

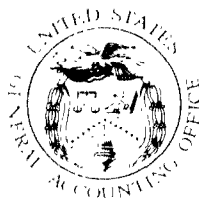
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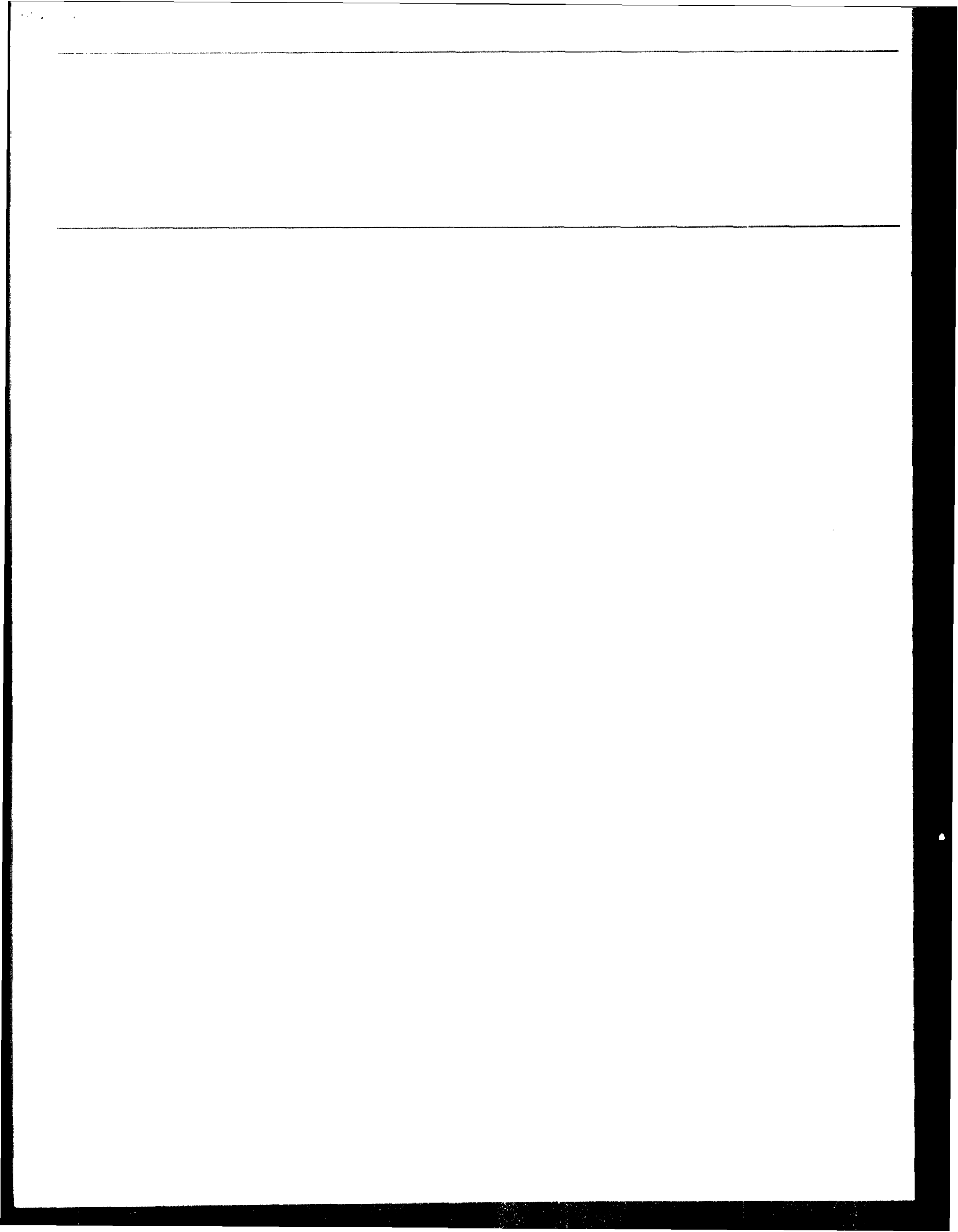
Briefing Report to the Chairman, RTC
Task Force, Committee on Banking,
Finance and Urban Affairs and the
Honorable Marge Roukema, House of
Representatives

September 1991

RESOLUTION TRUST CORPORATION

Monitoring RTC's Fitness and Integrity Policies for Independent Contractors







General Government Division

B-245500

September 25, 1991

The Honorable Bruce F. Vento
Chairman, Resolution Trust Corporation
Task Force
Subcommittee on Financial Institutions
Supervision, Regulation and
Insurance
Committee on Banking, Finance and
Urban Affairs
House of Representatives

The Honorable Marge Roukema
House of Representatives

At your request, we reviewed RTC's development and administration of ethics and conflict-of-interest policies as they relate to independent contractors. We briefed your offices on the results of this work on August 7, 1991. This briefing report contains the information we presented.

