AUDIT OF RTC MORTGAGE TRUST 1992-N1

Audit Report No. 99-035
August 23, 1999

OFFICE OF AUDITS

OFFICE OF INSPECTOR GENERAL

FDIC
Federal Deposit Insurance Corporation
Washington, D.C. 20434

Office of Audits
Office of Inspector General

DATE: August 23, 1999

TO: John F. Bovenzi, Director
Division of Resolutions and Receiverships

FROM: Sharon M. Smith, Director
Field Audit Operations

SUBJECT: *Audit of RTC Mortgage Trust 1992-N1* (Audit Report No. 99-035)

This report presents the results of an audit of the Resolution Trust Corporation's (RTC) Mortgage Trust 1992-N1. 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.[1] Mortgage Trust 1992-N1, created on December 18, 1992, consisted of a class A certificateholder—1992-N1 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 1992-N1 (the Trust), consisted of 432 loans with a book value of approximately $346 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 December 18, 1992, 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 the winning bidder, 1992-N1 Associates, LP, which consisted of four investors—Bankers Trust, Sterling American Properties, BEI Management, and

---

1December 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*.

GSR N-1. The RTC contracted with Aldridge, Eastman, and Waltch (AEW) to assist in its oversight responsibilities and oversee its class B interest in the Trust.

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 (1) service the Trust's mortgage loans and (2) manage, market, and dispose of the Trust's assets. In November 1994, BEI Management changed its name to AMRESCO Management (AMRESCO).

The Trust, under an agreement with the Bank of America National Trust and Savings Association (the bond trustee), issued $110 million of commercial, loan-backed bonds to third-party institutional investors through open-market transactions. As the class A certificateholder liquidated the Trust assets, the proceeds were first used to retire the bonds and then distributed to the class A and class B certificateholders. The bonds were retired in September 1994.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of the audit was to determine whether AMRESCO charged the Trust only allowable expenses and accurately accounted for and reported income. The audit covered the Trust's operations from its inception on December 18, 1992, through March 23, 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, the class A certificateholder, AMRESCO, AEW, and Ernst & Young—the Trust's auditor.

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 20 of the 432 assets to verify whether AMRESCO accurately accounted for and properly reported income and charged only allowable expenses. For the 20 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 $10 million of the $342 million settled or sold as of March 23, 1998.

For the first 10 of the 20 assets sampled, we determined whether related expenses were allowable under the terms of the Trust agreements. We also reviewed all of AMRESCO's and the class A certificateholder's overhead expenses charged to the Trust as well as AMRESCO's servicing fees. In total, we reviewed $7.8 million of the $8.6 million in expenses, other than bond amortization and interest expense, charged to the Trust.

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

RESULTS OF AUDIT

For the 20 sampled assets, AMRESCO accurately accounted for and reported the Trust's income. However, we questioned $2,474,410 of unallowable expenses that AMRESCO paid from the Trust's funds as shown in table 1.

Table 1: Summary of Unallowable Expenses Charged to the Trust by AMRESCO

Expense Type	Amount Questioned
Servicing fees	$1,001,068
Fees paid to affiliates	901,311
Refinancing project expenses	362,746
Class A certificateholder expenses	160,870
Miscellaneous expenses	48,415
Total	**$2,474,410**

Source: OIG analysis of expenses charged to the Trust by AMRESCO.

Unallowable Servicing Fees

AMRESCO charged the Trust $1,001,068 in unallowable servicing fees. The servicing agreement specified that AMRESCO's servicing fees be computed on a percentage of the principal balance of each mortgage loan as of a specified cut-off date. The mortgage loan schedule attached to the assignment of assets reported the RTC's ownership interest in the principal balance of each mortgage loan as of the cut-off date. However, AMRESCO computed its servicing fees based on the total principal balance of the loans including the portions owned by other investors.

The RTC transferred 432 loans with a total unpaid principal balance of $345,823,585 to the Trust according to the mortgage loan schedule. The RTC shared ownership of 79 of the 432 loans with other investors. From the Trust's inception on December 18, 1992, through August 1993, AMRESCO correctly used the RTC-owned total loan balance to compute its servicing fees. However, on August 31, 1993, AMRESCO began using the total unpaid principal balance of $432,156,074, which included the amounts owned by other investors. The difference between the total unpaid principal balance of the loans and the RTC's ownership interest transferred to the Trust was $86,332,488. In addition, AMRESCO retroactively adjusted its servicing fees from inception through August 1993. We recomputed AMRESCO's servicing fees from inception through February 28, 1998, using the RTC's ownership interest in the total loan balance transferred to the Trust and determined that AMRESCO charged unallowable servicing fees of $1,001,068.

The bond placement advisor prepared a revised mortgage loan schedule that showed the total unpaid principal balance of the loans including amounts owned by other investors. AMRESCO relied on the revised mortgage loan schedule's total unpaid principal balance as the basis for adjusting its servicing fees. AMRESCO officials stated that AMRESCO serviced the total unpaid principal balance of the loans because the Trust, as lead lender, was responsible for the servicing. The officials stated that to penalize the servicer for fulfilling all of its obligations did not seem fair. However, AMRESCO provided no support that the RTC approved the revised fee structure, which was required under both the servicing agreement and deposit trust agreement. Accordingly, we disagree with AMRESCO's contention that it was entitled to servicing fees from the Trust on the total unpaid principal balance of the loans.

