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**AUDIT OF RTC MORTGAGE TRUST 1993-N3**

**Audit Report No. 00-005**  
**March 17, 2000**



**OFFICE OF AUDITS**  
**OFFICE OF INSPECTOR GENERAL**

**DATE:** March 17, 2000

**TO:** Gail Patelunas, Deputy Director  
Asset Management Branch  
Division of Resolutions and Receiverships



**FROM:** Sharon M. Smith  
Assistant Inspector General

**SUBJECT:** *Audit of RTC Mortgage Trust 1993-N3* (Audit Report No. 00-005)

This report presents the results of an audit of Resolution Trust Corporation (RTC) Mortgage Trust 1993-N3. The Office of Inspector General (OIG) performed the audit in response to a request from the Federal Deposit Insurance Corporation's (FDIC) Division of Resolutions and Receiverships (DRR) to audit various trusts.<sup>1</sup> Mortgage Trust 1993-N3, created on October 5, 1993, consisted of a class A certificateholder—1993-N3 Associates, LP—and a class B certificateholder—the RTC.

## **BACKGROUND**

The RTC had the authority to create trusts that sold, through competitive bid sales, certificates representing a percentage of beneficial ownership in those trusts. One of those RTC-created trusts, Mortgage Trust 1993-N3 (the Trust), consisted of 318 loans with a principal balance of approximately \$324 million.

The objective of the Trust, organized as a Delaware business trust, was to dispose of the assets purchased from the RTC as promptly as possible in a manner that maximized economic return. On October 5, 1993, the RTC signed a deposit trust agreement with Wilmington Trust Company, the trustee. The trustee was responsible for ensuring that all parties to the transaction fulfilled their respective obligations under the deposit trust agreement.

In exchange for the assets, the RTC received from the trustee cash and two types of equity certificates—the controlling class A certificate and the noncontrolling class B certificate. The RTC, in turn, sold the class A certificate to 1993-N3 Associates, LP, which consisted of four investors—Bankers Trust, Sterling American Properties, BEI Management, and an individual investor. The RTC contracted with Aldridge, Eastman, and Waltch (AEW) to assist in its oversight responsibilities and oversee its class B interest in the Trust.

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<sup>1</sup>December 31, 1995, marked the RTC's legislatively mandated sunset date. Responsibility for all RTC-related work ongoing as of that date transferred to the FDIC in accordance with the *RTC Completion Act of 1993*.

The class A certificate provided for the holder to receive 49 percent of the Trust's income and be responsible for the Trust's daily operations. The class B certificateholder was entitled to the remaining 51 percent of income. The class A certificateholder entered into a servicing agreement with one of its partners—BEI Management—to service the Trust's mortgage loans and manage, market, and dispose of the Trust's assets. In November 1994, BEI Management changed its name to AMRESKO Management (AMRESKO).

The Trust, under an agreement with the Bank of America National Trust and Savings Association (the bond trustee), issued \$104 million of commercial, loan-backed bonds to third-party institutional investors through open-market transactions. As the class A certificateholder liquidated the Trust's assets, the proceeds were first used to retire the bonds and any remaining funds were then distributed to the class A and class B certificateholders. The bonds were retired in January 1996.

## **OBJECTIVE, SCOPE, AND METHODOLOGY**

The objective of the audit was to determine whether AMRESKO charged the Trust only allowable expenses and accurately accounted for and reported income. The audit covered the Trust's operations from its inception on October 5, 1993, through October 31, 1998.

To accomplish the objective, we interviewed FDIC personnel from the Agreement and Case Management Section, Oversight and Monitoring Branch, DRR. Additionally, we reviewed applicable FDIC policies and procedures relating to the administration of equity partnerships. We also interviewed personnel from AEW—DRR's oversight contractor—and AMRESKO—the Trust's servicer.

Our audit focused on the Trust's income and expenses from loan servicing, operating assets, and the sale or other disposition of assets. We randomly sampled 10 of the 318 assets to verify whether AMRESKO accurately accounted for and properly reported the Trust's income and charged the Trust only allowable expenses. For the 10 assets sampled, we tested the receipt of income from loan payments, operation of foreclosed assets, and asset dispositions through settlements or sales. Those assets represented \$6 million of the Trust's \$130 million in revenues as of October 31, 1998.

