

# **CBO TESTIMONY**

Statement of  
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before the  
Subcommittee on Financial Institutions  
Supervision, Regulation and Deposit Insurance  
Committee on Banking, Finance  
and Urban Affairs  
U.S. House of Representatives

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## **NOTICE**

This statement is not available for public release until it is delivered at 10:00 a.m. (EST), Wednesday, March 17, 1993.



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Mr. Chairman, I appreciate this opportunity to appear before the Subcommittee to discuss the Congressional Budget Office's (CBO's) assessment of the financial condition of the Resolution Trust Corporation (RTC) and its successor, the Savings Association Insurance Fund (SAIF).

In my testimony, I will focus on the following aspects of CBO's assessment:

- o How much the government has spent for the thrift cleanup to date: what funds have been provided, and how they have been used;
- o A review of CBO's latest baseline projections of spending by the RTC and the SAIF, and our analysis of the Clinton Administration's budget proposal for these agencies;
- o The effect that further delays in funding can have on the cost of future resolutions; and
- o The transition of responsibility from the RTC to the SAIF.

## THE THRIFT CRISIS: WHERE ARE WE NOW?

Deposit insurance had little impact on the budget before the late 1980s, but since then spending to protect depositors of failed financial institutions--particularly insolvent savings and loans--has become a significant and volatile factor in the federal budget. In 1991, net outlays for deposit insurance peaked at more than \$78 billion, with virtually all of that activity reflecting spending for resolving sick thrifts. The thrift crisis has witnessed the demise of roughly 2,000 institutions since 1980, and industry assets have shrunk from \$1.4 trillion to about \$850 billion.

The Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) established the framework for dealing with the crisis. First, FIRREA addressed the severe funding shortfalls that had been accumulating before the legislation was enacted. Next, it attempted to deal with the growing inventory of thrifts that were insolvent but not yet closed. Finally, the legislation created a new insurance fund with responsibility for future thrift failures.

## Past and Current Funding for Thrift Failures

In 1988, the Federal Savings and Loan Insurance Corporation (FSLIC), facing massive thrift failures but with barely any cash in its coffers, shut down hundreds of sick thrifts by issuing notes and promising to pay acquirers for losses on assets. FIRREA established the FSLIC Resolution Fund to carry out these past commitments. The FSLIC Resolution Fund receives funding, which the budget treats as mandatory, through the annual appropriation process.

Along with premium income and the proceeds of asset sales, appropriations of approximately \$43 billion from 1990 through 1992 have allowed the agency to pay off the bulk of the 1988 contracts. In addition, CBO expects that the FSLIC Resolution Fund will spend about \$7 billion over the 1993-1998 period. CBO estimates that losses totaling \$60 billion (measured in 1990 dollars) will be charged to the FSLIC and the FSLIC Resolution Fund for resolving those institutions closed before the RTC was established.

FIRREA also established the RTC to deal with the growing inventory of insolvent thrifts. Initially, the RTC was scheduled to stop accepting new cases on August 9, 1992; that deadline now runs through September 30, 1993.

The Congress has provided the RTC with \$105 billion to pay for losses incurred in resolving failed thrift institutions: \$50 billion under FIRREA; \$30 billion under the RTC Funding Act of 1991; and \$25 billion (available until April 1, 1992) under the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991.

Of the funds provided, \$85 billion has been obligated, and \$18 billion cannot be used because it was available only through March 31, 1992. The RTC has reserved the remaining \$2 billion to pay for administrative costs, meet liquidity needs, and adjust for accounting shortfalls (see Table 1 for a summary of the RTC's funding status through December 30, 1992). For almost a year now, the RTC has been unable to resolve any insolvent thrifts because it has no funds available for that purpose.

Although FIRREA tapped the thrift industry to help pay for the crisis, virtually all of the funding has come from the Treasury. The Treasury funds have been used to fill the gap between the sharply diminished value of the assets of failed thrifts and the obligations of those thrifts to their depositors-- thus enabling depositors to recover the full amount of their insured deposits. The agencies have also incurred administrative costs in resolving the failed institutions and selling their assets.

In addition, the RTC has borrowed from the Federal Financing Bank (FFB) for working capital to finance its caseload temporarily, using as collateral assets it has acquired from failed thrifts. The RTC is now receiving and will continue to receive substantial income from the sale of these assets, which it will use to repay the principal and interest owed to the FFB. Thus, this income is already committed and is not available to cover future insurance losses.

