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FEDERAL DEPOSIT INSURANCE CORPORATION

TESTIMONY OF

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WASHINGTON, D.C.

ON

STATUS OF THE RESOLUTION TRUST CORPORATION

BEFORE THE

COMMITTEE ON BANKING HOUSING, AND  
URBAN AFFAIRS  
UNITED STATES SENATE

10:00 A.M.  
October 4, 1989  
Room SD-538  
Dirksen Senate Office Building

SUMMARY STATEMENT  
STATUS OF THE RESOLUTION TRUST CORPORATION

Introduction: Much has been accomplished since FIRREA was enacted. However, much more remains to be done before the RTC is fully staffed with all operating policies and procedures in place. During this start-up period we have worked closely with the Oversight Board to institute policies.

RTC Organization Structure and Staffing: The RTC's major organizational components are the Asset and Real Estate Management Division and the Resolutions and Operations Division. Current Washington staff is approximately 100, with an expected total of about 250. The four regional offices established in Atlanta, Dallas, Denver and Kansas City each will be relatively small, with approximately 100 employees exclusive of accountants and attorneys. Consolidated field sites will be established in each region primarily to administer RTC's asset and real estate management function, and will have the bulk of employees. There are currently about 800 field employees with substantially more expected by year-end. The RTC expects to employ outside contractors wherever practical. RTC staffing will be minimized and will be mostly temporary employees. Even then, RTC could employ anywhere between 5,000 and 10,000 people by the end of 1990.

General Operating Policies: On the day FIRREA was enacted the RTC adopted FDIC policies as interim operating policies, which allowed the RTC to immediately begin its important tasks. The Oversight Board also has adopted policies which are being followed by the RTC.

Ethics and Conflicts of Interest: The RTC Board, at its August 9 organizational meeting, extended the FDIC's "standards of conduct" regulations to RTC independent contractors. On September 26, the RTC Board adopted an interim statement of principles of ethical conduct for independent contractors, developed in coordination with the Oversight Board. We anticipate publication in early November of proposed regulations, and foresee having final regulations in place by the February 5, 1990 statutory deadline.

Bribery: The RTC follows the FDIC in relying on three tiers of action to guard against bribery of an RTC official. These three tiers include the threat of criminal prosecution; internal RTC controls, audits and investigations; and encouraging those suspecting bribery to come forward.

Political Favoritism and Undue Political Influence: We expect FDIC's culture of political independence to carry over to the RTC by placing FDIC employees in key RTC positions and by hiring through competitive government procedures. Working with the Oversight Board, the RTC will establish specific written policies and procedures that will draw on current FDIC policies.

RTC Operations and Resolutions: As of September 30, the FDIC had placed 283 thrifts in the conservatorship program with gross total assets of \$112 billion and combined total liabilities of \$124 billion. Combined losses are estimated at about 31 percent of gross assets, or \$35 billion. As of September 30, the RTC had made secured loans to 151 conservatorships of \$8.1 billion to replace high cost funding sources, for an estimated savings of \$118 million on an annualized basis. As of September 18, only one of our institutions was among the top 35 highest rate payers. The RTC also has used funds to provide emergency liquidity to 41 conservatorships in the amount of \$0.5 billion.

As of September 30, the RTC had resolved 24 institutions and disbursed \$1.8 billion to cover insured deposits. There were twenty insured deposit transfers and four insured deposit payoffs. We expect to resolve five large institutions before the second week of October. These will be "clean" purchase-and-assumption transactions in which only good quality assets will be purchased by the acquirer. The cash outlay for these should be approximately \$8 billion.

Based on available financial data we estimate that another 300 thrifts may require failure resolution over the next three years, for a resolution total of nearly 600, with combined assets exceeding \$300 billion. This will require the RTC to dispose of assets of as much as \$180 billion.

RTC Funding Entity: The RTC is exploring various alternatives to provide working capital during the resolution process to purchase problem assets from failed institutions and to carry those assets until disposed of in an orderly manner. The amount of any working capital raised would be limited by the FIRREA debt limit and the value of the underlying assets.

Asset Management and Disposition: The biggest challenge facing the RTC will be properly managing and disposing of the billions of dollars of assets from the resolution of failed thrifts. The legislation requires RTC to sell property in "distressed" areas at 95 percent of market value or above. We have no present plans to lower that threshold. In all geographic areas the RTC will employ systematic and orderly marketing strategies and will avoid techniques that dispose of assets at any price. We therefore believe concerns about "dumping" should be eased considerably. The RTC will depend heavily on the committee process to make credit decisions. Adoption of Asset Management and Disposition Plans will insure that asset negotiations and strategies employed by contractors and in-house employees are consistent with FIRREA and RTC policy. Meeting the year-end real property asset inventory deadline is a real challenge. We are presently analyzing our needs and plan to contract out this function to the private sector soon.

Low Income Housing: The RTC is committed to maximizing the availability of affordable housing for moderate and lower income families. We are setting up communication channels with HUD and other officials to help identify and qualify purchasers for the program, and are exploring the best methods for assisting in sales financing and utilization of secondary market agencies. The RTC has created key supervisory and staff positions in each field office to manage program compliance.

