United States General Accounting Office 144489

GAO

Testimony

144489

For Release
on Delivery
Expected at
2:00 p.m. EDT
June 17, 1991

Resolution Trust Corporation:

Update on Funding and Performance

Statement of
Richard L. Fogel
Assistant Comptroller General
General Government Programs

Before the
RTC Oversight Task Force
Subcommittee on Financial Institutions
Supervision, Regulation and Insurance
Committee on Banking, Finance and
Urban Affairs
House of Representatives

Resolution Trust Corporation:
Update on Funding and Performance

SUMMARY OF STATEMENT BY
RICHARD L. FOGEL
ASSISTANT COMPTROLLER GENERAL
GENERAL GOVERNMENT DIVISION

From inception, GAO has been concerned about RTC's vulnerability to fraud, waste, and mismanagement. During the year, GAO has brought many concerns to the attention of RTC and its Oversight Board so they could correct underlying problems as quickly as possible.

In the past, GAO reported that the $80 billion already provided by Congress will not be sufficient to resolve all expected thrift failures. RTC's sales of troubled assets have been slower than expected and proceeds are likely to be lower than anticipated. As a result, resolution costs are likely to exceed the high end of RTC and Oversight Board estimates. In February, GAO said that RTC would need at least an additional $50 billion in 1992. This amount could increase significantly, however, if RTC accelerates its resolution schedule, or more thrifts than predicted fail.

It is also likely that some of RTC's working capital will not be repaid from asset sales proceeds, especially in light of a new RTC policy that allows it to aggressively discount distressed properties. Such a practice means that proceeds could be significantly lower than previously anticipated and less than what is needed to pay back RTC borrowings. This too would require additional funding.

RTC has had a great deal of difficulty in reconciling its accounts and was late in supplying its financial statements to GAO. Because of this and the complexity of estimating asset values, GAO will be unable to provide Congress with its audit opinion by the June 30 reporting date. GAO expects that its report to Congress will say the values shown in the financial statements are uncertain and subject to significant change.

GAO points out that the concerns it has raised over RTC's stewardship of thrift assets and the vast sums of taxpayer dollars it is spending are evidence of the urgent need for accounting and auditing reforms for financial institutions. Any plan to recapitalize the Bank Insurance Fund or to provide additional resolution funding to RTC without fundamental reforms to correct accounting and internal control problems will only perpetuate the problems that have contributed significantly to the demise of the insurance funds. Also, if the expanded bank powers that Congress is now considering are enacted without accounting and internal control reforms, losses to the Bank Insurance Fund are likely to worsen. Under these circumstances a future taxpayer bailout is quite possible.

In February, GAO expressed concerns about RTC's performance in managing conservatorships, resolving thrifts, selling assets, managing information, and contracting. GAO identified many areas where RTC needed to improve management and strengthen internal controls. In response to these concerns, Congress included specific management reforms in RTC's Funding Act that require improvements in these areas. RTC is taking a number of actions to address these requirements. Further, it anticipates that the pace of resolutions and asset sales will increase between now and September 1991. GAO will continue to monitor RTC's implementation progress.

RTC's progress in developing a sound information resources management program has been disappointing, but it is working hard to develop a compreshensive program. In this regard, the Funding Act required that RTC establish a strategic information resources management plan. It is doubtful that an adequate plan will be available by the end of June, as RTC planned, however. GAO is concerned about the systems development practices RTC is applying to develop its systems. GAO will be reviewing RTC's progress in addressing our concerns and in acquiring its asset information systems over the next few months.

GAO also suggests that discussions continue on the issue of whether RTC should be restructured and that Congress obtain the views and recommendations of the RTC Oversight Board.

Mr. Chairman and Members of the Committee

We are pleased to be here today to provide our views on the Resolution Trust Corporation's (RTC) estimates for future funding, the status of RTC's current operations and initiatives, and our observations about restructuring RTC.

From RTC's inception, we have been concerned about its vulnerability to fraud, waste and mismanagement for several reasons: the large dollar value of the assets under its control; the heavy reliance to be placed on private sector contractors; and the need for strong management information systems. During the year, we have brought our specific concerns about RTC's performance to the attention of the Oversight Board and RTC senior management so they could correct them as soon as possible and deal with the underlying deficiencies.

RTC has accomplished a great deal in resolving a large number of thrifts and selling assets. These accomplishments reflect RTC's perseverance in spite of the magnitude of the challenges it faces. But, the most difficult challenges still await RTC. Additional failed institutions will need to be resolved in an environment of shrinking demand and less marketable assets will require that RTC make intensive efforts to sell them in accordance with the objectives of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA).

The unparalleled dimensions of this effort places a special obligation on RTC to carry out its efforts as efficiently and effectively as possible. Therefore, as part of the Funding Act, Congress mandated several management reforms that require RTC to make improvements in conservatorship operations, asset disposition, information management, and contracting. In recent testimony before this Task Force RTC's Executive Director said that the Corporation is taking a number of actions to address the requirements for better management and stronger internal controls. The Funding Act requires RTC to report to the Congress by the end of September on its progress in meeting these requirements. Because of the importance of these actions, GAO will monitor RTC's progress in implementing them.

RTC FUTURE FUNDING NEEDS

The message I have to deliver related to RTC future funding needs is not a good one. The $80 billion already provided by the Congress will not be sufficient to resolve all expected thrift failures. Due to the current economic recession, we are seeing a slow but steady increase in the number of institutions with negative earnings and negative or low capital. Most or all of these troubled thrifts will eventually require resolution. In addition, market conditions have negatively impacted RTC's ability to sell the assets it has in receiverships. RTC sales of troubled assets have been slower than hoped and future proceeds will likely be lower than anticipated. As a result, resolution costs are likely to reach or exceed the high end of the estimate range produced by RTC and its Oversight Board.

At present the Oversight Board's high estimate for resolving 1,000 failed institutions totals approximately $155 billion on a cash basis. RTC estimates produced for its unaudited 1990 financial statements are slightly lower than $155 billion. The $50 billion provided by FIRREA and the $30 billion Treasury appropriation approved by the Congress in March 1991, represent only the first two payments on RTC's total bill. According to RTC's operating plan for April through December 1991, that appropriation will not be enough to fund the resolutions RTC has planned for the period. By December 31, 1991, RTC plans to have resolved 684 institutions at a cost of $85 billion--$5 billion more than currently provided. Obviously, RTC will need to request additional funds for resolutions during fiscal year 1992.

