United States General Accounting Office

GAO

Report to Congressional Committees

January 1993

DEPOSIT INSURANCE FUNDS

Compliance With Obligation and Repayment Requirements as of March 31, 1992

148410

GAO

United States
General Accounting Office
Washington, D.C. 20548

Accounting and Financial Management Division

B-251583

January 21, 1993

The Honorable Donald W. Riegle, Jr.
Chairman
Committee on Banking, Housing
and Urban Affairs
United States Senate

The Honorable Henry B. Gonzalez
Chairman
Committee on Banking, Finance
and Urban Affairs
House of Representatives

This is the first of our required reports on the Federal Deposit Insurance Corporation's (FDIC) compliance with the maximum obligation limitation established by the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). This obligation limitation applies separately to both the Bank Insurance Fund (BIF), insurer of commercial bank deposits, and the Savings Association Insurance Fund (SAIF), insurer of thrift deposits, and is designed to provide assurance that each fund's assets and other funding sources are sufficient to fund its obligations. FDIC administers both insurance funds.

FDICIA also requires us to report on BIF's and SAIF's ability to repay amounts borrowed from the Department of the Treasury for insurance losses and to analyze data related to the sale of failed bank assets. As agreed upon with your respective offices, the latter requirement was modified to include an assessment of whether BIF's total collections from the management and disposition of assets acquired from failed banks would be sufficient to repay the Fund's existing working capital borrowings.

Results in Brief

FDIC's maximum obligation limitation calculations for BIF and SAIF show that, as of March 31, 1992, BIF's assets and other funding sources exceeded its obligations by $36.5 billion and SAIF's assets and other funding sources exceeded its obligations by $155 million. On the basis of our review of FDIC's calculations and explanatory notes for both BIF and SAIF as of March 31, 1992, nothing came to our attention that would lead us to question the reasonableness of the amounts reported. However, FDIC has not yet finalized a formal policy for allocating Treasury borrowing authority between the two funds. For the first quarter of calendar year

1992, FDIC allocated the entire amount of Treasury borrowing authority to BIF. Implementation of a formalized allocation policy may significantly change how FDIC's borrowing authority with Treasury is allocated between the funds in future quarters and thus may significantly alter FDIC's future maximum obligation limitation calculations for the funds.

As of March 31, 1992, neither BIF nor SAIF had borrowed funds for insurance losses from the U.S. Treasury. However, the need for future borrowings for insurance losses, and each fund's ability to repay any such borrowings, is dependent on the impact of future economic conditions on financial institution failures, the failures' cost to the insurance funds, future assessment revenues, and other funding alternatives.

As of March 31, 1992, FDIC had borrowed approximately $12 billion from the Federal Financing Bank (FFB) for BIF's working capital needs. These working capital borrowings are to be repaid primarily from proceeds from the management and disposition of failed bank assets. We estimate that future net recoveries from BIF's March 31, 1992, inventory of failed bank assets will be about $22.5 billion. However, our estimates are based on an analysis of FDIC's historical experience in generating collections for BIF from the management and disposition of assets acquired from failed banks and, as such, are subject to significant uncertainties which could materially affect BIF's actual recoveries on these assets.

Background

Section 15(c) of the Federal Deposit Insurance (FDI) Act, as amended by FDICIA, requires that FDIC determine the limitation on outstanding obligations for BIF and SAIF based on a maximum obligation limitation formula. In general, the formula involves comparing the assets and liabilities of each of the two insurance funds to ensure that, at any particular point in time, each fund's assets are sufficient to cover its liabilities. The obligation limitation precludes FDIC's issuing or incurring obligations for BIF or SAIF if, after doing so, total outstanding obligations of each fund, considered separately, would exceed the sum of its available funding sources. The obligation formula is designed to provide assurance that the obligations of each fund are adequately supported by its assets and available funding sources and to alert the Congress to FDIC's funding needs. This new formula replaces the "net worth limitation" test imposed by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) (Public Law 101-73).

FDICIA defines funding sources for each fund as (1) its cash and cash equivalents, (2) the amount equal to 90 percent of the fair market value of its assets other than cash and cash equivalents, and (3) its allocated portion of the total amount authorized to be borrowed from Treasury under section 14(a) of the FDI Act, as amended by FDICIA. Section 14(a) of the FDI Act, as amended by FDICIA, provided FDIC with $30 billion in borrowing authority with Treasury to cover insurance losses. The borrowing authority is available for both BIF and SAIF, but FDICIA does not specify how the $30 billion should be allocated between the two funds. In defining obligations, the act requires that FDIC include all guarantees (excluding deposit guarantees), any amounts borrowed from Treasury or FFB pursuant to section 14 of the FDI Act, and any other obligations for which the funds have a direct or contingent liability.[1]

Objectives, Scope, and Methodology

The objectives of this review were to determine whether (1) BIF and SAIF have complied with the statutory maximum obligation limitation specified in FDICIA for the quarter ending March 31, 1992, (2) BIF and SAIF have borrowed from the U.S. Treasury for insurance losses and what factors may affect the need for future borrowings, as well as BIF's and SAIF's ability to meet established repayment schedules when borrowings occur, and (3) whether BIF will generate sufficient proceeds from the management and disposition of failed bank assets to repay working capital borrowings. See appendix I for details on the scope and methodology of our work.

