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Report to the Congress

July 1990

FINANCIAL AUDIT

Federal Savings and Loan Insurance Corporation's 1989 and 1988 Financial Statements

GAO/AFMD-90-79

GAO

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

Comptroller General
of the United States

B-114893

July 17, 1990

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

This report presents our opinion on the Federal Savings and Loan Insurance Corporation's final financial statements, disclosing that significant uncertainties remain that will affect the ultimate cost of assistance already provided to failed thrifts and the estimated cost of resolving problem thrifts not yet assisted. We expect final costs to be higher than estimated. This report also presents our reports on the Corporation's internal accounting controls and on its compliance with laws and regulations. We conducted our audits pursuant to the provisions of 31 U.S.C. 9105 and in accordance with generally accepted government auditing standards.

On August 8, 1989, its last day of operation, the Corporation reported a capital deficit of $87 billion—the largest ever reported by a public or private corporation. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) provided mechanisms to pay off the Corporation's obligations, which were transferred to a resolution fund. It also created the Resolution Trust Corporation and provided it $50 billion to resolve problem thrifts placed into conservatorship or receivership from January 1, 1989, through August 9, 1992.

On April 6, 1990, we testified before the Senate Committee on Banking, Housing and Urban Affairs that at least $325 billion will be needed to pay off existing obligations, to resolve the problems of institutions awaiting resolution, to pay interest on the bonds issued to effect resolutions, and to pay some administrative expenses. We recommended that the Resolution Trust Corporation Oversight Board and the Federal Deposit Insurance Corporation develop proposals to provide the additional funds and semiannually report to the Congress on the total cost.

The $325 billion represents a least cost estimate based on present conditions that are subject to significant change. It is also based on the Office of Management and Budget's optimistic interest rate assumptions. This estimate could easily rise to $400 billion if more thrifts fail than the 560 identified by the Corporation and could reach $500 billion if the economy suffers a downturn and interest rates rise.

On May 23, 1990, the Secretary of the Treasury, as Chairman of the Oversight Board, testified before the Senate Committee on Banking, Housing and Urban Affairs that the amounts authorized for the Resolution Trust Corporation in FIRREA will fall short of what is required. Depending on the ultimate number of failures and amount of losses incurred, the Secretary estimated that the Resolution Trust Corporation's cost would range from $90 billion to $130 billion if paid today. The Oversight Board intends to work with the Congress and the administration to develop a funding approach for the necessary resources.

We are sending copies of this report to the Chairmen of the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Banking, Finance and Urban Affairs; the Director of the Office of Management and Budget; the Secretary of the Treasury; and the Chairman of the Federal Deposit Insurance Corporation.

Charles A. Bowsher

Charles A. Bowsher
Comptroller General
of the United States

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Abbreviations

FSLIC	Federal Savings and Loan Insurance Corporation
FIRREA	Financial Institutions Reform, Recovery, and Enforcement Act of 1989
RTC	Resolution Trust Corporation

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of the United States

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To the Board of Directors
Federal Deposit Insurance Corporation

We have audited the accompanying consolidated statements of financial condition of the Federal Savings and Loan Insurance Corporation (FSLIC) as of August 8, 1989, and December 31, 1988, and the related consolidated statements of income and expense and reserves and statements of cash flows for the periods then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits. In addition to this report on our audits of the Corporation's financial statements, we are reporting on our consideration of its system of internal accounting controls and on its compliance with laws and regulations.

We conducted our audits in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audits 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. However, as discussed in the following paragraph, the estimated liabilities for assisted and unresolved institutions are subject to significant uncertainties that limited our audit and precluded us from opining on these reported balances.

To develop its estimated liabilities for assisted institutions and unresolved institutions, the Corporation used information available at the time. However, actual costs depend on various uncertainties, such as the extent of continued operating losses; the quality of each institution's assets; future interest rates; the potential effect of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA); and the economic outlook for certain sectors of the economy. For assisted institutions, the actual cost to the Corporation is also dependent on the results of independent audits to determine the value of each institution's assets and its negative net worth, most of which were not completed as of August 8, 1989. For unresolved institutions, actual costs will be further affected by any delays in completing resolution actions and any increase in the universe of troubled institutions. As a result of these uncertainties, the Corporation's estimates are subject to significant change, and we expect final costs to be higher than estimated.

In our opinion, except for the effects that the uncertainties discussed in the preceding paragraph may have on the cost of assisted institutions and unresolved institutions, the financial statements referred to above present fairly, in all material respects, the financial position of the Federal Savings and Loan Insurance Corporation as of August 8, 1989, and December 31, 1988, and the results of its operations and its cash flows for the periods then ended, in conformity with generally accepted accounting principles.

In response to the savings and loan industry crisis and the Corporation's mounting losses, FIRREA was enacted on August 9, 1989. FIRREA abolished the Corporation and transferred its insurance function to the Federal Deposit Insurance Corporation, which, among other things, will administer a newly created insurance fund for savings and loan associations, the Savings Association Insurance Fund. FIRREA also transferred the Corporation's assets, debts, obligations, contracts, and other liabilities to a newly established fund, the FSLIC Resolution Fund. The Federal Deposit Insurance Corporation is responsible for administering the fund to ensure that its assets are sold and liabilities paid. The necessary funds to pay these liabilities will come from a variety of sources including savings and loan insurance premiums and recoveries from asset sales. Any shortfall in the amounts needed to pay obligations and expenses is to be provided by the Department of the Treasury through appropriations.

FIRREA also created the Resolution Trust Corporation (RTC) to resolve the problems of institutions placed into conservatorship or receivership from January 1, 1989, until August 9, 1992. It provided RTC $50 billion to resolve the problems of those institutions and to pay administrative expenses.

The following sections provide details on the Corporation's liabilities and discuss the amount of funds needed to resolve the savings and loan industry crisis.

