of investment. The U.S./U.K. treaty reflects these views. But, if it is concluded that the U.S. must forgo any tax revenues on the premiums paid to U.K. underwriters in Lloyd's of London, that would significantly affect the balance of benefits that the Treasury Department understood it was securing in negotiating the current treaty.

VII. CONCLUSIONS

As is evident from the analysis, there are many questions and few clear answers in seeking to respond to Congress's question: What is the proper Federal income tax treatment of income earned by members of insurance or reinsurance syndicates? In addition, what, if anything, should be done with the 1980 closing agreement between the IRS and underwriters at Lloyd's of London?

Despite the uncertainties, we believe it is appropriate to suggest several conclusions:

1. The operations of Lloyd's of London are so unique, and so resistent to conventional tax categorization, that treatment under an appropriate closing agreement offers substantial advantages to both the Internal Revenue Service and the taxpayers. The same conclusion may not apply to other insurance syndicates, particularly U.S.-based syndicates, where the tax

status of participants is likely to be less diverse and where the interests of foreign governments are likely to be less significant.

2. It is appropriate to treat individual underwriters as the taxable entities in insurance syndicates structured in the general manner employed by Lloyd's of London. Arguments can be made that the appropriate taxable entity is either the separate syndicates or the entire organization (that is, treating each underwriter as a "shareholder" of the entity). However, there does not appear to be any sufficient justification to challenge the taxpayers' characterization of the individual as the appropriate taxable entity.

3. In the absence of a closing agreement, there appear to be two alternative methods of tax accounting that could be applied to determine the insurance income (underwriting income or loss and investment income) of an underwriter in Lloyd's of London or Lloyd's (U.S.) under the Internal Revenue Code.

a. The underwriter could be treated as or deemed to be a corporation and then taxed as an insurance company under subchapter L. This would permit the underwriter to take deductions for reserves. Tax would be imposed at the corporate level, using corporate rates; a second tax would be imposed upon an actual or deemed distribution of corporate profits.

b. Alternatively, an underwriter could be treated as an individual doing business as a sole proprietor. Such an individual would not be permitted to take reserve deductions, which are available only to insurance companies taxed under subchapter L. The individual could deduct claims in the years payments are made.

We are not persuaded by the assertion of Lloyd's of London or Lloyd's (U.S.) that individual underwriters should be subject to only one level of tax but be permitted to claim reserve deductions (or to delay recognition of premium income by placing premiums in a trust, which is similar in effect to establishing a reserve). We do not believe, and we do not think Congress believes, that it is appropriate for individuals, either as sole proprietors or as shareholders in a subchapter S corporation, to use a tax accounting method that allows reserve deductions and still be subject to only one level of tax. Congress may, of course, choose to revisit this issue in the future. Significantly, the passive loss rules adopted in 1986 reduced the magnitude of one problem that Congress saw with permitting individuals to claim reserve deductions -- the use of reserve deductions to shelter income from other, unrelated activities.

4. The 1980 closing agreement between the IRS and underwriters at Lloyd's of London should be revised in light of changes in the law since 1980 for the taxation of both U.S. persons and foreign persons. In particular, underwriters at

Lloyd's of London should not be permitted for U.S. tax purposes to use an accounting method that provides for reserves without being subject to a corporate level tax, or the equivalent thereof.

5. We believe that, as a matter of policy, nonresident underwriters at Lloyd's of London generally should be taxed on their U.S. insurance income (premium income and investment income) as if it were effectively connected with the conduct of a U.S. trade or business (or, in the case of underwriters eligible for treaty benefits, as if the income were attributable to a U.S. permanent establishment). This is the approach adopted in the current closing agreement. If nonresident underwriters are deemed to be conducting their activities as corporations, insurance income subject to net-basis U.S. taxation when it is earned should be subject to a second-level tax, the branch profits tax, upon its deemed distribution, unless an applicable treaty bars collection of the branch tax.

We recognize that, in the absence of a closing agreement, a significant amount of U.S. source income earned by underwriters at Lloyd's of London from U.S. situs business might not be subject to U.S. tax. Nonetheless, we conclude that taxing nonresident underwriters at Lloyd's of London on a net basis for their insurance income from U.S. business should be the primary premise for a closing agreement. We note, in particular, the following:

a. In the absence of a closing agreement and under existing law, net-basis taxation would be applicable to (i) some of the U.S. source income earned by most nonresident underwriters at Lloyd's of London (e.g., income attributable to licensed operations in Illinois and Kentucky), and (ii) most of the U.S. source income earned by some nonresident underwriters (e.g., underwriters not eligible for treaty benefits.)

i. Lloyd's of London underwriters are almost certainly engaged in the conduct of a U.S. trade or business for some, and perhaps a substantial portion, of their business operations. Thus, underwriters not eligible for treaty benefits would be subject to net-basis taxation on some, and perhaps a substantial portion, of their U.S. income.

ii. The operations of Lloyd's of London in Illinois and Kentucky most likely constitute permanent establishments. Thus, even nonresident underwriters eligible for treaty benefits probably are subject to net-basis taxation on at least some of their U.S. insurance income. It is possible that some non-Illinois, non-Kentucky insurance income is "attributable to" the permanent establishments in those two states.

iii. Some U.S. coverholders with binding authority to represent Lloyd's of London probably would be found by a court to be "dependent agents" so that they constitute a permanent

establishment within the meaning of the U.S./U.K. treaty. Thus, some additional amount of non-Illinois, non-Kentucky insurance income of nonresident underwriters eligible for treaty benefits would be subject to U.S. net-basis tax.

b. In the absence of a closing agreement, income earned by nonresident underwriters that is not subject to net-basis U.S. taxation would, in some instances, be subject to the insurance premium excise tax imposed by section 4371 of the Code. Although the U.S./U.K. treaty limits collection of this excise tax, many other treaties do not.

c. Without a closing agreement, it would be extremely difficult for the underwriters at Lloyd's of London (or the IRS) to determine what income is subject to U.S. net-basis tax, what income is subject to the insurance premium excise tax, and what income is not subject to U.S. tax at all. The enforcement procedures that would be required to ensure collection of the appropriate U.S. tax, in the absence of a closing agreement, would be disruptive to the underwriters and expensive for the IRS. A closing agreement offers an opportunity for certainty and fairness to the underwriters and IRS that could not be achieved otherwise.

6. In the event that U.S. citizens and resident aliens who are underwriters at Lloyd's of London are subject to U.S. tax under a closing agreement, the terms of that agreement must not cause a material difference in the tax that would otherwise be due on their insurance income.

7. If an appropriate closing agreement is not reached with the underwriters at Lloyd's of London and it is determined that, absent a closing agreement, premiums paid to U.K. resident underwriters in Lloyd's of London are not subject to either net-basis taxation or the insurance premium excise tax, the Treasury Department and Congress would need to reexamine the terms of the U.S./U.K. income tax treaty.

* * *

The legislation directing Treasury to conduct this study also requires Treasury to renegotiate the closing agreement with the underwriters at Lloyd's of London to reflect the conclusions of the study. We intend to do so. In particular, we intend to pursue the following objectives:

-- Income earned by nonresident underwriters of Lloyd's of London generally should be subject to net-basis taxation, and, where applicable, a branch profits tax.

-- The closing agreement should not create a material disparity between the taxation of U.S. citizens and resident aliens who are underwriters at Lloyd's of London and the taxation Of U.S. resident underwriters in U.S. based Lloyd's-type syndicates who earn income in an equivalent manner.

-- The tax accounting rules applied to all Lloyd's of London underwriters should be reexamined, and, if necessary, modified to ensure that use of special accounting rules does not result in a material difference in the tax due.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE

February 22, 1989

Monthly Release of U.S. Reserve Assets

The Treasury Department today released U.S. reserve assets data for the month of January 1989.

As indicated in this table, U.S. reserve assets amounted to $48,190 million at the end of January, up from $47,802 million in December.

U.S. Reserve Assets
(in millions of dollars)

End of Month	Total Reserve Assets	Gold Stock 1/	Special Drawing Rights 2/3/	Foreign Currencies 4/	Reserve Position in IMF 2/
1988					
Dec.	47,802	11,057	9,637	17,363	9,745
1989					
Jan.	48,190	11,056	9,388	18,324	9,422

1/ Valued at $42.2222 per fine troy ounce.

2/ Beginning July 1974, the IMF adopted a technique for valuing the SDR based on a weighted average of exchange rates for the currencies of selected member countries. The U.S. SDR holdings and reserve position in the IMF also are valued on this basis beginning July 1974.

3/ Includes allocations of SDRs by the IMF plus transactions in SDRs.

4/ Valued at current market exchange rates.

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TREASURY NEWS

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TESTIMONY OF THE HONORABLE
NICHOLAS F. BRADY
SECRETARY OF THE DEPARTMENT OF THE TREASURY
BEFORE THE
HOUSE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
THURSDAY, FEBRUARY 23, 1989

INTRODUCTION

Mr. Chairman, Mr. Wylie, and Members of the Committee.

From the day when I was sworn in as Secretary of the Treasury, a top priority has been to achieve a sound, responsible response to the savings and loan crisis. President Bush is correct: No simple or painless solution to this problem exists. Only eighteen days after he was inaugurated, however, he announced the Administration's plan. In doing so, President Bush reaffirmed our commitment to fix it now, fix it right, and fix it once and for all.

Two watch words guided us as we prepared a plan to solve this problem--NEVER AGAIN.

- Never again should a federal insurance fund that protects depositors become insolvent.
- Never again should insolvent federally-insured depository institutions remain open and operate without sufficient private risk capital.
- Never again should risky activities permitted by individual states put the federal deposit insurance fund in jeopardy.
- Never again should fraud committed against financial institutions or depositors be punished as if it were a victimless white-collar crime.
- Never again should the nation's savings and loan system, which is important to our commitment to available, affordable housing, be put in jeopardy.

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The Administration plan meets these standards. It serves as a blueprint for comprehensive reform and sound financing. It assures the emergence of a healthy and strong S&L industry and for this reason is pro-industry -- both for S&Ls and for the housing industry they serve. Moreover, it has the strong support of the federal regulators -- the Federal Reserve Board (Federal Reserve), the Federal Deposit Insurance Corporation (FDIC), the Federal Home Loan Bank Board (Bank Board), and the Comptroller of the Currency (OCC).

When the President announced his plan, he also called on Congress to join him -- with all possible speed -- to solve the savings and loan crisis. Today I can report to you that a key part of the administrative reform is already underway.

On February 7, the day after the President announced his plan, the Federal Savings and Loan Insurance Corporation (FSLIC), FDIC, OCC, and the Federal Reserve worked together to stabilize control of the remaining insolvent institutions and impede them from enlarging the S&L deficit. By that action we should begin to reduce the cost of funds over time -- for banks, as well as for savings and loans -- and to control the losses in the insolvent S&Ls. Moreover, our quick action will give us a head start on consummating the resolutions, which will be executed as soon as Congress provides the necessary financing.

This joint supervisory operation was designed with several purposes in mind: first, to conserve the assets of troubled savings institutions; and second, to preserve day-to-day banking services for the public until a permanent resolution of the institutions' problems can be put in place.

Our objectives are to minimize operating losses, restrict unwarranted or unsound growth, eliminate speculative activities and destructive competition in deposit rates, and to get rid of waste, fraud, and insider abuse wherever it exists.

I would like to emphasize that during this interim period, insured depositors remain fully protected, basic customer services will not change, and each institution's employees will continue to conduct the normal day-to-day operations of the institution. These institutions are open, with deposits backed by the federal government, and ready to do business with their customers.

The supervisory and resolution personnel of the FDIC and the other agencies are preparing for resolutions and are in a good position to act swiftly once the legislation is in place. This early start on the cooperative supervisory process saves us both time and money. Fast action by all parties -- the

Administration, the regulators, and the Congress -- will help reduce the industry's cost of funds by getting the insolvent institutions resolved, out of the marketplace, and out of the business of needlessly bidding up interest rates.

Given the magnitude of the problems we face, expedited and stabilizing action provides an orderly transition to the new regulatory structure we propose. We now need legislative action by the Congress to put the reform and financing plan into place to finish the job.

In short, we have proposed a blueprint for reform. We now need your help to build a solid structure for the savings and loan industry to ensure a strong foundation for housing finance in the future. The President has asked me to deliver to the bipartisan leadership of this Committee our comprehensive plan. We respectfully request that you introduce it today. In his budget message to the joint session of Congress on February 9, President Bush called on the Congress to deliver a reform package to him in 45 days. Once Congress acts, we will be ready to move to stem the hemorrhaging.

This is a tall order, but I pledge to you the full cooperation of the Administration. Cooperative and expedited action by the Congress and the Executive branch will help to reassure the millions of American savers, who rely on deposit insurance protection, that we indeed have a safe and sound financial system that will continue to meet their saving and borrowing needs in the future.

THE SAVINGS AND LOAN PROBLEM

Our plan attempts to right the wrongs of the past. Consequently, an understanding of how the current problem arose will not only place our plan in the proper context, but also explain why we have come forward with the detailed package we present to you today.

Causes of the Problem

Inflation, Interest Rates, and Regulation Q. In the middle 1960s, savings and loans began experiencing liquidity and earnings problems caused by increased inflation and the resulting high, volatile interest rates. Mainly to protect these institutions from the effects of rising interest rates and excessive competition for funds from commercial banks, Congress, in 1966, placed commercial banks, mutual savings banks and savings and loans under deposit interest rate regulation (Regulation Q).

Consumer Demands for Market Rates. In the late 1970s, when rising inflation and interest rates exceeded Regulation Q ceilings, many savers became unwilling to limit themselves to the returns allowed under these artificially low interest rate ceilings. These savers withdrew their deposits from traditional savings accounts -- a process called disintermediation -- and invested them in newly-emerging, uninsured money market mutual funds. As a result of market forces, both consumers and depository institutions pressured Congress to remove the Regulation Q ceilings, which it did in the Depository Institutions Deregulation and Monetary Control Act of 1980.

Changes in Technology. Starting in the 1970s, the development of electronic technologies made it possible for funds to be withdrawn or shifted between institutions and across geographic boundaries instantaneously. Devices such as repurchase agreements for securities and certificates of deposit, marketed aggressively through brokers and underwriters, made it possible for institutions to draw depositors from a broad geographic base. They also enable depositors to withdraw their money from those institutions very quickly, thus permitting funds to flow to the highest bidder.

Furthermore, technological innovations made possible the securitization of mortgage loans. This development has allowed thrifts and non-thrifts to originate mortgages and sell them in the broader capital markets to investors such as insurance companies and pension funds. This, in turn, has increased competition and reduced the interest rate spreads and profit margins at banks and savings and loans.

Spread Problem. The high, short-term cost of deposits and lower embedded fixed rates on mortgages produced losses and drained capital from the S&L industry during the late 1970s and early 1980s. The industry's tangible capital fell from $28 billion in 1978 to $4 billion in 1982, a reduction of 85 percent.

Broadened Powers. In 1982, responding to the interest rate problems of thrifts, Congress passed the Garn-St Germain Depository Institutions Act. This law gave the Federal Home Loan Bank Board authority to substantially broaden the powers of Federally chartered thrift institutions. Subsequently, the Bank Board relaxed controls on consumer and commercial real estate lending.

Direct Investments. In response to the reduced spreads available in mortgage lending, some states permitted state-chartered savings and loans to diversify their asset portfolios. That change pulled capital away from residential mortgage loans and into significant amounts of direct investment in real estate and equity securities not permitted to federally-chartered

institutions. State-chartered savings and loans that took advantage of these investments were still insured by the FSLIC, even though many of their investments extended beyond traditional home financing and were riskier than the activities Congress has authorized for federally-chartered institutions.

In the new regulatory environment, some institutions moved too quickly into activities for which they were unprepared. Regulators at all levels were slow to strengthen their supervision and enforcement capabilities. Diversification can be a healthy business practice, but proper supervisory practices are also required.

Inadequate Supervision Exacerbated by Deregulation. Supervisory and regulatory laxity in oversight also contributed to the current FSLIC problem. Inadequate capital requirements allowed thrifts to grow quickly with almost no "at-risk" capital. Low equity, in turn, encouraged greater risk taking. Belated authorization to issue adjustable rate mortgages prevented savings and loans from properly adjusting the maturity gap between deposits and mortgage loans. High turnover of the supervisory and examination personnel reduced the number and experience of much-needed industry watchdogs. And perhaps most disturbingly, the agency regulating the industry faced the often conflicting statutory goals of supervising, advocating, and insuring depository institutions in the name of promoting a stable housing finance market.

Imprudent Managers and Fraud. Compounding these problems has been the entry of some imprudent operators into the savings and loan industry. Managers used S&Ls and their authority to further their own business and other interests and not to foster traditional home financing.

Moreover, many of these "high fliers" used their institutions to finance lavish lifestyles and to engage in speculative and fraudulent business activities. Testimony to this effect was prepared by the Bank Board for presentation to the House Financial Institutions Subcommittee on June 9, 1987. An excellent report has been prepared by the House Government Operations Subcommittee chaired by Representative Doug Barnard.

The Justice Department continues to conduct large scale criminal investigations of financial institution fraud and embezzlement. As of September 30, 1988, 7,385 such investigations were open. Of these, 3,446 involved losses to institutions of $100,000 or more.

Attorney General Richard Thornburgh already has testified on the fraud problem confronting us. Estimates by the General Accounting Office (GAO) and others reveal that fraud may account

for more than one-third of the failures in the S&L industry that we must now finance. The Federal Home Loan Bank Board's list of "significant" fraud cases turned over to the Justice Department involve institutions with total assets of $160 billion.

Economic Downturn in the Southwest. Finally, the economic downturn and general price deflation in the agricultural, real estate, and oil and gas sectors of the economy have created serious problems in the Southwest. Even well-managed thrift institutions in the Southwest now face widespread non-accruing loans, collateralized, in many cases, with non-salable properties.

Summary. In sum, consumer demand for increasing market interest rates on deposits, combined with both technological changes as well as high and volatile interest rates, resulted in negative interest rate spreads in the late 1970s and early 1980s. This, in turn, drastically reduced the industry's aggregate capital-to-asset ratio from 5.6 percent in 1979 to 2.9 percent in 1982. Once market interest rates declined, most institutions became profitable again. They started to rebuild their capital holdings. Other institutions, however, took advantage of the expanded state-authorized asset powers, the low capital requirements, and inadequate examination and supervision. The resulting problem portfolios were characterized by excessive risk and poor asset quality due to rapid growth. The economic downturn in the Southwest quickly reduced such portfolios to collections of non-earning assets.

OBJECTIVES OF THE ADMINISTRATION'S PLAN

To ensure that the tremendous losses in the industry never happen again and to minimize the total cost of resolving the problem, the Administration plan makes structural reforms a prerequisite for the use of any taxpayer funds and provides for the necessary funding to solve the problem now. The following Administration objectives guided the development of our plan:

- Reform -- a prerequisite to additional funding;
- A flexible financing plan of sufficient capacity to repair the damage;
- Institutional arrangements that lessen the disruption in the industry and avoid creating new government bureaucracies;
- Utilizing a fair level of S&L industry sources of funds before using taxpayer funds;

- Precise and trackable accounting for all public and private funds employed in resolving the S&L problem;

- Structural reforms that are sound, but practical enough to accommodate the market-driven changes that develop in any competitive industry;

- Funding for an adequate, on-going, self-financed savings association insurance fund, so that Treasury funds will not be needed again to bolster the deposit insurance funds;

- Protecting American taxpayers by assuring full financial and regulatory accountability through Treasury oversight; and

- Finally, sufficient private capital and industry-financed insurance funds standing between financial institution failures and the taxpayers.

OUTLINE OF THE PLAN

Let me summarize the Administration's comprehensive reform proposal in the following manner: first, by delineating the major structural reforms we seek; second, by providing an overview of the other reforms we propose; and, finally, by explaining how the resolution of the remaining insolvent institutions, which we have already begun, will be financed. The President's legislative package and the section-by-section analysis to be provided later give you all of the necessary details.

Structural Reforms

One Strong, Independent Insurance Administrator. The current organization of the thrift system dates from the New Deal. As the events of the 1980s have demonstrated, this system is antiquated. Furthermore, the goals of the regulator as an industry advocate and insurer are inherently in conflict. To correct this systemic problem, the FSLIC will be separated from the Bank Board and attached administratively to the FDIC (see Chart 1). This will create a strong, independent insurer with the over-arching mission to protect depositors and to maintain the integrity of the deposit insurance fund.

The considerable administrative expertise of the two corporations will be available to manage financial, insurance, and regulatory issues. While a single agency will be created, however, separate insurance funds will be maintained for commercial banks and for savings and loans. The separate insurance funds will not be commingled, and premiums from each industry will be used only for its own insurance fund.

The FDIC Board will be expanded from three to five members. Three members, including the Chairman, will be private citizens appointed by the President and confirmed by the Senate. The two remaining members will be the Comptroller of the Currency and the Chairman of the newly-renamed Federal Home Loan Bank System (FHLBS).

The Chairman of the FHLBS will continue to be the chartering authority for federal savings and loan associations and mutual savings banks, will supervise the Federal Home Loan Mortgage Corporation, and it will be the primary federal supervisor of savings and loans (see Chart 1). The current board will be replaced by a single chairman. The Chairman of the FHLBS will be subject to the general direction of the Secretary of the Treasury in the same manner as the Comptroller of the Currency. The new FHLBS Chairman will also be the head of the system of 12 Federal Home Loan Banks (FHLBanks), which currently make loans to member institutions and supervise and examine them as well. The chief supervisory employee of each FHLBank will report directly to the chief supervisory officer in Washington.

By separating the insurer from the chartering agency, more serious disciplinary standards designed to protect the integrity of federally-insured deposits can be maintained. In addition, by subjecting the actions of the FHLBS to oversight by the Treasury Department, the interests of the taxpayers can be more fully and consistently protected. This Treasury oversight has existed for national banks since the Administration of President Abraham Lincoln. These steps will create a system of checks and balances for savings and loans that more closely parallels that for commercial banks.

Some observers have already expressed reservations about Treasury oversight of the primary thrift supervisor in a manner that parallels our authority over national banks. Let me assure the Committee that we do not intend to micro-manage the revitalized Federal Home Loan Bank System. That concern led to our designating a chairman who would serve and function as a chief executive officer.

It is critical, however, that we exercise the proper degree of oversight. The reason is clear: Treasury funds are being used for the first time as part of the clean-up operation.

Treasury oversight is essential to ensure that these problems and the strain they place on our financial system do not occur again. Treasury oversight is essential to ensure a strong and safe system for readily available home financing.

Enhanced Safety and Soundness Standards

Capital Requirements. We are experiencing the results today of an industry that collectively has not been adequately capitalized. We have learned a valuable lesson: Deposit insurance simply will not work without sufficient private capital at risk and up front.

The Administration plan will increase safety and soundness standards for savings and loan institutions by requiring these institutions to meet standards equivalent to commercial bank capital and regulatory standards within a two-year period. This is consistent with the on-going efforts of all the federal financial regulators, including the current Bank Board, to implement risk-based capital to ensure that sufficient private capital is at risk ahead of the deposit insurance fund. Again, private capital is the best assurance that the federal insurance of deposits will not be exposed to undue risk and imprudent investment behavior.

All savings and loans will be required to meet capital requirements equivalent to those for national banks by June 1, 1991. Some 1,240 savings and loans with total assets of $319 billion already meet this capital requirement, while the remaining 1,368 solvent institutions will be expected to raise the necessary capital internally or externally or by merging with stronger institutions.

The Chairman of the FHLBS will oversee and manage this transition period. When S&L capital standards become equivalent with those for banks, S&Ls could have a 50 percent break in the amount of required capital because of the treatment of home mortgage assets under the Basle capital agreement. Moreover, S&Ls will be given 10 years to amortize the goodwill on their balance sheets.

Some stockholders may suffer dilution of their holdings, but appropriately we are achieving a safer and stronger system where private capital stands ahead of the government's insurance of deposits, giving taxpayers enhanced protection. At the same time, we expect a lower cost of funds for the solvent portion of the industry once unfair competition from insolvent institutions is removed.

Incentives for New Capital. Incentives for attracting new capital will further increase the amount of private capital protecting depositors. Several barriers to the entry of traditional financial services companies will be eliminated. For example, bank holding companies will be permitted to acquire a failed or failing savings and loan without the existing cross-marketing and tandem restrictions. After two years, bank holding companies will be able to acquire any savings and loan without these restrictions.

Additional Supervisory Powers. The FDIC will be given enhanced authority to set insurance standards for all savings and loans, both federal and state-chartered. It will be able to restrict risky activities that have been authorized by some states in the past. The FDIC also would have a "fast whistle" to halt unsafe and unsound practices, while still protecting insured depositors. Furthermore, all insured depository institutions within holding companies would guarantee the insurance fund against loss in the event of the failure of any insured depository institution owned by the same holding company.

Putting Deposit Insurance on a Sound Financial Basis for the Future

There is a fundamental requirement that the federal deposit insurance funds are put on a sound financial basis. This can be accomplished by reestablishing the basic principle of industry-financed deposit insurance funds standing between any future industry problems and the taxpayer.

The cost of the S&L solution underscores the importance of requiring all federal deposit funds to be adequately capitalized. Consistent with this mandate is the creation of a sound savings association insurance fund, not just after-the-fact financing for insolvent S&Ls. It is equally important that we shore up the commercial bank insurance fund. The FDIC insurance fund's reserve-to-insured deposit ratio has fallen to an estimated all-time low of 0.83 percent from its historical average of 1.40 percent.

We propose increasing commercial bank premiums to bring the FDIC fund back in line with its historical reserve-to-deposit ratio to protect depositors and taxpayers. Specifically, we propose a gradual rise in the deposit insurance premiums paid by commercial banks from $.08 per $100 in deposits to $.15 per $100 in deposits by 1991. Premiums would be rebated when the bank insurance fund is in excess of a 1.25 percent reserve-to-deposit ratio.

It is important to point out that this is the first statutory increase in the FDIC's deposit insurance premium since 1935. During the intervening years, the amount of deposits insured per depositor in any one institution has increased from $2,500 in 1933 to the current level of $100,000.

Let me emphasize, however, that all of the increased premium revenue paid by commercial banks will go to the FDIC insurance fund; <u>not one penny from commercial banks will go to any S&L resolution or to the new savings association insurance fund</u>.

Emergency special assessment authority will be granted to the FDIC. The FDIC will be permitted to raise the overall premium level when the fund is too low, as well as to lower premiums when it is fully funded. Thus, risk-based capital and experience cost-based premiums will ensure that the costs to the funds are covered. The maximum cap on the premiums paid by commercial banks or S&Ls would be 35 basis points.

The Administration's reform plan also proposes to strengthen the National Credit Union Share Insurance Fund (NCUSIF) by having it use accounting procedures comparable to those used by the FDIC and FSLIC. The NCUSIF is currently structured such that each insured credit union places and maintains one percent of its shares on deposit in the fund and treats the contribution as an asset on its balance sheet. This contrasts with the practices of both the FSLIC and the FDIC in which insured institutions treat their premium contributions as expenses. As long as credit unions consider their contributions as assets, they will resist the using of these assets to cover insurance losses.

Therefore, we recommend that credit unions be required to expense the one percent of deposits they maintain at the NCUSIF over an 8-year transition period. During this transition period, no additional premiums would be collected. At the end of 8 years, the NCUSIF would avail itself of its existing statutory authority to collect a 1/12 of one percent premium.

<u>Enhanced Enforcement Authority</u>

As part of the comprehensive reform package, we must ensure that fraud and financial institution crimes are pursued and punished as befitting their grave societal costs. The fraud and abuse are widespread and well-known to the American public through news accounts. Our proposal will add new enforcement authorities, increase penalties for fraud, and increase funding to provide for dramatically increased law enforcement staff and

prosecutions. The scope of federal regulators' enforcement authority will be broadened to include all insiders, in addition to the managers of an institution. It will also grant regulators broader power to impose temporary cease-and-desist orders.

We have borrowed a page from the Administration's war on drugs and drug money laundering in drafting our new enforcement authority. Maximum civil penalties will be raised to $1,000,000 per day, and maximum criminal penalties to 20 years, with mandatory minimum sentencing. Authority will also be provided for regulatory agencies to pay rewards to informants. Civil penalty authority will be given to the Justice Department for the first time. These civil penalties will be cumulative to criminal sanctions. Also, we propose to add civil and criminal seizure and forfeiture authority similar to the forfeiture authority for drug and drug money laundering.

Most importantly, approximately $50 million per year would be authorized for three years for the Justice Department to fund a new national program to search out financial institution fraud. This program will include new investigators, auditors, analysts, and prosecutors trained in specialized and sophisticated methods of financial institution fraud. Indeed, the number of personnel devoted to investigating and prosecuting bank and thrift fraud will be approximately doubled.

A Revitalized Housing Finance System

Today, as in the past, the S&L industry plays an important role in housing finance. The S&L industry's problems do not stem fundamentally from their traditional business of mortgage financing. Nonetheless, problems in the S&L industry are a threat to the viability of our housing finance system.

The Administration's plan is designed explicitly to promote housing finance by revitalizing the S&L industry and the FHLBS. The regulatory reforms outlined earlier as well as oversight by Treasury of the FHLBS help insure a financially viable S&L industry to serve housing finance. We believe the best thing for housing finance in this country is a strong and sound S&L industry.

Moreover, the plan provides for explicit representation for the housing industry on the boards of directors of the regional Federal Home Loan Banks. The objective is to ensure that the concerns of the housing industry play a direct role in the policies and practices of these government sponsored enterprises.

Finally, the plan provides funding not just to resolve insolvent S&Ls, but also includes funding to establish a new S&L insurance fund for the future. The majority of future S&L insurance premiums are allocated to this insurance fund; none pay for REFCORP interest. And Treasury funds are allocated to the insurance fund as well, giving tangible proof of our commitment to the future of the S&L industry as a provider of housing finance.

Restoring the Industry to Financial Health

During 1988, the Bank Board resolved 205 institutions and stabilized 17 others. But the factors I have outlined combined to create such a problem that there still remain a total of about 350 S&Ls insolvent according to generally accepted accounting principles, or GAAP, and an additional roughly 150 which, while GAAP solvent, have negative tangible net worth. These institutions held about $265 billion in assets and had negative net worth on the order of $18 billion as of September 1988, the latest available figures.

Let me describe in some detail the Administration plan for restoring the S&L industry to financial health. It has three components. The first $50 billion is to resolve currently insolvent institutions and any other marginally solvent institutions which may become insolvent over the next several years. Secondly, the plan ensures adequate servicing of the $40 billion in past FSLIC obligations. And third, and perhaps most important, the plan provides $33 billion in financial resources necessary to put S&L deposit insurance on a sound financial basis for the future.

At the heart of our plan is the creation of a Resolution Trust Corporation (RTC), for which the FDIC will be the primary manager directed to resolve all S&Ls which are now GAAP insolvent or become so over the next three years (see chart 2). The creation of this new corporation will serve several practical business purposes: it will allow the isolation and containment of all insolvent S&Ls during the three-year resolution process and will facilitate a full and precise accounting of all the funds that are used. The RTC will seek to complete the resolution or other disposition of all insolvent institutions and their assets over a period of five years. An Oversight Board consisting of the Secretary of the Treasury, the Chairman of the Federal Reserve Board of Governors, and the Attorney General will monitor all RTC activities to ensure the most effective use of both private and public financial resources.

To accomplish its task, the RTC will have available $50 billion in new funding, which is provided by the Administration plan. The plan also provides funds to pay for the $40 billion

that already has been committed in past FSLIC resolutions. Finally, the plan will provide additional funds for handling insolvencies in the post-RTC period from 1992 to 1999, as well as to help build an insurance fund for the healthy S&Ls -- the Savings Association Insurance Fund (SAIF) -- which will be operating during this period.

Let me discuss now some specifics of the financing of the various component parts of our plan. Further details are contained in the Appendix to my testimony which includes materials provided to this Committee by the Office of Management and Budget.

To provide the $50 billion to the RTC, we will create a new, separate, privately-owned corporation, the Resolution Funding Corporation (REFCORP), which will issue $50 billion in long-term bonds to raise the needed funds. REFCORP will purchase zero-coupon, long-term Treasury securities whose maturity value will be $50 billion -- growing through compound interest -- to assure the repayment of the principal of the bonds issued by REFCORP. Funds to purchase these zero-coupon bonds will come exclusively from private sources (see Chart 2):

- The FHLBanks will contribute about $2 billion of their retained earnings -- which are currently allocated to, but not needed by, the existing Financing Corporation (FICO) -- plus approximately 20% of their annual earnings, or $300 million, in 1989, 1990 and 1991;
- The S&Ls will contribute a portion of their insurance premiums; and
- If necessary, proceeds from the sale of FSLIC receivership assets will be used.

No Treasury funds or guarantees will be used to repay any REFCORP principal.

Interest payments on the REFCORP bonds will come from a combination of private and taxpayer sources:

- The FHLBanks, beginning in 1992, will contribute $300 million a year;
- The RTC will contribute a portion of the proceeds generated from the sale of receivership assets, and proceeds from warrants and equity participations taken in resolutions; and
- Treasury funds will make up any shortfall.

All Treasury funds used to service REFCORP interest will be scored for budget purposes in the year expended.

Funds for the second component of our plan -- servicing the cost of the $40 billion in resolutions already completed by FSLIC -- also will come from a combination of S&L industry and taxpayer sources:

- o FICO will issue bonds under its remaining authority and contribute the proceeds;
- o The S&Ls will contribute a portion of their insurance premiums;
- o FSLIC will contribute the proceeds realized from the sale of receivership assets taken in already completed resolutions, as well as miscellaneous income; and
- o Treasury funds will be used to make up any shortfall.

The final component of the plan -- managing future S&L insolvencies and building SAIF, the new S&L insurance fund, during the post-RTC period -- is funded again from a combination of S&L industry and taxpayer sources:

- o The S&Ls contribute a portion of their insurance premiums; and
- o Treasury will contribute funds as needed.

These sources together provide about $3 billion per year to handle any insolvencies which occur in the 1992-99 period and in addition contribute at least $1 billion per year to building the new Savings Association Insurance Fund. Assuming that $24 billion is used for post-RTC resolutions, by 1999 the SAIF fund will still contain just under $9 billion at a minimum to support the healthy S&Ls. Overall the plan contains $33 billion in post-RTC funds from 1992 to 1999 to manage future insolvencies and contribute to building a healthy new S&L insurance fund. Found in the appendix are a chart (Chart 3) and a listing of sources and uses of funds.

Throughout the plan, all Treasury funds used are fully scored for budget purposes and increase budget outlays as expended. The level of expected outlays falls within the margin provided for in President Reagan's FY 1990 budget and should not interfere with President Bush's commitment to meet the Gramm-Rudman deficit reduction goals in future years. Over the 1989-1999 period, we estimate the net increase in the deficit to be roughly $40 billion.

The S&L industry will be a major beneficiary of restoring its own financial health. From the outset, the Administration has stated that the S&L industry must therefore contribute its fair share -- before the Federal government makes good on its pledge to protect insured depositors. As you can see, the plan requires a combination of private industry and public sources throughout. We believe that the share demanded of the industry is indeed fair, but not so great as to jeopardize the viability of the healthy S&L industry which will emerge from the RTC resolution process. And it will indeed be a healthy industry that emerges -- one with an attractive and viable charter, with a clean insurance fund, and one prepared to provide its traditional support for home financing.

Is the capacity of the Administration's plan sufficient to resolve those S&Ls presently insolvent and those marginal institutions which will become insolvent? The answer is surely yes.

To address the immediate problem, the Bank Board has already handled about 222 institutions in 1988. Funding for the estimated cost -- about $40 billion -- is contained in our plan.

What remains to resolve in the near future is the roughly 350 institutions which are insolvent by GAAP measures and about 150 additional institutions which, while GAAP solvent, have negative tangible net worth. These 500 institutions have about $18 billion of negative net worth and about $265 billion of assets. Importantly, the problems are concentrated in a relatively few institutions -- over 80% of the negative net worth is held in the most troubled 100 institutions.

How much will it cost assuming all of this caseload of 500 institutions have to be resolved? That, of course, depends on a number of factors -- future interest rates, real estate prices and the speed with which the FDIC can get to work on the job. Under likely scenarios, we estimate the size of the immediate problem at well under the $50 billion available to the RTC to handle it. To get our estimate, we start with the $18 billion of negative tangible net worth. To that cost we add some fraction of the assets which will be lost in the process of liquidation or merger. Our present estimate of the total cost is about $40 billion. Even under less likely scenarios which would make the problem worse, it is within the $50 billion available to the RTC.

Our best estimate of the size of the current problem -- $40 billion for the resolutions completed by the Bank Board last year plus something under $50 billion for the current caseload, a total of about $90 billion -- is in line with estimates from the FDIC, GAO, Federal Reserve, and the Bank Board.

What happens if in the future even more that 350 GAAP insolvent and 150 GAAP solvent and tangible with negative tangible net worth must be resolved, as a number of commentators have suggested? Our plan already contains a substantial amount of funds to support the S&L industry during the post-RTC period, 1992-99. A total of about $24 billion will be available during this period to resolve any S&Ls which become insolvent. This amount is in addition to about $9 billion which is allocated by the plan to building a new insurance fund for the healthy S&Ls.

Should a presently implausible economic scenario occur which markedly increases the cost of the RTC resolution task -- either by increasing the cost of resolving the roughly 500 institutions with negative tangible net worth or by adding a large number of presently solvent institutions to its caseload -- some portion of the additional $24 billion capacity could be used. If they are not needed for resolutions, these funds will be available for use in further building the new S&L insurance fund.

CONCLUSION

The Administration's activity of the past few weeks should illustrate clearly our commitment to a long-lasting resolution of the S&L crisis. We have presented a structurally sound plan. We have delivered to you a balanced financing package that requires contributions from the S&L industry and also lives within the government's means. If there is one recurring theme that I hear from my G-7 finance colleagues, it is this: They -- like all investors in our capital markets -- are closely watching our commitment to budget discipline and financial responsibility. Our expedited action will enhance financial stability both now and in the future.

In conclusion, the President's comprehensive solution to the savings and loan crisis -- if enacted by Congress in a timely manner -- will provide a sound, long-term answer to the savings and loan problem. We already have made a head start. The time to act is now.

The cooperative supervisory action already being implemented by the FSLIC and the FDIC paves the way to begin case resolutions immediately once the Congress acts. We stand ready and eager to work with the Members of this Committee and others to enact this plan into law as soon as possible. Working together, we can recreate and rejuvenate the vital savings and loan industry, which has served the nation's home owners so well in the past.

I will be happy to answer any questions the Members of the Committee may have.

# # # # #

Priority of Sources of Funds

1. Commercial bank premiums:

    1) Bank Insurance Fund (Old FDIC fund)

2. Savings and Loan premiums:

    1) Interest on FICO bonds
    2) Principal for REFCORP bonds
    3) FSLIC Resolution Fund (Old FSLIC assets and liabilities)*
    4) Savings Association Insurance Fund*
        * 3 and 4 above switch to 4 and 3 in 1992

3. Old Receivership Proceeds:

    1) Principal for REFCORP
    2) Interest on FICO bonds
    3) FSLIC Resolution Fund

4. New Receivership Proceeds:

    1) Interest on REFCORP bonds

5. Warrants and Participations:

    1) Interest on REFCORP bonds

6. Miscellaneous FSLIC Income:

    1) FSLIC Resolution Fund

7. FHLBank Retained Earnings and $300 million in FHLBank Profits:

    1) Principal on FICO bonds
    2) Principal on REFCORP bonds
    3) Interest on REFCORP bonds

8. Treasury funds:

    1) Interest on REFCORP bonds
    2) FSLIC Resolution Fund
    3) Savings Association Insurance Fund (Schedule of estimated resolution costs plus $1 billion starting in 1991 until earlier of 1999 or reaching 1.25 ratio)

9. REFCORP Proceeds

    1) Resolution Trust Corporation (RTC)

Priority of Uses of Funds

1. FDIC -- Bank Insurance Fund:

   1) Commercial bank premiums

2. FDIC -- Savings Association Insurance Fund:

   1) Savings and Loan premiums
   2) Treasury funds
   3) Offices and office supplies of FSLIC Resolution Fund (upon dissolution)

3. FSLIC Resolution Fund:

   1) Miscellaneous FSLIC income
   2) Proceeds of FICO bonds
   3) Old receivership proceeds
   4) S&L premiums
   5) Treasury funds

4. FICO Principal:

   1) FHLBank Retained Earnings and $300 million in FHLBank Profits

5. FICO Interest:

   1) S&L premiums
   2) Old receivership proceeds

6. REFCORP Principal:

   1) FHLBank Retained Earnings and $300 million in FHLBank Profits
   2) S&L premiums
   3) Old receivership proceeds

7. REFCORP Interest:

   1) New receivership proceeds
   2) Warrants and Participations
   3) FHLBank Retained Earnings and Profits
   4) Treasury funds

8. Resolution Trust Corporation (RTC):

   1) REFCORP proceeds ($50 billion)

9. Treasury:

   1) FSLIC Resolution Fund proceeds upon dissolution (net of offices and office supplies)
   2) REFCORP proceeds upon dissolution

Chart 1

General Organizational Structure

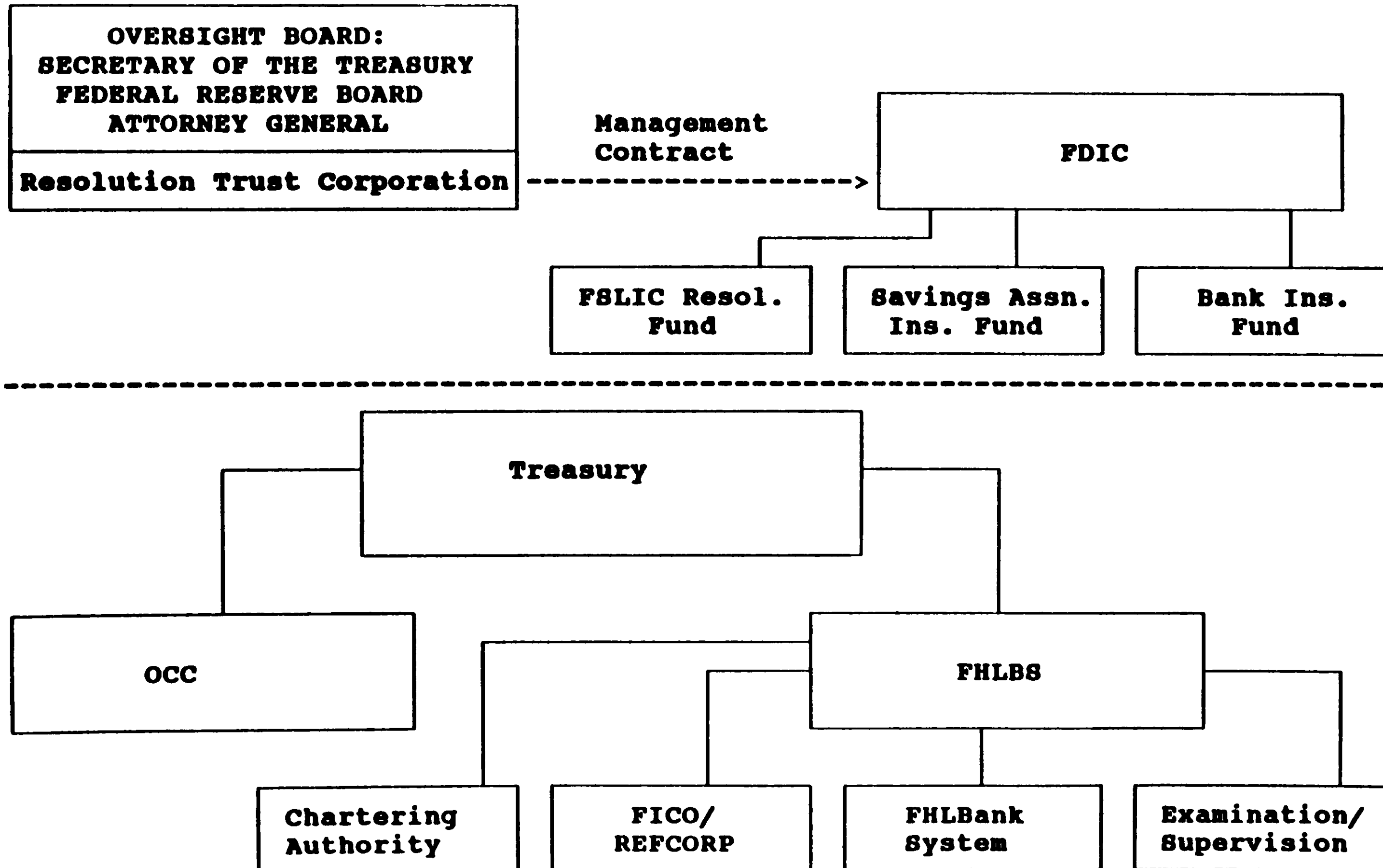
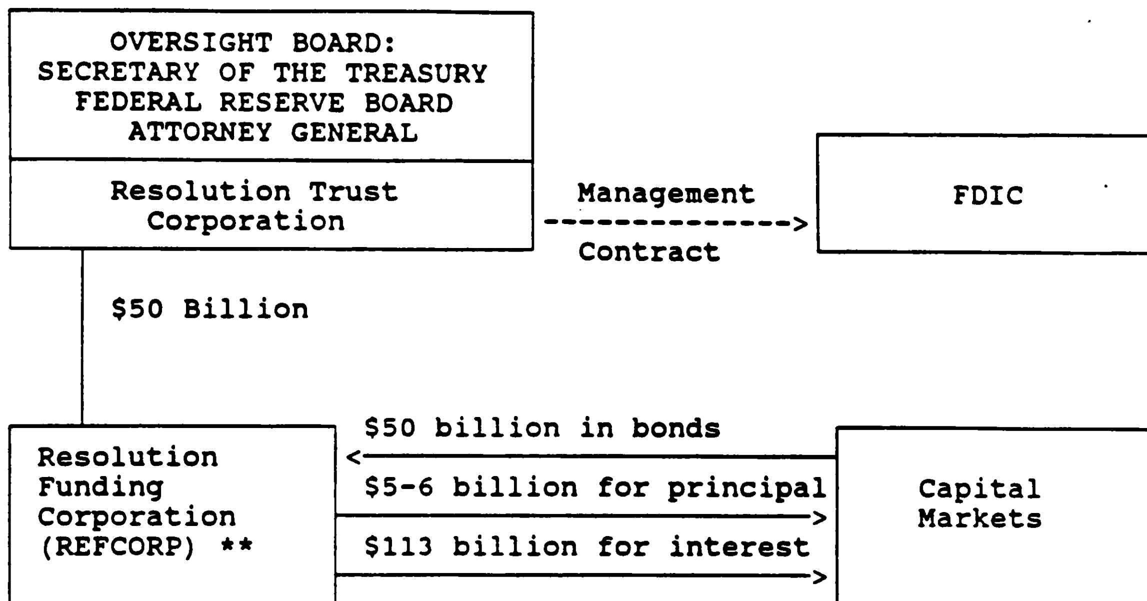


Chart 2

Insurance and Financing Structure

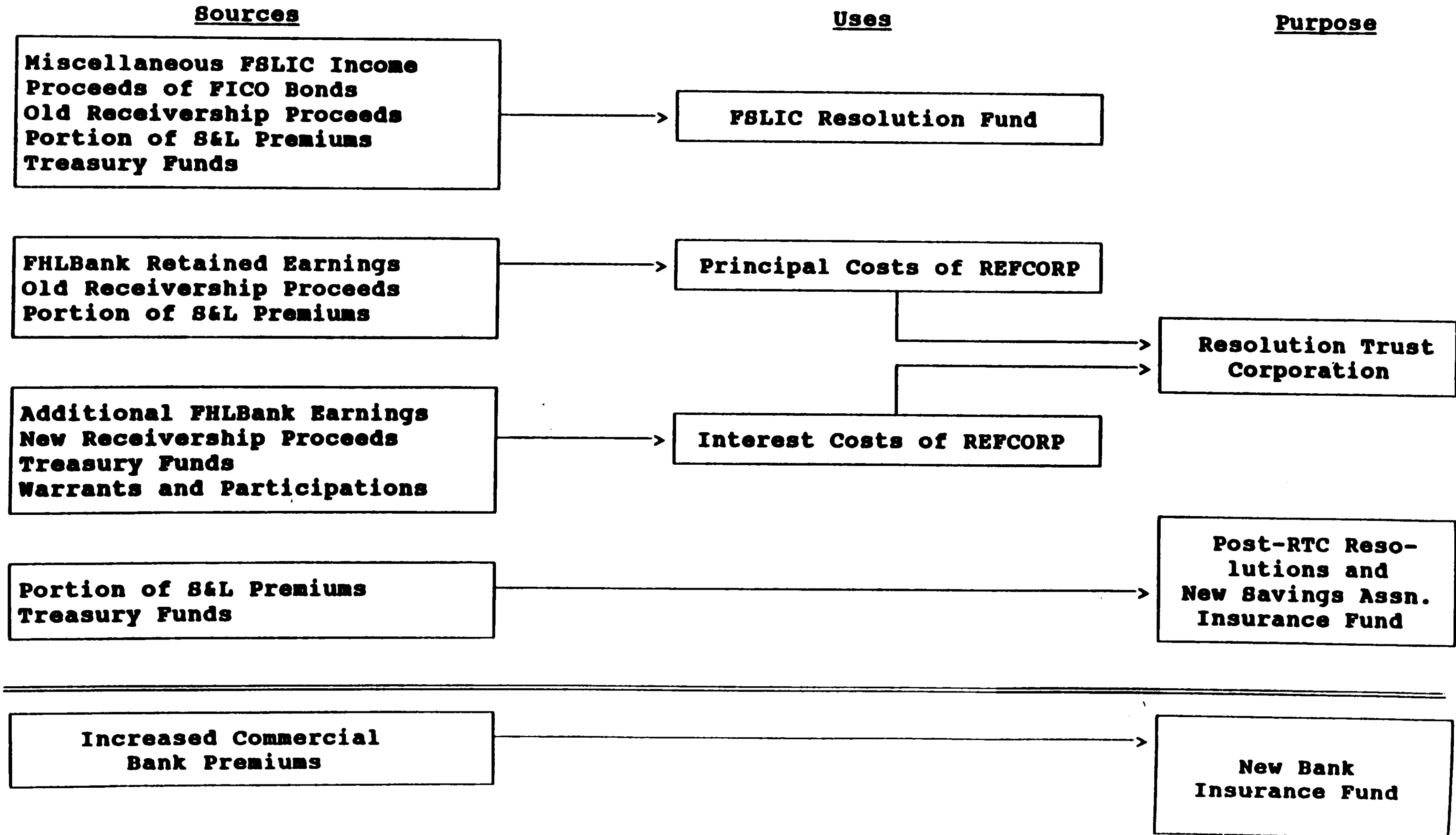


* The RTC will resolve all GAAP-insolvent S&Ls over a three-year period and will sunset after five years. NOTE: Although the RTC will contract with the FDIC, it will be subject to an Oversight Board composed of the Treasury Secretary, the Federal Reserve Chairman, and the Attorney General.

