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Report to the Congress

April 1991

FINANCIAL AUDIT

Resolution Trust Corporation's 1989 Financial Statements

GAO/AFMD-91-57

GAO

United States
General Accounting Office
Washington, D.C. 20548

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Comptroller General
of the United States

B-240108

April 4, 1991

To the President of the Senate and the
Speaker of the House of Representatives

This report presents our opinion on the financial statements of the Resolution Trust Corporation for the period August 9, 1989, through December 31, 1989, disclosing significant uncertainties related to the Corporation's cost estimates for resolving institutions. As a result, actual resolution costs could be higher than estimated. These uncertainties limited our audit and precluded us from opining on the Corporation's estimated liability for unresolved institutions and its estimated recovery from receiverships for claims paid on behalf of depositors. Our reports on the Corporation's internal control structure and on its compliance with laws and regulations are also presented. We conducted our audit pursuant to the provisions of section 21A(k)(1) of the Federal Home Loan Bank Act (12 U.S.C. 1441a(k)(1)) and in accordance with generally accepted government auditing standards.

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (Public Law 101-73), also known as FIRREA, created the Resolution Trust Corporation to resolve the problems of failed thrift institutions previously insured by the Federal Savings and Loan Insurance Corporation and placed into conservatorship or receivership between January 1, 1989, and August 9, 1992. The newly established Resolution Trust Corporation Oversight Board, under the chairmanship of the Secretary of the Treasury, has overall responsibility for the Corporation's activities. The Federal Deposit Insurance Corporation carries out the Corporation's duties and responsibilities and is reimbursed by the Corporation for all services performed.

FIRREA provided the Corporation with $50 billion to resolve failed savings institutions and to pay its administrative expenses. However, resolution cost estimates prepared by the Corporation and its Oversight Board indicate that, on a present value basis, between $89 billion and $132 billion will be needed. On January 23, 1991, the Oversight Board testified before the Senate Committee on Banking, Housing and Urban Affairs that while costs were still expected to fall within the above range, the recent economic downturn and the crisis in the Persian Gulf have made the higher end of the cost range more likely.

In January 1991, the Corporation received the last $7 billion available under FIRREA for resolutions. The Corporation does not expect these funds to last beyond March 1991, at which time resolution activities will cease. Therefore, in its January testimony, the Oversight Board requested an additional $30 billion to permit resolution activity to continue through the end of the fiscal year. Furthermore, the Oversight Board indicated its preference for permanent funding authority so that the Corporation could pursue its mandate aggressively and without costly interruption.

While we agree that the Corporation should be given the funds necessary to continue resolutions in a timely and orderly fashion, we do not agree with the Oversight Board's request for an "open checkbook". We believe that providing the Corporation funds as part of the annual budget and appropriations process would retain important congressional oversight control mechanisms and, therefore, would provide the best funding solution.

On March 13, 1991, the House approved a bill providing the Corporation with an additional $30 billion to cover depositor claims at hundreds of failed institutions. The Senate had approved similar legislation a week earlier. Before the Corporation can receive any of these funds, however, the House and Senate must reconcile some relatively minor differences in the bills.

We are sending copies of this report to the Chairmen of the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Banking, Finance and Urban Affairs; the Chairman and members of the Oversight Board; the Director of the Office of Thrift Supervision; and the Director of the Office of Management and Budget.

Charles A. Bowsher

Charles A. Bowsher
Comptroller General
of the United States

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Abbreviations

FDIC	Federal Deposit Insurance Corporation
FIRREA	Financial Institutions Reform, Recovery, and Enforcement Act of 1989
FSLIC	Federal Savings and Loan Insurance Corporation

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To the Board of Directors
Resolution Trust Corporation

We have audited the accompanying statement of financial position of the Resolution Trust Corporation as of December 31, 1989, the related statement of income and accumulated deficit, and the statement of cash flows for the period August 9, 1989, through December 31, 1989. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit. In addition, we are reporting on our consideration of the Corporation's internal control structure and on its compliance with laws and regulations.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion. However, as discussed in the following paragraphs, the Corporation's estimated liability for unresolved institutions and its estimated recovery from receiverships for claims paid on behalf of depositors are subject to significant uncertainties that limited our audit and precluded us from opining on these reported balances.

The Corporation developed a standard methodology in June 1990 to estimate its liability for the cost of unresolved institutions. The methodology was consistently applied and used the best information available at the time. However, the actual cost to the Corporation for future resolution actions will depend on the outcome of various uncertainties, including the number of institutions placed into conservatorship prior to August 9, 1992; the extent of these institutions' continuing operating losses; the quality and salability of each institution's assets; and the condition of the economy, especially in certain geographic locations. As a result of these uncertainties, the Corporation's estimated liability for unresolved institutions is subject to significant change and final costs could be much higher than estimated.

