CBO TESTIMONY

Statement of
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before the
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NOTICE

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Mr. Chairman, I appreciate this opportunity to appear before your Committee to discuss the condition of the federal deposit insurance funds and the banks and thrifts that hold the deposits safeguarded by those funds. I will present the Congressional Budget Office's (CBO's) new baseline projections of spending by the Bank Insurance Fund (BIF), the Resolution Trust Corporation (RTC), and the Savings Association Insurance Fund (SAIF), and our analysis of the Administration's midsession budget update for those funds. I will also share with you some concerns I have about the transition of responsibility from the RTC to the SAIF and the stability of long-term financing for the BIF and the SAIF.

In summary:

- Although a large majority of banks and thrifts appear relatively healthy, the outlook for a portion of each industry remains problematic in the near term, primarily because of large losses in recent years, generally weak economic conditions, and continuing real estate problems. Profits of banks and thrifts, in general, have rebounded, and the long-run outlook appears more promising for the majority of institutions.

- Bank Insurance Fund outlays in fiscal year 1992 have been lower than we had projected and far lower than the

Administration's budget estimates. CBO now estimates that BIF's net outlays will be about $9 billion in fiscal year 1992, rise to about $13 billion in 1993, and decline thereafter. We project that from 1992 through 1995, the BIF will incur gross losses of $39 billion in resolving failed banks. We estimate that the BIF's borrowing authority will be sufficient to cover its needs and that the borrowing can be repaid from bank premiums and asset sales over the next decade.

- CBO has revised downward--by about $20 billion--its estimate of the cost of the thrift cleanup. This revision reflects legislative and regulatory changes, the beneficial effect of removing failing thrifts from the marketplace, and the recent widening of interest rate spreads. Losses on failed institutions over the 1989-1998 period will cost the RTC or its successor $135 billion on a present-value basis, in addition to the $60 billion spent for thrift losses before 1989.

- Nevertheless, if the RTC stops accepting institutions for resolution by October 1993, as scheduled, and hands over the remaining caseload to the SAIF, that fund will not be able to handle the task without additional federal resources. This

situation has been worsened by the failure of the Administration and the Congress to agree on continued funding for the RTC.

HOW THE BANK AND THRIFT INDUSTRIES ARE FARING TODAY

The bank and thrift industries have been through some extraordinarily difficult times recently. However, both types of depository institutions are currently benefiting from unusual economic conditions that are temporarily adding to their profits and capital bases. In addition, actions by the Federal Reserve, recent legislation, and changes in the regulatory environment have improved the near-term outlook for these institutions. Data on the performance of thrifts and banks during 1991 and the first quarter of 1992 provide room for guarded optimism about the long-term viability of the nation's insured depositories. Nevertheless, the prospect of continued shrinkage in the number of financial institutions and in their share of total assets will continue to be a concern to policymakers.

Condition of the Bank and Thrift Industries

From 1987 through 1991, the number of federally insured commercial and savings banks fell by more than 2,200 institutions (about 16 percent); federal regulators resolved 927 of them, and the balance merged or withdrew at no cost to the Bank Insurance Fund. Over the same period, the number of thrifts declined by more than 1,100 (about one-third of the industry); more than 800 were resolved at government expense, and the remainder merged or withdrew on their own.

Although both the bank and thrift industries are going through consolidation, an important difference separates both the near-term and longer-term prospects of those industries: the asset base of the thrift industry has declined by nearly one-third, while assets held by the banking industry have expanded by about 15 percent over the 1987 level. In viewing the long-term trends, the contraction of the thrift industry is an important contrast with the continued growth of the banking industry.

Currently, both banks and thrifts are benefiting from an unusually wide spread between borrowing and lending rates, which has allowed them to add to their reported capital bases. This development improves the short-term financial picture for many banks and thrifts and will allow some that

regulators would have closed to remain open. However, because this interest rate spread may be temporary, it will not greatly affect the longer-term prospects for insured depositories. Competition heightened by overcapacity will narrow the spread, as will the anticipated pickup in the economy.

Another factor affecting the outlook for banks and thrifts is the change in regulation brought about by the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). Among other changes, the new law requires more timely resolution of failing institutions, imposes mandatory sanctions on institutions that fall below minimum capital standards, strengthens supervision by requiring on-site examinations, places restrictions on brokered deposits, and introduces risk-based insurance premiums. Because these changes affect the behavior of both the depository institutions and the regulators, they create a new and potentially safer environment for the nation's financial institutions. The legislation certainly has improved the outlook for the federal deposit insurance funds, even though those funds remain a concern.

