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Thrift Crisis: Strategic Plan for Resolution
Trust Corporation and Management of FSLIC
Deals

Statement of
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Before the
House Committee on Banking, Finance and
Urban Affairs
House of Representatives



Thrift Crisis: Strategic Plan
for the Resolution Trust Corporation
and Management of FSLIC Deals

SUMMARY OF STATEMENT BY
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The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 requires the Resolution Trust Corporation Oversight Board to issue a strategic plan for RTC resolution of thrifts for which a conservator or receiver had been appointed between January 1, 1989 and August 8, 1992. The Act also requires that GAO review the cost and management of the FSLIC resolutions that occurred between January 1, 1988 and FIRREA's enactment. GAO is testifying today to provide its views on the RTC Strategic Plan and on the results of its work to date on the FSLIC resolutions.

GAO believes that the Oversight Board's Strategic Plan presents the Board's policies in a reasonably comprehensive and understandable manner and that, with the issuance of implementing procedures and certain additions, it can serve as a roadmap for RTC operations. More information is needed on:

- the proposed method of acquiring working capital;
- the applicability of FIRREA provisions to thrifts still in conservatorship;
- harmonization of the sale of assets held by federal agencies;
- RTC's organization and management processes, including its method of monitoring cost exposure, expenditures, and conflict of interest abuses; and
- policies for implementing RTC's menu approach to sales of institutions.

GAO's preliminary work on the FSLIC transactions has borne out its earlier concerns that they would be extremely difficult to manage. And, it is GAO's general impression that FDIC, which was given responsibility for managing the assistance agreements, has not given its new responsibility sufficient priority. GAO has found problems in several areas so far related to assistance agreement management that need to be corrected. These include a failure to (1) complete the initial inventory audits of acquired thrifts, (2) provide guidance on appropriate asset management and disposition strategies and, (3) develop a covered asset tracking system. This is troublesome because the agreements include provisions that can be used to limit their cost, which are presently estimated by FDIC to be approaching \$40 billion in present value terms.

Mr. Chairman and Members of the Committee:

We are pleased to participate in your hearings on the Resolution Trust Corporation Oversight Board's strategic planning efforts and other aspects of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. My testimony covers two areas. First, I will discuss our views on the Strategic Plan. Then, I will provide some preliminary observations on the quality of oversight of the FSLIC thrift resolutions that occurred between January 1, 1988 and FIRREA's enactment.

RTC STRATEGIC PLAN

The Oversight Board's Strategic Plan for RTC operations presents the Board's policies in a reasonably comprehensive and understandable manner. But there are still several key areas of policy and procedure that need to be addressed more fully in the Plan or in the implementing procedures. Once those areas are addressed and implementing procedures published, the Plan should serve as a good roadmap for the operation and oversight of the RTC.

Areas Requiring More Explanation

We are disappointed that the Oversight Board has not finalized its plans for meeting RTC's working capital needs. Working capital is crucial to an efficient and economical case

resolution and asset disposition strategy. The joint RTC and Oversight Board letter dated January 16, 1990, to the Chairman of the House Committee on Ways and Means, says that three options are still under review: borrowing through the Federal Financing Bank (FFB); having RTC conservatorships borrow additional funds from the Federal Home Loan Banks; and packaging brokered deposits issued by thrifts for private placement.

The January 16 letter implies that a two-dimensional approach to the working capital issue is under consideration. Borrowing through the FFB would be used to finance assets acquired from thrift resolution actions until such assets can be sold. The other two options appear designed to reduce working capital needs through sale of assets while thrifts are still in the conservatorship program, and, at the same time, reduce operating losses by replacing high cost deposits with potentially lower cost ones.

We have said before and we continue to believe that the lowest cost source of cash for RTC's working capital would be Treasury borrowing (either directly, or indirectly through the FFB).¹

This is also in keeping with our view that government activities should be fully reflected in the budget. It is not apparent at this time how the other two options would contribute to the least

¹Testimony before the House Ways and Means Committee, October 31, 1989 (GAO/T-GGD-90-7.)

cost completion of RTC's mission. Such a determination cannot be made without specifics on these two options and how they would be integrated into RTC's case prioritization and resolution policies.

The Plan includes some policy guidance on the management of thrifts in RTC's conservatorship program. However, it does not specify how FIRREA provisions relating to asset sales, affordable housing, minority contracting and other matters will be applied to thrifts in true conservatorship.

