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Report to Congressional Requesters

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FAILED THRIFTS

No Compelling Evidence of a Need for the Federal Asset Disposition Association

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

The Honorable James J. Florio
Chairman, Subcommittee on Commerce,
Consumer Protection, and Competitiveness
Committee on Energy and Commerce
House of Representatives

This report responds to your May 1988 request for our assessment of the Federal Savings and Loan Insurance Corporation's (FSLIC)[1] continuing need for the Federal Asset Disposition Association (FADA).

Background

In 1985, the Federal Home Loan Bank Board (FHLBB) created FADA as a wholly owned FSLIC entity to assist FSLIC in the management and disposition of acquired assets.[2] FADA's sole purpose, according to its mission statement, is "to help strengthen the financial health of FSLIC by using private sector management and marketing techniques to manage problem assets held by FSLIC at the lowest cost consistent with sound operations and to sell those assets as fast as is consistent with obtaining the best possible return."

FADA provides asset management and disposition services to FSLIC in three ways. First, under contracts with some of FSLIC's liquidating receiverships, it provides asset management and disposition services. As of June 30, 1988, FADA was managing $3.9 billion in noncash assets for 38 of 80 FSLIC liquidating receiverships. Second, under contracts with thrifts in FSLIC's Management Consignment Program,[3] it also provides asset management services. As of June 30, 1988, FADA had one contract to manage $326 million in assets for a thrift in this program. Third,

[1]As used in this report, FSLIC refers both to corporate FSLIC, the insurer of thrift institutions, which sometimes acquires assets through assistance and other transactions involving institutions it insures, and also to FSLIC in its fiduciary capacity, which must manage and dispose of assets when appointed receiver for closed thrifts.

[2]FHLBB chartered FADA as a federal savings and loan association on November 1, 1985, pursuant to section 406 of the National Housing Act.

[3]This is an interim approach FHLBB is using to gain control of selected failing institutions by replacing deficient management and directors, taking appropriate steps to stabilize the institution, and actively managing the problem areas within an institution.

under contracts directly with corporate FSLIC, FADA provides specified services related to the liquidation process. (For example, FADA is developing a national marketing plan for certain types of assets.) As of June 30, 1988, FADA was providing services under four corporate FSLIC contracts with a total value of approximately $455,000.

Some Members of Congress have questioned the appropriateness of FADA, and legislation to revoke its charter was passed by the House Committee on Banking, Finance and Urban Affairs in October 1988.

Approach

We looked at both the legality of FHLBB's creation of FADA and FSLIC's current need for FADA. To address the legality issue, we considered whether FHLBB's actions, and their effects, conform with the provisions and intent of relevant laws. We (1) examined FADA's charter and other pertinent documents, (2) conferred with FHLBB and FSLIC officials regarding the means and circumstances of FADA's creation, and (3) analyzed provisions of applicable laws.

We considered whether compelling evidence exists that FADA is essential to FSLIC. In looking for such evidence, we (1) had discussions with current and former key officials of FADA, FHLBB, and FSLIC and with the managing officers of seven FSLIC receiverships that have contracted for FADA services; (2) reviewed FADA's handling of 20 selected assets from six FSLIC receiverships; (3) compared the education, experience, and other qualifications of FADA employees who were handling assets under FADA contracts with six FSLIC receiverships with the qualifications of similar employees of six FSLIC receiverships; and (4) reviewed FSLIC reports of FADA's and other contractors' performance in handling receivership assets. From our discussions with these officials and from our review of documents and employees' qualifications, we determined (1) the reasons for FADA's creation, (2) the services FSLIC currently relies on FADA to provide, and (3) FSLIC's alternatives for obtaining the services. We also sought indications of the quality of the approaches FSLIC currently uses to manage assets. (See app. I for a more complete description of our scope and methodology.)

Results in Brief

We found that FADA was illegally established as a federally chartered savings and loan association. Furthermore, we found no compelling evidence that FADA is essential to FSLIC's management and disposition of acquired assets.

FSLIC's combined use of (1) other private sector asset management firms, (2) federal employees in FSLIC headquarters and regions, and (3) employees in FSLIC's receiverships who are handling assets[4] could be increased to provide the services now done under contracts with FADA.

Legality of FADA's Creation

As part of a separate assignment,[5] we reviewed the legality of FHLBB's actions in establishing and placing certain of its functions in entities, including FADA, that consider themselves not subject to the salary limitations for federal employees in title 5 of the United States Code. In a legal opinion issued on September 6, 1988,[6] we concluded that FHLBB had acted improperly in creating FADA and that FADA employees should be regarded as federal employees.

While FADA was chartered as a federal savings and loan association, it does not do any of the basic functions of such an association. Instead, it is wholly owned and controlled by FHLBB and FSLIC, and its sole purpose is to assist FSLIC in carrying out its asset management and disposition functions.

Reasons for FADA's Creation

Before 1983, the total number of insured thrift institutions liquidated by FSLIC throughout its entire 50-year history was only 15. That number was matched in the following 2-year span as FSLIC was appointed receiver to liquidate an additional six thrifts in 1983 and an additional nine thrifts in 1984.

The dollar value of assets in FSLIC's inventory increased over 10-fold, from $267 million as of September 30, 1983, to over $3 billion as of September 30, 1985. Also, the complexity of the acquired assets increased.[7] The number of FSLIC federal employees responsible for dealing with these assets, however, rose from 8 to 23 during the same time period.

[4]Whether such employees should be federal employees or can properly be nonfederal has yet to be resolved.

[5]The legality of FADA's creation was reviewed as part of an assignment undertaken for the Subcommittee on Federal Services, Post Office, and Civil Service of the Senate Committee on Governmental Affairs.

[6]Comptroller General Opinion (B-226708, Sept. 6, 1988).

[7]The Garn-St Germain Depository Institutions Act of 1982, enacted on October 15, 1982, permitted federal savings and loan associations to engage in some activities, such as commercial lending and equipment leasing, from which they were previously prohibited.

It was clear to FSLIC officials in 1985 that FSLIC needed to expand its capability, both in terms of the number of people and the amount of specialized expertise, to manage and dispose of a rapidly increasing inventory of assets. FSLIC officials said they had sought to obtain needed personnel and expertise by (1) increasing the number and expertise of FSLIC federal employees, (2) using temporary nonfederal receivership employees, and (3) contracting with private sector firms. Current and former FSLIC officials said those approaches were not fully successful in providing FSLIC with the needed people and expertise. They cited Office of Management and Budget (OMB) restrictions on the number of federal employees, the Office of Personnel Management's (OPM) position that FSLIC employees are federal employees subject to federal pay rates, and other constraints. (See app. II.)

In July 1985, the Federal Savings and Loan Advisory Council, citing concern with the capacity of FSLIC to manage and liquidate its portfolio of receivership assets, recommended that FHLBB immediately study establishing an entity to manage and liquidate FSLIC's asset portfolio.[8] On October 2, 1985, FHLBB announced receipt of a formal application from a 15-member organizing group composed primarily of financial industry executives to charter a federal savings and loan association under section 406 of the National Housing Act to liquidate assets. In the press release, the FHLBB Chairman said that FHLBB welcomed the application. On November 1, 1985, FADA was chartered. (See app. II for details on the creation of FADA.)

The head of FSLIC, its Executive Director, emphasized to us that FADA currently serves two main functions. The primary function is to act as an interface between FHLBB and the savings and loan industry, which is greatly affected by the way FSLIC handles its large inventory of acquired assets. He explained that through FADA's Board of Directors—which is composed of 3 ex officio directors and 11 voting directors from the thrift industry—the industry can have direct knowledge of and input to the asset liquidation process. We note that FADA's charter and mission statement do not indicate that FADA is meant to serve an interface function.

The other main function served by FADA, he said, is to provide a vehicle to FSLIC for cost-effective asset management and disposition. He told us that FADA was intended to manage and dispose of some assets itself in a

[8]Congress established the Federal Savings and Loan Advisory Council in 1935 to provide FHLBB with discussion and advice on major questions facing the industry.

cost-effective manner and also, by its mere existence as an alternative source of asset services, to enhance FSLIC's ability to negotiate least-cost contracts with other private sector asset management firms. He added, however, that the latter function was not fulfilled during FADA's first 2 years of existence because the FADA contracts did not contain sufficient cost control mechanisms.[9]

Alternatives to FADA

FSLIC used corporate employees, receivership employees, and private sector firms to help manage and dispose of assets before the creation of FADA and continues to use all of these resources.

FSLIC Employees

FSLIC corporate employees, who are federal employees, are responsible for selecting assets from closed thrifts for assignment to FADA, other private sector contractors, and receiverships; for approving their plans for management and disposal of the assets; and for monitoring their performance. In addition, FSLIC in its corporate capacity directly manages and liquidates noncash assets acquired, under certain circumstances, from thrifts. As of July 31, 1988, the total was about $167 million, most of which was real estate. The management of these assets is controlled within FSLIC's Operations and Liquidation Division.