For the first 5 of the 10 assets sampled, we determined whether related expenses were allowable under the terms of the Trust's agreements. We also reviewed all of AMRESKO's and the class A certificateholder's overhead expenses charged to the Trust as well as AMRESKO's servicing fees. In total, we reviewed \$18.4 million of the \$65.8 million in expenses charged to the Trust.

We did not evaluate AMRESKO's system of internal controls because the OIG concluded that it could meet the audit objective more efficiently by conducting substantive tests rather than placing reliance on the internal control system. The OIG conducted the audit from October 1998 through December 1999 in accordance with generally accepted government auditing standards.

## RESULTS OF AUDIT

For the 10 sampled assets, AMRESKO accurately accounted for the Trust's income. However, the Trust did not remit \$402,161 due the FDIC for its share of a participation loan that the Trust sold but did not own. We also questioned \$685,655 of unallowable expenses that AMRESKO paid from the Trust's funds. Table 1 summarizes the questioned cost by category.

**Table 1: Summary of Questioned Cost**

<b>Category</b>	<b>Amount Questioned</b>
Participation sales proceeds due the FDIC	\$ 402,161
Unallowable fees paid to AMRESKO affiliates	454,676
Unallowable asset servicing fees	76,629
Unallowable class A certificateholder expenses	53,206
Unallowable miscellaneous expenses	101,144
<b>Total</b>	<b>\$1,087,816</b>

Source: OIG analysis of the Trust's revenues and expenses.

### Participation Sales Proceeds Due to the FDIC

AMRESKO did not remit \$402,161 due the FDIC from the sale proceeds of a participation loan. Specifically, the Trust purchased a 50-percent participation interest in a loan but recorded 100 percent of the sales proceeds as the Trust's income, which AMRESKO credited to certificateholders. The mortgage loan schedule accompanying the assignment of assets showed that the Trust purchased a 50-percent participation interest in a loan owned by Flagler Savings. The Trust did not purchase the remaining 50-percent interest, which Miami Savings (an RTC receivership) owned. However, AMRESKO sold the entire loan in a bulk sale on January 31, 1995. AMRESKO should have remitted 50 percent of the net sales proceeds to the RTC for Miami Savings' 50-percent share of the loan and credited the remaining 50 percent to the Trust's equity, which was later distributed to the certificateholders. Instead, AMRESKO credited 100 percent of the net sales proceeds to the Trust's equity. Accordingly, the Trust owed the FDIC \$402,161 for Miami Savings' share of the net sales proceeds.

### Unallowable Fees Paid to AMRESKO Affiliates

AMRESKO billed the Trust \$454,676 for an in-house tax consulting group. AMRESKO billed the Trust and paid itself despite the prohibition in the Trust's servicing agreement and other documents against payments to affiliates of either the servicer or the class A certificateholder. Both AMRESKO and class A certificateholder officials stated that the in-house tax consulting services were in addition to AMRESKO's normal servicing responsibilities. The officials added

that the services were performed at the discretion of the class A certificateholder and, therefore, not subject to the prohibition against payments to affiliates.

We disagree with the AMRESO and class A certificateholder officials on both points. The servicing agreement required AMRESO to establish subsidiary corporations and limited partnerships, owned by the Trust, to take title to foreclosed properties. AMRESO's in-house tax consulting group compiled information to file the subsidiary corporations' and limited partnerships' federal, state, and local tax returns and performed other tax-related functions for the Trust. Accounting for the subsidiary corporations and limited partnerships, including the tax consequences of operating the subsidiaries, was necessary to protect the Trust's assets and, therefore, a responsibility of the servicer.

We also disagree with the assertion that the affiliate prohibition did not apply to services performed at the discretion of the class A certificateholder. The servicing agreement clearly prohibits any payment of the Trust's funds to affiliates of either the servicer or the class A certificateholder. The deposit trust agreement prohibits the class A certificateholder from violating any term of the Trust's documents, which include the servicing agreement. Accordingly, any payment to an affiliate of the servicer or class A certificateholder, regardless of whether at the class A certificateholder's discretion, violated the terms of the deposit trust agreement.

