United States General Accounting Office

GAO

Report to the Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, and the Chairman, Committee on Banking, Finance and Urban Affairs, House of Representatives

July 1990

FAILED THRIFTS

FDIC Oversight of 1988 Deals Needs Improvement

141827

GAO/GGD-90-93

GAO

United States
General Accounting Office
Washington, D.C. 20548

General Government Division

B-238474

July 19, 1990

The Honorable Donald W. Riegle, Jr.
Chairman, Committee on Banking,
Housing, and Urban Affairs
United States Senate

The Honorable Henry B. Gonzalez
Chairman, Committee on Banking,
Finance and Urban Affairs
House of Representatives

This report is in response to the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) requirement that GAO examine and monitor all insolvent institutions resolved by the Federal Savings and Loan Insurance Corporation (FSLIC) from January 1, 1988, through the date of its enactment, on August 9, 1989. Altogether, 181 insolvent thrifts were resolved by selling them to 91 acquirers during this period. All but three were resolved by FSLIC during 1988. These 91 transactions were consummated with assistance agreements that specified responsibilities of FSLIC and the 91 assisted thrifts. FSLIC estimated that $49 billion in assistance would be provided to these assisted thrifts.

In these assisted transactions, FSLIC gave the assisted thrifts cash or a promissory note for the difference between the assumed assets and liabilities. Because FSLIC estimated that about $50 billion in covered assets transferred were not worth their book value, FSLIC assistance also included capital loss coverage and a yield guarantee.[1]

We testified on several occasions in 1989 that the terms of the agreements did not include incentives to help ensure that the assisted thrifts would maximize net recovery in disposing of covered assets and thus limit the government's cost and risk exposure. (See p. 36.) We emphasized that managing these agreements would be a huge job but that they did have reporting requirement provisions to help protect the government's interests.

[1] Acquired assets for which book value (capital loss coverage) and yield guarantees (yield maintenance) are provided for in the assistance agreements are referred to as covered assets. Covered assets include loans, real estate owned, and mortgage-backed securities with market values below their book values.

The Federal Deposit Insurance Corporation (FDIC) is now responsible for managing these agreements.[2] It can use the reporting provisions to approve or disapprove the assisted thrifts' management and disposition of the covered assets. This helps ensure the orderly disposition of these assets at a minimum cost while maximizing asset value.

Because the assisted thrifts' plans for disposition of these assets were not due, with few exceptions, until late 1989 or early 1990, we focused our initial work on FDIC's management of these assistance agreements. We also obtained data on the extent to which the assisted thrifts have submitted the reports as required in the agreements and the extent to which they have complied with the terms of forbearances from enforcement of regulations granted at the time of the transactions. Our follow-on work will focus on FDIC's oversight of the assisted thrifts' asset management and disposition plans.

We are reporting separately on our review of FDIC's cost estimates for all 1988 and 1989 assistance transactions, as is also required by FIRREA.

Background

To help protect the government's interest, the assistance agreements included various reporting requirements designed to enable FDIC to oversee the assisted thrifts' disposition of covered assets. (See app. I.) Under the terms of the agreements, FDIC approves or disapproves various plans, schedules, summaries, and budgets submitted by the assisted thrifts. These reports also allow FDIC to monitor the assisted thrifts' covered asset management performance and to ensure compliance with the terms, conditions, and standards of the agreements. These reports are generally to be submitted on an annual or quarterly basis.

The assisted thrifts are responsible for managing the covered assets and liabilities assumed from the failed thrifts ". . . by employing the higher of the standard of prudent business practice used by the acquiring association in administering its assets and liabilities not acquired from an acquired association or the standard employed in the savings and loan industry generally in administering similar assets and liabilities."

[2]FIRREA abolished the Federal Home Loan Bank Board and its component FSLIC, the entities originally responsible for regulating and insuring thrifts. FIRREA transferred to FDIC the insurance responsibility of FSLIC along with the responsibility for any FSLIC assistance agreements. FDIC's Division of FSLIC Operations is responsible for the assistance agreements. Also, FIRREA transferred the supervisory and enforcement responsibilities of the Federal Home Loan Bank Board to the Office of Thrift Supervision (OTS). In addition, FIRREA established the Resolution Trust Corporation (RTC) to manage and resolve all savings and loan associations that are placed in conservatorship or receivership between January 1, 1989, and August 9, 1992.

The assistance agreements usually require FDIC to complete an audit, referred to as an initial inventory audit, to account for all of the assets and liabilities of the failed thrifts at the acquisition date. In total, audits of 150 failed thrifts are required by the assistance agreements. These audits are to be completed 180 days after the effective date of the transactions and are to be used to determine the assisted thrifts' negative net worth assistance and the universe of covered assets. These audits are being done under contract and are to be considered completed after being reviewed and approved by FDIC.

In conjunction with—but separate from—the assistance agreements, the Federal Home Loan Bank Board granted various forbearances from regulatory enforcement in 80 of the 91 transactions at the time of the resolutions. OTS is responsible for assuring that the assisted thrifts comply with the terms of these forbearances.

We testified on March 11, 1989, that most agreements contained provisions allowing FDIC to pay off promissory notes that had been issued to the assisted thrifts for negative net worth assistance and to buy back the covered assets or require that they be written down or sold. We urged Congress to require that a study be made that would examine each transaction to identify opportunities to use these provisions to reduce transaction costs, assuming that funds for this purpose are available. Congress in FIRREA required the RTC to undertake this study and report to it and the RTC Oversight Board on any options to reduce costs.

Results in Brief

To help ensure that assisted thrifts maximize financial returns on the disposition of the estimated $50 billion in covered assets and correspondingly limit the government's cost, the assistance agreements provide the government the authority to approve or disapprove the thrifts' asset disposition plans and oversee adherence to those plans. We found that FDIC had not, however, given sufficient attention to its responsibilities for overseeing the disposition of the covered assets and managing the FSLIC assistance agreements.

We identified three areas in which FDIC had not taken the actions needed to help protect the government's interest and discussed these weaknesses in testimony before the House Banking Committee on January 25, 1990. Specifically, we said that FDIC had not developed an overall strategy for dealing with covered asset dispositions nor adopted criteria for approving or disapproving various asset disposition plans submitted by assisted thrifts. Moreover, FDIC had not established monitoring systems for ensuring the orderly disposition of covered assets by tracking the assisted thrifts' compliance with disposition plans. Also, FDIC had not completed the initial inventory audits.

