United States General Accounting Office

GAO

Report to the Chairman, Resolution Trust Corporation Oversight Board

September 1991

RESOLUTION TRUST CORPORATION

Immediate Action Is Needed to Control Insurance Costs

GAO/GGD-91-119

GAO

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

145023

General Government Division

B-245145

September 20, 1991

The Honorable Nicholas F. Brady
Chairman
Resolution Trust Corporation Oversight Board

Dear Mr. Brady:

During our examination of the Resolution Trust Corporation's (RTC) contracting practices, we found indications that its thrifts and contractors were inefficiently managing insurance coverage. We also found that an overall lack of RTC guidance on insurance issues was resulting in inconsistent risk management practices among the thrifts. Because of these conditions, we expanded our work on insurance issues to include an assessment of RTC's insurance-related policies, procedures, and initiatives.

Background

RTC holds billions of dollars worth of properties having direct exposure to physical damage caused by fires, floods, storms, and other perils. In addition, RTC faces potential exposure to third-party liability for bodily harm or property damage occurring while members of the public live in, use, or have access to RTC-held properties. Since it began operating in 1989, RTC has generally relied on preconservatorship insurance policies taken out by its thrifts to pay for any losses or claims. However, due to thrift resolutions and asset sales, RTC's exposure to physical perils and third-party liability is continually changing, causing a need to monitor and revise the policies. Further, RTC's practice of having contractors manage and dispose of assets is another reason it needs to monitor and revise the policies. The standard asset management and disposition agreement (SAMDA) requires contractors to maintain existing insurance coverage and take out new policies when (1) old ones lapse, (2) properties are repossessed, or (3) borrowers stop paying for insurance on loan collateral properties.

Each thrift develops its own approach to insurance. The types of policies in force vary widely and reflect a range of limits and deductibles. Further, approaches taken to acquiring and managing coverage vary widely. Some of the larger thrifts set up insurance subsidiaries staffed with professional risk managers who evaluated coverages and negotiated directly with carriers for favorable rates. In contrast, smaller thrifts generally obtained coverage through insurance brokers and did not have professional risk managers on their staffs.

When thrifts become RTC conservatorships, they usually have insurance policies for directors' and officers' liability; general liability; errors and omissions; workers' compensation; environmental impairment; physical damage to property, boiler, and machinery; information systems; and other types of risk. In the case of property/casualty coverages, many thrifts have one policy for all real estate owned or repossessed from defaulting borrowers. These are known as "blanket policies" and may cover hundreds of properties.

After a thrift becomes an RTC conservatorship, its needs for insurance coverage often change as old risks cease to exist, and new ones arise. Many of the changes are caused by asset sales, acquisitions, and changes in thrift staffing. For example, professional liability coverage for staff who have left the thrift can be safely eliminated.

Since its inception in 1989, RTC has purchased insurance from commercial carriers to insure against the risk of loss to its thrifts. However, Tillinghast, the management consulting firm retained by RTC to assess its risk management practices, recommended in its May 1990 report that RTC adopt a program of self-insurance. As a result, RTC has been considering an alternative approach of "risk retention" or self-insurance. Under a self-insurance program, RTC would cancel some or all of its insurance policies with outside carriers. If an RTC thrift incurs a loss, RTC would pay directly with funds set aside in a loss reserve.

In addition to its principal recommendation on a long-term approach to insurance coverage, Tillinghast recommended that RTC take interim steps to achieve consistency in insurance practices, avoid unnecessary premium expenses, and obtain refunds of premiums on canceled policies. To ensure consistency, it specifically recommended establishing standards for liability coverage limits, deductibles, and policy terms and conditions.

We have endorsed self-insurance programs in the past because our audit work has shown that the cost of actual losses incurred would likely be less than premiums charged by outside insurance carriers under conditions found at other agencies. Tillinghast also relied on this assumption when it made its primary recommendation and estimated RTC could save about $240 million over a 6-year period simply by implementing a self-insurance program. The savings would come from eliminating that part of premium payments charged for carriers' sales costs and profits.