Unallowable Fees Paid to AMRESCO Affiliates

AMRESCO charged the Trust a total of $901,311 in unallowable fees for affiliates who worked on three special projects. AMRESCO established affiliated billing centers for certain tasks performed either as part of its servicing function or at the request of the class A certificateholder. The affiliated billing centers included an in-house tax-consulting group, a refinancing project, and a record reconstruction project. However, the servicing agreement's terms prohibited the servicer from making payments to affiliates of either the servicer or the class A certificateholder.

As part of its asset servicing requirements, AMRESCO established 108 subsidiary corporations and limited partnerships owned by the Trust to take title to properties acquired through foreclosure. To compile the information necessary for preparing the subsidiaries' tax returns, AMRESCO set up an in-house tax-consulting billing center, which consisted of AMRESCO employees as well as temporary employees on an as-needed basis. AMRESCO charged the Trust an hourly rate for each employee working for the tax-consulting group for a total of $555,178.

AMRESCO also charged the Trust $227,920 for employees assigned to a refinancing project billing center. The class A certificateholder instructed AMRESCO to retain the services of a specific temporary employee to assist in the proposed refinancing of the Trust assets. AMRESCO charged the Trust an hourly rate for time charged to the project by the employee retained at the class A certificateholder's direction as well as for time charged by its regular employees.

In addition, AMRESCO charged the Trust $118,213 for employee time spent on a reconstruction and reconciliation project billing center to update loan records. The employees working on the project included asset managers and loan-servicing staff as well as a temporary employee. AMRESCO officials stated that the project was necessary because the prior servicers did not properly service the loans before the RTC transferred the loans to the Trust. The officials said that the class A certificateholder gave verbal approval for the project.

For each of the three affiliated billing centers, AMRESCO officials stated that the services provided were in addition to its normal servicing responsibilities covered by the servicing fees. However, we question whether the services charged through the affiliated billing centers were in fact outside of AMRESCO's normal servicing responsibilities or, in the case of the refinancing project, necessary. Nonetheless, the servicing agreement specifically prohibited the payment of trust funds to affiliates of either the servicer or the class A certificateholder unless specifically provided for in the servicing agreement.

Unallowable Refinancing Project Expenses

AMRESCO charged the Trust $362,746 in unallowable expenses for a project that the class A certificateholder initiated to refinance the Trust's remaining assets after the bonds were paid in full. To complete the due diligence necessary for the refinancing project, the class A certificateholder obtained the services of a contractor, which AMRESCO charged to the Trust along with other project-related expenses. However, the deposit trust agreement required the class A certificateholder to obtain the RTC's approval prior to the transfer of any rights or obligations (other than the right to share in the distributions) of the certificateholders. Refinancing of the remaining assets would have resulted in a transfer of the certificateholders' rights and obligations to the investors in the refinanced assets. Accordingly, the refinancing project required the RTC's prior approval.

The RTC obtained an independent analysis of the class A certificateholder's refinancing proposal, which concluded that:

> " . . . the releveraging proposal presented by [the class A] lowers the present value return to the RTC by extending the hold period of the portfolio. The securitization Proposal also results in more management fees being generated by the class A certificateholder, which also lowers the return to the RTC, and generates a self-dealing issue with [the class A] advising the Class A Securityholder and handling the securitization should it be approved."

The independent study also noted that the refinancing would not benefit the Trust, and the deposit trust agreement did not provide for the refinancing. Based on the independent study, the RTC did not approve the refinancing proposal. Accordingly, the cost of the class A certificateholder's refinancing study was not allowable.

Unallowable Class A Certificateholder Expenses

AMRESCO charged the Trust a total of $160,870 in unallowable expenses related to the class A certificateholder's operations. Those expenses included $83,906 in legal fees and $76,964 in travel and entertainment expenses. Neither the deposit trust agreement nor the servicing agreement provided for reimbursement of the class A certificateholder's expenses.

AMRESCO paid legal bills totaling $83,906 for law firms that provided legal services to the class A certificateholder both before and after the Trust was formed. The legal services provided to the class A certificateholder related to acquisition of the loan portfolio, due diligence efforts, annual compliance certifications, and other dealings with the Trust.

Generally, the invoices submitted by the law firms identified the class A certificateholder as the client and included legal services related to the class A certificateholder's operations rather than the Trust's activities. For example, the invoices included legal services provided before the class A certificateholder invested in the Trust. In addition, AMRESCO charged the Trust for legal services to

- prepare and review the class A certificateholder's and servicer's annual compliance certificates,
- review a claim against the RTC pertaining to bond cost estimates,
- form the partnership that purchased the class A certificate, and
- review various agreements between the class A certificateholder's partners.