Without adequate strategies, policies, and procedures to govern its approval of the assisted thrifts' covered asset disposition plans and without adequate tracking systems to monitor both the inventory of such assets and their actual disposition, FDIC cannot assure that the costs of these transactions are being minimized. Furthermore, the absence of guidance and monitoring systems exposes the government to potential fraud and abuse in the disposition of these assets—whose $50 billion value FDIC has guaranteed.

FDIC agreed with our concerns and testified before the House Banking Committee on April 2, 1990, that it had initiated specific corrective actions. At that time, FDIC had not set appropriate milestones to help management assure that the corrective actions were completed as expeditiously as possible. Our draft report suggested that FDIC establish date-specific milestones and insure that they were met.

On June 12, 1990, after FDIC commented on a draft of this report, the FDIC Board of Directors approved a comprehensive strategic plan for the administration of the FSLIC assistance agreements, together with implementing actions and target completion dates. FDIC's actions have been responsive to our concerns related to asset disposition strategy and policies, monitoring systems, and the initial inventory audits.

Objectives, Scope, and Methodology

To carry out our mandate under the act, we (1) examined FDIC's management of the 91 assistance agreements; (2) obtained information on the extent to which the assisted thrifts have complied with the reporting requirements specified in the assistance agreements; and (3) obtained information on OTS' monitoring of the assisted thrifts' compliance with the terms of any forbearances granted.[3]

[3]In addition to these 91 transactions, there were five consolidations involving 18 insolvent thrifts for which there were no acquirers. FSLIC entered into assistance agreements with the resulting entities, which were organized as federal mutual savings and loan associations. Because these consolidations—referred to as stabilizations—do not constitute final resolutions, they were not included within the scope of this review. However, they will be included in our review of FDIC's cost estimates. (See p. 2.)

We asked FDIC and OTS to give us their assessment of the 91 assisted thrifts' compliance with reporting requirements in their assistance agreements and any forbearances granted, respectively. For five of the largest FSLIC-assisted thrifts we followed up on FDIC's and OTS' determinations of compliance by examining the agencies' documentation on compliance.[4] These five transactions accounted for about $17 billion of the $49 billion FSLIC-estimated cost of the 91 assistance transactions. However, the results of our follow-up are not generalizable to the universe. We also interviewed FDIC officials responsible for managing these five agreements in Washington D.C.; San Francisco, Irvine, and Stockton, California; and in Dallas and Houston, Texas. To find out how the forbearances were monitored, we interviewed responsible officials in OTS' San Francisco and Dallas district offices as well as in Washington, D.C. We also reviewed various supporting documentation and the policies and procedures manuals of FDIC and OTS.

We interviewed FDIC headquarters officials to discuss FDIC's overall management of assistance agreements, including the development of policies and procedures for approving the assisted thrifts' plans for the disposition of the covered assets, the establishment of asset tracking systems, and the completion of the initial inventory audits. We provided copies of a draft of this report to FDIC and OTS for their review. The major points in their comment letters and our response are summarized on page 14. Each letter and our full response are presented in appendixes II and III.

We did our review from September 1989 through March 1990, in accordance with generally accepted government auditing standards.

FDIC Lacked an Overall Asset Disposition Strategy

FDIC had no overall written strategy expressing its principles and goals for covered asset disposition, nor was there any guidance on the criteria to be used for approving or disapproving various asset plans submitted by assisted thrifts. The assisted thrifts are responsible for the disposition of covered assets, estimated by FDIC to have a book value of $31 billion, as of December 31, 1989.

Because FDIC is required to guarantee the book value of the covered assets (referred to as capital loss coverage assistance) at disposition or

[4]The five transactions were: American Savings Federal Savings and Loan Association, New West Federal Savings and Loan Association; Columbia Savings, a Federal Savings and Loan, Pathway Financial, a Federal Association, and Cardinal Federal Savings Bank; First Gibraltar Bank, Federal Savings Bank; Pacific Southwest Savings Bank, Federal Savings Bank; and United Savings Association of Texas, Federal Savings Bank.

when such assets are written down and to pay yield maintenance, it is crucial that the assisted thrifts act to maximize the net return on these assets and thus limit FDIC's payment. FDIC has the right under the agreements to approve or disapprove asset management and disposition plans proposed by the assisted thrifts. However, it has not issued guidance outlining the basis for approvals to those FDIC officials responsible for reviewing the plans.

FDIC officials responsible for approving the asset plans submitted by the five assisted thrifts we focused on said that, because there was no formal policy guidance, they relied on FDIC staff and the experience and knowledge of real estate and asset management contractors that FDIC uses to help review the asset plans. The official responsible for three of the five assisted thrifts we studied said FDIC headquarters had not provided his office with an overall strategy for disposing of the covered assets nor had he directed that a strategy be developed for his region. The official said that policies covering such areas as underwriting, appraisals, foreclosures, and marketing could be beneficial. Although FDIC has recommended a specific format for each report submission, one official emphasized that FDIC had no written criteria for evaluating the adequacy of the assisted thrifts' proposed asset disposition plans. Further, FDIC's format only ensures that pertinent elements are covered. Its format is not a substitute for criteria.

In many areas of asset management and disposal, policy is needed to limit FDIC's cost. For example, an assisted thrift could propose self-financed sales of covered assets. Under the terms of its agreement, the newly financed asset would become a covered asset and the assisted thrift would therefore continue to receive the guaranteed yield, as well as capital loss coverage, on the asset's new book value. While the agreement with the assisted thrift allows for the possibility of such transactions, there was no FDIC guidance on the conditions under which such transactions should be approved or disapproved. Other examples where policy guidance is needed to limit the government's cost include the conditions under which (1) nonmarketable assets should be written down, (2) discounted payoffs or reductions in the interest rates for loans are appropriate, and (3) assets should be held in expectation of future increases in value.

We discussed these problems with the interim director of FDIC's Division of FSLIC Operations during March 1990, and he subsequently testified on April 2, 1990, that a strategic plan had been drafted, policies and procedures were being developed, and that a set of 3-year goals and objectives would be presented for action by FDIC's Board of Directors in May 1990. However, FDIC had not established an implementation plan, including appropriate milestones, for proceeding after the Board's approval.