Private Sector Contracting: The RTC's goal is to maximize the use of private contractors. Steps taken or in progress include developing contracting policies and procedures; establishing a senior executive position for coordination; providing contracting management specialists in field offices; and developing a computer data base on all qualified contractors.

Litigation and Legal Services: The RTC has inherited and is monitoring some 35,000 lawsuits and has already reduced expenditures on legal fees. Legal Division staffing will include about 80 Washington and 1,100 field employees, of which 500 will be attorneys. Estimated RTC expenditures for outside legal fees may reach \$125 million for 1990. In-house attorneys primarily will direct and control outside counsel.

Accounting and Auditing: The RTC is subject to almost unprecedented auditing and accountability. Oversight includes policy guidance by the Oversight Board, RTC's own Inspector General, FDIC's Inspector General, annual audits by the GAO, and Congressional oversight.

Minorities and Women Outreach Program: We are working to implement this important program as soon as possible. The program will include a commitment to comply with both the spirit and intent of FIRREA's mandate; providing and enhancing opportunities for minority- and women-owned firms to contract with RTC; identification of qualified firms; certification that firms are actually minority- or women-owned; proper qualifications; and execution and monitoring of the contracts.

Review of 1988 FSLIC Cases: Our review will cover 94 agreements involving \$110 billion in assets. This is an enormous task but must be accomplished quickly. Most work will be contracted out to private firms to speed completion and assure a credible and impartial review. We believe there are ways of reducing costs and will work with Treasury in exploring funding options.

Liquidation of FADA: Two approaches for liquidating FADA are being considered. These are the sale of the FADA organization, or, if that is not feasible, the dissolution of FADA and sale of its assets. Existing asset management contracts (or guarantee for future contracts) would not be for sale.

Good morning, Mr. Chairman and members of the Committee. It is a pleasure to be here today for the first time representing the Resolution Trust Corporation ("RTC") to apprise you of our progress since the RTC came into existence on August 9, 1989.

Much has been accomplished in less than two months since the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA") was signed into law. However, much more remains to be done before the RTC has a full staff of employees and all its operating policies and procedures in place. We and the Congress anticipated that the task at hand would be difficult. It is every bit as difficult as we contemplated. We have a tremendous task ahead of us.

Today we will discuss the Committee's specific areas of interest as stated in your letter of invitation. These include the operating policies adopted to date by the RTC and the safeguards we are implementing to protect against conflicts of interest, political favoritism and bribery by employees and agents of the RTC. In addition, we will provide a general overview of where the RTC stands and where it is headed, particularly in implementing many of the goals and specific mandates of FIRREA.

First, however, we would like to thank Secretary Brady and the rest of the Oversight Board and staff for their hard work and cooperation in getting this undertaking underway. During the start-up period we have worked closely with the Oversight Board to institute the policy statements discussed by Secretary Brady. Although we have had a few differences of opinion with the Oversight Board, these have been resolved. We look forward to a fruitful and positive relationship with the Oversight Board and staff as we jointly work to complete the start-up process and begin the greater task that lies ahead.

As an introduction to the Resolution Trust Corporation, we would like to outline the RTC's organizational and staffing structure and what we foresee in these areas for the future.

## RTC ORGANIZATION STRUCTURE AND STAFFING

Washington Office. Mr. David Cooke, my former Deputy at the Federal Deposit Insurance Corporation ("FDIC"), is the Executive Director of the RTC. The RTC's major organizational components are the Asset and Real Estate Management Division headed by Lamar C. Kelly, Jr. and the Resolutions and Operations Division headed by William H. Roelle. An Administrative Division and a Funding Operations Division will support the two main functions. (See Attachment A for the organizational structure of the RTC Washington office.)

Certain departments of the FDIC also provide significant support services to RTC. These include areas such as corporate communications, legislative affairs, legal services, accounting and personnel management, as well as other areas.

The RTC currently has a Washington staff of approximately 100 employees, many of whom are on temporary details from either the FDIC staff or the now defunct Federal Savings and Loan Insurance Corporation ("FSLIC"). We anticipate that the RTC's Washington Office ultimately will have approximately 250 employees.

Regional Offices. Four Regional Offices have been established and four former FDIC Regional Directors have been appointed as directors of those offices. The RTC's Regional Offices are located in Atlanta, Dallas, Denver and Kansas City. (See Attachment B for the geographic areas covered by each Region.) Each Regional Office will be relatively small, with anticipated staffing -- exclusive of accountants and attorneys -- of approximately 100 employees. (See Attachment C for the organizational chart of the Regional offices.)

Consolidated Field Sites. Consolidated sites will be established to manage the disposition of real estate and other assets owned by the RTC. These sites are where most of RTC's personnel will be located. The number of employees is difficult to determine with any degree of precision at this time. It will depend upon the volume and type of assets, as well as our ability to hire private contractors. The RTC expects to employ outside contractors wherever practical in executing its mandate under FIRREA. Even so, the consolidated field sites are likely to employ several thousand people altogether.

