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Report to the Congress

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FINANCIAL AUDIT

Savings Association Insurance Fund's 1990 and 1989 Financial Statements

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Comptroller General
of the United States

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January 8, 1992

To the President of the Senate and the
Speaker of the House of Representatives

This report presents our opinion on the financial statements of the Savings Association Insurance Fund for the year ended December 31, 1990, and the period from August 9, 1989 (its inception), through December 31, 1989. For those periods, the Fund's statements present fairly, in all material respects, its financial position and the results of its operations and cash flows in conformity with generally accepted accounting principles. Our reports on the Fund's internal control structure and on its compliance with laws and regulations are also presented. We conducted our audits pursuant to the provisions of section 17(d) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1827(d)), and in accordance with generally accepted government auditing standards.

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) (Public Law 101-73), created the Savings Association Insurance Fund to provide insurance to savings associations (thrifts). FIRREA also created the Resolution Trust Corporation (RTC) to resolve troubled thrifts whose accounts had been insured by the Federal Savings and Loan Insurance Corporation (FSLIC) and that had been placed into conservatorship or receivership from January 1, 1989, through August 8, 1992. The Savings Association Insurance Fund is responsible for assisting and resolving other federally insured thrifts for which RTC does not have resolution authority, such as those newly established since the Fund's inception. FIRREA made the Fund responsible for resolving all federally insured thrifts placed into conservatorship or receivership after August 8, 1992.

In recent testimonies before the Congress, RTC's Oversight Board and the Congressional Budget Office (CBO) predicted that a significant number of thrift resolutions will be necessary beyond August 8, 1992. In response to the Oversight Board's request, the Congress passed the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991, which provided $25 billion in additional funding and an extension of RTC's resolution authority to thrifts placed into conservatorship or receivership through September 30, 1993.[1] Whether this extension will allow the Fund to

[1]Any thrift requiring resolution after September 30, 1993, which had previously been under RTC conservatorship or receivership may be put back to RTC in accordance with the provisions of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991.

responsible for assisting and resolving other federally insured thrifts for which RTC does not have resolution authority, such as those established since the Fund's inception on August 9, 1989. In addition, the Fund will be responsible for resolving all federally insured thrifts placed into conservatorship or receivership for the first time after September 30, 1993. On September 12, 1991, RTC's Oversight Board appeared before the Congress to request additional funding for resolutions and an extension of RTC's resolution authority to cover thrifts placed into conservatorship or receivership through September 30, 1993. The extension granted by the act is intended to allow RTC to resolve additional troubled thrifts and allow the Savings Association Insurance Fund to assume its resolution responsibilities without a backlog.

As discussed in note 1 to the financial statements, FIRREA provided the Savings Association Insurance Fund with several revenue sources; however, only two sources—insurance premiums and Treasury payments—will provide the significant amounts that may be required for resolution activity. In 1991, we reported[4] that the Fund's ability to maintain adequate capital levels and provide insurance protection to depositors depends on the number and cost of thrift resolutions that must be undertaken. The following sections of this report discuss various estimates of future thrift failures, the source and availability of funds necessary for their resolution, and the resulting impact on the Savings Association Insurance Fund. In addition, this report discusses the higher cost of using entities other than the U.S. Treasury to raise funds for thrift resolutions.

Estimates of Future Thrift Failures Vary

In order to monitor the condition of the thrift industry, the Office of Thrift Supervision (OTS), the industry's federal regulator, classifies private sector thrifts (thrifts not under the government's control) into four groups based on their ability to meet capital standards, their prospects for future viability, and the results of supervisory/regulatory examinations. At the end of the second quarter of 1991, OTS reported 2,216 private sector thrifts grouped as follows:

- Group I consists of 1,005 thrifts, constituting 46 percent of the thrift industry and holding 33 percent of the industry's assets. This group is considered healthy and well-capitalized.

[4]Financial Audit: Savings Association Insurance Fund's 1989 Financial Statements (GAO/AFMD-91-31, March 1, 1991).

RTC's authority to resolve thrifts placed into conservatorship or receivership. In response to the Oversight Board's request, the Congress passed the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991, which provided $25 billion in additional funding and extended RTC's resolution authority as previously described. With the extension of RTC's resolution authority, the Oversight Board anticipates that RTC will have resolved more than 900 troubled thrifts since its inception on August 9, 1989, leaving the Fund with few, if any, thrifts in need of resolution.

In its September 17, 1991, testimony before the House Subcommittee on Financial Institutions Supervision, Regulation and Insurance, the Congressional Budget Office (CBO) stated that as many as 1,500 thrifts will most likely need to be resolved. CBO also stated that, if RTC is to resolve these thrifts, its authority must extend to thrifts placed in conservatorship or receivership through early 1995, 3 years beyond the period specified in FIRREA, and 2 years beyond the period estimated by the Oversight Board.