Estimated Liability for Assistance Agreements

At August 8, 1989, the Corporation reported a $38 billion present value liability (the cost if paid at the reporting date) for savings and loan associations already merged or sold with Corporation assistance. However, the Corporation estimated that net cash outlays for these agreements over the next 9 years would likely be more than $60 billion.

To develop its cost estimates for assistance agreements, the Corporation made various assumptions regarding future economic conditions and acquirer actions. For example, the Corporation assumed that, for most assistance agreements, interest rates would increase moderately and assets would be sold over periods ranging from 3 years to 7-1/2 years.

Using these various assumptions and information on the financial condition of the acquired institutions, the Corporation estimated its expected future net cash outlays. It then discounted these outlays back to present value. The resulting present value cost represents the estimated amount the Corporation would have needed at the report date to pay its liability for assistance agreements.

However, actual costs as well as cash outlays will likely differ from those projected. In particular, the Corporation needs to review detailed asset management plans on the assisted institutions' significant assets, most of which were not due until 1 year after the date of the agreement, to provide a more accurate estimate of the value of assets covered by guarantees. Also, it needs the results of audits of the institutions' financial condition to adjust the notes issued to acquirers for the estimated amount that liabilities exceeded assets. Once the required audits are completed, we expect the Corporation's costs to be higher.

Estimated Liability for Unresolved Institutions

At August 8, 1989, the Corporation reported a $55 billion present value liability for resolving 560 troubled but still operating institutions. However, the Corporation estimated that net future cash outlays for these resolutions will likely exceed $63 billion. To estimate its liability, the Corporation made various assumptions regarding future operating losses, economic conditions, interest rates, and projected resolution costs. For example, the Corporation assumed that half of the 560 troubled institutions would be resolved by March 31, 1991. It also assumed that the troubled institutions would continue to incur operating losses through resolution at a slightly increasing rate based upon third quarter 1989 losses.

In December 1989, the Office of Thrift Supervision estimated that 610 institutions not included in the Corporation's liability at August 8, 1989, would fail to meet the new capital requirements imposed by FIRREA. Some of these 610 may be able to increase their capital to meet the new requirements or be acquired with no assistance from RTC. However, it is also possible that some may be placed into conservatorship or receivership. In that case, they would represent a future liability for RTC.

Because the Corporation's estimate was based upon information available at the time, actual costs may differ from those projected. If asset values continue to decline or operating losses are higher than estimated, costs will increase. Also, any delays in resolving troubled institutions or growth in the universe of troubled institutions will increase ultimate resolution costs.

Funds Needed to Resolve the Savings and Loan Crisis

On April 6, 1990, we testified before the Senate Committee on Banking, Housing and Urban Affairs on our analysis of the amount of funds needed to resolve the savings and loan crisis.[1] In that testimony, we stated that at least $325 billion would be needed to pay off the Corporation's obligations, resolve the problems of institutions awaiting resolution, pay interest on the bonds to be issued by the Resolution Funding Corporation and on working capital funds RTC will need to borrow, and pay administrative and other expenses.

The $325 billion represents a least cost estimate, based on present conditions, of total cash needs over 40 years using the Office of Management and Budget's optimistic interest rate assumptions. Actual costs depend on various uncertainties, such as the number of institutions requiring resolution and the extent of continuing operating losses, the quality and value of assets in assisted or troubled institutions, future interest rates, the economic outlook for certain sectors of the economy, and the potential effect of FIRREA. Therefore, this estimate could easily rise to $400 billion if an increased number of institutions fail and could reach $500 billion if the economy suffers a downturn and interest rates rise.

As a result of our analysis and RTC's need for additional funds, we made recommendations to the Chairmen of the RTC Oversight Board and the Federal Deposit Insurance Corporation regarding the need to develop proposals to provide the additional funds RTC will need and to jointly report semiannually to the Congress on the total cash needs, net costs, and sources of funds to pay for FSLIC's obligations, RTC resolutions, and related costs.

On May 23, 1990, the Secretary of the Treasury, as Chairman of the Resolution Trust Corporation Oversight Board, testified before the Senate Committee on Banking, Housing and Urban Affairs that the amounts authorized for the Resolution Trust Corporation in FIRREA will

[1] Resolving The Savings And Loan Crisis: Billions More and Additional Reforms Needed (GAO/T-AFMD-90-15, April 6, 1990).

fall short of what is required. The Secretary cited three primary reasons for the increased costs: larger than expected losses in thrifts, marginal thrifts likely to fail sooner than expected and becoming the responsibility of the Resolution Trust Corporation, and an increased number of thrifts expected to fail. Depending on the ultimate number of failures and amount of losses incurred, the Secretary estimated that the Resolution Trust Corporation's cost would range from $90 billion to $130 billion if paid today. The Oversight Board intends to work with the Congress and the administration to develop a funding approach for the necessary resources.

Charles A. Bowsher
Comptroller General
of the United States

February 9, 1990

Report on Internal Accounting Controls

We have audited the consolidated financial statements of the Federal Savings and Loan Insurance Corporation for the period ended August 8, 1989, and the year ended December 31, 1988, and have issued our opinion thereon. As part of our audits, we made a study and evaluation of the Corporation's system of internal accounting controls to the extent we considered necessary to evaluate the system as required by generally accepted government auditing standards. This report pertains only to our study and evaluation of the system of internal accounting controls for the period ended August 8, 1989. Our report on the study and evaluation of internal accounting controls for the year ended December 31, 1988, is presented in GAO/AFMD-90-34, dated October 31, 1989.

The purpose of our study and evaluation was to determine the nature, timing, and extent of the auditing procedures necessary for expressing an opinion on the Corporation's consolidated financial statements. For purposes of this report, we have classified the significant internal accounting controls into the following categories:

- assistance to merged/acquired institutions,
- costs related to closed institutions,
- costs related to unresolved institutions,
- expenditures,
- financial reporting,
- revenue, and
- treasury.