At this early stage we have designed structures for three broad size categories of sites. Smaller consolidated sites will handle up to \$7.5 billion in assets. A medium-sized site will handle \$7.5 to \$15 billion in assets. Large sites, which we anticipate will be few in number, will handle over \$15 billion in assets. (See Attachment D for the list of consolidated sites.)

Initially 730 employees were transferred from the FDIC to the RTC's consolidated field sites. These employees were either in the FDIC's Asset Liquidation Division or were serving as Managing Agents in Conservatorships. Currently the RTC has approximately 800 field employees, the majority of which are involved in resolution and conservatorship operations.

We anticipate the number of people to be employed by the RTC will be substantial. Wherever possible, staffing for RTC will be minimized and most of the people employed will be hired as temporary employees. Even with these constraints, however, the RTC easily could employ between 5,000 and 10,000 people by the end of 1990.

#### GENERAL OPERATING POLICIES

On the day FIRREA was signed into law, the RTC adopted FDIC policies as interim operating policies. (See Attachment E for the text of these policies.) This allowed the RTC to begin its important tasks immediately. The policies provide general guidance in the areas of resolution transactions and asset disposition and management. These policies will be followed unless they conflict with policies adopted by the Oversight Board or until superseded by more specific or permanent RTC policies.

The Oversight Board also has adopted some policies which have been supplied to the Committee and described by Secretary Brady. Those policies are being followed by the RTC.

#### ETHICS AND CONFLICTS OF INTEREST

The Committee specifically requested information on the procedures and safeguards the RTC has and will put in place to protect against unethical conduct and conflicts of interest by its members, officers, employees and contractors. This process for establishing and implementing these procedures is well under way. Final regulations will be in place by the statutorily mandated deadline.

Within 180 days, FIRREA requires the RTC to (1) prescribe regulations which would govern conflicts of interest, ethical responsibilities and post-employment restrictions applicable to members, officers and employees of the RTC that shall be no less stringent than those applicable to officers and employees of the FDIC and (2) prescribe regulations applicable to RTC independent contractors which would govern conflicts of interest, ethical responsibilities and the use of confidential information, consistent with the goals and purposes of titles 18 and 41 of the United States Code.

As an interim measure, the RTC Board acted at its August 9 organizational meeting -- the date of enactment of FIRREA -- to extend the FDIC's "standards of conduct" regulations to independent contractors of the RTC, to the extent those standards "reasonably apply" to the activities of independent contractors. The Board included the "reasonably apply" standard because the FDIC's regulations prohibit employees from owning bank stock and obtaining extensions of credit (other than through the use of a credit card) from assisted banks or from acquirers of failed banks headquartered within their respective regions of assignment. We do not believe it reasonable or necessary to restrict bank stock ownership or credit of an independent contractor who, for instance, provides no more than lawn care services to the RTC.

This first action of the Board regarding ethical conduct standards was merely instituting the "bare essentials." Any credit restrictions ultimately imposed on independent contractors will depend upon the nature and extent of services the contractor is performing for the RTC. We expect to prohibit contractors from obtaining extensions of credit only from persons or institutions with whom their duties may require them to negotiate. We would not allow a contractor to obtain a loan from an institution with which he or she is negotiating the sale of an asset.

The RTC Board took further action on September 26 by adopting an interim statement of principles of ethical conduct for independent contractors. (See Attachment F for a copy of the statement.) The statement was developed in coordination with a joint policy group on ethical standards established by the RTC Oversight Board. While the principles set forth in the statement are effective immediately, we invited public comment before developing the proposed regulations which we plan to publish in early November for a 60-day public comment period.

In general terms, the principles set forth in the interim statement are designed to preclude contractors with the RTC from:

- o Performing services for the RTC which could affect their personal financial interests or the financial interests of their spouses, minor children, or persons or entities with whom they have business or financial ties;



- o Profiting from both sides of a transaction by performing services for the RTC in connection with a particular matter and simultaneously representing themselves or other parties to or before the RTC in connection with that same matter or a substantially related matter;
- o Using nonpublic information obtained while performing services for the RTC to engage in private financial transactions or to benefit members of their families or persons or entities with whom they have business or financial ties;
- o Using RTC property or the assets of institutions with respect to which they are performing services for the RTC for their personal use, or allowing the use of such property or assets by members of their families or persons or entities with whom they have business or financial ties; and
- o Having the quality and integrity of their services to the RTC clouded or impugned by their acceptance of gifts, favors, entertainment or other items of monetary value from persons or entities whose financial interests could be affected by the performance or nonperformance of their duties and responsibilities to the RTC under the terms of their contracts.

It is not our intention at this time to prohibit independent contractors who manage assets for the RTC in one part of the country from purchasing RTC assets in other parts of the country. We will require, however, that they establish and enforce screening mechanisms satisfactory to the RTC. These mechanisms must preclude the flow of nonpublic information (e.g., the formulas and procedures by which the RTC establishes reserve prices on assets) between independent contractor employees who are performing services for the RTC and those who are attempting to purchase assets from the RTC.

