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Report to the Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Senate

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# FAILED BANKS

# FDIC's Asset Liquidation Operations

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GAO United States
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General Government Division

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The Honorable William Proxmire
Chairman, Committee on Banking, Housing,
and Urban Affairs
United States Senate

Dear Mr. Chairman:

This report presents information on the Federal Deposit Insurance Corporation's management and liquidation of assets acquired from failed and assisted banks. It focuses on how the organization has adjusted to the increase in bank failures, how it manages the asset liquidation process, and how much it expects to recover on assets being liquidated.

Copies of this report are being sent to the Chairman, Federal Deposit Insurance Corporation, and other interested parties.

Sincerely yours,

Richard L. Fogel
Assistant Comptroller General

# Executive Summary

## Purpose

The Federal Deposit Insurance Corporation (FDIC) plays a central role in maintaining public confidence in the U.S. banking system by insuring bank deposits up to $100,000 against bank failures and acting as receiver for failed banks. FDIC's ability to liquidate assets acquired—that is, turn them into cash—in order to pay back uninsured depositors and other creditors, including the FDIC insurance fund, is critical to this mission.

GAO reviewed FDIC's liquidation operations for the Senate Committee on Banking, Housing, and Urban Affairs to determine (1) how the organization has adapted to the large increase in bank failures in the 1980s, (2) how it manages the asset liquidation process, and (3) how much of the book value of assets disposed of it recovers and in what time frames. This is an information report; it does not evaluate the effectiveness of FDIC's operations.

## Background

Within FDIC, the Division of Liquidation has responsibility for handling insured bank failures and liquidating assets acquired from failed or assisted banks. As of March 31, 1988, the division was liquidating over 177,895 assets with a book value of about $8.6 billion, acquired from 691 failed or assisted banks. (See p. 23.) Assets from the assisted Continental Illinois National Bank and Trust Company and the failed First National Bank and Trust Company of Oklahoma, which are being managed under contract outside the Division of Liquidation, bring the FDIC book value total of assets in liquidation to about $11.2 billion.

FDIC's ability to handle future bank failures depends on the value of all the assets in its insurance fund and their liquidity. The fund consists mainly of government securities and receivables from failed and assisted banks. Although the fund has grown during the 1980s, the increase in failed and assisted banks has made it relatively less liquid. (See pp. 17 and 18.)

## Results in Brief

In the early 1980s, FDIC officials foresaw a need to prepare for an increasing number of bank failures and resulting increase in the liquidation workload. They decided to create a decentralized structure, delegate authority, and rely on a large temporary employee workforce. Internal management reviews, an approval process for liquidation decisions, audits, and information systems were developed to oversee the decentralized program.

FDIC has taken steps to speed up and improve collections on assets in liquidation, recognizing the time value of money. It started emphasizing accepting less than the full amount owed by borrowers and also assembling individual assets into portfolios—or packages—for sale.

## GAO's Analysis

### Decentralization, Staffing, and Internal Controls

The Division of Liquidation has evolved into a large and decentralized organization. At year-end 1981, it had a staff of 429 and no regional offices. As of March 1988, the division had a staff of 4,118 and 6 regional offices overseeing 18 subregional offices. (See pp. 21 to 24.) Over the last several years, the division has delegated the authority to approve ever-higher dollar levels of liquidation actions. (See p. 30.)

FDIC uses an approval procedure for proposed actions to help maintain control over liquidation decisions; actions involving specified dollar ceilings must be approved by a higher organizational level. (See pp. 28 to 30.) The division also has a program in which teams of division staff review operations at subregional and regional offices. FDIC's Office of Corporate Audits and Internal Investigations also focuses its work on the Division of Liquidation. (See pp. 31 to 35.)

The division uses a large number of temporary employees, hired under annual contracts. As of December 31, 1987, about 80 percent of its liquidation workforce consisted of such employees. The use of temporary employees and subregional offices provides the flexibility of expanding and contracting the organization according to the volume and geographic distribution of the workload. (See pp. 24 and 25.)

FDIC recognizes that consistent and reliable information is needed to manage a decentralized organization. The current financial information system, which collects nationwide collection and expense information at the failed or assisted bank level, has been in use since 1986. (See pp. 46 to 49.) In 1983, it began work on a national asset management information system. This system encountered various problems, delays, and cost increases, but that part of the system that will include asset-specific information is now expected to be operational nationwide by year-end 1988.

## Initiatives to Speed Up Collections and Liquidation Results

FDIC's liquidation mission is to achieve "the highest possible level of collections on assets at the earliest practical time in the most cost-efficient manner." Assessing the results of liquidation operations is difficult because there are no direct measurement criteria. A high or low return on book value by itself, for example, is not a good indicator of FDIC performance because the quality and present value of the asset, which are beyond FDIC's control, are also important factors. FDIC has only recently begun to maintain information needed to analyze asset recovery information on a nationwide basis. Given this situation, indicators of performance must be used. (See p. 50.)

Before 1985, FDIC's unwritten policy was to try to collect 100 percent of the amount owed by borrowers. If payments were not made, the cases were often referred for legal action. In 1985, FDIC began stressing the use of loan compromises, in which a borrower is permitted to pay an amount less than the full amount owed if present value analysis shows this to be more cost effective. From 1985 to 1987, compromises on loans increased from 737 to 6,310 nationwide. GAO's review of proposals for large dollar value loan compromises in 1986 showed that the gross recovery was about 50 percent, excluding any prior collections, of book value. (See pp. 38 to 43.)

Another change intended to accelerate and improve the liquidation of assets was the packaging of loans and the marketing of the portfolios to potential purchasers. During the first 6 months of 1988, FDIC completed 228 such sales, involving a total of about 39,000 assets. The packages sold for $169 million, 34 percent of the book value of the assets. (See pp. 43 to 46.)

GAO analyzed the expected recovery from the assets of 63 banks that failed in the first half of 1986. The analysis showed that the combined actual and projected recovery, net of expenses as of March 31, 1988, averaged about 62 percent of the book value when FDIC was liquidating all the bank's assets (both lower and higher quality) and about 43 percent when it was liquidating only those assets not purchased by an assuming bank. (See pp. 51 to 54.)

The Division of Liquidation sets annual targets to help it assess its performance. Targets for 1987 were based on an assumption of 206 bank closings during the year. (There were actually 184 closings. There were also 19 financial assistance transactions, and in 2 of these, assets were acquired.) The 1987 results were: cash collections of $2.4 billion; an estimated book value of assets in liquidation of $8.3 billion; 4,400 staff at year-end; and estimated operating expenses equal to 11.2 percent of collections. (See p. 51.)

## Recommendations

GAO is making no recommendations.

## Agency Comments

GAO noted that receivables from failed and assisted banks as a percentage of insurance fund assets have increased in the 1980s. FDIC said this percentage is not an appropriate measure of the fund's liquidity. This report does not address the question of the adequacy of the fund. The sentence FDIC referred to has been revised to avoid misinterpretation. (See p. 20.)

# Contents

## Glossary



## Tables



## Figures

## Abbreviations

| | |
|---|---|
| ECR | Estimated Cash Recovery |
| FDIC | Federal Deposit Insurance Corporation |
| FIS | Financial Information System |
| GAO | General Accounting Office |
| GG | Government-graded |
| LAMIS | Liquidation Asset Management Information System |
| LAS | Liquidation Accounting System |
| LG | Liquidation-graded |
| OCAII | Office of Corporate Audits and Investigations |
| OCC | Office of the Comptroller of the Currency |

# Introduction

This report provides information on the efforts of the Federal Deposit Insurance Corporation (FDIC) to liquidate assets acquired from failed or assisted banks. FDIC plays a central role in maintaining public confidence in the U.S. banking system by insuring bank deposits up to $100,000 against bank failures and acting as receiver for failed banks. When a bank fails, the FDIC insurance fund is used to pay off insured deposits or to arrange for the assumption of deposits by a financially sound bank. FDIC, as receiver for the failed bank, acquires some or all of its assets to liquidate. FDIC also offers open bank assistance by providing cash and other forms of assistance to prevent a bank's failure; assets may be acquired in such transactions as well. Liquidation is the process whereby FDIC manages and disposes of acquired assets, obtaining cash to pay FDIC and other creditors of a failed bank or FDIC alone in the case of an assisted bank.

During the 1980s, FDIC has handled the greatest number of insured bank failures in its history. Almost 700 banks had failed as of June 30, 1988, compared to a total of 702 from 1934, the year FDIC began operations during the Great Depression, through 1979. During that 46-year period, annual failures averaged about 15, with a high of 84. In 1987 alone there were 184 failures and 19 banks were assisted. Failures in 1988 have continued at a high level, and FDIC expects the number to approximate the 1987 total.

Recent failures have resulted in an extraordinary increase in the number and book value[1] of assets[2] acquired by FDIC to liquidate. As of March 31, 1988, FDIC was managing for liquidation some 177,895 individual assets from 691 failed or assisted banks. The book value of these assets totaled about $8.6 billion.[3]

FDIC liquidates assets held in its receiver and corporate capacity. When a state-chartered insured bank fails, a receiver is appointed according to

[1]"Book value," as used in this report, is the dollar value of assets as they were carried on the books of failed or assisted banks at the date of acquisition by FDIC. For loans, it includes the remaining principal balance and, where applicable, amounts that have been charged off by the failed bank and similar adjustments.

[2]"Assets," as used in this report, are those items acquired by FDIC from failed or assisted banks that are categorized as "assets in liquidation" in FDIC's liquidation accounting system. They include such items as installment loans, commercial loans, real estate mortgages, and owned real estate.

[3]These figures exclude the assets acquired from Continental Illinois National Bank and Trust Company of Chicago and the First National Bank and Trust of Oklahoma. These assets are handled by banks under service agreements with FDIC, rather than directly by FDIC, as is the case with all other assets. (See page 20.)

state law; typically FDIC is the appointed receiver.[4] When a national bank is closed, its charterer—the Comptroller of the Currency (OCC)—appoints FDIC as receiver, as specified in the Federal Deposit Insurance Act (12 U.S.C. 1821). As receiver, FDIC has a fiduciary responsibility to repay debts of the failed bank. To do this, it must marshall all assets, determine the amount owed to each creditor of the bank, and assume the failed bank's financial obligations to all creditors and stockholders. It is also responsible for managing and liquidating the assets owned by the failed bank's estate, investing the proceeds after expenses are paid, and distributing court-approved dividends[5] obtained from the liquidation of assets. FDIC also obtains assets in its corporate capacity, that is, the assets are bought by the insurance fund from (1) receiverships, so that they may be terminated, and (2) assisted banks.

Since failures began rising in the early 1980s, a higher percentage of the insurance fund's assets has become tied up in receivables from receiverships, including loans and property once held by failed banks, or assets acquired as a part of assistance transactions, rather than invested in assets that are more liquid, such as U.S. Treasury securities. Net receivables and notes now constitute about 26 percent of the fund's assets, up from 7.6 percent in 1980. (See table 1.3 on p. 18.) FDIC officials have expressed a desire to maintain the liquidity of the fund in order to have the flexibility to deal efficiently with failing institutions and to maintain public confidence in the insurance fund. The more funds are tied up in outstanding loans and property, the less money is immediately available for use by the fund. Several steps have been taken in recent years to obtain cash from assets more quickly or minimize the impact on the insurance fund. For example, in 1987, FDIC began selling the entire operations of a failed bank, referred to as whole-bank sales. (See pp. 12 and 13.)

In the 1980s, FDIC also began providing assistance to banks that were in danger of failing. The purpose was to prevent the closing of an insured

[4]The Federal Deposit Insurance Act (12 U.S.C. 1811-1832) specifies that FDIC may act as receiver for a failed bank.

[5]Dividends are distributions of income in excess of expenses to creditors and stockholders to satisfy claims against the receivership estate. Typically, FDIC attempts to make the first dividend payment to creditors no later than 9 to 12 months after the bank's closure. Subsequently, dividends are to be paid whenever funds available for such payment equal 10 percent of total proven and unproven claims. The order for distribution of proceeds is typically: (1) liquidation expenses; (2) FDIC-preferred claim for collection after closing; (3) loans from FDIC to the receivership for advance dividend payments; (4) common claimants, which includes FDIC for advanced funds; (5) interest to claimants; (6) subordinated debt; (7) preferred stockholders; and (8) common stockholders. (Source: Accounting for Receivership Liabilities, Division of Accounting and Corporate Services, FDIC; Jan. 1987.)

bank. In the 1981 to 1987 period, assistance was provided to 47 banks. (See p. 16.) Although this method cannot always be used, the FDIC Act provides that when it is used, assistance must be proven to be less costly to the insurance fund than arranging purchase and assumption or deposit payoff/transfer transactions. (12 U.S.C. 1823) An exception is made, however, when the continued operation of the failing bank is considered essential to provide adequate banking services to the community or when severe financial conditions exist that may threaten a significant number of financial institutions.

## FDIC and Division of Liquidation Structure

FDIC has four divisions: The Division of Liquidation has primary responsibility for handling insured bank failures. Its responsibilities include (1) the prompt payment of a failed bank's insured deposits or the expeditious transfer of these deposits to a financially sound bank and (2) the liquidation of any assets under FDIC's control. The Division of Bank Supervision is responsible for bank examinations and supervision, key components of FDIC's efforts to promote and maintain the safety and soundness of banks and to secure compliance with laws and regulations. The Division of Accounting and Corporate Services and the Legal Division are primarily service organizations that provide the necessary accounting and legal support to accomplish FDIC's mission.

The Division of Liquidation is managed by a director and three associate directors in Washington, D.C. The associate director for credit is responsible for overseeing all credit-related decisions and the general disposition of acquired assets from failed banks. The associate director for operations is responsible for overseeing the paying of insured depositors, managing the closing of banks, and generally overseeing division operations at regional and subregional offices. The associate director for administration is primarily responsible for overseeing automated financial systems, general record keeping, and for special projects. Analogous positions are generally found in regional offices. (See pp. 21 to 24 for a discussion of the regional and subregional offices.)

## How FDIC Handles Failed Banks and Acquires Assets

FDIC relies on two basic types of transactions to handle bank failures: purchase and assumption transactions and deposit pay-offs or deposit transfers. In 1986, there were 98 purchase and assumption transactions, 21 deposit payoffs, and 19 deposit transfers. The 1987 totals were 114, 11, and 40, respectively. More recently, FDIC has been trying to sell the entire failed bank's assets in transactions it refers to as "whole-bank" purchase and assumption transactions.

