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RESOLUTION TRUST
CORPORATION

Management Improvements
Reduce Risks
But Transition Challenges
Remain

Statement of Gaston L. Gianni, Jr.
Associate Director, Government Business Operations Issues
General Government Division



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RESOLUTION TRUST CORPORATION
MANAGEMENT IMPROVEMENTS REDUCE RISKS
BUT TRANSITION CHALLENGES REMAIN

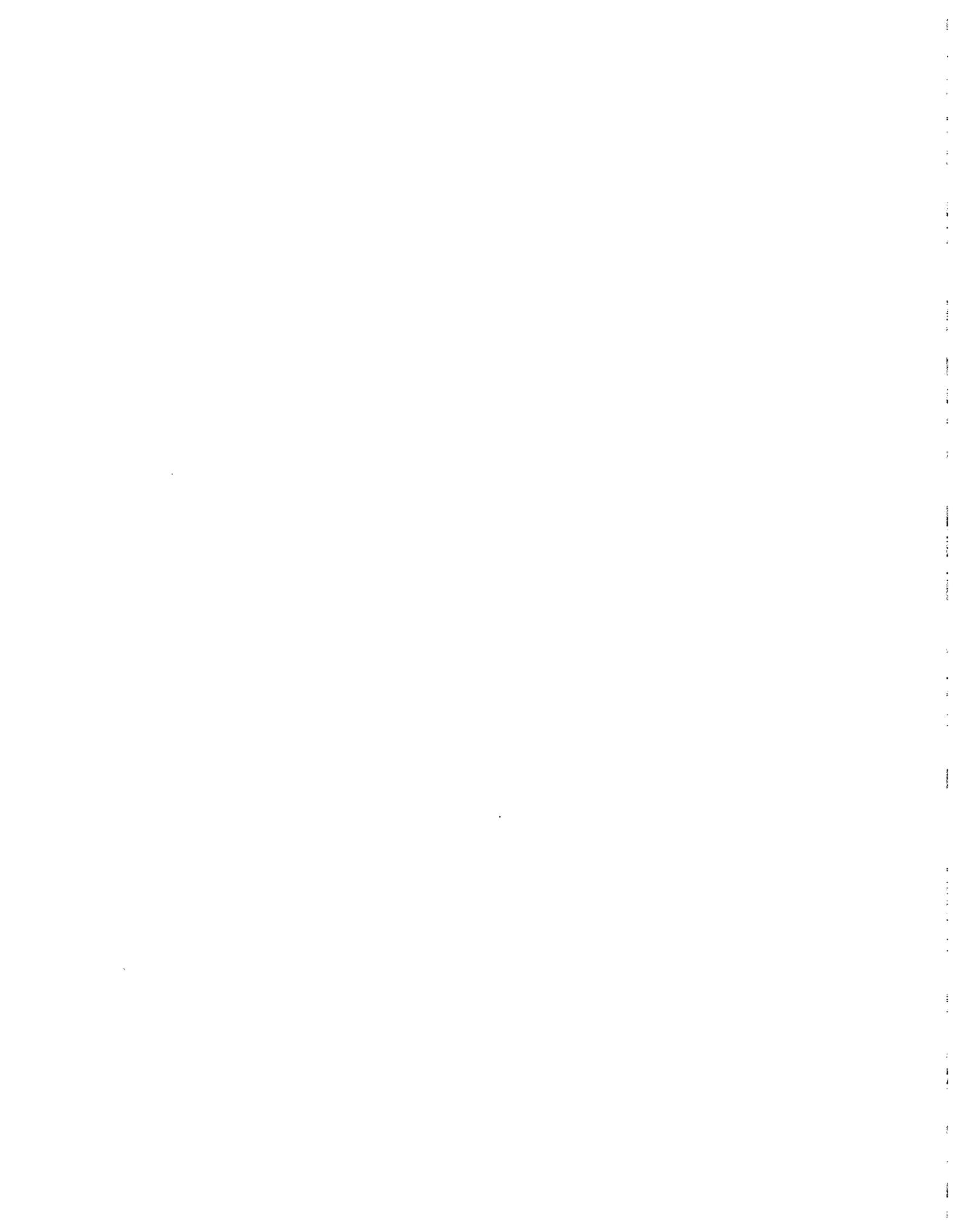
SUMMARY OF STATEMENT OF
GASTON L. GIANNI, JR.
ASSOCIATE DIRECTOR, GOVERNMENT BUSINESS
OPERATIONS ISSUES

From its inception in August 1989, through May 8, 1995, the Resolution Trust Corporation (RTC) has completed the depositor protection phase of its work for all 747 failed thrifts whose aggregate assets totaled about \$464 billion. In addition, RTC has made substantial progress in disposing of about \$443 billion of financial, real estate, and other assets. This significant decrease in RTC's responsibility lessens the magnitude of the remaining risks associated with the S&L cleanup. Furthermore, RTC's efforts to address the weaknesses identified in GAO's 1992 High Risk report have resulted in GAO's removal of its high-risk designation for RTC.