Contractors have the right to be adequately and reasonably compensated for any services they perform for the RTC. They should not be allowed, however, to profit from both sides of a transaction or otherwise conduct their activities in a manner that discredits or causes a loss of confidence in the Federal Government. Contractors who perform duties and responsibilities ordinarily performed by Federal employees should be expected to behave and to be held to similar standards of conduct as Federal employees. Since the RTC is charged with a public trust, it may expect that persons with whom it contracts for services will provide those services not only for adequate and reasonable compensation, but also for the public benefit.

The RTC needs the experience and expertise of independent contractors in performing its functions. Accordingly, it will be necessary to strike a delicate balance between the legitimate needs of the RTC for independent contractors and the interests of the RTC, the Congress, and the American public in protecting against unethical conduct and conflicts of interest. We hope to achieve that balance in the final regulations.

In summary, we are working in cooperation with the RTC Oversight Board's ethics and conflicts of interest joint policy group towards the publication in early November of proposed regulations. We foresee no obstacles to having final regulations in place by the February 5, 1990 statutory deadline.

#### BRIBERY

The FDIC traditionally has relied upon three tiers of action to guard against the possibility of any third party bribing an FDIC official. The same courses of action will be followed by the RTC.

The first tier is the threat of criminal prosecution and incarceration for any FDIC official who may solicit or accept an illegal bribe or gratuity. FDIC maintains a close relationship with law enforcement authorities to deal with such cases.

The second tier consists of internal FDIC controls, audits and investigations. The FDIC Office of Inspector General conducts a vigorous program of audit controls which are designed to detect the presence of any potential bribery. Also, periodic site visitations are conducted to ensure that financial and management controls are effectively in place. These programs supplement the standard operating procedure of checks, balances and review in each office.

The third tier depends on those suspecting bribery to come forward. If a debtor is approached for a bribe by an FDIC official or if an FDIC official is approached to accept a bribe, the unmasking of these acts will help establish a high level of public intolerance for such activity and public confidence that the offenders will be punished. The importance of this third tier should not be minimized since even the best systems to deter criminal activity are not fail safe.

### POLITICAL FAVORITISM AND UNDUE POLITICAL INFLUENCE

FIRREA requires that measures be taken to avoid political favoritism and undue influence with respect to the activities of the RTC. Working with the Oversight Board, the RTC plans to develop specific written policies and procedures that will draw upon current FDIC policies which also now govern RTC activities. The written guidelines adopted specifically for the RTC will delineate internal operating procedures and methods for responding to both appropriate and inappropriate inquiries.

The FDIC traditionally has conducted its operations independent of undue political pressures. We have policies that guard against such pressures. The policies allow us to investigate and provide information with respect to an inquiry, concern or complaint of those in political office. They do not permit us to discuss the substance of pending decisions with respect to specific actions nor alter or change a decision, policy or procedure of the FDIC at the request of any outside party.

The "independent" culture of the FDIC will carry over to the RTC. That objective will be facilitated by placing FDIC career employees in key RTC positions. By hiring through competitive government procedures, hiring will be based on merit not political connections.

### RTC OPERATIONS AND RESOLUTIONS

The RTC is responsible for: the management and operation of institutions in conservatorship; the resolution of closed thrift institutions; and the management of funds -- as those funds are provided by the RTC Oversight Board -- for resolutions, liquidity and the replacement of high-cost funds. Immediately following the enactment of FIRREA, the RTC began the process of resolving the substantial inventory of insolvent thrifts that had been placed in the conservatorship program.

Conservatorship Program. A major component of the President's plan was to place the worst institutions under government control and reduce operating losses. As of September 30, 1989, 283 thrifts had been placed in the conservatorship program. These institutions had gross combined total assets of \$112 billion and combined total liabilities of \$124 billion. Based on limited asset reviews, we estimate that the losses in these institutions total \$35 billion, or about 31 percent of gross assets. (See Attachment G.)

Our reviews also show that the estimated loss rate, on average, has declined for the more recent additions to the conservatorship program. Those institutions placed in conservatorship prior to March 31, 1989 have estimated losses as a percent of gross assets of 36 percent as compared to 21 percent for those placed in the program after March 31, 1989.

High-Cost Funding. Savings and loans in the conservatorship program are highly illiquid and prior to FIRREA were forced to compete aggressively for funds in a rising interest rate environment. As a result, despite aggressive liquidity management by our conservators, rates on brokered deposits increased by as much as 150 basis points in some sections of the country.

The availability of low-cost funds has decreased significantly the upward pressure conservatorship S&Ls were putting on interest rates. As of September 30, with funding provided by the Oversight Board, the RTC has made secured loans to 151 conservatorships in the amount of \$8.1 billion. The loans were made to replace high-cost sources of funding. These high-cost funds were primarily Federal Home Loan Bank advances, brokered deposits and secured borrowings. As a result of this action, the savings to the RTC, and ultimately to the taxpayers, is estimated to be \$118 million on an annualized basis.

The availability of this funding program has allowed institutions in conservatorship to exit from the high-cost funds market. When the program started, 25 of these institutions were among the top 35 rate payers in the country for 90 day CDs. As of September 18, one was in the top ten and it is the only RTC institution in the top 35. This reduction in interest rate market pressure should enable other financial institutions to lower their rates.