Receivership Staff

FSLIC liquidating receivership staff directly manage receivership assets that are not assigned to FADA or other private sector contractors, and receivership managing officers monitor the management of all receivership assets. As of July 31, 1988, some 84 FSLIC receiverships employed 940 full-time, temporary, nonfederal employees, of which approximately 196 were handling acquired assets. Although the FHLBB's Deputy General Counsel for FSLIC said that the only external constraint on receivership hiring, in terms of both number of positions and salary levels, is the mandate that FSLIC act in a manner that is consistent with its fiduciary responsibilities, concerns over the legality of the use of nonfederal employees remain. (See p. 16.)

[9]From its first assignment of receivership assets on July 18, 1986, through December 31, 1987, FADA contracts with receiverships provided for compensation in the form of a management fee. In addition, those contracts with receiverships allowed FADA to be reimbursed—without limitation—for all payments to parties that it subcontracted with for asset services. (FADA, in fact, contracted with third parties in the private sector for much of the asset management and disposition services it provided to FSLIC.) These contracts lacked both a cost control mechanism and incentives for FADA to dispose of assets as quickly as possible. The provisions in the current contracts provide for fees that include a disposition fee as well as a management fee and set limitations on reimbursement for subcontracts. (For a more detailed discussion of the contract changes, see app. IV.)

Private Sector Contracts

FSLIC also has had contracts with private sector firms for asset management and disposition services for at least 4 years. At the time FADA was created, FSLIC had contracts with at least five firms that were handling assets with a total value of over $1.1 billion. On June 30, 1988, nine FSLIC liquidating receiverships had contracts with six private sector firms, which were together managing $681.7 million in assets. FSLIC continues to use the asset management services of private firms. In fact, FSLIC's Executive Director recently said that FSLIC is increasing its use of such firms.

We did not examine the present availability and unused capacity of private sector asset management firms. However, in a survey of "firms in the troubled asset management industry," a major accounting firm under contract to FSLIC contacted 135 companies, and reported to FSLIC on January 19, 1988, that 29 of those companies provided information on fees they would charge for providing asset services. In addition, FSLIC officials have said that they receive almost daily inquiries from private sector asset management firms seeking contracts with FSLIC. They also said that private sector firms either currently have, or could quickly develop, sufficient capacity to manage FSLIC's asset portfolio.

Quality of the Alternatives

The following sections discuss information relating to the quality of the performance of the present resources used by FSLIC to help manage and dispose of assets.

FADA

For an indication of FADA's effectiveness in managing and disposing of assets, we relied on three sources: (1) contractor effectiveness reviews completed by FSLIC; (2) testimonial evidence from FSLIC, receivership, and FADA officials; and (3) our own review of FADA's handling of selected assets.

The FSLIC unit that oversees receivership operations had completed 12 performance evaluations of asset management contracts as of June 30, 1988. Each evaluation focused on a contractor's compliance with contract provisions and its performance in the execution of its duties under the contract. Four of the 12 evaluations were of FADA's performance on asset management contracts with FSLIC liquidating receiverships. The other eight involved the performance of other private sector asset management firms.

The four evaluations of FADA's performance focused partly on the asset business plans submitted by FADA to FSLIC for the required approval. These plans contain information describing the acquired asset, its proposed management, and a recommended disposition strategy. All four evaluations found that FADA's plans were not submitted to FSLIC on time. The plans submitted under two of the contracts were criticized as being insufficiently comprehensive or thorough, and under one contract, FADA was reported to have taken actions that did not conform to those specified in approved business plans. Other deficiencies of FADA's performance were also reported. The evaluation report on one contract recommended that the contract be terminated.

We did not validate the findings of these evaluations, and we recognize that their results may not be projectable to FADA's performance under its other 34 contracts with FSLIC receiverships. Furthermore, we have seen indications that a certain amount of tension has existed between some FSLIC employees and FADA. We realize that this tension could create a negative bias regarding any assessment of FADA's performance by FSLIC employees. In our review of FADA's handling of 20 assets (see p. 15), however, we found that for 13 of the 20 assets, FADA's business plans were not submitted within the required 90-day time frame. They were from 2 to 15 months late.

The testimonial evidence we gathered regarding FADA's overall asset management performance is conflicting and inconclusive. Some FSLIC officials spoke highly of FADA's performance while others were critical of it. Some found fault with FADA's early performance but believed that its performance has improved. Still other FSLIC officials said that FADA's performance has varied from contract to contract and from FADA region to region. The managing officers of some receiverships that have contracts with FADA said that FADA manages some assets well but that it should not be managing certain assets that were assigned to it because they do not involve legal issues or require sophisticated technical expertise. These managing officers said they believe receivership employees were capable of handling these assets. In fact, the managing officers of at least two receiverships have requested, in writing, FSLIC's permission to withdraw specified assets from FADA for this reason.

To gain a first-hand perspective on the extent and effects of FADA's asset services, we reviewed FADA's handling of 20 FSLIC assets in two of FADA's five regions. We found that for some assets, the sales price obtained by FADA exceeded the appraised value, while for other assets it did not.

Private Sector Firms

In our review of the eight non-FADA contract performance evaluations, we found that four of the contracts contained almost no criticism of the performance of the private sector firms. Reports on the other four contracts contained some criticism for deficiencies that were similar to those noted in the evaluations of FADA's performance (see pp. 6 and 7). However, none of the eight reports concluded that FSLIC should terminate the existing contractor and assign the assets to another entity.

The testimonial evidence we gathered regarding the performance of these firms was inconclusive, as was the case with FADA. FSLIC officials, while citing little specific criticism, said performance varied from contractor to contractor.

We also note that four of the six non-FADA firms currently providing asset management services to FSLIC are doing so under contracts which contain terms identical to those in FADA's contract. The asset management and disposition fee rates for those four firms are thus no more and no less than the fee rates for FADA.

FSLIC Receiverships

To help determine if FSLIC liquidating receiverships have employees as capable as FADA employees of providing effective asset management services, we compared their qualifications, as listed on their job applications. We compared the 26 employees of 6 FSLIC receiverships in Texas and California who had the title of asset manager, senior asset manager, assistant managing officer, or managing officer with the 42 employees in FADA's Dallas and Los Angeles regions who were managing assets for 6 FSLIC receiverships and who had the title of asset manager, senior asset manager, or portfolio manager. (Our methodology is described in app. I.)

Overall, we found the two groups had similar qualifications. A slightly higher percentage of FADA employees had advanced education degrees (40 percent to 31 percent) and, on average, FADA employees had more years of work experience in the real estate field (6.3 years to 3.5 years). However, receivership employees led FADA employees in the attainment of professional certifications (for receiverships, 62 percent had at least one certification, while 50 percent of FADA employees had at least one). In addition, the percentage of employees with loan workout and restructuring experience was about the same for receivership employees and FADA employees. It is noteworthy that the receivership employees in our sample received lower salaries on average than did the FADA employees. (The tabular results of our comparison are shown in app. III.)

To obtain an indication of the cost of using the receivership structure for services now provided by FADA, we asked the managing officers of five FSLIC receiverships to develop estimates of the additional costs they would have incurred during a recent 5-month period if they had had direct management responsibility for assets assigned to FADA. The estimates provided by the managing officers were all lower—considerably lower—than the FADA fees billed during the period and also lower than costs incurred by FADA during the period. We did not validate the managing officers' estimates. However, we cannot disagree with a statement made by one managing officer. He pointed out that if his receivership employed the same FADA employees who had worked on that receivership's assets during the subject period and paid them at their current FADA salaries, it would be less expensive than contracting with FADA, because of FADA's additional "overhead" costs.

FSLIC's Effectiveness Study

FSLIC has made its own internal study of the effectiveness of some of its sources of asset management services. The principal objective of the project was to evaluate, for the 1984 through 1988 period, the relative cost effectiveness and performance of FSLIC receiverships, private sector asset management firms, and FADA in the management and disposition of assigned assets. Quantitative and qualitative dimensions of performance were assessed. FSLIC officials gave us the staff paper containing the results of the study on September 13, 1988.

We note that the study concluded, on the basis of the qualitative performance measures established, that the quality of private sector firms' asset management was significantly higher than that of FADA. The quality of FADA's asset management was rated the same as the quality of that of the receiverships. The study's quantitative analysis focused on the ability to recover value from the managed assets and on the cost to FSLIC of the asset management services. It found the return to FSLIC was the same or larger when FADA managed the asset than when the receiverships or private sector asset management firms managed the asset. From a cost standpoint, the study found FADA costs to be about the same as receivership costs. It also found FADA costs to be the same as or lower than the costs of the private sector asset management firms.