Results in Brief

Although RTC has made some progress on a plan for self-insuring its real estate holdings and minimizing exposure to third-party liability, more could be done to control the cost of insurance premiums. RTC focused primarily on hiring contractors to assess its insurance needs and develop a program based on the concept of self-insurance. However, these processes have consumed more than a year—far more time than RTC's managers or Tillinghast thought it would take to get a long-term program started—and are still incomplete.

RTC missed opportunities to save on insurance costs as a result of delays in getting the self-insurance program started. For example, had RTC raised its insurance deductibles to $100,000 as an interim measure after the Tillinghast report was received in January 1991, it could have reduced its insurance costs. We estimate that between February and August 1991, when RTC implemented its policy to self-insure all properties valued at $300,000 or less, RTC could have saved about $10.5 million on insurance premiums. We believe it could have also saved an undetermined amount had it made greater use of blanket policies and canceled policies it no longer needed.

Objectives, Scope, and Methodology

The objectives of our review were to (1) identify actions RTC was taking to control insurance costs and (2) estimate amounts spent on inefficient and unneeded policies.

We gathered data on insurance policies in effect at 10 conservatorships and receiverships in RTC's Western Region in Denver to determine whether there were any unneeded policies and to review deductible levels.[1] We also obtained written guidance issued by headquarters and regional management to RTC's other offices, thrifts, and outside contractors to document any efforts made to control premium costs.[2] Finally, we reviewed a study on insurance issues commissioned by RTC to assist it in developing a risk management policy.

We obtained information on insurance policies and initiatives through discussions with RTC officials. They also provided opinions on RTC's risk environment and ways to control insurance costs. We also interviewed staff responsible for implementing national insurance directives in RTC's Western Region and its consolidated offices in California and Arizona.

[1]We gathered data in the Western Region because we were already doing work in that region.

[2]We did not attempt to determine potential dollar savings for each thrift and contractor.

These officials gave us information on guidance provided to thrifts and contractors and on staff responsible for insurance coverages.

We discussed with managers in charge of 10 Western Region conservatorships and receiverships the adequacy of RTC's guidance on insurance matters. We also interviewed four risk management specialists who provided insurance services to three large thrifts in Arizona. These specialists analyzed policies in force at their thrifts and gave us estimates of potential savings from increased deductibles and expanded use of blanket policies. Their analyses formed the basis for our conclusions about the magnitude of inefficient coverages.

Finally, we discussed insurance issues with two SAMDA contractors (located in California and Colorado) responsible for portfolios of loans to determine how they ensured that proper coverage was in effect on loan collateral and repossessed properties and to obtain their opinions on the adequacy of RTC's guidance on insurance matters.

We did our work from February through August 1991 in accordance with generally accepted government auditing standards.

RTC Has Moved Slowly on Its Self-Insurance Program

Tillinghast concluded that RTC could implement interim insurance measures and put a program of self-insurance in place by January 1991. However, RTC did little to address the interim recommendations and has not yet implemented the self-insurance program. Because RTC and its contractor must still complete several steps to achieve implementation, we believe a number of months could easily pass before RTC has a self-insurance program.

In August 1990, RTC issued an interim risk management policy to its regions. The policy was general in nature, essentially requiring that RTC thrifts should maintain several types of insurance policies previously in force and that regions should seek consistency in practices involving deductible levels and policy terms and conditions. No specific guidance was offered regarding cancellation of unneeded policies. Also, no steps were taken to monitor the practices of thrifts and contractors to ensure that it was being implemented consistently throughout RTC.

In October 1990, RTC hired a risk management professional in its headquarters office to manage implementation of a self-insurance program. Since that time, RTC's efforts have been directed at hiring a contractor to implement such a program. Few additional efforts were made to implement an interim program to control premium costs paid to carriers by thrifts and contractors.

