

FDIC
Speeches

LIBRARY

OCT 6 1989

TESTIMONY OF

FEDERAL DEPOSIT INSURANCE CORPORATION

L. WILLIAM SEIDMAN
CHAIRMAN
RESOLUTION TRUST CORPORATION
WASHINGTON, D.C.

ON

STATUS OF THE RESOLUTION TRUST CORPORATION

BEFORE THE

COMMITTEE ON BANKING HOUSING, AND
URBAN AFFAIRS
UNITED STATES SENATE

10:00 A.M.
October 4, 1989
Room SD-538
Dirksen Senate Office Building

SUMMARY STATEMENT
STATUS OF THE RESOLUTION TRUST CORPORATION

Introduction: Much has been accomplished since FIRREA was enacted. However, much more remains to be done before the RTC is fully staffed with all operating policies and procedures in place. During this start-up period we have worked closely with the Oversight Board to institute policies.

RTC Organization Structure and Staffing: The RTC's major organizational components are the Asset and Real Estate Management Division and the Resolutions and Operations Division. Current Washington staff is approximately 100, with an expected total of about 250. The four regional offices established in Atlanta, Dallas, Denver and Kansas City each will be relatively small, with approximately 100 employees exclusive of accountants and attorneys. Consolidated field sites will be established in each region primarily to administer RTC's asset and real estate management function, and will have the bulk of employees. There are currently about 800 field employees with substantially more expected by year-end. The RTC expects to employ outside contractors wherever practical. RTC staffing will be minimized and will be mostly temporary employees. Even then, RTC could employ anywhere between 5,000 and 10,000 people by the end of 1990.

General Operating Policies: On the day FIRREA was enacted the RTC adopted FDIC policies as interim operating policies, which allowed the RTC to immediately begin its important tasks. The Oversight Board also has adopted policies which are being followed by the RTC.

Ethics and Conflicts of Interest: The RTC Board, at its August 9 organizational meeting, extended the FDIC's "standards of conduct" regulations to RTC independent contractors. On September 26, the RTC Board adopted an interim statement of principles of ethical conduct for independent contractors, developed in coordination with the Oversight Board. We anticipate publication in early November of proposed regulations, and foresee having final regulations in place by the February 5, 1990 statutory deadline.

Bribery: The RTC follows the FDIC in relying on three tiers of action to guard against bribery of an RTC official. These three tiers include the threat of criminal prosecution; internal RTC controls, audits and investigations; and encouraging those suspecting bribery to come forward.

Political Favoritism and Undue Political Influence: We expect FDIC's culture of political independence to carry over to the RTC by placing FDIC employees in key RTC positions and by hiring through competitive government procedures. Working with the Oversight Board, the RTC will establish specific written policies and procedures that will draw on current FDIC policies.

RTC Operations and Resolutions: As of September 30, the FDIC had placed 283 thrifts in the conservatorship program with gross total assets of \$112 billion and combined total liabilities of \$124 billion. Combined losses are estimated at about 31 percent of gross assets, or \$35 billion. As of September 30, the RTC had made secured loans to 151 conservatorships of \$8.1 billion to replace high cost funding sources, for an estimated savings of \$118 million on an annualized basis. As of September 18, only one of our institutions was among the top 35 highest rate payers. The RTC also has used funds to provide emergency liquidity to 41 conservatorships in the amount of \$0.5 billion.

As of September 30, the RTC had resolved 24 institutions and disbursed \$1.8 billion to cover insured deposits. There were twenty insured deposit transfers and four insured deposit payoffs. We expect to resolve five large institutions before the second week of October. These will be "clean" purchase-and-assumption transactions in which only good quality assets will be purchased by the acquirer. The cash outlay for these should be approximately \$8 billion.

Based on available financial data we estimate that another 300 thrifts may require failure resolution over the next three years, for a resolution total of nearly 600, with combined assets exceeding \$300 billion. This will require the RTC to dispose of assets of as much as \$180 billion.

RTC Funding Entity: The RTC is exploring various alternatives to provide working capital during the resolution process to purchase problem assets from failed institutions and to carry those assets until disposed of in an orderly manner. The amount of any working capital raised would be limited by the FIRREA debt limit and the value of the underlying assets.

Asset Management and Disposition: The biggest challenge facing the RTC will be properly managing and disposing of the billions of dollars of assets from the resolution of failed thrifts. The legislation requires RTC to sell property in "distressed" areas at 95 percent of market value or above. We have no present plans to lower that threshold. In all geographic areas the RTC will employ systematic and orderly marketing strategies and will avoid techniques that dispose of assets at any price. We therefore believe concerns about "dumping" should be eased considerably. The RTC will depend heavily on the committee process to make credit decisions. Adoption of Asset Management and Disposition Plans will insure that asset negotiations and strategies employed by contractors and in-house employees are consistent with FIRREA and RTC policy. Meeting the year-end real property asset inventory deadline is a real challenge. We are presently analyzing our needs and plan to contract out this function to the private sector soon.

Low Income Housing: The RTC is committed to maximizing the availability of affordable housing for moderate and lower income families. We are setting up communication channels with HUD and other officials to help identify and qualify purchasers for the program, and are exploring the best methods for assisting in sales financing and utilization of secondary market agencies. The RTC has created key supervisory and staff positions in each field office to manage program compliance.

Private Sector Contracting: The RTC's goal is to maximize the use of private contractors. Steps taken or in progress include developing contracting policies and procedures; establishing a senior executive position for coordination; providing contracting management specialists in field offices; and developing a computer data base on all qualified contractors.

Litigation and Legal Services: The RTC has inherited and is monitoring some 35,000 lawsuits and has already reduced expenditures on legal fees. Legal Division staffing will include about 80 Washington and 1,100 field employees, of which 500 will be attorneys. Estimated RTC expenditures for outside legal fees may reach \$125 million for 1990. In-house attorneys primarily will direct and control outside counsel.

Accounting and Auditing: The RTC is subject to almost unprecedented auditing and accountability. Oversight includes policy guidance by the Oversight Board, RTC's own Inspector General, FDIC's Inspector General, annual audits by the GAO, and Congressional oversight.

Minorities and Women Outreach Program: We are working to implement this important program as soon as possible. The program will include a commitment to comply with both the spirit and intent of FIRREA's mandate; providing and enhancing opportunities for minority- and women-owned firms to contract with RTC; identification of qualified firms; certification that firms are actually minority- or women-owned; proper qualifications; and execution and monitoring of the contracts.

Review of 1988 FSLIC Cases: Our review will cover 94 agreements involving \$110 billion in assets. This is an enormous task but must be accomplished quickly. Most work will be contracted out to private firms to speed completion and assure a credible and impartial review. We believe there are ways of reducing costs and will work with Treasury in exploring funding options.

Liquidation of FADA: Two approaches for liquidating FADA are being considered. These are the sale of the FADA organization, or, if that is not feasible, the dissolution of FADA and sale of its assets. Existing asset management contracts (or guarantee for future contracts) would not be for sale.

Good morning, Mr. Chairman and members of the Committee. It is a pleasure to be here today for the first time representing the Resolution Trust Corporation ("RTC") to apprise you of our progress since the RTC came into existence on August 9, 1989.

Much has been accomplished in less than two months since the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA") was signed into law. However, much more remains to be done before the RTC has a full staff of employees and all its operating policies and procedures in place. We and the Congress anticipated that the task at hand would be difficult. It is every bit as difficult as we contemplated. We have a tremendous task ahead of us.

Today we will discuss the Committee's specific areas of interest as stated in your letter of invitation. These include the operating policies adopted to date by the RTC and the safeguards we are implementing to protect against conflicts of interest, political favoritism and bribery by employees and agents of the RTC. In addition, we will provide a general overview of where the RTC stands and where it is headed, particularly in implementing many of the goals and specific mandates of FIRREA.

First, however, we would like to thank Secretary Brady and the rest of the Oversight Board and staff for their hard work and cooperation in getting this undertaking underway. During the start-up period we have worked closely with the Oversight Board to institute the policy statements discussed by Secretary Brady. Although we have had a few differences of opinion with the Oversight Board, these have been resolved. We look forward to a fruitful and positive relationship with the Oversight Board and staff as we jointly work to complete the start-up process and begin the greater task that lies ahead.

As an introduction to the Resolution Trust Corporation, we would like to outline the RTC's organizational and staffing structure and what we foresee in these areas for the future.

RTC ORGANIZATION STRUCTURE AND STAFFING

Washington Office. Mr. David Cooke, my former Deputy at the Federal Deposit Insurance Corporation ("FDIC"), is the Executive Director of the RTC. The RTC's major organizational components are the Asset and Real Estate Management Division headed by Lamar C. Kelly, Jr. and the Resolutions and Operations Division headed by William H. Roelle. An Administrative Division and a Funding Operations Division will support the two main functions. (See Attachment A for the organizational structure of the RTC Washington office.)

Certain departments of the FDIC also provide significant support services to RTC. These include areas such as corporate communications, legislative affairs, legal services, accounting and personnel management, as well as other areas.

The RTC currently has a Washington staff of approximately 100 employees, many of whom are on temporary details from either the FDIC staff or the now defunct Federal Savings and Loan Insurance Corporation ("FSLIC"). We anticipate that the RTC's Washington Office ultimately will have approximately 250 employees.

Regional Offices. Four Regional Offices have been established and four former FDIC Regional Directors have been appointed as directors of those offices. The RTC's Regional Offices are located in Atlanta, Dallas, Denver and Kansas City. (See Attachment B for the geographic areas covered by each Region.) Each Regional Office will be relatively small, with anticipated staffing -- exclusive of accountants and attorneys -- of approximately 100 employees. (See Attachment C for the organizational chart of the Regional offices.)

Consolidated Field Sites. Consolidated sites will be established to manage the disposition of real estate and other assets owned by the RTC. These sites are where most of RTC's personnel will be located. The number of employees is difficult to determine with any degree of precision at this time. It will depend upon the volume and type of assets, as well as our ability to hire private contractors. The RTC expects to employ outside contractors wherever practical in executing its mandate under FIRREA. Even so, the consolidated field sites are likely to employ several thousand people altogether.

At this early stage we have designed structures for three broad size categories of sites. Smaller consolidated sites will handle up to \$7.5 billion in assets. A medium-sized site will handle \$7.5 to \$15 billion in assets. Large sites, which we anticipate will be few in number, will handle over \$15 billion in assets. (See Attachment D for the list of consolidated sites.)

Initially 730 employees were transferred from the FDIC to the RTC's consolidated field sites. These employees were either in the FDIC's Asset Liquidation Division or were serving as Managing Agents in Conservatorships. Currently the RTC has approximately 800 field employees, the majority of which are involved in resolution and conservatorship operations.

We anticipate the number of people to be employed by the RTC will be substantial. Wherever possible, staffing for RTC will be minimized and most of the people employed will be hired as temporary employees. Even with these constraints, however, the RTC easily could employ between 5,000 and 10,000 people by the end of 1990.

GENERAL OPERATING POLICIES

On the day FIRREA was signed into law, the RTC adopted FDIC policies as interim operating policies. (See Attachment E for the text of these policies.) This allowed the RTC to begin its important tasks immediately. The policies provide general guidance in the areas of resolution transactions and asset disposition and management. These policies will be followed unless they conflict with policies adopted by the Oversight Board or until superseded by more specific or permanent RTC policies.

The Oversight Board also has adopted some policies which have been supplied to the Committee and described by Secretary Brady. Those policies are being followed by the RTC.

ETHICS AND CONFLICTS OF INTEREST

The Committee specifically requested information on the procedures and safeguards the RTC has and will put in place to protect against unethical conduct and conflicts of interest by its members, officers, employees and contractors. This process for establishing and implementing these procedures is well under way. Final regulations will be in place by the statutorily mandated deadline.

Within 180 days, FIRREA requires the RTC to (1) prescribe regulations which would govern conflicts of interest, ethical responsibilities and post-employment restrictions applicable to members, officers and employees of the RTC that shall be no less stringent than those applicable to officers and employees of the FDIC and (2) prescribe regulations applicable to RTC independent contractors which would govern conflicts of interest, ethical responsibilities and the use of confidential information, consistent with the goals and purposes of titles 18 and 41 of the United States Code.

As an interim measure, the RTC Board acted at its August 9 organizational meeting -- the date of enactment of FIRREA -- to extend the FDIC's "standards of conduct" regulations to independent contractors of the RTC, to the extent those standards "reasonably apply" to the activities of independent contractors. The Board included the "reasonably apply" standard because the FDIC's regulations prohibit employees from owning bank stock and obtaining extensions of credit (other than through the use of a credit card) from assisted banks or from acquirers of failed banks headquartered within their respective regions of assignment. We do not believe it reasonable or necessary to restrict bank stock ownership or credit of an independent contractor who, for instance, provides no more than lawn care services to the RTC.

This first action of the Board regarding ethical conduct standards was merely instituting the "bare essentials." Any credit restrictions ultimately imposed on independent contractors will depend upon the nature and extent of services the contractor is performing for the RTC. We expect to prohibit contractors from obtaining extensions of credit only from persons or institutions with whom their duties may require them to negotiate. We would not allow a contractor to obtain a loan from an institution with which he or she is negotiating the sale of an asset.

The RTC Board took further action on September 26 by adopting an interim statement of principles of ethical conduct for independent contractors. (See Attachment F for a copy of the statement.) The statement was developed in coordination with a joint policy group on ethical standards established by the RTC Oversight Board. While the principles set forth in the statement are effective immediately, we invited public comment before developing the proposed regulations which we plan to publish in early November for a 60-day public comment period.

In general terms, the principles set forth in the interim statement are designed to preclude contractors with the RTC from:

- o Performing services for the RTC which could affect their personal financial interests or the financial interests of their spouses, minor children, or persons or entities with whom they have business or financial ties;

- o Profiting from both sides of a transaction by performing services for the RTC in connection with a particular matter and simultaneously representing themselves or other parties to or before the RTC in connection with that same matter or a substantially related matter;
- o Using nonpublic information obtained while performing services for the RTC to engage in private financial transactions or to benefit members of their families or persons or entities with whom they have business or financial ties;
- o Using RTC property or the assets of institutions with respect to which they are performing services for the RTC for their personal use, or allowing the use of such property or assets by members of their families or persons or entities with whom they have business or financial ties; and
- o Having the quality and integrity of their services to the RTC clouded or impugned by their acceptance of gifts, favors, entertainment or other items of monetary value from persons or entities whose financial interests could be affected by the performance or nonperformance of their duties and responsibilities to the RTC under the terms of their contracts.