For institutions already resolved, the Corporation has paid out funds required to settle depositor claims to either the depositors themselves or acquirers of the institutions. However, the Corporation expects to recover some portion of those paid claims (subrogated claims) through the sale of the failed institutions' assets that remain in Corporation receiverships. To develop its estimated net receivables from paid claims, the Corporation calculated the estimated market value of assets held in receivership less the associated costs of holding those assets for sale. The Corporation calculated asset recovery values based on appraisal and review processes. Because it had only been in existence for 5 months, however, the Corporation lacked historical asset sales experience with which to evaluate the accuracy of the resulting recovery estimates. Also, the Corporation's short operating life had not provided it with sufficient asset management experience to serve as the basis for estimating holding costs. Most important, the Corporation had never examined receivership inventories on an individual asset basis; instead, all valuation decisions had been based on samples of assets taken prior to the resolution process. As a result, the expected recovery value of assets in receivership could be significantly overstated. The current recessionary economy and the depressed real estate market are also likely to negatively affect asset recovery values.

In our opinion, except for the effects that the uncertainties discussed in the preceding paragraphs may have on the cost of unresolved institutions and the expected recoveries from resolved institutions, the financial statements referred to above present fairly, in all material respects, the financial position of the Resolution Trust Corporation as of December 31, 1989, and the results of its operations and its cash flows for the period then ended, in conformity with generally accepted accounting principles.

As discussed in note 1, the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 was enacted on August 9, 1989. FIRREA, which created the Resolution Trust Corporation, responded to the savings and loan industry crisis and the mounting losses of the industry's insurer by abolishing the Federal Savings and Loan Insurance Corporation (FSLIC) and transferring its functions to several newly established entities. FSLIC's insurance function was transferred to the Savings Association Insurance Fund, which is administered by the Federal Deposit Insurance Corporation (FDIC). The new insurance fund will be responsible for assisting and resolving troubled thrifts after August 9, 1992. FIRREA created the FSLIC Resolution Fund to accept the assets, debts, obligations, contracts, and other liabilities resulting from FSLIC's resolution activity prior to January 1, 1989. FDIC is responsible for administering the FSLIC Resolution Fund to ensure that its assets are sold and liabilities paid.

FIRREA created the Resolution Trust Corporation to resolve the problems of failed thrift institutions previously insured by FSLIC and placed into conservatorship or receivership from January 1, 1989, until August 9, 1992. The Corporation's newly established Oversight Board, under the chairmanship of the Secretary of the Treasury, has overall responsibility for the Corporation's activities. FDIC carries out the Corporation's duties and responsibilities and is reimbursed by the Corporation for all services performed.

FIRREA provided the Corporation with $50 billion to resolve failed savings institutions and to pay its administrative expenses. Through December 31, 1990, the Corporation had used $37 billion of the $43 billion then available to pay the losses of 352 failed institutions. However, resolution cost estimates prepared by the Corporation and its Oversight Board indicated that between $89 billion and $132 billion on a present value basis would eventually be needed to close a total of 700 to 1,000 failed institutions.[1]

In January 1991, the Corporation received the last $7 billion available under FIRREA for resolutions. Although the Corporation has slowed down marketing and resolving institutions, it does not expect these funds to last beyond March 1991. The Corporation has stated that without more funds, all resolution activity would cease. Accordingly, in January 1991, the Oversight Board appeared before the Congress to request an additional $30 billion to resolve approximately 225 institutions before the end of fiscal year 1991. The Oversight Board indicated its preference for permanent funding authority since that would allow the Corporation to pursue its mandate aggressively and without costly interruption.

We have no reason to disagree with the Board's stated need for more funds through the end of this fiscal year, and we expect that the Corporation will require substantial additional funds in fiscal year 1992. However, we do not agree with the Oversight Board on the best way to provide those funds. In our February 1991 testimony before the House Committee on Banking, Finance and Urban Affairs,[2] we stated that a permanent and indefinite appropriation would effectively eliminate the existing controls over the Corporation's obligational authority contained

[1] The Oversight Board calculated its cost estimate range in May 1990. In January 1991 testimony before the Senate Banking Committee, the Oversight Board stated that its present value cost range was still valid; however, due to the recent economic downturn and the war in the Persian Gulf, the most likely cost scenario has moved to the higher end of the range.

[2] Resolution Trust Corporation: Performance Assessment to Date (GAO/T-GGD-91-7, February 20, 1991).

in FIRREA. We expressed the belief that it is important to retain control mechanisms already in place and functioning.