The Banking Industry

Despite recent losses, the U.S. banking industry appears relatively healthy. Bank earnings were stronger in 1991 and early 1992 than in 1990. More than 90 percent of the roughly 12,000 commercial and savings banks in the United States earned profits last year. In the first quarter of calendar year 1992, commercial banks earned a record $7.6 billion, about 40 percent more than a year earlier; BIF-insured savings banks earned $176 million, the first quarterly profit for that group since 1989. The rate of return on assets at commercial banks rose dramatically in the first quarter of this year to 0.88 percent from 0.66 percent for the first quarter of 1991; the average rate for the 1988-1991 period was 0.50 percent. At the same time, however, the number of institutions on the Federal Deposit Insurance Corporation's (FDIC's) list of problem banks remains high, and the assets of commercial and savings banks on that list jumped in the first quarter of 1992 to $607 billion from $400 billion one year earlier.

Underlying these overall figures are really two separate banking industries. One, which comprises a large majority of banks, is well capitalized and earning money. The other, encompassing only a small proportion of banks, is poorly capitalized or losing money or both. In the first quarter of 1992, almost 10,600 banks had book-value equity-to-asset ratios of more than

6 percent and reported positive net income. Those banks account for more than half of the industry's assets and show every sign of long-term financial health. Recent experience suggests that such banks have a low probability of failure over the next four years.

At the other end of the spectrum are approximately 1,600 BIF-insured banks that reported equity-to-asset ratios of less than 6 percent, or net losses for the first quarter of 1992, or both. Approximately 1,000 banks are undercapitalized and hold equity-to-asset ratios of less than 6 percent. Those institutions account for about 8 percent of all banks, but they hold about 37 percent of the industry's assets. Approximately one-quarter of them, holding 10 percent of the industry's assets, are likely to fail within the next four years.

The performance of small and mid-sized banks outpaced that of many money-center banks during 1991. Many of the larger banks ($1 billion or more in assets) continue to suffer losses on loans and diminished earnings, primarily attributable to real estate loans. Approximately 4.3 percent of the loans of larger commercial banks were nonperforming during 1991, compared with 2.3 percent of smaller banks' loans. The rates of return on both assets and equity for larger banks were lower than for smaller banks. A few very large banks remain vulnerable.

The Thrift Industry

Recorded profits in the thrift industry were better in 1991 and early 1992 than they have been for many years. Overall, 1991 profits were equal to only 0.3 percent of assets, less than half of the average rate of about 0.7 percent for thrifts in the 1970s. Reported profits in the first quarter of 1992 returned to the 0.7 percent level (on an annual basis), but these numbers are preliminary and may not be sustained for the whole year. In 1991 and early 1992, profitability in the industry was enhanced by lower (and more stable) interest rates and a wide spread of long-term over short-term rates. Profits were also enhanced by realizing gains in asset values. These conditions were reflected in the net pretax income of $4.7 billion in 1991 and $2.3 billion in the first quarter of 1992.

Measured on a book-value basis, the capitalization of the industry has improved. Counting only tangible capital--that is, excluding "goodwill" and other intangible assets--the industry reached its nadir in 1984 when it held only $3 billion in tangible capital against $978 billion in assets (0.3 percent). Tangible capital equaled 4.9 percent of assets at the end of 1991 and 5.2 percent in the first quarter of 1992.

CBO's estimates and other data show that, like the banking industry, the thrift industry appears to be splitting in two. One group of about 1,300 to 1,500 institutions appears reasonably healthy, profitable, and for the most part well capitalized. Collectively this group has significantly improved its financial condition since 1988, and these institutions are likely to continue to form the core of the thrift industry into the next decade. Another group of about 500 to 700 institutions is in financial difficulty. Many of these thrifts are inadequately capitalized, although most report book-value ratios of capitalization between 3 percent and 6 percent. As a group, the unhealthy portion of the industry has substantially deteriorated in the past three years. Institutions in this group are likely to leave the industry, either through voluntary merger or government closure. Some may be acquired by healthy thrifts and banks, at no cost to the government. Others will require resolution at some government expense.

