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Report to Congressional Committees

May 1993

DEPOSIT INSURANCE FUNDS

Compliance With Obligation and Repayment Requirements as of June 30, 1992

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

Accounting and Financial Management Division

B-251583

May 27, 1993

The Honorable Donald W. Riegle, Jr.
Chairman
The Honorable Alfonse M. D'Amato
Ranking Minority Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Henry B. Gonzalez
Chairman
The Honorable Jim Leach
Ranking Minority Member
Committee on Banking, Finance and Urban Affairs
House of Representatives

This is the second of our required reports on the Federal Deposit Insurance Corporation's (FDIC) quarterly compliance with the maximum obligation limitation established by the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). This obligation limitation applies separately to both the Bank Insurance Fund (BIF), insurer of commercial bank deposits, and the Savings Association Insurance Fund (SAIF), insurer of thrift deposits, and is designed to provide assurance that each fund's assets and other funding sources are sufficient to fund its obligations. FDIC administers both insurance funds.

FDICIA also requires us to report on BIF's and SAIF's ability to repay amounts borrowed from the Department of the Treasury for insurance losses and to analyze data related to the sale of assets of failed institutions. As agreed upon with your respective offices, the latter requirement was modified to include an assessment of whether BIF's total collections from the management and disposition of assets acquired from failed institutions would be sufficient to repay its existing working capital borrowings.

Results in Brief

FDIC's maximum obligation limitation calculations for BIF and SAIF show that as of June 30, 1992, BIF's assets and other funding sources exceeded its obligations by $36.9 billion and SAIF's assets and other funding sources exceeded its obligations by $155 million. Based on our review of FDIC's calculations and explanatory notes for both BIF and SAIF, nothing came to

our attention that would lead us to question the reasonableness of the amounts reported as of June 30, 1992. However, FDIC had not yet finalized a policy for allocating Treasury borrowing authority between the two funds. For the second quarter of calendar year 1992, FDIC allocated the entire amount of Treasury borrowing authority to BIF based on BIF's projected funding needs when funding legislation was first proposed. Implementation of a formalized allocation policy might significantly change how FDIC's borrowing authority with Treasury is allocated between the funds in future quarters and thus might significantly alter FDIC's future maximum obligation limitation calculations for the funds.

As of June 30, 1992, neither BIF nor SAIF had borrowed funds for insurance losses from the U.S. Treasury. However, the need for future borrowings for insurance losses, and each fund's ability to repay any such borrowings, is dependent on the impact of future economic conditions on financial institution failures, the cost of these failures to the insurance funds, future assessment revenues, and other funding alternatives.

As of June 30, 1992, FDIC had borrowed approximately $15 billion from the Federal Financing Bank (FFB) for BIF's working capital needs. These working capital borrowings are to be repaid primarily with proceeds from the management and disposition of failed bank assets. We estimate that future net recoveries from BIF's June 30, 1992, inventory of failed bank assets will be about $22.3 billion. However, our estimates are based on an analysis of FDIC's historical experience in generating collections for BIF from the management and disposition of assets acquired from failed banks and, as such, are subject to significant uncertainties which could materially affect BIF's actual recoveries on these assets.

Background

Section 15(c) of the Federal Deposit Insurance (FDI) Act, as amended by FDICIA, requires that FDIC determine the limitation on outstanding obligations for BIF and SAIF based on a maximum obligation limitation formula. In general, the formula involves comparing the assets and liabilities of each of the two insurance funds to ensure that at any particular point in time, each fund's assets are sufficient to cover its liabilities. The obligation limitation precludes FDIC's issuing or incurring obligations for BIF or SAIF if, after doing so, total outstanding obligations of each fund, considered separately, would exceed the sum of its available funding sources. The obligation formula is designed to provide assurance that the obligations of each fund are adequately supported by its assets and available funding sources and to alert the Congress to FDIC's funding

needs. This formula replaced the "net worth limitation" test imposed by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) (Public Law 101-73).

FDICIA defines funding sources for each fund as (1) its cash and cash equivalents, (2) the amount equal to 90 percent of the fair market value of its assets other than cash and cash equivalents, and (3) its allocated portion of the total amount authorized to be borrowed from Treasury under section 14(a) of the FDI Act, as amended by FDICIA. Section 14(a) of the FDI Act, as amended by FDICIA, provided FDIC with $30 billion in borrowing authority with Treasury to cover insurance losses. The borrowing authority is available for both BIF and SAIF, but FDICIA does not specify how the $30 billion should be allocated between the two funds. In defining obligations, the act requires that FDIC identify all guarantees (excluding deposit guarantees), any amounts borrowed from Treasury or FFB pursuant to section 14 of the FDI Act, and any other obligations for which the funds have a direct or contingent liability.[1]

Objectives, Scope, and Methodology

The objectives of this review were to determine whether (1) BIF and SAIF have complied with the statutory maximum obligation limitation specified in FDICIA for the quarter ending June 30, 1992, (2) BIF and SAIF have borrowed from the U.S. Treasury for insurance losses and what factors may affect the need for future borrowings, as well as BIF's and SAIF's ability to meet established repayment schedules when borrowings occur, and (3) BIF will generate sufficient proceeds from the management and disposition of failed bank assets to repay working capital borrowings. See appendix I for details on the scope and methodology of our work.