BACKGROUND

The Resolution Trust Corporation (RTC) was established by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). One of RTC's responsibilities is to manage and dispose of the assets of insolvent thrifts. FIRREA mandated that RTC use the private sector if such services are available and RTC determines that it is practical and efficient to do so. Furthermore, RTC's strategic plan states that, due to the sheer number of assets, RTC will rely heavily on private contractors.

RTC has adopted regulations that require contractors to meet minimum standards for fitness and integrity. These regulations are set forth in the Independent Contractor Regulations, 12 C.F.R. part 1606.¹ The Independent Contractor Regulations identify certain mandatory criteria that contractors must meet or they are barred from doing business with RTC. (These criteria will be discussed later.) Additionally, even if contractors meet the mandatory criteria, RTC may still use its discretionary authority to bar certain contractors or restrict the activities.

¹"Qualification of, Ethical Standards of Conduct for, and Restrictions on the Use of Confidential Information by Independent Contractors."

RTC has established three main groups to identify, process, and make determinations on fitness and integrity issues. They are the Contractors' Conflicts Committee (CCC), the Contractors' Ethics Office, and the Contractors' Business Review Office. The CCC is the primary group that makes determinations and recommendations on fitness and integrity matters, such as ethics or conflict-of-interest issues, for independent contractors. When contractors have fitness and integrity issues they must request CCC review of their specific cases. Cases brought before the CCC are first processed through the ethics and business review offices. After a case has been decided, RTC files the decision with the Executive Secretary and makes it available to the public upon request. These decisions are also available in RTC's reading room.

RESULTS IN BRIEF

RTC has established policies and procedures to assure that independent contractors meet minimum standards for fitness and integrity. The CCC, along with the various RTC program ethics offices, has begun to establish operational guidelines by using a case law approach to determine fitness and integrity issues as they apply to independent contractors. During our review we found the following:

- A majority of contractors--about 67 percent--reviewed by CCC have been registered under discretionary authority.
- Procedures have been established--but not finalized--for the suspension and exclusion of contractors that do not meet the minimum standards of fitness and integrity contained in the Independent Contractor Regulations.
- One contractor's awards have been rescinded and the contractor has been excluded from providing services to RTC because of failure to meet the minimum standards contained in the Independent Contractor Regulations.
- RTC has not published and made available to the public all cases that have been decided, thereby creating a backlog of issued decisions.

A goal of RTC's fitness and integrity policies is to disseminate as widely as possible the bases for decisions. Such dissemination increases the potential for understanding RTC's operational guidelines within the contractor community. The current backlog of cases raises concerns. It suggests that

contractors may not be getting all the information they need in a timely manner.

Also, RTC is currently in the process of revising the procedures used to assess fitness and integrity issues before a contract is awarded. This is known as the pre-award fitness and integrity verification. RTC still needs to formalize these screening policies and procedures. We will continue to monitor this area.

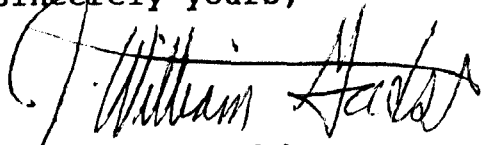
AGENCY COMMENTS

We obtained informal comments from RTC officials responsible for the administration of fitness and integrity policies as they relate to independent contractors. They agreed with our information.

Unless you publicly announce its contents earlier, we plan no further distribution of this report until 10 days from the date of this letter. At that time, we will send copies to interested congressional committees; the Chairman, FDIC; the Executive Director, RTC; the Chairman, RTC Oversight Board; and other interested parties. We will also make copies available to others upon request.

This report was prepared under the direction of Gaston L. Gianni, Associate Director, Federal Management Issues. Other major contributors are listed in appendix III. If you have any questions about this report, please call me at (202) 275-8387.

