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Budgetary Implications of the Savings and Loan Crisis

Statement of
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Committee on the Budget
United States Senate

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Mr. Chairman and Members of the Committee:

We are pleased to appear today to discuss issues related to the budgetary impact of the thrift crisis and of the Federal Savings and Loan Insurance Corporation's (FSLIC) use of notes payable and other commitments to help resolve its caseload of hopelessly insolvent thrifts. In discussing these issues, several points need to be considered. First, the severity of the industry's problems exceeds the resources FSLIC can marshall over the next decade through currently available sources. Accordingly, a substantial cash infusion will probably be required to enable FSLIC to continue to resolve problem cases and stem future losses. Second, because FSLIC's cash resources are severely constrained, it has resorted to issuing billions in notes and other commitments for which the federal government is ultimately responsible. Third, FSLIC's current and future commitments potentially represent significant amounts of federal spending, but, in our view, they have not been adequately disclosed in the budget process. Before discussing these issues in more detail, I would like to briefly discuss the financial condition of the savings and loan industry and its insurer, FSLIC, to provide some perspective on why FSLIC relies on the use of notes and other obligations in its resolution actions.

THE SAVINGS AND LOAN INDUSTRY'S FINANCIAL CONDITION

Over the last decade, the financial condition of many savings and loans, especially those in the Southwest, has suffered as a result of several factors including diversification into risky activities, high cost of funds, insufficient supervision, and severe economic downturn in certain sectors of the economy. Although almost two-thirds of the savings and loan industry was profitable in 1987, earning $6.6 billion, those profits were far outweighed by the $13.4 billion loss experienced by the remaining one-third of the 3,147 FSLIC-insured institutions. Thrifts in the Southwest, which account for only 15 percent of the industry, were responsible for 67 percent of the losses. At the end of 1987, over 500 insolvent institutions, including 124 in Texas alone, with negative net worth of $18 billion as measured by generally accepted accounting principles (GAAP), were still operating.

The industry's decline has continued into 1988. Second quarter results show that the thrift industry experienced an overall net loss of $7.5 billion during the first 6 months of 1988. While solvent institutions had net income of $1.2 billion, insolvent institutions incurred losses of $8.7 billion. As of June 30, 1988, 497 institutions with assets of $188 billion were insolvent with reported negative GAAP net worth of $26 billion. These continuing losses increase the costs of resolving the thrift industry's problems.

FSLIC'S FINANCIAL CONDITION

The worsening condition of the industry's troubled segment has had a corresponding effect on the condition of its insurer, FSLIC. Until relatively recently, FSLIC had been able to operate on a self-sustaining basis, generating sufficient revenues from premiums paid by member institutions to cover the costs of assisting or closing troubled institutions as needed. However, since 1981, FSLIC's insurance fund has steadily declined from a surplus of $6.3 billion in 1981 to a deficit of $6 billion at the close of 1986. As disclosed in our report to the Congress on FSLIC's 1987 financial statements (GAO/AFMD-88-58, July 5, 1988), during 1987, FSLIC incurred a net operating loss of $8.6 billion, resulting in a $14 billion deficit--more than double its 1986 deficit. This operating loss was primarily attributable to the $7 billion increase in FSLIC's liability for failed but still operating savings and loan institutions, as well as $3.5 billion in losses related to institutions that had received financial assistance or had already closed. During 1988, FSLIC's operating losses have continued. FSLIC's records indicate that it has incurred costs of $20.2 billion related to the 126 resolution actions carried out through September 30th of this year.

In the last few years, FSLIC did not act promptly to resolve the industry's problems due in part to its precarious financial condition and limited financial resources. Responding to FSLIC's need for additional funds, in 1987, the Congress authorized FSLIC to receive the proceeds from the sale of $10.8 billion in bonds over a minimum 3-year period. In the first year, FSLIC received the maximum amount allowable from the sale of $3.75 billion in bonds which were issued at interest rates of between 9.4 and 10.7 percent.

While these additional funds have helped, FSLIC's cash resources have remained low. At the end of 1987, FSLIC had cash and Treasury investments of only $2.9 billion; at September 30, 1988, it had cash and Treasury investments of only $1.7 billion. Because its cash resources are limited, FSLIC has been forced to rely upon the use of large promissory notes and other financial commitments in its efforts to act on the industry's most troubled thrifts.

FSLIC'S CURRENT RESOLUTION STRATEGY DEPENDS UPON NOTES TO FINANCE MERGER-TYPE TRANSACTIONS

As previously discussed, FSLIC has been insolvent for the past 2 years and continues to conduct its operations at a loss. Consequently, FSLIC's ability to deal with insolvent savings and loan institutions has been severely constrained. FSLIC is authorized by 12 U.S.C. 1729 and other provisions, at its sole discretion and upon terms and conditions it prescribes, to use loans, deposits, purchases, assumptions, and contributions to resolve cases and reduce the threat to the insurance fund. However, FSLIC is authorized to assist troubled institutions only if the assistance is less than the cost of liquidation, unless FSLIC determines that the continued operation of the institution is essential to its community.

FSLIC has essentially two options for resolving the problems of troubled institutions--liquidations or merger/acquisition transactions. While both options may involve substantial costs, FSLIC estimates have indicated that liquidation is more expensive and, therefore, should be the option of last resort.

In a merger or acquisition action, a troubled institution is acquired by another, presumably healthier, savings and loan, or by investors wanting to enter or expand their presence in the industry. The cost of this resolution action is the result of negotiations between FSLIC and the acquirer, and the action usually requires FSLIC to provide assistance in the form of cash, notes, and various guarantees to eliminate failed institutions' negative net worth and to help shield the acquirer from the risk of future losses on the institutions' assets or from litigation.

