



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

Accounting and Financial  
Management Division  
B-114893

May 20, 1988

The Honorable M. Danny Wall  
Chairman  
Federal Home Loan Bank Board  
1700 G Street, NW  
Washington, DC 20552



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Dear Mr. Wall:

As you are aware, we have completed our audit of the Federal Savings and Loan Insurance Corporation (FSLIC) and will be issuing our report on that audit shortly, together with our reports on our review of internal accounting controls and compliance with laws and regulations. We are issuing this separate report to bring to your attention three matters for which we believe the Federal Home Loan Bank Board should establish policies setting forth its intentions.

First, FSLIC has begun a policy of issuing notes in connection with many of its resolution actions. At the present time, there are few controls over the total amount of notes that FSLIC can issue. Accordingly, a fair degree of public uncertainty exists about the extent to which FSLIC will use notes. We believe that a public policy statement is needed to provide some degree of accountability and control over the amount of notes that will be issued and the resultant commitment of federal monies. Such a public statement is important to maintain the public credibility and acceptability of those notes.

Secondly, in connection with its assisted mergers and sales, FSLIC has also begun to issue more substantial amounts of long-term yield and other guarantees to acquirers and others involved in restructuring insolvent thrifts. As with notes, these guarantees are long-term commitments of the insurance fund. Accordingly, we believe that a public policy statement as to the extent to which FSLIC will commit resources under such guarantee arrangements is necessary to provide appropriate controls, public accountability, and public credibility.

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Finally, as we noted in our testimony to the Senate Banking Committee yesterday, we are also concerned about some of the new, creative, and highly complex financial instruments and hedging transactions in which we see savings and loan institutions entering, as well as some of the creative transactions that may disguise the nature of losses at thrifts. While we are aware that guidance on some financial transactions, such as risk controlled arbitrage, has been provided to the supervisory and examination force, new financial instruments are being created almost daily. Therefore, we believe that continued, prompt regulatory action to examine and establish specific policies for new financial transactions is needed to ensure that examiners and supervisors have clear guidelines and are able to recognize any problems that result from such activities. Moreover, guidance should also be provided to thrifts to ensure they are well aware of what they can and cannot do in these areas, and to ensure management understands the risks involved in these transactions.

Because of our concerns in these areas we are recommending that the Chairman, Federal Home Loan Bank Board

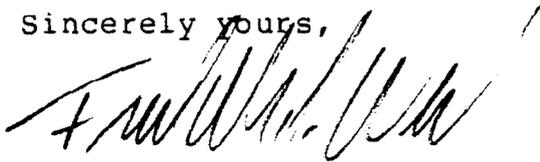
- issue a public policy statement, consistent with your cash flow projections, regarding the total amount of notes FSLIC intends to issue, as well as the total amount of yield and other guarantees FSLIC intends to provide, in connection with its resolution actions, and
- ensure that the Office of Regulatory Policy, Oversight and Supervision monitors and provides necessary guidance on new financial instruments and transactions to the supervisory and examination staff, as well as insured savings and loan associations.

As you are aware, the head of a federal agency is required by 31 U.S.C. 720 to submit a written statement on actions taken on these recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on

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Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

Sincerely yours,

A handwritten signature in black ink, appearing to read 'Frederick D. Wolf', written in a cursive style.

Frederick D. Wolf  
Director

cc: Chairman, Committee on Banking, Housing, and Urban  
Affairs, United States Senate

Chairman, Committee on Banking, Finance and Urban  
Affairs, House of Representatives

The Honorable James A. Baker, III, Secretary of the  
Treasury