We performed our work at FDIC's headquarters offices in Washington, D.C., and Arlington, Virginia, from March 1992 through October 1992. We performed our work in accordance with generally accepted government auditing standards. However, the scope of our work was substantially less than that of a financial audit and, as such, did not include a review of FDIC's internal control environment. Also, we did not test or verify FDIC's books and records or the data contained in appendixes II and III, except for the procedures detailed in appendix I. Our review of compliance with laws and regulations was limited to BIF's and SAIF's compliance with the maximum obligation limitation established by FDICIA. While we did not obtain written comments on this report, we discussed its contents with cognizant FDIC officials, who agreed with the report's findings and conclusions. We have incorporated their comments where appropriate.

[1]As agreed to by the Senate and House Banking Committees, FDIC's estimated liability for future bank failures or assistance transactions for which there is no contractual agreement between FDIC and the troubled institutions comprising the estimated liability is excluded in determining each fund's total obligations.

FDIC Reports BIF and SAIF Complied With Their Maximum Obligation Limitations

FDIC's maximum obligation limitation calculations for BIF and SAIF show that, as of March 31, 1992, BIF's assets and other funding sources exceeded its obligations by $36.5 billion[2] and SAIF's assets and other funding sources exceeded its obligations by $155 million. This excess is described in the calculations as "Remaining Obligation Authority." The obligation limitation calculations and explanatory notes for BIF and SAIF are included as appendixes II and III, respectively.

On the basis of our review of FDIC's first quarter 1992 calculations and explanatory notes for BIF and SAIF, nothing came to our attention that would lead us to question the reasonableness of the amounts reported.

FDIC Had Not Finalized an Allocation Policy for Treasury Borrowing Authority

During the course of our work, we noted that FDIC had not yet finalized a formal policy for allocating Treasury borrowing authority between BIF and SAIF. FDIC allocated all $30 billion of this borrowing authority to BIF for the first quarter of 1992 based on projections of BIF's funding needs when funding legislation was first proposed. At that time, projections of bank failures and their cost to the insurance fund indicated that BIF would need about $30 billion to cover insurance losses.

While nothing in FDICIA indicates how the $30 billion should be allocated between the two funds, subsequent events and future uncertainties impacting both insurance funds indicate that a formal process for allocating the borrowing authority may be warranted. For example, FDIC's maximum obligation limitation calculation for SAIF indicates that it is in compliance with FDICIA's limitation on outstanding obligations as of March 31, 1992. However, SAIF's future ability to incur additional obligations is tenuous, given its impending thrift resolution responsibilities.[3] SAIF is scheduled to begin its full resolution responsibility on October 1, 1993, but prior to that time it may incur resolution costs

[2]BIF is able to incur additional obligations despite its unaudited deficit fund balance of $6.9 billion at March 31, 1992, primarily because the maximum obligation limitation formula includes all of the Treasury borrowing authority and excludes BIF's estimated liability for future bank failures and assistance transactions.

[3]FIRREA established the Resolution Trust Corporation (RTC) to resolve thrifts whose deposits had been insured by the Federal Savings and Loan Insurance Corporation (FSLIC) that were placed into conservatorship or receivership from January 1, 1989, through August 8, 1992. The Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991 (Public Law 102-233), enacted on December 12, 1991, extended RTC's resolution authority to thrifts placed into conservatorship or receivership through September 30, 1993. However, in accordance with the provisions of Public Law 102-233, any thrift requiring resolution after September 30, 1993, which had previously been under RTC conservatorship or receivership may be transferred back to RTC for resolution.

related to certain institutions.[4] In the event that SAIF reaches its maximum obligation limitation, it would be prohibited from incurring any additional obligations and thus limited in its ability to fulfill its resolution responsibilities without some of the $30 billion currently allocated to BIF.

An Allocation Policy Could Consider Each Fund's Cash Flows and Alternative Funding Sources

FDIC has not yet finalized a formal allocation policy for future quarters. Because the policy developed to allocate Treasury borrowing authority could significantly affect the ability of each fund to incur obligations in future quarters, several factors merit FDIC consideration in finalizing this policy. Considering each fund's cash flows associated with resolution activity from financial institution failures, expected operating expenses, and anticipated assessment revenues would be a reasonable projection basis. FDIC has periodically developed such cash flow projections for BIF and could develop similar projections for SAIF using these projections to determine each fund's borrowing needs.

FDIC could also consider alternative sources of funding. For example, in addition to insurance assessments, the FDI Act, as amended, provides for Treasury payments to SAIF. To the extent that insurance assessments deposited in SAIF do not total $2 billion a year, section 11(a)(6) of the FDI Act requires Treasury to fund the difference for each fiscal year from 1993 to 2000 with funds specifically appropriated for that purpose. Assuming funds are appropriated, SAIF is assured of at least $16 billion in either assessment income or Treasury payments during this 8-year period. Section 11(a)(6) also requires Treasury to make annual payments, out of appropriated funds, as necessary to ensure that SAIF has a specified net worth, ranging from zero during fiscal year 1992 to $8.8 billion during fiscal year 2000. The cumulative amounts of the net worth payments cannot exceed $16 billion. Section 11(a)(6) authorizes funds to be appropriated to the Secretary of the Treasury for purposes of these payments.