We performed our work at FDIC's headquarters offices in Washington, D.C., and Arlington, Virginia, from December 1992 through April 1993. We performed our work in accordance with generally accepted government auditing standards. However, the scope of our work was substantially less than that of a financial audit and, as such, did not include a review of FDIC's internal control structure. Also, we did not test or verify FDIC's books and records or the data contained in appendixes II and III, except for the procedures detailed in appendix I. Our review of compliance with laws and regulations was limited to BIF's and SAIF's compliance with the maximum obligation limitation established by FDICIA. While we did not

[1]As agreed to by the Senate and House Banking Committees, FDIC's estimated liability for future financial institution failures or assistance transactions is excluded in determining each fund's total obligations where there is no contractual agreement between FDIC and the troubled institutions comprising the estimated liability.

obtain written comments on this report, we discussed its contents with cognizant FDIC officials, who agreed with the report's findings and conclusions. We have incorporated their comments where appropriate.

FDIC Reports BIF and SAIF Complied With Their Maximum Obligation Limitations

FDIC's maximum obligation limitation calculations for BIF and SAIF show that as of June 30, 1992, BIF's assets and other funding sources exceeded its obligations by $36.9 billion[2] and SAIF's assets and other funding sources exceeded its obligations by $155 million. This excess is described in the calculations as "Remaining Obligation Authority." The obligation limitation calculations and explanatory notes for BIF and SAIF are included as appendixes II and III, respectively.

Based on our review of FDIC's second quarter 1992 calculations and explanatory notes for BIF and SAIF, nothing came to our attention that would lead us to question the reasonableness of the amounts reported.

FDIC Had Not Finalized an Allocation Policy for Treasury Borrowing Authority

During the course of our work, we noted that FDIC had not yet finalized a policy for allocating Treasury borrowing authority between BIF and SAIF. FDIC allocated all $30 billion of this borrowing authority to BIF for the second quarter of 1992 based on projections of BIF's funding needs when funding legislation was first proposed. At that time, projections of bank failures and their cost to the insurance fund indicated that BIF would need about $30 billion to cover insurance losses. We also noted this condition in our report on FDIC's compliance with FDICIA's obligation and repayment requirements as of March 31, 1992.[3]

While nothing in FDICIA or its legislative history indicates how the $30 billion should be allocated between the two funds, subsequent events and future uncertainties impacting both insurance funds may warrant a reallocation of the $30 billion between BIF and SAIF, consistent with a formal allocation process. Although FDIC's calculation for SAIF shows that it is in compliance with FDICIA's limitation on outstanding obligations as of June 30, 1992, SAIF's future ability to incur additional obligations is

[2]BIF is able to incur additional obligations despite its unaudited deficit fund balance of $5.6 billion at June 30, 1992, primarily because the maximum obligation limitation formula includes FDIC's allocation of the Treasury borrowing authority and excludes BIF's estimated liability for future bank failures and assistance transactions.

[3]Deposit Insurance Funds: Compliance with Obligation and Repayment Requirements as of March 31, 1992 (GAO/AFMD-93-31, January 21, 1993).

tenuous, given its impending thrift resolution responsibilities.[4] SAIF is scheduled to begin its full resolution responsibility on October 1, 1993, but prior to that time it may also incur resolution costs related to certain institutions.[5] Additionally, in the event RTC does not receive the funding it estimates it will need to resolve troubled thrifts identified by the Office of Thrift Supervision before RTC's authority to take control of additional thrifts expires on September 30, 1993, SAIF could face a backlog of troubled thrifts awaiting resolution on October 1, 1993.[6] If SAIF reaches its maximum obligation limitation, it would be prohibited from incurring any additional obligations and potentially limited in its ability to fulfill its resolution responsibilities without some of the $30 billion currently allocated to BIF.

An Allocation Policy Could Consider Each Fund's Cash Flows and Alternative Funding Sources

FDIC is in the process of finalizing an allocation policy for future quarters. Because the policy developed to allocate Treasury borrowing authority could significantly affect the ability of each fund to incur obligations in future quarters, several factors merit FDIC consideration in finalizing this policy. Considering each fund's cash flows associated with resolution activity from financial institution failures, expected operating expenses, and anticipated assessment revenues would be a reasonable projection basis. FDIC has periodically developed such cash flow projections for BIF and could develop similar projections for SAIF and use these projections to determine each fund's borrowing needs.

FDIC could also consider alternative sources of funding. For example, in addition to insurance assessments, the FDI Act, as amended, provides for

[4]FIRREA established the Resolution Trust Corporation (RTC) to resolve thrifts whose deposits had been insured by the Federal Savings and Loan Insurance Corporation (FSLIC) that were placed into conservatorship or receivership from January 1, 1989, through August 8, 1992. The Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991 (Public Law 102-233), enacted on December 12, 1991, extended RTC's resolution authority to thrifts placed into conservatorship or receivership through September 30, 1993. However, in accordance with the provisions of Public Law 102-233, any thrift requiring resolution after September 30, 1993, which had previously been under RTC conservatorship or receivership may be transferred back to RTC for resolution.