In April 1991, the RTC board of directors met to discuss insurance issues. The board voted to move in the direction of self-insurance by establishing a policy of discontinuing property/casualty coverage on parcels of real estate valued below $300,000. This action, or policy of limited self-insurance, effectively established a standard for a $300,000 deductible level on RTC-held properties. RTC issued a directive implementing this policy in August 1991.

At its April 1991 meeting, the board also proposed setting up a self-insurance program with a loss reserve funded by RTC, rather than the thrifts. The purpose of this approach was to simplify the program's design and reduce the burden of administration. For example, analyses would no longer be required of insurance risks at the individual thrift level.

In response to the board's self-insurance proposal, RTC modified its solicitation for risk management services to reflect the board's proposals, selected a contractor, and initiated an investigation into the contractor's background. As of August 1991, however, the contract had not been finalized. Once an agreement is in place, the contractor will begin work on a plan for administering claims under the self-insurance program.

RTC officials stated they also need to resolve legal issues surrounding RTC's fiduciary responsibilities to creditors of the thrifts raised by the concept of self-insurance, present a case to RTC's board for the program, and obtain final approval for implementation. The earliest the board can hear the case will likely be October or November 1991.

Interim Steps Would Have Helped Reduce the Cost of Insurance Coverage

Because RTC has not aggressively managed its insurance program, premium costs incurred by its thrifts and contractors have been substantially higher than necessary. During the time RTC's staff worked on hiring a contractor to develop and implement a self-insurance program, inefficient insurance practices occurred in RTC field offices. Extra premiums were paid because RTC did not (1) actively promote the development and use of large blanket policies by all of its thrifts and contractors, (2) establish a standard for deductible levels on property/casualty policies, and (3) systematically identify and cancel unneeded policies.

Blanket Policies Could Have Reduced Premium Rates

We estimate that RTC also could have saved considerable dollars in premiums last year by expanding the scope of blanket policies in force at some of its large thrifts and by requiring contractors now acquiring individual policies to use blanket policies to insure collateral. Our work showed that little action was taken to obtain lower premium rates through large blanket policies. Because rates on these policies are lower than rates for smaller blanket policies and policies on individual assets, and because RTC now has about $11.8 billion in assets requiring property/casualty insurance, the stakes in terms of excess insurance costs are high.

In our audit work, we found that some contractors obtained property/casualty coverage on individual properties because RTC did not develop and actively promote the use of blanket policies. We also learned that RTC is taking some properties out of existing blanket policies when they are placed with a contractor. Risk management specialists familiar with RTC properties estimated premium costs for policies on individual assets could cost from 2 to 5 times as much as blanket policy coverage.

Recognizing the opportunity to reduce premium rates paid by its thrifts and contractors, staff in one of RTC's regions developed a proposal for a regionwide property/casualty blanket policy for repossessed real estate. However, RTC regional management rejected the proposal because they had been told that a self-insurance program would soon be implemented. They believed that, after implementation, all such policies would have to be canceled.

RTC headquarters officials told us that they neither encouraged nor discouraged regional efforts to obtain blanket policies. However, they cautioned the regions to avoid entering into agreements having cancellation penalties because of the forthcoming self-insurance program and to adhere to RTC contracting policies and procedures when they obtain insurance coverages. They also told us that some locations had done more to consolidate insurance under blanket policies than the Western Region offices.

Higher Deductibles Also Would Have Reduced Premium Rates

RTC also spent about $10.5 million in extra premiums in the past 6 months for property/casualty insurance on its real estate holdings because it did not (1) establish a standard for deductibles and (2) make reasonable adjustments to the terms of some insurance policies. Our analysis of policies in force at several large conservatorships and receiverships showed that RTC could have obtained premium rate reductions of over 50 percent by using the Federal Deposit Insurance Corporation's (FDIC) standard of a $100,000 deductible per property. Deductibles on the policies we reviewed generally ranged from $250 to $5,000 per loss occurrence. The highest deductible we found among these policies was $25,000.