In February, we said that RTC would need at least $50 billion in 1992. We have not yet seen RTC's expected resolution schedule for 1992 but we believe that $50 billion will remain the minimum necessary funding for the year. If RTC attempts to resolve all remaining troubled thrifts in that timeframe, its funding needs will be much higher. On the other hand, if RTC puts the remaining troubled thrifts into conservatorship to be resolved after 1992, its resolution funding needs will extend into 1993.

RTC will also require additional working capital to fund the purchase of failed institutions' assets at resolution and their management until sale. RTC is currently working under an agreement with the Federal Financing Bank (FFB) which allows working capital borrowings of up to $100 billion. However, RTC's operating plan indicates that a new agreement will have to be negotiated with FFB to allow working capital borrowings of $113 billion at December 31, 1991. Given the number and kinds of factors which affect RTC working capital needs, RTC and its Oversight Board are in the best position to estimate its required borrowings. Working capital needs must take into account the timing, number, type and asset value of resolved institutions. In addition, working capital needs increase by the amount of interest that RTC "rolls over" into a new principal borrowing each quarter.

For example, RTC estimates that interest rollovers will total $8 billion through December 1991. However, repayments of loans made to institutions in conservatorship and the proceeds from asset sales in RTC receiverships serve to reduce working capital requirements. These repayments and sales proceeds can be used to replace additional FFB borrowings and/or to pay back borrowings outstanding. Although we have not examined all of RTC's assumptions related to its working capital needs, its borrowings to date appear supported by its resolution activity.

However, some of RTC's working capital may not be repaid from asset sales proceeds. This appears likely in view of RTC's newly adopted policies that allow significant discounts of appraised or expected market values in order to generate asset sales. For example, current RTC policies allow distressed properties to be sold at a 20 percent discount from appraised value within 6 months of marketing, at a 40 percent discount from 6 to 18 months and at 50 percent off from 18 to 24 months. Such aggressive discounting means that RTC could receive much less for an asset than it borrowed from FFB to "purchase" it at resolution. If this occurs, funds will be required to cover the additional loss.

As you know, the obligations limitation formula included in FIRREA, as originally implemented by RTC, established cash reserves to cover possible future losses due to overvaluation of RTC assets in receivership. The reserves, equal to 15 percent of the estimated market value of assets purchased at resolution, were backed by a portion of unspent loss funds. Therefore, if assets sold for up to 15 percent less than estimated, the necessary monies to cover these losses and repay working capital borrowings were already available. However, the cash reserve feature was eliminated when RTC began to exclude Treasury funding from the formula calculation--a move that was legally allowed and approved by the Chairmen of both the House and Senate Banking Committees. As a result, any future losses resulting from differences between the estimated recovery value of RTC's assets and their actual net sales proceeds will require the Congress to provide additional funds at some later date. As an alternative, the Congress could amend FIRREA to reestablish the cash reserve feature and, in effect, provide funding now for unexpected losses arising from asset sales.

RTC and its Oversight Board are producing their estimates of losses and working capital within the limitations of current information; however, these estimates assume recoveries on the sale of failed institutions' assets which may not be realized. The uncertainties which affect recoveries are significant and include the continuing weakness in the economy and the seriously over-built real estate market. The RTC, the Bank Insurance Fund and other entities have a growing portfolio of troubled assets, including vast amounts of real estate. Given the over-built market, the income flows from many of these properties may never support the valuations that were assigned to them when they first entered the government inventory. In addition, RTC's policy of aggressive discounting to sell assets in the near term may have a significant effect on sales proceeds. Due to these factors, the best cost estimates for resolving failed thrifts today could be significantly understated and unexpected losses on asset sales could dramatically increase RTC's funding needs sometime in the future.

We have been working with RTC to complete our audit of its December 31, 1990 financial statements; however, at this time much still remains to be done. RTC was unable to produce its statements before mid-May 1991 in part because of problems with asset accountability and with estimating asset recovery values. The delay was also caused by various internal control and organizational problems. RTC has since initiated a series of changes which we hope will produce more timely statements next year. These changes include designating a chief financial officer, separating RTC's accounting function from that of the Federal Deposit Insurance Corporation, developing a statistical methodology for selecting and testing the valuation of assets in receivership, developing and implementing systems for tracking RTC's asset inventory and its value, and instituting a system of internal controls. The first two initiatives have been accomplished and plans are underway for the others.

To give you a sense of some of these open problems, I want to provide a brief sketch of very basic asset accountability and valuation problems that affected RTC's ability to produce accurate and timely information for its 1990 financial statements. RTC did not begin to reconcile its receivership and conservatorship advances as recorded in its general ledger with amounts recorded in the subsidiary records of its corporate funding group until October 1990. Since then, RTC has spent a great deal of time and effort on the reconciliation process. However, RTC was not able to produce a complete reconciliation of its December 31, 1990 records until April 1991. Also, RTC headquarters is still unable to track all its assets in receivership or to provide information related to the book value, estimated recovery value, date of sale, sales price, and sale gain/loss on an individual asset basis. Instead, RTC must request asset information from each receivership and then perform a "roll-up" at headquarters. At December 31, 1990, the detail supplied by individual receiverships did not reconcile to RTC's general ledger totals. Without assurance that receivership inventories are correct and without historical sales information for comparison, RTC cannot evaluate the reasonableness of its estimated asset sales recoveries.

Given the late receipt of RTC statements and the need to carefully test and evaluate its estimating methodology, we will be unable to provide the Congress with our audit opinion by the June 30 statutory reporting date. Also, due to the uncertainties discussed earlier, we expect that our report to the Congress will say the values shown in the financial statements are uncertain and subject to significant change--the amount of which cannot be reasonably estimated. I would like to stress that the uncertainties we have been discussing do not relieve RTC of the responsibility for continuing to produce its best estimates of expected asset recovery values for the Congress to use in its funding decisions. On the contrary, uncertainties make it even more important for RTC to continue to refine its methodology and to examine quarterly the resulting estimates in light of current conditions.