The study contained some noteworthy cautions. One was that

"statistical analysis allows us to draw conclusions about the entire population from a sample only if the sample is representative of the entire population. In this case it seems clear that the assets that FADA has sold were not typical of FADA's asset portfolio. We have no way of knowing whether FADA would perform as well if all of their assets were compared with all of the receiver and contractor assets."

Conclusion

In conclusion, we found no compelling evidence that FADA is essential to the management and disposition of assets acquired by FSLIC. Such functions could be done by a combination of other private sector asset management firms, FSLIC headquarters and regional employees, and receivership employees.

Agency Comments and Our Evaluation

The FHLBB was asked to comment on a draft of this report, and its response is contained in appendix V. This report presents two basic points. First, FADA was illegally established and, second, it is not essential to FSLIC (see pp. 2 and 3).

In its comments, the FHLBB was silent with respect to the first point—that FADA was illegally established as a federally chartered savings and loan association, with employees not considered subject to the salary limitations for federal employees (see p. 3).

The FHLBB did express concern regarding the report's conclusion that FADA is not essential. It said that the report correctly identified the two functions done by FADA (see pp. 4 and 5) and that the report presented no evidence which suggested that FADA was failing to achieve either of its functions. It then enumerated a series of specific criticisms, but did not challenge the factual accuracy of any information presented. Specifically, FHLBB said that the report (1) did not recognize that only FADA offers the services it provides, (2) did not recognize corrective steps taken and relied on outdated information, (3) did not prove that FADA's services could be provided by the alternatives discussed, and (4) did not consider the tremendous costs that would result from dissolution of FADA. Finally, the FHLBB cited the results of a FSLIC staff study as evidence that FADA was as cost effective or more cost effective than the alternatives. We either disagree with these points or believe they are irrelevant to the objective of the report. Our responses follow the FHLBB letter in appendix V.

We are sending copies of this report to the Chairman of the Federal Home Loan Bank Board and other interested parties. The major contributors to this report are listed in appendix VI.

Craig A. Simmons
Senior Associate Director

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Abbreviations

FADA	Federal Asset Disposition Association
FHLB	Federal Home Loan Bank
FHLBB	Federal Home Loan Bank Board
FSLAC	Federal Savings and Loan Advisory Council
FSLIC	Federal Savings and Loan Insurance Corporation
MCP	Management Consignment Program
OLD	FSLIC Operations and Liquidation Division
OMB	Office of Management and Budget
OPM	Office of Personnel Management

Scope and Methodology for Assessing FSLIC's Need for FADA

This appendix describes in detail the scope and methodology of our work.

To determine why the Federal Home Loan Bank Board (FHLBB) created the Federal Asset Disposition Association (FADA) in November 1985, we reviewed the minutes made available to us of FHLBB meetings in 1984 and 1985. We also asked top FHLBB and Federal Savings and Loan Insurance Corporation (FSLIC) officials for copies of all studies, decision papers, and other documents that were or might have been used during FHLBB's deliberations on FADA. However, they provided little of this type of material. We reviewed the minutes of meetings of FADA's Board of Directors from its first meeting in December 1985 through its May 1988 meeting. We also reviewed copies of FADA documents pertaining to its creation, including its charter, bylaws, and business plans. Finally, we interviewed present and former FHLBB, FSLIC, and FADA officials regarding their knowledge of the reasons for and purposes of FADA's creation.

To determine the nature of services that FADA currently provides to FSLIC, we reviewed (1) the contracts now and previously in force between FADA and FSLIC as receiver for liquidating thrifts and (2) the letter contract in use between FADA and corporate FSLIC. We also discussed this subject with FSLIC and FADA officials as well as with receivership managing officers and others.

We also discussed with these officials the asset management alternatives available to FSLIC for obtaining services now being provided by FADA and what, if any, constraints or obstacles would prevent their use. Issues related to FSLIC's ability to attract qualified receivership staff were often raised. We therefore compared the qualifications of selected receivership staff with those of FADA staff at selected locations. We selected the Dallas and Los Angeles regions because both FADA and FSLIC have regional offices in these cities and because over 50 percent of FADA-managed assets are located in these two regions. We looked at the qualifications of the staff of six FSLIC receiverships that had contracts with FADA and at the qualifications of FADA staff who were handling assets for five of the six receiverships. (The records of FADA staff handling the sixth receivership's assets were unavailable due to the closing of a FADA office, so we included in our analysis the FADA staff handling the assets of an additional FSLIC receivership.) We focused on individuals who did asset management-type work and analyzed their qualifications in terms of education; professional certifications, such as licenses to sell real estate; past work experience; and salary levels.

We sought information on FADA's effectiveness compared to that of the alternatives. We analyzed the results of contractor performance reviews completed by the Receivership Operations Branch within FSLIC's Operations and Liquidation Division (OLD). We requested all reports of such reviews that had been completed as of July 31, 1988. Of the 12 that had been completed, 4 were of FADA contracts and 8 were of contracts with other private sector firms.

To understand the procedures that FADA follows regarding asset management and disposition, we reviewed FADA's procedures manual. For an indication of the types of specific actions FADA employees take in handling assets, we asked the FADA regional directors in Dallas and Los Angeles to each give us four examples of assets handled effectively. We reviewed the handling of these eight assets by (1) discussing them with the FADA employees who had direct asset management responsibility for them, (2) discussing them with receivership officials who were responsible for monitoring them, and (3) examining the approved asset business plans and other pertinent documents. For comparison, we asked the FSLIC Dallas and Los Angeles regional managers to provide four examples each of assets that FADA had been assigned and for which its services were less effective. The Los Angeles regional manager did not provide examples. In addition, we selected four assets handled by FADA's Los Angeles and Dallas regions that had not been cited. In total, we reviewed 20 assets from six receiverships.

We did not do a comprehensive cost-effectiveness study of FSLIC's use of FADA asset management services and its use of alternatives because (1) the new FADA contract, in effect since January 1988, has significantly changed the incentives and fees paid by FSLIC to FADA so that assessment of FADA's prior relative cost-effectiveness would not be projectable; (2) according to FSLIC officials, in the event of private sector contracting, terms would be offered to private sector contractors that are identical to the terms now offered to FADA; (3) it was not possible to design and carry out a study within the available time frame that would allow us to reach a conclusion on this question; and (4) FSLIC had undertaken a comprehensive staff study of the effectiveness of two available options that was scheduled for completion during the summer of 1988.

Our work was done from May 1988 to September 1988 in accordance with generally accepted government auditing standards.

Circumstances and Factors Contributing to the Creation of FADA

The impetus behind the creation of FADA in 1985 was FSLIC's need to greatly expand its capability, both in terms of the number of personnel and the amount of specialized expertise, to deal with the rapidly increasing inventory of troubled assets FSLIC was acquiring in both its corporate and its receivership capacities. In fact, the FHLBB document that authorized the creation of FADA plainly states that "the necessity to liquidate and dispose of such assets has severely strained the resources of the FSLIC."

According to some key FHLBB and FSLIC officials, FSLIC's attempts to obtain additional federal employees with the needed expertise were hampered in two ways. First, the Office of Management and Budget (OMB) was not receptive to FSLIC requests for additional numbers of federal positions during the 1983 to 1985 period. Second, the Office of Personnel Management's (OPM) position that FSLIC employees are federal employees and therefore are subject to federal salary limitations, they said, drastically constrained FSLIC's ability to attract the kind of specialized expertise necessary to deal with the more complex assets. These dual constraints on the numbers of approved positions and levels of allowable salaries, we were told, prevented the development of a FSLIC staff of federal employees capable of doing much more than dealing with the most immediate problems.

Similarly, we were told that attempts by some FSLIC officials to deal with the burgeoning work load through an expanded receivership structure met with little success due primarily to (1) unresolved legal questions about the extent to which nonfederal employees could be used to do receivership functions[1] and (2) internally imposed constraints on compensation levels for the receivership employees.

Seemingly unable to secure the desired level of resources through organizational expansion, FSLIC officials contracted in 1984 and 1985 with

[1] FSLIC's use of receivership employees caused concern within the FHLBB's Office of General Counsel regarding unresolved legal issues. This concern apparently contributed to FSLIC's decision in 1985 not to further expand its receivership structure and to create FADA instead. In a May 20, 1987, memo, the FHLBB Acting General Counsel concluded that there was some legal authority for FSLIC to use nongovernment employees for the limited purpose of effecting the liquidation of assets held by the receiverships that employ them. As of July 31, 1988, FSLIC receiverships employed 940 full-time temporary nonfederal employees, of whom 196 were handling acquired assets. In September 1988, FHLBB approved a FSLIC reorganization plan. It included federalizing those positions in the FSLIC regions and receiverships which, in the opinion of FHLBB officials, were clearly federal in that they involved governmental decisionmaking. While these changes alleviate the concerns of FHLBB's Office of General Counsel, officials there told us that it is not yet clear whether all the issues have been resolved.

some private sector firms to provide needed asset management and disposition expertise and services. According to a former key FSLIC official, however, FSLIC's efforts to engage additional private sector contractors to handle more of the ever-increasing work load of complex assets were virtually halted in mid-1985 by the FHLBB Chairman. By order dated July 9, 1985, the Chairman directed that no contract could be entered into by FSLIC without prior approval by the Chairman.