Therefore, we support providing sufficient funds annually to cover the Corporation's resolution needs for that year. This would allow the Corporation to efficiently plan its workload to avoid costly slowdowns in resolution activity, and would retain existing congressional oversight control mechanisms. As stated in our testimony, we believe that a yearly appropriation, provided on-budget and linked with the Oversight Board reporting requirements, is the best funding alternative. FIRREA's obligation limit would have to be revised to reflect the Corporation's funding through the annual appropriation process, since currently it is linked to the $50 billion originally designated for unrecoverable losses.

On March 13, 1991, the House approved a bill providing the Corporation with an additional $30 billion to cover depositor claims at hundreds of failed institutions. The Senate had approved similar legislation a week earlier. Before the Corporation can receive any of these funds, however, the House and Senate must reconcile some relatively minor differences in the bills.

The following sections of this report provide details on the Corporation's liability for unresolved institutions and its expected recoveries from resolved institutions. In addition, our report on the Corporation's internal control structure provides additional information on its ability to produce reliable estimates for the expected recovery value of assets in both resolved and unresolved institutions.

Estimated Liability for Unresolved Institutions

The Corporation's estimated resolution liability is subject to many uncertain factors and future events that are likely to make actual costs higher than projected. At December 31, 1989, the Corporation accrued a $95 billion liability for resolving approximately 650 troubled institutions already in conservatorship or identified in the regulatory process as probable to fail. To estimate this liability, the Corporation assumed that all troubled institutions would be resolved on December 31, 1989, by directly paying off depositor claims. The Corporation also assumed that recovery rates for subsequent asset sales would be the same as those calculated for resolutions already performed.

However, some of the Corporation's assumptions may not hold true and future events may cause asset values to decline. For example, the number of institutions requiring resolution could increase significantly.

At September 30, 1990, approximately 350 institutions not included in the Corporation's liability had capital levels of less than 3 percent and were operating unprofitably. As the Corporation discussed in note 9 to its financial statements, some or all of these institutions could require resolution at an additional cost to the Corporation of as much as $18 billion. Also, the market values of Corporation-held assets might continue to decline, thereby reducing the amount recovered at sale. Although the Corporation assumed asset writedowns of 20 percent to 34 percent based on estimates calculated for institutions resolved through May 1990, worsening economic conditions could result in higher losses. Finally, delays in closing troubled thrifts could result in significant continuing operating losses that must be funded at the time of resolution. By not including operating losses in its liability calculation, the Corporation has increased the likelihood that actual resolution costs will exceed its estimate.

Estimated Recoveries on Paid Claims

Because the Corporation had not, at the time of our review, either examined all assets remaining in its receiverships or valued each asset based on actual sales experience, it may have overstated its expected recoveries from depositor claims paid. At December 31, 1989, the Corporation had resolved 37 failed savings institutions requiring disbursements of $9 billion for depositor liabilities. Although the Corporation has a subrogated claim for the entire disbursement amount against the failed institutions' assets remaining in receivership, the Corporation estimated that it would recover less than $4 billion from the sale of those assets. The Corporation calculated asset recovery values based on the results of reviews conducted in each conservatorship institution prior to resolution. As part of these valuation reviews, the conservatorships' assets were categorized according to type and performance (for example, performing mortgage loans, nonperforming consumer loans, and real estate owned). Based on the size of the institution, reviewers were required to sample certain dollar amounts and numbers of assets within the categories. The reviewers developed expected recovery values for the sampled assets using recent appraisals or following Corporation guidelines. Those rates were then projected to unreviewed assets. Upon resolution, an institution's asset valuation review became the basis for determining the recovery value of the assets remaining in Corporation receiverships.

Although the Corporation provided the reviewers with general guidelines to follow in determining expected recoveries, it had no historical experience in asset sales with which to evaluate the mark-to-market adjustments resulting from reviews and appraisals.[3] The Corporation also lacked experience in asset management with which to evaluate the estimated cost of holding assets for sale. In addition, receivership asset inventories were valued based on samples chosen prior to the acquirer taking the "good" assets at resolution and leaving the "bad" assets to be handled by the Corporation. By continuing to apply recovery rates based on a certain proportion of both good and bad assets, the Corporation could be significantly overstating the value of the assets remaining in receivership. Without reviewing each individual asset under receivership control, the Corporation cannot determine an asset's condition or set a realistic price for its sale.

As discussed, the Corporation's actual recoveries on paid claims could be lower than estimated if receivership assets are found to be more impaired than anticipated. Also, higher than expected contract management fees or "fix-up" costs would increase losses. However, the greatest unknown is the future health of the economy, particularly in geographic areas with large real estate asset portfolios for sale. If the economy continues its slowdown, asset sales could bring in significantly less than expected.

