TESTIMONY OF

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ON

STATUS OF THE RESOLUTION TRUST CORPORATION

BEFORE THE

OVERSIGHT SUBCOMMITTEE
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

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Good afternoon, Mr. Chairman and members of the Subcommittee. I am pleased to appear before you today to discuss the financial status and activities of the Resolution Trust Corporation (RTC).

The RTC is only about six months old, but already has accomplished the following:

- Developed a strategic plan with the RTC Oversight Board
- Established 4 regional offices and initiated the establishment of 14 consolidated offices
- Hired a staff of over 2,000 people
- Assumed management and institutional control of 369 thrifts in 38 states
- Downsized thrifts in conservatorship by about 20 percent
- Provided $9.2 billion in advances to over 150 conservatorships for high-cost funds replacement, including $1.9 billion to institutions which were subsequently resolved
- Provided $2.5 billion to almost 90 conservatorships for emergency liquidity financing, including $0.2 billion to institutions which have been subsequently resolved
- Sold or liquidated 49 institutions in 17 states
- Initiated sale of an additional 60 institutions
- Inventoried over 30,000 real estate properties and published a listing of their key investment characteristics in a 4 volume set
- Established and published conflict of interest guidelines
- Established marketing and open bidding process, including:

Prepared a guideline booklet, How to Purchase an S&L from the RTC

Scheduled the RTC Seminar Series

Established an 800 Hot Line

Provided Sample Bid Packages

Published a Resolution Schedule

- Put RTC asset managerial guidelines in place
- Developed methods for assigning priorities for scheduling restructure of institutions
- Established interim guidelines to promote low income housing
- Assumed litigation responsibility for over 40,000 lawsuits
- Filed the largest depository institution fraud suit in history (the $1.1 billion suit against Charles Keating, et.al.)

However, the greater part of our work lies ahead. Successful completion of that work depends on many factors, one of the most important of which is the availability of working capital. Today we will update you on this topic. We also will discuss the specific issues raised in your letter of invitation.

I. OVERALL FINANCIAL STATUS, ACTIVITIES, AND PLANS

Working Capital

We are pleased to report that the RTC Oversight Board has approved an initial plan to provide working capital for the Resolution Trust Corporation.

As you know, working capital is necessary for resolutions in order to finance problem assets pending their eventual sale. RTC's cash outlays take place up-front at the time of resolution whereas its cash inflows -- whether from REFCORP or the sale of assets -- will take place over a number of years.

Working capital is also necessary to replace high-cost funds at the savings associations under RTC conservatorship. Very high-cost funds (i.e., costing at least 125 basis points over market) currently represent roughly 20 percent of the liabilities of these associations. High-cost funds replacement would yield a tangible savings to the thrifts under RTC conservatorship, thereby reducing the ultimate cost of their resolution. Such a program applied on a nationwide scale would reduce the financing costs of <u>all</u> banks and thrifts, reducing the RTC's eventual case load and resulting in improved performance of the entire U.S. financial system.

After analyzing various alternatives, the Oversight Board has approved a plan to allow the RTC to use the Federal Financing Bank (FFB) as the primary source of working capital. These temporary borrowings will be used by the RTC to finance the acquisition of assets from failed thrifts. Other potential sources of working capital will continue to be studied.

As you know, questions have been raised about the RTC's authority under current law to borrow from the Federal Financing Bank. The Department of Justice has concluded that the RTC is, in fact, eligible to borrow from the FFB.

Under the plan approved, the RTC will be allowed to borrow up to $11 billion for use during the first quarter of calendar year 1990. For each subsequent quarter, the Oversight Board will approve a maximum amount of working capital funding, based on the RTC operating plan for that quarter. Each time it borrows from the Bank, the RTC will be required to certify to the Oversight Board that:

* it has a current need for the amount of the advance;
* the anticipated use of the advance is consistent with the quarterly operating plan approved by the Oversight Board; and
* the advance will not cause a violation of the statutory limitation of RTC obligations.

As we have noted, the Board has approved initial borrowings of up to $11 billion for the period ending March 31, 1990. Of this amount, the RTC may use up to $8 billion to finance the purchase of assets in connection with case resolutions or for emergency liquidity. Up to $3 billion will be available to replace high-cost funds in conservatorships to lower borrowing costs.

We would like to emphasize that amounts borrowed under this lending arrangement are by no means unlimited. RTC borrowing from the FFB is strictly limited by the obligation cap in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). This cap generally restricts borrowing to 85 percent of the fair market value of RTC assets, which ensures that tangible assets are adequate to pay off working capital obligations. In the near term, the cap allows the RTC to borrow against unused REFCORP borrowing authority.

A financing agreement between the RTC and the FFB recently has been completed. This will allow the RTC to begin to draw funds almost immediately.