It is not our intention at this time to prohibit independent contractors who manage assets for the RTC in one part of the country from purchasing RTC assets in other parts of the country. We will require, however, that they establish and enforce screening mechanisms satisfactory to the RTC. These mechanisms must preclude the flow of nonpublic information (e.g., the formulas and procedures by which the RTC establishes reserve prices on assets) between independent contractor employees who are performing services for the RTC and those who are attempting to purchase assets from the RTC.

Contractors have the right to be adequately and reasonably compensated for any services they perform for the RTC. They should not be allowed, however, to profit from both sides of a transaction or otherwise conduct their activities in a manner that discredits or causes a loss of confidence in the Federal Government. Contractors who perform duties and responsibilities ordinarily performed by Federal employees should be expected to behave and to be held to similar standards of conduct as Federal employees. Since the RTC is charged with a public trust, it may expect that persons with whom it contracts for services will provide those services not only for adequate and reasonable compensation, but also for the public benefit.

The RTC needs the experience and expertise of independent contractors in performing its functions. Accordingly, it will be necessary to strike a delicate balance between the legitimate needs of the RTC for independent contractors and the interests of the RTC, the Congress, and the American public in protecting against unethical conduct and conflicts of interest. We hope to achieve that balance in the final regulations.

In summary, we are working in cooperation with the RTC Oversight Board's ethics and conflicts of interest joint policy group towards the publication in early November of proposed regulations. We foresee no obstacles to having final regulations in place by the February 5, 1990 statutory deadline.

BRIBERY

The FDIC traditionally has relied upon three tiers of action to guard against the possibility of any third party bribing an FDIC official. The same courses of action will be followed by the RTC.

The first tier is the threat of criminal prosecution and incarceration for any FDIC official who may solicit or accept an illegal bribe or gratuity. FDIC maintains a close relationship with law enforcement authorities to deal with such cases.

The second tier consists of internal FDIC controls, audits and investigations. The FDIC Office of Inspector General conducts a vigorous program of audit controls which are designed to detect the presence of any potential bribery. Also, periodic site visitations are conducted to ensure that financial and management controls are effectively in place. These programs supplement the standard operating procedure of checks, balances and review in each office.

The third tier depends on those suspecting bribery to come forward. If a debtor is approached for a bribe by an FDIC official or if an FDIC official is approached to accept a bribe, the unmasking of these acts will help establish a high level of public intolerance for such activity and public confidence that the offenders will be punished. The importance of this third tier should not be minimized since even the best systems to deter criminal activity are not fail safe.

POLITICAL FAVORITISM AND UNDUE POLITICAL INFLUENCE

FIRREA requires that measures be taken to avoid political favoritism and undue influence with respect to the activities of the RTC. Working with the Oversight Board, the RTC plans to develop specific written policies and procedures that will draw upon current FDIC policies which also now govern RTC activities. The written guidelines adopted specifically for the RTC will delineate internal operating procedures and methods for responding to both appropriate and inappropriate inquiries.

The FDIC traditionally has conducted its operations independent of undue political pressures. We have policies that guard against such pressures. The policies allow us to investigate and provide information with respect to an inquiry, concern or complaint of those in political office. They do not permit us to discuss the substance of pending decisions with respect to specific actions nor alter or change a decision, policy or procedure of the FDIC at the request of any outside party.

The "independent" culture of the FDIC will carry over to the RTC. That objective will be facilitated by placing FDIC career employees in key RTC positions. By hiring through competitive government procedures, hiring will be based on merit not political connections.

RTC OPERATIONS AND RESOLUTIONS

The RTC is responsible for: the management and operation of institutions in conservatorship; the resolution of closed thrift institutions; and the management of funds -- as those funds are provided by the RTC Oversight Board -- for resolutions, liquidity and the replacement of high-cost funds. Immediately following the enactment of FIRREA, the RTC began the process of resolving the substantial inventory of insolvent thrifts that had been placed in the conservatorship program.

Conservatorship Program. A major component of the President's plan was to place the worst institutions under government control and reduce operating losses. As of September 30, 1989, 283 thrifts had been placed in the conservatorship program. These institutions had gross combined total assets of \$112 billion and combined total liabilities of \$124 billion. Based on limited asset reviews, we estimate that the losses in these institutions total \$35 billion, or about 31 percent of gross assets. (See Attachment G.)

Our reviews also show that the estimated loss rate, on average, has declined for the more recent additions to the conservatorship program. Those institutions placed in conservatorship prior to March 31, 1989 have estimated losses as a percent of gross assets of 36 percent as compared to 21 percent for those placed in the program after March 31, 1989.

High-Cost Funding. Savings and loans in the conservatorship program are highly illiquid and prior to FIRREA were forced to compete aggressively for funds in a rising interest rate environment. As a result, despite aggressive liquidity management by our conservators, rates on brokered deposits increased by as much as 150 basis points in some sections of the country.

The availability of low-cost funds has decreased significantly the upward pressure conservatorship S&Ls were putting on interest rates. As of September 30, with funding provided by the Oversight Board, the RTC has made secured loans to 151 conservatorships in the amount of \$8.1 billion. The loans were made to replace high-cost sources of funding. These high-cost funds were primarily Federal Home Loan Bank advances, brokered deposits and secured borrowings. As a result of this action, the savings to the RTC, and ultimately to the taxpayers, is estimated to be \$118 million on an annualized basis.

The availability of this funding program has allowed institutions in conservatorship to exit from the high-cost funds market. When the program started, 25 of these institutions were among the top 35 rate payers in the country for 90 day CDs. As of September 18, one was in the top ten and it is the only RTC institution in the top 35. This reduction in interest rate market pressure should enable other financial institutions to lower their rates.

Reports from the field indicate that this is a very successful program. The managing agents can set rates that allow them to be competitive with local healthy institutions and maintain their core deposits. Previously forced to be market leaders to obtain funds for day-to-day operations, they now can control their rate structures and borrowings without being in the broker markets, and they can rely on the RTC to provide liquidity when needed. This has greatly simplified their funding and allowed a return to rational pricing of deposits.

Moreover, these actions have produced a significant impact on the cost of funds for all institutions that must compete for money in the market. In particular, the cost of funds index used by FSLIC in the Southwest Plan resolutions has been reduced significantly.

Emergency Liquidity Advances. In addition to replacing high-cost funds, the RTC also serves as "lender of last resort" for S&Ls in conservatorship. As of September 30, the RTC has provided \$0.5 billion in emergency liquidity to 41 conservatorships that were unable to meet their daily liquidity needs and continues to maintain a reserve of \$0.9 billion for future emergencies.

Resolutions. As of September 30, the RTC had disbursed \$1.8 billion to resolve 24 institutions. It is important to note that the \$1.8 billion outlay is not the measure of ultimate cost to the RTC. The ultimate cost will be determined only after deducting collections that are realized through the liquidation of assets held by the RTC.

Twenty of the 24 resolutions to date have been handled as insured deposit transfers, whereby institutions pay a premium to act as the RTC's paying agent for insured deposits. The other four resolutions were handled as insured deposit payoffs.

In addition to these transactions, the RTC has allocated \$8 billion toward the resolution of five large institutions. These five transactions will be structured as "clean" purchase-and-assumption transactions in that the acquirer will receive only good quality assets and cash from the RTC to offset the assumption of deposits and other liabilities.

Originally we had planned to consummate these transactions by the end of September. However, due to recent clarifications in requirements for bidder eligibility and entrance and exit fees, we felt that a short postponement would be fair in order to ensure that no interested and eligible acquirers were excluded from the bid process.

The bidders' meetings were completed yesterday. Bidder interest in these five transactions is strong. We are highly confident these transactions will be completed by next week.

We also briefly postponed five smaller insured deposit transfers due to the clarification of bidder eligibility requirements. These transactions will use up the balance of the funds for resolutions.

In summary, the \$20 billion has been allocated as follows:

Resolutions	\$10.1 billion
Emergency liquidity	\$1.4 billion
Replacement of high-cost funding	\$8.5 billion

Bidding Procedures. Transactions consummated by the RTC to date generally have been smaller institutions with deposits of less than \$500 million. These transactions were standardized with bidders essentially bidding to become RTC's paying agent for insured deposits. The RTC solicited names of prospective bidders from the FDIC, Office of the Comptroller of the Currency ("OCC"), Federal Reserve Board ("FRB") and Office of Thrift Supervision ("OTS"). Generally, for these smaller transactions, only financial institutions were solicited as time frames were brief (generally 48 hours or less).

A press release dated September 27, 1989, outlined procedures to be followed by the RTC in order to qualify interested parties as acceptable bidders. As indicated in the release, "...potential bidders must be deemed acceptable by the primary federal regulator and holding company and state chartering authorities if applicable." However, a bidder could be disqualified by the RTC if it were unable to obtain an opinion from the FDIC that the transaction "results in no undue risk to the deposit insurance funds."

To implement the above procedures for the sale of the five large thrifts, the RTC requested names of acceptable bidders from the FDIC, OCC, FRB and OTS. As a result of the solicitation, a number of additional prospective bidders were contacted by overnight mail on September 28, 1989. (See Attachment H for copy of the mailing.)

PROJECTIONS

The 283 institutions in the conservatorship program represent only a portion of the likely RTC caseload. The OTS is in the process of completing a list of conservatorship-bound S&Ls. We expect the official list shortly but, in the interim, are projecting our workload based on available financial data. We estimate that OTS may turn over another 300 thrifts to the RTC. This would mean that, in total, the RTC may be required to handle nearly 600 failures during the next three years with combined assets exceeding \$300 billion (book value). These failures are widely disbursed geographically, with Texas accounting for the heaviest concentration.

How these cases are resolved will determine the volume of assets the RTC must manage. We estimate that only 40 to 45 percent of the assets will be sold to the acquirers of the failed institutions. Thus, RTC may have to manage the sale of as much as \$180 billion in assets. The quality and composition of these assets will determine the difficulty the RTC will have disposing of them. While liquid assets can be disposed of quickly and easily, distressed assets will require significant marketing efforts. Keeping in mind the

questionable quality of a failing institution's financial reports, we estimate that as much as \$100 billion in difficult, non-liquid assets may flow to the RTC.

We currently estimate about \$16 billion would be in real estate owned by thrifts (most of which is repossessed real estate). This figure is likely to be low if, as is often the case, real estate is the only source of repayment on non-performing or poor-quality loans.

The projections discussed above raise questions about the adequacy of the \$50 billion in RTC funding. Possible RTC losses are difficult to project because they are dependent upon many factors such as the number of failed institutions and their size, future interest rates, economic conditions and demand for thrift assets, as well as institution-specific factors such as ability to manage loans effectively. It is possible that \$50 billion will prove to be an insufficient amount to deal with potential failures, but it is really much too early to make a reliable new prediction of loss.

The Office of Thrift Supervision is in the best position to identify which institutions are likely to be turned over to the RTC and when. Even then, it is difficult to estimate likely losses until the RTC has actually gone into these institutions.

RTC FUNDING

Through the Treasury and the Resolution Funding Corporation, the RTC will be provided with \$50 billion to eliminate the negative net worth in institutions that are currently insolvent or will become insolvent within the next three years. While \$50 billion represents the current cost of "filling the hole," it does not represent the total cash or working capital needs of the RTC. As mentioned earlier, the RTC may have to acquire \$100 billion in illiquid assets out of failing S&Ls before they can be sold. The book value of these assets will have to be paid by the RTC to acquirers of insolvent S&Ls. Only after these assets are sold will the RTC be able to replace a portion of those cash outlays.

In effect the RTC must buy, then collect, on these illiquid assets. This ties up the RTC's cash very quickly. For example, after the five transactions are concluded next week we will have spent about \$10 billion -- 20 percent of the \$50 billion -- resolving institutions that account for only a small portion of the S&Ls to be resolved. A sizable portion of this \$10 billion will be recovered, however, through collections on the assets held by the RTC. The collection process tends to be slow. Forced sales, dumping or overly aggressive collection efforts will result in increased RTC losses as well as severe disruption in already distressed economies.

The RTC must establish a working capital program or funding entity to manage its working capital needs. This would ensure that the RTC has enough cash for S&L resolutions without triggering uneconomic asset disposition policies.

We want to make it clear that no working capital program will enable the RTC to "fill a hole" deeper than the original \$50 billion. If the resolution process reveals that \$50 billion is too low, additional funds will be required to make up the difference. Working capital would simply allow the RTC to quickly remove the unhealthy portion of the thrift industry and allow time for the orderly disposition of assets.

We have had considerable discussion with officials from Treasury, government agencies that issue securities and investment banking firms about various working capital alternatives. Any programs to raise working capital, of course, would be limited by the debt limit imposed by FIRREA and by the value of the underlying assets.

No final decisions have been made and we plan to confer with Congress before initiating any major working capital programs. No matter which approach we take, funding for RTC will be very complicated. Our first step is to hire personnel for RTC's funding operations. We expect to complete our search efforts for an experienced Funding Director soon.

ASSET MANAGEMENT AND DISPOSITION

The long-term challenge facing the RTC will be properly managing the billions of dollars of assets that come from the resolution of failed thrifts and disposing of those assets in a timely and efficient manner. This task includes maximizing returns and assuring that low and moderate income individuals and non-profit organizations are afforded the opportunity to purchase eligible single- and multi-family housing. It also requires procedures that maximize the use of private and minority contractors.

Asset Disposition. A primary objective of the RTC is to maximize the net present value of collections on assets it controls while minimizing the impact of these transactions on local real estate markets. FIRREA identified six states as "distressed areas" which require adoption of special asset disposition policies to protect the economies of these areas. Other areas can be designated as "distressed" if warranted.

The legislation requires RTC to sell property in "distressed" areas at 95 percent of market value or above. Selling property below this threshold is permitted only to satisfy RTC low income housing objectives or if the RTC's Board of Directors approves lowering the threshold for appropriate reasons. We have no present plans to lower that threshold.

We understand the concern expressed through the legislation about the potential damage from "dumping" assets on a weakened market. The RTC is fully prepared to meet the requirements in the law to assure that market values are achieved for properties sold and that the adverse economic impact of real property sales is minimized. We do not "dump" property and never have.

