

**Statement of
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**before the
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives**

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NOTICE

**This statement is not available
for public release until it is
delivered at 9:30 a.m. (EST),
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Mr. Chairman, I am pleased to appear before the Committee this morning to discuss the role of federal borrowing and loan guarantees in resolving insolvent federally insured savings and loan institutions. In response to your request, my remarks will focus on the working capital needs of the Resolution Trust Corporation (RTC)--the agency that the Financial Institutions Reform, Recovery, and Restructuring Act of 1989 (FIRREA) created to resolve insolvent thrifts--and alternative methods of funding those needs. I also will discuss the effect that the enactment of H.R. 3469, the Federal Agency Debt Management Act, would have on the operations of RTC and other federal agencies and instrumentalities.

RTC RESPONSIBILITIES AND SOURCES OF FUNDS UNDER FIRREA

FIRREA gives RTC the daunting task of resolving over 500 insolvent federally insured savings and loans that have assets of over \$300 billion. RTC estimates that other financial institutions may be willing to acquire about \$120 billion of those assets. The agency will be able to sell approximately \$80 billion more on the open market in the next few years. RTC believes that approximately \$100 billion in assets, much of it undeveloped land and unoccupied real estate, can be liquidated at only a fraction of book value. RTC will acquire these assets and liquidate them slowly over a number of years, thereby avoiding "fire sales" and keeping the costs of the bailout to a minimum. According to

the Administration, \$50 billion would be more than enough to cover RTC's net losses on the disposition of all three types of assets.

To finance the resolution of insolvent thrifts, FIRREA gives RTC the same powers that the new Bank Insurance Fund (BIF) and Savings Association Insurance Fund (SAIF) possess with respect to other failed depository institutions. These include the authority to purchase assets from, assume liabilities of, or issue notes or guarantees to acquirers of insolvent institutions. FIRREA restricts RTC's use of these authorities by establishing a limit on the total amount of obligations that the agency may have outstanding at any time. The statute also requires RTC to use the least costly means of resolving insolvent thrifts.

FIRREA gives RTC three sources of cash. The agency received \$18.8 billion in appropriations from the Treasury in fiscal year 1989 and \$1.2 billion from the Federal Home Loan Banks. It will receive another \$30 billion from the off-budget Resolution Funding Corporation (REFCORP) in fiscal years 1990 and 1991. FIRREA also allows RTC to raise another \$5 billion by borrowing from the Treasury. The statute does not appear to authorize the agency to issue debt securities to the general public, which would be another way to raise cash. RTC does have the authority to issue promissory notes to acquiring institutions, which is another form of borrowing from the public. However, FIRREA limits this authority, and such notes do not provide the same flexibility as cash.

As Federal Deposit Insurance Corporation (FDIC) Chairman Seidman indicated in recent testimony before the Senate Banking Committee, RTC may need \$100 billion in cash, or "working capital," to acquire the assets that the agency will place in receiverships. In other words, the agency may have to raise up to \$45 billion more cash than FIRREA authorizes it to receive from the Treasury and REFCORP and to borrow from the Treasury. This need for additional cash would be covered--at least in part--from the disposition of assets, but much of the proceeds from those assets will not be available soon enough to be used to resolve cases.

ALTERNATIVE WAYS OF PROVIDING RTC WORKING CAPITAL

The Congress could provide RTC working capital by appropriating additional money to the agency, increasing its line of credit with the Treasury, or authorizing it to borrow from the public. Any funds appropriated to or borrowed by RTC would be scored as budget authority, and RTC's expenditure of the funds would be scored as outlays in the years the transactions occurred.

All three options would increase the unified budget deficit in fiscal years 1990 and 1991 if RTC resolved insolvent institutions at the pace projected by the Administration. These increases in the deficit would be

partially or wholly offset in later years as RTC sold assets it had acquired and the proceeds of the sales offset other government spending.