Questions about the budget treatment of working capital remain to be resolved. As indicated in the President's budget, the Administration will work with the Congress to assure that a responsible system of budgetary accounting is developed.

Current Sources and Uses of Funds

The RTC's actual cash inflows and outflows to date are illustrated in Attachment 1. By mid-February the RTC had received $29.5 billion in capital contributions. Of this amount, $20 billion was provided by Treasury appropriations or Federal Home Loan Bank contributions, and $9.5 billion was provided from the proceeds of the first two quarterly REFCORP financings. The RTC's cash outlays totaled $24.0 billion, including $14.4 billion to resolve 49 thrift institutions, and $7.3 billion in advances for high-cost funds replacement at conservatorship institutions. Also included in the $24.0 billion total are advances for emergency liquidity which we were forced to make to meet depositor demands at conservatorships. The cash outlays for this purpose totaled $2.3 billion. (Resolution funds include over $2.0 billion originally advanced for high-cost funds replacement and emergency liquidity to institutions resolved through mid-February. These advances become secured claims on the receiverships. The high-cost funds replacement and emergency liquidity estimates, cumulative through mid-February, exclude the reclassified amounts.)

The RTC also has the potential availability of an additional $5 billion from the Treasury line of credit granted to the RTC by

FIRREA. This line is intended to be used only to satisfy the emergency liquidity needs of our conservatorships.

RTC's own operations are also a potential source of funds, but the cash available in the immediate future from our conservatorships and receiverships is quite limited. Specifically, if we were to force all of the conservatorships that have received advances from the RTC to repay whatever advances they could by divesting all of their cash and marketable securities, we would net less than $1 billion. Similarly, the maximum dividends expected to be payable from RTC receiverships this quarter -- through the liquidation of their assets -- is estimated not to exceed $1 billion.

Until the working capital funds are provided, the RTC has ceased virtually all advances to replace the high-cost funds of the conservatorships. As indicated earlier, this program has been successful in reducing the funding cost of conservatorships and, thus, limiting the growth of the loss that must be borne by the RTC.

<u>Administration</u>

In discussing the RTC's budget, it is important to understand that only a relatively small part of the RTC's operating costs are administrative in nature. By far, most costs will be incurred by and charged to the receiverships of failed thrifts subject to appropriate court review. This is because most operating costs will be related directly to evaluating and collecting receivership assets and settling with various claimants, of which the RTC is, by far, the largest.

The RTC plans to use the private sector extensively, particularly for asset management related services. FIRREA required regulations governing the use of private contractors were adopted within the last few weeks. The RTC is well under way in establishing necessary procedures, as well as retaining personnel, to implement its contracting program.

The RTC's goal is to contract out over 80 percent of the asset management workload. While programs are being developed, the RTC has arranged, where possible, for acquirers of failed thrifts to provide interim asset servicing. Moreover, the services of outside contractors arranged by the thrifts prior to failure usually are continued pending review and evaluation by the RTC staff. Currently, about 60 percent of all receivership assets are under private sector management.

Preliminary reports for calendar year 1989 estimate RTC operating expenses at $34 million. However, a full allocation of expenses for common services across the various FDIC and RTC funds has not yet been finalized, which may increase expenses $10 to $20 million.

It is anticipated that as the pace of operations and contracting policies and procedures are implemented the overall expenditure for outside contractors will account for over two-thirds of the RTC's operating expenses.

The RTC currently has slightly over 1,700 personnel, excluding about 600 managing agents and their staffs in conservatorships. We expect to have just over 4,800 fully dedicated RTC employees by December, 1990. Total personnel expenses, including salaries and benefits for FDIC employees who charge a portion of their time to the RTC, are estimated at $205 million for calendar year 1990. During calendar year 1991 this amount is estimated to reach $220 million at peak staffing of about 5,000 RTC employees.

The RTC employs only ten personnel in grades with annual salaries of $100,000 or greater. About 600 personnel are in grades with salaries of between $50,000 and $100,000, and about 1,100 personnel receive salaries of less than $50,000.

RTC Oversight Board personnel costs are running at an annual rate of $1.2 million for a staff of 23.

Case Resolution

With respect to case resolutions, the goal of the Strategic Plan is to: "Manage and resolve institutions under the RTC's jurisdiction in a timely and cost effective manner, while minimizing the negative effects on local financial and real estate markets."

To meet this case resolution goal, the Plan sets six objectives. These are: (1) manage thrifts under the RTC's jurisdiction conservatively; (2) prioritize resolutions based on levels of deterioration; (3) select resolution methods on the basis of cost; (4) develop procedures to keep all interested potential purchasers fully informed of the case resolution process and provide adequate time for the market to determine the best (i.e., the least costly) method of resolution; (5) maintain records sufficient to keep all interested parties informed of the case resolution process; and (6) use the private sector to manage and resolve institutions wherever practicable and efficient. All of these are worthy objectives given the task the RTC must manage. The RTC, and the FDIC before it, has been performing its task consistent with the Plan's objectives in this section.