AMRESCO also paid the class A certificateholder a total of $76,964 for travel and entertainment expenses. Generally, the expenses appeared to be for the class A certificateholder's partners to attend partnership meetings. For example, one of the class A certificateholder partners submitted invoices for $22,714 that only included a breakdown between transportation, lodging, and administrative costs. No other information was included such as who performed the travel or when, where, and why it was performed. Another partner submitted a $6,080 invoice for airline tickets purchased from a private jet company. In addition, the invoices also included meal and bar expenses for the partners.

Class A certificateholder officials stated that the legal and travel expenses were generally for services provided to the Trust. However, neither the deposit trust agreement nor the servicing agreement contained provisions for the reimbursement of legal fees or travel and entertainment expenses incurred by the class A certificateholder.

Miscellaneous Unallowable Expenses

AMRESCO charged the Trust $48,415, of which $17,312 was unsupported, for unallowable miscellaneous expenses. The servicing agreement provided that disbursements had to be directly related to the management and liquidation of the Trust's assets. However, AMRESCO charged expenses to the Trust that were either not related to the management and liquidation of the assets or were unsupported as follows:

- $152 for a trade magazine subscription;
- $25 for a charitable contribution;
- $108 for a baseball game tickets;

- $60 for an employee’s CPA license;
- $31 for a staff party;
- $1,218 for asset expenses related to a different trust;
- $1,075 for entertaining class A certificateholder senior executives;
- $2,888 for senior AMRESCO staff travel expenses, including first-class upgrades, to attend the Trust closing and initial class A certificateholder partner meetings;
- $22,542 for supplemental labor for normal servicing activities;
- $1,377 for servicing staff incentive bonuses;
- $1,627 for a property manager overpayment; and
- $17,312 for unsupported overhead and other miscellaneous expenses.

Class A certificateholder officials stated that several of the miscellaneous charges were normal business cost to enhance employee moral 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.

Conclusion and Recommendations

AMRESCO accurately accounted for and reported the Trust’s income for the sampled assets reviewed. However, AMRESCO charged the Trust $2,474,410 for expenses that were not allowable under the terms of the servicing agreement or the deposit trust agreement. Accordingly, we recommend that the Director, DRR, take the following actions:

(1) Disallow $1,001,068 in servicing fees paid to AMRESCO, and require AMRESCO to reimburse the Trust (questioned cost of $510,545 representing the FDIC’s 51-percent share).

(2) Disallow $901,311 in fees paid to AMRESCO affiliates, and require AMRESCO to reimburse the Trust (questioned cost of $459,669 representing the FDIC’s 51-percent share).

(3) Disallow $362,746 in refinancing project expenses paid to the class A certificateholder, and require AMRESCO to recover those funds and reimburse the Trust (questioned cost of $185,000 representing the FDIC’s 51-percent share).

(4) Disallow $83,045 in operating expenses paid to the class A certificateholder, and require AMRESCO to recover those funds and reimburse the Trust (questioned cost of $42,353 representing the FDIC's 51-percent share).

(5) Disallow $48,415 (of which $17,312 is unsupported) in miscellaneous expenses paid to AMRESCO, and require AMRESCO to reimburse the Trust (questioned cost of $24,692 representing the FDIC's 51-percent share, of which $8,829 is unsupported).

CORPORATION COMMENTS AND OIG EVALUATION

Although DRR officials agreed with our findings during our meetings at the completion of our survey work (May 1998), the completion of our fieldwork (September 1998), and our exit conference (October 5, 1998), on March 15, 1999, the Assistant Director, DRR, provided a written response to a draft of this report that disagreed with recommendations 1 through 3 in the draft report. Because the Deputy Director's written response differed significantly from DRR officials' comments provided throughout the audit, we had ongoing discussion of our positions with DRR officials and met with them again on June 25, 1999, to discuss each of the draft recommendations. On July 28, 1999, the Deputy Director, Asset Management Branch, DRR, provided a revised response to recommendation 2. The Assistant Director's and Deputy Director's responses are included as appendix I and appendix II to this report, respectively.

A summary of the Assistant Director's and Deputy Director's responses to each recommendation and our analysis follow.

Disallow $1,001,068 in servicing fees paid to AMRESCO, and require AMRESCO to reimburse the Trust (questioned cost of $510,545 representing the FDIC's 51-percent share) (recommendation 1): The Assistant Director disagreed that AMRESCO incorrectly calculated the servicing fees. He stated that the servicing agreement defined the servicing fee as a percentage of the outstanding principal balance of each mortgage loan set forth in the mortgage loan schedule. He added that the term mortgage loan is defined to encompass both whole loans and whole-loan participations, including those in which the Trust had lead servicing responsibility. However, the Assistant Director contended that the servicing agreement was silent—and, therefore, ambiguous—regarding whether to use the total principal balance of the participation loans or only the portions sold to the Trust to calculate the servicing fee. Further, the Assistant Director asserted that

- the final mortgage loan schedule (distributed October 1993) lists the principal balances for the entire loans, not just the lead participation balances;

- the servicing agreements in subsequent N transactions expressly provide that the servicing fee is based on the principal balance of the entire loan, not just the portion sold to the Trust;

- since the servicing of the participation loans involved the servicing of the entire loan, not just the portion owned by the Trust, it was equitable to compensate the servicer accordingly; and

- the RTC/FDIC acknowledges that AMRESCO properly used the entire principal balance during the remaining life of the agreement (after distribution of the final mortgage loan schedule in October 1993) to calculate its servicing fee for participation loans.