[5]Section 5(d)(3) of the FDI Act, as amended by FIRREA, generally allows bank holding companies to merge their SAIF-insured subsidiaries into their BIF-insured bank subsidiaries. The resulting banks would continue to pay a portion of their premiums to SAIF based on the amount of thrift deposits acquired. Accordingly, in the event of failure or assistance, any loss would be allocated between BIF and SAIF in proportion to the institution's deposits insured by each fund. FDICIA expanded on the FIRREA amendment to allow an insured bank or thrift to acquire, merge, or assume the deposit liabilities of the other type of insured depository institution. As with the FIRREA amendment, insurance premiums and loss expenses are to be allocated between BIF and SAIF.

[6]On March 16, 1993, the Chairman, Thrift Depositor Protection Oversight Board for RTC, testified before the House Committee on Banking, Finance and Urban Affairs on the need for the Congress to provide $28 billion in funding for RTC to enable it to resume resolution of troubled thrifts.

Treasury payments to SAIF.[7] To the extent that insurance assessments deposited in SAIF do not total $2 billion a year, section 11(a)(6) of the FDI Act requires Treasury to fund the difference for each fiscal year from 1993 to 2000 with funds specifically appropriated for that purpose. Assuming that such funds are appropriated, SAIF is assured of at least $16 billion in either assessment income or Treasury payments during this 8-year period. Section 11(a)(6) also requires Treasury to make annual payments out of appropriated funds as necessary to ensure that SAIF has a specified net worth, ranging from zero during fiscal year 1992 to $8.8 billion during fiscal year 2000. The cumulative amounts of the net worth payments cannot exceed $16 billion. Section 11(a)(6) authorizes funds to be appropriated to the Secretary of the Treasury for these payments.

While FDIC's allocation policy could consider each fund's cash flows and funding sources, FDIC would also need to consider any constraints associated with these funding sources. For example, FDIC cannot recognize Treasury payments for SAIF under section 11(a)(6) of the FDI Act, as amended, as funding sources when calculating the Fund's maximum obligation limitation until funds have been appropriated to Treasury for these payments. To date, none of these funds have been appropriated for fiscal year 1993.

Several Factors Will Affect FDIC's Treasury Borrowings and Efforts to Rebuild the Insurance Funds

To date, FDIC has not yet borrowed funds from Treasury to cover insurance losses for either BIF or SAIF. The timing and extent to which such funding may be needed will depend on a number of factors, including (1) the effect of future economic conditions on financial institution failures and the cost of these failures to the insurance funds and (2) future revenue streams available to the funds. These factors will also affect FDIC's ability to rebuild the insurance funds' reserves to designated levels.

FDICIA prohibits Treasury borrowing unless Treasury and FDIC have an agreement which provides a repayment schedule and demonstrates that income for BIF or SAIF will be sufficient to repay principal and interest on Treasury borrowings within the period established in the repayment schedule. Separate agreements must be established for BIF and SAIF.

Based on cash flow projections FDIC has developed for BIF, FDIC does not anticipate that BIF will need to borrow from Treasury for insurance losses during fiscal year 1993. However, these cash flow projections are

[7] As discussed in more detail later, legislation proposed by the administration and introduced on March 16, 1993 (H.R. 1340), would appropriate up to $17 billion for SAIF and repeal these funding provisions.

influenced in part by changes in economic conditions and fluctuations in interest rates. These factors can affect the timing of bank failures and the closure of banks by the regulators. Short-term profits due to the current low interest rates and gains from asset sales may delay some troubled banks' failures and, thus, the timing of FDIC's need to borrow from Treasury. However, these short-term profits do not necessarily eliminate the losses imbedded in the banks' asset portfolios or the ultimate losses to BIF.

FDIC also considers assessment revenues in projecting its borrowing needs. For premiums due in the semiannual period beginning on January 1, 1993, and thereafter, FDIC adopted a risk-based premium system. Under this system, banks and thrifts posing higher risks of loss to the insurance funds are charged higher premiums. The assessment rates charged to federally insured institutions range from 23 cents to 31 cents per $100 of domestic deposits. Recent FDIC estimates show the average assessments charged to BIF-insured institutions to be 24.8 cents per $100 of domestic deposits, an increase of about 8 percent over the assessment rate of 23 cents per $100 of domestic deposits in effect through calendar year 1992. FDIC's estimates show the average assessments charged to SAIF-insured institutions to be 25.3 cents per $100 of domestic deposits, an increase of about 10 percent over the assessment rate charged in 1992.

Resolution costs and assessment revenues are also significant factors to be considered in projecting BIF's and SAIF's future fund balances and, therefore, in determining borrowing needs. In order for BIF to achieve a level of self-sufficiency, FDICIA requires FDIC to develop a recapitalization plan for BIF that specifies target ratios of reserves to insured deposits at semiannual intervals, culminating in a reserve ratio equal to the designated 1.25 percent reserve ratio in no more than 15 years.