Charles A. Bowsher
Comptroller General
of the United States

December 14, 1990

[3] To address this concern, we recommended in our report, Obligations Limitation: Resolution Trust Corporation's Compliance as of March 31, 1990 (GAO/AFMD-90-101, July 27, 1990), that the Corporation institute a system to track and report the actual results of asset sales. In response, the Corporation stated that it is developing a Receivership Asset Inventory System that will have some reporting capability by March 31, 1991.

Report on Internal Control Structure

We have audited the financial statements of the Resolution Trust Corporation for the period August 9, 1989, through December 31, 1989, and have issued our opinion thereon. This report pertains only to our study and evaluation of the Resolution Trust Corporation's internal control structure for the period ended December 31, 1989.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit of the financial statements of the Resolution Trust Corporation for the period ended December 31, 1989, we considered the Corporation's internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control structure. Because the Corporation had only been in existence for 5 months, we found that it had not had sufficient time to develop and implement many of the formal internal control processes and procedures necessary to provide management with reasonable assurance that assets are safeguarded against loss and that transactions are executed in accordance with management's authorization. Instead, during the period under audit, the Corporation was operating with many informal and undocumented control processes and procedures. Therefore, we did not attempt to directly test or rely on the Corporation's internal control structure. Instead, we determined it was more efficient and effective to rely solely on increased substantive testing of account balances. Although our testing produced no evidence that material errors or irregularities occurred during the audit period due to the lack of a more formal internal control structure, we were unable to assure ourselves that the Corporation had sufficient controls to ensure that the assets in receiverships and conservatorships were fairly valued and reflected realistic recovery amounts.

Although we did not test the design, operation, and adequacy of the Corporation's internal control structure for the period ended December 31, 1989, we believe the results of our substantive testing provide sufficient evidence for our opinion on the Corporation's financial statements. The following discussion of the Corporation's system for valuing assets under its control provides information related to the qualifications we express in that opinion. Specifically, we were unable to opine on the Corporation's estimated liability for unresolved institutions and its estimated recovery from receiverships for claims paid on behalf of depositors, partially because of apparent weaknesses in the Corporation's procedures to ensure that estimated asset recovery values are reliable.

The Corporation's Asset Valuation Procedures

According to Corporation officials, during 1989, procedures adapted from those used by the Federal Deposit Insurance Corporation (FDIC) were instituted to determine the asset inventories of troubled institutions placed in conservatorship and to appropriately value the inventories for recovery purposes. At the time of takeover, an FDIC examination team verified the failed institution's financial reports and its opening asset inventory. This exam determined the beginning balances for the conservatorship on a book value basis. As soon as practicable after the conservatorship was established, an FDIC asset valuation team arrived to determine the market value of the conservatorship inventory. However, the valuation team was not responsible for ensuring that the conservatorship books reflected an accurate asset inventory. The valuation team used the book inventory to categorize assets, sampled assets from each category, reviewed documentation for the sampled assets, and determined the appropriate recovery value for each sampled asset. The net recoveries for all sampled assets within a category were used to calculate the net recovery rate to be applied to all unreviewed inventory assets in the category. The Corporation used the asset valuation review results as the basis for its cost test to determine the least expensive resolution method for each failed thrift institution.

At resolution, the Corporation closing team prepared a book value balance sheet for each newly created receivership by conducting an inventory of assets not passed to the acquirer. The closing team was concerned with the existence, not the valuation, of assets. Therefore, the team did not review each asset to determine its condition or each credit file to ensure the existence of supporting documentation or appraisals. The book value inventory balance sheet was then sent to Corporation headquarters, where the assets were adjusted to their expected market values using the recovery rates calculated by the asset valuation team while the institution was in conservatorship. The average asset recovery rates developed through the conservatorship asset valuation process for resolved institutions were then used to estimate recoveries for unresolved institutions.

Although we did not test the asset inventory and valuation procedures described above, they may be subject to several weaknesses that make the resulting recovery estimates uncertain. First, although the asset valuation process for real estate was based upon recent appraisals whenever available, the appraisals may not be realistic. We recently reported[4] that some of the appraisals on real estate assets held by the Bank Insurance Fund were based on overly optimistic assumptions concerning expected future occupancy and rental rates. We estimated that the resulting Bank Insurance Fund recoveries from real estate reviewed were overstated by 16 percent. Based on that experience, we are concerned that the Corporation's asset appraisals could also be optimistic and the resulting recovery values similarly overstated.

Second, the Corporation relied on formula appraisals for most conservatorship loans and mortgages; that is, the bulk of these assets were valued based on the review of a sample. For performing loans and mortgages, market value is highly dependent upon having proper documentation and title in each individual asset's credit file. By reviewing only a sample of loans and mortgages, the reviewers may have significantly underestimated the number of nonconforming or problem financial assets. As a result, the Corporation may be underestimating the discount required to sell these assets in the marketplace.

