TESTIMONY OF
JOHN F. BOVENZI
DIRECTOR
DIVISION OF DEPOSITOR AND ASSET SERVICES
FEDERAL DEPOSIT INSURANCE CORPORATION
ON
THE FDIC'S HANDLING OF SMALL BUSINESS ASSET FORECLOSURES
AND THE RTC'S HANDLING OF ASSETS FROM
COMFED SAVINGS BANK IN LOWELL, MASSACHUSETTS
BEFORE
COMMITTEE ON SMALL BUSINESS
SUBCOMMITTEE ON GOVERNMENT PROGRAMS
U.S. HOUSE OF REPRESENTATIVES
2:00 P.M.
WEDNESDAY, SEPTEMBER 25, 1996
ROOM B363, RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, D.C.

Mr. Chairman and members of the Subcommittee, my name is John F. Bovenzi, and I am Director of the Federal Deposit Insurance Corporation's Division of Depositor and Asset Services. We appreciate the opportunity to discuss our handling of small business assets acquired through the failure of insured depository institutions.

In your invitation letter, you asked the FDIC to provide testimony on its handling of small business asset foreclosures. In addition, you specifically asked for testimony on the Resolution Trust Corporation's (RTC) handling of small business asset foreclosures from ComFed Savings Bank in Lowell, Massachusetts. ComFed failed in December 1990. From December 1990 through December 31, 1995, the assets of ComFed were handled by the former RTC. The FDIC assumed responsibility for the ComFed assets when the remaining responsibilities of the RTC were transferred to the FDIC by law at the end of 1995. Although we have been responsible for these assets for only the past nine months, our testimony will attempt to address questions that you might have regarding ComFed.

The past ten years have posed tremendous challenges to the banking industry and the FDIC. During that time, nearly 1,250 commercial banks and Bank Insurance Fund-insured savings banks have failed with combined assets of over $225 billion and deposits of almost $190 billion. The FDIC has resolved these failures without taxpayer assistance.

Over the same period, almost 1,100 savings associations failed and were resolved by the former Federal Savings and Loan Insurance Corporation and RTC. These savings associations had combined assets of over $540 billion and deposits of almost $445 billion. According to the Government Accounting Office, the estimated direct cost to the taxpayers of these failures is almost $125 billion.

More recently, only five banks and three thrift institutions failed in 1995, and only four banks and two thrift institutions have failed so far this year. Our projections indicate that we will continue to experience a relatively small number of bank failures in the coming years.

Although our job of disposing of assets is not yet complete, the vast majority of acquired assets have been returned to the private sector. At the peak of its resolution activities, the RTC managed more than $175 billion in assets from failed thrift institutions. Similarly, the FDIC once managed more than $50 billion in assets from failed banks. Currently, our asset inventory, including those assets acquired from the RTC, is around $13 billion. We anticipate handling less than $8.5 billion of assets by year-end.

Despite a level of bank failures unprecedented since the Great Depression, no insured depositor has suffered a loss as a result of these failures. Because the FDIC was able to provide depositors with access to their deposits quickly, many depositors noticed little if any disruption in banking services when their banks failed. The FDIC's ability to accomplish this without taxpayer assistance was due in large part to our success in realizing market value on inherited assets and returning them to the private sector. On average, we recover about 95 percent of appraised value on loan sales and about 90 percent of appraised value on real estate sales.

In addition to making sure that insured depositors receive their funds as soon as possible after a bank fails, the FDIC has a statutory responsibility to the creditors and shareholders of the bank under the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) to minimize losses by obtaining maximum recovery from the assets of the receivership. The assets are owned by the estate of the failed bank, and many of our asset disposition activities are similar to those of a bankruptcy trustee in that funds we recover benefit other creditors of the estate as well. We try to carry out these responsibilities in a way that attempts to balance our obligation to maximize recoveries and minimize losses to the deposit insurance funds with the desire to work with borrowers as they repay their loans.

Another concern of the FDIC when it conducts its liquidation activities is to minimize any adverse effect on the economic stability and well-being of the local community. Returning the failed bank's loan assets to the private sector as quickly as possible permits borrowers and the local economy to reestablish the new lending relationships that will provide long-term funding for businesses. In this way, the FDIC works with local businesses to limit the impact of a bank failure on the availability of credit in the local economy.

When a bank fails, the FDIC first attempts to locate a buyer to assume the failed bank's deposits and purchase its assets. Even if an assuming bank is found, that bank generally will not assume problem loans. We work with the assuming bank to negotiate asset-purchase options, put-back provisions and loss-sharing arrangements in order to return loans to the private sector as soon as possible.

After a bank failure, borrowers are legally required to repay outstanding loans to the receivership estate just as they would if their bank had not failed. Recoveries on these loans then are used to pay off the failed bank's creditors, including the FDIC. In ComFed, as in other RTC receiverships, any recoveries on the thrift's assets also helped reduce the losses of U.S. taxpayers.

The FDIC evaluates the circumstances of each failed bank borrower individually and attempts to tailor a resolution of that borrower's debt based on the borrower's ability to pay and on the fair market value of any pledged collateral. FDIC employees, as well as asset management contractors, are directed to be receptive to any proposal a borrower may have that would help resolve a problem loan situation while fulfilling our mandate to maximize recoveries and minimize losses to the deposit insurance funds. Because each borrower's situation is unique, various options are evaluated and analyzed to formulate a repayment plan that offers the best chance for a successful resolution. Generally, it is in the best interests of both the FDIC and borrowers to return a loan to a performing status. This is especially true for small businesses whose value is more often retained in their ability to produce income, rather than in the value of their physical assets. The FDIC's policies for dealing with borrowers from a failed bank are contained in the FDIC's Asset Disposition Manual, which is publicly available.

