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CONGRESS MAY LOOK AT A $60-$77 BILLION FSLIC BORROWING

By Bob Duke

When Congress finally comes up with a FSLIC rescue funding authorization, the figure may range between $60 billion and $77 billion--with the financing mechanism structured as an on-budget borrowing rather than a direct appropriation.

While it's willing to look at every "reasonable" approach possible in seeking a solution to the thrift insurer's crisis, industry and congressional sources said, Congress is afraid the public might react hostilely if it mandated a public bailout.

Moreover, if FSLIC has to be rescued, the borrowing approach is recommended by the Congressional Research Service in a paper prepared for Congress.

CRS said a borrowing to cover FSLIC's shortfall wouldn't add to the macroeconomic problems caused by the federal budget deficit, since the economic effect of such a borrowing already has occurred.

In other words, it said, the borrowing wouldn't put pressure on the credit markets, raise interest rates, push up prices, add to aggregate demand or exacerbate the trade deficit.

"Essentially, the government already owes a debt to (thrift) depositors," CRS said. "Waiting until now to recognize it explicitly in the budget has not delayed its effects."

Whatever authorization Congress approves after despository insurance reform hearings this year is almost certain to be accompanied by major reforms in the savings and loan regulatory and insurance structures, these sources said.

They believe the odds favor FSLIC either becoming an independent entity or being placed under the the Federal Deposit Insurance Corporation. Under either scenario, they think, the Federal Home Loan Bank Board, which currently oversees FSLIC, would become simply a chartering and regulatory agency, just like the Office of the Comptroller of the Currency.

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The latest conservative estimates for a FSLIC bailout are provided by the General Accounting Office and sources close to the FHLBB.

In a report to Congress, GAO said it would cost FSLIC at least $77 billion to resolve 350 remaining insolvent S&Ls. FSLIC expects to have $27 billion of that amount available (over the 11-year period between 1988 and 1998) from existing resources, leaving a shortfall of $50 billion required to cover all of its anticipated insurance losses.

As large as the $77 billion estimate is, it nevertheless still underestimates the total resources FSLIC actually would need, GAO said.

It bases its statement on the fact that FSLIC has incurred substantial liabilities in the form of promissory notes and various guarantees requiring future payments.

Meanwhile, sources close to the FHLBB said the agency is considering a FSLIC rescue cost estimate of at least $60 billion, up $10 billion from its projection last fall.

"The Board doesn't want to offer too high an estimate or too low an estimate," one source said. "It got burned last spring when it projected a case-resolution cost of no more than $32 billion, then later had to increase the figure to around $50 billion."

This source noted that the Treasury Department is considering including a bailout figure of between $50 billion and $60 billion in a FSLIC plan it is to submit to the White House.

Its final bailout proposal would be structured as an on-budget borrowing, with Treasury paying the interest on the FSLIC debt.

Last fall, FDIC Chairman William Seidman suggested a $30 billion FSLIC borrowing to let it resolve its 100 worst remaining problem cases.

GAO, in its report, said FSLIC should be separated from the Bank Board and given independent status, with the authority and resources to regulate and supervise the S&L industry. The FDIC also has recommended an independent FSLIC.

Under the GAO's proposal, "profitable" thrifts would be placed under the reorganized FSLIC, while insolvent ones would be removed from the market and isolated in a special receivership arrangment.

GAO says the new FSLIC would be funded by the S&L industry, just as the old one is, with the Treasury Department covering any outflows of insured deposits from the insolvent thrifts held in special receivership.

"The new independent FSLIC would be in a position to establish regulatory and supervisory policies intended primarily to protect the interests of the insurance fund, and should be able to place stringent controls on improperly operated and undercapitalized thrifts," it said.

FSLIC, GAO said, should be allowed to do whatever is necessary to attract and retain qualified regulatory and examination personnel.

To ensure FSLIC's ability to do this, it said, its regulatory and examination functions should be exempted from federal personnel salary and other limitations, just as the FDIC is exempted from these restrictions.

GAO said the banking regulators should provide FSLIC with technical advice to help it set up a viable operation.

In an effort to pinpoint factors that triggered their problems, GAO analyzed 26 insolvent S&Ls.

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In its analysis, GAO found these contributory factors to the insolvencies:

• Poor internal controls and insider fraud and other abuses, including breaches of fiduciary duty, self-dealing, engaging in high-risk speculative ventures, excessive expenditures and compensation and conflicts of interest.

• Inadequate supervision by the boards of directors and domination of the institutions by one or more indviduals who initiated poor-quality loans.

• Over-reliance on volatile deposits to generate funds used for loans and investments.

• Inadequate loan documentation and related credit analysis and appraisal deficiencies.

• Noncompliance with loan terms by the thrifts themselves and unresponsiveness by S&L management to the federal regulators.

• Inadequate recordkeeping and violations of the loans-to-one-borrower regulation.

"Despite the fact that examination reports revealed critical problems at the failed thrifts, federal regulators did not always obtain agreements for corrective action, or they obtained them only months or years after problems first appeared," GAO said.

As an example of a violation of the loans-to-one-borrower regulation, the agency noted that a California thrift lent $40 million to one borrower principally to build condominiums and a shopping center. No feasibility studies were conducted, it said.

"Examiners stated that adequate feasibility studies would have shown that the area was already overbuilt with condominiums and shopping facilities before the loans were made," GAO said. "This thrift expects to lose over $10 million on this project."

In regard to conflicts of interest, the agency said such conflicts weren't confined to thrift officers and directors.

In fact, GAO said, the law firm representing one S&L also referred borrowers to the institution, represented both parties in the resulting transactions, received fees from both parties, allowed loans to close under terms materially different from those approved by the thrift and failed to obtrain documentation required by the loan commitments issued by the institution.

The agency feels that a reorganized FSLIC with sufficient regulatory and examination powers would prevent such abuses in the future.

(The information contained herein, while obtained from reliable sources, cannot be guaranteed.)