ACCOUNTING AND AUDITING REFORMS

The concerns we have raised over RTC's stewardship of the assets it has acquired from failed thrifts and the vast sums of taxpayer dollars RTC is spending to protect insured deposits are further evidence of the urgent need for accounting and auditing reforms. In April, we reported to the Chairmen of the Senate and House Banking Committees that internal control weaknesses continue to be a significant cause of bank failures and that the regulatory early warning system to identify troubled banks is seriously flawed[1]. We previously reported that internal control weaknesses contributed significantly to bank failures in 1987 as well as to thrift failures[2]. In reviewing 39 banks that failed in 1988 and

---

[1] Failed Banks: Accounting and Auditing Reforms Urgently Needed (GAO/AFMD-91-43, April 22, 1991).

[2] Bank Failures: Independent Audits Needed to Strengthen Internal Controls and Bank Management (GAO/AFMD-89-25, May 31, 1989) and Thrift Failures: Costly Failures Resulted From Regulatory Violations and Unsafe Practices (GAO/AFMD-89-62, June 16, 1989).

1989, we found that the same weaknesses were a major cause of bank failure.

The breakdowns in corporate governance by bank management and boards of directors, combined with flexible accounting rules, have led to both bank failures and a seriously flawed early warning system to identify troubled banks. We are concerned that this serious problem is continuing to cost the industry and the taxpayer dearly. Our April report, which you have received, contains our specific recommendations for improving financial management and controls at federally insured depository institutions.

The Bank Insurance Fund balance is dangerously low and needs to be recapitalized. The RTC will need at least another $50 billion to resolve troubled thrifts. Any plan to recapitalize the Bank Insurance Fund or to provide additional resolution funding to RTC without fundamental reforms to correct accounting and internal control problems will only perpetuate the problems that have contributed significantly to the demise of the insurance funds. Also, if the expanded bank powers that the Congress is now considering are enacted without accounting and internal control reforms, losses to the Bank Insurance Fund are likely to worsen. Under these circumstances a future taxpayer bailout is quite possible.

MANAGING CONSERVATORSHIPS

RTC had assumed control of 578 thrifts as of March 31, 1991; 374 of these have been resolved and 204 are in conservatorship. Another 164 thrifts have been identified by the Office of Thrift Supervision as likely to be transferred to RTC, and another 378 have an uncertain future. The inventory of actual and estimated failed thrifts increased from 1,066 institutions on December 31, 1990 to 1,120 on March 31, 1991. This constitutes an overall increase of 54 institutions since December.

The main objectives of RTC's conservatorship program are to take control of weak institutions, eliminate wasteful and unsound operations, and prepare the institutions for resolution. Earlier this year, we said that RTC's conservatorship program seemed to be operating reasonably well. But, we felt oversight needed to be strengthened.

RTC has undertaken several initiatives in this area. The Funding Act required RTC to increase the pace of resolutions with a goal of shortening the length of time that thrifts stay in conservatorship. RTC officials told us that starting in April 1991 they would give priority attention to resolving older conservatorships, and they anticipated that by September 30, 1991, virtually all institutions that were in conservatorship as of March 15, 1991, would be resolved. Our review of 22 thrifts showed that RTC has been giving priority to older conservatorships. In April and May 1991, 19 of the 22 thrifts resolved had been in conservatorship more than the average amount of time.

To meet its September goal, however, RTC will need to resolve approximately 185 more thrifts or 46 thrifts per month. To date, RTC has only met or exceeded this number in the second quarter of 1990, when it averaged about 52 resolutions per month. So the challenge before the RTC is substantial.

The Funding Act also required RTC to develop and implement standardized procedures for auditing conservatorships to monitor managing agents' performance and ensure compliance with policies and procedures. RTC has a task force that is preparing new policies and procedures for conservatorship audits and managing agent oversight and training. We plan to review them before they are finalized later this month. We will continue to monitor RTC's progress in this area to ensure that these steps are carried out effectively.

RESOLVING THRIFTS

RTC continues to prioritize thrifts for resolution, market them, and select resolution methods and acquirers in a manner that is generally consistent with its broad policies of minimizing costs and ensuring fairness and openness to bidders. As of March 31, 1991, RTC had resolved 374 institutions with assets totalling about $145 billion.

As shown in chart 1, of the 374 thrifts RTC had resolved, 194 were purchase and assumption transactions, in which all deposits, certain other liabilities, and a portion of the assets were sold. Another 128 were insured deposit transfers, in which the acquiring institution served as paying agent for RTC with regard to the insured deposits and frequently purchased some of the assets. The remaining 52 were insured deposit payouts, in which RTC directly paid depositors the amounts of their insured deposits and retained all the assets. For the 322 resolutions that were not deposit payouts, about $1.8 billion was saved over the estimated payout cost, a 3.9 percent savings.

As shown in chart 2, the 374 resolved thrifts held about $145 billion in assets. However, more than half of these--$86 billion--were retained by RTC. And of the $59 billion that were transferred to acquirers, about $37 billion were purchased with an option that allowed the acquirers to sell them back to RTC within specified timeframes. Chart 2 also shows that at March 31, 1991, about $16 billion of these assets had been returned to RTC, and $12 billion still could be returned.

Several improvements have been made in the resolution process this year. Methods for offering assets for acquisition at resolution have been revised to be more responsive to the market and the length of time in which assets could be returned was shortened significantly. Previously, RTC offered only whole thrifts when accepting bids. Starting in March, 1991, it began offering them on a branch-by-branch and branch cluster basis for almost all transactions. This change is intended to enhance the marketability of failed thrifts and better enable smaller banks and thrifts to participate in the bidding process. Also, RTC now lets organizations that bid on the initial offering indicate if they wish to be contacted if no acceptable bids are received and RTC is going to proceed with an insured deposit transfer. We support both of these actions as a way of expanding the market for such transactions.

SELLING ASSETS

The most difficult task RTC faces is effectively marketing and disposing of the assets it now owns from several hundred closed thrifts. While everyone would like to see as many assets sold as quickly as possible for as much as possible, that dual expectation may be very difficult to realize.