The Strategic Plan sheds little light on how asset management and disposition efforts will be coordinated and harmonized across the federal government. The RTC and other federal agencies holding nonperforming loans and foreclosed property must avoid working at cross purposes. Other federal agencies that hold real property are not bound by FIRREA's anti-dumping provisions. A real danger is that the enormous amount of real estate assets in federal inventories could tempt some federal agencies to quickly reduce holdings in anticipation of a growing surplus in real estate markets that may occur once RTC begins to actively market its assets. Such a development could impair RTC's ability to carry out its mission, as well as depress real estate markets generally. To avoid this outcome, it is essential that a coordinated strategy for effectively managing and disposing of the federal government's inventory of assets be developed.

Because of the Oversight Board's membership, it is in the best position to bring this about.

The Plan does not specify how RTC is to be organized and managed. We feel that either the Strategic Plan, its implementing procedures, or other planning documents need to address RTC strategies for ensuring accountability structures. Systems for obtaining and using management and other information, accounting systems, standards for personnel performance, and assessments of overall management capacity are needed. These systems and procedures are particularly important in view of the decentralized manner in which the RTC apparently intends to operate. Decentralized decisionmaking requires different and more complex controls and management oversight structures than would be necessary for a centralized organization.

The Plan does not specify how RTC is going to monitor its financial obligations as they relate to the obligation limitation in FIRREA. It is also not clear how RTC will track its potential cost exposure from thrifts that are currently being managed in the conservatorship program and from those that will fall within RTC's control. Given the financial magnitude of RTC's job, it must have a good system for monitoring its obligations, estimating the value of assets under its control, and evaluating its exposure to thrifts that will likely require resolution. This information is important for RTC to adequately plan for its

financial needs. Furthermore, if RTC's experience resolving thrifts and managing conservatorships reveals that the estimated cost of case resolutions exceeds the \$50 billion provided in FIRREA, the agency must be prepared to promptly notify Congress of the increased need.

We also are concerned with the Oversight Board's intention to allow potential acquirers to bid on a wide variety of resolution structures. As we understand this approach, potential acquirers may bid on the whole thrift, on the thrift's liabilities and certain assets, on individual branches, or on other combinations of the thrift's components.

The Board expects that this approach will provide RTC with the greatest opportunity to maximize the cost effectiveness of its resolutions. While this approach could yield the highest return, it may be difficult to assure that such a result has occurred because different bids on different pieces of a thrift may be very difficult to accurately compare. This difficulty could result in delays in the resolution process while extensive costing and comparisons of bids is done. It could also result in uncertainty about whether the RTC has accepted the most cost effective resolution. The complexity of the process could confuse bidders and bring about allegations of unfairness. It is critical that RTC bidding procedures and case resolution

decisions be understood and defensible. A broad menu approach to bidding could diminish the likelihood of that outcome.

At the present time we do not have much information on what is contemplated in carrying out this approach to case resolution. And, since it has not yet been implemented, there are no results to evaluate. Because this approach is new and untested, it should be used first on a limited basis and adopted as a matter of general policy only after it is proven worthy of expansion.

As a final matter, I want to emphasize the importance of protecting against conflict of interest and ethical abuses. The RTC will, according to the Oversight Board's Strategic Plan, rely heavily on the private sector to manage and dispose of assets acquired in case resolutions. The Plan also notes the importance of contract incentive structures and protections against conflict of interest and ethical abuses. These protections must be carefully designed and constantly reinforced, but should not be so burdensome that they become a barrier to doing business.

The FDIC has very limited experience with use of the private sector for asset management and disposition. We intend to carefully assess the guidance and procedures relating to contracting when they are issued. We also intend to devote considerable time to evaluating how well RTC is monitoring private sector compliance with the terms of the contracts.

MONITORING FSLIC TRANSACTIONS

FIRREA requires us to examine and monitor insolvent institution cases resolved by the Federal Savings and Loan Insurance Corporation (FSLIC) from January 1, 1988, through the date of its enactment, on August 9, 1989, and to provide cost estimates for all the transactions. We are to report on this work by April 30, 1990. Today I would like to discuss our approach to this work and offer some preliminary observations.

To carry out our mandate, we are working with the Federal Deposit Insurance Corporation (FDIC) and the Office of Thrift Supervision (OTS) to develop summary data on assisted thrift compliance with the terms of the agreements and forbearances. We are also evaluating the systems that FDIC and OTS are developing to oversee and assure compliance. In addition to a general review of these systems, we are examining, in detail, 5 very large transactions to test the quality of FDIC's and OTS's oversight.

