

CBO TESTIMONY

Statement of
Robert D. Reischauer
Director
Congressional Budget Office

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

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NOTICE

This statement is not available for public release until it is delivered at 10:00 a.m. (EDT), on Tuesday, September 17, 1991.



CONGRESSIONAL BUDGET OFFICE
SECOND AM) D) STREETS, S.W.
WASHINGTON, D.C. 20515

Mr. Chairman, I appreciate the opportunity to appear before the Subcommittee to discuss the Congressional Budget Office's (CBO's) assessment of the financial condition of the Resolution Trust Corporation (RTC).

In my testimony I will deal with three aspects of CBO's assessment:

- RTC spending to date, reviewing CBO's cost estimates as published in our summer budget update last month and comparing them with those the Administration recently made;
- The effect that any delay in funding can have on the pace and cost of future resolutions and;
- The implications of legislation restructuring the RTC.

RTC SPENDING TO DATE AND FUNDING NEEDS _____

To date, the Congress has provided the RTC with \$80 billion to use in covering losses incurred in resolving failed thrift institutions: \$50 billion under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (**FIRREA**) and \$30 billion under the RTC Funding Act of 1991. If the Congress votes no further funding before the end of the calendar year, the RTC will have exhausted this authority. Last week Chairman William Seidman, in testimony before your Subcommittee, indicated that losses incurred through early September total \$67 billion, and that by the end of the fiscal year, the RTC expects to use \$76 billion of the \$80 billion appropriated for insurance losses. The RTC's proposed operating

plan, which assumes that the corporation will not be constrained by lack of funds, anticipates that the RTC's losses will total **\$130** billion by September 30, 1992. CBO expects that the losses will amount to about \$73 billion by September 30, 1991, and that the remaining \$7 billion in loss funds will be disbursed early in the first quarter of fiscal year 1992. We estimate that RTC spending for thrift losses will total **\$120** billion by the end of fiscal year 1992.

The timing of RTC's disbursements is highly uncertain. It depends on when resolution contracts are signed and how much will be lost on each institution. As a result, some losses that we expect to be recorded in fiscal year 1991 could slip into the following year, or actual 1991 spending could exceed our current estimates. More certain is that the RTC will soon exhaust its authority to incur additional losses. Although all the loss money has not yet been disbursed, the agency has effectively committed all of those funds to resolving institutions over the next few months. Without knowing the amount and timing of additional funding, the RTC will not be able to solicit bids for the sale of additional thrifts.

In the next few years, the RTC will receive increasing income from the sale of assets it has acquired. This income, however, cannot be used to pay insurance losses. The assets acquired in closing failed thrifts can be viewed as collateral for RTC borrowing from the Federal Financing Bank (FFB) for working capital. In the short term, the RTC will use net recoveries from asset sales to acquire new assets instead of borrowing more from the FFB. Later, the RTC will use the recoveries to repay its loans from the FFB. Thus, the Treasury remains the only source of

funds to pay for insurance losses. The value that the RTC receives for the assets it sells is important, however, because RTC's recorded losses are only estimates based on assumptions about asset value, and the final price tag will not be known until all assets are sold.

PROJECTED COSTS OF RESOLVING THE SAVINGS AND LOAN CRISIS

For purposes of summarizing the costs of the savings and loan debacle, the single most useful figure is the present value of future costs, which indicates the value in current dollars of past, present, and future net costs of resolving failed thrifts. CBO estimates that the present-value cost of resolving the savings and loan crisis is **\$215 billion**. That figure includes the \$60 billion that will be charged to the Federal Savings and Loan Insurance Fund and the **FSLIC** Resolution Fund for those institutions that the regulators had closed before the RTC was established. We estimate that the cleanup, expressed in terms of 1990 dollars, will cost the RTC or its successor \$155 billion. CBO derives this estimate from cash flow projections through the year 2004 and assumes that about 1,500 institutions will ultimately be resolved.

The budget, by contrast, does not reflect present-value estimates. Instead, it records the yearly net flows of cash in the deposit insurance accounts. CBO's most recent budget projections are summarized in Table 1. We estimate that outlays for RTC's insurance losses, including on-budget administrative costs, will total

\$191 billion over the 1989-1996 period. Disbursements of working capital will total \$357 billion, including interest costs on working capital borrowed from the FFB. Receipts from the disposal of assets acquired through the resolution process are estimated to total \$298 billion. Additional sales of assets are projected to be made after 1996 until the assets acquired by the disbursements of working capital are sold.

