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## Government-Sponsored Enterprises

Statement of
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Subcommittee on Oversight
House Ways and Means Committee
House of Representatives

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Mr. Chairman and Members of the Subcommittee:

I welcome this opportunity to discuss government-sponsored enterprises (GSEs), and to address in particular GAO's work on GSEs. At this time of continuing deficits and a growing debt burden, it is particularly important that GSEs be thoroughly studied and understood. Before discussing our work, I would like to provide a brief overview of GSEs.

## OVERVIEW OF GSEs

GSEs have traditionally been privately-owned entities chartered by the federal government to perform specific functions. Their main purpose has been to increase credit availability to certain target groups--such as home buyers, farmers, and students.

There are now 11 GSEs, ranging from the large Federal Home Loan Banks to the smaller Student Loan Marketing Association ("Sallie Mae"). All together, the GSEs disbursed about $414 billion in 1988, equivalent to about one-third of the amount disbursed by the government.

### Characteristics of GSEs

Almost all GSE stock today is held by private investors. Most GSEs finance their operations, beyond their stock sales, primarily by borrowing from the public, selling mortgage-backed securities, or collecting fees for their guarantees and other services. Most of the resulting GSE debt and contingent liability is not explicitly guaranteed by the U.S. government. However, investors assume that the government stands behind the GSEs and their obligations. At the end of fiscal year 1988, GSE debt and outstanding mortgage-backed securities totaled about $725 billion.

Legislation usually does not provide for the payment of government funds to GSEs to help them liquidate their debt. Recently, however, that pattern was broken in connection with the rescue of the Farm Credit System and of the savings and loan deposit insurance system.

Most GSE board members are private persons selected by the GSEs' shareholders. However, there is a degree of federal control. Many of the GSE charters provide that a federal official, sometimes the President, shall appoint a certain number (a minority) of the GSE board's members. In addition, most GSEs are regulated or supervised to some degree by a government agency. Some, such as the Federal Home Loan Banks, are subject to audits by GAO.

Federal legislation also confers a number of direct benefits on GSEs. Some GSEs are given a line-of-credit with the Treasury (which most have not used), and their investors' interest income is exempted from state and local taxation. Although they sell securities, most are exempted from Securities and Exchange Commission registration requirements.

Because of their federal sponsorship, GSEs receive an indirect but very real benefit--lower borrowing costs. GSEs are able to borrow funds at interest rates only slightly higher than the rates paid by Treasury on its borrowings.

## Current Budget Treatment of GSEs

Let me now turn to the budget treatment of GSEs. GSE activities have traditionally been excluded from the U.S. government's surplus or deficit on the grounds that they are essentially private entities. This follows a recommendation of the 1967 President's Commission on Budget Concepts, which held that government-sponsored enterprises whose stock is "completely privately owned" should be excluded.

OMB's budget documents, however, contain special sections in which the activities and amounts of the GSEs are reported for information purposes. This, too, is in line with a recommendation of the 1967 Commission.

Until recently, there was little interest in GSEs and their budgetary implications for the federal government. In the last 2 years, though, some questions have emerged.

The Off-Budget Question

First, are GSEs being established to place governmental activities and costs off-budget that should be on-budget? GAO believes that the government will not be able to get its fiscal house in order if federal programs are placed off-budget and out-of-sight. In this regard, it has been assumed until recently that GSEs pose no problem. They have been widely viewed as essentially private entities that should not be included in any budget totals. However, the recent legislation to rescue and restructure the savings and loan (S&L) deposit insurance system raises an issue. I am referring to the decision to finance part of the costs through a new off-budget GSE called REFCORP, the Resolution Funding Corporation.

REFCORP meets the 1967 Commission criterion for an off-budget GSE--its shares are privately held. On the other hand, when we look closer at the substance of REFCORP's activities and transactions, we see that it is more of a governmental entity than a private one.

REFCORP's sole purpose and function is to borrow funds from the public and disburse those funds to a federal corporation, the Resolution Trust Corporation (RTC), for use in liquidating obligations of the federal government. The U.S. government is expected to pay REFCORP's interest costs. The funds REFCORP receives from the S&L industry resemble tax revenues in their involuntary nature, and these industry sources of REFCORP funds have little or no expectation of ever getting their money back.

Furthermore, unlike the traditional GSEs, the federal government exercises complete control over REFCORP. Although REFCORP has a board of directors that consists of private persons, it is tightly supervised by RTC's Oversight Board whose members are all federal officials.