Third, asset inventories and valuation reviews were performed on institutions in conservatorship while they were holding a certain proportion of good and bad assets. However, many of the good assets were either sold later while in conservatorship or were passed to acquirers at the time of resolution. Therefore, using conservatorship recovery rates based on the original mix of good and bad assets might be inappropriate if mostly poor quality assets were left in many receiverships.

Finally, at the time the estimates were prepared, the Corporation had not revalued its receivership assets even though, in many cases, a great deal of time had elapsed since the valuation reviews were performed. With the current slowdown in the economy and the depressed real estate markets, values that were realistic as recently as 6 months ago may be unrealistic today.

Given all of the above concerns, the Corporation may not recover as much as estimated on the assets it now owns or on those it expects to receive from future resolution actions. As a result, the Corporation's losses could be higher than anticipated. In conjunction with our audit of

[4]Bank Insurance Fund: Additional Reserves and Reforms Needed to Strengthen the Fund (GAO/AFMD-90-100, September 11, 1990).

the Corporation's 1990 financial statements, we are currently developing procedures to begin sampling and evaluating the Corporation's assets in receivership. Although we expect this valuation work to extend beyond the 1990 audit, we plan to discuss any preliminary results as part of that audit opinion report.

Report on Compliance With Laws and Regulations

We have audited the financial statements of the Resolution Trust Corporation for the period August 9, 1989, through December 31, 1989, and have issued our opinion thereon. This report pertains only to our review of the Corporation's compliance with laws and regulations for that period.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The Corporation's management is responsible for compliance with laws and regulations. As part of obtaining reasonable assurance as to whether the financial statements were free of material misstatements, we selected and tested transactions and records to determine the Corporation's compliance with certain provisions of section 21A of the Federal Home Loan Bank Act (12 U.S.C. 1441a) which, if not complied with, could have a material effect on the Corporation's financial statements. However, our objective was not to provide an opinion on overall compliance with such provisions. Because of the limited purpose for which our tests of compliance were made, the laws and regulations tested did not cover all legal requirements with which the Corporation has to comply.

The results of our tests indicate that with respect to the items tested, the Corporation complied, in all material respects, with those provisions of laws and regulations that could have a material effect on its financial statements. With respect to transactions not tested, nothing came to our attention that caused us to believe that the Corporation had not complied, in all material respects, with those provisions.

Financial Statements

Statement of Financial Position

As of December 31, 1989
(In thousands)

Assets	
Cash	$ 4,406,656
Advances and loans (Note 3)	11,277,480
Net subrogated claims (Note 4)	3,632,656
Other assets (Note 7)	28,932
Total Assets	**$ 19,345,724**
Liabilities	
Accounts payable, accrued liabilities and other	$ 7,950
Liabilities incurred from assistance and failures (Note 8)	4,037
Estimated cost of unresolved cases (Note 9)	94,669,000
Estimated losses from corporate litigation (Note 10)	83,719
Total Liabilities	**94,764,706**
Equity	
Contributed capital	18,800,000
Capital certificates	5,708,757
Accumulated deficit	(99,927,739)
Total Equity (Note 11)	**(75,418,982)**
Total Liabilities and Equity	**$ 19,345,724**

See accompanying notes

Statement of Income and Accumulated Deficit

For the Period August 9, 1989 (Inception) through December 31,1989
(In thousands)

Revenue	
Interest on advances and loans	$ 230,912
Servicing and other revenue	2,096
Total Revenue	**233,008**
Expenses and Losses	
Provision for losses (Note 6)	44,911,633
Administrative operating expenses	6,536
Other expenses	2,578
Total Expenses and Losses	**44,920,747**
Net Loss	**(44,687,739)**
Accumulated Deficit - August 9 (Inception) (Note 11)	**(55,240,000)**
Accumulated Deficit - December 31	**$ (99,927,739)**

See accompanying notes

Statement of Cash Flows

For the Period August 9, 1989 (Inception) through December 31, 1989
(In thousands)

Cash Flows From Operating Activities:	
Cash inflows from:	
Increase in accounts payable, accrued liabilities and other	$ 7,950
Servicing and other revenue	2,096
Receipts from subrogated claims	190
Cash outflows for:	
Increase in other assets	(28,932)
Disbursements for advances and loans	(11,046,568)
Disbursements for subrogated claims	(9,027,723)
Administrative operating expenses	(6,536)
Other expenses	(2,578)
Net Cash Used by Operating Activities (Note 14)	**(20,102,101)**
Cash Flows From Financing Activities:	
Cash inflows from:	
Contributed capital	18,800,000
Capital certificates	5,708,757
Cash Provided by Financing Activities	**24,508,757**
Net Increase in Cash	**4,406,656**
Cash - August 9 (Inception)	**-0-**
Cash - December 31	**$ 4,406,656**

