United States General Accounting Office

GAO

Report to the Chairman, Committee on Banking, Finance and Urban Affairs, House of Representatives

March 1992

OBLIGATIONS LIMITATION

Resolution Trust Corporation's Compliance as of March 31, 1991

RESTRICTED--Not to be released outside the General Accounting Office unless specifically approved by the Office of Congressional Relations.

GAO/AFMD-92-39

GAO

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

Accounting and Financial
Management Division

B-240108

March 11, 1992

The Honorable Henry B. Gonzalez
Chairman, Committee on Banking, Finance
and Urban Affairs
House of Representatives

Dear Mr. Chairman:

This is our fifth response to your December 19, 1989, letter requesting that we report quarterly on the Resolution Trust Corporation's compliance with the maximum obligation limit set forth in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Public Law 101-73. FIRREA established the formula for calculating the maximum allowable obligations outstanding and provided $50 billion in financing to resolve troubled savings and loan institutions placed into conservatorship or receivership from January 1, 1989, through August 9, 1992. Our reports on the Corporation's compliance for the four quarters in 1990 were issued in July 1990, December 1990, May 1991, and October 1991, respectively. See appendix IV for a list of our quarterly compliance reports.

On July 12, 1991, the Corporation issued to you its report of the estimated values of its obligations, assets, and contributions received for the quarter ending March 31, 1991. The Corporation reported that the financing it received from the Resolution Funding Corporation (REFCORP) plus its outstanding obligations exceeded the values of its assets by $41 billion. Consequently, its "adjusted obligation level" was $9 billion below the $50 billion limitation on outstanding obligations. The Corporation's report and an accompanying table providing details on the computation are included as appendixes I and II.

Results in Brief

Based on our review of the Corporation's July 12, 1991, report and table and its financial records, we determined that none of the categories for the formula required by FIRREA were omitted from the Corporation's calculation. However, as with its calculations for the third and fourth quarters of 1990, the Corporation did not include $18.8 billion of Department of the Treasury funding when calculating its first quarter 1991 adjusted obligation level. As a result of this practice, initially implemented for the third quarter of 1990, the adjusted obligation level calculated in the first quarter 1991 report is not comparable to those calculated in the first and second quarters of 1990. If the Corporation had included the Treasury funding in its calculation, its first quarter 1991 adjusted obligation level

would be nearly $10 billion over the $50 billion provided by FIRREA, and the Corporation would be precluded from incurring any additional obligations.

The accuracy of the Corporation's obligation limit calculation is highly dependent on the reasonableness of the estimated fair market value of its assets in receiverships. Our review of 60 receivership assets showed that asset file information for 11 did not support the estimated market values assigned by the Corporation at December 31, 1990. Although these results are not projectable to all assets in Corporation receiverships, they do raise concerns about the ownership and recovery value of some receivership assets. If assets are overvalued and ultimately sell for less than estimated, the Corporation may not be able to repay all of its working capital borrowings.

The obligation limit formula, as originally implemented, provided cash reserves to cover possible future losses due to overvaluation of the Corporation's assets in receivership. We believe that the cash reserve feature served as a valuable safeguard against the Corporation's need to request additional loss funds from the Congress to repay working capital. As a result, we continue to support the recommendation made in our third quarter 1990 report[1] that the Congress consider reestablishing the cash reserve feature by amending the obligation limit formula established by FIRREA to include all funding sources.[2]

Background

In response to the savings and loan crisis and the Federal Savings and Loan Insurance Corporation's (FSLIC) mounting losses, FIRREA was enacted on August 9, 1989. The act abolished FSLIC and transferred its insurance function to the Federal Deposit Insurance Corporation. FIRREA established the Resolution Trust Corporation to resolve the problems of institutions previously insured by FSLIC and placed into conservatorship or receivership from January 1, 1989, until August 9, 1992.[3] The act provided

[1]Obligations Limitation: Resolution Trust Corporation's Compliance as of September 30, 1990 (GAO/AFMD-91-63, May 31, 1991).