Manage thrifts under RTC jurisdiction conservatively. The objectives of the RTC when it places an institution into conservatorship are to establish control and oversight while promoting customer confidence; to evaluate the condition of the institution to determine the most cost effective method of resolution; and to operate the institution in a safe and sound manner pending resolution.

To achieve these goals of conservatorship, we have a Managing Agent and one or more Credit Specialists overseeing each conservatorship. The role of the Managing Agent is to ensure that management of the institution adheres to RTC policies and procedures. The Credit Specialist's function is to assist the Managing Agent with regard to RTC policies and procedures as they relate specifically to asset management and disposition. It is important to note that the asset disposition process begins immediately upon conservatorship -- appraisals are brought up to date, conservative underwriting standards are established for the purpose of marketing and selling real estate owned, and RTC delegations of authority are made a part of the operational structure of the institution.

Each Managing Agent is responsible for assessing the condition and acquiring control of the institution, eliminating any abusive or speculative practices, and investigating any evidence of fraudulent practices. New management is brought in to ensure conservative operation and preclude insider abuse, and a business plan for each conservatorship is developed within 60 days of the date the institution is placed into the program. To the extent possible, funding costs are reduced by replacing high-cost funds using RTC advances. Funding demands and RTC advances are contained through the process of downsizing institutions. Downsizing is accomplished by curtailing new lending activity and selling assets where possible.

RTC Conservatorship Case Load

	August	September	October	November	December	January	To Feb.16
Beginning of month	262	262	256	257	275	281	308
New conservatorships	11	7	10	18	10	32	19
Resolutions	11	13	9	0	4	5	7
End of month	262	256	257	275	281	308	320

The conservatorship program began last February under the auspices of the FDIC. By the time FIRREA was signed into law on August 9, and the RTC began its work, there were 262 thrifts under conservatorship. Since then 107 have been added, and 49 resolved, leaving 320 conservatorship thrifts as of February 16th. Attachment 2 provides a list of institutions currently in conservatorship, along with information on their size and location.

From the outset, downsizing institutions in the program has been a high priority, and it continues to be stressed as a basic objective of conservatorship. Efforts at downsizing have been successful, especially in institutions that have been under conservatorship for a number of months. Of the 243 institutions that were placed into the conservatorship program during the first three quarters of 1989 and that were still in the program at the end of the year, aggregate assets declined by 23.2 percent through November 30, 1989.

At the same time, core funding saw a much smaller decline, while more expensive or rate-sensitive funding fell sharply. These less stable and relatively high-cost sources of funding were replaced to a considerable degree with funds advanced by the RTC. High-cost funds replacement is a strategy the RTC follows to contain operating costs of conservatorship institutions, thus reducing the institutions' operating losses and thereby the ultimate cost of resolution. Essentially, the RTC has been able to shrink these thrifts and their interest expenses while preserving franchise values to the extent possible.

Downsizing of Institutions Under RTC Jurisdiction, Distributed by the Calendar Quarter They Entered the Conservatorship Program (excludes conservatorships resolved during 1989; dollars in millions)

Qtr.	Number of Thrifts	As of quarter-end before entering conservatorship			As of 11/30/89			% change since conservatorship		
		Assets	Core*	Other**	Assets	Core*	Other**	Assets	Core	Other
89:1	148	$ 67,761	$51,805	$21,828	$50,434	$47,038	$11,360	- 25.6	-9.2	-48.0
89:2	47	23,401	16,945	7,088	18,308	17,128	2,141	- 21.8	+1.1	-69.7
89:3	48	11,259	8,384	2,966	9,971	8,027	2,026	- 11.4	-4.3	-31.7
89:4	38	20,150	14,903	4,243	19,279	14,319	4,219	- 4.3	-3.9	- 0.6
1989	281	$122,571	$92,037	$36,125	$97,993	$86,513	$19,747	- 20.1	-6.0	-45.3

* -Core deposits = all deposits with total balances below $100,000

** -Other funds sources = all deposits with total balances over $100,000 + FHLB advances + reverse repurchase agreements; these figures do <u>not</u> include RTC advances.

NOTE: Assets reported net of reserves.

The 281 institutions under RTC conservatorship as of year-end 1989 had gross assets with a book value of $106.7 billion, based on their financial reports of November 30, 1989. Losses already had been taken on some assets, as of November 30, 1989, resulting in a lower book value than when the assets first came under RTC jurisdiction. The estimated fair market value of these assets, also as of November 30, was $89.2 billion. The following table shows the distribution of assets and the estimated declines in value based on a mark to market.