Our study and evaluation included all of the control categories listed above.

The Corporation's management is responsible for establishing and maintaining an effective system of internal accounting controls. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system of internal accounting controls are to provide management with reasonable assurance that (1) obligations and costs are in compliance with applicable laws, (2) funds, property, and assets are safeguarded against waste, loss, and unauthorized use or misappropriation, and (3) assets, liabilities, revenues, and expenditures applicable to operations are properly recorded and accounted for to permit the preparation of reliable financial reports and to maintain accountability over the Corporation's assets. Because of inherent limitations in any system of internal accounting controls, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

Our study and evaluation, made for the limited purpose described in the second paragraph, would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the Corporation's system of internal accounting controls taken as a whole or on the categories of controls identified in the second paragraph. Our study and evaluation did not disclose any internal accounting control weaknesses which we considered to be material in relation to the financial statements taken as a whole.

During our audit, we identified several internal accounting control matters which, although not material, nonetheless merit corrective action. Accordingly, we are reporting them separately to the Federal Deposit Insurance Corporation, which has taken over responsibility for the Corporation's activities.

Report on Compliance With Laws and Regulations

We have audited the consolidated financial statements of the Federal Savings and Loan Insurance Corporation for the period ended August 8, 1989, and the year ended December 31, 1988, and have issued our opinion thereon. Our audits were made in accordance with generally accepted government auditing standards and, accordingly, included such tests of compliance with laws and regulations as we considered necessary in the circumstances. This report pertains only to our review of compliance with laws and regulations for the period ended August 8, 1989. Our report on the review of compliance with laws and regulations for the year ended December 31, 1988, is presented in GAO/AFMD-90-34, dated October 31, 1989.

The Corporation's management is responsible for compliance with laws and regulations. In connection with our audits, we selected and tested transactions and records to determine the Corporation's compliance with laws and regulations, noncompliance with which could have a material effect on the financial statements.

As part of our audit, we reviewed and tested compliance with provisions of title IV of the National Housing Act, as amended (12 U.S.C. 1724-1730), title III of the Competitive Equality Banking Act of 1987 (12 U.S.C. 226 note), the Prompt Payment Act (39 U.S.C. 3901), and such other laws and regulations as we considered pertinent to the Corporation. In our opinion, the Corporation complied with the terms and provisions of laws and regulations for the transactions tested that could have materially affected the financial statements. In connection with our audit, nothing came to our attention that caused us to believe that the Corporation was not in compliance with the terms and provisions of laws and regulations for those transactions not tested.

Financial Statements

Consolidated Statements of Financial Condition

AUGUST 08, 1989 AND DECEMBER 31, 1988
(in thousands)

	AUGUST 08, 1989	DECEMBER 31, 1988
Assets		
Cash and Cash Equivalents (Note 3).........	$ 1,930,934	$ 3,090,776
Investments (Note 3)......................	574,226	574,002
Interest Receivable on Investments.........	0	765
Insurance Premiums and Accounts Receivable.	112,615	8,497
Subrogated Accounts from Receivers (Note 4)	5,191,380	5,200,380
Collateralized Advances due from Receivers (Note 5)................................	483,536	558,791
Loans to Receivers (Note 5)................	109,100	128,612
Interest Receivable on Loans to Receivers..	0	5,217
Collateralized Loans to Insured Institutions (Note 6)................................	800,000	830,000
Other Loans to Insured Institutions (Note 6)	198,803	205,123
Interest Receivable on Other Loans to Insured Institutions.....................	5,423	11,485
Real Estate, Mortgage Loans and Other Assets in Process of Liquidation.... (Note 7)................................	1,286,370	1,356,096
Income Capital Certificates (Notes 8 and 10)	182,152	257,819
Net Worth Certificates (Notes 9 and 10)....	162,325	171,200
Miscellaneous Assets......................	11,378	17,473
Total Assets..............................	11,048,242	12,416,236
Liabilities		
Accounts Payable and Other Liabilities.....	199,049	127,066
Notes Payable to Insured Institutions (Note 10)...............................	19,014,401	19,748,114
Miscellaneous Liabilities to Insured Institutions.....................	289,008	286,690
Accrued Interest on Notes Payable to Insured Institutions.....................	243,233	220,456
Notes Payable to Federal Home Loan Banks (Note 6)................................	800,000	830,000
Allowance for Loss - Assistance Agreements (Note 12)...............................	22,018,995	22,645,000
Allowance for Loss - Unresolved Cases (Note 13)...............................	55,240,000	43,550,000
Total Liabilities.........................	97,804,686	87,407,326

Insurance Fund Reserves		
Capital Stock..............................	602,500	497,000
Capital Certificates.......................	6,897,500	5,353,000
Insurance Reserves.........................	(94,256,444)	(80,841,090)
Total Primary Reserve (Note 17)...........	(86,756,444)	(74,991,090)
Total Liabilities and Reserves............	$ 11,048,242	$ 12,416,236

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

Consolidated Statements of Income and Expenses and Reserves

FOR THE PERIODS ENDED AUGUST 08, 1989 AND DECEMBER 31, 1988
(in thousands)