Despite this progress, however, GAO points out that some remaining risks related to the cleanup need further attention. For example, a substantial portion of the \$21 billion of remaining assets are classified as hard-to-sell. Further, RTC estimates that about \$8 billion in assets will remain unsold at the end of 1995 and will be transferred to the Federal Deposit Insurance Corporation (FDIC). Thus, it remains important that RTC use the sales strategies that are most effective for the types of assets left in its inventory. At the same time, RTC must continue its efforts to implement the management reforms mandated by the RTC Completion Act.

Winding down a large and complex organization with thousands of personnel and billions of dollars of assets, while minimizing disruption will be very difficult. For a successful transition, RTC and FDIC will need to ensure that sufficient controls are in place over the assets that will be sold during the remaining life of RTC, as well as over the assets that will be transferred to FDIC.

While transition efforts are well under way, there is still much work left to ensure the smooth transfer of remaining assets and responsibilities to FDIC. GAO identifies a number of issues that need to be resolved to ensure the overall success of the transition. These include (1) providing sufficient resources to FDIC to complete asset disposition and other work that will transfer from RTC, (2) making legal and policy decisions to determine how FDIC will absorb RTC's responsibilities and operations, (3) addressing staffing issues, and (4) developing specific asset disposition plans.



Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today in support of the Subcommittee's oversight of the Resolution Trust Corporation (RTC). As you requested, my testimony focuses on RTC's performance and the remaining challenges involving RTC's transition to the Federal Deposit Insurance Corporation (FDIC). Specifically, I will discuss (1) our recent report to the Acting Chief Executive Officer (CEO) of RTC on the management improvements that led to RTC's removal from our high-risk list, (2) the status of planning efforts for RTC's transition to FDIC, and (3) some of the unresolved transition issues that RTC and FDIC will be facing within the next few months.

BACKGROUND

To date, RTC has been authorized \$105 billion to be used for resolving thrifts that fail between January 1, 1989, and July 1, 1995. On the basis of the estimates presented in RTC's 1993 financial statements, which continue to be subject to uncertainties, we reported that RTC may not need all of its authorized funds, leaving unused funds of up to \$13 billion after RTC resolves all institutions for which it is responsible.¹ We are currently auditing RTC's 1994 financial statements and plan to report in June 1995.

From RTC's inception in August 1989, through May 8, 1995, it has accepted responsibility for resolving 747 failed thrifts with aggregate assets totaling about \$464 billion. Although RTC has disposed of more than 95 percent of these assets, more work remains before the thrift cleanup is completed. RTC had about \$21 billion in assets remaining on May 8, 1995, most of which it considered to be hard to sell. Further, RTC has estimated that about \$8 billion in assets will remain unsold at the end of 1995 and will be transferred to FDIC.

As RTC enters its final months of operation, we are pleased to note the progress it has made in addressing management issues that Congress, we, and the RTC Inspector General have identified over RTC's 5-1/2 year life. By addressing these issues, RTC has reduced the risks associated with its operations.

¹Financial Audit: Resolution Trust Corporation's 1993 and 1994 Financial Statements (GAO/AIMD-94-148, June 1994).

MANAGEMENT IMPROVEMENTS
RESULTED IN REDUCED RISKS

In December 1992, we reported on several aspects of RTC's operations that led us to designate RTC as a high-risk area.² In our report, we described risks related to RTC's (1) asset disposition practices, (2) contracting activities, (3) information systems, and (4) financial management and accountability. We also recognized the effect of future uncertainties on RTC's resolution activities, and we pointed to opportunities to reduce the overall cost of the thrift cleanup if RTC were given adequate funding. In addition, we warned that the thrift cleanup would not be completed by the time RTC sunsets and that the total cost of the cleanup would depend, in part, on how effectively FDIC applies RTC's investment in both processes and skilled personnel to manage the remaining responsibilities.