Since the mid-1960s, FDIC has preferred to use the purchase and assumption method in which a financially sound bank assumes the failed bank's depositor liabilities and some or all of its assets.[6] FDIC then advances funds to the assuming bank to cover the difference between the book value of the assets the bank acquires and the liabilities it assumes, adjusted by any premium (cash payment) offered by the assuming bank, and retains any assets the acquiring bank does not purchase. (FDIC generally also assumes responsibility for assets subsequently returned by the acquiring bank under a "repurchase agreement," which allows assets to be returned ("put back") within a specified period of time—typically ranging from 30 to 90 days.) We were told by a senior Division of Liquidation official that this method is preferred because it (1) provides full protection to depositors, (2) minimizes the disruption of banking services to the community, and (3) reduces the extent of losses to FDIC.

In whole-bank transactions, a new form of the purchase and assumption transaction, FDIC encourages the acquiring bank to purchase the maximum possible volume of the failed bank's assets. This departs from the practice of having the receiver retain poorer quality assets. Prospective bidders are invited to analyze all of a failing bank's assets and to submit bids to purchase those assets "as is" on a discounted basis. According to FDIC officials, this type of sale has two advantages: (1) it softens the impact on the local community because the failing bank's entire customer base continues to be serviced locally by an ongoing financial institution and (2) it lessens the growth in assets held by FDIC for liquidation. In 1987, 19 whole-bank transactions were consummated.

In a deposit payoff, FDIC as receiver pays off all deposits up to the legal limit, now $100,000, and retains all assets and all other liabilities. Deposits in excess of the limit are usually treated as other general debts of the bank, and their owners share proportionately in the proceeds from liquidating the bank's assets.[7] In a deposit transfer, FDIC makes the insured deposits available to their owners by transferring the accounts to an existing financially sound bank or a bank newly formed solely for paying insured depositors. A deposit transfer is preferred over a payoff because depositors are not inconvenienced. For example, a depositor can immediately do business at the assuming bank. This method was first used in 1983 and has been used more frequently in recent years.

[6]FDIC solicits bids from qualified potential purchasers in advance of the actual closing.

[7]In state bank receiverships with a statutory depositor preference provision, all depositors are paid ahead of common claimants.

The lack of interest on the part of a financially sound institution in assuming some of a failed bank's assets often stems from the fact that it is located in a state that does not allow banks to have branches or from the suspected involvement of fraud in the failure, in which case many assets may be worthless or disputed. FDIC officials say in such instances a deposit payoff or transfer is used instead.

FDIC may also acquire assets through a type of transaction known as a corporate purchase. FDIC may find it advantageous to purchase assets, in its corporate capacity, directly from an open bank that is in danger of failing or from the estate of a bank that has been put into receivership in order to terminate the receivership. As of March 31, 1988, assets on FDIC's books acquired through this method and managed by the Division of Liquidation amounted to about $197 million (about 2 percent of the book value of acquired assets so managed). Assets acquired by FDIC as receiver for failed banks and in a corporate capacity are, in general, liquidated the same way.

## Types of Assets Acquired by FDIC

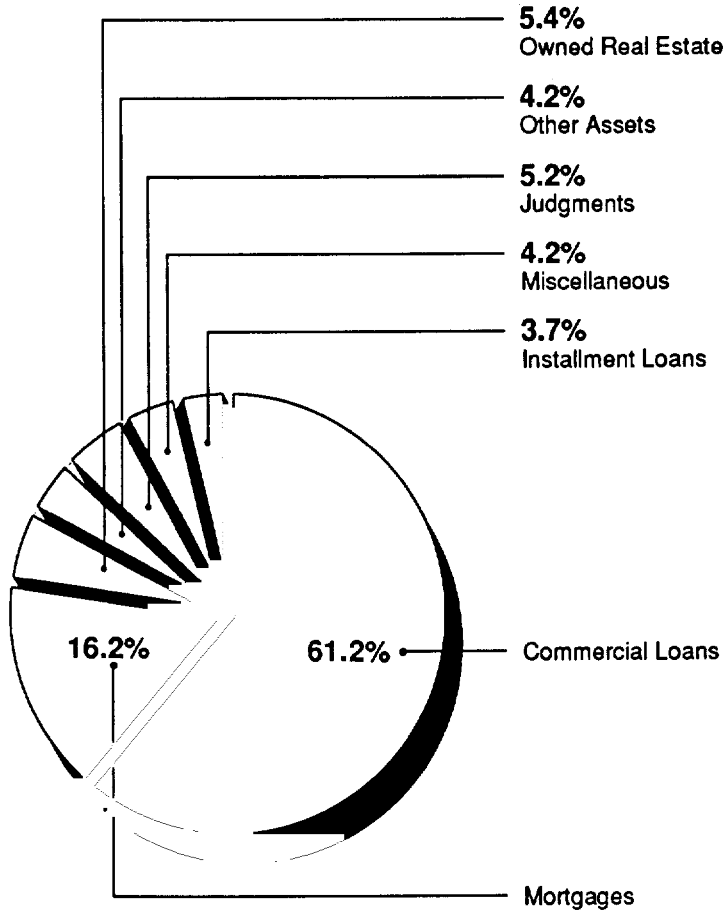
The types of assets to be liquidated in FDIC's total inventory of about $11 billion as of December 31, 1987, are shown in figure 1.1. Commercial loans make up 61.2 percent of the total, and mortgages another 16.2 percent. Installment loans, such as car loans, constitute another 3.7 percent. Some 5.4 percent of the total is composed of owned real estate.

As a result of its liquidation activities, FDIC has had interest in a variety of properties, including oil tankers, tuna boats, taxicab fleets, art objects, and various forms of real estate, including a horse-training facility.

## How Assets Are Liquidated

At a bank's closing, many of the FDIC staff present are assigned to control, balance, and inventory all assets. Assets acquired by FDIC are transferred to FDIC's inventory after the initial accounting. As receiver, FDIC first encourages all debtors to refinance their obligations at other institutions. If they can not or do not, FDIC designs a plan of payment, which adheres to the terms of the debtor's obligation. If this is not possible, programs (workouts) that extend the terms of repayment may be arranged, provided the debtor is able to furnish evidence that the debt cannot be repaid according to the original terms and/or furnish additional collateral security.

**Figure 1.1: Type of Assets Held by FDIC as of December 31, 1987**




Notes:Includes assets from Continental Illinois National Bank and Trust and First National Bank and Trust of Oklahoma.

Total is greater than 100 percent due to rounding.

Source:FDIC: All Banks Account Trial Balance for Liquidation Accounting, December 31, 1987.

When debtors cannot pay even if payments are stretched out, FDIC may compromise—modify the original debt—with the debtor for less than the amount owed. Where debtors fail to cooperate, appropriate legal action can be taken to collect. For example, once the decision is made to enforce collection, FDIC can act to foreclose, take possession of the collateral, and sell the loan collateral. A flowchart detailing the liquidation process is provided in appendix II.

While FDIC liquidates assets mostly through its own staff, it also contracts with outside attorneys, appraisers, consultants, and others to provide specialized support services. FDIC's 1988 budget for outside services is $114 million (18.3 percent of the agency's total costs). About 92 percent of the budgeted costs for outside services are for the Legal Division (about $54 million) and the Division of Liquidation (about $50 million). Outside legal services used specifically in connection with liquidating assets are included in the amount allocated to the Legal Division. The Division of Liquidation also budgeted $17.5 million for appraisal fees and $9.4 million for real estate commissions.

## Increase in Failed and Assisted Banks and Assets Acquired by FDIC

The increase in the number of insured bank failures and assistance transactions since 1980 is shown in table 1.1, as is the total book value of assets associated with the failed or assisted banks. (All these assets were not acquired by FDIC.)

**Table 1.1: Number of Failed or Assisted Banks Since 1980**

Dollars in millions

| Year | Number of bank failures | Number of banks assisted | Value of failed bank assets[a] | Value of assisted bank assets[a] |
|---|---|---|---|---|
| 1980 | 10 | 0 | $236 | $0 |
| 1981 | 7 | 3 | 104 | 4,755 |
| 1982 | 33 | 9 | 1,416 | 10,216 |
| 1983 | 45 | 3 | 4,137 | 2,890 |
| 1984 | 78 | 1[b] | 2,761 | 515 |
| 1985 | 116 | 4 | 2,845 | 5,896 |
| 1986 | 138 | 7 | 6,992 | 719 |
| 1987 | 184 | 19 | 6,851 | 2,516 |
| | **611** | **46** | **$25,342** | **$27,507** |

[a]Value is the dollar value of all assets as they were carried on the books of the banks at the date of failure or assistance, not just those acquired by FDIC to liquidate.

[b]Excludes Continental Illinois National Bank and Trust, which held assets with a book value of $41.5 billion as of March 31, 1984, before the start of the financial assistance program.

Source: FDIC, 1982-1987 Annual Reports.

As of March 31, 1988, FDIC had direct responsibility for assets acquired from 691 failed or assisted banks. A minimum of 28 banks (over 4 percent) failed before 1980. Table 1.2 shows the number of failed or assisted banks by the year their assets were first put on FDIC's books and the current book value of assets from these banks.

**Table 1.2: Age and Value of Failed or Assisted Banks on FDIC Books as of March 31, 1988**

Dollars in millions

| Year failed | | Number | Current book value[a] | Total book value of assets in inventory (percent) |
|---|---|---|---|---|
| Before | 1980 | 28 | $165.9 | 1.9% |
| | 1980 | 8 | 4.0 | .1 |
| | 1981 | 3 | 2.1 | .0 |
| | 1982 | 32 | 228.3 | 2.7 |
| | 1983 | 45 | 1,384.9 | 16.2 |
| | 1984 | 78 | 564.6 | 6.6 |
| | 1985 | 118 | 808.8 | 9.4 |
| | 1986 | 140 | 1,791.0 | 20.9 |
| | 1987 | 191 | 2,865.8 | 33.5 |
| | 1988 | 48 | 752.0 | 8.8 |
| **Total** | | **691** | **$8,567.4** | **100.1[b]** |

[a]Book value is the dollar value of assets as they were carried on the books of the failed or assisted banks at the date of acquisition by FDIC. For assets acquired through corporate-purchase transactions, the value is as of date the corporate-purchase account was created rather than the date the receivership was established. Book value on FDIC records, current book value, is subsequently adjusted for collections of principal and sales as well as writeoffs. Assets acquired from the Continental Illinois National Bank and Trust Company and the First National Bank and Trust of Oklahoma Company are excluded. Book value does not include data for three banks that were omitted from the March 1988 source report because the data were not yet available because the liquidation was less than 90 days old.

[b]Total is greater than 100 percent due to rounding.

Source: FDIC, Estimated Cash Recovery Report Number 2: ECR Assets in Liquidation by Appraisal Method and Estimated Cash Recovery Report Number 3: Timing of Estimated Cash Recoveries by Consolidated Office, as of March 31, 1988.

The increase in acquired assets has affected the liquidity of the FDIC insurance fund because the net amount FDIC, in its corporate capacity, expects to recover from them is an asset of the fund. These receivables are less liquid than other assets in the fund, such as short-term U.S. Treasury securities. FDIC financial statements show the fund's total assets have risen from $11.6 billion at year-end 1980 to $22.4 billion at year-end 1987, but that there has been a decline in the relative liquidity of the fund. At year-end 1980, 7.6 percent of the book value of all insurance fund assets were net receivables and notes from assistance to insured banks or from failures of insured banks. The percentage rose to a high of 32.5 in 1984 before declining to 25.7 at year-end 1987.[8] (The high 1984 and 1985 figures reflect the acquisition of assets from Continental Illinois National Bank and Trust.)

**Table 1.3: Value of Net Receivables and Notes Acquired by FDIC Since 1980**

Dollars in millions

| Year | Value at year-end[a] | Value to total assets in the fund (percent) |
|---|---|---|
| 1980 | $884.4 | 7.6 |
| 1981 | 977.5 | 7.4 |
| 1982 | 1,628.8 | 10.7 |
| 1983 | 2,434.6 | 14.4 |
| 1984 | 7,161.9 | 32.5 |
| 1985 | 5,661.7 | 25.7 |
| 1986 | 5,207.6 | 23.2 |
| 1987 | 5,771.4 | 25.7 |

[a]Value is the dollar value of all assets as they were carried on the corporate records of FDIC. In the financial statements, they are the net receivable accounts from assistance to insured banks or from failures of insured banks. Assets of Continental Illinois National Bank and Trust and First National Bank and Trust of Oklahoma are included.

Source: FDIC, 1986 and 1987 Annual Reports and GAO, Financial Audit: Federal Deposit Insurance Corporation, 1987 and 1986 Financial Statements (GAO/AFMD-88-43, Apr. 1988.)

## Objectives, Scope, and Methodology

This report responds in part to the Senate Committee on Banking, Housing and Urban Affairs' request for information on the asset liquidation efforts of FDIC and other entities. It is an information report to describe:

- How FDIC has adjusted its liquidation operations to an environment of increasingly high numbers of bank failures,
- How FDIC manages liquidations, and
- The results of FDIC liquidations, including the extent of recovery on the book value of acquired assets.

We interviewed officials at the (1) FDIC Washington headquarters; (2) FDIC Division of Liquidation regional offices in Dallas, San Francisco, and Kansas City; and (3) Division of Liquidation subregional offices in Oklahoma City, Denver, and Omaha, which are under the jurisdiction of the Dallas, San Francisco, and Kansas City regional offices, respectively.

[8]As of December 31, 1987, investments in U.S. Treasury obligations made up 71.8 percent of FDIC's assets, down from 92.1 percent as of year-end 1980.

The regional and subregional offices[9] were selected to provide diversity of size, types of assets, and regional economic conditions. Division officials advised us that the selected offices would provide us with a representative overview of their operations. The selected regional offices oversaw the management of 61 percent of the book value of assets and almost 70 percent of the total number of assets directly under FDIC's control, as of June 1987. The three consolidated offices selected directly managed about 16 percent of the book value of assets and 21 percent of the number of FDIC-managed assets at that time.

At the consolidated offices, we interviewed account officers—staff directly responsible for liquidating portfolios of failed bank assets—to determine how they managed and liquidated assets. We were particularly interested in strategies being used to liquidate assets. We obtained information from the account officers in the commercial loan department in Denver, the energy loan department in Oklahoma City, and the agricultural department in Omaha. Each type of asset was selected as it represented a predominant category of assets at the consolidated office.

Our objective of determining how much FDIC as receiver has recovered and expects to recover on the assets proved difficult to attain, primarily because the data for such analysis have not been collected by FDIC.[10] There were no central data available on the total amount recovered on assets in all the liquidations being managed and liquidated by FDIC. For the most part, the consolidated offices had a variety of manual and automated systems which were not specifically designed to develop information on recovery.