It is difficult to project what the ultimate number of resolutions will be and when they will occur. Currently, more than 300 of the 900 thrifts that the Oversight Board projected would be closed are still open. Most of these thrifts are still operating in the private sector and nearly half have positive capital. In addition, private sector thrifts, in aggregate, reported two consecutive profitable quarters during the first half of 1991. According to OTS, this is attributable to the government's continued success in its program to close failing and insolvent thrifts and the favorable spreads between the rates of interest thrifts earn and the rates they must pay to borrow funds.

Funding Sources May Be Inadequate

Although FIRREA provided the Fund with several revenue sources, our preliminary calculations indicate that it will have approximately $1 billion on October 1, 1993, the date on which it is scheduled to assume its full responsibility for federally insured thrifts in need of resolution. We also estimate that the Fund's total income is not likely to exceed $32 billion through 2000. Whether this will be sufficient to pay its obligations and achieve the net worth goals set by FIRREA will depend on future resolution demands.

After December 1992, the Fund will receive that portion of thrift insurance premium assessments not required to pay interest on the bonds that were have done so by the end of fiscal year 1993. If the interest rate spread continues to be favorable, many poorly capitalized thrifts may remain marginally viable long after their current expected failure dates. Also, the Fund faces the possibility that some institutions it is responsible for could fail before October 1, 1993.

Because of the uncertainties inherent in making projections, resolution costs and the Fund's viability cannot be reliably predicted at present. However, we will be monitoring future events, evaluating their effects on the Savings Association Insurance Fund, and reporting our findings as part of future financial statement audits.

Some Borrowing Costs Could Have Been Avoided

The Financing Corporation (FICO) was created by the Competitive Equality Banking Act of 1987 to raise funds for thrift resolution activities. To fulfill its purpose, FICO was authorized to issue $10.825 billion in debt obligations (bonds), the proceeds of which were to be remitted to the FSLIC Resolution Fund, formerly FSLIC. The Savings Association Insurance Fund's members are charged with paying the interest on the FICO bonds. To date, FICO has sold $8.170 billion in bonds. The recently passed Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991 terminated FICO's remaining obligation authority as of the date of enactment.

Raising funds through FICO borrowings will result in approximately $2 billion in interest costs that could have been avoided had Treasury issued the bonds. This is because, on average, the effective interest rate on FICO's bonds, which all have 30-year terms, exceeds Treasury's 30-year rates by approximately 0.788 percent. Because FICO's higher interest expense consumes funds that would otherwise be available to the Fund for thrift resolutions, it can have a direct effect on the government's cost of the thrift industry crisis. Thrift industry assessments must first be used to pay interest on the FICO borrowings, leaving less to be deposited in the Fund than would be deposited if Treasury had borrowed the funds. For this reason, contributions required from Treasury will most likely be higher.

- revenue/assessments, consisting of policies and procedures related to premium collections, and entrance and exit fees;
- treasury, consisting of policies and procedures related to investing activities, and cash receipts;
- payroll, consisting of policies and procedures related to payroll activity;
- other expenditures, consisting of policies and procedures related to travel and procurement activity; and
- financial reporting, consisting of policies and procedures related to the processing of journal entries into the general ledger and the preparation of financial statements.

For each internal control structure category listed above, we obtained an understanding of the design of the relevant policies and procedures, determined whether they have been placed in operation, and assessed the associated control risk. We performed limited tests of controls for all the categories above, except for investment and cash collection activities. For those activities, we determined that it was more efficient to rely solely on substantive audit tests. For all categories, we performed audit tests to substantiate account balances associated with each control category. Such tests can also serve to identify weaknesses in the internal control structure.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be considered reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect an organization's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

There are basically two levels of reportable conditions—those that are considered material weaknesses,[8] which could affect the fair presentation of the financial statements, and those that while not material are significant matters that merit management's attention. We noted no matters involving the internal control structure and its operation that we consider to be reportable conditions as defined above.

[8]A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Financial Statements

Statements of Financial Position

(in thousands)

	December 31 1990	December 31 1989
Assets		
Cash and cash equivalents (Note 3)	$ 16,535	$ -0-
Entrance and exit fees receivable, net (Note 4)	49,384	3,153
Other assets	637	2,153
	$ 66,556	$ 5,306
Liabilities and the Fund Balance		
Accounts payable, accrued liabilities and other	4,178	2,153
SAIF member exit fees held in reserve (Note 4)	62,376	3,151
Fund Balance	2	2
	$ 66,556	$ 5,306

The accompanying notes are an integral part of these financial statements.

