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RESOLUTION TRUST CORPORATION

Management Improvements Reduce Risks But Transition Challenges Remain

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RESOLUTION TRUST CORPORATION
MANAGEMENT IMPROVEMENTS REDUCE RISKS
BUT TRANSITION CHALLENGES REMAIN

SUMMARY OF STATEMENT OF
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From its inception in August 1989, through May 1995, the Resolution Trust Corporation (RTC) has completed the depositor protection phase of its work for all 747 failed thrifts, whose aggregate assets totaled about $465 billion. In addition, RTC has made substantial progress in disposing of about $445 billion of financial, real estate, and other assets. This significant decrease in RTC's responsibility lessens the magnitude of the remaining risks associated with the savings and loan cleanup. Furthermore, RTC's efforts to address the weaknesses identified in GAO's 1992 High-Risk report have resulted in GAO's removal of its high-risk designation for RTC.

Despite this progress, however, GAO points out that some remaining risks related to the cleanup need further attention. For example, a substantial portion of the $20 billion of assets held for sale by RTC's receiverships are classified as hard-to-sell. Further, RTC estimates that about $8 billion to $10 billion in assets will remain unsold at the end of 1995 and will be transferred to the Federal Deposit Insurance Corporation (FDIC). Thus, it remains important that RTC use the sales strategies that are most effective for the types of assets left in its inventory. At the same time, RTC must continue its efforts to implement the management reforms mandated by the RTC Completion Act.

Winding down a large and complex organization with thousands of personnel and billions of dollars of assets, while minimizing disruption, will be very difficult. For a successful transition, RTC and FDIC will need to ensure that sufficient controls are in place over the assets that will be sold during the remaining life of RTC, as well as over the assets that will be transferred to FDIC.

While transition efforts are well under way, there is still much work left to ensure the smooth transfer of remaining assets and responsibilities to FDIC. GAO identifies a number of issues that need to be resolved to ensure the overall success of the transition. These include (1) providing sufficient resources to FDIC to complete asset disposition and other work that will transfer from RTC, (2) addressing staffing issues, (3) developing specific asset disposition plans, and (4) merging the RTC and FDIC inspector general functions.

Mr. Chairman and Members of the Committee:

I am pleased to be here today in support of the Committee's oversight of the Resolution Trust Corporation (RTC). As you requested, my testimony focuses on RTC's performance and the remaining challenges involving RTC's transition to the Federal Deposit Insurance Corporation (FDIC). Specifically, I will discuss (1) our recent report to the Acting Chief Executive Officer (CEO) of RTC on the management improvements that led to RTC's removal from our high-risk list, (2) the status of planning efforts for RTC's transition to FDIC, and (3) some of the unresolved transition issues that RTC and FDIC will be facing within the next few months.

BACKGROUND

To date, RTC has been authorized $105 billion in loss funds to be used for resolving thrifts that fail between January 1, 1989, and July 1, 1995. On the basis of the estimates presented in RTC's 1994 financial statements,[1] which are subject to uncertainties, RTC will likely have $14.8 billion in unused loss funds after resolving all institutions for which it is responsible. RTC and FDIC are jointly reviewing the appropriate level of contingency funding that might be necessary to address adverse changes in economic conditions, litigation, and other factors beyond their control.

From RTC's inception in August 1989, through May 1995, it has accepted responsibility for resolving 747 failed thrifts with aggregate assets totaling about $465 billion. Although RTC has disposed of more than 95 percent of these assets, more work remains before the thrift cleanup is completed. As of the end of April 1995, most of the $20 billion in assets held for sale by RTC's receiverships were considered hard to sell. Further, RTC has estimated that about $8 billion to $10 billion in assets will remain unsold at the end of 1995 and will be transferred to FDIC.

As RTC enters its final months of operation, we are pleased to note the progress it has made in addressing management issues that Congress, we, and the RTC Inspector General have identified over RTC's 6-year life. By addressing these issues, RTC has reduced the risks associated with its operations.

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[1]We have completed our audit of RTC's 1994 financial statements and plan to report on it later this week.

MANAGEMENT IMPROVEMENTS RESULTED IN REDUCED RISKS

In December 1992, we reported on several aspects of RTC's operations that led us to designate RTC as a high-risk area.[2] In our report, we described risks related to RTC's (1) asset disposition practices, (2) contracting activities, (3) information systems, and (4) financial management and accountability. We also recognized the effect of future uncertainties on RTC's resolution activities, and we pointed to opportunities to reduce the overall cost of the thrift cleanup if RTC were given adequate funding. In addition, we warned that the thrift cleanup would not be completed by the time RTC sunsets and that the total cost of the cleanup would depend, in part, on how effectively FDIC applies RTC's investment in both processes and skilled personnel to manage the remaining responsibilities.