** The REFCORP will raise $50 billion in the capital markets, transfer that sum to the RTC for resolution costs for GAAP-insolvent S&Ls, and repay the principal and interest costs on the $50 billion.

Chart 3

SOURCES AND USES OF FUNDS
Resolution Trust Corporation * and
Resolution Funding Corporation (REFCORP) **



* The Resolution Trust Corporation will resolve GAAP insolvent savings and loans.

Administration Proposal: Cash Flow for Government
($ in billions)

2/15/89

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94	89-94	89-99
Cash Inflows (-):								
FSLIC/RTC collections from FICO	-3.8	-3.3					-7.1	-7.1
FSLIC/RTC collections from REFCORP	-10.0	-25.0	-15.0				-50.0	-50.0
S&L Premiums and other FSLIC Collections	-3.3	-1.5	-1.5	-3.2	-3.6	-3.5	-16.4	-31.2
Additional Collections to FDIC	0.0	-0.8	-1.6	-1.7	-1.8	-1.9	-7.9	-19.9
TOTAL CASH INFLOWS	-17.0	-30.6	-18.1	-4.9	-5.4	-5.5	-81.4	-108.2
Cash Outflows:								
Old Cases and administrative expenses -- cash	8.3	6.5	5.6	5.4	5.7	3.8	35.3	61.6
RTC cases	10.0	25.0	15.0				50.0	50.0
Post-RTC Cases			2.0	2.4	3.6	2.0	10.0	24.0
Contribution to REFCORP interest costs	0.5	1.4	1.6	0.9	0.8	1.1	6.3	22.0
TOTAL CASH OUTFLOWS	18.8	32.9	24.2	8.7	10.1	7.0	101.7	157.6
Net cash outflows	1.8	2.3	6.1	3.9	4.8	1.5	20.2	49.3
Debt transaction adjustments:								
New FSLIC debt issued	9.7	0.0	0.0	0.0	0.0	0.0	9.7	9.7
Redemption of FSLIC debt	-0.4	-0.3	-0.1	0.0	-1.1	0.0	-1.9	-19.2
NET COST TO GOVERNMENT (Budget Outlays)	11.1	1.9	6.0	3.8	3.7	1.5	28.1	39.9

FUNDING SUMMARY
($ in billions)

2/20/89

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94	89-94	89-99
FSLIC/RTC								
Disbursements	27.7	31.2	22.5	7.8	8.3	5.8	103.2	126.2
Old Cases & Other Expenses	17.7	6.2	5.5	5.4	4.7	3.8	43.2	52.2
New Cases	10.0	25.0	17.0	2.4	3.6	2.0	60.0	74.0
Collections (-)	-17.0	-29.8	-16.5	-3.2	-3.6	-3.5	-73.5	-88.3
New FICO(REFCORP) Bonds	-10.0	-25.0	-15.0				-50.0	-50.0
Old Premiums (Net)	-1.4	0.4	0.3	-1.5	-1.5	-2.0	-5.6	-19.0
Additional Premium 1/			-0.3	-0.3	-0.3	0.4	-0.4	2.1
Other Old Collections	-5.6	-5.2	-1.6	-1.4	-1.8	-1.9	-17.5	-21.4
FSLIC/RTC Net Outlays	10.7	1.4	6.0	4.6	4.7	2.3	29.7	37.9
Treasury Payments for Bond (REFCORP) Interest	0.5	1.4	1.6	0.9	0.8	1.1	6.3	22.0
Add'l FDIC Collections	0.0	-0.8	-1.6	-1.7	-1.8	-1.9	-7.9	-19.9
TOTAL BUDGET OUTLAYS	11.1	1.9	6.0	3.8	3.7	1.5	28.1	39.9

1/ A (-) indicates increase in premiums, a (+) indicates a decrease.

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NEW FICO (REFCORP) FINANCING
($ in billions)

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94	89-94	89-99
NEW FICO (REFCORP) 1/								
PRINCIPAL covered by zeros paid with private funds:								
FHLB Retained Earnings	0.8	1.1	0.8	0.0	0.0	0.0	2.7	2.7
S&L Insurance Premiums	0.0	1.7	1.7	0.0	0.0	0.0	3.3	3.3
TOTAL DEFEASANCE	0.8	2.8	2.5	0.0	0.0	0.0	6.0	6.0
INTEREST covered by private & public funds:								
FHLB future income	0.0	0.0	0.0	0.3	0.3	0.3	0.9	2.4
Receivership Proceeds	0.0	0.5	1.8	2.6	2.7	2.4	10.0	12.0
Treasury funds	0.5	1.4	1.6	0.9	0.8	1.1	6.3	22.0
TOTAL INTEREST	0.5	1.9	3.4	3.8	3.8	3.8	17.2	36.4

1/ Sells long-term bonds: $10B in FY 89, $25B in FY 90, $15B in FY 91.

[illegible] 1989

2/15/89

($ in billions)

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94	89-94	89-99
FSLIC & RTC ACCOUNT								
DISBURSEMENTS								
Old Cases & Other Expenses								
Admin and misc exp	0.3	0.3	0.3	0.3	0.3	0.2	1.6	2.8
Notes Issued	9.7						9.7	9.7
Interest on Notes Outstanding	1.4	1.5	1.1	0.9	0.8	0.7	6.4	9.2
Repay notes issued prior to FY 87	0.0	0.0	0.2	0.0	0.2	0.0	0.5	0.5
Assistance Payments	5.2	4.4	3.8	4.2	3.4	2.9	24.0	28.8
Liquidations	1.0						1.0	1.0
Total Old Cases and Other Exp	17.7	6.2	5.5	5.4	4.7	3.8	43.2	52.2
New Cases								
Assisted Mergers	5.0	12.5	8.5	1.2	1.8	1.0	30.0	44.0
Liquidations	5.0	12.5	8.5	1.2	1.8	1.0	30.0	30.0
Total New Cases	10.0	25.0	17.0	2.4	3.6	2.0	60.0	74.0
TOTAL DISBURSEMENTS	27.7	31.2	22.5	7.8	8.3	5.8	103.2	126.2
COLLECTIONS (-)								
FICO proceeds (CEBA) (-)	-3.8	-3.3					-7.1	-7.1
New REFCORP Proceeds (-)	-10.0	-25.0	-15.0				-50.0	-50.0
Insurance Premiums before deductions (-)	-2.1	-2.3	-2.7	-2.9	-3.1	-2.6	-15.6	-31.6
Deduct (+):								
FICO (CEBA) Interest	0.6	0.9	1.0	1.0	1.0	1.0	5.5	10.7
Sec. Reserve Credit	0.1	0.1	0.1	0.1	0.3	0.0	0.7	0.7
Defease New Bond Principal		1.7	1.7				3.3	3.3
Net Premium Income (-)	-1.4	0.4	0.1	-1.8	-1.7	-1.6	-6.0	-16.9
Proceeds from Receivers and Corporate-held Assets (old cases) (-)	-1.4	-1.4	-1.2	-1.0	-1.4	-1.5	-7.8	-9.7
Income on invest bal (-)	-0.1	0.0	0.0	0.0	-0.1	-0.1	-0.4	-1.1
Other Collections (-)	-0.4	-0.4	-0.4	-0.3	-0.3	-0.4	-2.1	-3.5
TOTAL COLLECTIONS	-17.0	-29.8	-16.5	-3.2	-3.6	-3.5	-73.5	-88.3
FSLIC/RTC NET OUTLAYS	10.7	1.4	6.0	4.6	4.7	2.3	29.7	37.9
Repayment of Notes Issued after FY 86	0.4	0.3	0.1	0.0	1.1	0.0	1.9	19.2
Balance of FSLIC Notes Outstanding (end-yr)	19.2	18.9	18.6	18.5	17.3	17.3	17.3	0.0
FSLIC/RTC Cash/Investment end-yr balances (9/30/88=$1.9B)								
balance for cases:	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.5
balance for new fund:	0.0	0.0	0.0	1.0	2.1	3.2	3.2	8.8
SUMMARY OF ACCOUNTS AFFECTED								
FSLIC/RTC Net Outlays	10.7	1.4	6.0	4.6	4.7	2.3	29.7	37.9
Treasury Contribution to REFCORP Interest	0.5	1.4	1.6	0.9	0.8	1.1	6.3	22.0
Add'l FDIC Collections	0.0	-0.8	-1.6	1.7	-1.8	1.9	7.9	19.9
TOTAL BUDGET OUTLAYS	11.1	1.9	6.0	3.8	3.7	1.5	20.1	39.9

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Assumptions	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94		
FICO (CEBA) Rates	9.8%	8.6%					wtd avg (88-90):	9.5%
REFCORP Rates	9.1%	7.9%	6.5%				wtd avg (89-91):	7.7%
Int Rate on LT Treasuries	8.8%	7.6%	6.2%				wtd avg (89-91):	7.4%
Discount on zeros	8.8%	7.6%	6.2%				wtd avg (89-91):	7.4%
Int Rate on FSLIC Notes	9.5%	7.8%	6.1%	4.9%	4.3%	4.0%		
FSLIC Deposit Base								
($ in trillions)	1.0	1.1	1.2	1.2	1.3	1.4		
1989-99 Growth Rate	7.2%							
FDIC Deposit Base								
($ in trillions)	2.1	2.3	2.4	2.6	2.8	2.9		
1989-99 Growth Rate	6.9%							

Recovery on receivership assets (new cases):
40 cents on each dollar over the 4 years subsequent to liquidation

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2/20/89

Assumptions	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94		
FICO (CEBA) Rates	9.8%	8.6%					wtd avg (88-90):	9.5%
REFCORP Rates	9.1%	7.9%	6.5%				wtd avg (89-91):	7.7%
Int Rate on LT Treasuries	8.8%	7.6%	6.2%				wtd avg (89-91):	7.4%
Discount on zeros	8.8%	7.6%	6.2%				wtd avg (89-91):	7.4%
Int Rate on FSLIC Notes	9.5%	7.8%	6.1%	4.9%	4.3%	4.0%		
FSLIC Deposit Base								
($ in trillions)	1.0	1.1	1.2	1.2	1.3	1.4		
1989-99 Growth Rate	7.2%							
FDIC Deposit Base								
($ in trillions)	2.1	2.3	2.4	2.6	2.8	2.9		
1989-99 Growth Rate	6.9%							

Recovery on receivership assets (new cases):
40 cents on each dollar over the 4 years subsequent to liquidation

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
February 22, 1989

CONTACT: Office of Financing
202/376-4350

RESULTS OF AUCTION OF 2-YEAR NOTES

The Department of the Treasury has accepted $9,263 million of $23,936 million of tenders received from the public for the 2-year notes, Series W-1991, auctioned today. The notes will be issued February 28, 1989, and mature February 28, 1991.

The interest rate on the notes will be 9-3/8%. The range of accepted competitive bids, and the corresponding prices at the 9-3/8% rate are as follows:

	Yield	Price
Low	9.47%*	99.831
High	9.50%	99.777
Average	9.49%	99.795

*Excepting 9 tenders totaling $1,375,000.

Tenders at the high yield were allotted 41%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 66,845	$ 66,845
New York	20,666,955	7,911,975
Philadelphia	48,790	48,790
Cleveland	110,815	110,815
Richmond	109,165	92,085
Atlanta	74,065	72,475
Chicago	1,274,915	326,680
St. Louis	112,765	93,175
Minneapolis	42,895	42,895
Kansas City	158,980	158,390
Dallas	62,350	54,375
San Francisco	1,092,545	168,875
Treasury	115,275	115,275
Totals	$23,936,360	$9,262,650

The $9,263 million of accepted tenders includes $1,565 million of noncompetitive tenders and $7,698 million of competitive tenders from the public.

In addition to the $9,263 million of tenders accepted in the auction process, $760 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $897 million of tenders was also accepted at the average price from Federal Reserve Banks for their own account in exchange for maturing securities.

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TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

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FOR IMMEDIATE RELEASE
February 23, 1989

CONTACT: Office of Financing
202/376-4350

FEB 27 8 55 AM '89
DEPARTMENT OF THE TREASURY

RESULTS OF AUCTION OF 5-YEAR 2-MONTH NOTES

The Department of the Treasury has accepted $ 7,812 million of $21,739 million of tenders received from the public for the 5-year 2-month notes, Series J-1994, auctioned today. The notes will be issued March 3, 1989, and mature May 15, 1994.

The interest rate on the notes will be 9-1/2%. The range of accepted competitive bids, and the corresponding prices at the 9-1/2% rate are as follows:

	Yield	Price
Low	9.48% *	99.996
High	9.49%	99.955
Average	9.49%	99.955

*Excepting 4 tenders totaling $32,000.
Tenders at the high yield were allotted 71%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 35,587	$ 35,587
New York	19,215,276	7,144,256
Philadelphia	19,493	19,493
Cleveland	44,535	44,535
Richmond	109,285	70,435
Atlanta	40,287	35,127
Chicago	1,207,314	281,754
St. Louis	46,282	30,277
Minneapolis	25,661	25,361
Kansas City	56,374	55,374
Dallas	21,829	17,829
San Francisco	913,753	48,753
Treasury	3,053	3,053
Totals	$21,738,729	$7,811,834

The $ 7,812 million of accepted tenders includes $ 696 million of noncompetitive tenders and $ 7,116 million of competitive tenders from the public.

In addition to the $ 7,812 million of tenders accepted in the auction process, $650 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities.

NB-152

file

A BILL

To reform, recapitalize, and consolidate the Federal deposit insurance system, to enhance the regulatory and enforcement powers of Federal financial institutions regulatory agencies, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Section 1. Short Title and Table of Contents

(a) Short Title.--This Act may be cited as the "Financial Institutions Reform, Recovery and Enforcement Act of 1989."

(b) Table of Contents.--

Sec. 1. Short Title and Table of Contents.

Title I--PURPOSE

Sec. 101. Purpose.

TITLE II--FEDERAL DEPOSIT INSURANCE CORPORATION AUTHORITIES AND RESPONSIBILITIES

Sec. 201. Financial Institutions.
Sec. 202. Duties of the Federal Deposit Insurance Corporation.
Sec. 203. FDIC Board Members.
Sec. 204. Definitions.
Sec. 205. Insured Savings Associations.
Sec. 206. Application Process; Insurance Fees.
Sec. 207. Insurability Factors.
Sec. 208. Assessments.
Sec. 209. FDIC Corporate Powers.
Sec. 210. Administration of Corporation.
Sec. 211. Insurance Funds; Corporation Powers as Receiver
Sec. 212. FSLIC Resolution Fund.
Sec. 213. Amendments to Section 12.
Sec. 214. Amendments to Section 13.
Sec. 215. Borrowing Authority.
Sec. 216. Limitation on Borrowing.
Sec. 217 Reports.
Sec. 218. Regulations Governing Insured Financial Institutions.
Sec. 219. Nondiscrimination.

TITLE III--SAVINGS ASSOCIATION SUPERVISION IMPROVEMENTS

Sec. 301. Definitions.

Sec. 302. Supervision of Savings Associations.

Sec. 303. Applicability.

Sec. 304. Conforming Name Changes.

Sec. 305. Safety and Soundness.

Sec. 306. Deposits.

Sec. 307. Supervisory Revisions.

Sec. 308. Receiverships.

Sec. 309. Technical Amendment.

Sec. 310. Technical Amendment.

Sec. 311. Amendment to Section 5.

Sec. 312. Technical Amendment.

Sec. 313. Conversions.

Sec. 314. Capital Standards.

Sec. 315. Technical Amendments.

Sec. 316. Repeal.

Sec. 317. Recovery Regulations Repealed.

Sec. 318. Cost of Examination and Reports.

Sec. 319. Savings and Loan Holding Companies.

Sec. 320. Transactions with Affiliates; Loans to Insiders.

Sec. 321. Advertising.

TITLE IV--DISSOLUTION AND TRANSFER OF FUNCTIONS, PERSONNEL AND PROPERTY OF THE FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION.

Sec. 401. Dissolution.

Sec. 402. Continuation of Rules.

Sec. 403. Personnel.

Sec. 404. Division of Property and Personnel.

Sec. 405. Repeals.

Sec. 406. Report.

TITLE V--FINANCING FOR THRIFT RESOLUTIONS

Subtitle A - Resolution Trust Corporation

Sec. 501. Resolution Trust Corporation Established.

Subtitle B - Resolution Financing Corporation

Sec. 502. Resolution Financing Corporation Established.

Sec. 503. Financing Corporation.

Sec. 504. Mixed Ownership Government Corporation.

TITLE VI--THRIFT ACQUISITION ENHANCEMENT PROVISIONS

Sec. 601. Acquisition of Thrifts by Bank Holding Companies.

Sec. 602. Investments by Savings and Loan Holding Companies in Unaffiliated Thrift Institutions.

Sec. 603. Technical Amendment to Bank Holding Company Act.

TITLE VII--FEDERAL HOME LOAN BANK SYSTEM REFORMS

Subtitle A - Federal Home Loan Bank Act Amendments

Sec. 701. Definitions.

Sec. 702. Federal Home Loan Bank System Chairman.

Sec. 703. Election of Bank Directors.

Sec. 704. Federal Home Loan Bank Lending.

Sec. 705 Chief Supervisory Officer.

Sec. 706. Thrift Advisory Council.

Sec. 707. Federal Savings and Loan Insurance Corporation Industry Advisory Committee.

Sec. 708. Rate of Interest.

Sec. 709. Liquidity Requirements.

Sec. 710. Advances.

Sec. 711. Conforming Federal Home Loan Bank Act Amendments.

Subtitle B - Conforming Amendments

Sec. 712. Federal Home Loan Mortgage Corporation Act Amendment.

Sec. 713. Repeal of Limitation of Obligation for Administrative Expenses.

Sec. 714. Amendment of Additional Powers of Chairman.

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Sec. 716. Amendment of Title 31, United States Code.

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TITLE I - PURPOSE.

Sec. 101. PURPOSE. - The purposes of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 are: to promote a safe and stable system of affordable housing finance through regulatory

reform; to improve supervision by strengthening capital, accounting, and other supervisory standards; to establish a relationship of general oversight by the Treasury Department over the Federal Home Loan Bank System similar to that of the Office of the Comptroller of the Currency; to establish an independent insurance agency to provide deposit insurance for savers; to put the federal deposit insurance system on a sound financial basis for the future; to create a new corporation to contain, manage and resolve failed thrift institutions; to provide the necessary private and public financing to resolve failed institutions in an expeditious manner; to provide for improved supervision and enhanced enforcement powers; to increase criminal and civil money penalties for crimes of fraud against financial institutions and depositors; and for other purposes.

TITLE II - FEDERAL DEPOSIT INSURANCE CORPORATION AUTHORITIES AND RESPONSIBILITIES.

Sec. 201. FINANCIAL INSTITUTIONS. - Except as otherwise hereinafter provided, the terms "insured bank", "insured banks", and "insured bank's" in the Federal Deposit Insurance Act, as amended (12 U.S.C. 1811 et seq.), are hereby deleted and the terms "insured financial institution", "insured financial institutions", and "insured financial institution's", respectively, are inserted in lieu thereof, provided however that where the term "insured bank" is preceded by the word "member" or

by the word "nonmember" such substitution of the term shall not be made; and the term "Federal Home Loan Bank Board" is deleted and the term "Federal Home Loan Bank System" is inserted in lieu thereof.

Sec. 202. DUTIES OF FEDERAL DEPOSIT INSURANCE CORPORATION. - Section 1 of the Federal Deposit Insurance Act (12 U.S.C. 1811) is hereby amended by adding "and savings associations" after "banks".

Sec. 203. FDIC BOARD MEMBERS. - Section 2 of the Federal Deposit Insurance Act (12 U.S.C. 1812) is hereby amended as follows:

(1) In the first sentence, by deleting "three" and inserting in lieu thereof "five", by adding after the second comma the phrase "one of whom shall be the Chairman of the Federal Home Loan Bank System", and by deleting "two" and inserting in lieu thereof "three";

(2) In the second sentence by deleting everything up to and including the word "members" the second time it appears therein, and inserting in lieu thereof the following:

> "One of the appointive members shall be designated by the President to serve from time to time as Chairman of the Board of Directors of the Corporation, and one

shall be designated by the President to serve from time to time as Vice Chairman of the Board, and not more than two of the appointive members";

(3) The fifth sentence shall be amended to read as follows:

"In the event of a vacancy in the office of the Comptroller of the Currency, or the Chairman of the Federal Home Loan Bank System, and pending the appointment of a successor, or during the absence or disability of any such member, the Acting Comptroller of the Currency, or the Acting Chairman of the Federal Home Loan Bank System, shall be a member of the Board of Directors in the place and stead of the Comptroller of the Currency or the Chairman of the Federal Home Loan Bank System, respectively.";

(4) In the sixth sentence, by deleting "Comptroller of the Currency" and inserting in lieu thereof "Vice Chairman of the Board";

(5) In the last sentence, by adding "or Federal Home Loan bank" after "Federal Reserve bank", and by adding "or financial institution holding company" before the semi-colon; and

(6) By adding the following new paragraph at the end thereof:

"The members of the Board of Directors on the date of enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 shall continue to serve in office until the fulfillment of their existing terms; the Chairman of the Board of Directors shall continue to serve until a successor has been appointed and qualified."

Sec. 204. DEFINITIONS. - Section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813) is hereby amended as follows:

(1) Notwithstanding Section 201 of this Act, subsection (h) shall not be amended to delete the term "insured bank" and insert the term "insured financial institution".

(2) Subsection (j) is amended by adding "conserving assets or" before "winding up", and by adding before the period therein the following phrase, ", or of a savings association";

(3) Subsection (l) is amended as follows:

(a) by adding the phrase "or savings association" after the phrases "a bank", "the bank", "receiving bank", or "such bank" each time such phrases appear in the subsection; and by adding the phrase "or savings

association's" after the word "bank's" each time it appears in the subsection; and

(b) by striking out the word "and" at the end of subparagraph (5)(A) and by replacing the period at the end of subparagraph (5)(B) with "; or"; and

(c) by adding a new subparagraph (5)(C) reading as follows:

"(C) any money denominated in any currency other than that of the United States, and any obligation otherwise equivalent to money but which is not expressed in terms of the currency of the United States."

(d) in paragraph (5), by adding ", Chairman of the Federal Home Loan Bank System" after "Comptroller of the Currency";

(4) Subsection (m) is amended by adding at the end thereof the following:

"(3) In the case of a savings association that becomes an insured financial institution as a result of the operation of section 4(a), the term "insured

deposit" shall include any liability of that financial institution which constituted an "insured account" within the meaning of section 401(c) of the National Housing Act immediately prior to enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (hereinafter referred to as "FIRREA"); Provided, that in the case of any such liability that would not otherwise be eligible for insurance provided by the Corporation:

"(A) if the liability has one or more fixed maturity dates, the liability shall cease to be included within the term "insured deposit" upon the earliest maturity date occurring after the expiration of six months from the date of enactment of FIRREA;

"(B) if the liability has a minimum required notice period, the required notice period shall be deemed to be initiated on the date of enactment of FIRREA and the liability shall cease to be included within the term "insured deposit" upon expiration of the required notice period or upon the expiration of six months after the date of enactment of FIRREA, whichever is later; or

"(C) if the liability has no fixed maturity date

or required notice period, the liability shall cease to be included within the term "insured deposit" upon the expiration of six months from the date of enactment of FIRREA.".

(5) Subsection (q) is amended to read as follows:

"(q) The term "appropriate Federal banking agency" shall mean --

"(1) the Comptroller of the Currency in the case of a national banking association, a District bank, or a federal branch or agency of a foreign bank;

"(2) the Board of Governors of the Federal Reserve System --

"(A) in the case of a State member insured bank (except a District bank),

"(B) in the case of any branch or agency of a foreign bank with respect to any provision of the Federal Reserve Act which is made applicable under the International Banking Act of 1978: Provided, that for the purposes

of subsections (b) through (n) of section 8 of this Act, the term "insured financial institution" includes an uninsured branch or agency of a foreign bank or a commercial lending company owned or controlled by a foreign bank,

"(C) in the case of any foreign bank which does not operate an insured branch,

"(D) in the case of any agency or commercial lending company other than a Federal agency, and

"(E) in the case of supervisory or regulatory proceedings arising from the authority given to the Board of Governors under section 7(c)(1) of the International Banking Act of 1978, including such proceedings under the Financial Institutions Supervisory Act;

"(3) the Federal Deposit Insurance Corporation in the case of a State nonmember insured bank (except a District bank) or a foreign bank having an insured branch; and

"(4) the Federal Home Loan Bank System in the case of a savings association or of a savings and loan holding company.

"Under the rule set forth in this subsection, more than one agency may be an appropriate Federal banking agency with respect to any given institution."

(6) By deleting the provisions of subsection (t) and reserving such subsection.

(7) By adding new subsections at the end thereof to read as follows:

"(u) The term "savings association" means any institution that was supervised by the Federal Savings and Loan Insurance Corportion immediately prior to the enactment of the FIRREA, a Federal savings and loan association or Federal savings bank, or a building and loan, savings and loan, homestead association, or cooperative bank organized and operating according to the laws of the State (as defined in the text of subsection (a) hereof) in which it is chartered or organized, or a corporation that the Board of Directors determines to be operating substantially in the same manner as a savings and loan association;

"(v) The term "bank" means all banks as defined in subsections (a) through (g) hereof;

"(w)(1) The term "financial institution" means a bank or savings association.

"(2) The term "insured financial institution" means a bank or savings association insured pursuant to the Federal Deposit Insurance Act.

"(x)(1) The term "default" with respect to an insured financial institution means an adjudication or other official determination of a court of competent jurisdiction, the appropriate Federal banking agency, or other public authority pursuant to which a conservator, receiver, or other legal custodian is appointed for an insured financial institution or, in the case of a foreign bank having an insured branch, for such branch.

"(2) The term "in danger of default" with respect to an insured financial institution means that the appropriate Federal banking agency or State chartering authority has advised the Corporation with respect to such institution (or in the case of a foreign bank

having an insured branch, with respect to such insured branch) that, in its opinion--

"(i)(I) the financial institution or insured branch is not likely to be able to meet the demands of its depositors or pay its obligations in the normal course of business, and

"(II) there is no reasonable prospect that the financial institution or insured branch will be able to meet such demands or pay such obligations without Federal assistance; or

"(ii)(I) the financial institution or insured branch has incurred or is likely to incur losses that will deplete all or substantially all of its capital, and

"(II) there is no reasonable prospect for the replenishment of the capital of the financial institution or insured branch without Federal assistance.

"(y)(1) The term "financial institution holding company" means a bank holding company or a savings-and-loan holding company.

(2) The term "bank holding company" has the meaning prescribed in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.).

(3) The term "savings and loan holding company" has the meaning prescribed in section (10)(a)(1)(D) of the Home Owners' Loan Act of 1933 (12 U.S.C.).

Sec. 205. INSURED SAVINGS ASSOCIATIONS. - Section 4 of the Federal Deposit Insurance Act (12 U.S.C. 1814) is hereby amended as follows:

(1) Subsection (a) is amended by adding the following new sentence at the end thereof:

"Every savings association, the deposits of which were insured by the Federal Savings and Loan Insurance Corporation on the date immediately preceding the date of enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, shall be, without application or approval, an insured financial institution as of the date of enactment of that Act, and shall be subject to the provisions of this Act."

(2) Subsection (b) is amended by adding the following phrase prior to the first period therein:

"; provided, however, that any application or notice for membership or to commence or resume business must be promptly provided by the appropriate Federal banking agency to the Corporation and the Corporation shall have a reasonable period to provide comments with respect thereto which must be considered by the appropriate Federal banking agency in making its findings thereon and with respect to the statutory factors in section 6 of this Act."

(3) By deleting the last two sentences of subsection (b) and all of subsection (c) and inserting the following new subsections in lieu thereof:

"(c) Except as provided in subsection 5(d), a State financial institution resulting from the conversion of an insured Federal financial institution shall continue as an insured financial institution.

"(d) Except as provide in subsection 5(d), a State financial institution resulting from the merger or consolidation of insured financial institutions, or from the merger or consolidation of a noninsured financial institution with an insured financial institution, shall continue as an insured financial

institution."

Sec. 206. APPLICATION PROCESS; INSURANCE FEES. - Section 5 of the Federal Deposit Insurance Act (12 U.S.C. 1815) is hereby amended as follows:

(1) by adding the following new paragraphs at the end of subsection (a) thereof:

"Subject to the provisions of this Act, any Federal savings association that is authorized by the Federal Home Loan Bank System to engage in the business of receiving deposits, other than trust funds as herein defined, upon application by the association to the Federal Home Loan Bank System, may become an insured financial institution following submission of such application to the Corporation together with a certificate issued to the Corporation by the Federal Home Loan Bank System, unless insurance is denied by the Board of Directors; provided, however, that with respect to any interim Federal savings association chartered by the Federal Home Loan Bank System, and which will not open for business, such insurance shall be automatically granted upon issuance of such association's charter by the Federal Home Loan Bank System. Such certificate shall state that the savings

association is authorized to transact business as a savings association and that consideration has been given to the factors enumerated in section 6 of this Act. Upon Corporation review of such certificate and application, and any appropriate examination by the Corporation, the Board of Directors shall give consideration to factors (1), (2), (3), (4), and (5) of section 6 of this Act in determining whether to deny insurance. If the Board of Directors, after giving due deference to the determination of the Federal Home Loan Bank System with respect to such factors, does not concur with the determination thereof, the Board of Directors shall promptly notify the Federal Home Loan Bank System that insurance has been denied, giving specific reasons in writing for the Corporation's determination with reference to factors (1), (2), (3), (4) and (5) of section 6 of this Act and no charter or insurance shall be granted. Determinations by the Board of Directors to deny insurance under this subsection may not be delegated."

(2) The first sentence of subsection (a) is amended, by deleting the comma following "State nonmember bank" and adding thereafter "and State savings association,"; and

(3) The second sentence of subsection (a) is amended, by

deleting the comma following "State nonmember bank" and adding thereafter "or such State savings association,", and by deleting the comma after "such bank" and adding thereafter "or savings association,", and by adding before the period at the end of the sentence "or savings association".

(4) Subsection (b) is amended by redesignating paragraphs (5), (6), and (7) as paragraphs (6), (7), and (8) respectively; and by inserting a new paragraph (5) to read as follows:

"(5) The risk presented to the Deposit Insurance Fund, the Bank Insurance Fund and the Savings Association Insurance Fund."

(5) New subsection (d) and (e) are added at the end thereof to read as follows:

"(d) <u>INSURANCE FEES</u>. --

"(1) <u>UNINSURED INSTITUTIONS</u>. --

"(A) Every noninsured financial institution that becomes insured by the Corporation, and every noninsured branch that

becomes insured by the Corporation, shall pay the Corporation any such fees as the Corporation may by regulation prescribe: Provided, that a financial institution that becomes an insured financial institution as a result of the operation of section 4(a) of this Act shall not pay any fee.

"(B) The fee paid by the financial institution shall be credited to the Bank Insurance Fund if the financial institution becomes a Bank Insurance Fund member, and to the Savings Association Insurance Fund if the financial institution becomes a Savings Association Insurance Fund member.

"(2) CONVERSIONS. --

"(A) No insured financial institution may participate in a conversion transaction without the prior consent of the Corporation. Except as provided in paragraph (C), the Corporation shall not provide its consent to any conversion transaction occurring before the expiration of five years from the date of enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989.

"(B) A "conversion transaction" means --

"(i) The change of status of an insured financial institution, whether as a result of a charter conversion or otherwise, from a Bank Insurance Fund member to a Savings Association Insurance Fund member or from a Savings Association Insurance Fund member to a Bank Insurance Fund member;

"(ii) The merger or consolidation of a Bank Insurance Fund member with a Savings Association Insurance Fund member;

"(iii) (I) The assumption on the part of a Bank Insurance Fund member of liability to pay any deposits in a Savings Association Insurance Fund member, or

"(II) The assumption on the part of a Savings Association Insurance Fund member of liability to pay any deposits in a Bank Insurance Fund member; or

"(iv) (I) The transfer on the part of a Bank Insurance Fund member of assets to any Savings Association Insurance Fund member in consideration of the assumption of liabilities

for any portion of the deposits in such Bank Insurance Fund member, or

"(II) The transfer on the part of a Savings Association Insurance Fund member of assets to a any Bank Insurance Fund member in consideration of the assumption of liabilities for any portion of the deposits in such Savings Association Insurance Fund member.

"(C) The Corporation may provide its consent at any time to a conversion transaction if:

"(i) The conversion transaction affects an insubstantial portion, as determined by the Corporation, of the insured liabilities of each financial institution participating in the conversion transaction; or

"(ii) The Corporation and, during the existence of the Resolution Trust Corporation, the Resolution Trust Corporation Oversight Board determine that the conversion transaction is in the best interests of the Bank Insurance Fund and the Savings Association Insurance Fund.

"(D) Every financial institution participating in a conversion transaction shall pay:

"(i) In the case of a conversion transaction in which the resulting or acquiring financial institution is a Bank Insurance Fund member, an exit fee to be determined by the Secretary of the Treasury, which fee shall be paid to the Resolution Trust Corporation or to such agency as the Secretary of the Treasury may specify; and

"(ii) An entrance fee to be determined by the Corporation, provided:

"(I) That in the case of a conversion transaction in which the resulting or acquiring financial institution is a Bank Insurance Fund member, the fee shall be in an amount necessary to prevent dilution of the Bank Insurance Fund, and shall be paid to the Bank Insurance Fund; and

"(II) That in the case of a conversion transaction in which the resulting or acquiring financial institution is a Savings Association Insurance Fund member, the fee shall be in an

amount necessary to prevent dilution of the Savings Association Insurance Fund, and shall be paid to the Savings Association Insurance Fund.

"(e) LIABILITY OF COMMONLY-CONTROLLED FINANCIAL INSTITUTIONS. --

"(1) REQUIRED. -- Notwithstanding any provision of law, State or Federal, or the constitution of any State, or of any contract or other instrument or security, on and after the date of enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, whenever the Corporation incurs a loss in connection with the default of an insured financial institution, or in connection with providing assistance to an insured financial institution in danger of default, any other commonly-controlled insured financial institution shall be liable to the Corporation following notice to the institution as provided below and on request shall reimburse the Corporation for any such loss. No such liability shall arise under this subsection if the Corporation fails to provide notice within two years of the date the Corporation incurs such loss.

"(2) AMOUNT OF COMPENSATION; PROCEDURES. --

"(A) USE OF ESTIMATES. -- When an insured financial institution is in default or requires assistance to prevent default, the Corporation

shall in good faith estimate its prospective losses resulting from such default or assistance, shall advise any commonly-controlled financial institution of the amount of its liability in connection with such losses, and if there is more than one such commonly-controlled financial institution, determine such commonly-controlled financial institution's share of such liability.

"(B) PROCEDURES; IMMEDIATE PAYMENT. -- The Corporation, after consultation with the appropriate Federal banking agency, may specify the procedures and schedule by which each such commonly-controlled financial institution must reimburse the Corporation for its liability under this subsection on a case-by-case basis. The Corporation may compel any or all commonly-controlled financial institutions to make immediate payment of any compensation required under paragraph (1).

"(C) PRIORITY. -- The liability estabished pursuant to the provisions of this subsection shall be:

"(i) superior to the following obligations and liabilities of the financial institution:

"(I) any obligation subordinated to depositors or other general creditors;

"(II) any obligation to shareholders arising as a result of their status as shareholders (including a bank holding company or savings and loan holding company or any shareholder or creditor of such company);

"(III) any obligation or liability owed to any other commonly-controlled company or commonly-controlled insured financial institution; or

"(IV) any liability which is a contingent liability on the date the liability of the financial institutions to the Corporation is determined; and

"(ii) subordinate in right or payment to the following obligations and liabilities of the financial institution:

"(I) deposit liabilities other than those to commonly-controlled financial institutions;

"(II) secured obligations; and

"(III) other general liabilities, except to the extent specified in (i) above; and

"(iii) pari passu with other liabilities and obligations of the financial institution.

"(D) ADJUSTMENT OF ESTIMATED PAYMENT. --

"(i) OVERPAYMENT. -- If the amount of compensation estimated by and paid to the Corporation by one or more such commonly-controlled financial institutions is greater than the actual loss incurred by the Corporation, the Corporation shall reimburse each such commonly-controlled financial institution its pro-rata share of any overpayment.

"(ii) UNDERPAYMENT. -- If the amount of compensation estimated by and paid to the

Corporation by one or more such commonly-controlled financial institutions is less than the actual loss incurred by the Corporation, the Corporation shall redetermine in its discretion the liability of each such commonly-controlled financial institution to the Corporation and shall require each such commonly-controlled institution to make payment of any additional liability to the Corporation.

"(3) REVIEW. --

"(A) ADMINISTRATIVE REVIEW. -- The Corportion shall by regulation establish an administrative procedure for review of the amount of losses, the liability of individual commonly-controlled financial institutions, and the schedule of payments to be made by such commonly-controlled financial institutions. The regulations shall provide for a hearing on the part of any such commonly-controlled financial institution.

"(B) JUDICIAL REVIEW. -- Determination made by the Corporation of the amount of losses, the

liability of commonly-controlled financial institutions, or the procedures or scheduling of the payments required, shall be reviewable by the Court of Appeals for the District of Columbia Circuit or the Court of Appeals for the circuit where the financal institution in default or is located, and shall be upheld unless found to be arbitrary or capricious.

"(4) LIMITATION ON RIGHTS OF PRIVATE PARTIES. -- No court shall give effect to any rights or powers conferred on any person, whether such rights or powers are conferred by State constitution or statute or by Federal statute or by the articles or by-laws of a financial institution, a financial institution holding company or any subsidiary therof or by any debt or equity security of any such financial institution, financial institution holding company or subsidiary thereof or by any other contract or other instrument or otherwise, and any provision of any such statute or security or article or by-law or contract or instrument shall be void, insofar as giving effect to any such rights or powers would impair the ability of the financial institution to perform its obligations under this subsection.

"(5) LIMITATION. -- For a period of five years from the date of enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, no Savings Association Insurance

Fund member shall have any liability to the Corporation under this subsection arising out of assistance provided to or loss incurred as a result of the default of a Bank Insurance Fund member, and no Bank Insurance Fund member shall have such liability with respect to assistance provided to or loss incurred as a result of the default of a Savings Association Insurance Fund member.

"(6) DEFINITIONS. -- For the purpose of this section:

"(A) COMMONLY-CONTROLLED INSTITUTIONS. -- Financial institutions are "commonly-controlled" whenever:

"(i) one financial institution is controlled by or under common control with any company that controls or is under common control with another financial institution, or

"(ii) one financial institution controls or is controlled by another financial institution.

"(B) DEFINITIONS. -- the terms "company" and "control" have the meanings specified in the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841 et seq.)."

Sec. 207. INSURABILITY FACTORS. - Section 6 of the Federal

Deposit Insurance Act (12 U.S.C. 1816) is hereby amended to read as follows:

"Except as otherwise provided, the factors to be considered and enumerated in the certificate required under section 4 hereof and to be considered by the Board of Directors under section 5 shall be the following:

"(1) The financial history and condition of the financial institution;

"(2) The adequacy of its capital structure;

"(3) Its future earnings prospects;

"(4) The general character and fitness of its management;

"(5) The risk presented to the Deposit Insurance Fund, the Bank Insurance Fund and the Savings Association Insurance Fund;

"(6) The convenience and needs of the community to be served; and

"(7) Whether or not its corporate powers are

consistent with the purposes of this Act."

Sec. 208. ASSESSMENTS. - Section 7 of the Federal Deposit Insurance Act (12 U.S.C. 1817) is amended as follows:

(1) Paragraph (2) of subsection (a) thereof is amended as follows:

(a) the words "or the Federal Home Loan Bank System or any Federal Home Loan Bank" are added after "Comptroller of the Currency" each time they appear;

(b) the word "either" is deleted and "any" is inserted in lieu thereof;

(c) the words "State nonmember bank (except a District bank)" are deleted and the words "financial institution" are inserted in lieu thereof; and

(d) subparagraph (B) is deleted and in lieu thereof the following shall be inserted:

"(B) The Board of Directors may from time to time require any or all insured financial institutions to file such additional reports as the Corporation, after agreement with the Comptroller of the Currency, the

Board of Governors of the Federal Reserve System, and the Federal Home Loan Bank System, as appropriate, may deem advisable for insurance purposes.".

(2) Paragraph (3) of subsection (a) thereof is amended by:

(a) deleting everything prior to the words "four reports" and inserting in lieu thereof the following:

"Each insured financial institution shall make to the appropriate Federal banking agency";

(b) adding after the word "bank" each time it appears in the second, fifth, and sixth sentences, the words "or savings association"; and

(c) by adding after the words "member bank" in the seventh sentence the words "and each insured savings association"; and

(d) paragraphs (4) and (7) are amended by adding after the words "bank", "bank's", or "banks" the words "or savings association", "or savings association's", or, "or savings associations", respectively, except that no words shall be added after the words "insured bank" or "insured financial institution" or "foreign banks".

(3) By replacing "bank" with "financial institution" and "bank's" with "financial institution's" respectively everywhere those words appear in paragraphs (3) through (8) of subsection (b), except that the phrases "foreign bank" and "foreign bank's" shall not be amended; and by deleting paragraphs (1) and (2) of subsection (b) and inserting in lieu thereof the following:

"(1) ASSESSMENT RATES.--

"(A) ANNUAL ASSESSMENT RATES PRESCRIBED.--The Corporation shall set assessment rates for insured financial institutions annually. The Corporation shall fix the annual assessment rate for Bank Insurance Fund members independently from the annual assessment rate for Savings Association Insurance Fund members.

"(B) ASSESSMENT RATE FOR BANK INSURANCE FUND MEMBERS.--

"The annual assessment rate for Bank Insurance Fund members shall be:

"(i) Until December 31, 1989, one-twelfth of one per centum;

"(ii) From January 1, 1990, through December 31, 1990, 12 one-hundredths of one per centum; and

"(iii) On and after January 1, 1991, 15 one-hundredths of one per centum.

"(C) ASSESSMENT RATES FOR SAVINGS ASSOCIATION INSURANCE FUND MEMBERS.--

"The annual assessment rate for Savings Association Insurance Fund members shall be:

"(i) Until December 31, 1990, 20.8 one-hundredths of one per centum;

"(ii) From January 1, 1991, through December 31, 1993, 23 one-hundredths of one per centum; and

"(iii) From January 1, 1994, and thereafter, 18 one-hundredths of one per centum.

"(D) FACTORS TO BE CONSIDERED IN ADJUSTING RATE.--The Corporation shall have authority and discretion to fix the annual assessment rates for insured financial

institutions above the levels described in paragraphs (B) and (C) provided the Corporation makes the findings herein prescribed; Provided, that except as otherwise expressly provided herein the Corporation shall not fix any such annual assessment rates that exceed the maximum levels specified in paragraph (E); and Provided further, That before increasing the annual assessment rates, the Corporation determines that one or more of the following conditions exist:

"(i) BANK INSURANCE FUND.--In the case of Bank Insurance Fund members, the factors shall be the following:

"(I) That the Bank Insurance Fund has experienced a net loss during any one of the prior three years;

"(II) That the Bank Insurance Fund reserve ratio or the Deposit Insurance Fund reserve ratio is less than 1.20 per centum; or

"(III) That, in the opinion of the Board of Directors, extraordinary circumstances exist that raise a reasonable risk of serious future losses to the Bank Insurance Fund or

to the Deposit Insurance Fund as a whole.

"(ii) SAVINGS ASSOCIATION INSURANCE FUND.--In the case of Savings Association Insurance members, the factors shall be the following:

"(I) That the Savings Association Insurance Fund has experienced a net loss during any one of the prior three years;

"(II) That the Savings Association Insurance Fund reserve ratio or the Deposit Insurance Fund ratio is less than 1.20 per centum; or

"(III) That, in the opinion of the Board of Directors, extraordinary circumstances exist that raise a reasonable risk of serious future losses to the Savings Association Insurance Fund or to the Deposit Insurance Fund as a whole.

"(iii) MAXIMUM ANNUAL INCREASE.--The maximum annual increase in the annual assessment rate with respect to each fund shall not exceed a 50 percent annual increase over the annual assessment rate of the prior year.

"(E) Notwithstanding subparagraphs (B), (C) and (D) of this paragraph (1), the Corporation may in its discretion set a lower minimum annual assessment rate for the Bank Insurance Fund or the Savings Association Insurance Fund if the respective fund has a reserve ratio greater than 1.25 per centum and it is likely that such reserve ratio will not decrease over the following five year period; (ii) each insured financial institution shall pay a minimum annual assessment of $500, or such higher amount as may be calculated by the Corporation to cover direct expenses incurred by the Corporation related to such institutions, or a lower amount if the conditions provided in (i) of this subparagraph (E) exist; and (iii) the annual assessment rate shall not exceed 35 one-hundredths of one per centum, except as provided in (ii) of this subparagraph (E).

"(F) FINANCING CORPORATION AND FUNDING CORPORATION ASSESSMENTS. Notwithstanding any authority provided herein, with respect to Savings Associaton Insurance Fund members, amounts assessed by the Financing Corporation and the Funding Corporation under section 21 and 21b, respectively, of the Federal Home Loan Bank Act, as amended, shall be substracted from the amounts authorized to be assessed by the Corporation hereunder.

"(2) ASSESSMENT PROCEDURES. --

"(A) SEMIANNUAL ASSESSMENTS.--Except as provided in subsection (c)(2) of this section,

"(i) the semiannual assessment due from any Bank Insurance Fund member for any semiannual period shall be equal to one-half the annual categorical assessment rate applicable to such Bank Insurance Fund member multiplied by such Bank Insurance Fund member's average assessment base for the immediately preceding semiannual period; and

"(ii) the semiannual assessment due from any Savings Association Insurance Fund member for any semiannual period shall be equal to one-half the annual categorical assessment rate applicable to such Savings Association Insurance Fund member multiplied by such Savings Association Insurance Fund member's average assessment base for the immediately preceding semiannual period.

"(B) For the purposes of this section the term "semiannual period" means a period beginning on January 1 of any calendar year and ending on June 30 of the same year, or a period beginning on July 1 of any calendar year and ending on December 31 of the same year."

(4) By amending subsection (d) to read as follows:

"(d) ASSESSMENT CREDITS.--

"(1) IN GENERAL -- As of December 31, 1990, and as of December 31 of each calendar year thereafter, the Corporation shall compute the aggregate amount to be credited to insured financial institutions.

"(2) AMOUNT OF ASSESSMENT CREDIT.--

"(A) CREDIT BARRED.--Whenever the Board of Directors determines that the Bank Insurance Fund reserve ratio is equal to or less than 1.25 per centum, the Board of Directors shall not credit any amount to Bank Insurance Fund members.

"(B) CREDIT AUTHORIZED.--

"(i) AGGREGATE CREDIT.--Whenever the Board of Directors determines that the Bank Insurance Fund reserve ratio exceeds 1.25 per centum, or such higher level as the Board of Directors in its discretion may determine, the Board of Directors may in its discretion credit the smaller of the following amounts to Bank Insurance Fund members:

"(I) The amount necessary to reduce the Bank Insurance Fund reserve ratio to 1.25 per centum or such

higher level as the Board of Directors may determine; or

"(II) 60.00 per centum of the net assessment income received from Bank Insurance Fund members the prior year.

"(ii) The Corporation shall deduct any outstanding obligations owed to the Corporation by an individual insured financial institution from any assessment credit to be credited to such financial institution.