On May 24, 1990, FDIC officials submitted to the FDIC Board of Directors for consideration a draft strategic plan together with a statement of 3-year goals and objectives to support the strategic plan. The latter established a goal of managing "the acquirers' disposal of covered assets within the terms of the assistance agreements to ensure orderly dispositions at minimum cost to the FSLIC Resolution Fund while maximizing asset values." It then identified a series of eight key asset disposition issues for which policy statements are needed, such as hold versus sell decisions, and set out a completion target date for each policy statement. On June 12, 1990, the Board approved the plan.

Integrated Management Information Systems Needed for Asset Management and Disposition

We have reported that the assisted thrifts lack incentives to most effectively manage and liquidate the covered assets.[5] Nevertheless, the government must pay for any losses incurred on the disposition of these assets and maintain their yield at specified levels until they are disposed of. Because of this, FDIC needs to be vigilant in managing these agreements to limit the government's cost. However, in carrying out its responsibilities for covered asset dispositions, FDIC has no integrated systems for tracking (1) the number and book value of covered assets in the assisted thrifts, (2) the assisted thrifts' progress in accomplishing the goals set out in their various asset management plans, and (3) the assisted thrifts' compliance in meeting the reporting requirements outlined in their assistance agreements.

FDIC needs a system to track its inventory (both the number and book value) of the covered assets managed by the individual assisted thrifts. FSLIC had estimated that the book value of 215,000 covered assets was $50 billion at year-end 1988. FDIC estimated that the 91 assisted thrifts had about $31 billion in covered assets as of December 31, 1989; however, FSLIC's original estimate of the number of covered assets was not updated until we asked for current data. It took FDIC about a week to provide an estimate that the thrifts had 219,000 covered assets. FDIC could not provide information on the value and the type of asset dispositions that comprised the overall $19 billion net decrease and the 4,000 net increase in the number of covered assets between the time of the resolutions and December 31, 1989.

[5] Failed Thrifts: GAO's Analysis of Bank Board 1988 Deals (GAO/T-GGD-89-11, Mar. 14, 1989).

FDIC needs to be able to systematically monitor the assisted thrifts' progress in accomplishing their goals for covered asset disposition. Although this information has been maintained manually on an asset disposition plan-by-plan basis, FDIC does not have a system to monitor the assisted thrifts' implementation of all disposition plans. Because FDIC is responsible for over 200,000 covered assets, a system is needed to provide comprehensive information so that FDIC can promptly identify instances where plans are not being followed and to initiate corrective actions.

FDIC also needs to track assisted thrifts' compliance with the reporting requirements so that it can be assured that the assisted thrifts are in compliance. There are an extensive number of required reports, but FDIC cannot now, on an aggregated basis, monitor the assisted thrifts' compliance with those requirements. (See app. I.) FDIC cannot, therefore, on a routine basis, promptly identify noncompliance so that it can require corrective action.

FDIC's Division of FSLIC Operations staff said they plan to implement in June 1990 a tracking system for covered assets in the 18 assisted thrifts located within the Dallas region. They said that the system, referred to as the Covered Asset Management System, will allow them to track on an ongoing basis the amount of covered assets in the assisted thrifts, the submissions of required reports, and the progress these thrifts have made in meeting the goals outlined in their various asset management plans. They also said another system, being developed for major covered assets, was being tested for two of the assisted thrifts located in the region.[6]

The interim director of FDIC's Division of FSLIC Operations advised us in March 1990, and subsequently testified on April 2, 1990, that a task force was being established to work on the development of integrated management information systems for asset management and disposition. According to this official, integrated systems should provide, on an ongoing basis, information on the status of all covered assets as well as assisted thrifts' compliance with approved asset disposition plans and with reporting requirements. FDIC had not, however, set milestones to

[6]A major covered asset is one that generally has a book value of $5 million or more, or an anticipated liquidation loss of $1 million or more. The two other classes of covered assets are "significant" and "other." "Significant" covered assets generally have book values of between $1 million and $5 million or anticipated liquidation losses of between $300,000 and $1 million. A covered asset classified as "other" is one with a book value of less than $1 million and an anticipated liquidation loss of less than $300,000.

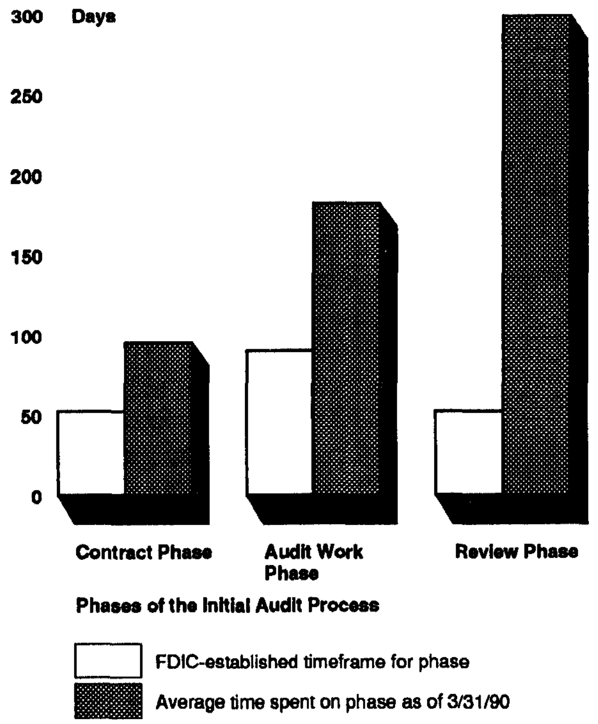
govern the task force's work and assure implementation of the systems as expeditiously as possible.

The strategic plan and the goals and objectives statement submitted to the FDIC Board for consideration on May 24 and approved on June 12, 1990, (see p. 7) established a goal of developing and implementing "an enhanced management information system that will be an effective resource in the management decision making process, especially covered asset tracking." It set out various implementing actions and target completion dates for these tasks. FDIC officials have advised us that the target implementation date is March 31, 1991.