Risk management specialists in the field we spoke to estimated that RTC could have reduced property/casualty premium rates from an average of about 32 cents to about 14 cents per $100 of book value by using FDIC's standard of a $100,000 deductible. Applying this rate difference to the $11.8 billion in properties held by RTC in February 1991, we estimated that RTC paid extra premiums of as much as $10.5 million in the past 6 months for this type of coverage alone. However, RTC's gains in premium savings would have been offset by losses under $100,000 on some of its properties.

RTC's August 1991 policy of limited self-insurance, if effectively implemented, should also result in significant premium savings. Because RTC will be self-insuring properties with values less than $300,000, these savings will exceed those previously estimated from implementing a $100,000 deductible.

Some Unneeded Policies Not Identified and Canceled

RTC did not systematically gather information on insurance policies in force at its thrifts or hire staff with sufficient training and experience to identify unneeded policies. As a result, RTC paid additional premiums for unneeded policies and did not obtain refunds due from the cancellations.

RTC did not gather basic information on insurance policies—such as policy types, limits, and deductibles in force—needed to identify areas of potential cost savings. Further, RTC's thrifts sometimes did not give brokers and specialists managing insurance policies access to current, accurate information on assets requiring coverage. Our review of policies in force at five thrifts revealed policies that may have been unneeded in every case.[3]

Even if basic information on insurance policies had been gathered, RTC did not hire staff with professional risk management training and experience in its field offices who could review policies and identify unneeded ones. Instead, RTC tasked several of its existing staff working in regional and consolidated office asset departments with insurance

[3]Some of these were large thrifts with professional risk managers.

duties. RTC still has no plans to hire professional risk management specialists because it will need a different set of skills—claims administration rather than risk management—once a self-insurance program is in place.

Conclusions

RTC has taken steps to assess its overall condition in relation to insurance, develop a long-term insurance plan, and hire contractors with risk management expertise. However, it needs to move forward as quickly as possible to resolve the open issues and seek final approval from the RTC board of directors to implement the self-insurance program. Further, if RTC decides that it is in the government's best interests to retain certain types of coverage, it should act quickly to set standards for coverage limits, deductibles, and policy terms and conditions for those types of coverage.

RTC admittedly missed opportunities for potential savings due to the course it elected to pursue. We estimate that about $10.5 million in additional premiums were paid in the last 6 months by not raising policy deductibles to at least $100,000. It also missed opportunities to reduce its insurance costs by an undetermined amount because it did not monitor the implementation of its August 1990 interim risk management policy to ensure that thrifts were achieving consistency in deductibles and other policy terms and conditions and taking other steps to reduce insurance premium rates. To prevent incurring additional excess insurance costs, RTC should take steps to ensure that the August 1991 policy of limited self-insurance and the forthcoming long-term self-insurance program are effectively implemented at all locations.

Recommendations

We recommend that RTC's Oversight Board direct RTC to move aggressively to finalize the implementation plans for the self-insurance program and present them to the RTC board of directors as soon as possible. If the plans call for continuing some types of private insurance, we also recommend that the Oversight Board require RTC to (1) set standards for liability coverage limits, deductibles, and policy terms and conditions for those types of coverages and (2) develop the information systems needed to effectively manage those policies.

Further, we recommend that the Oversight Board ensure that RTC has procedures in place to monitor the implementation of both the interim policies issued in August 1990 and August 1991 and the long-term self-insurance program when it is finalized. We also recommend that RTC review practices to ensure consistency throughout the Corporation.

RTC Comments

We discussed a draft of this report with RTC headquarters officials and they provided us a letter summarizing their comments. (See app. I.) We considered RTC's comments in finalizing our conclusions and recommendations. RTC officials acknowledged that they could have realized savings earlier had they been able to implement self-insurance sooner. However, they asserted that they relied completely on and strictly adhered to advice received from Tillinghast, RTC's insurance consulting firm, when they made decisions on a course of action on insurance matters. Further, had RTC foreseen the lengthy period of time required to develop a self-insurance program, they acknowledged that different decisions probably would have been made regarding management of insurance matters. We made certain revisions to the draft based on the additional information RTC officials provided. RTC concurred with the recommendations and agreed to implement them.