The Oversight Board is formulating policies to govern RTC with respect to asset dispositions. Our policy, until a different policy is developed, is to institute an orderly disposition of assets at market values over time.

We do not believe that keeping property off the market -- if it can be sold at current appraised value -- would necessarily have the effect of maintaining higher values in the market place. In fact, holding properties off the market that can be sold at today's values can be a destabilizing factor. The cost of maintaining properties during a holding period must be balanced against ultimate realization values to protect the cost to the taxpayer.

In all geographic areas, including "distressed" areas, the RTC will employ systematic and orderly marketing strategies basing sale prices on current appraisals and other independent sources of market information. These sources will include brokers, market analysts and other Federal agencies. These strategies will avoid techniques such as "absolute" property auctions, which could be viewed as a mechanism to dispose of assets at any price. FDIC's uniform appraisal instructions are being revised to require consideration of sales with typical term financing offered as opposed to a strict cash sale basis.

Asset Disposition Decision Process. The asset disposition decision-making process utilized by the RTC is based upon Delegations of Authority approved by the RTC's Board of Directors.

Credit decisions can cover a wide array of areas, but most frequently consist of recommendations to sell real estate or other assets at specified prices, make advances to protect assets, or compromise and restructure loan agreements. Recommendations for a particular action are originated by the account officer or contractor managing the asset and presented in a written credit case format to the individual or committee authorized to approve the transaction.

The RTC will depend heavily upon the committee process to make credit decisions. Major decisions will be made by credit committees formed at the consolidated site and Regional level. Cases involving complex legal issues and large-dollar

assets generally will flow to RTC's Committee on Management and Disposition of Assets -- a senior level committee at RTC headquarters in Washington, D.C. To allow for an orderly workflow, various personnel with asset management expertise throughout the organization also will have lesser levels of individual delegated authority to approve routine transactions.

An additional component of the RTC's asset management process will include the preparation and approval of Asset Management and Disposition Plans outlining strategies for disposition of major assets acquired by the RTC. Adoption of Asset Management and Disposition Plans will help insure that asset negotiations and strategies employed by contractors and in-house employees are consistent with the objectives of FIRREA and RTC policy.

Real Property Asset Inventory. FIRREA requires the RTC to publish, semiannually, an inventory of real property assets of institutions subject to its jurisdiction. In particular, we are required to clearly delineate those real property assets that have "natural," "cultural," "recreational," or "scientific" values of special interest. The first such inventory must be published before January 1, 1990.

Because of the large number of assets in the conservatorships now under RTC control, meeting the year-end deadline is a real challenge. We are presently analyzing our needs based on the task at hand. We plan to contract out this function to the private sector in the near future.

Low Income Housing. One of the primary missions of the RTC under FIRREA is to maximize the preservation and availability of affordable housing for moderate- and lower-income families. To accomplish this objective the RTC will identify eligible single-family and multi-family residential units and provide non-profit organizations, public agencies and lower-income families a right of first refusal to purchase these properties.

For single-family dwellings, as eligible properties with clear title are identified, written property listings will be distributed to clearinghouses responsible for passing this information on to eligible purchasers. Qualified purchasers will have three months from the date of eligibility to make a bona fide offer to purchase the property.

Qualified purchasers of multi-family residential units have 90 days after the RTC notifies clearinghouses (or until the RTC determines the property is ready for sale, if earlier) to provide notice of serious interest in purchasing the property. Upon the RTC providing notice that the property is

ready for sale, any qualified purchaser who has expressed serious interest has 45 days to make a bona fide offer to purchase.

The RTC is in the process of setting up communication channels with the Department of Housing and Urban Development and other officials to develop strategies to identify and qualify purchasers for the program. We also are exploring the best methods for assisting in sales financing and the utilization of secondary market agencies to comply with the statutory requirement of the program.

To make certain that the lower income housing programs are properly carried out, the RTC has created key supervisory and staff positions in each of its field offices to manage program compliance. These managers will provide responsive execution and communication between the field offices and the Washington office, interact with the other agencies involved in the program and provide direct management of sales activities at the local level.

Private-Sector Contracting. FIRREA requires the RTC to utilize private-sector resources -- including asset management firms, property management firms, leasing companies, brokerage services, etc. -- whenever practicable. We have concluded that the use of private-sector resources, particularly in managing and disposing of complex real estate assets, is both practicable and efficient. Therefore, we have established a goal to maximize the use of private contractors.

Several steps have been taken or are in process to achieve the goals set forth above:

- o We are in the process of developing contracting policies and procedures. Although not finalized, the process will include a thorough ethics/conflict-of-interest screening, a qualification determination, competitive bidding, negotiation, execution, and monitoring. The Washington office will handle national contracts while the regional offices will manage local contracts under delegated authority.
- o Organizationally, we have established a senior executive position in the Washington office to establish contracting policies and procedures. Similarly, we have provided for contracting management specialists in both the regional offices and consolidated field sites.

- o During the past several weeks, we have met or communicated with hundreds of contractors to discuss the types of services the RTC will need and the policies and procedures under which contracting will be implemented.
- o We plan to develop a computer data base on all qualified contractors which can be used by RTC field personnel to quickly identify potential contractors by types of services performed and geographical location.

LITIGATION AND LEGAL SERVICES

As a result of the conservatorships and receiverships set up to date, the RTC has inherited approximately 35,000 matters in litigation.* The suits range from simple collection and foreclosure actions to large complex commercial litigation.

In order to hold down costs and avoid disruption in conservatorships, the RTC has utilized, to the greatest extent possible, the law firms retained by the thrifts prior to conservatorship, provided there is no conflict of interest with the RTC or the FDIC. Through the use of existing FDIC regional legal operations, we have begun monitoring all of these cases. The cases involving large dollar amounts (usually \$250,000 or more), high fee amounts (\$5,000 or more per month), or special issues, receive close supervision by our in-house legal staff. Other cases are monitored on a periodic basis by our Legal staff. All fee bills are reviewed and are subject to approval by our legal personnel.

We already have begun to realize cost savings. Our initial estimates indicate significantly reduced expenditures by these thrifts on legal fees. Hard estimates are not yet available, but it appears that these reductions may reach \$50 million on an annualized basis for existing caseloads. Through improved monitoring, elimination of actions which are not cost effective, and aggressive movement of cases toward judgment or settlement, it is anticipated that any poorly controlled handling of litigation in these institutions will be brought under control.

* In fact, with the assimilation of RTC's caseload and FSLIC Resolution Fund matters, including the Southwest Plan cases, the FDIC will be involved in approximately 60,000 legal cases in addition to its caseload of approximately 13,000 that existed on the day FIRREA was enacted.

✓ Eventually the FDIC's Legal Division will provide full in-house support to RTC in Washington and all the regional and field offices. The Legal Division will supply some 80 employees in Washington and approximately 1,100 employees in the field. Of these employees, approximately 500 will be attorneys. Recruiting has begun at all levels and we anticipate that by year-end some 200 attorneys will be in place along with appropriate support staff. As the field operations become fully staffed, the oversight of outside counsel will become better controlled and additional savings are anticipated.

Current estimates are that RTC expenditures for outside legal fees and expenses may reach \$125 million for 1990. The actual expenditures, as well as the personnel estimates, will depend on the rate at which we can move forward with in-house staffing as well as the ultimate make-up of the caseload, the number of thrifts handled by RTC and the extent of the assets RTC has to liquidate.

The emphasis placed on outside contracting will apply to legal services as well. In-house attorneys will conduct litigation where practical and cost-effective. However, their primary role will be to direct and control outside counsel in order to provide the most effective and efficient blend of legal services.

ACCOUNTING AND AUDITING

The RTC is subject to oversight, auditing and accountability to an extent that probably is unprecedented in the history of government. In addition to the audit policy guidance provided by the Oversight Board, that Board also will be supported by an internal analytical group assessing operations. In addition, the RTC will have its own Inspector General reporting jointly to the Oversight Board and the RTC Board of Directors. Complementing the Inspector General will be the FDIC's own Inspector General that will audit and investigate as necessary the FDIC's provision of personnel and essential services to the RTC.

The General Accounting Office will audit the RTC annually either directly or through an accounting firm acting as its agent. In addition, the GAO presumably will perform periodic reviews and studies initiated by Members of Congress and/or their Committees.

Finally, we anticipate the Congress will exercise strenuous oversight of the RTC's operations -- as already evidenced by this hearing today and the creation of a special oversight task force of the House Banking Committee. In fact, FIRREA specifically mandates regularly scheduled appearances by the

RTC before this Committee. All in all, the readers and reviewers of audits will keep busy with the RTC.

MINORITIES AND WOMEN OUTREACH PROGRAM

FIRREA requires the RTC to establish an outreach program to ensure that minorities and women are afforded an opportunity to contract with the RTC on matters relating to asset management, property management, legal services, etc.

We are working to implement this program as soon as possible. A draft of RTC's program has been developed and is being reviewed at this time. We anticipate the program will include the following elements:

- o Policy Statement - a commitment to comply with the spirit and intent of FIRREA's mandate
- o Goals and Objectives - to provide and enhance opportunities for minority- and women-owned firms to contract with RTC
- o Identification of qualified firms
- o Certification - to ensure that the firms are indeed minority- or women-owned firms
- o Qualification - to ensure that the minority- or women-owned firms have sufficient qualified staff and other resources to render the services
- o Promotion - to communicate to minority- and women-owned firms RTC's commitment to contract with such firms
- o Execution and Monitoring

REVIEW OF 1988 FSLIC AGREEMENTS

The RTC is required under FIRREA to estimate the cost to the Government of the 1988 FSLIC resolutions and, to the extent possible, find methods of reducing those costs. The review will cover 94 agreements involving \$110 billion in assets. It will increase efficiency if the review is accomplished as promptly as possible. Our goal is to complete the review within one year.

We are recommending that most of the work be contracted out to private firms, which will coordinate closely with a small group of in-house staff. The use of private-sector analysts will help to ensure a credible and impartial review.

A preliminary look leads us to believe there may be ways of reducing costs. Some agreements provide guaranteed spreads and capital loss coverage on a large volume of problem assets. In many cases it may be feasible to prepay FSLIC notes or buy back or force the writedown of problem assets. This would reduce the Treasury's carrying cost and could improve collection incentives and performance. We hope to work with Treasury in exploring funding options that are consistent with the legislation.

LIQUIDATION OF FADA

FIRREA requires liquidation of the Federal Asset Disposition Association ("FADA") by the RTC within 180 days of enactment. Two alternative approaches are being considered: (1) The sale of the FADA organization or (2) the dissolution of FADA and the taking of its resources by the FDIC.

We will first attempt to sell the FADA organization. This approach would entail selling just the FADA structure. FADA's name, charter, capital stock and liquid assets would not be for sale. Furthermore, existing asset management contracts (or any guarantee for future contracts) would not be for sale. Any contingent liabilities resulting from FSLIC's indemnities with the FADA, its Board of Directors and its Officers would remain with the FSLIC Resolution Fund.

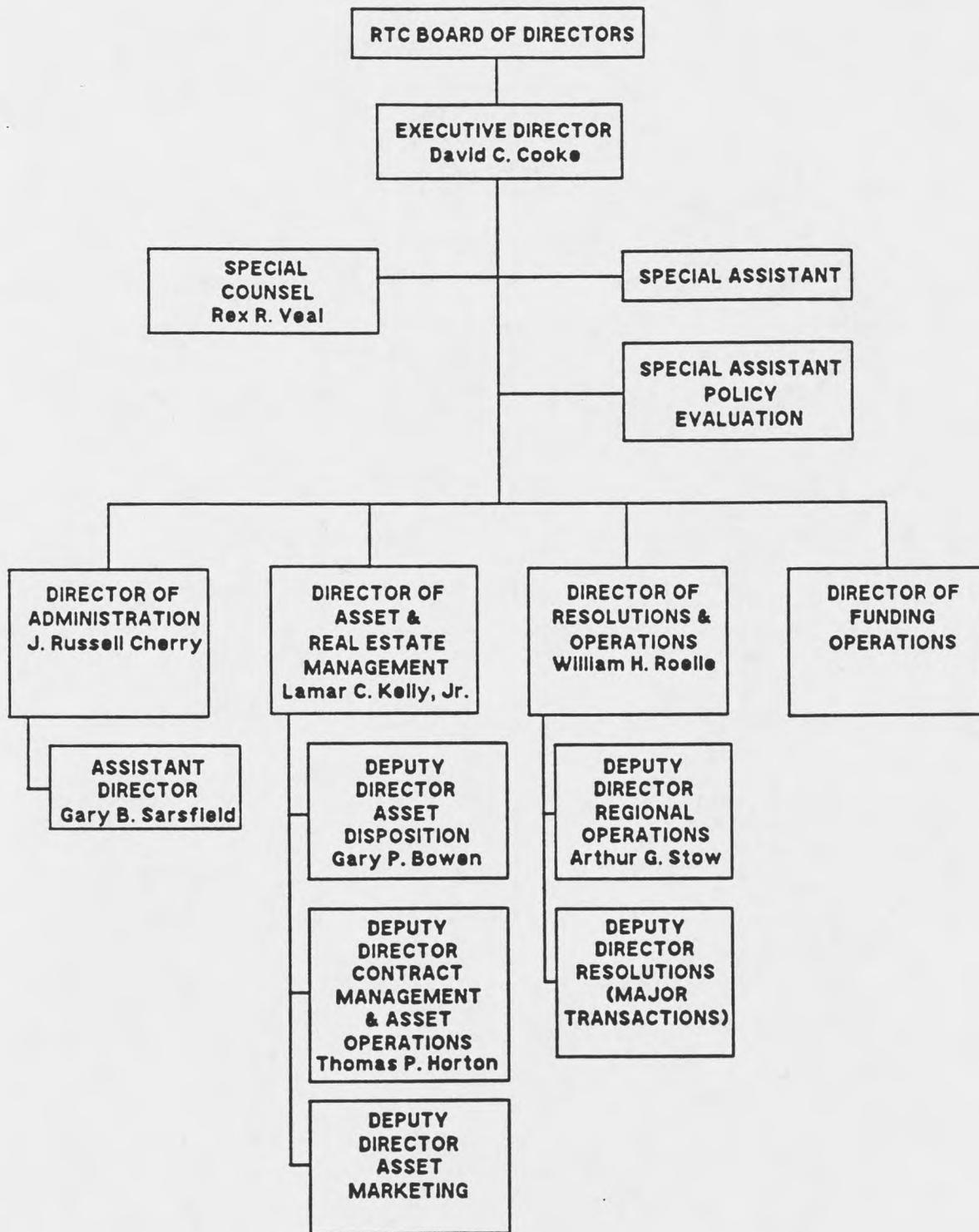
If we cannot sell FADA, the RTC will dissolve FADA and sell or use its assets. Asset-management duties would be transferred to the FDIC and FADA employees would be offered positions with the FDIC at government pay scales. The next step would be to sell, utilizing a competitive sale process, those of FADA's furniture, fixtures and similar assets that are not needed by the FSLIC resolution fund. This transition would occur during November and December and the asset sales would be during January.