At June 30, 1992, FDIC reported that BIF had a deficit fund balance of $5.6 billion. The most recent FDIC projections contained in FDIC's revised BIF recapitalization schedule show that BIF will achieve the designated ratio by the year 2002, within the 15-year period stipulated in FDICIA. However, these projections are subject to significant uncertainties. Forecasting bank failures and their costs to BIF over the long term is a highly imprecise process. Additionally, assumptions about the level of bank failures, growth in industry assets and insured deposits, and growth in BIF's assessment revenues over extended periods are subject to considerable fluctuations due to future economic conditions, further

industry consolidation, and the implementation of regulatory reforms mandated by FDICIA.

Section 7(b) of the FDI Act also establishes SAIF's designated reserve ratio at 1.25 percent of estimated insured deposits and stipulates that this ratio is to be achieved within a "reasonable period of time." FDIC is not required to establish, and has not established, a formal recapitalization schedule for SAIF. As of June 30, 1992, FDIC reported that SAIF had a fund balance of $160 million, making its ratio of reserves to insured deposits negligible.

The administration recently proposed the Thrift Depositor Protection Act of 1993, introduced as H.R. 1340, which would provide additional funding for RTC and funding for SAIF. If this legislation is enacted, it would provide up to $28 billion for RTC to carry out its resolution responsibilities through September 30, 1993. It would also provide up to $17 billion for SAIF to cover future thrift industry losses, instead of the periodic payments provided for in section 11(a)(6) of the FDI Act.

BIF's Ability to Repay Existing Working Capital Borrowings Is Subject to Significant Uncertainties

FDIC's experience in generating recoveries from the management and disposition of failed institution assets indicates that if FDIC's future recoveries mirror its historical experience, BIF should be able to repay its June 30, 1992, outstanding borrowings from FFB. However, significant uncertainties exist which could affect FDIC's ability to generate future collections from its asset liquidation activity at levels similar to those experienced in the past.

FDIC has authority to borrow funds for BIF's working capital needs from FFB, but the amount of its outstanding working capital borrowings is subject to BIF's maximum obligation limitation. We reviewed FDIC's historical experience in generating funds from the management and disposition of assets acquired from failed BIF-insured financial institutions as a source for repaying FFB borrowings. Using data from FDIC's Financial Information System, its accounting system of record, our analysis aggregated collection and loss data on BIF's failed bank asset inventory from 1987 through the second quarter of 1992. We did not rely on data from FDIC's Liquidation Asset Management Information System (LAMIS), its primary system for managing assets from failed financial institutions, because weak controls over LAMIS have resulted in data integrity problems.[8] Additionally, LAMIS does not include assets managed through the Division

[8] Financial Audit: Bank Insurance Fund's 1991 and 1990 Financial Statements (GAO/AFMD-92-73, June 30, 1992).

of Liquidation's Contractor Oversight and Monitoring Branch, which comprised approximately 30 percent of BIF's failed bank asset inventory as of June 30, 1992. These assets are maintained on the systems of the servicing institutions.

From the data provided, we derived collection rates, stratified by major asset categories, as a percentage of the reduction in the book value of the asset inventory (which results from payment of principal and sales or writedowns of assets). We applied these collection rates to the remaining book values of BIF's failed bank asset inventory by major asset category as of June 30, 1992, to estimate future collections on the inventory.

As of June 30, 1992, BIF had borrowed approximately $15 billion in working capital funds from FFB. If FDIC's historical collection experience is a valid basis for estimating future recoveries, BIF's failed bank asset inventory should generate approximately $22.1 billion in gross principal collections, or about 60 percent of the $36.6 billion book value of the failed bank assets in BIF's inventory at June 30, 1992. BIF's failed bank asset inventory also should generate other gross collections, such as interest and rental income, of approximately $5.8 billion, or about 16 percent of the book value of the asset inventory. Consequently, total estimated gross collections should equal about $27.8 billion. However, FDIC has historically incurred liquidation and other overhead administrative expenses approximating 20 percent of gross collections. Applying this historical cost experience, we estimate that BIF's net recoveries from the liquidation of its asset inventory at June 30, 1992, should equal about $22.3 billion, or about 61 percent of the book value of the failed bank assets in BIF's inventory at that date. (Appendix IV provides the details of our calculations.) These estimated recoveries, if realized, would be sufficient to ultimately repay BIF's outstanding FFB borrowings.[9]

However, as discussed in our first quarter 1992 report on FDIC's compliance with FDICIA's obligation and repayment requirements,[10] estimates of future recoveries derived from historical collection experience are subject to significant uncertainties. For example, in recent years, economic conditions have adversely affected asset values, particularly real estate assets. Furthermore, the rapid growth in

[9]During the third quarter of 1992, BIF had outstanding FFB borrowings of about $15 billion. On September 30, 1992, however, BIF repaid $5 billion of these borrowings, reducing its outstanding FFB borrowings to about $10 billion. BIF's outstanding balance of FFB borrowings remained at this level through December 31, 1992.

[10]See footnote 3.

government-held assets and the significant volume of real estate assets now on the market, coupled with the significant discounts the Resolution Trust Corporation offers in order to reduce its inventory of real estate assets, could materially affect FDIC's ability to generate future recoveries for BIF from the management and disposition of BIF's failed bank asset inventory at rates comparable to those in the past.

