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Resolution Trust Corporation:

Funding, Asset Disposition, and Structure Issues

Statement of
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Comptroller General of the United States

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

GAO/T-GGD-91-67

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Mr. Chairman and Members of the Committee:

We are pleased to be here today to discuss the Resolution Trust Corporation's (RTC) current and future funding needs, its progress in disposing of assets, and issues related to restructuring RTC.

RTC is now about 2 years old. During this time it has struggled with the tasks of resolving a large number of thrifts and selling assets. The management initiatives contained in the RTC Funding Act of 1991 have helped RTC focus on making needed improvements in several of its operations and programs. The act requires RTC to report to Congress by September 30, 1991, on the progress being made in implementing the initiatives. We are currently reviewing RTC's efforts to make these improvements and will be in a position to analyze and comment on RTC's report to Congress. At this time, we can report that RTC has made progress in implementing the funding act initiatives, and I will address some of them throughout my statement.

But even though some progress is being made, very much more remains to be done, and the challenges facing RTC continue to change and grow. More failed institutions will need to be resolved in an environment of shrinking demand. Also, less marketable assets will require RTC to continue to enhance its strategies to sell them. While facing these challenges, RTC will need to assure Congress and the taxpayers that it can efficiently and effectively carry out its multibillion dollar operations without fraud, waste, and mismanagement.

RTC FUNDING NEEDS

On September 12, 1991, RTC and its Oversight Board testified before this Subcommittee and requested that the Congress appropriate $80 billion in loss funds in addition to the $80 billion already provided. They also requested that RTC's working capital borrowing authority be increased to $160 billion. In addition, the Oversight Board sought a one year extension of the August 8, 1992, deadline for transferring thrifts to RTC for resolution. These requests were intended to complete the clean up of insolvent thrifts and allow the Savings Association Insurance Fund to assume its responsibilities without a backlog of troubled thrifts to resolve.

Precisely when and how much additional funding RTC will require--as well as whether RTC's authority for resolving troubled thrifts should be extended--depends on a number of factors that are subject to significant uncertainties. These factors include the number and timing of additional thrift failures; the duration and extent of problems in the economy, particularly the real estate markets; and the recovery value of receivership assets. Faced with these uncertainties, neither the Oversight Board nor RTC can provide assurance that the $80 billion loss fund request will be the final installment in resolving the thrift industry crisis.

RTC testified that it expects to resolve 569 institutions with $182 billion in assets by September 30, 1991, at a cost of $76 billion. RTC's current resolution plans indicate that it will need additional loss funds before the beginning of November 1991 or be forced to cease closing institutions. RTC also testified on September 12, 1991, that it used $59 billion in working capital and expects to need another $58 billion to carry it through fiscal year 1992. If RTC adheres to its plan, it will exceed its current borrowing authority by $17 billion in 1992. Thus new funding legislation to provide additional loss monies and raise the limit on borrowings needs to be in place soon or RTC will face resolution delays and their associated costs. But, RTC's funding requests go beyond its needs for the next year.

The $160 billion resolution cost funding requested by RTC and its Oversight Board assumes that RTC will resolve a total of more than 900 institutions and will incur high level losses on asset sales. Today, more than 300 institutions included in the Oversight Board's projection are still open. Most of these institutions are still operating in the private sector and nearly half have positive capital. If and when these institutions will become RTC's responsibility are critical questions also subject to uncertainties.

Under FIRREA, the Office of Thrift Supervision (OTS) has the authority to close institutions and appoint RTC conservator or receiver. In its most recent thrift quarterly reports, OTS has declared 118 open institutions (Group IV) as "likely to be transferred to RTC." As a group, these institutions have negative tangible capital and are consistently unprofitable. OTS expects to transfer these thrifts to RTC for resolution over the next fiscal year. RTC has estimated that it will resolve all remaining institutions in conservatorship and in Group IV during fiscal year 1992 at a cost of approximately $30 billion to $40 billion in loss funds and $30 billion to $45 billion in additional working capital borrowings.

RTC also estimated it would resolve 60 institutions during the next year that are currently in OTS's Group III. With these additional resolutions, RTC estimates its total loss funds needs through September 30, 1992, will be between $40 billion and $50 billion. OTS has categorized Group III institutions as "troubled with poor earnings and low capital" but has also defined them as "not expected to require government assistance." According to OTS, these institutions have "reasonable prospects of meeting the 3 percent capital requirement through retention of earnings, restructuring or recapitalization." Although the institutions considered for resolution within the next year have the lowest net worth and poorest earnings of Group III thrifts, it is hard to determine exactly when these thrifts will meet OTS's criteria for closing and be transferred to RTC.

In addition, RTC has requested funds for resolving another approximately 100 Group III thrifts at an estimated cost of between $5 billion and $25 billion. These institutions currently have tangible capital of between 1 and 2 percent and are profitable or have tangible capital greater than 2 percent but are unprofitable. RTC does not expect these institutions to be resolved before fiscal year 1993. At this time, it is difficult to predict with reasonable certainty whether and when OTS will close these institutions and how much assistance will then be needed.

Obviously, how much money to give RTC now is a difficult decision. No one wants to provide insufficient funding and thereby slow down the required resolution process but, at the same time, no one should be lulled into thinking that providing an additional $80 billion to RTC today guarantees an end to RTC funding requests. Again, the reliability of long term predictions regarding how many thrifts will fail and when they will require RTC assistance is affected by significant uncertainties. Until all the assets are sold from all the receiverships, RTC's--and the government's--final cost will be unknown. Depressed market conditions and RTC's strategy of aggressively discounting selected assets to encourage sales make it highly likely that receivership assets will sell for less than anticipated. In that case, RTC may need to request additional funds from the Congress to repay working capital borrowed from the Federal Financing Bank.