[2]The obligation limit formula is contained in section 21A(j) of the Federal Home Loan Bank Act, 12 U.S.C. 1441a(j) (1990 Supp.), added by section 501(a) of FIRREA.

[3]The Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991 (Public Law 102-33) extended the Corporation's resolution responsibility through September 30, 1993, and provided for the Corporation to resolve certain thrifts after that date.

the Resolution Trust Corporation $50 billion to resolve the problems of those institutions and to pay administrative expenses.[4] FIRREA also transferred FSLIC's assets and liabilities, except for those assumed by the Corporation, to the newly established FSLIC Resolution Fund.

FIRREA gave the Corporation certain powers to accomplish its task, including the authority to issue obligations and guarantees when resolving institutions within its jurisdiction. The full faith and credit of the United States is pledged to pay such obligations if the principal amounts and maturity dates are stated in the obligations.

Section 501(a) of FIRREA established a formula for calculating the maximum outstanding obligations of the Corporation. FIRREA states that the sum of contributions received through REFCORP plus outstanding obligations may not exceed the Corporation's available cash plus 85 percent of the fair market value of its other assets by more than $50 billion.

Although FIRREA provided for the Corporation to receive $18.8 billion from Treasury in 1989, the formula established in section 501(a) does not explicitly contain this funding. Therefore, as a matter of law, the Corporation is not required to include the Treasury funding in its calculation of whether the FIRREA limit on outstanding obligations has been reached. On November 2, 1990, the Corporation's Oversight Board directed it to exclude the funding from the formula when computing the third quarter, as well as future, compliance with the obligations limitation. The Oversight Board's action had been expressly encouraged by the Chairmen of the House and Senate Banking Committees.

Objectives, Scope, and Methodology

As agreed with your office, we performed a review of the Corporation's first quarter 1991 report to test its reasonableness. Specifically, our objectives were to determine if (1) all categories for the formula required by FIRREA were included in the Corporation's calculation and (2) the values reported appeared reasonable for select components of the calculation. This report also provides information on the possible overvaluation of Corporation receivership assets and the effect of eliminating the Treasury funding from the obligation limit formula.

[4]The $50 billion provided by FIRREA consisted of $18.8 billion provided by Treasury, $1.2 billion of contributions from the Federal Home Loan Banks, and $30 billion in bond sale proceeds transferred from REFCORP.

As part of our review work, we also followed up on the status of the recommendation we made to the Corporation's Executive Director which had not been fully implemented as of the date of our last report. Details on the status of the recommendation regarding sales data for receivership assets are included as appendix III.

To ensure that the formula calculation included all required components, we compared the Corporation's reports with its March 31, 1991, general ledger trial balance. To determine the reasonableness of the values of selected components included in the Corporation's calculation, we performed various standard audit tests. When possible, we relied on tests performed for our previous reports and tested only the activity for the first quarter of 1991. For this report, our review included the following tests:

- confirming contributions received from REFCORP and Treasury;
- analyzing changes in legal liability from December 31, 1990, to March 31, 1991;
- recalculating lease obligations for headquarters and regional office space;
- confirming notes payable with the Federal Financing Bank;
- recalculating interest owed to the Federal Financing Bank;
- confirming cash with Treasury and reviewing cash reconciliation reports;
- randomly sampling and tracing to supporting documentation 78 percent of the advances disbursed to conservatorships during the first quarter 1991;
- tracing to supporting documentation 100 percent of the advance repayments from conservatorships during the first quarter of 1991;
- tracing to supporting documentation 100 percent of loans disbursed to receiverships during the first quarter of 1991;
- randomly sampling and tracing to supporting documentation 63 percent of the advance and loan repayments from receiverships during the first quarter of 1991;
- independently estimating interest receivable on advances and loans outstanding; and
- randomly sampling and tracing to supporting documentation 75 percent of the increased dollar value in the Corporation's subrogated claims paid to depositors during the first quarter of 1991.