Although several key individuals provided differing opinions on FADA's origins, by early 1985 a proposal had surfaced calling for the creation of a separate entity for managing and disposing of assets acquired by FSLIC. The idea soon gained the support of some FHLBB and FSLIC officials (due in part to the fact that FSLIC's previous attempts to obtain needed resources were unsuccessful). In September 1985 hearings before a House banking subcommittee, the then-Director of FSLIC testified that the proposed entity would be a way to replace the receivership system with a centralized and controlled mechanism for managing assets.[2] (He characterized the receivership system as awkward—a combination of government employees and contract personnel—and difficult to manage.) Additional proponents came from the savings and loan industry, while still others in the industry registered their support with the FHLBB in their capacity as concerned citizens. However, views differed on how the proposed entity should be organized.

In a July 1985 letter to FHLBB, the Federal Savings and Loan Advisory Council (FSLAC) envisioned a single corporation—with regional offices, if needed, that would be wholly owned by FSLIC and that would be able to recruit talented people from the private sector with substantial incentive compensation. FSLAC anticipated that the new entity's employees and FSLIC would share any returns on assets that exceeded liquidation value (adjusted for delays in receipt).

The U.S. League of Savings Institutions also supported the idea of a single corporation, envisioning that the new corporation would be jointly owned and capitalized by FSLIC and the Federal Home Loan Banks (FHLB). The League also envisioned that the corporation would actually purchase assets from FSLIC—using a mix of stocks and notes. The corporation would pay off the notes by borrowing funds on the open market, thus providing the insurance fund with an infusion of cash. The League

[2]Testimony by Peter Stearns during September 1985 Hearings held by the Subcommittee on Financial Institutions Supervision, Regulations and Insurance of the House Committee on Banking, Finance and Urban Affairs.

saw the establishment of a 406 corporation as a vehicle for "mobilizing some of the excess capital of the Federal Home Loan Bank System."[3] Similarly, the National Association of State Savings and Loan Supervisors supported utilizing some of the "vast resources" of the FHLB system. It suggested designing a corporation that would (1) purchase and hold assets acquired by FSLIC and (2) assume responsibility for managing and liquidating these assets so as to maximize returns to FSLIC.

The National Council of Savings Institutions, on the other hand, supported the establishment of 12 special purpose corporations—one in each FHLB district—to be financed, at least in part, by the FHLBs.

On November 1, 1985, the FHLBB chartered FADA for a period of 10 years as a federal stock savings and loan association under section 406 of the National Housing Act. Its capital stock is wholly owned by FSLIC. In return for the capital stock, FSLIC provided $25 million to FADA to be used for capital expenditures and start-up costs. In addition, FADA was given a $50 million line of credit at the Federal Home Loan Bank of Topeka. FADA does not acquire title to the assets it manages; rather, it acts as FSLIC's agent.

[3]Testimony by Gerald Levy during October 1985 Hearings held by the House Committee on Banking, Finance and Urban Affairs.

Comparison of the Qualifications of Selected FADA and FSLIC Receivership Personnel (as of June 1, 1988)

	Dallas		Los Angeles		Dallas and Los Angeles	
	FADA	FSLIC	FADA	FSLIC	FADA	FSLIC
Number of employees	36	15	6	11	42	26
Average annual salary ($000)	61	49	76	46	63	48
Annual salary range ($000)	50–93	28–71	60–95	28–59	50–95	28–71
Educational degrees (%)						
Bachelor degree	89%	100%	67%	73%	86%	88%
Master of Business Administration	36	33	17	9	33	23
Other graduate degrees	6	7	17	9	7	8
Professional certifications (%)						
Certified Public Accountant	6%	40%	0%	0%	5%	23%
Certified Appraiser	6	0	17	18	7	8
Real estate license	25	47	33	36	26	42
Securities license	8	20	17	0	10	12
Attorney at Law	6	0	17	9	7	4
Employees with at least one certification	50%	67%	50%	55%	50%	62%
Employees with no certifications	50	33	50	45	50	38
Work experience (%)						
Loan workout/restructure experience	50%	60%	33%	27%	48%	46%
Years of work experience						
Average	9.6	9.7	17.2	10.5	10.7	10.0
Range						
Low	5	3	8	5	5	3
High	23	30	31	20	31	30
Type of work experience						
Lending institution						
Number of employees	27	9	4	8	31	17
Average years	6.3	5.3	7.3	7.8	6.4	6.5
Real estate						
Number of employees	23	13	6	10	29	23
Average years	5.0	3.0	11.3	4.1	6.3	3.5
Public accounting						
Number of employees	2	8	0	0	2	8
Average years	3.5	3.0	0.0	0.0	3.5	3.0
Other						
Number of employees	14	9	3	5	17	14
Average years	4.0	3.9	2.0	2.4	3.6	3.4

Notes: FADA employees are those in FADA's Dallas and Los Angeles regional offices who are handling assets for six FSLIC receiverships, who are directly involved in asset management in six FSLIC liquidating receiverships in Texas and California. FADA personnel have titles of Asset Manager, Senior Asset Manager, or Portfolio Manager. FSLIC receivership personnel have titles of Asset Manager, Senior Asset Manager, Assistant Managing Officer, and Managing Officer.

Source: Data were compiled from FADA and FSLIC receivership employee job applications.

Description of How FSLIC Acquires, Manages, and Disposes of Assets

FSLIC acquires thrift assets in two basic ways. Some assets are acquired by "corporate FSLIC" from troubled thrifts through assistance programs or to terminate a receivership. Other assets are acquired by "FSLIC as receiver" after it has been demonstrated that a federally insured thrift (1) has become insolvent or (2) is the victim of fraud and the Federal Home Loan Bank Board or the appropriate state authority names FSLIC as receiver for the closed thrift.

FSLIC establishes a new organizational structure to handle the affairs of a closed thrift, referred to as a liquidating receivership. The receivership (1) liquidates assets and pays creditors and (2) terminates the thrift's existence. Each receivership is headed by a managing officer, a special representative of "FSLIC as receiver," who is under contract to oversee receivership operations, such as accounting, creditor claims, loan servicing, and asset management and disposal. The managing officer hires, with FSLIC's approval, full-time, temporary, nonfederal employees to staff the receivership. The managing officer, as well as many of the receivership staff, are often former employees of the closed thrift.

The focus during the first few weeks after a thrift is closed is to gather sufficient information to assist the receiver in making business decisions. Starting the night of closure, employees from FSLIC's Operations and Liquidations Division (OLD) work to secure the facilities, analyze the conditions of the failed thrift, and begin the liquidation of assets and payment of claims. Several teams work simultaneously to meet these goals.

The asset liquidation process begins with what is called "due diligence." Due diligence involves making a file review on each asset to determine what information is available that is relevant to the management of the asset, such as the name of the borrower, asset type, asset value, and guarantors. Concurrently with due diligence, OLD staff debrief loan officers of the closed thrift to obtain additional information on particular assets.

Using the information obtained from the above processes, asset-assignment decisions are made on an asset-by-asset basis. FSLIC, not the receivership managing officer, makes the asset assignment decision. Each asset is assigned for direct management services to either (1) the receivership, (2) FADA, or (3) another private sector contractor. However, because of FSLIC's fiduciary responsibilities, receivership employees are responsible for monitoring all receivership assets, regardless of which entity directly manages the asset.

The primary mechanism used to direct the management of FSLIC-acquired assets is the asset business plan. FSLIC requires the preparation and submission for approval of business plans for any asset with a book value at the time of acquisition of $500,000 or more. Business plans are to be prepared by whichever entity is managing the asset—FADA, the receivership, or a private contractor. In a business plan, various alternative management strategies are to be discussed, and ones that are considered most appropriate recommended. (Usually those that will result in the highest dollar return to FSLIC computed on a net present value basis are recommended.) FSLIC must approve each business plan. The approved business plan's purpose is to serve as a road map for the asset manager to follow in managing, marketing, and disposing of a particular asset.

Changes in FADA Contract Provisions

On March 10, 1988, FHLBB approved a new asset management contract for use between FSLIC and FADA. The new contract, which had a retroactive effective date of January 1, 1988, substantially changed FADA's asset management fee structure and provided for the payment of disposition fees. In addition, several other provisions of the new contract differ significantly from the provisions of the previous contract, as amended.