FSLIC's strategy for maximizing its limited financial ability to act on seriously troubled institutions, particularly those in the Southwest, emphasizes using acquisitions or mergers rather than liquidations and, to the extent possible, providing assistance in the form of notes and guarantee agreements rather than cash. Between January 1st and September 30th of this year, FSLIC acted on the problems of 126 savings and loan institutions: 106 institutions were merged with and/or acquired by other institutions in 52 transactions, and 20 institutions were liquidated. In carrying out these transactions, FSLIC issued a total of 28 notes, with combined principal amounts of $8.5 billion. The terms of the notes varied, ranging from 6 months to 15 years, and, for the most part, carrying variable interest rates.

FSLIC Is Also Expanding Use Of Assistance Guarantees

In addition to cash and notes to compensate for net worth deficiencies, FSLIC often agrees to compensate acquirers for future losses of failed institutions in merger-type transactions. Assistance agreement provisions usually include some or all of the following guarantees:

-- coverage of net capital losses due to writedowns or sales of problem assets;

-- yield subsidies on non-performing assets to ensure a specified rate of return on assets;

-- indemnification against undisclosed liabilities or litigation; and

-- purchase of certain impaired assets from the failed thrift.

Such guarantees represent a significant portion of the costs of FSLIC's resolution actions. For example, FSLIC's guaranteed assistance commitment for Southwest Plan cases thus far amounts to about $9 billion on a present value basis and about $15 billion on a cash basis.

Ultimately, guaranteed assistance represents a claim on FSLIC's future cash resources; however, unlike notes, the ultimate cost of guaranteed assistance can only be estimated when the agreement is signed. Even the best estimates may substantially differ from the eventual costs. We understand that the assistance agreements generally do not establish a limit on the maximum dollar liability to which FSLIC is exposed. Instead, FSLIC's exposure depends on conditions or events about which it has incomplete knowledge and over which it has little or no control. We believe FSLIC should amend its policy in this regard to set an upper limit on all such future guarantee agreements.

In providing guaranteed assistance against future losses, FSLIC is gambling that the thrift's performance will improve through better management, changed economic conditions, or better than anticipated quality of its assets. Favorable changes in interest rates or in real estate markets in certain currently depressed areas could result in FSLIC payments on guaranteed assistance being lower than the amount an acquirer would demand at the time a merger agreement is ratified. However, the downside risk of such guarantees is that future conditions may be unfavorable, thereby increasing the payouts required to meet FSLIC's obligations under the agreements. For the acquirer, FSLIC assistance guarantees remove many of the risks inherent in merging with a thrift with demonstrated asset problems and undisclosed liabilities.

We believe FSLIC commitments under notes and assistance guarantees constitute commitments of the United States. Accordingly, they are of concern from a budget perspective because a strong likelihood exists that appropriated funds will be required to pay at least part of these obligations. For this and other reasons, we recently issued a report (GAO/AFMD-88-57, May 20, 1988) to the Chairman of the Federal Home Loan Bank Board in which we recommended that he publicly announce the total amount of notes and guaranteed assistance FSLIC intends to provide in connection with resolution actions. The Bank Board responded that it has given public assurances that its projected revenues would limit the amount of notes to be issued, and that FSLIC's cash flow projection, as provided to the Congress on July 7, 1988, showed it would be able to meet its commitments for both notes and guarantees.

We believe a more certain limitation on notes and other commitments needs to be established rather than simply linking them to FSLIC's cash forecasts. As discussed later, these projections are based upon extremely optimistic assumptions and are subject to change solely at FSLIC's discretion. Furthermore, FSLIC has already exceeded the amounts of notes to be issued and total notes outstanding for fiscal year 1988 as specified in the cash projection the Bank Board provided to the Congress on July 7, 1988. Accordingly, we believe a specific dollar limit should be established on the total amount of notes and other commitments which FSLIC may issue.

BUDGETARY IMPACT OF FSLIC NOTES AND GUARANTEES

When FSLIC issues notes, the principal amounts of the notes are recorded as outlays, and budget authority and obligations for making the outlays are also recorded at the same time. The recorded outlay, as with other budget outlays, increases the reported budget deficit. We believe that this method of scorekeeping for FSLIC notes, currently employed by the administration and the Congressional Budget Office (CBO), is appropriate.

We understand that FSLIC did not follow these scorekeeping policies prior to the issuance in February 1988 of the President's budget for fiscal year 1989. Consequently, prior budgets did not show outlays for the FSLIC notes when they were issued, but only for the cash payments later made on the notes. Because of the payment terms on the notes, this practice reduced their impact on the deficit for the years in which they were issued.

For the fiscal year 1989 budget and beyond, the Office of Management and Budget (OMB) has required FSLIC to record the face value of the notes as outlays in the fiscal year in which they are issued, on the theory--a reasonable one, we think--that the notes are cash-type transactions intended to satisfy an obligation of government entities. For Treasury reporting purposes, this practice was adopted for fiscal year 1988.

Including outlays in the budget for FSLIC notes provides more timely budget disclosure to the Congress and the public of FSLIC's financial activities. This is a step forward. However, we emphasize that such improved disclosure does not, in itself, reflect a legal constraint on the amount of notes FSLIC may actually issue. For fiscal year 1988, FSLIC issued notes in amounts exceeding those estimated for 1988 in the OMB budget materials. As of September 30, 1988, FSLIC had issued about $10 billion in notes. The President's budget, released in February 1988, estimated that note issuances for 1988 would total only $4 billion. Subsequently, OMB's July 1988 mid-session adjustments to the estimate for the 1988 budget only raised this amount to $5.8 billion.