While FDIC's allocation policy could consider each fund's cash flows and funding sources, FDIC would also need to consider any constraints associated with these funding sources. For example, FDIC cannot recognize

[4]Section 5(d)(3) of the FDI Act, as amended by FIRREA, generally allowed bank holding companies to merge their SAIF-insured subsidiaries into their BIF-insured bank subsidiaries. The resulting banks would continue to pay a portion of their premiums to SAIF based on the amount of thrift deposits acquired. Accordingly, in the event of failure or assistance, any loss would be allocated between BIF and SAIF in proportion to the institution's deposits insured by each fund. FDICIA expanded on the FIRREA amendment to allow an insured bank or thrift to acquire, merge, or assume the deposit liabilities of the other type of insured depository institution. As with the FIRREA amendment, insurance premiums and loss expenses are to be allocated between BIF and SAIF.

Treasury payments for SAIF under section 11(a)(6) of the FDI Act, as amended, as funding when calculating the Fund's maximum obligation limitation until funds have been appropriated to Treasury for these payments. As of March 31, 1992, none of these funds had been appropriated for fiscal year 1993.

FDIC's Treasury Borrowings and Efforts to Rebuild the Insurance Funds Will Be Affected by Several Factors

FDIC has not yet borrowed funds from Treasury to cover insurance losses for either BIF or SAIF. The timing and extent to which such funding may be needed will depend on a number of factors, including (1) the effect of future economic conditions on financial institution failures and the failures' cost to the insurance funds and (2) future revenue streams available to the funds. These factors will also affect FDIC's ability to rebuild the reserves of the insurance funds to designated levels.

FDIC is currently working with Treasury to develop a general repayment agreement in anticipation of future Treasury borrowings. FDICIA prohibits Treasury borrowing unless Treasury and FDIC have an agreement which provides a repayment schedule and demonstrates that income for BIF or SAIF will be sufficient to repay principal and interest on Treasury borrowings within the period established in the respective repayment schedule. Separate agreements will be established for BIF and SAIF.

Based on cash flow projections FDIC has developed for BIF, FDIC does not anticipate that BIF will need to borrow from Treasury for insurance losses until some time in calendar year 1993. However, these cash flow projections are influenced in part by changes in economic conditions and fluctuations in interest rates. These factors can affect the timing of bank failures and the closure of banks by the regulators. Short-term profits due to the current low interest rates and gains from asset sales may delay some troubled banks' failures and, thus, the timing of FDIC's need to borrow from Treasury. However, these short-term profits do not necessarily eliminate the losses imbedded in the banks' asset portfolios or the ultimate losses to BIF.

FDIC also considers assessment revenues in projecting its borrowing needs. FDIC has adopted a risk-based premium system applicable to premiums due in the first semiannual period of 1993 and thereafter, under which banks and thrifts posing higher risks of loss to the insurance funds are to be charged higher premiums. The assessment rates to be charged to federally insured institutions will range from 23 cents to 31 cents per $100 of domestic deposits. FDIC estimates that the average assessments charged to

BIF-insured institutions will be 25.4 cents per $100 of domestic deposits, an increase of 10 percent over the current assessment rate of 23 cents per $100 of domestic deposits. FDIC estimates that the average assessments charged to SAIF-insured institutions will be 25.9 cents per $100 of domestic deposits, an increase of about 13 percent over the current assessment rate.

Resolution costs and assessment revenues are also significant factors to be considered in projecting BIF's and SAIF's future fund balances and, therefore, in determining borrowing needs. In an effort to achieve some level of self-sufficiency, FDICIA requires FDIC to develop a recapitalization plan for BIF that specifies target reserve ratios at semiannual intervals, culminating in a reserve ratio equal to the designated reserve ratio of 1.25 percent in no more than 15 years. At March 31, 1992, FDIC reported that BIF had a deficit fund balance of $6.9 billion. The most recent FDIC projections show that BIF will achieve the designated ratio within 15 years but will continue to have a deficit fund balance until the year 2000. However, these projections are subject to significant uncertainties. Forecasting bank failures and their costs to BIF over the long-term is a highly imprecise process. Additionally, assumptions about the level of bank failures, growth in industry assets and insured deposits, and growth in BIF's assessment revenues over a 15-year period are subject to considerable fluctuations due to future economic conditions, further industry consolidation, and the implementation of regulatory reforms mandated by FDICIA.

Section 7(b) of the FDI Act also establishes SAIF's designated reserve ratio at 1.25 percent of estimated insured deposits. This designated reserve ratio is to be achieved within a "reasonable period of time." FDIC is not required to establish, and has not established, a formal recapitalization schedule for SAIF. As of March 31, 1992, FDIC reported that SAIF had a fund balance of $123 million, making its ratio of reserves to insured deposits negligible. SAIF's ability to achieve its designated reserve ratio may depend, in part, on whether it receives the appropriated funds from Treasury, as discussed above.