See accompanying notes

Notes to Financial Statements

DECEMBER 31, 1989

1. Impact of FIRREA Legislation:

Creation of the RTC:

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) became public law on August 9, 1989. This landmark legislation established organizations and procedures to obtain and administer the necessary funding to resolve failed thrifts and to dispose of the assets of these institutions. FIRREA abolished the Federal Savings and Loan Insurance Corporation (FSLIC) and the Federal Home Loan Bank Board (FHLBB). Their functions were transferred, in a prescribed manner, to the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision, the Federal Housing Finance Board, and the Resolution Trust Corporation (RTC).

Under FIRREA, the RTC was established to aid in resolving the thrift industry crisis. This newly created mixed-ownership Government corporation was tasked with replacing the FSLIC in future case resolution activity by managing and resolving all troubled savings associations that were previously insured by FSLIC and for which a conservator or receiver is appointed during the period January 1, 1989 through August 8, 1992. The FSLIC Resolution Fund, a separate fund under FDIC management, will complete the resolution of all thrifts that failed before January 1, 1989 or were assisted before August 9, 1989. Beginning on August 9, 1992, the Savings Association Insurance Fund will replace the RTC in resolving troubled thrift institutions.

To allow the RTC to carry out its legislative mandate, FIRREA authorized the FDIC to act as exclusive manager, subject to removal by the RTC Oversight Board. Thus, the FDIC shall carry out all duties and responsibilities of the RTC and shall be reimbursed by the RTC for all services performed. The Board of Directors of the FDIC serves as the Board of the RTC, and the Chairperson of the FDIC Board is the Chairperson of the RTC Board.

The activities of the RTC are subject to the general oversight of the newly established Oversight Board. The Oversight Board was created by FIRREA to oversee and be accountable for the RTC, to provide the RTC with general policy direction, and to review and monitor the RTC's performance. The Oversight Board consists of five members: the Secretary of the Treasury; the Chairman of the Board of Governors of the Federal Reserve System; the Secretary of Housing and Urban Development; and two independent members appointed by the President, with the advice and consent of the Senate.

FIRREA established the Resolution Funding Corporation (REFCORP) to provide funds to the RTC to enable the RTC to carry out its legislative mandate. The REFCORP, under general oversight of the Oversight Board, was granted power to issue up to $30 billion in long-term debt securities, the net proceeds of which shall be used to purchase capital certificates issued by the RTC or to refund any previously issued obligation.

The RTC will terminate on or before December 31, 1996. All remaining assets and liabilities will be transferred to the FSLIC Resolution Fund, with the requirement that any net proceeds from the sale of such assets be transferred to the REFCORP for interest payments. At the time of the RTC's termination, the FDIC will succeed the RTC as conservator or receiver for failed thrift activity.

Purpose of the RTC:

- Maximize return on the sale or other disposition of institutions or the assets of such institutions;
- Minimize the amount of any loss from case resolutions;
- Review all insolvent institution cases resolved by the FSLIC between January 1, 1988 and August 9, 1989, exercising all legal rights to modify, renegotiate, or restructure agreements where savings would be realized;
- Manage, and before February 9, 1990 liquidate, the Federal Asset Disposition Association; and
- Conduct all such operations in accordance with the special restrictions and objectives of the FIRREA as specified therein.

Source of Funds:

The RTC is funded from the following sources: 1) U.S. Treasury payments and borrowings; 2) amounts borrowed by REFCORP; 3) the issuance of debt obligations and guarantees as permitted by the Oversight Board; and 4) income earned on the assets of the RTC, proceeds from the sale of assets, and collections made on claims received by the RTC from receiverships, to the extent such amounts are needed for further resolution costs (as determined by the Oversight Board).

The Secretary of the Treasury has contributed capital of $18.8 billion to the RTC as of December 31, 1989. The RTC has also issued capital certificates of $5.7 billion to REFCORP as of December 31, 1989 (see Note 11). The RTC is also authorized to borrow from the Treasury an amount not to exceed in the aggregate $5.0 billion outstanding at any one time. As of December 31, 1989, the RTC had no borrowings outstanding.

Beginning in 1990, working capital will be made available to the RTC under an agreement between the RTC and the Federal Financing Bank. The working capital will be available to fund the resolution of thrifts operating as conservatorships and for use in the RTC's high-cost funds replacement and emergency liquidity programs. These borrowings, approved by the Oversight Board, are to be within the maximum obligation limitation.