During August and September 1991, we conducted a review of the estimated fair market values of 60 receivership assets. The estimated market values for receivership assets are the basis for the $51.4 billion of noncash assets shown in the Corporation's first quarter 1991 obligation limit report. We randomly chose our sample from the universe of assets sampled and valued by the Corporation in conjunction with preparing its

financial statements for 1990. However, as we discussed in our audit report on the Corporation's 1990 financial statements[5], the Corporation's methodology for selecting its valuation sample was not statistically valid and therefore may not be representative of nonsampled assets. For this reason, results of our asset review cannot be projected to nonsampled Corporation assets.

The Corporation revised its methodology for selecting and valuing receivership assets in 1991. Corporation personnel have indicated that a statistically valid sample will be drawn and that consistent valuation procedures will be followed to estimate recovery values for the sampled assets. Sample recovery values will then be projected to all nonsampled assets in Corporation receiverships. In conjunction with our audit of the Corporation's 1991 financial statements, we will evaluate this new methodology and again review the estimated market values assigned to a random sample of receivership assets at December 31, 1991. The results of this review should be statistically valid and projectable to the Corporation's universe of receivership assets.

In conjunction with our first quarter 1991 review, we were unable to determine the amount of any undisclosed obligations of the Corporation, which, if disclosed, might have affected the calculation of the obligations limitation. Such undisclosed obligations would decrease the amount the Corporation could borrow to fund its working capital needs.

During our review of the Corporation's first quarter 1991 compliance report, we performed our work at the Corporation's headquarters and in each of its four regions. We performed our work in accordance with generally accepted government auditing standards. The scope of our work, however, did not include a review of the Corporation's internal control environment. Our review of compliance with laws and regulations was limited to the Corporation's compliance with the obligations limitation.

While we did not obtain written comments on this report, we discussed its contents with cognizant Corporation officials, who agreed with the report's findings and conclusions.

[5]Financial Audit: Resolution Trust Corporation's 1990 Financial Statements (GAO/AFMD-92-20, October 25, 1991).

Calculation Methodology Lowered the Corporation's Adjusted Obligation Level

Based on our review of the Corporation's July 12, 1991, report and table and its financial records, we determined that none of the required categories for the formula established by FIRREA were omitted from the Corporation's calculation. However, as in its third and fourth quarter 1990 reports, the Corporation did not include $18.8 billion of Department of the Treasury funding when calculating its adjusted obligation level. As a result of this practice, the adjusted obligation level calculated in the first quarter 1991 report, like those in its reports for the third and fourth quarters of 1990, is not comparable to those calculated in the first and second quarters of 1990. If the Corporation had included the Treasury funding in its calculation, its first quarter 1991 adjusted obligation level would be $10 billion over the $50 billion provided by FIRREA and the Corporation would be precluded from incurring any additional obligations.

Valuation of Some Receivership Assets Not Supported by File Documentation

Our review of 60 randomly sampled receivership assets showed that the estimated market values for 11 assets were not supported by information in the individual asset files. Our review also raised questions about the existence and ownership of some assets being included in the Corporation's recovery value calculations. Because of these problems, the recovery value to the Corporation for 7 of the 60 assets sampled is likely to be zero. We did not attempt to calculate a more accurate estimated recovery for the other four problem assets.

Our review of sampled asset file documentation uncovered the following problems:

- one asset file was missing the original promissory note for a consumer loan more than 270 days delinquent;
- three asset files contained information on actual sales prices listed with a realtor or bid prices received from potential purchasers that ranged from 5 percent to 15 percent lower than the estimated market value assigned;
- available information indicated that two assets were owned by parties other than the Corporation at December 31, 1990;
- one asset was not an asset, but rather a special bookkeeping account which was offset by another bookkeeping account that resulted in a net balance of zero at December 31, 1990; and
- no file documentation could be located for four assets.

As a result of our asset valuation review, we can state with reasonable assurance that between 7 and 29 percent of the assets in the Corporation's sampled universe have similar problems with ownership and/or file

documentation. Because the Corporation's sample was not statistical, we cannot project these results to the universe of receivership assets as a whole. However, our results do raise concerns about the existence, salability, and valuation of assets. Therefore, we are unable to offer any assurance that the fair market values reported by the Corporation in its first quarter 1991 compliance report are reasonable. If the Corporation receives significantly less than estimated from the sale of its receivership assets, it will be unable to repay all of its working capital borrowings as intended.