281 Institutions in Conservatorship as of 12/31/89
November, 1989 Financial Data

Type of asset	in millions		Loss (%)
	Book value	Fair value	
Residential mortgage loans	$ 36,740.6	$ 33,513.7	8.8
Other real estate loans	20,707.8	16,631.9	19.7
Total non-real estate loans	6,466.4	5,405.7	16.4
Mortgage pool securities	9,204.5	8,509.2	7.5
Other investment securities	7,308.4	6,832.8	6.5
Repossessed assets and other real estate owned	13,429.5	8,821.2	34.3
All other assets	12,798.9	9,497.1	25.6
TOTAL ASSETS	106,656.0	89,211.8	16.4

The estimated loss on these assets -- the difference between book and market values -- was $17.4 billion as of November 30, 1989. Additionally, the book liabilities of these 281 institutions exceeded book assets by $13.8 billion. Thus, the estimated total loss on these thrifts was $31.2 billion as of November 30.

As shown on Attachment 3, 49 cases involving conservatorship institutions have been resolved through February 16. These institutions were handled using a variety of options, which are discussed in more detail later in this testimony. Where possible, the RTC tries to find an acquirer of the failed thrift who will take over its deposit liabilities and, in effect, buy as many of its assets as possible.

In summary, the RTC sells assets in three stages: First, by selling assets as part of downsizing programs while the thrift is in conservatorship; Second, by selling assets as part of the resolution transaction; Third, by subsequent sales of assets not acquired as part of the resolution process. Preliminary data indicate that conservatorships sold approximately $14 to $15 billion in assets during 1989 and collected another $6 billion through loan payments and settlements. These proceeds were used primarily to pay down high-cost funding. Approximately $2.7 billion of thrift assets were sold during 1989 as part of the resolution process. This represents about 25 percent of the total assets held by the resolved thrifts. Finally, another $300 million was collected by receiverships through 1989.

Prioritize resolutions based on levels of deterioration. In accordance with Oversight Board direction, the RTC has to develop a prioritization schedule for case resolutions. These guidelines and prioritization procedures attempt to comply with the Oversight Board's objective to prioritize based on the rate of deterioration both in absolute and in relative terms. The guidelines leave room to schedule prioritizations on other than just quantitative factors. For instance, the RTC plans to resolve 16 minority-owned institutions now under its jurisdiction relatively early on so as to preserve what chance there may be for them to be restructured as viable enterprises, preferably owned by new minority investors.

The guidelines for making the prioritization determination focus on four factors:

1. Giving priority to institutions with relatively high rates of deterioration;

2. Minimizing the ongoing risk of exposure to the RTC;

3. Maximizing the recovery of franchise values; and

4. Ensuring the most efficient use of RTC resources and staff.

These factors, using eight quantitive measures in all, are combined to yield a single prioritization schedule. A prioritization schedule is developed nationwide as well as for each of the RTC's four regions to facilitate the resolution of institutions with less than $500 million in assets in those regions. A prioritization schedule is also developed for the major transaction resolution process headquartered in Washington, D.C. Each schedule divides the case load into four levels, or quartiles, of priority -- the most precise level of categorization considered practical. Each schedule is updated 30 days before the end of each calendar quarter, to reflect additions to the RTC's conservatorship program, changes in investor interest, and new data on institutions already in the conservatorship program.

This approach was used recently to identify those institutions to be marketed by the RTC during the first quarter of 1990. The RTC will continue to publicize the case resolution schedules in order to generate maximum interest in the competitive bidding process.

Select resolution methods on the basis of cost. The RTC has developed written guidelines for the "Cost Test" calculation required by Section 13(c) of the Federal Deposit Insurance Act and the loss minimization criteria in FIRREA. Case resolution options are geared towards maximizing competition and minimizing costs. The RTC offers a menu of bid options to open the competitive bidding process, maximizing the private funds brought to the table. This approach is designed to allow the market maximum flexibility and access in the bidding process, and minimize the RTC's costs.

It is especially important that bidders can select the amount of assets they will acquire under current put provisions in that it minimizes the time required for due diligence. This should promote bidder interest and hasten resolutions, thus lowering the RTC's cost. The RTC and the Oversight Board have recently agreed to allow puts for one year, with extended flexibility to go longer than one year where justified.

The ability to offer cash to fill the asset short-falls reduces costs, as the market discounts the use of government notes and guarantees. Cash should lead to a better price. It also gives the RTC more flexibility in the resolution process, again helping to minimize cost.

The RTC offers five approaches in its current bidding format:

1. Clean Thrift Option: Bidder acquires only cash and investment-grade and mortgage-backed securities, 1-4 family residential mortgage loans, performing consumer loans, with a put for forged, stolen or fictitious instruments.