Our most recent RTC report describes actions taken by Congress, RTC, and FDIC that address many of our prior concerns.³ In our report, we describe risks related to RTC's (1) asset disposition practices, (2) contracting activities, (3) information systems, and (4) financial management and accountability. Congress, in the RTC Completion Act, gave RTC the additional funding it needed to accomplish its work, mandated that RTC implement specific management reforms, and required that an interagency transition task force be established to help transfer RTC's assets, personnel, and operations to FDIC. We reported earlier this year that RTC had implemented most of these reforms.⁴ Further, RTC and FDIC have established the interagency task force, and it is in the process of planning for a smooth and efficient transition. In addition, RTC has eliminated its inventory of thrifts waiting to be resolved and dramatically reduced assets available for sale, further diminishing the remaining risk.

In the area of real estate disposition, our 1992 high-risk report highlighted the risk that RTC might not be maximizing revenues due to its lack of reliable information on the best disposition methods for the various types of properties. RTC has not completed the comprehensive sales method comparison study we recommended to remedy this situation, but it has implemented two congressionally mandated management reforms related to its marketing and disposition methods that should help it obtain

²High-Risk Series: Resolution Trust Corporation (GAO/HR-93-4, Dec. 1992).

³Resolution Trust Corporation: Efforts Under Way to Address Management Weaknesses (GAO/GGD-95-109, May 1995).

⁴Resolution Trust Corporation: Implementation of the Management Reforms in the RTC Completion Act (GAO/GGD-95-67, Mar. 1995).

maximum revenues. In addition, RTC established a process for gathering some information that may be useful for evaluating sales techniques used for multiasset dispositions. Despite this progress, we are concerned that the lack of a valid sales method comparison may hamper transition team efforts to identify RTC sales methods that FDIC should adopt.

Regarding the contracting function at RTC, we noted in our 1992 high risk report that RTC's contract issuance process was poor and that its oversight of contractor performance needed improvement. Actions taken by RTC prior to, and as a result of, the mandated management reforms addressed contracting activities. These actions have improved RTC's processes for issuing and overseeing contracts. However, contract audits continue to identify weaknesses in operating controls related to contracts issued before these improvements were made. As a result, RTC cannot ensure that it recovers all that it should from its receiverships. Also, as discussed in more detail later, RTC is still vulnerable to risks associated with closing out contracts in an untimely manner.

RTC has also improved internal accounting controls over its receiverships' transactions, accounting operations, and systems. Specifically, RTC has issued internal control policies, finalized field accounting procedures, and established controls over receivership receipts and payments. In addition, RTC has implemented several new systems that contribute to improved accountability and reporting.

RTC's information systems remain critical to its efforts to manage and sell failed thrift assets and to FDIC's task of assuming responsibility for any remaining RTC operations after December 31, 1995. In the past, we found that RTC's information systems contained inaccurate and incomplete data. RTC is making progress in improving the quality of data in its systems. However, as it reduces staffing levels, RTC may have fewer resources to ensure that data errors are corrected. The quality of RTC's data will affect FDIC when it assumes responsibility for those assets that remain to be sold after its sunset.

A source of continuing concern stems from this being the final months of RTC's existence, after which FDIC will absorb any remaining operations and workload. Winding down a large and complex organization with thousands of personnel and billions of dollars of assets, while minimizing disruption, will be very difficult. RTC and FDIC face the challenge of planning the transition, while RTC faces the challenges of disposing of the \$21 billion in assets that remain, and in maintaining internal controls.

STATUS OF THE TRANSITION OF RTC TO FDIC

The RTC Completion Act required RTC and FDIC to establish a transition task force to facilitate the transfer of RTC assets, personnel, and operations to FDIC in a coordinated manner. The transition planning task force was established in February 1994. Its members are two RTC officials, who report to the Acting CEO of RTC, and two FDIC officials, who report to the Chairman of FDIC.⁵ The RTC Completion Act assigned the task force specific duties, including examining the operations of RTC and FDIC, evaluating the differences, and recommending which RTC systems should be preserved for use by FDIC.

The act also required three reports to Congress on the transition. The first report from the task force, issued December 28, 1994, describes the task force's planning activities. The second report, due on July 1, 1995, will include the task force's recommendations on RTC practices and systems to be adopted by FDIC. The final transition report is due on December 31, 1995, from FDIC. This report should contain information on transition task force recommendations accepted by FDIC and a rationale to account for any recommendations not accepted.

The task force, which has been operating for over a year, has established a reasonable process for planning the transition. From our monitoring, we believe the process is well designed with no known major gaps or omissions. This transition process provides for the involvement of top management at RTC and FDIC and also ensures that RTC and FDIC program managers who are most knowledgeable about the operations involved will have input. GAO, the RTC Inspector General, and the Thrift Depositor Protection Oversight Board have also been involved in monitoring elements of the transition planning process.