To determine actual rates of recovery, we had to limit our analysis to liquidations for banks that had failed since January 1, 1986. This is when a liquidation-specific information system known as the Financial Information System (FIS) first became operational. Since it did not incorporate liquidation collections and expenses that occurred before 1986, we had to focus our analysis on bank failures since January 1986. Another method we developed was to obtain asset-specific data from proposals for the final liquidation of large assets.

[9]The subregional offices are referred to as consolidated offices because the liquidations of a number of banks are consolidated in one office.

[10]The Division of Liquidation is in the process of implementing a comprehensive management information system that it expects to be capable of summarizing the individual asset (and liquidation) information needed to make such analyses in the future. (See pp. 44 to 48.)

To estimate future liquidation results for assets still held from the bank failures since January 1986, we used information from FDIC's Estimated Cash Recovery Information System (ECR). ECR, a new system implemented in the latter part of 1986, is used in determining the loan loss allowance for the insurance fund. (See fn. 6, p. 52.) A senior Division of Liquidation official said that it could provide a realistic estimate of what they expect to recover, before expenses, on each asset in the future. The September 1987 ECR data were the latest available for our analysis.

FDIC contracted with the financially assisted Continental Illinois National Bank and Trust Company of Chicago and the acquiring bank of failed First National Bank and Trust Company of Oklahoma to manage and liquidate specific assets.[11] Except where expressly noted, references and figures throughout the report regarding the total number of banks and the total number or value of assets handled by FDIC exclude the assets obtained from these two banks in order to focus directly on the liquidation efforts of the regional offices and consolidated offices.

We did our work between March 1987 and May 1988 in accordance with generally accepted government auditing standards.

## Agency Comments and Our Response

FDIC's only written comment on a draft of this report was that a sentence concerning a decline in the liquidity of the insurance fund was inaccurate and misleading. (See app. II.) We have revised the sentence on page 17 to make clear that our point is simply that while the value of the fund has risen, receivables from failed and assisted banks and notes make up a higher percentage of fund assets than they did earlier in the 1980s. This report does not address the question as to the appropriateness of the fund's liquidity. Suggestions made informally to revise and clarify the presentation of some material have been made, as appropriate.

[11] FDIC, in its corporate capacity, acquired assets with a book value of $3.7 billion from Continental Illinois National Bank and Trust in September 1984 and additional assets with a book value of $1.5 billion by September 1987. As of March 31, 1988, the remaining book value of Continental Illinois assets in liquidation was $2.1 billion.

In July 1986, it acquired assets with a book value of about $809 million, and later acquired another $58 million, from First National Bank and Trust of Oklahoma. It contracted with the assuming bank to liquidate these assets. As of March 31, 1988, the book value of remaining assets was about $502 million.

# How FDIC Has Changed Its Liquidation Operations

During the 1980s, FDIC has changed and is still changing the way it liquidates acquired assets in order to handle its expanding workload. Operations have been decentralized, staffing has increased 10-fold, and certain procedures have been changed with the aim of improving operational effectiveness. This chapter discusses these changes and describes how FDIC manages and monitors the liquidation process. Key Division of Liquidation management controls include (1) the credit review process used to approve proposed actions to liquidate assets and (2) the visitation program, in which teams of division staff review operations at consolidated and regional offices. In order to maintain flexibility in terms of its workforce and location, the division uses a large number of temporary employees.

## The Evolution of the Division of Liquidation

Since FDIC began operations in 1934, the Division of Liquidation's primary functions have been to handle the closing of insured banks and collect on the assets that FDIC acquires in its role as receiver. Before the early 1980s, the division was headquartered in Washington and had field offices located throughout the nation. Field offices were temporary sites, most often located at the failed bank. While FDIC-acquired assets were worked and liquidated in the field, major credit decisions, such as selling assets, agreeing on workout arrangements for loans, or referring assets for litigation, were made at headquarters. Account officers were basically a transient group. Some were temporary employees, often hired from the failed bank, while others were permanent employees relocated frequently by the division. Once the account officers had substantially liquidated the number and value of assets of the failed bank, the field office was closed. Any remaining assets and their records were transferred to FDIC headquarters for further liquidation. The division had 460 employees and was responsible for liquidating assets from 83 failed banks at the end of 1980.

### Decentralization and Growth

During the latter part of 1981, the Chairman of FDIC and the Director of the Division of Liquidation began planning for an organization and workforce that would respond readily to anticipated increases in bank failures. According to the Director, he and the then FDIC Chairman developed plans for an organization that could handle an average of 50 bank failures a year, a five-fold increase from the level in 1980 and 1981.

### Reorganization

In November 1982, the division established its first two regional offices and the next year decentralized into an organization with five regional offices, supervising a total of five subregional (or consolidated) offices. (See pp. 25 to 28 for a discussion of these offices.) The purpose of this structure was to (1) consolidate the liquidation of assets from several failed banks, thereby reducing overhead costs and achieving other economies of scale, (2) decentralize decisionmaking authority, and (3) provide flexibility to meet a changing workload. The division director told us he believed establishing consolidated offices reduced overhead costs by at least 40 percent. (There are not, however, any formal studies supporting this estimate.)

During the next 3 years, a sixth regional office and 20 more consolidated offices were opened. Meanwhile, the primary role of the regional offices evolved from liquidating assets to overseeing the operations of consolidated offices. (Some do, however, have direct responsibility for liquidating a small percentage of the region's assets; see p. 26.)

Typically, the operations and records of a failed bank are moved to a consolidated office within several months of the failure. Liquidation offices at banks are intended to be temporary, until records have been appropriately set up so that assets and records can be transferred to a consolidated office. At the consolidated office, the failed bank's assets are segregated by type and assigned to the department specializing in that type of asset (e.g., commercial loan, agricultural loan, owned real estate). Consolidated offices are managed by a liquidator-in-charge or a managing liquidator.

Within each department, account officers are individually assigned a group of assets, known as an asset portfolio, to be liquidated. These assets often come from many failed banks. Time spent by account officers, as well as other FDIC employees involved in liquidation activities, is charged biweekly through the Financial Information System (FIS) (see p. 49) directly to the liquidation account maintained for each failed bank.

As of March 1988, 18 consolidated offices were responsible for liquidating over 94 percent of the total book value of acquired assets, and 4 of the 6 regional offices were directly responsible for the remaining 6 percent. Table 2.1 shows the number of failed or assisted banks, the number of assets, and the book value of assets managed by each region and consolidated office.

**Table 2.1: Division of Liquidation Regions and Offices and Their Assigned Assets as of March 31, 1988**

Dollars in millions

| Region or consolidated office | Banks[a] | Assets[b] | Current book value[c] |
|---|---|---|---|
| Atlanta, GA. | 18 | 239 | $35 |
| Clearwater/Orlando, FL. | 16 | 7,369 | 593 |
| Bossier City, LA. | 29 | 10,410 | 477 |
| **Atlanta Region total** | **63** | **18,018** | **1,105** |
| Oak Lawn, IL. | 43 | 3,825 | 107 |
| Des Moines, IA. | 28 | 3,769 | 105 |
| Burnsville, MN. | 33 | 3,818 | 122 |
| **Chicago Region total** | **104** | **11,412** | **334** |
| Kansas City, MO. | 61 | 4,119 | 157 |
| Omaha, NE. | 35 | 3,953 | 95 |
| Wichita, KS. | 24 | 3,628 | 139 |
| **Kansas City Region total** | **120** | **11,700** | **391** |
| Dallas, TX. | 18 | 2,228 | 50 |
| Oklahoma City, OK. | 60 | 19,532 | 1,162 |
| Midland, TX. | 30 | 16,979 | 885 |
| Addison, TX. | 43 | 20,539 | 678 |
| Houston, TX. | 40 | 11,305 | 908 |
| Tulsa, OK. | 15 | 7,625 | 217 |
| **Dallas Region total** | **206** | **78,208** | **3,900** |
| New York, NY. | 17 | 5,426 | 386 |
| San Juan, PR. | 6 | 1,527 | 199 |
| Knoxville, TN. | 44 | 16,613 | 986 |
| **New York Region total** | **67** | **23,566** | **1,571** |
| San Francisco, CA. | 10 | 516 | 23 |
| Costa Mesa, CA. | 34 | 9,913 | 406 |
| Denver, CO. | 50 | 13,920 | 338 |
| San Jose, CA. | 37 | 10,642 | 499 |
| **San Francisco Region total** | **131** | **34,991** | **1,266** |
| **Total FDIC** | **691** | **177,895** | **$8,567** |

[a]Number of failed or assisted banks with assets assigned to the regional or consolidated office.

[b]Number of assets assigned to the consolidated or regional office. This number excludes assets from 25 liquidations for which the asset count was not available, primarily because these liquidations were less than 90 days old.

[c]Value of the assets assigned to the consolidated or regional office as carried on FDIC's March 31, 1988, books. (Value is net of collections and writeoffs. This value excludes the book value of three liquidations that were less than 90 days old and had not yet submitted book value information.)

Notes: Information presented in this table excludes data for Continental Illinois and First Oklahoma.

Components may not add up to totals due to rounding.

Source: FDIC, Estimated Cash Recovery Report Number 2: ECR Assets in Liquidation by Appraisal Method and Report Number 3: Timing of Estimated Cash Recoveries by Consolidated Office, as of March 31, 1988.

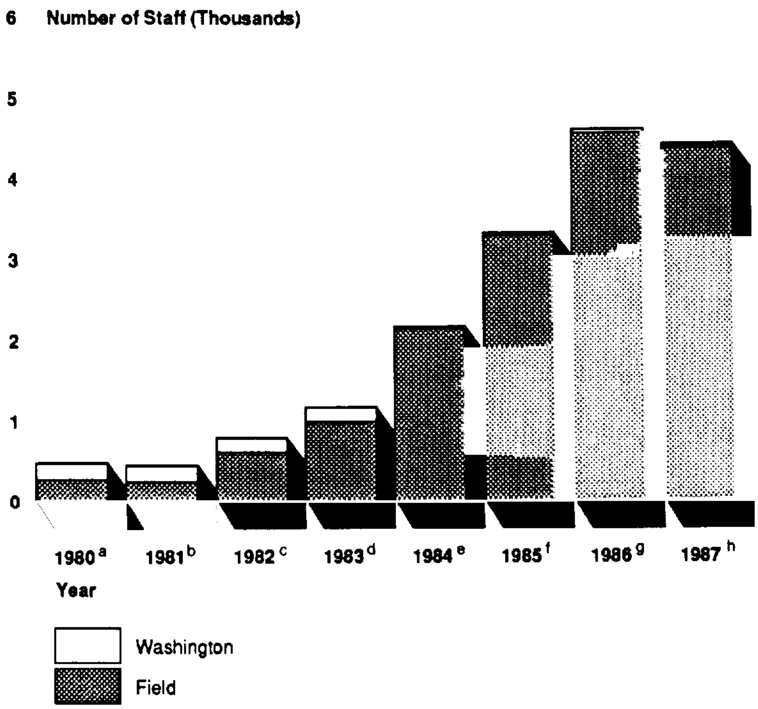
## Growth of Staff

The number of Division of Liquidation employees has increased almost 10-fold since 1982, reaching 4,586 at year-end 1986 before declining to 4,118 as of March 31, 1988. At the same time, the percentage of division staff located in the field increased from 55 percent at year-end 1980 to 99 percent at year-end 1987. (See fig. 2.1.)

The proportion of temporary staff in the division's workforce has also increased. From year-end 1980 to year-end 1987, its temporary workforce grew from 55 percent to 80 percent of its total personnel. Temporary staff, referred to as LGS or liquidation graded, typically have year-to-year contracts with no assurance of renewal. Permanent staff are subject to FDIC rotation policies and may be transferred to new locations on fairly short notice. According to a senior division manager, the increased use of temporary staff was intended to give the division the flexibility to readily respond to the needs of an unpredictable financial environment and to more efficiently manage its changing workload.

While most of FDIC's acquired assets are liquidated directly within its Division of Liquidation workforce, some are serviced and liquidated through service agreements with certain banks. As noted on page 20, this is the case with assets acquired from Continental Illinois and First Oklahoma.

**Figure 2.1: Division of Liquidation Workforce: Washington and Field From 1980 to 1987**




Source: FDIC Annual Reports, 1982 and 1987.

[a] Field 253, Washington 207
[b] Field 230, Washington 199
[c] Field 593, Washington 185
[d] Field 983, Washington 170
[e] Field 2130, Washington 28
[f] Field 3281, Washington 37
[g] Field 4542, Washington 44
[h] Field 4357, Washington 43

## Differences in Regional and Consolidated Offices Visited

To determine how regional offices operated, we visited three that varied considerably in their workload and geographical coverage: the San Francisco, Dallas, and Kansas City Regional Offices. Table 2.2 shows selected data for these offices.

**Table 2.2: Selected Data for Three Regional Offices as of December 31, 1987**

Dollars in millions

| | San Francisco | Dallas | Kansas City |
|---|---|---|---|
| **Total number of assets** | **32,409** | **94,448** | **16,380** |
| Banks covered | 130 | 184 | 116 |
| Current book value of assets | $1,339 | $4,449 | $539 |
| Estimated Cash Recovery | $484 | $1,358 | $155 |
| **Total number of division staff** | **746** | **1,609** | **655** |
| Number of consolidated offices | 3 | 5 | 4 |
| States covered | 13 | 3 | 3 |

[a]Includes a consolidated office located in Kansas City, separate from the Kansas City Regional Office.

Source:The above figures were provided by the individual FDIC regions.

Regional offices oversee the operations of consolidated offices, issue guidance, set goals for consolidated offices, and approve certain liquidation actions. Within each region, consolidated offices are allowed various levels of freedom to set policy and procedures, depending on regional management's preference. Consolidated offices were directly responsible for liquidating 94 percent of the assets (in terms of book value) as of March 31, 1988; regional offices were liquidating the remaining 6 percent.

To determine how consolidated offices operated, we visited the Denver, Oklahoma City, and Omaha offices. They differed in age, available staff resources, type and amount of work, organization, and supporting accounting systems. Table 2.3 shows selected data for these offices.