As for the implications of this 1988 pattern of underestimates for the Gramm-Rudman-Hollings deficit reduction law and procedures, two points should be made. First, the issuance of FSLIC notes in fiscal year 1988 above earlier projections did not trigger any 1988 sequestrations in other parts of the budget to meet overall deficit reduction targets. The deficit reduction statute does not apply to--and therefore no fiscal year spending reductions result from--actual FSLIC note issuances in fiscal year 1988 that exceed the administration projections that were made as required in fiscal year 1987.

Second, the administration's underestimates for fiscal year 1988 raise a question about what to expect for fiscal year 1989. OMB is required by law to include its estimates of FSLIC outlays for fiscal year 1989 in its projection of the 1989 budget deficit. As part of these outlays, OMB estimated that FSLIC will issue $4.6 billion in notes in 1989. Based upon FSLIC costs to date, this estimate appears hopelessly low. The projection was important in OMB's initial determination that a governmentwide sequestration would not be required in 1989. (While FSLIC itself is exempt from sequestration, its activities can effect whether other agencies' spending will be cut under the Gramm-Rudman-Hollings deficit reduction.) Meaningful deficit reduction requires accurate OMB estimates, and we can only hope that OMB's future estimates regarding FSLIC notes are more accurate forecasts.

We agree with OMB's position that requires these notes to be reflected as outlays when issued. We also believe that legislatively placing limits on the amount of notes FSLIC can issue would provide an important control mechanism that is not included in the federal budget process.

Current Budget Treatment Does Not Adequately Reflect Commitments Under Guarantee Agreements

FSLIC guarantee agreements, unlike notes, are not recorded as budgetary outlays until the time of cash payout. Such treatment assumes that these agreements are analogous to traditional loan guarantees, and that payments by FSLIC under these agreements are not certain. Under current budgetary law and convention, there are no recordings of obligations, liabilities and outlays at the time that loan guarantees are extended. This is because the guarantor's responsibility for payment is contingent upon some future occurrence which is considered unlikely or only possible. For example, the government does not incur an obligation and liability for specific loans guaranteed under its student loan program unless the loans go into default.

However, it may be argued that FSLIC guaranteed assistance agreements are not the same as typical guarantees. This is recognized, in part, by the budget's current treatment of the FSLIC guarantees--obligations are recorded for the guarantees at the time of their issuance. This reflects the fact that a FSLIC payment is not an uncertainty at the time an assistance agreement is issued, only the ultimate cost of the required payout is unknown. Therefore, we would go one step further and treat the guarantees as transactions that, like the notes, essentially satisfy FSLIC's commitments under the assistance agreements. For this reason, we would suggest that OMB and CBO report outlays for the assistance agreements in the year of their issuance.

FSLIC analyzes the various types of assistance involved in each agreement and prepares a "best estimate" of the total payout required under the terms of the agreement on both a cash and present value basis. We believe that the cash basis estimate is most useful as an indicator of the size of the government's commitment and should be used to record the budget outlay amount.

Further, reflecting assistance agreements in the budget in a way that captures the essential nature of the transactions would facilitate placing a legislative limit on the amount of the agreements. Because of the strong likelihood the taxpayers will ultimately have to bear some of the cost of honoring these agreements, it is important that the Congress be aware of--and in a position to control--the amounts being spent by FSLIC.

We would add that reporting outlays for the FSLIC guarantees would not affect the fiscal year 1989 budget totals for Gramm-Rudman-Hollings deficit calculation purposes. The technical and conceptual assumptions governing the 1989 calculation have already been published by OMB. Such a change, however, would increase the outlays affecting the calculations for subsequent years.

FSLIC'S RECENT RESOLUTION ACTIONS

The costs of 1988 resolution actions continue to exceed the amounts FSLIC estimated in conjunction with its 1987 financial statements. These statements indicated its total resolution costs could amount to $22.7 billion for about 500 institutions that were insolvent according to generally accepted accounting principles as of December 31, 1987. This amount was comprised of two parts--$17.4 billion primarily for about 200 institutions for which FSLIC had formally accepted responsibility for incurring resolution costs, and $5.3 billion for the remaining 300 or so additional insolvent institutions. In our report on FSLIC's 1987 financial statements, we concurred with the $17.4 billion accrual for the approximately 200 FSLIC cases, but noted that a more realistic estimate for the remaining 300 insolvents would be between $9 and $19 billion. Accordingly, we estimated that total resolution costs at December 31, 1987, ranged from $26 to $36 billion.

FSLIC's resolution costs during 1988 have vastly exceeded the December 31, 1987, estimates.[1] FSLIC has acted on 126 problem institutions in 1988 at a reported cost of $20.2 billion. One hundred six institutions were merged or acquired and 20 were liquidated. For liquidations, the actual cost of $2.3 billion exceeded FSLIC's estimate of $1.7 billion by 35 percent. For mergers, the actual cost of $17.9 billion exceeded the estimate of $8 billion by 124 percent. Bank Board and FSLIC officials have attributed the differences to:

-- losses experienced between the time of the estimate and the time of closing;

-- the decision to liquidate certain high-paying thrifts, rather than continue to search for merger partners, in order to reduce the cost of funds for the industry as a whole; and

-- additional guaranteed assistance being demanded by acquirers due to the seriously impaired nature of assets held by failed thrifts.

Based upon the 1988 resolution experience, we have revised our estimate of the total cost to FSLIC for resolving the problems of the currently insolvent thrift institutions. We now believe that the cost will be at least $45 to $50 billion.

<u>Actions Under the Southwest Plan</u>

Included in the actions discussed above were 42 thrifts merged in 10 separate transactions between May 13, 1988, and September 30, 1988, under the Bank Board's Southwest Plan. The total estimated cost to FSLIC of these transactions is $13.9 billion, consisting of $3.6 million in cash outlays, $5.1 billion in notes payable (principal and interest), and $8.8 billion under various assistance and guarantee agreements. According to Bank Board officials, the combined net worth of the

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[1]Details of FSLIC's 1988 actions are included in Attachment I to this statement.

individual institutions before merger was negative $9.1 billion. The officials estimated the capital ratios of the new institutions created through the first six Southwest Plan mergers at between 0 and 3.6 percent as calculated using regulatory accounting principles. Attachments II and III provide more data on the individual transactions under this plan.