Determining whether and how long to extend RTC's responsibility for resolving failed thrifts are also difficult decisions. Nothing we have seen indicates that a one year extension will guarantee that all thrifts needing assistance will have failed within the extension period. If the interest rate spread continues to be favorable, many poorly capitalized thrifts may remain marginally viable long after their current expected failure dates. If this happens, RTC may be holding funds intended for resolving thrifts that will become the responsibility of the Savings Association Insurance Fund after 1993.

Therefore, we believe that at this time the Congress has two funding options.

-- Provide RTC with an $80 billion loss funds appropriation and increase its borrowing authority to $160 billion as requested by RTC and its Oversight Board. In addition, extend the deadline for RTC to accept thrifts for resolution so that RTC has the time necessary to handle all the thrift failures envisioned in its funding request. If this option is selected, the Congress needs to reassess the responsibilities of and funding mechanisms for the Savings Association Insurance Fund.

-- Provide RTC with sufficient funding and borrowing authority to continue operations through August 8, 1992. RTC now estimates it will need $50 billion in loss funds and $117 billion in borrowing authority for fiscal year 1992. Under this option, the Congress would give greater recognition to the many uncertainties regarding the number, timing and cost of expected thrift failures. Also, RTC, its Oversight Board and the Congress would be able to reassess RTC's funding needs in June 1992 after evaluating current economic conditions, the viability of various thrift institutions and RTC's progress in improving its operations.

STATUS OF THE 1990 FINANCIAL AUDIT

Our audit of RTC's financial statements for the year ending December 31, 1990, is not yet complete. We are currently conducting tests to evaluate the methodology RTC used to estimate recoveries for its receivership assets. It should be noted that RTC only applied its valuation methodology to 20 selected receiverships holding approximately 60 percent of the book value of assets; therefore, even if we found that the methodology and resulting recorded values for the selected receiverships were reasonable, we would be unable to project those findings to the assets of the other 332 institutions in receivership.

In addition to the limitations inherent in RTC's valuation methodology, its lack of historical data regarding asset sales and its present strategy for aggressively discounting selected assets to encourage sales may preclude determination of whether recorded market values can, in fact, be realized. The government's large portfolio of troubled assets and RTC's need to sell in a soft market could also result in substantial losses not considered in the valuation process. Therefore, it is likely that we will report that the values shown in the financial statements are uncertain and subject to significant reduction, the amount of which cannot be reasonably estimated now.

SELLING ASSETS

Disposing of the assets of failed thrifts is the largest challenge facing RTC, both now and in the next several years. Figure 1 shows the cumulative total assets taken under RTC's control, reductions in that total, and the inventory remaining. From its inception to June 1990, RTC had taken a total of nearly $244 billion in assets under its control, and at that time had liquidated 31 percent of those assets. By June 1991, RTC had taken a total of about $328 billion in assets under its control and liquidated 51 percent.

Selling Financial Assets

As figure 2 shows, the largest asset category is still financial assets. These assets include cash and securities, mortgages and other loans. From RTC's inception to June 30, 1991, the cumulative value of the financial assets taken under RTC's control was about $275 billion. As of June 30, 1991, about $124 billion remained in RTC's inventory--about 78 percent of RTC's total assets. As shown in Figure 3, RTC has been making steady progress in loan sales and collections.

Securities sales by RTC's Capital Markets Branch continue at a steady pace. From July through December 1990, RTC sold about $11 billion in various securities. From January through June 1991, RTC sold an additional $10.6 billion. The remaining inventory in both conservatorships and receiverships as of June 30, 1991, was about $29 billion, or 18 percent of RTC's total assets of $160 billion.

The Funding Act of 1991 required RTC to develop and implement a centralized securities portfolio management system not later than September 30, 1991. In April 1991, a solicitation for this system was sent to 175 interested firms, and the contract was awarded in August 1991. RTC officials think this off-the-shelf system can be operational by the September 30 deadline.

RTC's National Sales Center located in Washington, D.C., is the principal advisor for the disposition of financial instruments and real estate held by RTC nationwide. The National Sales Center coordinates the selection and marketing of these assets through portfolio sales, large auctions, sealed bids, and other transactions. It has completed six large loan portfolio sales aggregating about $1.7 billion, and several other transactions are in different stages of completion. In addition, many other loan sales have been arranged by RTC's regional sales centers. For example, the Chicago, Denver, and Dallas sales centers sponsored auctions of smaller portfolios of non-performing loans. These auctions resulted in gross sales proceeds of about $63 million with prices ranging from 10 percent to 69 percent of book value. We believe that further centralization and coordination of these loan sales efforts would be beneficial because it would allow RTC to respond to the marketplace preference for larger scheduled offerings.

RTC's securitization program has also made progress. Six transactions aggregating about $2.5 billion have been completed in the past 3 months. RTC officials expect to close another $7 billion to $9 billion in transactions by the end of the calendar year. In addition, RTC has continued to execute agency swap transactions with the secondary mortgage market agencies, Fannie

Mae and Freddie Mac. As a result of better training, improved policies and procedures, and increased regional activity, RTC officials expect to execute a total of about $6.6 billion in agency swap contracts by December 31, 1991.

Real Estate Sales

The pace of real estate sales has been slow. As of June 30, 1991, RTC had realized about $5.4 billion on the sale of real estate assets. Figure 4 shows the relationship between real estate sales and real estate inventory which is currently at $20.7 billion. The figure clearly illustrates the difficult challenge that lies before RTC.