"(C) CREDIT BARRED.--Whenever the Board of Directors determines that the Savings Association Insurance Fund reserve ratio is equal to or less than 1.25 per centum, the Board of Directors shall not credit any amount to Savings Association Insurance Fund members: Provided that no credit shall be made as long as the Financing Corporation is authorized to assess on Savings Association Insurance Fund members an assessment to cover Financing Corporation interest obligations pursuant to Section 21 of the Federal Home Loan Bank Act.

"(D) CREDIT AUTHORIZED.--

"(i) AGGREGATE CREDIT.--Whenever the Board of Directors determines that the Savings Association Insurance Fund reserve ratio exceeds 1.25 per centum or such higher level

as the Board of Directors in its discretion may determine, the Board of Directors may in its discretion credit the smaller of the following amounts to Savings Association Insurance Fund members:

"(I) The amount necessary to reduce the Savings Association Insurance Fund reserve ratio to 1.25 per centum, or such higher level as the Board of Directors may determine; or

"(II) 60.00 per centum of the net assessment income received from Savings Association Insurance Fund members the prior year.

"(ii) The Corporation shall deduct any outstanding obligations owed to the Corporation by an individual insured financial institution from any assessment credit to be credited to such financial institution.

"(3) APPLICATION OF ASSESSMENT CREDIT.--Each year any such credit shall be applied by the Corporation toward the payment of the total assessment becoming due for the semiannual assessment period beginning the next ensuing July 1 and any excess credit shall be applied upon the assessments next becoming due.

"(4) "NET ASSESSMENT INCOME" DEFINED.--The term "net assessment

income" as used herein means the total assessments which become due during the calendar year less:

"(A) the operating costs and expenses of the Corporation for the calendar year;

"(B) additions to reserve to provide for insurance losses during the calendar year, except that any adjustments to reserve which result in a reduction of such reserve shall be added;

"(C) the insurance losses sustained in said calendar year plus losses from any preceding years in excess of such reserves; and

"(D) any lending costs for the calendar year, which costs shall be equal to the amount by which the amount of interest earned, if any, from each loan made by the Corporation under section 13 of this Act after January 1, 1982, is less than the amount which the Corporation would have earned in interest for the calendar year if interest had been paid on such loan during such calendar year at a rate equal to the average current value of funds to the United States Treasury for such calendar year.

"If the above deductions exceed in amount the total

assessments which become due during the calendar year, the amount of such excess shall be restored by deduction from total assessments becoming due in subsequent years."

(6) By replacing "bank" wherever it appears in subsections (e), (f), (g) and (i) with "financial institution."

(7) By amending subsection (j) as follows:

(a) The last sentence in paragraph (1) is amended by inserting before the words "any bank holding company" the numeral "(1)" and by inserting before the period the following:

"; (2) any "savings and loan holding company" which has control of any insured financial institution, and the appropriate Federal banking agency in the case of savings and loan holding companies shall be the Federal Home Loan Bank System; and (3) any other company that controls an insured financial institution that is not a bank holding company or a savings and loan holding company."

(b) In subparagraph (2)(A), the word "failure" is deleted and "default" is inserted in lieu thereof; and the word "bank" is deleted and the word "financial institution"

is inserted in lieu thereof."

(c) In subparagraph (2)(D), the words "unless it finds that an emergency exists," are added after the comma following the word "shall";

(d) In paragraph (7), the word "or" at the end of subparagraph (D) and the period at the end of subparagraph (E) are deleted and the word "; or" is added at the end of subparagraph (E), and a new subparagraph (F) is added to read as follows:

"(F) The appropriate Federal banking agency determines that the proposed transaction would result in an adverse effect on the Bank Insurance Fund, the Savings Association Insurance Fund, or the Deposit Insurance Fund.";

(e) Deleting paragraph (17) and inserting in lieu thereof the following:

"(17) This subsection shall not apply to a transaction subject to section 3 of the Bank Holding Company Act of 1956 (12 U.S.C. 1842) or section 18 of this Act (12 U.S.C. 1828) or section 10 of the Home Owners' Loan Act of 1933, as amended.";

(f) Inserting the following new subsection (l) to read as follows:

"(l) For purposes of this section --

"(1) The "Deposit Insurance Fund reserve ratio" is the ratio of the net worth of the Deposit Insurance Fund to the value of the aggregate insured deposits held in all insured financial institutions.

"(2) The "Bank Insurance Fund reserve ratio" is the ratio of the net worth the Bank Insurance Fund of the Deposit Insurance Fund to the value of the aggregate insured deposits held in all Bank Insurance Fund members.

"(3) The "Savings Association Insurance Fund reserve ratio" is the ratio of the value of the net worth of the Savings Association Insurance Fund of the Deposit Insurance Fund to the value of the aggregate insured deposits held in all Savings Association Insurance Fund members.

"(4) "Bank Insurance Fund member" means any insured financial institution other than a Savings Association Insurance Fund member.

"(5) "Savings Association Insurance Fund member" means any financial institution that was insured by the Federal Savings and Loan Insurance Corporation immediately prior to the enactment of FIRREA, and any insured savings association other than a Federal savings bank chartered pursuant to section 5(o) of the Home Owners' Loan Act of 1933.

"(6) The "Deposit Insurance Fund" is comprised of the Bank Insurance Fund and Savings Insurance Fund."

Sec. 209. FDIC CORPORATE POWERS. - Section 9 of the Federal Deposit Insurance Act (12 U.S.C. 1819) is hereby amended:

(1) by striking out the words "bank" and "banks" wherever they appear and inserting "financial institution" or "financial institutions", respectively, in lieu thereof;

(2) by inserting "other than as received under the provisions of section 11(e)(2) or 11(e)(3)" immediately before the words "and which involves" in paragraph Fourth; and

(3) by adding at the end thereof the following new paragraph:

"Eleventh. To define any terms used in the Federal

Deposit Insurance Act, as amended, that are not specifically defined in such Act, and to interpret the definitions of any terms that are not so defined; Provided, That no such definition shall be binding on any other Federal banking agency as it may implement or enforce the provisions of this Act."

Sec. 210. ADMINISTRATION OF CORPORATION. - Subsection 10(b) of the Federal Deposit Insurance Act (12 U.S.C. 1820) is hereby amended as follows:

(a) In the first sentence, by adding after "or other institution," a comma and the phrase "including a State savings association".

(b) In the second sentence, by deleting "insured Federal savings bank" and by inserting in lieu thereof "insured savings association".

Sec. 211. INSURANCE FUNDS; CORPORATION POWERS AS RECEIVER. - Section 11 of the Federal Deposit Insurance Act (12 U.S.C. 1821) is hereby amended as follows:

(1) Subsection (a) is amended as follows:

(a) Paragraph (1) is amended to read as follows:

"(1) On and after the effective date of the "Financial Institutions Reform, Recovery and Enforcement Act of 1989" the Corporation shall insure the deposits of all insured financial institutions as provided in this Act. Except as provided in paragraph 2, the maximum amount of the insured deposit of any depositor shall be $100,000."

(b) In subparagraph (2)(B), the words "time and savings" are deleted.

(c) By adding a new paragraph (4) to read as follows:

"(4) There are hereby established two insurance funds both to be operated and administered by the Corporation and to be separately maintained and not commingled, which shall be used by the Corporation for the purposes of carrying out the insurance purposes of this chapter in the manner set forth below.

"(A) As of the effective date of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, there is hereby established a fund to be designated the Bank Insurance Fund. On that date, the Permanent Insurance Fund shall be dissolved and all the assets, debts, obligations,

contracts, and other liabilities of the Permanent Insurance Fund, matured or unmatured, accrued, absolute, contingent, or otherwise shall hereby be transferred in their entirety to the Bank Insurance Fund. Money in the Bank Insurance Fund shall be available to the Corporation for the uses and purposes herein provided with respect to the Bank Insurance Fund members. All amounts assessed Bank Insurance Fund members by the Corporation shall be deposited into the Bank Insurance Fund.

"(B)(i) As of the effective date of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, there is hereby established a fund to be designated the Savings Association Insurance Fund. All amounts assessed Savings Associations Insurance Fund members from the date of enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, and not required for the Financing Corporation or for the Resolution Funding Corporation pursuant to section 21 and 21b, respectively, of the Federal Home Loan Bank Act, or for the FSLIC Resolution Fund pursuant to section 11A of this Act, shall be covered into the Savings Association Insurance Fund; provided, however that beginning in 1992, no amounts assessed Savings Association Insurance Fund members shall be provided to the FSLIC Resolution Fund.

"(ii) Beginning in fiscal year 1991, in order to provide funding to the Savings Association Insurance Fund, the Secretary of the Treasury shall, subject to the availability of appropriations, pay to the Fund the amounts per fiscal year, less the assessment paid by the savings associations to the Fund for such fiscal year, as set forth in the table below; provided, however, that at such time as the Savings Association Insurance Fund reserve ratio is equal to 1.25 per centum no further amounts shall be paid to the Fund by the Secretary of the Treasury.

Fiscal Year Beginning October 1,	Dollars in Billions
1991	$2.0
1992	3.4
1993	4.6
1994	3.0
1995	4.0
1996	4.0
1997	4.0
1998	4.0
1999	3.0

"(iii) There are hereby authorized to be appropriated to

the Secretary of the Treasury, without fiscal year limitation, such sums as may be necessary for payments to individual funds as authorized by this Act.

"(iv) The Corporation is hereby authorized to borrow from the Federal Home Loan Banks, with the concurrence of the Chairman of the System, such funds as the Corporation deems necessary for the use of the Savings Association Insurance Fund, which borrowings shall be a direct liability of such Fund and shall be subject to the limitations in paragraph (b) of Section 15 of the Federal Deposit Insurance Act (12 U.S.C. 1825(b)).

"(v) Money in the Savings Association Insurance Fund shall be available to the Corporation for the uses and purposes herein provided with respect to Savings Association Insurance Fund members. All amounts assessed Savings Association Insurance Fund members by the Corporation which do not include those required for the Financing Corporation or the Resolution Funding Corporation pursuant to the Federal Home Loan Bank Act, or for the FSLIC Resolution Fund pursuant to section 11A of this Act, shall be deposited into the Savings Association Insurance Fund."

(2) Subsection (c) is amended to read as follows:

"(c) CORPORATION AS RECEIVER OR CONSERVATOR.

"(1) Notwithstanding any other provision of law, State or Federal, or the constitution of any State, the Corporation is authorized to accept appointment and act as receiver or conservator for financial institutions in default upon appointment as set out in subsection (d) or (e) hereof.

"(2) As such receiver or conservator, the Corporation shall have the following authorities and duties:

"(A) the Corporation is authorized:

"(i) to take over the assets of and operate the financial institution with all the powers of the member or shareholders, the directors, and the officers of the financial institution and shall be authorized to conduct all business, including taking deposits, and perform all functions of the financial institution in its own name,

"(ii) to take such action as may be necessary to put the financial institution in a sound and solvent condition,

"(iii) to merge the financial institution with another insured financial institution,

"(iv) to organize, with respect to savings associations, by application to the Chairman of the Federal Home Loan Bank System a new Federal Savings Association to take over such assets and/or such liabilities as the Corporation may deem appropriate, or with respect to any insured financial institution, to organize a bridge bank under subsection (i) hereof or a new national bank under subsection (h) hereof.

"(v) to transfer any assets or liabilities of the financial institution in default (including assets and liabilities associated with any trust business), such transfer to be effective without any further approval, assignment or consent with respect thereto, provided that when the transferee is another financial institution, the transfer must be approved by the appropriate Federal banking agency for the acquiring institution,

"(vi) to place the financial institution in liquidation and to proceed to realize upon the assets of the financial institution, having due regard to the condition of credit in the locality,

"(vii) to determine claims under the provisions set forth under subsection (1),

"(viii) to exercise all powers and authorities specifically

granted by the provisions of this Act and such incidental powers as shall be necessary to carry out the powers so granted, and to take any actions authorized by this Act, or

"(ix) to exercise any combination of the powers enumerated in clauses (2)(A)(i) through (2)(A)(viii),

"whichever shall appear to be in the best interests of the financial institution in default, of its depositors, or the Corporation;

"(B) the Corporation shall pay all valid credit obligations of the financial institution in accordance with the prescriptions and limitations set forth in this Act;

"(C) in cases of liquidation, or other closing or winding up of the affairs of a closed financial institution, the Corporation:

"(i) shall promptly publish a notice to the financial institution's creditors to present their claims, with proof thereof, to the receiver by a date specified in the notice (at least 90 days after first publication). The notice shall be published again approximately 1 month and 2 months respectively after first publication. Claims filed after the specified date shall be disallowed. The receiver shall

mail a similar notice at the time of first publication to any creditor shown on the financial institution's books at the creditor's last address appearing thereon or upon discovery of the name and address of a claimant not appearing on the financial institution's books within 30 days of discovery;

"(ii) shall allow any claim seasonably received and proved to its satisfaction. The receiver may wholly or partly disallow any creditor claim or claim of security, preference, or priority not so proved, and shall notify the claimant of the disallowance and the reason therefore. Mailing notice of the disallowance to the claimant's last address appearing on the financial institution's books or on the proof of claim shall be sufficient notice. Unless, within 30 days after notice is mailed, the claimant files a written objection to the disallowance, disallowance shall be final. Those claims to which an objection is properly and timely filed shall be decided in accordance with the provisions of subsection (1).

"(iii) may pay creditor claims which are allowed by the receiver or approved by a final determination by the receiver in accordance with subsection (1), from time to time, in the receiver's discretion, to the extent funds are available, in such manner and amounts as are authorized

under this Act;

"(D) the Corporation shall pay to itself for its own account such portion of the amounts realized from any liquidation as it shall be entitled to receive on account of its subrogation to the claims of depositors, and it shall pay to depositors and other creditors the net amounts available for distribution to them;

"(E) the Corporation may, in its discretion, pay dividends on proved claims at any time, and no liability shall attach to the Corporation itself or as such receiver by reason of any such payment for failure to pay dividends to a claimant whose claim is not proved at the time of any such payment;

"(F) the Corporation may request a stay for a period of up to 90 days after the appointment of the receiver as to any legal action or proceeding to which the receiver or the financial institution in default is or may become a party. Upon petition, the court shall grant such stay as to all parties;

"(G) the Corporation is authorized to disaffirm or repudiate any contract or lease the performance of which the Corporation in its discretion considers to be burdensome, or in its discretion considers the disaffirmance or repudiation

of which will promote the orderly administration of the financial institution's affairs. So long as the Corporation disaffirms or repudiates the contract within 90 days from the date the Corporation is appointed conservator or receiver or discovers the existence of the contract or lease subject to disaffirmance or repudiation, neither the Corporation nor the estate of the financial institution will incur any liability with respect to such contract or lease, except that lessors shall be entitled to the contractual rent for the period from the appointment of the receiver to the date the notice of disaffirmance or repudiation is mailed or effective: Provided, That nothing herein is intended in any way to limit the authority of the Corporation as receiver to disaffirm or repudiate such contract or lease after the 90-day period set out above;

"(H) the Corporation may enforce any contract entered into by the financial institution to the same extent as the financial institution in default, notwithstanding any provision of the contract to the contrary, which it deems in its discretion to be necessary for the orderly execution of its duties;

"(I) the Corporation shall keep a full accounting of each receivership estate and conservatorship estate or other disposition of institutions in default and make such

accounting available to the shareholders of the financial institution, the Secretary of the Treasury, and the Comptroller General;

"(J) in any case in which funds remain after all depositors, creditors, other claimants, and administrative expenses are paid, the Corporation shall distribute such funds to the financial institution's shareholders or members along with the accounting specified in paragraph (I); and

"(K) the Corporation may, any time five years after its appointment as receiver of a Federal financial institution, destroy any records of such institution which the Corporation in its discretion deems to be unnecessary."

(3) Subsection (d) is amended to read as follows:

"(d) CORPORATION AS RECEIVER OR CONSERVATOR OF FEDERAL FINANCIAL INSTITUTIONS.

"(1) Except as provided in Section 21a of the Federal Home Loan Bank Act notwithstanding any other provision of law, State or Federal, or the constitution of any State, whenever a receiver or conservator is appointed for an insured Federal or District financial institution by the authority having supervision of such financial institution for the

purpose of liquidation or winding up its affairs, the Corporation shall be appointed, and shall accept appointment, as such receiver or conservator. The Corporation may, at the discretion of the supervisory authority, be appointed conservator not for the purpose of liquidation or winding up the financial institution's affairs, and the Corporation may accept such appointment.

"(2) As such receiver or conservator, the Corporation shall have all powers and duties set forth in this Act, and such other powers and duties possessed by receivers and conservators for Federal financial institutions under any other provisions of law, in addition to and not in derogation of the powers conferred in this Act;

"(3) As such receiver or conservator, the Corporation shall not be subject to the direction or supervision of any other agency or Department in the exercise of its rights, powers, and privileges as receiver or conservator, Provided that, in cases in which the financial institution continues to operate in conservatorship the institution shall remain subject to the supervision of its primary regulator."

(4) Subsection (e) is amended to read as follows:

"(e) CORPORATION AS RECEIVER OR CONSERVATOR OF STATE

FINANCIAL INSTITUTIONS.

"(1)(A) Whenever the authority having supervision of any insured State financial institution (except a District financial institution) appoints a receiver or conservator for such State financial institution and tenders appointment to the Corporation, the Corporation may accept appointment as receiver or conservator.

"(B) The Corporation as such receiver or conservator shall possess all the rights, powers, and privileges granted by State law to a receiver or conservator of a State financial institution of any kind, in addition to and not in derogation of the powers conferred upon the Corporation under subsection (c).

"(C) As such receiver or conservator, the Corporation shall not be subject to the direction or supervision of any other agency or Department, State or Federal, in the exercise of its rights, powers, and privileges.

"(2) Whenever the Chairman of the Federal Home Loan Bank System appoints a conservator or receiver under the provisions of section 5(d)(2)(C) of the Home Owners' Loan Act of 1933, as amended (12 U.S.C. 1464(d)(2)(C), the Corporation shall be appointed.

"(3) The Corporation shall have power and jurisdiction to appoint itself as sole conservator or receiver of an insured State financial institution in the event the Corporation determines--

"(A) that

"(i) a conservator, receiver, or other legal custodian has been or is hereafter appointed for an insured State financial institution other than by the Federal Home Loan Bank System or by the Comptroller of the Currency and that the appointment of such conservator, receiver, or custodian, or any combination thereof, has been outstanding for a period of at least 15 consecutive days, and that one or more of the depositors in such institution is unable to obtain a withdrawal of this deposit, in whole or in part; or

"(ii) an insured State financial institution has been closed by or under the laws of any State; and

"(B) that one or more of the grounds specified in paragraph (2)(A) of Section 5(d) of the Home Owners' Loan Act of 1933, as amended (12 U.S.C. 1464(d)) existed with respect to such financial institution at the time a conservator, receiver,

or other legal custodian was appointed, or at the time such financial institution was closed, or exists thereafter during the appointment of the conservator, receiver, or other legal custodian or while the institution is closed.

"(4) In any case where the Corporation is appointed conservator or receiver of an insured State financial institution--

"(A) the provisions of this Act shall be applicable in the same manner and to the same extent as if such institution were a Federal financial institution with respect to which the Corporation had been appointed conservator or receiver; and

"(B) the Corporation shall have authority to liquidate such financial institution in an orderly manner or to make such other disposition of the matter as it deems to be in the best interests of the institution, its savers, and the Corporation.

"(5) The authority conferred by paragraphs (2) and (3) shall be in addition to, and not a limitation upon, appointment under paragraph (1)."

(5) Subsection (f) is amended to read as follows:

"(f) PAYMENT OF INSURED DEPOSITS.--

"(1) In cases of the liquidation, or other closing or winding up of the affairs of a closed insured financial institution or insured branch of a foreign bank, payment of the insured deposits in such financial institution or branch shall be made by the Corporation as soon as possible, subject to the provisions of subsection (g) of this section either by cash or by making available to each depositor a transferred deposit in a new financial institution in the same community or in another insured financial institution in an amount equal to the insured deposit of such depositor: Provided, however, that all payments made pursuant to this section on account of a closed bank or insured branch of a foreign bank shall be made only from the Bank Insurance Fund, and all payments made pursuant to this section on account of a closed savings association shall be made only from the Savings Association Insurance Fund.

"(2) The Corporation, in its discretion, may require proof of claims to be filed and may approve or reject such claims. In the case of a disputed claim, the Corporation shall have the power to adjudicate such dispute according to rules and regulations established for that purpose. Final determination made by the Corporation shall be reviewable by the Court of appeals for the District of Columbia Circuit or

the Court of Appeals for the circuit where the financial institution is located and shall be upheld unless found to be arbitrary or capricious. In the absence of rules and regulations, the Corporation may require the final determination of a court of competent jurisdiction before paying such claim."

(6) Subsection (g) is amended to read as follows:

"(g) SUBROGATION.--

"Nothwithstanding any other provision of law, State or Federal, or the constitution of any State, the Corporation, upon the payment to any depositor as provided in subsection (f) of this section, or the assumption of any deposit pursuant to Section 13, shall be subrogated to all rights of the depositor against the financial institution or branch to the extent of such payment. Such subrogation shall include the right on the part of the Corporation to receive the same dividends from the proceeds of the assets of such financial institution or branch and recoveries on account of stockholders' liability as would have been payable to the depositor on a claim for the insured deposit, but such depositor shall retain such claim for any uninsured or unassumed portion of the deposit: Provided, That, with respect to any bank which closes after May 25, 1938, the

Corporation shall waive, in favor only of any person against whom stockholders' individual liability may be asserted, any claim on account of such liability in excess of the liability, if any, to the bank or its creditors, for the amount unpaid upon his stock in such bank; but any such waiver shall be effected in such manner and on such terms and conditions as will not increase recoveries or dividends on account of claims to which the Corporation is not subrogated: Provided further, That if the Corporation determines not to invoke the authority conferred in subsection (e)(3), the rights of depositors and other creditors of any State financial institution shall be determined in accordance with the applicable provisions of State law."

(7) Subsection (h) is amended as follows:

(a) The term "closed bank" is deleted, and the term "financial institution in default" is inserted in lieu thereof wherever it appears;

(b) In paragraph (1), the words "closing of an insured bank" are deleted and the words "default of an insured financial institution" are inserted in lieu thereof;

(c) In paragraph (2), the words ", State or Federal, or the

constitution of any State," are added after "Nothwithstanding any other provision of law" in the last sentence; and

(d) In paragraph (4), the words "closed insured bank" are deleted, and the words "financial institution in default" are inserted in lieu thereof.

(8) Subsection (i) is amended to read as follows:

"(i) BRIDGE BANKS.--

"(1) ORGANIZATION.--

"(A) PURPOSE.--When one or more insured financial institutions are in default or in anticipation of its or their becoming in default, the Corporation may, in its discretion, organize a bridge bank or banks with respect thereto and upon the granting of a charter to such bridge bank, the bridge bank may--

"(i) assume such deposits of such insured financial institution or institutions that is or are in default or in danger of default as the Corporation may, in its discretion, determine to be appropriate;

"(ii) assume such other liabilities (including liabilities associated with any trust business) of such insured financial institution or institutions that is or are in default or in danger of default as the Corporation may, in its discretion, determine to be appropriate;

"(iii) purchase such assets (including assets associated with any trust business) of such insured financial institution or institutions that is or are in default or in danger of default as the Corporation may, in its discretion, determine to be appropriate; and

"(iv) perform any other temporary function which the Corporation may, in its discretion, prescribe in accordance with this Act.

"(B) ARTICLES OF ASSOCIATION.--The articles of association and organization certificate of a bridge bank as approved by the Corporation shall be executed by three representatives designated by the Corporation.

"(C) NATIONAL BANK.--A bridge bank shall be organized as a national bank.

"(D) INTERIM DIRECTORS.--A bridge bank shall have an interim board of directors consisting of not fewer than five

nor more than ten members appointed by the Corporation.

"(2) CHARTERING.--

"(A) CONDITIONS.--A bridge bank shall be chartered by the Comptroller of the Currency as a national bank only if the Board of Directors determines that--

"(i) the amount which is reasonably necessary to operate such bridge bank will not exceed the amount which is reasonably necessary to save the cost of liquidating, including paying the insured accounts of, one or more insured financial institutions in default with respect to which the bridge bank is chartered;

"(ii) the continued operation of such insured financial institution or financial institutions in default with respect to which the bridge bank is chartered is essential to provide adequate banking services in the community where each such financial institution in default is located; or

"(iii) the continued operation of such insured financial institution or institutions in default with respect to which the bridge bank is chartered is in the best interest of the depositors of such financial institution or institutions in default or the public.

"(B) INSURED NATIONAL BANK.--A bridge bank shall be an insured bank from the time it is chartered as a national bank.

"(C) BRIDGE BANK TREATED AS BEING IN DEFAULT FOR CERTAIN PURPOSES.--Notwithstanding any other provision of law, State or Federal, or the constitution of any State, any bridge bank shall be treated as a financial institution in default at such times and for such purposes as the Corporation may, in its discretion, determine.

"(D) MANAGEMENT.--A bridge bank, upon the granting of its charter, shall be under the management of a board of directors consisting of not fewer than five nor more than ten members appointed by the Corporation.

"(E) BYLAWS.--The board of directors of a bridge bank shall adopt such bylaws as may be approved by the Corporation.

"(3) TRANSFER OF ASSETS AND LIABILITIES.--

"(A) IN GENERAL.--Upon the granting of a charter to a bridge bank pursuant to this subsection, the Corporation, as receiver, or any other receiver appointed with respect to any insured financial institution in default with respect to which the bridge bank is chartered may, transfer any assets

and liabilities of such financial institution in default to the bridge bank in accordance with paragraph (1) of this subsection. Thereafter, the Corporation, as receiver, or any other receiver appointed with respect to an insured financial institution in default may transfer any assets and liabilities of such insured financial institution in default as the Corporation may, in its discretion, determine to be appropriate in accordance with paragraph (1) of this subsection. For purposes of this paragraph of this subsection, the trust business, including fiduciary appointments, of any insured financial institution in default, is included among its assets and liabilities. The transfer of any assets or liabilities associated with any trust business of an insured financial institution in default transferred to a bridge bank shall be effective without any further approval, assignment or consent with respect thereto, notwithstanding any other provision of law, State or Federal, or the constitution of any State.

"(B) INTENT OF CONGRESS REGARDING CONTINUING OPERATIONS.--It is the intent of the Congress that, in order to prevent unnecessary hardship or losses to the customers of any insured financial institution in default with respect to which a bridge bank is chartered, especially creditworthy farmers, small businesses, and households, the Corporation should--

"(i) continue to honor commitments made by the financial institution in default to creditworthy customers, and

"(ii) not interrupt or terminate adequately secured loans which are transferred under subparagraph (A) and are being repaid by the debtor in accordance with the terms of the loan instrument.

"(4) POWERS OF BRIDGE BANKS.--Each bridge bank chartered under this subsection shall have all corporate powers of, and be subject to the same provisions of law as, a national bank, except as otherwise provided in this subsection and except that-

"(A) the Corporation may--

"(i) remove the interim directors and directors of a bridge bank;

"(ii) fix the compensation of members of the interim board of directors and the board of directors and senior management, as determined by the Corporation in its discretion, of a bridge bank; and

"(iii) waive any requirement established under section 5145, 5146, 5147, 5148, or 5149 of the Revised Statutes

(relating to directors of national banks) or section 31 of the Banking Act of 1933 which would otherwise be applicable with respect to directors of a bridge bank by operation of paragraph (2)(B);

"(B) the Corporation may idemnify the representatives for purposes of subparagraph (1)(B) and the interim directors, directors, officers, employees and agents of a bridge bank on such terms as the Corporation determines to be appropriate;

"(C) no requirement under section 5138 of the Revised Statutes or any other provision of law relating to the capital of a national bank shall apply with respect to a bridge bank;

"(D) the Comptroller of the Currency may establish a limitation on the extent to which any person may become indebted to a bridge bank without regard to the amount of the bridge bank's capital or surplus;

"(E)(i) the board of directors of a bridge bank shall elect a chairperson who may also serve in the position of chief executive officer: Provided, That such person shall not serve either as chairperson or as chief executive officer without the prior approval of the Corporation;

"(ii) the board of directors of a bridge bank may appoint a chief executive officer who is not also the chairperson: Provided, That such person shall not serve as chief executive officer without the prior approval of the Corporation;

"(F) a bridge bank shall not be required to purchase stock of any Federal Reserve bank;

"(G) the Comptroller of the Currency shall waive any requirement for a fidelity bond with respect to a bridge bank at the request of the Corporation;

"(H) any action to which a bridge bank becomes a party by virtue of its acquisition of any assets or assumption of any liabilities of a financial institution in default shall be stayed from further proceedings for a period of up to 90 days at the request of the bridge bank;

"(I) no agreement which tends to diminish or defeat the right, title or interest of a bridge bank in any asset of an insured financial institution in default acquired by it shall be valid against the bridge bank unless such agreement:

"(i) shall be in writing,

"(ii) shall have been executed by such insured financial institution in default and the person or persons claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by such insured financial institution in default,

"(iii) shall have been approved by the board of directors of such insured financial institution in default or its loan committee, which approval shall be reflected in the minutes of said board or committee, and

"(iv) shall have been, continuously from the time of its execution, an official record of such insured financial institution in default; and

"(J) except with the prior approval of the Corporation, a bridge bank may not, in any transaction or series of transactions, issue capital stock or be a party to any merger, consolidation, disposition of assets or liabilities, sale or exchange of capital stock, or similar transaction, or change its charter.

"(5) CAPITAL.--

"(A) NO CAPITAL REQUIRED.--The Corporation shall not be required to--

"(i) issue any capital stock on behalf of a bridge bank chartered under this subsection; or

"(ii) purchase any capital stock of a bridge bank: Provided, That notwithstanding any other provision of law, State or Federal, or the constitution of any State, the Corporation may purchase and retain capital stock of a bridge bank in such amounts and on such terms as the Corporation, in its discretion, determines to be appropriate.

"(B) OPERATING FUNDS IN LIEU OF CAPITAL.--Upon the organization of a bridge bank, and thereafter, as the Board of Directors may, in its discretion, determine to be necessary or advisable, the Corporation may make available to the bridge bank, upon such terms and conditions and in such form and amounts as the Corporation may in its discretion determine, funds for the operation of the bridge bank.

"(C) AUTHORITY TO ISSUE CAPITAL STOCK.--Whenever the Board of Directors determines it is advisable to do so, the Corporation shall cause capital stock of a bridge bank to be issued and offered for sale in such amounts and on such terms and conditions as the Corporation may, in its discretion, determine.

"(6) NO FEDERAL STATUS.--

"(A) AGENCY STATUS.--A bridge bank is not an agency, establishment, or instrumentality of the United States.

"(B) EMPLOYEE STATUS.--Representatives for purposes of subparagraph (1)(B), interim directors, directors, officers, employees, or agents of a bridge bank are not, solely by virtue of service in any such capacity, officers or employees of the United States for purposes of Title 5, United States Code, or any other provision of law. Any employee of the Corporation or of any Federal instrumentality who serves at the request of the Corporation as a representative for purposes of subparagraph (1)(B), interim director, director, officer, employee or agent of a bridge bank shall not

"(i) solely by virtue of service in any such capacity lose any existing status as an officer or employee of the United States for purposes of Title 5, United States Code, or any other provision of law, or

"(ii) receive any salary or benefits for service in any such capacity with respect to a bridge bank in addition to such salary or benefits as are obtained through employment with the Corporation or such Federal instrumentality.

"(7) ASSISTANCE AUTHORIZED.--The Corporation may, in its discretion, provide assistance under section 13(c) to facilitate any transaction contemplated in subparagraph (10)(A)(i), (ii) or (iii) with respect to a bridge bank in the same manner and to the same extent as such assistance may be provided under such section with respect to an insured financial institution in default, or to facilitate a bridge bank's acquisition of any assets or the assumption of any liabilities of an insured financial institution in default.

"(8) ACQUISITION

"(A) IN GENERAL.--Any transaction with respect to the merger or sale of a bridge bank requiring approval under section 18(c), unless immediate action is necessary to prevent the probable failure of an insured financial institution, shall be deemed to be an emergency requiring expeditious action. The responsible agency shall notify the Attorney General thereof and if a report on competitive factors is requested within ten days, such transaction may not be consummated before the fifth calendar day after the date of approval by the responsible agency with respect thereto.

"(B) BY OUT-OF-STATE HOLDING COMPANY.--Notwithstanding any

other provision of law, State or Federal, or the constitution of any State, any financial institution, including an out-of-State financial institution, or any out-of-State financial institution holding company may acquire and retain the capital stock or assets of, or otherwise acquire and retain a bridge bank: Provided, That the bridge bank at any time had assets aggregating $500,000,000 or more, as determined by the Corporation on the basis of the bridge bank's reports of condition or on the basis of the last available reports of condition or thrift financial reports of any insured financial institution in default, which institution has been acquired, or whose assets have been acquired, by the bridge bank; and Provided further, That the acquiring entity may acquire the bridge bank only in the same manner and to the same extent as such entity may acquire an insured bank in default under section 13(f)(2).

"(9) CORPORATE EXISTENCE OF BRIDGE BANK.--Subject to paragraphs (10) and (11) of this subsection, the corporate existence of a bridge bank shall not exceed the period of two years from the date it is granted a charter: Provided, That the Board of Directors may, in its discretion, extend the corporate existence of the bridge bank for additional three one-year periods.

"(10) TERMINATION OF BRIDGE BANK STATUS.--

"(A) IN GENERAL.--A bridge bank shall terminate its status as such upon the earliest to occur of the following:

"(i) The merger or consolidation of the bridge bank with a financial institution that is not a bridge bank: Provided, That in connection with such a transaction, the bridge bank may request conversion of its charter to that of a financial institution that is not a bridge bank;

"(ii) The sale of all or substantially all of the capital stock of the bridge bank to an entity other than the Corporation and other than another bridge bank.

"(iii) The assumption of all or substantially all of the deposits and other liabilities of the bridge bank by a financial institution holding company or a financial institution that is not a bridge bank, or the acquisition of all or substantially all of the assets of the bridge bank by a financial institution holding company, a financial institution that is not a bridge bank, or other entity as permitted under applicable law.

"(iv) The dissolution of the bridge bank by the Corporation in accordance with paragraph (11) of this subsection prior to the initial two-year period of corporate existence of the bridge bank and any extension thereof in accordance with

paragraph (9) of this subsection.

"(v) The expiration of the initial two-year period of corporate existence of the bridge bank and any extension thereof in accordance with paragraph (9) of this subsection.

"(11) DISSOLUTION OF BRIDGE BANK.--

"(A) IN GENERAL.--Notwithstanding any other provision of law, State or Federal, or the constitution of any State--

"(i) the Board of Directors may, in its discretion, dissolve a bridge bank in accordance with this paragraph (11) at any time during the corporate existence of a bridge bank if the Board of Directors determines that the amount which is reasonably necessary to dissolve the bridge bank will not exceed the amount which is reasonably necessary to either continue operation of the bridge bank or effect a transaction with respect to the bridge bank as contemplated in subparagraph (10)(A)(i), (ii) or (iii) of this subsection;

"(ii) the Board of Directors may, in its discretion, commence such dissolution proceedings in accordance with this paragraph (11) with respect to a bridge bank as the Board of Directors determines to be necessary following the

consummation of a transaction contemplated in subparagraph (10)(A)(ii) or (iii); and

"(iii) the Board of Directors shall commence dissolution proceedings in accordance with this paragraph (11) upon the expiration of the period of corporate existence of a bridge bank as provided in paragraph (9) of this subsection.

"(B) PROCEDURES.--The Comptroller of the Currency shall appoint the Corporation receiver for a bridge bank upon certification by the Board of Directors to the Comptroller of the Currency of its determination to dissolve the bridge bank. The Corporation as such receiver shall wind up the affairs of the bridge bank in conformity with the provisions of law relating to the liquidation of closed national banks. With respect to any such bridge bank, the Corporation as such receiver shall have all the rights, powers and privileges now possessed or hereafter granted by law to a receiver of a national bank or a District bank and notwithstanding any other provision of law in the exercise of such rights, powers, and privileges the Corporation shall not be subject to the direction or supervision of the Secretary of the Treasury or the Comptroller of the Currency.

"(12)(A) Each bridge bank established under this subsection

may operate branches in only one state.

"(B) The Corporation may, in the Corporation's discretion, organize two or more bridge banks under this subsection to assume any deposits of, assume any other liabilities of, and purchase any assets of a single financial institution in default."

(9) Subsection (j) is amended by deleting the term "closed bank" and inserting "financial institution in default" in lieu thereof.

(10) By adding new subsection (k), (l) and (m) at the end thereof to read as follows:

"(k) VALUATION OF CLAIMS AGAINST FINANCIAL INSTITUTIONS IN DEFAULT.--Notwithstanding any other law, State or Federal, or the constitution of any State, and regardless of the method which the Corporation determines to utilize with respect to an insured financial institution in default or in danger of default, including but not limited to transactions authorized under subsection (i) and under section 13(c)(2)(A), the following provisions shall govern the rights of the creditors (other than insured depositors) of such financial institution:

"(1) MAXIMUM LIABILITY.--The maximum liability of the Corporation to any person having a claim against the estate of an insured financial institution in default shall be equal to the amount such claimant would have received from the estate of the financial institution if the Corporation had liquidated such estate. In the case of an insured financial institution which the Corporation elects to operate, the point in time for determining what such claimant will receive from the estate of the financial institution had the Corporation liquidated such estate shall be the date the receiver ceases operating the financial institution, and begins to wind up the affairs of the financial institution, and the Corporation shall not be liable to any such claimant should the estate of the financial institution be diminished from the time the Corporation begins operating the financial institution to the time the Corporation ceases operating the financial institution and begins to wind up the affairs of the financial institution, absent a finding of bad faith on the part of the Corporation; and

"(2) ADDITIONAL PAYMENTS AUTHORIZED.--The Corporation may, in its discretion, use its own resources to make additional payments or credit additional amounts to or with respect to or for the account of any claimant or category of claimants: Provided, That the Corporation shall not be obligated, as a

result of having made any such payment or credited any such amount to or with respect to or for the account of any claimant or category of claimants, to make payments to any other claimant or category or claimants; and Provided further;

"(A) That if the financial institution in default is a Bank Insurance Fund member, the Corporation may only make such payments out of fund held in the Bank Insurance Fund of the Deposit Insurance Fund; and

"(B) That if the financial institution in default is an a Savings Association Insurance Fund member, the Corporation may only make such payments out of funds held in the Savings Association Insurance Fund of the Deposit Insurance Fund.

"(3) The Corporation may make the payments or credit the amounts specified in paragraph (2) directly to the claimants or may make such payments or credit such amounts to an open insured financial institution to induce the open insured financial institution to accept liability for such claims.

"(1) RULE-MAKING AND CLAIMS DETERMINATION AUTHORIZED.--

"(1) The Corporation shall have power to make rules and regulations for the conduct of conservatorships and of

receiverships and the Corporation may, by regulation or order, provide for the exercise of functions by members or stockholders, directors, or officers of a financial institution during conservatorship or receivership. The Corporation shall also have the power to determine claims in accordance with rules and regulations it shall prescribe and subject to judicial review as herein provided.

"(2) The authority to determine claims shall only be exercised after the Corporation has established rules or regulations governing the processing of claims, the accounting of estate funds, and the distributing of residual funds to shareholders. Final determinations made by the Corporation with respect to claims asserted against the estate of a financial institution shall be reviewable by the Court of Appeals for the District of Columbia Circuit or the Court of Appeals for the circuit where the financial institution is located and shall be upheld unless found to be arbitrary or capricious.

"(3) In the absence of rules and regulations established by the Corporation for the resolution of claims against the estate of the financial institution, any action or proceeding against a financial institution for which the Corporation has been appointed receiver, or against the Corporation as receiver of such financial institution, shall

be brought in the district or territorial court of the United States held within the district in which that financial institution's principal place of business is located, or, in the event any State, county, or municipal court has jurisdiction over such an action or proceeding, in such court in the county or city in which the financial institution's principal place of business is located.

"(m) JUDICIAL REVIEW--Except as provided in this section, no court may take any action, except at the request of the Board of Directors by regulation or order, to restrain or affect the exercise of powers or functions of the Corporation as a conservator or receiver."

SEC. 212. FSLIC RESOLUTION FUND. - There is hereby added after Section 11 of the Federal Deposit Insurance Act a new section 11A (12 U.S.C. 1821A) to read as follows:

"Sec. 11A. FSLIC RESOLUTION FUND. (a) ESTABLISHED. There is hereby established a separate fund to be designated as the FSLIC Resolution Fund which shall be managed by the Corporation and separately maintained and not commingled. On the date of the dissolution of the Federal Savings and Loan Insurance Corporation in accordance with section 401 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, all reserves and all other assets of any kind, and debts, obligations, contracts

and other liabilities of the Federal Savings and Loan Insurance Corporation, matured or unmatured, accrued, absolute, contingent, or otherwise shall hereby be transferred in their entirety to the FSLIC Resolution Fund; provided however that such liabilities transferred to the FSLIC Resolution Fund shall not include liabilities specifically transferred pursuant to section 21a of the Federal Home Loan Bank Act. Such reserves assets, debts, obligations, contracts, or other liabilities as are so transferred shall be exclusive assets and liablities of the FSLIC Resolution Fund and not of the Corporation and shall not be consolidated with the assets and liabilities of the Deposit Insurance Fund or the Corporation for accounting or reporting or any other purpose.

"(b) SOURCE OF FUNDS. The FSLIC Resolution Fund shall be funded from the following sources in the listed priority to the extent funds are needed: (i) miscellaneous income from assets of the Federal Savings and Loan Insurance Corporation that were transferred to the FSLIC Resolution Fund on the date of enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989; (ii) the proceeds of the resolution of insolvent thrift institutions which became insolvent prior to December 31, 1988, to the extent such funds are not required by the Resolution Funding Corporation pursuant to section 21b of the Federal Home Loan Bank Act; (iii) proceeds from borrowings by the Financing Corporation pursuant to section 21 of the Federal Home Loan Bank

Act; (iv) all amounts assessed Savings Association Insurance Fund members by the Corporation pursuant to section 7 from the date of enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, and not required by the Financing Corporation pursuant to section 21 of the Federal Home Loan Bank Act, or for the Resolution Trust Corporation pursuant to section 21a of the Federal Home Loan Bank Act, which shall be covered into the FSLIC Resolution Fund until December 31, 1991.

"(c) TREASURY BACKUP. In the event that all the above funds are insufficient for the funding purposes of the FSLIC Resolution Fund, the Secretary of the Treasury shall, subject to the availability of appropriations, provide such excess funds determined by the Federal Deposit Insurance Corporation and the Secretary to be necessary for FLSIC Resolution Fund purposes. There are hereby authorized to be appropriated to the Secretary of the Treasury, without fiscal year limitation, such sums as may be necessary to carry out the provisions of this paragraph.

"(d) LEGAL PROCEEDINGS. Notwithstanding any other provision of law, any judgment resulting from civil action, suit, or proceeding to which the Federal Savings and Loan Insurance Corporation was a party prior to its dissolution hereunder, or which is initiated against the Corporation or its assets thereafter, shall be limited to the assets of the FSLIC Resolution Fund.

"(e) DISSOLUTION. The FSLIC Resolution Fund shall be dissolved upon satisfaction of all debts and liabilities and sale of all assets acquired in case resolutions and otherwise. Upon dissolution any remaining funds shall be covered into the Treasury, provided that any tangible assets, including offices and office supplies, shall be transferred to the Corporation for use by and to be held as asset of the Savings Association Insurance Fund."

Sec. 213. AMENDMENTS TO SECTION 12. - Section 12 of the Federal Deposit Insurance Act (12 U.S.C. 1822) is hereby amended as follows:

(1) The words "closed bank" are deleted wherever they occur, and the words "financial institution in default" are inserted in lieu thereof;

(2) Subsection (a) is amended to read as follows:

"(a) BOND NOT REQUIRED; AGENTS; FEE.--Notwithstanding any other provision of law, State or Federal, or the constitution of any State, the Corporation as receiver of an insured financial institution or branch of a foreign bank shall not be required to furnish bond and shall have the right to appoint an agent or agents to assist it in its duties as such receiver, and all fees, compensation, and

expenses of liquidation and administration thereof shall be fixed by the Corporation, and may be paid by it out of funds coming into its possession as such receiver."

(3) In subsection (d), the words "as a stockholder or the closed bank, or of any liability of such depositor" are deleted; and the words "such bank" are deleted and "such financial institution" are inserted in lieu thereof.

Sec. 214. AMENDMENTS TO SECTION 13. - Section 13 of the Federal Deposit Insurance Act (12 U.S.C. 1823) is amended as follows:

(1) Subsection (a) is amended to read as follows:

"(a) INVESTMENT OF CORPORATION FUNDS.--

"(1) AUTHORITY.--Funds belonging to the Corporation and held in either the Bank Insurance Fund or the Savings Association Insurance Fund that are not otherwise employed shall be invested in obligations of the United States or in obligations guaranteed as to principal and interest by the United States: Provided, that funds held in the Bank Insurance Fund and the Savings Association Insurance Fund shall be invested separately and not commingled.

"(2) LIMITATION.--The Corporation shall not sell or

purchase any such obligations for its own account and in its own right and interest, at any one time aggregating in excess of $100,000, without the approval of the Secretary of the Treasury. The Secretary of the Treasury may waive the requirement of his approval with respect to any transaction or classes of transactions subject to the provisions of this subsection for such period of time and under such conditions as he may determine."

(2) Subsection (b) is amended as follows:

(a) by deleting the words "banking and checking" wherever they occur, and inserting the word "depository" in lieu thereof;

(b) by deleting the word "bank" wherever it occurs, and inserting the words "financial institution" in lieu thereof, except the the phrase "Federal Reserve bank" shall remain unchanged.

(3) Subsection (c) is amended as follows:

(a) The words "closing or "closed" are deleted wherever they occur, and the words "default" or "in default" are inserted in lieu thereof respectively;

(b) Notwithstanding Section 201 of this Act, the term "closed insured bank" is deleted wherever it occurs and the term "insured financial institution in default" is inserted in lieu thereof;

(c) In subparagraph (2)(A), the words "insured institution" are deleted wherever they occur and the words "another insured financial institution" are inserted in subparagraph (2)(A) in lieu thereof, and the words "such other insured financial institution" are inserted in subparagraph (2)(A)(ii) and (iii) in lieu thereof;

(d) In paragraph (2), a new subparagraph (2)(C) is added to read as follows:

> "(C) Any action to which the Corporation is or becomes a party by virtue of its acquisition of any asset or exercise of any other authority set forth in this section shall be stayed for a period of ninety days at the request of the Corporation.";

(e) In paragraph (3) the words "section 13(f) of this Act" are deleted, and the words "subsections (f) and (g) hereof" are inserted in lieu thereof;

(f) In paragraph (4), the word "banking" is deleted and the

word "financial" is inserted in lieu thereof, and the following new sentences are inserted immediately after the period at the end of paragraph (A):

"In determining the cost of assistance, the Corporation shall consider the immediate and long-term obligations of the Corporation with respect to such assistance, including contingent liabilities. The Corporation shall also consider the Federal tax revenues foregone by the government, to the extent reasonably ascertainable, as a result of the provisions of the Technical and Miscellaneous Revenue Act of 1988 providing specific tax benefits to acquirers of financial institutions in default or in danger of default or to such institutions as a result of assistance provided by the Corporation, or any similar statutory provision."; and

(g) By redesignating existing paragraph (6) and (7) as paragraphs (7) and (8); and by deleting existing paragraph (8); and by inserting a new paragraph (6) to read as follows:

"(6) Notwithstanding any other provision of law, State or Federal, or the constitution of any State, the transfer of any assets or liabilities associated with

any trust business of an insured financial institution in default under subparagraph (2)(A) shall be effective without any further approval, assignment, or consent with respect thereto."

(4) Subsections (d) and (e) are amended to read as follows:

"(d) SALE OF ASSETS TO CORPORATION.--Conservators, receivers, or liquidators of insured financial institutions in default shall be entitled to offer the assets of such financial institutions for sale to the Corporation or as security for loans from the Corporation. The proceeds of every such sale or loan shall be utilized for the same purposes and in the same manner as other funds realized from the liquidation of the assets of such financial institutions. The Corporation, in its discretion, may make loans on the security of or may purchase and liquidate or sell any part of the assets of an insured financial institution which is now or may hereafter be in default.

"(e) AGREEMENTS AGAINST INTERESTS OF CORPORATION.--No agreement which tends to diminish or defeat the right, title or interest of the Corporation in any asset acquired by it under this section or section 11, either as security for a loan or by purchase or as receiver of any insured financial institution, shall be valid against the Corporation unless

such agreement (1) shall be in writing, (2) shall have been executed by the financial institution and the person or persons claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the financial institution, (3) shall have been approved by the board of directors of the financial institution or its loan committee, which approval shall be reflected in the minutes of said board or committee, and (4) shall have been, continuously, from the time of its execution, an official record of the financial institution."

(5) Subsection (f) is amended as follows:

(a) Notwithstanding section 201 of this Act, subsection (f) shall not be amended to delete the term "insured bank" and insert the term "insured financial institution";

(b) The words "closed" and "closing" are deleted wherever they occur and the words "in default" or "default" are inserted in lieu thereof respectively;

(c) In subparagraph (2)(B)(iii) the phrase "a unanimous vote" is replaced by "a vote of 75 per centum of";

(d) The word "depository" is deleted wherever it occurs and the word "financial" is inserted in lieu thereof;

(e) In subparagraph (3)(E) the word "relevant" is added before the words "State supervisor"; and a new sentence is added at the end thereof to read as follows:

> "The "relevant State supervisor" means the State supervisor having authority to supervise the financial institution in danger of default."