We will provide copies of this report to interested congressional committees, agencies, and the public.

This report was prepared under the direction of Gaston Gianni, Associate Director, Federal Management Issues. Other major contributors are listed in appendix II. Please contact me at (202) 275-8387 if you have any questions concerning this report.

Sincerely yours,

J. William Gadsby
Director, Federal
Management Issues

Comments From the Resolution Trust Corporation

Resolution Trust Corporation

September 13, 1991

Mr. J. William Gadsby
Director, Federal Management Issues
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Gadsby:

Thank you for the opportunity to review and provide you with comments on the draft report entitled Immediate Action is Needed to Control Insurance Costs. We have considered its contents and agree with most of your recommendations; however, we do not agree with the accuracy of a number of the statements and conclusions presented in the report. Accordingly, I am providing you with the following comments for your consideration prior to the issuance of the final report.

1. The RTC should "move aggressively to finalize the implementation plans for the self-insurance program and present them to the Oversight Board as soon as possible". We agree that implementation plans for the self-insurance program should be finalized as soon as possible. In furtherance of that goal, we have modified the Risk Management Consulting contract to reflect the direction received from the RTC Board. We have awarded the contract, and the final report from Phase I will be delivered by the end of September. At that time we will return to the RTC Board of Directors for approval.

2. "If the plans call for continuing some types of private insurance, we recommend that ...RTC...set standards for liability coverage limits, deductibles, and policy terms and conditions for those types of coverages". We agree that standards should be set if some types of insurance are necessary. We have included a requirement in our Consultant's scope of work to perform an analysis of insurance needed and a recommendation of the amounts and terms of the coverage. Based upon their recommendation, RTC will establish standards for the purchase of insurance.

801 17th Street, NW ■ Washington, DC 20434-0001

Mr. Gadsby
Page 2

September 13, 1991

3. The RTC should "develop the information systems needed to effectively manage those policies". The RTC has made significant progress to date in the design and implementation of a risk management information system. We have prioritized the development of an insurance policy subsystem in our Real Estate Owned Management System (REOMS), and will include an insurance module in the next REOMS system release. Given this progress, a more accurate recommendation would be that the RTC "continue its efforts in the development of..."

4. The RTC should have "procedures in place to monitor the implementation of both the interim policies issued in August 1990 and August 1991 and the long-term self-insurance program when it is finalized." We agree that procedures should be in place to monitor implementation of the interim policies. For some time now, RTC has been conducting "Program Compliance Reviews" in each Consolidated Office. These reviews include a section on insurance which we updated after the August 1991 Directive was issued. This has proven to be an effective way of monitoring the implementation of policies and we intend to continue this approach.

5. The RTC should "review practices to ensure consistency throughout the Corporation". We agree that consistency is beneficial in many areas. The Consultant's recommendation concerning consistency among insurance contracts was incorporated into the 8/8/90 directive. Subsequently, field office insurance personnel spent a day of insurance training that covered extensively the interim policy recommended by the Consultant. RTC has continued to work towards consistency of policy provisions and has recently issued an additional directive establishing a standard for retained risk and formalized loss handling procedures. Consistency, although desirable, must be balanced against the RTC's fiduciary responsibility to the creditors of each institution. RTC Legal has studied this question, and has concluded that it is not clear whether RTC may impose across-the-board standards of this type.

With respect to the report's conclusions, the first one stated is RTC should "move forward as quickly as possible to resolve the open legal issues regarding its fiduciary responsibilities to creditors of the thrifts and seek final approval...to implement the self-insurance program". In fact, the legal issues can not be resolved by RTC, but can only be resolved by the judicial system. The unresolved legal issues have not hampered our ability to implement our self-insurance program. We have steadily worked towards the self-insurance objective and will soon be in a position to obtain RTC Board of Directors approval.