To date, we have not analyzed the Southwest Plan strategy or its individual transactions in detail. However, based upon the limited information we have, we can offer the following two observations.

First, authoritative information on the net worth of the newly merged institutions, as calculated according to generally accepted accounting principles, will not be available until the new entity is audited as required by the merger agreement. However, based on the reported regulatory capital ratios, these institutions appear to be thinly capitalized. Merging several insolvent institutions into a larger entity that remains thinly capitalized does not necessarily represent a final problem resolution. In our view, the term "resolution" is only appropriate when the new entity has recognized all losses on problem assets, meets established capital requirements, and is otherwise economically viable. Consolidations that fall short of this criteria may result in reduced losses to some extent through such factors as economies of scale, reduced competition for deposits, and enhanced supervisory oversight. However, whether or not such institutions can become viable entities without further assistance remains to be seen.

Second, the cost of implementing the Southwest Plan is significantly greater than FSLIC anticipated. FSLIC's estimate prepared in conjunction with its December 31, 1987, financial statements amounted to about $7 billion. More recently, the Bank Board Chairman revised the cost estimate for the Southwest Plan upward to $15.2 billion in his testimony before the House Committee on Banking, Finance and Urban Affairs on July 7, 1988. However, the cost of actions taken under the Southwest Plan this year have already amounted to almost $14 billion. Final costs may be even higher once the auditors determine the final net worth and asset valuation for the newly formed institutions and FSLIC adjusts the note or guaranteed assistance estimate to reflect these audited figures, as provided for in the merger agreements.

In summary, FSLIC actions taken under the Southwest Plan cannot be considered final solutions until the newly created institutions prove viable. In addition, the higher than expected cost of actions taken under the Plan calls into question FSLIC's ability to marshall the financial resources necessary to pursue this strategy without additional funding. The likelihood is therefore increasing that the Congress will be faced with the difficult task of determining where the necessary additional funds may be obtained.

Questionable Assumptions In FSLIC's Financial Forecasts

Despite continuing industry losses and FSLIC's own insolvency, Bank Board officials have maintained that FSLIC can marshall sufficient financial resources to deal with the industry's problems without resorting to a request for federal funds. As you know, the Bank Board has produced various projections of the funds it expects to have available and the corresponding outlays it expects to incur. These cash flow projections indicate that FSLIC will be able to generate about $42 billion in revenues over the next 10 years and will be able to meet all of its obligations. However, we believe that these projections are based upon extremely optimistic assumptions regarding both expected revenues and resolution costs.

In determining the costs related to its caseload, FSLIC has assumed that:

-- It can minimize its resolution costs by selling or merging substantially all institutions rather than liquidating them since FSLIC liquidation estimates are almost invariably more expensive than mergers. However, in the last 9 months, nearly one-sixth of all resolution actions were liquidations.

-- New institutions created through the merger process will be economically viable and will not require FSLIC to incur additional assistance or resolution costs beyond those anticipated at the merger date.

-- It can act on most of the problem institutions in the next 2 years, thus minimizing those institutions' additional losses and the cost to FSLIC. Since assistance agreements usually contain provisions requiring FSLIC to, as a minimum, compensate the acquirer for the negative net worth of the troubled institutions, allowing severely troubled institutions to continue to operate and incur additional losses would increase FSLIC's resolution costs.

-- Interest rates will remain favorable and will not increase to any significant extent. Any significant increase in the cost of funds to the thrift industry could again exacerbate the financial pressures on the industry and cause additional deterioration in capital and profitability.

-- Virtually no new problem cases will develop in the industry over the next 10 years, and no further significant resolution costs will be incurred beyond those currently identified. FSLIC's cash flow projections show virtually no reserve for future losses at the end of the 10-year period.

Similarly, FSLIC's revenue projections are based on several relatively optimistic assumptions regarding interest rates and future conditions in the savings and loan industry and in the U.S. financial markets. The effects of these assumptions are interrelated--should future conditions vary significantly, both FSLIC's projected revenues and outlays could be adversely affected.

-- FSLIC assumes that insured deposits will grow about 7 percent annually, roughly doubling insured deposits over 10 years. Because FSLIC's premium income (both regular and special assessment) is based upon fixed percentages of insured deposits, its revenues increase significantly under this scenario. While this growth rate is consistent with the overall growth experienced over the past decade, we believe it may be overly optimistic. While deposits grew dramatically in 1983 and 1984, the growth rate declined in 1985, 1986, and 1987. Moreover, the moratorium on thrifts leaving the FSLIC system expires in August 1989--any significant departures of thrifts would result in corresponding decreases in deposit growth. This assumption further implies that other financial institutions are not able to take away any substantial portion of the thrift industry's current business.

-- FSLIC's forecast assumes FSLIC will continue the special assessment of 1/8 of 1 percent of insured deposits throughout the next 10 years. Long-term continuation of the special assessment could encourage healthy thrifts to transfer to the Federal Deposit Insurance Corporation, thus eroding the deposit base from which FSLIC's premium income is generated. Conversely, not continuing the special assessment would potentially shift a portion of resolving the crisis currently borne by the industry to the taxpayer.

-- FSLIC's revenue forecast projects that recapitalization bonds will be marketed at interest rates of about 10 percent, which has been the case thus far. While FSLIC receives the proceeds from the bond sales, it must also bear the interest costs on the bonds. The interest costs will be paid from FSLIC's assessment income over the 30-year life of the bonds. Thus, significant increases in overall interest rates would reduce FSLIC's income. Such a reduction would be compounded if higher interest rates were accompanied by slower deposit growth than FSLIC has projected.