Reports from the field indicate that this is a very successful program. The managing agents can set rates that allow them to be competitive with local healthy institutions and maintain their core deposits. Previously forced to be market leaders to obtain funds for day-to-day operations, they now can control their rate structures and borrowings without being in the broker markets, and they can rely on the RTC to provide liquidity when needed. This has greatly simplified their funding and allowed a return to rational pricing of deposits.

Moreover, these actions have produced a significant impact on the cost of funds for all institutions that must compete for money in the market. In particular, the cost of funds index used by FSLIC in the Southwest Plan resolutions has been reduced significantly.

Emergency Liquidity Advances. In addition to replacing high-cost funds, the RTC also serves as "lender of last resort" for S&Ls in conservatorship. As of September 30, the RTC has provided \$0.5 billion in emergency liquidity to 41 conservatorships that were unable to meet their daily liquidity needs and continues to maintain a reserve of \$0.9 billion for future emergencies.

Resolutions. As of September 30, the RTC had disbursed \$1.8 billion to resolve 24 institutions. It is important to note that the \$1.8 billion outlay is not the measure of ultimate cost to the RTC. The ultimate cost will be determined only after deducting collections that are realized through the liquidation of assets held by the RTC.

Twenty of the 24 resolutions to date have been handled as insured deposit transfers, whereby institutions pay a premium to act as the RTC's paying agent for insured deposits. The other four resolutions were handled as insured deposit payoffs.

In addition to these transactions, the RTC has allocated \$8 billion toward the resolution of five large institutions. These five transactions will be structured as "clean" purchase-and-assumption transactions in that the acquirer will receive only good quality assets and cash from the RTC to offset the assumption of deposits and other liabilities.

Originally we had planned to consummate these transactions by the end of September. However, due to recent clarifications in requirements for bidder eligibility and entrance and exit fees, we felt that a short postponement would be fair in order to ensure that no interested and eligible acquirers were excluded from the bid process.

The bidders' meetings were completed yesterday. Bidder interest in these five transactions is strong. We are highly confident these transactions will be completed by next week.

We also briefly postponed five smaller insured deposit transfers due to the clarification of bidder eligibility requirements. These transactions will use up the balance of the funds for resolutions.

In summary, the \$20 billion has been allocated as follows:

Resolutions	\$10.1 billion
Emergency liquidity	\$1.4 billion
Replacement of high-cost funding	\$8.5 billion

Bidding Procedures. Transactions consummated by the RTC to date generally have been smaller institutions with deposits of less than \$500 million. These transactions were standardized with bidders essentially bidding to become RTC's paying agent for insured deposits. The RTC solicited names of prospective bidders from the FDIC, Office of the Comptroller of the Currency ("OCC"), Federal Reserve Board ("FRB") and Office of Thrift Supervision ("OTS"). Generally, for these smaller transactions, only financial institutions were solicited as time frames were brief (generally 48 hours or less).

A press release dated September 27, 1989, outlined procedures to be followed by the RTC in order to qualify interested parties as acceptable bidders. As indicated in the release, "...potential bidders must be deemed acceptable by the primary federal regulator and holding company and state chartering authorities if applicable." However, a bidder could be disqualified by the RTC if it were unable to obtain an opinion from the FDIC that the transaction "results in no undue risk to the deposit insurance funds."

To implement the above procedures for the sale of the five large thrifts, the RTC requested names of acceptable bidders from the FDIC, OCC, FRB and OTS. As a result of the solicitation, a number of additional prospective bidders were contacted by overnight mail on September 28, 1989. (See Attachment H for copy of the mailing.)

#### PROJECTIONS

The 283 institutions in the conservatorship program represent only a portion of the likely RTC caseload. The OTS is in the process of completing a list of conservatorship-bound S&Ls. We expect the official list shortly but, in the interim, are projecting our workload based on available financial data. We estimate that OTS may turn over another 300 thrifts to the RTC. This would mean that, in total, the RTC may be required to handle nearly 600 failures during the next three years with combined assets exceeding \$300 billion (book value). These failures are widely disbursed geographically, with Texas accounting for the heaviest concentration.

How these cases are resolved will determine the volume of assets the RTC must manage. We estimate that only 40 to 45 percent of the assets will be sold to the acquirers of the failed institutions. Thus, RTC may have to manage the sale of as much as \$180 billion in assets. The quality and composition of these assets will determine the difficulty the RTC will have disposing of them. While liquid assets can be disposed of quickly and easily, distressed assets will require significant marketing efforts. Keeping in mind the

questionable quality of a failing institution's financial reports, we estimate that as much as \$100 billion in difficult, non-liquid assets may flow to the RTC.

We currently estimate about \$16 billion would be in real estate owned by thrifts (most of which is repossessed real estate). This figure is likely to be low if, as is often the case, real estate is the only source of repayment on non-performing or poor-quality loans.

The projections discussed above raise questions about the adequacy of the \$50 billion in RTC funding. Possible RTC losses are difficult to project because they are dependent upon many factors such as the number of failed institutions and their size, future interest rates, economic conditions and demand for thrift assets, as well as institution-specific factors such as ability to manage loans effectively. It is possible that \$50 billion will prove to be an insufficient amount to deal with potential failures, but it is really much too early to make a reliable new prediction of loss.