Some key elements of the transition planning process include (1) "best practice reviews" being conducted jointly by RTC and FDIC groups to identify differences in their respective operations to formulate recommendations on the best practices that should be adopted by FDIC after RTC's sunset, (2) information systems reviews to assist the Secretary of the Treasury in making recommendations on RTC systems that should be adopted by FDIC, and (3) implementation plans that identify staffing and organizational structure for RTC functions after they are absorbed by FDIC.

⁵The RTC task force members are the General Counsel and the Vice President for Planning, Research, and Statistics. The FDIC members are the Deputy to the Chairman of the FDIC Board and the Director of the Division of Depositor and Asset Services.

Additionally, RTC and FDIC are in the process of reviewing legal and policy issues related to the transfer of RTC's responsibilities and operations to FDIC. They are also reviewing internal controls to ensure that vulnerabilities to waste, fraud, and abuse are minimized during and after the transition.

The transition of RTC to FDIC is well under way. In the past year, the RTC/FDIC transition planning task force has made many important decisions regarding personnel issues and time frames for merging many operations. To date, over 800 staff have made the transition from RTC to FDIC, RTC has transferred its asset disposition staff from one of its regional offices, and others are scheduled to merge with FDIC offices in the next few months. RTC and FDIC have also started detailed planning for the merger of some functions, such as the information management function, that is scheduled to merge next month. However, the transition task force has not completed its review and approval of many of the ongoing planning efforts. While we have had discussions with task force staff about their approach and progress, we are not in a position today to comment on the results of best practice reviews, information systems reviews, and other efforts.

TRANSITION PLANNING EFFORTS ARE IN A CRITICAL PHASE, AND MANY ISSUES STILL NEED RESOLUTION

Transition planning has reached a critical phase. The transition task force plans to make many key decisions in the next 2 months. The decisions made now could affect both the costs of the cleanup and FDIC's efficiency and effectiveness after RTC's sunset.

Within the next 2 months, the task force plans to finalize its best practice reviews and information systems recommendations. It also plans to complete transition implementation plans to provide details on staffing, workload, and organizational structure after the transition. The task force is also to review legal and policy issues relating to the transfer of RTC operations and responsibilities.

While it has shown promise, the task force's best practice review process has not yet resulted in the issuance of best practice recommendations. RTC and FDIC have identified more than 70 operational differences for best practice reviews and have completed studies of most of them. For example, one best practice review is to focus on the relative merits of RTC's centralized securities sales versus FDIC's decentralized approach. The task force plans to consider these studies over the next few weeks as it completes its best practice recommendations.

Although the task force has not yet made the best practice studies available to us, we have reviewed the studies' methodology. We believe that the methodology is sound and can be

used to ensure that the most significant operational differences between RTC and FDIC are fairly and thoroughly evaluated. The methodology also includes a review committee to ensure consistent application of the review methodology and supply technical assistance. We believe the quality of the best practice recommendations will depend on the degree of adherence to the methodology, on the quality of the supporting data and analysis, and on the degree of cooperation between RTC and FDIC managers. The quality of contractor products will also affect recommendation quality since contractors were used to perform some of the best practice analyses.

Another important aspect of the transition planning is the task force's review of information systems. RTC and FDIC identified over 60 RTC information systems and studied them to determine if they should be transferred to FDIC. The transition task force is in the process of considering the information systems reviews in order to make recommendations to the Secretary of the Treasury concerning which RTC systems should be transferred to FDIC.

Although the task force's recommendations on transferring information systems are scheduled to be announced in the July 1, 1995, report to Congress, it is important to note that they are being made at a time when FDIC is redefining its mission and reassessing its own information needs. FDIC will need to assess the long-term applicability of RTC systems in the context of its own efforts.

Implementation plans are another key aspect of the transition planning process that is currently under way. These plans are to provide the details necessary to implement the merger of RTC functions and staff. These plans address workload, staffing, and organizational structure, as well as how the merged organization will operate. FDIC intends to review these implementation plans within the context of its own mid-year budget review process to ensure proper consideration of various corporate activities.

Although RTC and FDIC have made progress in planning the transition, several critical issues still remain to be addressed. Through discussions with the task force members and staff, we identified eight issues that are particularly significant because of the impact they will have on the overall success of the transition and future operations of FDIC. The task force members have expressed their commitment to resolving these issues, and plan to make many decisions within the next few months. These issues are as follows:

- Providing sufficient resources to FDIC to complete asset disposition and other work that will transfer from RTC. The Thrift Depositor Protection Oversight Board, RTC, and FDIC are in the process of determining the additional funding needed by FDIC at sunset to dispose of RTC assets and settle

liabilities remaining at December 31, 1995. This process should also take into account FDIC's needs for contingency funding that may be required because of the uncertainty regarding general economic conditions, interest rates, and real estate markets that are beyond the control of RTC and FDIC.