Sincerely yours,



J. William Gadsby
Director, Federal
Management Issues

APPROACH USED

GAO Objectives, Scope, and Methodology

- **Monitor RTC's fitness and integrity policies for independent contractors.**
 - Reviewed formal rules and directives
 - Reviewed organization and staffing
-

OBJECTIVES, SCOPE, AND METHODOLOGY

Our overall objective was to review the process used by RTC in establishing and carrying out its fitness and integrity responsibilities. This process is described on page 8. While our monitoring of RTC's approach to fitness and integrity issues continues, in this briefing we focus on RTC's efforts as they relate to contracting.

We reviewed the regulations and directives established by RTC and the RTC Oversight Board related to fitness and integrity matters as they apply to ethics and conflict-of-interest issues for independent contractors. We did not review the policies and procedures related to ethics and conflict-of-interest issues for law firms. We also reviewed the organization and staffing of the offices responsible for the oversight and administration of the fitness and integrity policies. We analyzed the number and types of decisions that RTC has issued related to fitness and integrity issues with respect to independent contractors.

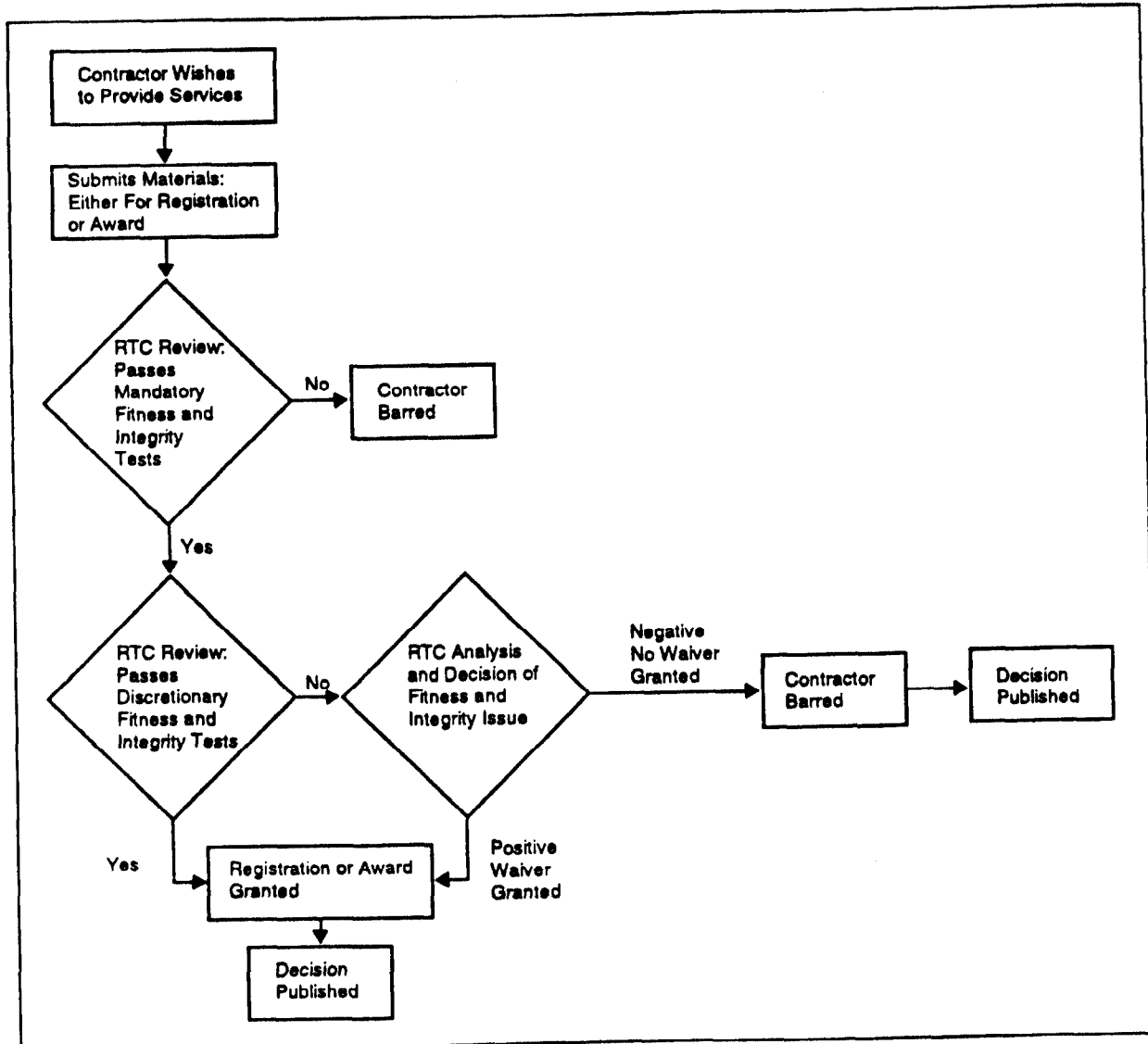
Finally, we held interviews with key personnel at the Federal Deposit Insurance Corporation (FDIC) and RTC about the development and implementation of policies for fitness and integrity issues.