Treasury Funding Exclusion Eliminates Reserve

As discussed in our third quarter report, the obligations limitation formula, as originally implemented, provided cash reserves to cover possible future losses due to overvaluation of the Corporation's assets in receivership.[6] Excluding Treasury funding of $18.8 billion from the formula, however, effectively eliminated the 15-percent cash reserve feature and resulted in a potentially misleading assessment of the Corporation's ability to fund any future losses resulting from asset sales at less than their recorded value.

Furthermore, the Corporation has been provided with an additional $55 billion of Treasury funding for losses incurred in resolving failed thrift institutions.[7] Because the obligation limit formula was not amended to fully recognize this additional funding, the Corporation also is not required to include this funding in its calculations. Accordingly, the Corporation does not have to reserve any of those funds to cover future losses on assets purchased in connection with the resolutions.

We believe that the obligation limit formula, as originally implemented, provided some reserves against unexpected future losses on asset sales. Therefore, in our third quarterly report, we recommended that the Congress consider reestablishing the cash reserve feature by amending the obligations limit formula established by FIRREA to recognize all funding sources. We continue to support such a feature and reiterate our caution that the significant uncertainties related to the economy and the government's growing portfolio of troubled assets may result in losses

[6]See Obligations Limitation: Resolution Trust Corporation's Compliance as of September 30, 1990 (GAO/AFMD-91-63) for an explanation of the cash reserve feature of the obligations limitation formula as originally implemented.

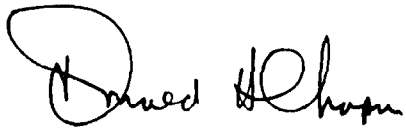
[7]The Resolution Trust Corporation Funding Act of 1991 (Public Law 102-18), signed March 23, 1991, provided $30 billion, while the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991 (Public Law 102-33), signed December 12, 1991, provided $25 billion.

from the sales of Corporation assets exceeding even a 15-percent cash reserve amount.

As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies to interested parties and make copies available to others upon request.

This report was prepared under the direction of Robert W. Gramling, Director, Corporate Financial Audits, who may be reached on (202) 275-9406 if you or your staff have any questions.

Sincerely yours,



Donald H. Chapin
Assistant Comptroller General

Contents

Abbreviations

FIRREA	Financial Institutions Reform, Recovery, and Enforcement Act
FSLIC	Federal Savings and Loan Insurance Corporation
REFCORP	Resolution Funding Corporation

Resolution Trust Corporation Obligations and Assets as of March 31, 1991

RTC
Resolution Trust Corporation

July 12, 1991

Honorable Henry B. Gonzalez
Chairman
Committee on Banking, Finance
and Urban Affairs
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

We are pleased to submit the 1991 first quarterly report relating to the working capital needs of the Resolution Trust Corporation. This quarterly report provides estimated values of the RTC's obligations and assets as of March 31, 1991, which are used to determine whether the RTC remains within the limitation on obligations as mandated by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. We have also included a table presenting the computation of the obligation limitation as of March 31, 1991.

We hope that this information will be of assistance to you. If you have any questions, please let me know.

Sincerely,

David C. Cooke
Executive Director

bcc: David Cooke
Bill Roelle
Lamar Kelly
Paul Sachtleben
Barry Kolatch
RTC Board of Directors
Gerald Jacobs
Randy McFarlane
Steve Katsanos
Peter Monroe

RESOLUTION TRUST CORPORATION

**Obligations and Assets
as of March 31, 1991**

1. **Outstanding Obligations** — **$ 58.5 billion**

   Includes $57.0 billion in notes issued to the Federal Financing Bank (FFB) plus $0.9 billion accrued interest; and $0.6 billion in accounts payable and other liabilities, lease commitments, and estimated losses from litigation. Contingent liabilities already applied to the value of RTC's claims on failed thrift assets are not included here. The estimated future costs of resolving RTC conservatorships and other troubled thrifts are also excluded.