Initial Inventory Audits Not Yet Completed

FDIC has not yet completed the initial inventory audits. These audits were to have been completed between August 1988 and August 1989. As of March 31, 1990, only 17 of the 150 required audits had been finished. The average time spent in each phase of the initial audit process for those audits completed or in progress is shown in figure 1.

Figure 1: Average Time Spent in Initial Inventory Audit Phases



Note: Average time spent includes audits in progress or completed.
Source: GAO Analysis of FDIC-Provided Information.

Until the audits are completed by FDIC, the quarterly payments to the assisted thrifts for yield maintenance on covered assets and for interest on negative net worth promissory notes will continue to be based on estimates that may prove incorrect. If the estimates are incorrect, FDIC and the assisted thrifts will have to reconcile past payments with the new adjusted amounts.

Divided responsibility for the audits within the Federal Home Loan Bank Board and then within FDIC until November 1, 1989, contributed significantly to past delays. Since early November 1989, FDIC's Division of FSLIC Operations has had responsibility for the audits. Continued delays in finalizing the audits have been attributed by officials in FDIC's Division of FSLIC Operations to a lack of resources—both staff and computer resources.

The interim director of FDIC's Division of FSLIC Operations, in a March 8, 1990, memorandum, however, stated that additional resources would be provided. He set a goal to complete all of the audits by May 31, 1990. This goal was cited in FDIC testimony on April 2, 1990. In commenting on a draft of this report, FDIC advised us that all but six of the audits would be completed by June 30. We were subsequently told by FDIC officials that this goal had been met and that the six remaining audits would be completed by December 31, 1990.

FDIC officials advised us that the results of 24 of the 144 completed audits, which cannot be generalized, show that the negative net worth of these acquired thrifts was about $32.8 million (2.7 percent) higher than the $1.2 billion estimated at the time FSLIC entered into the agreements. An increase of about $33.3 million in negative net worth assistance occurred in 14 cases, a decrease of about $0.5 million occurred in 1 case, and in 9 cases there was no change. An FDIC official also advised us that the adjustments based on the other 120 completed audits should be done by August 31, 1990.

Most Assisted Thrifts Were in Compliance With Reporting Requirements

Our analysis of FDIC-provided data shows that from April 1, 1988, through September 30, 1989, on average, the assisted thrifts submitted their required reports 90 percent of the time. FDIC officials said that they had asked any noncomplying assisted thrifts to submit their reports, but these officials could not readily tell us whether these reports were subsequently submitted.

Our analyses of FDIC's documentation for our five cases showed that with minor exceptions, the assisted thrifts had submitted the required reports. In a few cases, FDIC had granted extensions of report due dates and/or returned reports to the assisted thrifts for resubmission.

Assisted Thrifts in Most Cases Had Complied With the Terms of Forbearances

OTS officials said that the 80 assisted thrifts with forbearances, with few exceptions, were in compliance with the terms of their forbearances as of September 30, 1989, the most current data available at the time of our review. These officials also stated that regulatory actions had been taken to resolve the few instances of noncompliance.

OTS officials said that they relied primarily on analysis of the assisted thrifts' quarterly financial reports to determine compliance. According to OTS, 72 of the 80 assisted thrifts with forbearances were in compliance as of September 30, 1989, with the terms of the forbearances granted at the time of the resolutions. OTS officials also stated that they had taken regulatory actions to bring the other eight assisted thrifts into compliance.

Compliance with the terms of certain forbearances, such as those relating to transactions with affiliates, cannot be determined from the financial reports but must be assessed at the thrift. According to OTS officials, they assess forbearance compliance as part of the ongoing supervisory process, which includes on-site examinations. Seventy-five of the 91 assisted thrifts had been examined as of December 31, 1989, and five examinations were in process as of February 28, 1990. The other 11 examinations had not been started as of that date.

We found, through discussions with OTS officials and analyses of agency documentation, that the assisted thrifts in our five case studies were in compliance with their forbearances as of September 30, 1989. Four of these five assisted thrifts had been examined in 1989. One transaction had not been scheduled for an exam, as of March 31, 1990.

The passage of FIRREA brought the status of certain forbearances granted in conjunction with the agreements, most significantly the capital forbearances, into question by some savings associations. Capital forbearances had been granted to 79 assisted thrifts. Accordingly, OTS, on January 9, 1990, issued a thrift bulletin stating that the new, more stringent, capital standards "... apply to all savings associations, including those associations that have been operating under previously granted capital and accounting forbearances."[7]

OTS determined that 64 of the 91 assisted thrifts met the new capital standards as of December 31, 1989. Twenty-one of the 27 thrifts that were unable to meet the new capital standards as of December 7, 1989, submitted capital plans to their OTS district directors as of January 8, 1990, outlining how they planned to achieve compliance with the new capital requirements by December 31, 1994. Using their discretion, OTS officials did not require five thrifts to submit a plan, and the remaining thrift was in the process of being placed into conservatorship/receivership. Subsequently, according to OTS, the five thrifts that were not required to submit a plan came into compliance as of December 31, 1989.

[7]OTS Thrift Bulletin TB-38-2, January 9, 1990, Capital Adequacy: Guidance on the Status of Capital and Accounting Forbearances and Capital Instruments Held by a Deposit Insurance Fund. The impact of FIRREA's capital requirements and OTS' actions on previously granted capital forbearances is currently the subject of several lawsuits filed by savings associations.

The impact of FIRREA on the remaining forbearances granted assisted thrifts was being studied by OTS as of March 1990. Until a decision is made, OTS advised us that these forbearances will remain in effect. In the interim, OTS advised us that capital plans are not accepted which are dependent upon the continuation of these forbearances.

Conclusions

FDIC officials agreed with us that they needed (1) an overall strategy and policies and procedures for approving assisted thrifts' covered asset disposition plans, (2) integrated management information systems for asset management and disposition, and (3) expedited completion of the initial inventory audits. During April 1990, FDIC testified on their planned corrective actions.

While these planned corrective actions were a good start, the plans did not establish realistic, date-specific milestones to enable FDIC management to better oversee implementation of the plans and, if needed, intercede with appropriate actions to expeditiously bring about the needed changes. For example, regarding the establishment of policies and procedures, FDIC has established an interim milestone—the presentation of a decision document—but neither a plan nor milestone for implementation should the document be approved. For the information systems, FDIC has established a task force, but no milestones were set to govern the task force's work. With regard to the plan for completing the initial audits, the completion milestone did not seem realistic.