**Table 2.3: Selected Data for Three Consolidated Offices as of December 31, 1987**

Dollars in millions

| | Denver | Oklahoma City | Omaha |
|---|---|---|---|
| Approximate age of office in months | 28 | 43 | 38 |
| Number of failed or assisted banks handled | 49 | 55 | 35 |
| **Total number of assets** | **10,908** | **22,141** | **4,654** |
| Number of assets in status bankruptcy[a] | 1,868 | 810 | 385 |
| Number of assets in litigation (excluding bankruptcy) | 513 | 1,861 | 338 |
| Book value of assets | $326 | $1,309 | $148 |
| Appraised value | $119 | $372 | $29[d] |
| **Total number of division employees[b]** | **205** | **493** | **148** |
| Permanent employees | 30 | 15 | 5 |
| Temporary employees | 175 | 478 | 143 |
| Number of bank failures in 1986 | 14 | 13 | 6 |
| Number of bank failures in 1987 | 17 | 21 | 7 |
| Number of accounting systems[c] | 3 | 1 | 3 |

[a]This represents assets belonging to borrowers who have been declared or are in the process of being declared legally bankrupt.

[b]Other FDIC employees (i.e., accounting and legal staff) were also located at the consolidated office. Total FDIC staff at Denver, Oklahoma City, and Omaha were 257, 606, and 182, respectively.

[c]For an explanation, see p. 49.

[d]Appraised value for six newly closed banks was not available and therefore not included in this total.

Source: The above figures were provided by the consolidated offices visited.

The Denver Consolidated Office was established in August 1985 and in the first several months hired 65 employees to handle the liquidation of assets from 15 banks, primarily in Colorado and Wyoming, that had failed between 1979 and 1985. During its first 27 months, Denver's workload and staff grew significantly. By December 31, 1987, its 205 plus employees were responsible for 49 failed banks and almost 11,000 assets with a book value of $326 million. At the time of our visit, the office was managed by a liquidator-in-charge, who had an assistant for operations, an assistant for credit, and a commercial loan department head reporting directly to him.

Oklahoma City was designated as a consolidated office in January 1984 and at the time of our visit in 1987 handled bank failures in Oklahoma and one in Texas. As of December 1987, the Oklahoma City Consolidated Office was the division's largest, on the basis of the book value of assets assigned. Primarily because of its size (over 490 employees), the office was managed by a managing liquidator. Department heads responsible for managing the energy, commercial, real estate, and operations areas reported directly to him.

The Omaha Office was established in November 1984 to handle bank failures that had occurred primarily in Nebraska and Iowa. As of December 1987, 148 employees were responsible for 35 failed banks. At the time of our visit in 1987 two assistants responsible for various aspects of credit, one assistant responsible for operations, and a department head for investigations reported directly to the liquidator-in-charge. In April 1988, FDIC sold a package of almost 2,500 loans for about $18.3 million, from the Omaha office. (See ch. 3 for a discussion of packaging assets for sale.) FDIC was in the process of closing the Omaha office in June 1988, primarily because the book value of assets being handled by the office was low and incoming collections did not warrant the costs associated with operating the office. Table 2.4 shows the types of assets being managed by the three consolidated offices.

**Table 2.4: Types of Assets at Three Consolidated Offices as of December 31, 1987**

Dollars in millions

| | Denver | | Oklahoma City | | Omaha | |
|---|---|---|---|---|---|---|
| | Book value[a] | Percent | Book value[a] | Percent | Book value[a] | Percent |
| Installment loans | $20.4 | 6.3 | $42.1 | 3.3 | $7.0 | 4.7 |
| Commercial loans | 192.4 | 59.0 | 817.5 | 63.1 | 97.9 | 66.2 |
| Student loans | 0.2 | [b] | 0.4 | [b] | 0.1 | [b] |
| Securities | 0.1 | [b] | 10.8 | 0.8 | 0.0 | 0.0 |
| Mortgages | 22.4 | 6.9 | 215.8 | 16.6 | 16.7 | 11.3 |
| Owned real estate | 12.1 | 3.7 | 69.7 | 5.4 | 7.1 | 4.8 |
| Other owned assets | 6.3 | 1.9 | 20.1 | 1.5 | 0.2 | 0.1 |
| Charged-off assets[c] | 60.1 | 18.4 | 22.1 | 1.7 | 12.5 | 8.5 |
| Other assets | 12.1 | 3.7 | 98.2 | 7.6 | 6.5 | 4.4 |
| **Total** | **$326.1** | **100.0** | **$1,296.7** | **100.0** | **$148.0** | **100.0** |

[a]Book value is the remaining value (i.e., the original book value adjusted for collections) of assets on FDIC's inventory as of December 31, 1987.

[b]Percent of total is less than .1 percent.

[c]Charged-off assets are those that the bank, before failure, had written off completely.

Source: The above figures were provided by the consolidated offices visited.

## Increased Delegations of Authority

Division of Liquidation officials' authority to liquidate assets and take other actions is established by a series of delegations of authority from FDIC's Board of Directors. In 1983, the division management (with FDIC

Board approval) determined that, given the expected increase in bank failures and its decentralization, the division needed to expand its delegations of authority; new delegations were issued in April 1983. In March 1987, additional authority was delegated. Table 2.5 shows these selected current delegations. The Board of Directors must approve all actions not delegated.

Liquidation action decisions delegated subject to certain dollar ceilings include: (1) compromising on loans, (2) selling property, (3) expending funds, (4) releasing collateral, (5) entering a bid or no bid proposal on a foreclosure where FDIC is not the only lien holder of the property, (6) restructuring debt, (7) accepting a deed in lieu of foreclosure, and (8) authorizing auctions. According to division officials, the level of delegated authority—that is the dollar amount—has also evolved as staff in the field have gained experience. Account officers do not, however, have authority to proceed with credit actions (e.g., selling an asset, foreclosing on collateral, or agreeing on a loan compromise) without prior approval from a credit review committee.

**Table 2.5: Delegation of Authority for Three Major Actions in Effect Since March 1987**

Dollars in millions

| Authority delegated to | Maximum authorized: Loan compromises | Maximum authorized: Sale of property[a] | Expenditures |
|---|---|---|---|
| Committee on Liquidations[b] | $10.0[c] | $10.0 | Unlimited |
| Division Director | 5.0[c] | 5.0 | 1.0 |
| Division Associate Director | 4.0[c] | 5.0 | 0.5 |
| Division Regional Director | 2.5[c] | 2.5 | 0.25 |
| Division Consolidated office manager[d]: | | | |
| Maximum | 1.0 | 1.5 | 0.1 |
| Minimum | 0.125 | 0.25 | 0.05 |

[a]In 1987, dollar authorizations for sale of property were based on appraised value of the asset. Delegations regarding the sale of property require that the offer be 80 percent or more of the asset's appraised value, otherwise the offer requires Board approval.

[b]The Committee on Liquidations, Loans, and Purchases of Assets, established for the purpose of reviewing case proposals, is authorized to approve recommendations of the Division of Liquidation or the Legal Division. In 1983, its authority was up to $1 million for loan compromises and unlimited for sale of property and expenditures. This committee is comprised of the following voting members or their designees: the Directors of the Division of Liquidation, the Division of Accounting and Corporate Services, and the Office of Research and Strategic Planning, and the General Counsel, and three representatives of the Board of Directors.

[c]Dollar authorizations for compromises are based on the book value of the asset. The Division of Liquidation has no limit if the offer is at least 85 percent of the asset's principal and interest. The region has no limit if the offer is at least 90 percent. In 1983, the division director's authority for sale of property was up to $.5 million, $.1 million for expenditures, and $.25 million for loan compromises.

[d]Delegation of authority varies by the size of the office and grade-level of the liquidator-in-charge or managing liquidator.

Source: FDIC "Certified Copy of Resolution of Board of Directors," April 4, 1983, and March 17, 1987, and the Credit Manual.

Committees are used to approve many credit actions. The Division of Liquidation's Credit Manual states that the regional director shall establish a credit review committee to approve certain matters and may delegate any or all of his or her authority for credit-related matters to this committee. Although the manual does not have a similar provision for consolidated offices, senior division management told us the process is also used by the consolidated offices. The committees consist of senior managers who, we were told, typically meet twice a week to review, discuss, and decide on proposed credit actions. Each case is presented in writing with a summary of the proposal, a description of the asset, and the justification for the recommended action. A case may involve only one asset or a number of assets associated with a single debtor.

The committees, according to senior division management, provide a very effective review over day-to-day business decisions being made in the field and are a mechanism through which the division establishes control and accountability and assures itself that recommended actions are being approved by managers.

## Management Oversight of Decentralized Operations

Prior to the early 1980s, FDIC's liquidation operations were centralized and activity was relatively low. (See pp. 21 and 22.) Because of the decentralized nature of the division's operations and the latitude given field managers, we believe mechanisms to oversee field performance are very important. Division managers in Washington and in the region and consolidated offices told us they rely on various reports for information pertaining to field operations. They said the division's visitation program is an extensively used review mechanism. Audits are also done by FDIC's Office of Corporate Audits and Internal Investigations and by external certified public accounting firms. And, regional and consolidated offices have internal review units.

### Visitation Programs

"Visitations" are internal evaluations done by teams of Division of Liquidation managers and staff familiar with day-to-day liquidation operations to provide management with information on field operations. The division's Operations Manual says visitations are designed to (1) ensure that proper controls are in place to safeguard the assets in liquidation, (2) check the accuracy and reliability of records, (3) promote operational efficiency, and (4) encourage adherence to policies.

The program was established in 1983. During 1983 and 1984, division headquarters was responsible for all visitations. In 1985, the regional offices were also given responsibility for the visitation reviews of consolidated offices. Although a uniform checklist is available, members are permitted latitude in using the checklist. We found in our review of reports that, although similar in format, the reports did not uniformly address the same points at all offices visited. Operational deficiencies noted were based primarily on observations, discussions with liquidation staff, and limited testing of records. Deficiencies were summarized and, we were told, presented to the consolidated office or regional manager. The offices reviewed, in turn, are requested to formally respond to the visitation report. Typically, the next visitation team checks for corrective actions. The number of visitation reviews is shown in table 2.6.

The division headquarters coordinator for the visitation program emphasized to us that it is not a formal audit and does not require observations to be supported by evidence developed under strict standards because they are management reviews for information. He also said that since flexibility is desired because the consolidated offices operate under different conditions, consistency among regional review procedures is not considered necessary.

**Table 2.6: Visitations Performed by Division Headquarters and Regions 1983 to 1987**

| Year | Washington | Regional | Total | Offices visited[a] |
|---|---|---|---|---|
| 1983 | 1 | 0 | 1 | 1 |
| 1984 | 2 | 1 | 3 | 3 |
| 1985 | 7 | 12 | 19 | 13 |
| 1986 | 12 | 20 | 32 | 28 |
| 1987 | 18 | 23 | 41 | 28 |
| | 40 | 56 | 96 | 73 |

[a]Some offices were visited more than once during the year.

Source: The figures were provided by Division of Liquidation officials.

## Division Headquarter's Visitation Program

The Division of Liquidation designated an individual at headquarters to be responsible for (1) reviewing all visitation reports prepared by the regional offices and (2) arranging visitations of all regional offices and major consolidated offices at least once a year.

Visitations we reviewed had been done by teams of 2 to 24 people, over a period ranging from several days to over a month, depending on the scope of the evaluation. Team members were drawn from division staff who do the same or similar work at other regional or consolidated offices. They evaluated each regional or consolidated office's compliance with division policies and procedures.

## The Regional Office Visitation Program

Regional offices are responsible for reviewing subordinated consolidated offices and major liquidation sites at least once a year, according to the division's Directive 7400.3. Development and implementation of the regional visitation program, including the scope and methodology of reviews and the type and extent of evidence needed to support findings, are left to the discretion of regional management.

This discretion, we found, has led to variations in the way regional offices implement the programs. The San Francisco Regional Office, for example, used the questionnaire provided in the division's Operations Manual to fulfill its visitation responsibilities. The Dallas Regional Office, on the other hand, developed its own visitation questionnaire, focusing on the areas of review it considered most important. Similarly, the Kansas City Regional Office developed its own questionnaire and has experimented with different ways of implementing the program. For example, in place of yearly visitations of its consolidated offices, the region first developed a monthly visitation program of smaller scale reviews, then changed to a quarterly visitation program.

## Visitation Results

Between 1983, when the visitation program began, and year-end 1987, 96 visitations were done (see table 2.6 on p. 32). We analyzed 42 visitation reports issued between 1983 and October 1986 and the visitation reports issued between November 1986 and December 1987 by the three regional offices we visited to determine if there were systemwide problems. Although numerous problems were cited, we were not able to determine how significant they were at the office under review, or whether they were systemic regionwide or nationwide. This was due largely because no standard report content was required, some observations were based on limited testing, and other reports did not indicate what testing, if any, had been done.

We categorized some of the more frequently identified observations in the 27 reports issued in 1986 and 1987 by the regions we visited. These observations are provided as examples of the types of findings noted through the visitation program:

Portfolio management

- Assignment of assets not made to account officer with appropriate grade level/experience.
- Assets not assigned to be worked.
- Lack of adequate documentation in asset files.

Debtor follow-up

- Inadequate follow-up system.

Operations

- Staff vacancies not filled.
- Lack of training.
- Lack of formal procedures for certain liquidation operations.

## Office of Corporate Audits and Internal Investigations

The Office of Corporate Audits and Internal Investigations (OCAII) is FDIC's formal internal control mechanism that independently assesses FDIC's various activities, including liquidation activities. The mission of OCAII is to provide a managerial control that examines and evaluates the adequacy and effectiveness of control systems. According to OCAII's 1985 to 1987 detailed operating plan, activities were focused on the Division of Liquidation in 1987 because of the vulnerability of liquidation activities. (We were told this vulnerability was a result of the high degree of delegations of authority, large dollar amounts involved, and the use of temporary employees, as well as FDIC's strong commitment to the integrity of receivership operations.) This emphasis continues in 1988.

OCAII primarily makes two types of liquidation audits that are essentially financial in nature—inventory audits and financial and compliance audits. Inventory audits are made on all newly closed banks to determine whether the opening entries in bank liquidations are properly supported by the failed bank records. These audits are to be started within 90 to 120 days from the inception date of the liquidation. And, their scope includes a review of the inventory of assets and a review of the financial and operational activities of the bank closing.

OCAII's financial and compliance audits of Division of Liquidation's regional and consolidated offices are generally done on an annual cycle. These audits are basically designed to ensure that acquired assets are adequately safeguarded and that appropriate internal controls have been implemented. The scope of these audits may include adherence to the delegations of authority; compliance with policies and directives; and the adequacy of records, reports, and accounting systems being used.

OCAII also does management and special reviews that emphasize items related to the Division of Liquidation's loan management and disposition, expenditures, and disbursements. The division may request specific audits of certain liquidation processes, such as appraisal procedures, although, these occur infrequently.

In 1987, OCAII completed management audits of one regional office and four consolidated offices that focused on certain key segments of the division's operations including the management of real estate owned (properties) and loans in the office's inventory. Specifically, the audits attempted to determine the adequacy of appraisals and marketing plans for the assets, adherence to such plans, and whether appropriate approvals were obtained for credit actions taken.

