United States General Accounting Office

GAO

Testimony

Before the Committee on Banking, Housing, and Urban Affairs
United States Senate

For Release on Delivery
Expected at
10:00 a.m.
June 2, 1992

BANK AND THRIFT FAILURES

FDIC and RTC Could Do More to Pursue Professional Liability Claims

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054513/146771

GAO/T-GGD-92-42

GAO Form 160 (12/91)
OPR:OIMC/PCC

BANK AND THRIFT FAILURES: FDIC AND RTC COULD DO MORE TO PURSUE PROFESSIONAL LIABILITY CLAIMS

SUMMARY OF STATEMENT BY HAROLD A. VALENTINE
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The Chairman of the Committee on Banking, Housing, and Urban Affairs requested GAO to discuss the efforts of FDIC and RTC to pursue civil professional liability claims arising out of insured bank and thrift failures. Failed financial institutions have cost the financial institution insurance funds and the public billions of dollars. A key component in these failures was wrongdoing, including negligence and fraud, on the part of directors, officers, and other professionals associated with the institutions. FDIC and RTC officials estimate that suspected wrongdoing was present in more than 75 percent of the failed banks and thrifts.

FDIC and RTC have filed professional liability claims in connection with a relatively small number of institutions where wrongdoing was suspected. FDIC has filed such claims in about 20 percent of the banks that failed in 1988. RTC, on the other hand, had claims pending in about 41 percent of the thrifts that failed from January through April 1989.

FDIC and RTC have sound reasons for not always filing claims in cases of suspected wrongdoing. For example, the particular activity may not meet legal or evidentiary standards or it may not be cost effective to pursue the claim. GAO believes, however, that other factors within the control of these agencies, particularly staff shortages, inadequate asset tracing procedures, and weak oversight, have limited these agencies' ability to do more.

Both FDIC and RTC have been slow to hire the attorneys needed to pursue civil claims more effectively. For example, in October 1990, FDIC had only 18 Professional Liability Section attorneys working on RTC professional liability claims. Although RTC now has about 70 such attorneys, senior RTC officials say they need twice this number. FDIC efforts are also hampered by inadequate procedures to identify assets that could be recovered through potential claims. Both agencies face the expiration of statutes of limitations for filing claims in connection with many institutions during the next 12 months. Adding to these problems are uncertainties surrounding the future of RTC's professional liability program because of RTC's downsizing and eventual dissolution in 1996.

Both agencies need to work together to plan for the future of the professional liability program. They need to develop realistic staffing plans, programs to ensure adequate asset tracing, and improved information for effective program oversight.

Mr. Chairman and Members of the Committee:

We are pleased to be here to discuss FDIC's and RTC's pursuit of civil professional liability claims arising from bank and thrift failures. As you know Mr. Chairman, in the past 6 years, over 2,000 banks and thrifts have failed or been placed in conservatorship, costing the financial institution insurance funds and the public billions of dollars. Although regulators and others have attributed these failures to a variety of factors, a key component was wrongdoing, including negligence and fraud on the part of directors, officers, and other professionals associated with the financial institutions. An important part of the government's efforts to recover funds lost from these failures are civil professional liability claims that the Federal Deposit Insurance Corporation (FDIC) and Resolution Trust Corporation (RTC) can file against individuals who engaged in wrongdoing; e.g., were negligent or fraudulent in carrying out their fiduciary responsibilities.

In summary, FDIC's and RTC's performance in investigating and litigating civil professional liability claims could be better. Even though FDIC and RTC officials have estimated that suspected wrongdoing was present in more than three-quarters of the failed institutions, FDIC has filed claims in about 20 percent of the banks that failed in 1988. RTC had claims pending in about 41 percent of the thrifts that failed from January through

April 1989.[1] While FDIC and RTC have sound reasons for not pursuing all potential claims, we believe that more could be done. In particular, staffing shortages, lack of standardized and systematic asset tracing procedures, and weak oversight have limited the agencies' ability to pursue potential claims. Adding to these problems are uncertainties surrounding the future of RTC's professional liability program.

Our work for this study involved interviews with numerous officials at the headquarters and selected field offices of FDIC and RTC. We also talked to private attorneys hired by FDIC and the former Federal Savings and Loan Insurance Corporation (FSLIC) who litigate civil professional liability claims. We reviewed agency documents and correspondence and analyzed caseload and staffing data from these agencies. In addition, we reviewed the investigator files for a sample of 98 banks that failed between January 1, 1986, and June 30, 1990, to determine what, if any, actions the federal government took against individuals or their firms whose wrongdoing contributed to the failures. Our work was done in accordance with generally accepted government auditing standards.

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[1]Our use of the word "claim" when referring to FDIC's workload also includes cases in which settlements were reached.