Chart 3 shows how much of the total value of each asset category RTC has disposed of and how much remains in inventory at March

31, 1991. Chart 4 shows that of the total value disposed of, more than half has been through sales and the remainder through collections. Specifically, from inception, RTC has sold $87 billion and collected $60 billion, leaving a balance of $162 billion in inventory as of March 31.

Selling Financial Assets

As chart 3 shows, the largest categories of assets are financial assets. These assets included cash and securities, mortgages and other loans. The book value of these assets when RTC assumed them was about $260 billion. As of March 31, 1991, RTC's financial asset inventory totaled $129 billion. This represents 80 percent of RTC's total assets.

Most of RTC's financial assets are in categories which should be readily marketable. As of March 31, 1991, about 64 percent of RTC's total inventory consisted of cash and securities and performing loans. But, the job RTC faces in selling assets that are not as marketable, such as delinquent loans, will prove to be more challenging.

In February, we were concerned because improvements were needed in RTC's three financial asset disposition programs--securities sales, bulk loan sales, and securitization. While RTC's headquarters-based Capital Markets Branch had made good progress in putting together large packages of securities from a number of institutions and selling them, securities were also being sold, less efficiently, by individual institutions in conservatorship. Also, RTC needed to coordinate and consolidate bulk loan sales efforts and standardize processes for due diligence[3] and marketing to compete more effectively in the marketplace. In addition, securitization efforts were delayed because of RTC's concern that directors could be held personally liable for misrepresentation about the quality of the securities. Finally, RTC's efforts in all three programs were severely hampered by the lack of adequate information systems to track and manage assets.

A number of RTC actions should improve its performance in financial asset disposition. The Funding Act called for RTC to standardize due diligence and the marketing of 1-to-4 family mortgages. RTC had adopted and communicated to the field in April 1991 a standard procedure for performing due diligence. While we have not yet reviewed the implementation of this procedure, it does conform to industry standards and, from that standpoint, should enhance the marketability of 1-4 family mortgages.

In addition, recent policy changes to introduce negotiation into the later stages of the bulk loan sales process and to offer more

[3]Due diligence is a process in which the records and supporting documentation for individual assets are thoroughly reviewed to generate marketing information and to estimate market value.

creative seller financing have the potential to produce positive results because they also conform to common industry practices. However, these new policies pose very real risks to the taxpayers. These transactions are complicated and the sales amount RTC receives is very dependent on how well it negotiates with the buyer. RTC must be prepared to manage and minimize these risks in order for these strategies to succeed. Therefore, RTC will need to develop specific program guidelines for this activity and ensure it has qualified staff well-versed in these types of transactions.

The directors' liability issue, which was viewed by RTC as a barrier to securitization efforts, was resolved by providing limited immunity to these individuals in RTC's Funding Act. According to agency officials, RTC's securitization efforts can now proceed quickly, with the first issue of securities planned for July 1991. In addition, swap transactions with the secondary mortgage market agencies have been increasing steadily. For example, RTC did only about $524 million in these transactions during its first 18 months of operation, but approximately $1.1 billion have been completed in the past 3 months.

It is critical that RTC develop and implement successful approaches for it to be effective in the sophisticated, well-established markets for securities, mortgages, and other loans.

Financial asset disposition will clearly be an area where we will continue to closely monitor RTC's progress.

Selling Real Estate Assets

From inception to March 31, 1991, RTC has taken control of real estate assets valued at about $23 billion. As of March 31, it had disposed of about $4.5 billion. As shown in chart 5, RTC had 45,172 properties in its inventory at March 31 with a total book value of about $18.4 billion.

In February, we reported that the sale of distressed real estate has been much more difficult than most people expected. The general downturn in the economy had clearly affected RTC's ability to sell real estate. Nonetheless, we were disappointed with RTC's progress in developing the necessary strategies to maximize their ability to sell these assets.

RTC has undertaken a number of initiatives to generate sales. For example, a March 1991 pricing policy change permits RTC to more aggressively adjust the price of distressed real estate to better reflect true market values. As I mentioned earlier in my statement, under the new policy, properties can be sold at 80 percent of appraised value within up to 6 months of marketing, at 60 percent from 6 to 18 months, and at 50 percent from 18 to 24 months. New appraisals would be required for property that had not been sold after 2 years. We agree that price discounting is necessary, however, we are concerned about how this policy will be implemented and what controls will be put in place to ensure fair dealings.

RTC's seller financing policy changes, which will give them an equity position in certain assets sold, also pose risks for taxpayers. These transactions are complicated and RTC's return on their equity position is very dependent on how well the purchaser manages and sells the asset. Therefore, RTC needs to develop specific guidelines as well as ensure it has qualified staff who are well-versed in these types of transactions to implement and oversee them and thereby minimize RTC's risks.

Both of the above changes are designed to increase real estate sales. But to date, few transactions have been completed. RTC anticipates that the pace of sales will pick up between now and September. We will be monitoring this area closely during the coming months.

MANAGING INFORMATION

RTC's progress in developing a sound information resources management (IRM) program has been disappointing, but RTC's information resources management staff is working hard to develop a comprehensive IRM program. A strong IRM program is crucial to building a smooth-functioning information system to oversee the resolution of thrifts and to manage and dispose of assets.

The Funding Act required that RTC establish an IRM program by developing a strategic plan that includes (1) a translation of program requirements into automation needs, (2) a systems architecture, and (3) an identification of corporation information and system needs at all operational levels. To meet this requirement, RTC's Office of Corporate Information has drafted a strategic IRM plan that it expects to complete by June 30, 1991. We are currently reviewing this draft.

According to RTC, a needs assessment has been completed as part of this plan. But, RTC officials told us the assessment did not include the systems and information needs of managing agents who operate thrifts in conservatorship. Until all these user needs are fully addressed, RTC will not have control over substantial information demands which these thrifts will have to respond to in an ad-hoc fashion. In addition, RTC will not be able to assure that information from the field is timely and accurate and supports the effective disposition of assets. We plan to work with RTC officials to strengthen their strategic plan, but it is doubtful that an adequate plan will be available by the end of June.