Financial Statements:

The FIRREA transferred all of the assets and liabilities of the now defunct Federal Savings and Loan Insurance Corporation (FSLIC) to the FSLIC Resolution Fund (FRF), except for the $55.2 billion liability for estimated losses on unresolved cases, which became a liability of the RTC and resulted in RTC reporting an accumulated deficit at August 9, 1989 (inception) (see Notes 6 and 11).

The FIRREA requires that the assets, liabilities and equity of the RTC be maintained separately, and not be consolidated with any fund for accounting purposes. As mandated by FIRREA, RTC is managing seven receiverships that were effected by FSLIC after January 1, 1989 but prior to FIRREA. Activities of these entities are excluded from the financial statements of the RTC because FRF remains financially responsible for the losses associated with these resolution cases.

2. Summary of Significant Accounting Policies:

General. These statements do not include accountability for assets and liabilities of closed thrifts for which the RTC acts as receiver or liquidating agent.

Allowance for Loss on Subrogated Claims. The RTC records as assets the amounts advanced for assisting and closing thrifts. An allowance for loss is established against subrogated claims representing the difference between the amounts advanced and the expected repayment, based on the estimated cash recoveries from the assets of the assisted or failed thrift, net of all estimated liquidation costs.

Estimated Cost of Unresolved Cases. The RTC has recorded the estimated losses related to thrifts in conservatorship and those identified in the regulatory process as probable to fail.

Litigation Losses. The RTC recognizes an estimated loss for litigation against it in its Corporate, conservatorship and receivership capacities. The RTC's Legal Division recommends these estimated losses on a case-by-case basis.

Depreciation. The cost of furniture, fixtures, equipment, and other fixed assets is expensed at time of acquisition and reported in the administrative operating expenses. This policy is a departure from generally accepted accounting principles, however, the financial impact is not material to the RTC's financial statements.

Cash Equivalents. The RTC considers cash equivalents to be short-term, highly liquid investments with original maturities of three months or less. As of December 31, 1989, the RTC did not have any cash equivalents.

3. Advances and Loans (in thousands):

This line item includes both secured advances and loans made to conservatorships and receiverships by the RTC. The Corporation accrues interest on these advances and loans which is included in the Statement of Income and Accumulated Deficit. The Corporation expects repayment of these advances and loans before any subrogated claims are paid by receiverships.

	December 31, 1989
Secured advances from conservatorships	$ 10,077,033
Secured advances from receiverships	863,934
Loans to receiverships	105,601
Accrued Interest	230,912
	$ 11,277,480

4. Net Subrogated Claims (in thousands):

Subrogated claims from failures represent those disbursements made by the RTC for depositor liabilities. The Corporation recognizes an estimated loss on these subrogated claims.

	December 31, 1989
Subrogated claims	$ 9,028,383
Claims of depositors pending and unpaid	3,187
Allowance for Losses	(5,398,914)
	$ 3,632,656

5. Analysis of Change in Allowance for Loss from Receiverships (in thousands):

	Balance August 9, 1989 (Inception)	Provision for Losses	Transfers and Adjustments	Balance December 31, 1989
Due from Receiverships	$ -0-	$ -0-	$ 5,398,914	$ 5,398,914

Transfers and adjustments represent amounts transferred from the liability for the estimated cost of unresolved cases to the allowance for loss for subrogated claims as a result of case resolutions.

6. Analysis of Change in Estimated Cost of Unresolved Cases and Losses from Corporate Litigation (in thousands):

	Balance * August 9, 1989 (Inception)	Provision for Losses	Transfers and Adjustments	Balance December 31, 1989
Estimated cost of unresolved cases	$ 55,240,000	$ 44,827,914	$ (5,398,914)	$ 94,669,000
Estimated losses from corporate litigation	-0-	83,719	-0-	83,719
	$ 55,240,000	**$ 44,911,633**	**$ (5,398,914)**	**$ 94,752,719**

The estimated cost of unresolved cases includes amounts transferred to the allowance for loss for subrogated claims as a result of case resolutions.

* Transferred from FSLIC upon its dissolution as required by the FIRREA.

7. Other Assets:

The following are the components of other assets (in thousands):

	December 31, 1989
Reimbursements due from receiverships and conservatorships for operating expenses	$ 27,979
Miscellaneous assets	953
	$ 28,932

Reimbursements due from receiverships and conservatorships for operating expenses represent amounts paid by the RTC on behalf of the receiverships and conservatorships for which full repayment is expected.