Press reports and other information suggest that the Administration has considered a fourth option for funding RTC's needs for working capital. Although no details are available, it appears that RTC might be able to charter a thrift or "funding bank" that would issue debt to the public. The debt would be collateralized by assets that RTC had acquired from insolvent thrifts and placed in receiverships. RTC would guarantee the securities sold by the funding bank, which would transfer the proceeds from the sale of the securities (probably less administrative and interest costs) to the receiverships, which would in turn declare a "liquidating dividend" and transfer the funds to RTC, which would use them to purchase more assets. This procedure could be repeated several times to raise the additional "working capital" that RTC needed to acquire the \$100 billion in assets of insolvent institutions that it plans to "warehouse" rather than sell immediately.

One potential consequence of such an arrangement would be that payments from the receiverships to RTC would be treated as offsetting collections, consistent with the current budgetary treatment of payments from receiverships to FDIC. This treatment, which would allow RTC to purchase large amounts of assets from insolvent institutions and place them in receiverships without the expenditures

increasing its outlays or the deficit, would be based on the premise that a funding bank and the receiverships would be private entities.

A second result would be that, if RTC estimated accurately the market value of the assets acquired and financed by a funding bank, it might be able to claim that its guarantees of the entity's debt would not cost anything and, therefore, would not count against the limit on the agency's obligations established by FIRREA.

Without sufficient details about such a financing plan, it is difficult to comment on its possible budgetary treatment. However, based on information that we have obtained to date, CBO probably would disagree with the assumption that a funding bank would be a private firm, since it clearly would be more like a federally owned subsidiary of RTC than a private company for disposing real estate assets. Its sole purpose would be to raise funds for the RTC, and the markets would view the RTC guarantee as more important than the value of the underlying assets. Consequently, we would argue that the funds raised in this manner and laundered through the receiverships should not be treated as offsetting collections, but as the proceeds of RTC borrowing from the public.

Without the details of a specific proposal, it is also difficult to estimate the interest rates that investors would require on RTC-guaranteed debt issued by a funding bank. However, such debt is

certain to be more expensive than Treasury borrowing. It seems likely that yields on RTC guaranteed notes would exceed yields on Treasury securities with comparable maturities by between 25 and 75 basis points. Thus, if \$45 billion were to be borrowed in this way, interest costs would be \$100 million to \$300 million a year above Treasury borrowing costs.

EVALUATING ALTERNATIVE MEANS OF PROVIDING RTC WORKING CAPITAL

From the perspective of the budget process, the Congress can use three principles to evaluate alternative ways of financing any agency's activities, including raising working capital for RTC. CBO believes that each of these principles represents sound budgetary practice.

First, the government should seek to minimize its costs of borrowing. This is the debt management principle that motivated the creation of the Federal Financing Bank (FFB). Allowing RTC to raise working capital by borrowing from the public, either directly or by guaranteeing notes issued by a funding bank, would be inconsistent with this principle.

Second, agency spending should be controlled in the annual budget process. On the other hand, it may be desirable to give an insurance agency unlimited authority to spend money, subject to the availability

of funds, in order to provide it with the flexibility to deal with rapidly changing situations. In that case, a fallback principle is that an agency's authority to borrow should be limited, either with a cumulative cap or through the annual budget process. The Congress sought to do this in FIRREA by limiting RTC's obligations and capping its borrowing from the Treasury at \$5 billion. Similar action could be taken to limit direct or indirect RTC borrowing to raise working capital.

Third, government borrowing and expenditures generally should be recorded in the unified budget. An off-budget RTC funding bank would violate this principle, as do REFCORP and the Financing Corporation (FICO), another off-budget borrowing corporation established in 1987 to finance the resolution of insolvent thrifts. All of these arrangements cancel out government expenditures by having the funds they transfer to the government count as offsetting collections.

However, having RTC finance its needs for working capital on budget would make it significantly more difficult to reach the Balanced Budget Act baseline deficit targets in fiscal year 1991. The cash basis of the unified budget and the Balanced Budget Act baseline is ill-suited to measuring the impact on taxpayers of RTC's activities. The ultimate cost of the thrift bailout is likely to be much less than RTC's cash outflows in the initial years.