Our most recent RTC report describes actions taken by Congress, RTC, and FDIC that address many of our prior concerns.[3] In our report, we describe risks related to RTC's (1) asset disposition practices, (2) contracting activities, (3) information systems, and (4) financial management and accountability. Congress, in the RTC Completion Act, gave RTC the additional funding it needed to accomplish its work; mandated that RTC implement specific management reforms; and required that an interagency transition task force be established to help transfer RTC's assets, personnel, and operations to FDIC. We reported earlier this year that RTC had implemented most of these reforms.[4] Further, RTC and FDIC have established the interagency task force, and it is in the process of planning for a smooth and efficient transition. In addition, RTC has eliminated its inventory of thrifts waiting to be resolved and dramatically reduced assets available for sale, further diminishing the remaining risk.

In the area of real estate disposition, our 1992 high-risk report highlighted the risk that RTC might not be maximizing revenues due to its lack of reliable information on the best disposition methods for the various types of properties. RTC has not completed the comprehensive sales method comparison study we recommended to remedy this situation, but it has implemented two congressionally mandated management reforms related to its marketing and disposition methods that should help it obtain

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[2] High-Risk Series: Resolution Trust Corporation (GAO/HR-93-4, Dec. 1992).

[3] Resolution Trust Corporation: Efforts Under Way to Address Management Weaknesses (GAO/GGD-95-109, May 1995).

[4] Resolution Trust Corporation: Implementation of the Management Reforms in the RTC Completion Act (GAO/GGD-95-67, Mar. 1995).

maximum revenues. In addition, RTC established a process for gathering some information that may be useful for evaluating sales techniques used for multiasset dispositions. Despite this progress, we are concerned that the lack of a valid sales method comparison may hamper transition team efforts to identify RTC sales methods that FDIC should adopt.

Regarding the contracting function at RTC, we noted in our 1992 high-risk report that RTC's contract issuance process was poor and that its oversight of contractor performance needed improvement. Actions taken by RTC prior to, and as a result of, the mandated management reforms addressed contracting activities. These actions have improved RTC's processes for issuing and overseeing contracts. However, contract audits continue to identify weaknesses in operating controls related to contracts issued before these improvements were made. As a result, RTC cannot ensure that it recovers all that it should from its receiverships. Also, as discussed in more detail later, RTC is still vulnerable to risks associated with closing out contracts in an untimely manner.

RTC has also improved internal accounting controls over its receiverships' transactions, accounting operations, and systems. Specifically, RTC has issued internal control policies, finalized field accounting procedures, and established controls over receivership receipts and payments. In addition, RTC has implemented several new systems that contribute to improved accountability and reporting.

RTC's information systems remain critical to its efforts to manage and sell failed thrift assets and to FDIC's task of assuming responsibility for any remaining RTC operations after December 31, 1995. In the past, we found that RTC's information systems contained inaccurate and incomplete data. RTC is making progress in improving the quality of data in its systems. However, as it reduces staffing levels, RTC may have fewer resources to ensure that data errors are corrected. The quality of RTC's data will affect FDIC when it assumes responsibility for those assets that remain to be sold after RTC's sunset.

A source of continuing concern stems from this being the final months of RTC's existence, after which FDIC will absorb any remaining operations and workload. Winding down a large and complex organization with thousands of personnel and billions of dollars of assets, while minimizing disruption, will be very difficult. RTC and FDIC face the challenge of planning the transition, while RTC faces the challenges of disposing of the $20 billion in assets that remain, and of maintaining internal controls.

STATUS OF THE TRANSITION OF RTC TO FDIC

The RTC Completion Act required RTC and FDIC to establish a transition task force to facilitate the transfer of RTC assets, personnel, and operations to FDIC in a coordinated manner. The transition planning task force was established in February 1994. Its members are two RTC officials, who report to the Acting CEO of RTC, and two FDIC officials, who report to the Chairman of FDIC.[5] The RTC Completion Act assigned the task force specific duties, including examining the operations of RTC and FDIC, evaluating the differences, and recommending which RTC systems should be preserved for use by FDIC.

The act also required three reports to Congress on the transition. The first report from the task force, issued on December 28, 1994, describes the task force's planning activities. The second report, due on July 1, 1995, should include the task force's recommendations on RTC practices and systems to be adopted by FDIC. The final transition report is due on December 31, 1995, from FDIC. This report should contain information on transition task force recommendations accepted by FDIC and a rationale to account for any recommendations not accepted.

The task force, which has been operating for over a year, has established a reasonable process for planning the transition. From our monitoring, we believe the process is well designed, with no known major gaps or omissions. This transition process provides for the involvement of top management at RTC and FDIC and also ensures that RTC and FDIC program managers who are most knowledgeable about the operations involved will have input. GAO, the RTC Inspector General, and the Thrift Depositor Protection Oversight Board have also been involved in monitoring elements of the transition planning process.