Given the enormity of the dollars involved—the covered asset value guaranteed by FDIC is about $50 billion—and the government's related exposure to unnecessary costs and potential fraud and abuse, our draft report stressed that it was essential that FDIC ensure that the corrective actions are made as quickly as possible. Accordingly, in our draft report we suggested that FDIC establish date-specific milestones, and take interim actions as appropriate to ensure that the milestones are met, for expeditiously

- issuing an overall strategy for covered asset management and disposition and related policy guidance,
- establishing integrated management information systems to track covered asset management and disposition, and
- completing the initial inventory audits.

On May 24, 1990, after commenting on a draft of this report, FDIC officials submitted to the FDIC Board of Directors for consideration a draft strategic plan for the administration of the assistance agreements, together with a statement of goals and objectives. The Board approved the plan and statement on June 12, 1990. These documents set forth target completion dates for issuing asset disposition policies, establishing the needed management information systems, and expediting completion of the initial inventory audits.

FDIC has been responsive to our concerns. The actions described, if fully implemented, will satisfy the thrust of the suggestions in our draft report. Accordingly, we are not making recommendations in this report.

Agency Comments and Our Evaluation

FDIC, in its May 18, 1990, letter, expressed concern that the report reflected a misunderstanding of certain facts and failed to recognize the short-term versus long-term objectives of its management of the assisted transactions. However, FDIC also noted that a draft strategic plan and a statement of goals and objectives would be presented to the FDIC Board of Directors for consideration in May. As discussed above, these documents were submitted on May 24 and approved on June 12, 1990. The actions taken, as noted above, have satisfactorily addressed the concerns expressed in the draft report. A more detailed discussion of FDIC's specific comments is provided in appendix II.

OTS provided a number of editorial and technical comments in its letter, which is enclosed and discussed in appendix III.

We are providing copies of the report to other interested members of Congress, appropriate congressional committees, FDIC, OTS, and other interested parties.

Major contributors are listed in appendix IV. If you have any questions about this report, please call me on 275-8678.

Craig A. Simmons
Director, Financial Institutions
and Markets Issues

Contents

Abbreviations

FDIC	Federal Deposit Insurance Corporation
FIRREA	Financial Institutions Reform, Recovery, and Enforcement Act of 1989
FSLIC	Federal Savings and Loan Insurance Corporation
OTS	Office of Thrift Supervision
RTC	Resolution Trust Corporation

Assistance Agreement Reporting Requirements

Covered Asset Reports

1. Covered asset schedule
2. Covered asset summary schedule
3. Covered asset budget summary
4. Subsidiary business plan
5. Collection plan
6. Property plan

Quarterly Assistance Payment Report

1. Special reserve accounts I & II

Three Year Business Plan[1]

Litigation Reports[2]

1. Litigation schedule
2. Litigation analysis
3. Litigation plan & budget
4. Litigation summary

Note: Specific reports required vary in accordance with the assistance agreement requirements and the type of covered asset.

[1]For some assisted thrifts, short, medium, and long-term business plans were required. Subsequently, FDIC decided that the OTS 3-year business plan requirement would satisfy these reporting requirements.

[2]These reports are required for any litigation to which any of the acquired associations was a party immediately before the effective date or with respect to a liability assumed by the acquiring association pursuant to the acquisition agreement.

Source: FDIC data.

Comments From the Federal Deposit Insurance Corporation

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

FDIC
Federal Deposit Insurance Corporation
Washington, DC 20429

May 18, 1990

Mr. Richard L. Fogel
Assistant Comptroller General
General Accounting Office
Washington, D.C. 20548

Dear Mr. Fogel:

See comment 1.

This is in response to your request for comments on the draft report entitled Failed Thrifts: Oversight of 1988 Deals Needs Improvement. We are concerned the draft reflected misunderstanding of certain facts and failed to recognize the short-term versus long-term objectives of FDIC's management of the very complex assisted transactions approved by the former Federal Home Loan Bank Board. We hope our meeting of May 15th with Ms. Kern and Mr. Ford was helpful towards correcting the record. Our comments are presented below and are organized by major findings.

I. Strategy and Management Process

See comment 2.

The draft report implies that there is not a management process or an overall strategy for dealing with these transactions. The report seems to suggest that there is only one way to manage this process that being a strategic plan checklist approach with accomplishment of goals and objectives tracked against specific milestones. We believe this is a classic textbook over-simplification of a complex problem.

See comment 3.

The FDIC's approach is comprehensive and designed to factor in the enormous complexity presented by over 200 individual negotiated contracts, each of which has unique provisions which must be considered when directing the acquirers' efforts. Key elements of the FDIC's management approach include:

- Controls - Specific delegations of authority to control approval of expense are in place. A committee structure is used to review transactions above certain dollar thresholds. Staffing levels have been increased significantly to improve management of these transactions. We are further reviewing our approach to delegations with the objective of streamlining transaction processing.

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See comment 4.

- Policy and procedures for both staff and for management of assisted institutions. Note that policy has been developed in order to recognize the contractual obligations between FDIC and acquirers. The complexity of the transactions and of the covered assets dictate guidance rather than a checklist approach. Very detailed procedures for both staff and acquirers have been in place for a considerable period of time and those manuals were made available to your staff.

See comment 2.

- Development of strategy and goals with monitoring of accomplishment against targets. FDIC uses this element in its management approach. However, as we discussed at our March 23rd meeting, it is critical to recognize that longer term strategy may be substantially affected by recommendations made as a result of the FIRREA mandated RTC review. An immediate objective is assisting in this review to identify potential cost saving measures. With respect to an asset disposition strategy, FDIC has established well-defined goals. Development of such a strategy is significantly more complex and involved than is implied in GAO's comments. Again, acquirers have long been guided by policy manuals provided GAO staff.

See comment 4.

See comment 5.

The concept of the Assistance Agreements presumes that the Acquiring Institution possesses expertise in the management and disposition of troubled assets, and that these institutions have entered into a contract with us to do this at minimum cost to the FSLIC Resolution Fund. The agreements provide a general plan for the liquidation of Covered Assets. The assistance agreements include requirements for developing asset plans which contain disposition strategies and for complying with management standards contained in agreements. Failure to comply can lead to loss of assistance payments.