CONCLUSION

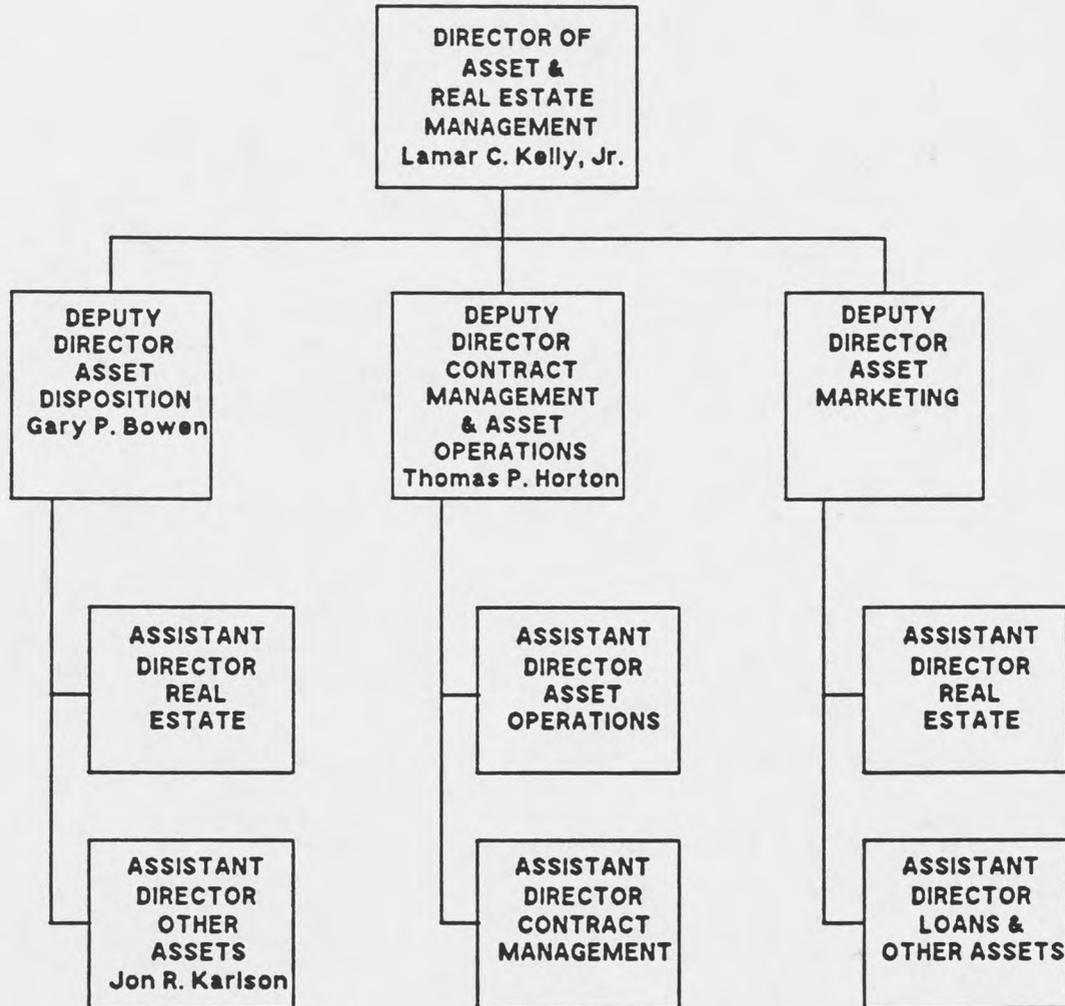
In conclusion, we believe we have made a good start. We are working under established FDIC policies while implementing, with the Oversight Board, new policies to guide our future work. We know that much remains to be done. The bulk of our work lies ahead.

RESOLUTION TRUST CORPORATION

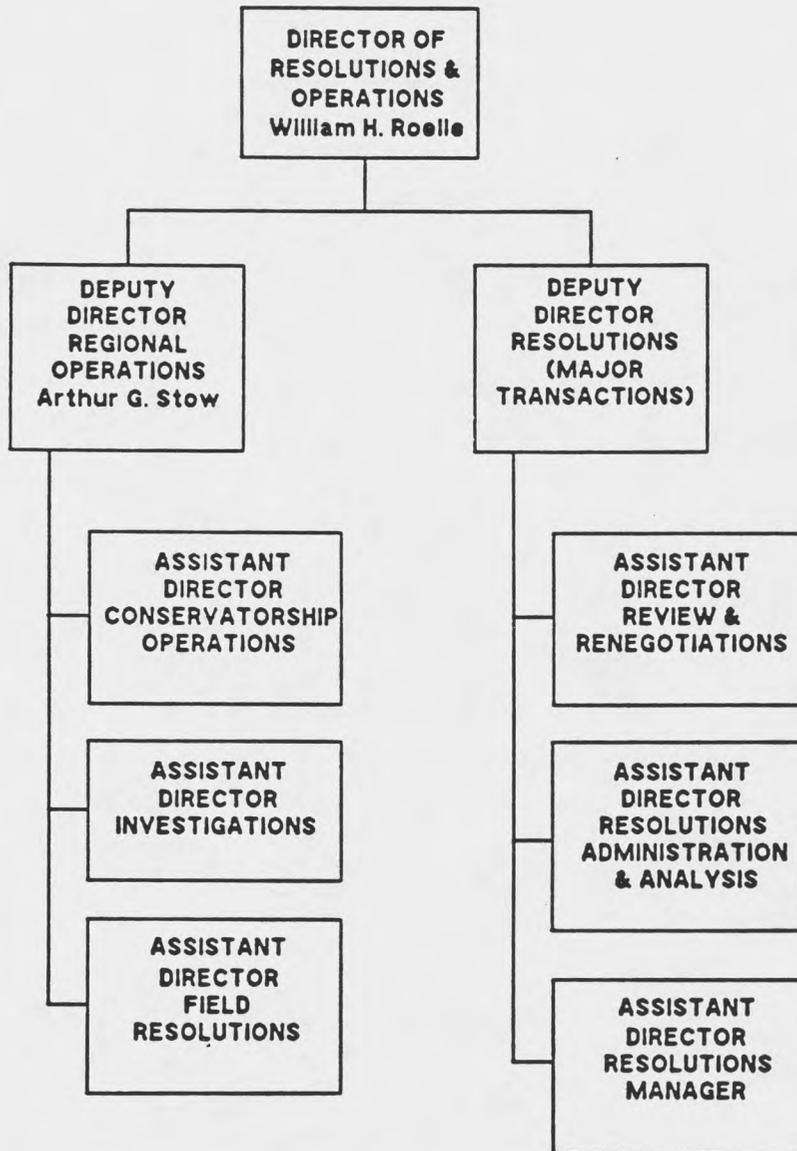
WASHINGTON, D.C.



RESOLUTION TRUST CORPORATION
WASHINGTON, D.C.

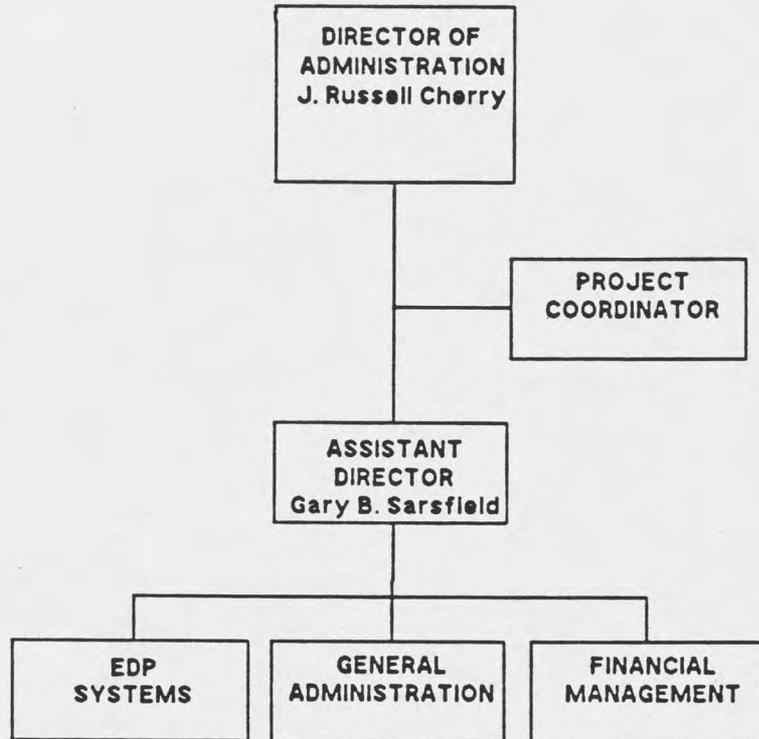


RESOLUTION TRUST CORPORATION
WASHINGTON, D.C.



RTCSUM14 9/29/89

RESOLUTION TRUST CORPORATION
WASHINGTON, D.C.