The Office of Thrift Supervision is in the best position to identify which institutions are likely to be turned over to the RTC and when. Even then, it is difficult to estimate likely losses until the RTC has actually gone into these institutions.

#### RTC FUNDING

Through the Treasury and the Resolution Funding Corporation, the RTC will be provided with \$50 billion to eliminate the negative net worth in institutions that are currently insolvent or will become insolvent within the next three years. While \$50 billion represents the current cost of "filling the hole," it does not represent the total cash or working capital needs of the RTC. As mentioned earlier, the RTC may have to acquire \$100 billion in illiquid assets out of failing S&Ls before they can be sold. The book value of these assets will have to be paid by the RTC to acquirers of insolvent S&Ls. Only after these assets are sold will the RTC be able to replace a portion of those cash outlays.

In effect the RTC must buy, then collect, on these illiquid assets. This ties up the RTC's cash very quickly. For example, after the five transactions are concluded next week we will have spent about \$10 billion -- 20 percent of the \$50 billion -- resolving institutions that account for only a small portion of the S&Ls to be resolved. A sizable portion of this \$10 billion will be recovered, however, through collections on the assets held by the RTC. The collection process tends to be slow. Forced sales, dumping or overly aggressive collection efforts will result in increased RTC losses as well as severe disruption in already distressed economies.

The RTC must establish a working capital program or funding entity to manage its working capital needs. This would ensure that the RTC has enough cash for S&L resolutions without triggering uneconomic asset disposition policies.

We want to make it clear that no working capital program will enable the RTC to "fill a hole" deeper than the original \$50 billion. If the resolution process reveals that \$50 billion is too low, additional funds will be required to make up the difference. Working capital would simply allow the RTC to quickly remove the unhealthy portion of the thrift industry and allow time for the orderly disposition of assets.

We have had considerable discussion with officials from Treasury, government agencies that issue securities and investment banking firms about various working capital alternatives. Any programs to raise working capital, of course, would be limited by the debt limit imposed by FIRREA and by the value of the underlying assets.

No final decisions have been made and we plan to confer with Congress before initiating any major working capital programs. No matter which approach we take, funding for RTC will be very complicated. Our first step is to hire personnel for RTC's funding operations. We expect to complete our search efforts for an experienced Funding Director soon.

#### ASSET MANAGEMENT AND DISPOSITION

The long-term challenge facing the RTC will be properly managing the billions of dollars of assets that come from the resolution of failed thrifts and disposing of those assets in a timely and efficient manner. This task includes maximizing returns and assuring that low and moderate income individuals and non-profit organizations are afforded the opportunity to purchase eligible single- and multi-family housing. It also requires procedures that maximize the use of private and minority contractors.

Asset Disposition. A primary objective of the RTC is to maximize the net present value of collections on assets it controls while minimizing the impact of these transactions on local real estate markets. FIRREA identified six states as "distressed areas" which require adoption of special asset disposition policies to protect the economies of these areas. Other areas can be designated as "distressed" if warranted.

The legislation requires RTC to sell property in "distressed" areas at 95 percent of market value or above. Selling property below this threshold is permitted only to satisfy RTC low income housing objectives or if the RTC's Board of Directors approves lowering the threshold for appropriate reasons. We have no present plans to lower that threshold.



We understand the concern expressed through the legislation about the potential damage from "dumping" assets on a weakened market. The RTC is fully prepared to meet the requirements in the law to assure that market values are achieved for properties sold and that the adverse economic impact of real property sales is minimized. We do not "dump" property and never have.

The Oversight Board is formulating policies to govern RTC with respect to asset dispositions. Our policy, until a different policy is developed, is to institute an orderly disposition of assets at market values over time.

We do not believe that keeping property off the market -- if it can be sold at current appraised value -- would necessarily have the effect of maintaining higher values in the market place. In fact, holding properties off the market that can be sold at today's values can be a destabilizing factor. The cost of maintaining properties during a holding period must be balanced against ultimate realization values to protect the cost to the taxpayer.

In all geographic areas, including "distressed" areas, the RTC will employ systematic and orderly marketing strategies basing sale prices on current appraisals and other independent sources of market information. These sources will include brokers, market analysts and other Federal agencies. These strategies will avoid techniques such as "absolute" property auctions, which could be viewed as a mechanism to dispose of assets at any price. FDIC's uniform appraisal instructions are being revised to require consideration of sales with typical term financing offered as opposed to a strict cash sale basis.

Asset Disposition Decision Process. The asset disposition decision-making process utilized by the RTC is based upon Delegations of Authority approved by the RTC's Board of Directors.

Credit decisions can cover a wide array of areas, but most frequently consist of recommendations to sell real estate or other assets at specified prices, make advances to protect assets, or compromise and restructure loan agreements. Recommendations for a particular action are originated by the account officer or contractor managing the asset and presented in a written credit case format to the individual or committee authorized to approve the transaction.