See comment 6.

Development of a comprehensive strategy for disposing of assets requires detailed analysis of the asset portfolio, the volume and types of assets, their marketability and the costs associated with targeting specific assets or categories of assets for disposition. Without such analysis, decisions can be made that could pose serious economic consequences in future years. For example, it may be more cost-effective to de-emphasize the marketing and disposition of income producing assets (e.g., apartment complexes) since they "carry" themselves at least when written down to their market value. This approach would concentrate on development of disposition strategies for assets: for which a viable market does not currently exist (e.g., raw, unimproved land); those that for various reasons are not currently marketable due to title problems, environmental problems, etc.; and those that are not currently in default (e.g., performing commercial loans) but absent intensive collection efforts will most likely go into default.

A thorough understanding of the limitations and consequences of gain sharing, tax sharing and other cost considerations in the Assistance Agreement is required prior to development of an overall disposition strategy. Additionally, comprehensive asset disposition strategy could be altered at the time the Office of Thrift Supervision opines on whether it will waive certain constraints on seller financing imposed by FIRREA.

See comment 7.

FDIC has concluded that the appropriate strategy is to manage the process rather than focus on thousands of individual asset transactions. Implementation of this approach requires that the associations' internal controls and review processes meet or exceed certain minimum standards. To properly evaluate performance and compliance with the terms of the Assistance Agreements, FDIC must have reporting and evaluation mechanisms in place. FDIC is taking the following steps in development of that process:

We are reviewing the Associations' business plans to evaluate the strategies concerning future growth, capital requirements, and most importantly, its approach to marketing and disposing of Covered Assets. This will help identify those Associations that have sound strategies for eliminating covered assets and that are currently successful in meeting the objectives of the assistance agreements.

See comment 8.

Preliminary data on covered assets and reporting requirements through automated systems is being gathered. Completion of the Covered Asset Management System (CAMS), an asset tracking system, is scheduled for June 30, 1990. The system will collect information on the inventory (including the number and dollar amount) of Major (MCA) and Significant Covered Assets (SCA) on an individual basis and track all submissions requiring FDIC approval, including those for Other Covered Assets (OCA). Eventually, CAMS will assist in the monitoring of critical milestones contained in asset plans required for MCAs, SCAs and selected OCAs. Integration of this preliminary system into FDIC mainframe is underway.

See comment 9.

The Management Reporting/Performance Monitoring system was implemented in January 1990. This system provides aggregate information to measure institutions' performance under, and compliance with, the terms of the Assistance Agreement monitored

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on a portfolio basis. This system includes quarterly consolidated information on the Covered Asset Portfolio by property and asset type, sales activity and other changes to the portfolio, the status of required submissions (including the number of delinquent reports), litigation, assistance payments, consolidation and basic financial data on each institution. This will provide FDIC with the ability to perform peer group analyses concerning performance and compliance. It will allow FDIC to target, oversight and review.

See comments 4 and 7.

Revised asset plan and budget formats have been developed and training for FDIC staff, contractors and association asset managers has been conducted. The new formats are to be implemented on July 1, 1990 and October 1, 1990. Revised asset plans were developed to standardize formats to allow FDIC to review facts and make decisions efficiently. The revised plans are designed to provide a complete account of the asset and a detailed description of the asset disposition strategy. The revised plans emphasize an implementation plan which requires the asset manager to include specific steps and actions needed to achieve results. This will improve staff's ability to monitor progress against the plan.

These steps are critical to obtaining information needed to complete a comprehensive asset disposition strategy. Our Strategic Plan will also include preliminary targets in its goals and objectives. Generally, these will call for a $15 billion decrease in the covered asset portfolio by December 31, 1992. These disposition targets were identified to set basic expectations; they will be refined with management of assisted institutions. We still plan to have these documents to our Board of Directors by the end of this month.

II. Systems

See comment 10.

It is our view that automated systems are a tool not a solution in themselves and that development of useful systems requires a detailed understanding of business objectives. Significant progress has been made meeting both financial and management information needs of the Division of FSLIC Operations.

See comment 11.

A Task Force has been established to focus on additional resources on development of automated systems for DFO. This group has been meeting weekly since mid-March. The mission of the Task Force is to develop and implement a management information system that will be an effective resource in the management decision making process. The MIS Task Force has:

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Reviewed and identified computer software capabilities available to the FDIC for meeting the needs of the DFO;

Prioritized the computerization requirements of the DFO;

Identified previously developed systems for conversion to the FDIC mainframe;

Identified staff resources for training and development of DFO needs on available FDIC computerized systems; and

Initiated the process of defining the data requirements of the DFO from the perspectives of both operational needs and management reporting requirements. This effort is well underway.

The Strategic Plan recognizes these efforts and sets goals and objectives for completing implementation tasks.

Our PC-based system development has continued and is being supported pending completion of this MIS project. This includes:

See comment 9.

1) The Management Reporting/Performance Monitoring System provides aggregate information on the portfolios of covered assets held by assisted institutions, covered asset dispositions and other changes to the portfolios, the status of required submissions under the terms of the assistance agreements, financial assistance payments, litigation and consolidation information, and basic institution financial information. This system allows the monitoring of the financial performance of the acquiring institutions and their compliance with the requirements of the assistance agreements, including the submissions of plans and budgets. Performance measures include: submission compliance, covered asset management, staffing levels, and peer group analysis. The system was initially implemented with the agreements administered by Case Management Section II in February 1990. Since February, DFO has further refined the data submission schedule and reporting parameters of this system.

See comment 8.

2) The Covered Asset Management System will provide DFO with information on the inventory of covered assets held by assisted institutions, track approved plans and

budgets and any other required submissions. The target date for implementation of the Covered Assets Management System for Texas and Oklahoma associations is June 30, 1990.

It is envisioned that as these two PC-based systems are integrated into the DFO MIS they will be used by all sections of the Division. This will allow a uniform approach to the entire portfolio of cases.

It is also important to note that FRF assistance agreements have already been integrated into the FDIC's Financial Information System (FIS). This process automatically reflects payments in the general ledger for the FRF and is a major accomplishment.

III. Initial Inventory Audits

See comment 12.