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TABLE 1. STATUS OF FUNDING FOR THE RESOLUTION TRUST CORPORATION THROUGH DECEMBER 30, 1992 (In billions of dollars)

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Source	Appropriated	Used	Expired	Remaining
FIRREA (August 1989)	50	50.0	0	0
RTC Funding Act (March 1991)	30	27.7	0	2.3
RTCRRIA (December 1991)	<u>25</u>	<u>6.7</u>	<u>18.3</u>	<u>0</u>
Total	105	84.5	18.3	2.3

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SOURCE: Congressional Budget Office.

NOTES: FIRREA = Financial Institutions Reform, Recovery and Enforcement Act of 1989; RTCRRIA = Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991.

Numbers may not add to totals because of rounding.

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## Future Funding for Thrift Failures

CBO's baseline budget projections assume that the RTC will receive additional funding this spring and that continued funding will be made available without interruption. Funding delays, such as those that occurred in fiscal year 1991 and again in 1992, affect the amount of disbursements and receipts each year, increase the length of time needed to complete the resolution process, and raise the final cost of the thrift crisis.

For the years beyond 1993, when under current law the RTC will no longer be accepting new institutions to close, CBO assumes that either the life of the RTC will be extended once more or its successor--the Savings Association Insurance Fund--will be given sufficient resources on a timely basis. We estimate that disbursements for insurance losses, including administrative costs, will total about \$51 billion over the 1993-1998 period. This estimate reflects the projected failure over the six-year period of thrifts with \$225 billion to \$300 billion in assets. Most of the losses are projected to occur between 1993 and 1996, at a rate of roughly \$10 billion a year. Although we expect that losses in 1997 and 1998 will be smaller, they may still be significant, since excess capacity and competition from other types of financial institutions are likely to put continued strain on the thrift industry.

CBO estimates that net outlays by the RTC and the SAIF will total about \$2 billion over the 1993-1998 period (see Table 2). Outlays will be negative in 1993, because no new spending authority has been provided to date and receipts from the sale of assets will exceed any spending. Assuming that funding is made available this spring, we project that net outlays by the RTC and the SAIF will total about \$17 billion over the 1994-1996 period, before turning negative again in 1997 and 1998 as losses for thrift failures decline. In addition, the FSLIC Resolution Fund will spend an estimated \$7 billion during this period on final resolution of institutions that failed before 1989.

Aside from Treasury appropriations, the only source of funds available to finance the outlays is the insurance premiums that thrifts pay on deposits. If the SAIF uses these insurance premiums (along with cash reserves) to pay for insurance losses and administrative costs over the 1993-1998 period, CBO expects that the Congress would need to appropriate about \$43 billion to the RTC or the SAIF or both to cover the shortfall in losses from insolvent thrifts.



TABLE 2. OUTLAYS FOR SAVINGS AND LOAN-RELATED DEPOSIT INSURANCE IN THE BASELINE (By fiscal year, in billions of dollars)

	Estimate	Projections					
	1992	1993	1994	1995	1996	1997	1998
<b>Resolution Trust Corporation and Savings Association Insurance Fund</b>							
Insurance losses <sup>a</sup>	10	9	11	11	9	5	5
Working capital							
Disbursements	21	12	17	19	15	8	8
Receipts	-43	-32	-24	-22	-21	-19	-14
Interest costs	3	2	2	2	2	2	2
Insurance premiums	<u>0</u>	<u>-1</u>	<u>-1</u>	<u>-1</u>	<u>-1</u>	<u>-1</u>	<u>-1</u>
Total	-9	-9	4	9	4	-5	-1
FSLIC Resolution Fund	8	4	2	1	b	b	0

SOURCE: Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1994-1998* (January 1993).

NOTES: The Resolution Trust Corporation is currently scheduled to stop accepting new cases after September 30, 1993, and to turn over responsibility for future resolutions to the Savings Association Insurance Fund. The transfer of responsibility could possibly be delayed by the Congress, but the costs incurred would not be significantly affected by such a change. CBO therefore presents the estimates on a combined basis.

FSLIC = Federal Savings and Loan Insurance Corporation.

Numbers may not add to totals because of rounding.

- a. Includes less than \$500 million per year in administrative costs.
- b. Less than \$500 million.