As CBO pointed out in testimony before the Ways and Means Committee in April, a case can be made for excluding RTC's expenditures from the Balanced Budget Act baseline deficit calculation, but one cannot be made for excluding the interest payments on debt issued to finance that spending. Such an exemption would recognize that RTC is liquidating federal liabilities that already exist, so that borrowing to finance its activities will not absorb private savings and will have economic effects that are quite different from the consequences of Treasury borrowing to finance ordinary federal spending.

The Congress, however, did not take this approach to the budgetary treatment of RTC spending in FIRREA. Using an off-budget mechanism to raise working capital for RTC could be viewed as an extension of the REFCORP approach, although FIRREA does not authorize a funding bank or similar entity.

On the other hand, there is a danger in raising RTC's working capital through an off-budget funding mechanism such as a funding bank--namely, it creates an open invitation to use similar approaches to finance other federal spending. We have already seen examples of such approaches in legislation considered by the House during the 101st Congress.

H.R. 3469: THE FEDERAL AGENCY DEBT MANAGEMENT ACT

In the Subcommittee's letter of invitation, we were asked to comment on H.R. 3469, the Federal Agency Debt Management Act, which Representative Stark introduced with nine other members of the Ways and Means Committee. H.R. 3469 would apply to any federal agency or instrumentality that was established under any law enacted after 1988 and authorized to borrow from the Treasury. Beginning December 1, 1989, the bill would specify that such an entity "may borrow amounts only from the Treasury," and would not allow it to "issue any other obligation or otherwise borrow any amount," "guarantee any obligation," or "incur any direct or contingent liability to pay any amount in respect of an obligation."

If enacted, H.R. 3469 would prevent RTC and the two federal deposit insurance funds, BIF and SAIF, from issuing promissory notes to acquirers of failing or insolvent depository institutions after December 1, 1989. Current law requires all three agencies to use the least costly method of resolution at their disposal. In the past, FDIC has argued that in some cases the least costly method of resolving insolvent institutions involves giving an acquirer promissory notes. Thus, H.R. 3469 would be a more severe limitation on the authority of these agencies to issue notes.

The bill would also prevent RTC from raising the working capital it needs to resolve insolvent thrifts by issuing guarantees of debt issued by a funding bank or through any other off-budget means. This stipulation would reduce the cost of RTC borrowing relative to those approaches. At the same time, the measure would force RTC to seek legislation to increase its authority to borrow from the Treasury.

Moreover, H.R. 3469 could prevent RTC from giving acquirers of assets of insolvent thrifts the option to sell the assets to the agency under certain conditions for a limited period of time. Such arrangements may be the least costly means of resolution, particularly for large institutions.

Finally, the legislation would prevent any new government-sponsored enterprise (GSE), or any other federal instrumentality that was created in the future and given a Treasury line of credit, from borrowing from the public, or guaranteeing or incurring contingent liabilities associated with the debt obligations of another party. This proposal would have the effect of converting all borrowing by any new GSE into on-budget direct lending by the Treasury, and could discourage the creation of new GSEs.

On the other hand, converting all borrowing by a new GSE into federal direct lending would greatly overstate the cost to the government of the GSE's activities. Alternative approaches to

measuring or limiting the cost of GSEs to the government include monitoring their risks more closely, limiting their risk-taking more directly, measuring the cost to the government of the implicit federal guarantee of their obligations, and using estimates of that cost in the budget process.

CONCLUSION

In conclusion, Mr. Chairman, CBO has several concerns about the creation of an off-budget funding bank to raise working capital for RTC. Such an arrangement could be used to hide large federal outlays outside the budget and could increase the cost of financing RTC's activities compared with borrowing from the Treasury. In addition, the Congress might have little control over the amount of funds RTC borrowed in this manner.