Mr. Gadsby
Page 3

September 13, 1991

The report further states that "RTC officials acknowledged that much waste has occurred because of delays in implementing the self-insurance program and additional premiums paid for inefficient coverages". We never "acknowledged" to the GAO, that "inefficient coverages" have resulted in "much waste". Certainly, had we been able to implement self-insurance earlier, we would have achieved the savings from it earlier. Our comments on each of the three categories of inefficiencies suggested are as follows:

1. "Blanket Policies Could Have Reduced Premium Rates. We estimate that RTC could have saved millions of dollars...by expanding the scope of blanket policies in force at some of its large thrifts...". RTC has already consolidated a large number of its assets into blanket policies. GAO's estimate of reduced premiums from blanket policies was based upon a study of only 10 institutions in one Region and is misleading. The Region sampled has done the least amount of consolidation into blanket policies. By comparison, the Kansas City Consolidated Office solicited and awarded a single blanket policy for all of its assets.

2. "Higher Deductibles Also Would Have Reduced Premium Rates. RTC also spent millions of dollars in extra premiums...because it did not...establish a standard for deductibles". This statement is misleading because it fails to offset premium savings with the costs of additional losses falling within the higher deductible. The report acknowledges these offsets, but does not apply them to the calculations to reduce the projected savings. Furthermore, the report fails to take into consideration that higher deductibles will reduce asset values for institutions that experience significant losses. As a consequence, RTC could be liable for higher claims from creditors, further eroding savings from premium reduction.

   Nevertheless, RTC does agree that some savings will result from higher deductibles. RTC staff has evaluated the legal implications of higher deductibles and has requested and obtained approval from the RTC Board to self-insure up to $300,000. A directive to this effect has been issued to RTC Field Offices. GAO acknowledges that RTC has taken this cost saving action, but does not describe the necessary actions that prevented earlier implementation.

3. "Some Unneeded Policies Not Identified and Canceled. RTC paid additional premiums for unneeded policies...RTC did not gather basic information on insurance policies...needed to identify areas of potential cost savings...Even if basic information on insurance policies had been gathered, RTC did not hire staff with professional risk management training

Mr. Gadsby
Page 4

September 13, 1991

and experience in its field offices who could review policies and identify unneeded ones...RTC still has no plans to hire professional risk management specialists". A recommendation for staffing will be part of the Risk Management Consultant's report and will serve as the basis for establishing risk management positions in RTC Field Offices. It is true that analyzing every policy would be a major undertaking requiring a staff of experienced insurance specialists. The RTC self insurance program, however, will not involve numerous insurance policies and will not require insurance policy experience.

To summarize, the report endorses the decision taken by RTC to establish a self insurance program and recommends that RTC continue developing it. However, the report includes an inaccurate estimate of "millions of extra dollars on inefficient or unneeded insurance policies". This estimate is based upon a very limited sampling of RTC operations which is not representative and does not reflect additional costs (in loss costs and payroll expenses) necessary to achieve savings in premiums. Furthermore, the report's conclusions do not consider the limitations on RTC action imposed by its fiduciary responsibilities.

We hope that cost-saving steps that RTC has already taken and a more accurate estimate of potential savings from further modifications to existing insurance policies will be incorporated into the final report. If further discussions are warranted concerning our comments, we would be delighted to meet at your earliest convenience.

Sincerely,

David C. Cooke
Executive Director

Major Contributors to This Report

General Government Division, Washington, D.C.

Ronald L. King, Assistant Director, Federal Management Issues
Tammy R. Conquest, Evaluator

Denver Regional Office

Lowell E. Hegg, Regional Assignment Manager
Peggy A. Stott, Evaluator-in-Charge

Ordering Information

The first copy of each GAO report is free. Additional copies are $2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20877

Orders may also be placed by calling (202) 275-6241.

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

Official Business
Penalty for Private Use $300

First-Class Mail
Postage & Fees Paid
GAO
Permit No. G100