The Funding Act further required RTC to develop and implement systems to manage its portfolio of securities and to track an inventory of real estate owned assets by September 30, 1991. By that date, RTC plans to have all five of its asset information systems developed and implemented to manage, track and report on all RTC's failed thrift assets. Specifically, RTC is developing a (1) Real Estate Owned Management System; (2) Securities Portfolio Management System; (3) Loans and Other Assets Inventory System; (4) Asset Manager System; and (5) Furniture, Fixtures, and Equipment System.

RTC's Real Estate Owned Management System is intended to replace the current microcomputer-based real estate asset inventory system with a nationwide mainframe system. RTC expects this system to provide its managers with current and accurate information including centralized information needed for property sales and contractor oversight. RTC estimates the system will be operational in mid-July.

The Securities Portfolio Management System is being designed to provide RTC with a centralized database containing information about each security owned or managed by RTC. The system is planned to have sufficient capacity to provide information to automate trading operations and to support the settlement of securities sales. RTC has issued a solicitation of services for this system and is in the final stages of selecting a qualified vendor. RTC expects to have this system developed and implemented by September.

RTC is designing its Loans and Other Assets Inventory System to provide a national inventory system of all RTC loans and other miscellaneous assets at the failed thrifts. RTC wants to replace the existing manual and regional-based automated systems with a consolidated database that permits RTC to expediently collect large volumes of loan data and to track distressed loans and facilitate sales. RTC plans to have this system developed and implemented nationwide by September.

The Asset Manager System is being designed to monitor and track the activities of asset managers under contract to RTC through SAMDA contracts. The system will provide a national database of SAMDA activities, including detailed information on SAMDA asset receipts and disbursements. The system will also make possible the electronic transfer of funds arising from those transactions. RTC is currently developing this system and expects to implement part of it by mid-August.

RTC's Furniture, Fixtures, and Equipment System will be used for automated inventory control and appraisal of furniture, fixtures, and equipment received by RTC through thrift closings. This system is currently in the development phase and RTC expects it to be completed nationwide by September.

According to RTC, these five asset information systems will serve as feeder systems to provide needed financial data to the Financial Information System and summary data to a planned Corporate Information System which will be developed to meet RTC's reporting requirements and management information needs.

Even if RTC's asset systems are completed by September, their usefulness will depend on whether they are completed in accordance with sound systems development principles, and the extent to which they are an integral part of a comprehensive and effective IRM program. From our review of RTC's progress in developing its Real Estate Owned Management System, we are concerned about the RTC's development practices. For example, we are concerned whether this system system will (1) meet user and management needs; (2) have adequate interfaces for the timely transfer of information with other asset systems; (3) have sufficient capacity to adequately support all the systems' users; (4) be adequately tested; and (5) have adequate controls to provide reasonable assurance the information will be secure, accurate, and complete.

Because of the difficulties and potential delays inherent in putting in extensive information systems, like the Real Estate Owned Management System, we will be reviewing RTC's progress in acquiring its asset information systems over the next few months.

CONTRACTING

As mentioned earlier, from RTC's inception, we have been concerned about its vulnerability to fraud, waste and mismanagement because of the large dollar value of assets under its control and its heavy reliance on private sector contractors. To guard against these potential problems, a sound contracting program and strong internal controls are essential.

The Funding Act required RTC to take several actions to improve its contracting system. Specifically, the act stated that RTC should consult on a regular basis with other agencies and organizations that have large scale contracting systems and should review on a regular basis its organizational structure and relationships. Additionally the act required RTC to:

- -- develop a comprehensive policies and procedures manual;
- -- clearly define contracting roles and responsibilities;
- -- set forth detailed contractor evaluation procedures;
- -- develop standardized solicitation and contract documents;
- -- develop standardized contractor training modules; and,
- -- describe several requirements related to minority and women-owned business contracting.

Since the Act's passage RTC has taken steps to implement many of these requirements. Most importantly, RTC has compiled a comprehensive draft contracting manual which defines RTC staff's contracting and contract oversight roles and responsibilities. Standard Asset Management and Disposition Agreement (SAMDA) contract oversight managers are in place and the RTC's Office of Contractor Surveillance has initiated its first two audits of SAMDA contractors focusing on contractor internal controls. RTC also has developed a standardized solicitation for SAMDA contracts and is developing standardized training courses on its contracting procedures.

Overall, RTC's recent progress on the development of its contracting system has been encouraging, but more needs to be done before RTC has a complete contracting system. For example, the proposal evaluation process still lacks objective technical evaluation criteria and financial resource qualification standards. In the contract administration area, RTC needs to create a system of penalties short of contract termination or withdrawal of assets for cause to motivate contractors to comply with contract provisions. Additionally, RTC has not issued final regulations for the minority and women-owned business program, and has not decided how it will meet the Funding Act's requirement to consult with other agencies on the development of its contracting system. Without progress on these issues, RTC cannot be certain the contracts needed to complete the bailout are functioning effectively.

RESTRUCTURING RTC

Frustration with the slow pace of progress in disposing of the assets of failed thrifts has generated proposals about restructuring RTC. Currently, three approaches are being discussed--(1) eliminating the dual board structure (2) consolidating the FDIC and RTC liquidation functions and (3) separating RTC from FDIC.

There are currently two bills before the Senate Banking Committee that propose the elimination of RTC's dual board structure. One would merge the Oversight Board and the RTC Board of Directors to form one nine-member Board of Governors. This board would be composed of many of the same members of the two current boards, plus 5 independent members to be appointed by the President. Another proposal would create one board by dissolving the Oversight Board, and expanding the membership of the RTC Board to include 4 additional full-time members. Both of these bills are based on the premise that the RTC's dual board structure causes confusion, diffused accountability, and inefficiency.

Clearly, there are some complexities in operating with the current dual board structure, and these have been recognized from the outset. Shortly after the dual board structure was created, there was some confusion and delays in decisionmaking. At that time Chairman Seidman said such a structure was unlike anything ever tried in government and that because there were a lot more people involved in making decisions, such a structure would be somewhat slower. If the Congress chooses to change the dual board structure of RTC, some form of a separate oversight function is still important because of the magnitude of the S&L crisis and the need for good accountability.