The RTC will depend heavily upon the committee process to make credit decisions. Major decisions will be made by credit committees formed at the consolidated site and Regional level. Cases involving complex legal issues and large-dollar

assets generally will flow to RTC's Committee on Management and Disposition of Assets -- a senior level committee at RTC headquarters in Washington, D.C. To allow for an orderly workflow, various personnel with asset management expertise throughout the organization also will have lesser levels of individual delegated authority to approve routine transactions.

An additional component of the RTC's asset management process will include the preparation and approval of Asset Management and Disposition Plans outlining strategies for disposition of major assets acquired by the RTC. Adoption of Asset Management and Disposition Plans will help insure that asset negotiations and strategies employed by contractors and in-house employees are consistent with the objectives of FIRREA and RTC policy.

Real Property Asset Inventory. FIRREA requires the RTC to publish, semiannually, an inventory of real property assets of institutions subject to its jurisdiction. In particular, we are required to clearly delineate those real property assets that have "natural," "cultural," "recreational," or "scientific" values of special interest. The first such inventory must be published before January 1, 1990.

Because of the large number of assets in the conservatorships now under RTC control, meeting the year-end deadline is a real challenge. We are presently analyzing our needs based on the task at hand. We plan to contract out this function to the private sector in the near future.

Low Income Housing. One of the primary missions of the RTC under FIRREA is to maximize the preservation and availability of affordable housing for moderate- and lower-income families. To accomplish this objective the RTC will identify eligible single-family and multi-family residential units and provide non-profit organizations, public agencies and lower-income families a right of first refusal to purchase these properties.

For single-family dwellings, as eligible properties with clear title are identified, written property listings will be distributed to clearinghouses responsible for passing this information on to eligible purchasers. Qualified purchasers will have three months from the date of eligibility to make a bona fide offer to purchase the property.

Qualified purchasers of multi-family residential units have 90 days after the RTC notifies clearinghouses (or until the RTC determines the property is ready for sale, if earlier) to provide notice of serious interest in purchasing the property. Upon the RTC providing notice that the property is

ready for sale, any qualified purchaser who has expressed serious interest has 45 days to make a bona fide offer to purchase.

The RTC is in the process of setting up communication channels with the Department of Housing and Urban Development and other officials to develop strategies to identify and qualify purchasers for the program. We also are exploring the best methods for assisting in sales financing and the utilization of secondary market agencies to comply with the statutory requirement of the program.

To make certain that the lower income housing programs are properly carried out, the RTC has created key supervisory and staff positions in each of its field offices to manage program compliance. These managers will provide responsive execution and communication between the field offices and the Washington office, interact with the other agencies involved in the program and provide direct management of sales activities at the local level.

Private-Sector Contracting. FIRREA requires the RTC to utilize private-sector resources -- including asset management firms, property management firms, leasing companies, brokerage services, etc. -- whenever practicable. We have concluded that the use of private-sector resources, particularly in managing and disposing of complex real estate assets, is both practicable and efficient. Therefore, we have established a goal to maximize the use of private contractors.

Several steps have been taken or are in process to achieve the goals set forth above:

- o We are in the process of developing contracting policies and procedures. Although not finalized, the process will include a thorough ethics/conflict-of-interest screening, a qualification determination, competitive bidding, negotiation, execution, and monitoring. The Washington office will handle national contracts while the regional offices will manage local contracts under delegated authority.
- o Organizationally, we have established a senior executive position in the Washington office to establish contracting policies and procedures. Similarly, we have provided for contracting management specialists in both the regional offices and consolidated field sites.

- o During the past several weeks, we have met or communicated with hundreds of contractors to discuss the types of services the RTC will need and the policies and procedures under which contracting will be implemented.
- o We plan to develop a computer data base on all qualified contractors which can be used by RTC field personnel to quickly identify potential contractors by types of services performed and geographical location.

#### LITIGATION AND LEGAL SERVICES

As a result of the conservatorships and receiverships set up to date, the RTC has inherited approximately 35,000 matters in litigation.\* The suits range from simple collection and foreclosure actions to large complex commercial litigation.

In order to hold down costs and avoid disruption in conservatorships, the RTC has utilized, to the greatest extent possible, the law firms retained by the thrifts prior to conservatorship, provided there is no conflict of interest with the RTC or the FDIC. Through the use of existing FDIC regional legal operations, we have begun monitoring all of these cases. The cases involving large dollar amounts (usually \$250,000 or more), high fee amounts (\$5,000 or more per month), or special issues, receive close supervision by our in-house legal staff. Other cases are monitored on a periodic basis by our Legal staff. All fee bills are reviewed and are subject to approval by our legal personnel.

We already have begun to realize cost savings. Our initial estimates indicate significantly reduced expenditures by these thrifts on legal fees. Hard estimates are not yet available, but it appears that these reductions may reach \$50 million on an annualized basis for existing caseloads. Through improved monitoring, elimination of actions which are not cost effective, and aggressive movement of cases toward judgment or settlement, it is anticipated that any poorly controlled handling of litigation in these institutions will be brought under control.

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\* In fact, with the assimilation of RTC's caseload and FSLIC Resolution Fund matters, including the Southwest Plan cases, the FDIC will be involved in approximately 60,000 legal cases in addition to its caseload of approximately 13,000 that existed on the day FIRREA was enacted.