Projecting the Future of the Bank and Thrift Industries

CBO's view of the bank and thrift industries could be significantly affected by several factors. Among them are macroeconomic conditions, conditions in real estate markets, the nature of competition among banks and thrifts and

with other financial institutions, the introduction of risk-based premiums for deposit insurance, and the behavior of government regulators.

Macroeconomic Conditions. The economic recovery that appears to be under way may offer both good news and bad news for insured depositories. On the one hand, the recovery should increase demand for loans and reduce late payments and defaults. On the other hand, as short-term interest rates begin to rise, which they normally do in an expansion, the spread between borrowing and lending rates may narrow. In addition to the obvious squeeze that would put on profits, the value of some assets, especially real estate assets held by thrifts, may again be vulnerable to risk from rising interest rates. Over the last year, as long-term interest rates declined, many homeowners refinanced costly fixed- and variable-rate mortgages to lock in lower interest rates on fixed-rate mortgages. Although thrifts are in a far better position to hedge against rising interest rates than they were a decade ago, the industry's net operating income is still sensitive to both the level and the volatility of interest rates. At the end of 1991, thrifts held 44 percent of their total loans as fixed-rate instruments.

If the economy follows a course similar to CBO's forecast, macroeconomic developments should not change the long-term outlook of the banks and thrifts by much. A stronger economic recovery that is not

accompanied by inflationary pressures would benefit all banks and thrifts. A weaker economy with some fluctuations or weak shocks could probably be weathered by the well-capitalized institutions.

Real Estate and Other Assets. Banks and thrifts hold somewhat different asset portfolios. Thrifts are major holders of assets in residential real estate, primarily in the form of mortgages and mortgage-backed securities; in fact, nearly half of all thrifts' assets are in home mortgages. Banks' assets are more concentrated in commercial and industrial loans and commercial real estate.

Many experts believe that the thrift crisis will not truly be over until real estate markets recover from the speculative overbuilding that took place in the early and mid-1980s. Although no one can say with certainty that real estate markets have bottomed out, residential markets seem to be stabilizing, particularly in those regions of the country where the bubble burst first--that is, the southwestern and northeastern regions. Although other regions, such as the Far West, may yet experience similar real estate problems, the general economic recovery and lower interest rates may offset these problems.

The commercial real estate market continues to plague the financial health of the commercial banks. Overbuilding during the last decade has left

an excess supply of commercial buildings in many of the nation's large cities and has depressed real estate prices. Recent, well-publicized defaults by commercial real estate developers are reminders of the vulnerability of banks that hold loans on such properties.

Over the past year, banks have increased their holdings of government and government-backed securities. Such securities, which now amount to nearly 15 percent of banks' assets, provide a highly liquid, secure, and profitable investment opportunity for banks. This portfolio adjustment has lowered the overall riskiness of banks' assets and improved the safety and soundness of banks.

Competition. A key factor in determining the fate of both banks and thrifts is their competitiveness relative to that of other financial institutions. For the most part, depositories chartered as thrifts are very similar to those chartered as banks. Nevertheless, differences remain. Some differences tend to favor thrifts slightly--most notably, the lack of restrictions on engaging in interstate branching. Other differences, such as the qualified thrift lender test, may be viewed as handicaps for thrifts because they limit the diversification of a thrift's assets. In the near term, well-capitalized banks and thrifts appear able to withstand competitive pressures from each other and from nondepository financial institutions. Many thrifts are now thriving in their traditional role

of providing community depository services and originating mortgages. Banks have become more conservative in their lending practices.

Over the longer term, however, both banks and thrifts will continue to feel the effects of competition, especially from nondepositories. Between 1950 and 1991, the commercial banks' share of financial assets dropped from 50 percent to 22 percent; the thrifts' share dropped from a high of 16 percent in 1984 to 8 percent in 1991. These general trends are unlikely to change. Banks are especially vulnerable to competition from nonbank lenders and from foreign competition.

Risk-Based Premiums. The introduction of risk-based premiums could have a significant effect on the bank and thrift industries. In the long run, the effect clearly will be to improve the performance of the deposit insurance system, as insured institutions react to the incentive to reduce risk in order to reduce their premium payments. In the short run, however, the direction of change is less certain. During the upcoming transition period, as the new premium structure is put into place, some institutions may be unable to maintain solvency because of the higher premiums they must pay. Although most of these firms may already be candidates for closure, the higher premium payments may accelerate their demise and temporarily increase deposit insurance outlays. Nevertheless, very preliminary indications are that

even the modest premium differential suggested by the FDIC's rate structure could act as an incentive for banks and thrifts to avoid behavior that would cause their premium rates to rise.