Statements of Cash Flows

(in thousands)

	Jan 1 - Dec 31 1990	Aug 9 - Dec 31 1989
Cash Flows From Operating Activities:		
Cash inflows from:		
Transition assessment principal proceeds	$ -0-	$ 98,827
Interest on transition assessment principal proceeds	-0-	1,914
FRF funding transfer (Note 1)	56,088	4,482
Entrance and exit fee collections (Note 4)	12,961	-0-
Miscellaneous receipts	703	-0-
Cash outflows for:		
Transition assessment payment transferred to FRF	120	100,672
Administrative operating expenses (Note 1)	53,097	4,551
Net Cash Provided By Operating Activities (Note 8)	**16,535**	**-0-**
Cash and Cash Equivalents - Beginning	**-0-**	**-0-**
Cash and Cash Equivalents - Ending	**$ 16,535**	**$ -0-**

The accompanying notes are an integral part of these financial statements.

Beginning on August 9, 1989 and ending on September 30, 1991, the administrative and supervisory expenses incurred by the SAIF will be the funding responsibility of the FRF. Such expenses will have priority over other obligations of the FRF. Funding by the FRF is effective as expenses are recognized by the SAIF.

Source of Funds. FIRREA provides seven primary funding sources for the SAIF: (1) FRF funding of administrative and supervisory expenses, as discussed above; (2) SAIF member assessments available which are not required for the FICO, the REFCORP, or the FRF; (3) U. S. Treasury payments for the amount, if any, by which $2,000,000,000 exceeds the amount of assessments deposited in the SAIF for each of the fiscal years 1992 through 1999; (4) U. S. Treasury payments for any additional amounts which may be necessary to ensure that the SAIF has the minimum net worth set by FIRREA for each of the fiscal years 1992 through 2000; (5) discretionary payments by the RTC; (6) Federal Home Loan Bank borrowings; and (7) U. S. Treasury borrowings up to $5,000,000,000.

These sources of funds may not be adequate for the SAIF to remain solvent if it accepts resolution responsibility in August 1992 as required by FIRREA. Only the SAIF member assessments and the Treasury payments will provide significant funding resources. Whether either amount will be sufficient to pay SAIF's obligations and achieve the minimum net worth set by FIRREA will depend on the ability of the RTC to resolve expected future failures and the demands the SAIF faces in the future.

In November 1990, Congress enacted the *FDIC Assessment Rate Act of 1990* (1990 Act). Principal provisions of the 1990 Act removed annual assessment rate restrictions, timing of rate increases and the upper limit on the designated reserve ratio, and permitted the FDIC, on behalf of the BIF or SAIF, to borrow from the Federal Financing Bank (FFB) in accordance with terms and conditions determined by the FFB. The borrowing authority is in addition to the $5 billion Treasury borrowing authority and is limited by the Federal Deposit Insurance (FDI) Act which provides that the FDIC may not issue notes or incur obligations that would cause the net worth of the SAIF to be less than 10 percent of its assets.

Other miscellaneous sources of SAIF revenue include insurance fees from new SAIF members, entrance fees from insured depository institutions involved in allowable conversion and transfer transactions between the BIF and the SAIF, and investment revenue earned on assessment collections and such fees.

2. Summary of Significant Accounting Policies

Assessment Revenue Recognition. The SAIF recognizes as assessment revenue only that portion of SAIF member assessments not claimed by the FICO, the REFCORP or the FRF.

Litigation Losses. The SAIF accrues as a charge to current period income an estimate for probable loss from litigation against the SAIF. The FDIC Legal Division recommends these estimated losses on a case-by-case basis. As of December 31, 1990 and 1989, no litigation was pending against the SAIF.

Furniture, Fixtures and Equipment. The cost of furniture, fixtures and equipment purchased by the FDIC on behalf of the three Funds under its administration is allocated among these Funds on a pro rata basis. The SAIF expenses its share of these allocated costs at the time of acquisition. This policy is a departure from generally accepted accounting principles; however, capitalizing these expenditures would not be cost-beneficial to SAIF.

Within specified parameters, the interim regulations allow an acquiring institution to pay its entrance/exit fees due, interest free, in equal annual installments over a period of not more than five years. When an institution elects such a payment plan, the SAIF records the entrance and exit fee receivable at its present value.

Entrance and Exit Fees Receivable as of December 31 consisted of the following (in thousands of dollars):

	1990	1989
Entrance Fees Receivable	$ 2	$ 2
Entrance Fees Collections	(2)	-0-
Exit Fees Receivable	71,525	3,716
Exit Fees Collections	(12,991)	-0-
Unamortized Discount	(9,150)	(565)
	$ 49,384	$ 3,153

5. Assessments

The FDI Act authorizes the FDIC to set assessment rates for SAIF members. Assessments are levied semiannually against a member's average assessment base.

The FDI Act also provides for an assessment credit to SAIF members when the Board of Directors determines that the SAIF reserve ratio is expected to exceed the designated reserve ratio in the succeeding year, after taking into account expected expenses and revenues. The FDI Act defines the SAIF designated reserve ratio as (i) 1.25 percent of estimated insured deposits; or (ii) such higher percentage of estimated insured deposits as the Board of Directors determines for that year to be justified by circumstances that raise a significant risk of substantial future losses to the SAIF.