- Making legal and policy decisions to determine how FDIC will absorb RTC's responsibilities and operations. Transition planners have identified more than 50 issues that need legal analysis and other decisions. These issues cover a broad range of RTC's operations. For example, some issues relate to the applicability to FDIC of RTC management improvements mandated in the RTC Completion Act, while others address the employment rights of RTC employees after sunset. As of today, about half of these issues have been decided. Decisions on these issues will shape the future of FDIC's operations and need to be made soon to avoid planning delays.
- Making decisions regarding RTC and FDIC Professional Liability Sections (PLS). The transition team has decided that RTC's PLS will transfer to FDIC after December 31, 1995. However, there is some uncertainty over the best timing for fully integrating RTC's PLS with FDIC's PLS. One approach being discussed is the immediate integration of the two PLS units at transition for the purpose of achieving efficiencies and to better ensure consistency in staff recommendations on both RTC's and FDIC's professional liability claims. The other approach would keep the two PLS units organizationally distinct, for accountability and case continuity purposes, until December 31, 1996, a year after RTC's PLS becomes part of FDIC's Legal Department.
- Addressing staffing issues. While many RTC staff have already transferred to FDIC, an additional 1,203 of RTC's 5,171 staff have FDIC employment rights until 1997. Specific staffing assignments have not yet been made for most of the 1,203 individuals. FDIC is currently reviewing its mission and undergoing employee downsizing. This complicates planning for the transfer of RTC staff. FDIC will have to closely monitor for workload and staffing imbalances since the transfer of RTC employees may cause overstaffing in some occupations, functional areas, or geographic regions. FDIC will also need to evaluate the proportion of work done by contractors as opposed to its own staff to ensure maximum efficiency.
- Developing specific asset disposition plans. FDIC needs to develop specific plans on how it will manage and dispose of the remaining RTC assets. To assist FDIC in this effort, RTC needs to provide accurate and complete information on

these remaining assets. Communication between RTC and FDIC asset disposition staff on best practices should help with asset disposition planning, but several of the best practice decisions have not been made. Furthermore, the nature of some assets remaining at RTC's sunset may present FDIC with special challenges. Specifically, FDIC will need to be prepared to manage and dispose of significant numbers of subsidiaries, special resource properties, and environmentally hazardous properties. FDIC will also need to be prepared to monitor the government's continuing interests in RTC's equity partnerships.

- Deciding the future of minority and women's programs. RTC and FDIC have different programs for providing opportunities to minorities and women through the contracting and resolution processes. Decisions need to be made on how these opportunities will apply post-sunset. The task force plans to use a contractor to independently evaluate the applicability of RTC management reforms and best practices related to minority and women's programs. However, a number of decisions relating to the future of minority and women's programs may still have to be made by the FDIC Chairman.
- Addressing contracting issues. RTC needs to devote continued attention to closing out contracts on a timely basis. According to a November 1994 RTC estimate, at least 12,000 prime contracts issued before December 31, 1992, with estimated fees of about \$2.8 billion, needed to be closed. Additionally, RTC has identified about 800 asset management contracts recommended for continuation at FDIC after RTC's sunset. It will be critical for FDIC to ensure adequate management and oversight of these contracts. Also, FDIC may benefit by evaluating its own contracts in conjunction with RTC contracts to explore opportunities to combine, cancel, or extend them.
- Merging the RTC and FDIC Inspector General Functions. Currently, FDIC is awaiting congressional action on the confirmation of its statutorily mandated Inspector General. The absence of a confirmed Inspector General at FDIC may complicate the merger of RTC and FDIC inspector general operations. Successful accomplishment of the merger will require major decisions that will affect the future FDIC Inspector General's organizational structure, staffing, policies, and practices.

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In closing, I would like to say that Congress and RTC have taken actions over the years to improve RTC operations, and now RTC's mission has nearly been completed. As a result, the risks once associated with RTC have been reduced, and consequently we have

removed RTC from our list of high risk programs. We are pleased with the transition planning efforts to date, but the true test of this transition is yet to come. Although RTC's remaining life is short, Congress should be aware that there is still much work left to be done to ensure the smooth transfer of remaining assets and responsibilities to FDIC. RTC and FDIC will need to make several key decisions in the next few months, and then implement them by year-end when RTC sunsets. The success of the transition depends on the quality of these decisions and on how well they are executed.

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

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