The results of OCAII audits are discussed during the exit conference; significant findings along with the auditees' responses are summarized in written audit reports to the Chairman of FDIC through a three person audit committee.

In an April 1987 letter to the various division and office heads, the Deputy to the Chairman stated that they were trying to improve the information in OCAII audit reports. Specifically, only significant audit deficiencies were to be included in the main body of the report along with the auditee's comments regarding the specific deficiencies and, if appropriate, actions to be taken to correct the problems. The less significant deficiencies or "house-keeping items" were to be discussed in an accompanying letter. According to its director, the Division of Liquidation's policy is to prepare detailed replies to both audit reports and accompanying letters covering reported findings and notable items. Responses are also to discuss conditions or circumstances that led to the significant deficiencies as reported by OCAII.

### Certified Public Accountant Audits

OCAII uses certified public accounting firms to audit inventories of newly closed banks. In addition, the Division of Liquidation may contract with a CPA firm to do reviews or evaluations of certain processes or operations. For example, in the latter part of 1986, the division contracted with a CPA firm to undertake an organizational review.

## Consolidated Office Monitoring of Liquidation Activities

The consolidated offices visited used other internal methods for monitoring their own operations. Methods most commonly used or emphasized, were monthly supervisory reviews, reviews of certain office reports pertaining to the status of assets being liquidated, ranking of account officers, and internal reviews.

The Denver and Omaha—but not Oklahoma City—offices relied heavily on the use of supervisory reviews as a tool for monitoring account officer activities. Oklahoma City and Omaha had developed methods for quantifying the efforts of their account officers and ranking them. Denver, however, was just starting to develop a system for ranking its account officers at the time of our visit. Denver and Oklahoma City used very similar summary reports for monitoring account officer activities. These reports specifically identified the liquidation strategies being used for each asset and the status of cases submitted by account officers for committee review. Omaha used status reports on borrowers for monitoring.

The internal review function is intended to be a consolidated office management tool, and implementation of the program is left to the discretion of the liquidator-in-charge. The division's Operations Manual states that internal reviews are to be made on a regular basis to examine and evaluate liquidation activities and to provide management with information about the adequacy and effectiveness of the operation.

Each of the three consolidated offices visited had one person assigned to the office's internal review function. The internal reviewers at Oklahoma City and Denver were directly responsible to the managing liquidator-in-charge, while in Omaha, the individual reported to the manager of operations. The responsibilities of the internal reviewer also varied by consolidated office. In Oklahoma City, the internal reviewer was primarily responsible for completing "special projects," as deemed necessary by the liquidator-in-charge. These projects covered a wide range of issues, only some of which related directly to liquidation operations. In Omaha, the internal reviewer was also responsible for coordinating the closure of banks. About 75 percent of this individual's time was spent on projects and administrative duties not directly related to internal review. At the time of our visit to Denver, in 1987, the internal review function was new and still being defined, but we were told that the designated internal reviewer would emphasize internal review work. In June 1988, the liquidator-in-charge said that the internal reviewer's primary responsibilities were to make audits of the office, follow-up on corrective actions taken on visitation or OCAII reports, sit on the office's management committee, and occasionally assist with regional audits as requested.

## Summary

In the early 1980s, the Division of Liquidation began to evolve from a small unit to a major organization responsible for servicing and liquidating an increasingly large inventory of assets. The 10-fold increase in staff and the decentralization of its operations throughout the country reflect the growth and direction of this organization.

Accompanying the rapid growth and change in organizational structure was an effort to maintain flexibility in terms of workforce and location. The division significantly increased the use of temporary employees in order to respond readily to the changing level of assets being handled and the various locations of the work. The consolidated office structure offered a way to let the division expand and contract according to where its workload was.

Regions and consolidated offices have been given increasingly greater authority. This management philosophy of decentralized operations and delegated authority to the field relies heavily on being able to oversee operations and management decisions. The division relies on controls such as the credit review committee process, the visitation program, and the internal review program. Division management views the credit review committee process as a very effective review over day-to-day credit decisions. Officials say it provides a systematic means of assuring that credit decisions are being reviewed by senior managers. FDIC management also has in place its internal audit function, managed by OCAII.

# Recent Liquidation Initiatives

FDIC has changed its operating philosophy for liquidating assets because of (1) its expanding workload and the increasingly distressed quality of many assets, (2) its requirement that the time value of money be considered, and (3) its desire to maintain the liquidity of the insurance fund. FDIC is now more willing to compromise on loans—to accept less than the full amount of the principal and interest due—if that will bring the greatest return after expenses. FDIC is emphasizing bulk sales—the assembling of similar assets into packages—and marketing the packages. To help market assets, it is developing a national inventory of assets for sale. In early 1988, FDIC also began trying to transfer the low quality assets as well as the higher quality assets of a failed bank to the assuming bank.

Finally, FDIC is implementing a national asset management system. This system, the Liquidation Asset Management Information System (LAMIS), has fallen behind the original schedule and exceeded initial cost estimates, but its basic component, the integrated loan subsystem, is now expected to be operational nationwide by the end of 1988.

## Loan Compromises

The number of approved compromise cases was almost nine times higher in 1987 than in 1985. Although compromising has always been an option, it was not encouraged nor often used before 1985. Unwritten policy, according to the Division of Liquidation, had been to attempt to collect 100 percent of the outstanding loan amount due, no matter how long this took. However, FDIC realized that compromising may often be a more cost-effective way to liquidate assets. This is because of the time value of money and the expenses that may be incurred in trying to obtain the full amount due.[1] Present value analysis[2] is used to compare the results of different liquidation strategies.

FDIC officials explained that when it holds an asset without collecting on it, FDIC and other creditors lose the opportunity to invest the amount tied up in the asset in an interest-bearing holding. At the same time, there may also be expenses in holding the asset. Therefore, it can be advantageous to liquidate the asset for less than its book value, rather

[1] According to division senior management, in 1983, FDIC started providing to its account officers financial analysis seminars that focused on net present value and internal rate of return techniques. Current instructions pertaining to compromising, including the use of present value, are contained in the Division of Liquidation Credit Manual, "Compromises on Assets."

[2] Present value analysis is used to calculate the value today of a future payment or stream of payments discounted to account for the time value of money. Treasury security rates are generally used by FDIC in discounting.

than to hold onto it indefinitely with the expectation of obtaining this value.

This is the case in the following hypothetical situation. A borrower from a failed bank had an outstanding loan with a current book value of $100,000. The collateral was property, appraised at $70,000. The borrower was unable to meet the terms of the original loan agreement and offered to settle with FDIC, as receiver, with an initial cash payment of $55,000 plus an additional $15,000 paid in $5,000 annual increments over the next 3 years. The account officer reviewed this offer, in relation to other options available to FDIC—in this instance, foreclosure. Factors considered in assessing the latter option are the value of the collateral, litigation costs, and opportunity costs. (There may also be holding and marketing costs.) FDIC's Legal Division believed FDIC had a very strong chance of receiving court approval to foreclose, but the litigation process was expected to take about 3 years. The account officer analyzed the two options as follows:

| | | |
|---|---|---|
| Recovery based on offer to compromise: | | |
| Initial cash payment | | $55,000 |
| Present value of $5,000 at end of year 1: | $4,673 | |
| Present value of $5,000 at end of year 2: | $4,367 | |
| Present value of $5,000 at end of year 3: | $4,081 | $13,121 |
| Present value of offer | | $68,121 |
| Recovery based on litigation option: | | |
| Value of collateral | | $70,000 |
| Estimated litigation costs | | ($10,000) |
| Opportunity costs ($55,000 x .06 interest x 3 years) | | ($9,900) |
| Estimated net collections from foreclosure option | | $50,100 |

On the basis of the present value analysis of the compromise offer and the litigation option, the account officer recommended to the appropriate credit review committee that the borrower's offer to compromise on the loan be accepted.

The emphasis on compromising is clearly reflected in the number of approved compromise cases under delegated authority within the Division of Liquidation. In 1985 there were 737; in 1987 there were 6,310. To put this increase in perspective, the percentage of approved compromise cases to total approved cases under similar delegations of authority increased from 7 percent in 1985 to almost 23 percent in 1987, as shown in table 3.1.

**Table 3.1: Number of Loan Compromise Cases and Total Cases Approved Within the Division of Liquidation 1985 Through 1987[a]**

| | 1985 | 1986 | 1987 |
|---|---|---|---|
| Approved loan compromise cases | 737 | 2,541 | 6,310 |
| Total approved cases | 10,112 | 19,930 | 27,519 |
| Percent of compromise cases to total cases | 7.3 | 12.7 | 22.9 |

[a]Loan compromise cases are those that propose accepting less than full amount owed by the borrower. Total cases include all those submitted for approval, such as sales of assets, debt restructures, write-offs, and requests for expenditures.

Source:Division of Liquidation Actions Approved Under Delegated Authority for 1985, 1986, and 1987.

## Use of Loan Compromises at Consolidated Offices

At the consolidated offices we visited, account officers often chose compromise as a means of liquidating assets. We asked account officers in Denver's commercial loan department, Omaha's agricultural loan department, and Oklahoma City's energy loan department what their strategies were for assets in their portfolios.[3] As can be seen from table 3.2, loan compromises accounted for over 30 percent of the planned actions in Omaha and Oklahoma City and almost 20 percent in Denver. The table also shows that at all three offices, a large proportion of assets were included in the legal action categories. (This total included assets that were already in litigation when the bank failed as well as those subsequently referred or planned for referral because, for example, foreclosure on collateral was initiated.)

[3]Account officers in these departments constituted 78, 36, and 55 percent of all account officers directly responsible for the liquidation of assets, in the Denver, Oklahoma City, and Omaha consolidated offices, respectively.

**Table 3.2: Liquidation Strategies Used in Selected Departments for Assets in Inventory[a]**

| | Proportion of Portfolio | | |
|---|---|---|---|
| **Liquidation strategy** | **Denver** | **Oklahoma City** | **Omaha** |
| Number of assets | (3685) | (1748) | (1922) |
| Paying as agreed | 9% | 5% | 4% |
| Loan compromises | 17 | 33 | 33 |
| Workout | 3 | 3 | 3 |
| Legal action: | | | |
| Bankruptcy | 13 | 25 | 25 |
| Foreclosure or repossession | 5 | 1 | 5 |
| Other | 13 | 17 | 13 |
| To be written off | 3 | 4 | 7 |
| No strategy identified | 18[b] | 3 | 1 |
| Other[c] | 19 | 9 | 9 |
| **Total** | **100%** | **100%** | **100%** |

[a]As of May 1987 (Denver), April 1987 (Oklahoma City), and August 1987 (Omaha).

[b]In Denver, account officers had not developed liquidation strategies for 18 percent of the assets in their portfolios. Denver managers explained that the month before our visit, they had reassigned portfolios throughout the office, and the account officers were reevaluating each asset assigned to them to develop their own approach.

[c]The "other" category includes judgments, assets under investigation, assets being pursued for full payment, assets still being negotiated, and owned or miscellaneous assets.

Source:Division of Liquidation account officers at the consolidated offices.

## Results of Loan Compromises

One way we developed to obtain an indication of FDIC's recovery on assets was to analyze proposals, referred to as cases, for the final liquidation of assets, including loan compromises. We limited our analysis to those cases that were referred to Washington for approval by FDIC's Board of Directors and/or the Division of Liquidation's Committee on Liquidations, Loans, and Purchases of Assets (see table 2.5, p. 30) because they were the largest. We analyzed the proposals approved in 1986, the latest full year for which data were available, which involved the final disposition of a single asset or a number of related assets.[4] Over 50 percent of the proposals reviewed involved assets acquired by FDIC during 1983 and 1984; the time that had elapsed since the institution failed was on average 3.6 years. Given the delegations of authority in effect in 1986, proposals meeting the following criteria required approval by the Committee and/or FDIC Board:

- compromising on assets whose book value exceeded $500,000, except for those cases in which the offer was at least 90 percent of the asset(s)' principal plus interest;
- sale of property having an appraised value exceeding $1 million or whenever the present value of the offer was less than 80 percent of the property's appraised value;
- sale of loans with a book value over $500,000 for less than book value plus interest; and
- write-offs of assets with a book value of over $500,000.

We reviewed the 86 proposals for the final disposition of an asset; these ac omises, sales of property, sales of loans, and write-offs. (We excluded all requested operational actions and proposed credit actions that created another asset, such as a foreclosure, in which a mortgage loan was replaced with a piece of property. As noted, we also excluded bulk sale cases.)

Our analysis showed that, on average, 50 percent of the current book value[5] of the assets was anticipated to be recovered in proposals for loan compromises. For property to be sold (obtained by foreclosure or owned by the bank at failure), the anticipated average gross recovery rate was 61 percent. When loans or notes were sold, about 46 percent of the current book value was expected to be recovered. (We could not deduct

[4] In calculating the potential gross recoveries for these cases, we used the approved amounts for two related reasons. FDIC officials told us centralized records to confirm that assets were actually disposed of at the approved price were not available and assured us that, for the most part, approved cases are ultimately consummated and the proposed amounts are actually realized. The approved action's amount also represents what FDIC would receive on the final disposition of the asset(s), but not necessarily the total realized since acquisition. We could not include any prior collections in our calculation of recovery since such data were not typically included in the case memorandums; division senior managers said it would be too time-consuming for consolidated office staff to compile the prior collection data.

Proposals for bulk sales were excluded since the Division of Liquidation has established reporting requirements that allowed for easy summarization of recoveries pertaining to bulk sales (see pp. 43 to 46.)

[5] Current book value is the same as original book value if there have been no prior principal payments on the debt. If there have been, they were subtracted from the original book value to arrive at the current book value.

expenses because they were not consistently included in the proposals and so were not available.)

**Table 3.3: Recovery Rates for Various Actions Approved by Washington During 1986**

Dollars in millions

| | Number of cases[a] | Book value | Percent of book value recovered |
|---|---|---|---|
| Loan compromises | 57 | $121.9 | 50.3 |
| Sale of property | 16 | 59.3 | 61.0 |
| Sale of loans/notes | 8 | 24.0 | 45.9 |
| Write-offs | 5 | 25.9 | 0.0 |
| **Total** | **86** | **$231.1** | |
| Overall recovery rate | | | 47.0% |

[a]A case may involve a single asset or a number of related assets.

Source: Committee on Liquidations, Loans, and Purchases of Assets, FDIC.