However, all of these estimates are very uncertain because they depend on regulatory actions, availability of funding, economic conditions, and other variables. No one can predict how many thrifts the regulators will decide to close, or how fast the RTC will resolve failed or failing institutions. For example, over the last year, CBO has reduced from 1,700 to 1,500 the expected number of thrifts that will become insolvent and must be merged or closed over the next four years.

Despite this reduction in the caseload, CBO's present-value estimate of total losses has not changed significantly. Many of the thrifts on the edge of insolvency have relatively few assets, and the cost of resolving them is small. Alternatively, the unexpected failure or recovery of just a few large institutions can change the estimate of losses substantially. Recently, the RTC revised upward by \$6.4 billion its estimates of losses for thrifts closed before 1990. CBO had predicted losses of that order of magnitude.

Fluctuations in the economy also contribute to the uncertainty. The financial health of banks and thrifts is sensitive to the pace of economic activity, and to such conditions as the level of interest rates. While CBO has not developed a precise

TABLE 1. OUTLAYS FOR **SAVINGS-AND-LOAN-RELATED**
DEPOSIT INSURANCE IN THE BASELINE
(By **fiscal year**, in **billions** of dollars)

	Estimate		1991	1992	1993	1994	1995	1996
	1989	1990						
Resolution Trust Corporation								
Insurance losses*	1	35	37	47	32	31	8	b
Working capital								
Disbursements	9	33	50	78	64	60	14	0
Receipts	0	-3	•24	-42	•58	.65	-61	-45
Interest costs	b	b	4	7	10	11	11	8
Payments from Federal Home Loan Banks	-1	0	0	0	0	0	0	0
Receipts from Resolution Funding Corporation (REFCORP)	<u>0</u>	<u>-18</u>	<u>-12</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total Budget Outlays	9	47	55	90	47	37	-28	-37
Total Including REFCORP	9	65	67	90	47	37	-28	-37
Federal Savings and Loan Insurance Corporation (FSLIC)	10	c	c	c	c	c	c	c
FSLIC Resolution Fund	b	5	9	7	6	1	1	1
Savings Association Insurance Fund (SAIF)	b	b	b	-1	b	-1	1	2

SOURCE: Congressional Budget Office, *The Economic and Budget Outlook: An Update (August 1991)*.

NOTE: Budget **outlays** reflect the treatment of the Resolution Funding Corporation (REFCORP) and Financing Corporation (FICO), **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** that RTC will be provided with resources beyond **those** available under current law.

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

method of accounting for such economic impacts, and hence cannot offer a rule of thumb, a significant change in the economy's course could clearly affect the government's costs.

Fluctuations of interest rates are a particular source of uncertainty, partly because of their effect on real estate values. Because of these fluctuations, it is difficult to project how much the RTC will recoup from disposing of the assets of failed thrifts. As a result, the actual cost of resolving failed savings and loan institutions will not be known until the last asset has been disposed of, which probably will be well beyond the year 2000. The actual cost could easily vary from our current estimate by \$30 billion in either direction.

COMPARING CBO AND ADMINISTRATION ESTIMATES

While 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 resolution will be higher, more institutions will be closed, and the cleanup job will take longer than the Administration anticipates.

The Administration has estimated that the cost of the savings and loan cleanup will be in the range of \$90 billion to \$130 billion (in 1989 dollars). This range is lower than CBO's present-value estimate (in 1990 dollars) of \$155 billion. In nominal or budget dollars, the Administration has projected that as much as

\$160 billion in loss funds would be needed for the RTC to complete its work. CBO foresees nominal losses of \$191 billion.

Of the additional \$80 billion it is requesting, the Administration expects that \$50 billion would be needed in fiscal year 1992. CBO expects that about \$40 billion in additional loss money will be needed for fiscal year 1992, though the amount could easily vary by several billion dollars in either direction. The Administration has also requested that the authority of the RTC to borrow from the **FFB** be increased from \$125 billion to \$160 billion. CBO estimates that the requested borrowing authority would be sufficient to cover RTC's needs for working capital.