Also, our analysis showed that if we break collection experience down by year of receivership inception, older receiverships show a marked decrease in their collection rates as time passes. For example, receiverships established from bank failures which occurred in 1986 showed an average principal collection rate of 60 percent of the reduction in these receivership assets' book value. However, the annual collection rates for these receiverships ranged from approximately 92 percent of the reduction in receivership assets' book value in 1986, the first year of the receiverships, to only 23 percent in 1991. We believe this may be attributable to two factors: (1) better quality assets tend to be sold first, leaving the less marketable assets, which generally yield a lower percentage of book value, and (2) the longer an asset remains in the liquidation inventory, the greater the potential that its value will decline and, ultimately, the greater the potential for increased losses to BIF. However, because many of the bank failures from which BIF currently holds assets occurred within the past few years, a substantial portion of the assets acquired by BIF from bank resolutions should generate recoveries toward the higher end of the scale over the next several years. For example, at June 30, 1992, about $31.4 billion or 86 percent of the $36.6 billion total book value of BIF's failed bank asset inventory was associated with bank failures that occurred after 1989. In comparison, only $1.2 billion, or less than 4 percent of the total book value of BIF's failed bank asset inventory at June 30, 1992, was associated with receiverships established prior to 1986.

Our analysis did not address when recoveries will occur. Additionally, our projections of BIF's estimated recoveries based on our analysis of FDIC's historical collection experience to date assumed that all of the assets in the inventory will ultimately be liquidated. If all assets are not liquidated or are liquidated at a lower yield or a slower pace than in the past, actual recoveries could differ significantly from these estimates.

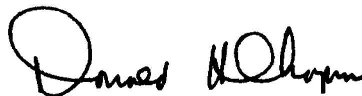
An additional factor that may affect the timing of BIF's repayment of FFB borrowings is the timing of the fund transfer from failed bank receiverships to BIF. BIF cannot use funds collected by the receiverships

until the receiverships declare a dividend to BIF. To expedite the transfer of cash from receiverships to BIF, FDIC instituted an "accelerated dividend" policy in 1992. Under the accelerated dividend policy, a receivership will, shortly after its inception, declare a dividend to BIF for up to 75 percent of the collections it expects to receive over the life of the receivership. For BIF, this process will allow FDIC to collect, on a daily basis, cash in excess of the receivership's immediate working capital needs. This process should expedite the transfer of funds from receiverships to BIF and provide BIF with more timely cash inflows to fund bank resolutions or repay existing working capital borrowings.

While FDIC's ability to generate future recoveries from its asset liquidation activity at levels similar to those in the past is subject to significant uncertainties, it is important to note that FDIC's rate of recovery on its June 30, 1992, existing asset inventory would have to decline to less than 41 percent before liquidation collections would be insufficient to repay the level of FFB outstanding borrowings that existed at June 30, 1992. Additionally, at June 30, 1992, BIF had collected assessment revenue totaling approximately $2.8 billion. BIF's unaudited total assessment revenue for calendar year 1992 equaled about $5.6 billion. To the extent recoveries from liquidation activity are insufficient to repay FFB borrowings, BIF may utilize its assessment revenue to make up the shortfall.

We are sending copies of this report to the Acting Chairman of the Board of Directors, Federal Deposit Insurance Corporation; the Director, Office of Management and Budget; and the Secretary of the Treasury.

This report was prepared under the direction of Robert W. Gramling, Director, Corporate Financial Audits, who may be reached on (202) 512-9406 if you or your staffs have any questions. Other major contributors are listed in appendix V.



Donald H. Chapin
Assistant Comptroller General

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Abbreviations

BIF	Bank Insurance Fund
FDI	Federal Deposit Insurance
FDIC	Federal Deposit Insurance Corporation
FDICIA	Federal Deposit Insurance Corporation Improvement Act of 1991
FFB	Federal Financing Bank
FIRREA	Financial Institutions Reform, Recovery, and Enforcement Act of 1989
FSLIC	Federal Savings and Loan Insurance Corporation
LAMIS	Liquidation Asset Management Information System
RTC	Resolution Trust Corporation
SAIF	Savings Association Insurance Fund

Scope and Methodology

To determine whether BIF and SAIF complied with the statutory maximum obligation limitation specified in FDICIA for the quarter ending June 30, 1992, we reviewed the completeness and reasonableness of the components and explanatory notes in FDIC's second quarter calendar year 1992 maximum obligation limitation reports for BIF and SAIF. For this review, we performed procedures substantially more limited in scope than those conducted in an actual financial statement audit of the insurance funds. Also, we only reviewed the activity that occurred in the second quarter of 1992 and relied on the results of the review procedures performed on the March 31, 1992, balances in our first quarter 1992 maximum obligation limitation reports for BIF and SAIF to provide us with assurance as to the reasonableness of second quarter 1992 opening balances. Nevertheless, we believe our procedures provide us with sufficient assurance to draw conclusions regarding FDIC's second quarter 1992 compliance with its maximum obligation limitation.