OVERVIEW

GAO RTC's Fitness and Integrity
Policies for Contractors

- FIRREA required minimum standards of fitness and integrity.
 - RTC has mandatory criteria and discretionary authority for rejecting contractors.
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DESCRIPTION OF FITNESS AND INTEGRITY PROCESS



*Source: RTC provided information

RTC'S FITNESS AND INTEGRITY POLICIES FOR CONTRACTORS

FIRREA mandated that RTC employ the private sector in the management and disposition of insolvent thrifts' assets if such services are available and RTC determines that it is practical and efficient to do so. Another requirement was to issue regulations to assure that contractors who provide services meet minimum fitness and integrity standards.

In its strategic plan, the Oversight Board emphasized that the appearance of conflicts of interest as well as actual abuses should be avoided. To comply with both the law and the objectives of the strategic plan, RTC developed rules, policies, and procedures for fitness and integrity issues.

The RTC and the Oversight Board adopted regulations applicable to independent contractors for minimum standards of fitness and integrity. These regulations became effective February 5, 1990, and apply to law, accounting, and investment banking firms; asset managers; real estate brokers, appraisers, and property managers; and other service contractors.

FIRREA and the implementing regulations require mandatory ineligibility for those contractors who

- have been convicted of a felony;
- have been removed from or prohibited from participating in the affairs of any insured depository institution pursuant to any final enforcement action by any federal banking agency;
- have demonstrated a pattern or practice of defalcation;
- have caused a substantial loss to the federal deposit insurance funds;
- are currently in default on one or more obligations to the FDIC, the FSLIC, or the RTC.

In addition to those contractors not mandatorily barred from providing services, RTC, may use its discretionary authority to decide that a contractor is ineligible to provide services. In other words, RTC may determine that a contractor not excluded by the mandatory bars listed above fails to meet the minimum standards of fitness and integrity to perform work for the RTC because of other past activities.

Depending on the specifics of the case reviewed, RTC may decide that a contractor with a fitness and integrity issue, such as a conflict of interest or the appearance of a conflict of interest, is eligible to provide services, provided this conflict does not constitute a mandatory bar.

GAO Description of Program
Organization

- **Contractors' Conflicts Committee (CCC)**
 - Can approve contractor registration
 - Can provide waivers for contractors to work
 - Can impose conditions or screens for work
-

DESCRIPTION OF PROGRAM ORGANIZATION: CONTRACTORS' CONFLICT COMMITTEE

The CCC was established by the RTC Board of Directors to (1) consider matters in which a conflict or the appearance of a conflict with respect to independent contractors arises, (2) waive a conflict or the appearance of a conflict of interest where the disqualifying relationship or financial interest is not so significant as to warrant disqualification, and (3) make referrals and recommendations to the RTC Board of Directors concerning conflict-of-interest matters where the engagement of a contractor is in the best interest of the government.

The CCC is composed of high-level officials or their designated representatives from RTC, FDIC, the Office of Thrift Supervision (OTS) and the Office of Comptroller of the Currency (OCC). These individuals have the authority to vote on cases involving fitness and integrity issues. In addition, the CCC also contains nonvoting members from RTC's fitness and integrity program offices. The nonvoting members are responsible for the preparation and presentation of recommendations for cases that the CCC will consider.

When a fitness and integrity issue, such as a conflict of interest, exists, contractors must request the CCC to review and determine whether the contractor can do business with RTC, as discussed in the previous section.

CCC determinations generally fall into three categories: (1) discretionary determination(s) that a contractor meets the minimum standards of fitness and integrity and can register on RTC's contractor database, (2) waivers of discretionary criteria for specific contracts, and (3) denials of registration. Decisions to grant registration or waivers usually require contractors to meet certain conditions. These conditions are designed to assure that contractors establish the appropriate organizational control mechanisms to comply with FIRREA and the regulations.

CCC decisions are in writing and describe the bases for the decision. The decisions are then filed with the RTC executive secretary and made available to the public upon request. The CCC has delegated certain authority to the ethics officer to make contractor fitness and integrity determinations under the discretionary authority of the Independent Contractor Regulations. However, the CCC still requires that cases that have national implications or are precedent-setting be brought before it for disposition.