Asset Management Fees

FADA manages receivership assets and those held by thrifts in the Management Consignment Program (MCP) for a fee. Under the provisions in effect through December 31, 1987, this fee was calculated by applying the annual rate of 0.75 percent to the net realizable values of the managed assets, then adjusting the amount to reflect the portion of 1 year represented by the time period for which the fee was being computed.[1] Thus, FADA's asset management fees were based on the expected value to be obtained from the asset upon its sale. In some instances, this meant

[1] As defined in a May 1987 amendment to this contract, the net realizable value of an asset was the present value of the estimated net cash proceeds adjusted by the present value of revenues and expenses anticipated throughout the period from the date the receiver acquired the asset to the probable disposition date. Upon initial asset assignment to FADA, and until the net realizable values were established, the asset net book values were used for fee calculation purposes. As these values were subsequently adjusted to reflect approved net realizable values, so were previous billings to receiverships and thrifts in the MCP. (Before May 1987, net book values generally were the basis for receivership billings. When net realizable market values for assets were approved, FADA's billings were adjusted prospectively from the date of approval to reflect the approved values.)

that FADA received no management fees for some management intensive assets because, although specialized management was required, net realizable value for those assets was zero.

Under the new contract, FADA's asset management fee is calculated by applying an annual rate of .50 percent to the net takeover value of an asset and then adjusting the amount to reflect the portion of 1 year represented by the time period for which the fee is being computed. The net takeover value is defined as the dollar amount of the asset on the association's books and records as of the receivership date, less any reserves on the association's books as of that date. Under this arrangement, if a closed thrift had carried assets assigned to FSLIC on its books at inflated values, FADA could receive large management fees for assets that have little or no expected market value (or low net realizable value) simply because they had high net takeover values.

Management Fees for Participation Assets

Under the previous contract provisions, asset management fees for assets subject to participation agreements were calculated on the basis of (1) 100 percent of the asset value in those instances when the receiver or thrift in the MCP was the lead participant and (2) the actual participation percentage when it was not the lead participant. Under this arrangement, FADA could have received asset management fees from two or more receiverships that were participants in the same asset. Further, if one of the receiverships was the lead participant, FADA could have received fees based on more than 100 percent of a participation asset's value.

Under the new contract, FADA may still base its asset management fee on 100 percent of the value of a participation asset when the receiver or MCP thrift is the lead participant. However, if FADA is managing one or more portions of that same participation asset for another receivership or insured institution that is not in the lead position, the net takeover value (or participation percentages) of any other portion of the asset is subtracted from the total value of the asset for fee determination purposes. This provision prevents FADA from receiving a management fee based on more than 100 percent of the value of a participation asset.

Disposition Fees

Under the terms of the previous contract, FADA was not entitled to disposition fees upon the sale of assets. Under the new contract provisions, however, FADA is paid disposition fees, in addition to management fees, on assets. The amounts of disposition fees decrease each year an asset remains under FADA management. For example, if an asset is disposed of on or before the first anniversary of the contract's effective date, FADA is entitled to 0.15 percent of the net disposition proceeds.[2] For any asset disposed of after this date but on or before the second anniversary, the fee drops to 0.125 percent of the net disposition proceeds. Similarly, for any asset disposed of after the second anniversary of the contract's effective date, FADA is entitled to 0.10 percent of the net disposition proceeds.

Reimbursable Expenses

Under the previous contract, FADA could contract with third parties (subcontractors) to carry out its obligations under the contract without limits. As long as such third-party contracts were consistent with approved business plans, FADA's costs for such contracts were reimbursable by the receivership. This arrangement led some FSLIC officials to question whether FADA was needed to serve as a middleman for FSLIC.

Under the new contract provisions, FADA is still allowed to enter into contracts with third parties to carry out its obligations under the contract. However, FADA is to pay these contract costs and they may not be passed through to the receivership. FADA may, at receivership expense, engage third-party contractors to provide services not considered to be FADA's duties under the new contract. FADA is to approve fees for such services, but the fees must be submitted to the receivership for payment.

Letter Agreement Sets Out Additional Fees

In addition to the asset management and disposition fees previously discussed, FADA now receives fees for legal, appraisal, and accounting services.[3] By letter agreement dated March 14, 1988, FSLIC, when acting as receiver, agreed to compensate FADA for these services effective January 1, 1988.

FSLIC, in its corporate capacity, also agreed to pay FADA a retainer fee for advisory services that may be needed during calendar year 1988. The retainer fee is to be calculated by taking one-twelfth of 0.10 percent of

[2]Net disposition proceeds, as defined in the contract, means the sum of (1) total cash received by the receiver from any disposition and (2) the principal balance of any credit instruments accepted by the receiver from any financed disposition, partial disposition, or facilitating loan transaction.

[3]FADA's fee for providing legal, appraisal, and accounting services to receiverships is calculated by applying an annual rate of 0.30 percent of the net takeover value of a particular receivership's assets that are subject to FADA's current asset management contract. This amount is then adjusted to reflect the portion of 1 year represented by the time period for which the fee is being computed.

the net takeover value of all receivership assets under management by FADA at the end of each preceding month. Fees payable to FADA under such task orders entered into by FSLIC are to be offset by the annual retainer. No fees will be paid to FADA under such task orders until the retainer has been fully exhausted.

Comments From the Federal Home Loan Bank Board

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

Federal Home Loan Bank Board
OFFICE OF THE CHAIRMAN

M. DANNY WALL, Chairman

1700 G Street, N.W.
Washington, D.C. 20552

Federal Home Loan Bank System
Federal Home Loan Mortgage Corporation
Federal Savings and Loan Insurance Corporation

October 5, 1988

Mr. Frederick D. Wolf
Director
Accounting and Financial Management Division
General Accounting Office
General Accounting Office Building
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Wolf:

The Federal Home Loan Bank Board ("Bank Board") would appreciate having the following comments included in the final version of the GAO Report entitled "Failed Thrifts: No Evidence of a Need for the Federal Asset Disposition Association" ("report"). We are very concerned by the conclusions of the report.

See pp. 4 and 5.

The report correctly identifies the functions of the Federal Asset Disposition Association ("FADA") as acting as an interface between the Bank Board and the savings and loan industry through FADA's independent board of directors and as providing cost effective asset management and disposition services to the Federal Savings and Loan Insurance Corporation ("FSLIC"). No evidence is presented in the report that suggests that FADA is failing to achieve either of these objectives.

See comment 1.

Since FADA's incorporation in 1985, the FSLIC has utilized FADA to manage and sell the troubled loans and properties of failed and supervised savings and loan associations. FADA's mission is to assist in strengthening the financial health of the FSLIC and savings and loan industry. FADA uses private sector management and marketing techniques to manage problem loans and properties at the lowest cost consistent with sound operations. FADA seeks to resolve these problems expeditiously while obtaining the best possible return.

See comment 2.

FADA delivers real estate services from its three regional offices -- Los Angeles, Dallas, and Atlanta -- and provides expertise to the FSLIC in five areas: appraisal and valuation services, management of third party assistance, participation loans, national marketing coordination, and property and liability insurance. FADA does not take title to any troubled real estate, but rather acts as a manager and professional real estate consultant to the FSLIC.

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See comment 2.

FADA's staff includes specialized asset managers who work under FADA's portfolio managers; an in-house group of asset appraisal managers; and a small legal staff which supports FADA's asset management function.

See comment 2.

No other organization in the asset management field provides all of these services. This saves the FSLIC and claimants of insolvent associations a considerable amount of money.

See comment 3.

It should be remembered that all of FADA's "profits" accrue to the FSLIC as its sole stockholder. This reduces the cost of the disposition process considerably.

See comment 4.

See p. 15

Many of the concerns raised in the report have already been recognized by the Bank Board, and corrective measures have been taken. The report, by its own admission, fails to consider the substantial changes that have taken place since the beginning of this year with regard to the FSLIC/FADA relationship and FADA's improvement in the asset management and disposition areas: "We did not do a comprehensive cost-effective study of FSLIC's use of FADA asset-management services and its use of alternatives because (1) the new FADA contract, in effect since January 1988, has significantly changed the incentives and fees paid by FSLIC to FADA...." In other words, in assessing FADA's "essentiality", relative cost was deemed not to be a factor worthy of review.

See comment 5.

The report fails to consider the fact that an entirely new management team, headed by Ambassador Gerald P. Carmen, took over FADA in February, 1988, and has reduced expenses in almost all categories. In addition to reducing its staff extensively, FADA recently closed its San Francisco office, and is in the process of collocating its regional offices with those of the FSLIC. The close proximity resulting from this collocation will allow for a number of things: better communications between the FSLIC and FADA, earlier and quicker resolution of cases, equitable distribution of workload, and optimization of FSLIC and FADA's management and specialized expertise. It will also make it easier to implement new/common initiatives, permit flexibility for future workload expansions/contractions, and allow FSLIC and FADA management to achieve the most efficient management of FSLIC-controlled assets. This will reduce expenses even further. This situation could not be achieved with private contractors.