The Assistant Director stated that DRR would ratify the past use (before distribution of the final mortgage loan schedule in October 1993) of the servicing fee calculation based upon the language in subsequent N transactions.

We disagree that the servicing agreement was silent—and, therefore, ambiguous—regarding how to calculate the servicing fee. The servicing agreement defined the servicing fee as a percentage of the "**principal balance as set forth on the mortgage loan schedule attached to the assignment of assets**" (emphasis added). Contrary to being ambiguous, this clearly indicated that the principal balance identified on the mortgage loan schedule in existence on the closing date and specifically referred to in the transaction documents should have been used for the calculations. The mortgage loan schedule attached to the assignment of assets identified only the RTC's share of participation loans for inclusion in the principal balance. Moreover, for the first 9 months of the equity partnership, AMRESCO used the principal balance in that mortgage loan schedule for computing its servicing fees.

We also disagree with the Assistant Director's characterization that the revised mortgage loan schedule (distributed October 1993) lists the entire principal balance for each participation loan, not just the RTC's portion. A more accurate characterization is that the revised mortgage loan schedule prepared by the bond placement advisor identified both the RTC's portion of each participation loan and the entire loan balance, including portions owned by other participants. In any event, the production of the October 1993 mortgage loan schedule does not provide a basis for AMRESCO to change the servicing fee computation because:

- The bond placement advisor was not a party to the transaction agreements and, therefore, its actions, more than 6 months after the transaction closing date, should not result in a modification of the agreements.

- The servicing agreement required the RTC's approval for a change in the fee structure. However, neither AMRESCO nor the FDIC was able to provide any evidence that the RTC approved the revised mortgage loan schedule as the basis for computing servicing fees. Further, there is no indication that either the FDIC or AEW—its oversight contractor—was aware of the servicing fee computation change until the OIG pointed it out in meetings with DRR officials. Accordingly, AMRESCO acted unilaterally in changing the servicing fee computation. Absent a formal amendment of the fee structure, AMRESCO was bound to the terms of the original agreement.

It is important to note that when we commenced this audit, neither the FDIC nor AEW had a copy of the loan list included in the mortgage loan schedule. When AMRESCO changed the servicing fee computation in October 1993, the RTC was in existence and the oversight contractor was someone other than AEW. In fact, when we met with DRR and AEW officials in May 1998 to brief them on our audit survey, neither DRR nor AEW was aware that AMRESCO had charged servicing fees on the entire participation loan balances. Further, DRR and AEW officials agreed with the OIG's position on the servicing fees during May 1998 and October 1998 meetings. DRR has not presented any evidence or change in circumstances to warrant its change in position.

We further disagree with the Assistant Director's contention that AMRESCO's servicing fees on the entire participation loan balances should be permitted because subsequent N-transaction agreements provided for servicing fees to be calculated on the entire participation loan balances. We believe that each transaction should be governed by its own agreements. The Assistant Director also contended that since AMRESCO serviced the entire participation loans and not just the portion owned by the Trust that it is equitable to compensate AMRESCO accordingly. We do not disagree with AMRESCO being properly compensated for servicing the entire balance of participation loans. However, we disagree that it is equitable for the RTC/FDIC to pay servicing fees on other participants' shares of the loans. We believe that other investors participating in the loans should pay their shares of the servicing fees.

Finally, we disagree with the Assistant Director's decision to ratify AMRESCO's past calculation of servicing fees based upon language used in subsequent N-transaction agreements. As stated above, we disagree with the premise that subsequent agreements affect the terms of this agreement. We also disagree with the inference that AMRESCO's method for computing servicing fees was improper for part of the agreement and proper for the remaining part (before and after distribution of the revised mortgage loan schedule, respectively). Servicing fees on the participation loan balances owned by third parties should be either allowed or disallowed for the *entire* period of the agreement.

In summary, we continue to question AMRESCO's $1,001,068 in servicing fees on participation loan balances owned by other investors. Neither DRR nor AMRESCO provided any documentation to support the RTC's approval of those servicing fees. Accordingly, we continue to believe that the change in the fee structure represented a violation of the Trust agreements.

Disallow $901,311 in fees paid to AMRESCO affiliates, and require AMRESCO to reimburse the Trust (questioned cost of $459,669 representing the FDIC's 51-percent share) (recommendation 2): The Deputy Director's revised response stated that DRR agreed with the OIG's conclusion that payments to affiliates were prohibited under the deposit trust agreement as well as the servicing agreement. The Deputy Director added, however, that DRR would not disallow most of the expenses paid to affiliates because they were incurred in the good faith belief that they were allowable. The Deputy Director stated that it would be inequitable to disallow expenses related to services that benefited the Trust. The Deputy Director did agree to disallow $143,107 of the expenses related to AMRESCO's asset management and servicing staff.