The GAO draft report correctly identifies the need to complete the opening inventory audits related to the assistance agreements. Despite specific reports to your staff, however, the draft report ignores results of the special project team since February 1990. Significantly, of the 94 audits still to be finished, all but 9 are past the field work stage. Consequently, we confidently expect that all but 6 audits will be completed by June 30, 1990. These remaining 6 include audits which require extensive reconstruction of accounting records of certain acquired institutions. The specified status of the 94 open audits is as follows:

Audit Categorization

Status	No.
Field Work	09
Audit Report Draft	00
Audit Revisions	00
Acceptable Draft to Assn.	07
Resolution of Assn. Comments	03
Audit Report Revisions	18
Final Report Revisions	21
Final Report Review	36
Total	94

This progress has been achieved through employment of the dedicated project team, increased communication and involvement with contract audit firms and acquirers, and

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effective streamlining of the audit review process to incorporate concurrent reviews where possible.

We look forward to working with you to provide assistance in completing this report.

Sincerely,

Stanley J. Poling
Interim Director

bcc: Chairman Seidman
Gerald Stanton
Dennis Pittman

The following are GAO's comments on the Federal Deposit Insurance Corporation's letter dated May 18, 1990.

GAO Comments

1. At the May 15, 1990, meeting referred to, FDIC officials, including the interim director of FDIC's Division of FSLIC Operations who signed the comment letter, told us they felt the report: (1) repeated what we had said in earlier testimony; (2) reflected a misunderstanding of FDIC's present responsibilities, particularly those for managing the covered asset provisions, which may be subject to change as a result of an RTC study on ways to lower assistance agreement costs which will not be completed until later this year; and (3) did not reflect the tasks FDIC is faced with.

We agreed with the first point. Before this report was completed we had brought the matters which concerned us to FDIC's—and Congress'—attention by testifying because we believed corrective actions should be initiated as expeditiously as possible. The officials' second point is discussed in comment (2) below. With respect to their third point, the report addresses the enormity of tasks facing FDIC. This complexity of the challenge is the reason we believe management of the FSLIC assistance agreements should receive FDIC's full attention. See comment (2) below, also.

2. FDIC's comment that our report "implies that there is not a management process or an overall strategy for dealing with these transactions" is difficult to interpret. Our report clearly states our focus on the strategy and policy guidance available to those reviewing the asset disposition plans submitted by the assisted thrifts and the systems needed to track covered asset management and disposition. (GAO's audit in progress of the FSLIC Resolution Fund's financial statements will address the financial internal control structure.)

FDIC does not dispute the need for a strategic plan for covered assets and, as reflected in our report and its comments, has developed a draft strategic plan that includes principles, goals and guidance in this area. The report does not advocate a "strategic plan checklist approach," as described in the comments. It does call for establishment of milestones, which FDIC has now included in its draft strategic plan. (See p. 7.)

On page 2 of its letter, FDIC says that "it is critical to recognize that longer term strategy may be substantially affected by recommendations made as a result of the FIRREA mandated RTC review." We recognize that this RTC study, described on page 3 of our report, may have an impact on covered asset disposition issues. We believe, however, that an overall asset disposition strategy and guidelines are needed now.

3. FDIC is correct in saying that it has to manage over 200 individual contracts entered into by FSLIC. However, most of the covered assets—upwards of $50 billion—are accounted for by the 91 resolution transactions discussed in this report and 5 stabilizations entered into by FSLIC after January 1, 1988. (See pp. 1 and 4.) According to FDIC, there are about $700 million in covered assets outside these 96 agreements.

4. FDIC mentions "policy and procedures for both staff and for management of assisted institutions" that have "been developed in order to recognize the contractual obligations between FDIC and acquirers." The manuals referred to lay out the technical requirements of the agreements and detail the procedural requirements to guide acquirers and case managers through the submission and approval process for asset business plans and budgets. Neither these manuals nor the formats for submitting asset plans provide policy guidance and criteria to be used by FDIC officials when reviewing asset management and disposition submissions.

5. While the "concept" of the assistance agreements may "presume" that the acquiring institutions possess expertise in the management and disposition of troubled assets, we found no explicit statement in agency guidance that possession of such expertise was a prerequisite for being selected as a thrift acquirer by FSLIC. FDIC states that the acquiring institutions (referred to in this report as the assisted thrifts) have entered into contracts to manage and dispose of troubled (covered) assets "at minimum cost to the FSLIC Resolution Fund." We did not find such explicit language in any assistance agreements we reviewed.

The agreement language we saw is more general and is described on page 2 of our report. The agreements do, however, require the assisted thrifts to submit various covered asset plans and give FDIC the right to approve or disapprove these plans, as discussed in the report on page 2. Our concern, as expressed in the report, is with the lack of guidance containing criteria for approving and disapproving asset disposition plans.

6. We do not disagree with these general comments on the need to assess an assisted thrift's covered asset inventory. We also agree that knowledge of gain and loss sharing arrangements is indeed important and that

strategies can change over time. (The complex details of these arrangements for 12 assisted thrifts are described in our March 14, 1989, testimony, which is listed on page 36.)

7. The statement "FDIC has concluded that the appropriate strategy is to manage the process rather than focus on thousands of individual asset transactions" is difficult to interpret. FDIC's comments set forth in the preceding two paragraphs and the four paragraphs that follow indicate that it plans an extensive focus on individual covered assets. For example, FDIC says in the following paragraphs that it plans to review the assisted thrifts' asset disposition plans, gather data on all the covered assets and reporting requirements, and use a revised asset plan format that will provide a complete account of the asset and a description of the disposition strategy. We support this asset-based focus as a means to help manage the process.

8. This system is discussed on page 8 of our report. In response to FDIC's comment on pages 3, 5 and 6, it is important to note that the system is now planned for completion on June 30 of this year, not March 30 as previously planned, and will only be implemented in one region at that time.

9. We discussed the somewhat conflicting references in the comment letter to the system referred to as the Management Reporting/ Performance Monitoring System with FDIC officials. (Page 3 of the comment letter says that this system had been implemented in January 1990, but page 5 indicates that it was initially implemented in one region only as of February 1990 and that refinements are being made.) The officials advised us that the assistance agreements in one region only have been placed on this system.

10. FDIC agrees with our position that integrated management information systems are needed for asset management and disposition. It adds that such systems are a tool rather than a solution in themselves; we agree.