8. Liabilities Incurred From Assistance and Failures:

The following are the major components from liabilities incurred from assistance and failures (in thousands):

	December 31, 1989
Pending claims of depositors	$ 3,187
Other	850
	$ 4,037

9. Estimated Cost of Unresolved Cases:

The RTC has established a liability of $94.7 billion for the future cost of resolving troubled thrifts already in conservatorship and those identified in the regulatory process as probable to fail. The liability recorded is the amount that is probable and can be reasonably estimated as of December 31, 1989. The liability for unresolved cases was estimated using RTC's cost test methodology. The estimate was based on the assumption that all unresolved cases would be resolved through a pay-out liquidation and that losses on net assets would occur at the same rate as losses experienced on actual resolutions. This estimated cost is based upon loss rates for resolutions completed through June 1, 1990. As of September 30, 1990, the liability for the estimated cost of unresolved cases totaled $67.6 billion.

In addition, there are other open institutions from which losses to the RTC are reasonably possible. The losses from those institutions may range as high as $18 billion.

10. Estimated Losses from Corporate Litigation:

As of December 31, 1989, the RTC has been named in numerous legal or administrative actions while serving in its Corporate, conservatorship or receivership capacities. Currently, it is not possible to predict the outcome for all of the various actions. A provision totalling $83.7 million has been made for those actions that management feels will result in a probable loss. It is management's opinion that the outcome for the remaining actions, while not determinable, will not result in liabilities to such an extent that they will materially affect the Corporation's financial position.

11. Changes in Equity:

Equity for the RTC is as follows (in thousands):

	Contributed Capital	Capital Certificates	Accumulated Deficit	Total Equity
Balance August 9, 1989 (Inception)	$ -0-	$ -0-	$ (55,240,000)	$ (55,240,000)
Net Loss	-0-	-0-	(44,687,739)	(44,687,739)
Treasury Payments	18,800,000	-0-	-0-	18,800,000
Issuance of Capital Certificates:				
09/22/89	-0-	1,200,000	-0-	1,200,000
10/30/89	-0-	4,508,757	-0-	4,508,757
Balance December 31, 1989	**$ 18,800,000**	**$ 5,708,757**	**$ (99,927,739)**	**$ (75,418,982)**

12. Pension Plan and Accrued Annual Leave

The FDIC eligible employees assigned to the RTC are covered by the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS). Matching employer contributions provided by the RTC for all eligible employees were approximately $676,000 for the period August 9, 1989 through December 31, 1989.

Although the RTC contributes a portion of pension benefits for eligible employees and makes the necessary payroll withholdings from them, the RTC does not account for the assets of either of these retirement funds and does not have actuarial data with respect to accumulated plan benefits or the unfunded liability relative to its eligible employees. These amounts are reported by the U.S. Office of Personnel Management (OPM) and are not allocated to the individual employers. OPM also accounts for all health and life insurance programs for retired eligible employees.

The RTC's liability to employees for accrued annual leave is approximately $2,352,000 at December 31, 1989.

13. Commitments and Guarantees:

Rental Expense:

The RTC is currently leasing office space to accommodate its staff. The RTC's lease agreements for office space are approximately $97,311,000. The minimum yearly rental expense for all locations is as follows (in thousands):

1990	1991	1992	1993	1994	1995/Thereafter
$ 9,216	$ 8,517	$ 8,532	$ 8,390	$ 8,414	$ 54,242

Guarantees of RTC:

Guarantees made by the FSLIC from January 1, 1989 through enactment of FIRREA became guarantees of RTC. There were three such guarantees made by FSLIC to the Federal Home Loan Banks (FHLBs) payable in the event an identified institution defaults on its loan payments to the FHLBs. These guarantees involved institutions which have already been placed into conservatorship. The total amount contingently payable is $121 million. However, no losses from these arrangements are anticipated by management.

14. Supplementary Information Relating to the Statement of Cash Flows (in thousands):

Reconciliation of net loss to net cash used by operating activities:

	For the Period August 9, 1989 (Inception) Through December 31, 1989
Net Loss:	$ (44,687,739)
Increase in accounts payable, accrued liabilities and other	7,950
Increase in other assets	(28,932)
Provision for losses	44,911,633
Disbursements for advances and loans	(11,046,568)
Disbursements for subrogated claims	(9,027,723)
Accrued interest from assistance and failures	(230,912)
Receipts from subrogated claims	190
Net cash used by operating activities	**$ (20,102,101)**

Schedule of non-cash transactions incurred from thrift assistance and failures (in thousands):

	For the Period August 9, 1989 (Inception) Through December 31, 1989
Increase (decrease) in subrogated claims from failures:	
Outstanding depositor claims paid	$ 850
Depositor claims unpaid	3,187
Transfer of allowance for loss	(5,398,914)
Decrease (increase) in liabilities incurred from assistance and failures:	
Outstanding depositor claims paid	(850)
Pending claims of depositors	(3,187)
Estimated cost of unresolved transfer	5,398,914
	$ -0-

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