BIF's Ability to Repay Existing Working Capital Borrowings Is Subject to Significant Uncertainties

FDIC's experience in generating recoveries from the management and disposition of failed institution assets indicates that, if FDIC's future recoveries mirror its historical experience, BIF should be able to repay its March 31, 1992, outstanding borrowings from FFB. However, significant uncertainties exist which could affect FDIC's ability to generate future collections from its asset liquidation activity at levels similar to those experienced in the past.

FDIC has authority to borrow funds for BIF's working capital needs from FFB, but the amount of its outstanding working capital borrowings is subject to BIF's maximum obligation limitation. We reviewed FDIC's historical experience in generating funds from the management and disposition of assets acquired from failed BIF-insured financial institutions as a source of repaying FFB borrowings. Using data from FDIC's Financial Information System, its accounting system of record, our analysis aggregated collection and loss data on BIF's failed bank asset inventory from the time an institution failed through the first quarter of 1992. We did not rely on data from FDIC's Liquidation Asset Management Information System (LAMIS), its primary system for managing assets from failed financial institutions, because weak controls over LAMIS have resulted in data integrity problems.[5] Additionally, assets managed through the Division of Liquidation's Assistance Transaction Branch, which comprised approximately 31 percent of BIF's failed bank asset inventory as of March 31, 1992, are not included on LAMIS. These assets are maintained on the systems of the servicing institutions.

From the data provided, we derived collection rates, stratified by major asset categories, as a percentage of the reduction in the book value of the asset inventory (which results from payment of principal and sales or writedowns of assets). We applied these collection rates to the remaining book values of BIF's failed bank asset inventory, by major asset category, as of March 31, 1992, to estimate future collections on the inventory.

In some instances, we had to estimate loss information because it was not available or FDIC had identified erroneous data for certain types of resolutions. FDIC officials stated they are working on correcting the erroneous data for subsequent reports.

As of March 31, 1992, BIF had outstanding approximately $12 billion in FFB borrowings. If FDIC's historical collection experience is a valid basis for estimating future recoveries, BIF's failed bank asset inventory should generate approximately $23.8 billion dollars in gross principal collections, or about 67 percent of the $35.7 billion book value of the failed bank assets in BIF's inventory at March 31, 1992. BIF's failed bank asset inventory also should generate other gross collections, such as interest and rental

[5]Financial Audit: Bank Insurance Fund's 1991 and 1990 Financial Statements (GAO/AFMD-92-73, June 30, 1992).

income, of approximately $4.3 billion, or about 12 percent of the book value of the asset inventory. Consequently, total estimated gross collections should equal about $28.1 billion. However, FDIC has historically incurred liquidation and other overhead administrative expenses approximating 20 percent of gross collections. Applying this historical cost experience, we estimate that BIF's net recoveries from the liquidation of its asset inventory at March 31, 1992, should equal about $22.5 billion, or about 63 percent of the book value of the failed bank assets in BIF's inventory at March 31, 1992. (Appendix IV provides the details of our calculations.) These estimated recoveries, if realized, would be sufficient to ultimately repay BIF's current level of outstanding FFB borrowings.[6]

However, as discussed in our 1991 financial audit report,[7] estimates of future recoveries derived from historical collection experience are subject to significant uncertainties. For example, in recent years, economic conditions have adversely affected asset values, particularly real estate assets. Furthermore, the rapid growth in government-held assets and the significant volume of real estate assets now on the market, coupled with the significant discounts the Resolution Trust Corporation offers in an attempt to reduce its inventory of real estate assets, could materially affect FDIC's ability to generate future recoveries for BIF from the management and disposition of BIF's failed bank asset inventory at rates comparable to those in the past.

Also, our analysis showed that if we break collection experience down by year of receivership inception, older receiverships show a marked decrease in their collection rates as time passes. For example, receiverships established from bank failures which occurred in 1986 show an average principal collection rate of 60 percent of the reduction in these receivership assets' book value. However, the annual collection rates for these receiverships ranged from approximately 92 percent of the reduction in receivership assets' book value in 1986, the first year of the receiverships, to only 23 percent in 1991. We believe this may be attributable to two factors: (1) better-quality assets tend to be sold first, leaving the less marketable assets, which generally yield a lower percentage of book value, and (2) the longer assets remain in the liquidation inventory, the greater the potential that their value will decline and, ultimately, the greater the potential for increased losses to BIF.

[6]During the third quarter of 1992, BIF had outstanding FFB borrowings of $15.1 billion. On September 30, 1992, however, BIF repaid $5 billion of these borrowings, leaving it with outstanding FFB borrowings of about $10.1 billion as of September 30, 1992.

[7]See footnote 5.

However, because many of the bank failures from which BIF holds assets have occurred within the past 2 years, a substantial portion of the assets acquired by BIF from bank resolutions should generate recoveries toward the higher end of the scale over the next several years.