2. Modified Clean Thrift Option: Bidder acquires only cash and securities, performing 1-4 family residential mortgage loans, and all consumer loans, and other performing loans (construction, multifamily and commercial loans) with an expanded put, including for forged, stolen or fictitious instruments.

3. Modified Whole Thrift Option: Bidder acquires all assets of the institution, except real estate owned and

other specific assets, with a put for forged, stolen or fictitious instruments.

4. Whole Thrift Option: Bidder acquires all assets of the institution with a put for forged, stolen or fictitious instruments.

5. Branch-by-Branch Clean Thrift Option: Bidder acquires only fixed assets and limited other assets in certain cases. This approach provides maximum access for smaller parties to the bidding process.

Under all of these options, the bidder assumes all deposit liabilities, and is required to pay the contractual interest rate on those deposits for 14 days. Bidders have the option to purchase all fixed assets (required in whole-thrift and branch-by-branch options).

If the RTC fails to receive a bid that meets the "cost test" during the initial round of bidding, then an insured deposit transfer option is offered. This second bidding round might include a simple insured deposit transfer, an insured deposit transfer that also includes the purchase of certain assets, and an insured deposit transfer transaction offered on a branch-by-branch basis.

We believe that the broader the marketing, the more open the process, and the more flexible the product, the better the price will be. However, this approach does have some side effects. The menu of options offered tends to be fairly standardized. Negotiations with individual bidders for more complex or customized transactions are precluded in the interest of open and competitive bidding. While we offer a menu, which certainly will change as the market dictates, customers cannot get customized orders. That may discourage some potential bidders -- particularly in an ever increasing buyer's market.

Another side effect is that some of the options, particularly the whole thrift option, take a <u>lot</u> of time for bidders to evaluate. Depending on the condition of the records of the particular thrift, even the so-called clean thrift option can take a lot of time. Smart buyers shop carefully -- and slowly. The less time they get, the less they are willing to buy. The more buyers, the slower the sale. This is the primary reason that sales of 21 institutions started last quarter rolled over into this quarter. We are happy to report that, of these, sixteen have been sold, and the rest should be resolved over the next two to four weeks. This would bring our total resolutions to 54, and we have announced the process to start selling another 52 this quarter. Undoubtedly, a number of these will roll over to next quarter.

Develop procedures to keep all interested potential purchasers fully informed of the case resolution process and provide adequate time for the market to determine the best (i.e., least costly) method of resolution. It is the RTC's policy to open the bidding process for institutions under its conservatorship to all SAIF or BIF insured depository institutions and corporations, partnerships or individuals who have the potential for receiving approval from chartering authorities for an assisted acquisition. Solicitations for bidders on conservatorship thrifts are made to the greatest number of potential purchasers possible, without regard to existing or potential organizational structure (i.e., thrift or bank). In an effort to attract the widest possible market, the RTC is committed to keep the marketplace of potential purchasers informed of its plans wherever practical.

The RTC publicizes and communicates its case resolution plans, procedures and results to potential purchasers through the use of various techniques including RTC publications, advertising, conferences, outreach programs, and the RTC reading room.

On November 27, 1989, the RTC published "A Buyer's Guide: How to Purchase a Savings Association from the RTC," which was announced in a press release. The Buyer's Guide is found at Attachment 4. This pamphlet explains the RTC's marketing process for the institutions that have come under RTC conservatorship. It is available free of charge. To date, the RTC marketing department has mailed approximately 3,000 copies. These mailings were in response to written requests, general interest calls to the RTC, and calls received on the RTC "hot line." Included with the "Guide" is the RTC clearance package, which contains a financial statement form for all private investors, a bidder fact sheet for financial institutions, and a list of all institutions currently under RTC conservatorship, which is updated weekly.

The RTC toll-free "hot line" also was established on November 27, 1989, and announced in a press release explaining its usage. To date, the RTC has responded to approximately 1,600 calls from individuals expressing interest in purchasing a savings institution.

The RTC announces a case resolution schedule for each quarter, listing each savings institution for which active marketing has begun or is planned, along with names and telephone numbers of RTC officials to contact for more information. For each institution listed in the case resolution schedule, a public information package is available containing general information, financial statements and branch location and deposit information.

The RTC also publishes the case resolution schedules and contact names and numbers in the Federal Register and advertises in appropriate newspapers, such as The Wall Street Journal. In addition to these announcements, the RTC schedules marketing conferences to provide potential bidders more information on upcoming resolutions. Attachment 5 provides the most recent "invitation to bid" list for institutions scheduled for resolution.