Regulation. Probably the most significant variable in determining both the long-run and short-run condition of the depository institutions is the intensity and type of regulation pursued by federal and state officials. The stronger regulators are in the short run (in both supervising insured depositories and closing institutions that become insolvent), the stronger the industry will be in the long run; conversely, the more lenient regulators are now, the weaker the industry will be later.

Of all the variables that could affect CBO's estimates, this one is the hardest to predict and has the greatest impact on budget projections. CBO baseline projections are based on current law; they assume that regulators will be responsive to the regulatory directives of FDICIA. CBO also assumes that the regulators will have sufficient resources to close failed thrifts and banks in an orderly process and that they will do so.

BASELINE PROJECTIONS

Deposit insurance cost the government little before the late 1980s, but deposit insurance outlays are now a major factor in the federal budget. Table 1 shows outlays for deposit insurance in the CBO baseline from 1991 through 1997. Total outlays, including those financed by the Resolution Funding Corporation, are estimated to fall from $78 billion in 1991 to $13 billion in 1992 before rising in 1993 to $49 billion. By the end of the projection period, proceeds from asset sales more than offset spending, and funds are actually returned to the Treasury.

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

Table 1.
Outlays for Deposit Insurance in the Baseline (By fiscal year, in billions of dollars)

	1991	1992	1993	1994	1995	1996	1997
			Bank-Related and Other				
Bank Insurance Fund							
Losses	7	8	12	10	9	6	5
Working capital	10	10	15	13	11	8	6
Liquidations	-5	-6	-9	-11	-13	-13	-13
Net interest	a	a	1	1	2	2	1
Premiums and other	-4	-4	-6	-7	-7	-8	-8
Total	7	9	13	6	2	-5	-8
Other[b]	a	a	a	a	a	a	a
			Savings-and-Loan-Related				
Resolution Trust Corporation[c]							
Insurance losses[d]	38	9	23	15	12	11	7
Working capital							
Disbursements	56	22	46	33	27	21	12
Receipts	-34	-39	-37	-40	-40	-35	-28
Interest costs	3	3	3	4	4	4	3
Receipts from Resolution Funding Corporation (REFCORP)	-12	0	0	0	0	0	0
Total Budget Outlays	51	-5	35	12	4	b	-7
Total Including REFCORP	63	-5	35	12	4	b	-7
FSLIC Resolution Fund	9	10	2	a	a	a	a
Savings Association Insurance Fund	a	a	-1	-1	-1	-1	-1
			Total				
Total Budget Outlays for Deposit Insurance	66	13	49	17	5	-7	-16
Total Including REFCORP	78	13	49	17	5	-7	-16

SOURCE: Congressional Budget Office, *The Economic and Budget Outlook: An Update* (August 1992).

NOTE: Budget outlays reflect the treatment of the Resolution Funding Corporation and a predecessor, the Financing Corporation, shell corporations created solely to borrow funds for savings and loan resolutions, as government-sponsored enterprises. This treatment permits their borrowing to reduce the deficit. CBO has long viewed this treatment as inappropriate. The estimates assume the provision of additional resources to the Resolution Trust Corporation.

a. Less than $500 million.

b. Primarily National Credit Union Share Administration.

c. Or its successor.

d. Includes up to $500 million per year in administrative costs.

Estimates of losses are especially sensitive to sales prices for disposing of securities, loans, and real estate assets that the FDIC or the RTC retains as a result of bank and thrift resolutions. The actual cost of resolving failed depository institutions will not be known until the last asset has been removed from the government's hands, which probably will be well beyond the year 2000. The actual cost of deposit insurance could easily vary from our current estimate by tens of billions of dollars in either direction.

The Bank Insurance Fund

CBO has updated its January baseline projections to reflect the most recent data on 1992 BIF activity and on financial conditions in the banking industry. In particular, we have reduced--from $43 billion to $39 billion--the estimate of losses we expect to be incurred in resolving failed banks over the 1992-1996 period. We have also reduced slightly our estimate of the amount of working capital the BIF will expend to acquire assets of failed institutions, reflecting the FDIC's most recent experience in this regard. Our latest baseline projections for the BIF are summarized in Table 2.