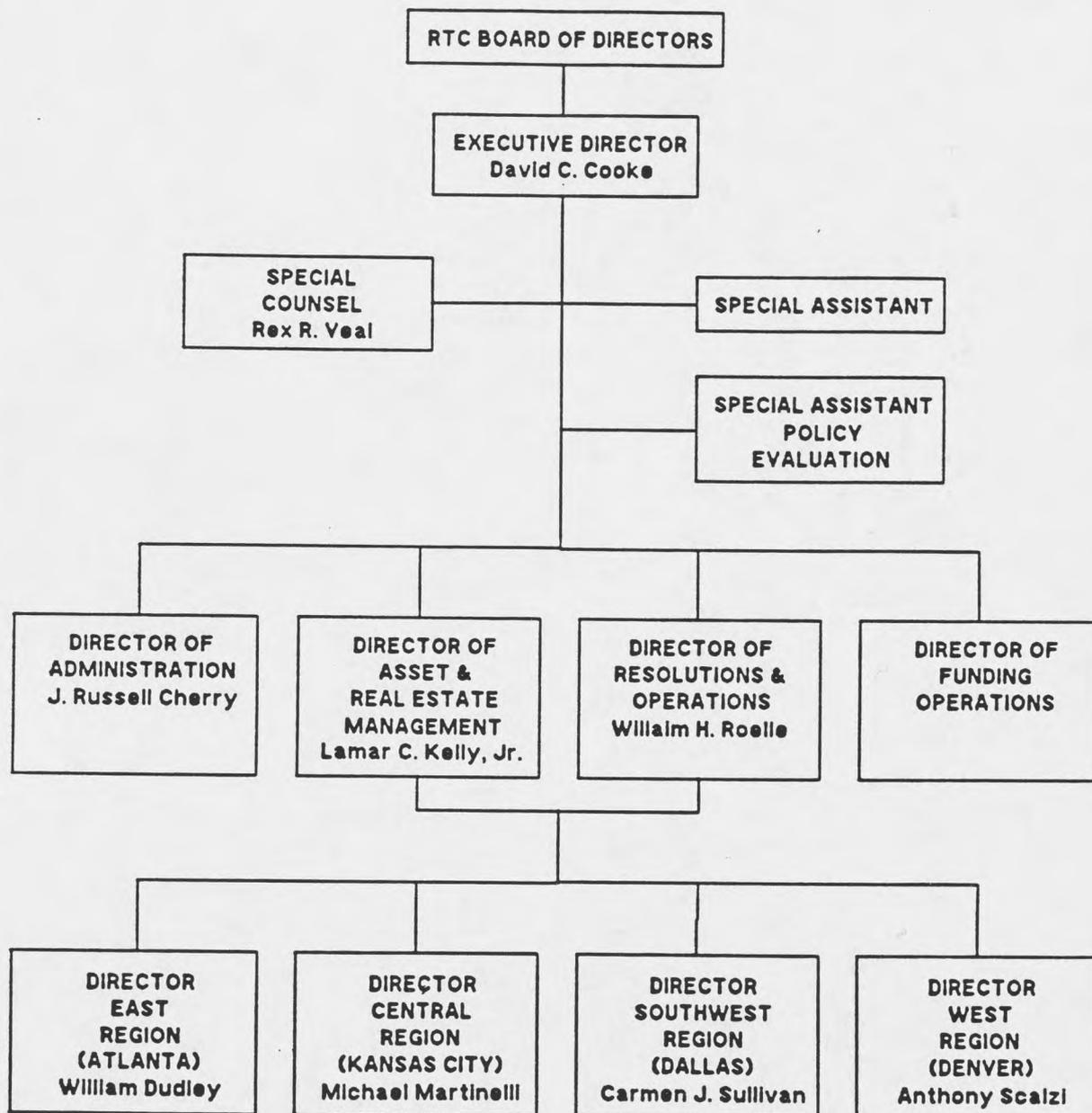
RTCBUM12 9/29/89

RESOLUTION TRUST CORPORATION

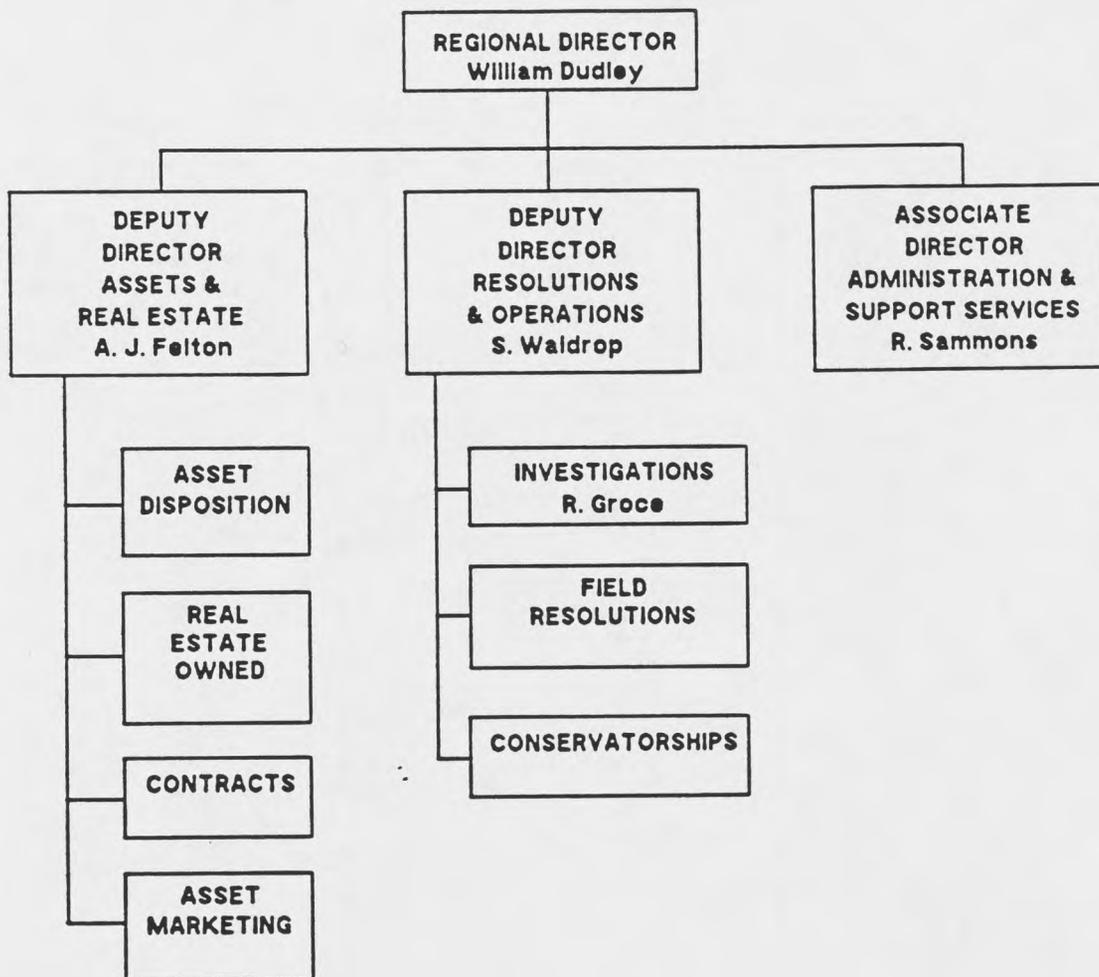


RECHAMP 0122/90

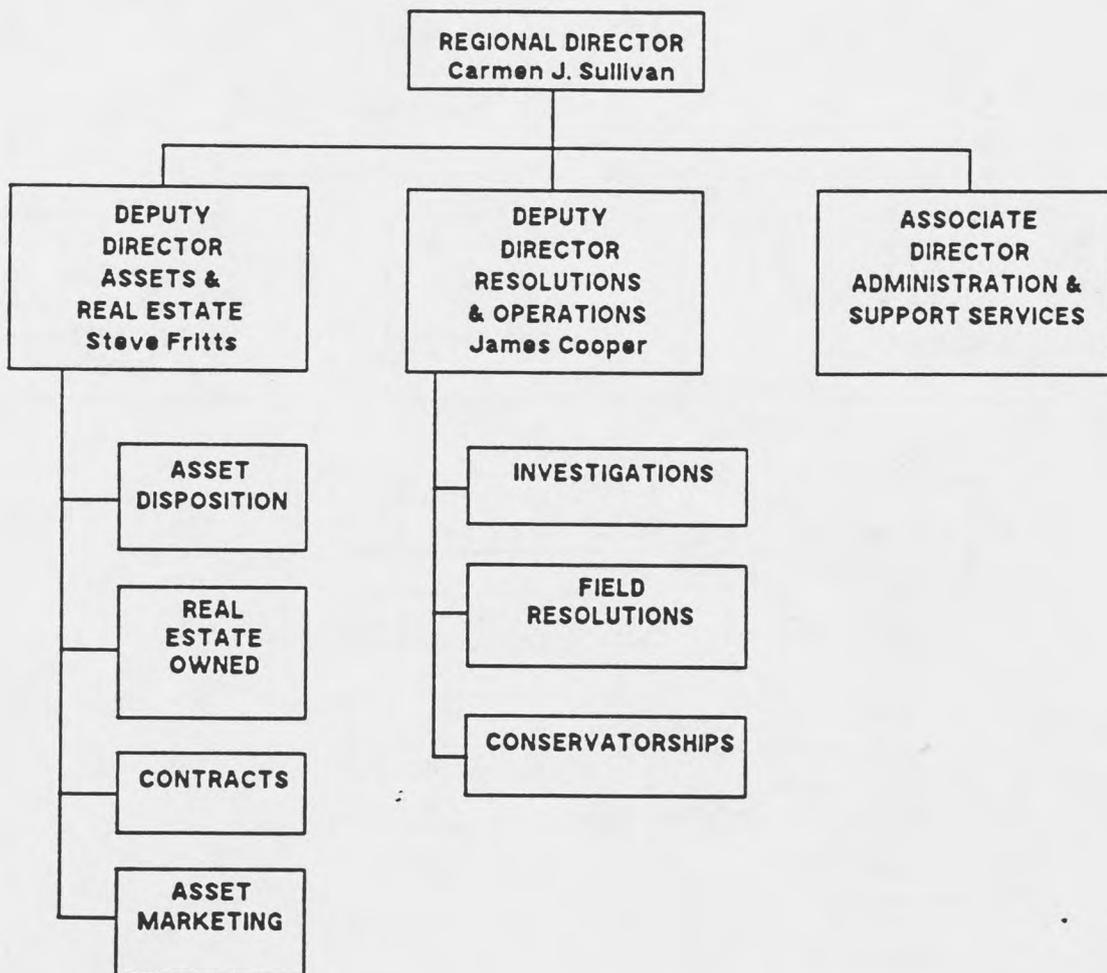
RESOLUTION TRUST CORPORATION



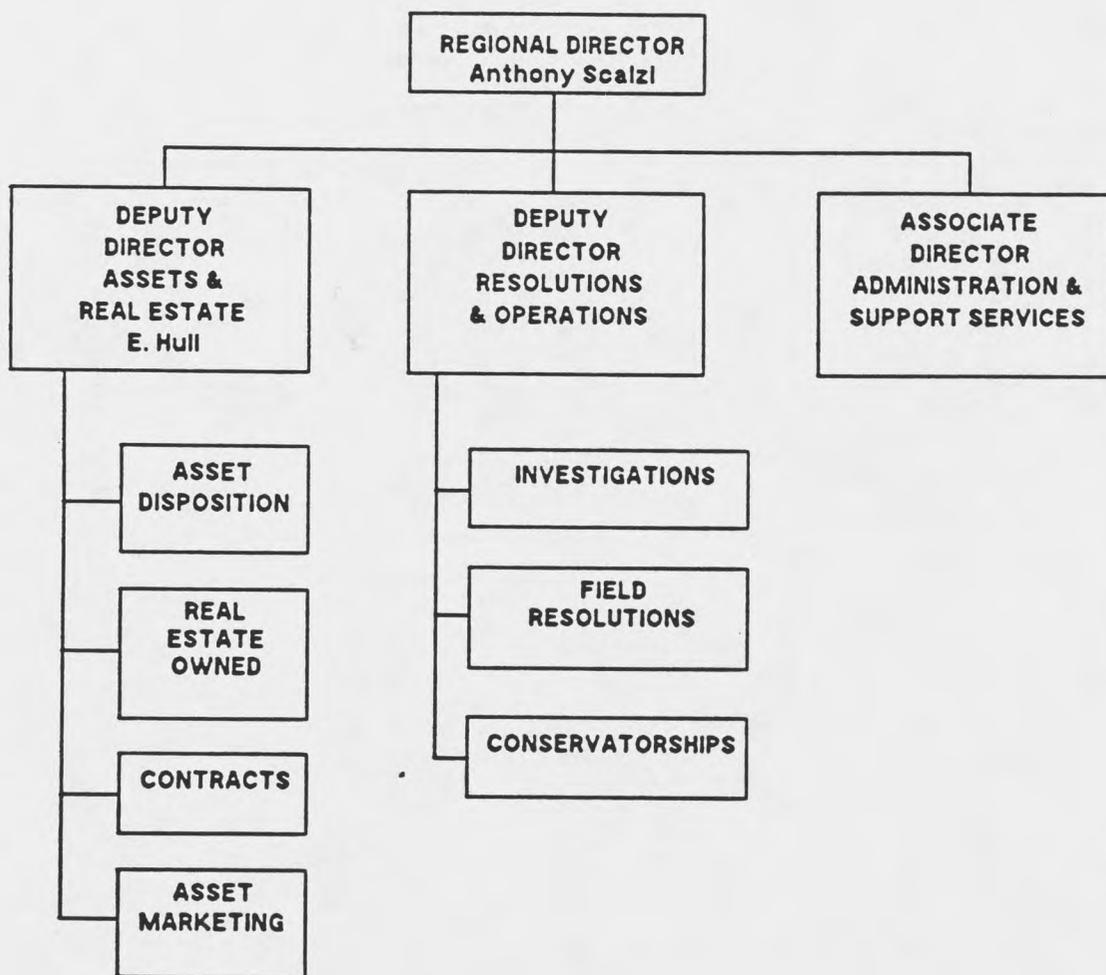
RESOLUTION TRUST CORPORATION
ATLANTA REGIONAL OFFICE



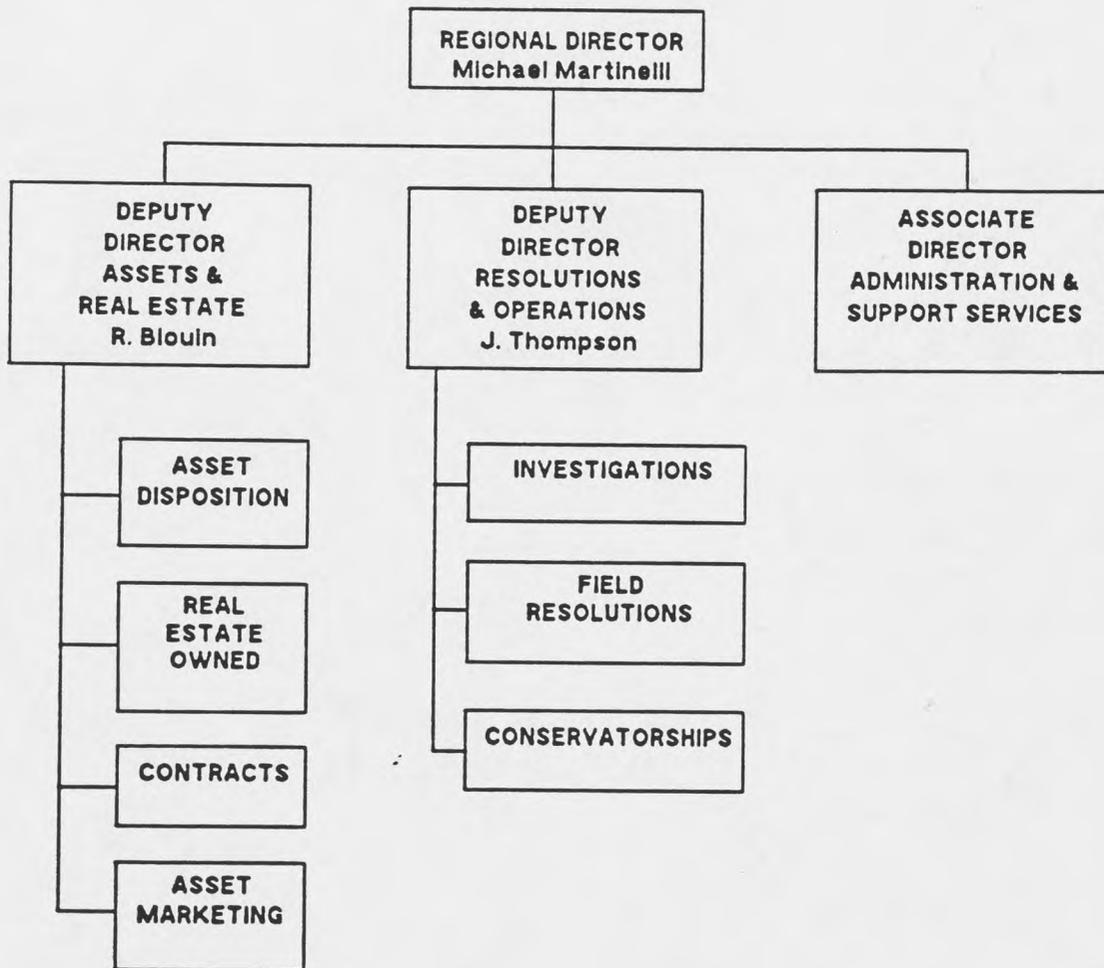
RESOLUTION TRUST CORPORATION
DALLAS REGIONAL OFFICE



RESOLUTION TRUST CORPORATION
DENVER REGIONAL OFFICE



RESOLUTION TRUST CORPORATION
KANSAS CITY REGIONAL OFFICE



RTC Consolidated Sites

East Region

Bayou Consolidated Office - Baton Rouge, Louisiana
Northeast Consolidated Office - Philadelphia, Pennsylvania
Southeast Consolidated Office - Tampa, Florida
Mid-Atlantic Consolidated Office - Atlanta, Georgia

Central Region

Mid-Central Consolidated Office - Kansas City, Missouri
North Central Consolidated Office - Burnsville, Minnesota
Lake Central Consolidated Office - Schaumburg, Illinois

Southwest Region

Metroplex Consolidated Office - Dallas, Texas
Gulf Coast Consolidated Office - Houston, Texas
Southern Consolidated Office - San Antonio, Texas

West Region

Intermountain Consolidated Office - Denver, Colorado
Central Western Consolidated Office - Phoenix, Arizona
Coastal Consolidated Office - Costa Mesa, California

RESOLUTION

BE IT RESOLVED that the attached document represents the General Operating Policies hereby adopted by the Resolution Trust Corporation on an interim basis. These General Operating Policies summarize the major existing resolution policies of the Federal Deposit Insurance Corporation. The adoption of these General Operating Policies is consistent with the actions taken by the Oversight Board in its meeting today.