BACKGROUND

FDIC is responsible for resolving federally insured bank failures.[2] In addition, with the passage of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), FDIC assumed from the former FSLIC responsibility for managing the receivership of federally insured thrifts that failed prior to January 1, 1989. RTC is responsible for resolving thrifts failing between January 1, 1989, through September 30, 1993. The agency is to cease operating by December 31, 1996. FDIC will generally become responsible for (1) resolving those thrifts that fail after September 30, 1993, and (2) completing the resolution of thrifts remaining in RTC's workload when it is abolished.

When FDIC or RTC takes over a federally insured bank or thrift through receivership or conservatorship, it receives the right to pursue civil professional liability claims. In pursuing these claims, these agencies seek recovery (1) from former directors or officers of the failed institution based primarily on their obligations as a director or officer; (2) from accountants, attorneys, commodities or securities brokers, and appraisers based primarily on their obligations to the institution as

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[2]Resolving means disposing of an institution by such methods as sale of the institution, transfer of its deposits and assets, or an insured deposit payout.

professionals; or (3) under a fidelity bond or from insurers of these individuals.

The most common claim is for participation in unsafe or unsound banking practices, in particular for approval of loans that were patently bad at inception. In some cases, directors and officers may have acted fraudulently or used their relationship with the institution to advance their own interests. Typical abuses include improper insider loans or fraudulently contrived loans to permit funds to be funneled to friends of the directors or officers. The following are examples of civil lawsuits filed by the FDIC and RTC:

-- In April 1991, RTC filed a $270 million lawsuit against former directors and officers of an Arizona thrift charging the defendants with negligence, gross negligence, and breach of fiduciary and other duties involving various loans and joint ventures.

-- In December 1991, RTC filed a $140 million lawsuit against former directors of another Arizona thrift alleging that the defendants were negligent and failed to carry out their fiduciary duties in connection with loan underwriting and loan disbursements.

-- In December 1988, FDIC took over a $250 million lawsuit against 27 former directors and officers of a Florida thrift and the law firm and accounting firm that represented the thrift. The lawsuit alleged that the defendants breached their fiduciary responsibilities in failing to prevent unsafe and unsound practices and in violating numerous federal and state regulations and statutes.

-- In June 1991, RTC filed a lawsuit in excess of $31 million against 14 former officers and directors of a Massachusetts thrift for their breach of fiduciary duty, breach of contract, negligence, and gross negligence for their participation in or failure to control certain loan underwriting practices of the thrift.

-- In October 1990, FDIC filed a $220 million lawsuit against three former officers of an Idaho thrift for their negligence, breach of fiduciary duties, and violations of federal and state laws in connection with the thrift's trading in futures and options.

In pursuing civil actions, FDIC and RTC are attempting to recover funds for losses brought about by culpable individuals. Recoveries can come directly from the assets of the individuals or from insurance policies covering professional misconduct.

Ultimately, the recoveries are to help cover the cost of resolving the failed institutions.

FDIC and RTC investigators and attorneys assess the viability of professional liability claims. The goal of these investigators and attorneys is to pursue claims where a sufficient factual and legal basis exists to demonstrate liability and where the expected recovery exceeds the cost of the suit.[3] Among other things, investigators review prior examination reports, loan files, and other records to identify wrongdoing and look for insurance coverage or assets that could be recovered through a civil claim.[4] Attorneys in the FDIC and RTC Professional Liability Section (PLS) advise the investigators on information needed to develop and support claims.

For the most part, FDIC and RTC professional liability attorneys do not actually litigate the claims in court. Instead, once claims are authorized, they hire private law firms to litigate the claims. However, a key responsibility of RTC and FDIC attorneys involves not only the hiring of these private law firms, but also the oversight and management of the cases. Frequently, the cases are extremely complex and FDIC and RTC

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[3]According to FDIC and RTC, exceptions may be made for deterrent or precedential purposes.

[4]RTC expects to contract out about 60 percent of its investigative work in 1992. FDIC, on the other hand, expects to continue to use outside contractors only to meet specialized needs.

attorneys must help to ensure that the agency is taking consistent positions throughout the country. The RTC and FDIC attorneys must approve all major strategic decisions by the private law firms. In some cases, FDIC and RTC have also used private outside law firms to help decide whether to file a claim. In 1991, FDIC and RTC spent approximately $110 million for professional liability outside counsel.

Civil professional liability claims are not the only actions the federal government can take against professionals whose wrongdoing contributed to the failure of a bank or thrift. The bank and thrift supervisory regulatory agencies can pursue administrative enforcement actions, and the Department of Justice can pursue criminal prosecution. When FDIC and RTC investigators identify wrongdoing that they suspect to be criminal in nature, they are to report it to the FBI and the U.S. Attorneys Office. In 1990 and 1991, RTC made more than 2,000 criminal referrals to the Department of Justice. During the same period, FDIC made more than 4,000 criminal referrals, but this includes referrals involving both failed and on-going institutions. Separate FDIC referral data on failed and on-going institutions are not available.