✓ Eventually the FDIC's Legal Division will provide full in-house support to RTC in Washington and all the regional and field offices. The Legal Division will supply some 80 employees in Washington and approximately 1,100 employees in the field. Of these employees, approximately 500 will be attorneys. Recruiting has begun at all levels and we anticipate that by year-end some 200 attorneys will be in place along with appropriate support staff. As the field operations become fully staffed, the oversight of outside counsel will become better controlled and additional savings are anticipated.

Current estimates are that RTC expenditures for outside legal fees and expenses may reach \$125 million for 1990. The actual expenditures, as well as the personnel estimates, will depend on the rate at which we can move forward with in-house staffing as well as the ultimate make-up of the caseload, the number of thrifts handled by RTC and the extent of the assets RTC has to liquidate.

The emphasis placed on outside contracting will apply to legal services as well. In-house attorneys will conduct litigation where practical and cost-effective. However, their primary role will be to direct and control outside counsel in order to provide the most effective and efficient blend of legal services.

#### ACCOUNTING AND AUDITING

The RTC is subject to oversight, auditing and accountability to an extent that probably is unprecedented in the history of government. In addition to the audit policy guidance provided by the Oversight Board, that Board also will be supported by an internal analytical group assessing operations. In addition, the RTC will have its own Inspector General reporting jointly to the Oversight Board and the RTC Board of Directors. Complementing the Inspector General will be the FDIC's own Inspector General that will audit and investigate as necessary the FDIC's provision of personnel and essential services to the RTC.

The General Accounting Office will audit the RTC annually either directly or through an accounting firm acting as its agent. In addition, the GAO presumably will perform periodic reviews and studies initiated by Members of Congress and/or their Committees.

Finally, we anticipate the Congress will exercise strenuous oversight of the RTC's operations -- as already evidenced by this hearing today and the creation of a special oversight task force of the House Banking Committee. In fact, FIRREA specifically mandates regularly scheduled appearances by the

RTC before this Committee. All in all, the readers and reviewers of audits will keep busy with the RTC.

#### MINORITIES AND WOMEN OUTREACH PROGRAM

FIRREA requires the RTC to establish an outreach program to ensure that minorities and women are afforded an opportunity to contract with the RTC on matters relating to asset management, property management, legal services, etc.

We are working to implement this program as soon as possible. A draft of RTC's program has been developed and is being reviewed at this time. We anticipate the program will include the following elements:

- o Policy Statement - a commitment to comply with the spirit and intent of FIRREA's mandate
- o Goals and Objectives - to provide and enhance opportunities for minority- and women-owned firms to contract with RTC
- o Identification of qualified firms
- o Certification - to ensure that the firms are indeed minority- or women-owned firms
- o Qualification - to ensure that the minority- or women-owned firms have sufficient qualified staff and other resources to render the services
- o Promotion - to communicate to minority- and women-owned firms RTC's commitment to contract with such firms
- o Execution and Monitoring

#### REVIEW OF 1988 FSLIC AGREEMENTS

The RTC is required under FIRREA to estimate the cost to the Government of the 1988 FSLIC resolutions and, to the extent possible, find methods of reducing those costs. The review will cover 94 agreements involving \$110 billion in assets. It will increase efficiency if the review is accomplished as promptly as possible. Our goal is to complete the review within one year.

We are recommending that most of the work be contracted out to private firms, which will coordinate closely with a small group of in-house staff. The use of private-sector analysts will help to ensure a credible and impartial review.

A preliminary look leads us to believe there may be ways of reducing costs. Some agreements provide guaranteed spreads and capital loss coverage on a large volume of problem assets. In many cases it may be feasible to prepay FSLIC notes or buy back or force the writedown of problem assets. This would reduce the Treasury's carrying cost and could improve collection incentives and performance. We hope to work with Treasury in exploring funding options that are consistent with the legislation.

#### LIQUIDATION OF FADA

FIRREA requires liquidation of the Federal Asset Disposition Association ("FADA") by the RTC within 180 days of enactment. Two alternative approaches are being considered: (1) The sale of the FADA organization or (2) the dissolution of FADA and the taking of its resources by the FDIC.

We will first attempt to sell the FADA organization. This approach would entail selling just the FADA structure. FADA's name, charter, capital stock and liquid assets would not be for sale. Furthermore, existing asset management contracts (or any guarantee for future contracts) would not be for sale. Any contingent liabilities resulting from FSLIC's indemnities with the FADA, its Board of Directors and its Officers would remain with the FSLIC Resolution Fund.

If we cannot sell FADA, the RTC will dissolve FADA and sell or use its assets. Asset-management duties would be transferred to the FDIC and FADA employees would be offered positions with the FDIC at government pay scales. The next step would be to sell, utilizing a competitive sale process, those of FADA's furniture, fixtures and similar assets that are not needed by the FSLIC resolution fund. This transition would occur during November and December and the asset sales would be during January.

#### CONCLUSION

In conclusion, we believe we have made a good start. We are working under established FDIC policies while implementing, with the Oversight Board, new policies to guide our future work. We know that much remains to be done. The bulk of our work lies ahead.