The FDIC prefers to work with borrowers to achieve a mutually agreeable repayment plan for unpaid loans. Foreclosure or other legal action is utilized rarely and only as a last resort. In working with borrowers, we analyze all viable alternatives for resolving a loan and weigh the recovery from a negotiated settlement against the expected recovery through a competitive sale or foreclosure. Consequently, we generally reach agreements with the vast majority of borrowers.

For borrowers who cannot repay their obligations as originally intended, several options are available. For example, we will release collateral for fair market value, establish repayment schedules based on ability to pay, and compromise loans for less than the full amount owed. To facilitate a borrower's refinancing efforts, we also have absorbed closing costs and out-of-pocket expenses associated with obtaining a new loan.

Each of these approaches requires the borrower's full cooperation. Frequently, loan files that we acquire from a failed bank are poorly documented. Therefore, it is essential that borrowers work with us to furnish current financial and other relevant information so that a mutually acceptable resolution can be reached. If a borrower refuses to pay or to provide necessary financial information, the FDIC has no choice but to seek recovery from the collateral. Under no circumstances, however, will the FDIC foreclose or litigate with a borrower who is meeting its obligations under a loan agreements with the failed institution.

A review of our past record in dealing with borrowers from failed banks shows that we consistently exhaust viable consensual alternatives that maximize recovery before resorting to foreclosure. A few years ago, at the height of credit problems in New England, we reviewed more than 130,000 loans from failed New England banks. We completed foreclosure actions on just over one percent of them. Further, many of these foreclosures were initiated by the banks before they failed, and before the FDIC stepped in, or involved cases where the borrower voluntarily relinquished their property.

Because of the time and expense involved, foreclosure generally is not a cost-effective method of resolution. Moreover, we are aware of no cases where we foreclosed on a borrower who demonstrated a willingness to cooperate and has the ability to maintain a realistic payment program. Unfortunately, we are sometimes left with no reasonable alternative than to foreclose due to the inability or unwillingness of the borrower to make consistent payments.

ComFed Savings Bank

On December 13, 1990, ComFed was declared insolvent by the Office of Thrift Supervision and the former RTC was appointed conservator. ComFed subsequently was placed into a liquidating receivership by the RTC on September 13, 1991. The RTC was responsible for the resolution of ComFed's assets through December 31, 1995. During this period, the FDIC had no oversight or other responsibility with respect to ComFed. On January 1, 1996, by operation of law, the RTC ceased to exist and the FDIC succeeded to all rights, titles and interests of the RTC in its capacity as receiver of ComFed.

At the time of conservatorship, ComFed had assets of approximately $1.4 billion. When ComFed was placed into a liquidating receivership, the RTC retained $723 million in assets, of which approximately $578 million were loans and owned real estate. Currently, less than $56 million in ComFed assets remain in liquidation. The remaining ComFed portfolio includes 295 loans with an aggregate book value of $12 million, of which 276 are loans secured by one-to-four family residential properties. The bulk of the remaining assets consists of owned real estate.

The loan tracking system used by the RTC was not operational at the beginning of the ComFed conservatorship, but has been operational since mid-1992. This system tracked approximately $485 million in ComFed real estate loan dispositions. Negotiated sales and securitized transactions accounted for 95 percent of the loan dispositions. Completed foreclosures from the ComFed receivership accounted for less than one percent of total loan dispositions. Our research indicates that the vast majority of the foreclosed properties were in foreclosure at the time of ComFed's failure.

While the Committee's invitation did not request testimony about any specific asset of ComFed, we note that Ms. Rhetta Sweeney will appear as a witness. For the Committee's information, we have attached an Appendix describing the history of resolution efforts of Ms. Sweeney's loan. We note that Ms. Sweeney received a loan of $1.6 million in 1987, but has failed to make any principal payments on that debt. The Appendix also describes recent settlement offers made by the FDIC to resolve this matter, which it inherited from the RTC.

Summary

In conclusion, the FDIC is faced with the arduous and occasionally unpleasant task of dealing with problem assets in a sometimes difficult economy. As you are aware, the success of our efforts has a direct impact on the banking industry that pays deposit insurance premiums. In addition, the success of our efforts as successor to the RTC has a direct impact on the taxpayers of this country and the total costs for the resolution of the savings and loan crisis.

Above all else, we must protect the depositors of failed banks. To do this, borrowers must be expected to repay their financial obligations to the extent that they are capable of doing so. While we work with borrowers to reach mutually acceptable repayment terms, we sometimes are left with no acceptable alternative than to resort to legal action and foreclosure. These actions are wholly consistent with our statutory responsibilities. Although the FDIC was not responsible for RTC assets prior to this year, the low number of foreclosure actions out of ComFed is consistent with the FDIC's past experience.

Despite the shocks to the U.S. financial system over the past 15 years, no losses have been suffered by insured depositors, thousands of loans have been amicably resolved and returned to the private sector, public confidence in our banking system has been maintained, and no taxpayer money has been required to resolve any failed banks.

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