Commercial properties represent a large portion of RTC's real estate portfolio--about $7.9 billion. The commercial real estate market is in a dismal state. A major market imbalance and other economic factors have resulted in asset devaluation and a dramatic increase in foreclosures on a national basis. Considering the size of RTC's growing inventory and the current depressed market environment, RTC will need market-responsive disposition strategies to meet this mammoth challenge.

A variety of disposition methods are being used by RTC to support its sales efforts including individual sales, auctions, and portfolio offerings. We support the use of these methods including RTC's increased emphasis on portfolio sales as a cost-effective and expedient means to achieve its liquidation goals.

Although it is too early to judge results, recently there has been increasing activity in portfolio transactions with several large sales recently announced. Equally important, RTC has reported that it is scheduling portfolio sales, including real estate and non-performing loans valued at $10 billion, over the next 6 months.

A key to the success of these initiatives will be RTC's ability to attract major investors through the development of market-responsive sales and financing programs. Flexible financing programs will be an important tool to induce sales of RTC's non-performing and distressed commercial assets given the current limited supply of traditional real estate funding sources. However, in developing these new financing programs, such as the recently announced participating cash flow mortgages, RTC will need to maintain tight control over these transactions and develop diligent oversight procedures in order to minimize taxpayer risk.

Although these financing programs may be more acceptable than the alternatives that are realistically available to RTC now, such as substantial price reductions or continuing to hold assets, we believe it is important for RTC to take advantage of opportunities for cash sales whenever possible and continue to develop other disposition strategies that are responsive to the marketplace.

Affordable Housing Disposition Program

RTC's Affordable Housing program has had mixed results. The program has primarily focused on the sale of eligible single family properties and only recently begun to sell eligible multifamily properties. As a result, multifamily property sales have lagged behind single family sales.

As of June 30, 1991, 17,293 single family properties and 485 multifamily properties had been listed with clearinghouses. Figure 5 shows that RTC has closed sales on 3,882 (22 percent) of its eligible single family properties, and 47 (10 percent) of its eligible multifamily properties. Also, RTC has offers still in process on 5,895 (34 percent) of its single family properties and 64 (13 percent) of its multifamily properties. But, unfortunately for both types of properties, the largest inventory category is properties with no offers.

According to RTC officials, the decision to focus efforts on single family sales was based on several factors. First, the Oversight Board wanted the corporation to move slowly into the sale of multifamily properties. Second, RTC wanted to have a consistent set of procedures and policies in place before large numbers of multifamily properties were sold. Finally, single family properties would be subject to considerably more deterioration than multifamily properties.

Although FIRREA gave RTC the authority to sell its affordable housing multifamily properties, RTC is only now developing a national strategy for marketing these properties. This strategy includes defining the intended sales market and providing policy and guidance for making sales decisions. Because of the delay in providing this guidance, RTC's various field offices have made different, and often inconsistent, sales decisions on matters such as marketing periods, comparing similar bids, the treatment of non-profit organizations, and emphasizing preservation of low-income housing. RTC officials plan to issue a national directive addressing these issues in the near future.

Similarly, RTC has not made use of the special financing and pricing options made available by FIRREA to facilitate multifamily sales to non-profit organizations. Specifically, RTC has not provided 100 percent seller financing, below market rate interest, and price discounting for non-profit organizations.

CONTRACTING

A sound contracting system is vital to RTC's operations because contracting is its principal tool for managing and disposing of assets. The Funding Act of 1991 mandated that RTC take several actions to enhance accountability, fairness, and effectiveness of the contracting process. Specifically, it required RTC to

-- develop a manual with policies and procedures;

-- define contracting roles and responsibilities;

-- prescribe standard proposal evaluation procedures;

-- develop standardized contract documents;

-- develop training for RTC employees and contractors; and

-- implement several requirements relating to minority- and women-owned business contracting policy.

Since the act's passage, RTC has taken steps to implement these requirements. Just this month, RTC published the first edition of its comprehensive contracting manual. The manual defines RTC staff's contracting roles and responsibilities including basic procedures for contract oversight. RTC also developed a standardized solicitation for its Standard Asset Management Disposition Agreements (SAMDA) and is developing standardized training courses.

Additionally, RTC's Office of Contractor Oversight and

Surveillance (OCOS) has started to review asset manager contractor performance. Recently, OCOS completed a handbook entitled Contractor Responsibilities Under the Anti-Kickback Act of 1986.[1] OCOS also is providing fraud awareness training for each RTC office and has completed the fieldwork for trial reviews of internal control and cash management reviews for 2 of the 133 SAMDA contractors. Clearly, much more needs to be accomplished and OCOS has proposed initiating similar reviews of 25 contractors by the end of 1991.

Overall, RTC is moving in the right direction, but progress has not been adequate in some fundamental areas, and much more will need to be done before RTC has a complete contracting system. For example, RTC has not completed work on developing objective standards to evaluate SAMDA technical proposals, and work on financial resource qualification standards has been slow. Without these standards, RTC can not be assured that it will select contractors who have the technical and financial capabilities to fulfill the scope and terms of contracts.

In the contract administration area, RTC still needs to create a system of penalties, short of contract termination or partial termination, to motivate contractors to comply with contract provisions. In other words, as the SAMDA contract is now structured, a contractor is entitled to its entire management

[1]41 U.S.C. 51-58.

fee--even if the contractor does not meet all of the contract requirements--unless RTC withdraws the asset for cause or terminates the agreement for cause. To correct this situation, penalties short of termination should be developed for lack of performance such as failing to conduct the initial inspections of real estate assets within the required period.