The Deputy Director also stated that DRR will send a letter to all class A certificateholders informing them that expenses paid to affiliates are not normally permitted under any of the transaction documents, including the deposit trust agreement.

We disagree with the Deputy Director's reasons for not seeking reimbursement for all the fees paid to AMRESCO affiliates and continue to question the $901,311 paid to affiliates of AMRESCO. In addition to the expenses being inappropriate under the terms of the Trust agreements, the use of affiliates provided AMRESCO with the opportunity to gain additional revenues and profits through a potentially 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.

Disallow $362,746 in refinancing project expenses paid to the class A certificateholder, and require AMRESCO to recover those funds and reimburse the Trust (questioned cost of $185,000 representing the FDIC’s 51-percent share) (recommendation 3): The Assistant Director disagreed with the OIG's recommendation. He stated that the work on the refinancing proposal was undertaken in consultation with the RTC and the refinancing analysis was consistent with one of the purposes of the Trust—to issue and sell “other debt obligations” under certain circumstances. The Assistant Director stated that the class A certificateholder was required to obtain the RTC’s approval for the issuance of new financing contemplated by the proposal and the proposal presented alternatives to the RTC prior to obtaining such approval.

In addition, the Assistant Director stated that the class A certificateholder had sole authority and responsibility for the operation and management of the Trust property in a manner that achieved the purposes of the Trust. He stated that the purposes of the Trust included disposing of property in a manner that maximized the economic return to the certificateholders and engaging in any activities necessary, consistent, or incidental to the purposes of the Trust. The Assistant Director asserted that the purpose of the proposal was to explore new financing structures that would maximize returns to the Trust, which was a valid management activity. He further asserted that as an administrative expense incurred at the direction of the class A certificateholder in the management of the Trust, the refinancing proposal expenses were properly payable under the deposit trust agreement.

We disagree with the Assistant Director’s conclusion that the refinancing proposal expenses are allowable. The Assistant Director’s statement that the refinancing analysis is consistent with one of the purposes of the Trust—to issue and sell “other debt obligations” under certain circumstances—omitted an important phrase. The deposit trust agreement, section 2.01(b)(ii), which the Assistant Director cited, also states “**to the extent permitted herein**” (emphasis added). The deposit trust agreement discusses borrowings and debt obligations in two other sections. Section 10.04 of the deposit trust agreement allows the Trust to borrow funds from certificateholders. In addition, section 3.01(b) of the deposit trust agreement allows the trustee to issue additional debt securities **for the transfer of additional property to the Trust.** Apart from those two sections, the deposit trust agreement does not address any other type of borrowing or refinancing.

Furthermore, we do not agree that the class A certificateholder had unrestricted authority to refinance the Trust assets. The deposit trust agreement, article VIII, section 8.01, states

> "The class A certificateholder shall have the sole authority and responsibility for the operation and management of the Trust and the handling and disposition of the Trust property, pursuant to section 2.06 and otherwise, in a manner that achieves the purposes of the Trust set forth in Section 2.01(b)(iv)."

Although that section provides the sole authority to the class A certificateholder, the authority is restricted to the confines of section 2.01(b)(iv), which states

> " . . . to service the mortgage loans and manage any property acquired in respect thereof or otherwise included in the Trust property with the objective of disposing of the mortgage loans and such properties as promptly as possible and in an orderly manner that maximizes the economic return to the certificateholders."

Section 2.01(b)(iv) addresses only the **servicing and disposition of trust assets,** not **refinancing**. Further, the class A certificateholder's refinancing proposal suggested borrowing and securitization. Borrowing, as mentioned earlier, is permitted if from the certificateholders. In summary, we continue to believe that refinancing is not addressed by the deposit trust agreement and, therefore, is not consistent with the purpose of the Trust.

Moreover, the RTC contracted for an independent study of the class A certificateholder's refinancing proposal. That study found, among other things, that the refinancing did not benefit the Trust and that the deposit trust agreement did not provide for the refinancing. It is difficult to reconcile the Assistant Director's assertion that " . . . the refinancing analysis and proposal was undertaken in consultation with the RTC . . . " with the independent study's conclusion that the deposit trust agreement did not provide for the refinancing. Based on that study, the RTC did not approve the refinancing project. Accordingly, we do not understand the Assistant Director's basis for asserting that the refinancing project expenses were permissible.

Acccordingly, we continue to believe that the refinancing proposal expenses should be borne entirely by the class A certificateholder, just as the RTC bore the cost of its independent analysis of the refinancing proposal.

Disallow $160,870 in operating expenses paid to the class A certificateholder, and require AMRESCO to recover those funds and reimburse the Trust (questioned cost of $82,044 representing the FDIC's 51-percent share) (recommendation 4): The Assistant Director disagreed with part of the questioned legal expenses for firms representing the class A certificateholder. He stated that DRR obtained a breakdown of the charges representing the Trust's operations versus the charges for the class A certificateholder's operations and determined that $6,081 of the legal fees should be disallowed. The Assistant Director agreed that the class A certificateholder's travel and entertainment expenses totaling $76,964 should also be disallowed.