(f) In subparagraph (6)(A) the words "the offeror which made the initial lowest acceptable offer and" are inserted after "the Corporation shall permit";

(g) Paragraph (7) is amended by adding a new subparagraph (7)(C) to read as follows:

> "(C) if in the opinion of the Corporation the acquisition threatens the safety and soundness of the acquiror or does not result in the future viability of the resulting financial institution.";

(h) In paragraph (8), subparagraphs (A), (B), (C), (D), (F) and (G) are deleted and subparagraph (E) is redesignated to become paragraph (8); and

(i) Paragraph (9) is amended as follows: (i) in the

paragraph heading the word "nonbank" is deleted and the word "certain" is inserted in lieu thereof; (ii) in subparagraph (9)(A), the words ", other than a subsidiary that is an insured bank," are added after the word "subsidiary" and the phrase "which is not an insured bank" is deleted; and (iii) in subparagraph (9)(B) the words "or an affiliate of an insured bank" are added after the words "intermediate holding company;" in the sentence.

(6) In subsection (h), the terms "a closed insured bank", "closing" and "insurance fund" are deleted, and the terms "an insured financial institution in default," "default" and "Bank Insurance Fund" are inserted in lieu thereof respectively.

(7) Subsection (i) is amended:

(a) by inserting the word "financial" before the word "institution" wherever it occurs;

(b) in subparagraph (1)(C) by deleting the words "chartered bank" and inserting "financing institution" in lieu thereof, by adding the words "a savings association," after "State member bank," and by adding "Chairman of the Federal Home Loan Bank System," after "Federal Reserve System,"; and

(c) in paragraph (5)(C) by deleting the words "greater than

zero and".

(8) Section 408(m) of the National Housing Act, as amended (12 U.S.C. 1730a(m)), is hereby transferred to and shall become part of the Federal Deposit Insurance Act, as amended, at Section 13 and shall become subsection (k) thereof (12 U.S.C. 1823(k)), and is further amended as follows:

(a) After transfer to the Federal Deposit Insurance Act, the term "Corporation" shall mean the Federal Deposit Insurance Corporation;

(b) By deleting the words "insured institution", "an insured institution" and "insured institutions" wherever they appear and inserting in lieu thereof "Savings Association Insurance Fund member", "a Savings Association Fund member: and "Savings Association Insurance Fund members" respectively;

(c) By deleting the words "depository institution" and "depository institutons" wherever they occur and inserting in lieu thereof "financial institution" and "financial institutions" respectively;

(d) Notwithstanding Section 201 of this Act, subparagraph (A)(i) of paragraph (1) shall not be amended to delete the

term "insured bank" and insert the term "insured financial institution".

(e) In subparagraph (1)(A)(i), the phrase "this section" is deleted and the phrase "section 10 of the Home Owners' Loan Act of 1933, as amended," is inserted in lieu thereof, and the words "section 1729(f) of this title" are deleted, and the words "subsection (c) are inserted in lieu thereof;

(f) In subparagraph (1)(A)(iii), the words "the party thereto that is not an insured institution" are deleted, and the words "every party thereto" are inserted in lieu thereof;

(g) The language in subparagraph (1)(A)(iv) is deleted and the following language is inserted in lieu thereof:

> "In authorizing any transactions under this subsection, the Corporation must obtain the prior concurrence of (i) the Chairman of the Federal Home Loan Bank System in connection with the override of any provisions of the laws or constitution of any State or any provision of Fedeal law other than section 10(e)(3) of the Home Owners' Loan Act of 1933, as amended; and (ii) the Board of Governors of the Federal Reserve System in connection with

the override of the provisions of the Federal Reserve Act or the Bank Holding Company Act."

(h) Subparagraph (1)(B)(iii) is amended:

(i) by deleting in the first sentence everything after the words "only by", and inserting in lieu thereof the words "a vote of seventy-five per centum or more of the voting members of the Board of Directors."; and

(ii) by deleting in the second sentence the words "Federal Home Loan Bank Board" and inserting in lieu thereof the words "the Corporation";

(i) Subparagraph (3)(A) is amended:

(i) by deleting the words "savings and loan holding company" and inserting "holding company that controls a Savings Association Insurance Fund member" in lieu thereof; and

(ii) by inserting after the words "shall permit" the words "the offer or which made the lowest acceptable offer and";

(j) In subparagraph (3)(C), insert the word "financial"

before the words "institution" and "institutions";

(k) Amend paragraph (4):

(i) by deleting the language in subparagraph (A) and inserting in lieu thereof the following language:

"the term 'of the same type' means financial institutons that are 'savings associations' as defined in section 10(a) of the Home Owners' Loan Act of 1933, as amended, or holding companies thereof; and"

(ii) in subparagraph (B), by deleting the words "the term 'in-State depository institution or in-State depository institution holding company' means" and inserting in lieu thereof the words "a financial institution is 'within the same State' where the financial institution is".

Sec. 215. BORROWING AUTHORITY. - Section 14 of the Federal Deposit Insurance Act (12 U.S.C. 1824) is hereby amended as follows:

(1) by deleting "$3,000,000,000" and inserting in lieu

thereof "$5,000,000,000, subject to the approval of the Secretary of the Treasury"; and

(2) by adding at the end of the section the following:

"The Corporation may employ such funds for purposes of the Bank Insurance Fund or the Savings Association Insurance Fund and the borrowing shall become a liability of each such fund to the extent funds are employed therefore."

Sec. 216. LIMITATION ON BORROWINGS. - Section 15 of the Federal Deposit Insurance Act (12 U.S.C. 1825) is hereby amended as follows:

(1) by redesignating the existing paragraph as subsection (a) and by adding at the end thereof the following:

"and such State, territorial, county, municipal or local taxation shall be the only type of State, territorial, county, municipal, or local tax to which the Corporation for itself or as receiver of an insured financial institution shall be subjected. Further, the failure of an insured financial institution to pay or remit any State, territorial, county, municipal, or other local tax shall not subject the Corporation as receiver or conservator of that

financial institution to any penalty, forfeiture, or limitation with respect to the enforceability of any right, title, or interest the Corporation as receiver or conservator may have and such failure to pay the tax shall only result in a claim for such tax against the estate of the financial institution."; and

(2) by adding a new subparagraph(b) to read as follows:

"All notes, debentures, bonds, or other similar obligations including estimated losses for guarantees or other liabilities, of the Bank Insurance Fund or the Savings Association Insurance Fund (other than obligations to the Treasury) outstanding at any one time, may not exceed 50 per centum of the net worth of the Bank Insurance Fund or the Savings Association Insurance Fund, respectively, as calculated based on the most recent audit by the General Accounting Office, or $10,000,000,000 to each fund, whichever is less.

Sec. 217. REPORTS. - Section 17 of the Federal Deposit Insurance Act (12 U.S.C. 1827) is hereby amended:

(1) By striking out subsection (a) and inserting in lieu thereof the following:

"(a) The Corporation shall annually submit a full report of its operations, activities, budget, receipts and expenditures for the preceding 12-month period. Such report shall be submitted to the President of the Senate and the Speaker of the House of Representatives, who shall cause the same to be printed for the information of Congress, and the President as soon as practicable after the first day of January each year."

(2) By redesignating subsections (b), (c) and (d) as (c), (d) and (e) respectively, and by adding a new subsection (b) to read as follows:

"(b) As soon as practicable, prior to the beginning of each fiscal quarter, the Corporation shall submit a report to the Secretary of the Treasury and the Director of the Office of Management and Budget with respect to the Corporation's financial operating plans and forecasts (including estimates of actual and future spending, and estimates of actual and future non-cash obligations) taking into account the Corporation's financial commitments, guarantees and other contingent liabilities. Nothing herein implies in and of itself any obligation on the part of the Corporation to obtain the consent or approval of the Secretary or the Director of the plans and forecasts provided pursuant hereto."

Sec. 218. REGULATIONS GOVERNING INSURED FINANCIAL INSTITUTIONS.

- Section 18 of the Federal Deposit Insurance Act (12 U.S.C. 1828) is hereby amended as follows:

(1) Subsection (a) is amended by adding before the period in the first sentence the following:

"; Provided further that such signs displayed by financial institutions will further represent whether the financial institution is a Bank Insurance Fund member or a Savings Association Insurance Fund member."

(2) Subsection (c) is amended --

(a) in paragraph (2), by deleting subparagraph (C) and inserting in lieu thereof the following:

"(C) the Corporation if the acquiring, assuming, or resulting bank is to be a State nonmember insured bank (except a District bank or a savings bank supervised by the Federal Home Loan Bank System); and

"(D) the Federal Home Loan Bank System if the acquiring, assuming, or resulting institution is to be a savings association.";

(b) by deleting subparagraph (12);

(c) in subparagraphs (3), (4), (6), (7) and (9), by adding after the word "bank" or "banks" each time it appears, the words "or savings association" or "or savings associations", respectively.

(d) in subparagraph (3), the word "failure" is deleted, and the word "default" is added in lieu thereof.

(3) Subsection (d) is amended by adding after "(except a District bank)" each time they appear, the words "or savings bank supervised by the Federal Home Loan Bank System.

(4) Subsection (i) is amended --

(a) in paragraph (1) by deleting the words "nonmember bank (except a District bank)" and replacing in lieu thereof the words "financial institution (except a member bank or a District bank)";

(b) in paragraph (2):

(i) by adding before the period the following

"; (D) the Federal Home Loan Bank System if the resulting institution is to be a State savings association or a savings bank to be supervised by the Federal Home Loan Bank System; and

(ii) in subsection (C), by adding after the words "resulting bank" the words "or savings association", and by adding after the words "(except a District bank)" the words "a savings bank to be supervised by the Federal Home Loan Bank System)."

(5) By inserting the following new subsections after subsection (l) therein:

"(m) ACTIVITIES OF SAVINGS ASSOCIATIONS SUBSIDIARIES. --

"(1) PROCEDURES. -- Whenever an insured savings association establishes or acquires control of a company or whenever an insured savings association elects to conduct any new activity through a company that the insured savings association controls, the insured savings association:

"(A) shall notify the Corporation and the Federal

Home Loan Bank System not less than 30 days prior to the establishment, or acquisition, of any such new company, and not less than 30 days prior to the commencement of any such activity, and in either case shall provide at that time such information as each such agency may, by regulation, require;

"(B) except as provided in subsection 5(t)(1) of the Home Owners' Loan Act, as amended, shall deduct its entire investment in and loans and other financial accommodations to the company from its own capital for the purposes of determining capital adequacy if the company is engaged in activities not permissible for a national bank; and

"(C) shall conduct the activities of the company in accordance with such rules, regulations and orders as may be established by the Federal Home Loan Bank System.

"(2) ENFORCEMENT POWERS. -- With respect to any company controlled by an insured savings association:

"(A) the Corporation and the Federal Home Loan Bank System shall each have, with respect to such

company, the respective powers and authorities that each may possess with respect to the insured savings association pursuant to this section or to section 8; and

"(B) the Federal Home Loan Bank System shall have authority to determine, after notice and opportunity for hearing, that the continuation by the insured savings association of its ownership or control of, or its relationship to, the company constitutes a serious risk to the financial safety, soundness or stability of the insured savings association is inconsistent with sound banking principles or with the purposes of this Act, and upon making any such determination the agency shall have authority to order the insured savings association to divest itself of control of the company; the Federal Home Loan Bank System shall also have the authority to take any other corrective measures with respect to the company, including the authority to have the company terminate the activities or operations posing such risks, as the agency may deem appropriate.

"(3) ACTIVITIES INCOMPATIBLE WITH DEPOSIT INSURANCE. --

"(A) The Corporation shall have authority to determine by regulation of general applicability to all State-chartered Savings Association Insurance Fund members that any specific activity after determination by the Board of Directors poses a serious threat to the Savings Association Insurance Fund: Provided, that prior to adopting any such regulation, the Corporation shall consult with the Chairman of the Federal Home Loan Bank System and shall provide appropriate State supervisors the opportunity to review such regulation and comment thereon, and the Corporation shall specifically take such comments into consideration. Upon issuing such a regulation with respect to an activity, the Corporation may order that no Savings Association Insurance Fund member may engage in any activity directly that is not permissible for a federal savings and loan association under the Home Owners' Loan Act. In addition, no Savings Association Insurance Fund member shall be or become liable for the liabilities or obligations arising out of any such activity conducted indirectly, except to the extent such liability or obligation (i) is in writing, (ii) shall have been executed by the member and person or entity to whom the liability or obligation is owed either

contemporaneously with the creation of the liability or obligation, or if the liability or obligation was created prior to the effective date of the FIRREA, within 120 days of the effective date of the FIRREA, (iii) has been approved by the Board of Directors or an official committee of the member, and (iv) shall have been, continuously, from the time of its creation, an official record of the bank.

"(B) Nothing in this section shall limit the authority of the Federal Home Loan Bank System to issue regulations to promote safety and soundness or to enforce compliance with other applicable laws.

"(4) "COMPANY" DEFINED. -- As used in this subsection (m), the term "company" shall not include an insured financial institution.

"(5) Nothing contained in subsection (m) shall derogate from the rights and authorities of the Corporation under other provisions of law."

Sec. 219. NONDISCRIMINATION. - Section 22 of the Federal Deposit Insurance Act (12 U.S.C. 1830) is hereby amended to read as

follows:

"It is not the purpose of this chapter to discriminate in any manner against State nonmember banks or State savings associations and in favor of national or member banks or Federal savings associations, respectively; but the purpose is to provide all banks and savings associations with the same opportunity to obtain and enjoy the benefits of this chapter."

TITLE III - SAVINGS ASSOCIATION SUPERVISION IMPROVEMENTS.

Sec. 301. DEFINITIONS. - Section 2 of the Home Owners' Loan Act of 1933 (12 U.S.C. 1462) is hereby amended as follows:

(1) by amending subsection (a) to read as follows:

"(a) The term "Chairman" means the Chairman of the Federal Home Loan Bank System.";

(2) by amending subsection (b) to read as follows:

"(b) The term "System" means the "Federal Home Loan Bank System",

(3) by amending subsection (c) to read as follows:

"(c) The term "savings association" means any institution that was supervised by the Federal Savings and Loan Insurance Corporation immediately prior to the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, a Federal savings and loan association or Federal savings bank, a building and loan, savings and loan or homestead association, a cooperative bank or a state savings bank that is a member of the Savings Association Insurance Fund, the deposits of which are insured by the Federal Deposit Insurance Corporation.

(4) by amending subsection (d) to read as follows:

"(d) The term "federal savings association" means a Federal savings and loan association or a Federal savings bank chartered under section 5 of this title.",

(5) by adding new subsection (e) to read as follows:

"(e) The term "Federal banking agencies" means the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation." and

Sec. 302. SUPERVISION OF SAVINGS ASSOCIATIONS. - (a) The Home

Owners' Loan Act of 1933, as amended, is hereby further amended by inserting a new Section 3 as follows:

"Section 3 SUPERVISION OF SAVINGS ASSOCIATIONS. (a) The Chairman is authorized to provide for the examination, safe and sound operation, and regulation of savings associations. The Chairman may issues rules and regulations, including regulations defining the terms used in this chapter, to carry out the responsibilities of the Chairman, or the System. The authorities conferred by this section are intended to encourage savings associations to maintain their role of providing credit for housing in a manner consistent with principles of safe and sound operation.

"(b) The Chairman shall by regulation prescribe uniform accounting and disclosure standards for all savings associations to be used in determining their compliance with all applicable rules and regulations. These uniform accounting standards shall incorporate generally accepted accounting principles to the same degree that generally accepted accounting principles are used to determine compliance with rules and regulations issued by the Federal banking agencies, shall require full compliance therewith no later than the schedule provided in 12 C.F.R. Section 563, and shall be coordinated with the capital standards established by the Chairman pursuant to section 5 (t)(1) of this Act, provided that there will be no deviation from full compliance with the

uniform accounting standards after December 31, 1993.

"(c) The rules, regulations and policies of the Chairman governing the safe and sound operation of savings associations, including policies governing asset classification and appraisals, shall be no less stringent than those of the Office of the Comptroller of the Currency.

"(d) No savings association shall make loans beyond one hundred miles from its principal office except (1) loans in the area beyond such one hundred mile limit in which it was operating prior to June 27, 1934, and (2) loans which are made pursuant to regulations of the Federal Home Loan Bank System: Provided, that any loan made beyond fifty miles from the savings association's principal office (and outside the territory in which it was operating on such date also shall be subject to such regulations.".

(b) Section 409 of the National Housing Act (12 U.S.C. 1730b) relating to investment of certain funds in accounts of savings associations is hereby transferred to and shall become a part of the Home Owners' Loan Act of 1933 as new Section 3(e) hereof and is further amended by replacing the words "institutions insured by the Corporation," with "savings associations, to the extent they are insured by the Federal

Deposit Insurance Corporation".

(c) Section 410 of the National Housing Act (12 U.S.C. 1730c) relating to participation by savings associations in lotteries and related activities is hereby transferred to and shall become part of the Home Owners' Loan Act of 1933, amended, at Section 3(f), and is further amended by deleting the term "insured institution" and "institution" each time they appear and inserting in lieu thereof the term "savings association".

(d) Section 413 of the National Housing Act (12 U.S.C. 1730f) relating to disclosures with respect to certain federally related mortgage loans is hereby transferred to and shall become a part of the Home Owners' Loan Act of 1933 as new Section 3(g) thereof and is further amended by replacing the words "insured institution" and "institution," wherever they appear in that section, with the words "savings associations".

(e) Section 414 of the National Housing Act (12 U.S.C. 1730g) relating to state usury override for certain loans is hereby transferred to and shall become a part of the Home Owners' Loan Act of 1933 as new Section 3(h) hereof and is further amended by:

(1) replacing the terms "insured institution" and "institution," wherever they appear in that section, with the

term "savings association"; and

(2) deleting the words "(which, for the purpose of this section, shall include a Federal association the deposits of which are insured by the Federal Deposit Insurance Corporation)".

(f) Section 403 of the National Housing Act (12 U.S.C. 1726(b)) relating to the form and maturity of securities is hereby transferred to and shall become a part of the the Home Owners' Loan Act of 1933 as a new section Section 3(i) hereof to provide as follows:

"(i) No savings association shall issue securities which guarantee a definite maturity except with the specific approval of the System, or issue any securities the form of which has not been approved by the System.".

Sec. 303. APPLICABILITY. - The Home Owners' Loan Act of 1933, as amended, is further amended by adding new section 4 as follows:

"Section 4. Applicability. (a) The following sections of this Act apply to all savings associations: sections 3, 5(d), 5(f), 5(i), 5(o), 5(p), 5(q), 5(s), 5(t), 5(u), 5(v), 6, 7, 9, 10, 11, and 12.

"(b) The following sections of this Act apply to Federal

savings associations: sections 5(b), 5(c), 5(e), 5(g), 5(h), 5(j), 5(l), 5(m), 5(n), 5(r), and 8.".

Sec. 304. CONFORMING NAME CHANGES. - Section 5 of the Home Owners' Loan Act of 1933 (12 U.S.C. Section 1464) is hereby amended, as follows":

(1) Except as otherwise provided in this section, all references to "association," "Federal association," or "Federal savings and loan association" shall be replaced with "Federal savings associations," in the following subparts: 5(b), (c), (g), (h),(i), (j), (l), (n), (p) and (r) (12 U.S.C. 1464(b), (c), (g), (h), (i), (j), (l), (n), (p) and (r), respectively).

(2) All references to "association" shall be replaced with "savings association," in the following subparts: (5)(d), (f), (k), (o), (q), and (s) (12 U.S.C. 1464(d), (f), (k), (o), (q), and (s), respectively).

(3) The following miscellaneous changes and exceptions to the foregoing portions of this section are as follows:

(A) References to "associations" in subsections 5(c)(1)(D), and (F) (12 U.S.C. 1464(c)(1)(D), (F)) shall remain unchanged.

(B) References to "savings and loan association" in subpart 5(c)(1)(R) (12 U.S.C. 1464(c)(1)(R)) shall be amended by deleting "and loan."

(C) References to "association" in subparts 5(i)(3)(A)(iv)-(v) and 5(i)(3)(B)(ii)(12 U.S.C. 1464(i)(3)(A)(iv)-(v), (B)(ii)) shall be replaced with "savings associations."

(D) The reference to "building and loan" in subpart 5(m) (12 U.S.C. 1464(m)) shall be replaced with "savings."

(E) The reference to "mutual savings and loan association" in subpart 5(p)(1) (12 U.S.C. 1464(p)(1)) shall be replaced with "mutual savings association."

(F) The reference to "domestic building and loan assocaition" in subpart 5(r)(1) (12 U.S.C. 1464(r)(1) shall remain unchanged.

Sec. 305 SAFETY AND SOUNDNESS. Section 5(a) of the Home Owners' Loan Act of 1933 (12 U.S.C. 1464 (a)), is hereby amended by inserting after the words "credit for housing" the words "consistent with the safe and sound operation of Federal savings associations".

Sec. 306. DEPOSITS. - Section 5(c) of the Home Owners' Loan Act of 1933, as amended (12 U.S.C. 1464(c)), is hereby amended by revising paragraph (c)(1)(G) to read as follows:

"(G) Deposits. Investments in time deposits, savings accounts certificates, or accounts of any financial institution, the deposits of which are insured by the Federal Deposit Insurance Corporation."

Sec. 307. SUPERVISORY REVISIONS. - (a) Section 5(d) of the Home Owners' Loan Act is amended by deleting paragraphs 2 through 5, 7 through 10, 12(a), 13 and 15.

(b) Section (5)(d)(1) of the Home Owners' Loan Act of 1933 shall be hereby redesignated as (5)(d)(1)(A).

(c) Section 407(m) of the National Housing Act (12 U.S.C. 1730(m)) is hereby transferred to and shall become a part of the Home Owners' Loan Act of 1933, as amended, at section (5)(d)(1)(B) and is further amended by substituting the term "savings association" for the terms "institution" and "insured institution", and the term "savings associations" for the terms "institution" and "insured institutions", deleting the phrase "on behalf of the Corporation" and substituting the term "System" for "Corporation" everywhere else it appears and is further amended by redesignating paragrahs (m)(1) through (m)(4) as clauses

(5)(d)(1)(B)(i) through (5)(d)(1)(B)(iv) respectively.

Sec. 308. RECEIVERSHIPS. - Section 5(d)(6) of the Home Owners' Loan Act of 1933 (12 U.S.C. 1464(d)(6)) is redesignated as Section 5(d)(2) and is hereby amended:

(1) by deleting the words "the Federal Savings and Loan Insurance Corporation or" from subparagraph (B) thereof;

(2) Subsections (C), (D), and (E) of section 5(d)(2) as redesignated of the Home Owners' Loan Act of 1933 are hereby redesignated as (D), (E), and (F) and a new subsection (C) is added to read as follows:

"(C) Notwithstanding any other provision of law, State or Federal, or the constitution of any State, or of this section, the System shall have power and jurisdiction to appoint the Federal Deposit Insurance Corporation as sole conservator or receiver of an insured State savings association, in the event that the System determines that any of the following grounds for the appointment of a conservator or receiver exist with respect to such financial institution:

"(i) insolvency in that the assets of the financial institution are less than its obligations to its creditors and others,

"(ii) substantial dissipation of assets or earnings due to any violation or violations of law, rules, or regulations, or to any unsafe or unsound practice or practices, or

"(iii) an unsafe or unsound condition to transact business.

"(B) In such cases the Federal Deposit Insurance Corporation shall have powers and duties specified in subsection (c) and in subsection (1) of section 11 of the Federal Deposit Insurance Act.

"(C)(i) The authority conferred by this paragraph (2) shall not be exercised without the written approval of the State official having jurisdiction over the insured State financial institution that the grounds specified for such exercise exist.

"(ii) If such approval has not been received within 30 days of receipt of notice to the State that the System has determined such grounds exist, and the System has responded in writing to the State's written reasons, if any, for withholding approval, then the System may proceed without State approval."

(3) by deleting the words "Federal Savings and Loan Insurance Corporation" from redesignated subparagraph (E) thereof and substituting the words "Federal Deposit Insurance Corporation"; and

(4) by deleting the last sentence of redesignated subparagraph (E) thereof.

Sec. 309. TECHNICAL AMENDMENT. - Section 5(d)(11) of the Home Owners' Loan Act of 1933 is redesignated as Section 5(d)(3).

Sec. 310. TECHNICAL AMENDMENT. - Section 5(d)(12) of the Home Owners' Loan Act of 1933 is redesignated as (5)(d)(4) and is further amended by redesignating existing paragraphs (A) and (B) as (B) and (C) respectively.

Sec. 311. AMENDMENT TO SECTION 5. - Section 5(d)(14) of the Home Owners' Loan Act of 1933 is redesignated as Section 5(d)(5) and is amended to read as follows:

"(3)(A) As used in this subsection, the term "savings association" includes any former savings association that retains deposits insured by the Federal Deposit Insurance Corporation notwithstanding termination of its status as an institution insured by such corporation and any Federal savings bank whose deposits are insured by the Federal Deposit Insurance Corporation, and any former Federal savings bank that retains deposits insured by the Federal Deposit Insurance Corporation notwithstanding termination of its status as an insured bank.

"(B) References in this subsection to savings account

holders and to members of savings associations shall be deemed to be references to holders of withdrawable accounts in savings institutions over which the System has any statutory power of examination or supervision as provided in this paragraph, and references therein to boards of directors of savings associations shall be deemed to be references to boards of directors or other governing boards of such associations. The System shall have power by regulation to define, for the purposes of this paragraph, terms used or referred to in the preceding sentence and other terms used in this subsection.".

Sec. 312. TECHNICAL AMENDMENT. - Section 5(d)(16) of the Home Owners' Loan Act of 1933 (12 U.S.C. 1464(d)(16) is redesignated as section 5(d)(6) (12 U.S.C. 1464(d)(6)).

Sec. 313. CONVERSIONS. - Section 5(i) of the Home Owners' Loan Act of 1933 (12 U.S.C. 1464(i)) is hereby amended by deleting paragraph (2) and inserting in lieu thereof the following:

"(2)(A) No savings association may convert from the mutual to the stock form, or from the stock form to the mutual form, except in accordance with the rules and regulations of the System.

"(B) Any aggrieved person may obtain review of a final action of the Federal Home Loan Bank System which approves, with

or without conditions, or disapproves a plan of conversion pursuant to this subsection only by complying with the provisions of subsection (d) of section 10 of this Act within the time limit and in the manner therein prescribed, which provisions shall apply in all respects as if such final action were an order the review of which is therein provided for, except that such time limit shall commence upon publication of notice of such final action in the Federal Register or upon the giving of such general notice of such final action as is required by or approved under regulations of the System, whichever is later.

"(C) Any Federal savings association may change its designation from a Federal savings and loan association to a Federal savings bank, or the reverse.".

Sec. 314. CAPITAL STANDARDS. - Section 5 of the Home Owners' Loan Act of 1933 as amended (12 U.S.C. 1464) is hereby further amended by adding the following new subsection (t) at the end thereof to read as follows:

"(t) (1) Not later than 90 days after enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, the Chairman shall by regulation establish uniformly applicable capital standards for savings associations. Such standards shall be not less stringent than the capital standards applicable to national banks, provided that any deviation from such standards

shall not result in materially lower capital standards than are applicable to national banks; Provided that the standard may include, as a component of capital, goodwill (limited to goodwill existing on the date of the enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989) to be amortized on a straight-line basis over a ten-year period or over such shorter period as may be determined by the Chairman with the concurrence of the Secretry of Treasury. For purposes of determining such capital adequacy, the savings association's entire investment in, and loans to, any subsidiary engaged in activities not permissible for a national bank shall be deducted from the capital of the savings association. In any event, any investments in, and loan to, a subsidiary engaged solely in mortgage banking activities shall not be deducted from the capital of the associations. The standards established under the subsection shall include all relevant substantive definitions established by the appropriate Federal banking agency for national banks. The Chairman shall prescribe a timetable for the implementation of these capital standards that requires their full implementation by no later than June 1, 1991.

"(2) Until June 1, 1991, the Chairman may restrict the asset growth of any savings association not in compliance with capital standards established pursuant to this subsection. After June 1, 1991, the Chairman shall prohibit the asset growth of any savings association or class of savings associations not in compliance

with capital standards established pursuant to this subsection. The Chairman may restrict the asset growth of any savings association that the Chairman determines is taking excessive risks or is paying excessive rates for deposits."

"(3) For purposes of this subsection, the term "national bank" shall have the same meaning as it has in section 3(d) of the Federal Deposit Insurance Act (12 U.S.C. 1813(d))."

Sec. 315. TECHNICAL AMENDMENT. -- Section 8 of the Home Owners' Loan Act of 1933 (12 U.S.C. 1466a), is hereby amended by replacing all references to "association" with "savings association", except with respect to references to "Federal savings and loan association", which shall be replaced with "Federal savings association."

Sec. 316. REPEAL. - Section 9 of the Home Owners' Loan Act of 1933 as amended (12 U.S.C. 1467) is repealed.

Sec. 317. RECOVERY REGULATIONS REPEALED. (a) Section 10 of the Home Owners' Loan Act of 1933 (12 U.S.C. 1467a) is hereby repealed effective on the date of enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, provided that associations that had entered into a plan approved by the Federal Home Loan Bank Board shall be grandfathered hereunder as long as the association adheres to the plan and

continues to submit to the Chairman of the Federal Home Loan Bank System regular and complete reports on the association's progress in meeting the association's goals under the plan.

(b) Section 416 of the National Housing Act (12 U.S.C. 1730i) is hereby repealed effective on the date of enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, provided that insured institutions which had entered into a plan approved by the Federal Savings and Loan Corporation shall be grandfathered hereunder as long as the insured institution adheres to the plan and continues to submit to the Chairman of the Federal Home Loan Bank System regular and complete reports on the insured institutions progress in meeting the insured institutions goals under the plan. For the purpose of this section, the term 'insured institution' shall have the same meaning as in 12 U.S.C. 1730a(a)(1)(A).

Sec. 318. COST OF EXAMINATION AND REPORTS. - A new Section 9 is added to the Home Owners' Loan Act of 1933 as amended to read as follows:

"Section 9. EXPENSES OF EXAMINATIONS OF SAVINGS ASSOCIATIONS OR AFFILIATES. (a) The expense of examination of savings associations provided for by section 5 of this chapter shall be assessed by the Chairman upon savings associations in proportion to their assets or resources.

"(b) The expense of examinations of an affiliate of a savings association provided for by this Act may be assessed by the Chairman upon the affiliates examined in proportion to assets or resources held by the affiliates on the dates of such examination.

"(c) If any affiliate shall refuse to pay such expense, or other expense imposed pursuant to this section, or shall fail to do so within sixty days after the date of such assessment, then such expenses may be assessed against the affiliated savings association and when so assessed, shall be paid by such association; Provided however, That, if the affiliation is with two or more savings associations or affiliates, such expenses may be assessed against, and collected from, any or all of such savings associations in such proportions as the Chairman prescribe.

"(d) If any affiliate of a savings association shall refuse to permit an examiner to make an examination of the affiliate or shall refuse to give any information required in the course of any examination, the savings association with which it is affiliated shall be subject to a penalty of not more than $25,000 for each day that any such refusal shall continue. Notwithstanding the foregoing, for violations made with reckless disregard for the safety and soundness of the financial institution, the Corporation may, in its discretion, assess a

penalty of not more than $1,000,000 per day for each day during which such violation contniues. Such penalty may be assessed by the Chairman, and collected for the use of the System and deposited in the same manner as expenses of examinations.

"(e) The Funds derived from such assessments may be deposited by the Chairman as provided in sections 1439 and 1439a, as amended, of this title, or upon the approval of the Secretary of the Treasury, in any Federal Reserve Bank or other Government depository under the same provisions as apply in section 192 of this title to the Comptroller of the Currency. The funds derived from such assessments shall not be construed to be Government or public funds or appropriated monies.

"(f) The Chairman, is authorized and empowered to prescribe regulations governing the computation and assessment of the expenses of examinations herein provided for and the collection of such assessments from the savings associations of affiliates examined.

"(g) In addition to the expense of examination to be assessed by the Chairman, as provided in this section, all savings associations exercising fiduciary powers and all savings associations or similar institutions in the District of Columbia exercising fiduciary powers, shall be assessed by the Chairman for the examination of their fiduciary activities a fee adequate

to cover the expenses thereof, and which fee shall be treated, paid, and deposited in the same manner as an assessment for expenses of examination provided for in this section.

"(h) In addition to the expense of examinations to be assessed by the Chairman in accordance with paragraphs (a) and (b), savings associations or affiliates of savings associations examined more frequently than twice in one calendar year shall be assessed the expense of those additional examinations. Funds from such assessment shall be treated, paid, and deposited in the same manner as an assessment for expenses of examination provided for in this section.

"(i) All savings associations and affiliates shall provide the System with access to any information or report with respect to any examination made by any public regulatory authority and furnish any additional information with respect thereto as the System may require.".

Sec. 319. SAVINGS AND LOAN HOLDING COMPANIES. - Section 408 of the National Housing Act (12 U.S.C. 1730a) is hereby transferred to and shall become new section 10 of the Home Owners' Loan Act of 1933, as amended, and is further amended as follows:

(1) by deleting the words "insured and institution", "insured institutions", and "institution" wherever they occur and

inserting in lieu thereof "savings association", "savings associations" and "association", respectively;

(2) by deleting the word "Corporation" wherever it occurs and inserting in lieu thereof "System";

(3) by deleting all references to subsection (m) and section 1729(f) of this title wherever they occur and inserting in lieu thereof "setion 1823(c) of this title" and "section 1823(k) of this title", respectively;

(4) by deleting subparagraph (a)(1)(A) and inserting in lieu thereof the following:

"(A) "savings association" means a Federal savings and loan association or Federal savings bank, a building and loan, savings and loan or homestead association, a cooperative bank or a state savings bank that is a member of the Savings Association Insurance Fund, the deposits of which are insured by the Federal Deposit Insurance Corporation, and shall include a savings bank which is deemed by the System to be a savings association under subsection (m)";

(5) by deleting subparagraph (a)(1)(B) and inserting in lieu thereof the following:

"(B) "uninsured institution" means any financial institution the deposits of which are not insured by the Federal Deposit Insurance Corporation;";

(6) by striking out "and" at the end of subparagraph (a)(1)(K) thereof; by striking out the period at the end of subparagraph (a)(1)(L) thereof and inserting in lieu thereof a semicolon; and by adding a new subparagraph (a)(1)(M) to read as follows:

"(M) "System" means the Federal Home Loan Bank System and";

(7) by deleting subsections (d), (g), (m), (p) and (t), by redesignating subsections (h), (i), (j), (k), (l), (n), (o), (q), (r) and (s) as paragraphs (g), (h), (i), (j), (k), (l), (m), (n), (o), (p) and (q), respectively, and by inserting the following new subsection (d) to read as follows:

"(d) TRANSACTIONS WITH AFFILIATES. Transactions between any subsidiary savings associations of a savings and loan holding company and any affiliate (of such savings association subsidiary) shall be subject to the limitations and prohibitions specified in section 11 of this Act.";

(8) by deleting paragraph (e)(4) thereof and by redesignating paragraph (e)(5) as new paragraph (e)(4);

(9) by amending subsection (2)(i) by striking out "(A), except with the prior approval of the Board, to serve at the same time as a director, officer, or employee of an insured institution or another savings and loan holding company, not a subsidiary of such holding company, or (B)", and inserting a comma in lieu thereof;

(10) by deleting paragraph (4) of redesignated subsection (n) and inserting in lieu thereof the following:

"(4) Failure to Achieve and Maintain QTL Status.

"(A) A savings association that fails to achieve or maintain its status as a qualified thrift lender shall, within three years of the date on which the association loses its status as a qualified thrift lender, convert its charter to one or more bank charters, unless during the one year period following the date it loses its status as a qualified thrift lender, the association becomes a qualified thrift lender and does not thereafter lose its status as a qualified thrift lender.

"(B) Until such conversion is complete, such savings association shall not:

"(i) after three years from the date it loses it

qualified thrift lender status, be eligible to obtain advances from any Federal Home Loan Bank and shall repay any outstanding advances promptly;

"(ii) expand its activities beyond those conducted on the date the savings association loses its status as a qualified thrift lender;

"(iii) open any additional branch offices; or

"(iv) after three years from the date it loses its qualified thrift lender status, engage directly or through a subsidiary in an activity unless such activity is permissible for either a bank or a state bank (other than a savings bank) located in the State in which the association is located.

"(C) Any company that controls a savings association identified in paragraph (A) shall, after three years following the date on which the savings association loses its status as a qualified thrift lender, be subject to all of the provisions of the Bank Holding Company Act of 1956, as amended, and other applicable statutes as if the company were a bank holding company and the savings association were a bank as those terms are defined in the Bank Holding Company Act of 1956, as amended.

"(D) Any bank chartered as a result of the requirements of this section shall be obligated until December 31, 1993, to pay the assessments assessed on savings associations under the Federal Deposit Insurance Act. Such institution shall also be assessed the exit fee provided in section 5(d)(2) of the Federal Deposit Insurance Act.

"(E) as used in this subsection, "bank" shall mean a national member bank or a State bank (other than a savings bank), as defined in section 3 of the Federal Deposit Insurance Act."

(11) By deleting paragraph (7) of redesignated subsection (n).

Sec. 320. TRANSACTIONS WITH AFFILIATES; LOANS TO INSIDERS. - The Home Owners' Loan Act of 1933 as amended is further amended by adding at the end thereof the following new section 11:

"Section 11. TRANSACTIONS WITH AFFILIATES; LOANS AND EXTENSIONS OF CREDIT TO EXECUTIVE OFFICERS, DIRECTORS AND CONTROLLING PERSONS. (a) Except to the extent that the System determines for reasons of safety and soundness that additional restrictions should apply, the provisions of section 23a and section 23B of the Federal Reserve Act shall

be applicable to every savings association in the same manner and to the same extent as if such savings association were a member bank as defined in that Act and for this purpose any company which would be an affiliate of a savings association for the purposes of section 23A and section 23B of the Federal Reserve Act if such savings association were a member bank as defined in that Act shall be deemed to be an affiliate of such savings association.

"(b) Except to the extent that the System determines for reasons of safety and soundness that additional restrictions should apply, the provisions of section 22(h) of the Federal Reserve Act relating to limits on loans and extensions of credit by a member bank to its executive officers or directors or to any person who directly or indirectly owns, controls, or has the power to vote more than 10 per centum of any class of voting securities of such member bank shall be applicable to every savings association in the same manner and to the same extent as if such savings association were a member bank as defined in that Act.

"(c) Violations of this section shall be enforced by the System in accordance with section 8 of this Federal Deposit Insurance Act.".

Sec. 321. ADVERTISING. - The Home Owners' Loan Act of 1933, as

amended, is hereby amended by adding a new section 12 to read as follows:

"Section 12. ADVERTISING. No savings association shall carry on any sale, plan or practices, or any advertising, in violation of regulations promulgated by the System.".

TITLE IV. DISSOLUTION AND TRANSFER OF FUNCTIONS, PERSONNEL AND PROPERTY OF FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION

Sec. 401. DISSOLUTION. - Sixty days after enactment of this Act, except as otherwise provided in it, the Federal Savings and Loan Insurance Corporation, shall cease to exist and shall for all purposes be considered dissolved. Except as otherwise provided in this Act, after its enactment, all insurance and receivership functions previously performed by the Federal Savings and Loan Insurance Corporation shall be performed as appropriate, by the Federal Deposit Insurance Corporation or the Resolution Trust Corporation. The Federal Deposit Insurance Corporation shall also have the power to take any action necessary on behalf of the Federal Savings and Loan Insurance Corporation in connection with its dissolution in accordance with this Act.

Sec. 402. CONTINUATION OF RULES. - (a) All rules, regulations, and orders of the Federal Savings and Loan Insurance Corporation, or the Federal Home Loan Bank Board as operating head thereof, in effect on the date of enactment of this Act and relating to (i) the provision, rates, cancellation, or payment of insurance of accounts, (ii) administration of the insurance fund, or (iii) conduct of conservatorships or receiverships, including the handling of claims against receiverships, shall remain effective and enforceable by the Federal Deposit Insurance Corporation or the Resolution Trust Corporation, as appropriate, unless otherwise determined by the Federal Deposit Insurance Corporation after consultation with the Chairman of the Federal Home Loan Bank System.

(b) All other rules, regulations, and orders of the Federal Savings and Loan Insurance Corporation shall remain effective and enforceable by the Chairman of the Federal Home Loan Bank System.

(c) Within 60 days after enactment of this Act, the Chairman of the Federal Home Loan Bank System and the Chairman of the Federal Deposit Insurance Corporation shall identify the rules, regulations, and orders referred to in subsections (a) and (b) of this section in accordance with the allocation of authority between them under this Act and promptly publish

notice thereof in the Federal Register.

(d) The Federal Deposit Insurance Corporation shall have the power to promulgate and enforce rules, regulations, or orders to prevent actions or practices of savings associations that pose a serious threat to the Savings Association Insurance Fund or the Bank Insurance Fund.

Sec. 403. PERSONNEL. - (a) The Chairman of the Federal Home Loan Bank System, jointly with the Chairman of the Federal Deposit Insurance Corporation, shall identify those employees of the Board and the Federal Savings and Loan Insurance Corporation who, on the date of enactment of this Act, were engaged in functions or activities (hereinafter, "functions") related primarily to the functions which are transferred from the Board and/or Federal Savings and Loan Insurance Corporation to the Federal Deposit Insurance Corporation. The employees so identified shall be entitled to the following rights:

(1) Each employee identified in a transferred function shall be transferred to the Federal Deposit Insurance Corporation for employment and shall be guaranteed a position. All Board and Federal Savings and Loan Insurance Corporation employees electing to transfer with their function shall be transferred to the Federal Deposit Insurance Corporation no later than 60 days after the date of enactment of this Act. For purposes of determining

assignment rights, any transfer from the Board and/or Federal Savings and Loan Insurance Corporation to the Federal Deposit Insurance Corporation shall be deemed to be a transfer of function as defined by the regulations promulgated by the Office of Personnel Management pursuant to 5 U.S.C. 3503 and transferring employees shall be entitled to all rights and benefits under the regulations promulgated by the Office of Personnel Management pursuant to 5 U.S.C. 3502. All Board and Federal Savings and Loan Insurance Corporation employees who agree to transfer with their functions shall be placed in a competitive area of their own at Federal Deposit Insurance Corporation separate and apart from the competitive areas in existence at Federal Deposit Insurance Corporation for purposes of placement under this section. In placing transferring employees under 5 CFR 351 procedures, Federal Deposit Insurance Corporation may provide for the assignment of a transferred employee in an excepted service position to a position in the competitive service. In addition Federal Deposit Insurance Corporation may elect to bring into the competitive service any or all excepted service positions transferred from the Board or Federal Savings and Loan Insurance Corporation. Transferring employees who are in the excepted service and are placed by Federal Deposit Insurance Corporation in a competitive service position will have their appointments converted to career or career conditional in accordance with 5 CFR 315.701. Transferring employees shall receive notice of their assignment

rights pursuant to 5 CFR 351 and this section no later than 90 days after the effective date of their transfer to Federal Deposit Insurance Corporation. Transferring employees shall be entitled to pay and grade retention in accordance with the principles reflected in the regulations promulgated by the Office of Personnel Management pursuant to 5 U.S.C. 5361-66.

(2) Any employee who declines to transfer with his or her function to the Federal Deposit Insurance Corporation shall be entitled to severance pay in accordance with the regulations promulgated by the Office of Personnel Management pursuant to 5 U.S.C. 5595 and shall be entitled to placement assistance under the Office of Personnel Management's Displaced Employee Program as defined at 5 CFR 330, Subpart C. Notwithstanding the foregoing, severance pay shall in no event be less than 90 days pay. All such severance pay shall be paid by the Federal Home Loan Bank System. Each employee in an excepted service position who declines to transfer shall be entitled to placement assistance under the Office of Personnel Management's Interagency Placement Assistance Program for a period of 120 days after receipt of their termination notice.

(3) A transferred Board or Federal Savings and Loan Insurance Corporation employee who declines an offer of employment by the Federal Deposit Insurance Corporation which is not considered a reasonable offer under regulations promulgated

by the Office of Personnel Management pursuant to 5 U.S.C. 8336(d)(1) shall be entitled to the benefits specified in paragraph 2 of this subsection for employees declining to transfer and any such employee who is otherwise eligible shall be entitled to early optional retirement under 5 U.S.C. 8336(d)(2). Within one year after the transfer of functions to the Federal Deposit Insurance Corporation is completed, should Federal Deposit Insurance Corporation determine that a reorganization of the combined workforce is required, that reorganization shall be deemed a "major reorganization" for purposes of affording employees early optional retirement under 5 U.S.C. 8336(d)(2).

(4) Any employee accepting employment with the Federal Deposit Insurance Corporation as a result of this transfer may retain any benefit of or continue membership in any employee benefit program of the Federal Home Loan Bank Board, including insurance, to which he or she belongs on the date of enactment of this Act, provided the employee does not elect to give up the benefit or membership in the program and further provided the benefit or program is continued by the Federal Home Bank System. The difference in the costs between the benefits which would have been provided by the Federal Deposit Insurance Corporation and those provided by this section shall be paid by the Federal Home Loan Bank System.

Sec. 404. DIVISION OF PROPERTY AND PERSONNEL. - Within 60 days

after enactment of this Act, the Chairman of the Federal Home Loan Bank System, jointly with the Chairman of the Federal Deposit Insurance Corporation, shall divide between the Federal Home Loan Bank System and the Federal Deposit Insurance Corporation in accordance with the division of responsibilities effected by this Act, all personnel and all property of the Federal Savings and Loan Insurance Corporation previously employed to perform its functions and those of the Federal Home Loan Bank Board. Any disagreement between them in so doing shall be resolved by the Director of the Office of Management and Budget.

Sec. 405. REPEALS. - Except as otherwise provided in this Act, sections 401, 402, 403, 404, 405, 406, 407, 411, 415 and 416 of the National Housing Act are hereby repealed.

Sec. 406. REPORT. - Immediately prior to its dissolution, the Federal Savings and Loan Insurance Corporation shall provide by written report to the Secretary of the Treasury, the Director of the Office of Management and Budget and to the Congress, a final accounting of its finances and operations, and shall thereafter cease operations.

TITLE V - FINANCING FOR THRIFT RESOLUTIONS. -

Subtitle A -- Resolution Trust Corporation

Sec. 501. RESOLUTION TRUST CORPORATION ESTABLISHED.

The Federal Home Loan Bank Act (12 U.S.C. 144 et seq.) is hereby amended by inserting after section 21 the following new section:

"Section. 21a. RESOLUTION TRUST CORPORATION ESTABLISHED. ESTABLISHMENT. (a) There is hereby established the Resolution Trust Corporation (hereinafter in this section also referred to as the Corporation) with the powers, authorities and purposes herein provided. The Oversight Board and the Corporation shall not be an "agency" or "executive agency" for purposes of title 5, United States Code.

(b) PURPOSES. (1) The purpose of the Corporation shall be to carry out a program, under the direction of the Oversight Board, to manage and resolve all cases involving institutions, the accounts of which were insured by the Federal Savings and Loan Insurance Corporation, prior to enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, for which a receiver or liquidating conservator has been appointed or is appointed within the three-year period following the date of the

enactment of that Act; to manage the assets of the Federal Asset Disposition Association; and to peform such other functions as authorized under this Act. In its resolution activities, the Resolution Trust Corporation is authorized to take warrants, voting and nonvoting equity, or other participation interests in resolved institutions or assets or properties acquired in connection with resolution..

"(2) In carrying out its obligations, the Corporation shall possess all of the rights and powers provided in Sections 11, 12 or 13 of the Federal Deposit Insurance Act, or otherwise granted herein; provided that it shall not have the power to obligate the Federal Deposit Insurance Corporation or its funds (except as otherwise specifically provided); and in connection with providing assistance to or liquidating or otherwise resolving an institution as provided above, it shall consider and be subject to the limitations set forth in Section 13(c)(4) of the Federal Deposit Insurance Act.

"(c) OVERSIGHT BOARD.

"(1) Membership. The Oversight Board of the Resolution Trust Corporation, which shall serve as the board of directors thereof, shall consist of three members: the Secretary of the Treasury, the Chairman of the Federal Reserve Board, and the Attorney General

of the United States, or their respective designees.

"(2) Chairman. The Chairman of the Oversight Board shall be the Secretary of the Treasury.

"(3) Terms of Office, Succession, Delegation, Vacancies. The term of each member of the Oversight Board shall expire when the Resolution Trust Corporation is terminated. Vacancies on the Oversight Board shall be filled in the same manner as the vacant position was previously filled.

"(4) Compensation. Members of the Oversight Board shall receive resonable allowances for necessary expenses of travel, lodging, and subsistence incurred in attending meetings and other activities of the Oversight Board, as set forth in the bylaws issued by the Oversight Board, except that such level shall not exceed the maximum fixed by subchapter 1 of chapter 57 of title 5, United States Code, for officers and employees of the United States.