11. This task force is discussed on pages 8 and 9.

12. FDIC agrees that the initial inventory audits need to be completed and does not disagree that 133 of the 150 audits had yet to be completed as of March 31, 1990. We are pleased that FDIC added staff and emphasis to the initial inventory audit work in recent months. FDIC notes also that it has extended the completion date from May 30, 1990, to June 30, 1990,

and expects that all but six of the audits will be completed by then. (Subsequently, FDIC officials told us that this goal was met. See p. 11.)

Comments From the Office of Thrift Supervision

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

Office of Thrift Supervision
Department of the Treasury
1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6000

May 16, 1990

Mr. Richard L. Fogel
Assistant Comptroller General
GAO
441 G Street N.W., Suite 3858-C
Washington, DC 20548

Dear Mr. Fogel:

Thank you for providing a copy of the draft report, currently titled FAILED THRIFTS: Oversight of 1988 Deals Needs Improvement, to OTS for comments.

One of the primary objectives of this study is to assess the quality and effectiveness of OTS' monitoring of the assisted institutions' compliance with the terms of any forbearances. In this regard, the GAO concludes that most institutions complied with the terms of the forbearances and observes that in the few cases of noncompliance, appropriate supervisory responses have been initiated. The report does not make recommendations for corrective actions by OTS.

In addition to assessing the OTS' performance, this report also assesses the FDIC's FSLIC Division's management of the 91 assistance agreements and the assisted institutions' compliance with the specified reporting requirements. The GAO has made recommendations for improvement to the FDIC.

See comment 1.

As documented in this report, the OTS and the FDIC have distinctly different roles. Rather than blend the roles in a way that may lead an outside observer to conclude that significant recommendations have been made to OTS, a distinction should be made. Perhaps the easiest way would be to issue separate reports.

In addition to this conceptual modification, we have attached a schedule that details suggested edits. The purpose of these edits is to elaborate upon and to clarify the effect of FIRREA on OTS policies.

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See comment 2.

As you know, FIRREA gave the OTS the same statutory status as the other banking agencies vis-a-vis the GAO. Although the OTS did not need the full 30 days to comment on this report, it is quite likely that 30 days will be required for larger, more comprehensive audits.

Assuming that all of our comments and edits are incorporated into the final report, there is no reason to print them therein. We would appreciate copies prior to its release.

Sincerely,

Jonathan Fiechter

Jonathan Fiechter
Principal Senior Deputy Director

Schedule A

See comment 3.

p.20 The first two paragraphs are repetitive. Some consolidation may be appropriate.

See comment 4.

p.21 Change the first sentence of paragraph two to read:

> "As a result of FIRREA, capital and accounting forbearances granted in conjunction with the agreements, were superseded by the requirements and specified exception and exemption processes incorporated into the new law."

See comment 5.

Introduce the third sentence of paragraph two with "Accordingly."

See comment 6.

p.21 Change the second sentence of footnote seven to read:

> "The impact of FIRREA in eliminating previously granted capital forbearances and OTS' actions implementing the new FIRREA requirements are currently subject to legal challenge by several savings associations."

See comment 7.

p.22 Last sentence of the first paragraph. Change "receivership" to "conservatorship/receivership."

See comment 8.

p.22 Add a sentence to the first paragraph to the effect that:

> "In the interim, capital plans are not accepted which are dependent upon the continuation of these forbearances."

See comment 9.

p.22 The five assisted institutions referenced in the last sentence of the first paragraph which were not required to submit capital plans, have all come into capital compliance as of year-end. Appropriate modifications to the statistics in this paragraph should be made.

bcc: Director Ryan
Billy Wood
John Downey
Cathern Smith

The following are GAO's comments on the Office of Thrift Supervision's letter dated May 16, 1990.

GAO Comments

1. We do not agree with OTS that a separate report should be issued on its oversight of the assisted thrifts just because we were not suggesting any improvements in this area. Because the forbearances were granted in conjunction with the assistance agreements, we believe that our review of the oversight responsibilities of both OTS and FDIC is appropriately presented in one report.

2. OTS says that FIRREA gave the agency the same statutory status as the other banking agencies vis-a-vis GAO. OTS adds that although it did not need 30 days to comment on this report, it is quite likely that it will require 30 days for larger, more comprehensive audits. This procedural issue will be discussed with appropriate OTS personnel.

3. No change needed.

4. The issue of FIRREA's impact on previously granted capital forbearances is currently in litigation (see p. 12, footnote 7). It would therefore not be appropriate to adopt OTS' suggested language, which would require us to draw a conclusion on this issue.

5. We agree with OTS' suggestion and have inserted the suggested word.

6. Footnote 7, now on page 13, has been expanded to recognize that the effect of FIRREA's capital requirements on previously granted forbearances is one issue in litigation.

7. OTS had previously supplied documentation stating that this thrift was being placed into receivership. We have changed the sentence in accord with the new information provided in its comment letter.

8. We have added a sentence on page 12 saying that OTS has advised us that capital plans are not accepted which are dependent upon the continuation of previously granted forbearances.

9. We have added a sentence on page 12 stating that OTS informed us that the five thrifts subsequently achieved compliance with the new capital requirements.

Major Contributors to This Report

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Related GAO Products

Thrift Crisis: Strategic Plan for Resolution Trust Corporation and Management of FSLIC Deals (GAO/T-GGD-90-14, Jan. 25, 1990).

Failed Thrifts: GAO's Analysis of Bank Board 1988 Deals (GAO/T-GGD-89-11, Mar. 14, 1989).

Failed Thrifts: Bank Board's 1988 Texas Resolutions (GAO/GGD-89-59, Mar. 11, 1989).

Resolving Texas Thrift Problems (GAO/T-GGD-89-10, Mar. 11, 1989).

Resolving the Savings and Loan Crisis (GAO/T-GGD-89-7, Feb. 22, 1989).

Troubled Financial Institutions: Solutions to the Thrift Industry Problem (GAO/GGD-89-47, Feb. 21, 1989).

Resolving the Savings and Loan Crisis (GAO/T-GGD-89-4, Feb. 2, 1989).

Resolving the Savings and Loan Crisis (GAO/T-GGD-89-3, Jan. 26, 1989).

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