2. **"Full Faith and Credit" Obligations** — **$ 58.2 billion**

   Includes accounts payable and other liabilities, and notes issued to the FFB plus accrued interest.

3. **Total Fair Market Value of [Non-Cash] Assets Held by RTC** — **$ 51.4 billion**

   Includes $22.3 billion principal value of advances, loans, accrued interest, and reimbursable expenses due from conservatorships and receiverships. RTC advances have a claims priority ahead of general creditors; most are estimated to be fully collectible. Also includes $29.1 billion for the net realizable value of RTC subrogated claims on receiverships. The net realizable value accounts for estimated total losses to RTC for resolved cases, including expenses incurred to manage and dispose of assets, as well as estimated losses on assets covered under "put" agreements. The obligation limitation counts the total of all non-cash assets at 85 percent of the fair market value shown above.

4. **Cash Held by RTC** — **$ 5.1 billion**

5. **Obligations [Bonds] Issued by REFCORP** — **$ 30.0 billion**

   Includes $4.5 billion issued in October 1989, $5.0 billion issued in January 1990, $3.5 billion issued in April 1990, $5.0 billion issued in July 1990, $5.0 billion issued in October 1990 and $7.0 billion issued in January 1991. RTC also received $18.8 billion in Treasury funds (excluded from the calculation of the obligation limitation with the concurrence of the Oversight Board and the Congress) and a $1.2 billion contribution from the Federal Home Loan Banks transferred to RTC through REFCORP. The $30 billion of outstanding REFCORP bonds is the maximum allowed under FIRREA.

Resolution Trust Corporation Maximum Amount Limitation on Outstanding Obligations

RESOLUTION TRUST CORPORATION
FIRREA
MAXIMUM AMOUNT LIMITATION ON
OUTSTANDING OBLIGATIONS
AS OF MARCH 31, 1991
(IN MILLIONS)

A) CONTRIBUTIONS RECEIVED FROM REFCORP		31,288
B) OUTSTANDING OBLIGATIONS		
1) LITIGATION - ESTIMATED LOSSES	175	
2) LEASE COMMITMENTS	156	
3) ACCOUNTS PAYABLE AND OTHER LIABILITIES	304	
4) NOTES PAYABLE AND OTHER DEBT	57,897	
TOTAL OUTSTANDING OBLIGATIONS		58,532

LESS:		
C) CASH AND CASH EQUIVALENTS		5,060
LESS:		
D) ESTIMATED FMV OF OTHER ASSETS		
1) ADVANCES AND LOANS 22,279 @ 85%	18,937	
2) NET SUBROGATED CLAIMS 29,143 @ 85%	24,772	
3) MISC. RECEIVABLES AND OTHER ASSETS 5 @ 85%	4	
TOTAL OTHER ASSETS @ 85%		43,713
ADJUSTED OBLIGATION LEVEL (A+B–C–D)		41,045
MAXIMUM LEVEL		50,000
EXCESS OF MAXIMUM LEVEL OVER ADJUSTED OBLIGATION LEVEL AT 03/31/91 **		8,955

** A positive amount indicates compliance with the obligation limitation. It does not represent the limit on additional borrowings. Additional borrowing authority depends on the estimated value of RTC assets.

FIRREA Section 501(a) (j)
Maximum Amount Limitation on Outstanding Obligations
Explanatory Notes

A. Contributions Received

Includes the $1.2 billion FHLB contribution (through REFCORP) and REFCORP bond proceeds. Does not include the initial $18.8 billion Treasury contribution. This contribution has been excluded from the calculation with the concurrence of the Oversight Board and the Congress.

B. Outstanding Obligations

1. Litigation-Estimated Losses: The expected cost of those pending or threatened litigations, claims, or assessments where an estimated loss to RTC (in its Corporate and Receivership capacities) is both probable and reasonably estimable. These are over and above legal expenses already included in the resolution loss estimates.