Some key elements of the transition planning process include (1) "best practice reviews" being conducted jointly by RTC and FDIC groups to identify differences in their respective operations for the purpose of formulating recommendations on the best practices that should be adopted by FDIC after RTC's sunset, (2) information systems reviews to assist the Secretary of the Treasury in making recommendations on RTC systems that should be adopted by FDIC, and (3) implementation plans that identify staffing and organizational structure for RTC functions after they are absorbed by FDIC.

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[5]The RTC task force members are the General Counsel and the Vice President for Planning, Research, and Statistics. The FDIC members are the Deputy to the Chairman of the FDIC Board and the Director of the Division of Depositor and Asset Services.

Additionally, RTC and FDIC are in the process of reviewing legal and policy issues related to the transfer of RTC's responsibilities and operations to FDIC. They are also reviewing internal controls to ensure that vulnerabilities to waste, fraud, and abuse are minimized during and after the transition.

The transition of RTC to FDIC is well under way. In the past year, the RTC/FDIC transition planning task force has made many important decisions regarding personnel issues and time frames for merging many operations. To date, about 900 staff have made the transition from RTC to FDIC, RTC has closed its asset operations in one of its regional offices, and plans to close asset operations in another region by the end of this month. RTC and FDIC have also started detailed planning for the merger of some functions, such as the information management function, that is scheduled to merge this month. However, the transition task force has not completed its review and approval of some of the ongoing planning efforts. While we have had discussions with task force staff about their approach and progress, we are not in a position today to comment on the results of best practice reviews, information systems reviews, and other efforts.

TRANSITION PLANNING EFFORTS ARE IN A CRITICAL PHASE, AND MANY ISSUES STILL NEED RESOLUTION

Transition planning has reached a critical phase. The transition task force plans to make many key decisions in the next month. The decisions made now could affect both the costs of the cleanup and FDIC's efficiency and effectiveness after RTC's sunset.

Within the next month, the task force plans to finalize its best practice reviews and information systems recommendations. It also plans to complete, within the next few months, transition implementation plans to provide details on staffing, workload, and organizational structure after the transition. The task force is also reviewing legal and policy issues relating to the transfer of RTC operations and responsibilities.

While it has shown promise, the task force's best practice review process has not yet resulted in the issuance of best practice recommendations. RTC and FDIC have identified 76 operational differences for best practice studies and staff have completed the studies for most of these differences. For example, one best practice study is to focus on the relative merits of RTC's centralized securities sales versus FDIC's decentralized approach. The task force has reviewed and discussed 63 of the completed studies and is in the process of documenting the results of its deliberations. The remaining studies are in various stages of preparation and will be considered by the task force over the next few weeks.

Although the task force has not yet made its final best practice recommendations, we have reviewed the methodology used to perform the best practice studies. We are also in the process of reviewing some of the documentation considered by the task force as it formulates its recommendations. We believe that the best practice methodology should assist the task force to meet requirements in the RTC Completion Act and can be used to ensure that the most significant operational differences between RTC and FDIC are fairly and thoroughly evaluated. The methodology also includes a review committee to ensure consistent application of the review methodology and to supply technical assistance. We believe the quality of the best practice recommendations will depend on the degree of adherence to the methodology, on the quality of the supporting data and analysis, and on the degree of cooperation between RTC and FDIC managers. The quality of contractor products will also affect recommendation quality since contractors were used to perform some of the best practice analyses.

Another important aspect of the transition planning is the task force's review of information systems. RTC and FDIC identified over 60 RTC information systems and studied them to determine if they should be transferred to FDIC. The transition task force has nearly completed its consideration of the information systems reviews in order to make recommendations to the Secretary of the Treasury concerning which RTC systems should be transferred to FDIC.

Although the task force's recommendations on transferring information systems are scheduled to be announced in the July 1, 1995, report to Congress, it is important to note that they are being made at a time when FDIC is redefining its mission and reassessing its own information needs. FDIC will need to assess the long-term applicability of RTC systems in the context of its own efforts.

Implementation plans are another key aspect of the transition planning process that is currently under way. These plans are to provide the details necessary to implement the merger of RTC functions and staff. These plans address workload, staffing, and organizational structure, as well as how the merged organization will operate. FDIC intends to review these implementation plans within the context of its own mid-year budget review process to ensure proper consideration of various corporate activities.

Although RTC and FDIC have made progress in planning the transition, several critical issues still remain to be addressed. Through discussions with the task force members and staff, we identified eight issues that are particularly significant because of the impact they will have on the overall success of the transition and future operations of FDIC. The task force members have expressed their commitment to resolving these issues, and plan to make many decisions within the next few weeks. These issues are as follows:

-- Providing *sufficient resources* to FDIC to complete asset disposition and other work that will transfer from RTC. RTC and FDIC are jointly reviewing the appropriate level of contingency funding that might be necessary to address adverse changes in economic conditions, litigation, and other factors that are beyond the control of RTC and FDIC.