We believe that the prohibition against the use of affiliates was included to safeguard the Trust against self-dealing on the part of either the servicer or the class A certificateholder. The use of its in-house tax consulting group provided AMRESO with additional revenues and profits not contemplated under the Trust's documents. Such arrangements raise concerns as to whether the charges were reasonable and necessary and, in fact, benefited the Trust. Accordingly, we questioned \$454,676 paid to AMRESO for its tax consulting group.

While we consider the entire payment made to AMRESO for its tax consulting group to be unallowable because of the aforementioned reasons, we also identified that AMRESO marked up its direct cost associated with the tax consulting group. Using AMRESO's analysis of markups of direct costs,<sup>2</sup> we estimated that AMRESO billed the Trust \$197,923 more than it incurred for the tax consulting group as shown in table 2.

**Table 2: AMRESO's Markup of Tax Consulting Group Costs**

<b>Employee Status</b>	<b>Direct Cost</b>	<b>Markup</b>	<b>Total Billed</b>
AMRESO employees	\$205,665	\$180,780	\$386,445
Temporary employees	51,088	17,143	68,231
<b>Total</b>	<b>\$256,753</b>	<b>\$197,923</b>	<b>\$454,676</b>

Source: OIG analysis of the Trust's expenses.

<sup>2</sup>AMRESO prepared an analysis of its markup on this and three other trusts based on concerns raised by the OIG in another report entitled *Audit of RTC Mortgage Trust 1992-N1* (audit report number 99-035 dated August 23, 1999).

## **Unallowable Asset Servicing Fees**

In addition to its monthly servicing fees, AMRESKO billed the Trust an additional \$76,629 in unallowable servicing fees, which included the reconstruction and reconciliation of loan files, clerical assistance, and bonuses paid to its asset managers. AMRESKO was responsible for servicing the assets, and the fee schedule included in the servicing agreement specified AMRESKO's compensation for all servicing activities. The servicing agreement allowed AMRESKO to subcontract—at its own cost—for all or a portion of its servicing requirements. Accordingly, we questioned \$76,629 in asset servicing fees that were in addition to the specified monthly servicing fees. AMRESKO billed the Trust additional servicing fees as follows:

- \$74,841 for staff time relating to the reconstruction and reconciliation of the mortgage loan files,
- \$312 for temporary clerical assistance to an asset manager, and
- \$1,476 for asset manager bonuses.

According to AMRESKO officials, the loan files were in disarray and need of updating and selected asset managers were paid incentive bonuses to continue employment through a major asset sale.

## **Unallowable Class A Certificateholder Expenses**

AMRESKO paid \$53,206 from the Trust's funds for unallowable expenses related to the class A certificateholders' operations. Those expenses included \$6,358 in due diligence expenses, \$19,120 in legal fees, and \$27,728 in travel and entertainment expenses for the class A certificateholder. Neither the deposit trust agreement nor the servicing agreement provided for reimbursement of those class A certificateholder's expenses.

The \$6,358 that AMRESKO paid the class A certificateholder for due diligence expenses included the class A certificateholders' travel, entertainment, and administrative expenses incurred before the formation of the Trust. AMRESKO also paid legal bills totaling \$19,120 for a law firm representing the class A certificateholder. The bills included services relating to the class A certificateholder's operations as well as services provided to the Trust. Those services included the class A trust compliance certification, a bond transfer proposal, and the Trust's servicing requirements. However, because the law firm did not designate whether it provided the services to the Trust or the class A certificateholder, we questioned the total legal fees billed.

In addition, AMRESKO paid the class A certificateholder \$27,728 for travel and entertainment expenses. Generally, the expenses appeared to be for the class A certificateholder's partners to attend partnership meetings at the class A certificateholder's offices in New York, New York, or the servicer's offices in Dallas, Texas. The invoices in most cases lacked receipts or other support and appeared excessive. For example, one invoice included a \$199 charge identified only as "drinks."

Neither the deposit trust agreement nor the servicing agreement contain provisions for the reimbursement of due diligence costs, legal fees, travel and entertainment expenses, or partnership administration costs incurred by the class A certificateholder.