GAO Description of Program
Organization

- **Contractors' Ethics Office**
 - Developed and implements Independent Contractor Regulations
 - Works with Contractors' Business Review Office
 - Has delegated authority for certain issues
-

DESCRIPTION OF PROGRAM ORGANIZATION: CONTRACTORS' ETHICS OFFICE

The Contractors' Ethics Office is responsible for administration, interpretation, implementation, compliance, and enforcement of the Independent Contractor Regulations, as well as other policies and procedures related to fitness and integrity issues. It also reviews recommendations of the Contractors' Business Review Office regarding fitness and integrity issues related to independent contractors and refers cases not covered by its delegated authority for CCC review. All matters referred to the CCC are processed through the business review and ethics offices prior to being placed on the CCC agenda.

The ethics office also has responsibility for implementing guidelines related to fitness and integrity rules. For example, it is currently developing formal procedures for the suspension and exclusion of contractors who do not meet the minimum standards of fitness and integrity. RTC ethics officials expect to have final regulations by October 1991.

Once the CCC makes a determination on a particular case, the ethics office prepares the decision and notifies the contractor.

Current headquarters personnel consists of five professional and two administrative staff. Each RTC regional and consolidated office has an ethics officer dedicated to contractor matters.

GAO Description of Program
Organization

- **Contractors' Business Review Office**
 - Works with contractors in registration and other conflicts issues
 - Prepares cases for CCC review
 - Develops screening mechanisms
-

DESCRIPTION OF PROGRAM ORGANIZATION: CONTRACTORS' BUSINESS REVIEW OFFICE

The Contractors' Business Review Office is responsible for reviewing and processing all contractor fitness and integrity issues that arise either at the registration phase or later. Registration issues are referred by the receiving RTC contractor group, which may be located either at a regional or consolidated field office, to the national office.

The business review office works with the contractor to obtain and analyze information related to the fitness and integrity issues in question. The business review office can request additional information as required and refer the matter to the ethics office for concurrence or nonconcurrence under delegated authority or for final referral to the CCC. In situations where it is determined to be in RTC's best interest to allow registration of a contractor, the business review office, with assistance from field personnel, prescribes the mechanisms or controls that the contractor must establish in order to comply with RTC's minimum standards for fitness and integrity.

When a fitness and integrity issue arises, the business review office gathers information to present to the CCC or the ethics office where it has delegated authority to make a fitness and integrity determination. To date, a majority of these determinations have been to register contractors under RTC's discretionary authority.

The current headquarters staff consists of five professional and one administrative staff. Currently, there are no staff in the field. Because of this, the responsibilities for case documentation and analysis rest jointly with the contract specialist and the ethics officer in the field.

**GAO Overview of Registration
and Award Process**

- Process is in two phases.
 - Registration relies mainly on self-certification.
 - Contract requires pre-award verification.
 - Certain acts result in mandatory bars.
 - Conditions exist for waivers.
-

OVERVIEW OF THE REGISTRATION AND AWARD PROCESS

A two-phase process is used to determine whether contractors comply with the Independent Contractor Regulations. The first phase requires the contractor to submit a Contractor Registration Request (CRR), in which the contractor certifies that it meets all the minimum standards for fitness and integrity as established by the Independent Contractor Regulations. The receiving RTC contract group reviews the information submitted in the CRR. If it contains information requiring mandatory ineligibility, the contractor will be barred from providing services. This means that the contractor does not meet the minimum standards of fitness and integrity and cannot register with the RTC. If no fitness and integrity issues are found, the contractor will be registered on RTC's contractor database and may in the future compete for RTC contracts.

If the contractor is not mandatorily barred from providing services to the RTC, it still may have past activities that could bar it under discretionary authority. In these situations RTC may nevertheless decide that it is in its best interest to issue either a determination that the contractor can register with the RTC, or if the contractor is already registered, a waiver for award.

As mentioned previously, the business review office investigates, prepares, and coordinates with the ethics office for cases that can be resolved under delegated authority by the ethics office and identifies those that must be referred to the CCC.

After registration, the contractor may receive solicitations for services. Contractors that respond to these solicitations must reaffirm that the initial information regarding the minimum standards of fitness and integrity is still accurate. This information is reviewed by RTC, and if it is likely that the contractor will be awarded a contract, a pre-award fitness and integrity verification is done. RTC has developed and implemented policies and procedures to do these investigations and is currently in the process of revising these procedures and relocating this function within RTC. If as a result of this investigation a fitness or integrity issue is identified, then the business review office will either prepare a case to be handled by the CCC or resolve the issue with the delegated authority granted to the ethics office.