2. Lease Commitments and Other Contractual Obligations: The non-cancelable portion of outstanding contractual obligations. As of March 31, 1991, these included primarily multi-year lease commitments for space in Washington and other locations.

3. Accounts Payable and Other Liabilities: Full face value of routine, current liabilities such as accounts payable and accrued liabilities. Also, includes the full face value of the liability related to pending claims of depositors (insured deposits owed but not yet paid).

4. Notes Payable and Other Debt: Full face value of all Federal Financing Bank borrowings and accrued interest due thereon.

Additional Notes on Outstanding Obligations:

A. Guarantees: There were no guarantees issued or assumed from FSLIC (i.e., FHLB advances guaranteed by FSLIC) as of March 31, 1991, that the Corporation expects will result in additional losses.

B. Asset Puts: Included in the allowance for losses on claims against receiverships is an estimate of losses on assets likely to be returned to the RTC under a put agreement. Therefore, the Corporation's claims have already been adjusted for the contingent liabilities relating to put agreements.

C. Contingent Liabilities Related to the Resolution of Conservatorships and Other Troubled Thrifts: Not included as outstanding obligations.

C. Cash and Cash Equivalents

Includes cash, cash equivalents (as defined in FAS #95).

D. Estimated Fair Market Value of Other Assets Held by the Corporation (85% thereof)

1. Advances and Loans: Included at 85% of fair market value. Includes principal on advances, accrued interest and other receivables from conservatorships and receiverships. These receivables have a claims priority ahead of general creditors. Reserves are established when the net liquidation value from conservatorship assets does not cover the principal and interest on RTC advances and other priority claims.

2. Net Subrogated Claims: Included at 85% of the Net Realizable Value of such claims. RTC has estimated recoveries from receivership assets, net of all expenses including interest, to determine the value of its claims against receiverships and corresponding loss allowances.

3. Miscellaneous Receivables and Other Assets: Includes current assets, all at 85%.

Implementation Status of Open Recommendation

Our first quarter report on the Corporation's compliance with the maximum obligation limit set forth in FIRREA identified several factors that could affect the cost of resolutions and the point at which the limit is reached. To address these factors, we made specific recommendations to the Corporation's Executive Director. As part of our first quarter 1991 review, we evaluated the Corporation's response to our remaining open recommendation concerning its lack of a comprehensive, integrated asset tracking system.

Because the market value of receivership assets is a key component in the obligation limit calculation, overestimation of these values could result in the Corporation incurring liabilities it would be unable to repay from sales proceeds. Therefore, we recommended that the Corporation track and report the actual results of asset sales to provide the information necessary for evaluating the accuracy of estimated market values. In particular, we noted that collecting data on initial estimated market value assigned, date available for sale and date sold, sales price, and gain or loss would provide historical information to use as the basis for adjusting current estimates and preparing future estimates.

In response to our recent inquiries regarding asset sales information, the Corporation indicated that it does not have an integrated asset management system capable of providing sales and valuation information on all receivership assets. The Corporation is currently developing several asset systems which are at various stages of completion. Some of these systems have the capability to provide the recommended valuation information while the others do not. We will continue to monitor the development of asset information systems in conjunction with our audit of the Corporation's financial statements.

GAO Quarterly Compliance Reports

Obligations Limitation: Resolution Trust Corporation's Compliance as of March 31, 1990 (GAO/AFMD-90-101, July 27, 1990).

Obligations Limitation: Resolution Trust Corporation's Compliance as of June 30, 1990 (GAO/AFMD-91-41, December 21, 1990).

Obligations Limitation: Resolution Trust Corporation's Compliance as of September 30, 1990 (GAO/AFMD-91-63, May 31, 1991).

Obligations Limitation: Resolution Trust Corporation's Compliance as of December 31, 1990 (GAO/AFMD-92-4, October 22, 1991).

Ordering Information

The first copy of each GAO report is free. Additional copies are $2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20877

Orders may also be placed by calling (202) 275-6241.

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

Official Business
Penalty for Private Use $300

First-Class Mail
Postage & Fees Paid
GAO
Permit No. G100