The supervisory regulatory agencies may take an administrative enforcement action against a financial institution or an institution-affiliated party for engaging in unsafe and unsound practices or violations of law or other regulatory guidelines.[5] Examples of actions these agencies may take against an institution-affiliated party both before or after the institution failed are (1) barring the individual from participating, in any manner, in the conduct of the affairs of any federally insured institution; (2) assessing civil money penalties (the proceeds of which go to the U.S. Treasury); and (3) requiring affirmative action, such as restitution or providing reimbursement, to correct conditions resulting from violations or unsafe or unsound practices.

These agencies have taken administrative enforcement actions involving failed institutions. For example, in the largest recovery by the Office of Thrift Supervision (OTS), a New York law firm agreed to pay $41 million and to bar two of its partners from representing financial institutions to settle a $275 million suit charging that the law firm misled thrift regulators concerning a California thrift. In another action connected with a Colorado thrift, OTS obtained agreement from a law firm to bar one of its partners from serving as a director or officer of any insured depository institution for 5 years. Other federal and state agencies are attempting to take additional enforcement actions against individuals connected with failed financial

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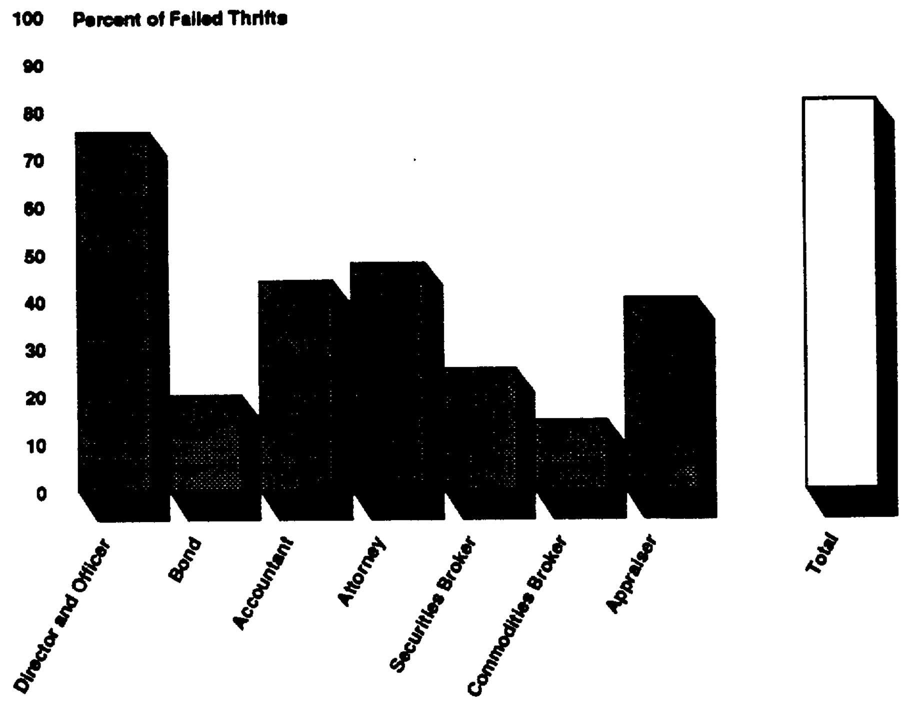
[5]Institution-affiliated parties include directors, officers, employees, controlling stockholders, and independent contractors such as attorneys, appraisers, and accountants.

institutions. Our study, however, focussed on FDIC's and RTC's civil professional liability program.

CIVIL RECOVERIES FROM BANK AND THRIFT WRONGDOERS HAVE BEEN LIMITED

RTC and FDIC officials estimate that possible wrongdoing was present in more than three-fourths of failed banks and thrifts. Senior FDIC headquarters and field officials told us, for example, they have found indications of suspected wrongdoing by directors, officers, or other professionals in 90 percent of failed banks. More detailed information shows that FDIC at least anticipates filing a claim in 75 percent of the banks that failed in 1990 and 1991. In addition, RTC data shows that RTC attorneys at least suspect that wrongdoing was present in over eighty percent of the failed thrifts. Figure 1 illustrates the percent of RTC thrifts where wrongdoing was, at least, suspected.

Figure 1: Suspected Wrongdoing in Most Failed Thrifts



Note: This data is based on the RTC PLS attorneys' views of potential claims as of September 30, 1991. The percent was based on the number of thrifts where they had sufficient information to at least make an initial determination.

Source: RTC.

When all categories of professionals are considered, RTC attorneys at least suspect wrongdoing on the part of one or more professionals affiliated with the institutions in 81 percent of failed thrifts.