	August 08, 1989	December 31, 1988
Income		
Insurance Premiums (Note 1)	$ 29,397	$ 473,167
Special Assessment Premiums (Note 1)	602,218	1,195,037
Less Secondary Reserve Offset (Note 1)	(64,878)	(162,220)
Interest on Investments	128,679	179,978
Interest on Collateralized Advances and Loans to Receivers	1,372	36,378
Interest on Other Loans to Insured Institutions	25,183	44,130
Interest on Collateralized Loans to Insured Institutions	48,321	62,627
Interest on Advances to Insured Institutions	0	1,256
Interest from Real Estate, Mortgage Loans and Other Assets in Process of Liquidation	35,119	11,432
Gain on Sale of Assets	27,601	54,457
Gain on Transfer of Insured Accounts	2,967	73,998
Other Income	87,059	482,603
Total Income	923,038	2,452,843
Expenses		
Insurance Settlement and Administrative Expenses	174,306	223,928
Services Rendered to FSLIC by the FHLBB (Note 2)	23,825	30,562
Interest on Notes Payable to the FHLBanks	52,918	64,731
Interest on Notes Payable to Insured Institutions	1,090,850	522,351
Provision for Loss on:		
Subrogated Accounts from Receivers	(4,554)	2,813,697
Collateralized Advances due from Receivers	6,560	(3,780)
Real Estate, Mortgage Loans and Other Assets in Process of Liquidation	(169)	2,587,454
Loans to Receivers	1,777	8,775
Other Loans to Insured Institutions	400	97,600
Income Capital Certificates	498	113,938
Assistance Agreements	1,301,981	35,794,457
Unresolved Cases	11,690,000	26,150,000
Total Expenses	14,338,392	68,403,713

Net Loss From Operations.................	(13,415,354)	(65,950,870)
Primary Reserve at Beginning of Period...	(74,991,090)	(13,690,220)
Net Loss............................	(13,415,354)	(65,950,870)
Capital Stock.........................	105,500	367,500
Capital Certificates.................	1,544,500	4,282,500
Primary Reserve at End of Period (Note 17)	$ (86,756,444)	$ (74,991,090)

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

Consolidated Statements of Cash Flows

FOR THE PERIODS AUGUST 08, 1989 AND DECEMBER 31, 1988
(in thousands)

	AUGUST 08, 1989	DECEMBER 31, 1988
Operating Activities		
Net Loss	$ (13,415,354)	$ (65,950,870)
Adjustments to Reconcile Net Income to Net Cash Used by Operating Activities:		
Gain on Sale of Assets	(27,601)	(54,457)
Gain on Transfer of Insured Accounts	(2,967)	(73,998)
Provision for Loss on:		
Subrogated Accounts from Receivers	(4,554)	2,813,697
Collateralized Advances due from Receivers	6,560	(3,780)
Income Capital Certificates	498	113,938
Assistance Agreements	1,301,981	35,794,457
Loans to Receivers	1,777	8,775
Real Estate and Mortgage Loans	(169)	2,587,454
Loans to Insured Institutions	400	97,600
Unresolved Cases	11,690,000	26,150,000
Changes in Operating Assets & Liabilities:		
Decrease (Increase) in Accounts Receivable	(104,118)	3,054
Decrease (Increase) in Accrued Interest Receivable	12,044	(2,183)
Decrease (Increase) in Subrogated Accounts from Receivers	15,512	(2,917,454)
Decrease in Other Assets	6,095	9,081
Increase in Accounts Payable	71,983	7,643
Increase in Interest Payable	22,777	120,444
Increase (Decrease) in Miscellaneous Liabilities to Insured Institutions	2,318	(15,455)
Payments made on Assistance Agreements	(1,868,908)	(1,715,490)
Sale (Purchase) of Acquired Assets	97,496	(85,092)
Net Cash Used by Operating Activities	(2,194,230)	(3,112,636)

Investing Activities		
Maturity of Marketable Securities.....	1,001	54,007
Purchase of S&L Stock................	0	(133,230)
Repayment of Collateralized Advances due from Receivers..................	68,695	259,270
Repayment of Loans to Receivers.......	17,735	(23,804)
Increase in Other Loans to Insured Institutions........................	5,920	(15,109)
Redemption of Income Capital Certificates	75,169	2,334
Net Cash Provided by Investing Activities	168,520	143,468
Financing Activities		
Sale of Capital Stock.................	105,500	367,500
Sale of Capital Certificates..........	1,544,500	4,282,500
Redemption of Notes Payable to Insured Institutions.................	(784,132)	(1,512,880)
Net Cash Provided by Financing Activities	865,868	3,137,120
Increase (Decrease) in Cash & Cash Equivalents (Note 1)....................	(1,159,842)	167,952
Cash & Cash Equivalents Beginning of the Period (Note 3)...........................	3,090,776	2,922,824
Cash & Cash Equivalents End of the Period (Note 3).........................	$ 1,930,934	$ 3,090,776

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

Notes to Financial Statements

AUGUST 8, 1989 AND DECEMBER 31, 1988

On August 9, 1989 President Bush signed into law the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), PL 101-73, which abolished the Federal Home Loan Bank Board, its authority, and its functions. The act also dissolved the Federal Savings and Loan Insurance Corporation (FSLIC) and transferred its insurance function to a newly-created thrift industry insurance fund called the Savings Association Insurance Fund (SAIF). In addition to the transfer of FSLIC's insurance function, the act transferred all of FSLIC's assets, debts, obligations, and contracts to a newly-created FSLIC Resolution Fund (FRF), except for the liability for unresolved cases, which the Resolution Trust Corporation (RTC) assumed. Both SAIF and FRF funds are to be administered by the Federal Deposit Insurance Corporation (FDIC) in its corporate capacity. These statements reflect the the final accounting of the Federal Savings and Loan Insurance Corporation and the Federal Asset Disposition Association as of August 8, 1989.