CBO estimates that gross spending by the fund will total about $20 billion in fiscal year 1992, rise to about $29 billion in 1993, and drop off in

TABLE 2. FINANCIAL PROJECTIONS FOR THE BANK INSURANCE FUND
(By fiscal year, in billions of dollars)

	Actual 1991	1992	1993	1994	1995	1996	1997
			Outlays				
Gross Spending[a]	19	20	29	26	24	17	14
Collections	11	12	16	19	21	22	22
Net Budget Outlays[b]	7	9	13	6	2	-5	-8
			Accrued Income or Losses				
Gross Losses[c]	-8	-8	-12	-10	-9	-6	-5
Net Income or Losses[d]	-8	-10	-4	-3	0	2	3
			End-of-Year Balances				
Cumulative Borrowings from FFB and Treasury	8	13	26	33	35	30	22
Accrued Fund Balance[e]	2	-7	-11	-14	-14	-12	-10

SOURCE: Congressional Budget Office.

NOTE: FFB = Federal Financing Bank.

a. Includes cash disbursed for bank failures, plus other cash expenditures.

b. Gross spending less collections.

c. Losses accrued in resolving failed banks.

d. Assessment income less gross losses, additional reserves for future losses, and other expenses.

e. For fiscal years 1992-1997, includes a reserve for losses equal to projected losses in the subsequent year.

subsequent years. That spending would cover losses on bank resolutions of $8 billion in 1992, $12 billion in 1993, and another $30 billion over the following four years. (The differences between gross spending and the losses on bank resolutions consist primarily of working capital to cover the cost of acquired assets, as well as administrative expenses.) CBO estimates that approximately 600 banks may be resolved over the 1992-1995 period.

CBO's projections assume further premium increases--to 28 cents on January 1, 1993 (as announced by the FDIC) and to 30 cents on January 1, 1994. Even with such premium increases, the fund would incur net losses of about $12 billion from fiscal year 1992 through 1997. The accrued fund balance, which was more than $10 billion on September 30, 1990, has disappeared.

We anticipate that the BIF will have to borrow from the Treasury for losses and from the Federal Financing Bank (FFB) for working capital each year through 1995 and that the borrowing will total about $35 billion. Assuming that the banking industry enters a period of relative stability over the last part of this decade, we project that the BIF's debt to the Treasury and the FFB can be repaid by the year 2000.

The fate of a small number of extremely large banks can swing the projection results substantially in either direction. How regulators will close failed large banks, or whether they will close them at all, is highly uncertain. If the average rates for bank failures and BIF losses were applied to the largest troubled banks, the estimate of the costs of resolution would dwarf the fund's recently buttressed resources. Although these rates of losses will probably not apply to the largest banks, such calculations indicate how sensitive projections of bank losses can be.

Projected Costs of Resolving the Savings and Loan Crisis

For purposes of summarizing the costs of the savings and loan crisis, the most useful measure is a present-value estimate of past, present, and future net costs of resolving failed thrifts. CBO now estimates that losses in failed financial institutions will cost the RTC or its successor $135 billion on a present-value basis, bringing the total cost of the thrift crisis to $195 billion.

The $135 billion estimate for cleaning up the thrift crisis is $20 billion less than the estimate we have used for the last two and one-half years. The reduction in estimated losses confirms a pattern that has been evolving over the last two years. Our analysis of the quarterly financial condition of the

thrift industry during that time suggested that, relative to each previous period, fewer institutions were facing insolvency and that the losses associated with resolving those thrifts were moving very slowly, but consistently, in a downward direction. CBO believes that these data confirm a trend, which our summer baseline now reflects.

Despite this downward revision in the size of the problem, however, one should not assume that leaving insolvent institutions open represents a savings to the taxpayer. Historically, a substantial share of the losses associated with closing failed savings and loans could have been avoided had the institutions been shut down when they first became insolvent. We agree with the Administration that delay in closing failed thrifts is only adding costs to the final tab for this crisis.