Our analysis did not address when recoveries will occur. Additionally, our projections of BIF's estimated recoveries based on our analysis of FDIC's historical collection experience to date assumed that all of the assets in the inventory will ultimately be liquidated. If all assets are not liquidated, or are liquidated at a lower yield or a slower pace than in the past, actual recoveries could differ significantly from these estimates.

An additional factor that may affect BIF's repayment of FFB borrowings is the timing of the fund transfer from failed-bank receiverships to BIF. BIF cannot use funds collected by the receiverships until the receiverships declare a dividend to BIF. To expedite the transfer of cash from receiverships to BIF, FDIC instituted an "accelerated dividend" policy in 1992. Under the accelerated dividend policy, a receivership will, shortly after its inception, declare a dividend to BIF for up to 75 percent of the collections it expects to receive over the life of the receivership. For BIF, this process will allow FDIC to collect, on a daily basis, cash in excess of the receivership's immediate working capital needs. This process should expedite the transfer of funds from receiverships to BIF and provide BIF with more timely cash inflows to fund bank resolutions or repay existing working capital borrowings.

While FDIC's ability to generate future recoveries from its asset liquidation activity at levels similar to those experienced in the past is subject to significant uncertainties, it is important to note that FDIC's rate of recovery on its March 31, 1992, existing asset inventory would have to decline to less than 42 percent of the reduction in the book value of the inventory before liquidation collections would be insufficient to repay the existing FFB outstanding borrowings. Additionally, at March 31, 1992, BIF had collected assessment premiums totaling approximately $2.8 billion. FDIC estimates BIF's total assessment revenue for calendar year 1992 to be $5.8 billion. To the extent recoveries from liquidation activity are insufficient to repay FFB borrowings, BIF may utilize its assessment revenue to make up the shortfall.

This report was prepared under the direction of Robert W. Gramling, Director, Corporate Financial Audits, who may be reached on

(202) 275-9406 if you or your staffs have any questions. Other major contributors are listed in appendix V.

We are sending copies of this report to the Chairman of the Board of Directors, Federal Deposit Insurance Corporation; the Director, Office of Management and Budget; the Secretary of the Treasury; and the Ranking Minority Members of your committees.

Donald H. Chapin

Donald H. Chapin
Assistant Comptroller General

Contents

Abbreviations

BIF	Bank Insurance Fund
FDI	Federal Deposit Insurance
FDIC	Federal Deposit Insurance Corporation
FDICIA	Federal Deposit Insurance Corporation Improvement Act of 1991
FFB	Federal Financing Bank
FIRREA	Financial Institutions Reform, Recovery, and Enforcement Act of 1989
LAMIS	Liquidation Asset Management Information System
SAIF	Savings Association Insurance Fund

Scope and Methodology

To determine whether BIF and SAIF complied with the statutory maximum obligation limitation specified in FDICIA for the quarter ending March 31, 1992, we reviewed the completeness and reasonableness of the components and explanatory notes in FDIC's first quarter calendar year 1992 maximum obligation limitation reports for BIF and SAIF. For this review, we performed procedures that are substantially less in scope than those conducted in an actual financial statement audit of the insurance funds. Also, we only reviewed the activity that occurred in the first quarter of 1992 and relied on the results of the audit procedures performed on the December 31, 1991, balances in our 1991 BIF and SAIF financial statement audits to provide us with assurance as to the reasonableness of first quarter 1992 opening balances. Nevertheless, we believe our procedures provide us with sufficient assurance to draw conclusions regarding FDIC's first quarter 1992 compliance with its maximum obligation limitation.

Our review work included the following:

- We compared the components of FDIC's maximum obligation limitation calculations for BIF and SAIF to the provisions of FDICIA and to each fund's March 31, 1992, Statement of Financial Position and corporate general ledger trial balance.
- We performed analytical procedures on the individual accounts that comprised each of the maximum obligation limitation calculation's line item components to identify (1) the dollar and percentage change in the account balances from December 31, 1991, to March 31, 1992, and (2) any unusual account balances.
- We developed criteria to identify accounts that required detailed review procedures. These criteria considered the account's materiality as it relates to the balance of the line item in which it is grouped and the extent to which the account balance changed from quarter to quarter. For those accounts meeting these criteria, we performed the following additional procedures: (1) obtained explanations for any large or unusual fluctuations in the account balances from appropriate FDIC officials, (2) obtained and reviewed supporting documentation for those accounts exhibiting large or unusual fluctuations for which FDIC officials did not provide sufficient explanation, (3) obtained and reviewed account reconciliations as of March 31, 1992, for specific accounts and verified the adequacy of these reconciliations, (4) confirmed balances for specific accounts, and (5) selected a judgmental sample of transactions for certain accounts and traced these transactions to supporting documentation.

To determine whether BIF and SAIF had borrowed from the U.S. Treasury for insurance losses and what factors might affect the need for future borrowings, as well as BIF's and SAIF's ability to meet established repayment schedules, we reviewed the status of FDIC borrowings from Treasury as of March 31, 1992. We also reviewed FDIC's progress in developing a borrowing agreement with Treasury and discussed with FDIC officials anticipated borrowing needs. Additionally, we monitored factors which could affect future borrowing needs, such as FDIC's recent regulation on increased assessments and on recapitalization plans for BIF and SAIF.