1. Summary of Significant Accounting Policies:

   a) Principles of Consolidation - The Federal Savings and Loan Insurance Corporation (FSLIC) began accounting for its investment in the Federal Asset Disposition Association (FADA), a wholly owned subsidiary, through consolidation effective December 31, 1986. However, these consolidated statements do not include accountability for assets and liabilities of closed insured institutions for which the Corporation acted as receiver or liquidating agent. The Corporation furnished periodic and final accountability reports of its receivership or liquidating agent activities to courts, supervisory authorities, and other interested parties as requested.

   b) Premium Income Recognition - Insurance premium income was recognized as earned when member institutions were assessed. These premiums were assessed annually and semi-annually based on an institution's insurance anniversary date. On August 10, 1987, the Congress passed the Competitive Equality Banking Act of 1987 (CEBA), PL 100-86. Title III, Section 305 of this act limited FSLIC's authority to collect assessment premiums by a combined limit shared with the Financing Corporation. The combined maximum rate of assessment could not exceed 1/12 of one percent of the insured institution's total savings capital, whether the premiums were paid to the FSLIC, the Financing Corporation, or a combination of both. As a result of CEBA, $452.8 and $340.8 million of insurance premiums were assessed and collected by the Financing Corporation through 8/8/89 and 12/31/88 respectively.

c) Special Assessment Recognition - In addition to the regular insurance premiums, the Corporation had the authority under Section 404(c) of the National Housing Act to assess each insured member a special premium not to exceed 1/8 of one percent of their total savings capital. The special assessment was billed quarterly and income was recognized as earned when member institutions were billed. Title III, Section 307 of CEBA authorized insured institutions to offset against future special assessment premiums amounts that were previously part of the "Secondary Reserve". This offset reduced special assessment premiums by $64.9 and $162.2 million through 8/8/89 and 12/31/88 respectively.

Title III, Section 306(c) of CEBA also placed limitations on the amount of special assessments for the years 1987 through 1991. The 1989 limitation was 1/16 of one percent, while the 1988 limitation was 1/12 of one percent of total savings capital. However, the Act allowed the Bank Board to postpone the reduction in this assessment if the Board determined that severe pressures on the Corporation warranted an infusion of additional funds. The Board approved postponement of the reduction in both 1989 and 1988.

d) Allowance for Loss - The Corporation's policy was to establish an estimated allowance for loss at the time the Bank Board approved either financial assistance to or the liquidation of an insured institution. Financial assistance or liquidation costs took several forms (Notes 4 through 12). The estimated allowance for loss represents the purchase price of the assets of an institution less the estimated recovery value, including all disposition costs. These allowances were reviewed at least annually and adjusted to reflect changes in projected interest rates, recent appraisals, historical experience, etc.

The Allowance for Loss on Unresolved Cases was the estimated cost to FSLIC of all unresolved, troubled institutions (Note 13). This allowance represented the estimated present value cost to the Government to resolve financially troubled thrift institution cases that were probable and could be reasonably estimated as of August 8, 1989, and was not a projection of the cost to resolve all future problems in the savings and loan industry.

e) Furniture, Fixtures, and Equipment (FF&E) - FSLIC's FF&E cost as of August 8, 1989 and December 31, 1988 was zero. In 1987, it was decided that all FF&E of the FSLIC should be expensed rather than capitalized. However, the FF&E of FADA was capitalized and stated at cost less accumulated depreciation, with depreciation computed on a straight line basis over the estimated useful lives of the assets. The net FADA FF&E balance is nominal and was included in other assets.

f) Statement of Cash Flows - In November 1987, the Financial Accounting Standards Board issued Statement No. 95, Statement of Cash Flows (SFAS 95). Pursuant to SFAS 95, the FSLIC elected the indirect method of reporting cash flows from operations. For the purposes of the Statement of Cash Flows, all highly liquid investments with original maturities of three months or less were considered to be cash equivalents.

2. Related Parties - The Federal Savings and Loan Insurance Corporation, a government agency created by the National Housing Act of 1934, was governed by the Federal Home Loan Bank Board. Bank Board expenses were met through assessments to the FSLIC and the Federal Home Loan Banks (FHLBanks). The FSLIC's share of the Bank Board assessment was charged to operating expenses of the Corporation during the year in which the assessment was levied. In addition to the Bank Board, the FSLIC interacted with FHLBanks, FADA and the Financing Corporation which were also under the Bank Board's direction.

FHLBanks - The FSLIC, as part of its default prevention activities, guaranteed repayment of FHLBank advances that had been made to certain insured institutions. These guarantees generally cover advances that are secured. As of August 8, 1989, the FSLIC had guaranteed commitments of $9.3 billion, of which $1.1 billion had been advanced to member associations. By comparison, as of December 31, 1988, guaranteed commitments totaled $4.5 billion, of which $1.6 billion had been advanced. In the event that FSLIC had been called upon to honor these guarantees, they would have been recorded as an asset on FSLIC's books with a FSLIC claim against any assets pledged as collateral to secure such advances.

The FHLBanks are also authorized, as directed by the Bank Board, to make loans to the FSLIC. All such loans must be in accordance with the provisions of section 402(d) of the National Housing Act. Loans from FHLBanks have been passed through to member institutions as Collateralized Loans (Note 6). These loans totaled $800 million as of August 8, 1989, and $830 million as of December 31, 1988.

FADA - In November 1985, the Bank Board approved the formation of the Federal Asset Disposition Association (FADA). The FADA, which was a wholly owned subsidiary of the FSLIC, managed and disposed of certain assets received by the FSLIC in case resolution actions. As of December 31, 1986, the FSLIC had purchased 25,000 shares of FADA common stock for $25 million. As of July 31, 1989, FADA reported assets of $20.8 million, liabilities of $1.7 million, net income of $1.4 million, a retained deficit of $5.9 million, and total stockholder's equity of $19.1 million.

As required by FIRREA, the FADA ceased operations on February 2, 1990. However, due to outstanding litigation actions, a final liquidating dividend to FADA's sole stockholder, the FRF, will not be made until such time as FADA's litigation liability, if any, is definitively established.

Under a contract with the Federal Home Loan Bank of Topeka, the FSLIC guaranteed repayment of up to $50 million in Bank advances to the FADA. As of August 8, 1989 and December 31, 1988, the FADA had no outstanding borrowings against this open line of credit. FADA's July 31, 1989 statements are unaudited.

Financing Corporation - Title III, Section 302 of CEBA established a newly created Financing Corporation. The Financing Corporation (FICO) is funded by the FHLBanks investment and its issuance of public debt offerings which are limited to $10.8 billion. The net proceeds of obligations issued by the Financing Corporation are required to be used to purchase Capital Stock or Capital Certificates issued by the FSLIC (Note 17). Through August 8, 1989, the FICO has purchased $7.5 billion in FSLIC Capital Stock and Capital Certificates.