Further, several fundamental tools for contractor oversight are not in place and operating. Currently, RTC does not have a system to ensure that field staff, especially SAMDA oversight managers, are complying with the requirements to monitor contract performance. Further, RTC has not developed a training course on SAMDA contract oversight to provide field staff. Also, the primary information system to be used by the field staff for SAMDA oversight, the Asset Manager System, is still only in the early stages of implementation. Getting all of these aspects of the program operating effectively is vital to assuring that the taxpayers' dollars are protected against fraud and waste.

Minority and Women Outreach Program

FIRREA required RTC to include minority- and women-owned businesses in all contracting opportunities to the maximum extent possible. At the request of Congressman Mfume, we reviewed RTC's minority- and women-owned business programs for outside legal counsel and asset management activities.

We found that RTC got off to a very slow start in implementing these programs. This has resulted in inconsistent implementation among offices as well as indications that minority- and women-owned businesses have been included in contracting opportunities to the maximum extent possible as shown in figure 6. However, in the last 4 months, RTC has undertaken several initiatives that, if fully implemented, should improve these programs.

On August 15, 1991, RTC published interim final regulations for both minority- and women-owned business contracting programs in The Federal Register. Also, RTC has plans to increase staffing levels for both programs, and program directives have been prepared that define roles and responsibilities for field staff and outline procedures for verifying and certifying the eligibility of firms being considered for contracts over $25,000. In addition, several training seminars have been conducted, and staff have participated in other outreach efforts.

Although RTC has recently taken steps in the right direction in both of the minority- and women-owned business contracting programs, it needs to continue enhancing its ability to achieve the objectives of these programs. We have recommended that RTC continue to assess the adequacy of staffing levels, enhance oversight, and improve the accuracy of the list used to select its outside legal counsels.[2] We also recommended that RTC reexamine both its technical and cost preferences to ensure that they are applied consistently across regions and are meeting their objectives. RTC has agreed to act on our recommendations.

MANAGING INFORMATION

RTC is making progress in developing a sound information resources management (IRM) program, but continued leadership and management attention will be needed to sustain and enhance the progress RTC has made. A sound IRM strategic plan, as well as smooth-functioning information systems, are crucial 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 to include a translation of program goals into automation needs, a system architecture, and an identification of corporation information and systems needs at all operational levels. To meet this requirement, RTC's Office of Corporate Information completed a strategic IRM plan in June 1991.

RTC has drafted an update to the June 1991 plan that it expects to complete by September 30, 1991. We are currently studying

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[2] Resolution Trust Corporation: Progress Under Way in Minority and Women Outreach Program for Outside Counsel (GAO/GGD-91-121; August 30, 1991).

this draft in detail, but our initial review suggests RTC is addressing both the Oversight Board's and our concerns.

Both we and the Oversight Board had similar concerns with the June 1991 plan. The concerns included (1) the need to define the expected contribution of its systems to RTC's business operations, (2) the inability to determine whether systems were going to be integrated by function or would stand alone, and (3) the absence of a description of how RTC's systems would be used by all RTC operational levels, including failed thrifts and SAMDA contractors.

With respect to its asset systems, RTC is taking steps to ensure that the systems are being completed in accordance with sound systems development principles. For example, RTC published sound system development principles in June 1991 and established an independent quality assurance function last spring to ensure the needed systems were being properly developed. Nevertheless, our ongoing work has led us to be concerned about how the systems are being developed and implemented. Specifically, we are concerned about whether all of the asset systems will meet user and management needs at operating levels, and have sufficient network and system capacity and responsiveness to adequately support all users. We are also concerned about whether asset systems will have sufficient internal controls to provide reasonable assurance the information will be secure, accurate, and complete. Finally, we are concerned about RTC properly managing the systems to control the cost, schedule, and performance of systems development efforts.

For example, RTC's Real Estate Owned Management System was designed to provide its managers with current and accurate real estate asset information, including centralized information needed for property sales and contractor oversight. The system was accepted from the contractor on July 15, 1991, but because of development problems related to data integrity it is not yet implemented nationwide.

Because difficulties and potential delays are inherent in putting in extensive information systems, we will continue to carefully monitor RTC's progress in acquiring its asset information systems.

RESTRUCTURING RTC

Last February, in testimony before the House Banking Committee, we raised the need to consider separating the leadership of the FDIC and RTC because of the formidable tasks facing both agencies. We said it was time to consider a CEO for RTC. In testimony last week, the Administration agreed that a separate CEO is needed for RTC.

As the Subcommittee knows, there are a variety of other proposals that have been advanced by different parties aimed at restructuring RTC. We believe there are at least two organizational concepts we would like to see included in any restructuring proposal enacted by the Congress.

The first, the need for a strong CEO responsible for the day-to-day operations of the RTC, is already embodied in the proposals. This individual should be skilled in the business of asset management and disposition and have sufficient latitude to direct the RTC in meeting the challenges it faces. It is also important that the CEO build a strong top management team because one person cannot effectively run an organization as large and diverse as RTC.

The second concept is the need for strong oversight by an entity independent of the day-to-day operations of the RTC. Special attention is needed because of the magnitude of both the overall operations of RTC and the funding required. An oversight board meets this criteria, and could help assure that the effort does not get off track.

In pursuing restructuring, careful attention needs to be given to avoiding changes or delays that would be counter-productive to the progress RTC is making in improving both its operations and asset disposition strategies.