Beginning April 1990, the RTC plans to hold a series of one-day seminars around the country to inform the public on RTC's operations. Among the topics will be how to purchase a savings association from the RTC. All potential purchasers who have contacted the RTC about the case resolution process will receive invitations to these seminars.

In concert with RTC's Minority and Women's Affairs Officer, the Washington and Regional Office case resolution staffs will speak at various non-RTC programs around the country in an effort to encourage the active participation in the bidding process of all potential purchasers, including minorities and women.

The RTC maintains a data base which includes, to date, over 2,800 potential bidders who have expressed direct interest in purchasing an insolvent savings association and have completed the clearance package. This list consists of bank holding companies, savings associations, commercial banks, and corporate and private investors.

As outlined in our discussion of case resolution prioritization above, the Strategic Plan calls for a quarterly update and announcement of resolutions planned for the upcoming quarter.

Keep records sufficient to keep all interested parties informed of the case resolution process. In the spring of 1990, the RTC will open a reading room in Washington, D.C. It will house in one central location all documents of interest to potential purchasers, the media, academicians and the general public, and will be staffed by public information specialists. All of the RTC's policies, procedures, guidelines and other sources of public information, including purchase and assumption agreements entered into since August 9, 1989, will be available for public inspection. Copies of all documents will be made available to any interested part for a nominal charge.

Low Income Housing. The RTC has developed interim guidelines to address the eligible residential housing requirements of FIRREA. These guidelines have been forwarded to the Oversight Board for review and approval.

The RTC Oversight Board has granted approval for us to begin sales of a limited number of properties presently being put on the market. This demonstration program will allow the RTC to gain experience and put in place a process to market all low-income properties consistent with our mandate. The Oversight Board has also encouraged this demonstration effort so that they can determine whether subsidies, discounts, or concessionary financing are needed and how we can structure financing that meets the needs of qualified buyers consistent with secondary mortgage market underwriting criteria.

With respect to discount prices during the demonstration program, the Low Income Housing staff has placed considerable emphasis on identifying an array of resources that can be marshalled in support of financing the sale of properties to low- and moderate-income home buyers. This area will be critical to the ability of low-income families to be able to purchase a home.

As we begin the pilot demonstration, we want to understand what resources are available from private lenders, the Department of Housing and Urban Development, and the low-income housing programs of Fannie Mae and Freddie Mac. We will look closely to determine what gaps in financing still remain for review with the Oversight Board prior to developing final RTC programs.

Approximately 700 properties will be offered pursuant to the interim guidelines. Our regional staff informs us that, as a result of the dissemination of the affordable housing inventory, there have been numerous expressions of interest by potentially qualified buyers.

By far the vast majority of affordable housing, however, is held by conservatorships. We have identified 10,000 properties (half of which are in Texas) that appear to meet the affordable housing criteria. Surely, as new appraisals come in, the numbers will increase. We have heard concerns that we may try to sell all these properties outside the low-income housing program because FIRREA specifically excludes conservatorships. That is not our intent. We anticipate that the vast majority of these properties will pass to the RTC as thrifts are sold.

II. POLICIES AND PROCEDURES

It is the RTC's policy that a property should be extensively marketed for sale immediately after acquiring title. The primary reasons for this policy are:

* A prompt sale reduces the RTC's direct and indirect asset holding costs;
* An expeditious sale minimizes physical deterioration of property;
* An expeditious sale minimizes the risk exposure from unforeseen problems that may arise from owning property, especially operating properties; and
* An early sale returns the property quickly to private ownership, which, we believe, is the best way to achieve efficient use of the property.

The RTC does not intend to postpone marketing efforts for the purpose of improving occupancy of the property before marketing, or to speculatively hold property in the hope that values will increase. However, this policy does not preclude attempts to improve occupancy while aggressively marketing the property.

Upon acquiring title to a commercial property, at least one independent appraisal conforming to the RTC's Uniform Appraisal Instruction for Appraisals will be obtained to determine the current market value of the property. Additionally, a marketing strategy will be developed, generally relying on one of four methods of sale: 1) sealed bid; 2) broker; 3) RTC staff; or 4) auction. Each method has its relative advantages depending upon the situation; accordingly, the appropriate budget and marketing strategy will be developed, approved, and implemented on a case-by-case basis.

The RTC has developed policies to minimize the possibility of 'dumping' assets, particularly real estate assets. The RTC recognizes FIRREA's mandate of maximizing the net present value return from the sale of assets and minimizing the impact of these transactions on local real estate and financial markets. Dumping of assets does not further these objectives.

The RTC has implemented thresholds of selling properties at prices greater than 90 percent of appraised value in non-distressed markets and 95 percent of appraised value in distressed areas. The latter threshold was established pursuant to Section 501 of FIRREA, which directs the RTC normally to not sell a real property asset located in a distressed area without obtaining at least the minimum disposition price, defined to be 95 percent of the market value established by the RTC.