We attribute the growing strength of the thrift industry to several factors. One is the beneficial effect of removing hemorrhaging thrifts from the marketplace. To keep the cash-starved operations replenished with deposits, insolvent thrifts drove up the cost of funds for all financial institutions. They were willing to pay excessively high rates to attract deposits, often from out-of-state brokers. They also competed for good loans, bidding below market rates. As the sick thrifts have been closed, the remaining thrifts and banks have seen their cost of funds drop and market conditions improve. As mentioned earlier, we also believe that the legislative and regulatory

changes put into place over the last several years have contributed to the improved financial condition of thrifts. The positive effect of these changes is reflected in the slower rate of deterioration, relative to historical rates, of weak thrifts that are allowed to remain open. Nonetheless, allowing ailing institutions to languish increases the amount of taxpayer funds needed to resolve this crisis.

Current and Future Funding for Thrift Failures

CBO's estimates assume that the RTC will receive funding this fall and that continued funding will be made available without interruption. Funding delays, such as those that occurred in fiscal year 1991 and again in 1992, affect the level of disbursements and receipts in any time period, the length of time needed to complete the resolution process, and the final cost of the thrift crisis. Although the Banking Committees have reported out legislation providing additional funding for the RTC, the Congress and the Administration have not yet taken the steps needed to provide the deposit insurance accounts with sufficient cash to close insolvent institutions. The Budget Enforcement Act does not restrict the Congress's ability to recapitalize the RTC. One reason for this special treatment was to ensure that the RTC had the resources necessary to close insolvent institutions to avoid another thrift crisis.

In contrast to the present-value estimates, the federal budget records yearly flows of cash in deposit insurance accounts. On this basis, the Congress has provided the RTC with $105 billion to pay for losses incurred in resolving failed thrift institutions: $50 billion under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA); $30 billion under the RTC Funding Act of 1991; and $25 billion (available until April 1, 1992) under the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991. Of the funds provided, $85 billion has been obligated and $18 billion cannot be used because it was available only through March 31, 1992; the RTC has reserved the remaining $2 billion to pay for administrative costs, meet liquidity needs, and adjust for accounting shortfalls. Table 3 summarizes the RTC's funding status through July 10, 1992.

TABLE 3. STATUS OF FUNDING FOR THE RESOLUTION TRUST CORPORATION THROUGH JULY 10, 1992 (In billions of dollars)

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

SOURCE: Congressional Budget Office.

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

For the years beyond 1993, when, under current law, the RTC will no longer be accepting new institutions to close, we assume that either the life of the RTC will be extended once more or its successor--the Savings Association Insurance Fund--will be given sufficient resources on a timely basis. CBO estimates that disbursements for insurance losses, including administrative costs, will total about $157 billion over the 1989-1997 period. The summer baseline stretches out the period in which we expect the regulators to close insolvent thrifts by an additional three years--through 1998. This assumption reflects our view that the Office of Thrift Supervision will avoid closing weak thrifts quickly, choosing instead to work with them in developing business plans that, with sufficient time, might bring their capital levels to regulatory standards.

If funding for the RTC is delayed until spring, CBO's current budget projections over the 1992-1997 period will be significantly affected. Pushing the caseload backward by even six months could reduce 1993 net outlays from $35 billion to zero but increase outlays by $25 billion in 1994 and by about $10 billion in 1995. More important, the losses in insolvent institutions will continue to grow, thereby adding several billion dollars to the cost of the crisis.

Although CBO does not have enough information about the Administration's latest estimates to make a precise comparison, our analysis suggests that the final costs of thrift resolutions will be higher, more institutions will be closed, and the cleanup job will take longer than the Administration anticipates.

The midsession review does not reveal the Administration's estimate of the cost of the savings and loan cleanup; just last week the Secretary of the Treasury reaffirmed that the Administration anticipated losses near the mid-point of the range of $90 billion to $130 billion (in 1989 dollars). This estimate is slightly lower than CBO's present-value estimate (in 1990 dollars) of $135 billion. In nominal or budget dollars, the Administration's midsession review includes $128 billion for the RTC or the SAIF to continue its work through 1994. CBO foresees nominal losses of $157 billion--$126 billion through 1994 plus an additional $31 billion from 1995 through 1997. The Administration does not reveal how many institutions it expects will fail over the projection period. We estimate that 1,400 institutions will not survive over the 1989-1997 period; the regulators will resolve most of these, but several hundred will probably leave the industry at little or no federal cost.