Our review work included the following:

- We compared the components of FDIC's maximum obligation limitation calculations for BIF and SAIF to the provisions of FDICIA and to each fund's June 30, 1992, Statement of Financial Position and corporate general ledger trial balance.
- We performed analytical procedures on the individual accounts that comprised each of the maximum obligation limitation calculation's line item components to identify (1) the dollar and percentage change in the account balances from March 31, 1992, to June 30, 1992, and (2) any unusual account balances.
- We developed criteria to identify accounts that required detailed review procedures. These criteria considered the account's materiality as it relates to the balance of the line item in which it is grouped, and the extent to which the account balance changed from quarter to quarter. For those accounts meeting these criteria, we performed the following additional procedures: (1) obtained explanations for any large or unusual fluctuations in the account balances from appropriate FDIC officials, (2) obtained and reviewed supporting documentation for those accounts exhibiting large or unusual fluctuations for which FDIC officials did not provide sufficient explanation, (3) obtained and reviewed account reconciliations as of June 30, 1992, for specific accounts and verified the adequacy of these reconciliations, (4) confirmed balances for specific accounts, and (5) selected a judgmental sample of transactions for certain accounts and traced these transactions to supporting documentation.

To determine whether BIF and SAIF had borrowed from the U.S. Treasury for insurance losses, what factors may affect the need for future borrowings, and whether BIF and SAIF will be able to meet established repayment schedules, we reviewed the status of FDIC borrowings from Treasury as of June 30, 1992. We also discussed anticipated borrowing needs with FDIC officials. Additionally, we monitored factors which could affect future borrowing needs, such as FDIC's recent regulation on risk-based assessments and on its recapitalization plans for BIF and SAIF.

To determine whether BIF will generate sufficient proceeds from the management and disposition of failed bank assets to repay working capital borrowings, we gained an understanding of FDIC's collection processes. From this understanding, we designed and implemented procedures to review FDIC's historical experience in generating funds for BIF from the management and disposition of assets acquired from failed financial institutions through June 30, 1992. As agreed upon with your respective offices, our work was limited to an analysis of FDIC's historical collection experience to determine whether FDIC can generate sufficient funds for BIF from the management and disposition of failed bank assets to repay the Fund's existing working capital borrowings; we did not audit the collection and loss information provided.

BIF Maximum Obligation Limitation Calculation and Notes at June 30, 1992

BANK INSURANCE FUND
MAXIMUM OBLIGATION LIMITATION
(dollars in millions)

		June 30 1992
Funding Sources		
Cash and Cash Equivalents		$ 2,050
Investments in U.S. Treasury Obligations and Accrued Interest		2,546
Estimated Fair Market Value (FMV) of Other Assets		
Other Assets 91 @ 90%	82	
Net Receivables from Bank Resolutions 25,798 @ 90%	23,218	
Total Other Assets @ 90%		23,300
U.S. Treasury Borrowing Authority		30,000
Total Funding Sources		57,896
Obligations		
Accounts Payable, Accrued and Other Liabilities		135
Notes Payable – Federal Financing Bank (FFB) Borrowings		15,290
Notes Payable – U.S. Treasury Borrowings		0
Liabilities Incurred from Bank Resolutions		5,519
Estimated Liabilities for Litigation Losses		14
Lease Commitments		84
Total Obligations		21,042
Remaining Obligation Authority		$ 36,854

The accompanying notes are an integral part of this Maximum Obligation Limitation Calculation

Federal Deposit Insurance Corporation
Bank Insurance Fund
Maximum Amount Limitation on Outstanding Obligations
Explanatory Notes
June 30, 1992

A. FUNDING SOURCES

1. Cash and Cash Equivalents

Cash and cash equivalents are included as defined in Statement of Financial Accounting Standards (SFAS) No. 95. SFAS No. 95 defines cash and cash equivalents as short-term, highly liquid investments that are both (a) readily convertible to cash and (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Generally, only investments with original maturities of three months or less qualify under this definition. This component includes $1.561 billion in Overnight Treasury Investments and $489 million in cash.

2. Investments in U.S. Treasury Obligations and Accrued Interest

This component represents the acquisition cost of the investments, net of unamortized premiums, and the accrued interest receivable on these investments. The investments and interest are treated similar to cash equivalents for purposes of the MOL calculation because the FDIC intends to hold these investments to maturity. Accordingly, the risk factor associated with these investments is not considered significant.

Included in this component are $2.490 billion in U.S. Treasury bills, notes and bonds (acquisition cost net of $14 million in unamortized premiums) and $56 million of accrued interest.

3. Estimated FMV of Other Assets (90%)

The maximum obligation limitation calculation includes the total of all non-cash assets at 90 percent of their fair market value in accordance with Section 15(c) of the Federal Deposit Insurance Act as amended by Section 102(a) of the FDIC Improvement Act of 1991. For these non-cash assets, reported amounts will be considered full fair market value.

Since the FDIC does not intend to liquidate the building or any other capitalized asset in the future to satisfy its obligations, property and buildings were excluded from "other assets" classification.