"(5) Duties. The Oversight Board shall review and have overall responsibility over the work, progress, management and activities of the Resolution Trust Corporation and may disapprove, in its discretion, any

and all regulations, policies, procedures, guidelines, statements, contracts, and other actions of the Resolution Trust Corporation and shall approve or disapprove, in its discretion, any and all agreements for the purchase of assets and assumption of liabilities, any and all agreements for the acquisition, consolidation or merger, or any other transaction proposed by the Resolution Trust Corporation by which any person or entity will acquire an institution subject to the provisions of this title.

"(6) Quorum Required. A quorum shall consist of two members of the Oversight Board and all decisions of the Board shall require an affirmative vote of at least a majority of the members voting.

"(7) The Oversight Board is authorized to employ such staff as it deems necessary and appropriate to fulfill its obligations under this Act, which shall be subject to the terms and conditions of employment applicable to the Resolution Trust Corporation, provided however that the Oversight Board as it considers necessary shall utilize the personnel of the agencies of the three members of the Oversight Board, without additional compensation to carry out the Oversight Board's staff functions.

"(8) Rules and Records. The Oversight Board shall adopt such rules as it may deem appropriate for the transaction of its business and the accomplishment of its duties hereunder, and shall keep permanent and accurate records of its acts and proceedings.

"(d) CHIEF EXECUTIVE OFFICER. A chief executive officer of the Resolution Trust Corporation shall be selected by the Oversight Board and shall serve at the pleasure of the Board.

"(e) CORPORATE POWERS. The Resolution Trust Corporation shall be a body corporate that shall have the power to --

"(1) operate under the direction of the Oversight Board;

"(2) adopt, alter, and use a corporate seal, which shall be judicially noted;

"(3) issue capital certificates as provided in this Act;

"(4) provide for one or more vice presidents, a secretary, a treasurer and such other officers, employees, and agents, as may be necessary, define their duties, and require surety bonds or make other

provisions against losses occasioned by acts of such persons;

"(5) subject to the approval of the Oversight Board, hire, promote, compensate, and discharge officers and employees of the Resolution Trust Corporation, without regard to title 5, United States Code, provided that compensation and benefits of such employees shall be consistent with those of the Federal Deposit Insurance Corporation;

"(6) prescribe by the Oversight Board its bylaws that shall be consistent with law and that shall provide for the manner in which--

"(A) its officers employees, and agents are selected;

"(B) its property is acquired, held and transferred;

"(C) its general operations are to be conducted; and

"(D) the privileges granted by law are exercised and enjoyed.

"(7) with the consent of any executive department or agency, use the information, services, staff, and

facilities of such in carrying out this title;

"(8) enter into contracts and make advance, progress, or other payments with respect to such contracts;

"(9) acquire, hold, lease, mortgage, or dispose of, at public or private sale, real and personal property, and otherwise exercise all the usual incidents of ownership of property necessary and convenient to its operations;

"(10) obtain insurance against loss;

"(11) modify or consent to the modification of any contract or agreement to which it is a party or in which it has an interest under this title;

"(12) deposit its securities and its current funds under the terms and conditions applicable to the Federal Deposit Insurance Corporation under Section 13(b) of the Federal Deposit Insurance Act and pay fees therefor and receive interest thereon as may be agreed; and

"(13) exercise such other powers as set forth in this title, and such incidental powers as are necessary to

carry out its powers, duties and functions in accordance with this title.

"(f) SPECIAL POWERS.

"(a) In General. The Resolution Trust Corporation is authorized--

"(1) to enter into contracts with the Federal Deposit Insurance Corporation and with such other persons or entities, public and private, as it deems advisable and necessary in order to manage the institutions for which it is responsible and their assets; provided, however, that the Federal Deposit Insurance Corporation shall be the primary manager of the Resolution Trust Corporation, in accordance with an agreement between the Federal Deposit Insurance Corporation and the Oversight Board, except in such case where the Oversight Board shall specifically contract with another person or entity on a case by case basis; provided further that all contracts with persons or entities other than the Federal Deposit Insurance Corporation must be subject to a competitive bid process;

"(2) to set the policy on credit standards to be used

by the institution for which it is responsible;

"(3) to require a merger or consolidation of an institution for which it is responsible;

"(4) to organize one or more Federal mutual savings associations, which shall be chartered by the Federal Home Loan Bank System and the deposits of which shall be insured by the Federal Deposit Insurance Corporation through the Savings Association Insurance Fund;

"(5) to review and analyze all insolvent institution cases resolved by the Federal Savings and Loan Insurance Corporation since January 1, 1988, through the date of enactment of this Act, and to actively review all means by which it can reduce costs under existing Federal Savings and Loan Insurance Corporation agreements, including through the exercise of rights to restructure such agreements, subject only to the monitoring of the Oversight Board. The Corporation shall report to the Oversight Board the results and conclusions of its examination, and thereafter the Corporation, as permitted by the terms of any resolution agreement and upon the express concurrence of the Oversight Board, shall restructure

such agreements where savings would be realized therefrom, the costs of which restructuring shall be a liability of the Corporation;

"(6) to exercise all resolution powers and activities authorized to be exercised by the Federal Deposit Insurance Corporation under the Federal Deposit Insurance Act and the Federal Savings and Loan Insurance Corporation under Title IV of the National Housing Act including but not limited to the powers and authorities with respect to receiverships or conservatorships, to engage in assistance transactions, to collect indebtedness, to enforce liabilities and obligations, and to exercise the incidental powers and authorities provided the Federal Deposit Insurance Corporation all of which may be performed and exercised by the Corporation under this section as may be necessary to fulfill its obligations and duties under this Act; and

"(7) to take such other incidental powers as the Resolution Trust Corporation determines as may be necessary to carry out the purposes of this title.

"(g) INSTITUTIONS MANAGED BY THE CORPORATION.

"(1) All insured savings associations organized by the Corporation under this section shall be subject to such limitations, restrictions, and conditions as determined by the Corporation with respect to the following activities:

"(A) growth of assets;

"(B) lending activities;

"(C) asset acquisitions (except as necessary to serve its existing customer base with residential mortgages or consumer loans;

"(D) use of brokered deposits; and

"(E) payment of deposit rates.

"(2) All insured savings associations organized by the Corporation under this section shall be subject to all laws, rules, and regulations otherwise applicable to them as insured savings associations.

"(3) Any insured savings association organized by the Corporation under this section that holds deposits insured by the Federal Deposit Insurance Corporation shall continue to be subject to supervision by the Federal Home Loan Bank System and

Federal Deposit Insurance Corporation as otherwise provided by law.

"(h) FADA. The Corporation shall convert the Financial Asset Disposition Association to a corporation or other business entity and sell such other corporate entity or business entity, or wind down such Association or dissolve it no later than 180 days after the enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989; provided that in connection with any such sale, no contract rights to manage savings association resolution shall be transferred.

(i) CAPITAL CERTIFICATES. The Resolution Trust Corporation shall be authorized to issue capital certificates to the Resolution Funding Corporation consistent with the provisions of section 21b of this Act.

(1) Authorization to Issue.

"(1) In General. Notwithstanding any other provision of law, the Resolution Trust Corporation is hereby authorized to issue to the Resolution Funding Corporation nonvoting capital certificates.

"(2) Requirement Relating to the Amount of Certificates. The amount of certificates issued by the

Resolution Trust Corporation under paragraph (A) shall be equal to the aggregate amount of funds provided by the Resolution Funding Corporation to the Resolution Trust Corporation under section 21b of the Federal Home Loan Bank Act.

"(3) Certificates May be Issued Only to the Resolution Funding Corporation. Capital certificates issued under subparagraph (A) may be issued only to the Resolution Funding Corporation in the manner and to the extent provided in section 21 of the Federal Home Loan Bank Act and this subsection.

"(4) No Dividends. The Resolution Trust Corporation shall pay no dividends on any capital certificates issued under this paragraph.

"(j) EXEMPTION FROM TAXATION. The Resolution Trust Corporation, the capital, reserves, and surplus thereof, and the income derived therefrom, shall be exempt from Federal, State, municipal, and local taxation except taxes on real estate held by the Resolution Trust Corporation, according to its value as other similar property held by other persons is taxed.

"(k) TERMINATION.

"(1) Resolution Trust Corporation. The Resolution Trust

Corporation shall terminate five years after the date of enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989.

"(2) Case Resolutions. Simultaneously with the termination of the Resolution Trust Corporation as provided in subsection (1), all assets and liabilities of the Corporation would be transferred to the FSLIC Resolution Fund to be managed by the Federal Deposit Insurance Corporation with the proceeds of the net assets being provided to the Resolution Funding Corporation."

"(1) POWER TO REMOVE: JURISDICTION. -- Notwithstanding any other provision of law, any civil action, suit or proceeding to which the Corporation is a party shall be deemed to arise under the laws of the United States, and the United States District Courts shall have original jurisdiction over such. The Resolution Trust Corporation may, without bond or security, remove any such action, suit, or proceeding from a State court to the United States District Court for the District of Columbia, or if the action, suit or proceeding arises out of the actions of the Corporation with respect to an institution for which a receiver or liquidating conservator has been appointed, the United States District Court for the district where the institution is located.

"(m) GUARANTEES OF FSLIC. (1) Guarantees issued by the Federal Savings and Loan Insurance Corporation after January 1, 1989, and before the date of enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, made in connection with loans made to savings associations extended by the Federal Reserve Banks and Federal Home Loan Banks (the "Lenders") and guaranteed by the Federal Savings and Loan Insurance Corporation during such period, shall by operation of law and without further action by the Federal Home Loan Bank System, the Federal Savings and Loan Insurance Corporation, or any court, become and be converted into obligations, entitlements, and instruments of the Corporation.

(2) Obligations under the guarantees to the Lenders, assumed by the Corporation under (1) above, shall be paid by the Corporation one year after the date of enactment of this title, to the extent that the loans referred to in (1) above have not previously been paid, using any funds or other assets available to the Corporation; and, in any event, the Corporation shall draw upon the resources available to it through borrowing by Resolution Funding Corporation.

"(n) ISSUE REGULATIONS. The Corporation may issue such regulations, policies, procedures, guidelines, or statements as that Corporation considers necessary or appropriate to carry out this title, all of which shall be promulgated and enforced

without regard to subchapter II of chapter 5 of title 5, United States Code.

"(o) BORROWING. The Corporation is authorized to borrow from the Treasury, and the Secretary of the Treasury authorized and directed to loan to the Corporation on such terms as may be fixed by the Secretary of the Treasury not exceeding in the aggregate $5,000,000,000 outstanding at any one time. Provided, That each such loan shall bear interest at a rate determined by the Secretary of the Treasury, taking into consideration the current average rate on outstanding marketable obligations of the United States as of the last day of the month preceding the making of such loan: For purposes of this subsection, the Secretary of the Treasury is authorized to use as a public-debt transaction the proceeds of the sale of any securities hereafter issued under the Second Liberty Bond Act, as now or hereafter in force, and the purposes for which securities may issued under the Second Liberty Bond Act, as now or hereafter in force, are hereby extended to include such loans.

Subtitle B -- Resolution Funding Corporation

Sec. 502. RESOLUTION FUNDING CORPORATION ESTABLISHED. - The Federal Home Loan Bank Act (12 U.S.C. 1421 et seq.) is hereby

amended by inserting after new section 21a the following new section:

"Section 21b. RESOLUTION FUNDING CORPORATION ESTABLISHED. (a) PURPOSE. The purpose of the Resolution Funding Corporation is to provide funds to the Resolution Trust Corporation in order for that corporation to carry out its purposes under this Act.

"(b) ESTABLISHMENT. Notwithstanding any other provision of law and not later than five days after the enactment of this title, the Chairman of the Federal Home Loan Bank System shall be authorized to and shall charter a corporation to be known as the Resolution Funding Corporation (hereinafter referred to in this Act as the 'Funding Corporation').

"(c) MANAGEMENT OF THE FUNDING CORPORATION.

"(1) Directorate. The Funding Corporation shall be under the management of a directorate composed of three members as follows:

"(A) The director of the Office of Finance of the Federal Home Loan Banks (or the head of any successor office to such office); and

"(B) Two members selected by the Oversight Board from among the presidents of the Federal Home Loan Banks.

"(2) Terms. Of the two members appointed under (1)(b) with respect to initial terms, one shall be appointed for a term of two years and one shall be appointed for a term of three years, and thereafter, each member appointed under paragraph (1)(b) shall be appointed for a term of three years.

"(3) Vacancy. If any member leaves the office in which such member was serving when appointed to the Directorate -

"(A) such member's service on the Directorate shall terminate on the date such member leaves such office; and

"(B) the successor to the office of such member shall serve the remainder of such member's term.

"(4) Equal Representation of Banks. No president of a Federal Home Loan Bank may be appointed to serve an additional term on the Directorate until such time as the presidents of each of the other Federal Home Loan Banks have served as many terms on the Directorate as the president of such bank (before the appointment of such president to such additional term).

"(5) Chairperson. The Oversight Board shall select the chairperson of the Directorate from among the three members of the Directorate.

"(6) Staff.

"(A) No paid employees. The Funding Corporation shall have no paid employees.

"(B) Powers. The Directorate may, with the approval of the Chairman of the Federal Home Loan Bank System, authorize the officers, employees, or agents of the Federal Home Loan Banks to act for and on behalf of the Funding Corporation in such manner as may be necessary to carry out the functions of the Funding Corporation.

"(7) Administrative Expenses, Insurance Costs and Custodian Fees.

"(A) In general. All administrative expenses issuance costs (as defined in subsection (k)(4)) and custodian Fees (as defined in subsection (k)(5)) of the Funding Corporation shall be paid by the Federal Home Loan Banks.

"(B) Pro rata distribution. The amount each Federal Home Loan Bank shall pay shall be determined by the

Oversight Board by multiplying the total administrative expenses, issuance costs and custodian fees for any period by the percentage arrived at by dividing --

"(i) the aggregate amount the Oversight Board required such bank to invest in the Funding Corporation (as of the time of such determination) under paragraphs (4) and (5) of subsection (e) (as computed without regard to paragraphs (3) or (6) of such subsection); by

"(ii) the aggregate amount the Oversight Board required all Federal Home Loan Banks to invest (as of the time of such determination) under such paragraphs.

"(C) Administrative expenses defined. For purposes of this paragraph, the term 'administrative expenses' does not include any interest on (and any redemption premium with respect to) any obligation of the Funding Corporation.

"(8) Regulation by Oversight Board. The Directorate of the Funding Corporation shall be subject to such regulations, orders, and directions as the Oversight Board may prescribe.

"(9) No Compensation from Funding Corporation. Members of the Directorate of the Funding Corporation shall receive no pay, allowances, or benefits from the Funding Corporation by

reason of their service on the Directorate.

"(d) POWERS OF THE FUNDING CORPORATION. The Funding Corporation shall have only the following powers, subject to the other provisions of this section and such regulations, orders, and directions as the Oversight Board may prescribe:

"(1) To issue nonvoting capital stock to the Federal Home Loan Banks;

"(2) To purchase capital certificates issued by the Resolution Trust Corporation under section 21a of this Act;

"(3) To issue debentures, bonds, or other obligations and to borrow, to give security for any amount borrowed, and to pay interest on (and any redemption premium with respect to) any such obligation or amount;

"(4) To impose assessments in accordance with subsection (e)(7);

"(5) To adopt, alter, and use a corporate seal;

"(6) To have succession until dissolved;

"(7) To enter into contracts;

"(8) To sue and be sued in its corporate capacity, and to complain and defend in any action brought by or against the Funding Corporation in any State or Federal court of competent jurisdiction; and

"(9) To exercise such incidental powers not inconsistent with the provisions of this section or section 21a(i) of the Federal Home Loan Bank Act as are necessary or appropriate to carry out the provisions of this section.

"(e) Capitalization of the Funding Corporation.

"(1) In General. Purchase of Capital Stock by Federal Home Loan Banks. Each Federal Home Loan Bank shall invest in nonvoting capital stock of the Funding Corporation at such times and in such amounts as the Oversight Board may prescribe under this subsection.

"(2) Par Value; Transferability. Each share of stock issued by the Funding Corporation to a Federal Home Loan Bank shall have a par value in an amount determined by the Oversight Board and shall be transferable only among the Federal Home Loan Banks in the manner and to the extent prescribed by the Oversight Board at not less than par value.

"(3) Maximum Investment Amount Limitation for Each

Federal Home Loan Bank. The cumulative amount of funds invested in nonvoting capital stock of the Funding Corporation by each Federal Home Loan Bank shall not exceed the aggregate amount of--

"(A) the sum of -

"(i) the reserves maintained by such bank on December 31, 1988, pursuant to the requirement contained in the first two sentences of section 16 of this Act (12 U.S.C. 1436); and

"(ii) the undivided profits (as defined in paragraph (8) hereof) of such bank on such date; minus

"(iii) the amounts used to invest in the capital stock of the Financing Corporation pursuant to the requirement contained in of section 21 of this Act (12 U.S.C. 1441); and

"(B) for the period December 31, 1988 through December 31, 1991, or such later date as necessary to fund the Funding Corporation Principal Fund pursuant to this Act, the sum of -

"(i) the amounts added to reserves after December 31, 1988, pursuant to the requirement contained in the

first two sentences of section 16 of this Act (12 U.S.C. 1436); and

"(ii) the undivided profits of such bank accruing after December 31, 1988; minus

"(iii) the amounts required to be used to invest in the capital stock of the Financing Corporation pursuant to the requirement contained in section 21 of this Act (12 U.S.C. 1441) after December 31, 1988.

"(4) Pro Rata Distribution of First $1,000,000,000 Invested in the Funding Corporation by the Federal Home Loan Banks. With respect to the first $1,000,000,000 which the Oversight Board may require the Federal Home Loan Banks to invest in capital stock of the Funding Corporation under this subsection, the amount which each Federal Home Loan Bank (or any successor to such bank) shall invest shall be determined by the Oversight Board by applying to the total amount of such investment by all such banks the percentage appearing in the following table for each such bank:

"Bank	Percentage
Federal Home Loan Bank of Boston	1.8629

Federal Home Loan Bank of New York	9.1006
Federal Home Loan Bank of Pittsburgh	4.2702
Federal Home Loan Bank of Atlanta	14.4007
Federal Home Loan Bank of Cincinnati	8.2653
Federal Home Loan Bank of Indianapolis	5.2863
Federal Home Loan Bank of Chicago	9.6886
Federal Home Loan Bank of Des Moines	6.9301
Federal Home Loan Bank of Dallas	8.8181
Federal Home Loan Bank of Topeka	5.2706
Federal Home Loan Bank of San Francisco	19.9644
Federal Home Loan Bank of Seattle	6.1422

"(5) Pro Rata Distribution of Amounts Required to be Invested in Excess of $1,000,000,000. With respect to any amount in excess of $1,000,000,000 which the Oversight Board may require the Federal Home Loan Banks to invest in capital stock of the Funding Corporation under this subsection, the amount which each Federal Home Loan Bank (or any successor to such bank) shall invest shall be determined by the Oversight Board by multiplying such excess amount by the percentage arrived at by dividing--

"(A) the sum of the total assets (as of the most recent December 31) held by all insured savings associations which are members of such bank; by

"(B) the sum of the total assets (as of such date) held by all insured savings associations which are members of any Federal Home Loan Bank.

"(6) Special Provisions Relating to Maximum Amount Limitations.

"(A) In General. If the amount any Federal Home Loan Bank is required to invest in capital stock of the Funding Corporation pursuant to a determination by the Oversight Board under paragraph (5) (or under subparagraph (B) of this paragraph) exceeds the maximum investment amount applicable with respect to such bank under paragraph (3) at the time of such determination (hereinafter in this paragraph referred to as the 'excess amount') -

"(i) the Oversight Board shall require each remaining Federal Home Loan Bank to invest (in addition to the amount determined under paragraph (5) for such remaining bank and subject to the maximum investment amount applicable with respect to such remaining bank under paragraph (3) at the time of such determination) in such capital stock on behalf of the bank in the amount determined under subparagraph (B);

"(ii) the Oversight Board shall require the bank to subsequently purchase the excess amount of capital stock

from the remaining banks in the manner described in subparagraph (C); and

"(iii) the requirements contained in subparagraphs (D) and (E) relating to the use of net earnings available for dividends shall apply to such bank until the bank has purchased all of the excess amount of capital stock.

"(B) Allocation of Excess Amount Among Remaining Home Loan Banks. The amount each remaining Federal Home Loan Bank shall be required to invest under subparagraph (A)(i) is the amount determined by the Oversight Board by multiplying the excess amount by the percentage arrived at by dividing--

"(i) the amount of capital stock of the Funding Corporation held by such remaining bank at the time of such determination; by

"(ii) the aggregate amount of such stock held by all remaining banks at such time.

"(C) Purchase Procedure. The bank on whose behalf an investment in capital stock is made under subparagraph (A)(i) shall purchase, annually and at such issuance price, from each remaining bank an amount of such stock determined by the Oversight Board by multiplying the amount available for such

purchases (at the time of such determination) by the percentage determined under subparagraph (B) with respect to such remaining bank until the aggregate amount of such capital stock has been purchased by the bank.

"(D) Limitation on Dividends. The amount of dividends which may be paid for any year by a bank on whose behalf an investment is made under subparagraph (A)(i) shall not exceed an amount equal to 1/4 of the net earnings available for dividends of the bank for the year.

"(E) Transfer to Account for the Purchase of Stock Required. Of the net earnings available for dividends for any year of a bank on whose behalf an investment is made under subparagraph (A)(i), such amount as is necessary to make the purchases of stock required under subparagraph (A)(ii) shall be placed in a reserve account (established in such manner as the Oversight Board shall prescribe by regulations) the balance in which shall be available only for such purchases.

"(F) Net Earnings Available for Dividends Defined. For purposes of this paragraph, the term 'net earnings available for dividends' means the net earnings of a bank for any period as computed after reducing the amount of earnings for such period by the amount required to be carried (for such period) to reserves maintained by such bank pursuant to the first two sentences of

section 16 of this Act (12 U.S.C. 1436).

"(7) Additional Sources. In the event that each Federal Home Loan Bank has exhausted the investment amount applicable with respect to such bank under paragraph (3) with respect to investments under paragraphs (4), (5), and (6), then the amounts necessary to provide additional funding for the Funding Corporation Principal Fund shall be obtained as follows:

"(A) First, the Funding Corporation, with the approval of the Board of Directors of the Federal Deposit Insurance Corporation, shall assess each insured savings association an assessment as if such assessment was assessed by the Federal Deposit Insurance Corporation with respect to Savings Association Insurance Fund members pursuant to section 7 of the Federal Deposit Insurance Act, as amended; provided that the maximum amount of the aggregate amount assessed shall be the amount of additional funds necessary to fund the Funding Corporation Principal Fund; provided that the amount assessed hereunder and the amount assessed by the Financing Corporation under section 21 of this Act shall not exceed the amount authorized to be assessed pursuant to section 7 noted above and that the Financing Corporation shall have first priority to make such assessments; all such amounts shall be subtracted from the amounts authorized to be assessed by the Federal Deposit Insurance Corporation pursuant to section 7 noted above.

"(B) To the extent funds available pursuant to paragraph (A) are insufficient to capitalize the Funding Corporation so as to provide funds for the Funding Corporation Principal Fund, then the Federal Deposit Insurance Corporation shall transfer to the Funding Corporation from the proceeds of the FSLIC Resolution Fund the remaining amount of funds necessary for such purpose.

"(8) Undivided Profits Defined. For purposes of paragraph (3), the term 'undivided profits' means retained earnings minus the sum of -

"(A) that portion required to be added to reserves maintained pursuant to the first two sentences of section 16 of this Act (12 U.S.C. 1436); and

"(B) the dollar amounts held by the respective Federal Home Loan Banks in special dividend stabilization reserves on December 31, 1985, as determined by the table set forth in section 21(d)(7) of this Act (12 U.S.C. 1441(d)(7)).

"(9) Aggregate Annual Federal Home Loan Banks Contribution. Notwithstanding any other provision in sections 21, 21a and 21b of this Act, the aggregate annual amount contributed by the Federal Home Loan Banks (for the period from the date of enactment of the Financial Institutions Reform,

Recovery and Enforcement Act of 1989, until such time as the Funding Corporation has no more liabilities) for Funding Corporation principal and interest payments and Financing Corporation principal payments under section 21 of this Act shall be $300,000,000; provided, however, that such aggregate annual amount shall be such lesser number equal to all the amounts needed for the purposes above if such total amounts shall be less than $300,000,000.

"(f) Obligations of the Funding Corporation.

"(1) Issuance. The Funding Corporation, subject to the direction of the Resolution Trust Corporation, may issue bonds, notes, debentures, and similar obligations, in an aggregate amount not to exceed $50,000,000,000.

"(2) Interest Payments. The Funding Corporation shall pay the interest due on (and any redemption premium with respect to) such obligations from funds obtained for such interest payments from the following sources.

"(A) The Resolution Trust Corporation shall pay to the Funding Corporation the net proceeds received by the Resolution Trust Corporation from the liquidation of institutions under its management pursuant to section 21a of this Act to the extent they are determined by the Oversight Board to be in excess

of funds necessary for resolution costs in the near future and any proceeds from warrants and participations of the Resolution Trust Corporation; and

"(B) To the extent the funds available pursuant to clause (A) are insufficient to cover the amount of interest payments, then the Federal Home Loan Banks shall pay to the Funding Corporation the aggregate annual amount of $300,000,000 minus the amounts needed by the Financing Corporation pursuant to section 21 of this Act and for the purchase of Funding Corporation capital certificates, with each bank's individual share to be determined pursuant the formulation and limitations of paragraphs (3) through (6) of subsection (e);

"(C) The proceeds of all net assets of the Resolution Trust Corporation, upon its dissolution, which shall be transferred to the Funding Corporation; and

"(D) Notwithstanding any other provision of this Act, to the extent that the Directorate determines after consultation with and approval of the Secretary of the Treasury that the Funding Corporation is unable to pay the interest on any obligation issued under this subsection from the sources of funds under (A), (B), and (C), the Secretary of the Treasury shall pay to the Funding Corporation the additional amount due which shall be used by the Funding Corporation to pay such interest. In each

such instance where the Secretary of the Treasury is required to make a payment under this paragraph to the Funding Corporation, the amount of the payment shall become a liability of the Funding Corporation to be repaid to the Secretary of the Treasury upon dissolution of the Funding Corporation to the extent that the Funding Corporation may have any remaining assets. There is authorized to be appropriated to the Secretary of the Treasury, for fiscal year 1989 and each fiscal year thereafter, such sums as may be necessary to carry out this paragraph.

"(3) Principal Payments. On maturity of an obligation issued under this subsection, the obligation shall be repaid by the Funding Corporation from the liquidation of noninterest bearing instruments held in the Funding Corporation Principal Fund established by subsection (g)(2). The Funding Corporation shall obtain funds for such Principal Fund from the funds obtained pursuant to subsection (e) of this section, all of which such funds shall be invested in noninterest bearing instruments described in subsection (g)(1).

"(4) Proceeds To Be Invested in Capital Certificates of the Resolution Trust Corporation. Subject to such terms and conditions as may be approved by the Oversight Board, the proceeds of any obligation issued by the Funding Corporation shall be used to -

"(A) purchase the capital certificates issued by the Resolution Trust Corporation under section 21a of this Act; or

"(B) refund any previously issued obligation the net proceeds of which were invested in the manner described in subparagraph (A).

"(5) Investment of United States Funds in Obligations. Obligations issued under this section by the Funding Corporation, with the approval of the Oversight Board shall be lawful investments, and may be accepted as security, for all fiduciary, trust, and public funds the investment or deposit of which shall be under the authority or control of the United States or any officer of the United States.

"(6) Market for Obligations. All persons having the power to invest in, sell, underwrite, purchase for their own accounts, accept as security, or otherwise deal in obligations of the Federal Home Loan Banks shall also have the power to do so with respect to obligations of the Funding Corporation.

"(7) Tax Exempt Status.

"(A) In General. Except as provided in subparagraph (B), obligations of the Funding Corporation shall be exempt from

tax both as to principal and interest to the same extent as any obligation of a Federal Home Loan Bank is exempt from tax under section 13 of this Act (12 U.S.C. 1433).

"(B) Exception. The Funding Corporation, like the Federal Home Loan Banks, shall be treated as an agency of the United States for purposes of the first sentence of section 3124(b) of title 31, United States Code (relating to determination of tax status of interest on obligations).

"(8) Obligations Are Exempt Securities. Notwithstanding paragraph (10) below, obligations of the Funding Corporation shall be deemed to be exempt securities (within the meaning of the laws administered by the Securities and Exchange Commission) to the same extent as securities which are direct obligations of the United States or are guaranteed as to principal or interest by the United States.

"(9) Minority Participation in Public Offerings. The Oversight Board and the Directorate shall ensure that minority owned or controlled commercial banks, investment banking firms, underwriters, and bond counsels throughout the United States have an opportunity to participate to a significant degree in any public offering of obligations issued under this section.

"(10) No Full Faith and Credit of the United States.

Obligations of the Funding Corporation shall not be obligations of, or guaranteed as to principal by, the Federal Home Loan Bank System, the Federal Home Loan Banks, the United States, or the Resolution Trust Corporation and the obligations shall so plainly state. The Secretary of the Treasury shall pay interest on such obligations as required pursuant to subsection (f).

"(g) USE AND DISPOSITION OF ASSETS OF THE FUNDING CORPORATION NOT INVESTED IN RESOLUTION TRUST CORPORATION.

"(1) In General. Subject to such regulations, restrictions, and limitations as may be prescribed by the Oversight Board, assets of the Funding Corporation, which are not invested in capital certificates issued by the Resolution Trust Corporation under section 21a of this Act and which are not needed for current interest payments, shall be invested in -

"(A) direct obligations of the United States;

"(B) obligations, participations, or other instruments of, or issued by, the Federal National Mortgage Association or the Government National Mortgage Association;

"(C) mortgages, obligations, or other securities for sale by, or which have been disposed of by, the Federal Home Loan Mortgage Corporation under section 305 or 306 of the Federal

Home Loan Mortgage Corporation Act [12 U.S.C. 1454 or 1455]; or

"(D) any other security in which it is lawful for fiduciary and trust funds to be invested under the laws of any State.

"(2) Segregated Accounts for Zero Coupon Instruments Held to Assure Payment of Principal. The Funding Corporation shall invest funds from sources specificed in subsection (e) in, and hold in a segregated account (the "Funding Corporation Prnicipal Fund"), noninterest bearing instruments -

"(A) which are securities described in paragraph (1); and

"(B) the total of the face amounts (the amount of principal payable at maturity) of which is approximately equal to the aggregate amount of principal on the obligations of the Funding Corporation.

"(h) MISCELLANEOUS PROVISIONS RELATING TO THE FUNDING CORPORATION.

"(1) Treatment for certain purposes. Except as provided in subsection (f)(7)(b), the Funding Corporation shall be treated as a Federal Home Loan Bank for purposes of sections

13 and 23 of this Act (12 U.S.C. 1433 and 1443).

"(2) Federal Reserve Banks as Depositaries and Fiscal Agents. The Federal Reserve banks are authorized to act as depositaries for or fiscal agents or custodians of the Funding Corporation.

"(3) Applicability of Certain Provisions Relating to Government Corporations. Notwithstanding the fact that no Government funds may be invested in the Funding Corporation, the Funding Corporation shall be treated, for purposes of sections 9105, 9107, and 9108 of title 31, United States Code, as a mixed-ownership Government corporation which has capital of the Government.

"(4) Power to Remove and Jurisdiction. Notwithstanding any other provision of law, any civil action, suit, or proceeding to which the Resolution Funding Corporation is a party shall be deemed to arise under the laws of the United States, and the United States District Court for the District of Columbia shall have original jurisdiction over such. The Resolution Funding Corporation may, without bond or security, remove any such action, suit, or proceeding from a State court to the United States District Court for the District of Columbia.

"(i) TERMINATION OF THE FUNDING CORPORATION.

"(1) In General. The Funding Corporation shall be dissolved, as soon as practicable, after the date by which all capital certificates purchased by the Funding Corporation in the Resolution Trust Corporation have been retired.

"(2) Oversight Board Authority To Conclude the Affairs of the Funding Corporation. Effective on the date of the dissolution of the Funding Corporation under paragraph (1), the Oversight Board may exercise on behalf of the Funding Corporation, any power of the Funding Corporation which the Oversight Board determines to be necessary to settle and conclude the affairs of the Funding Corporation.

"(j) REGULATIONS. The Oversight Board may prescribe such regulations as may be necessary to carry out the provisions of this section, including regulations defining terms used in this section.

"(k) DEFINITIONS. For purposes of this section -

"(1) Insured Savings Association. The term 'insured savings association' means a savings association as such term is defined by section 3(u) of the Federal Deposit Insurance Act and which is insured by the Federal Deposit Insurance Corporation.

"(2) Oversight Board. The term 'Oversight Board'

means the Oversight Board of the Resolution Trust Corporation under section 21a of the Federal Home Loan Bank Act, and after the termination of said Corporation the term shall mean the Secretary of the Treasury, the Chairman of the Federal Reserve Board and the Attorney General.

"(3) Directorate. The term 'Directorate' means the directorate established in the manner provided in subsection (c)(1) to manage the Funding Corporation.".

"(4) Issuance Costs. The term "issuance costs"--

"(i) means issuance fees and commissions incurred by the Funding Corporation in connection with the issuance or servicing of any obligation of the Funding Corporation; and

"(ii) includes legal and accounting expenses, trustee and fiscal paying agent charges, costs incurred in connection with preparing and printing offering materials, and advertising expenses, to the extent that any such cost or expense is incurred by the Funding Corporation in connection with issuing any obligation; and

"(5) Custodian Fees. The term "custodian fee" means--

"(i) any fee incurred by the Funding Corporation in connection with the transfer of any security to, or the maintenance of any security in, the segregated accounts established under subsection (g); and

"(ii) any other expense incurred by the Funding Corporation in connection with the establishment or maintenance of such accounts.

Sec. 503. FINANCING CORPORATION. Section 21 of the Federal Home Loan Bank Act (12 U.S.C. 1441) is hereby amended as follows:

(1) By deleting the term "insured institution" and "institution" each time they appear and inserting "insured savings association" and "savings association" in lieu thereof respectively; and by deleting the term "Federal Home Loan Bank Board" and "Board" each time they appear and inserting in lieu thereof "Chairman of the Federal Home Loan Bank System" and "Chairman" in lieu thereof respectively.

(2) In subsection (c), in paragraph (2) by adding "prior to the date of the enactment of the Financial Institution Industry

Reform, Recovery and Enforcement act of 1989 and thereafter the FSLIC Resolution Fund" before the period therein; and in paragraph (9) by striking out "or section 402(b) of the National Housing Act [12 USCS § 1725(b)]".

(3) In subsection (e), in paragraph (3) by adding "prior to the enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, and therafter purchase capital certificates or capital stock issued by the FSLIC Resolution Fund" before the semi-colon;

(4) In subsection (e), in paragraph (7) by deleting "the Federal Savings and Loan Insurance Corporation" and inserting "the FSLIC Resolution Fund" in lieu thereof.

(5) In subsection (f), by striking out everything thereunder and inserting the following:

"(f) Sources of Funds for Interest Payments; Financing Corporation Assessment Authority. The Financing Corporation shall obtain funds for interest payments on obligations issued hereunder from the following sources:

"(1) The Financing Corporation assessments which were assessed on insured institutions pursuant to subsection (f) of this section prior to the enactment of the Financial Institutions

Reform, Recovery and Enforcement Act of 1989;

"(2) The Financing Corporation, with the approval of the Board of Directors of the Federal Deposit Insurance Corporation, shall assess on each insured savings association an assessment as if such assessment was assessed by the Federal Deposit Insurance Corporation with respect to Savings Association Insurance Fund members pursuant to section 7 of the Federal Deposit Insurance Act: Provided, That the amount assessed hereunder and the amount assessed by the Funding Corporation under section 21b of this Act shall not exceed the amount authorized to be assessed pursuant to section 7 of the Federal Deposit Insurance Act, and that the Financing Corporation shall have first priority to make such assessments; and Provided, further, that all assessments made by the Financing Corporation under this section and the Funding Corporation under section 21b shall be subtracted from the amounts authorized to be assessed by the Federal Deposit Insurance Corporation pursuant to section 7 of the Federal Deposit Insurance Act; and

"(3) To the extent the funds available pursuant to paragraphs (1) and (2) are insufficient to cover the amount of interest payments, then to the extent the funds are not required by the Resolution Funding Corporation so as to provide funds for the Funding Corporation Principal Fund under section 21b of this Act, then the Federal Deposit Insurance Corporation shall

transfer to the Financing Corporation from the proceeds of the FSLIC Resolution Fund the remaining amount of funds necessary for the Financing Corporation to make interest payments.

"(4) In subsection (g), by deleting the comma after "[12 USCS 1725(b)(1)(A)]" and inserting thereafter "prior to the enactment of the Financial Institution Industry Reform, Recovery and Enforcement Act of 1989 and thereafter in capital certificates or capital stock issued by the FSLIC Resolution Fund,".

(5) In subsection (l), by deleting subparagraph (1) and inserting in lieu thereof a new subparagraph (1) to read as follows:

"(1) Insured Savings Association means a savings association as defined by section 3(u) of the Federal Deposit Insurance Act (12 USCS § 1813(u)) that is insured by the Federal Deposit Insurance Corporation."

Sec. 504. MIXED OWNERSHIP GOVERNMENT CORPORATION.

Section 9101(2) of title 31, United States Code, is amended by adding at the end thereof the following new subparagraph:

"(L) The Resolution Funding Corporation".

TITLE VI - THRIFT ACQUISITION ENHANCEMENT PROVISIONS

Sec. 601. ACQUISITION OF THRIFTS BY BANK HOLDING COMPANIES. Section 4 of the Bank Holding Company Act of 1956 (12 U.S.C. 184 is amended by adding at the end thereof the following new subsection:

"(i) Acquisition of Savings Associations.

"(1) Beginning on the date two years following the enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, the Board may approve an application by a bank holding company under subsection (c)(8) to acquire any savings association pursuant to the requirements and limitations of this section. In approving applications by bank holding companies to acquire a savings association, the Board shall not impose restrictions on transactions between the savings association and its holding company affiliates, except as required under the provisions of section 23A and 23B of the Federal Reserve Act (12 U.S.C. 371c and 371c-1) or other applicable statute."

Sec. 602. INVESTMENTS BY SAVINGS AND LOAN HOLDING COMPANIES IN UNAFFILIATED THRIFT INSTITUTIONS. Section 408(e)(1)(A)(iii) of the National Housing Act (12 U.S.C. 1730a(e)(1)(A)(iii)) is amended to read as follows:

"(iii) to acquire, by purchase or otherwise, or to retain more than 5 percent of the voting shares of an insured institution not a subsidiary, or of a savings and loan holding company not a subsidiary, or in the case of a multiple savings and loan holding company, to so acquire or retain more than 5 percent of the voting shares of any company not a subsidiary which is engaged in any business activity other than those specified in paragraph (2) of subsection (c) of this section.".

Sec. 603. TECHNICAL AMENDMENT TO THE BANK HOLDING COMPANY ACT. Section (2)(j) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(j)) is amended to read as follows:

"(j) INSURED INSTITUTION; SAVINGS ASSOCIATION.--For purposes of this Act, the terms 'insured institution' and 'savings association' have the meaning given to the term 'savings association' in section 10(a)(1)(A) of the Home Owners' Loan Act (12 U.S.C. _____)."

TITLE VII - FEDERAL HOME LOAN BANK ACT SYSTEM REFORMS

Subtitle A. Federal Home Loan Bank Act Amendments

Sec. 701 DEFINITIONS.

(a) Add new paragraph (10) to section 2 of the Federal Home Loan Bank Act (12 U.S.C. 1422) to read as follows:

"(10) The term "savings association" has the same meaning as in section 2(c) of the Home Owners Loan Act (12 U.S.C. §1462(c))."

(b) Add a new paragraph (11) to Section 2 of the Federal Home Loan Bank Act and (12 U.S.C. 1422) to read as follows:

"(11) The term "Chairman" means "Chairman of the Federal Home Loan Bank System."

(c) All provisions of Federal law are hereby amended by deleting the term "Federal Home Loan Bank Board" or "Board" where such term refers to the Federal Home Loan Bank Board, and inserting "Chairman of the Federal Home Loan Bank System" or "Chairman" in lieu thereof, respectively.

Sec. 702. FEDERAL HOME LOAN BANK SYSTEM CHAIRMAN. Section 17 of

the Federal Home Loan Bank Act (12 U.S.C. 1437) is hereby amended to read as follows:

"(a) The Federal Home Loan Bank Board is hereby abolished and all power and authority vested in it or its Chairman immediately prior to enactment of the Financial Institution Industry Reform, Recovery and Enforcement Act of 1989 are, except as otherwise provided in that Act, vested in the Chairman of the Federal Home Loan Bank System, which System shall be a bureau in the Department of the Treasury. The Chairman shall supervise the Federal Home Loan Banks and their members and shall promulgate and enforce such rules, regulations, and orders, as are necessary from time to time for carrying out the provisions of this Act and all other laws it is his duty to implement. The Chairman shall perform his duties under the general directions of the Secretary of the Treasury.

"(b) The Chairman, who shall be a citizen of the United States, shall be appointed by the President, by and with the advice and consent of the Senate, and shall hold office for a term of five years unless sooner removed by the President, upon reasons to be communicated by the President to the Senate; provided, however, that the individual serving as the Chairman of the Federal Home Loan Bank Board on the date of enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 shall be the Chairman until the

date on which his term as Chairman of the Federal Home Loan Bank Board would have expired notwithstanding subsection (a). The Chairman may continue to serve until a successor has been appointed and qualified.

"(c) Subject to the approval of the Secretary of the Treasury, the Chairman of the Federal Home Loan Bank System may employ, direct and fix the compensation of such employees, attorneys and agents as he deems necessary to carry out his duties. In directing and fixing such compensation, the Chairman shall seek to maintain comparability with the compensation at the other Federal bank regulatory agencies. The Chairman may designate who shall serve in his absence; may continue or establish collective offices or administrative units of the Federal Home Loan Banks and, after consultation with the Federal Home Loan Banks, appoint the heads of such collective offices or administrative units; and, notwithstanding any other provisions of law, may delegate to any duly authorized employee, representative, or agent (including the Office of Finance or Office of Regulatory Affairs of the Federal Home Loan Banks or any other joint office or administrative unit of the Federal Home Loan Banks) any power vested in the Chairman by law.

"(d) The Chairman shall have the power to suspend or remove any director, officer, employee or agent of any Federal Home

Loan Bank or administrative unit of such Banks (including the Office of Finance and the Office of Regulatory Affiars or any other joint office or administrative unit of the Federal Home Loan Banks), the fact of such suspension or removal to be communicated in writing forthwith to such director, officer, employee, or agent and to such Bank or joint office or administrative unit.

"(e) The salaries of the Chairman and other employees of the bureau and all other expenses thereof shall be paid from assessments levied on the Federal Home Loan Banks pursuant to section 18 of this Act, and the funds derived from such assessments shall not be construed to be Government Funds or appropriated monies, or subject to Presidential apportionment for the purposes of Chapter 15 of Title 31 or any other authority. Such compensation, other than that of the Chairman, shall be paid without regard to the provisions of other laws applicable to officers or employees of the United States.

"(f) It shall not be lawful for the Chairman of the Federal Home Loan Bank System to have a financial interest either directly or indirectly, in any member of a Federal Home Loan Bank.

"(g) Notwithstanding any other provision of law, the Chairman shall have and may exercise all functions which the

Chairman of the Federal Home Loan Bank Board, the Federal Home Loan Bank Board, and the Federal Savings and Loan Insurance Corporation had or could exercise immediately prior to August 24, 1954, or immediately prior to June 24, 1954, which are not expressly transferred or consolidated into the Federal Deposit Insurance Corporation or the Resolution Trust Corporation pursuant to this Act.

"(h) The Chairman of the Federal Home Loan Bank System shall make an annual report to Congress."

Sec. 703. ELECTION OF BANK DIRECTORS. Section 7 of the Federal Home Loan Bank Act (12 U.S.C. 1427) is hereby amended as follows: (1) By striking out subsections (a), (b), (c), and by inserting the following new subsections in lieu thereof:

"(a) NUMBER OF MEMBERS; CLASSES. The management for each Federal Home Loan Bank shall be vested in a board of directors selected as hereinafter specified and shall consist of nine members, all of whom shall be citizens of the United States, holding office for three years, and divided into three classes, designated as classes A, B, and C, as follows.

"(1) Class A shall consist of three members, without discrimination on the basis of race, creed, color, sex, or

national origin, who shall be chosen by and be representative of the stockholding members.

"(2) Class B shall consist of three members, who shall represent the public and who shall be elected without discrimination on the basis of race, creed, color, sex, or national origin, and with due consideration to the interests of the financial services industry and the housing industry, who shall be chosen by the Class A and C directors.

"(3) Class C shall consist of three members who shall be designated by the Chairman of the Federal Home Loan Bank System. They shall be selected to represent the public, without discrimination on the basis of race, creed, color, sex, or national orgin, and with due but not exclusive consideration to the interests of commerce, industry (other than the savings and loan industry), services, agricultture and consumers. No Class C director shall be an officer, director, employee of stockholder of any member.".

"(b) CLASS A DIRECTORS; SELECTION. Directors of Class A shall be chosen in the following manner:

"(1) The System shall classify the members of a district into three general groups or divisions, designating each group by number. Each group shall consist of as nearly as may be of members of similar capitalization. Each member

shall be permitted to nominate, in writing to the chairman of the board of directors of the Federal Home Loan Bank of the district, one candidate for director of Class A. The candidates so nominated shall be listed by the chairman, indicating by whom nominated, and a copy of said list shall, within fifteen days after its completion, be furnished by the chairman to each member. Each member by a resolution of the board or by amendment to its bylaws shall authorize its president, cashier or some other officer to cast the vote of the member in the elections of Class A directors. Provided that whenever any member within the same Federal Home Loan Bank district are subsidiaries of the same savings and loan holding company, within the meaning of Section 10 of the Home Owners' Loan Act of 1933, as amended, participation in any such nomination or election by such member, including such holding company if it is also a member, shall be confined to one of such members, which may be designated for the purpose by such holding company.

"(2) Within fifteen days after receipt of the list of candidates, the duly authorized officer of the member shall certify to the chairman his first, second, and other choices for director of Class A upon a preferential ballot upon a form furnished by the chairman of the board of directors of the Federal Home Loan Bank of the district. Each such officer shall make a cross opposite the name of the first, second, and other choices for a director of Class A, but

shall not vote more than one choice for any one candidate. No officer or director of a member shall be eligible to serve as a Class A director unless nominated and elected by members which are of the same group as the member of which he is an officer or director.

"(3) Any person who is an officer or director of more than one member shall not be eligible for nomination as a Class A director except by members in the same group as the member having the largest aggregate resources of any of those of which such person is an officer or director.

"(4) Any candidate having a majority of all votes cast in the column of first choice shall be declared elected. If no candidate has a majority of all the votes in the first column, then there shall be added together the votes cast by the electors for such candidates in the second column and the votes cast for the several candidates in the first column. The candidate then having a majority of the electors voting and the highest number of combined votes shall be declared elected. If no candidate has a majority of electors voting and the highest number of votes when the first and second choices shall have been added, then the votes cast in the third column for other choices shall be added together in like manner, and the candidate then having the highest number of votes shall be declared elected. An immediate report of election shall be declared.

"(c) CLASS B DIRECTORS; SELECTION. Class B directors shall be chosen by the Class A and C directors. They shall have been for at least two years residents of the district for which they are apointed.

"(d) CLASS C DIRECTORS; SELECTION. Class C directors shall be appointed by and serve at the pleasure of the Chairman of the System. They shall have been for at least two years residents of the district for which they are appointed. One Class C director shall be designated by the Chairman of the System as chairman of the board of directors of the Federal Home Loan Bank. The chairman of the board of directors shall be a person of tested experience and shall be required to maintain, under regulations established by the System, a local office of said board on the premises of the Federal Home Loan Bank. The chairman of the board shall make regular reports to the Chairman of the System and receive an annual compensation to be fixed by the Chairman of the System and paid monthly by the Federal Home Loan Bank to which the chairman of the board is designated. One other Class C director shall be appointed by the Chairman of the System as deputy chairman of the board to exercise the powers of the chairman of the board when necessary. In case of the absence of the chairman and deputy chairman, the third Class C director shall preside at meetings of the board.";

(2) Renumber subsection (d) as (e), and strike out the first two sentences thereof;

(3) Delete existing subsection (e) and inserting in lieu thereof the following new subsection as subsection (f):

"(f) ESTABLISHMENT OF TERMS. At the first meeting of the full board of directors of each Federal Home Loan Bank, it shall be the duty of the Class A, B, and C directors, respectively to designate one of the members of each class whose term of office shall expire in one year from the 1st of January nearest to the date of such meeting, one whose term of office shall expire at the end of two years from said date, and one whose term of office shall expire at the end of three years from said date. Thereafter every director of a Federal Home Loan Bank chosen as hereinbefore provided shall hold office for a term of three years."; and

(4) Renumber existing subsection (f) as (g) and delete subsections (g) and (h), and redesignating (i) and (j) as (g) and (h), respectively.