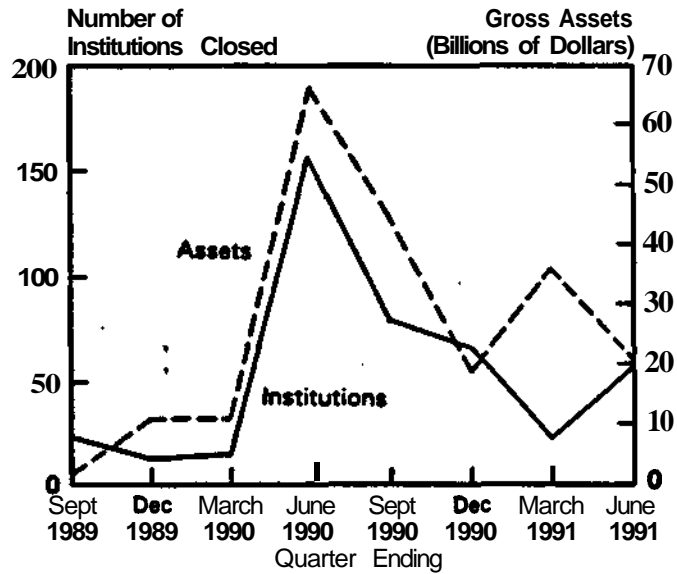
The Administration apparently expects that the RTC may have to resolve between 900 and 1,000 thrifts, and that the job can be completed by the end of fiscal year 1993. CBO believes that the RTC or its successor will most likely have to resolve as many as 1,500 thrift institutions, or between 500 and 600 more than the number the Administration anticipates.

Under current law, the RTC's authority to resolve institutions ends on August 9, 1992, except for those thrifts already placed in **conservatorship**. The Administration has requested that the Office of Thrift Supervision be authorized to continue transferring failed thrifts to the **RTC** through September 30, 1993. Our August estimates assume that the RTC would remain active through early 1995, three years beyond the period contemplated by FIRREA.

CBO's estimates assume that the RTC would receive adequate funds on a timely basis. Funding delays, such as those that occurred in fiscal year 1991, could affect the amount of disbursements and receipts in any given time period, the length of time needed to complete the resolution process, and the final cost of the thrift crisis. After experiencing start-up pains, the RTC has built a staff and developed procedures that allow the agency to close about 75 or more thrifts each quarter, depending on asset size and assuming adequate resources. The actual quarterly pattern to date has been far more erratic: 155 institutions were closed during April 1990 through June 1990, while only 22 institutions were closed between January 1991 and the end of March 1991 (see the Figure below).

**Figure
Caseload of the
Resolution Trust
Corporation,
by Quarter**

SOURCES: Congressional
Budget Office;
Resolution Trust
Corporation.



NOTE: The RTC began operations in August 1989.

The Budget Enforcement Act of 1990 places no impediments in the way of RTC recapitalization. Legislation providing more funding to the deposit insurance agencies is specifically exempt from the pay-as-you-go discipline as long as it merely honors the government's existing commitment. The budget estimates of both CBO and the Administration assume that deposit insurance agencies will be given sufficient resources to handle future caseloads.

Allowing ailing institutions to stay in business can drive up the ultimate cost of resolution. A recent CBO study concluded that as a result of **forbearance--the** policy of delaying the resolution of thrift **institutions--insolvent** thrifts remained open for an average of 38 months, and the resolution of **1,130** thrift institutions between 1980 and 1991 cost an extra \$66 billion (in 1990 dollars), roughly doubling the total cost of their resolution. While some of the sources of these **costs--undertaking** highly risky projects and paying premium rates for deposits, for example--may now be under better regulatory scrutiny, they cannot all have been eliminated.

We estimate that the 900 thrifts that will have to be resolved, but that the RTC had not taken over as of June 30, 1991, lost about **\$17** billion in market value during 1990. Only part of this loss could have been avoided by earlier action. Nevertheless, any further delays, caused by lack of funding or other factors, could add significantly to the ultimate costs that the taxpayers will bear.

EFFECTS OF RESTRUCTURING THE RTC

Current law assigns the responsibility and accountability for policy and operations of the RTC to both the RTC Oversight Board and the Board of Directors of the Federal Deposit Insurance Corporation. The Secretary of the Treasury is Chairman of the Oversight Board, and the Treasury **staff** plays a major role in developing and coordinating federal policy affecting financial institutions. We believe that the division of responsibility and accountability among these agencies has at times led to confusion, and that streamlining the decision process would increase efficiency and accountability.

Proposed changes in the organization of the RTC vary in design and scope. We have not studied these proposals, and I have no basis for commenting on their relative merits. It is critical, though, to avoid potential delays and disruptions, and thus minimize the added cost of further delays. Therefore, the Congress should ensure that the RTC can continue closing failed thrifts and selling assets during any transition to a new structure. Adequate funding, well-defined lines of authority in any new organizational structure, and a transition process that would not disrupt the RTC's resolution activity will help to minimize the costs that the government must pay to protect deposits in failed institutions.