The assessment rate set for 1991 is 0.23 percent. Based on the present and projected status of the SAIF, and anticipated expenses and revenue for the next year, the reserve ratio is not expected to exceed the current designated reserve ratio of 1.25 percent. Therefore, savings associations will not receive an assessment credit in 1991.

Secondary Reserve Offset. The FDI Act authorizes insured savings associations to offset against any assessment premiums their pro rata share of amounts that were previously part of the FSLIC's "Secondary Reserve". FIRREA limits the allowable offset to 20 percent of an institution's remaining pro rata share for any calendar year beginning before 1993. After calendar year 1992, there is no limitation on the remaining offset amount.

The Secondary Reserve offset serves to reduce the gross SAIF member assessments due, thereby reducing the assessment premiums available to the FICO, the REFCORP, the FRF and the SAIF. The Secondary Reserve balance was $ 359,121,133 and $ 521,284,758 for 1990 and 1989 respectively.

Transition Assessment. In September 1989, the FDIC allowed for a one-time, transition assessment against SAIF members to change such members' premium assessment due dates to a semiannual basis. This special assessment available from SAIF members totalled $393,827,000, of which $295,000,000 was claimed by the Financing Corporation for debt servicing needs. Remaining funds of $98,827,000 were deposited in the SAIF until the proper owner of the funds could be determined. These funds, in addition to interest earned thereon, were subsequently allocated to the FSLIC Resolution Fund in the absence of assessment authority by the Resolution Funding Corporation on the transition assessment date. As of December 31, 1989, $120,000 in interest remained to be transferred to the FSLIC Resolution Fund in 1990.

FDIC Health Insurance Plan	1990	1989
Premiums Paid	$ 41,376	$ 32,554
Participating retirees	16	15
FDIC Dental Insurance Plan		
Premiums Paid	$ 3,464	$ 3,165
Participating retirees	20	18

The life insurance program is underwritten by Metropolitan Life Insurance Company and provides for basic coverage at no cost and allows converting optional coverages to direct-pay plans with Metropolitan Life. The FDIC does not make any contributions towards annuitants basic life insurance coverage, this charge is built into rates for active employees.

7. Commitments

The SAIF is currently sharing in the FDIC lease of office space to accommodate its staff. Lease commitments for office space total $1,424,000 for future years. Leased space expense was approximately $3,383,000 for the year ended December 31, 1990 and $25,000 for the period August 9, 1989 through December 31, 1989.

Leased fees, which are committed per contractual agreement, for future years are as follows (in thousands of dollars):

1991	1992	1993	1994	1995	1996/Thereafter
$ 766	$ 318	$ 214	$ 112	$ 13	$ 1

8. Subsequent Event

In December 1989, Southeast Bank for Savings, Miami, was acquired by Southeast Bank, N.A., Miami, one of two subsidiaries of Southeast Banking Corporation, Miami, Florida. This acquisition transaction was authorized pursuant to the "Oakar amendment" in FIRREA. This amendment generally allows a bank holding company that controls a savings association to merge or consolidate the assets and liabilities of such savings association with, or transfer such assets and liabilities to, any subsidiary bank which is a Bank Insurance Fund member with the approval of the appropriate Federal banking agency and the Board of Governors of the Federal Reserve System. The deposits transferred to the subsidiary bank are transferred as SAIF deposits, assessed at SAIF assessment rates, and continue to be SAIF's insurance responsibility.

In September 1991, Southeast Bank, N.A., Miami, which held deposits insured by both BIF and SAIF, was closed by its chartering authority. The FDIC estimated cost for the failures of Southeast Bank, N.A., Miami, and Southeast Bank of West Florida, Pensacola is $350 million, of which SAIF has responsibility for $40 million (its allocated share of the loss incurred). At December 31, 1990, Southeast Bank, N.A., Miami, was not deemed to be in-substance insolvent and, therefore, not probable to fail. Accordingly, no contingent liability was established.

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9. Supplementary Information Relating to the Statements of Cash Flows

Reconciliation of net income to net cash provided by operating activities for the year ended December 31, 1990 and for the period August 9, 1989 through December 31, 1989 (in thousands of dollars):

	1990	1989
Net Income	$ -0-	$ 2
Adjustments to reconcile net income to net cash provided by operating activities:		
Increase in entrance and exit fees receivable	(46,231)	(3,153)
Decrease (Increase) in other assets	1,516	(2,153)
Increase in accounts payable, accrued liability and other	2,025	2,153
Increase in SAIF member exit fees held in reserve	59,225	3,151
Net cash provided by operating activities	**$ 16,535**	**$ -0-**

1990 assessments against SAIF members yielded the following results (in thousands of dollars):

Gross SAIF member assessments due	$ 1,929,594
Less: Secondary Reserve offset	(99,749)
Other adjustments/credits	(1,403)
Net SAIF member assessments available	**1,828,442**
Less: FICO assessment	(738,200)
REFCORP assessment	(1,061,495)
Funds available to the FRF	**28,747**
Funds available to the SAIF	**$ -0-**

1990 SAIF member assessments of $28.7 million previously claimed by REFCORP were transferred to the FRF on January 22, 1991. REFCORP did not require the funds because they have no further plans for public debt issuance. FRF is next in line to claim assessments not required by FICO or REFCORP.