The approach which would consolidate the RTC and FDIC liquidation functions was advanced recently by the FDIC Chairman. He proposed that RTC's mission be expanded to make RTC the government's entity in charge of liquidating all bank and thrift assets. This approach aims to improve efficiency, but we have not seen any specific proposals yet.

FDIC currently is directly responsible for liquidating about $30 billion in assets, and this amount could grow significantly over the next several years. FDIC's liquidation operations are backed by insurance premiums charged to banks, while RTC's activities are backed by taxpayers. If this were done, a strategy would have to be developed to assure that the taxpayers would not bear the burden for the problems faced by the banks, and conversely, that bank insurance premiums would not be used to fund losses on assets from failed thrifts.

A third approach being discussed seeks to separate RTC from FDIC. This approach is based on the premise that the FDIC's ways of doing business, which rely heavily on disposing of assets using in-house capability, are inappropriate for RTC, which is mandated to rely heavily on the private sector. Proponents of this proposal suggest that the influence of the FDIC culture hampers RTC in carrying out its mission, and that FDIC has its hands full addressing problems with banks.

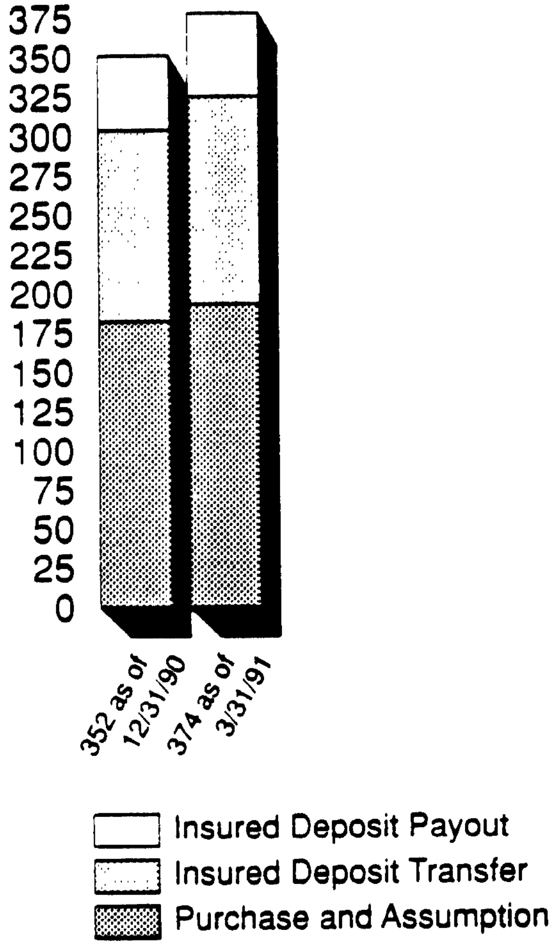
Consideration of this proposal needs to recognize that, as established by FIRREA, RTC is a temporary organization and its 6,000 people are technically FDIC employees. In addition, over 50 percent of RTC's senior managers were with FDIC before RTC was created. If FDIC and RTC were to be separated, clarification would be needed on how such a separation could impact employees. Without such clarification, the resulting uncertainty could be disruptive, and hamper RTC in its efforts to accomplish its mission in an already difficult market environment.

As we said in February 1991, the administration and the Congress need to examine the question of whether the interest of the American taxpayers would be best served by separating RTC from FDIC and giving RTC its own chief executive officer. Given the current condition of the banking industry and the need for the FDIC Chairman to probably devote full-time to assuring the efficient operations of the Bank Insurance Fund this takes on added importance. But, it is also necessary to fully understand the implications of any new structure and be prepared to put people with the right skills in place to make it work. As Congress continues to search for ways to improve RTC's efficiency and effectiveness, dialogue on this topic should continue. The Congress should obtain the views and recommendations of the RTC Oversight Board.

- - - - - -

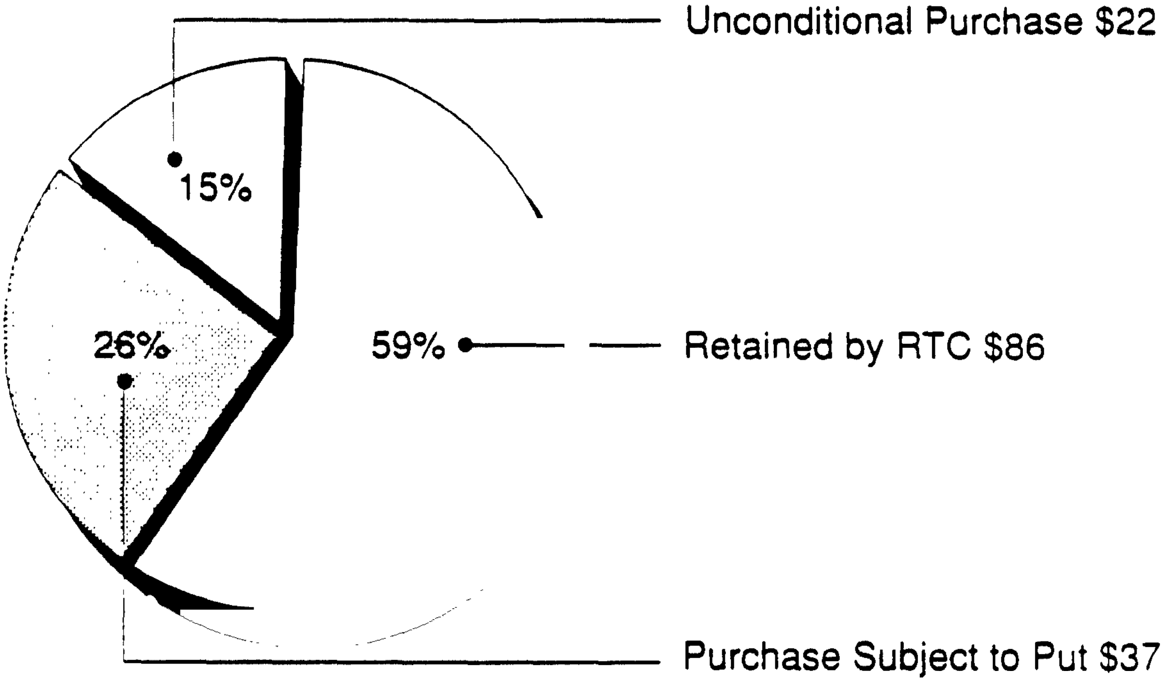
This concludes our prepared remarks. We would be pleased to answer questions.