## Bulk Sales

In 1985, the division began a program, known as asset marketing or bulk sales, which involved assembling loans that are similar in type, quality, size, or other characteristics into packages and marketing them on a regional and national scale. The purpose is to provide maximum exposure of assets to the broadest possible investor base, with the ultimate goal of securing the highest return from a given group of assets in the shortest time. (Previously, assets were typically handled individually or by borrower.) So far, the packages have been assembled by consolidated offices and regional offices. FDIC establishes a minimum acceptable (reserve) price for the package of assets by estimating their market value, deducting direct expenses it would incur in liquidating them individually, and adding a provision for profit. An FDIC official also said that flyers announcing the sale are mailed to parties identified in FDIC's automated list of potential purchasers of loan packages. Sealed bids are subsequently accepted and FDIC accepts the best offer, if it exceeds the reserve price.

A mortgage banking firm, under contract to FDIC, collects payments on performing mortgage loans, develops pools of these loans for bulk sale, assists with packaging and marketing the loans, and coordinates with a securities firm; the latter assumes the role of underwriter for the pools. During 1987, 681 loans having a book value of $25 million were sold for their full appraised value of $23 million.

During 1986, the emphasis was on selling packages of small clean loans, according to a senior division official. Since then, the number of bulk sale packages and the book value of assets sold nationwide have increased. The proportion of poorer quality assets included in the packages has resulted in reductions in the percent of book value recovered, according to division officials. (See table 3.4.)

**Table 3.4: Division of Liquidation Bulk Sales[a] for 1986 and 1987**

Dollars in millions

| | 1986 | 1987 | 1988[b] |
|---|---|---|---|
| Number of packages | 196 | 574 | 228 |
| Number of assets | 129,203 | 91,123 | 38,863 |
| Appraised value of assets | Not Available | $331 | $199 |
| Book value of assets | $342 | $860 | $492 |
| Sale price | $178 | $303 | $169 |
| Recovery based on book value | 52.0% | 35.3% | 34.3% |

[a]Bulk sales data include packages of performing loans assembled through the service agreement. Percentages are calculated from unrounded numbers.

[b]Bulk sales from the 6 months ending June 30, 1988.

Source: Division of Liquidation.

The recovery based on book value can vary considerably, depending on the type of assets included in the bulk sale package. For example, in 1987, the recovery rate was 5 percent for distressed assets,[6] which made up half of the book value of the assets sold, and 65.7 percent for the other half.

## Bulk Sales Results at Three Consolidated Sites

Although little written guidance was issued by the division before mid-1987 on the bulk sales program, the use of this method to dispose of assets has been emphasized, particularly at the consolidated office level. Offices we visited had goals for bulk sales in their 1987 and 1988 strategic plans. Denver's 1987 Strategic Plan and its Quarterly Asset Marketing Plan, for example, established a goal of focusing marketing efforts on assets under $25,000; the ceiling was subsequently lowered to $15,000 according to the department head. In addition, the plan called for marketing groups of assets at bank closings before the assets were placed in FDIC's inventory. During 1987, the Denver office collected over $5.3 million for over 6,200 assets sold through the bulk sales program with a book value of about $9.0 million.

[6]Distressed assets are primarily loans with gross estimated cash recovery of less than 25 percent of principal balance owed.

Oklahoma City's 1987 Strategic Plan established marketing goals to collect $150 million from bulk sales of 15,000 assets with an aggregate book value of $300 million. The strategic plan anticipated that a large number of the assets sold would be of a distressed nature: charge-offs, small assets, and larger assets with nominal or no appraised value. By year-end it had collected $24.5 million from the sale of 11,863 assets with a book value of $138 million. According to the asset marketing manager, the goal regarding the number of assets was given priority in order to reduce account officer workload. He also said the recovery goal had been based on the assumption that they would have several deposit payoffs in 1987 but there were none. (Deposit payoffs generally result in FDIC's acquiring all the assets of a failed bank, including higher quality assets that are more readily marketable at higher percentages of book value.)

The Omaha Consolidated Office's 1987 goals and objectives emphasized bulk sales as one of the office's three highest priorities. One of its 1987 goals was to sell 15 to 25 percent of the office's assets through bulk sales. The types of assets being considered for bulk sale varied greatly, from charged-off loans to relatively higher quality loans from newly failed banks. During 1987, it sold 19 percent of the average beginning and ending book value of the office's assets through this program. The office collected almost $15 million for over 1,300 assets with a book value of almost $30 million. FDIC's decision to close this office is discussed on page 28.

Table 3.5 shows that bulk sale activity at Oklahoma City in 1987 was the highest among the consolidated offices visited. Oklahoma City also was the first office to successfully market almost all assets of an entire bank in a single transaction.[7] It had the most bulk sales in terms of number of assets and book value among the three offices visited; however, it realized the lowest overall recovery rates associated with these bulk sales, particularly during 1987. The lower recoveries realized from Oklahoma City's bulk sale efforts were, in part, due to marketing a large portion of distressed assets, which yielded an average recovery rate of about 2 percent. In 1987, such assets accounted for 69.3 percent of the book value of Oklahoma City's bulk sales, some 21.3 percent of Denver's bulk sales and 29.6 percent of Omaha's.

[7]These assets were acquired in a November 1986 deposit payoff. Initial asset marketing efforts involved the bulk sale of the failed bank's installment loans and its trust department. During this initial marketing effort, potential buyers interested in the failed bank's other assets were identified. Within a couple of months, Oklahoma City reduced its inventory of assets acquired from this failed bank from over 6,000 loans to 29 loans.

**Table 3.5: Bulk Sales Packages Sold by the Consolidated Offices Visited in 1986 and 1987**

Dollars in thousands

| | Year ending 1986 | 1987 |
|---|---|---|
| **Denver Consolidated Office** | | |
| Total number of packages | 11 | 28 |
| Total number of assets sold | 491 | 6,215 |
| Book value of assets sold | $3,198 | $9,028 |
| Sale price of packages | $3,155 | $5,344 |
| Recovery based on book value | 98.7% | 59.2% |
| **Oklahoma City Consolidated Office** | | |
| Total number of packages | 29 | 46 |
| Total number of assets sold | 10,254 | 11,863 |
| Book value of assets sold | $98,315 | $138,088 |
| Sale price of packages | $49,877 | $24,452 |
| Recovery based on book value | 50.7% | 17.7% |
| **Omaha Consolidated Office** | | |
| Total number of packages | 26 | 28 |
| Total number of assets sold | 319 | 1,375 |
| Book value of assets sold | $9,757 | $30,252 |
| Sale price of packages | $6,754 | $14,754 |
| Recovery based on book value | 69.2% | 48.8% |

Source: Data were provided by the consolidated offices.

## Management and Financial Information Systems

Another component of FDIC asset management is the information system used. Division of Liquidation officials have, to date, had to rely on limited financial and management information to help manage liquidation efforts nationwide. At the time of our review, information was maintained on a number of generally incompatible systems at the consolidated offices. A new nationwide system is now being implemented, however, which when fully operational is expected to enhance the management of assets as well as oversight. The Division of Liquidation also had an overall agency accounting system that did not include sufficiently detailed information to manage and track assets. In January 1986, FDIC implemented a new accounting system that provides more accurate and detailed information.

## Development of an Asset Management Information System

According to senior division management, the dramatic increase in the number of bank failures underscored the need for an improved financial information system that would enable it to more effectively carry out and oversee liquidation activities. Having the liquidations on different subsidiary ledgers and asset inventory systems, they said, makes monitoring them and reconciling accounting records with the general ledger a very difficult and time-consuming task.

In 1983, senior FDIC managers began to consider design of an asset management system that could be used by both account officers and managers. During the same year, FDIC adopted a two-phase plan for an automated asset management system. The first phase, an interim solution, consisted of automating assets using a limited number of contractors until an in-house automation system was developed. FDIC identified two key service companies and, as new banks failed, entered the assets on one of these systems. FDIC then converted most of the assets in inventory that were either still on manual systems or systems of other service companies to one of the key service companies.

## Liquidation Asset Management Information System

The second phase, FDIC's long-term solution, was to develop a flexible and fully integrated in-house liquidation asset management information system, known as LAMIS. In January 1984, FDIC's Board of Directors approved $8.4 million, plus an additional $570,000 for hardware and telecommunications, for the development of LAMIS. A steering committee comprised of associate directors from the Division of Liquidation and Division of Accounting and Corporate Services was established to oversee and coordinate the development and implementation of the new system.

LAMIS was originally intended to be an integrated system of several automated subsystems designed to support the operations and management of the Division of Liquidation and the Financial Services Branch of the Division of Accounting and Corporate Services. The subsystems were as follows:

- The integrated loans subsystem: The core or primary component of LAMIS. This would support the acquisition and servicing of commercial, installment, and mortgage loans as well as collateral processing and reporting on the status of assets. Although titled a loans subsystem, it was also to include all other types of FDIC-acquired assets.
- The customer information subsystem: This would include demographic and business-related information on all debtors, endorsers, and guarantors.
- The on-line collection subsystem: This would support ongoing loan collection activities and provide delinquency and loan collection productivity information.

- The marketing information subsystem: Known as SMAPS (Secondary Marketing Asset Pricing System). This would help in facilitating the sale of assets both on an individual basis and also in bulk packages.
- The management reporting subsystem: This would provide corporate, regional, consolidated office, and ad hoc reporting.
- The payee subsystem: This would carry out disbursement processing to participants, insurance companies, taxing authorities, lawyers, and other payees.
- The financial information subsystem: This would provide asset budget and cost information.
- The corporate accounting subsystem: This would upgrade the general ledger system.

Initial project plans called for all FDIC-acquired assets to be converted to LAMIS by the end of 1985. By that time, all Division of Liquidation regions and consolidated offices were expected to be using the system and their staff to be trained in its use. Subsequently, FDIC decided to develop several of the subsystems outside the LAMIS project, as discussed below. The LAMIS project team currently anticipates that the core component, the integrated loans subsystem, and the customer information subsystem will be operational throughout the division by the end of 1988.

Development costs for the two LAMIS components are expected to be between $16 and $17 million, plus $5 million for conversion costs—nearly twice the 1984 approved budget for implementing the entire system. Reasons given by FDIC officials for the cost and time overruns range from inadequate initial planning to unexpected growth in the number of assets and unforeseen changes in the organization. The need for the regional and consolidated reporting portions and on-line collections subsystem are to be re-evaluated in 1989. According to an FDIC internal planning document, however, LAMIS is expected to recover all development costs in about 6 years—mostly from savings derived by not contracting with outside service companies.

Some portions of LAMIS as originally planned were dealt with outside LAMIS. Senior officials identified four of the subsystems as high priority areas and expedited their implementation by handling them separately. In 1985, FDIC changed the scope of the planned financial information subsystem contracting with an outside contractor to develop a system to also include payee and corporate accounting systems; these are currently in use. SMAPS, in the meantime, was developed internally and is expected to be fully operational by July 1988.

As of March 1988, about 22 percent of FDIC's acquired assets had been converted to the integrated loans subsystem of LAMIS. Conversion of all assets to LAMIS is expected to be complete by the end of 1988. Data conversion efforts consist of transferring primary data for all assets and supplemental data for those assets exceeding $20,000. (Supplemental data for those assets totaling $20,000 or less may be converted at the option of the various regions.) These include acquired assets handled by the San Francisco, Chicago, and New York (except the Knoxville Consolidated Office) regional offices. Offices using an outside service company's automated system (Atlanta, Kansas City, and Dallas regional offices, along with the Knoxville Consolidated Office) are to be converted last.

## Financial Information System

FDIC implemented the Financial Information System (FIS) accounting system as its general ledger system in January 1986. FIS, which is maintained by the Division of Accounting and Corporate Services, was designed to provide FDIC with the general ledger financial accounting records, as well as to support liquidation responsibilities. To accommodate these intended design objectives, FDIC developed a very large FIS capacity for data storage. FIS, in its series of liquidation accounting reports, captures principal collection data. FIS tracks pertinent financial data for each liquidation and provides the Division of Liquidation with a series of monthly reports that include balance sheet and income statement reports by consolidated office, by region, and overall.

Subsidiary ledger systems used at the consolidated offices, which provide more detail and support for FIS entries, are generally not uniform. Different subsidiary ledger systems may even be used at one consolidated office.

## Summary

Two of the Division of Liquidation's three major initiatives for obtaining the maximum net present value from assets in liquidation—increasing loan compromises and increasing bulk sales—have been implemented and their use has increased sharply. The development and implementation of a comprehensive asset management information system has experienced delays, increased costs, and a reduction in its initial objectives. Senior managers believe, however, that the system will meet its reduced objectives, and that its key component will be operational nationwide by the end of 1988.

# Results of Liquidation Operations

A key question is whether FDIC is meeting its basic liquidation mission of achieving "the highest possible level of collections on assets at the earliest practical time in the most cost-efficient manner."[1] We found this question difficult to answer for two reasons. First, there are no measurable criteria that directly and fully address the issue and, second, FDIC has only recently started to maintain the consolidated information needed to address the question on a nationwide basis.

The three goals of FDIC's liquidation mission (maximizing recovery, at the earliest practical time, and in the most efficient manner) can conflict. Before the 1980s, the emphasis was on the maximum return, and account officers attempted to obtain 100 percent of the principal and accrued interest owed without regard to how long it took. The time value of money was subsequently recognized, and discounting became a factor in liquidation decisions. (See the discussion of present value analysis on pp. 38 and 39.) FDIC has not yet fully implemented its new asset management data system nationwide and only has had an improved receivership-specific[2] financial information system in place since January 1986 (see pp. 47 to 49). For that reason, information on actual collections and expenses before 1986 was not available, practically speaking. Because of these data limitations, we were not able to develop useful historical data on the results of liquidation operations.

FDIC's FIS, in place since January 1986, contains data at the receivership level but does not contain information on specific assets. Furthermore, senior Division of Liquidation officials said that information from its predecessor for liquidation data, the Liquidation Accounting System (LAS), would not be appropriate to use for an analysis of receivership-level trends because the criteria for such concepts as book value, appraised value, and expense items have changed, and data from the two systems would not necessarily be fully comparable. They also said that LAS data could not be relied on totally. We thus had to develop a combination of indicators of liquidation results. Specific data we were able to obtain or develop on the results of compromises and bulk sales are discussed in chapter 3.

[1]FDIC, 3 - 5 Year Strategic Plan, Division of Liquidation, issued in 1986.

[2]"Receivership" as used in this report refers to entities representing the remaining assets and liabilities of failed banks, whether handled by deposit payoff/transfers or by purchase and assumption transactions.