To determine whether BIF will generate sufficient proceeds from the management and disposition of failed bank assets to repay working capital borrowings, we gained an understanding of FDIC's collection processes. From this understanding, we designed and implemented procedures to review FDIC's historical experience in generating funds for BIF from the management and disposition of assets acquired from failed financial institutions through March 31, 1992. As agreed upon with your respective offices, our work was limited to an analysis of FDIC's historical collection experience to determine whether FDIC can generate sufficient funds for BIF from the management and disposition of failed bank assets to repay the Fund's existing working capital borrowings; we did not audit the collection and loss information provided.

Maximum Obligation Limitation Calculation and Notes for BIF at March 31, 1992

BANK INSURANCE FUND
MAXIMUM OBLIGATION LIMITATION
(dollars in millions)

			March 31 1992
Funding Sources			
Cash and Cash Equivalents			$ 2,471
Investments in U.S. Treasury obligations and accrued interest			3,397
Estimated FMV of Other Assets			
Other assets	86 @ 90%	77	
Net receivables from bank resolutions	29,994 @ 90%	26,995	
Total Other Assets @ 90%			27,072
Treasury Borrowing Authority			30,000
Total Funding Sources			62,940
Obligations			
Accounts payable, accrued and other liabilities			96
Notes Payable – FFB Borrowings			11,982
Notes Payable – Treasury Borrowings			0
Liabilities incurred from bank resolutions			14,162
Estimated Liabilities for Litigation losses			161
Lease Commitments			88
Total Obligations			26,489
Remaining Obligation Authority			$ 36,451

The accompanying notes are an integral part of this Maximum Obligation Limitation Calculation

Federal Deposit Insurance Corporation
Bank Insurance Fund
Maximum Amount Limitation on Outstanding Obligations
Explanatory Notes

A. FUNDING SOURCES

1. Cash and Cash Equivalents

Cash and cash equivalents are included as defined in Statement of Financial Accounting Standards (SFAS) No. 95. SFAS No. 95 defines cash and cash equivalents as short-term, highly liquid investments that are both (a) readily convertible to cash and (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Generally, only investments with original maturities of three months or less qualify under this definition. This component includes $2.4 billion in Overnight Treasury Investments and $.1 billion in cash.

2. Investments in U.S. Treasury Obligations, Net

This component represents the acquisition cost of the investments, net of unamortized premiums, and the accrued interest receivable on these investments. The investments and interest are treated similar to cash equivalents for purposes of the MOL calculation because the FDIC intends to hold these investments to maturity. Accordingly, the risk factor associated with these investments is not considered significant.

Included in this component are $3.5 billion in U.S. Treasury bills, notes and bonds (acquisition cost), net of $.2 billion in unamortized premiums, and $.1 billion of accrued interest.

3. Estimated FMV of Other Assets Held by the Corporation (90%)

The maximum obligation limitation calculation includes the total of all non-cash assets at 90 percent of their fair market value in accordance with Section 15(c) of the Federal Deposit Insurance Act as amended by Section 102(a) of the FDIC Improvement Act of 1991. For these non-cash assets, reported amounts will be considered full fair market value.

Since the FDIC does not intend to liquidate the building or any other capitalized asset in the future to satisfy its obligations, property and buildings were excluded from "other assets" classification.

4. Net Receivables from Bank Resolutions (90%)

This component includes the net realizable value of subrogated claims on closed banks ($27.5 billion), the net realizable value of corporate purchases ($2.0 billion) and amounts due from open bank assistance ($.5 billion). The net realizable value accounts for estimated total losses to FDIC for resolved cases, including expenses incurred to manage and dispose of assets.

An allowance for loss is established for the Fund's receivables from bank resolutions. The allowance for loss represents the difference between amounts advanced and the expected repayment, based upon the estimated cash recoveries from the assets of the assisted or failed bank, net of all estimated liquidation costs. An estimate of losses on assets likely to be returned to the FDIC's on-balance sheet separate asset pools under put agreements is included in the allowance for losses on claims against separate asset pools.

5. Treasury Borrowing Authority

The FDIC Improvement Act of 1991 provides the FDIC with $30 billion in Treasury borrowing authority for use by both BIF and SAIF. However, the Act does not specify a methodology for allocating the $30 billion between the two funds. For future periods, the FDIC intends to develop an allocation policy. This policy will consider the projected cash flow needs and alternative funding sources of each fund.

For example, the SAIF has access to additional funds from the Secretary of the Treasury to carry out its mission and to maintain its statutorily required minimum new worth. A maximum of $32 billion in appropriations has been authorized for these purposes through fiscal year 2000. The SAIF may also borrow funds from the Federal Home Loan Banks with approval of the Federal Housing Finance Board.