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

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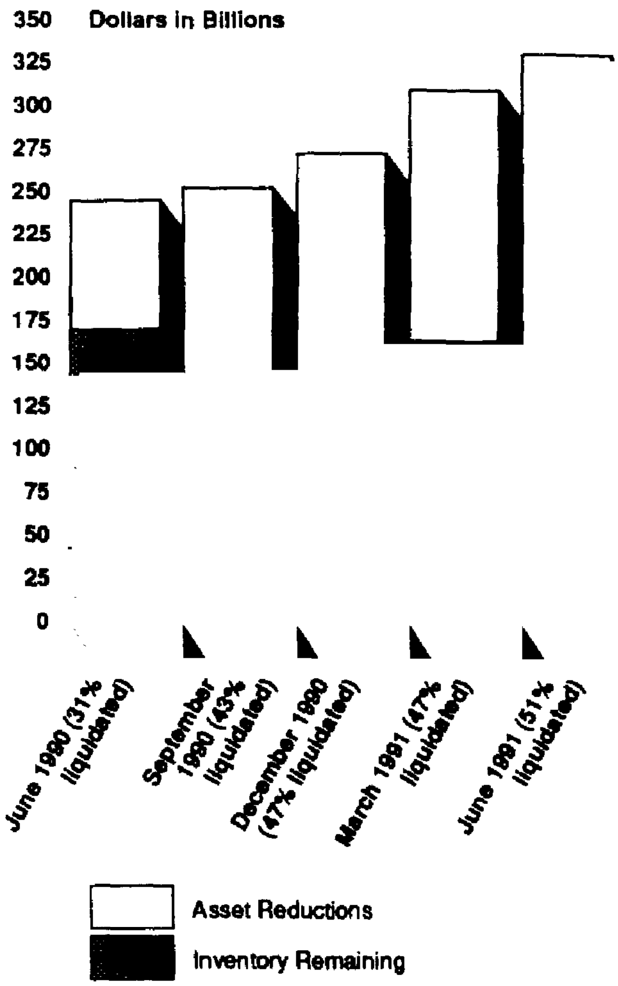
Cumulative Assets Under RTC Control & Inventory Remaining



"% liquidated" refers to total asset reduction divided by the total assets put under RTC's control at any given point in time.

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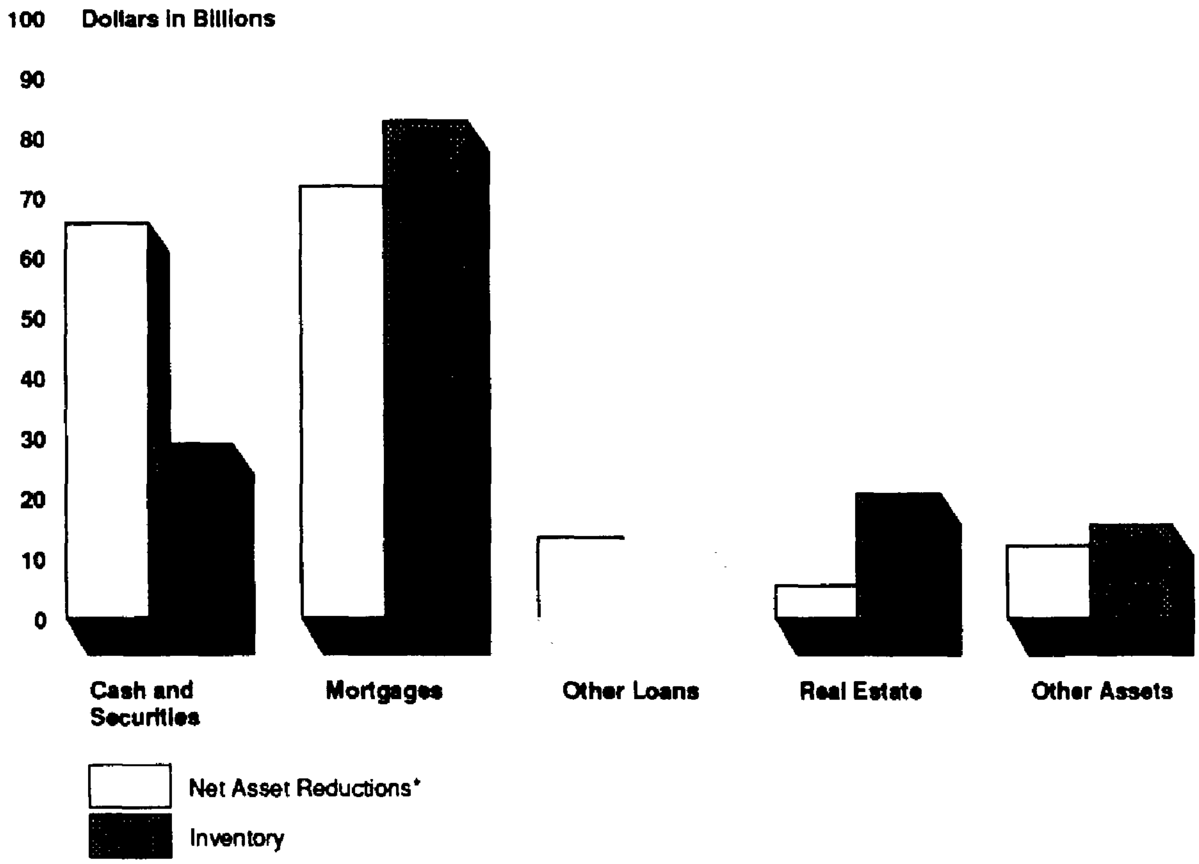
Status of RTC Assets as of June 30, 1991



*Net Asset Reduction figure equals (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 $168.3 billion and total inventory holdings (book value) equaled $160 billion as of June 30, 1991.