Based on the information provided, we agreed with management's decision and have revised our questioned costs to $42,353, representing the FDIC's 51-percent share of the $83,045 disallowed by management.

Disallow $48,415 (of which $17,312 is unsupported) in miscellaneous expenses paid to AMRESCO, and require AMRESCO to reimburse the Trust (questioned cost of $24,692 representing the FDIC's 51-percent share, of which $8,829 is unsupported) (recommendation 5): The Assistant Director agreed to disallow the $48,415 in miscellaneous expenses as well as an additional $11,405 identified after our draft report was issued. The Assistant Director's response provided the requisites for a management decision.

Based on the audit work, the OIG will report questioned costs of $1,222,259 (of which $8,829 is unsupported) in its *Semiannual Report to the Congress*.

The Corporation's response to the draft report provided the elements necessary for management decisions on each of the five recommendations. Accordingly, no further response to this report is necessary. Appendix III presents management's proposed action on our recommendations and shows that there is a management decision for each recommendation in this report.

APPENDIX I

FDIC

Federal Deposit Insurance Corporation

Washington D.C. 20429 Division of Resolutions and Receiverships

DATE: March 15, 1999

MEMORANDUM TO: Sharon M. Smith, Director
Field Office Operations
Office of the Inspector General

FROM: Douglas G. Stinchcum
Assistant Director, DRR

SUBJECT: OIG Draft Report Entitled
RTC Mortgage Trust 1992 – N1

On December 15, 1998 the Office of the Inspector General (OIG) issued its draft report on the results of an audit of the RTC Mortgage Trust 1992-N1 (Trust), in which the FDIC is the Class B Certificateholder (Class B Holder). 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, except as noted below, the Servicer, AMRESCO Management (AMRESCO), complied with the provisions of the Deposit Trust Agreement (DTA) and Servicing Agreement and charged the Trust allowable expenses and accurately collected income.

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

1. *AMRESCO Management incorrectly calculated servicing fees resulting in an overpayment totaling $1,001,068.*

Management disagrees with the OIG's conclusion that AMRESCO incorrectly calculated servicing fees. Under the definition of Servicing Fee[1] in the Servicing Agreement, this fee is to be computed as a percentage of the outstanding principal balance of each Mortgage Loan set forth in the Mortgage Loan Schedule. The term Mortgage Loan is defined to encompass both whole loans and participations in whole loans, including those in which the Trust has lead servicing responsibility ("lead participations"). The transaction documents, however, are silent as to whether the principal balances for the entire loans (including portions owned by other investors) or only those portions sold to the Trust are to be used in calculating the Servicing Fee. Silent or

[1] Terms in caps used here are defined terms under the transaction documents.

otherwise ambiguous contract provisions are typically interpreted by looking at evidence outside the contract, trying to reasonably reconcile the ambiguous provision to the rest of the contract, and, where one party has had principal responsibility for drafting the provision, in the way least favorable to the drafter.

Management concludes that the entire loan balances should be used to compute the Servicing Fee for the following reasons:

- The final Mortgage Loan Schedule (distributed October 1993) lists the principal balances for the entire loans, not just the lead participation balances;

- The Servicing Agreement in subsequent N transactions expressly provides that the Servicing Fee calculation for lead participations is to be based on the principal balance of the entire loan, not just the portion sold to the Trust;

- Since the servicing of lead participations involves the servicing of the entire loan, not just the portion owned by the Trust, it is equitable to compensate the Servicer accordingly;

- RTC/FDIC acknowledges that AMRESCO was properly using the entire principal balance during the remaining life of the agreement to calculate its Servicing Fee for lead participations.

Accordingly, Management will effect a ratification of the past use of the fee calculation based upon the language used in subsequent N transactions that specifies the entire outstanding principal balance be used as the basis for the Servicing Fee calculation. An amendment of the Servicing Agreement is not required as all assets in the Trust have been liquidated.

2. *AMRESCO Management inappropriately charged the Trust $901,311 in unallowable fees for affiliates.*

The Corporation provided a revised response to recommendation 2 on July 28, 1999.

See appendix II.

The Corporation provided a revised response to recommendation 2 on July 28, 1999.

See appendix II.

3. *AMRESCO Management improperly billed the Trust $362,746 for work done on a refinancing proposal.*

Management disagrees with the OIG's finding that the work done on the refinancing analysis and proposal constitutes an unallowable expense.

The refinancing analysis is consistent with one of the purposes of the Trust to issue and sell "other debt obligations" under certain circumstances (DTA, Section 2.01(b)(ii)). The work on the refinancing analysis and proposal was undertaken in consultation with the RTC, which provided certain criteria for proposal parameters. Under Sections 2.07 and 3.01(b) of the DTA, the Class A Holder would have had to obtain the RTC’s approval for the issuance of new financing contemplated by the proposal. The Class A Holder prepared the proposal in order to present alternatives to the RTC prior to obtaining such approval.