Using all available funds in this fashion would leave the SAIF with negligible resources for subsequent needs, and the fund would not attain the targets for net worth specified in FIRREA. If the goal of the Congress is to build the SAIF's reserves to the level specified by FIRREA--\$7.6 billion by October 1, 1998--then, under CBO's baseline assumptions, it will need to appropriate approximately \$50 billion to cover RTC and SAIF expenses through 1998.

These estimates are very uncertain, however. The financial data on thrifts, on which CBO bases its projections, leave much to be desired. Financial statements show the book value of assets, which does not accurately reflect current or future values. Deposit insurance losses are sensitive to the economy in general and to interest rates and real estate markets in particular. Both the banking and thrift industries are consolidating as the number of independent institutions declines, but it is virtually impossible to predict how fast consolidation will take place and how much of it the regulators will mandate. How promptly the regulators close institutions and how they set deposit insurance premiums will also affect deposit insurance losses.

Estimates of losses are especially sensitive to prices received in disposing of securities, loans, and real estate that the RTC retains after closing or merging thrifts. The actual cost of resolving failed depository

institutions will not be known until the government has disposed of the last asset, which probably will be well beyond the year 2000. Even the "actual" losses recorded for institutions already resolved by the RTC are only estimates. The amount of thrift losses could easily vary from CBO's current estimate by billions of dollars in either direction.

### Total Costs of Resolving the Savings and Loan Crisis

For purposes of summarizing the long-term costs of the savings and loan crisis, the most useful measure is a present-value estimate of past, present, and future net costs of resolving failed thrifts. (The federal budget, in contrast, records the yearly net flows of cash in nominal dollars.) CBO now estimates that losses in failed financial institutions will cost the RTC or its successor \$120 billion on a present-value basis, bringing the total cost of the thrift crisis to \$180 billion since 1980.

The \$120 billion estimate for cleaning up the thrift crisis is \$15 billion lower than the estimate CBO prepared last summer, reflecting continued improvement in the condition of the thrift industry. Our analysis of the financial condition of the thrift industry in recent quarters suggests that fewer institutions are facing insolvency and that the losses associated with resolving

those thrifts are diminishing. The removal of many hemorrhaging thrifts, the unusually wide spread between borrowing and lending rates, and changes in law and regulatory behavior have all contributed to this improvement. Several different methodologies used to estimate future losses seem to confirm this pattern and provide the basis for the projections.

Despite this reduction in the estimated size of the problem, a significant number of problem thrifts may still require closure and resolution, and one should not assume that leaving insolvent institutions open represents a savings to the taxpayer. Historically, a substantial share of the losses associated with closing failed savings and loans could have been avoided had the institutions been shut down when they first became insolvent.

Delay in closing failed thrifts is still adding to the final cost of this crisis for three reasons. First, conservatorships continue to incur high borrowing costs. Second, undercapitalized thrifts still face incentives to make risky investments that may result in additional losses. Finally, competition between these institutions and healthier thrifts may result in more failures of marginal institutions.

## COMPARING CBO AND CLINTON ADMINISTRATION ESTIMATES

CBO's analysis suggests that the final cost of thrift resolutions will be higher, more institutions will be closed, and the cleanup job will take longer than the Clinton Administration anticipated in its February 1993 budget projections. For the RTC and the SAIF, CBO is projecting outlays from 1993 through 1998 that are \$23 billion above the Office of Management and Budget (OMB) estimate; most of the difference occurs in 1995 and 1996. President Clinton's February budget projections do not reveal the Administration's estimate of the total cost of the savings and loan cleanup, but they probably reflect losses at the lower end of the \$90 billion to \$130 billion range (in 1989 dollars) previously suggested by the Bush Administration. This estimate would be somewhat below CBO's present-value estimate (in 1990 dollars) of \$120 billion.

In nominal or budget dollars, the Clinton Administration's budget includes \$34 billion in spending by the RTC and the SAIF to pay for losses from 1993 through 1998. The Administration has requested \$45 billion for this purpose, which allows for additional funding in the event that losses exceed its current projection. CBO estimates that \$50 billion will be needed to pay for losses and to capitalize SAIF through 1998, and such spending has been incorporated into the recently reported House and Senate budget

resolutions. In view of the difficulty of estimating these amounts, the Administration's request is well within the range of uncertainty surrounding CBO's estimate.