Sec. 704. FEDERAL HOME LOAN BANK LENDING. Section 11(k) of the Federal Home Loan Bank Act (12 U.S.C. 1431(k)) is hereby amended to read as follows:

"(k) The Federal Home Loan Banks are hereby authorized, as

directed by the Federal Deposit Insurance Corporation with the concurrence of the Chairman of the System, to make loans to such Corporation for the use of the Savings Association Insurance Fund, which loans shall be a direct liability of such Fund.

Sec. 705. CHIEF SUPERVISORY OFFICER. (a) Section 19 of the Federal Home Loan Bank Act (12 U.S.C. 1439) is hereby amended by deleting the first sentence and adding a new second sentence to read as follows:

"The senior supervisory employee of each Federal Home Loan Bank, the principal supervisory agent, shall report to the chief supervisory official of the Federal Home Loan Bank System and may be removed for cause by the Chairman."

(b) The title to section 19 of the Federal Home Loan Bank Act (12 U.S.C. 1439) is amended to read "Supervision; Receipts and Expenditures".

Sec. 706. THRIFT ADVISORY COUNCIL. Section 8a of the Federal Home Loan Bank Act (12 U.S.C. 1428a) is amended as follows:

(1) The words "Federal Savings and Loan" are deleted from the first sentence and title of this section and the word "Thrift" substituted.

(2) In paragraph (1) of Section 8a delete the following words "and board of trustees of the Federal Savings and Loan Insurance Corporation" and the words "and such Corporation".

(3) In paragraph (2) of Section 8a delete the following words "and the board of trustees of such Corporation".

Sec. 707. FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION INDUSTRY ADVISORY COMMITTEE. Subsection (i) of Section 21 of the Federal Home Bank Act (12 U.S.C. 1441(i)) is hereby repealed.

Sec. 708. RATE OF INTEREST. Section 5B of the Federal Home Loan Bank Act (12 U.S.C. 1425b) is hereby repealed.

Sec. 709. LIQUIDITY REQUIREMENTS. Section 5A of the Federal Home Loan Bank Act (12 U.S.C. 1425a) is hereby amended as follows:

(1) The first sentence of paragraph 1 of subsection (b) is amended by deleting the words "an insured institution as defined in Section 1724(a) of this title" and by adding the words "a savings association" in place thereof;

(2) Subsection (d) is hereby amended by deleting in the first sentence the word "its" and by substituting the word "his" in lieu thereof and in the second sentence by deleting the words "Federal Savings and Loan Insurance Corporation" and by

substituting the words "Federal Deposit Insurance Corporation" in lieu thereof;

(3) Subsection (f) is hereby amended by deleting the last sentence and by adding the following in lieu thereof:

"The provisions of Section 5(d)(1) of the Home Owners' Loan Act as redesignated shall govern the conduct of any such examination or investigation."

(4) Section 5A(b)(1) of the Federal Home Loan Bank Act (12 U.S.C. § 1425a(b)(1) is hereby amended:

(a) by striking out "and" at the end of subparagraph (F);

(b) by striking out the period at the end of subparagraph (G) and inserting in lieu thereof "; and"; and

(c) by adding at the end thereof the following new subparagraph:

"(H) to such extent as the Chairman may approve, other assets prescribed by the Chairman by regulation and of a type such that their inclusion as liquid assets would comport with the purpose of this section as described in subsection (a)."

Sec. 710. ADVANCES. Subsection (e) of Section 10 of the Federal

Home Loan Bank Act is hereby amended as follows:

(a) The words "insured institution" are deleted wherever they occur and the words "savings association" are added in lieu thereof.

(b) In paragraph (3)(A), "Section 1730a(a)(1)(A)" is deleted and "Section 1467a" is substituted in lieu thereof.

(c) In paragraph (3)(B), "Section 1730a(o)" is deleted and "Section 1467a" is substituted in lieu thereof.

(d) In paragraph (3)(c), "Section 1730a(o)(5)(A)" is deleted and "Section 1467a" is substituted in lieu thereof.

Sec. 711. CONFORMING FEDERAL HOME LOAN BANK ACT AMENDMENTS. (a) Amend §1438(c)(5) to delete everything in the first sentence after "under this subsection".

(b) Amend the first sentence of §1438(c)(6) to delete everything after "budget program" and before "and (B)".

(c) Delete §1438(a) entirely.

(d) Delete the last sentence of §1439.

(e) Amend § 101 of Title I of the Act of June 16, 1943 (12

U.S.C. § 1439a) to delete everything after "Federal Home Loan Bank Administration".

(f) Amend Section 111 of Title I of Public Law 93-495 (12 U.S.C. 250) to delete "the Federal Home Loan Bank Board".

Subtitle B -- Conforming Amendments

Sec. 712. FEDERAL HOME LOAN MORTGAGE CORPORATION ACT AMENDMENTS. The Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1451 et seq.) is hereby amended as follows:

(1) Section 303 (12 U.S.C. Section 1452) is amended as follows:

(a) the first sentence of subsection (a) is amended by deleting the words "members of the Federal Home Loan Bank Board" and inserting in place thereof the words "three members who shall serve without additional compensation and who shall be the Chairman of the Federal Home Loan Bank System, the Secretary of the Treasury, or his designate, and the Secretary of Housing and Urban Development, or his designate. The Board of Directors may elect a Vice Chairman."

(b) the second sentence of subsection (a) is amended by deleting the word "Federal Home Loan Bank Board" and inserting in place thereof the words "Federal Home Loan Bank System".

(c) the fourth sentence of subsection (a) is amended by deleting the words "Federal Home Loan Bank Board" and inserting in place thereof the words "Chairman of the Federal Home Loan Bank System".

(2) Section 305 (12 U.S.C. Section 1454) is amended as follows:

(a) deleting the words "Federal Savings and Loan Insurance Corporation" each time they appear in this section and inserting "Resolution Trust Corporation" in lieu thereof; and,

(b) deleting the word "Board" in the second to last sentence of subsection (a)(2) and inserting the word "System" in lieu thereof.

Sec. 713. REPEAL OF LIMITATION OF OBLIGATION FOR ADMINISTRATIVE EXPENSES. - Section 7 of the First Deficiency Appropriation Act of 1936 (15 U.S.C. Section 712a) is amended by deleting from subsection (b) the following enumerated entities:

"1. Federal Home Loan Bank System; 2. Home Owners' Loan Corporation; 11. Federal Savings and Loan Insurance Corporation;".

Sec. 714. AMENDMENT OF ADDITIONAL POWERS OF CHAIRMAN. -

(A) Subsection (c) of section 502 of the Housing Act of

1948, as amended (12 U.S.C. Section 1701c(b)), is amended by striking out the terms "Federal Home Loan Bank Board (which term as used in this section shall also include and refer to the Fedeal Savings and Loan Insurance Corporation, and the Chairman of the Federal Home Loan Bank Board)," and inserting in lieu thereof the following: "Chairman, Federal Home Bank System,"; and

(B) Subsection (1) of subsection (c) of said section 502 is amended by inserting between the term "of any" and "State or" the following term: "Federal".

Sec. 715. AMENDMENT OF TITLE 5, UNITED STATES CODE. -

(A) Section 5314 of Title 5, United States Code (5 U.S.C. Section 5314) is amended by deleting the term "Board" from the phrase "Chairman, Federal Home Loan Bank Board" and inserting in lieu thereof the term "System"; and

(B) Section 5373 of Title 5, United States Code is hereby amended by inserting at subparagraph (2), between the terms, "481," and "and" the following terms: "1437, 1439,".

Sec. 716. AMENDMENT OF TITLE 31, UNITED STATES CODE. -

(A) Chapter 3 of Title 31, United States Code is amended by inserting at subchapter I, a new section 307a to read as follows:

Section 307a. Federal Home Loan Bank System

The Federal Home Loan Bank System, established under section 17 of the Federal Home Loan Bank Act, as amended (12 U.S.C. 1437) is subject to the general oversight of the Secretary of the Treasury.

(B) Subsection (c) of section 321, Title 31, United States Code (31 U.S.C. Section 321) is amended by adding thereto a new subparagraph (3) as follows:

"(3) of the Chairman, Federal Home Loan Bank System."; and

(C) Subsection (a) of section 714, Title 31, United States Code (31 U.S.C. Section 714) is amended by adding to the end of the first sentence the following:

"and the Office of the Chairman, Federal Home Loan Bank System."; and

(D) Section 9101 of Title 31, United States Code (31 U.S.C. Section 9101) is amended by striking from subsection (3) the following:

"(E) the Federal Savings and Loan Insurance Corporation."

Sec. 717. AMENDMENT OF BALANCED BUDGET AND EMERGENCY DEFICIT CONTROL ACT PROVISIONS. - (A) Subsection (1)(A) of subsection (g) of section 255 of the Balanced Budget and Emergency Deficit Control Act of 1985 (2 U.S.C. Section 905) is amended by striking out the following terms: "Federal Home Loan Bank Board;" and "Federal Home Loan Bank Board, Federal Savings and Loan Insurance Corporation;" and inserting in lieu thereof:

"Federal Home Loan Bank System and Resolution Trust Corporation;"; and

(B) Subsection (4) of subsection (b) of section 256 of the Balance Budget and Emergency Deficit Control Act of 1985 (2 U.S.C. Section 256) is amended by -- (1) striking out the term "(C) Federal Home Loan Bank Board" and inserting in lieu thereof:

"(C) Federal Home Loan Bank System and Resolution Trust Corporation."; and

(2) by striking out the term "(D) Federal Savings and Loan Insurance Corporation."

Sec. 718. AMENDMENT OF TITLE 18, UNITED STATES CODE.-

(A) Sections 1008 and 1009 of Title 18, United States Code (18 U.S.C. Sections 1008, 1009) are repealed; and

(B) Section 1014 of Title 18, United States Code (18 U.S.C. Secitn 1014) is amended --

(1) by striking out the term "the Federal Home Loan Bank Board, the Home Owner's Loan Corporation" and inserting in lieu thereof the following:

"a Federal Savings Bank;"; and

(2) by striking out the terms, "any institution the accounts of which are insured by the Federal Savings and Loan Insurance Corporation, and Bank" and inserting in lieu thereof the following:

"any financing institution the accounts or"; and

(3) by amending the term "any member of the Federal Home Loan Bank System" by striking out the term "member" therein and inserting in lieu theeof the following: "component or office"; and

(4) by striking out the term "the Savings and Loan Insurance Corporation".

TITLE VIII -- BANK CONSERVATION ACT AMENDMENTS

Sec. 801. DEFINITIONS. Section 202 of title II of the Act of March 9, 1933 (48 Stat. 2, 12 U.S.C. 202), the Bank Conservation Act (hereinafter "Bank Conservation Act"), is amended by adding the words "or any other financial institution chartered under Federal law and subject to the supervision of the Comptroller of the Currency after the words "national banking association".

Sec. 802. APPOINTMENT OF CONSERVATOR. Section 203 of the Bank Conservation Act (12 U.S.C. 203) is amended to read as follows:

"Section 203. APPOINTMENT OF CONSERVATOR

(a) APPOINTMENT

The Comptroller of the Currency may, without notice, appoint a conservator which may be the Federal Deposit Insurance Corporation, to take possession and control of a bank whenever the Comptroller determines that one or more of the following circumstances exists:

(1) the conditions for appointment of a receiver for the bank are present;

(2) the bank is in danger of closing, such that the bank is not likely to be able to meet the demands of its depositors, or pay its obligations in the normal course of business, or the bank has incurred or is likely to incur losses that will deplete all

or substantially all of its capital;

(3) a violation or violations of laws, rules or regulations or any unsafe or unsound practice or condition which is likely to cause insolvency or substantial dissipation of assets or earnings, or is likely to weaken the condition of the bank or otherwise seriously prejudice the interests of its depositors;

(4) the bank is in an unsafe and unsound condition to transact business;

(5) the bank's board of directors consists of less than five members;

(6) a willful or continuing violation of an order enforceable under the provisions of section 8(i) and (j) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1818 (i));

(7) concealment of books, papers, records, or assets of the bank or refusal to submit books, papers, records, or affairs of the bank for inspection to any examiner or to any lawful agent of the Comptroller; or

(8) such other circumstances which, in the Comptroller's opinion, warrant appointment of a conservator for the benefit of depositors and other creditors.

(b) JUDICIAL REVIEW

(1) Not later than ten days after the initial appointment of a conservator pursuant to this section, the bank may bring an action in the United States District Court for the judicial district in which the home office of such bank is located, or in the United States District Court for the District of Columbia, for an order requiring the Comptroller to terminate the appointment of a conservator, and the court, upon the merits, shall dismiss such action or shall direct the Comptroller to terminate the appointment of such conservator. The Comptroller's decision to appoint a conservator pursuant to this provision shall be set aside only if the court shall find that such decision was arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.

(2) Upon the commencement of such an action, the court having jurisdiction of any other action or proceeding to which the bank, or the conservator thereof, is a party shall stay such action or proceeding during the pendency of the action for removal of the conservator.

(3) Except as provided in this section, no court shall have jurisdiction to affect by injunction or otherwise the appointment of a conservator, or to review, modify, suspend, terminate or set aside any order or action taken pursuant to such conservatorship: Provided, That a court, upon application by the Comptroller,

shall enforce an order of the Comptroller relating to the conservatorship and the bank in conservatorship or restraining or affecting the exercise of powers of functions of a conservator.

(c) ADDITIONAL GROUNDS FOR APPOINTMENT

In addition to the foregoing provisions, the Comptroller may appoint a conservator for a bank in the event that (i) the bank, by an affirmative vote of a majority of its board of directors or by an affirmative vote of a majority of its shareholders, consents to such appointment, or (ii) in lieu of the provisions of section 8(o) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1818(o)), the bank's status as an insured bank is terminated by the Federal Deposit Insurance Corporation. The appointment of a conservator pursuant to this subsection shall not be subject to review.

(d) EXCLUSIVE AUTHORITY

The Comptroller shall have exclusive power and jurisdiction to appoint a conservator for a bank. Whenever the Comptroller appoints a conservator for any bank, he may appoint the Federal Deposit Insurance Corporation conservator for such bank. The Federal Deposit Insurance Corporation, as such conservator, shall have all powers granted under the Federal Deposit Insurance Act, and (when not inconsistent therewith) any other rights, powers, and privileges possessed by conservators or receivers of banks

under this Act and any other provisions of law. The Comptroller may also appoint another person as conservator, who shall be subject to the provisions of this Act.

(e) The Comptroller may, without notice or hearing, replace a conservator with another conservator. Such replacement shall not affect the bank's right under subsection (b) to obtain judicial review of the Comptroller's original decision to appoint a conservator.

Sec. 803. EXAMINATIONS. Section 204 of the Bank Conservation Act (12 U.S.C. 204) is amended to read as follows:

"Section 204. EXAMINATIONS

The Comptroller of the Currency, in consultation with the Board of Directors of the Federal Deposit Insurance Corporation when the Corporation is appointed conservator, is authorized to examine and supervise the bank in conservatorship as long as the bank continues operations as an ongoing national bank. The Comptroller may use reports and other information provided by the Federal Deposit Insurance Corporation for this purpose."

Sec. 804. TERMINATION OF CONSERVATORSHIP. Section 205 of the Bank Conservation Act (12 U.S.C. 205) is amended read as follows:

"Section 205. TERMINATION OF CONSERVATORSHIP

(a) At any time the Comptroller becomes satisfied that it may safely be done and that it would be in the public interest, the Comptroller, with the agreement of the Board of Directors of the Federal Deposit Insurance Corporation when the Corporation is appointed conservator, may:

(1) terminate the conservatorship and permit the involved bank to resume the transaction of its business subject to such terms, conditions and limitations as the Comptroller may prescribe; or

(2) terminate the conservatorship upon a sale, merger, consolidation, purchase and assumption, change in control, or voluntary liquidation of the involved bank.

(b) The Comptroller also may terminate the conservatorship upon a declaration that the bank is insolvent and upon the appointment of a receiver pursuant to section 1 of the Act of June 30, 1876 (12 U.S.C. 191).

(c) Such terms, conditions and limitations as prescribed by subsection (a)(1) of this section shall be enforceable under the provisions of section 8(i) and (j) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1818(i) and (j)) to the same extent as an effective and outstanding order issued pursuant to section 8(b) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1818(b)) that has become final: *Provided* , that the bank

may bring an action in the United States district court for the judicial district in which the home office of such bank is located or in the United States District Court for the District of Columbia for an order requiring the Comptroller to terminate the order. An action for judicial review of the terms, conditions and limitations may not be commenced later than 30 days from the date of the termination of the conservatorship or the imposition of the order, whichever is later.

(d) Upon termination of the conservatorship under subsection (a)(2) of this section --

(1) when the Federal Deposit Insurance Corporation is appointed conservator, the Federal Deposit Insurance Corporation, as conservator, shall proceed to wind up the affiars of the conservatorship; or

(2) when another person is appointed conservator, the conservator shall proceed to wind up the affairs of the conservatorship as follows:

(A) Within 180 days of the sale, merger, consolidation, purchase and assumption, or voluntary liquidation, the conservator shall deposit all net proceeds received from the transaction, less any expenses of the conservatorship that are outstanding, with the United States District Court for the judicial district in which the home office of such bank is

located and shall cause notice to be published for three consecutive months and notify by mail all known creditors and shareholders. Within sixty days thereafter, any depositor, creditor, or other claimant of the bank, or any shareholder of the bank may bring an action in interpleader in that court for distribution of the proceeds. The District Court shall disseminate such funds in an equitable manner. If no such action is instituted within one year of the date the funds were deposited with the District Court, title to such net proceeds shall revert to the United States and the District Court shall remit the funds to the Treasury of the United States.

(B) The conservator shall be deemed to have discharged all responsibility of the conservatorship upon the deposit of the proceeds with the District Court and fulfillment of the required notifications.

Sec. 805. CONSERVATOR; POWERS AND DUTIES. Section 206 of the Bank Conservation Act (12 U.S.C. 206) is amended to read as follows:

"Section 206. CONSERVATOR; POWERS AND DUTIES

(a) A conservator shall have all the powers of the shareholders, directors, and officers of the bank and shall be authorized to operate the bank in its own name unless the Comptroller in the order of appointment limits the authority o

the conservator.

(b) The conservator shall be subject to such rules, regulations, and orders as the Comptroller from time to time deems appropriate; and, except as otherwise specifically provided in such rules, regulations, or orders, shall be vested with or subject to the same rights privileges, duties, restrictions. penalties, conditions, and limitations that apply to directors, officers, or employees of a national bank, except as otherwise provided in Sectin 209 of this Act.

(c) The Comptroller may require the conservator to set aside and make available for withdrawal by depositors and payment to other creditors such amounts as in the opinion of the Comptroller may safely be used for this purpose: Provided, That all depositors and creditors who are similarly situated shall be treated in the same manner.

(d) The conservator and professional employees appointed to represent or assist the conservator shall be paid amounts no greater than are payable for employees of the Federal Government for similar services, except that the Comptroller of the Currency may authorize payment at higher rates, not to exceed rates prevalent in the private sector, if the Comptroller determines that payment of such higher rates is necessary in order to recruit and retain competent personnel.

(e) All expenses of any such conservatorship shall be paid by the bank and shall be a lien upon the bank which shall be prior to any other lien.

Sec. 806. LIABILITY PROTECTION. Section 209 of the Bank Conservation Act (12 U.S.C. 209) is amended to read as follows:

"SECTION 209. LIABILITY PROTECTION.

(a) The conservator shall not be held liable for damages in tort or otherwise for acts or omissions of acts performed pursuant to and in the course of the duties and responsibilities of the conservatorship unless such acts or omissions of acts are grossly negligent, as determined by a court.

(b) The Comptroller shall have authority to indemnify the conservator on such terms as the Comptroller deems proper.

Sec. 807. RULES AND REGULATIONS. Section 211 of the Bank Conservation Act (12 U.S.C. 211) is amended to read as follows:

"SECTION 211. RULES AND REGULATIONS

"The Comptroller of the Currency is hereby authorized and empowered to prescribe such rules and regulations as the Comptroller may deem necessary to carry out the provisions of this Act."

Sec. 808. REPEALS. Section 207 and 208 of the Bank Conservator Act (48 Stat. 3, 12 U.S.C. 207 and 208) are hereby repealed.

Sec. 809. CONFORMING AMENDMENT. Section 5373(2) of Title 5, United States Code, is amended to read as follows:

"(2) sections 203, 248, 481 and 1819 of title 12,".

TITLE IX -- REGULATORY AUTHORITY AND CRIMINAL ENHANCEMENTS

SEC. 901. SHORT TITLE.

This title may be cited as the "Enforcement Powers Improvement Act of 1989".

SUBTITLE A -- REGULATION OF FINANCIAL INSTITUTIONS

SEC. 902. AMENDMENTS TO THE FEDERAL DEPOSIT INSURANCE ACT.

(a) Section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818) is amended --

(1) by replacing the following phrases in each place they appear with the phrase "institution-related party":

(A) "director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank";

(B) "director, officer or other person"; and

(C) "director, officer, employee, agent or other person";

(2)(A) by redesignating subsection (a) as subsection 8(a)(1) and by replacing the words "one hundred and twenty days" with the words "sixty days";

(B) by replacing the words "shall continue for a period of two years" with the words "shall continue for a period of at least six months or up to two years, within the discretion of the Board of Directors."; and

(C) by adding the following new paragraph (a)(2):

"(2) In addition to the foregoing administrative proceedings described in subsection (a)(1), whenever the Board of Directors, after consultation with the appropriate federal banking agency, shall find that an insured financial institution has no tangible shareholders' equity that qualifies as tier one capital under the capital guidelines or regulations of the appropriate Federal banking agency,

the Corporation may issue a temporary order suspending deposit insurance on all deposits received by the institution after the effective date of such order. Such order shall become effective not earlier than ten days from the date of service upon the institution and, unless set aside, limited or suspended by a court in proceedings authorized hereunder, such temporary order shall remain effective and enforceable pending completion of the administrative proceedings or until the Corporation shall dismiss such administrative proceedings. Within ten days after the temporary order has been served upon the institution as hereinabove provided, the institution may apply to the United States District Court for the District of Columbia, or the United States district court for the judicial district in which the home office of the institution is located, for an injunction setting aside, limiting or suspending the enforcement, operation or effectiveness of such order, and such court shall have jurisdiction to issue such injunction. The insured deposits of each depositor in such financial institution on the effective date of the order issued under this paragraph (8), less all subsequent withdrawals from any deposits of such depositor, shall continue to be insured, subject to the administrative proceedings as provided in this Act. In addition, the Corporation may publish notice of any order issued under this paragraph (8) and the financial institution shall give notice of such order to each of its

depositors in such manner and at such times as the Board of Directors may find to be necessary and may order for the protection of depositors. In the event the Corporation determines that the financial institution has not substantially complied with the notice to depositors required by the Board of Directors, the Corporation may provide such notice in such manner as the Board of Directors may find to be necessary and appropriate. The failure of a depositor to receive notice shall not affect the effectiveness of any order issued under this paragraph.";

(3) at the end of paragraph (1) of subsection (b), by striking the period and inserting: "including, without limitation, reimbursement, restitution, indemnification, rescission, the disposal of loans or assets, prohibitions or restrictions on growth of the institution, guarantees against loss, or other action the appropriate Federal banking agency deems appropriate. Such order may place limitations on the activities or functions of the financial institution or any institution-related party necessary to correct the conditions resulting from any such violation or practice.";

(4) in paragraph (3) of subsection (b), by striking out "Nothing" in the second sentence thereof and inserting in lieu thereof "Except as provided in subsection (b)(6) of this section, nothing";

(5) at the end of subsection (b), by adding the following new paragraph:

"(6) This subsection and subsections (c) through (n) of this section shall apply to any savings and loan holding company and to any subsidiary (other than a bank or subsidiary of that bank) of a savings and loan holding company, to any service corporation of a savings association and to any subsidiary of such service corporation, whether wholly or partly owned, in the same manner as they apply to a savings association.";

(6) in paragraph (1) of subsection (c), by striking the words "substantial" and "seriously" and by inserting the following sentence after the first sentence: "Such order may place limitations on the activities or functions of the financial institution or prohibitions or restrictions on the growth of the institution or any institution-related party.";

(7) at the end of subsection (c), by adding the following new paragraph:

"(3) Whenever a notice of charges specifies that an insured financial institution's books and records are so incomplete or inaccurate that the appropriate Federal banking agency is unable with reasonable effort to determine the financial condition of

that financial institution or the details or purpose of any transaction or transactions that may have a substantial effect on the financial condition of that financial institution, the agency may issue a temporary order requiring cessation of any activities the agency deems appropriate, including prohibitions or restrictions on the growth of the institution, or affirmative action to restore such books and records to a complete and accurate state, or both, until completion of proceedings conducted under paragraph (1) of subsection (b) of this section. Such order shall become effective upon service, and unless set aside, limited, or suspended by a court in proceedings authorized by paragraph (2) of this subsection, shall remain effective and enforceable pending completion of the administrative proceeding initiated under such notice or until the Federal banking agency determines by examination or otherwise that the financial institution's books and records are accurate and capable of reflecting the financial condition of the financial institution.";

(8) in subsection (e), by striking paragraph (2) and amending paragraph (1) to read as follows:

"(1)(A) Whenever the appropriate Federal banking agency determines that any institution-related party, directly or indirectly, has violated any law, rule, regulation, or cease-and-desist order which has become final, or has engaged or participated in any unsafe or unsound practice in connection with

any insured financial institution or business institution, or has committed or engaged in any act, omission, or practice which constitutes a breach of fiduciary duty, and

"(B) such insured financial institution or business institution has suffered or will probably suffer financial loss or other damage, or the interests of its depositors have been or could be prejudiced by reason of such violation, practice, or breach, or the institution-related party has received financial gain by reason of such violation, practice, or breach, and

"(C) such violation, practice, or breach involves personal dishonesty on the part of such institution-related party or demonstrates willful or continuing disregard for the safety or soundness of such insured financial institution or business institution,

the agency may serve upon such institution-related party a written notice of its intention to remove such party from office or to prohibit the party's further participation in any manner in the conduct of the affairs of any insured financial institution.";

(9) in subsection (e), by redesignating paragraphs (3) through (6) as paragraphs (2) through (5), respectively, and by amending paragraph (3), as redesignated, to read as follows:

"(3) In respect to any institution-related party referred to in paragraph (1) or (2) of this subsection, the appropriate Federal banking agency may, if it deems it necessary for the protection of the financial institution or the interests of its depositors, by written order to such effect served upon such party, suspend such party from office or prohibit such party from further participation in any manner in the conduct of the affairs of the financial institution. Such suspension or prohibition shall become effective upon service of such order on the institution-related party and, unless stayed by a court in proceedings authorized by subsection (f) of this section, shall remain in effect pending the completion of the administrative proceedings pursuant to the notice served under paragraph (1) or (2) of this subsection and until such time as the agency shall dismiss the charges specified in such notice, or, if an order of removal or prohibition is issued against such party, until the effective date of any such order. Copies of any order issued pursuant to this paragraph shall also be served upon any financial institution where the party involved is presently associated.";

(10) after paragraph (5) of subsection (e), as redesignated, by inserting the following new paragraph:

"(6) Any person who is subject to a removal, suspension, or prohibition order pursuant to this subsection or subsection (g)

shall also be removed, suspended, or prohibited from participation in the conduct of the affairs of --

"(A) any insured financial institution,

"(B) any bank holding company or subsidiary of a bank holding company (as those terms are defined in the Bank Holding Company Act of 1956),

"(C) any organization organized and operated under section 25A of the Federal Reserve Act or operating under section 25 of the Federal Reserve Act,

"(D) any service corporation or subsidiary of a service corporation whether wholly or partly owned of any insured financial institution,

"(E) any savings and loan holding company or any subsidiary of a savings and loan holding company (as those terms are defined in the Home Owners' Loan Act),

"(F) any depository institution whose accounts are insured by the National Credit Union Share Insurance Fund, and

"(G) any institution chartered under the Farm Credit Act of 1971,

unless the party involved has received the prior written approval of the appropriate Federal regulatory agency to continue such affiliation or to continue participating in the affairs of such institution.";

(11) in subsection (f), by striking "(e)(4)" in subsection (f) and inserting "(e)(3)", and by striking "(e)(1), (e)(2), or (e)(3)" and inserting "(e)(1) or (e)(2)";

(12) in subsection (i), by redesignating paragraphs (1) and (2) as paragraphs (2) and (3), respectively, and by inserting after "(i)" the following new paragraph:

"(1) The jurisdiction and authority of the appropriate Federal banking agency to proceed under this section against any institution-related party shall not be affected by the resignation, termination of employment, or other separation of such person from an insured financial institution.";

(13) by amending redesignated subsection (i)(3)(i) by replacing the words "$1,000 per day for each day during which such violation continues" with the words "$25,000 for each day during which such violation continues. Notwithstanding the foregoing, for violations made with reckless disregard for the safety and soundness of the

financial institution, the Corporation may, in its discretion, assess a penalty of not more than $1,000,000 per day for each day during which such violation continues.";

(14) by adding paragraph (i)(4) as follows:

"(4)(A) Any insured financial institution and any institution-related party which has violated any law or regulation relating to financial institutions, or any condition imposed in writing by the appropriate Federal banking agency in connection with the grant of any application or other request by such insured bank, or has breached any fiduciary duty or engaged in any unsafe or unsound practice where such breach or practice has resulted in a loss to the financial institution or pecuniary gain to the institution-related party, shall pay a civil penalty of not more than $25,000 for each day during which such violation continues. Notwithstanding the foregoing, for violations made with reckless disregard for the safety and soundness of the financial institution, the Corporation may, in its discretion, assess a penalty of not more than $1,000,000 per day for each day during which such violation continues.

"(B) Any penalty imposed under subparagraph (A) shall be assessed, determined, reviewed, and collected

in the manner provided in paragraph (3) for any penalty imposed under such paragraph.

"(C)(i) The assessment of any penalty under subparagraph (A) with respect to any violation shall not preclude the appropriate Federal banking agency from issuing any order under subsection (b), (c), (e), (g), or (s) with respect to such violation, or taking any other action authorized by law with respect to such violation.

"(ii) No civil penalty may be imposed under subparagraph (A) for any violation for which a civil penalty is imposed under paragraph (3) or any other provision of law.";

(15) in (i)(2)(vi), by removing the period at the end thereof and by adding the words "and shall have the authority to promulgate regulations to define any term not otherwise defined in this section.";

(16) by amending subsection (j) to read as follows:

"(j) Penalty. -- Any institution-related party against whom there is any outstanding and effective order served upon such person under paragraph (3) or (4) of subsection (e) or under subsection (g) who, directly or indirectly, without the prior

written approval of the appropriate Federal regulatory agency

"(1) participates in any manner in the conduct of the affairs of any insured financial institution, any bank holding company or subsidiary of a bank holding company (as those terms are defined in the Bank Holding Company Act of 1956), any organization organized and operated under section 25A of the Federal Reserve Act or operating under section 25 of the Federal Reserve Act, any service corporation or subsidiary of a service corporation of any insured financial institution, any savings and loan holding company or subsidiary of a savings and loan holding company (as those terms are defined in the Home Owners' Loan Act), any depository institution whose accounts are insured by the National Credit Union Share Insurance Fund, or any institution chartered under the Farm Credit Act of 1971, from which he has been suspended, removed, or prohibited, or solicits or procures, or transfers or attempts to transfer, or votes or attempts to vote any proxies, consents, or authorization in respect to any voting rights in such institution; or

"(2) votes for a director, or serves or acts as a director, officer, employee, or agent, or otherwise participates in any manner in the conduct of the affairs of any insured institution, any bank holding company or subsidiary thereof or any other institution described in paragraph (1) of this subsection

shall be fined not more than $1,000,000 for each day the

violation continues or imprisoned for not more than five years, or both. Any order issued under subsection (e) of this section may prohibit any act that would violate this subsection.";

(17) by amending subsection (k) to read as follows:

"(k) Definitions. -- As used in this section:

"(1) The term 'appropriate Federal regulatory agency' means --

"(A) the appropriate Federal banking agency, as provided in subsection (q) of section 3 (12 U.S.C. 1813);

"(B) the National Credit Union Administration Board in the case of a depository institution whose accounts are insured by the National Credit Union Share Insurance Fund; and

"(C) the Farm Credit Administration in the case of an institution chartered under the Farm Credit Act of 1971.

"(2) The terms 'cease-and-desist order which has become final' and 'order which has become final' mean a cease-and-desist order or other order issued by the

appropriate Federal banking agency (i) with the consent of the financial institution or the institution-related party concerned; (ii) with respect to which no petition for review of the action of the agency has been filed and perfected in a court of appeals as specified in paragraph (2) of subsection (h) of this section; (iii) with respect to which the action of the court in which such a petition is so filed is not subject to further review by the Supreme Court of the United States in proceedings provided for in that paragraph; or (iv) under paragraph (1) or (3) of subsection (g) of this section.

"(3) The term "controlling shareholder" means a person that directly or indirectly, or acting through or in concert with one or more persons, owns or controls a financial institution. Shares owned or controlled by a member of an individual's immediate family are considered to be held by the individual. For the purpose of this paragraph, a "person" means an individual or a corporation, partnership, trust, association, joint venture, pool, syndicate, sole proprietorship, unincorporated organization, or any form of entity not specifically listed herein.

"(4) The term 'institution-related party' means a director, officer, employee, agent, independent contractor, controlling shareholder (other than a holding company), or other person participating in the conduct of the affairs of

an insured financial institution or a subsidiary of an insured financial institution, or any person who has filed or is required to file a change-in-control notice with the appropriate Federal banking agency under section 7(j).

"(5) The term 'violation' includes without limitation any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding or abetting a violation.";

(18) by adding at the end thereof the following new subsections:

"(t)(1) An appropriate Federal banking agency, within its discretion, after notification to the Attorney General, may pay a reward to a person who provides original information which leads directly to recovery which exceeds $50,000, of a criminal fine, restitution or civil penalty under this title or under section 215, 656, 657, 1005, 1006, 1007, 1014, 1344 or 3663 or a forfeiture under section 983 or 984 of title 18, United States Code, or of a penalty under this section.

"(2) An appropriate Federal banking agency may not pay a reward of more than 25 per cent of the amount of the fine, penalty, restitution, or forfeiture or $100,000, whichever is less.

"(3) An officer or employee of the United States, State or local government who provides information described in subsection (a), obtained in the performance of official duties, is not eligible for a reward under this section.

"(4) A reward decision, or decision not to give a reward, made pursuant to this section by the appropriate Federal banking agency is final and not reviewable by any court.

"(u)(1) No federally insured financial institution may discharge or otherwise discriminate against any employee with respect to compensation, terms, conditions or privileges of employment because the employee (or any person acting pursuant to the request of the employee) provided information to any financial institution regulatory authority or to the Department of Justice regarding a possible violation of any law or regulation by the financial institution or its officers, directors or employees.

"(2) Any employee or former employee who believes he has been discharged or discriminated against in violation of paragraph (1) may file a civil action in federal district court within two years from the date of such discharge or discrimination.

"(3) If the district court determines that a violation

of paragraph (1) has occurred, it shall order the financial institution who committed the violation to reinstate the employee to his former position together with compensatory damages and otherwise remedy any past discrimination.

"(4) The protections of this subsection do not apply to any employee who deliberately causes the alleged violation of law or regulation.

"(v) The Corporation, based on an examination of a savings association by the Corporation or by the Federal Home Loan Bank System, may recommend that the System take any enforcement action authorized under this section with respect to any savings association. If the System fails to take the recommended action or to provide an acceptable plan for addressing the concerns of the Corporation as set forth in its recommendation within 60 days of receipt of the formal recommendation from the Corporation, the Board of Directors may order the Corporation to take such action if the Board determines that the association is in an unsafe or unsound condition to continue as an insured financial institution or that failure to take the recommended action will result in continuance of unsafe or unsound practices in conducting the business of the savings association. Notwithstanding the above, the Board of Directors may order the Corporation to exercise its authority without regard to the time period set forth, in exigent circumstances upon notification of the System. The Corporation shall, by agreement with the System, set forth those exigent

circumstances in which the Corporation may act without regard to the time period set forth above.

"(w) The authority granted to the appropriate Federal banking agencies under this section shall be in addition to, and not be restricted by, any other authority provided by Federal or State law."

"(x) Any decision by the Board of Directors to:

(1) issue a notice of intention to terminate insured status;

(2) issue a temporary order terminating deposit insurance;

(3) issue a final order terminating deposit insurance; or

(4) initiate an enforcement action against an ongoing association pursuant to subsection (v)

shall be made by the Board of Directors and may not be delegated.".

(b) Section 19 of the Federal Deposit Insurance Act (12 U.S.C. 1829) is amended to read as follows:

"SEC. 1829. Penalty for participation.

"Except with the prior written consent of the Corporation, no person who has been convicted, or who is hereafter convicted, of any criminal offense involving dishonesty or a breach of trust shall act or serve as an institution-related party of an insured financial institution or shall participate in the conduct of the affairs of any insured financial institution. For each knowing violation of this section, the financial institution or the individual involved each shall be fined not more than $1,000,000 for each day such prohibition is violated or imprisoned for not more than five years, or both, and be subject to a civil penalty of not more than $1,000,000 for each day such prohibition is violated. The Corporation may recover the costs of assessment and collection of such penalty for its use.

SEC. 903. PARALLEL INCREASES IN CIVIL PENALTY PROVISIONS.

(a) Section 29(a) of the Federal Reserve Act (12 U.S.C. 504(a)) is amended by replacing the words "$1,000 per day for each day during which such violation continues" with the words "$25,000 for each day during which such violation continues. Notwithstanding the foregoing, for violations made with reckless disregard for the safety and soundness of the financial institution, the Corporation may, in its discretion, assess a penalty of not more than $1,000,000 per day for each day during

which such violation continues.".

(b) Section 8 of the Bank Holding Company Act of 1956 (12 U.S.C. 1847) is amended --

(1) by amending section 1847(a) to read as follows:

"Any company which willfully violates any provision of this chapter, or any regulation or order issued by the Board pursuant thereto shall be subject to a fine of $1,000,000 for each day during which such violation continues. Any individual who willfully participates in a violation of any provision of this chapter or any rule, regulation or order thereunder, shall be subject to a fine of not more than $1,000,000 for each day during which such violation continues or shall be imprisoned for not more than five years, or both."; and

(2) in section 1847(b)(1) --

(A) by replacing the first sentence with the following:

"Any company which or individual who willfully participates in a violation of any provision of this chapter, or any regulation or order issued pursuant thereto, shall pay a civil penalty of not more than $1,000,000 per day for each day during which such violation continues and

for all other violations shall pay a civil penalty of not more than $25,000 per day for each day during which such violation continues."; and

(B) by adding at the end thereof the following sentence: "Criminal and civil penalties under this section are cumulative.".

(c) Section 106(b)(2)(F)(i)) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1972(2)(F)(i)) is amended by replacing the words "$1,000 per day for each day during which such violation continues:" with the words "25,000 for each day during which such violation continues. Notwithstanding the foregoing, for violations made with reckless disregard for the safety and soundness of the financial institution, the agency having authority to impose a penalty may, in its discretion, assess a penalty of not more than $1,000,000 per day for each day during which such violation continues.".

(d) Section 5239 of the Revised Statutes (12 U.S.C. 93) is amended in subsection (b)(1) by replacing the words "$1,000 per day for each day during which such violation continues" with the words "$25,000 for each day during which such violation continues. Notwithstanding the foregoing, for violations made with reckless disregard for the safety and soundness of the financial institution, the Corporation may, in its discretion, assess a penalty of not more than $1,000,000 per day for each day

during which such violation continues.".

(e) Section 5240 of the Revised Statutes (12 U.S.C. 481) is amended by replacing the words "$100 for each day such refusal shall continue" with the words "not more than $25,000 for each day such refusal continues. Notwithstanding the foregoing, for violations made with reckless disregard for the safety and soundness of the bank, the Comptroller may, in his discretion, assess a penalty of not more than $1,000,000 for each day during which such refusal continues.".

SEC. 904. PENALTY FOR VIOLATION OF "CHANGE IN BANK CONTROL ACT".

Section 7(j)(16) of the Federal Deposit Insurance Act (12 U.S.C. 1817(j)(16)) is amended to read as follows:

"(16)(A) Any person who violates any provision of this subsection, or any regulation or order issued by the appropriate Federal banking agency pursuant thereto, shall pay a civil penalty of not more than $25,000 for each day during which such violation continues. Notwithstanding the foregoing, for violations made with reckless disregard for the safety and soundness of the financial institution, the agency having authority to impose a civil money penalty, in its discretion, may assess a penalty of not more than $1,000,000 per day for each day during which such violation continues. The agency having authority to impose a civil money penalty may, in its discretion,

compromise, modify, or remit any civil money penalty which is subject to imposition or has been imposed under such authority. The penalty may be assessed and collected by the appropriate Federal banking agency by written notice. As used in this paragraph, the term 'violates' includes without any limitation any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding or abetting a violation.

"(B) In determining the amount of the penalty, the appropriate Federal banking agency shall take into account the appropriateness of the penalty with respect to the size of financial resources and good faith of the person charged, the gravity of the violation, the history of previous violations, and such other matters as justice may require.

"(C) The person assessed shall be afforded an opportunity for an agency hearing upon request made within 10 days after receipt of the notice of assessment. In such hearing all issues shall be determined on the record pursuant to section 554 of title 5, United States Code. The agency determination shall be made by final order which may be reviewed only as provided in subparagraph (D). If no hearing is requested as herein provided, the assessment shall constitute a final and unappealable order.

"(D) Any financial institution or person against whom an order imposing a civil money penalty has been entered after an

agency hearing under this section may obtain review by the United States court of appeals for the circuit in which the home office of the insured financial institution is located, or the United States Court of Appeals for the District of Columbia Circuit, by filing a notice of appeal in such court within 20 days from the date of such order and simultaneously sending a copy of such notice by registered or certified mail to the appropriate Federal banking agency. The agency shall promptly certify and file in such court the record upon which the penalty was imposed, as provided in section 2112 of title 28, United States Code. The findings of the agency shall be set aside if found to be unsupported by substantial evidence as provided by section 706(2)(E) of title 5, United States Code.

"(E) If any person fails to pay an assessment after it has become a final and unappealable order, or after the court of appeals has entered final judgment in favor of the agency, the agency shall refer the matter to the Attorney General, who shall recover the amount assessed by action in the appropriate United States district court. In such action, the validity and appropriateness of the final order imposing the penalty shall not be subject to review.

"(F) All penalties collected under authority of this section shall be paid into the Treasury of the United States."

SEC. 905. REPORTS.

(a) Section 3 of the Bank Protection Act of 1968 (12 U.S.C. 1882) is amended by striking in the first sentence of subsection (b) the phrase "and shall require the submission of periodic reports with respect to the installation, maintenance, and operation of security devices and procedures".

(b) Section 5211 of the Revised Statutes (12 U.S.C. 161) is amended --

(1) by striking, in the fifth sentence of subsection (a), "within ten days after the receipt of a request thereof from him;" and inserting "within the period of time specified by him;";

(2) by striking "; penalties" in the heading of subsection (c); and

(3) by striking the last sentence of subsection (c).

(c) National Banks. -- Section 5213 of the Revised Statutes (12 U.S.C. 164) is amended by striking the first sentence and inserting the following:

"Every association which fails to make, obtain, transmit or publish any report or information required by the Comptroller under section 5211 of the Revised Statutes (12

U.S.C. 161) or which submits any false, misleading, or incomplete report or information shall be subject to a penalty for such failure, submission, or publication of not more than $25,000 for each day during which such failure continues or for each day from the time of submission or publication until such false, misleading, or incomplete report or information is corrected. Notwithstanding the foregoing, for violations made with reckless disregard for the safety and soundness of the financial institution, the Comptroller may, in his discretion, assess a penalty of not more than $1,000,000 per day for each day during which such failure continues or for each day from the time of submission or publication until such false, misleading, or incomplete report or information is corrected.".

(d) State Nonmember Banks.--Section 7(a)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1817(a)(1)) is amended by striking the last sentence and inserting the following:

"Every such bank which fails to make or publish any such report within the period of time specified by the Corporation or which submits or publishes any false, misleading, or incomplete report or information shall be subject to a penalty for such failure, submission, or publication of not more than $25,000 for each day during which such failure continues or for each day from the time of submission or publication until such false, misleading, or incomplete report or information is corrected.

Notwithstanding the foregoing, for such failure, submission or publication resulting from reckless disregard for the safety and soundness of the institution, such bank shall be subject to a penalty of not more than $1,000,000 for each day during which such failure continues or for each day from the time of submission or publication until such false, misleading, or incomplete information is corrected. Such penalty may be collected by the Corporation by suit or otherwise and the costs of assessment and collection for such penalty retained by the Corporation for its own use.".

(e) Section 9 of the Federal Reserve Act (12 U.S.C. 324) is amended by striking the fourth sentence and inserting "Every bank which fails to make such reports within the period of time specified by the Board of Governors of the Federal Reserve System or which submits or publishes any false, misleading, or incomplete report or information shall be subject to a penalty for such failure, submission, or publication of not more than $25,000 for each day during which such failure continues or for each day from the time of submission or publication until such false, misleading, or incomplete report or information is corrected. Notwithstanding the foregoing, for such failure, submission or publication resulting from reckless disregard for the safety and soundness of the bank, such bank shall be subject to a penalty of not more than $1,000,000 for each day during which such failure continues or for each day from the time of submission or publication until such false, misleading or

incomplete information is corrected, and for all other such failures, submissions, or publications a penalty shall be assessed and collected in the same manner as prescribed by section 8(i)(3) of the Federal Deposit Insurance Act.".

(f) Section 8(b) of the Bank Holding Company Act of 1956 (12 U.S.C. 1847(b)) is amended --

(1) by redesignating subsection (b)(1) as subsection (b) and redesignating sections (b)(2) through (6) as sections (d)(1) through (5); and

(2) by adding a new subsection (c) as follows: "Any company which fails to make such reports as are required by this chapter or any regulation or order issued pursuant thereto within the period of time specified by the Board or which submits or publishes any false, misleading or incomplete report or information shall pay a civil penalty of not more than $25,000 for each day during which such failure continues or for each day from the time of submission or publication until such false, misleading, or incomplete report or information is corrected. Notwithstanding the foregoing, for such failure, submission or publication made with reckless disregard, the company shall be subject to a penalty of not more than $1,000,000 for each day during which such failure continues or from each day from the time of submission or publication until such false or misleading report or submission is corrected.

SUBTITLE B -- REGULATION BY THE FEDERAL HOME LOAN BANK SYSTEM

SEC. 906. EXAMINATION AUTHORITY.

Section (5)(d)(1) of the Home Owners' Loan Act of 1933 (12 U.S.C. 1464(d)) is redesignated as (5)(d)(1)(A) and section 407(m) of the National Housing Act (12 U.S.C. 1730(m)) is redesignated as section 5(d)(1)(B) of the Home Owners' Loan Act of 1933 and is further amended by substituting the term "savings association" or "savings associations" for the terms "institution" and "insured institutions", by deleting the phrase "on behalf of the Corporation" and by substituting the term "System" for "Corporation" everywhere it appears and a new subparagraph (5)(d)(1)(C) is added as follows:

"(C) References in this subsection to savings account holders and to members of associations shall be deemed to be references to holders of withdrawable accounts in institutions over which the System has any statutory power of examination or supervision as provided in this paragraph, and references therein to boards of directors of associations shall be deemed to be references to boards of directors or other governing boards of such institutions. The System shall have power by regulation to define, for the purposes of this paragraph, terms used or referred to in the preceding sentence and other terms used in this subsection.".

SEC. 907. REPORTS OF CONDITION AND PENALTIES.

Section 5 of the Home Owners' Loan Act of 1933 (12 U.S.C. 1464) is amended by inserting after new subsection (t) the following new subsection:

"(u)(1) Each association shall make reports of condition to the System which shall be in such form and shall contain such information as the System may require.

"(2) The System may require reports of condition to be published in such manner as the System may direct.

"(3) Any association which fails to submit or publish any report or information required by the System under paragraph (1) or (2) within the period of time specified by the System, or submits or publishes any false, misleading or incomplete report or information shall be subject to a penalty for such failure, submission or publication of not more than $25,000 for each day during which such failure continues, or for each day from the time of submission or publication until such false, misleading, or incomplete report or information is corrected. Notwithstanding the foregoing, for violations resulting from reckless disregard for the safety and soundness of an association, the system may, in its discretion, assess a penalty of not more than $1,000,000 for each day during which such failure continues

or for each day from the time of submission or publication until such false or misleading report or information is corrected.

"(4) Any penalty imposed under paragraph (3) shall be assessed, and collected by the System in the manner provided in section 8(i) of the Federal Deposit Insurance Act (12 U.S.C. 1818(i)) and any such assessment (including the determination of the amount of the penalty) shall be subject to the provisions of such section.

"(5) The Federal Deposit Insurance Corporation shall have access to reports of condition made to the System pursuant to paragraph (1) and any revision made to any such report.".

SEC. 908. SAVINGS AND LOAN HOLDING COMPANIES.

(a) Redesignated sections 10(j)(1) and (2) of the Home Owners' Loan Act (formerly 12 U.S.C. 1730a(j)(1) and (2)) are amended to read as follows:

"(j)(1) Any company which willfully violates any provision of this section, or any regulation or order issued by the System pursuant thereto shall be subject to a fine of $1,000,000 for each day during which such violation continues. Any individual who willfully participates in a violation of any provision of this

section or any rule, regulation or order thereunder, shall be subject to a fine of not more than $1,000,000 for each day during which such violation continues or shall be imprisoned for not more than five years, or both."; and

"(2) Any company which or individual who willfully participates in a violation of any provision of this section, or any regulation or order issued pursuant thereto, shall pay a civil penalty of not more than $1,000,000 per day for each day during which such violation continues and for all other violations, shall pay a civil penalty of not more than $25,000 per day for each day during which such violation continues.".