Moreover, Section 8.01 of the DTA gives the Class A Holder “sole authority and responsibility for operation and management of the Trust Property… in a manner that achieves the purposes of the Trust set forth in Section 2.01(b)(iv)”. This subsection and subsection (v) provide that the purposes of the Trust include, respectively, to dispose of property in a “manner that maximizes the economic return to the Certificateholders” and “to engage in any activities necessary, consistent, or incidental to the foregoing”. Since the purpose of the proposal was to explore new financing structures that would maximize returns to the Trust, it is a management activity. Accordingly, as an “administrative expense” incurred at the direction of the Class A Holder in management of the Trust, costs for the preparation of the proposal are properly payable under the DTA.

4. *Disallow payment of $83,906 for legal fees and $76,964 for travel (total $160,870) related to the Class A Certificateholders’ operations.*

Management partially disagrees with the OIG's finding that $83,907 in legal expenses are related to the Class A Certificateholders only, and are not related to the operation of the Trust. The table below provides additional information on the specific invoices questioned in the OIG’s report.

Date Paid	Purpose	Amount Paid	Allowed by Management as Trust Expense	Disallowed by Management
25-May-93	Post Closing Legal work	$7,464	$3,464	$4,000
11-Jun-93	Trust legal services	$19,540	$19,540	$0
16-Jul-93	Trust Organizational issues	$4,230	$4,230	$0

16-Jul-93	Trust Powers of Attorney	$4,873	$4,873	$0
16-Jul-93	Misc. Trust matters	$2,467	$2,467	$0
16-Jul-93	Powers of Attorney	$5,253	$5,253	$0
20-Jul-93	Pre-closing matters	$927	0	$927
10-Aug-93	Powers of Attorney, Owner Trustee, Bond Trustee	$1,604	$1,604	$0
4-Aug-95	Bondholder consents, custodial issues	$6,330	$6,330	$0
31-Aug-94	Bond prepayment issues	$6,740	$6,740	$0
16-Aug-95	Custodial Agreements	$16,429	$15,659	$770
20-Dec-95	Class A Certifications	$384	0	$384
16-Feb-96	Custodial Issues (old bill)	$2,923	$2,923	$0
16-Feb-96	Refinancing Proposal	$ 4,744	$4,744	$0
Totals		**$83,907**	**$77,826**	**$6,081**

These legal fees were reimbursed to the Class A Holder from Trust funds. Management believes that, with the exception of $6,081 consisting of $927 in fees related to "Pre-closing Matters" incurred prior to Trust closing and $5,154 for services related to Class A Holder business, these are legitimate operating or administrative expenses of the Trust payable under the DTA after the bond financing was retired.

Management concurs with the OIG's finding and recommendation that $76,964 in travel expense be disallowed. Therefore, reimbursement will be sought for $77,826 in disallowed legal fees and $76,964 in disallowed travel expense for a total of $83,045 under Recommendation #4.

5. AMRESCO Management improperly paid miscellaneous expenses totaling $48,415.

Management concurs with the OIG's finding that AMRESCO charged the Trust for $17,312 in unsupported expenses and $8,561 in other expenses unrelated to the Trust. Management will request reimbursement in the amount of $25,873 for these expenses.

Management disagrees with the OIG's finding that $22,542 paid to accounting contractors hired through an independent agency (Accountemps) to assist the tax consultants in preparing tax returns for the Trust and its subsidiaries should be disallowed. These expenses are proper Trust expenses paid by AMRESCO as "other operating or administrative expenses" performed at the direction of the Class A Holder under the DTA. However, the Class A Holder has indicated this charge was inadvertently double-billed to the Trust and has agreed to reimburse the Trust $22,542. Therefore, Management will seek recovery of $48,415.

In addition, during its review of expenses at the request of DRR, the Servicer discovered that it had also charged the Trust $11,405 for work performed by Accountemps on another Trust. This amount was not mentioned in the OIG's Preliminary Report, but will be reimbursed also.

Within thirty days of the issuance of the final report by the OIG, Management will request that AMRESCO or the Class A Holder, as appropriate, reimburse the Trust $285,972 (of which the FDIC will receive as its 51% $145,846 share) the amount agreed to as disallowed costs

cc: Gail Patelunas, DRR
Nick Ravichandran, OIG
Cynthia Shaughnessy, Legal
Hank Abbot, DRR
Dean Eisenberg, DRR
Joci Spector, DRR
Edward Dox, AEW

FDIC

Federal Deposit Insurance Corporation

Washington D.C. 20429 Division of Resolutions and Receiverships

DATE: July 28, 1999

MEMORANDUM TO: Sharon M. Smith, Director
Field Office Operations
Office of the Inspector General

D Steinbacher for

FROM: Gail Patelunas
Deputy Director, DRR

SUBJECT: Supplemental Response to OIG Draft Report Entitled
RTC Mortgage Trust 1992 – N1

On December 15, 1998 the Office of the Inspector General (OIG) issued its draft report on the results of an audit of the RTC Mortgage Trust 1992-N1, in which the FDIC is the Class B Certificateholder. 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, except as noted, the Servicer, AMRESCO Management (AMRESCO), complied with the provisions of the Deposit Trust Agreement and Servicing Agreement and charged the Trust allowable expenses and accurately collected income.