Therefore, the FDIC has made an initial allocation of all $30 billion in Treasury borrowing authority to BIF. This initial allocation is based on the FDIC's projections which indicate that BIF has the current need for the borrowing authority. The allocation could change in subsequent periods as projections are revised.

B. OBLIGATIONS

6. Accounts Payable, Accrued and Other Liabilities

This component represents the full face value of routine, current liabilities such as accounts payable and accrued liabilities.

Unearned assessments are excluded, because these liabilities are not considered obligations. These unearned assessments are advance payments, which are deferred, and subsequently recognized by the passage of time.

7. Notes Payable - FFB and U.S. Treasury Borrowings

These components represent the full face value of all FFB and U.S. Treasury borrowings and the accrued interest thereon. The FDIC has not yet borrowed funds from the U.S. Treasury. The FFB outstanding borrowings component consists of $11.9 billion in notes issued to the FFB and $114 million in accrued interest. Interest rates are based on the U.S. Treasury bill auction rate in effect during the quarter plus 12.5 basis points.

The FDIC rolled over the $10.7 billion 1991 year-end note balance into a new note on January 2, 1992. The FDIC borrowed an additional $1.2 billion from FFB during the first quarter. On April 1, 1992, FDIC rolled over the outstanding note balance of $11.9 billion into a new note.

8. Liabilities Incurred from Bank Resolutions

Escrowed funds from resolution transactions comprise the major portion of this component ($13.9 billion). In various resolution transactions, the BIF pays the acquirer the difference between failed bank liabilities assumed and assets purchased, plus or minus any premium or discount. The BIF considers the amount of the deduction for assets purchased by acquiring institutions to be funds held on behalf of the receivership. Accordingly, escrowed funds represents the difference in the amount that the BIF pays to an acquirer for failed bank liabilities and assets purchased, adjusted for any premium or discount.

An adjustment has been added to this component for the contingent liabilities relating to assets likely to be returned to the FDIC under put agreements related to off-balance sheet pools.

9. Estimated Liabilities for Litigation Losses

This contingent liability represents the expected cost of those pending or threatened litigations, claims, or assessments where an estimated loss to FDIC (in its Corporate and Receivership capacities) is both probable and reasonably estimable. This amount reported represents the December 31, 1991 balance. The March 31st balances are not available.

10. Lease Commitments and Other Contractual Obligations

This component which is an off-balance sheet item, represents the non-cancelable portion of outstanding contractual obligations as of December, 1991. These primarily include multi-year lease commitments for space in Washington and other locations. The March 31, 1992 commitments balances were not available.

11. Exclusions

As agreed upon by the Congressional Banking Committees, total obligations exclude FDIC's estimated liability for unresolved cases (future bank failure and/or assistance transactions) because there is, at this time, no contractual agreement between the FDIC and the troubled institutions comprising the estimated liability. The estimated liability for unresolved cases as of March 31, 1992, was $15 billion.

Maximum Obligation Limitation Calculation and Notes for SAIF at March 31, 1992

SAVINGS ASSOCIATION INSURANCE FUND
MAXIMUM OBLIGATION LIMITATION
(dollars in millions)

			March 31 1992
Funding Sources			
Cash and Cash Equivalents			$ 0
Due from the FSLIC Resolution Fund			181
Estimated FMV of Other Assets			
Entrance fees receivable		0	
Other assets	2 @ 90%	2	
Total Other Assets @ 90%			2
Treasury Borrowing Authority			0
Total Funding Sources			183
Obligations			
Accounts payable, accrued and other liabilities			5
Notes Payable – FFB Borrowings			0
Notes Payable – Treasury Borrowings			0
Due to the Bank Insurance Fund			21
Lease Commitments			2
Total Obligations			28
Remaining Obligation Authority			155

The accompanying notes are an integral part of this Maximum Obligation Limitation Calculation

Federal Deposit Insurance Corporation
Savings Association Insurance Fund
Maximum Amount Limitation on Outstanding Obligations
Explanatory Notes

A. FUNDING SOURCES

1. Cash and Cash Equivalents

Cash and cash equivalents are included as defined in Statement of Financial Accounting Standards (SFAS) No. 95. SFAS No. 95 defines cash and cash equivalents as short-term, highly liquid investments that are both (a) readily convertible to cash and (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Generally, only investments with original maturities of three months or less qualify under this definition. Excluded is $74.9 million in Overnight Treasury Investments representing exit fees which are restricted and consequently are not funding sources.

2. Due from the FSLIC Resolution Fund

This component includes $181 million for the inter-fund receivables due from the FSLIC Resolution Fund (FRF): $179 million for the Oakar assessments; and $2 million for the administrative and supervisory expenses that have not been reimbursed. This is an inter-fund receivable and therefore highly liquid.

On March 27, 1992, the FDIC's Legal Division rendered the opinion that assessments paid on SAIF-insured deposits by "Oakar" banks must be retained in the SAIF, and, thus, are not subject to the draws by the Financing Corporation (FICO), the Resolution Funding Corporation (REFCORP), or the FRF. Oakar banks are BIF-insured banks which have acquired SAIF deposits. This opinion is based on their interpretation of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). The collections for the Oakar assessments were received in April 1992.