FDIC Resolution Policies

This document summarizes the major resolution policies of the Federal Deposit Insurance Corporation.

The FDIC's primary goal is to resolve insolvent institutions in a manner that minimizes the long-term cost to the government. FDIC will strive to ensure that restructured institutions are adequately capitalized and well managed and do not impose unacceptable risks on the deposit insurer.

Another major goal of the FDIC is to maximize the recovery on failed institutions' assets while utilizing the private sector as much as possible.

GENERAL OPERATING POLICIES

Treatment of Potential Acquirers

*Potential bidders and the general public will be kept fully informed regarding the ground rules of the resolution process and the structure and parameters of completed transactions.

*In most cases, insolvent institutions will be resolved subject to a competitive bidding process.

*Qualified bids by entities other than depository institutions will receive no more and no less favorable treatment than bids by bank or acquirers.

*Offers will be accepted that do not include the management of problem assets; acquirers will be regarded as one among many potential asset managers. The FDIC will retain the flexibility to dispose of assets separately.

*In general, transactions will not include yield maintenance arrangements that guarantee a built-in spread on selected assets.

Capitalization of Restructured Institutions

*Acquirers of restructured institutions will be expected to fully capitalize the institution at levels consistent with those required for national banks.

*Capitalization typically will not be required for problem assets retained by the FDIC and managed by the acquirer under appropriate incentive arrangements.

*Generally, the FDIC will avoid taking ownership interests in institutions resulting from assistance transactions.

Forbearances

*The FDIC will avoid granting any forbearances from federal laws or supervisory requirements; nor will it authorize any powers or rights denied to federally chartered institutions. The FDIC may use its powers to grant forbearances from state laws that interfere with the cost effective and efficient resolution of insolvent institutions.

TRANSACTIONS

Preference for Market-Determined Consolidations

*The FDIC generally does not pursue administratively imposed consolidations of geographically proximate institutions.

*Offering institutions in the same area for sale at the same time is a market-based approach to consolidations can be considered.

Solicitation of Bids

*Wherever appropriate, potential acquirers will bid for standardized "clean-institution" or "whole-institution" packages.

*In some cases, especially for larger or more complex institutions, a customized package will be designed and put out for bid.

*The FDIC will delegate the handling of many smaller institutions to regional offices.

Asset Reviews

*In appropriate cases, the FDIC will attempt to provide bidders with the results of asset reviews performed by a third party. The FDIC will retain the flexibility to pursue other approaches on a case-by-case basis.

Asset Puts

*Where acquirers retain assets of questionable quality, the FDIC will generally provide some form of asset protection, such as post-transaction markdowns or putbacks for a limited time-period. The FDIC will consider the possibility of providing short-term protection against market fluctuations on long-term, fixed-rate assets to facilitate portfolio restructuring.

Transaction Structure

*In each case, FDIC will evaluate the feasibility of successfully arranging a "whole-institution" solution where substantially all assets pass to the acquirer. Whole institution transactions will not be pursued where they appear impractical due to lack of market interest, would result in unreasonable delays in the resolution process, or where the volume of problem assets is unduly large relative to the acquirer's capital account or ability to manage.

RESOLUTION TRUST CORPORATION

Interim Statement of
Principles of Ethical Conduct for Independent Contractors
to the Resolution Trust Corporation

AGENCY: Resolution Trust Corporation (RTC).

ACTION: Adoption of interim statement and request for comments.

SUMMARY: The RTC hereby adopts an interim statement prescribing the minimum standards of ethical conduct to which it expects persons or entities with which it contracts for services to adhere and, since the minimum standards are likely to be incorporated into any final conflict-of-interest rules and regulations applicable to independent contractors which the RTC promulgates, invites comments on the appropriateness of these standards to the activities of independent contractors.

DATE: The standards set forth in the interim statement are effective immediately. Comments on the standards should be submitted no later than October 31, 1989.

ADDRESS: All comments should be submitted to John M. Buckley, Jr., Executive Secretary, Resolution Trust Corporation, 550 - 17th Street, N.W., Washington, D.C. 20429. Comments may be hand-delivered to Room 6097 between 8:30 a.m. and 5:00 p.m. on business days. Comments may also be inspected in Room 6097 between 8:30 a.m. and 5:00 p.m. on business days. (Fax number: (202) 347-2773 or 2775).

FOR FURTHER INFORMATION CONTACT: Katherine A. Corigliano, Ethics Program Manager, Federal Deposit Insurance Corporation, 550 - 17th Street, N.W., Washington, D.C. 20429, telephone (202) 898-7272.

SUPPLEMENTARY INFORMATION: The RTC was established by section 21A(b) of the Federal Home Loan Bank Act, as added by section 501 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, and its purposes are (1) to manage and resolve all cases involving depository institutions (a) the accounts of which were previously insured by the Federal Savings and Loan Insurance Corporation and (b) for which a conservator or receiver was or is appointed during the period beginning on January 1, 1989 and ending on August 9, 1992; and, in so doing, (2) to sell or otherwise dispose of such institutions or the assets of such institutions with due consideration to the objectives, among others, of maximizing the net present value return from the sale or other disposition of such institutions or assets, making efficient use of funds provided by the Federal Government (i.e., the American taxpayer) for the resolution of cases, and minimizing any loss to the Federal Government in the resolution of cases.

Section 21A(b)(11)(A)(ii) of the Federal Home Loan Bank Act directs the RTC, in carrying out its duties, to use the services of private persons (including real estate and loan portfolio asset management, property management, auction marketing, and brokerage services) if such services are available in the private sector and the RTC determines use of such services is practicable and efficient.

Section 21A(p)(6) of the Federal Home Loan Bank Act prohibits the RTC from engaging independent contractors to perform services on its behalf, and contractors in turn may not retain subcontractors or assign any of their employees to perform services on behalf of the RTC, who--

(1) do not meet the minimum standards of competence, experience, integrity, and fitness to be established by the RTC Oversight Board; and

(2) have (A) been convicted of a felony; (B) been removed from, or prohibited from participating in the affairs of, any insured depository institution pursuant to any final enforcement action by any Federal banking agency; (C) demonstrated a pattern or practice of defalcation regarding obligations to insured depository institutions; or (D) caused a substantial loss to the Federal deposit insurance funds.

Other relevant provisions of the Federal Home Loan Bank Act require persons seeking contracts with the RTC--

-- to include in their offers, in addition to such other information as the RTC Oversight Board may prescribe by regulation, a list and description of any instance during the preceding five years in which the person or company under such person's control defaulted on a material obligation to any insured depository institution; and

-- to agree that no person will be employed, directly or indirectly, under any contract with the RTC unless a list and description of any instance during the preceding five years in which the person defaulted on a material obligation to any insured depository institution, and such other information as the RTC Oversight Board may prescribe by regulation, is submitted to the RTC and the RTC does not disapprove of the direct or indirect employment of such person.

Further, section 21A(p)(3) of the Federal Home Loan Bank Act requires the RTC, not later than 180 days from the date of enactment of that section, to promulgate rules and regulations applicable to independent contractors governing conflicts of interest, ethical responsibilities, and the use of confidential information consistent with the goals and purposes of titles 18 and 41 of the United States Code.

Recognizing that the important work of the RTC must commence immediately and that the prior notice, public participation, and delayed effective date provisions of the Administrative Procedure Act will delay the promulgation of final rules and regulations for several months, the Board of Directors (the "Board") of the RTC considers it imperative that individuals or entities with whom the RTC contracts for services understand immediately and acknowledge that the Board will not tolerate or condone behavior or actions on their part or on the part of their employees assigned to perform functions on behalf of the RTC (hereinafter collectively referred to as "RTC contractors") which evidence self-dealing or political or other favoritism.

Further, the Board expects RTC contractors to perform their duties and responsibilities to the RTC with the highest degree of honesty and integrity, so as to maintain public confidence in the RTC. Actions on the part of RTC contractors which result in or create the appearance of a conflict of interest or which suggest political or other favoritism may result in the termination of contracts. In any case where any such action indicates a possible violation of Federal criminal conflict-of-interest or other applicable criminal statutes, such as making false or fraudulent statements in a Government matter, the matter will be referred immediately to the Department of Justice for investigation and prosecution.

Pending the promulgation of final rules and regulations implementing the provisions of section 21A(p)(3) of the Federal Home Loan Bank Act, RTC contractors are expected by the Board to conduct their activities in an exemplary manner and to adhere, at a minimum, to the following:

**INTERIM STATEMENT OF PRINCIPLES OF ETHICAL CONDUCT FOR INDEPENDENT
CONTRACTORS TO THE RESOLUTION TRUST CORPORATION**

1. RTC contractors will NOT hold financial interests that conflict with the conscientious performance of duty. Before being engaged by the RTC, contractors will be required, under appropriate circumstances, to make disclosures relative to their employment and financial interests and those of their spouses, their minor children, and others with whom they may have business or financial ties. The information required to be disclosed in any given case shall be limited to that which is reasonably necessary to allow the RTC to determine that no conflicts or potential conflicts of interest exist with respect to the services proposed to be performed for the RTC and shall also include certifications to the effect that the contractor meets minimum standards of competence, experience, integrity, and fitness and is not otherwise ineligible to be engaged by the RTC.

2. RTC contractors will NOT participate in any matter in which they, their spouses, their minor children, persons or organizations with whom they have business or financial ties, or persons or organizations with whom they are negotiating or have an arrangement for future employment have a financial interest, unless the Contractor Conflicts Committee, to be formed for the purpose of reviewing such conflicts-of-interest issues, determines that the relationship or financial interest is not so significant as to warrant disqualification from participation in the matter.

3. RTC contractors will protect and conserve RTC property and will not use it or allow its use for other than authorized activities. They will not, for example, use or allow the use of property or assets of a savings association in conservatorship or receivership or of property otherwise held by the RTC (e.g., automobiles, furniture and equipment, or objets d'art) for their personal use or for the use of other firm members, family members, personal friends, or persons with whom they have business or financial ties.

4. RTC contractors will NOT directly or indirectly acquire or assist another person or organization in acquiring an interest in any institution or the assets or property of any institution in conservatorship or receivership with respect to which they are rendering or have rendered services to the RTC.

5. RTC contractors will NOT allow the unauthorized use of non-public information obtained as a result of rendering services to the RTC and shall take all reasonable measures to avoid unintentional or inadvertent disclosure of such information both within and outside the contracting organization. All information obtained by a contractor as a result of rendering services to the RTC will be treated as non-public information unless its disclosure is specifically authorized in writing by the RTC or unless it becomes part of the body of public information from a source other than the contractor.

6. RTC contractors will NOT engage in financial transactions using non-public information from RTC or allow the improper use of such information to further any private interest.

7. During the term of their engagement, RTC contractors will NOT offer to any RTC employee any gifts or other items of monetary value (e.g., food, refreshments, and entertainment; "green" fees; boating excursions; and tickets to theatrical, sporting, social, or charitable events).

8. During the term of their engagement, RTC contractors will NOT solicit or accept for themselves or for others gifts or other items of monetary value from any person or entity who, to the knowledge of each contractor, is seeking official action from the RTC in connection with the contract under which services are being rendered to the RTC or has interests which may be substantially affected by the performance or nonperformance of the contractors' duties to the RTC. They will not, for example, solicit or accept gifts or other items of monetary value from--

(a) directors, trustees, officers, or employees of, or suppliers of goods and services to, any savings association in conservatorship or receivership with respect to which they are rendering services to the RTC;

(b) debtors to or creditors of any savings association in conservatorship or receivership with respect to which they are rendering services to the RTC;

(c) potential acquirers of failing or failed savings associations or of the assets of such associations with respect to which they are rendering services to the RTC;

(d) persons or entities, and their representatives, in litigation with the RTC in connection with matters with respect to which they are rendering services to the RTC;

(e) contractors or subcontractors to, or persons or entities seeking contracts with, the RTC.

9. RTC contractors will make no unauthorized commitments or promises of any kind purporting to bind the RTC.

10. RTC contractors will act impartially and not give preferential treatment to any private organization or individual in the performance of their duties and responsibilities under their terms of their contracts.

11. Firms or individuals with an interest in obtaining an RTC contract or who are negotiating the terms of an RTC contract will NOT make an offer of employment to any RTC employee who is personally and substantially involved in the negotiation of the contract.

12. RTC contractors will endeavor to avoid any actions which could create the appearance that they are violating the ethical principles and standards stated herein or any laws related thereto and will agree to monitor compliance with such standards and laws by any subcontractors they retain or any of their employees they assign to perform services on behalf of the RTC.

13. RTC contractors will NOT subcontract with anyone who would not otherwise be eligible to contract with the RTC directly.

14. RTC contractors will certify that they are in compliance with these principles.

Other Considerations for RTC Contractors

Persons or entities seeking contractual relationships with the RTC are reminded that, pursuant to section 21A(p)(1)(B) of the Federal Home Loan Bank Act, ". . . [a]ny individual who, pursuant to a contract or any other agreement, acts for or on behalf of the [RTC] shall be deemed to be a public official for the purposes of section 201 of title 18, United States Code." That statute imposes criminal sanctions against public officials (and, consequently, against contractors to the RTC) who accept bribes in connection with the performance of their official duties.