For these reasons, we concluded that REFCORP was more like a federal agency than a private GSE, and that it should be placed on-budget. However, this was not done, and because REFCORP was established as an off-budget GSE with higher interest costs than the U.S. Treasury's, the government will incur billions in extra costs for the S&L crisis. Furthermore, we are concerned that if the practice of using off-budget GSEs to carry out federal activities continues, budget discipline will be severely undermined. Such budgetary gimmicks make the deficit numbers look better, but they hide the true picture and only postpone the day of reckoning.

We believe that the Congress needs meaningful criteria or standards--which are now lacking--to use in deciding whether a proposed activity should be established as an on-budget federal activity or an off-budget private GSE. We therefore have underway a study for the Congress on this matter. Our report will set forth the criteria and discuss whether the other GSEs are properly classified as off-budget entities.

## The Financial Risk Question

A second question is, do GSEs pose a potential financial risk to the federal government? Outstanding GSE securities total about $725 billion. How much of a risk does this pose for the federal government? For example, in 1987 the federal government did not stand aside and allow the Farm Credit System to fail, despite the fact that none of that GSE's debt was guaranteed by the government.

In the mid-1980s, the Farm Credit System suffered multibillion dollar losses. In response to this the Agricultural Credit Act of 1987 created the Financial Assistance Corporation (FAC)--an off-budget GSE--as a means of providing capital to failing Farm Credit institutions. FAC was authorized to issue $4 billion in debt obligations guaranteed by the U.S. government. In addition, the U.S. Treasury will pay part of FAC's interest cost over the next 10 years, projected by the administration to total about $1 billion.

To reduce future risk, the act also ordered the merger of many of the system's institutions, imposed tight capital standards for each institution, and required more stringent federal regulation and supervision.

As you see, Mr. Chairman, the problems in the Farm Credit System and the S&L deposit insurance system have increased general concern about the potential budgetary impact of off-budget activities. In this environment, legislators saw the need for more information on the potential government risk posed by off-budget GSE activities. Therefore, as part of the new S&L legislation, Congress mandated studies of GSEs, including a GAO study.

## GAO STUDY REQUIRED UNDER S&L LEGISLATION

Under this legislation, we are beginning a study of the risks undertaken by GSEs and the capital requirements that are appropriate for such enterprises. Our study design will follow the requirements of the S&L rescue legislation. We will examine and evaluate issues related to degrees and types of risks, various methods to measure risk, actual levels of risk, and the appropriate level of capital for each GSE. We will also consider the potential costs and benefits of a risk-based capital standard, the effect of GSEs on federal borrowing, and the information available to the public and to regulators about GSE activities and their financial risk.

We understand your strong interest in this study. We would be happy to meet with the Subcommittee as this study progresses to brief you on its status. As required by the act, we will issue two reports. Our first report is scheduled for issuance in May 1990 and our second report in May 1991.

Thank you, Mr. Chairman. This concludes my prepared statement, and I would be glad to answer any questions you or members of the Subcommittee may have.

## GOVERNMENT SPONSORED ENTERPRISES

| Government Sponsored Enterprise | Fiscal Year 1988 Disbursements | Securities Issued | Securities Outstanding |
|---|---|---|---|
| | (Dollars in billions) | | |
| Financing Corporation | 0.0 | 3.2 | 3.7 |
| Resolution Funding Corp. | 0.0 | 0.0 | 0.0 |
| Federal Home Loan Banks | 188.7 | 21.6 | 126.7 |
| Federal Home Loan Mortgage Corp. | 40.9 | 15.4 | 241.3 |
| Federal National Mortgage Assoc. | 87.2 | 50.0 | 273.2 |
| Student Loan Marketing Assoc. | 10.1 | 3.7 | 25.0 |
| College Construction Loan Insurance Assoc. | 0.0 | 0.0 | 0.0 |
| Banks for Cooperatives | 67.3 | 2.3 | 11.2 |
| Farm Credit Banks | 19.2 | (2.2) | 43.4 |
| FCS Financial Assistance Corp. | 0.4 | 0.5 | 0.5 |
| Federal Agricultural Mortgage Corp. | 0.0 | 0.0 | 0.0 |
| Subtotal | 413.8 | 94.5 | 725.0 |
| Less: Borrowing from other GSEs | | (0.4) | (0.9) |
| Total | 413.8 | 94.1 | 724.1 |