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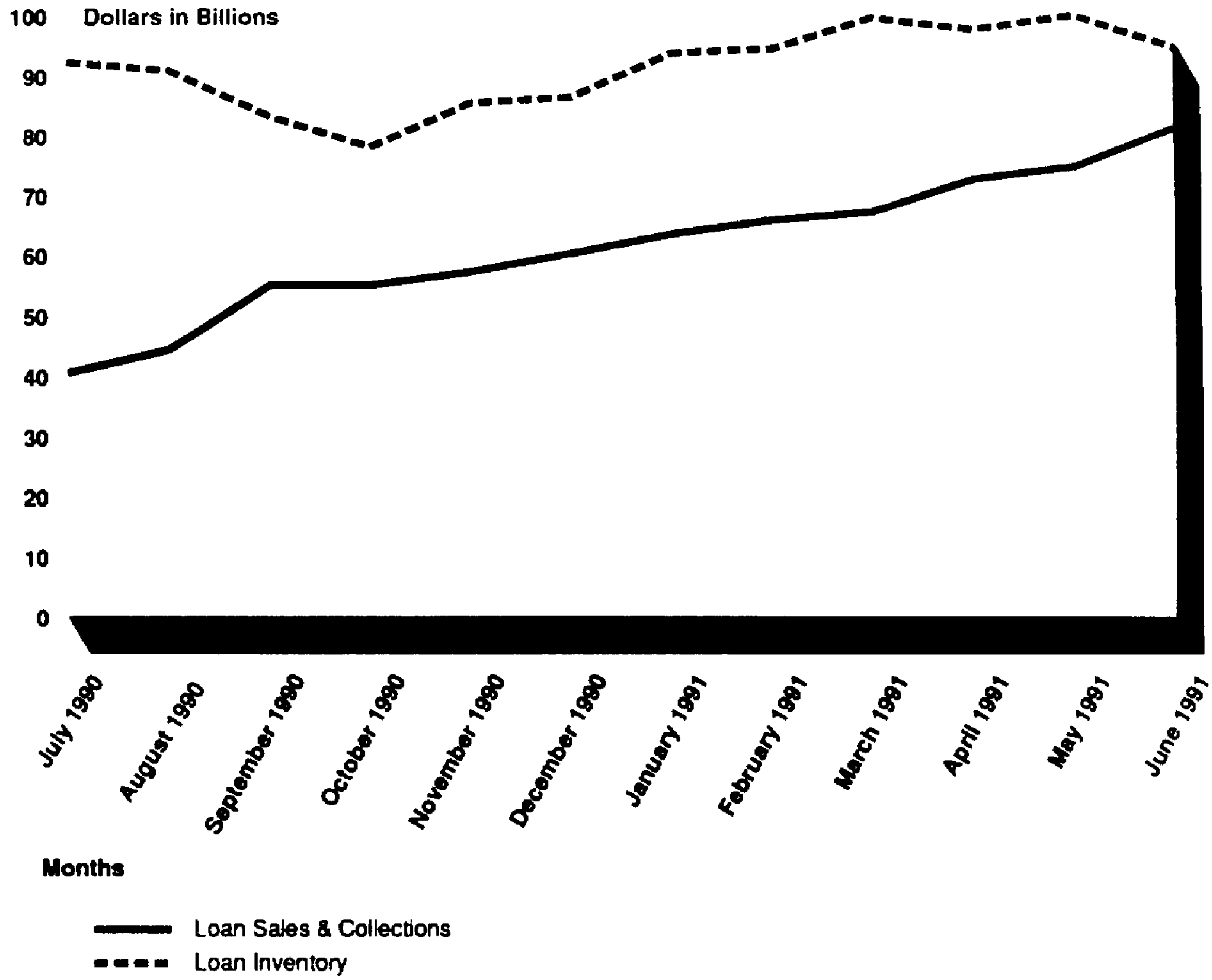
RTC Loan Inventory and Sales & Collection Changes