GAO Observations

- CCC permitted registration under discretionary authority for 67% of contractors reviewed.
 - CCC uses case law approach and publishes cases.
 - Standards for certain functions are still being developed.
-

OBSERVATIONSCCC Decisions

As of July 31, 1991, the CCC had decided 318 cases regarding fitness and integrity issues. The vast majority of these cases were decided at the initial registration phase. In 214 of the cases (67 percent) the CCC decided that the contractor could be registered under RTC's discretionary authority as provided in the Independent Contractor Regulations. Often these decisions required the contractor to take certain steps, such as establishing appropriate organizational mechanisms or controls to comply with the Independent Contractor Regulations, before being entered into RTC's contractor database. In four cases, the CCC decided to issue a waiver for award to contractors that had already been registered on RTC's contractor database. In 60 cases the CCC denied registration or award either because of a mandatory bar or under its discretionary authority determined the contractor did not meet the minimum standards of fitness and integrity. Forty cases were withdrawn from CCC consideration at the request of the contractor before a determination could be made.

CCC Uses a Case Law Approach

The director of the contractors' ethics office told us that the CCC uses a case law approach to make decisions. In essence, the CCC is building a set of operational guidelines by deciding similar cases in a similar fashion. The implementation of policies and procedures is developed from the review and precedents set in previous cases presented to the CCC. The CCC plans to publish the bases for decisions for all cases, giving first priority to cases that are precedent-setting or have national implications. As mentioned earlier, we are concerned that RTC is not publishing these cases in a timely manner.

Standards for Certain Functions Still Being Developed

The ethics office is in the process of developing formal suspension and exclusion procedures for registered contractors and for contractors who have been awarded an RTC contract. In April 1991, the ethics office established interim procedures for suspension and exclusion of registered contractors.

An interim final rule was published in the Federal Register on July 5, 1991.² RTC is soliciting comments from interested parties regarding the scope and applicability of these regulations and intends to publish the final regulations in the Federal Register by the end of October 1991.

²"Suspension and Exclusion of Registered Contractors and Rescission of Contracts'" 12 C.F.R. part 1618.

GAO Observations

- Effectiveness of screening procedures is unknown.
 - Firms in violation of fitness and integrity rules have received contracts.
 - Some decisions are not documented and available.
-

OBSERVATIONSEffectiveness of Screening Procedures Is Unknown

As mentioned previously, RTC may determine that it is in its best interest to grant a contractor registration or an award under its discretionary authority. Sometimes RTC requires that the contractor meet certain conditions or establishes certain mechanisms or controls to ensure compliance with the Independent Contractor Regulations. These conditions, often referred to as screens, are to be put into place by the contractor. RTC is currently assessing how well contractors are complying with these conditions. RTC has retained three law firms to examine four types of contractors who are providing services based upon screening requirements. RTC plans to obtain reports on how well the screening requirements work and what, if any, changes are needed. RTC officials could not provide a specific time frame for when they expect all the reports to be completed.

Firms in Violation of Fitness and Integrity Rules Have Received Contracts

In two specific cases RTC registered and awarded contracts to firms that it subsequently determined were either ineligible under the mandatory criteria of the Independent Contractor Regulations or in violation of the regulations because of nondisclosure of a material fact. In one case, RTC awarded 11 contracts valued at over \$21 million to the Ralph Edgar Group, Inc. RTC later determined that a key management official had defaulted on loans to insured depository institutions, thus violating a mandatory bar. The ethics office recommended the contractor be removed from all contracts. The contracts have subsequently been rescinded.

On October 31, 1990, the RTC awarded a contract with fees of approximately \$2 million to the Pillar Investment Company. It was later determined that its chief operating officer had not fully disclosed involvement with a savings and loan institution. The chief operating officer has subsequently resigned from the position in the thrift. Pillar is still providing services to RTC.

Backlog of Issued Decisions

The ethics office has responsibility for writing the CCC decisions. As of July 31, 1991, there was a backlog of 257 cases that had been decided but not documented. As a result, RTC may not be providing the contracting community with timely information on the nature of its decisions. This delays communication of CCC decisions and suggests the contracting community may not be getting all available information on RTC operational guidelines in a timely manner.

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