6. Pension Benefits, Savings Plans and Accrued Annual Leave

Pension Benefits and Savings Plans expenses for the period ending December 31, 1990 and for the period August 9, 1989 through December 31, 1989 consisted of the following (in thousands of dollars):

	1990	1989
Civil Service Retirement System (CSRS)	$ 840	$ 130
Federal Employee Retirement System (FERS) (Basic Benefits)	1,187	158
FDIC - 401K Plan	735	108
Thrift Savings Plan (TSP)	256	38
	$ 3,018	**$ 434**

The FDIC eligible employees assigned to the SAIF are covered by either the CSRS or the FERS. Automatic and matching employer contributions are provided by the SAIF for all eligible employees. Matching contributions are also provided by the SAIF on behalf of all eligible employees to the FDIC - 401K Plan and the TSP.

Although the SAIF contributes a portion of the pension benefits for eligible employees and makes the necessary payroll withholdings from them, the SAIF does not account for the assets of either retirement system, nor does it have actuarial data with respect to accumulated plan benefits or the unfunded liability relative to its eligible employees. These amounts are reported by the U. S. Office of Personnel Management and are not allocated to the individual employers.

The SAIF liability to employees for accrued annual leave is approximately $1,610,000 and $0 at December 31, 1990 and 1989, respectively.

The FDIC provides certain health (including dental care) and life insurance coverage for its eligible retirees. Eligible retirees are those that have elected the FDIC's health and/or life insurance program and are entitled to an immediate annuity. The health insurance coverage is a comprehensive fee-for-service program underwritten by Blue Cross/Blue Shield of the National Capital Area, with hospital coverage and a major medical wrap-around (the dental care is underwritten by Connecticut General Insurance Company). The FDIC makes the same contributions for retirees as those of active employees. The FDIC benefit programs are fully insured and expenses are recognized as premiums are paid. The cost of benefits provided and the number of retirees are as follows:

Travel Advances. The allocation of travel advances from the BIF to the SAIF was discontinued in 1990. The change was made to facilitate administrative record keeping and meets the conditions under which FIRREA allows the common use of the BIF and SAIF resources. The effect of the change applied retroactively to 1989 would reduce the balance in the "Other assets" line item and the "Accounts payable, accrued liabilities and other" line item by $601,000. The balances presented in the SAIF 1989 Statement of Financial Position have not been adjusted to reflect the change.

Recovery/Allocation of Common Expenses. Administrative operating expenses include allocated personnel, administrative, and other overhead expenses not directly related to the SAIF. These expenses are allocated in amounts reflecting the relative degree to which the expenses were incurred by the SAIF.

Reclassifications. Reclassifications have been made in the 1989 financial statements to conform to the presentation used in 1990.

Related Parties. The nature of related party relationships and descriptions of related party transactions are disclosed throughout the SAIF financial statements and related footnotes.

3. Cash and Cash Equivalents

The SAIF considers cash equivalents to be short-term, highly liquid investments with original maturities of three months or less. This includes the purchase of one-day Special Treasury Certificates. Cash and cash equivalents as of December 31 consisted of the following (in thousands of dollars):

	1990	1989
Cash	$ 6,241	$ -0-
Cash Equivalents	10,294	-0-
	$16,535	**$ -0-**

SAIF exit fees collected, in accordance with policies discussed in Note 4, comprise a substantial portion of cash and cash equivalent balances that may be used to meet SAIF's potential obligation to the FICO.

4. Entrance and Exit Fees

In accordance with FIRREA provisions, the SAIF will receive entrance and exit fees for conversion transactions in which an insured depository institution converts from the BIF to the SAIF (resulting in an entrance fee) or from the SAIF to the BIF (resulting in an exit fee). Interim regulations approved by the FDIC Board of Directors and published in the Federal Register on March 21, 1990 expanded the FIRREA provisions by directing that exit fees paid to SAIF be held in a reserve account until such time as the FDIC and the Secretary of the Treasury determine that it is no longer necessary to reserve such funds for the payment of interest on the obligations of the FICO.