"(b) Section 5 of the Home Owners' Loan Act of 1933 (12 U.S.C. 1464) is amended by inserting after new subsection (u) the following new subsection:

"(v) Any savings and loan holding company, and any subsidiary of such holding company, which fails to submit or publish any report or information required under section 5 of the National Home Owners' Loan Act or regulations prescribed by the System within the period of time specified by the System, or submits or publishes any false, misleading or incomplete report or information shall be subject to a penalty for such

failure, submission or publication, or false, misleading or incomplete submission of not more than $25,000 for each day during which such failure continues or for each day from the time of submission or publication until such false, misleading, or incomplete report or information is corrected. Notwithstanding the foregoing, for violations resulting from reckless disregard for the safety and soundness of the association, of not more than $1,000,000 for each day during which such failure continues or for each day from the time of submission or publication until such false or misleading, or incomplete report or information is corrected;

"(2) Any penalty imposed under paragraph (1) shall be assessed and collected by the System in the manner provided in section 8(i) of the Federal Deposit Insurance Act (12 U.S.C. 1818(i)) and any such assessment (including the determination of the amount of the penalty) shall be subject to the provisions of such section.".

SEC. 909. CONTINUITY OF AUTHORITY FOR ONGOING LITIGATION.

All ongoing litigation in which the Federal Home Loan Bank Board or the Federal Savings and Loan Insurance Corporation are named parties, shall be pursued after the effective date of this Act by

the Federal Home Loan Bank System or the Federal Deposit Insurance Corporation, as appropriate under this Act.

SEC. 910. TEMPORARY EXTENSION OF AUTHORITY.

Any administrative hearing or proceeding initiated prior to the effective date of this Act or any order issued, agreement entered, condition imposed, memorandum of understanding entered, penalty assessed or capital directive issued pursuant to those provisions in section 5(d) of the Federal Home Owners' Loan Act (12 U.S.C. 1464(d)), repealed by section 307 of this Act, or pursuant to section 407(e) through (h), (k) or (p) of the National Housing Act (12 U.S.C. 1730) shall be continued by the Federal Home Loan Bank System as if those provisions remained in effect.

SUBTITLE C -- CREDIT UNIONS

SEC. 911. AMENDMENTS TO SECTION 206.

Section 206 of the Federal Credit Union Act (12 U.S.C. 1786) is amended --

(1) by striking the following phrases:

(A) "director, officer, committee member, employee, agent, or other person participating in the conduct of

the affairs of such a credit union";

(B) "director, officer, committee member, employee, agent, or other person";

(C) "director, officer, committee member, or employee";

(D) "director, officer, or committee member";

(E) "director, committee member, or officer";

(F) "director, committee member, officer, or other person";

(G) "officer, director, committee member, employee, agent, or other person participating in the conduct of the affairs of such a credit union";

(H) "officer, director, committee member, employee, agent, or other person participating in the conduct of the affairs of such credit union";

(I) "director, committee member, or officer or other person";

(J) "director, officer, committee member, or other

person"; and

(K) "director, committee member, or officer of an insured credit union, or other person participating in the conduct of the affairs of such credit union";

each place they appear and inserting "institution-related party";

(2) in section (b)(1) by replacing the words "one hundred and twenty days" with the words "sixty days";

(3) in section (c), by replacing the words "one year" with the words "a minimun of six months up to two years";

(4) at the end of section (e)(1) by striking the period and inserting the following: "including, without limitation, reimbursement, restitution, indemnification, rescission, the disposal of loans or assets, prohibitions or restrictions on growth of the institution, guarantees against loss, or other action the Board deems appropriate. Such order may place limitations on the activities or functions of the credit union or any institution-related party necessary to correct the conditions resulting from any such violation or practice.";

(5) after the first sentence of paragraph (1) of

subsection (f), by inserting the following sentence: "Such order may place limitations on the activities or functions of the credit union or any institution-related party.";

(6) in subsection (f), by redesignating paragraphs (2) and (3) as paragraphs (3) and (4), respectively, and by inserting after paragraph (1) the following new paragraph:

"(2) Whenever a notice of charges specifies that any insured credit union's books and records are so incomplete or inaccurate that the Board is unable with reasonable effort to determine the financial condition of that credit union or the details or purpose of any transactions that may have a substantial effect on the financial condition of that credit union, the Board may issue a temporary order requiring cessation of any activities the Board deems appropriate, including prohibitions or restrictions on the growth of the institution, or affirmative action to restore such books and records to a complete and accurate state, or both, until completion of proceedings conducted under paragraph (1) of subsection (e) of this section. Such order shall become effective upon service, and, unless set aside, limited, or suspended by a court in proceedings authorized by paragraph (3) of this subsection, shall remain effective and enforceable pending completion of the administrative proceeding initiated under such notice or until the Board determines by examination or otherwise that the credit union's books and records are accurate and capable of reflecting the financial condition of the credit

union.";

(7) by striking paragraph (2) and amending paragraph (1) of subsection (g), to read as follows:

"(1) Whenever the Board determines that --

"(A) any institution-related party, directly or indirectly, has violated any law, rule, regulation, or cease-and-desist order which has become final, or has engaged or participated in any unsafe or unsound practice in connection with any insured credit union or other business institution, or has committed or engaged in any act, omission, or practice which constitutes a breach of fiduciary duty, or by conduct or practice has evidenced such party's personal dishonesty or unfitness to continue as an institution-related party; and

"(B) such insured credit union or other business institution has suffered or will probably suffer financial loss or other damage, or the interests of its insured members have been or could be prejudiced by reason of such violation, practice, or breach, or the institution-related party has received financial gain by reason of such violation, practice, or breach

the Board may serve upon such institution-related party a written

notice of its intention to remove such party from office or to prohibit such party's further participation in any manner in the conduct of the affairs of any insured credit union."

(8) in subsection (g), by striking subparagraph (7) and by redesignating paragraphs (3) through (6) of subsection (g) as paragraphs (2) through (5), respectively, and by amending paragraph (3) (as so redesignated) to read as follows:

"(3) In respect to any institution-related party referred to in paragraph (1) or (2) of this subsection, the Board may, if it deems necessary for the protection of the credit union or the interests of its members, by written order to such effect served upon such party, suspend that party from office or prohibit that party from further participation in any manner in the conduct of the affairs of the credit union. Such suspension or prohibition shall become effective upon service of such order on the institution-related party and, unless stayed by a court in proceedings authorized by paragraph (5) of this subsection, shall remain in effect pending the completion of the administrative proceedings pursuant to the notice served under paragraphs (1) and (2) of this subsection and until such time as the Board shall dismiss the charges specified in such notice, or, if an order of removal or prohibition is issued against such party, until the effective date of any such order. Copies of any order issued pursuant to this paragraph also shall be served upon any

institution where the party involved is presently associated.";

(9) in subsection (g)(5), as redesignated, by striking "(4)" and inserting "(3)", and by striking "(1), (2), or (3)" and inserting "(1) or (2)";

(10) in subsection (k)(2)(A), by replacing the words "$1,000 per day during which such violation continues" with the words "$25,000 for each day such violation continues. Notwithstanding the foregoing for violations made with reckless disregard for the safety and soundness of the institution, the Board, in its discretion may assess a penalty of not more than $1,000,000 per day for each day such violation continues.";

(11) by adding the following new subparagraphs (3) and (4) to subsection (k):

"(3)(A) Any insured credit union which, and any director or officer of such credit union or other person participating in the conduct of the affairs of such credit union who, has violated any law or regulation on which no civil penalty has been assessed under any other provision of law, or any condition imposed in writing by the Board in connection with the grant of any application or other request by such credit union, or has breached any fiduciary duty or engaged in any unsafe or unsound practice, where

such breach or practice has lead to a loss to the credit union or pecuniary gain to the institution-related party, shall pay a civil penalty of not more than $25,000 for each day such violation continues. Notwithstanding the foregoing, for violations made with reckless disregard for the safety and soundness of the institution, the Board, in its discretion, may assess a penalty of not more than $1,000,000 per day for each day such violation continues.

"(B) Any penalty imposed under subparagraph (A) shall be assessed, determined, reviewed, and collected in the manner provided in paragraph (2) for any penalty imposed under such paragraph.

"(C)(i) The assessment of any penalty under subparagraph (A) with respect to any violation shall not preclude the appropriate Federal banking agency from --

"(I) issuing any order under subsection (e), (f), or (g) with respect to such violation; or

"(II) taking any other action authorized by any such subsection with respect to such violation.

"(ii) No civil penalty may be imposed under subparagraph (A) for any violation for which a civil penalty is imposed under paragraph (2) or other provision of law.

"(4) The jurisdiction and authority of the Board to proceed under this section against any institution-related party shall not be affected by the resignation, termination of employment, or other separation of such person from an insured credit union.";

(12) in the first sentence of paragraph (3)(A) of subsection (k), by inserting after "this section" the following: "or any condition imposed in writing by the Board in connection with the granting of any application or other request by the credit union", and by striking "subsection (e), (f), or (q)" and inserting "subsection (e), (f), or (p)";

(13) by amending subsection (l) to read as follows:

"(l) Any person against whom there is outstanding and effective any order served upon such person under paragraph (3) or (4) of subsection (g) or under subsection (i) who, directly or indirectly, without the prior written approval of the Board participates in any manner in the conduct of the affairs of --

"(A) any insured institution,

"(B) any bank holding company or subsidiary of a bank holding company (as those terms are defined in the Bank

Holding Company Act of 1956),

"(C) any organization organized and operated under section 25A of the Federal Reserve Act or operating under section 25 of the Federal Reserve Act,

"(D) any savings and loan holding company or subsidiary of a savings and loan holding company, or

"(E)(1) any institution chartered under the Farm Credit Act of 1971,

from which such person has been suspended, removed, or prohibited, or solicits or procures, or transfers or attempts to transfer, or votes or attempts to vote any proxies, consents, or authorization in respect to any voting rights in such institution; or

"(2) votes for a director, or serves or acts as a director, officer, committee member, employee, or agent, or otherwise participates in any manner in the conduct of the affairs of any insured institution, any bank holding company or subsidiary thereof, or any other institution described in paragraph (1) of this subsection,

shall be fined not more than $1,000,000 or imprisoned for not more than five years, or both. Any order issued under

subsection (g) of this section may prohibit any act that would violate this subsection.";

(14) by striking subsection (m) and redesignating subsections (n), (o), (p), and (q) of this section as subsections (m), (n), (o), and (p), respectively; and

(15) by adding at the end thereof the following new paragraphs, (q), (r), (s), and (t):

"(q) (A) The Board, within its discretion, after notification of the Attorney General may pay a reward to a person who provides original information which directly leads to recovery of a criminal fine or restitution or civil penalty under this title, or under section 215, 656, 657, 1005, 1006, 1007, 1014, 1344 or 3663 or of a forfeiture under section 983 or 984 of title 18, United States Code, or penalty under this section, which exceeds $50,000.

"(B) The Board may not pay more than 25 per cent of the amount of the fine, penalty or forfeiture or $100,000, whichever is less.

"(C) An officer or employee of the United States, State, or local government who provides information described in paragraph (A), obtained in the performance

of official duties, is not eligible for a reward under this section.

"(D) A reward decision or decision not to make a reward made pursuant to this section by the Board is final and not reviewable by any court.

"(r)(1) No federally insured credit union may discharge or otherwise discriminate against any employee with respect to compensation, terms, conditions or privileges of employment because the employee (or any person acting pursuant to the request of the employee) provided information to any financial institution regulatory authority or to the Department of Justice regarding a possible violation of any law or regulation by the financial institution or its officers, directors or employees.

"(2) Any employee or former employee who believes he has been discharged or discriminated against in violation of paragraph (1) may file a complaint in federal district court within two years from the date of such discharge or discrimination.

"(3) If the district court determines that a violation of paragraph (1) has occurred, it shall order the financial institution who committed the violation to

reinstate the employee to his former position together with compensatory damages and otherwise remedy any past discrimination.

"(4) The protections of this subsection do not apply to an employee who deliberately caused the alleged violation of law or regulation.

"(s) Definitions. -- As used in this section:

"(1) The term 'appropriate Federal regulatory agency' has the same meaning as in section 8(k) of the Federal Deposit Insurance Act.

"(2) The terms 'cease-and-desist order which has become final' and 'order which has become final' mean a cease-and-desist order or other order issued by the Board (A) with the consent of the credit union or the institution-related party concerned; (B) with respect to which no petition for review of the action of the agency has been filed and perfected in a court of appeals as specified in paragraph (2) of subsection (j) of this section; (C) with respect to which the action of the court in which such a petition is so filed is not subject to further review by the Supreme Court of the United States in proceedings provided for in that paragraph; or (D) under paragraphs (1) or (3) of

subsection (i) of this section.

"(3) The term 'institution-related party' means a director, officer, committee member, employee, agent, independent contractor, or other person participating in the conduct of the affairs of an insured credit union.

"(4) The term 'insured institution' means an insured credit union, as defined in section 101, or a depository institution whose accounts are insured by the Federal Deposit Insurance Corporation.

"(5) The term 'violation' includes without limitation any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding or abetting a violation.

"(t) The authority granted to the Board under this section shall be in addition to, and not restricted by, any other authority provided by Federal or State law.".

SEC. 912. AMENDMENTS TO SECTION 205.

Section 205 of the Federal Credit Union Act (12 U.S.C. 1785) is amended --

(1) in the first sentence of subsection (d), by inserting after the phrase "insured credit union", the

phrase "or shall participate in the conduct of the affairs of such insured credit union";

(2) by striking the second sentence of subsection (d) and inserting "For each violation of this subsection, the credit union or the individual involved shall pay a civil penalty of not more than $25,000 for each day such violation continues. Notwithstanding the foregoing, for violations made with reckless disregard for the safety and soundness of the institution, the Board, in its discretion may assess a penalty of not more than $1,000,000 per day for each day such violation continues. The Board may recover the costs of penalty assessment and collection for its use."; and

(3) in the first sentence of paragraph (2) of subsection (e), by inserting a period after the word "standards" and striking the phrase "and shall require the submission of periodic reports with respect to the installation, maintenance, and operation of security devices and procedures".

SEC. 913. AMENDMENTS TO SECTION 202.

Section 202(a)(3) of the Federal Credit Union Act (12 U.S.C. 1782(a)(3)) is amended by striking out the second sentence and inserting in lieu thereof the following new sentences: "Any insured credit union which --

"(A) fails to submit or publish any report required under this subsection or section 106 within the period of time specified by the Board; or

"(B) submits or publishes any false, misleading, or incomplete report or information shall be subject to a penalty for such failure, submission, or publication or false, misleading, or incomplete submission of not more than $25,000 for each day during which such failure continues or for each day from the time of submission or publication until such false, misleading, or incomplete report or information is corrected. Notwithstanding the foregoing, for violations made with reckless disregard for the safety and soundness of a credit union, the Board, in its discretion, may assess a penalty of not more than $1,000,000 for each day during which such failure continues or for each day from the time of submission or publication until such false, misleading, or incomplete report or information is corrected. Any penalty imposed by the preceeding sentence shall be assessed and collected by the Board in the manner provided in section 206(k)(2) (for penalties imposed under such section), and any such assessment (including the determination of the amount of the penalty) shall be subject to the provisions of such section.".

SUBTITLE D -- RIGHT TO FINANCIAL PRIVACY ACT

SEC. 914. AMENDMENTS TO RIGHT TO FINANCIAL PRIVACY ACT.

(a) Section 1101 of the Right to Financial Privacy Act of 1978 (Title XI of Public Law 95-630, 12 U.S.C. 3401) is amended--

(1) by redesignating paragraphs (6) and (7) as paragraphs (7) and (8), respectively; and

(2) by deleting in paragraph (7), as redesignated, all before subparagraph (A) and inserting in lieu thereof:

"(7) 'supervisory agency' means with respect to any particular financial institution, holding company or any subsidiary of a financial institution or holding company, any of the following which has statutory authority to examine the financial condition, business operations or records or transactions of that institution, holding company or subsidiary --"; and

(3) by inserting after paragraph (5) the following new paragraph (6) to read as follows:

"(6) 'Holding company' means any 'bank holding company' as defined in section 2 and any company described in section 3(f)(1) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841), or any

'savings and loan holding company' as defined in the National Home Owners' Loan Act.".

(b) Section 1113 of the Right of Financial Privacy Act of 1978 (Title XI of Public Law 95-630, 12 U.S.C. 3413(b)) is amended--

(1) by amending subsection (b) to read as follows:

"(b) Nothing in this chapter applies to the examination by or disclosure to any supervisory agency of financial records or information in the exercise of its supervisory regulatory or monetary functions, including conservatorship or receivership functions, with respect to any financial institution, holding company or any subsidiary of a financial institution or holding company or any officer, director, employee, agent or other person participating in the affairs thereof."; and

(2) by adding new paragraphs (m) and (n) as follows:

"(m) Nothing in this title shall apply to the examination by or disclosure to employees or agents of the Board of Governors of the Federal Reserve System or any Federal Reserve Bank of financial

records or information in the exercise of the Federal Reserve System's authority to extend credit to depository institutions or others.

"(n) Nothing in this title shall apply to the examination by or disclosure to the Resolution Trust Corporation or its employees or agents of financial records or information in the exercise of its conservatorship, receivership or liquidation functions with respect to a financial institution.".

(c) Section 3420 of the Right to Financial Privacy Act of 1978 (12 U.S.C. 3420) is amended by adding at the end thereof the following: "A financial institution on which a grand jury subpoena has been served, relating to a possible violation of sections 215, 656, 657, 1005, 1006, 1007, 1008, 1014, or 1344 of title 18, United States Code, shall not notify the customer whose records are sought or any other party about the existence or contents of the subpoena or information that has been furnished to the grand jury in response to that subpoena. Any person who violates the requirement of the preceding sentence shall be punished as provided in section 1510(b) of title 18, United States Code.".

SUBTITLE E -- CRIMINAL ENHANCEMENTS

SEC. 915. INCREASED CRIMINAL PENALTIES AND CIVIL PENALTIES FOR CERTAIN FINANCIAL INSTITUTION OFFENSES.

(a) Section 215, title 18, United States Code, is amended --

(1) by replacing "$5,000" with "$1,000,000" and the word "five" with the word "twenty" in subsection 215(a) and removing the period at the end thereof and adding the following:

"and shall be subject to a civil penalty of $1,000,000 or the amount of the thing given, offered, promised, solicited, demanded, accepted or agreed to be accepted, whichever is greater. Civil and criminal penalties under this section are cumulative." and

(2) in subsection 215(b)--

(A) by replacing the words "a bank" in subsection (b)(1) with the words "an institution"; and

(B) by removing subsections (b)(2) and (b)(8) and by redesignating subsections (b)(3), (4), (5), (6), and (7) subsections (b)(2), (3), (4), (5), and (6); and

(3) by adding new subsections (e) and (f) as follows:

"(e) The Attorney General may bring a civil action against any person who violates the provisions of the preceding section. The suit may be brought in any district court of the United States or the United States courts of any territory in which the defendant or, in the case of multiple defendants, any one defendant resides, is doing business, may be found, or in which any proscribed act was committed. A subpoena requiring the attendance of a witness at trial or hearing conducted under this provision may be served at any place in the United States. The court in which such action is brought shall determine the existence of a violation upon a preponderance of the evidence, shall assess the civil penalty, and shall have power to grant such other relief, including injunctions, as may be appropriate. Such remedies shall be in addition to any other remedy available under statutory or common law.

"(f)(1) For the purpose of any civil investigation or proceeding under this chapter, the Attorney General or any officer designated by him is empowered to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, or other records which the Attorney General deems relevant or material to the inquiry. Such attendance of witnesses and the production of any such

records may be required from any place in the United States or any State at any designated place of hearing.

"(2) In case of contumacy by, or refusal to obey a subpoena issued to, any person, the Attorney General may invoke the aid of any court of the United States within the jurisdiction of which such investigation or proceeding is carried on, or where such person resides or carries on business, in requiring the attendance and testimony of witnesses and the production of books, papers, correspondence, memoranda, and other records. And such court may issue an order requiring such person to appear before the Attorney General or officer designated by the Attorney General to produce records, if so ordered, or to give testimony touching upon the matter under civil investigation or in question. Any failure to obey such order of the court may be punished by such court as a contempt thereof. All process in any such case may be served in the judicial district where such person is an inhabitant or wherever he may be found. Any person who shall, without just cause, fail or refuse to attend and testify or to answer any lawful inquiry or to produce books, papers, correspondence, memoranda, and other records, if in his power so to do, in obedience to the subpoena of the Attorney General shall be guilty of a misdemeanor and, upon conviction, shall be subject to a fine of not more than $1,000 or to

imprisonment for a term of not more than one year, or both.".

(b) Section 656, title 18, United States Code, is amended --

(1) by replacing "$5,000" with the words "$1,000,000 or twice the amount authorized by section 3571(d) of this title, whichever is greater," and the word "five" with the word "twenty";

(2) by removing the period at the end of the first paragraph and adding the following:

"and shall be subject to a civil penalty of $1,000,000 for each day the violation continues or the amount embezzled, abstracted, purloined or willfully misapplied and any pecuniary gain attributable to that amount, or $5,000,000, whichever is greater. Civil and criminal penalties and restitution under this section are cumulative."; and

(3) by redesignating current section 656 as 656(a) and by adding new subsections (b) and (c) as follows:

"(b) The Attorney General may bring a civil action against any person who violates the provisions of the preceding section. The suit may be brought in any

district court of the United States or the United States courts of any territory in which the defendant or, in the case of multiple defendants, any one defendant resides, is doing business, may be found, or in which any proscribed act was committed. A subpoena requiring the attendance of a witness at trial or hearing conducted under this provision may be served at any place in the United States. The court in which such action is brought shall determine the existence of a violation upon a preponderance of the evidence,shall assess the civil penalty, and shall have power to grant such other relief, including injunctions, as may be appropriate. Such remedies shall be in addition to any other remedy available under statutory or common law."

"(c)(1) For the purpose of any civil investigation or proceeding under this chapter, the Attorney General or any officer designated by him is empowered to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, or other records which the Attorney General deems relevant or material to the inquiry. Such attendance of witnesses and the production of any such records may be required from any place in the United States or any State at any designated place of hearing.

"(2) In case of contumacy by, or refusal to obey a subpoena issued to, any person, the Attorney General may invoke the aid of any court of the United States within the jurisdiction of which such investigation or proceeding is carried on, or where such person resides or carries on business, in requiring the attendance and testimony of witnesses and the production of books, papers, correspondence, memoranda, and other records. And such court may issue an order requiring such person to appear before the Attorney General or officer designated by the Attorney General to produce records, if so ordered, or to give testimony touching upon the matter under civil investigation or in question. Any failure to obey such order of the court may be punished by such court as a contempt thereof. All process in any such case may be served in the judicial district where such person is an inhabitant or wherever he may be found. Any person who shall, without just cause, fail or refuse to attend and testify or to answer any lawful inquiry or to produce books, papers, correspondence, memoranda, and other records, if in his power so to do, in obedience to the subpoena of the Attorney General shall be guilty of a misdemeanor and, upon conviction, shall be subject to a fine of not more than $1,000 or to imprisonment for a term of not more than one year, or both.".

(c) Section 657, title 18, United States Code, is amended --

(1) by replacing "$5,000" with the words "$1,000,000 or twice the amount authorized by section 3571(d) of this title, whichever is greater, and any pecuniary gain attributable to that amount," and the word "five" with the word "twenty";

(2) by removing the period at the end of the section and adding the following:

"and shall be subject to a civil penalty of $1,000,000 for each day the violation continues or the amount embezzled, abstracted, purloined or willfully misapplied and any pecuniary gain attributable to that amount, or $5,000,000, whichever is greater. Civil and criminal penalties and restitution under this section are cumulative."; and

(3) by redesignating current section 657 as 657(a) and by adding new subsections (b) and (c) as follows:

"(b) The Attorney General may bring a civil action against any person who violates the provisions of the preceding section. The suit may be brought in any district court of the United States or the United States courts of any territory in which the defendant or, in

the case of multiple defendants, any one defendant resides, is doing business, may be found, or in which any proscribed act was committed. A subpoena requiring the attendance of a witness at trial or hearing conducted under this provision may be served at any place in the United States. The court in which such action is brought shall determine the existence of a violation upon a preponderance of the evidence,shall assess the civil penalty, and shall have power to grant such other relief, including injunctions, as may be appropriate. Such remedies shall be in addition to any other remedy available under statutory or common law."

"(c)(1) For the purpose of any civil investigation or proceeding under this chapter, the Attorney General or any officer designated by him is empowered to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, or other records which the Attorney General deems relevant or material to the inquiry. Such attendance of witnesses and the production of any such records may be required from any place in the United States or any State at any designated place of hearing.

"(2) In case of contumacy by, or refusal to obey a subpoena issued to, any person, the Attorney General may

invoke the aid of any court of the United States within the jurisdiction of which such investigation or proceeding is carried on, or where such person resides or carries on business, in requiring the attendance and testimony of witnesses and the production of books, papers, correspondence, memoranda, and other records. And such court may issue an order requiring such person to appear before the Attorney General or officer designated by the Attorney General to produce records, if so ordered, or to give testimony touching upon the matter under civil investigation or in question. And any failure to obey such order of the court may be punished by such court as a contempt thereof. All process in any such case may be served in the judicial district whereof such person is an inhabitant or wherever he may be found. Any person who shall, without just cause, fail or refuse to attend and testify or to answer any lawful inquiry or to produce books, papers, correspondence, memoranda, and other records, if in his power so to do, in obedience to the subpoena of the Attorney General shall be guilty of a misdemeanor and, upon conviction, shall be subject to a fine of not more than $1,000 or to imprisonment for a term of not more than one year, or both.".

(d) Section 1005, title 18, United States Code, is amended --

(1) by adding the words "bank or savings and loan holding company," after the words "member bank," in the third clause thereof;

(2) by replacing the "--" at the end of the third clause following the words "Federal Reserve System" with a semicolon and adding a fourth clause immediately thereafter as follows:

"Whoever with intent to defraud the United States or any agency thereof, or any financial institution referred to in this section, participates or shares in or receives directly or indirectly any money, profit, property, or benefits through any transaction, loan, commission, contract, or any other act of any such financial institution".

(3) by replacing "$5,000" with the words "$1,000,000 or twice the amount authorized by section 3571(d) of this title, whichever is greater" and the word "five" with the word "twenty";

(4) by removing the period at the end of the first paragraph and by adding the following:

"and shall be subject to a civil penalty of $1,000,000 for each day the violation continues or the amount of

any pecuniary gain attributable to the proscribed actions, or $5,000,000, whichever is greater. Civil and criminal penalties and restitution under this section are cumulative."; and

(5) by redesignating current section 1005 as 1005(a) and by adding new subsections (b) and (c) as follows:

"(b) The Attorney General may bring a civil action against any person who violates the provisions of the preceding section. The suit may be brought in any district court of the United States or the United States courts of any territory in which the defendant or, in the case of multiple defendants, any one defendant resides, is doing business, may be found, or in which any proscribed act was committed. A subpoena requiring the attendance of a witness at trial or hearing conducted under this provision may be served at any place in the United States. The court in which such action is brought shall determine the existence of a violation upon a preponderance of the evidence,shall assess the civil penalty, and shall have power to grant such other relief, including injunctions, as may be appropriate. Such remedies shall be in addition to any other remedy available under statutory or common law."

"(c)(1) For the purpose of any civil investigation

or proceeding under this chapter, the Attorney General or any officer designated by him is empowered to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, or other records which the Attorney General deems relevant or material to the inquiry. Such attendance of witnesses and the production of any such records may be required from any place in the United States or any State at any designated place of hearing.

"(2) In case of contumacy by, or refusal to obey a subpoena issued to, any person, the Attorney General may invoke the aid of any court of the United States within the jurisdiction of which such investigation or proceeding is carried on, or where such person resides or carries on business, in requiring the attendance and testimony of witnesses and the production of books, papers, correspondence, memoranda, and other records. And such court may issue an order requiring such person to appear before the Attorney General or officer designated by the Attorney General to produce records, if so ordered, or to give testimony touching upon the matter under civil investigation or in question. And any failure to obey such order of the court may be punished by such court as a contempt thereof. All process in any such case may be served in the judicial

district where such person is an inhabitant or wherever he may be found. Any person who shall, without just cause, fail or refuse to attend and testify or to answer any lawful inquiry or to produce books, papers, correspondence, memoranda, and other records, if in his power so to do, in obedience to the subpoena of the Attorney General shall be guilty of a misdemeanor and, upon conviction, shall be subject to a fine of not more than $1,000 or to imprisonment for a term of not more than one year, or both.".

(e) Section 1006, title 18, United States Code, is amended --

(1) by replacing "$5,000" with the words "$1,000,000 or twice the amount authorized by section 3571(d) of this title, whichever is greater" and the word "five" with the word "twenty";

(2) by removing the period at the end of the section and adding the following:

"and shall be subject to a civil penalty of $1,000,000 for each day the violation continues or the amount of pecuniary gain attributable to the proscribed actions, or $5,000,000, whichever is greater. Civil and criminal penalties and restitution under this section are

cumulative."; and

(3) by redesignating current section 1006 as 1006(a) and by adding new subsections (b) and (c) as follows:

"(b) The Attorney General may bring a civil action against any person who violates the provisions of the preceding section. The suit may be brought in any district court of the United States or the United States courts of any territory in which the defendant or, in the case of multiple defendants, any one defendant resides, is doing business, may be found, or in which any proscribed act was committed. A subpoena requiring the attendance of a witness at trial or hearing conducted under this provision may be served at any place in the United States. The court in which such action is brought shall determine the existence of a violation upon a preponderance of the evidence,shall assess the civil penalty, and shall have power to grant such other relief, including injunctions, as may be appropriate. Such remedies shall be in addition to any other remedy available under statutory or common law."

"(c)(1) For the purpose of any civil investigation or proceeding under this chapter, the Attorney General or any officer designated by him is empowered to administer oaths and affirmations, subpoena witnesses,

compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, or other records which the Attorney General deems relevant or material to the inquiry. Such attendance of witnesses and the production of any such records may be required from any place in the United States or any State at any designated place of hearing.

"(2) In case of contumacy by, or refusal to obey a subpoena issued to, any person, the Attorney General may invoke the aid of any court of the United States within the jurisdiction of which such investigation or proceeding is carried on, or where such person resides or carries on business, in requiring the attendance and testimony of witnesses and the production of books, papers, correspondence, memoranda, and other records. And such court may issue an order requiring such person to appear before the Attorney General or officer designated by the Attorney General to produce records, if so ordered, or to give testimony touching upon the matter under civil investigation or in question. And any failure to obey such order of the court may be punished by such court as a contempt thereof. All process in any such case may be served in the judicial district where such person is an inhabitant or wherever he may be found. Any person who shall, without just cause, fail or refuse to attend and testify or to answer

any lawful inquiry or to produce books, papers, correspondence, memoranda, and other records, if in his power so to do, in obedience to the subpoena of the Attorney General shall be guilty of a misdemeanor and, upon conviction, shall be subject to a fine of not more than $1,000 or to imprisonment for a term of not more than one year, or both.".

(f) Section 1007, title 18, United States Code, is amended to read:

"(a) Whoever, for the purpose of inducing the insurance of the accounts of any institution by the Federal Deposit Insurance Corporation, for the purpose of obtaining any loan from the Federal Deposit Insurance Corporation, for the purpose of obtaining any extension or renewal of such insurance or such loan, or for the purpose of obtaining the acceptance, release, or substitution of security for such loan, or for the purpose of inducing the Federal Deposit Insurance Corporation to purchase any assets, or for the purpose of obtaining the payment of any insured deposit or transferred deposit or the allowance, approval, or payment of any claim, or for the purpose of influencing in any way the action of the Federal Deposit Insurance Corporation, makes, passes, utters, or publishes any statement, knowing it to be false; utters, forges, or

counterfeits any instrument, paper, or document, or utters, publishes, or passes as true any instrument, paper or document, knowing it to have been uttered, forged, or counterfeited; or willfully overvalues any security, asset, or income, of any institution insured or applying for insurance by the Federal Deposit Insurance Corporation shall be fined not more than $1,000,000 or twice the amount authorized by section 3571(d) of this title, whichever is greater, or imprisoned for not more than twenty years, or both, and shall be subject to a civil penalty of $1,000,000 for each day the violation continues, or the amount of pecuniary gain attributable to the proscribed actions, or $5,000,000, whichever is greater. Civil and criminal penalties and restitution under this section are cumulative.

"(b) The Attorney General may bring a civil action against any person who violates the provisions of the preceding section. The suit may be brought in any district court of the United States or the United States courts of any territory in which the defendant or, in the case of multiple defendants, any one defendant resides, is doing business, may be found, or in which any proscribed act was committed. A subpoena requiring the attendance of a witness at trial or hearing conducted under this provision may be served at any

place in the United States. The court in which such action is brought shall determine the existence of a violation upon a preponderance of the evidence,shall assess the civil penalty, and shall have power to grant such other relief, including injunctions, as may be appropriate. Such remedies shall be in addition to any other remedy available under statutory or common law."

"(c)(1) For the purpose of any civil investigation or proceeding under this chapter, the Attorney General or any officer designated by him is empowered to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, or other records which the Attorney General deems relevant or material to the inquiry. Such attendance of witnesses and the production of any such records may be required from any place in the United States or any State at any designated place of hearing.

"(2) In case of contumacy by, or refusal to obey a subpoena issued to, any person, the Attorney General may invoke the aid of any court of the United States within the jurisdiction of which such investigation or proceeding is carried on, or where such person resides or carries on business, in requiring the attendance and testimony of witnesses and the production of books,

papers, correspondence, memoranda, and other records. And such court may issue an order requiring such person to appear before the Attorney General or officer designated by the Attorney General to produce records, if so ordered, or to give testimony touching upon the matter under civil investigation or in question. And any failure to obey such order of the court may be punished by such court as a contempt thereof. All process in any such case may be served in the judicial district where such person is an inhabitant or wherever he may be found. Any person who shall, without just cause, fail or refuse to attend and testify or to answer any lawful inquiry or to produce books, papers, correspondence, memoranda, and other records, if in his power so to do, in obedience to the subpoena of the Attorney General shall be guilty of a misdemeanor and, upon conviction, shall be subject to a fine of not more than $1,000 or to imprisonment for a term of not more than one year, or both.".

(g) Section 1008, title 18, United States Code, is repealed.

(h) Section 1014, title 18, United States Code, is amended --

(1) by replacing "$5,000" with the words "$1,000,000 or twice the amount authorized by section 3571(d) of this

title, whichever is greater" and the word "two" with the word "twenty";

(2) by removing the period at the end of the first paragraph and by adding the following:

"and shall be subject to a civil penalty of $1,000,000 for each day the violation continues, or the amount of any pecuniary gain attributable to the false statement or report or overvaluation, or $5,000,000, whichever is greater. Civil and criminal penalties and restitution under this section are cumulative."; and

(3) by redesignating current section 1014 as 1014(a) and by adding new subsections (b) and (c) as follows:

"(b) The Attorney General may bring a civil action against any person who violates the provisions of the preceding section. The suit may be brought in any district court of the United States or the United States courts of any territory in which the defendant or, in the case of multiple defendants, any one defendant resides, is doing business, may be found, or in which any proscribed act was committed. A subpoena requiring the attendance of a witness at trial or hearing conducted under this provision may be served at any place in the United States. The court in which such

action is brought shall determine the existence of a violation upon a preponderance of the evidence,shall assess the civil penalty, and shall have power to grant such other relief, including injunctions, as may be appropriate. Such remedies shall be in addition to any other remedy available under statutory or common law.

"(c)(1) For the purpose of any civil investigation or proceeding under this chapter, the Attorney General or any officer designated by him is empowered to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, or other records which the Attorney General deems relevant or material to the inquiry. Such attendance of witnesses and the production of any such records may be required from any place in the United States or any State at any designated place of hearing.

"(2) In case of contumacy by, or refusal to obey a subpoena issued to, any person, the Attorney General may invoke the aid of any court of the United States within the jurisdiction of which such investigation or proceeding is carried on, or where such person resides or carries on business, in requiring the attendance and testimony of witnesses and the production of books, papers, correspondence, memoranda, and other records.

And such court may issue an order requiring such person to appear before the Attorney General or officer designated by the Attorney General to produce records, if so ordered, or to give testimony touching upon the matter under civil investigation or in question. And any failure to obey such order of the court may be punished by such court as a contempt thereof. All process in any such case may be served in the judicial district where such person is an inhabitant or wherever he may be found. Any person who shall, without just cause, fail or refuse to attend and testify or to answer any lawful inquiry or to produce books, papers, correspondence, memoranda, and other records, if in his power so to do, in obedience to the subpoena of the Attorney General shall be guilty of a misdemeanor and, upon conviction, shall be subject to a fine of not more than $1,000 or to imprisonment for a term of not more than one year, or both.".

(i) Section 1344(a), title 18, United States Code, is amended --

(1) by replacing "$10,000" with the words "$1,000,000 or twice the amount authorized by section 3571(d) of this title, whichever is greater" and the word "five" with the word "twenty";

(2) by removing the period at the end and adding the following:

"and shall be subject to a civil penalty of $1,000,000 for each day the violation continues or the amount of pecuniary gain attributable to the fraud, or $5,000,000,whichever is greater. Civil and criminal penalties and restitution under this section are cumulative."; and

(3) by adding new subsections (c) and (d) as follows:

"(c) The Attorney General may bring a civil action against any person who violates the provisions of the preceding section. The suit may be brought in any district court of the United States or the United States courts of any territory in which the defendant or, in the case of multiple defendants, any one defendant resides, is doing business, may be found, or in which any proscribed act was committed. A subpoena requiring the attendance of a witness at trial or hearing conducted under this provision may be served at any place in the United States. The court in which such action is brought shall determine the existence of a violation upon a preponderance of the evidence, shall assess the civil penalty, and shall have power to grant such other relief, including injunctions, as may be

appropriate. Such remedies shall be in addition to any other remedy available under statutory or common law."

"(d)(1) For the purpose of any civil investigation or proceeding under this chapter, the Attorney General or any officer designated by him is empowered to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, or other records which the Attorney General deems relevant or material to the inquiry. Such attendance of witnesses and the production of any such records may be required from any place in the United States or any State at any designated place of hearing.

"(2) In case of contumacy by, or refusal to obey a subpoena issued to, any person, the Attorney General may invoke the aid of any court of the United States within the jurisdiction of which such investigation or proceeding is carried on, or where such person resides or carries on business, in requiring the attendance and testimony of witnesses and the production of books, papers, correspondence, memoranda, and other records. And such court may issue an order requiring such person to appear before the Attorney General or officer designated by the Attorney General to produce records, if so ordered, or to give testimony touching upon the

matter under civil investigation or in question. And any failure to obey such order of the court may be punished by such court as a contempt thereof. All process in any such case may be served in the judicial district where such person is an inhabitant or wherever he may be found. Any person who shall, without just cause, fail or refuse to attend and testify or to answer any lawful inquiry or to produce books, papers, correspondence, memoranda, and other records, if in his power so to do, in obedience to the subpoena of the Attorney General shall be guilty of a misdemeanor and, upon conviction, shall be subject to a fine of not more than $1,000 or to imprisonment for a term of not more than one year, or both."

(j) Chapter 213 of title 18, United States Code, is amended by adding at the end thereof the following new section:

"Section 3293. Financial Institution Offenses

"No person shall be prosecuted, tried, or punished for violation of any provision of sections 215, 656, 657, 1005, 1006, 1007, 1008, 1014 and 1344 of this title, or for conspiracy to commit violations of any of the aforementioned sections, unless the indictment is returned or the information is filed within ten years after the commission of the offense. This section shall apply to any of the

aforementioned offenses committed before the effective date of this section, if the statute of limitations applicable to that offense under this chapter had not run as of the effective date of this section.".

(k) Pursuant to its authority under section 994(p) of title 28, United States Code, and section 21 of the Sentencing Act of 1987, the United States Sentencing Commission shall promulgate guidelines, or shall amend existing guidelines, to provide that a defendant convicted of violating section 215, 656, 657, 1005, 1006, 1007, 1008, 1014, or 1344 of title 18, United States Code, under circumstances which substantially jeopardize the safety and soundness of a financial institution shall be assigned an offense level under chapter 2 of the sentencing guidelines that is not less than level 24. If the sentencing guidelines are amended after the effective date of this section, the Sentencing Commission shall implement the instruction set forth in this provision so as to achieve a comparable result.

SEC. 916. MISCELLANEOUS REVISIONS TO TITLE 18

(a) The term "Federal Home Loan Bank Board" is replaced by the term "Federal Home Loan Bank System" wherever it appears.

(b) Section 212 of title 18, United States Code, is amended by replacing the word "bank" or "banks" wherever they appear with the words "financial institution" or "financial institutions",

respectively (except in the phrases "land bank" and "member banks") and by adding in the second sentence the words "Federal Home Loan Bank System" after the words "Federal Deposit Insurance Corporation".

(c) Section 213 of title 18, United States Code, is amended by replacing the words "banks the deposits of which" with the words "financial institutions the deposits of which".

(d) Section 1009, title 18, United States Code, is repealed.

(e) Section 1030, title 18, United States Code, is amended by removing the words "a bank" from subsection (e)(4)(A) and replacing it with the words "an institution," by removing subsection (e)(4)(C), and by redesignating subsections (e)(4)(D), (E), (F), (G), and (H), as subsections (e)(4)(C), (D), (E), (F), and (G), respectively.

(f) Section 1114, title 18, United States Code, is amended by removing the words "the Federal Savings and Loan Insurance Corporation,".

(g) Section 1306, title 18, is amended by removing the words "section 20 of the Federal Deposit Insurance Act, or section 410 of the National Housing Act" and replacing it with the words "or section 20 of the Federal Deposit Insurance Act."

(h) Section 1510, title 18, United States Code, is amended (1) by redesignating subsection (b) as subsection (c), and (2) by adding a new subsection (b) as follows: "Whoever, being an officer, director, partner, or employee of a financial institution (as that term is defined in section 3401 of title 12, United States Code), directly or indirectly notifies a customer of that financial institution whose financial records are sought by a grand jury subpoena served on that financial institution, relating to a possible violation of sections 215, 656, 657, 1005, 1006, 1007, 1008, 1014, or 1344 of title 18, United States Code, or any other party about the existence or contents of the subpoena or information that has been furnished to the grand jury in response to that subpoena shall be fined not more than $1,000,000 or twice the amount authorized by section 3571(d) of this title, whichever is greater, or be imprisoned not more than twenty years, or both.".

(i) Section 2113, title 18, United States Code, is amended --

(1) by removing from subsection (f) the words "any bank the deposits of which" and replacing it with "any institution the deposits of which";

(2) by adding before the period at the end of subsection (h) the words ", and any 'Federal credit union' as defined in section 2 of the Federal Credit Union Act"; and

(3) by removing subsection (g) and redesignating subsection (h) as subsection (g).

(j) Section 1961(1), title 18, United States Code, is amended by adding the words "Sections 656 and 657 (relating to financial institution embezzlement)," after the words "(relating to counterfeiting)," and the words "section 1344 (relating to financial institution fraud)," following the words "(relating to wire fraud),".

SEC. 917. CIVIL AND CRIMINAL FORFEITURE.

(A) Title 18, United States Code is amended by adding the following new sections 983 and 984 as follows:

"§ 983. Civil forfeiture relating to certain financial institution violations.

"(a) Any property, real or personal, which constitutes or is derived from proceeds traceable to a violation of sections 215, 656, 657, 1005, 1006, 1007, 1014, or 1344 of this title affecting a federally insured financial institution, shall be subject to forfeiture to the United States, except that no property shall be forfeited under this section, to the extent of the interest of an owner or lienholder by reason of any act or omission established by that owner or lienholder

to have been committed or omitted without the knowledge or consent of that owner or lienholder.

"(b) Any property subject to civil forfeiture to the United States under this section may be seized by the Attorney General upon process issued pursuant to the Supplemental Rules for Certain Admiralty and Maritime Claims by any district court of the United States having jurisdiction over the property, except that seizure without such process may be made when the seizure is incident to a lawful arrest or search or if the Attorney General has probable cause to believe that the property is subject to civil forfeiture under this section. In the event of seizure pursuant to paragraph (1) or (2) of this subsection, proceedings under subsection (d) of this section shall be instituted promptly. The government may request the issuance of a warrant authorizing the seizure of property subject to forfeiture under this section in the same manner as provided for a search warrant under the Federal Rules of Criminal Procedure.

"(c) Property taken or detained under this section shall not be repleviable, but shall be deemed to be in the custody of the Attorney General, subject only to the orders and decrees of the court or the official having jurisdiction thereof. Whenever property is seized under

any of the provisions of this subchapter, the Attorney General may --

"(1) place the property under seal;

"(2) remove the property to a place designated by him; or

"(3) require that the General Services Administration take custody of the property and remove it, if practicable, to an appropriate location for disposition in accordance with law.

"(d) The provisions of law relating to the seizure, summary and judicial forfeiture, and condemnation of property for violation of customs laws; the disposition of such property or the proceeds from the sale thereof; the remission or mitigation of such forfeitures; and the compromise of claims shall apply to seizures and forfeitures incurred, or alleged to have been incurred, under this section, insofar as applicable and not inconsistent with the provisions hereof; except that such duties as are imposed upon the customs officer or any other person with respect to the seizure and forfeiture of property under the customs laws shall be performed with respect to seizures of property under this section by the Federal Bureau of Investigation, and

with respect to custody and forfeitures under this section by such officers, agents, or other persons as may be authorized or designated for that purpose by the Attorney General.

"(e)(1) Whenever property is forfeited under this section, the Attorney General may sell any forfeited property which is not required to be destroyed by law and which is not harmful to the public.

"(2)(a) The Attorney General shall transfer the property or proceeds from the sale of such property to any federal financial institution regulatory agency to the extent of such agency's contribution of resources to, or expenses involved in, the seizure and forfeiture, and the investigation leading directly to the seizure and forfeiture, of such property; and

"(b) The Attorney General may retain property and proceeds from the sale of such property to the extent of the Attorney General's contribution of resources to, or expenses involved in, the seizure and forfeiture, and the investigation leading directly to the seizure and forfeiture, of such property. Such expenses include, but are not limited to, expenses for maintenance of custody, advertising, and court cost.

"(3) Notwithstanding any other provision of law, if the affected financial institution is in receivership, property forfeited pursuant to this section, or proceeds from the sale of such property, less any amount transferred pursuant to subsection (e)(2) of this section, shall be deposited to the General Fund of the Treasury.

"(4) Notwithstanding any other provision of law, if the affected financial institution is not in receivership, property forfeited pursuant to this section, or proceeds from the sale of such property, less any amount transferred pursuant to subsection (e)(2) of this section, shall be deposited to the General Fund of the Treasury or may be made available upon the order of the appropriate federal financial institution as restitution to that financial institution. Amounts received by the financial institution shall be set off against any amounts later recovered by the institution as compensatory damages in any State or Federal proceeding.

"(5) The United States shall not be liable in any action arising out of a transfer made pursuant to subsection (e)(2), (3), or (4).

"(f) All right, title, and interest in property

described in subsection (a) of this section shall vest in the United States upon commission of the act giving rise to forfeiture under this section.

"(g) The filing of an indictment or information alleging a violation of law which is also related to a civil forfeiture proceeding under this section shall, upon motion of the United States and for good cause shown, stay the civil forfeiture proceeding.

"(h) In addition to the venue provided for in section 1395 of Title 28 or other provision of law, in the case of property of a defendant charged with a violation that is the basis for forfeiture of the property under this section, a proceeding for forfeiture under this section may be brought in the judicial district in which the defendant owning such property is found or in the judicial district in which the criminal prosecution is brought.

"§ 984. Criminal Forfeiture relating to certain financial institution violations.

"(a) Any person convicted of an offense under section 215, 656, 657, 1005, 1007, 1014, or 1344 of this title affecting a federally insured financial institution, shall forfeit to the United States,

irrespective of any provision of state law, any property constituting, or derived from, proceeds the person obtained directly or indirectly, as the result of such violation. The court, in imposing sentence on such person shall order, in addition to any other sentence imposed, that the person forfeit to the United States all property described in this section.

"(b) Property subject to criminal forfeiture under this section includes --

"(1) real property including things growing on, affixed to, and found in land; and

"(2) tangible and intangible personal property, including rights, privileges, interest, claims and securities.

"(c) All right, title and interest in property described in Subsection (a) vests in the United States upon the commission of the act giving rise to forfeiture under this section. Any such property that is subsequently transferred to a person other than the defendant may be the subject of a special verdict of forfeiture and thereafter shall be ordered forfeited to the United States, unless the transferee establishes in a hearing pursuant to subsection (m) that he is a bona

fide purchaser for value of such property who at the time of purchase was reasonably without cause to believe that the property was subject to forfeiture under this section.