We believe that these assumptions are highly optimistic and that a strong likelihood exists that they will prove incorrect. Moreover, we have already seen costs being incurred at a rate showing that FSLIC's projected resources, even under the most favorable assumptions, will not be adequate to cover them. An adverse change in any of these assumptions will reduce the Corporation's available funds and lessen its ability to resolve the industry's problems. In addition, while the Congress initially contemplated, both in originally establishing FSLIC and in recapitalizing it in 1987, that the industry would be able to provide the funds needed to resolve its problems, the deteriorated capital position and poor operating results of a large segment of the industry seriously impair its ability to do so.

Other Sources of Funds

In addition to funds from recapitalization proceeds, insurance premiums, investment income, and liquidating assets, FSLIC and the Bank Board have access to funds from other sources. However, each of these sources has drawbacks, and most do not add to FSLIC's reserves because the money must be repaid.[2]

-- Borrowing From the Treasury - FSLIC has a $750 million line of credit available if the Bank Board determines funds are needed for insurance purposes.

-- Borrowing From the Federal Reserve System - Two statutory provisions provide that the Federal Reserve Banks may make advances to corporations on notes secured by obligations of the United States and discount notes arising from commercial transactions in unusual and exigent circumstances. We are unaware of FSLIC requesting such advances or discounts or that the Federal Reserve Banks have determined whether FSLIC's transactions and available collateral are of the type for which these funding sources should be made available.

-- Borrowing From the Federal Home Loan Banks - FSLIC is authorized to borrow from the Bank System under certain

[2]For more detailed information on these sources of funds, see Thrift Industry: The Treasury/Federal Home Loan Bank Board Plan for FSLIC Recapitalization (GAO/GGD-87-46BR, March 3, 1987).

limitations.[3] In addition, if the Secretary of the Treasury and the Chairman of the Bank Board certify to the Congress that alternative means of raising funds cannot be used and the ability to supply such funds is impaired, the Treasury can purchase up to $4 billion of Federal Home Loan Bank obligations, which could then be used to assist the thrift industry.

-- Mandatory Infusion of Up To 1 Percent of Withdrawable Deposits Into FSLIC - The Bank Board is authorized to require insured thrift institutions to make such deposits into FSLIC. According to Bank Board officials, FSLIC could raise over $9 billion in this manner; however, its liabilities would increase by an equal amount.

FSLIC has not included funds from these sources in its projection and we agree with that decision. In our view, these sources are accompanied by serious disadvantages, and their use should only be considered in an extreme emergency.

SUMMARY

In summary, we would emphasize the following considerations.

-- A significant imbalance exists between the thrift industry's problems and FSLIC's financial capabilities. The Congress has provided FSLIC the means to obtain some additional resources, but the likely resolution costs for dealing with the currently troubled thrifts far exceed the resources that FSLIC will be able to marshall over the next 10 or so years. More importantly, the long-term effectiveness of FSLIC resources already used to prop up the industry remains to be seen.

-- FSLIC's financial condition is such that it cannot undertake substantial actions on the industry's problems without resorting to making future commitments. FSLIC notes and guarantees are obligations of the United States but, at present, no statutory provision limits the amount of commitments FSLIC can issue. Accordingly, we believe that the Congress should place a specific limitation on the commitments FSLIC may issue, regardless of whether they are in the form of notes, guarantees, or any other types of obligations.

-- Whether or not the strategy of merging insolvent institutions results in viable entities remains to be

[3] FSLIC has used this authority twice to fund pass-through loans to insured institutions.

seen and must currently be considered a gamble. Should these newly formed institutions continue to incur losses or require higher than expected payouts under FSLIC's guaranteed assistance agreements, the ultimate cost of resolving the industry's problems could be significantly higher than our current estimates. In this regard, we believe all future assistance guarantee agreements should contain a dollar limit on FSLIC's maximum liability.

-- The costs FSLIC has incurred and will continue to incur in attempting to resolve the thrift industry's problems have not been adequately reflected in the budget. First, the amount of notes to be issued in fiscal year 1988 was grossly underestimated at $5.8 billion only 3 months ago; however, notes actually issued for the year amounted to about $10 billion. Second, in regard to fiscal year 1989, OMB estimates net outlays of $2.7 billion for FSLIC which include $4.6 billion in estimated note issuances. Based upon FSLIC's remaining caseload, this estimate appears totally inadequate and brings into question the deficit calculations for fiscal year 1989 under the Gramm-Rudman-Hollings law. Third, current budget and reporting practices do not fully recognize FSLIC's use of assistance agreements in the year they are entered. Finally, any substantial infusion of taxpayer funds that may be required could reduce amounts available for other government programs.

Mr. Chairman, this concludes my formal statement. At this time, I would be pleased to answer any questions you may have.