GAO Thrifts Resolved by RTC

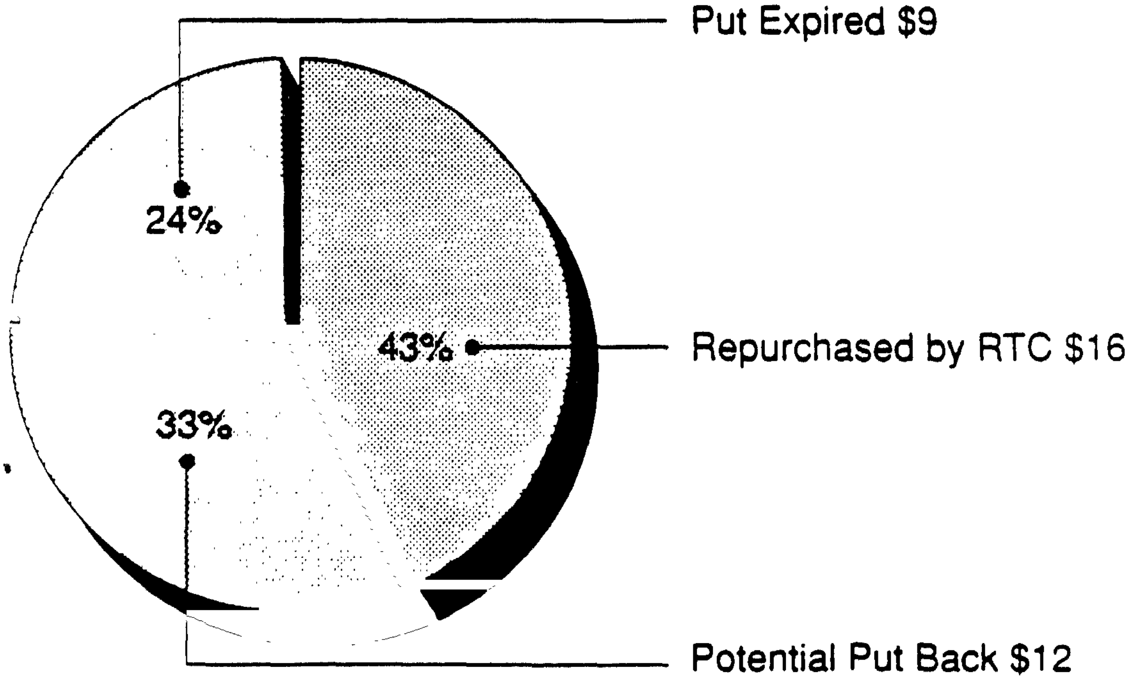


GAO Assets Transferred as of March 31, 1991

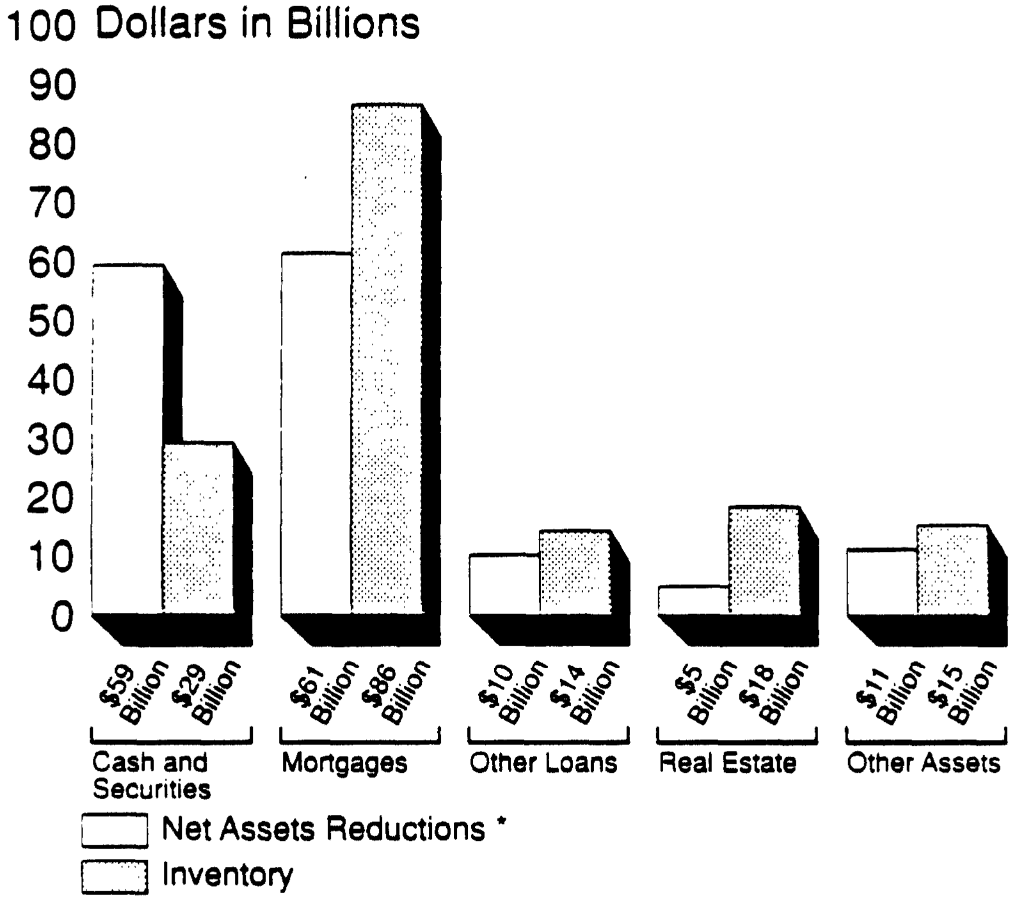
Assets in 374 Thrifts: $145 Billion



Purchased Subject to Put: $37 Billion



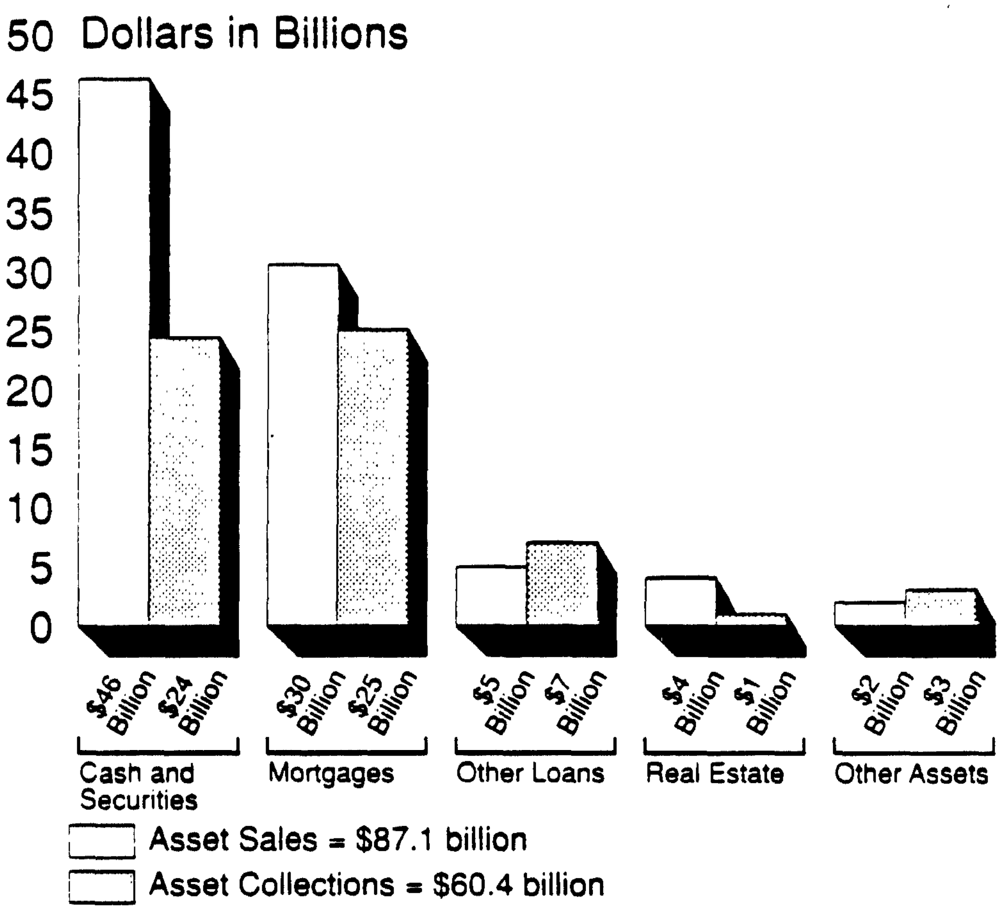
GAO Status of RTC Assets as of March 31, 1991



* Net Asset Reduction figures equal (1) sales; (2) collections; and (3) other changes that include net losses on sales, charge-offs of goodwill, accumulation and investment of cash, and adjustments of assets.