3. Cash and Investments - All cash received by the Corporation which was not used to defray operating expenses or for outlays related to assistance to insured institutions and liquidation activities, was invested in U.S. Treasury securities. Other investments were mostly S&L stock and GNMAs issued by Federal Government Agencies other than the U.S. Treasury which were obtained through the Corporation's default prevention activities.

Investment securities were stated at cost, adjusted for amortization of premiums and accretion of discounts. Such amortization and accretion were computed by the interest method at rates based upon the maturity dates of the related securities. Both amortization and accretion are recognized as an adjustment to interest on investments. Through August 8, 1989, the Corporation earned an average rate of return of 9.61% on all investments, excluding preferred stock.

As of August 8, 1989 and December 31, 1988, the Corporation's cash and investment portfolio consisted of the following:

	8/8/89		12/31/88	
	Book Value (in thousands)	Market Value	Book Value (in thousands)	Market Value
Cash and Cash Equivalents:				
Cash	$ 57,207	$ 57,207	$ 77,301	$ 77,301
U.S Treasury Overnight Funds	1,869,309	1,869,309	3,004,775	3,004,775
FADA Money Market Funds	4,418	4,418	8,700	8,700
Total Cash and Cash Equivalents:	1,930,934	1,930,934	3,090,776	3,090,776

	8/8/89		12/31/88	
	Book Value (in thousands)	Market Value	Book Value (in thousands)	Market Value
Investments:				
Maturities up to One Year	0	0	0	0
Maturities Over One Year	2,010	1,958	3,011	2,853
Total Securities:	2,010	1,958	3,011	2,853
Preferred Stock	572,216	572,216	570,991	570,991
Total Investments:	$ 574,226	$ 574,174	$ 574,002	$ 573,844

4. Subrogated Accounts - As required by statute, an institution was closed unless there was a default prevention measure that would have been less costly than liquidation. In the case of liquidation, the FSLIC settled insurance claims either by cash payout of insured accounts or by transferring insured accounts to another insured institution. The FSLIC's subrogated account claim against the receivership of the liquidated institution was equal to the amount of the insured accounts transferred or paid out.

   As assets were liquidated by the receivership, the FSLIC and other creditors received periodic liquidating dividends in payment of their claims against the receiver. In most cases, a receivership does not have sufficient assets to pay all claims. The FSLIC estimated the amount of its recovery over the life of the receivership and recorded the difference as an allowance for loss against the claim.

   The changes in Subrogated Accounts for the periods ended August 8, 1989 and December 31, 1988 are:

	8/8/89 (in thousands)	12/31/88
Balance: Beginning of Period	$16,232,992	$10,847,248
Additions During the Period	534,198	5,394,620
Receiverships Closed During the Period	0	(8,478)
Losses Realized During the Period	0	(398)
Gross Subrogated Accounts	16,767,190	16,232,992
Less: Liquidating Dividends from Open Receiverships	2,260,363	1,712,612
Less: Allowance for Loss for Open Receiverships	9,315,447	9,320,000
Net: End of Period	$ 5,191,380	$ 5,200,380

5. Collateralized Advances Due from Receivers and Loans to Receivers - At times, the FSLIC guaranteed repayment of advances made by FHLBanks to insured institutions. If, subsequently, such an institution was closed by the FSLIC, the FSLIC may have been required by the FHLBank to repay the advance. The FSLIC repayment of the advance resulted in a claim against the receivership for the insured institution and establishment of a FSLIC asset, Collateralized Advances Due from Receivers. These Collateralized Advances are recovered from the receivership's liquidation of assets.

The FSLIC also made loans to meet the administrative and operating expense requirements of certain receiverships. These loans are to be repaid from the liquidation of assets of the receivership.

The changes in Collateralized Advances Due from Receivers and Loans to Receivers for the periods ended August 8, 1989 and December 31, 1988 are:

	Collateralized Advances		Loans to Receivers	
	8/8/89	12/31/88	8/8/89	12/31/88
	(in thousands)		(in thousands)	
Balance: Beginning of Period	$731,791	$990,827	$161,612	$137,798
Net Increase (Decrease)	(68,695)	(259,036)	(17,735)	23,814
End of Period	663,096	731,791	143,877	161,612
Less: Allowance for Loss	179,560	173,000	34,777	33,000
Net: End of Period	$483,536	$558,791	$109,100	$128,612

6. Other Loans to Insured Institutions - The FSLIC made both collateralized and other types of loans in assistance cases. The collateralized loans were funded by pass-through loans from FHLBanks. In these transactions, FSLIC issued a note payable to the FHLBank and loaned the proceeds to an insured institution. The FSLIC had two loans of this type, one for $600 million and one for $200 million, totaling $800 million. Interest rates on the $200 million loan and the corresponding note to the FHLBank are the same and averaged 9.4% in 1989. The interest rate on the remaining $600 million loan receivable is based on the monthly weighted-average cost of funds charged to members of the FHLBank in which the institution is located and ranged from 8.0% to 8.9% in 1989. Interest on the corresponding note payable to the FHLBank is based on the cost of FHLBank funds plus 20 basis points. This rate varied between 9.0% and 10.0% during 1989. Principal payments on the $600 million collateralized loan began in 1988 and end in 1995, while principal payments on the $200 million collateralized loan begin August 15, 1989 and end in 1995. The $198.8 million in Other Loans to Insured Institutions is shown net of a $103.4 million allowance. The interest rate on these loans varies with each note.

7. Real Estate, Mortgage Loans, and Other Assets in Process of Liquidation - At times the FSLIC made direct acquisitions of troubled assets from problem associations in its attempt to merge a failing institution. The vast majority of these assets consists of real estate and mortgage loans. An allowance for loss has been established to reduce these assets to their net realizable value.