"(d)(1) Upon application of the United States, the court may enter a restraining order or injunction, require the execution of a satisfactory performance bond, or take any other action to preserve the availability of property described in subsection (a) for forfeiture under this section -

"(A) upon the filing of an indictment or information charging a violation of section 215, 656, 657, 1005, 1006, 1007, 1014, or 1344 of this title and alleging that the property with respect to which the order is sought would, in the event of conviction, be subject to forfeiture under this section; or

"(B) prior to the filing of such an indictment or information, if, after notice to persons appearing to have an interest in the property and opportunity for a hearing, the court determines that --

"(i) there is a substantial probability that the United States will prevail on the issue of

forfeiture and that failure to enter the order will result in the property being destroyed, removed from the jurisdiction of the court, or otherwise made unavailable for forfeiture; and

"(ii) the need to preserve the availability of the property through the entry of the requested order outweighs the hardship on any party against whom the order is to be entered:

"Provided, however, that an order entered pursuant to subparagraph (B) shall be effective for not more than ninety days, unless extended by the court for good cause shown or unless an indictment or information described in subparagraph (A) has been filed.

"(2) A temporary restraining order under this subsection may be entered upon application of the United States without notice or opportunity for a hearing when an information or indictment has not yet been filed with respect to the property, if the United States demonstrates that there is probable cause to believe that the property with respect to which the order is sought would, in the event of conviction, be subject to forfeiture under this section and that provision of notice will jeopardize the availability of the property

for forfeiture. Such a temporary order shall expire not more than ten days after the date on which it is entered, unless extended for good cause shown or unless the party against whom it is entered consents to an extension for a longer period. A hearing requested concerning an order entered under this paragraph shall be held at the earliest possible time, and prior to the expiration of the temporary order.

"(3) The court may receive and consider, at a hearing held pursuant to this subsection, evidence and information that would be inadmissible under the Federal Rules of Evidence.

"(e) Upon conviction of a person under section 215, 656, 657, 1005, 1006, 1007, 1014, or 1344 of this title, the court shall enter a judgment of forfeiture of the property to the United States and shall also authorize the Attorney General to seize all property ordered forfeited upon such terms and conditions as the court shall deem proper. Following the entry of an order declaring the property forfeited, the court may, upon application of the United States, enter such appropriate restraining orders or injunctions, require the execution of satisfactory performance bonds, appoint receivers, conservators, appraisers, accountants, or trustees, or take any other action to protect the interest of the United Stats in the

property ordered forfeited. Any income accruing to, or derived from, an enterprise or an interest in an enterprise which has been ordered forfeited under this section may be used to offset ordinary and necessary expenses to the enterprise which are required by law, or which are necessary to protect the interests of the United States or third parties.

"(f) Following the seizure of property ordered forfeited under this section, the Attorney General shall direct the disposition of the property by sale or any other commercially feasible means, making due provision for the rights of any innocent persons. Any property right or interest not exercisable by, or transferable for value to, the United States shall expire and shall not revert to the defendant, nor shall the defendant or any person acting in concert with or on behalf of the defendant be eligible to purchase forfeited property at any sale held by the United States. Upon application of a person, other than the defendant or a person acting in concert with or on behalf of the defendant, the court may restrain or stay the sale or disposition of the property pending the conclusion of any appeal of the criminal case giving rise to the forfeiture, if the applicant demonstrates that proceeding with the sale or disposition of the property will result in irreparable injury, harm or loss to him.

"(g) With respect to property ordered forfeited under this section, the Attorney General is authorized to --

"(1) grant petitions for mitigation or remission of forfeiture, restore forfeited property to victims of the violation, or take any other action to protect the rights of innocent persons which is in the interest of justice and which is not inconsistent with the provisions of this section;

"(2) compromise claims arising under this section;

"(3) award compensation to persons providing information resulting in a forfeiture under this section;

"(4) direct the disposition by the United States of all property ordered forfeited under this section, making due provision for the rights of innocent persons; and

"(5) take appropriate measures necessary to safeguard and maintain property ordered forfeited under this section pending its disposition.

"(h) Except to the extent that they are inconsistent with the provisions of this section, the provisions of

sections 983(d) and 983(e) of this title shall apply to a criminal forfeiture under this section.

"(i) Except as provided in subsection (m) of this section, no party claiming an interest in property subject to forfeiture under this section may --

"(1) intervene in a trial or appeal of a criminal case involving the forfeiture of such property under this section; or

"(2) commence an action at law or equity against the United States concerning the validity of his alleged interest in the property subsequent to the filing of an indictment or information alleging that the property is subject to forfeiture under this section.

"(j) The district court of the United States shall have jurisdiction to enter orders as provided in this section without regard to the location of any property which may be subject to forfeiture under this section or which has been ordered forfeited under this section.

"(k) In order to facilitate the identification and location of property declared forfeited and to facilitate the disposition of petitions for remission or mitigation of forfeiture, after the entry of an order declaring property

forfeited to the United States, the court may, upon application of the United States, order that the testimony of any witness relating to the property forfeited be taken by deposition and that any designated book, paper, document, record, recording, or other material not privileged be produced at the same time and place, in the same manner as provided for the taking of depositions under Rule 15 of the Federal Rules of Criminal Procedure.

"(1)(1) Following the entry of an order of forfeiture under this section, the United States shall publish notice of the order and of its intent to dispose of the property in such manner as the Attorney General may direct. The Government may also, to the extent practicable, provide direct written notice to any person known to have alleged an interest in the property that is the subject of the order of forfeiture as a substitute for published notice as to those persons so notified.

"(2) Any person, other than the defendant, asserting a legal interest in property which has been ordered forfeited to the United States pursuant to this section may, within thirty days of the final publication of notice or his receipt of notice under paragraph (1), whichever is earlier, petition the court for a hearing to adjudicate the validity of his alleged interest in the property. The hearing shall be held before the

court alone, without a jury.

"(3) The petition shall be signed by the petitioner under penalty of perjury and shall set forth the nature and extent of the petitioner's right, title, or interest in the property, the time and circumstances of the petitioner's acquisition of the right, title, or interest in the property, any additional facts supporting the petitioner's claim, and the relief sought.

"(4) The hearing on the petition shall, to the extent practicable and consistent with the interests of justice, be held within thirty days of the filing of the petition. The court may consolidate the hearing on the petition with a hearing on any other petition filed by a person other than the defendant under this subsection.

"(5) At the hearing, the petitioner may testify and present evidence and witnesses on his own behalf, and cross-examine witnesses who appear at the hearing. The United States may present evidence and witnesses in rebuttal and in defense of its claim to the property and cross-examine witnesses who appear at the hearing. In addition to testimony and evidence presented at the hearing, the court shall consider the relevant portions of the record of the criminal case which resulted in the

order of forfeiture.

"(6) If, after the hearing, the court determines that the petitioner has established by a preponderance of the evidence that --

"(A) the petitioner has a legal right, title, or interest in the property, and such right, title, or interest renders the order of forfeiture invalid in whole or in part because the right, title, or interest was vested in the petitioner rather than the defendant or was superior to any right, title, or interest of the defendant at the time of the commission of the acts which gave right to the forfeiture of the property under this section; or

"(B) the petitioner is a bona fide purchaser for value of the right, title, or interest in the property and was at the time of the purchase reasonably without cause to believe that the property was subject to forfeiture under this section, the court shall amend the order of forfeiture in accordance with its determination.

"(7) Following the court's disposition of all petitions filed under this subsection, or if no such petitions are filed following the expiration of the

period provided in paragraph (2) for the filing of such petitions, the United States shall have clear title to property that is the subject of the order of forfeiture and may warrant good title to any subsequent purchaser or transferee.

"(m) If any of the property described in subsection (a) of this section, as a result of any act or omission of the defendant --

"(1) cannot be located upon the exercise of due diligence;

"(2) has been transferred or sold to, or deposited with, a third party;

"(3) has been placed beyond the jurisdiction of the court;

"(4) has been substantially diminished in value; or

"(5) has been commingled with other property which cannot be divided without difficulty

"the court shall order the forfeiture of any of the property of the defendant up to the value of any property described in paragraph (1) through (5).".

SEC. 918. GRAND JURY AMENDMENTS.

(a) Paragraphs (A), (B), and (C) of Rule 6(e)(3) of the Federal Rules of Criminal Procedure are amended to read as follows:

"(A) Disclosure otherwise prohibited by this rule of matters occurring before the grand jury, other than its deliberations and the vote of any grand juror, may be made to --

"(i) any attorney for the government for use in the performance by an attorney of the government's duty to enforce federal criminal or civil law; and

"(ii) such government personnel (including personnel of a state or subdivision of a state) as are deemed necessary by an attorney for the government to assist an attorney for the government in the performance of such attorney's duty to enforce federal criminal law.

"(B) Any person to whom matters are disclosed under subparagraph (A)(ii) of this paragraph shall not utilize that grand jury material for any purpose other than assisting an attorney for the government in the performance of such attorney's duty to enforce federal criminal or civil law. An attorney for the government shall promptly provide

the district court, before which was impaneled the grand jury whose material has been so disclosed, with the names of the persons to whom such disclosure has been made, and shall certify that the attorney has advised such persons of their obligation of secrecy under this rule.

"(C) Disclosure otherwise prohibited by this rule of matters occurring before the grand jury may also be made --

"(i) when so directed by a court, upon a showing of particularized need, preliminarily to or in connection with a judicial proceeding;

"(ii) when permitted by a court at the request of the defendant, upon a showing that grounds may exist for a motion to dismiss the indictment because of matters occurring before the grand jury;

"(iii) when the disclosure is made by an attorney for the government to another federal grand jury;

"(iv) when permitted by a court at the request of an attorney for the government, upon a showing that such matters may disclose a violation of state criminal law, to an appropriate official of a state or subdivision of a state for the purpose of enforcing such law; or

"(v) at the request of an attorney for the government, and when so permitted by a court upon a showing of substantial need, to personnel of any department or agency of the United States (a) when such personnel are deemed necessary to provide assistance to an attorney for the government in the performance of such attorney's duty to enforce federal civil law, or (b) for use in relation to any matter within the jurisdiction of such department or agency.".

The first sentence of paragraph (D) of Rule 6(e)(3) of the Federal Rules of Criminal Procedure is amended to read as follows:

"(D) A petition for disclosure pursuant to subdivision (e)(3)(C)(i) or (v) shall be filed in the district where the grand jury convened."

(b) Paragraph (1) of section 1681b of title 15, United States Code, is amended by inserting after "an order" the following: ", or a subpoena issued in connection with proceedings before a grand jury".

SEC. 919. LITIGATION AUTHORITY.

Nothing in this Act may be construed as impairing or diminishing the authority of the Attorney General under section 516 of title

28, United States Code, to conduct and coordinate litigation on behalf of the United States government.

SEC. 920. DEPARTMENT OF JUSTICE APPROPRIATION.

There is hereby authorized to be appropriated, without fiscal year limitation, from the General Fund of the Treasury, $50,000,000 for the fiscal year ending September 30, 1989 and for each of the two fiscal years thereafter, to the Attorney General, for purposes of investigations and prosecutions involving financial institution crimes.

TITLE X. -- STUDY OF FEDERAL DEPOSIT INSURANCE AND BANKING REGULATION.

Sec. 1001. STUDY. The Secretary of the Treasury, in consultation with the Comptroller of the Currency, the Chairman of the Board of Governors of the Federal Reserve System, the Chairman of the Federal Home Loan Bank System, the Chairman of the Federal Deposit Insurance Corporation, and the Director of the Office of Management and the Budget, shall conduct a study of the Federal deposit insurance system, including an appropriate structure for the offering of competitive products and services to consumers consistent with standards of safety and soundness.

Sec. 1002. TOPICS. As part of such study, the Secretary shall investigate, review and evaluate the following:

(a) risk and rate structure for deposit insurance;

(b) incentives for market discipline;

(c) the scope of deposit insurance coverage and its impact on the liability of the insurance fund;

(d) the feasibility of market value accounting, assessments on foreign deposits, limitations on brokered deposits, the addition of collateralized borrowings to the deposit insurance base, and multiple insured accounts;

(e) policies to be followed with respect to the recapitalization or closure of insured depositories whose capital is depleted to or near the point of, insolvency; and (f) the efficiency of housing subsidies through the Federal Home Loan Bank System.

Sec. 1003. FINAL REPORT. The Secretary shall submit to Congress within eighteen months from the date of enactment of this Act, a final report which shall contain a detailed statement of findings and conclusions, including recommendations for advisable administrative and legislative action.

TITLE XI -- MISCELLANEOUS PROVISIONS

Sec. 1101. AMENDMENTS TO SECTION 202 OF THE FEDERAL CREDIT UNION ACT. -- Section 202 of the Federal Credit Union Act, 12 U.S.C. 1782, is amended as follows:

1. in paragraph (1) of subsection (b), by deleting "both the amount of its deposit or adjustment thereof and" and "both as computed under subsection (c) of this section".

2. in subsection (c) by striking paragraph (1), redesignating pararaph (2) as paragraph (1) and by adding a new paragraph (2) to read as follows:

"In the event the operating level of the Fund at the end of a given insurance year is below a minimum level specified by the Board or extraordinary circumstances exist that in the opinion of the Board raise a risk of serious future insurance losses, the Board shall have authority to assess a premium in excess of that specified in (c)(1). In no event shall any increase in the premium rate exceed fifty percent over the previous year, and in no event shall the premium in a given year exceed 0.35 percent of total member accounts. In no event shall the premiums or fees assessed under this chapter be considered appropriated monies."

3. in paragraph (1) of subsection (d) by striking "deposit

or any".

4. in paragraphs (2) and (3) of subsection (d), by striking "its deposit or" and "deposit or the" each time they appear therein.

5. in subsections (e) and (f), by striking "deposit or" "deposit or any", and "its deposit or" each time they appear therein.

6. in subsection (g), by striking "deposits" in the first sentence, and by striking in the second sentence "any deposit or adjustment thereof or" each time it appears therein.

7. in paragraph (2) of subsection (h) by striking "1.30" and inserting "1.25".

8. adding a new paragraph (i) to read as follows:

"(1) Over an eight year transition beginning one year after the date of enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, insured credit unions shall expense the one percent deposit maintained with the Board pursuant to P.L. 98-369. The method of expensing the deposit shall be established pursuant to rules and regulations of the Board.

"(2) Credit unions that obtain insurance from the Fund during the transition period in (i)(1) above shall not be required to maintain a deposit with the Board, but the Board shall have authority to assess such additional premiums on those credit unions as are necessary and appropriate to ensure that the economic cost of maintaining the Fund is comparable for all insured credit unions."

Sec. 1102. AMENDMENT TO SECTION 203 OF THE FEDERAL CREDIT UNION ACT. -- Section 203 of the Federal Credit Union Act, 12 U.S.C. 1783, is amended by striking "deposits and" in paragraph (b).

Sec. 1103. AMENDMENT TO SECTION 5240 OF THE REVISED STATUTES. --

Section 5240 of the Revised Statutes (12 U.S.C. 482) is amended by --

(1) by deleting the first sentence; and

(2) by inserting in lieu thereof the following:

"Subject to the approval of the Secretary of the Treasury, the Comptroller of the Currency shall fix the compensation of employees of the Office of the Comptroller of the Currency and shall make a report thereof to the Congress. Such compensation shall be determined by the Comptroller without regard to the provisions of any law or regulation (including, but not limited

to, provisions in Title 5 of the United States Code) relating to federal employee and officer compensation. In setting and adjusting such compensation, the Comptroller shall seek to maintain comparability with the compensation at the other Federal bank regulatory agencies."

SEC. 1104. SEPARABILITY OF PROVISIONS - If any provision of this Act or the application thereof to any person or circumstances is held invalid, the remainder of the Act and the application of the provision to other persons not similarly situated or to other circumstances shall not be affected thereby.

TREASURY NEWS

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FOR IMMEDIATE RELEASE
February 27, 1989

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,211 million of 13-week bills and for $7,206 million of 26-week bills, both to be issued on March 2, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing June 1, 1989			:	26-week bills maturing August 31, 1989		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	8.68%	9.00%	97.806	:	8.76% a/	9.29%	95.571
High	8.74%	9.06%	97.791	:	8.77%	9.30%	95.566
Average	8.73%	9.05%	97.793	:	8.77%	9.30%	95.566

a/ Excepting 1 tender of $200,000.

Tenders at the high discount rate for the 13-week bills were allotted 34%.
Tenders at the high discount rate for the 26-week bills were allotted 99%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 45,995	$ 45,995	:	$ 33,600	$ 33,600
New York	21,610,470	6,046,695	:	20,411,800	6,146,450
Philadelphia	24,970	24,970	:	26,880	26,880
Cleveland	44,540	44,540	:	47,195	47,195
Richmond	47,705	47,705	:	43,430	43,430
Atlanta	44,780	44,780	:	40,935	40,935
Chicago	2,367,170	119,270	:	1,412,615	188,265
St. Louis	51,670	30,670	:	34,145	28,125
Minneapolis	10,150	10,150	:	8,285	8,285
Kansas City	68,235	64,265	:	47,130	47,130
Dallas	49,625	39,625	:	31,660	21,660
San Francisco	1,754,020	217,360	:	1,778,010	74,010
Treasury	474,595	474,595	:	500,150	500,150
TOTALS	$26,593,925	$7,210,620	:	$24,415,835	$7,206,115
Type					
Competitive	$22,425,475	$3,042,170	:	$19,608,590	$2,398,870
Noncompetitive	1,372,810	1,372,810	:	1,147,575	1,147,575
Subtotal, Public	$23,798,285	$4,414,980	:	$20,756,165	$3,546,445
Federal Reserve	2,189,100	2,189,100	:	2,100,000	2,100,000
Foreign Official Institutions	606,540	606,540	:	1,559,670	1,559,670
TOTALS	$26,593,925	$7,210,620	:	$24,415,835	$7,206,115

An additional $84,460 thousand of 13-week bills and an additional $247,330 thousand of 26-week bills will be issued to foreign official institutions for new cash.

1/ Equivalent coupon-issue yield.

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TREASURY NEWS

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DEPARTMENT OF THE TREASURY

Testimony by
Secretary of the Treasury
Nicholas F. Brady
Before the
Committee on the Budget
U.S. House of Representatives
Tuesday, February 28, 1989

Chairman Panetta, Representative Frenzel and members of the Committee, I am pleased to be here today to discuss with you President Bush's proposed fiscal year 1990 budget. I know that you have already heard from the Director of the Office of Management and Budget, Richard Darman, and the Chairman of the Council of Economic Advisors, Michael Boskin, so in my testimony I will not repeat a detailed presentation of the Bush budget. The approach to the budget I wish to take today is from the perspective of overall economic policy, thus, I will discuss the importance of deficit reduction to the continued vitality and strength of our national economy and to maintaining and improving our position in the world economy.

We are all aware that we continue to be in a period of extraordinary economic expansion, which has produced millions of jobs, while reducing inflation. We must equally be aware that to sustain this expansion we must reduce the deficit.

As you know, last week the Federal Reserve raised the discount rate one half of a percent to seven percent. I'd like to say a few words about that. First, and foremost, the Bush Administration and the Federal Reserve share absolutely a firm commitment to fighting inflation. It is possible to have somewhat differing interpretations of the same economic statistics, to think one set of statistics means more than another, and still share the same goal of fighting inflation.

The Federal Reserve is using the strongest weapon in its arsenal to fight inflation to advance the cause of the long-term strength and vitality of our national economy. The strongest weapon we in the government have to further the cause of our long-term economic strength is deficit reduction. We must do our part. Even to delay action costs us -- in terms of interest rates, jobs, the Savings and Loan crisis, the third world debt problem.

Let us be frank with one another. We are constrained between revenue levels which are the result of the 1988 election

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which validated President's Bush's commitment to "No new taxes" and a Gramm-Rudman-Hollings maximum deficit level of $100 billion prescribed in law. So, there are not funds to do all that we want.

Stepping back from the roar of the budget discussions for a minute, one could say, "this is where the country wants us to operate." The key is to have the American people say, "They did what we wanted with what we gave them."

ECONOMIC ASSUMPTIONS

The Bush Administration is absolutely committed to working with you to reduce the deficit. But, some have questioned our economic assumptions. First, I would like to point out that historically the executive branch's economic assumptions have not had a consistent bias toward a rosy scenario. In fact, in the last seven years, the Reagan Administration underestimated growth four times and overestimated it three.

For this year, we believe that the economy will continue to grow, but at a slightly slower pace than last year's drought adjusted rate. We are projecting that GNP will grow 3.5 percent next year. But when we exclude the impact of the rebound from the drought, our forecast is for a moderate 2.8 percent growth rate. This is slower than last year's 3.3 percent drought adjusted growth rate. Our long term forecast for a 3.2 percent sustainable growth rate is right in line with our experience over the past 40 years, during which real GNP growth averaged 3.3 percent.

As one who worked for over 30 years in financial markets, may I make a few comments on interest rate assumptions. During my first year in business, 1954, ten year government bonds carried an interest rate of 2.4 percent. They reached 14 percent in 1981. These same ten year government bonds were 12.4 percent as recently as 1984, but declined to 7.7 percent in 1986. They now carry an interest rate of 9.3 percent.

Attached as an exhibit to my testimony is a graph showing the decline in rates surrounding the passage of Gramm-Rudman-Hollings. From three and one-half months prior to the passage of this all-important fiscal legislation until three and one-half months after, interest rates declined 300 basis points. Was it the only cause of this rapid decline in interest rates? No. Was it a principal cause? Yes.

This would indicate to me that while there is plenty of room for honest disagreement about the future level of interest rates, there is some evidence that fiscal actions have an effect on interest rates, particularly long-term rates. My conclusion is that investors and savers all over the world are waiting for a

sign from our government that we are committed to fiscal prudence, and are willing to do something about it. Delay in reaching a budget agreement may only maintain the current high level of interest rates and cost the U.S. and the world unnecessary pain.

In sum, do I think our economic assumptions will prove true if we don't reduce the deficit? No. Will they prove accurate if we do? I believe so.

PRESIDENT'S BUDGET

I know that you have heard a great deal about the specific proposals in our budget from Budget Director Darman. However, I would like to reiterate a few key points. Within the confines of meeting the Gramm-Rudman-Hollings target, the President has proposed budget priorities which if adopted will make a significant investment in our country's future. Among his key proposals, he has:

-- pledged $6 billion to winning the war against drugs;

-- kept his promise to emphasize education, not just through an increase in funding but through programs which encourage excellence in education: awards to successful schools, a recognition program for superior students, a national science scholars program, and a plan to foster magnet schools;

-- addressed environmental issues, particularly that of acid rain; and

-- proposed fully funding the McKinney Act and increasing overall funding to assist the homeless by nearly 30 percent over last year's levels.

Mindful of the growing need for child care, the President proposes to increase assistance to low-income families through changes in the tax code. He proposes a new, refundable tax credit of up to $1,000 for each child under four in low-income working families. This credit would be available to very low-income families, in which at least one parent works, in tax year 1990, and will be expanded to include additional families in following years. By this tax assistance the President's budget provides vital support to families while permitting families to make their own choices about child care that best fits their needs. The President further proposes to make the existing dependent care credit refundable. In its current state the existing credit is of no value to lower income families who do not pay tax.

THE SAVINGS AND LOAN SOLUTION

The President's budget also contains the funding required to resolve the Savings and Loan crisis. It has three components. The first part consists of $50 billion to resolve currently insolvent institutions which may become insolvent over the next several years. Secondly, the plan ensures adequate servicing of the $40 billion in past FSLIC obligations.

And third, and perhaps most important, the plan provides $33 billion in financial resources necessary to put S&L deposit insurance on a sound financial basis for the future.

At the heart of our plan is the creation of a Resolution Trust Corporation (RTC), for which the FDIC will be the primary manager directed to resolve all S&Ls which are now insolvent or become so over the next three years.

To provide the $50 billion to the RTC, we will create a new, separate, privately-owned corporation, the Resolution Funding Corporation (REFCORP), which will issue $50 billion in long-term bonds to raise the needed funds. To pay the principal, industry funds will be used to purchase zero-coupon, long-term Treasury securities which will grow through compound interest to a maturity value of $50 billion. This assures the repayment of the principal of the bonds issued by REFCORP. Funds to purchase these zero-coupon bonds will come exclusively from private sources:

-- The FHLBanks will contribute about $2 billion of their retained earnings -- which are currently allocated to, but not needed by, the existing Financing Corporation (FICO) -- plus approximately 20 percent of their annual earnings, or $300 million, in 1989, 1990 and 1991;

-- The S&Ls will contribute a portion of their insurance premiums; and

-- If necessary, proceeds from the sale of FSLIC receivership assets will be used.

No Treasury funds or guarantees will be used to repay any REFCORP principal.

Interest payments on the REFCORP bonds will come from a combination of private and taxpayer sources:

-- The FHLBanks, beginning in 1992, will contribute $300 million a year;

-- The RTC will contribute a portion of the proceeds generated from the sale of receivership assets, and proceeds from warrants and equity participations taken in resolutions; and

-- Treasury funds will make up any shortfall.

All Treasury funds used to service REFCORP interest will be scored for budget purposes in the year expended.

Funds for the second component of our plan -- servicing the cost of the $40 billion in resolutions already completed by FSLIC -- also will come from a combination of S&L industry and taxpayer sources:

-- FICO will issue bonds under its remaining authority and contribute the proceeds;

-- The S&Ls will contribute a portion of their insurance premiums;

-- FSLIC will contribute the proceeds realized from the sale of receivership assets taken in already completed resolutions, as well as miscellaneous income; and

-- Treasury funds will be used to make up any shortfall.

The final component of the plan is managing future S&L insolvencies and building the Savings Association Insurance Fund (SAIF), the new S&L insurance fund, during the post-RTC period. The funding will come from a portion of S&Ls' insurance premiums and Treasury funds as needed.

These sources provide about $3 billion per year to handle any insolvencies which occur in the 1992-99 period and in addition contribute at least $1 billion per year to building the new Savings Association Insurance Fund. Overall the plan contains $33 billion in post-RTC funds from 1992 to 1999 to manage future insolvencies and contribute to building a healthy new S&L insurance fund. Assuming that $24 billion is used for post-RTC resolutions, by 1999 the SAIF fund will still contain just under $9 billion at a minimum to support the healthy S&Ls.

The net impact of the entire plan -- which includes paying for completed S&L resolutions, paying for the S&L resolutions still to be completed, and providing for fully funded insurance funds for both commercial banks and thrifts -- is $1.9 billion in FY90 and $39.9 billion over the next 10 years.

CAPITAL GAINS

The President's budget includes important revenue-related measures that fall within the jurisdiction of the Treasury Department. These measures also directly reflect the President's commitment to a budget that sustains a strong economy and builds upon it to enhance our future economic power.

We propose a major tax initiative designed to enhance America's long-term growth and competitiveness: a reduction and restructuring of the capital gains tax to encourage long-term investment. Our proposal calls for a 45 percent exclusion of long-term gains or a 15 percent tax rate cap, whichever is more advantageous to the taxpayer. As an important part of this plan, we have targeted the greatest relative benefits to those with incomes lower than $20,000, if married, and $10,000 if single. Such taxpayers would be eligible for a 100 percent exclusion--no tax at all on long-term capital gains.

The policy of a lower tax rate for capital gains was first established in the Revenue Act of 1921. This policy remained in effect for 65 years. During this time it was endorsed by Democrats and Republicans alike as an important means of stimulating investment. The Tax Reform Act of 1986 eliminated that differential in 1987. In my judgement, the benefits of a lower capital gains tax merit its reinstatement. It is important for the long-term strength of our economy that our tax laws encourage saving and investment in entrepreneurial activities. I believe the essential benefit of a reduction in the capital gains tax goes beyond simply encouraging short-term investment and growth. Over the next four years, we propose to phase in a three year holding period for capital assets sold to qualify for the lower capital gains tax rates. Thus we want to shift the focus of investors from the short-term to the long-term, because ultimately, it is long-term investment which will provide our economy with its fundamental strength. Thus we propose to restore this long-acknowledged incentive to American enterprise.

Enhancing incentives for long-term investment is not the only area in which we need to act if the United States is going to remain a leader in the world economy. It is equally important that we take steps to augment policies and programs which stimulate research and development and which foster our long-term productive capacity.

To this end, the President's budget increases investment in basic research by increasing funding for science and technology programs by 13 percent over the enacted 1989 funding levels. Furthermore, we propose to make the tax credit for research and experimentation permanent. For a number of years, we have had a temporary tax credit to encourage additional research and

experimentation (R&E) by U.S. industry. The current credit expires at the end of 1989. It's time we stopped sending stop and go signals to the business community on the importance of research to our economic strength.

Accordingly, the President has proposed to make this credit a permanent feature of the landscape so that U.S. corporations can make their R&E plans with a longer horizon. With this same purpose in mind, the President has also proposed a permanent and more beneficial formula for the allocation of R&E expenses between domestic and foreign income.

INTERNATIONAL CONTEXT

Improving our competitive position in the world economy is very important to our future international economic position. Reducing the deficit will not only improve our competitive position, but is of vital importance to our overall international economic standing. I wish to take a few minutes to address the international implications of our work on the budget this year.

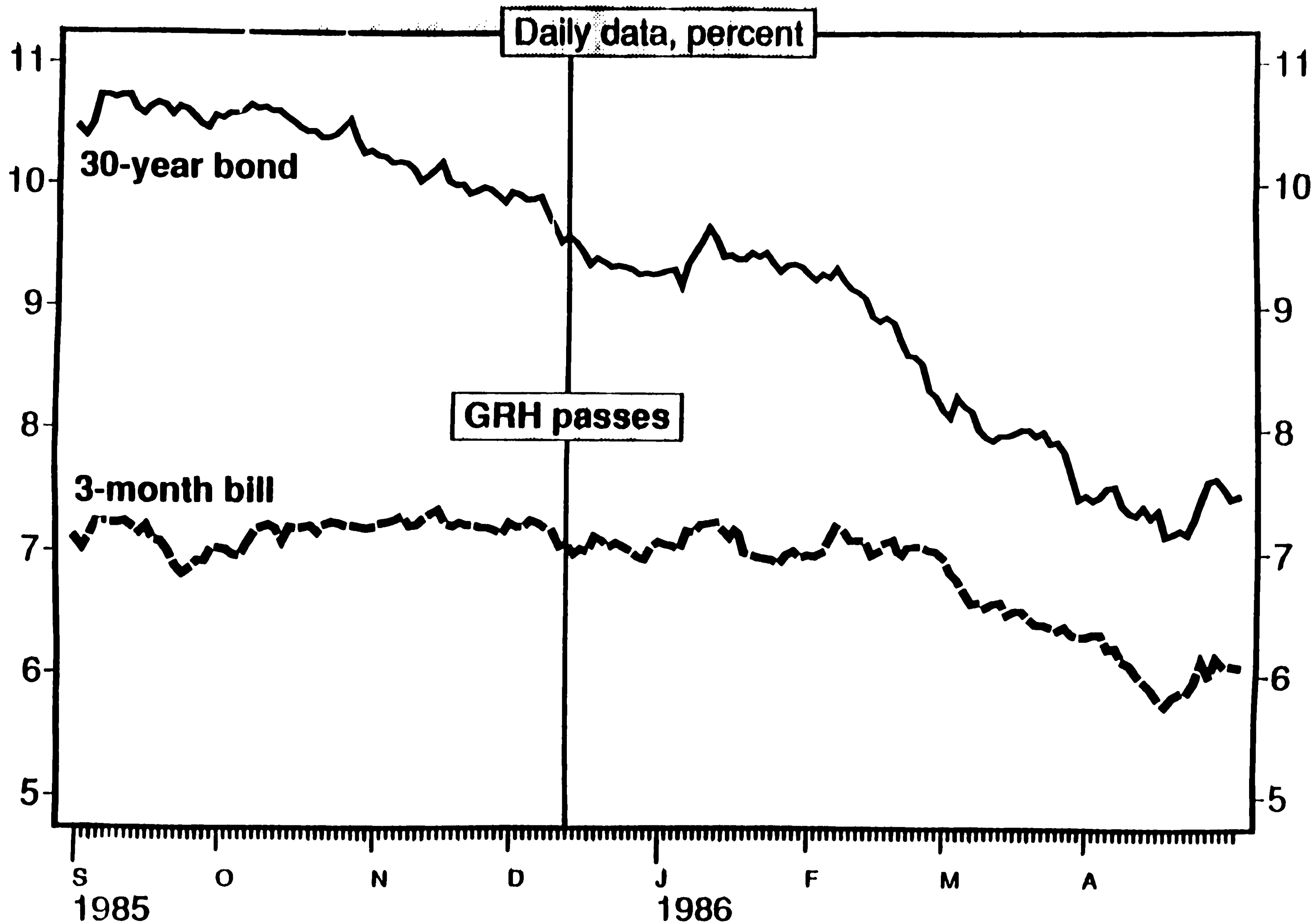
The new reality is that there are no more international boundaries when it comes to the flow of dollars--no border control, no customs officials and no barriers. The influence of foreign financial markets on our economy is great and deep. Most of the world's financial transactions settle daily through the New York Federal Reserve Bank. Before the advent of instantaneous transfer of information and electronic funds transfers this settling of accounts would have taken weeks, now it occurs every night. There are two "wires" through which the transactions settle. The CHIPS wire which largely handles international transactions, and the Fed wire which handles mostly, but not exclusively, domestic transactions. Last month on average about $735 billion worth of transactions were settled per day on the CHIPS wire. And the level of activity is increasing on average at a rate of 25 percent a year. If you approximate the international transactions settled via the Fed wire, then there are about $1 trillion of international transactions settled every day on these wire systems. This amounts to $5 trillion a week, in other words greater each week than our yearly GNP.

Another statistic which demonstrates the power of international finance on our economy is that at the end of 1987 the total stock of U.S. assets held by foreigners was almost $400 billion greater than the stock of foreign assets held by Americans. Ten years ago this difference was $50 billion in our favor. While one can have different views of how to interpret those numbers, one point is clear -- we cannot ignore the effect of international markets on our balance of payments when considering the need for deficit reduction.

Both the flow of financial transactions through the Fed wire and CHIPS and the amount of U.S. assets held by foreigners are in a sense a measure of foreign confidence in our ability to maintain a sound economy and reduce our budget deficit. The tally of the world's opinion of our progress is registered every day through the Federal Reserve's wire's. It is vital that we act decisively to preserve that confidence.

Lest there be any doubt about the extent of the world's interest and concern about the deficit, let me share with you some of the feelings of my G-7 colleagues -- who met here in Washington, DC the first week in February. We are engaged in a team effort, the economic policy coordination process, to provide a growing world economy. I have been pressing them to stimulate their domestic economies and open their markets to sustain world economic growth. They, in turn, are deeply concerned about our ability to reduce the deficit. They worry that we lack the strength of purpose to meet the Gramm-Rudman-Hollings target. They are knowledgeable about the details of our budget process and are watching very carefully how we handle our budget negotiations. They are concerned that our commitment to abiding by the current Gramm-Rudman targets is less than firm and unequivocal, that if meeting the $100 billion target becomes too onerous that we will move the goal line. I assured them on behalf of us all that people in this government--executive and legislative branches alike--are firmly and absolutely committed to meeting the deficit reduction target. I have told them that we will get there one way or the other.

I know you share this commitment. I am delighted to be here today to discuss with you how we can achieve this common goal.


INTEREST RATES, SEPTEMBER 1985 TO APRIL 1986
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FOR IMMEDIATE RELEASE February 28, 1989

FEDERAL FINANCING BANK ACTIVITY

Charles D. Haworth, Secretary, Federal Financing Bank (FFB), announced the following activity for the month of June 1988.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $149.8 billion on June 30, 1988, posting a decrease of $0.2 billion from the level on May 31, 1988. This net change was the result of decreases in holdings of agency debt of $90.3 million, of agency-guaranteed debt of $62.1 million, and in agency assets of $0.4 million. FFB made 75 disbursements during June.

Attached to this release are tables presenting FFB June loan activity and FFB holdings as of June 30, 1988.

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FEDERAL FINANCING BANK

JUNE 1988 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
AGENCY DEBT					
EXPORT-IMPORT BANK					
Note # 73	6/1	$ 164,000,000.00	6/1/98	9.325%	9.219% qtr.
NATIONAL CREDIT UNION ADMINISTRATION					
Central Liquidity Facility					
+Note #467	6/1	60,000,000.00	8/30/88	6.783%	
TENNESSEE VALLEY AUTHORITY					
Advance #904	6/6	106,000,000.00	6/13/88	6.775%	
Advance #905	6/8	141,000,000.00	6/15/88	6.752%	
Advance #906	6/13	105,000,000.00	6/20/88	6.768%	
Advance #907	6/15	138,000,000.00	6/24/88	6.668%	
Advance #908	6/20	18,000,000.00	6/23/88	6.684%	
Advance #909	6/20	87,000,000.00	6/29/88	6.684%	
Advance #910	6/24	5,000,000.00	7/1/88	6.845%	
Advance #911	6/24	154,000,000.00	7/4/88	6.845%	
Advance #912	6/29	92,000,000.00	7/4/88	6.930%	
Advance #913	6/30	15,000,000.00	7/5/88	6.909%	
Advance #914	6/30	159,000,000.00	7/8/88	6.909%	
GOVERNMENT - GUARANTEED LOANS					
DEPARTMENT OF DEFENSE					
Foreign Military Sales					
Greece 16	6/3	470,000.00	9/1/13	9.257%	
Portugal 2	6/13	2,233,958.45	9/10/88	8.920%	
Greece 16	6/14	378,652.00	9/1/13	9.109%	
Greece 17	6/14	23,296.72	8/25/14	9.099%	
Greece 17	6/21	4,194,750.00	8/25/14	9.187%	
Greece 17	6/27	106,245.00	8/25/14	8.990%	
Morocco 12	6/29	302,987.00	9/12/88	8.848%	

+rollover

FEDERAL FINANCING BANK

JUNE 1988 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
DEPARTMENT OF HOUSING & URBAN DEVELOPMENT					
Community Development					
Florence, SC	6/2	$ 25,548.97	7/1/88	6.794%	
San Juan, PR	6/2	192,404.77	10/3/88	6.979%	
San Juan, PR	6/10	466,349.67	10/3/88	6.866%	
Detroit, MI	6/13	9,000,000.00	9/1/89	7.719%	7.868% ann.
Ponce, PR	6/14	608,633.53	10/3/88	6.861%	
*Kansas City, MO	6/15	1,200,000.00	6/15/92	8.063%	8.226% ann.
Mayaguez, PR	6/21	38,000.00	8/1/88	6.683%	
Florence, SC	6/24	16,264.30	7/1/88	6.845%	
RURAL ELECTRIFICATION ADMINISTRATION					
*Tex-La Electric Coop #208A	6/2	560,000.00	12/31/16	9.209%	9.105% qtr.
*Colorado Ute-Electric #203A	6/2	600,000.00	7/2/90	8.230%	8.147% qtr.
Tex-La Electric Coop. #329	6/3	2,179,000.00	12/31/21	9.263%	9.158% qtr.
*Colorado Ute-Electric #203	6/6	3,272,000.00	7/2/90	8.190%	8.108% qtr.
*Wolverine Power #191	6/6	821,000.00	12/31/15	9.149%	9.047% qtr.
*Wolverine Power #183A	6/6	7,519,000.00	7/2/90	8.188%	8.106% qtr.
*Wolverine Power #183A	6/10	2,796,000.00	1/2/90	7.919%	7.842% qtr.
*Wolverine Power #182A	6/10	2,134,000.00	1/2/90	7.919%	7.842% qtr.
*Cajun Electric #197A	6/13	22,000,000.00	7/2/90	8.122%	8.041% qtr.
Associated Electric #328	6/14	4,465,000.00	7/2/90	8.110%	8.029% qtr.
*Northwest Electric #176	6/16	812,000.00	12/31/18	8.921%	8.824% qtr.
*Northwest Electric #176	6/17	820,000.00	6/17/93	8.587%	8.497% qtr.
*Wolverine Power #190	6/20	4,092,000.00	12/31/15	9.195%	9.092% qtr.
*Wabash Valley Power #252	6/22	2,000,000.00	1/3/17	9.196%	9.093% qtr.
*Wabash Valley Power #252	6/23	2,000,000.00	1/3/17	9.042%	8.942% qtr.
Oglethorpe Power #320	6/23	13,915,000.00	7/2/90	8.164%	8.082% qtr.
So. Mississippi Electric #330	6/27	244,000.00	7/2/90	8.160%	8.078% qtr.
*United Power #129A	6/27	15,530,000.00	7/2/90	8.148%	8.067% qtr.
*United Power #67A	6/27	600,000.00	7/2/90	8.146%	8.065% qtr.

*maturity extension

FEDERAL FINANCING BANK

JUNE 1988 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
RURAL ELECTRIFICATION ADMINISTRATION (Cont'd.)					
Brazos Electric #230	6/29	$ 1,275,000.00	1/3/23	9.008%	8.909% qtr.
Brazos Electric #332	6/29	515,000.00	12/31/19	9.000%	8.901% qtr.
*Wolverine Power #191	6/29	700,000.00	12/31/15	8.993%	8.894% qtr.
Tex-La Electric Coop. #329	6/30	139,132.78	1/3/22	9.030%	8.930% qtr.
*Tex-La Electric Coop. #208A	6/30	4,136,000.00	1/3/17	9.022%	8.922% qtr.
*Tex-La Electric Coop. #208A	6/30	3,469,000.00	1/3/17	9.022%	8.922% qtr.
*Chugach Electric #204	6/30	58,000.00	1/3/17	9.019%	8.920% qtr.
*Chugach Electric #204	6/30	1,276,000.00	1/3/17	9.019%	8.920% qtr.
*Chugach Electric #224	6/30	752,000.00	1/3/17	9.019%	8.920% qtr.
*Colorado Ute-Electric #8A	6/30	617,351.31	7/2/90	8.146%	8.065% qtr.
*Colorado Ute-Electric #78A	6/30	383,890.88	7/2/90	8.147%	8.066% qtr.
*Colorado Ute-Electric #78A	6/30	423,663.84	7/2/90	8.153%	8.072% qtr.
*Colorado Ute-Electric #78A	6/30	2,641,256.80	7/2/90	8.153%	8.072% qtr.
*Colorado Ute-Electric #96A	6/30	994,000.00	7/2/90	8.153%	8.072% qtr.
*Colorado Ute-Electric #276	6/30	2,064,453.80	7/2/90	8.148%	8.067% qtr.
*Colorado Ute-Electric #297	6/30	2,689,056.90	7/2/90	8.149%	8.068% qtr.
*Colorado Ute-Electric #297	6/30	3,139,951.20	7/2/90	8.149%	8.068% qtr.
*Wolverine Power #182A	6/30	3,457,000.00	1/2/90	7.990%	7.912% qtr.
*Wolverine Power #183A	6/30	4,389,000.00	1/2/90	7.990%	7.912% qtr.
*Cooperative Power Assoc. #130A	6/30	9,752,066.11	7/2/90	8.149%	8.068% qtr.
SMALL BUSINESS ADMINISTRATION					
State and Local Development Company Debentures					
S. Georgia Area Dev. Corp.	6/8	147,000.00	6/1/03	9.019%	
E. Toledo Local Dev. Corp.	6/8	50,000.00	6/1/08	9.086%	
Region Eight Dev. Corp.	6/8	166,000.00	6/1/08	9.086%	
South Dakota Dev. Corp.	6/8	259,000.00	6/1/08	9.086%	
Wisconsin Bus. Dev. Fin. Corp.	6/8	380,000.00	6/1/08	9.086%	
New Haven Community Inv. Corp.	6/8	239,000.00	6/1/13	9.127%	
Long Beach Local Dev. Corp.	6/8	500,000.00	6/1/13	9.127%	
TENNESSEE VALLEY AUTHORITY					
Seven States Energy Corporation					
Note #A-88-09	6/30	645,001,637.10	7/30/88	6.930%	

*maturity extension

FEDERAL FINANCING BANK HOLDINGS
(in millions)

Program	June 30, 1988	May 31, 1988	Net Change 6/1/88-6/30/88	FY '88 Net Change 10/1/87-6/30/88
Agency Debt:				
Export-Import Bank	$ 11,226.2	$ 11,488.5	$ -262.3	$ -1,237.3
NCUA-Central Liquidity Facility	96.5	106.5	-10.0	-14.9
Tennessee Valley Authority	16,950.0	16,768.0	182.0	564.0
U.S. Postal Service	5,592.2	5,592.2	-0-	1,238.8
sub-total*	33,864.9	33,955.1	-90.3	550.6
Agency Assets:				
Farmers Home Administration	59,674.0	59,674.0	-0-	-5,335.0
DHHS-Health Maintenance Org.	84.0	84.0	-0-	-0-
DHHS-Medical Facilities	102.2	102.2	-0-	-0-
Overseas Private Investment Corp.	-0-	-0-	-0-	-0.7
Rural Electrification Admin.-CBO	4,071.2	4,071.2	-0-	-170.0
Small Business Administration	16.4	16.8	-0.4	-3.2
sub-total*	63,947.8	63,948.2	-0.4	-5,508.9
Government-Guaranteed Lending:				
DOD-Foreign Military Sales	18,539.2	18,588.6	-49.4	-624.7
DEd.-Student Loan Marketing Assn.	4,940.0	4,940.0	-0-	-0-
DOE-Geothermal Loan Guarantees	50.0	50.0	-0-	50.0
DHUD-Community Dev. Block Grant	329.7	320.7	9.0	5.5
DHUD-New Communities	-0-	-0-	-0-	-30.6
DHUD-Public Housing Notes +	2,037.0	2,037.0	-0-	-37.3
General Services Administration +	387.5	390.7	-3.2	-8.0
DOI-Guam Power Authority	32.6	32.6	-0-	-0.5
DOI-Virgin Islands	26.7	26.7	-0-	-0.4
NASA-Space Communications Co. +	949.4	949.4	-0-	140.8
DON-Ship Lease Financing	1,758.9	1,758.9	-0-	-29.4
Rural Electrification Administration	19,204.1	19,217.7	-13.6	-1,992.8
SBA-Small Business Investment Cos.	678.5	693.1	-14.6	-62.1
SBA-State/Local Development Cos.	884.0	885.8	-1.8	-15.7
TVA-Seven States Energy Corp.	1,976.9	1,965.4	11.6	153.2
DOT-Section 511	48.5	48.5	-0.1	-6.9
DOT-WMATA	177.0	177.0	-0-	-0-
sub-total*	52,020.2	52,082.3	-62.1	-2,459.0
grand total*	$ 149,832.9	$ 149,985.6	$ -152.7	$ -7,417.2

*Figures may not total due to rounding
+does not include capitalized interest

TREASURY NEWS

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FOR RELEASE AT 4:00 P.M.
February 28, 1989

MAR 8 ... 89
DEPARTMENT ...

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $14,400 million, to be issued March 9, 1989. This offering will result in a paydown for the Treasury of about $600 million, as the maturing bills are outstanding in the amount of $14,990 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Standard time, Monday, March 6, 1989. The two series offered are as follows:

91-day bills (to maturity date) for approximately $7,200 million, representing an additional amount of bills dated June 9, 1988, and to mature June 8, 1989 (CUSIP No. 912794 SC 9), currently outstanding in the amount of $16,706 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $7,200 million, to be dated March 9, 1989, and to mature September 7, 1989 (CUSIP No. 912794 SW 5).

The bills will be issued on a discount basis under competitive and noncompetitive bidding, and at maturity their par amount will be payable without interest. Both series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, on the records either of the Federal Reserve Banks and Branches, or of the Department of the Treasury.

The bills will be issued for cash and in exchange for Treasury bills maturing March 9, 1989. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rates of accepted competitive tenders. Additional amounts of the bills may be issued to Federal Reserve Banks, as agents for foreign and international monetary authorities, to the extent that the aggregate amount of tenders for such accounts exceeds the aggregate amount of maturing bills held by them. Federal Reserve Banks currently hold $1,904 million as agents for foreign and international monetary authorities, and $4,932 million for their own account. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 5176-1 (for 13-week series) or Form PD 5176-2 (for 26-week series).

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Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. This information should reflect positions held as of one-half hour prior to the closing time for receipt of tenders on the day of the auction. Such positions would include bills acquired through "when issued" trading, and futures and forward transactions as well as holdings of outstanding bills with the same maturity date as the new offering, e.g., bills with three months to maturity previously offered as six-month bills. Dealers, who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities, when submitting tenders for customers, must submit a separate tender for each customer whose net long position in the bill being offered exceeds $200 million.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

Payment for the full par amount of the bills applied for must accompany all tenders submitted for bills to be maintained on the book-entry records of the Department of the Treasury. A cash adjustment will be made on all accepted tenders for the difference between the par payment submitted and the actual issue price as determined in the auction.

No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches. A deposit of 2 percent of the par amount of the bills applied for must accompany tenders for such bills from others, unless an express guaranty of payment by an incorporated bank or trust company accompanies the tenders.

Public announcement will be made by the Department of the Treasury of the amount and yield range of accepted bids. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. Subject to these reservations, noncompetitive tenders for each issue for $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. Cash adjustments will be made for differences between the par value of the maturing bills accepted in exchange and the issue price of the new bills. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

If a bill is purchased at issue, and is held to maturity, the amount of discount is reportable as ordinary income on the Federal income tax return of the owner for the year in which the bill matures. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, any gain in excess of the basis is treated as ordinary income.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76, 27-76, and 2-86, as applicable, Treasury's single bidder guidelines, and this notice prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars, guidelines, and tender forms may be obtained from any Federal Reserve Bank or Branch, or from the Bureau of the Public Debt.

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