See comment 6.

During the first nine months of this year, FADA provided approximately $356 million to the FSLIC from property sales, loan payoffs, asset restructures, and settlements.

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See pp. 6, 7, 8, and 15.

Much of the report is devoted to summarizing conclusions of contract evaluation reports written by FSLIC staff during FADA's first two years of existence. These reports served as valuable tools to the FSLIC and the Bank Board in modifying the contractual relationship between FADA and the FSLIC's receiverships earlier this year. These reports, however, neither evaluate the current relationship between the entities nor the current performance of FADA. A much more valuable and timely document is the Contractor Cost Comparison Study ("CCCS"), which was recently completed by FSLIC staff and released. This study, briefly alluded to in the report, compares the actual performance of FADA, receivership staff, and independent contractors.

See comment 7.

See pp. 9 and 10.

See comment 4.

The CCCS was mandated by the Executive Director of the FSLIC in order to develop an analytical perspective, in the most objective fashion possible, as to which organization was the most cost effective in the management and disposition of FSLIC receivership assets over the period examined. It was anticipated that the results of the analysis would play an important role in decisions involving future assignments of FSLIC-controlled assets to FADA, FSLIC receiverships, and private contractors.

See comment 8.

The empirical results of the comprehensive study of FSLIC-controlled assets managed and disposed of over the 1984-1988 time period generally indicate that FADA was as cost effective or more cost effective than both FSLIC receiverships and private contractors. These results are particularly impressive in light of the fact that FADA's first assignment was in July 1986, and that a certain amount of experience would be necessary before peak performance could be expected. We reasonably anticipate even further improved performance over time.

See comment 8.

The first phase of the study developed a quantitative cost comparison model that was used to evaluate performance on a sample of assets that were both disposed of as well as managed over the 1984-1988 period. The principal determinant of cost effectiveness was the percentage of total historic cost and Net Takeover Value of each asset that was recovered by the respective organizations when the assets were sold for the FSLIC. For assets that were managed but not sold, the appraised value or Net Realizable Value was used to estimate the final sales price. Other measures of performance were utilized in different capacities, including the final sales price and the total costs for a particular asset. Factors such as property type, location, amount of time the asset was held, year of disposition, size of asset and difficulty of management and disposition were included in the statistical

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analysis to make the comparison equitable.

See comment 8.

The results, based upon the sample of disposed assets, indicate that the FSLIC recovered a percentage of historic costs and Net Takeover Values from FADA as high as or higher than it received from FSLIC receiverships and private contractors.

See comment 8.

Based upon the sample of assets that were managed and not sold, the FSLIC obtained the same or larger returns when FADA managed the assets as when FSLIC receiverships or private contractors managed the assets. When the total costs of management were evaluated for all of these types of asset managers, FADA costs were no different from those of FSLIC receiverships, and were the same or lower than the costs of private contractors.

See comment 8.

The second phase of the analysis was a qualitative evaluation of the management services provided by the receivership staff, private contractors and FADA. Based upon a subjective evaluation of the services provided and expertise rendered, the quality of FADA management was slightly lower than that provided by private contractors, but about the same as that provided by FSLIC receiverships.

See comment 8.

Overall, taking into account the limitations of the data and the analyses that are fully outlined in the report, the research supports the conclusion that FADA performs as well as or better than private contractors or FSLIC receiverships in the management of complex assets.

See comment 9.

A Touche Ross report commissioned by the FSLIC further buttresses these conclusions and demonstrates that the FSLIC is getting a much better value for its dollars spent with FADA than with other private contractors. Such companies would charge the FSLIC higher fees than what FADA charges and would deliver fewer services on the assets which make up the FADA portfolio.

See p. 3.

See comment 10.

See p. 6.

The receivership liquidation area is extremely complex and esoteric. In order to fulfill its fiduciary responsibilities, the Bank Board must be able to develop and maintain a highly skilled cadre of professionals to dispose of receivership assets in an orderly and prudent manner. The evidence supporting the GAO report's central "finding", that FADA services could be provided by FSLIC staff and private sector asset management firms, is, at best, inconclusive. We question the availability and unused capacity of asset management firms that can handle unusually complex assets and have the appropriate receivership law backgrounds. As the report admits, "We did not examine the present availability

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See p. 6.

and capacity of private sector asset management firms."

See comment 11.
See comment 12.
See comment 13.

One of the principal rationales for continuing to utilize FADA is that receivership staff, FADA, and private contractors do not have comparable expertise and experience. Their functions are not interchangeable because they provide what, in practice, are different services, and there are some functions - specifically the management of unusually complex assets - that FADA carries out better than any alternative. The findings of the report do not invalidate this rationale.

See comment 14.

FADA's expertise in the appraisal, loan restructuring, and legal areas has been invaluable to the FSLIC. Expenses in the legal area comprise some of the highest expenses for the FSLIC, which we are striving to contain.

See comment 15.

FADA has proven its expertise in the participation loan area as well. Due to the special problems posed by participation loans, the FSLIC assigns most such assets to FADA for management. FADA is uniquely qualified to handle these loans, which are some of the most difficult and complex to resolve. Because of FADA's expertise in this area, the FSLIC has asked FADA to consult the Bank Board's newly created Participation Loan Strike Force.

See comment 16.
See p. 7.
See p. 7.

We question certain of the conclusions and inferences drawn from specific items mentioned in the report. The report contends that the four evaluations of FADA suggest that FADA's performance has been less than exemplary: "The evaluation report on one contract recommended that the contract be terminated." The fact that occasionally with time it becomes apparent that assets are not optimally distributed among FADA, private contractors, and FSLIC receivership staff is not, in itself, a problem. In fact, it is a sign of good management that the referenced contract review raised the issue and proposed a solution. The FSLIC, in the case cited by the report, demonstrated its efforts to adjust the portfolios of FADA and other asset managers to obtain maximum returns.

See p. 7.
See comment 17.
See comment 18.

The report states, "We realize this tension could create a bias regarding any assessment of FADA's performance by FSLIC employees." The report presents no evidence that the FSLIC is unable to evaluate FADA's performance. In fact, it was the FSLIC's vigilant examination that led to the replacement of FADA's top management in late 1987, and to the major revision of the Bank Board's basic agreement with FADA.

See p. 7.
See comment 19.

The report states, "...other officials said that FADA's performance has varied from contract to contract and from FADA region to region." This is no doubt true, but all

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See comment 19.

asset managers vary in performance from time to time. The report's assertion that FADA's performance varies is not, contrary to the report's implication, a criticism of FADA. The question that would permit a criticism of FADA in this context is: does the variation in FADA's performance cross the lower boundary of acceptable asset management? This question is not raised in the report.

See p. 7.

According to the report, "The managing officers of some receiverships that have contracts with FADA said that FADA manages some assets well but that it should not be managing other assets... because they do not involve legal issues or require sophisticated technical expertise. These managing officers said they believe receivership employees were capable of handling... [FADA's] assets." In some cases, as noted above, the initial distribution of assets among FADA and other asset managers is changed following review to a more optimal distribution. The trend is toward assigning FADA the most complicated assets. Further, just because a receivership is "capable" of handling an asset does not mean that it necessarily should be assigned that asset. Other factors govern the assignment of assets, such as the relative quality of management. Also, the receivers quoted may be biased because they have an interest in the assignment of assets.

See comment 20.

The FSLIC is in the process of completing a new policy statement with regard to the assignment of FSLIC-controlled assets. It will define the criteria for the specific assignment of assets. This policy, which is nearing management approval, will provide for the return to the receiverships of the assets that have been identified as inappropriately assigned to FADA. As stated before, FADA will continue to be assigned the complex assets that it specializes in managing.

See pp. 8 and 19.

The report's comparison of the qualifications of asset managers in receiverships with the qualifications of FADA's asset managers omits consideration of an important criterion: experience in dealing with complex assets. Without this point of comparison, there is no hard support for the report's conclusion that receivership staff can do the same work as FADA.

See comment 21.

See comment 22.

Two studies, not alluded to in the report, are worth mentioning with regard to the cost of dissolving FADA, a vital issue not addressed by the report. The "Cost of Dissolving FADA Estimate", prepared by FSLIC staff and transmitted to House Banking Committee Chairman St Germain on July 6, 1988, conservatively estimates the cost of dissolving FADA at approximately $40 million. It estimates that the delay in achieving projected sales of assets will alone cost at least $25 million.

See comment 22.

The sudden abolition of FADA would ultimately cost the FSLIC many millions of dollars of delay/startup time in redirecting current FADA contractual assignments to other parties. If Congress were to enact the House legislation that would abolish FADA within sixty days, Congress would be adding further costs to an already insolvent, depleted, and certainly struggling FSLIC Insurance Fund.

See comment 22.