Since 1989, FDIC and RTC have recovered nearly one billion dollars from professional liability claims and settlements. Table 1 details these recoveries.

Table 1: FDIC and RTC Recoveries Received from Professional Liability Claims and Settlements

FDIC and RTC recoveries[a] (in millions of dollars)					
	1989	1990	1991	1992[c]	Total
FDIC: Banks	$ 60.5	$131.7	$ 72.9	$ 18.7	$283.8
FDIC: Thrifts	87.4[b]	231.4	246.4	75.9	641.1
RTC	4.2	9.9	30.6	15.9	60.6
Totals	$152.1	$373.0	$349.9	$110.5	$985.5

[a]FDIC figures include collected judgments and settlements that have been collected or are highly likely to be collected. RTC figures are actual civil cash recoveries.

[b]Includes approximately $50 million collected by FSLIC prior to the passage of FIRREA.

[c]FDIC data as of March 31, 1992; RTC data as of May 1, 1992.

Source: FDIC and RTC.

About half of these recoveries came from director and officer claims and settlements. Bond claims comprised about 18 percent, accountant claims about 5 percent, attorney claims about 18 percent, and other claims about 7 percent.

A small portion of the FDIC recoveries came from the personal assets of the wrongdoers. The source of most of the money has been the insurance policies held by either the financial institution or associated professional organizations, such as accountant or law firms. FDIC officials estimate that 95 percent of total recoveries for 1989 through 1991 came from insurance companies. According to RTC, about two-thirds of the recoveries have come from the individuals and about one-third from the insurers.

RTC and FDIC currently have a number of lawsuits in process that have not been litigated or settled. As of May 1992, RTC had 170 claims pending that involve more than $4.5 billion. As of the same date, FDIC had about 330 pending claims, but it did not specifically know the dollar amount involved. FDIC officials estimated it was several billion dollars. Settlements and recoveries from claims are usually considerably less than the amount of damages called for in the lawsuit.

For various reasons, FDIC and RTC do not pursue all claims of suspected wrongdoing. As of March 1992, FDIC had filed 41 claims in about 20 percent of the banks that failed in 1988. As of March 1992, for those institutions that have failed between January 1, 1988, and December 31, 1991, FDIC filed 69 claims involving less than 10 percent of the banks.[6]

Our review of case files in a sample of 98 failed banks also indicated that few claims had been filed. We looked at investigator files for 98 banks that failed between

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[6]This information on FDIC claims was provided by FDIC Investigations officials.

January 1, 1986, and June 30, 1990.[7] For the 98 banks we reviewed, FDIC pursued 16 professional liability claims involving 14 of the banks. Of these, 6 were director and officer claims and 10 were bond claims.

RTC, on the other hand, has filed claims in a larger percentage of its failed institutions. As of May 12, 1992, RTC had claims pending in about 41 percent of the 218 thrifts that failed from January through April 1989. In total, RTC had about 170 claims pending in 125 failed thrifts. These actions were taken in about 18 percent of the thrifts RTC was responsible for.[8] On May 28, 1992, RTC officials told us that in the 342 institutions where the investigation had progressed to the point of a decision, RTC had filed a claim or an RTC official had made a decision that a suit is warranted in 189, or 55 percent, of those institutions.

FDIC and RTC have sound reasons for not always filing a claim in cases of suspected wrongdoing. For example, the particular activity may not meet the legal or evidentiary standard or pursuing the claim may not be cost effective. There are, however, other factors within the control of these agencies that have hampered their litigation efforts.

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[7]We reviewed the investigator files in selected FDIC consolidated field offices for all failed banks for which the professional liability claims were closed.

[8]As of May 1, 1992, RTC had received recoveries on 40 settlements.

INADEQUATE STAFFING HAS PUSHED CASES UP AGAINST THE STATUTE OF LIMITATIONS

FDIC's and RTC's efforts to plan for future staffing needs were inadequate and contributed to professional liability attorney shortages. These shortages have resulted in many cases facing the FIRREA 3-year statute of limitations.[9] Although staffing levels in both agencies have improved, RTC's downsizing initiative may result in future staffing problems. In addition, RTC's rapidly increasing number of claims will require substantial numbers of attorneys.

Professional liability attorneys are critical to the professional liability program. Not only do they oversee work of investigators and make decisions about whether to file a claim, they also must hire and manage private law firms who litigate the claims.

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[9]The 3 year FIRREA statute of limitations for tort claims begins to run on the date of appointment of FDIC or RTC as conservator or receiver, or the date on which the cause of action accrues, whichever is later. Actions may also be brought, in certain circumstances, beyond this 3-year period. First, actions may be brought under the limitations period applicable under state law. FDIC noted in recent testimony that 14 states have a longer limitations period than FIRREA. Second, FDIC and RTC may enter into tolling agreements that temporarily extend the statute of limitations.