Loan Inventory includes mortgages and other loans

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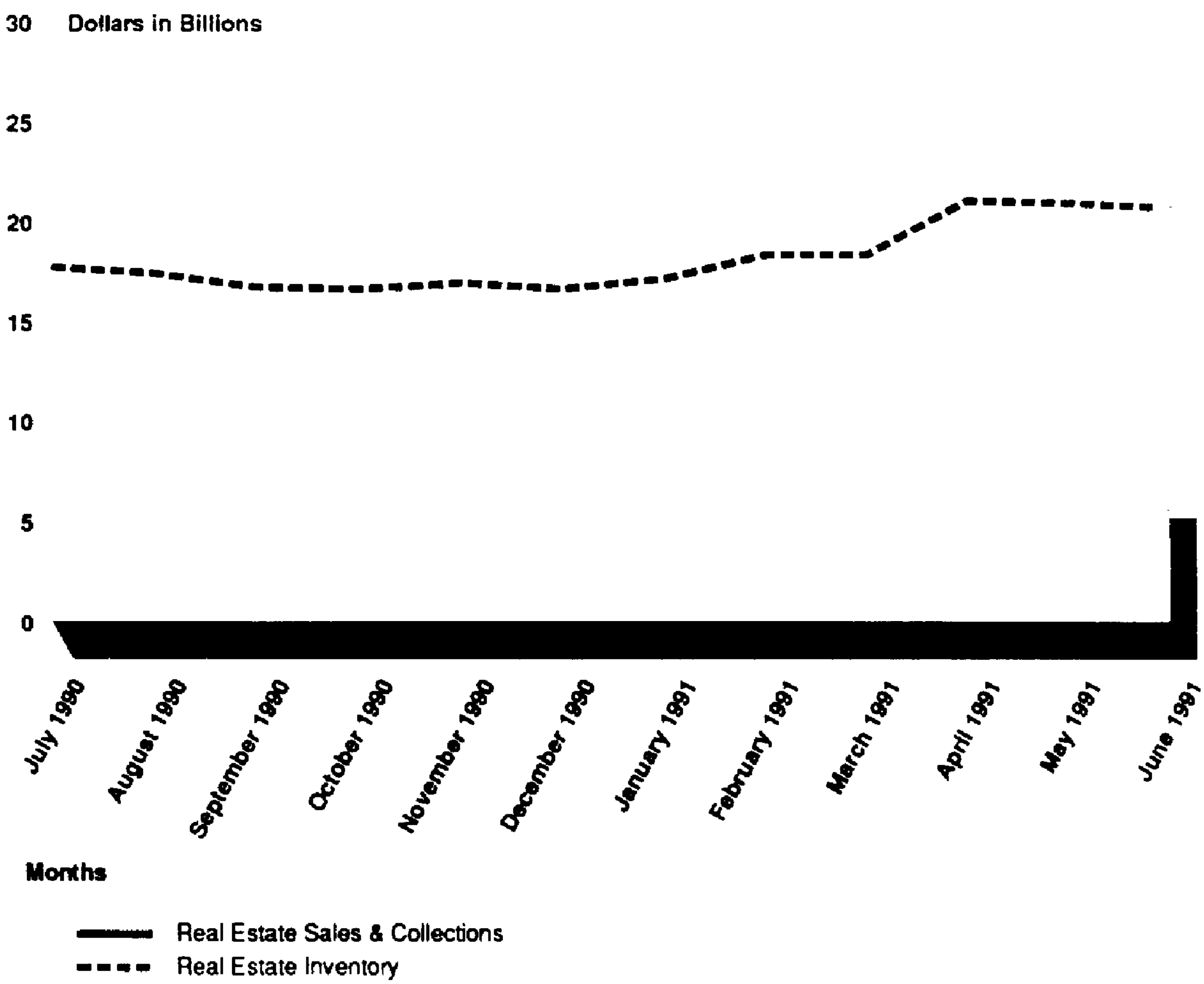
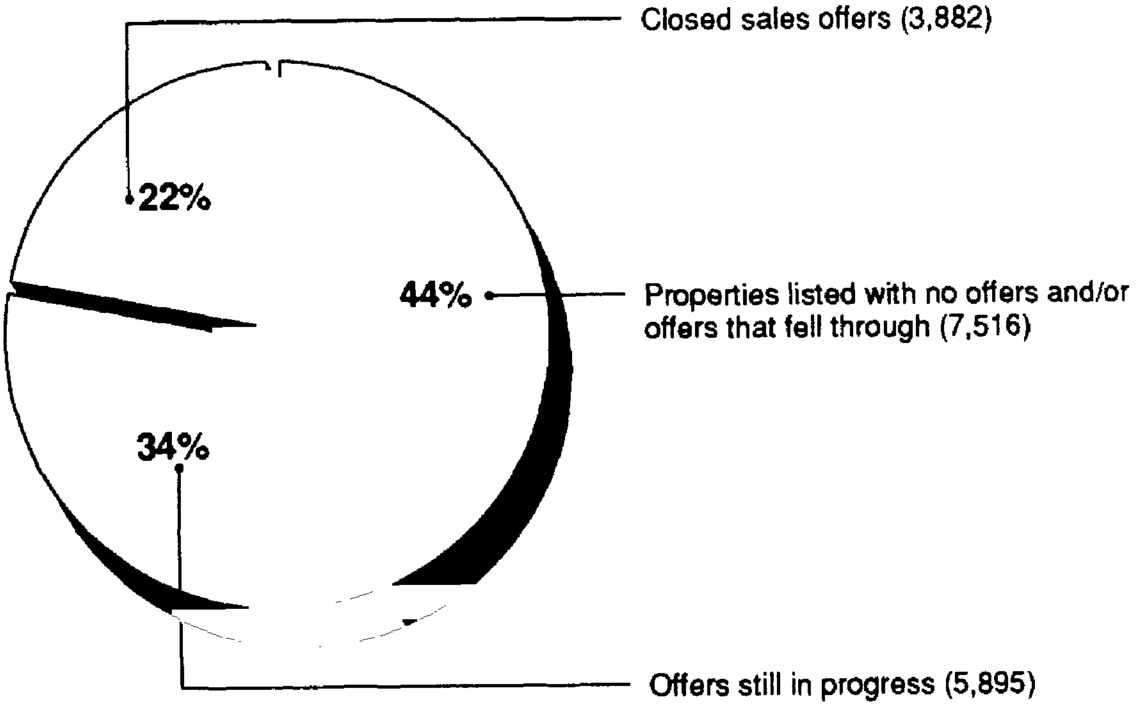
RTC Real Estate Inventory and Sales & Collection Changes