FSLIC ASSISTED TRANSACTIONS
TO MERGE OR CLOSE PROBLEM INSTITUTIONS
FROM JANUARY 1, 1988 THROUGH SEPTEMBER 30, 1988
(Unaudited)
(All figures in thousands)

TRANS #	FAILED ASSOCIATION	TYPE OF ACTION	TOTAL ASSETS AT DATE OF FSLIC ACTION	REPORTED COST TO FSLIC	PROJECTED COST AT 12/31/87 **	INCREASE/ (DECREASE) OVER PROJECTED COST
1	FIRST FS&LA	ACQUISITION	$31,100	$14,000	$13,150	$850
2	MAGNET BANK, FSB TRADERS FS&LA MOUNTAIN STATE FS&LA	ACQUISITION	$710,000	$81,500	$81,470	$30
3	FIRST FS&LA	ACQUISITION	$30,900	$3,805	$3,810	($5)
4	FIRST FEDERATED SB PERPETUAL S&LA FIRST FSB PEOPLES FS&LA	ACQUISITION	$566,400	$157,000	$158,180	($1,180)
5	TRI-CITIES S&LA	ACQUISITION	$54,500	$15,800	$16,610	($810)
6	CITIZENS S&LA	ACQUISITION	$39,020	$6,100	$6,780	($680)
7	VALLEY FS&LA	ACQUISITION	$87,500	$7,080	$7,420	($340)
8	ALLIANCE S&LA COLORADO COUNTY FS&LA SECURITY S&LA CAMERON COUNTY S&LA	ACQUISITION	$455,800	$146,226	$48,009	$98,217
9	LAMAR SA CITY S&LA STOCKTON SA BRIERCROFT SA	ACQUISITION	$3,998,400	$1,980,323	$984,620	$995,703
10	FIRST FS&LA	ACQUISITION	$245,500	$72,100	$66,290	$5,810
11	EUREKA FS&LA	ACQUISITION	$1,740,000	$304,000	$285,050	$18,950
12	FRONTIER FSB	ACQUISITION	$48,050	$11,000	$10,640	$360
13	BLUEBONNET SA	ACQUISITION	$24,100	$9,900	$8,520	$1,380
14	FIRST FINANCIAL SA BROWNFIELD FS&LA	ACQUISITION	$370,000	$83,868	$27,997	$55,871
15	STANFORD SA	ACQUISITION	$76,500	$8,400	$5,840	$2,560
16	LYNNWOOD S&LA	ACQUISITION	$24,600	$6,100	$4,620	$1,480

FSLIC ASSISTED TRANSACTIONS
TO MERGE OR CLOSE PROBLEM INSTITUTIONS
FROM JANUARY 1, 1988 THROUGH SEPTEMBER 30, 1988
(Unaudited)
(All figures in thousands)

TRANS #	FAILED ASSOCIATION	TYPE OF ACTION	TOTAL ASSETS AT DATE OF FSLIC ACTION	REPORTED COST TO FSLIC	PROJECTED COST AT 12/31/87 ##	INCREASE/ (DECREASE) OVER PROJECTED COST
17	MUSKEGON FS&LA	ACQUISITION	$202,000	$4,000	$4,200	($200)
18	GALVA FS&LA MUTUAL S&LA HOME FS&LA	ACQUISITION	$172,980	$33,800	$42,000	($8,200)
19	REPUBLIC SVGS. FS&LA	ACQUISITION	$36,500	$17,800	$17,800	$0
20	FIRST FS&LA	ACQUISITION	$84,900	$13,300	$19,850	($6,550)
21	FIRST FS&LA	ACQUISITION	$36,400	$2,700	$2,260	$440
22	IRVING SA LONGVIEW S&LA GLADEWATER FS&LA RICHARDSON S&LA MAJESTIC SA COMMERCE FS&LA PARIS S&LA AMERICAN BANC SA SKYLINE SA BEN MILAM S&LA MERCURY SA SOUTHLAND SA	ACQUISITION	$2,217,200	$1,313,780	$540,128	$773,652
23	FIRST FEDERAL BANK FSB WESTERN FS&LA	ACQUISITION	$49,600	$13,000	$12,210	$790
24	CAPITOL FS OF AM	ACQUISITION	$242,600	$16,100	$51,060	($34,960)
25	FIRST FS&LA FIRST FS&LA FIRST FS&LA WASHINGTON FSB PEOPLES S&LA PIONEER FS&LA	ACQUISITION	$1,088,900	$299,000	$251,535	$47,465
26	STATE FS&LA	ACQUISITION	$454,000	$581,787	$418,140	$163,647
27	COMMERCE FSB	ACQUISITION	$40,200	$17,400	$17,850	($450)
28	NORTHWEST FS&LA	ACQUISITION	$26,700	$2,390	$170	$2,220

ATTACHMENT I

FSLIC ASSISTED TRANSACTIONS
TO MERGE OR CLOSE PROBLEM INSTITUTIONS
FROM JANUARY 1, 1988 THROUGH SEPTEMBER 30, 1988
(Unaudited)
(All figures in thousands)

TRANS #	FAILED ASSOCIATION	TYPE OF ACTION	TOTAL ASSETS AT DATE OF FSLIC ACTION	REPORTED COST TO FSLIC	PROJECTED COST AT 12/31/87 **	INCREASE/ (DECREASE) OVER PROJECTED COST
29	HOMESTATE S&LA	ACQUISITION	$190,000	$44,700	$41,460	$3,240
30	BELL FS&LA	ACQUISITION	$953,500	$565,000	$600,050	($35,050)
31	SUNBELT SA INDEPENDENT AMERICAN SA WESTERN FS&LA SUMMIT SA TEXANA S&LA FEDERATED S&LA FIRST CITY SA MULTIBANK SA	MERGER	$4,826,300	$6,166,657	$2,488,359	$3,678,298
32 33 34 35 36 37	CAPITAL FSB MUTUAL FS&LA FIRST OK SB MID AMERICA FS&LA KINGFISHER FS&LA SUNBELT SAV FS&LA FRONTIER FS&LA HOME S&LA PHOENIX FS&LA CIMARRON FS&LA FIRST FS&LA HERITAGE S&LA HOME SB, FA PEOPLES FS&LA	MERGER	$3,559,000	$1,898,200	$282,528	$1,615,672
38	CITIZENS FS&LA	ACQUISITION	$62,700	$0	$3,986	($3,986)
39	FIRST FS&LA	ACQUISITION	$124,800	$19,600	$16,450	$3,150
40	FIDELITY FS&LA	ACQUISITION	$41,120	$3,700	$2,210	$1,490
41	BAY CITY FS&LA GULF COAST S&LA ALLENPARK FS&LA HEIGHT SA, FSB	ACQUISITION	$689,000	$556,866	$285,318	$271,548
42	COOSA FS&LA	ACQUISITION	$78,400	$12,900	$6,357	$6,543