But despite the crucial nature of these attorney positions, both FDIC and RTC have been slow to add staff. Even though FDIC's PLS faced a dramatically increasing workload in the late 1980s, it was slow to add attorneys. In addition to managing bank failures, in February 1989 FDIC became responsible for managing thrifts placed in conservatorship or receivership from February 6, 1989, to August 9, 1989.[10] By August 1989, these thrift failures totaled 253. According to a senior FDIC official, the combination of these thrifts and additional bank failures resulted in FDIC's average professional liability attorney workload doubling from approximately 20 to 25 failures per attorney in 1988 to 40 to 50 in August 1989. In August 1989, FDIC had 22 professional liability attorneys. During this period, according to a senior FDIC official, some attorneys had a workload as high as 70 institutions. This official noted that this high workload hindered the attorneys' ability to effectively handle their cases.

FDIC and RTC were also slow to add staff for RTC cases. When RTC was initially established, RTC's professional liability work was handled within the FDIC PLS. The FDIC PLS formed separate teams to handle RTC and non-RTC claims. As late as October 1990, the RTC teams had only 18 attorneys to oversee professional liability investigations and claims involving almost 500 failed thrifts.

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[10]According to an FDIC official, about 12 thrifts that failed during that time frame were handled by FSLIC.

In early 1991, RTC established a separate Professional Liability Section within its Legal Division.

PLS staffing has increased substantially, but FDIC and RTC officials noted that most of the new attorneys, while qualified, did not have experience handling all types of professional liability claims when they were hired. Agency officials estimated the learning curve to be between 9 and 18 months, depending upon experience level. As of April 1992, RTC had 70 attorneys and FDIC had 105.

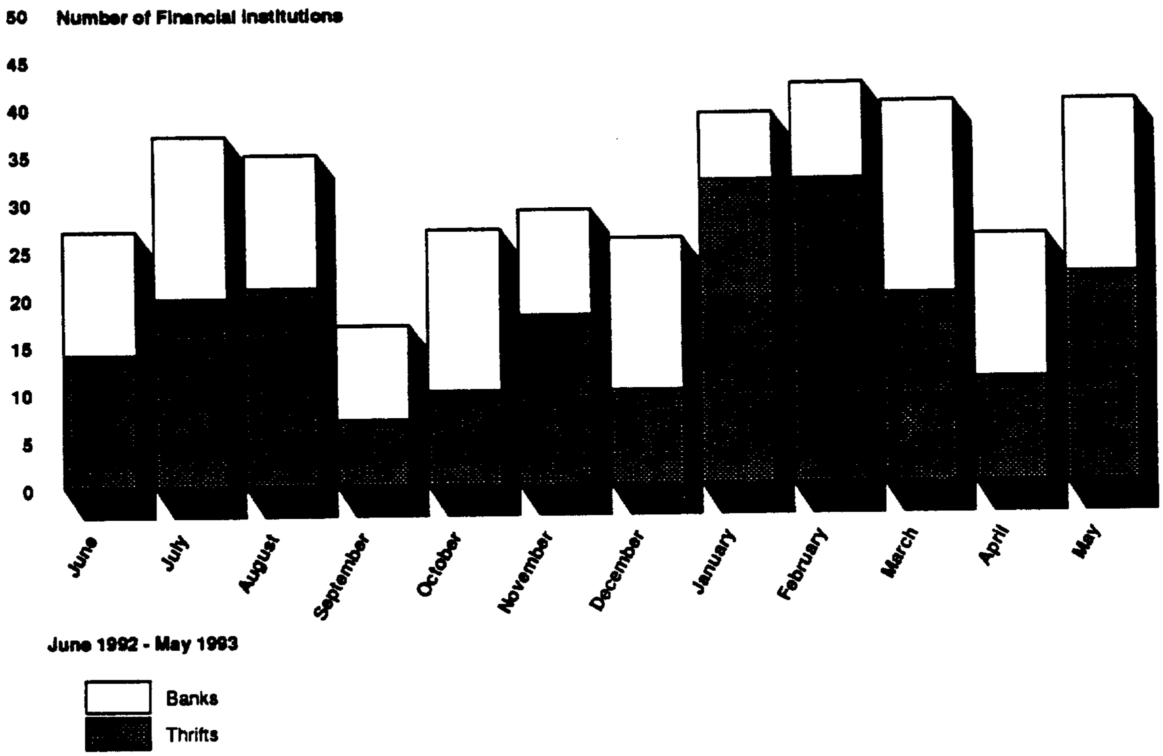
In an August 1991 memorandum to the Executive Director, RTC's General Counsel reported that the PLS needed 140 attorneys to adequately carry out the work generated by both the current number of conservatorships and receiverships, as well as the additional thrift failures. He said that PLS needs were barely being met by hiring outside counsel to help make the sensitive decisions on what claims to file. Since that time, PLS staffing has dropped from 73 to 70. On the other hand, the FDIC PLS Associate General Counsel believes he now has adequate staff to handle the current and anticipated workload, assuming PLS' responsibilities do not change.