### THE TRANSITION FROM THE RTC TO THE SAIF

Current law authorizes the Resolution Trust Corporation to continue closing insolvent thrifts that are in receivership or conservatorship before October 1, 1993. Although the Savings Association Insurance Fund is scheduled to assume the job of protecting depositors in failed thrifts beginning in fiscal year 1994, the agency will face that responsibility with a modest balance of about \$1 billion. The SAIF's potential liabilities are much greater, however. If the RTC is closed, the SAIF will be responsible for that portion of remaining losses not paid by the RTC. Whether the RTC or the SAIF performs these resolutions does not change the need for appropriated funds to carry out the job.

Beginning in 1993, all insurance premiums paid by thrifts will go to the SAIF, except for the \$794 million a year paid to the Financing Corporation. (The Financing Corporation, an off-budget corporation created solely to raise funds for FSLIC, uses the premium income to pay interest on the 30-year

bonds it issued in 1988 and 1989.) Certain banks that have acquired failed thrifts (commonly known as "Oakar thrifts") already pay to the SAIF the portion of their assessments that is equal to the ratio of thrift deposits to bank deposits at the time of acquisition. Annual assessments received by SAIF will total about \$1 billion during 1993, increasing to \$1.4 billion by 1998.

FIRREA and subsequent legislation anticipated that the SAIF might need Treasury funding to build sufficient cash reserves and authorized two types of annual payments for this purpose. One authorization provides for a payment each year through 2000 equal to the difference between \$2 billion and the assessment income paid into the fund that year. The second authorization provides for payments to maintain the net worth of the SAIF according to a designated schedule starting at \$1 billion for the beginning of fiscal year 1993 and increasing to \$8.8 billion for the beginning of fiscal year 2000.

The Federal Deposit Insurance Corporation (FDIC) has authority to borrow up to \$30 billion to allow the Bank Insurance Fund (BIF) and the SAIF to finance insurance losses. Without sufficient funding for the RTC, and if the SAIF assumes responsibility for thrift failures beginning in October 1993, the FDIC probably will need to tap that borrowing authority for use by the SAIF, thereby reducing the amount of funding available for the

BIF. (Any amount that the FDIC borrows on behalf of the SAIF probably would be repaid by the thrifts, not the banks. The amount of such borrowing would be constrained by the legal requirement that the FDIC and the Secretary of the Treasury agree on a repayment schedule. This schedule must show that assessment income will be sufficient to pay both principal and interest on the loan.) Under the assumptions of CBO's baseline projections, the BIF will not be tapping any of the authorized \$30 billion.

Current law requires that the SAIF reach a reserve ratio of 1.25 percent of insured deposits within a reasonable period of time. The thrifts insured by SAIF now pay risk-based assessment rates averaging about 26 basis points, up from a rate of 23 basis points last year. Although the recent increase in premium rates will help to correct long-term imbalances in expenses and income, the FDIC also expects that the SAIF will need appropriated funds to finance short-term losses.

## CONCLUSIONS

The RTC needs additional funding to carry out its task of resolving thrifts that have already failed and to ensure that the government's pledge to insured depositors is fulfilled. Failure to provide sufficient funds now would lead to



a weaker industry in the long run and to an insurance fund that was likely to spend substantially more money than it would if those funds were provided expeditiously.

The amount of funds needed is hard to predict. If funding is to cover current and prospective thrift failures for the next five years and also to build up the SAIF reserves, CBO estimates that about \$50 billion would be necessary for the RTC and the SAIF--but it is possible that a smaller amount would be sufficient. If too little is provided, SAIF would be unable to build up its reserves or additional funding might be required in a few years. Also, some of the borrowing authority given to the FDIC to ensure sufficient funds for the BIF might end up being swallowed by the SAIF. The FDIC's borrowing authority would be of only limited help, however, because the income from thrift insurance premiums will be sufficient to finance no more than \$10 billion to \$15 billion in FDIC borrowing over the next decade.

CBO's estimate has been and continues to be that a significant portion of the cleanup of the thrift crisis remains to be completed. The improvement of the thrift industry reflected in CBO's new baseline is hardly cause for complacency or for further delay in funding. The longer the delay in closing failed institutions, the more expensive it will be to both the taxpayer and the economy as a whole.