The changes in Real Estate, Mortgage Loans and Other Assets in Process of Liquidation for the periods ended August 8, 1989 and December 31, 1988 are:

		8/8/89	12/31/88
		(in thousands)	
Balance:	Beginning of Period	$4,043,096	$ 287,919
Add:	Increase (Decrease)	(89,193)	3,755,177
Balance:	End of Period	3,953,903	4,043,096
Less:	Allowance for Loss	2,667,533	2,687,000
Net:	End of Period	$1,286,370	$ 1,356,096

8. Income Capital Certificates - Since 1981 the FSLIC had purchased Income Capital Certificates (ICCs) from insured institutions as part of its default prevention activities. The FSLIC usually purchased an ICC by issuing a note payable and recorded the ICC at cost (Note 10). The ICCs earn annual income payments based on the United States Treasury Bill rates. The annual income payments and principal are due when the issuing institution has profitable operations and attains a specified net worth level.

The changes in the ICCs for the periods ended August 8, 1989 and December 31, 1988 are:

		8/8/89	12/31/88
		(in thousands)	
Balance:	Beginning of Period	$ 415,819	$ 1,645,883
Add:	Net Purchases or (Cancellations)	(122,666)	(1,230,064)
Balance:	End of Period	293,153	415,819
Less:	Allowance for Loss	111,001	158,000
Net:	End of Period	$ 182,152	$ 257,819

9. Net Worth Certificates - Since 1982, the FSLIC had purchased Net Worth Certificates (NWCs) from insured institutions as part of its default prevention activities. The FSLIC purchased an NWC by issuing a note payable and recorded the NWC at cost (Note 10). NWCs earn annual income payments based on the cost of Federal Home Loan Bank System Obligations plus 1/4 of one percent. Annual income and principal payments are due when the issuing institution has profitable operations and attains a specified net worth level. The legislation authorizing the issuance of Net Worth Certificates expired in October 1986 and was reinstated with the passage of the Competitive Equality Banking Act of 1987 on August 10, 1987. The program will expire on October 13, 1991.

The changes in the NWCs for the periods ended August 8, 1989 and December 31, 1988 are:

		8/8/89	12/31/88
		(in thousands)	
Balance:	Beginning of Period	$ 171,200	$ 225,025
Add:	Net Purchases or (Cancellations)	(8,875)	(53,825)
Net:	End of Period	$ 162,325	$ 171,200

10. Notes Payable and Other Liabilities to Insured Institutions - The FSLIC had outstanding negotiable notes to purchase ICCs and promissory notes to purchase ICCs and NWCs. Generally, variable interest is paid semi-annually based on the cost of Federal Home Loan Bank System Obligations or the average auction yield for United States Treasury Notes with maturities from 5-10 years. In addition to issuing notes to purchase ICCs and NWCs, the FSLIC had also issued notes to insured institutions who have acquired the deposits of defaulted S&Ls. The principal on these notes may be paid through the transfer of cash and/or assets to the acquirer. The interest on these notes is paid either quarterly or semi-annually based on various indices. The weighted average rate as of August 8, 1989 was 9.56%. In addition to these notes, FSLIC had other liabilities to acquiring institutions of $289.0 million.

The aggregate amount of the Notes Payable to Insured Institutions and their maturity dates as of August 8, 1989 are as follows:

	ICCs	NWCs	Acquirers & Other	Total
		(in thousands)		
1989	$ 0	$ 0	$ 2,284,177*	$ 2,284,177
1990	58,801	0	475,238	534,039
1991	1,000	0	174,756	175,756
1992	15,000	16,300	174,756	206,056
1993	0	33,825	1,980,244	2,014,069
1994	0	60,950	54,636	115,586
Later	27,000	51,250	13,606,468	13,684,718
Total	$101,801	$162,325	$18,750,275	$19,014,401

* Includes $2,036,478 in renewable notes.

11. Joint Lending Program - On February 23, 1989, the Bank Board and the Federal Reserve Board announced the establishment of the Joint Lending Program, as an interim measure, to meet the liquidity needs of troubled savings and loans. To be eligible for this cooperative venture, a thrift had to have exhausted its normal sources of liquidity, including FHLBank advances, brokered deposits, and funding from repurchase agreements.

Under the program, funds for these eligible thrifts were shared by using Federal Reserve resources (45%), FHLBank resources (45%), and FSLIC resources (10%). The FSLIC resources were derived from its $750 million borrowing authority with the U.S. Treasury. Had funds from FSLIC's U.S. Treasury borrowings been exhausted, the FSLIC's share of lending to individual thrifts would have been shared 50-50 by the FHLBanks and the Federal Reserve Banks.

As of August 8, 1989, $120.6 million in loans were outstanding under the program and FSLIC had utilized $34.8 million of its U.S. Treasury borrowing authority. All outstanding loans from the Federal Reserve and Federal Home Loan Banks were guaranteed by FSLIC and have subsequently been repaid by member institutions. The $34.8 million owed to FSLIC remains as an accounts receivable, and its repayment will be used to pay an off-setting accounts payable to the U.S. Treasury in full satisfaction of the FSLIC's borrowings covered by this program.

12. Allowance for Loss - Assistance Agreements - The FSLIC entered into assistance agreements, which were usually associated with mergers, to prevent the default of insured institutions. Under these arrangements, the Corporation agreed to give financial assistance over time. All future cash outlays are estimated and discounted to their present value using discount rates of 9.86% and 9.64% for August 8, 1989 and December 31, 1988, respectively. The changes in the Allowance for Loss on Assistance Agreements for the periods ended August 8, 1989 and December 31, 1988 are:

	8/8/89	12/31/88
	(in thousands)	
Balance: Beginning of Period	$ 22,645,000	$ 749,069
Add: Provisions	1,301,980	35,794,457
Less: Assistance Provided	1,927,985	13,898,526
Balance: End of Period	$22,018,995	$ 22,645,000

13. Allowance for Loss - Unresolved Cases - The Corporation established a liability for future assistance to, or liquidation of, troubled institutions. The recorded liability represented the present value of future Federal assistance that is probable and can be reasonably estimated as of August 8, 1989. Present value discount rates of 8.61% and 9.95% were used for August 8, 1989 and December 31, 1988, respectively. The liability was determined by using Federal Home Loan Bank Board thrift financial reports and FHLBank estimates to adjust the liability for anticipated asset write downs, interest rate market adjustments, and projected resolution costs.