## Performance Targets

One measure of operational results used by the Division of Liquidation is its ability to meet its divisionwide goals. The division began setting annual numerical performance objectives in 1986. Its main objectives for 1987, based on an initial projection of 206 bank closings during the year, were (1) collecting $2.7 billion in cash (this includes collections from actions such as directors and officers lawsuits as well as collections from assets in liquidation); (2) maintaining the book value of assets at the year-end 1986 level of about $10.9 billion (this includes assets acquired from Continental Illinois and First Oklahoma); (3) maintaining division staffing at a level not to exceed 5,000 filled positions; and (4) holding operating expenses at 10 percent of collections.

During 1987, FDIC handled 184 bank failures and provided assistance to 19 failing banks. In only 2 of the 19 instances were assets acquired. Cash collections for 1987 totaled $2.4 billion, about $285 million under the goal of $2.7 billion. The estimated book value of assets in liquidation (including Continental Illinois and First Oklahoma assets) was $11.3 billion, about $400 million over the January 1, 1987, level. Division of Liquidation staff at year-end 1987 was 4,400, a reduction of 285 filled positions during the year. The division estimated operating expenses were 11.2 percent of collections, over the objective but lower than the 13.1 percent level for 1986.

The division's 1988 goals are now based on a projection that 201 bank failures will occur during the year.[3] In 1988, it hopes to (1) collect $2.4 billion in cash, (2) end the year with a book value of assets at about $7.0 billion (excluding Continental Illinois and First Oklahoma assets); (3) end the year with staffing at about 3,707; and (4) keep operating expenses at a level not to exceed 11 percent of collections.

## Recovery Rates

The rate of recovery on assets liquidated, which we define as the percentage of collections (either gross or net of expenses) to the original book value, is another indicator of the results of liquidation operations. It must be emphasized that recovery rates alone cannot be used to judge FDIC's performance because they reflect asset quality and prevailing economic conditions as well as the effectiveness of liquidation efforts.

[3]In FDIC's 1987 Annual Report, the FDIC Chairman estimated that 1988 failures would be about the same as the 1987 totals.

## Estimated Recovery Rates for 63 Failed Banks

Reliable nationwide asset collection and expense data before 1986, even at the liquidation level, were not obtainable from FDIC's liquidation accounting systems. Thus we were unable to determine recoveries on assets for banks failing before January 1986. We therefore developed data on banks that failed in the first half of 1986. This period allowed the maximum amount of time possible for actual recovery (15 to 21 months). We were able to develop actual collection and expense data as of September 30, 1987, for 63 of the 65 banks that failed in the first half of 1986.[4] To the actual information,[5] we added the projected collections and expenses.[6] This allowed us to estimate future gross and net recovery rates.

We found that the actual average gross and net recovery rates, 15 to 21 months after failure, were 34 percent and 29 percent of book value, respectively. It was projected that an additional 26 percent, gross, and 20 percent, net, of book value would be collected.[7] Table 4.1 shows that the actual and expected net recovery on the book value for assets of those 63 banks averaged about 48 percent.

Table 4.1 also shows that the recovery for assets acquired from purchase and assumption transactions is significantly lower than that for deposit payoffs and deposit transfers. This is logical because in the former instance, good assets were purchased by the assuming bank.

[4]Data for 2 of the 65 banks were not included in our analysis. In one case, data were inadvertently omitted from the ECR report provided to us and, in another case, the ECR data proved to be inaccurate. (See note 6.)

[5]We focused our analysis on actual collection and expense data directly pertaining to the liquidation of assets. For example, proceeds from bond claims, directors' liability, accountants' liability claims and other litigation settlements were excluded. Corresponding legal expenses were also excluded.

[6]We used FDIC's Estimated Cash Recovery (ECR) System to obtain estimates of future gross cash collections on assets in liquidation and to determine projected gross recovery rates based on book value of assets in liquidation. ECR was designed to improve the method of calculating the insurance fund reserve for loan loss. (An "estimated allowance for loss" is established at the time a bank fails. The allowance for loss represents the difference between the funds advanced from the insurance fund and the expected repayment. Account officers estimate the cash that will be received from the liquidation of each asset; discounting is used for the 6th year on.) A ratio for each receivership, the relationship between collections received and expenses incurred for assets in liquidation in the prior 10 months, is then applied to the estimated cash recoveries to determine the amount of expected expenses. The netted figure (projected collections less estimated expenses) is then used in calculating the insurance fund's loan loss reserve. We used a different method to project expenses, as described in table 4.1.

We used the September 30 data because it was the latest available at the time for our analysis.

[7]A senior division official believed that projected cash recoveries may be understated because account officers might underestimate recoveries so as to be able to meet them.

**Table 4.1: Average Estimated Recovery Rates as of March 31, 1988, for Banks Failing January through June 1986**

Dollars in millions

| | Total (63) | Purchase and assumption transactions (43) | Deposit payoffs and transfers (20) |
|---|---|---|---|
| Adjusted original book value of acquired assets[a] | $1,747 | $1,245 | $503 |
| **Actual** | | | |
| Actual expenses (1/86 to 9/87) | $102 | $74 | $28 |
| Actual collections (1/86 to 9/87) | 600 | 338 | 262 |
| Actual writeoffs | 156 | 99 | 57 |
| Actual gross recovery rate[b] | 34.4% | 27.2% | 52.1% |
| Actual net recovery rate[b] | 28.5 | 21.3 | 46.5 |
| Actual writeoff rate[c] | 8.9 | 7.9 | 11.4 |
| **Estimated** | | | |
| Estimated gross cash collections | $450 | $361 | $90 |
| Estimated future expenses[d] | 103 | 89 | 14 |
| Projected gross recovery rate[e] | 25.8% | 29.0% | 17.9% |
| Projected net recovery rate[f] | 19.9 | 21.8 | 15.2 |
| **Combined recovery rate** | | | |
| Combined actual gross and projected gross recovery: | | | |
| Average | 60.1% | 56.2% | 70.0% |
| Median | 63.5 | 59.5 | 72.1 |
| Combined actual net and projected net recovery: | | | |
| Average | 48.4% | 43.1% | 61.6% |
| Median | 42.6 | 37.2 | 64.4 |

[a]Adjusted original book value of acquired assets includes the original book value, discovered assets, repurchased assets, and advances made to debtors to protect FDIC's interest in its assets.

[b]The actual gross recovery rate is calculated by dividing actual collections by the adjusted original book value of acquired assets. The actual net recovery rate is determined by using the same calculation but deducting actual expenses from actual collections.

[c]The actual writeoff rate is calculated by dividing the actual writeoffs by the adjusted original book value of acquired assets.

[d]Estimated future expenses are determined by multiplying the estimated gross cash collections by the ratio of actual expenses to actual collections using the liquidations' 15 to 21 months of historical data.

[e]The projected gross recovery rate is calculated by dividing the estimated gross cash collections by the adjusted original book value of acquired assets.

[f]The net projected recovery rate is determined by dividing the projected gross cash collections less the estimated future expenses by the adjusted original book value of acquired assets.

Notes: Numbers in parentheses indicate the number of liquidations in each category.

Adjusted original book value and estimated gross cash collections categories do not add up to the total because of rounding.

Source: Developed by GAO from data provided by FDIC using the Financial Information System and Estimated Cash Recovery Report Number 3: Timing of Estimated Cash Recoveries as of September 30, 1987.

## Timing of Recoveries

FDIC officials told us that generally it should take an average of 5 years to liquidate the assets of a failed bank, with the majority of assets disposed during the first 3 years. Data developed from the 63 liquidations and from the Omaha Consolidated Office appear to support the belief that a large portion of the book value is reduced during the initial 3 years of liquidation; however, the data show that it takes an average of 12 years to terminate receiverships.

## Timing of Liquidations for 63 Failed Banks

Information obtained on the 63 failed banks allowed us to estimate the extent that failed bank assets were liquidated within the first 2 years of liquidation. As of September 1987, these liquidations had been under FDIC management for at least 15 months and as long as 21 months, with an average of 17 months. We found that, on the average, 40 percent of the adjusted original book value of acquired assets from the 63 liquidations was reduced within these first 15 to 21 months of liquidation. Conversely, about 60 percent of the book value was still remaining to be liquidated by FDIC.

## Timing of Liquidations at Omaha

At the Omaha Consolidated Office, we were able to obtain data on the book value of assets over the life of each liquidation handled by the office. This was possible because all bank failures then handled by the Omaha office were relatively new—none had failed before June 1984. Also, managers at the Omaha office tracked balances by asset type for internal information purposes. Similar data from the Denver and Oklahoma City consolidated offices were not available; these offices handled 49 liquidations dating back to 1979 and 55 liquidations dating back to 1982, respectively.

As of December 31, 1987, the Omaha Consolidated Office was handling 35 liquidations, which consisted of 29 purchase and assumptions and 6 deposit payoffs. We focused on the 27 liquidations that were at least 1 year old[8] and developed an aging schedule to determine the extent the number and book value of assets were reduced after 1 to 2 years of liquidation, after 2 to 3 years of liquidation, and after 3 to 3.5 years of liquidation. The results of this analysis are shown in table 4.2.

**Table 4.2: Reduction in Number and Book Value of Assets[a] at Omaha Consolidated Office**

Dollars in millions

| | Period of time in liquidation status | | |
|---|---|---|---|
| | 1-2 yrs. | 2-3 yrs. | 3-3.5 yrs. |
| Number of liquidations | 27 | 21 | 9 |
| Average age (months) | 17.3 | 28.4 | 39.5 |
| Original number of assets retained by FDIC[a] | 12,061 | 10,000 | 5,496 |
| Number of assets remaining after 1-2 years, 2-3 years, and 3-3.5 years in liquidation | 5,048 | 2,487 | 730 |
| Percent reduction in number of assets | 58.2% | 75.1% | 86.7% |
| Original book value of assets retained by FDIC[a] | $253.0 | $171.8 | $86.7 |
| Asset book value remaining after 1-2 years, 2-3 years, and 3-3.5 years in liquidation | $148.7 | $74.6 | $26.0 |
| Percent reduction in asset book value | 41.2% | 56.6% | 70.0% |

[a]The original values do not consider any subsequent repurchases, discovered assets, or other adjustments that may have been made to the liquidations' original inventory of assets because that information was not readily obtainable and would be too time-consuming to reconstruct, according to officials at the Omaha office. Making adjustments similar to those used in our analysis of the 63 liquidations (see table 4.1, p. 53), we found that the median adjustment was 33 percent. Thus, the reduction in book values noted in table 4.2 above may be understated; based on the assumption that additions to the original book values were about 33 percent, the above reductions in book value are underestimated by an average of 10 percent for the three periods.

Source: Number and book value of assets provided by the Omaha Consolidated Office.

## Projected Future Recovery From FDIC-Acquired Assets

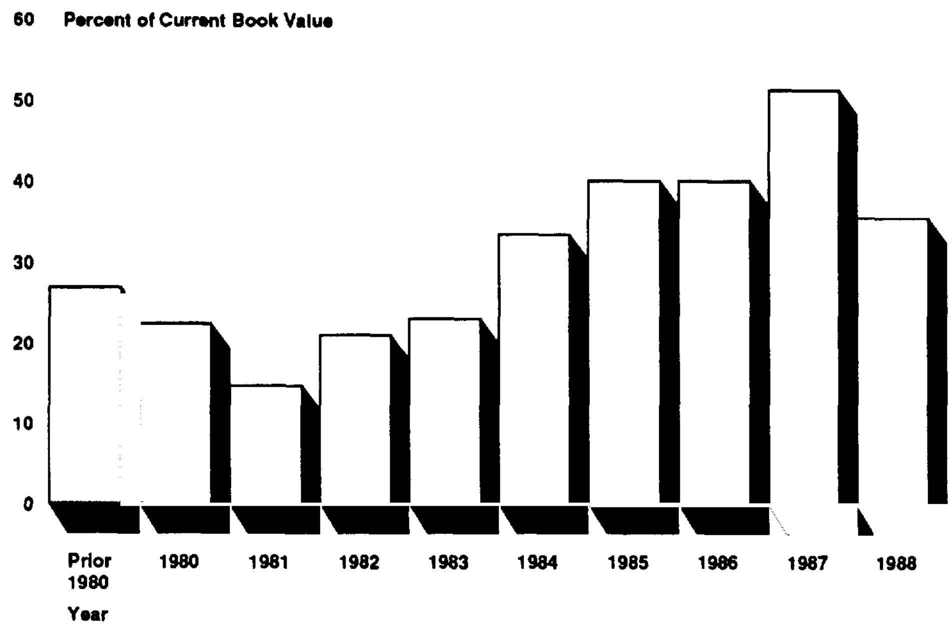
Two important questions that relate to the liquidity of the insurance fund are (1) what does FDIC expect to recover on the assets in its current inventory of acquired assets and (2) over what period of time are collections and recoveries expected to occur? We used the ECR data to determine the recovery rates for assets handled by FDIC for liquidation as of March 31, 1988. We found that gross collections were projected at almost 40 percent, on average, of the current book value. (It should be noted that any past collections on individual assets are not included in this percentage and estimated recoveries represent additional future collections.) For recently closed banks, no assets may have been collected on, or written off, yet. As expected, the numbers in figure 4.1 show that projected additional recoveries from assets of older failed or assisted

[8]We focused on liquidations that were at least 1 year old because additions, such as repurchases and discovered assets, to original book value generally made during the first year may offset collections for this initial period and result in negative recovery rates.

banks are generally lower than from assets of the more recently failed or assisted banks. The primary exception is for 25 of 46 banks which failed during the first quarter of 1988. The reason for this lower rate according to FDIC officials is that estimates made within the first 90 days of a receivership are preliminary estimates which tend to be conservative. For the 379 liquidations created from January 1986 through March 1988, recoveries were expected to be about 46 percent.

The March 1988 ECR data also showed that 77 percent of the total estimated collections would occur in the 2 years following liquidation. Between the 3rd year and 5th year of liquidation, 18 percent more of the estimated collections would be realized and the remaining 5 percent would be realized beyond the 5th year.

**Figure 4.1: Gross Future Projected Recovery Based on Year of Bank Failure Assets in Inventory as of March 1988**




Source: FDIC Estimated Cash Recovery Report Number 3: Timing of Estimated Cash Recoveries as of March 31, 1988.

## Termination of Receiverships

The life cycle of a bank liquidation—from failure of the bank to termination of the receivership—can vary considerably, depending primarily on the level of litigation involved and complexity of the assets. Before recommending termination to the court, FDIC considers factors such as the extent to which it, as receiver, has repaid the insurance fund for advances; how much more it might recover, net of expenses, including judgments; and any outstanding claims against the liquidation. We were told by senior division management that one benchmark used to recommend termination is when the expense of continuing the liquidation is greater than the appraised value of the remaining assets.