4. Net Receivables from Bank Resolutions (90%)

This component includes the net realizable value of: 1) subrogated claims on closed banks ($23.1 billion); 2) corporate purchases ($2.3 billion); and 3) amounts due from open bank assistance ($410 million). The net realizable value accounts for estimated total losses to the FDIC for resolved cases, including expenses incurred to manage and dispose of assets.

An allowance for loss is established for the Fund's receivables from bank resolutions. The allowance for loss represents the difference between amounts advanced and the expected repayment, based upon the estimated cash recoveries from the assets of the assisted or failed bank, net of all estimated liquidation costs. An estimate of losses on assets likely to be returned to the FDIC's on-balance sheet serviced asset pools under put agreements is included in the allowance for losses on claims against serviced asset pools.

5. U.S. Treasury Borrowing Authority

The FDIC Improvement Act of 1991 provides the FDIC with $30 billion in Treasury borrowing authority for use by both the BIF and the SAIF. However, the Act does not specify a methodology for allocating the $30 billion between the two funds. For future periods, the FDIC intends to finalize an allocation policy that will consider the projected cash flow needs and alternative funding sources of each fund.

For example, the SAIF has access to additional funds from the Secretary of the Treasury to carry out its mission and to maintain its statutorily required minimum net worth. A maximum of $32 billion in appropriations has been authorized for these purposes through fiscal year 2000. The SAIF may also borrow funds from the Federal Home Loan Banks with approval of the Federal Housing Finance Board.

Initially, the FDIC has allocated all $30 billion in Treasury borrowing authority to the BIF. This allocation is based on the FDIC's projections which indicate that the BIF has the current need for the borrowing authority. The allocation could change in subsequent periods as projections are revised.

B. OBLIGATIONS

6. Accounts Payable, Accrued and Other Liabilities

This component represents the full face value of routine, current liabilities such as accounts payable and accrued liabilities.

Unearned assessments, if any, are excluded because these liabilities are not considered obligations. Unearned assessments are advance payments, which are deferred, and subsequently recognized by the passage of time.

7. Notes Payable - FFB and U.S. Treasury Borrowings

These components represent the full face value of all FFB and U.S. Treasury borrowings and the accrued interest thereon. The FDIC has not yet borrowed funds from the U.S. Treasury. The FFB outstanding borrowings component consists of $15.2 billion in notes issued to the FFB and $130 million in accrued interest. Interest rates are based on the U.S. Treasury bill auction rate in effect during the quarter plus 12.5 basis points.

The FDIC rolled over the $11.9 billion first quarter 1992 note balance into a new note on April 1, 1992. The FDIC borrowed an additional $3.3 billion from the FFB during the second quarter.

8. Liabilities Incurred from Bank Resolutions

Escrowed funds from resolution transactions ($5.1 billion) comprise the major portion of this component. In various resolution transactions, the BIF pays the acquirer the difference between failed bank liabilities assumed and assets purchased, plus or minus any premium or discount. The BIF considers the amount of the deduction for assets purchased by acquiring institutions to be funds held on behalf of the receivership. Accordingly, escrowed funds represents the difference in the amount that the BIF pays to an acquirer for failed bank liabilities and assets purchased, adjusted for any premium or discount.

An adjustment has been added to this component for the contingent liabilities relating to assets likely to be returned to the FDIC under put agreements related to off-balance sheet pools.

9. <u>Estimated Liabilities for Litigation Losses</u>

This contingent liability represents the expected cost of those pending or threatened litigations, claims or assessments where an estimated loss to the FDIC in its Corporate capacity is both probable and reasonably estimable.

10. <u>Lease Commitments</u>

This component, which is an off-balance sheet item, represents the non-cancelable portion of multi-year lease commitments for space in Washington and other locations.

11. <u>Exclusions</u>

As agreed upon by the Congressional Banking Committees, total obligations exclude the FDIC's estimated liability for unresolved cases (future bank failure and/or assistance transactions) where there is no contractual agreement between the FDIC and the troubled institutions comprising the estimated liability. The estimated liability for unresolved cases as of June 30, 1992, was $15 billion.

SAIF Maximum Obligation Limitation Calculation and Notes at June 30, 1992

SAVINGS ASSOCIATION INSURANCE FUND
MAXIMUM OBLIGATION LIMITATION
(dollars in millions)

			June 30 1992
Funding Sources			
Cash and Cash Equivalents			$ 162
Due from the FSLIC Resolution Fund			2
Estimated Fair Market Value (FMV) of Other Assets			
Entrance Fees Receivable		0	
Other Assets		2	
	2 @ 90%		
Total Other Assets @ 90%			2
U.S. Treasury Borrowing Authority			0
Total Funding Sources			166
Obligations			
Accounts Payable, Accrued and Other Liabilities			7
Notes Payable – Federal Financing Bank (FFB) Borrowings			0
Notes Payable – U.S. Treasury Borrowings			0
Lease Commitments			4
Total Obligations			11
Remaining Obligation Authority			155

The accompanying notes are an integral part of this Maximum Obligation Limitation Calculation

Federal Deposit Insurance Corporation
Savings Association Insurance Fund
Maximum Amount Limitation on Outstanding Obligations
Explanatory Notes
June 30, 1992

A. FUNDING SOURCES

1. Cash and Cash Equivalents

Cash and cash equivalents are included as defined in Statement of Financial Accounting Standards (SFAS) No. 95. SFAS No. 95 defines cash and cash equivalents as short-term, highly liquid investments that are both (a) readily convertible to cash and (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Generally, only investments with original maturities of three months or less qualify under this definition. Excluded is $81 million in Overnight Treasury Investments representing exit fees which are restricted and consequently are not funding sources.