On an infrequent, case-by-case basis, a property may be sold below its appropriate threshold with justification. In these situations, a determination must be made that the part of the disposition price below the appropriate threshold is directly attributable to the savings of verifiable projected marketing and holding costs. This provision is consistent with the objective of maximizing the return from the sale of assets.

The RTC relies on current independent appraisals to determine the market value of properties in their "as is" condition. Appraisals are based upon the following definition of market value: "the most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus." Furthermore, appraisers are specifically instructed not to provide fire sale or liquidation value appraisals.

The RTC believes that these asset disposition and appraisal policies will prevent "dumping" of real estate assets and the resulting impact on local real estate markets.

The RTC's goal will be to sell assets for the highest possible price and maximize return on the asset. Our policy is to thoroughly market assets to the widest group of potential investors, which may include prior owners. In some circumstances the previous owner of the asset could make the highest offer to purchase. The decision to sell the asset would be analyzed on a case-by-case basis.

In making a decision to sell to a prior owner, the RTC would consider the circumstances involved. Specifically, we would review the initial transaction to determine if any conflicts or ethics violations, such as fraud, exist. The marketing efforts would be carefully reviewed to ascertain that all potential investors were solicited and that a full disclosure of information on the property was made to all parties. After this review and a determination that an offer from prior ownership is clearly the most beneficial to the RTC, we may proceed and close the sale. To date, we know of no examples where this has occurred.

The RTC will honor all loan agreements with borrowers. Borrowers will be allowed to continue to make agreed upon payments throughout the duration of their loan contracts. In order to insure that the borrowers are provided professional servicing of their accounts, the RTC will soon issue a Request for Proposal to contract with a group of experienced mortgage loan servicing companies. This core group of servicing companies will be available to the RTC Regional Offices to provide ongoing services to the public on current performing mortgage credits acquired by the RTC.

In addition, we anticipate expanding this program and contracting out the servicing of other performing loans acquired by the RTC. Current performing consumer loans, credit card and mobile home loans, etc., will be contracted out to the private sector for servicing.

The final disposition of these types of assets will be accomplished primarily through bulk sales or a securitization vehicle. Currently the Southeast Region is conducting a pilot program for securitization or sale on a whole loan basis of a $12 billion portfolio of mortgage loans currently held in conservatorship. The concepts used in this pilot project will evolve into a nationwide policy regarding the disposition of many types of performing loans.

In general, the RTC policy is that foreclosure on residential and commercial property is the collection method of last resort. The

RTC will work with troubled borrowers to restructure or compromise existing indebtedness when possible. However, in order for the RTC to perform its mandate for maximizing value, troubled borrowers must cooperate with the RTC by providing current financial and income statements, and allow access for an appraisal on the property. Upon receipt of this information we will work with the borrower and attempt to agree on an acceptable workout.

In general, the net present value of a workout should exceed the anticipated recovery of the foreclosure alternative. Currently, illiquid and distressed mortgages total $4.9 billion. The normal collection process will involve a substantial number of foreclosures for loans in this category. The exact number is impossible to determine until the individual capacity of the borrower is determined. Obviously we prefer prudent restructuring of loans over foreclosure.

Pursuant to the intent of Congress, RTC policy is to use the capacity and expertise of the private sector wherever practicable and efficient. The Strategic Plan directs the RTC to develop targets and mechanisms for measuring what our proper reliance on the private sector should be. The development of such mechanisms demands a base of knowledge from which to make comparisons and evaluate alternatives.

The RTC's asset management fee structure varies depending on the composition of the portfolio. Where the RTC holds marketable title, we expect to pay asset managers a minimal management fee to cover their overhead along with a substantial disposition fee. This disposition fee, earned upon the close of sale of an asset, is a function of three variables: a) the sale price, adjusted for expenses; b) the length of time a contractor was associated with the asset; and c) the percentage the price exceeds a target sale price.

The RTC oversees the activities of contractors chiefly through its Standard Asset Management Agreement (SAMA) and its Asset and Management Disposition Manual. The SAMA outlines the nature and scope of the contractual relationship between asset managers and the RTC. The Asset and Management Disposition Manual guides the RTC staff and the contractor as to RTC's expectations and procedures.

As mentioned earlier, the RTC generally arranges for acquirers of failed thrifts to provide interim management for assets not acquired while contractor programs are being developed more fully. Also, when the RTC assumes control of an asset, those firms previously associated with the asset continue in most instances. Soon after taking on the management of assets, the RTC evaluates the effectiveness and efficiency of these firms and only seeks to find alternatives for deficient managers.