The SAIF records entrance fees as a receivable and related revenue once the BIF-to-SAIF conversion transaction is consummated. However, due to the requirement that SAIF exit fees be held in a reserve account, thereby restricting the SAIF's use of such proceeds, the SAIF does not recognize exit fees as revenue. Instead, the SAIF recognizes the consummation of a SAIF-to-BIF conversion transaction by establishing a receivable from the institution and an identical reserve account to recognize the potential payment to the FICO. As exit fee proceeds are received, the receivable is reduced while the reserve remains pending the determination of funding requirements for interest payments on the FICO's obligations.

Notes To the Financial Statements

DECEMBER 31, 1990 and 1989

1. Legislative Reform

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) became public law on August 9, 1989. The primary purpose of the legislation was to reform, recapitalize, and consolidate the federal deposit insurance system in order to restore the public's confidence in the savings and loan industry and to ensure a safe and stable system of affordable housing finance through major regulatory reforms, strengthened capital standards and safeguards for the disposal of recoverable assets. FIRREA abolished the Federal Savings and Loan Insurance Corporation (FSLIC) and the Federal Home Loan Bank Board. Their functions were transferred, in a prescribed manner, to the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision, the Federal Housing Finance Board, and the Resolution Trust Corporation (RTC).

Under FIRREA, the FDIC became the administrator of two separate and distinct insurance funds: the Bank Insurance Fund (BIF), which insures the deposits of all BIF member banks, and the Savings Association Insurance Fund (SAIF), which insures the deposits of all SAIF member savings associations (formerly a function of the FSLIC). Both insurance funds are maintained separately to carry out their respective legislative mandates. In addition, FIRREA created the FSLIC Resolution Fund (FRF), a third separate fund under FDIC management.

The Resolution Funding Corporation (REFCORP) was established by FIRREA to provide funds to the RTC to enable the RTC to carry out its mandate. The Financing Corporation (FICO), established under the Competitive Equality Banking Act of 1987, is a mixed-ownership government corporation whose sole purpose is to function as a financing vehicle for the FRF (formerly the FSLIC).

Creation and Purpose of the SAIF. FIRREA authorized and directed the FDIC to establish and administer a separate insurance fund to be known as the SAIF. Savings associations which were insured by the FSLIC prior to FIRREA automatically became insured depository institutions and members of the SAIF without application or approval. The primary mission and purpose of the SAIF is to insure the deposits and to protect the depositors of insured savings associations.

The SAIF began operations with no assets or liabilities on August 9, 1989. All assets and liabilities of the FSLIC existing on August 8, 1989 were transferred to the FRF, except for certain liabilities which were assumed by the RTC. Any administrative facilities and supplies remaining after dissolution of the FRF will be transferred to the SAIF.

The RTC will manage and resolve all thrifts that were previously insured by the FSLIC and for which a conservator or receiver is appointed during the period January 1, 1989 through August 8, 1992. The SAIF is financially responsible for: (1) all insured depository institutions that became members of the SAIF after August 8, 1989 for which RTC does not have resolution authority; (2) all deposits insured by the SAIF which are held by banks, pursuant to Section 5(d)(3) of the FDI Act (commonly referred to as the "Oakar amendment" provision); and (3) all member depository institutions placed in conservatorship or receivership after August 8, 1992.

Statements of Income and the Fund Balance

(in thousands)

	Jan 1 - Dec 31 1990	Aug 9 - Dec 31 1989
Revenue		
Entrance fee revenue (Note 4)	$ -0-	$ 2
Expenses		
Administrative operating expenses	56,088	5,602
Net Loss before Funding Transfer	(56,088)	(5,600)
Funding Transfer from FSLIC Resolution Fund (Note 1)	56,088	5,602
Net Income	-0-	2
Fund Balance - Beginning	2	-0-
Fund Balance - Ending	$ 2	$ 2

The accompanying notes are an integral part of these financial statements.

Report on Compliance With Laws and Regulations

We have audited the financial statements of the Savings Association Insurance Fund for the year ended December 31, 1990, and the period August 9, 1989, through December 31, 1989, and have issued our opinion thereon. This report pertains only to our review of the Federal Deposit Insurance Corporation's (FDIC) compliance with laws and regulations as they relate to the Savings Association Insurance Fund for the year ended December 31, 1990. The report on our review of FDIC's compliance with laws and regulations as they relate to the Fund for the period August 9, 1989, through December 31, 1989, is presented in GAO/AFMD-91-31, dated March 1, 1991.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

FDIC's management is responsible for compliance with laws and regulations applicable to the Savings Association Insurance Fund. As part of obtaining reasonable assurance as to whether the financial statements were free of material misstatement, we selected and tested transactions and records to determine FDIC's compliance with certain provisions of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1811 et seq.), which, if not complied with, could have a material effect on the Savings Association Insurance Fund's financial statements. We also tested compliance with provisions of the Prompt Payment Act (31 U.S.C. 3901-3907) and such other laws and regulations which we considered pertinent. However, it should be noted that our objective was not to provide an opinion on overall compliance with such provisions. Because of the limited purpose for which our tests of compliance were made, the laws and regulations tested did not cover all legal requirements with which FDIC has to comply.