### **Miscellaneous Unallowable Expenses**

AMRESO charged the Trust \$101,144, of which \$25,624 was unsupported, for unallowable miscellaneous expenses. The Trust's servicing agreement provided that disbursements from the Trust's funds had to be directly related to the management and liquidation of the Trust's assets. However, AMRESO billed expenses to the Trust that were either unrelated to asset management and liquidation or unsupported as follows:

- \$59,196 for duplicate payments to a temporary employment agency;
- \$8,056 for travel, duplicating, and delivery expenses incurred before the Trust's closing;
- \$1,981 for travel expenses, including first class airfare, for an AMRESO official to attend the Trust's closing;
- \$2,720 for tax return preparation when no expense was paid by AMRESO;
- \$3,497 for entertainment, including \$534 for a baseball game outing and \$696 for a nightclub outing for class A certificateholder executives and AMRESO staff;
- \$60 for an employee's CPA license;
- \$10 for a credit card fee; and
- \$25,624 for unsupported overhead and other miscellaneous expenses.

Class A certificateholder officials stated that the miscellaneous charges were normal business cost to enhance employee morale and those expenses were reasonable given the overall performance of the Trust. However, the servicing agreement limited use of the Trust's funds to expenses necessary for management and liquidation of the Trust's assets. The miscellaneous expenses listed above were not necessary for those purposes and were, therefore, unallowable.

### **CONCLUSIONS AND RECOMMENDATIONS**

AMRESO accurately accounted for and properly reported the Trust's income for the sampled assets reviewed. However, the Trust did not remit participation loan sales proceeds of \$402,161 due the FDIC for the non-Trust portion of the loan. In addition, AMRESO charged the Trust \$685,655 for expenses that were not allowable under the terms of the servicing agreement or the

deposit trust agreement. Accordingly, we recommend that the Deputy Director, Asset Management Branch, DRR, take the following actions:

- (1) Disallow the net participation sales proceeds not remitted to the FDIC and require AMRESCO to remit that amount to the FDIC.
- (2) Disallow \$454,676 in fees paid to AMRESCO affiliates and require AMRESCO to reimburse the Trust (questioned cost of \$231,885 representing the FDIC's 51-percent share).
- (3) Disallow \$76,629 in unallowable servicing fees paid to AMRESCO and require AMRESCO to reimburse the Trust (questioned cost of \$39,081 representing the FDIC's 51-percent share).
- (4) Disallow \$53,206 in operating expenses paid to the class A certificateholder and require AMRESCO to recover those funds and reimburse the Trust (questioned cost of \$27,135 representing the FDIC's 51-percent share).
- (5) Disallow \$101,144 (of which \$25,624 is unsupported) in miscellaneous expenses paid to AMRESCO and require AMRESCO to reimburse the Trust (questioned cost of \$51,583, of which \$13,068 is unsupported, representing the FDIC's 51-percent share).

## **CORPORATION COMMENTS AND OIG EVALUATION**

On February 18, 2000, the Deputy Director, DRR, provided a written response to a draft of this report. The Deputy Director's response agreed with recommendations 2, 3, 4, and 5 and disagreed with recommendation 1. The response provided the requisites for a management decision on each of the five recommendations. The Deputy Director's response is presented as appendix I to this report.

A summary of the Deputy Director's response to recommendations 1 and 2 and our analysis follows. The response to recommendations 3, 4, and 5 is not summarized because the actions planned or completed are identical to those recommended.

**Disallow \$402,161 in net participation sales proceeds not remitted to the FDIC and require AMRESCO to remit that amount to the FDIC (questioned cost of \$197,059 representing the difference between the recommended disallowance of \$402,161 and \$205,102—the FDIC's 51-percent share of that amount) (recommendation 1):** The Deputy Director disagreed that the Trust purchased only 50 percent of the participation loan. The Deputy Director stated that the mortgage loan schedule included in the Trust documents was erroneous because it failed to show that the participation interest owned by Miami Savings was also conveyed to the Trust. After we issued the draft report, DRR provided a reconciliation that showed 100 percent of the participation loan was conveyed to the Trust instead of the 50-percent interest shown on the mortgage loan schedule. Based on the additional information provided, we agree with the



Deputy Director's response, which provided the requisites for a management decision. Accordingly, we have reduced the questioned costs in our final report by \$197,059.