There are numerous examples of firms whose contracts we assume. For example, in Colorado we are continuing to use Bry Property Management, and in California Larken Management, IBM Realty and Noyes Alexander Realty. About 60 percent of the approximately $10 billion of assets held in receivership through January are under private sector management.

The RTC's policies and procedures governing the qualification of real estate agents are no different from the qualifications procedures for any other type of asset-related service. All firms wishing to provide asset-related services must register their interest with the RTC, utilizing the RTC's "Contractor Registration Request" form. This form asks the firm to identify itself and the services it provides, as well as the geographic area it services. In addition, the firm is asked to certify that it is in compliance with the RTC's <u>Qualification of, Ethical Standards of Conduct for, and Restrictions on the Use of Confidential Information by Independent Contractors</u>. This regulation became effective February 5, 1990. The RTC has now begun the process of verifying and "approving" the many forms we have already received. As specific solicitations are issued, firms will submit their qualifications and experience as part of a "technical proposal", which will be rated in accordance with RTC criteria.

We are unaware of any locations where a majority of real estate agents are disqualified. To reduce the possibility of such an event, large amounts of staff time are used to assist interested persons in understanding the RTC's contracting program and ethical regulations. This activity ranges from presentations by senior RTC staff at large conventions to consolidated site officials speaking at the local chapter of the realtors association.

III. INTERACTION WITH THE DEPARTMENT OF JUSTICE

The RTC has established an Office of Investigations to identify the individuals who caused thrift insolvencies through their reckless mismanagement, fraud, or criminal conduct, and to recover the assets they misappropriated. The corps of RTC investigators, which is expected to reach 300 by year-end, will help determine whether and what sort of litigation should be initiated against insiders and others. The RTC will vigorously assist the Department of Justice in prosecuting individuals who benefitted personally at the taxpayers' expense.

In many of the thrifts under RTC control, the conduct of insiders and affiliated parties did not go beyond negligence or gross mismanagement. In these instances, the RTC will limit asset recovery activities to civil actions; for example, pursuing professional liability claims against directors, officers and possibly accountants and appraisers. There are also cases where the insiders acted deliberately, either alone or in conjunction with other affiliated parties to harm depositors, or were personally enriched at the expense of depositors. In these cases, the RTC will work closely with the Department of Justice to gain a criminal conviction and a restitution order restoring stolen funds to the RTC. In the more serious cases, both civil and criminal actions will be pursued.

The information needed by the Department of Justice to begin a criminal investigation is provided in a criminal referral, a standard form used by all insured financial institutions and regulatory agencies. In the case of an RTC thrift, criminal referrals may have been prepared and sent: (1) by the institution's management prior to the date of conservatorship; (2) by the Federal Home Loan Bank Board or the Federal Savings and Loan Insurance Corporation prior to August 9, 1990; (3) by FDIC or the management during the S&L Management Program; or (4) by RTC investigators. The important issue is not who or what agency initiated the criminal referral or how many were filed, but whether adequate resources are being applied to the cases of serious criminal misconduct that demand attention.

In FIRREA, Congress authorized the Department of Justice to dedicate additional resources to bank and S&L fraud cases. These resources are sorely needed to relieve the backlog of criminal cases in many districts. The FDIC and other regulatory agencies provided input into the process that Justice used to allocate these additional resources. We believe they have placed proper emphasis on the districts experiencing the greatest caseload and those having to deal with complex prosecutions.

Over 1200 criminal referrals have been sent to the Justice Department naming insiders, borrowers or agents of RTC-controlled thrifts. Apparent violations range from embezzlement and petty theft to complex conspiracies and schemes to defraud the institutions.

Many of the complex schemes involve over-valued property that was swapped several times between borrowers or among various S&Ls. These land flip schemes created false values on which loans were made and generated excessive fees that were parcelled out to appraisers, brokers, developers and other participants in the scheme, including insiders of the S&Ls. We are pursuing several instances where assets of doubtful value were exchanged with assets of even more questionable value to deceive regulators into believing the capital position of the thrift was not impaired. We are also looking into several instances of unauthorized trading in mortgage-backed securities and other financial instruments where insiders benefitted personally at the expense of the institution.

Our current estimate is that about 60 percent of RTC thrifts have been victimized by serious criminal activity. We are conducting a comprehensive survey of regional and field sites to determine the exact number and nature of referrals that have been made or are expected to be made in the near future. With this information in hand, we will be better able to project the expected caseload in each geographic area of the country. The results of this survey should be in about March 10, 1990.

We estimate that about 75 percent of the 1200 criminal referrals pertaining to RTC thrifts are being handled by U.S. Attorneys in the priority areas. Over one-half of the referrals involving RTC thrifts are in the following U.S. Attorney Districts: Houston, Dallas, Los Angeles, Chicago, San Antonio and San Francisco.