 ATTACHMENT I

FSLIC ASSISTED TRANSACTIONS
TO MERGE OR CLOSE PROBLEM INSTITUTIONS
FROM JANUARY 1, 1988 THROUGH SEPTEMBER 30, 1988
(Unaudited)
(All figures in thousands)

TRANS #	FAILED ASSOCIATION	TYPE OF ACTION	TOTAL ASSETS AT DATE OF FSLIC ACTION	REPORTED COST TO FSLIC	PROJECTED COST AT 12/31/87 ##	INCREASE/ (DECREASE) OVER PROJECTED COST
43	FREEDOM FS&LA	ACQUISITION	$315,400	$23,100	$37,250	($14,150)
44	LOVES PARK FSB	ACQUISITION	$42,400	$4,900	$1,560	$3,340
45	CHAMPION SA	ACQUISITION	$656,700	$533,367	$355,020	$178,347
46	ARSENAL SA FRANKTON FS&LA	ACQUISITION	$197,000	$40,000	$37,800	$2,200
47	BUTTERFIELD FS&LA	ACQUISITION	$541,300	$281,100	$76,670	$204,430
48	DELTA SVGS OF TEXAS GUARANTY FS&LA FIRST FS&LA	ACQUISITION	$3,190,200	$1,489,130	$291,440	$1,197,690
49	CREDITBANC SA FRANKLIN SA GREAT WEST SB	ACQUISITION	$1,184,400	$999,545	$324,396	$675,149
50	UNITED SA OF CENT. IND.	ACQUISITION	$60,800	$9,300	$4,840	$4,460
51	CITIZENS FS&LA	ACQUISITION	$53,600	$5,400	$6,090	($690)
52	ADOBE SB	ACQUISITION	$47,000	$2,900	$412	$2,488
			$29,967,970	$17,878,624	$7,968,405	$9,910,219
	* LIQUIDATIONS *					
53	FIRST SA OF EAST TX	LIQUIDATION	$62,900	$86,700	$87,990	($1,290)
54	TERRITORY S&LA	LIQUIDATION	$37,800	$52,000	$46,190	$5,810
55	CITIZENS S&LA	LIQUIDATION	$150,000	$135,000	$141,270	($6,270)
56	MT. WHITNEY S&LA	LIQUIDATION	$34,000	$46,400	$46,380	$20
57	RAMONA FS&LA	LIQUIDATION	$45,000	$76,300	$76,340	($40)
58	FIRST FS&LA	LIQUIDATION	$130,000	$52,300	$52,340	($40)

FSLIC ASSISTED TRANSACTIONS
TO MERGE OR CLOSE PROBLEM INSTITUTIONS
FROM JANUARY 1, 1988 THROUGH SEPTEMBER 30, 1988
(Unaudited)
(All figures in thousands)

TRANS #	FAILED ASSOCIATION	TYPE OF ACTION	TOTAL ASSETS AT DATE OF FSLIC ACTION	REPORTED COST TO FSLIC	PROJECTED COST AT 12/31/87 ##	INCREASE/ (DECREASE) OVER PROJECTED COST
59	INVESTORS S&LA UNITED S&LA	LIQUIDATION	$167,600	$76,300	$84,850	($8,550)
60	FIRST FS&LA	LIQUIDATION	$128,780	$138,200	$29,880	$108,320
61	AMERICAN FS&LA	LIQUIDATION	$164,400	$67,200	$32,630	$34,570
62	CARDINAL SB	LIQUIDATION	$93,800	$34,400	$25,622	$8,778
63	LARUE FS&LA	LIQUIDATION	$13,100	$6,600	$5,110	$1,490
64	VICTOR S&LA	LIQUIDATION	$230,000	$241,000	$124,850	$116,150
65	THE AMERICAN FS&LA	LIQUIDATION	$70,400	$106,900	$71,690	$35,210
66	UNIVERSAL SA	LIQUIDATION	$54,800	$10,800	$29,780	($18,980)
67	NORTH AMERICAN S&LA	LIQUIDATION	$98,200	$133,000	$66,170	$66,830
68	AMER. DIVERSIFIED SB	LIQUIDATION	$509,000	$798,000	$631,170	$166,830
69	FARMERS FS&LA	LIQUIDATION	$181,500	$198,900	$119,940	$78,960
70	ULTIMATE SB, FSB	LIQUIDATION	$192,500	$55,700	$0	$55,700
71	PEOPLES S&LA	LIQUIDATION	$21,500	$15,700	$8,340	$7,360
			$2,385,280	$2,331,400	$1,680,542	$650,858
	** TOTAL **		$32,353,250	$20,210,024	$9,648,947	$10,561,077

Represents either amount accrued or negative tangible net worth at 12/31/87

Source: FSLIC Records

ESTIMATED COSTS OF
SOUTHWEST PLAN RESOLUTIONS ACTIONS
THROUGH SEPTEMBER 30, 1988
(Unaudited)