Once the court agrees to the termination, the Division of Liquidation proceeds with termination procedures. FDIC as receiver pays uninsured depositors, the FDIC insurance fund and other creditors, their share of any cash remaining in the liquidation and removes the liquidation from FDIC books. (If any funds remain after all these claimants are paid, they are distributed to stockholders.)

As of March 31, 1988, 58 failed bank receiverships have been terminated since 1980. Almost 70 percent of the banks failed before 1977. The average life of a liquidation was almost 12 years, while the range was about 4.3 to 23 years. The percentage of terminations to bank failures occurring each year is shown in table 4.3. (Failures occurring before 1970 have all been terminated and are no longer carried in FDIC's inventory.)

Table 4.3: Terminations of Receiverships

| Year | Number of failed banks | Number terminated[a] | Percent terminated[b] |
|---|---|---|---|
| 1965 | 9 | 9 | 100.0 |
| 1966 | 8 | 8 | 100.0 |
| 1967 | 4 | 4 | 100.0 |
| 1968 | 3 | 3 | 100.0 |
| 1969 | 9 | 9 | 100.0 |
| 1970 | 8 | 7 | 87.5 |
| 1971 | 6 | 5 | 83.3 |
| 1972 | 3 | 1 | 33.3 |
| 1973 | 6 | 6 | 100.0 |
| 1974 | 4 | 1 | 25.0 |
| 1975 | 14 | 10 | 71.4 |
| 1976 | 17 | 10 | 58.8 |
| 1977 | 6 | 3 | 50.0 |
| 1978 | 7 | 5 | 71.4 |
| 1979 | 10 | 6 | 60.0 |
| 1980 | 10 | 0 | 0.0 |
| 1981 | 7 | 2 | 28.6 |
| 1982 | 33 | 2 | 6.1 |
| 1983 | 45 | 1 | 2.2 |
| 1984 | 78 | 0 | 0.0 |
| 1985 | 116 | 0 | 0.0 |
| 1986 | 138 | 0 | 0.0 |
| 1987 | 184 | 0 | 0.0 |

[a]This column represents the number of bank failures in the given year which were terminated between the year of failure and March 31, 1988.

[b]This column represents the percentage of bank failures in the given year that were terminated as of March 31, 1988.

Source: FDIC, Estimated Cash Recovery Timing Report Number 3: Timing of Estimated Cash Recoveries by Consolidated Office, as of March 31, 1988, and Annual Reports for FDIC.

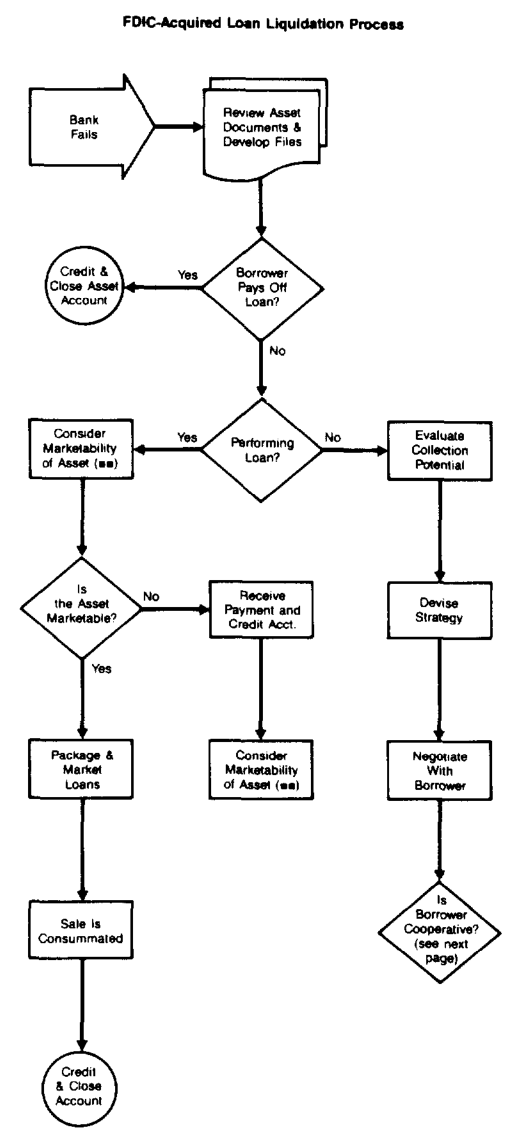
As of March 31, 1988, 27 failed banks were classified as being in termination status—that is, they were no longer active liquidations, their accounts were frozen and subsequent expenses were not allowed to be charged to their accounts. In some instances, a court action such as settlement of litigation was needed before the liquidation could be fully terminated.

## Summary

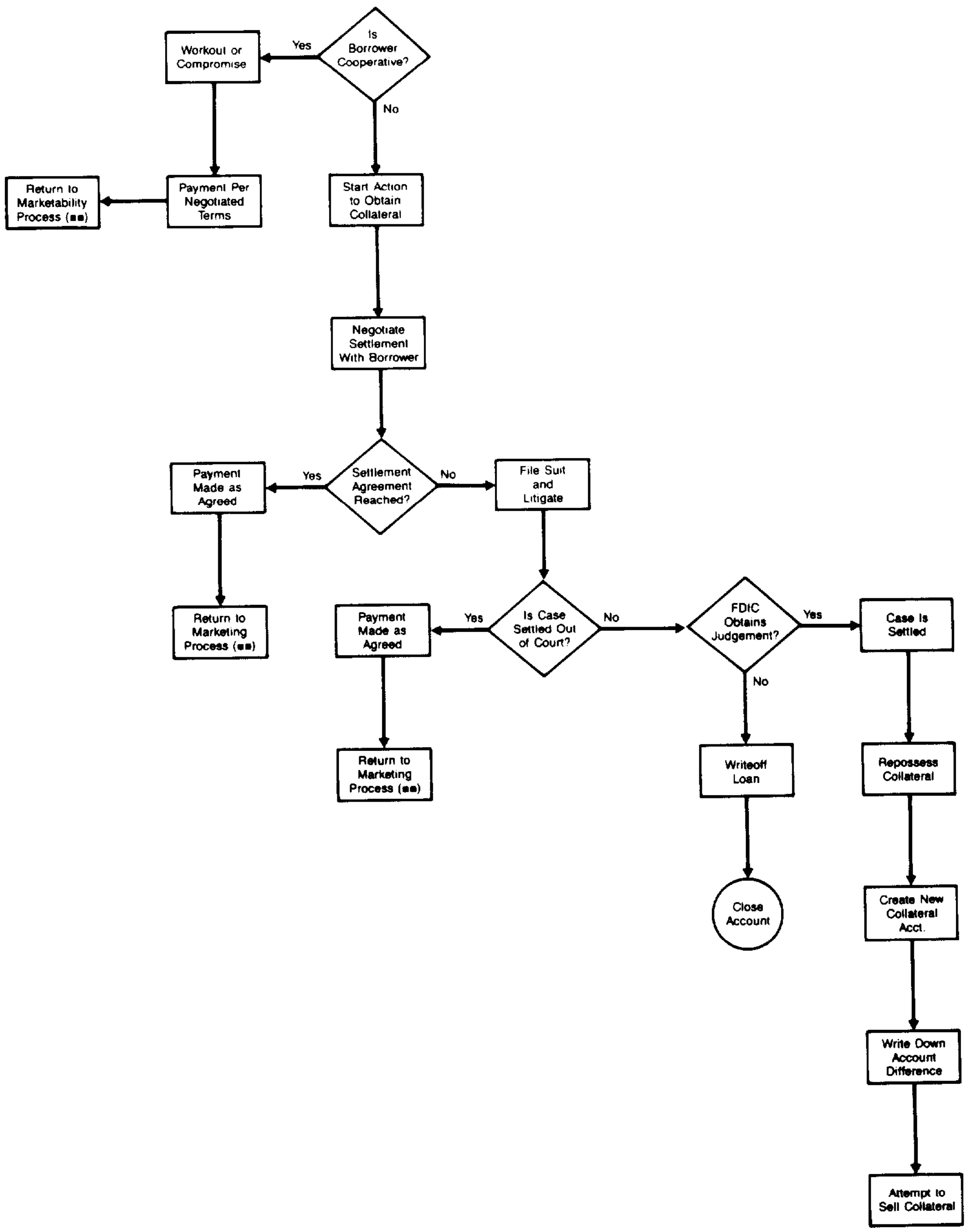
With the implementation of the FIS and ECR, FDIC now has the ability to assess its operations in terms of liquidation recoveries and timeliness. When LAMIS becomes operational, analysis of asset-specific performance, including recovery rates, on a national basis will be possible. FDIC officials have been reluctant to use recovery rates in their analyses of performance because they say the rates reflect not only the effectiveness of liquidation efforts but also the prevailing economic conditions and quality of assets being worked. We do not disagree.

Information on recovery rates, by liquidation or by asset type, for example, can be used as benchmarks that provide a relative measure of collections associated with assets being liquidated. Such data might be used to establish internal liquidation criteria and goals, as well as provide useful information to managers, giving them a basis for year-to-year comparisons, for example.

# FDIC-Acquired Loan Liquidation Process



FDIC-Acquired Loan Liquidation Process




Source: Flowchart was developed in consultation with Division of Liquidation officials.

# Comments From the Federal Deposit Insurance Corporation

**FDIC**
**Federal Deposit Insurance Corporation**
Washington, DC 20429

Office of the Director, Division of Liquidation

August 8, 1988

Richard L. Fogel
Assistant Comptroller General
General Accounting Office
Washington, D.C.

Dear Mr. Fogel:

The draft report "Failed Banks: FDIC's Asset Liquidation Operations In A Changing Environment" has been referred to my office for review and appropriate response.

See p. 20.

The Division's staff has discussed a number of deficiencies relating to incorrect or inconsistent presentation of data with Mr. Michael Koury of GAO in the absence of Ms. Alison Kern. One significant matter deserves reconsideration and relates to a presentation on Pages 22 and 23 of the report which reads, "FDIC financial statements show a general decline in the liquidity of the Fund since 1980." This is not correct and is misleading. In 1980, the Fund had less than $11 billion in cash and securities and at the end of 1987, the Fund had $16 billion in cash and securities. The percentage of receivables and notes as a percentage of the Fund is not, in our opinion, an appropriate measure of the liquidity in the Fund available for assisting banks or handling failed bank transactions.

Sincerely yours,

James A. Davis

James A. Davis
Director
Division of Liquidation

# Glossary

| | |
|---|---|
| Allowance for Loss | An account on FDIC's corporate books as opposed to those on the Liquidation Accounts used to establish an estimated allowance for loss after an insured bank is assisted or closed. This allowance for loss represents the difference between the funds advanced by the FDIC's insurance fund and the expected repayment, based on the estimated cash recoveries from the assets of the assisted or failed bank, minus all liquidation costs. |
| Assets in Liquidation | Assets from failed or assisted banks normally take the form of outstanding loans, but may be actual physical assets, such as real estate. This report deals with acquired assets from failed and assisted banks, which include such items as installment loans, commercial loans, student loans, securities, real estate mortgages, owned real estate, assets written off by the failed bank, judgments, serviced mortgages, and international loans. |
| Appraised Value | The value of any asset as determined by a written valuation or estimate by a disinterested person of suitable qualifications. |
| Book Value | The dollar value of an asset carried on FDIC records. It represents the full legal claim against the borrower—the value on the bank's books at the time of closing plus any partial chargeoffs. The original book value is the amount the debtor should have paid on the day the bank closed. It also includes amounts that were partially charged off by the bank and similar adjustments. Book value on FDIC records is adjusted to account for collections of principal or for adjustments, such as the write-off of part of the principal. |
| Bulk Sale | The sale of a portfolio—or package—of loans that are similar in type, quality, size, or other characteristics. |
| Current Book Value | The book value of assets in the inventory as of the end of the period noted. |
| Deposit Transfer | A method used by FDIC to handle bank failures by transferring insured deposits to an existing healthy bank or a bank newly formed solely for paying insured depositors. It then acts as receiver, marshalling remaining assets and determining the amount owed to each creditor of the |

bank, and disburses collections, net of expenses, to all creditors on a pro rata basis. (Compare "receivership transaction.")

| | |
|---|---|
| Discounting | The valuing of an asset in today's dollars recognizing future potential collections and expenses. |
| Distressed Assets | Primarily loans with gross estimated cash recovery of less than 25 percent of the principal. |
| Estimated Cash Recovery | An estimate of the gross cash that will actually be received by liquidation over the life of an asset. All anticipated "gross cash receipts" (principal plus interest plus other income) are projected for 5 calendar years without adjustment or reduction for direct expenses, costs of collection, prospect for bulk sale, or time value of money. Anticipated recoveries beyond 5 years are projected on an annual basis and expressed in their present value at the end of the 5th year. |
| Estimated Cash Recovery System | A system, established in 1986, whereby each account officer estimates the gross cash that will be collected over the life of each asset. |
| Judgment | A court ordered obligation legally binding a debtor, replacing the original promissory note or evidence of indebtedness. When a judgment is awarded by the court, FDIC records are changed to record a new amount, possibly a new interest rate, and a new statute of limitations. |
| Loan Compromise | An agreement by FDIC with a borrower, guarantor, or endorser to accept less than full payment of a debt. |
| Portfolio | A group of assets managed by an account officer. |
| Present Value | Present value analysis is used to calculate the value today of a future payment or stream of payments discounted to account for the time value of money. Treasury security rates are generally used by FDIC in discounting. |

| | |
|---|---|
| Purchase and Assumption Transaction | In this transaction, FDIC, as receiver of a failed bank, contracts with an open bank to purchase specified assets of the failed bank and assume depositor liabilities. It then acts as receiver, marshalling remaining assets and determining the amount owed to each creditor of the bank, and disburses collections, net of expenses, to all creditors on a pro rata basis. (Compare "receivership transaction.") |
| Receiver | As "receiver" of a failed bank, a court assigns to FDIC the task of liquidating the bank's assets and settling its claims (liabilities), including claims for deposits in excess of the insured limit, those of the FDIC on behalf of the insured depositors, and all the creditors and shareholders. |
| Receivership Transaction | In this transaction, FDIC as receiver of a failed bank, assumes responsibility for marshalling all assets and determining the amount owed to each creditor of the bank, and disburses collections, net of expenses, to all creditors on a pro rata basis. (Compare "purchase and assumption transaction.") |
| Termination | The legal closing out by a state or federal court relinquishing FDIC's fiduciary responsibility with regards to the estate of a failed bank. |
| Workout | An alteration of payment terms or maturity date of a loan. The principal is not affected. |
| Write-Off | An asset that has been judged uncollectible and deleted from FDIC's accounts. |

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