STATE
ALABAMA
ARIZONA
ARKANSAS
CALIFORNIA
COLORADO
FLORIDA
GEORGIA
ILLINOIS
KANSAS
LOUISIANA
MISSISSIPPI
MISSOURI
NEBRASKA
NEW MEXICO
TENNESSEE
TEXAS
OTHER STATES

TOOLS
CONSERVATION
2-01-89
4-01-89
AFTER 6

TOTALS
RTC REVENUE
EASTERN
CENTRAL
SOUTH
WESTERN

TOTALS
ASSET
<= 500
> 500

TOTAL
INCOME
ORIGINAL
CUMULATIVE

RTC CONTROLLED S&L'S
ASSET & LOSS PROFILE
 AS OF SEPTEMBER 25, 1989
 (IN MILLIONS)

	NO. S&L'S	*ORIGINAL GROSS ASSETS	**CURRENT GROSS ASSETS	\$ CHANGE GROSS ASSETS	% CHANGE GROSS ASSETS	CURRENT TOTAL LOSS	CURRENT TOTAL LOSS/ GROSS ASSETS
STATE							
ALABAMA	5	1,520	1,255	(265)	-17.42%	229	18.28%
ARIZONA	5	10,504	10,200	(303)	-2.89%	2,552	25.02%
ARKANSAS	12	3,807	3,335	(472)	-12.40%	1,625	48.71%
CALIFORNIA	22	22,216	19,081	(3,135)	-14.11%	2,822	14.79%
COLORADO	12	2,610	2,432	(178)	-6.83%	856	35.20%
FLORIDA	14	5,379	4,922	(457)	-8.50%	1,277	25.94%
GEORGIA	6	1,495	1,381	(114)	-7.61%	242	17.51%
ILLINOIS	19	3,112	2,854	(258)	-8.29%	547	19.17%
KANSAS	14	4,348	4,184	(164)	-3.77%	1,328	31.74%
LOUISIANA	28	3,159	3,095	(64)	-2.04%	1,350	43.62%
MISSISSIPPI	6	1,070	1,048	(22)	-2.06%	246	23.50%
MISSOURI	6	2,272	2,097	(175)	-7.72%	540	25.77%
NEBRASKA	5	1,503	1,418	(85)	-5.69%	380	26.77%
NEW MEXICO	5	1,676	1,601	(75)	-4.48%	975	60.93%
TENNESSEE	5	517	486	(31)	-5.97%	103	21.12%
TEXAS	83	35,784	32,186	(3,608)	-10.08%	16,345	50.78%
OTHER STATES	36	21,196	20,099	(1,098)	-5.18%	3,079	15.32%
TOTALS	283	122,179	111,673	(10,506)	-8.60%	34,496	30.89%
CONSERVATORSHIP							
2-01-89 TO 3-31-89	177	83,352	74,930	(8,422)	-10.10%	26,738	35.68%
4-01-89 TO 6-30-89	57	26,794	24,775	(2,019)	-7.53%	5,317	21.46%
AFTER 6-30-89	49	12,032	11,968	(65)	-0.54%	2,440	20.39%
TOTALS	283	122,179	111,673	(10,506)	-8.60%	34,496	30.89%
RTC REGIONS							
EASTERN	79	22,630	21,075	(1,555)	-6.87%	4,316	20.48%
CENTRAL	67	21,086	19,502	(1,584)	-7.51%	5,921	30.36%
SOUTHWEST	87	36,656	33,026	(3,629)	-9.90%	16,584	50.22%
WESTERN	50	41,807	38,069	(3,738)	-8.94%	7,674	20.16%
TOTALS	283	122,179	111,673	(10,506)	-8.60%	34,496	30.89%
ASSET SIZE							
< 500 MILLION	232	28,863	26,951	(2,012)	-6.95%	11,318	42.00%
> 500 MILLION	51	93,216	84,722	(8,494)	-9.11%	23,178	27.36%
TOTALS	283	122,179	111,673	(10,506)	-8.60%	34,496	30.89%

INCLUDES 283 ACTIVE AND 20 RESOLVED CASES

* ORIGINAL GROSS ASSETS BASED ON MONTH IMMEDIATELY PRIOR TO CONSERVATORSHIP

** CURRENT GROSS ASSETS BASED ON MOST RECENT FINANCIAL REPORTS AVAILABLE



Resolution Trust Corporation

September 28, 1989

Dear Prospective Bidder:

During the week of September 10, 1989, the RTC notified you [certain parties] that it was beginning the resolution process for ten large savings associations. Included among the group of early resolutions were the following five savings associations:

- o Freedom Savings and Loan Association, Tampa, Florida
- o Hill Financial Savings Association, Red Hill, Pennsylvania
- o Pacific Savings Bank, Costa Mesa, California
- o Peoples Heritage Savings, A Federal Savings and Loan Association, Salina, Kansas
- o University Federal Savings Association, Houston, Texas

The RTC's expedited case resolution process for these five institutions included the goal of consummation of transactions for as many of the five as possible over the September 30 weekend. The RTC Board of Directors on September 27, adopted capital requirements for newly formed state chartered nonmember banks and thrifts created as a result of RTC transactions, postponed the acceptance of bids due that day and reopened marketing to qualified bidders on the above five savings associations.

In addition to reopening marketing, the RTC Board of Directors directed its staff to notify all prospective bidders of the new policies as outlined in the enclosed press release. As indicated, the capital requirements for each financial institution interested in bidding on RTC's savings institutions are the domain of the primary Federal and State regulatory authorities. Each prospective bidder should discuss its capital plans with its respective primary Federal and State regulator and the FDIC if the transactions contemplate newly chartered thrifts or state nonmember banks requiring deposit insurance.

If you or your institution wish to pursue an assisted acquisition of any of the five institutions named herein, complete one copy of the enclosed Confidentiality Agreement for each institution you wish to pursue. Unless previously sent, please return it/them to the "Express Mail" address or by using the facsimile (FAX) numbers given below. If faxed, Confidentiality Agreements with original signatures should be mailed subsequently to the regular mail address, also below. In any case, we ask your assistance by completing the enclosed "Investor Interest Form" and returning it by FAX to the RTC.

On Tuesday, October 3, the RTC will meet with all prospective bidders who have returned completed Confidentiality Agreements in the past, or as a result of this communication. The meeting is scheduled to begin at 11:00 AM and will be held in the Amphitheater (Basement Level) of the RTC Building located at 801 17th Street, NW. Packages containing information about the institutions and draft assistance agreements will be provided to all parties returning Confidentiality Agreements whom are deemed pre-qualified. In the case of individuals, investor groups, non-depository institutions or corporations RTC will make a preliminary judgement on qualifications subject to subsequent concurrence by the chartering and insurance authorities.

If you have any questions, please contact J. Richard Earle at (202) 416-4316.

Sincerely,

Sherwin R. Koopmans
Deputy Director, Resolutions

Enclosures

"Express Mail or Courier"
Resolution Trust Corporation
Attention: RTC Marketing List
J. Richard Earle
801 17th Street, NW (4th Floor)
Washington, D.C. 20006

"Regular Mail"
Resolution Trust Corporation
Attention: RTC Marketing List
J. Richard Earle
550 17th Street, NW
Washington, D.C. 20429

FAX Numbers: 202-898-1850
202-898-1851
202-898-1852

INVESTOR INTEREST FORM

Name of Bidder: _____

Contact Person: _____

Telephone Number: _____

We are interested/remain interested in pursuing an assisted acquisition of (please check all that apply):

- _____ Freedom Savings and Loan Association
- _____ Hill Financial Savings Association
- _____ Pacific Savings Bank
- _____ Peoples Heritage Savings, A Federal Savings and Loan Association
- _____ University Federal Savings Association

We wish to perform due diligence/additional due diligence at:

- _____ Freedom Savings and Loan Association
- _____ Hill Financial Savings Association
- _____ Pacific Savings Bank
- _____ Peoples Heritage Savings, A Federal Savings and Loan Association
- _____ University Federal Savings Association

We are not interested in any of the five institutions (please check _____)

Please return by FAX by October 2 to 202-898-1850, 202-898-1851, or 202-898-1852.

CONFIDENTIALITY AGREEMENT

Agreement of Potential Acquiror

The undersigned hereby acknowledges that it desires to receive an information package and may conduct due diligence review of

_____, (Name of Insured Institution)

_____, _____
(City) (State)

(the "Insured Institution"), in order to evaluate a possible acquisition of the Insured Institution by the undersigned in its own right and not as an agent, representative or broker for or on behalf of an undisclosed party or parties.

Upon receipt of any financial or operational information regarding the above referenced institution, the undersigned hereby acknowledges and agrees to be bound by the restrictions set forth herein:

1. On-Premises Review and Reproduction of Documents.

All documents and other items made available to the undersigned by the Insured Institution, the Resolution Trust Corporation ("RTC") as conservator of the Insured Institution or the Federal Deposit Insurance Corporation (the "FDIC") as managing agent for the conservator, other than those in the information package, may only be reviewed by the undersigned on the Insured Institution's premises. No reproductions of such documents, other than handwritten summaries or notes and self-generated computer

records, may be made by the undersigned.

2. Information Package

The RTC or FDIC may provide an information package containing operational or financial information about the insured institution. The undersigned agrees that such information package is the property of RTC and is not to be used for any purpose other than to assist the undersigned in the proposal process. The information package may be disseminated to employees, organizations, and other persons associated with the undersigned engaged to assist the undersigned in the proposal process. However, prior to dissemination the undersigned agrees and affirmatively covenants to make the provisions of this agreement known to any person, organization and employee and to obtain from such the commitment to maintain the confidentiality of the information package in accordance with the terms of this agreement.

3. Briefing and Disclosure Requirement.

At any time after 30 days have passed since the completion of any review and on request of the FDIC or RTC, the undersigned will make available to FDIC or RTC at a reasonable time and in a reasonable manner the persons who conducted any review for the purpose of briefing FDIC or RTC, which briefing may include

discussion and disclosure of any data, charts, graphs, summaries, memoranda or conclusions drawn from or based upon the documents made available to the undersigned (any information of any kind provided by the undersigned, whether orally or in writing, is herein called the "Undersigned's Information"). Such briefing will be used by FDIC or RTC for internal informational purposes only. The undersigned shall not in any event be required to disclose or make available opinions, privileged communications, or information relating to the internal bidding policies, guidelines or decisions of the undersigned.

4. Destruction of Documents and Information.

The undersigned further hereby acknowledges and agrees that all the documents and information provided to the undersigned including the information package, all memoranda, notes, computer records and other writings prepared by the undersigned based on the information in these documents and copies made of any of the foregoing will be destroyed by the undersigned if it is determined that no proposal is to be made by the undersigned, or if any proposal submitted by the undersigned is not accepted with respect to the Insured Institution. On request of the FDIC or RTC, such destruction shall be certified in writing to the FDIC or RTC by an authorized officer of the undersigned.

5. Restriction on Use of Documents and Information/Exceptions.

The undersigned also hereby acknowledges and agrees that the documents and information referred to herein made available and any other material related to this potential acquisition provided by the Insured Institution, RTC or the FDIC to the undersigned, are to be used in its decision to make a bid and for no other purposes, that the information contained therein will be kept confidential and disclosed only to the partners, directors, officers, agents, advisors and employees of the undersigned who are working on, or consulted in connection with, the proposed acquisition, that all such persons to whom such information is disclosed shall be advised of the restrictions contained herein, and that it shall undertake all necessary steps to ensure that these restrictions are followed. Such restrictions shall not apply to information which (i) is already in the undersigned's possession, provided that such information is not known by the undersigned to be subject to another confidentiality agreement with or other obligation of secrecy to the FDIC, RTC or another party, or (ii) is or becomes generally available to the public other than as a result of a disclosure by the undersigned or its partners, directors, officers, employees, shareholders, co-investors, agents, representatives or advisors, or (iii) becomes available to the undersigned on a non-confidential basis from a source other than the FDIC or RTC, provided that such source is not known by the undersigned to be bound by a confidentiality agreement with or other obligation of secrecy to the FDIC, RTC or

another party. If, in the opinion of the undersigned's counsel, any disclosure otherwise prohibited by this paragraph is required by law or court order, the undersigned shall, prior to any such disclosure, advise and consult with the FDIC and RTC and their counsel concerning the reasons for, and nature of, the proposed disclosures.

6. No Warranties or Representations.

The undersigned hereby acknowledges and agrees that the FDIC and RTC make no representations or warranties, express, implied or otherwise, as to the accuracy or completeness of any documents made available to the undersigned whether such documents have been prepared by the FDIC, RTC or the Insured Institution or any other party.

The undersigned further hereby acknowledges and agrees that it shall not rely nor allow or advise any other party to rely through the undersigned, upon the work product, memoranda, statements, opinions, representations, factual or historical summaries or disclosures of any kind of any employee, accountant, officer, attorney, agent, representative or advisor, made known to it by the FDIC or RTC, whether through discussions with any such person or through review of any FDIC, RTC or Insured Institution's files, pleadings or documents, whether supplied by the FDIC, RTC or another party.

7. Disclosure of Affiliations.

The undersigned agrees that should it submit a proposal to acquire the Insured Institution, the undersigned will disclose all affiliations which the undersigned, an affiliate, subsidiary, employee or agent of the undersigned has, or in the past five years had, with the Insured Institution. For the purposes of this paragraph, affiliation shall include, but not necessarily be limited to situations where the undersigned:

- a) Holds or held an equity interest in the Insured Institution;
- b) Has or had an indebtedness, line of credit or loan commitment, including letters of credit;
- c) Is or was employed or acted as agent, broker or advisor to the Insured Institution or any other similar arrangement.

The undersigned agrees to submit such information, in writing, as part of its proposal to acquire the Insured Institution.

Date: _____

Signature

Name

Title

Organization

Phone Number

FAX Number

FOR IMMEDIATE RELEASE

PR-188-89 (9-27-89)

CAPITAL REQUIREMENTS ADOPTED FOR FAILED THRIFT RESOLUTIONS

The Boards of Directors of the Federal Deposit Insurance Corporation (FDIC) and the Resolution Trust Corporation (RTC) today adopted a policy defining the procedures that will be used to qualify financial institutions interested in bidding on RTC's savings institutions. In addition, the FDIC adopted capital requirements for newly-formed state-chartered nonmember banks and thrifts created as a result of RTC transactions.

At the same time, the RTC announced that today's deadline for submission of bids on five institutions has been delayed to permit all parties interested in bidding to evaluate this newly adopted policy. The RTC plans to meet with interested bidders on October 3.

The policy follows:

In order to qualify as an acceptable bidder for a failed thrift institution, potential bidders must be deemed acceptable by the primary federal regulator, and holding company and state chartering authorities if applicable. In addition, the RTC will obtain the opinion of the FDIC that the ultimate transaction results in no undue risk to the deposit insurance funds.

The FDIC will require a 4-1/2% tangible capital-to-assets ratio for new applications for deposit insurance by state-chartered nonmember banks and thrifts resulting from RTC transactions. Capital in these cases would be defined by risk-based guidelines. It would include at least 3% Tier 1 capital and no more than 1-1/2% from Tier 2. Loan loss reserves would be excluded.