If the dissolution of FADA is congressionally mandated, the subject should be thoroughly researched and a more reasonable and prudent statute should be developed. The current bill would create confusion and tremendous management disruption because it would force the FSLIC to reallocate approximately $4 billion in assets in a short period of time.

See comment 22.

The other study, referenced in a letter from the Congressional Budget Office to Chairman St Germain, dated August 4, 1988, states, "In addition, the proposal to abolish the Federal Asset Disposition Association (FADA) is likely to create temporary delays in resolving claims from receiverships, thus reducing income to the Federal Savings and Loan Insurance Corporation (FSLIC) by perhaps hundreds of millions of dollars in 1989." It states further, "... assuming sales of assets managed by FADA are delayed until new staff is available to assume this function, it is likely that FSLIC would experience a temporary drop in collections from liquidations, perhaps amounting to several hundred million dollars in 1989."

See comment 23.
See comment 24.
See comment 25.

While we concede that few entities could be considered "essential" in an environment where cost was no object, we consider the report to be further lacking in a number of respects: (1) the report's evidence is outdated in that it utilizes obsolete evaluations and does not consider recent developments regarding FADA, (2) it does not fully examine alternatives to FADA and fails to prove that FADA's services could be provided by private contractors and FSLIC receivership staff, and (3) it does not consider the tremendous costs involved with the dissolution of FADA. We contend that there is a need for FADA; that FADA is successfully fulfilling its functions.

See comment 26.

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The multiple efforts among the leadership at the Bank Board, the FSLIC, and FADA that have been taken to reorganize and improve the operation of FADA have worked. FADA's commitment to strengthening its management and reducing its costs has greatly enhanced FADA's operational efficiencies. FADA's profitability this year demonstrates that the management change is working and that FADA is providing cost effective asset management and disposition.

Sincerely,

M. Danny Wall
Chairman
Federal Home Loan Bank Board

GAO Comments

1. FHLBB said that the report does not present evidence suggesting that FADA is failing to achieve its objectives of (1) acting as an interface between FHLBB and the savings and loan industry, and (2) providing cost-effective asset management and disposition services to FSLIC.

We do not disagree. The purpose of our report was to determine if FADA is essential to FSLIC's management and disposition of acquired assets, not to assess how well it was doing this function. Our work showed that FSLIC's increased use of private sector firms and of employees in its headquarters, regions, and receiverships could provide the asset management and disposition services FADA now provides.

With respect to the interface role, there is no such purpose given to FADA in its charter, which was granted by FHLBB. Furthermore, the Federal Savings and Loan Advisory Council (established in 1935) and the Federal Savings and Loan Insurance Corporation Industry Advisory Committee (established in 1987) were established by Congress and serve as interfaces between FHLBB and the savings and loan industry.

2. FHLBB enumerated three categories of FADA employees (asset managers, asset appraisal managers, and legal staff) who provide expertise to FSLIC in five areas. It says that "no other organization in the asset management field provides all of these services" and concludes that this saves FSLIC and claimants of insolvent associations a considerable amount of money.

We have several comments on this statement. First, FADA does not provide all these services in-house. It subcontracts with private sector firms for many of the services it provides to FSLIC. As noted in FSLIC's recently completed staff study, the Contractor Cost Comparison Study, FADA was intended to be a master contractor. For example, FADA's top appraisal official told us in June 1988 that FADA had not done a single property appraisal in-house but had subcontracted out all the appraisal services it had provided to FSLIC.

Second, FHLBB mentioned savings resulting from FADA's unique capability. But FADA is paid fees for appraisal and legal services under a separate letter agreement, in addition to the asset management fees it is paid under the asset management contract. As noted in our report (see p. 8.), FADA's asset management fee rate is identical to that paid to four of the six private sector firms now providing asset management services to FSLIC; these firms do not receive additional appraisal and legal fees under a separate letter agreement as does FADA.

Finally, the FSLIC staff study cited above says that ". . . the tasks performed by FSLIC receiverships, private contractors, and FADA are similar enough so that a comparison of each group's efficiency is possible." This study did not find that FADA—because of its uniqueness or other factors—caused a considerable amount of money to be saved. It found FADA costs to be about the same as receivership costs.

3. FHLBB said that because FADA's profits accrue to FSLIC, the cost of the disposition process is reduced considerably.

We note that FADA's costs exceeded its operating revenues every month but one from the time it began handling assets in July 1986 through December 31, 1987, according to FADA income statements. While FADA showed a profit for more recent reporting periods, its total costs from inception through September 30, 1988, exceed its total revenues, so FSLIC has yet to benefit from any FADA profits.

4. FHLBB faulted the report for not noting that many of the concerns raised had been addressed and for not considering recent changes that had taken place with regard to the FSLIC/FADA relationship and FADA's improvement in the asset management and disposition area. It then quoted, out of context, one of the four reasons listed in the report explaining why we did not do a comprehensive cost-effectiveness study of the use of FADA and the alternatives (see p. 15 of our report) and concludes that we did not believe relative cost was worthy of review.

We disagree. The focus of the report was the essentiality of FADA, not its relative cost. And, as we said in point four of the reasons given for why we did not do a comprehensive cost comparison study, FSLIC had begun such a study for completion in the summer of 1988, which officials said would be made available to us. This study, the Contractor Cost Comparison Study, was provided to us on September 13, 1988, a week before the draft of this report was sent to FHLBB for comment. We did, however, describe its conclusions and its stated cautions in our report and have provided additional information from the study in responding to FHLBB comments.

5. FHLBB said that the report did not consider management changes at FADA and the organizational and operational changes made by the new management team.

It is true that the report does not contain a detailed discussion of these matters. We did, however, meet with the new management team twice:

early in its tenure to discuss planned changes to FADA and in late June 1988 to discuss the effects of any implemented or planned changes. On both occasions, we were informed by the top FADA officials that they did not plan any changes to the functions FADA serves or to the services it provides to FSLIC.

FHLBB enumerated several benefits which it expected to flow from the recent organizational and operational changes at FADA and added that this situation could not be achieved with private contractors. However, with private contractors, FSLIC has the flexibility of opting not to renew contracts or to cancel contracts if performance is unsatisfactory. As commendable as any improvements in FADA may be, they are not directly relevant to the question this report addresses—is FADA essential?

6. FHLBB stated that in the first 9 months of 1988, FADA provided about $356 million to FSLIC from property sales. While this may indicate a significant accomplishment by FADA, FHLBB provided no evidence that alternatives to FADA could not have obtained as much as or more for the assets liquidated by either obtaining a higher gross sales price or having lower expenses.

For example, FHLBB does not provide the book value of the assets sold to obtain the $356 million, nor the time it took FADA to produce the revenues. Nor is it clear whether or not the $356 million is net of all FADA expenses. Finally, FHLBB's statement may be subject to misinterpretation. FADA remits revenues from property sales to the FSLIC receiverships whose properties it was managing for distribution to all creditors—including FSLIC. Such revenues should not be confused with the FADA profits discussed in comment 3.

7. FHLBB said that much of the report is devoted to summarizing the conclusions of contract evaluations written during FADA's first 2 years of existence. We believe these evaluations represent the most reliable and up-to-date information on the performance and relative costs of FADA and private sector firms that was provided to us by FSLIC during our analysis.

As important as we consider these evaluations to be, however, much of our report contains other evidence on the need for FADA. It should be noted that we reviewed all such evaluations completed and approved by FSLIC through July 31, 1988. (We asked FSLIC, in addition, for information on the results of any contract evaluations that were substantially complete but were told we could not have information regarding reviews not yet completed and approved.)

FHLBB also said FSLIC's Contractor Cost Comparison Study is much more valuable and timely than the FSLIC performance evaluation reports we reviewed. However, this study evaluated the performance of FADA and the alternatives through December 31, 1987; the most current contractor evaluation we reviewed covered the performance of FADA through October 16, 1987.

8. In its comments, FHLBB described the methodology for and results of FSLIC's Contractor Cost Comparison Study, which FHLBB said was only briefly alluded to in the report.

In our view, it has been amply summarized in the report. (See pp. 9 and 10.) Also, FHLBB in its letter said that FSLIC's Contractor Cost Comparison Study found the quality of FADA management was slightly lower than that provided by private contractors. The FSLIC study, on page 3, actually said that ". . . the quality of the contractors' asset management was significantly higher than the receivers' or FADA's."

9. FHLBB says that a report by Touche Ross, a large accounting firm, buttresses the conclusions of the FSLIC staff study regarding the relative quality and cost effectiveness of FADA as compared with the alternatives.

The accounting firm report referred to did not evaluate FADA services, nor did it evaluate the quality, cost effectiveness, or range of services which could be obtained from alternatives. Rather, as noted on page 6 of this report, the accounting firm report was a survey of companies regarding fees they would charge for providing asset services for a hypothetical portfolio of assets.