The Administration has lowered its estimate of the outlays expected for the Bank Insurance Fund by $22 billion in 1992 and by $37 billion over the 1992-1997 period. This dramatic change has sharply narrowed the difference between the estimates of the Office of Management and Budget (OMB) and CBO. The Administration's January budget estimates of BIF outlays over the six-year period exceeded CBO's baseline projections by $43 billion, reflecting substantially greater expected spending for both losses and working capital. That difference is now down to $14 billion. (OMB's outlay estimates in the midsession review are $2 billion to $3 billion per year above CBO's.) Thus, although OMB is still more pessimistic about BIF spending than CBO, the differences are much smaller than they were earlier in the year.

THE TRANSITION FROM THE RTC TO THE SAIF

Current law authorizes the Resolution Trust Corporation to continue closing insolvent thrifts that are in receivership or conservatorship before October 1, 1993. Although the Savings Association Insurance Fund is scheduled to assume the job of protecting depositors in failed thrifts beginning in fiscal year 1994, the agency will face that responsibility with a modest balance of about $1 billion. The SAIF's potential liabilities are much greater, however. If the RTC is closed, the SAIF will receive that portion of the estimated $157 billion

in losses not paid by the RTC. Whether the RTC or the SAIF performs these resolutions does not change the need for appropriated funds to carry out the job.

Beginning in 1993, thrifts will pay assessment premiums to the SAIF, net of the contributions to the Financing Corporation. Certain banks that have acquired failed thrifts (commonly known as "Oakar thrifts") also will pay to the SAIF the portion of their assessments that is equal to the ratio of thrift deposits to bank deposits at the time of acquisition. Annual assessments will bring in about $1.3 billion during 1993, increasing to $1.4 billion by 1997. FIRREA and subsequent legislation anticipated that the SAIF might need Treasury funding to build sufficient cash reserves and authorized two types of annual payments for this purpose. One authorization provides for a payment each year through 2000 equal to the difference between $2 billion and the assessment income paid into the fund that year. The second authorization provides for payments to maintain the net worth of the SAIF according to a designated schedule starting at $1 billion for the beginning of fiscal year 1993 and increasing to $8.8 billion for the beginning of fiscal year 2000. To date, the Administration has not requested any appropriations for the SAIF.

The Federal Deposit Insurance Corporation has authority to borrow up to $30 billion to allow the Bank Insurance Fund and the SAIF to finance insurance losses. Without sufficient funding for the RTC, and if the SAIF assumes responsibility for thrift failures beginning in October 1993, the FDIC probably will need to tap that borrowing authority for use by the SAIF, thereby reducing the amount of funding available for the BIF. (Any amount that the FDIC borrows on behalf of the SAIF would be repaid by the thrifts, not the banks.) Under the assumptions of CBO's baseline projections, the BIF would need less than $20 billion of the $30 billion authorized.

Current law requires that the SAIF reach a reserve ratio of 1.25 percent of insured deposits within a reasonable period of time. The FDIC board of directors recommended in May that the SAIF's assessment rate be raised from the current 23 basis points to 28 basis points and that a risk-related premium system be adopted. We expect that these new rates will be effective beginning in January 1993. Although the adjustments to premium rates will help to correct long-term imbalances in expenses and income, the FDIC also expects that the SAIF will need appropriated funds to finance short-term losses.

CONCLUSION

CBO remains cautiously optimistic that the additional funds provided last year to the Bank Insurance Fund will be sufficient to carry it through a difficult period for the banks. One threat, previously unforeseen by many analysts, is that borrowing authority given to the FDIC to ensure sufficient funds for the BIF will end up being swallowed by the SAIF. That could happen if the Congress and the Administration fail to agree on renewed funding for the RTC, leaving an expensive backlog of failed thrifts for the SAIF when it takes over from the RTC in October 1993 the responsibility for resolving those institutions.

The RTC needs additional funding to carry out its task of resolving thrifts that have already failed and to help avert demand by the SAIF for the borrowing authority already provided. Failure to provide sufficient funds now would lead to a weaker industry in the long run and to an insurance fund that was likely to spend substantially more money than it would if those funds were provided expeditiously. CBO's estimate has been and continues to be that a substantial portion of the cleanup of the thrift crisis remains to be completed. The small improvement of the thrift industry reflected in CBO's new baseline is hardly cause for complacency or for further delay in funding. The longer the delay in recognizing, through closure, the economic failure of

insured depositories, the more expensive it will be for both budget resources and the economy as a whole.