2. Due from the FSLIC Resolution Fund

This component represents the interfund receivable due from the FSLIC Resolution Fund (FRF) for administrative expenses that have not been reimbursed. This is an interfund receivable and therefore highly liquid.

3. Estimated FMV of Other Assets (90%)

The maximum obligation limitation calculation includes the total of all non-cash assets at 90 percent of their fair market value in accordance with Section 15(c) of the Federal Deposit Insurance Act as amended by Section 102(a) of the FDIC Improvement Act of 1991. For these non-cash assets, reported amounts will be considered full fair market value.

4. Entrance Fees Receivable (90%)

The SAIF will receive entrance fees for conversion transactions in which an insured depository institution converts from the BIF to the SAIF. The SAIF records entrance fees as a receivable and related revenue once the BIF-to-SAIF conversion transaction is consummated.

5. U.S. Treasury Borrowing Authority

The FDIC Improvement Act of 1991 provides the FDIC with $30 billion in Treasury borrowing authority for use by both the BIF and the SAIF. However, the Act does not specify a methodology for allocating the $30 billion between the two funds. For future periods, the FDIC intends to finalize an allocation policy that will consider the projected cash flow needs and alternative funding sources of each fund.

The SAIF has access to additional funds from the Secretary of the Treasury to carry out its mission and to maintain its statutorily required minimum net worth. A maximum of $32 billion in appropriations has been authorized for these purposes through fiscal year 2000. The SAIF may also borrow funds from the Federal Home Loan Banks with approval of the Federal Housing Finance Board.

Initially, the FDIC has allocated all $30 billion in Treasury borrowing authority to the BIF. This allocation is based on the FDIC's projections which indicate that the BIF has the current need for the borrowing authority. The allocation could change in subsequent periods as projections are revised.

B. OBLIGATIONS

6. Accounts Payable, Accrued and Other Liabilities

This component represents the full face value of routine, current liabilities such as accounts payable and accrued liabilities.

Unearned assessments, if any, are excluded because these liabilities are not considered obligations. Unearned assessments are advance payments, which are deferred, and subsequently recognized by the passage of time.

7. Notes Payable - FFB and U.S. Treasury Borrowings

These components represent the full face value of all FFB and U.S. Treasury borrowings and the accrued interest thereon. The FDIC has not yet borrowed funds from either the FFB or the U.S. Treasury on behalf of the SAIF.

8. Lease Commitments

This component, which is an off-balance sheet item, represents the non-cancelable portion of multi-year lease commitments for space in Washington and other locations.

9. <u>Exclusions</u>

Pursuant to an FDIC-approved regulation, exit fees paid to the SAIF are to be held in a reserve account until such time as the FDIC and the U.S. Treasury determine that it is no longer necessary to reserve for the payment of interest on the obligations of the Financing Corporation. This regulation allows the exit fees to be paid over a five-year period. The SAIF recognizes a receivable and a reserve for the principal due. Since these fees are not considered to be funds for the SAIF, as their availability has been restricted by the regulation, the exit fee reserve account activity is excluded from the MOL calculation.

10. <u>Due to the Bank Insurance Fund</u>

The amount reported for this component in the first quarter MOL calculation was $21 million (for the SAIF's share of the Southeast Bank, N.A., loss). This amount was paid during the second quarter.

BIF Estimated Net Recoveries on Assets in Liquidation at June 30, 1992

Dollars in millions

Asset type	Book value of asset inventory	Collections as a percentage of book value reduction	Estimated collections on inventory	Estimated administrative expenses	Net estimated recoveries
Securities	$ 244.1	95.4	$ 233.0	$ 46.6	$ 186.4
Consumer loans	633.7	60.0	380.5	76.1	304.4
Commercial loans	14,016.0	56.5	7,925.7	1,585.1	6,340.6
Mortgages	9,485.2	71.4	6,770.1	1,354.0	5,416.1
Owned assets	3,884.1	56.7	2,202.6	440.5	1,762.1
Other assets	8,373.5	54.2	4,542.3	908.5	3,633.8
Total on assets	**36,636.6**	**60.2[a]**	**22,054.2**	**4,410.8**	**17,643.4**
Other collections		15.8	5,790.8	1,158.2	4,632.6
Total estimated recoveries			**$27,845.0**	**$5,569.0**	**$22,276.0**

[a]The collections as a percentage of book value reduction (total on assets) represents the result of dividing total estimated collections into total book value. This amount has been rounded. Therefore, multiplying this percentage by total book value will yield a slightly different result than adding estimated collections for each individual asset type.

Note: Totals may not add due to rounding.

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