Staffing shortages contributed to FDIC and RTC decisions on many cases facing the expiration of the statute of limitations. According to the FDIC General Counsel, FDIC has been taking an average of 33 months from the time the institution fails to the filing of a claim. The Associate General Counsel for PLS said that for some claims, FDIC had been working in a crisis mode. FDIC was processing memos to authorize the filing of claims 2 weeks before the statute of limitations period expired.

RTC has also operated under a crisis mode. During the first 4 months of 1992, RTC was faced with the expiration of the limitations period on 218 thrifts. RTC had about 127 claims on about 90 of these thrifts pending as of May 12, 1992. About 60 percent of these claims were filed not earlier than 1 week before the expiration of the limitations period.

Both FDIC and RTC face the expiration of the statute of limitations in numerous institutions during the next 12 months. Both agencies still need to make decisions on a significant number of these institutions. Figure 2 shows the number of institutions in which there are claims that will be time-barred in the 12 months beginning June 1992.

Figure 2: Many Civil Liability Cases Facing Statute of Limitations



Source: FDIC and RTC.

Future staffing needs will be affected by a number of factors. First, both the FDIC and RTC PLS have set a goal of reducing the amount of time it takes from an institution's failure to the decision of whether to file a claim. FDIC wants to reduce the time from almost 3 years to 2 years and finally 1 year by 1994. RTC wants to reduce the time to 1-1/2 years. Second, as I will explain in a minute, both agencies will need to spend increasing amounts of time tracing assets of the wrongdoers. Finally, staffing needs will be affected by RTC's downsizing and eventual disbandment. This last point will be discussed in the last section of my testimony.

EFFORTS TO IDENTIFY RECOVERABLE ASSETS HAMPERED BY INADEQUATE ASSET TRACING PROCEDURES

FDIC and RTC officials said that the key reason cases are not filed against suspected wrongdoers is recoverable assets are not identified, so officials do not know if the claim would be cost effective. Asset identification will be increasingly important to future program success as the primary source of recoveries in the past--director and officer liability insurance--becomes less available. Yet the agencies' ability to pursue personal assets of the culpable individuals has been hampered by not only inadequate staffing as noted above, but also by a lack of standardized asset identification procedures.

FDIC and RTC investigators and attorneys work together to develop potential professional liability claims. FDIC and RTC investigators and attorneys told us that a key factor limiting greater recoveries is difficulty identifying recoverable assets of the wrongdoers. When the investigators and attorneys decide a potentially meritorious claim exists, the investigator will look to see what recoverable assets are available from, among other sources, the personal assets of the wrongdoers, and the attorneys will examine any applicable insurance policies. If adequate recovery sources are identified, the investigator will do more in-depth work to support the claim.

FDIC and RTC officials said they have encountered difficulties in determining what, if any, assets these individual wrongdoers have. We were told by one FDIC regional senior investigation official that ascertaining the true net worth is probably the most frustrating step in the investigative process. Without reliable financial data, FDIC and RTC do not have the information needed to make a well-informed decision on the cost effectiveness of potential litigation.

Asset tracing will be even more important in the future because the availability of the largest source of recoveries--insurance policies--is diminishing. Historically, the biggest source of FDIC recoveries in civil professional liability cases has been the insurance industry. As mentioned before, FDIC officials told us that 95 percent of the recoveries between 1989 and 1991 had been paid by insurance companies. They said that of the banks that have recently failed, fewer have had insurance coverage than those in the past. RTC officials told us that few of the thrifts that failed recently have had insurance coverage, so the director and officer and bond insurance industry have not been the primary source of their recoveries. Only one-third of RTC's recoveries have come from insurance.

FDIC and RTC officials also expect to recover less through insurance due to the evolution of regulatory exclusion provisions in director and officer policies. The FDIC believes these exclusions, which usually bar any claim brought against a director or officer by a federal agency, pose serious obstacles to the pursuit of director and officer claims. According to the FDIC PLS Associate General Counsel, prior to FIRREA, FDIC was winning at least two out of three cases in which it challenged regulatory exclusions in director and officer insurance policies; FDIC is now losing most of these cases on the trial court level. Several recent court decisions have upheld the exclusions, rejecting FDIC's argument that the exclusions violate public policy.[11] In holding that the public policy argument lacks statutory support, the courts have pointed to language in section 212 (e) (12) of FIRREA. This language authorizes FDIC and RTC to enforce a failed institution's contracts notwithstanding clauses that terminate rights upon insolvency or the appointment of a conservator or receiver, but it explicitly excludes director and officer liability insurance contracts from this enforcement authority.