The FRF received the assessments paid on SAIF-insured deposits in 1990 and 1991. Since the enactment of FIRREA was effective in August of 1989, the SAIF 1990 financial statements were restated, resulting in the establishment of an inter-fund receivable from the FRF.

3. Estimated FMV of Other Assets Held by the Corporation (90%)

The maximum obligation limitation calculation includes the total of all non-cash assets at 90 percent of their fair market value in accordance with Section 15(c) of the Federal Deposit Insurance Act as amended by Section 102(a) of the FDIC Improvement Act of 1991. For these non-cash assets, reported amounts will be considered full fair market value.

4. Entrance Fees Receivable (90%)

The SAIF will receive entrance fees for conversion transactions in which an insured depository institution converts from the BIF to the SAIF. The SAIF records entrance fees as a receivable and related revenue once the BIF-to-SAIF conversion transaction is consummated.

5. Treasury Borrowing Authority

The FDIC Improvement Act of 1991 provides FDIC with $30 billion in Treasury borrowing authority for use by both BIF and SAIF. However, the Act does not specify a methodology for allocating the $30 billion between the two funds. For future periods, FDIC intends to develop an allocation policy. This policy will consider the projected cash flow needs and alternative funding sources of each fund.

The SAIF has access to additional funds from the Secretary of the Treasury to carry out its mission and to maintain its statutorily required minimum new worth. A maximum of $32 billion in appropriations has been authorized for these purposes through fiscal year 2000. The SAIF may also borrow funds from the Federal Home Loan Banks with approval of the Federal Housing Finance Board.

Therefore, FDIC has made an initial allocation of all $30 billion in Treasury borrowing authority to BIF. This initial allocation is based on FDIC's projections which indicate that BIF has the current need for the borrowing authority. The allocation could change in subsequent periods as projections are revised.

B. OBLIGATIONS

6. Accounts Payable, Accrued and Other Liabilities

This component represents the full face value of routine, current liabilities such as accounts payable and accrued liabilities.

Unearned assessments are included in other liabilities although they are excluded from the MOL calculation because these liabilities are not considered obligations. These unearned assessments are advance payments, which are deferred, and subsequently recognized by the passage of time.

7. Notes Payable - U.S. Treasury Borrowings

This component represents the full face value of all U.S. Treasury borrowings and the accrued interest thereon. FDIC has not yet borrowed funds from the U.S. Treasury.

8. Due to the Bank Insurance Fund

This component represents the payable to BIF established for the SAIF's portion of the estimated loss for the failure of Southeast Bank, N.A., and its affiliate Southwest Bank of West Florida, Pensacola.

In September 1991, Southeast Bank, N.A., Miami, which held deposits insured by both BIF and SAIF pursuant to the "Oakar amendment" provisions, was closed by its chartering authority. The BIF, which provided the funds and administers the resolution, has estimated the loss for the failures at $178 million, of which SAIF has the responsibility for $21 million (its allocated share of the loss incurred). In addition, interest will accrue on the SAIF's obligation based on the quarterly FFB borrowing rate.

9. Lease Commitments and Other Contractual Obligations

This component which is an off-balance sheet item, represents the non-cancelable portion of outstanding contractual obligations as of December, 1991. These primarily include multi-year lease commitments for space in Washington and other locations. The March 31, 1992 commitments balances were not available.

10. <u>Exclusions</u>

Pursuant to an FDIC approved regulation, exit fees paid to the SAIF are to be held in a reserve account until such time as the FDIC and the U.S. Treasury determine that it is no longer necessary to reserve for the payment of interest on the obligations of the Financing Corporation. This regulation allows the exit fees to be paid over a five year period. SAIF recognizes a receivable and a reserve for the principle due. Since these fees are not considered to be funds for the SAIF, as their availability has been restricted by the regulation, the exit fee reserve account activity is excluded from the MOL calculation.

BIF Estimated Net Recovery From Assets in Liquidation at March 31, 1992

Dollars in millions

Asset type	Book value of asset inventory	Collections as a percentage of book value reduction	Estimated collections on inventory	Estimated administrative expenses	Net estimated recoveries
Securities	$ 158	95.6	$ 151.1	$ 30.2	$ 120.8
Loans	15,726	64.7	10,174.7	2,034.9	8,139.8
Mortgages	9,327	75.1	7,004.6	1,400.9	5,603.7
Owned assets	4,374	54.3	2,375.1	475.0	1,900.1
Other assets	6,155	67.4	4,148.5	829.7	3,318.8
Total on assets	**35,740**	**66.7[a]**	**23,853.9**	**4,770.8**	**19,083.1**
Other collections		12.0	4,288.8	857.8	3,431.0
Total estimated recoveries			**$28,142.7**	**$5,628.5**	**$22,514.2**

Note: Totals may not add due to rounding.

[a]The collections as a percentage of book value reduction (total on assets) represents the result of dividing total estimated collections into total book value. This amount has been rounded. Therefore, multiplying this percentage by total book value will yield a slightly different result than adding estimated collections for each individual asset type.

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