A comparison of the August 8, 1989 and December 31, 1988 Allowances for Loss on Unresolved Cases indicates a $11.7 billion on-statement increase that is primarily the result of additional operating losses incurred and projected within the savings and loan industry subsequent to the 1988 Financial Statements. Various uncertainties could cause this estimate to further increase or decrease. Changes in the Allowance for Loss on Unresolved Cases for the periods ended August 8, 1989 and December 31, 1988 are:

	8/8/89	12/31/88
	(in thousands)	
Balance: Beginning of Period	$ 43,550,000	$ 17,400,000
Add: Provisions	11,690,000	26,150,000
Balance: End of Period	$ 55,240,000	$ 43,550,000

14. Retirement Plan - Approximately 31% of the FSLIC's employees are covered by the Civil Service Retirement System (CSRS), which is currently two-tiered. For employees hired prior to January 1, 1984, the FSLIC withheld approximately 7 percent of their gross earnings. This contribution was then matched by the FSLIC and the sum was transferred to the Civil Service Retirement Fund, from which this group will receive retirement benefits.

    For employees hired on or after January 1, 1984, with more than five years of service (not necessarily continuous), the FSLIC withheld, in addition to Social Security withholdings, .94 percent of their gross earnings, but matched such withholdings with a 7 percent contribution. At the point such earnings exceeded the FICA maximum wages of $48,000 for 1989, employees covered under this tier of CSRS were required to have 7.51 percent of their earnings withheld, while the agency expense matched this withheld amount. This second employee group will receive retirement benefits from the CSRS along with the Social Security System, to which they concurrently contribute.

    Beginning in January 1987, all employees hired since January 1, 1984, either as new employees or as having less than 5 years of accumulated service (with a break in service over one year) are included in the new Federal Employee Retirement System (FERS). For such employees, the FSLIC withheld .94 percent of their gross earnings and matched those withholdings with a 12.86 percent contribution. This group of employees will receive benefits from the FERS, as well as the Social Security System, to which they concurrently contribute. The retirement expenses incurred for all plans during the periods ended August 8, 1989 and December 31, 1988 were $2,025,133 and $2,323,854 respectively.

    Although the FSLIC funded a portion of pension benefits under both of the above Retirement Systems relating to its employees and made the necessary payroll withholdings from them, the FSLIC did not account for the assets of either retirement plan nor did it have actuarial data with respect to accumulated plan benefits or the unfunded pension liability relative to its employees. These amounts are reported by the Office of Personnel Management for both Retirement Systems and are not allocated to the individual employers. The Office of Personnel Management accounts for all health and life insurance programs for retired federal employees.

15. Lease Commitments - At the beginning of 1989, FSLIC was leasing office space in five Washington D.C. locations. FSLIC's rental expenses for the period ending August 8, 1989 were $5.2 million. As a result of FIRREA, FSLIC's lease obligations were transferred to various FIRREA mandated agencies.

16. Litigation - As of August 8, 1989, FSLIC was named in numerous legal or administrative actions while serving in its corporate, receivership, or conservator capacities. Currently, it is not possible to predict the eventual outcome of the various actions. However, it is management's opinion that these claims will not result in liabilities to such an extent that they will materially affect the FSLIC's financial position.

17. Reserves - As of August 8, 1989 and December 31, 1988, the Corporation's Primary Reserve consisted of the following:

	8/8/89	12/31/88
	(in thousands)	
Balance: Beginning of Period	$ (74,991,090)	$ (13,690,220)
Net Loss	(13,415,354)	(65,950,870)
Capital Stock	105,500	367,500
Capital Certificates	1,544,500	4,282,500
Balance: End of Period	$ (86,756,444)	$ (74,991,090)

Title III, Section 304 of CEBA authorizes the FSLIC to issue equity in the form of redeemable non-voting Capital Stock and non-redeemable Capital Certificates. The non-voting Capital Stock is issued in an amount equal to the aggregate investment by the FHLBanks in the Financing Corporation. The Financing Corporation is the sole purchaser of both the Capital Stock and Capital Certificates, and proceeds paid to the FSLIC from that purchase are included as part of its Primary Reserve. The FSLIC was prohibited from paying any dividends to the Financing Corporation on the Capital Stock or Certificates.

18. Supplementary Cash Flow Information

	8/8/89	12/31/88
	(in thousands)	
Noncash Investing Activities:		
Increase in S&L Stock	$ 1,225	$ 48,000
Increase in Collateralized Advances due from Receivers	0	234
Decrease in Collaterlized Loans *	(30,000)	(70,000)
Increase in Loans to Receivers	0	10
Increase in Other Loans to Insured Institutions	0	73,433
Decrease in Income Capital Certificates	(47,497)	(1,227,730)
Decrease in Net Worth Certificates *	(8,875)	(53,825)
Total Noncash Investing Activities	(85,147)	(1,229,878)
Noncash Financing Activities:		
Increase in Notes Payable	50,419	16,599,901
Decrease in Notes Payable - FHLB *	(30,000)	(70,000)
Total Noncash Financing Activities	20,419	16,529,901
Total Noncash Investing and Financing Activities	$ (64,728)	$ 15,300,023
Cash paid during the year for: Interest Expenses	$1,120,991	$ 466,531

* 1988 presentation was revised to conform with GAAP.

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