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Testimony



143163

For Release
on Delivery
Expected at
9:30 a.m. EST
Thursday
December 6, 1990

Resolution Trust Corporation:
Status of Selected Management Issues

Statement of
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Before the
Committee on Banking, Finance and Urban Affairs
U.S. House of Representatives



Mr. Chairman and Members of the Committee:

We are pleased to be here today to discuss the status of selected management issues at the Resolution Trust Corporation (RTC). From RTC's inception, we have been concerned about its vulnerability to fraud, waste, and mismanagement for several reasons: the large dollar value of the assets under its control, the heavy reliance to be placed on private sector contractors, which requires proper RTC oversight and the need for strong management information systems. For these reasons, I identified RTC, earlier this year, as 1 of 14 federal programs most vulnerable to potential financial loss to the Government because of internal control problems or mismanagement. These programs are now receiving priority audit attention.

ASSESSMENT OF RTC'S FIRST YEAR PERFORMANCE

The magnitude of RTC's operation makes it absolutely critical that the Congress have an adequate assessment of whether the approach and processes RTC is using will effectively and efficiently resolve the thrift industry's problems. When dealing with an issue of this magnitude, we can not adopt a "business as usual" approach. The government must continually strive to secure the public's confidence that it can more effectively manage the work out of the S&L crisis than it did the regulatory processes that led to the S&L disaster.

To assist the Congress in making the critical assessment of whether RTC is on the right track, we are committed to report to you early in the next session on our assessment of RTC's overall performance. I can not emphasize strongly enough how important it is to have a continuing, constructive dialogue between the Administration and the Congress regarding RTC's operations. Government in general will lose if all affected parties can not openly and honestly discuss all issues and reach a consensus on how to critically resolve outstanding problems and issues. It is up to those involved in the largest work out in the history of the United States to demonstrate to the public that they are competent and capable of adequately fulfilling their expectation that they do it well.

Our assessment will address five key questions about RTC's performance:

- (1) How well did it establish its organization?
- (2) How effectively does it manage conservatorships?
- (3) Has RTC resolved failed thrifts in a cost-efficient manner?
- (4) How well has it performed in selling financial assets?
- (5) Has RTC done a good job in managing and disposing of real estate?

Establishing Its Organization

RTC has grown rapidly into a large, decentralized operation with more than 5,000 employees. To be managed efficiently, an organization of this size requires effective strategies for setting agencywide direction and good communication policies. Therefore, our assessment will address the following key questions:

- How effective is RTC's planning process?
- Is there adequate control over decentralized operations?
- How well did RTC meet its staffing needs? and
- Are there good strategies for managing information and for contracting?

Managing Conservatorships

As of September 30, 1990, RTC managed 206 conservatorships with assets totalling \$91 billion. When an institution is in conservatorship, RTC gets its first real chance to understand the assets and liabilities of the organization, begin dealing with its problems, and get it ready for resolution. In assessing its performance in this area, we will address key questions about the way RTC selects and monitors managing agents, develops and uses business plans, provides guidance for conservatorship operations, and identifies strategies for downsizing institutions.

Resolving Failed Thrifts

Since its inception in August 1989 through September 1990, RTC has resolved 287 thrifts. It controlled receiverships with \$51 billion in assets as a result of its resolution activities through September 30, 1990. The resolution process is vital because how well it is done influences the ultimate cost to the government as well as the taxpayers. Key questions to be addressed here will be:

- How well does RTC schedule thrifts for resolution?
- Has its solicitation process been open and fair to bidders?
- Are the resolution methods selected the most cost effective available?

Selling Financial Assets

As of September 30, 1990, RTC had responsibility for managing and disposing of \$142 billion in total assets, of which approximately \$113 billion, or 80 percent, were financial assets, such as cash, securities, mortgages, and other loans. Selling these assets will require putting together packages that are attractive to the investment community and effectively marketing them to get the best dollar return. RTC has begun to dispose of these assets and our work will address key questions about its sales activities, including:

- Does RTC accurately value and track financial assets?
- How good is decision making for what and when to sell?
- How accurate, complete, and timely is information provided to potential purchasers?
- Is RTC effective in completing transactions?

Managing And Selling Real Estate

Real estate assets under RTC's control totalled approximately \$17 billion as of September 30, 1990. While not the largest in dollar value, this category of assets is the most visible, will likely be the most difficult to dispose of because many were the product of poor investment decisions, and will have to be sold in local markets, many of which are depressed. It is important that RTC have an effective strategy for marketing these assets and ensuring that their value will be maintained. Key questions in this area will address how well RTC determines market values, preserves asset values, and prevents market disruption.

We expect to complete the work for the performance assessment early next year and be ready to testify on our results before your committee in February 1991.

Because we are still in the midst of our work that will provide the foundation for our initial report card on RTC, I would like

to highlight the results of some of our previous work on RTC's asset management practices, controls over contracting, information policies, and funding levels.

RTC'S ASSET MANAGEMENT STRATEGY IS EVOLVING

During its first year of operation, RTC required acquiring institutions to service the assets that RTC retained. At the same time, RTC was developing a Standard Asset Management and Disposition Agreement (SAMDA). Released in June 1990, the agreement will generally be used to award contracts for the management of a pool of similar assets in a defined geographic location. The agreement requires contractors to prepare business plans for the management and disposition of assets, provide asset management services, and ultimately sell the assets.