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[11]See Powell v. American Casualty Company of Reading, Pennsylvania, 772 F. Supp. 1188 (W.D.Okl. 1991); American Casualty Company of Reading, Pennsylvania v. Baker, 758 F. Supp. 1340 (C.D.Cal. 1991).

FDIC estimates that it lost as much as $29 million in potential director and officer insurance claims in 1991 because the courts are upholding this exclusion. In addition, FDIC and RTC estimate that the government could also lose as much as $800 million in outstanding claims. In order to reclaim this source of recoveries, FDIC has continued to challenge the exclusion in litigation and has urged the amendment of section 212 of FIRREA. According to FDIC, this exclusion is now appearing in other forms of professional liability insurance policies, such as attorney malpractice policies.

Despite the increasing importance of asset tracing, FDIC does not have any standardized systematic asset tracing procedures or an asset tracing program. FDIC is developing a standardized policies and procedures manual for the investigators in an attempt to get consistency throughout the country. According to FDIC officials, the manual will include a section on asset tracing that will provide information on sources available for tracing assets rather than procedures or guidelines on how to search for assets. FDIC does not plan to develop a standardized asset tracing program.

RTC recognized the importance of asset tracing shortly after its inception and decided to initiate a project to develop in-house asset tracing capabilities. It developed a structured program that is divided into three phases. Briefly, phase I is done in the regional and field offices and consists of a search of (1) public record databases, (2) court records, and (3) thrift records. If leads are found, a search can be elevated to the second phase, which primarily involves a search of federal databases. RTC headquarters staff coordinate the searches for this phase. RTC is working on the third phase, which will involve getting international data. RTC began setting up asset tracing units in the field in September 1991 and by mid April 1992 had units established in all but three offices. According to RTC officials, the in-house system has several advantages over the use of outside contractors. It is more cost effective, the data are more comprehensive and reliable, and results are available more quickly. Regarding standardized policies and procedures overall, RTC Investigations expects to have a standard policy manual by mid-summer that will include a framework for the procedures to be used.

BETTER MANAGEMENT INFORMATION IS NEEDED

In addition to the problems with staffing and asset tracing, FDIC and RTC do not have adequate management information to oversee the professional liability program. Specifically, neither FDIC nor RTC have complete and current information on (1) the status and disposition of investigations and claims and (2) the cost of investigation and litigation. FDIC and RTC have made some progress in developing or enhancing their management information systems to capture this information. However, both agencies are using several different data systems to keep track of their investigations and claims, and these systems do not interface with each other. As a result, neither FDIC nor RTC can determine how effective they have been in pursuing those individuals whose wrongdoing contributed to bank and thrift failures.

Both FDIC and RTC PLS offices are currently using an FDIC microcomputer-based system called the Professional Liability Case Tracking System to track the progress of cases in litigation. The system, which became operational during the summer of 1990, tracks, among other things, the number of claims, suits, settlements, judgments, and the amount of the recovery. The FDIC system does not have complete historical data on professional liability activity prior to its implementation in 1990. Further, FDIC and RTC headquarters do not have on-line access to information maintained by field office PLS attorneys.

In 1989, FDIC's Division of Liquidation (DOL) began using a computer-based system called the Management Investigation Data and Analysis System (MIDAS). Initially, FDIC and RTC planned to use this system to capture data for both FDIC and RTC professional liability investigations. However, both FDIC and

RTC have decided not to use MIDAS and are developing other systems.

In June 1991, after experiencing many problems, FDIC abandoned MIDAS and is currently developing a replacement system called the Division of Liquidation Locating and Reporting System (DOLLARS). FDIC officials said that the system is currently being tested in selected consolidated field offices and is expected to be completely operational in June 1992. Currently, when agencywide data are needed, FDIC headquarters currently must obtain the information from each regional office. The regional offices, in turn, must get the information from their consolidated field offices. Consequently, FDIC experiences delays in obtaining current information about its investigations. Our problems in obtaining basic information on FDIC's professional liability program illustrate this point. In January of this year we requested information on the status of FDIC's investigations. It took FDIC more than 3 months to provide this information.

RTC developed its own data system in 1990--the Thrift Investigation Management System (TIMS)--to track its investigative work. However, this system has limitations. RTC headquarters does not have on-line access to data in the regional or field office systems. Each field office sends updated information on a monthly basis to the appropriate regional office. The regional offices consolidate the information from their field offices and send the information to headquarters, where the data from all regional offices are merged into the headquarters database. RTC is currently analyzing the benefits of a mainframe system to allow quick and concise access to all merged consolidated office data.

Officials at both agencies acknowledged that in the past updating information in their data systems was not a priority because of their heavy workload. Consequently, their data systems do not have current information on the status of all of their investigations and claims. In addition, neither agency keeps track of investigative or litigation costs on a case-by-case basis or information on reasons why claims are not filed.

