COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-195849

August 27, 1979

The Honorable Henry S. Reuss
Chairman, Committee on Banking,
Finance and Urban Affairs
House of Representatives

HSE 05499

Dear Mr. Chairman:

This is in response to your letter of August 20, 1979, in which you posed certain questions about the risk exposure and budget impact of various means of financing a hypothetical loan of $1 billion to the Chrysler Corporation. Our responses to these questions, using the assumptions set forth in your letter, are as follows:

1. Would not the Federal Government's exposure be the same if a Federal direct loan or loan guarantee were made to Chrysler? The exposure would be the same unless there were some differences in the terms of the financing. For example, with a loan guarantee it is possible to require some measure of coinsurance on the part of the primary lending institution. Assuming a loan carrying such a coinsurance requirement were marketable, it would serve to reduce the Federal Government's exposure. It would also, however, undoubtedly raise the interest rate charged on the underlying loan to compensate for the increased risk faced by the lender. Other factors which might alter the exposure of the Federal Government would include, for example, the priority given the Federal Government's claims to the assets of the Corporation in the event of default. There is no basis, however, for assuming that these would be different in the case of a direct loan versus a loan guarantee.

2. What would be the difference between the Federal Government making a loan or loan guarantee to Chrysler as far as its Federal budgetary impact is concerned? If a direct loan is made by an on-budget Federal agency, the full amount of the loan counts as budget outlays at the time it is disbursed. Repayments and interest count as negative outlays when they are received.

The direct loan case is complicated, however, when the possibility exists of the loan being made by, or sold to, an off-budget agency, such as the Federal Financing Bank. In that situation, the direct loan outlays might never appear

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in the budget, or might be cancelled by an offsetting transaction. The misleading nature of these arrangements have led us on previous occasions to recommend that the FFB (and other off-budget agencies) be brought into the unified budget.

In the case of a loan guarantee, outlays are recorded only if--and when--payments under the guarantee are made (i.e., the loan goes into default and the lender demands payment under the guarantee). If a fee is charged for the guarantee, collections would normally be recorded as negative outlays.

3. What would be the difference in income to the Federal Government as compared to the income to a commercial bank(s) if a loan guarantee were to be made by the Federal Government which charged 3/4 of 1 percent for the guarantee and the commercial bank(s) were to charge the current prime rate plus one or two points in the amount of $1 billion? With these assumptions and a current prime rate of 12 percent, the annual income of the two parties would be as follows:

--Federal Government (annual fee of 3/4 percent): $7.5 million.

--Commercial bank(s) (prime plus two points, or 14 percent annual interest): $140.0 million.

We would point out, however, that if the Federal guarantee is complete (i.e., no coinsurance required), the commercial bank loan is essentially risk-free. In that case, prime plus two points may well be a higher rate than is warranted by the circumstances because the prime rate is the rate charged for unsecured short-term loans extended to the most credit worthy private borrowers.

4. What would be the amount of interest income received by the Federal Government if the Federal Government were to make a direct loan to the Chrysler Corporation for $1 billion at: (a) the annual cost of money to the Federal Government plus a fee of 3/4 of 1 percent, or, (b) the current commercial bank prime rate plus a fee of 3/4 of 1 percent? The answer to this question involves a slight complication because of the multiplicity of ways of measuring "the annual cost of money to the Federal Government." One way, often used, is to measure the average yield on outstanding medium and long-term Treasury bonds. At present, this figure is 8.9 percent, and is used in Case #1, below. An alternative is to measure the current yield on short-term Treasury bills (up to 180 days) because

the Treasury most often borrows in this maturity range. Also, shorter-term Treasury bill yields are, for comparative purposes, more analogous to the prime lending rate than are medium to longer-term yields. At present, this figure is 9.6 percent, and is used in Case #2 below. For Case #3, we have used 12 percent as the current commercial bank prime rate.

Case #1: Current yield on long-term Treasury bonds plus 3/4 percent (9.65 percent) - $96.5 million

Case #2: Current yield on short-term Treasury bills plus 3/4 percent (10.35 percent) - $103.5 million

Case #3: Current prime rate plus 3/4 percent (12.75 percent) - $127.5 million

Of course, after the cost of borrowing is considered, net interest income in Cases #1 and #2 remains at $7.5 million, while in Case #3, it would be either $38.5 million or $31.5 million, depending on which assumption is made about the term structure of the Federal borrowing. In each case, the amounts shown would represent annual income, exclusive of any repayments.

I hope this information is helpful.

Sincerely yours,

Comptroller General
of the United States