The agreement contains a fee structure that is intended to create incentives for RTC's contractors to maximize proceeds from the sale of assets and to sell assets quickly. Generally, the contractor's compensation will consist of three components: (1) a monthly management fee, (2) a disposition fee, and (3) an incentive fee. The management fee is compensation for managing the assets. The disposition fee varies depending upon how well the contractor either matches, exceeds, or falls short of meeting the expected recovery value of the asset. Both the management fee and the disposition fee are proposed by the contractor and

evaluated during the contractor selection process. The incentive fee rewards the contractor for speed in selling the assets. In other words, the sooner an asset is sold, the higher the contractor's payment.

While the contract provisions appear sound, there is no question that market conditions will influence how these provisions affect contractor behavior and profitability. Therefore, as RTC begins using these new agreements, oversight will be needed to ensure that the incentives encourage contractor behavior that is consistent with RTC's goals and objectives.

Within the last few months, RTC has begun to place assets under the new agreement. By the end of December 1990, it plans to have about \$30 billion of the \$40 billion of assets held in receiverships as of June 30, 1990, under management by contractors. As of November 30, RTC had placed \$8.2 billion of assets, or 27 percent of its December 1990 goal, under the SAMDA. It also had solicitations pending for contractors to manage an additional \$14.6 billion. Taken together, these two amounts represent 76 percent of its asset management goal for the year.

STRONG INTERNAL CONTROLS IN
CONTRACTING ARE NEEDED

RTC's progress in implementing internal controls has not been as good as we would like. To be fully functional, RTC's internal control system should include: (1) policies, procedures, and other directives to guide staff in carrying out their duties; (2) separation of duties to reduce the risk of fraud; (3) adequate supervision of personnel; (4) an effective contractor oversight program; and (5) adequate information so that managers can determine whether policies and procedures have the desired effects. While RTC has developed some essential controls, many have not been tested and others need additional development.

For example, one of our key concerns is that RTC does not have an effective contractor oversight program. During field visits we made late last summer, RTC staff told us that more guidance was needed to effectively oversee contracts. Specifically, they said standards were needed to determine when contractor performance was unacceptable.

Also, during October 1990, RTC training staff told us it was difficult to develop effective training courses on contract administration without more specific guidance and standards. They felt they could be put in a position of establishing policy

through their responses to questions during training sessions and did not think this was an appropriate role for them.

As of late November 1990, RTC completed a draft outlining a program for contractor oversight. This program includes a directive to provide guidance to RTC's field staff on some aspects of contractor oversight, such as conducting on-site visits. But this directive does not contain specific standards for RTC employees to make uniform decisions regarding contractor performance. Because of the large dollar value of assets to be placed under contractor control, we believe it is essential that an effective system be put in place as quickly as possible to assure proper contract management and oversight, and minimize RTC's vulnerability to fraud, waste, and mismanagement.

RTC NEEDS TO EFFECTIVELY
MANAGE INFORMATION RESOURCES

Information is critical to good controls. Obtaining timely, accurate, and complete financial and operational information on failed thrifts and related assets is one of RTC's biggest challenges. RTC believes, and we agree, that automation is crucial in meeting this challenge. However, as we reported earlier this year, RTC needs to apply sound information resources management principles if its automation efforts are to be successful.

The first principle, which is an effective IRM framework includes:

- strong leadership to direct RTC's automation efforts,
- a strategic IRM plan that identifies the information resources needed to carry out its main lines of business, and
- a technology plan or systems architecture to ensure that all individual systems will work together.

The second principle consists of sound management practices for the development of each individual system, including:

- clearly articulated systems requirements that describe exactly what the system is supposed to do,
- an analysis of the alternatives available to meet these requirements, and
- effective management controls over each system's development and operation.

We recently reported that because these principles were not firmly in place at RTC, it runs the risk of acquiring and operating costly information technology that may not meet its needs, perform as desired, be cost effective, or be compatible with existing and future RTC systems. For example, RTC was preparing to award a contract for its real estate asset management information system before completing its overall IRM framework. In response to our concerns, RTC's top managers

agreed to complete the needed IRM framework and then establish systems development practices. It took an important first step with the appointment of a senior IRM official in September 1990. This official is currently hiring technical staff to help prepare a strategic IRM plan and a systems architecture before the real estate information system contract's anticipated award date in early January. He plans to use this staff to prepare systems development practices by next spring which will ensure that RTC designs systems that best meet its information needs. By taking these steps, RTC is moving in the right direction to effectively manage its automation efforts. But, RTC will not have assurance that its information needs are being met until these important management principles are in place and working.

STATUS OF RTC FUNDING IS UNCERTAIN

RTC is currently approaching a funding crisis. Without sufficient funds to absorb the losses and to purchase the assets of failed institutions, RTC will have to slow down its resolution activity. Sources may differ when calculating the ultimate cost of such a slowdown, but all agree that allowing failed institutions to continue to incur operating losses will increase resolution costs.

In past testimonies, we said that RTC would need at least \$100 billion, or \$50 billion more than already provided by FIRREA, to

cover resolution and administrative costs. To address the funding shortfall, we recommended that RTC's Oversight Board develop alternative funding proposals. The administration has since proposed the following general funding mechanisms to address RTC's cash flow needs:

- a short term funding bill to keep resolution activity going into early 1991;
- funding to cover estimated needs for some intermediate period; or
- a permanent and indefinite appropriation to complete the job of resolving failed thrifts.

Although the Administration has not recently appeared before your Committee to discuss funding options, on October 10, 1990, the Secretary of the Treasury sent a letter to Congress saying that without additional funding, RTC's resolution activity would cease before the end of the calendar year. RTC has taken some short term steps to address its funding needs through early next year. However, quick action is needed to identify a long term solution that will ensure RTC's continued ability to respond to the nation's thrift crisis.

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This concludes my prepared statement. I would be pleased to respond to your questions.