**Disallow \$454,676 in fees paid to AMRESKO affiliates and require AMRESKO to reimburse the Trust (questioned cost of \$231,885 representing the FDIC's 51-percent share):** The Deputy Director agreed that payments to affiliates were not allowable under the Trust agreements. However, the Deputy Director stated that to the extent that the questioned payments, including any imputed markup, were reasonable and within industry standards for such services, DRR would not pursue reimbursement of the expenses because they were incurred in good faith. The Deputy Director added that it would be inequitable not to pay the questioned amounts because the Trust benefited from the services. Although the Deputy Director's response contained the requisites for a management decision, we disagree with the Deputy Director's reasons for not seeking reimbursement for the fees paid to AMRESKO affiliates. In addition to the fees being unallowable under the terms of the Trust agreements, the use of affiliates provided AMRESKO with additional revenues and profits through a self-dealing arrangement. Such an arrangement raises concerns over whether the charges were reasonable and necessary and, therefore, benefited the Trust as asserted by the Deputy Director.

Appendix II presents management's proposed action on our recommendations and shows that there is a management decision for each recommendation in this report. Based on the audit work, the OIG will report questioned costs of \$349,684 (of which \$13,068 is unsupported) in its *Semiannual Report to the Congress*.


**FDIC****Federal Deposit Insurance Corporation**

Washington D.C. 20429

Division of Resolutions and Receiverships

DATE: February 18, 2000

MEMORANDUM TO: Sharon M. Smith  
Assistant Inspector General

FROM: Gail Patelunas   
Deputy Director, DRR

SUBJECT: OIG Draft Report Entitled  
*RTC Mortgage Trust 1993 – N3*

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On December 17, 1999 the Office of the Inspector General (OIG) issued its draft report on the results of an audit of the RTC Mortgage Trust 1993-N3 (Trust), in which the FDIC is the Class B Certificateholder (Class B). As noted in the report, OIG selected this Trust for review in response to DRR's request for an audit of various trusts. The report concludes that the Servicer, AMRESKO Management (AMRESKO), accurately accounted for and properly reported the Trust's income; however, the Trust did not remit \$402,161 due FDIC for its share in a participation loan sold and charged the Trust \$685,655 for expenses that were not allowable under the terms of the transaction documents. Total questioned costs are \$1,087,816.

Following are Management's responses to the areas questioned in the audit report.

1. *AMRESKO did not remit \$402,161 to the FDIC from the proceeds of a participation loan. (Questioned costs of \$197,059 representing FDIC's share.)*

Management disagrees with the OIG's finding that the Trust purchased only a 50% participation in the subject loan and therefore proceeds are owed to the FDIC. Exhibits A and B to the Assignment and Assumption of Assets list a 50% interest conveyed by one FIN, Flagler FSLA, but fail to show the 50% conveyed by Miami S&L, a co-participant in the asset, as reflected in DOF records. The number of loans listed for Flagler also is inconsistent with DOF records. Upon review of the Closing Binder and DOF documents provided by the OIG, it is apparent that the Assignment is erroneous. Figures on the Exhibits do not foot with those on the Closing Memoranda which were used for reconciliation purposes. At the time of closing DOF records indicate the loan was held by both Flagler and Miami and reflect that sale proceeds were apportioned between the two. (Later, according to IG discussions with DOF-Dallas personnel, a number of internal accounting entries were made to credit the entire sale proceeds to Flagler.) Further, Exhibit A, while listing only Flagler's interest, reflects the

**RTC Mortgage Trust 1993 – N3 Draft Audit Report Response**  
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full principal balance (BV) of the asset (as confirmed by DOF), and Exhibit B shows the entire DIV for the asset (confirmed by DOF). Finally, a check of NAIS (National Asset Inventory System), DRR's system of record, indicates RTC conveyed 100% of the asset to the Trust. Management therefore concludes that the Trust purchased and paid for 100% of the loan and properly apportioned proceeds from its sale to a third party.

- 2. AMRESKO Management inappropriately charged the Trust \$454,676 in unallowable fees for an in-house tax consulting group.*

Management agrees in principle with the OIG's position that restrictions on payments to affiliates apply to expenses authorized under the Deposit Trust Agreement (DTA) as well as to those under the Servicing Agreement. However, to the extent that the questioned payments including any imputed "mark-up" are reasonable and within industry standards for such services, DRR will not pursue reimbursement of the expenses as they were incurred in the good faith belief that they were payable and it would be inequitable not to pay them under the facts and circumstances because the Trust benefited from the services.