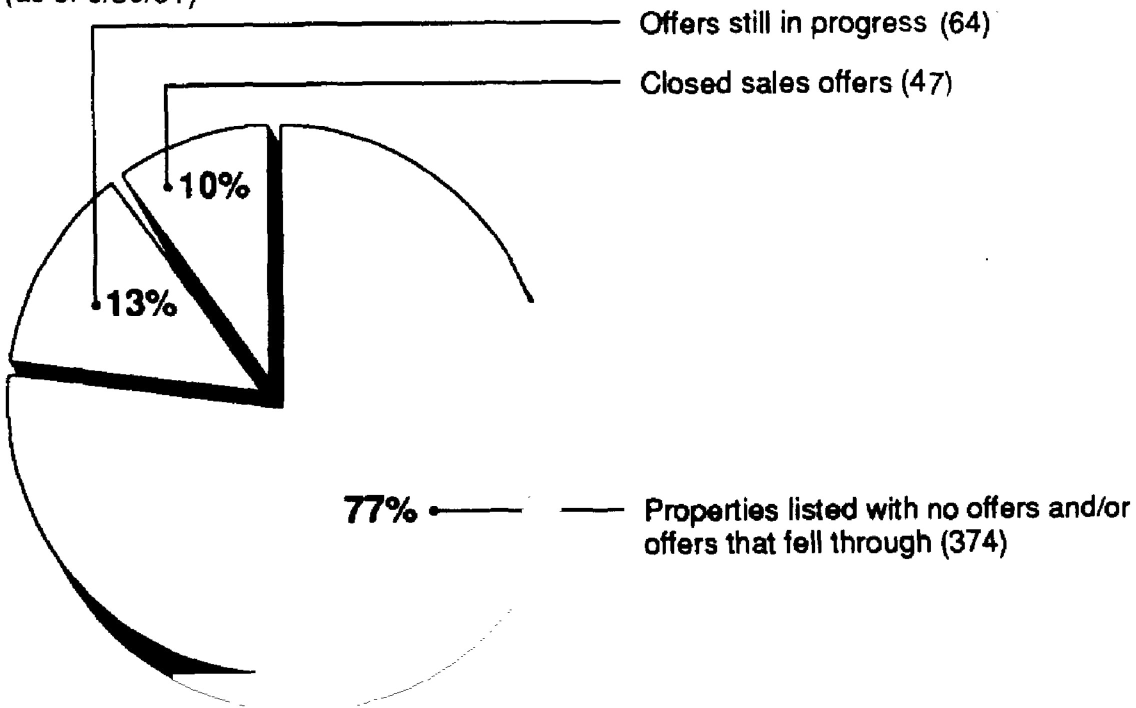


GAO RTC Affordable Housing Sales as of June 30, 1991

Single Family Affordable Housing Sales
(as of 6/30/91)

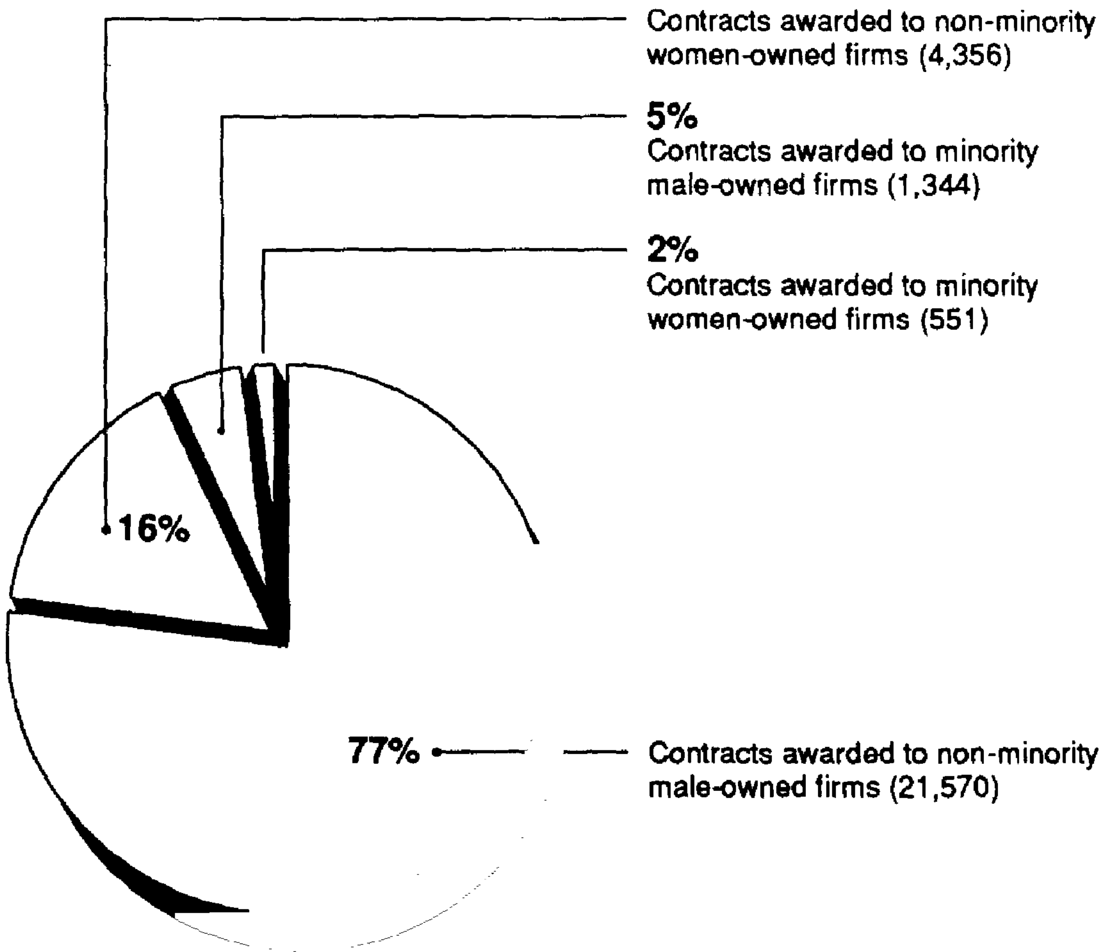


Multi-Family Affordable Housing Sales
(as of 6/30/91)



Based on historical data, only an average of 40 percent of the "offers in progress" will eventually be closed sales.

GAO Percent Contracts Awarded to Minority & Women Owned Firms



Total number of contracts as of 7/31/91 = 27,821