-- Making *legal and policy decisions* to determine how FDIC will absorb RTC's responsibilities and operations. Transition planners have identified more than 50 issues that needed legal analysis and other decisions. These issues cover a broad range of RTC's operations and will shape the future of FDIC's operations. For example, some issues relate to the applicability to FDIC of RTC management improvements mandated in the RTC Completion Act, while others address the employment rights of RTC employees after sunset. As of today, most of these issues have been decided, and decisions on remaining issues are expected to be made within the next few weeks. The task force will need to ensure these decisions are communicated to program staff and reflected in implementation plans.

-- Making decisions regarding *RTC and FDIC Professional Liability Sections* (PLS). The transition team has decided that RTC's PLS will transfer to FDIC after December 31, 1995. However, there is some uncertainty over the best timing for fully integrating RTC's PLS with FDIC's PLS. One approach being discussed is the immediate integration of the two PLS units at transition for the purpose of achieving efficiencies and to better ensure consistency in staff recommendations on both RTC's and FDIC's professional liability claims. The other approach would keep the two PLS units organizationally distinct, for accountability and case continuity purposes, until December 31, 1996, a year after RTC's PLS becomes part of FDIC's Legal Department.

-- Addressing *staffing issues*. While many RTC staff have already transferred to FDIC, an additional 1,300 of RTC's 5,000 staff have FDIC employment rights until 1997. Specific staffing assignments have not yet been made for most of these 1,300 individuals. FDIC is currently reviewing its mission and undergoing employee downsizing. This complicates planning for the transfer of RTC staff. FDIC will have to closely monitor for workload and staffing imbalances since the transfer of RTC employees may cause overstaffing in some occupations, functional areas, or geographic regions. FDIC will also need to evaluate the relative proportion of work done by contractors and its own staff to ensure maximum efficiency.

-- Developing specific *asset disposition plans*. FDIC needs to develop specific plans on how it will manage and dispose of the remaining RTC assets. To assist FDIC in this effort, RTC needs to provide accurate and complete information on these remaining assets. Communication between RTC and FDIC asset disposition staff on best practices should help with asset disposition planning, but several of the best practice decisions have not been made. Furthermore, the nature of some assets remaining at RTC's sunset may present FDIC with special challenges. Specifically, FDIC will need to be prepared to manage and dispose of significant numbers of subsidiaries, special resource properties, and environmentally hazardous properties. FDIC will also need to be prepared to monitor the government's continuing interests in RTC's equity partnerships.

-- Deciding the future of *minority and women's programs*. RTC and FDIC have different programs for providing opportunities to minorities and women through the contracting and resolution processes. Decisions need to be made on how these opportunities will apply after RTC's sunset. The task force has contracted for an evaluation of the applicability of RTC management reforms and best practices related to minority and women's programs. However, a number of decisions relating to the future of minority and women's programs may still have to be made by the FDIC Chairman.

-- Addressing *contracting issues*. RTC needs to devote continued attention to closing out contracts on a timely basis. According to a November 1994 RTC estimate, at least 12,000 prime contracts issued before December 31, 1992, with estimated fees of about $2.8 billion, still needed to be closed. Approximately 1,400 of these contracts will be transferred to FDIC for closeout. Additionally, RTC has identified about 800 contracts recommended for continuation at FDIC after RTC's sunset. It will be critical for FDIC to ensure adequate management and oversight of these contracts. In addition, FDIC may benefit by evaluating its own contracts in conjunction with RTC contracts to explore opportunities to combine, cancel, or extend them.

-- Merging the *RTC and FDIC inspector general functions*. Currently, FDIC is awaiting congressional action on the confirmation of its statutorily mandated Inspector General. The absence of a confirmed Inspector General at FDIC may complicate the merger of RTC and FDIC inspector general operations. Successful accomplishment of the merger will require major decisions that will affect the future FDIC Inspector General's organizational structure, staffing, policies, and practices.

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In closing, I would like to say that Congress and RTC have taken actions over the years to improve RTC operations, and now RTC's mission has nearly been completed. As a result, the risks once associated with RTC have been reduced, and consequently we have removed RTC from our list of high-risk programs. We are pleased with the transition planning efforts to date, but the true test of this transition is yet to come. Although RTC's remaining life is short, Congress should be aware that there is still much work left to be done to ensure the smooth transfer of remaining assets and responsibilities to FDIC. RTC and FDIC will need to make several key decisions in the next few months, and then implement them before RTC's sunset at year-end. The success of the transition depends on the quality of these decisions and on how well they are executed.

This concludes my prepared statement. I would be pleased to respond to any questions.

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