- 3. AMRESKO Management improperly billed the Trust \$76,629 in unallowable servicing fees including work done on the reconstruction and reconciliation of loan files.*

Management concurs with the OIG recommendation and will seek recovery of \$76,629 in expenses improperly charged to the Trust.

- 4. Disallow payment of \$53,206 for expenses related to the Class A Certificateholders' operations.*

Management concurs with the OIG's finding that \$19,120 in legal expenses are related to the Class A Certificateholders only, and are not related to the operation of the Trust.

We also agree that \$34,086 in Class A operating expense be disallowed. Therefore, reimbursement will be sought for a total of \$53,206 in disallowed legal fees and Class A expenses.

- 5. AMRESKO Management improperly paid miscellaneous expenses totaling \$101,144.*

Management concurs with the OIG's finding and will request reimbursement in the amount of \$101,144 for these expenses.

Within thirty days of the issuance of the final report by the OIG, Management will issue a demand letter requesting that AMRESKO or the Class A Holder, as appropriate, reimburse the Trust \$230,979 (of which the FDIC will receive \$117,799 as its 51% share) the amount agreed to as disallowed costs.

**RTC Mortgage Trust 1993 – N3 Draft Audit Report Response**  
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cc: Nick Ravichandran, OIG  
Cynthia Shaughnessy, Legal  
Doug Stinchcum, DRR  
Hank Abbot, DRR  
Dean Eisenberg, DRR  
Joci Spector, DRR  
Edward Dox, AEW

## MANAGEMENT RESPONSES TO RECOMMENDATIONS

The Inspector General Act of 1978, as amended, requires the OIG to report on the status of management decisions on its recommendations in its semiannual reports to the Congress. To consider the FDIC's responses as management decisions in accordance with the act and related guidance, several conditions are necessary. First, the response must describe for each recommendation

- the specific corrective actions already taken, if applicable;
- corrective actions to be taken together with the expected completion dates for their implementation; and
- documentation that will confirm completion of corrective actions.

If any recommendation identifies specific monetary benefits, FDIC management must state the amount agreed or disagreed with and the reasons for any disagreement. In the case of questioned costs, the amount that the FDIC plans to disallow must be included in management's response.

If management does not agree that a recommendation should be implemented, it must describe why the recommendation is not considered valid.

Second, the OIG must determine that management's descriptions of (1) the course of action already taken or proposed and (2) the documentation confirming completion of corrective actions are responsive to its recommendations.

This table presents the management responses that have been made on recommendations in our report and the status of management decisions. The information for management decisions is based on management's written response to our report.

Rec. Number	Corrective Action: Taken or Planned / Status	Expected Completion Date	Documentation That Will Confirm Final Action	Monetary Benefits	Management Decision: Yes or No
1	The Deputy Director, DRR, disagreed with our recommendation and provided additional information to show that the mortgage loan schedule in the Trust's closing documents was erroneous.	04/30/00	Deputy Director's response and demand letter.	\$-0-	Yes
2	The Deputy Director, DRR, agreed with our recommendation. However, the Deputy Director stated that DRR would not pursue recovery of the questioned costs—including any imputed markup—to the extent that they were reasonable and within industry standards for such services.	04/30/00	Deputy Director's response and demand letter.	\$-0-	Yes
3	The Deputy Director, DRR, agreed with our recommendation and stated that DRR would seek recovery of the questioned costs.	04/30/00	Deputy Director's response and demand letter.	\$39,081	Yes

<b>Rec. Number</b>	<b>Corrective Action: Taken or Planned / Status</b>	<b>Expected Completion Date</b>	<b>Documentation That Will Confirm Final Action</b>	<b>Monetary Benefits</b>	<b>Management Decision: Yes or No</b>
4	The Deputy Director, DRR, agreed with our recommendation and stated that DRR would seek recovery of the questioned costs.	04/30/00	Deputy Director's response and demand letter.	\$27,135	Yes
5	The Deputy Director, DRR, agreed with our recommendation and stated that DRR would seek recovery of the questioned costs.	04/30/00	Deputy Director's response and demand letter.	\$51,583	Yes