Twenty-nine companies responded to the survey. (Our review of the accounting firm's report indicates that little detailed information was given to these entities on which to base their estimates, and the results were obtained through telephone interviews.) FHLBB questioned the availability and expertise of private firms to provide needed services; therefore, the relevance of the cost information provided by these 29 companies is uncertain. (See comment 11.)

10.FHLBB questioned the availability and unused capacity of asset management firms that can handle unusually complex assets and have the appropriate receivership law backgrounds.

As noted on page 6, FSLIC officials told us that private firms either currently have, or could quickly develop, sufficient capacity to manage FSLIC's asset portfolio were FADA to cease to exist. Those FSLIC officials said they receive inquiries almost daily from private sector asset management firms seeking contracts with FSLIC. FADA itself, it should be noted, was an entirely new entity when chartered in 1985 and managed to attract and hire personnel in the quantities and with the expertise FADA felt necessary.

11.FHLBB said that one of the principal rationales for continuing to use FADA is that receivership staff, FADA, and private contractors do not have comparable expertise and experience.

Our analysis of the educational degrees, professional certifications, and work experience of 42 FADA staff and 26 receivership staff in Dallas and Los Angeles who handle assets showed their qualifications to be similar. (See app. III.) Also, at the time FADA was created in November 1985, FSLIC had contracts with at least five firms that were providing management and disposition services for assets with a total value of over $1.1 billion. One of those firms has managed assets for FSLIC continuously since at least December 1984, over a year-and-a-half longer than FADA has.

12.FHLBB said that the functions of receivership staff, FADA, and private contractors are not interchangeable because they provide what, in practice, are different services, but FHLBB did not provide any examples of these "different services." FSLIC's own Contractor Cost Comparison Study says on page 7 that ". . . the tasks performed by FSLIC receiverships, private contractors, and FADA are similar enough so that a comparison of each group's efficiency is possible."

13. FHLBB said that there are some functions—specifically the management of unusually complex assets—that FADA carries out better than any alternative, and that this is a rationale for continuing to use FADA.

FHLBB did not cite any evidence to support this statement. FSLIC's Contractor Cost Comparison Study contains no conclusions regarding complex assets. Furthermore, in our meetings with FHLBB, FSLIC, and FADA officials, no official ever mentioned any study that would support such an assessment of FADA's abilities.

14. FHLBB said that FADA's expertise in the appraisal, loan restructuring, and legal areas has been invaluable to FSLIC.

We note, however, that FADA subcontracts with private sector firms for the property appraisals it provides to FSLIC. Regarding loan restructuring, our analysis of 42 FADA staff and 26 receivership staff in Dallas and Los Angeles who handle assets showed that 48 percent of the FADA employees and 46 percent of the receivership employees had previous loan workout and restructuring experience. Regarding legal services, we note that FSLIC's planned reorganization of its receivership and regional structure includes adding legal representation from FHLBB's Office of General Counsel to each of the FSLIC regional offices, which will increase the availability of in-house legal services at the regional offices.

15.FHLBB emphasized that FADA is uniquely qualified to handle participation loans and that FSLIC assigns most such assets to FADA for management.

Nothing in FSLIC's Contractor Cost Comparison Study indicates FADA is unique in its ability to handle participation loans. In fact, some private firms have managed participation loans for FSLIC receiverships. Additionally, the FSLIC contractor performance evaluation report which recommended that a FADA contract be terminated (see p. 7) concerned a FADA contract under which all the assets assigned to FADA were "complex, problem-laden participation loans." The evaluation report, in recommending that the FADA contract be terminated, noted that (1) very little in the way of progress has been made with the portfolio, (2) the Receiver has indicated that management of the portfolio is within its existing capabilities, and (3) the Director of FSLIC's regional office indicated that experienced and motivated receivership personnel were available.

16.FHLBB said that the report, in discussing FSLIC contractor performance evaluations of FADA, contends that the evaluations suggest "that FADA's performance has been less than exemplary."

The report makes no such statement or suggestion regarding FADA's overall performance. Rather, it notes that the findings in the evaluation reports we reviewed "may not be projectable to FADA's performance under its other 34 contracts with FSLIC receiverships." The specific contract evaluation referred to by FHLBB is discussed in comment 15.

FHLBB said that it is a sign of good management that this contract evaluation raised the issue and proposed a solution and that FSLIC demonstrated its efforts to adjust the portfolio. We add, however, that the FADA contract with this receivership has not been terminated nor have assets been withdrawn from FADA. The contract between the receivership and FADA continued in effect at least through October 27, 1988, a full year after the recommendation was made.

17.FHLBB said the report's citing of tension between FSLIC and FADA and the suggestion that such tension could create a bias regarding any assessment of FADA's performance by FSLIC employees is unsupported by evidence. It implies that the bias we are referring to is in favor of FADA.

Our intent was to caution about possible bias against FADA and the report now specifies that the bias we referred to was a negative bias. With regard to the lack of evidence, tension between FSLIC and FADA staff and resentment of FADA on the part of FSLIC staff were cited by the present executive director of FSLIC before his assumption of that position. Acting as a paid consultant to FHLBB in 1987, he studied the FSLIC/FADA relationship, and his report contained references to tensions.

18.FHLBB said that it was the FSLIC's vigilant examination that led to the replacement of FADA's top management in late 1987 and to the major revision of FHLBB's basic agreement with FADA. This report does not address why these changes were made, but it should be noted that several congressional committees and individual Members of Congress questioned the adequacy of FADA's management before the changes were made.

19.FHLBB said that the report's assertion that FADA's performance varies is presented as a criticism of FADA but that the report does not address whether FADA's performance crosses the lower boundary of acceptable asset management.

As mentioned in our comments 1, 4, and 5, the basic question this report addressed was the essentiality of FADA's asset management and disposition services. While we do include some information on the quality of FADA's services, we do not have a conclusion in the report on the relative quality of FADA and the alternatives.

20. FHLBB said that just because a receivership is capable of handling an asset does not mean that it necessarily should be assigned that asset. It added that other factors govern the assignment of assets, such as the relative quality of management.

We do not disagree. However, FSLIC's Contractor Cost Comparison Study found that the quality of FADA's asset management was the same as the quality of that of the receiverships, and significantly lower than the quality of private sector firms' asset management.

21. FHLBB said there is no hard support for the report's conclusion that receivership staff can do the same work as FADA because the report's comparison of the qualifications of receivership asset managers and FADA asset managers did not include consideration of their experience in dealing with complex assets.

We did include such a consideration. Before making our comparison, we asked FSLIC and FADA officials what aspect of employee qualifications would be the most reliable indicator of ability and experience needed for dealing with complex assets. There was general agreement among the officials we asked that experience in the area of loan workout and restructuring would be the most reliable indicator.

As seen in appendix III, we included this factor in our analysis of 42 FADA staff and 26 receivership staff in Dallas and Los Angeles who handle assets. Our analysis showed similar qualifications in this area, with 48 percent of the FADA employees and 46 percent of the receivership employees having had loan workout and restructuring experience before joining their respective current employers.

22. FHLBB correctly pointed out that the report does not include a discussion of the costs that would be entailed in the dissolution of FADA.

The FSLIC and Congressional Budget Office estimates referred to were apparently prepared on the basis of provisions contained in one legislative proposal requiring FADA's dissolution. We believe that the costs involved in dissolution of FADA would be greatly dependent upon the timing and method of dissolution, specifics that were beyond the scope of this report. We note, however, that according to FSLIC officials, no significant amounts of assets have been assigned to FADA since April 1, 1988, and that FSLIC has taken other steps to bring some functions once done by FADA within FSLIC itself. Such actions should help minimize the costs of FADA's dissolution.

23. This point is addressed in comments 4, 5, and 7.

24. This point is addressed in comments 2, 10, 11, 12, 13, 14, 20, and 21.

25. This point is addressed in comments 1, 2, 11, 12, 13, 14, and 22.

26. FHLBB said that FADA's profitability this year demonstrates that FADA is providing cost-effective asset management and disposition services.

We do not see how a judgment can be made on the cost-effectiveness of FADA's services simply by considering whether FADA's revenues exceed its costs. FADA's revenues are controlled by the rates it is paid by FSLIC for its services. FSLIC can choose to adjust, and has in the past adjusted, the fee formulas under which FADA is paid. Such actions can change FADA from unprofitable to profitable, or vice versa, without any change to the cost-effectiveness of FADA's services.

In addition, we believe that it is significant that FHLBB did not challenge the statement in the report (see p. 9) that managing officers of five FSLIC receiverships estimated costs for asset management and liquidation would have been lower if they—the receiverships—had had direct responsibility for assets assigned to FADA. The managing officers' estimates seem to indicate that some assets can be managed more cost effectively by the receiverships than by FADA. Even if a case could be made that FADA's profitability is an indicator of the cost-effectiveness of its services, it is not directly relevant to the issue in this report of whether FADA is essential.

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