In our March 11, 1989, testimony before this Committee we indicated that the transaction agreements would be extremely difficult to administer because of their structure and complexity and because of the long period of time that the federal government remains exposed to risk.² Our preliminary work has

²Testimony before the Committee on Banking, Finance and Urban Affairs, (GAO/T-GGD-89-10.)

borne out this concern. And, it is our general impression that FDIC, which now has responsibility for managing the assistance agreements resulting from the FSLIC transactions, has not given this new responsibility sufficient priority. This is troublesome because the assistance agreements include provisions that can, if properly administered, limit the government's risk exposure on these transactions that currently have an estimated present value cost approaching \$40 billion. We have found problems in several areas so far that need to be corrected.

First, FDIC has no overall written strategy for covered asset disposition nor is there any formal guidance on the criteria to be used for approving or disapproving various asset plans submitted by acquirers. Without FDIC guidance on the appropriateness of the various asset management and disposition approaches being proposed by the assisted thrifts, there is little assurance that the government's cost and risk exposure are being minimized. This lack of FDIC guidance also diminishes the ability of thrifts formulating plans to determine what constitutes an acceptable approach to asset management.

For example, certain asset management plans propose the sale of covered assets with financing from the assisted thrifts. Under the terms of most of the agreements, the new financing itself will become a covered asset and therefore the assisted thrift can continue to receive the guaranteed yield as well as capital loss

coverage on its book value. While the agreements with the assisted thrifts allow for the possibility of such transactions, there is no FDIC guidance on whether these types of transactions should be approved or disapproved even though they can expose the government to continued risk and cost long after the covered assets have been placed with new owners.

FDIC's lack of guidance for approving assisted thrifts' asset management plans is surprising since the RTC, which is managed by the FDIC Board of Directors, has developed fairly extensive guidance and policies in its Strategic Plan on this and other issues concerning how assets are to be managed and sold. We have discussed this problem with the responsible FDIC officials, who told us that policy guidance would be developed. We intend to follow up with the FDIC to ensure that this is done promptly.

In addition to a lack of policy guidance, there is no management information system for tracking either the amount of covered assets in assisted thrifts or progress made in meeting the goals outlined in the various asset management plan submissions. FDIC cannot tell us, for example, the current amount of covered assets, which had totaled about \$60 billion at the time of the resolutions. FDIC told us that they have an asset tracking system which is in the process of being implemented, but officials do not know when it will be fully operational. The

development of this system needs to be accorded a higher priority than it has received to date.

Our other concern relates to the initial inventory audits of the thrifts sold by FSLIC. FDIC needs to expedite the completion of these audits because they are critical to effective management of the FSLIC Thrift Resolution Agreements. The purpose of these audits is to account for all the assets and liabilities of each failed thrift and to determine its negative net worth at the time of sale. These audits are the basis for final determinations of both the amount of the negative net worth assistance payment and the universe of covered assets. Until the audits are finalized by FDIC, the quarterly payments to the assisted thrifts for interest on negative net worth notes and for yield maintenance on covered assets will continue to be based on estimates that may prove incorrect.

These inventory audits were to have been completed 180 days after the date of each of the transactions, or, for the most part, by mid 1989. We found that only 9 of the 152 required audits have been finalized so far. Review and approval of the rest is way behind schedule. Divided responsibility for the audits within the Federal Home Loan Bank Board and, then, within FDIC contributed in the past to the delays. Continued delays are, according to FDIC officials that are now responsible for the audits, due to a lack of resources.

The results of the 9 finalized audits, which were for relatively small thrifts and cannot be generalized, show that the negative net worth of the acquired thrifts was about 13 percent higher than estimated at the time FSLIC entered into the transactions. An increase of an estimated \$13.8 million in negative net worth assistance will be provided to the acquirers of 7 of the 9 thrifts, while there will be a decrease of an estimated \$1.4 million for the other two thrifts.

While only 9 of the 152 audits have been finalized, the preliminary draft reports on another 105 have been submitted by the firms doing the audits and are being reviewed by FDIC. We intend to incorporate the results of the finalized and preliminary draft audits into our report on the cost of the FSLIC transactions. Our report will also present an estimate of the total cost to the federal government and a comparison of current estimates with the administration's estimates of cash flows prepared during the deliberations on FIRREA.

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That concludes my prepared statement. My colleagues and I would be pleased to answer questions.