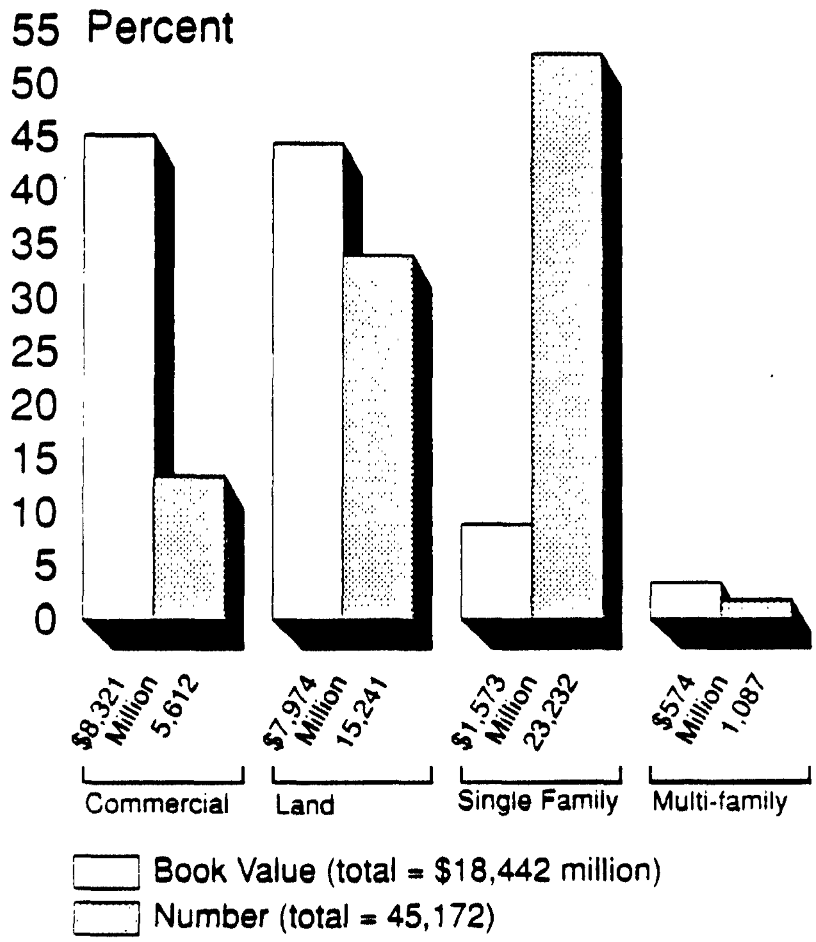
Total asset reductions equaled $146 billion and total inventory holdings (book value) equaled $162 billion as of March 31, 1991.

GAO RTC Sales and Collections by Asset Type as of March 31, 1991



Total asset sales and collections equaled about $148 billion as of March 31,1991 (this figure does not include other net changes of about $2 billion).

GAO Attributes of RTC Real Estate Inventory as of March 31, 1991



Several thousand multi-family properties have been reclassified as single family since RTC's December inventory.