The results of our tests indicate that with respect to the items tested, FDIC complied, in all material respects, with those provisions of laws and regulations referred to above. With respect to transactions not tested, nothing came to our attention that caused us to believe that FDIC had not complied, in all material respects, with those provisions.

Report on Internal Control Structure

We have audited the financial statements of the Savings Association Insurance Fund for the year ended December 31, 1990, and the period August 9, 1989, through December 31, 1989, and have issued our opinion thereon. This report pertains only to our study and evaluation of the Federal Deposit Insurance Corporation's (FDIC) internal control structure as it relates to the Savings Association Insurance Fund for the year ended December 31, 1990. The report on our study and evaluation of FDIC's internal control structure as it relates to the Fund for the period August 9, 1989, through December 31, 1989, is presented in GAO/AFMD-91-31, dated March 1, 1991.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. In planning and performing our audit, we considered the Fund's internal control structure in order to determine what auditing procedures were needed for purposes of expressing our opinion on the financial statements and not to provide assurance on the internal control structure.

FDIC's management is responsible for establishing and maintaining an internal control structure over the Fund. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles.

Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the internal control structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For purposes of this report, we have classified FDIC's significant internal control structure policies and procedures for the Fund into the following categories:

Continued use of entities such as FICO to raise funds to resolve failed thrifts almost certainly will result in unnecessary costs to the government. In our report on the 1989 financial statements of the Resolution Funding Corporation (REFCORP),[7] the financing vehicle for RTC, we expressed similar concerns with using REFCORP rather than Treasury to fund thrift resolution activities.

Charles A. Bowsher
Comptroller General
of the United States

September 30, 1991

[7]Financial Audit: Resolution Funding Corporation's 1989 Financial Statements (GAO/AFMD-91-49, April 2, 1991).

sold to raise funds for the thrift industry.[6] To the extent that these assessments do not total $2 billion a year, Treasury is required to fund the difference for each fiscal year from 1993 through 2000. Because of this requirement, the Fund is assured of at least $16 billion in assessment-related income during this 8-year period. Over the same period, Treasury also is required to pay the Fund amounts needed to ensure that the Fund has the annual minimum net worth specified in FIRREA. However, the cumulative amount of net worth payments over the same period from the Treasury cannot exceed $16 billion. Assuming optimistic annual deposit growth rates of 5 percent and no change in premium assessment rates applied against these deposits, the Fund's assessment income is not likely to exceed $2 billion in any year through 2000. Thus, the total of assessments and Treasury payments that the Fund will receive under the statutory scheme through 2000 is not likely to exceed $32 billion.

With the extension of RTC's resolution authority, the Savings Association Insurance Fund is not expected to face an immediate or significant case resolution liability and, thus, can use its assessments and Treasury payments to increase its net worth. The Fund would then be in a position to build a deposit insurance base to meet the needs of the savings and loan industry.

However, determining whether the extension of RTC's responsibility for resolving failed thrifts is sufficient and how much money RTC will ultimately need are difficult decisions that depend on uncertain economic and real estate market conditions. The Oversight Board cannot provide assurance that its latest $80 billion funding request, $25 billion of which has been provided, will be the final installment in resolving the thrift industry crisis. Further, nothing we have seen indicates that the extension of RTC's authority will relieve the Fund of significant resolution costs since there is no guarantee that all troubled thrifts that will ultimately fail will

[6] Through December 1992, the Savings Association Insurance Fund will not receive any insurance premium assessment proceeds; after that date, the Fund will receive part of the assessment amounts. The Financing Corporation (FICO), established in 1987 by Public Law 100-86 to issue obligations (bonds) for recapitalizing FSLIC, has first claim on insurance premium assessment funds for payment of interest on its bonds. FICO's claim will continue until the 30-year recapitalization bonds mature. In addition, the Resolution Funding Corporation (REFCORP), established by FIRREA to provide $30 billion of funding to RTC, was entitled to insurance premium assessment funds to finance payment of bond principal. REFCORP provided for the payment of the bonds by investing the insurance premium assessments in nonmarketable, noninterest-bearing (that is, zero-coupon) Treasury securities with the same maturity dates and values as the bonds sold. REFCORP issued the last bonds in early January 1991 and will therefore have no further claim to assessments. Finally, the FSLIC Resolution Fund, established by FIRREA to liquidate the assets and liabilities of the former FSLIC, is entitled through December 31, 1992, to any assessment income not taken by FICO or REFCORP.