In adopting this policy, the FDIC Board emphasized that the policy is designed to expedite the thrift resolution process and does not affect long-term capital standards. Directors Robert L. Clarke and M. Danny Wall specifically indicated that their votes approving the policy were intended to permit the RTC to go forward with case resolutions but did not indicate endorsement of the specific ratio set forth in the policy for institutions under their supervision.

(The five savings institutions for which the RTC has delayed the deadline of submission of bids are: Freedom Savings & Loan Association, Tampa, Florida; Hill Financial Savings Association, Red Hill, Pennsylvania; Pacific Savings Bank, Costa Mesa, California; Peoples Heritage Savings, A Federal Savings & Loan Association, Salina, Kansas; and University Federal Savings Association, Houston, Texas.)

significant economic impact on a substantial number of small business entities, in this case small state nonmember banks, in accord with the spirit and purposes of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) While all insured banks will presumably be required to make some revisions to their reporting procedures to permit supervisory monitoring of risk-based capital ratios, the FDIC, in conjunction with the other Federal banking agencies, intends to adopt, after an opportunity for public comment, reporting procedures designed to minimize the burden on small institutions.

The risk-based capital framework set forth in this statement of policy is designed primarily to take account of those practices, such as the increased use of off-balance sheet activities and the decline in the holdings of low-risk, liquid assets, which have been engaged in primarily by certain larger banking organizations. Moreover, rather than requiring all banks to raise additional capital, the statement of policy is directed at institutions whose capital positions are less than fully adequate in relation to their risk profiles.

List of Subjects in 12 CFR Part 325

Bank deposit insurance, Banks, banking, Capital adequacy, State nonmember banks.

Accordingly, 12 CFR Part 325 is amended as follows:

PART 325—CAPITAL MAINTENANCE

1. The authority citation for Part 325 continues to read as follows:

Authority: 12 U.S.C. 1815(a), 1818(b), 1818, 1818(a), 1815(b), 1819(Tenth), 1828(c), 1828(d), 1828(i), 3907, 3909.

2. A new Appendix A is added to read as follows:

Appendix A to Part 325—Statement of Policy on Risk-Based Capital

Capital adequacy is one of the critical factors that the FDIC is required to analyze when taking action on various types of applications and when conducting supervisory activities related to the safety and soundness of individual banks and the banking system. In view of this, the FDIC's Board of Directors has adopted Part 325 of its regulations, which sets forth (1) minimum standards of capital adequacy for insured state nonmember banks and (2) standards for determining when an insured bank is in an unsafe or unsound condition by reason of the amount of its capital.

This capital maintenance regulation was designed to establish, in conjunction with other Federal bank regulatory agencies, uniform capital standards for all federally-regulated banking organizations, regardless of size. The uniform capital standards were based on ratios of capital to total assets.

While those leverage ratios have served as a useful tool for assessing capital adequacy, the FDIC believes there is a need for a capital measure that is more explicitly and systematically sensitive to the risk profiles of individual banks. As a result, the FDIC's Board of Directors has adopted this Statement of Policy on Risk-Based Capital to supplement the Part 325 regulation. This statement of policy does not replace or eliminate the existing Part 325 capital-to-total assets leverage ratios. Once the risk-based capital framework is implemented, the FDIC will consider whether the Part 325 definitions of capital for leverage purposes and the minimum leverage ratios should be amended.

The framework set forth in this statement of policy consists of (1) a definition of capital for risk-based capital purposes, (2) a system for calculating risk-weighted assets by assigning assets and off-balance sheet items to broad risk categories, and (3) a schedule, which includes transitional arrangements during a phase-in period, for achieving a minimum supervisory ratio of capital to risk weighted assets. A bank's risk-based capital ratio is calculated by dividing its qualifying total capital base (the numerator of the ratio) by its risk-weighted assets (the denominator).¹ Table I outlines the definition of capital and provides a general explanation of how the risk-based capital ratio is calculated. Table II summarizes the risk weights and risk categories, and Table III sets forth the credit conversion factors for off-balance sheet items. Additional explanations of the capital definitions, the risk-weighted asset calculations, and the minimum risk-based capital ratio guidelines are provided in Sections I, II and III of this statement of policy.

This statement of policy applies to all FDIC-insured state-chartered banks (excluding insured branches of foreign banks) that are not members of the Federal Reserve System, hereafter referred to as "state nonmember banks," regardless of size, and to all circumstances in which the FDIC is required to evaluate the capital of a banking organization. Therefore, the risk-based capital framework set forth in this statement of policy will be used in the examination and supervisory process as well as in the analysis of applications that the FDIC is required to act upon.

The risk-based capital ratio focuses principally on broad categories of credit risk; however, the ratio does not take account of many other factors that can affect a bank's financial condition. These factors include overall interest rate risk exposure; liquidity, funding and market risks; the quality and level of earnings; investment or loan portfolio concentrations; the quality of loans and investments; the effectiveness of loan and investment policies; and management's overall ability to monitor and control

¹ Period-end amounts, rather than average balances, normally will be used when calculating risk-based capital ratios. However, on a case-by-case basis, ratios based on average balances may also be required if supervisory concerns render it appropriate.

financial and operating risks. In addition to evaluating capital ratios, an overall assessment of capital adequacy must take account of each of these other factors, including, in particular, the level and severity of problem and adversely classified assets. For this reason, the final supervisory judgment on a bank's capital adequacy may differ significantly from the conclusions that might be drawn solely from the absolute level of the bank's risk-based capital ratio.

In light of these other considerations, banks generally are expected to operate above the minimum risk-based capital ratio. Banks contemplating significant expansion plans, as well as those institutions with high or inordinate levels of risk, should hold capital commensurate with the level and nature of the risks to which they are exposed.

I. Definition of Capital for the Risk-Based Capital Ratio

A bank's qualifying total capital base consists of two types of capital elements: "core capital elements" (Tier 1) and "supplementary capital elements" (Tier 2). To qualify as an element of Tier 1 or Tier 2 capital, a capital instrument should not contain or be subject to any conditions, covenants, terms, restrictions, or provisions that are inconsistent with safe and sound banking practices.

A. The Components of Qualifying Capital (see Table I)

1. Core capital elements (Tier 1) consists of:

- Common stockholders' equity capital (includes common stock and any related surplus, undivided profits, disclosed capital reserves that represent a segregation of undivided profits, and foreign currency translation adjustments; less net unrealized losses on marketable equity securities);
- Noncumulative perpetual preferred stock,² including any related surplus; and
- Minority interests in the equity capital accounts of consolidated subsidiaries.

At least 50 percent of the qualifying total capital base should consist of Tier 1 capital. Core (Tier 1) capital is defined as the sum of core capital elements³ minus all intangible assets other than mortgage servicing rights.⁴

Although nonvoting common stock noncumulative perpetual preferred stock, and

² Preferred stock issues where the dividend is reset periodically based, in whole or in part, upon the bank's current credit standing, including but not limited to, auction rate, money market or remarketable preferred stock, are assigned to Tier 2 capital, regardless of whether the dividends are cumulative or noncumulative.

³ In addition to the core capital elements, Tier 1 may also include certain supplementary capital elements during the transition period subject to certain limitations set forth in Section III of this statement of policy.

⁴ An exception is allowed for intangible assets that are explicitly approved by the FDIC as part of the bank's regulatory capital on a specific case basis. These intangibles will be included in capital for risk-based capital purposes under the terms and conditions that are specifically approved by the FDIC.

minority interests in the equity capital accounts of consolidated subsidiaries are normally included in Tier 1 capital, voting common stockholders' equity generally will be expected to be the dominant form of Tier 1 capital. Thus, banks should avoid undue reliance on nonvoting equity, preferred stock and minority interests.

Although minority interests in consolidated subsidiaries are generally included in regulatory capital, exceptions to this general rule will be made if the minority interests fail to provide meaningful capital support to the consolidated bank. Such a situation could arise if the minority interests are entitled to a preferred claim on essentially low risk assets of the subsidiary. Similarly, although intangible assets in the form of mortgage servicing rights are generally recognized for risk-based capital purposes, the deduction of part or all of the mortgage servicing rights may be required if the carrying amounts of these rights are excessive in relation to their market value or the level of the bank's capital accounts.

2. *Supplementary capital elements (Tier 2)* consist of:

—Allowances for loan and lease losses, up to a maximum of 1.25 percent of risk-weighted assets;

—Cumulative perpetual preferred stock, long-term preferred stock (original maturity of at least 20 years) and any related surplus;

—Perpetual preferred stock (and any related surplus) where the dividend is reset periodically based, in whole or part, on the bank's current credit standing, regardless of whether the dividends are cumulative or noncumulative;

—Hybrid capital instruments, including mandatory convertible debt securities; and

—Term subordinated debt and intermediate-term preferred stock (original average maturity of five years or more) and any related surplus.

The definition of supplementary capital does not include revaluation reserves or hidden reserves that represent unrealized appreciation on assets such as bank premises and equity securities. Although such reserves will not be explicitly recognized when calculating a bank's risk-based capital ratio, these reserves may be taken into account as additional factors when assessing a bank's overall capital adequacy.

The maximum amount of Tier 2 capital that may be recognized for risk-based capital purposes is limited to 100 percent of Tier 1 capital (after any deductions for disallowed intangibles). In addition, the combined amount of term subordinated debt and intermediate-term preferred stock that may be treated as part of Tier 2 capital for risk-based capital purposes is limited to 50 percent of Tier 1 capital. Amounts in excess of these limits may be issued but are not included in the calculation of the risk-based capital ratio.

(a) *Allowance for loan and lease losses.* Allowances for loan and lease losses are reserves that have been established through a charge against earnings to absorb future losses on loans or lease financing receivables. Allowances for loan and lease losses exclude "allocated transfer risk

reserves,"⁶ and reserves created against identified losses.

This risk-based capital framework provides a phasedown during the transition period of the extent to which the allowance for loan and lease losses may be included in an institution's capital base. By year-end 1990, the allowance for loan and lease losses, as an element of supplementary capital, may constitute no more than 1.5 percent of risk-weighted assets and, by year-end 1992, no more than 1.25 percent of risk-weighted assets.⁶

(b) *Preferred stock.* Perpetual preferred stock is defined as preferred stock that does not have a maturity date, that cannot be redeemed at the option of the holder, and that has no other provisions that will require future redemption of the issue. Long-term preferred stock includes limited-life preferred stock with an original maturity of 20 years or more, provided that the stock cannot be redeemed at the option of the holder prior to maturity, except with the prior approval of the FDIC.

Cumulative perpetual preferred stock and long-term preferred stock qualify for inclusion in supplementary capital provided that the instruments can absorb losses while the issuer operates as a going concern (a fundamental characteristic of equity capital) and provided the issuer has the option to defer payment of dividends on these instruments. Given these conditions, and the perpetual or long-term nature of the instruments, there is no limit on the amount of these preferred stock instruments that may be included with Tier 2 capital.

Noncumulative perpetual preferred stock where the dividend is reset periodically based, in whole or in part, on the bank's current credit standing, including auction rate, money market, or remarketable preferred stock, are also assigned to Tier 2 capital without limit, provided the above conditions are met.

(c) *Hybrid capital instruments.* Hybrid capital instruments include instruments that have certain characteristics of both debt and equity. In order to be included as supplementary capital elements, these instruments should meet the following criteria:

(1) The instrument should be unsecured, subordinated to the claims of depositors and general creditors, and fully paid-up.

(2) The instrument should not be redeemable at the option of the holder prior to maturity, except with the prior approval of

⁶ Allocated transfer risk reserves are reserves that have been established in accordance with Section 905(a) of the International Lending Supervision Act of 1983 against certain assets whose value has been found by the U.S. supervisory authorities to have been significantly impaired by protracted transfer risk problems.

⁷ The amount of the allowance for loan and lease losses that may be included as a supplementary capital element is based on a percentage of gross risk-weighted assets. A bank may deduct reserves for loan and lease losses that are in excess of the amount permitted to be included in capital, as well as allocated transfer risk reserves, from gross risk-weighted assets when computing the denominator of the risk-based capital ratio.

the FDIC. This requirement implies that holders of such instruments may not accelerate the payment of principal except in the event of bankruptcy, insolvency, or reorganization.

(3) The instrument should be available to participate in losses while the issuer is operating as a going concern. (Term subordinated debt would not meet this requirement.) To satisfy this requirement, the instrument should convert to common or perpetual preferred stock in the event that the sum of the undivided profits and capital surplus accounts of the issuer results in a negative balance.

(4) The instrument should provide the option for the issuer to defer principal and interest payments if: (a) the issuer does not report a profit in the preceding annual period, defined as combined profits (i.e., net income) for the most recent four quarters, and (b) the issuer eliminates cash dividends on its common and preferred stock.

Mandatory convertible debt securities that meet the criteria set forth in 12 CFR 325.2(e) will qualify as hybrid capital instruments. There is no limit on the amount of hybrid capital instruments that may be included within Tier 2 capital.

(d) *Term subordinated debt and intermediate-term preferred stock.* The aggregate amount of term subordinated debt (excluding mandatory convertible debt securities) and intermediate-term preferred stock (including any related surplus) that may be treated as Tier 2 capital for risk-based capital purposes is limited to 50 percent of Tier 1 capital. Term subordinated debt and intermediate-term preferred stock should have an original average maturity of at least five years to qualify as supplementary capital and should not be redeemable at the option of the holder prior to maturity, except with the prior approval of the FDIC. To qualify as supplementary capital, term subordinated debt instruments issued by state nonmember banks should meet the criteria for subordinated debt set forth in 12 CFR 325.2(j), except that the minimum original maturity requirement is five years for risk-based capital purposes.

Discount of limited-life supplementary capital instruments. As a limited-life capital instrument approaches maturity, the instrument begins to take on characteristics of a short-term obligation and becomes less like a component of capital. Therefore, for risk-based capital purposes, the outstanding amount of term subordinated debt and limited-life preferred stock eligible for inclusion in capital will be adjusted downward, or discounted, as the instruments approach maturity. Each limited-life capital instrument will be discounted by reducing the outstanding amount of the capital instrument eligible for inclusion as supplementary capital by a fifth of the original amount (less redemptions) each year during the instrument's last five years before maturity. Such instruments, therefore, will have no capital value when they have a remaining maturity of less than a year.