Overall, because of inadequate information, managers cannot effectively oversee the professional liability program. In particular, managers do not have the necessary information to (1) determine whether specific investigations and claims are cost effective or (2) evaluate the performance of field offices or the private attorneys who litigate the claims.

BETTER PLANNING NEEDED TO MINIMIZE PROBLEMS AS RTC DOWNSIZES AND IS DISSOLVED

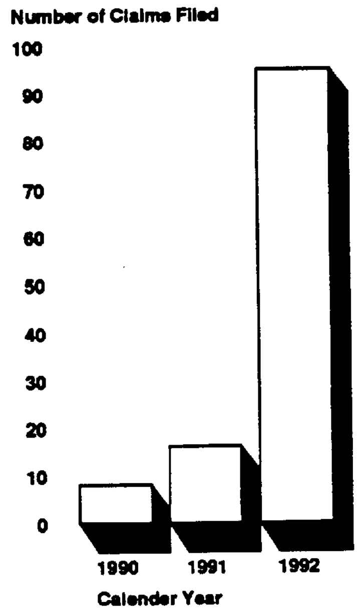
The uncertainties surrounding RTC's professional liability program further highlight the need to improve management of this area. Since 1989, there has been a high level of change surrounding the professional liability program, including what agency is responsible for what failures, the reporting lines for the responsible legal sections, and the geographic placement of the attorneys doing the work. We were told of various problems that were associated with these realignments, many of which are interrelated and have been mentioned earlier. They include delays in staffing decisions, heavy workloads, low staff morale, difficulties in finding records, and delays in attorneys giving guidance to investigators and investigators providing information to attorneys.

In addition, RTC announced plans in March 1992 to reduce staff and consolidate operations. The restructuring is part of RTC's phase-down as the number of conservatorships projected to come under RTC's control decreases. By September 1993, RTC will merge 15 consolidated field offices and 4 regions into 6 field offices and will reduce its field staff by about 50 percent.

RTC's downsizing efforts obviously affect all parts of the agency. Their impact, though, may be felt more strongly by the units doing professional liability work. The combination of deciding whether to file claims in the additional thrifts, coupled with monitoring and supporting the rapidly increasing litigation, suggests the bulk of RTC's work is yet to come. According to agency officials, it takes on average 2 to 3 years from the date of failure for RTC to determine whether or not to file a claim. If a claim is filed, resolution often takes another 2 to 3 years. As noted before, by early May 1992, RTC had made decisions on whether to file a claim in over 200 thrifts. There are about 465 additional thrifts for which RTC must make these decisions between June 1992 and the end of 1994.

RTC's attorney workload will also be affected by the rapidly expanding number of claims they are filing. During the first 4 months of 1992, RTC filed 94 claims, significantly more than any previous period. As noted previously, even though these claims will be litigated by private counsel, RTC attorneys will need to support and oversee this litigation. The increase in the number of RTC claims is illustrated by figure 3.

Figure 3: RTC Filing More Claims



Note: Data based on claims pending as of May 12, 1992.

Source: RTC.

With RTC's downsizing and eventual disbandment, many of the problems that occurred when RTC was getting established could recur. FIRREA and the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991 stipulate that FDIC is generally to assume responsibility for thrifts that fail after September 30, 1993, and is to take over RTC's entire workload by 1997. However, FDIC and RTC PLS and investigation officials said it was not clear how RTC's pending caseload and future professional liability cases will be transferred to FDIC. FDIC officials said they are not planning for this future workload.

FDIC and RTC need to plan for the orderly transition of RTC work and need to address a number of issues. The primary issue is how integrate the two agencies' work. The agencies have developed their own methods of doing the professional liability work and have different management styles and approval processes. As is evident by the failure of these agencies past attempts to work together, FDIC's integration of the two agencies' work will not be an easy task. For example, the agencies' investigative units initially tried to work together on a variety of projects, including the design of a management information system and an introductory training program. For a number of reasons, these joint efforts failed and the units are working and developing procedures and projects on their own.

CONCLUSIONS AND RECOMMENDATIONS

In summary, Mr. Chairman, wrongdoing on the part of directors, officers, and other professionals was a key factor in the failure of many banks and thrifts. FDIC and RTC have pursued professional liability claims against these individuals, but staffing shortages and inadequate asset tracing procedures and management information systems have hampered this effort. In addition, uncertainties surrounding the future of RTC's professional liability program complicate these issues.

Accordingly, we recommend that FDIC and RTC work together to plan for the future of the professional liability program. This planning needs to address how FDIC will assume responsibility for

RTC's professional liability cases. In addition, the agencies should develop (1) realistic staffing plans, (2) programs to ensure adequate asset tracing, and (3) improved management information for effective program oversight.

That concludes my statement, Mr. Chairman, we would be happy to respond to any questions.