ACQUIRER	ESTIMATED COST OF ASSISTANCE AGREEMENTS (PRESENT VALUE)	PRESENT VALUE BASIS @ CASH	NOTES (PRINCIPAL)	NOTES (INTEREST)	CAPITAL LOSS COVERAGE	YIELD SUBSIDY	OTHER **
COASTAL BANC SA	$146,226	$3,627	$12,584	$22,569	$52,001	$52,888	$2,557
SOUTHWEST SA	$1,980,323		$219,637	$290,136	$817,137	$653,413	
MERABANK FSB	$665,655		$69,122	$96,177	$291,277	$215,326	($6,247)
GIBSON GROUP, INC.	$1,313,780		$197,393	$297,739	$317,319	$481,404	$19,925
SUNBELT SA	$6,166,637		$918,691	$1,492,472	$1,721,533	$2,033,941	
PULTE DIVERSIFIED CO.	$1,090,233		$191,189	$330,929	$238,959	$335,846	($6,690)
TEMPLE-INLAND	$1,489,130		$253,385	$426,691	$329,844	$540,300	($61,090)
CLUB CORPORATION	$999,545		$98,766	$164,138	$294,455	$446,061	($3,875)
TOTAL	$13,851,529	$3,627	$1,960,767	$3,120,851	$4,062,525	$4,759,179	($55,420)

** "Other" column includes mark to market adjustments, prepayment penalties on FHLB advances and projected future income from FSLIC ownership interests and return of tax benefits.

@ All figures in thousands.

ESTIMATED COSTS OF
SOUTHWEST PLAN RESOLUTIONS ACTIONS
THROUGH SEPTEMBER 30, 1988
(Unaudited)

ACQUIRER	ESTIMATED COSTS OF ASSISTANCE AGREEMENTS (CASH BASIS)	CASH BASIS @					
		CASH	NOTES (PRINCIPAL)	NOTES (INTEREST)	CAPITAL LOSS COVERAGE	YIELD SUBSIDY	OTHER **
COASTAL BANC SA	$237,225	$3,627	$32,639	$35,041	$112,752	$61,870	($8,704)
SOUTHWEST SA	$3,521,024		$569,682	$450,050	$1,738,990	$762,302	
MERABANK FSB	$1,241,227		$187,602	$153,658	$662,206	$257,014	($19,253)
GIBSON GROUP, INC.	$2,379,171		$535,743	$472,633	$752,155	$617,277	$1,363
SUNBELT SA	$11,509,284		$2,459,761	$2,383,834	$4,061,931	$2,603,758	
PULTE DIVERSIFIED CO.	$1,993,689		$511,840	$526,547	$562,961	$429,733	($37,392)
TEMPLE-INLAND	$2,808,221		$710,146	$681,456	$804,641	$700,065	($88,087)
CLUB CORPORATION	$1,620,461		$264,443	$258,962	$538,782	$571,406	($13,132)
TOTAL	$25,310,302	$3,627	$5,271,856	$4,962,181	$9,234,418	$6,003,425	($165,205)

** "Other" column includes mark to market adjustments, prepayment penalties on FHLB advances and projected future income from FSLIC ownership interests and return of tax benefits.

@ All figures in thousands.

Source: FSLIC Records

ATTACHMENT III

CAPITAL CONTRIBUTIONS AND COSTS OF ACTIONS
UNDER THE SOUTHWEST PLAN
THROUGH SEPTEMBER 30, 1988
(Unaudited)
(all figures in thousands)

ACQUIRER	THRIFTS ACQUIRED	ACQUIRER CONTRIBUTION	FSLIC ASSISTANCE	TOTAL ASSETS OF ACQUIRED ASSOCIATIONS	FSLIC COST AS A PERCENT OF ASSETS
COASTAL BANC SA	ALLIANCE S&LA	$3,500	$146,226	$455,800	32.08%
	COLORADO COUNTY FS&LA				
	SECURITY S&LA				
	CAMERON COUNTY SA				
SOUTHWEST SA	LAMAR SA				
	CITY S&LA	$25,000	$1,980,323	$3,998,400	49.53%
	STOCKTON SA				
	BRIERCROFT SA				
MERABANK FSB	BROWNFIELD FS&LA	$28,800	$665,655	$824,000	80.78%
	FIRST FINANCIAL				
	STATE FS&LA OF LUBBOCK				
GIBSON GROUP, INC.	IRVING SA	$48,000	$1,313,780	$2,217,200	59.25%
	LONGVIEW S&LA				
	GLADEWATER FS&LA				
	RICHARDSON S&LA				
	MAJESTIC SA				
	COMMERCE FS&LA				
	PARIS S&LA				
	AMERICAN BANC SA				
	SKYLINE SA				
	BEN MILAM S&LA				
	MERCURY SA				
	SOUTHLAND SA				
SUNBELT SA	SUNBELT SA	$0	$6,166,637	$4,826,300	127.77%
	INDEPENDENT AMERICAN SA				
	SUMMIT SA				
	WESTERN FS&LA				
	TEXANA S&LA				
	FEDERATED S&LA				
	FIRST CITY SA				
	MULTIBANC SA				

ATTACHMENT III

CAPITAL CONTRIBUTIONS AND COSTS OF ACTIONS
UNDER THE SOUTHWEST PLAN
THROUGH SEPTEMBER 30, 1988
(Unaudited)
(all figures in thousands)

ACQUIRER	THRIFTS ACQUIRED	ACQUIRER CONTRIBUTION	FSLIC ASSISTANCE	TOTAL ASSETS OF ACQUIRED ASSOCIATIONS	FSLIC COST AS A PERCENT OF ASSETS
PULTE DIVERSIFIED	ALLENPARK FS&LA BAY CITY FS&LA GULF COAST S&LA HEIGHTS SA, FSB CHAMPION SA	$45,000	$1,090,233	$1,345,700	81.02%
TEMPLE-INLAND	DELTA SVGS OF TEXAS GUARANTY FS&LA FIRST FS&LA	$128,000	$1,489,130	$3,190,200	46.68%
CLUB CORPORATION	CREDITBANC SA FRANKLIN SA GREAT WEST SB	$25,000	$999,545	$1,184,400	84.39%
		$303,300	$13,851,529	$18,042,000	76.77%
		2.14%	97.86%		

Source: FSLIC Records