On March 15, 1999, the Division of Resolutions and Receiverships (DRR) issued its Management Response to the OIG's Draft Report. On June 25, 1999 representatives from DRR, the Legal Division, and OIG met to discuss their different positions as well as certain legal interpretations of the Trust documents. As a result of that and subsequent conversations between DRR and its counsel and the OIG and its counsel, DRR is hereby amending its Management Response to the second area questioned in the OIG's Draft Audit Report.

2. AMRESCO Management inappropriately charged the Trust $901,311 in unallowable fees for affiliates.

The questioned amount consists of several discrete categories as follows:

Tax Consultation: AMRESCO billed the Trust $555,178 for a tax consultant and other temporary employees to compile and process information for preparation of individual tax returns for subsidiary corporations and partnerships of the Trust.

Refinancing Project: AMRESCO billed the Trust $203,027 for work by a contractor to analyze a refinancing proposal submitted to the RTC by the Class A Certificateholder. In addition the Trust was billed $24,894 in fees to employees of BEI (the predecessor to AMRESCO.) As noted in its initial response Management agrees the fees paid to BEI employees were improperly charged to the Trust and will seek reimbursement of $24,894.

<u>Reconstruction & Reconciliation Project</u>: AMRESCO charged the Trust $118,213 for employee time spent on a reconstruction and reconciliation project billing center to update loan records. As noted in its initial response Management agrees this was an improper charge to the Trust and will seek full reimbursement.

As a result of its further review, 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. Management will review the OIG questioned costs and determine which are collectible. However, to the extent that they are reasonable, DRR will not pursue reimbursement of the expenses paid to affiliates when 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.

With regard to the refinancing proposal, Management believes that this work was properly a Trust expense and that the individual cited as being an affiliate is more appropriately classified as a third party contractor rather than an affiliate. The payment of such expenses therefore should be allowed. In addition, the expenses were incurred at the request of the RTC in connection with its evaluation of the proposal. *(For more in depth discussion of Management's analysis please refer to Finding #3 in the March 15, 1999 Management Response.)*

Management will therefore seek reimbursement for a total of $143,107 in questioned costs under this Finding #2 including $24,894 paid to BEI employees on the refinancing project and $118, 213 in expenses charged to the Trust for the reconciliation project. Total reimbursement sought for all questioned costs noted in the draft report will be $285,972. *(Please refer to the March 15, 1999 Management Response for more detail.)*

Furthermore, in light of the subsequent productive discussions with the OIG, Management will send a letter to all Class A Certificateholders and Servicers informing them that the FDIC takes the position that expenses paid to affiliates are not normally permitted under any of the transaction documents, including the DTA, but that previously incurred expenses may be allowed on a case by case basis.

The request to AMRESCO for reimbursement and letters to partners and servicers will be issued within thirty days of issuance of the final audit report by the OIG.

Finally, Management currently is developing a "second generation" equity program to have in place for use in the year 2000. In reviewing and revising transaction documents for this program, every attempt will be made to clarify the ambiguities noted in the above findings, and to emphasize the prohibition against paying expenses to any affiliated party.

cc: Giovanni Recchia
Nick Ravichandran
Doug Stinchcum
Cynthia Shaughnessy
Joci Spector
Ed 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 Assistant Director, DRR, disagreed with our recommendation to disallow $1,001,068 in excess servicing fees.	Completed	Final report.	$-0-	Yes
2	The Deputy Director, Asset Management Branch, DRR, agreed to disallow and seek reimbursement for $143,107 ($72,985 of which is the FDIC's 51-percent share) of the $901,311 in questioned expenses paid to AMRESCO's affiliates. The Deputy Director stated that the Corporation will not seek reimbursement for the remaining $758,204 of the questioned expenses. The Deputy Director added, however, that DRR will send a letter to all class A certificateholders and servicers informing them that expenses paid to affiliates are not normally permitted under any of the transaction documents.	30 days from issuance of the final report	Copies of the Trust income statement reflecting AMRESCO's reimbursement of the disallowed expenses, and copies of DRR's letters to its equity partners and servicers.	$72,985	Yes

Rec. Number	Corrective Action: Taken or Planned / Status	Expected Completion Date	Documentation That Will Confirm Final Action	Monetary Benefits	Management Decision: Yes or No
3	The Assistant Director, DRR, disagreed with our recommendation to disallow $362,746 in expense for a refinancing proposal.	Completed	Final report.	$-0-	Yes
4	The Assistant Director, DRR, agreed to disallow and seek reimbursement for $83,045 ($42,352 of which is the FDIC's 51-percent share) in questioned operating expenses paid to the class A certificateholder.	30 days from issuance of the final report	Copies of the Trust income statement reflecting the class A certificateholder's reimbursement of the disallowed expenses.	$42,352	Yes
5	The Assistant Director, DRR, agreed to disallow and seek reimbursement for $59,820 ($30,508 of which is the FDIC's 51-percent share) in questioned miscellaneous expenses paid to AMRESCO.	30 days from issuance of the final report.	Copies of the Trust income statement reflecting AMRESCO's reimbursement of the disallowed expenses.	$24,692	Yes