- Group II consists of 716 thrifts, constituting 32 percent of the industry and holding 32 percent of the industry's assets. This group currently meets or is expected to meet capital requirements.
- Group III consists of 377 thrifts, constituting 17 percent of the industry and holding 26 percent of the industry's assets. This group is considered "troubled," with poor earnings and low capital. However, not all thrifts in this group are expected to require government assistance. OTS has further categorized these thrifts in order to formulate potential strategies for resolving them.
  - Category A consists of 217 thrifts that have more than 2 percent tangible capital[5] and are profitable, or if unprofitable, have tangible capital that equals at least 4 percent of tangible assets. This category holds 37 percent of group III assets.
  - Category B consists of 116 thrifts that have between 1 and 2 percent tangible capital and are profitable, or if unprofitable, have tangible capital between 2 and 4 percent of tangible assets. This category holds 40 percent of group III assets.
  - Category C consists of 44 thrifts that if profitable, have less than 1 percent tangible capital, or if unprofitable, have tangible capital of less than 2 percent of tangible assets. This category holds 23 percent of group III assets.
- Group IV consists of 118 thrifts, constituting 5 percent of the industry and holding 9 percent of the industry's assets. As a group, these thrifts have negative tangible capital and are consistently unprofitable. OTS expects to transfer these thrifts to RTC for resolution by August 8, 1992.

By grouping thrifts according to their likelihood of becoming resolution candidates, OTS has created a useful tool for defining the size and composition of the potential resolution universe and for producing comparable cost estimates. It is important to remember, however, that the condition of the thrift industry is not static. Thrifts will, and have, moved from one category to another based on new quarterly financial data and on RTC resolution activity.

In its September 12, 1991, testimony before the House Subcommittee on Financial Institutions Supervision, Regulation and Insurance, RTC's Oversight Board stated that virtually all nonviable thrifts, which it defines as OTS Groups IIIB, IIIC, and IV, would require resolution during the next 2 years. Further, the Board requested additional funding and an extension of

[5]Tangible capital equals assets, less any intangible assets (such as goodwill), minus liabilities. Tangible capital is often expressed as a percentage of tangible assets.

GAO

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

Comptroller General
of the United States

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To the Board of Directors
Federal Deposit Insurance Corporation

We have audited the accompanying statements of financial position of the Savings Association Insurance Fund[2] as of December 31, 1990 and 1989, and the related statements of income and fund balance and the statements of cash flows for the year ended December 31, 1990, and the period August 9, 1989, through December 31, 1989. These financial statements are the responsibility of the Federal Deposit Insurance Corporation (FDIC), the Fund's administrator. Our responsibility is to express an opinion on these financial statements based on our audit. In addition, we are reporting on our consideration of FDIC's internal control structure and its compliance with laws and regulations as they relate to the Fund.

We conducted our audits in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Savings Association Insurance Fund as of December 31, 1990 and 1989, and the results of its operations and its cash flows for the periods then ended, in conformity with generally accepted accounting principles.

As a result of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991, the Resolution Trust Corporation (RTC) is now responsible for assisting and resolving troubled thrifts whose accounts had been insured by FSLIC and that have been placed into conservatorship or receivership from January 1, 1989, through September 30, 1993.[3] The Savings Association Insurance Fund is

[2]The Savings Association Insurance Fund was established on August 9, 1989, by section 211 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) to provide deposit insurance to savings associations (thrifts). Formerly, this was the function of the Federal Savings and Loan Insurance Corporation (FSLIC).

[3]The act also provides that any thrift requiring resolution after September 30, 1993, which had previously been under RTC conservatorship or receivership may be put back to RTC.

Contents

Abbreviations

CBO	Congressional Budget Office
FDIC	Federal Deposit Insurance Corporation
FICO	Financing Corporation
FIRREA	Financial Institutions Reform, Recovery, and Enforcement Act
FSLIC	Federal Savings and Loan Insurance Corporation
OTS	Office of Thrift Supervision
REFCORP	Resolution Funding Corporation
RTC	Resolution Trust Corporation

assume its responsibilities without a significant backlog depends on the timing and ultimate number of thrift resolutions needed. For example, CBO has estimated that thrift resolutions could continue through early 1995.

FIRREA provides the Fund with several revenue sources; however, only two sources will provide the significant amounts that may be required for resolution activity—insurance premiums and Treasury payments. We estimate that the Fund's total income from these two sources is not likely to exceed $32 billion through 2000. The Fund's ability to maintain adequate capital levels and provide insurance protection to depositors is directly dependent on the number and cost of thrifts that it must resolve. If there is still a significant number of thrifts in need of resolution after September 30, 1993, the Fund could be insolvent when it assumes its full resolution responsibility. Our report discusses various estimates of future thrift failures and the adequacy of the Fund's revenue sources. Our report also discusses the higher cost of using entities other than the U.S. Treasury to raise funds for thrift resolutions.

We are sending copies of this report to the Chairmen and Ranking Minority Members of the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Banking, Finance and Urban Affairs; the Secretary of the Treasury; the Director of the Office of Management and Budget; and the Director of the Office of Thrift Supervision.

Charles A. Bowsher

Charles A. Bowsher
Comptroller General
of the United States