

Lessons from the Home Owners' Loan Corporation and The Resolution Trust Corporation

Each financial crisis is of course unique. It would be simplistic to suggest the federal government reconstitute the RTC or HOLC. The RTC and HOLC do, however, offer successful examples of government agencies taking on new responsibilities similar to those presently at hand. By considering their stories—their administrative strengths and shortcomings—we identify 10 organizational features and capabilities that facilitated success and timely liquidation. These features warrant consideration in 2009.

Lesson One: A temporary, dedicated administrative entity was key.

The HOLC and RTC were both government corporations, though some other type of administrative entity could be equally effective. In each case, a single administrative entity proved a key organizational feature for several reasons. First, using an entity dedicated to the resolution task facilitated focusing on that task and developing the remaining organizational capacities we highlight in its service. Secondly, the arrangement was efficient by virtue of concentrating resources—expertise and money—within a single organization rather than distributing them thinly across multiple agencies. Third, each entity was effective due in large measure to centralized, coherent policy direction, even though implementation was decentralized. Finally, a single entity in each case facilitated accountability. Congress knew whom to ask for answers.

In the case of the TARP, which includes two very different kinds of programmatic charges, the clear focus characteristic of HOLC and RTC would require two separate administrative entities:

- **Entity One:** dedicated to dealing with financial institutions' asset problems

- **Entity Two:** focused on assisting home owners through mortgage modifications

Lesson Two: Clear formulation of the critical task is crucial.

James Q. Wilson, longtime dean of public administration scholars, views an organization's critical task as "those behaviors which, if successfully performed ... enable the organization to manage its critical environmental problem" (1989, p. 25). Critical tasks are not goals or even mandates, which may be vague and inconsistent. Instead, the critical task is what an organization needs to do to cope with the complexities and challenges of its environment. When the definition of the critical task is widely accepted, it becomes the mission of the organization.

The HOLC quickly came to view its critical task as helping distressed homeowners while minimizing taxpayers' risk. Successfully straddling the horns of that dilemma took time, thus HOLC's eighteen-year life. RTC, on the other hand, viewed its critical task as the resolution of failed thrift institutions and sale of their assets as quickly as possible. RTC closed up shop after just five and a half years.

Lesson Three: Autonomy and discretion are needed in performing critical tasks.

Once a crisis resolution entity identifies its critical task, it must be free from micromanagement. That does not mean undermining public accountability. Instead, permitting an organization autonomy and discretion recognizes that it is only in implementing the task in the field that relevant aspects of the environment become clear, and how to perform the task given that environment.

Both HOLC and RTC developed understandings of how to deal with the problems assigned to them that varied at the margins from what Congress initially foresaw. Both agencies explained themselves to Congress repeatedly throughout their lifetimes, and Congress typically supported them with leeway to reframe the task and additional money.

Lesson Four: Flexibility to adapt in the field is essential.

In addition to autonomy and discretion, an entity charged with implementing crisis resolution responsibilities needs the related capacity to be flexible, both in how it does its job and in how it is organized to do the job. Flexibility in performing the critical task means being able to change tactics in response to environmental changes and new information. Indeed, one should expect that such shifts will be necessary. Unanticipated at the outset, HOLC found that new loans to homeowners required intensive hands-on servicing to avoid defaulting again, and even so, found itself managing foreclosed houses across the U.S.

RTC too, unexpectedly found itself with a large inventory of real assets throughout the country which required management and sale. Along with implementation tactics, the organizational structure of the entity has to be flexible. As their tactics shifted, HOLC and RTC articulated a more decentralized implementation structure than originally anticipated. The critical task should drive the organizational structure, not the other way around.

Lesson Five: The temporary administrative entities must understand and be responsive to market conditions.

Like the RTC and HOLC's critical tasks, TARP initiatives require government to operate and intervene in private markets, while avoiding harm to markets and not replacing them. This is tricky business: if markets were not in disarray, the organization would not exist. Moreover, what works in one locale may do harm in another, and what benefits stakeholders in a financial institution with global, national or super-regional interests may damage the interests of locally-focused financial institutions. Accordingly, administrative policymakers must understand how national, regional and local markets operate and how the organization's actions affect those markets.

HOLC and RTC both consciously walked this tight-rope; maintaining balance required decentralized implementation and centralized policy direction.

Lesson Six: Government must have the expertise to hit the ground running in responding to a financial crisis.

The TARP, like the HOLC and RTC, was created in a crisis environment. As in the cases of HOLC and RTC, there is increasing consensus that government lacks adequate in-house human resources to implement the new responsibilities. Direct hires from the private sector and private contractors are thus essential to timely performance of the critical task. The HOLC and RTC used both approaches to harness private expertise. Areas where contractors' expertise can be particularly important are in law, auditing, asset management, asset appraisals, and housing finance.

Lesson Seven: Government must have the ability to effectively monitor and manage contractors.

Capacity to effectively manage contractors and monitor private partners in implementation rises in importance with every dollar spent on external private support. In HOLC, appraisal practice was a key to effectively assisting homeowners, supporting markets, and protecting taxpayers. While HOLC hired an army of contract appraisers who knew local markets, the valuation method was developed by HOLC, contractors were trained by HOLC, and contractors' reports were reviewed by HOLC employees.

HOLC's advancements to appraisal practice set the standard in the U.S. for decades. RTC, on the other hand, suffered challenges to its legitimacy as contractors hired subcontractors, and important valuation and disposition decisions were made without review or standardized documentation.

Thus, given the large role contractors will likely play in implementing the new responsibilities, it is essential that a new resolution entity be able to oversee and manage the performance and payment of contractors. *Subcontracting public authority* should be avoided. In practice this means having enough public sector employees with the necessary expertise to effectively manage contractors, even if the organization has to hire and train them. Secondly, given the

scale of the need for contractors, an information technology system must be in place to effectively monitor the hiring and performance of contractors.

Lesson Eight: Government must have sufficient financial and personnel resources to complete the task.

Public entities charged with implementing the new financial institution-focused and home owner assistance-focused responsibilities must have the financial and human resources to carry out the critical tasks. Without adequate financial resources to finish the job, government is likely to be ineffective and may be diverted from the critical task. Uncertainty about adequate funding, for example, delayed resolutions in the RTC and made planning within the RTC difficult. Without adequate in-house personnel, contractors and private financial stakeholders will define the critical task in terms of their own values. Private firms' understandings of the critical task are likely to result in:

- doing the job in a way that costs more than if an entity with taxpayers' interests uppermost drives implementation decisions, and
- short term solutions that do not last.

Lesson Nine: Government must have exit strategies.

The agencies must adopt strategies to ensure they will work themselves out of a job. At the same time there is a trade-off between the risk that an organization established to address a crisis becomes entrenched, and the risk that the entity dissolves itself too rapidly to ensure that its impact is lasting and taxpayers are fairly treated. Mandated by Congress to wind down rapidly, RTC successfully resolved the S&L crisis, but at significant taxpayer cost. Without a specific sunset date, HOLC resisted pressure from some quarters to liquidate until it had ensured stability for its borrowers over the long haul, and earned enough money on its assets to about break even for taxpayers.

Lesson Ten: There must be clear and transparent oversight.

Finally, administrative entities charged with implementing the TARP must be governed by clear, transparent oversight structures. Clarity requires that a single governing oversight board have authority over each entity's budget and policy direction. HOLC

reported to the old Federal Home Loan Bank Board. The clear line of accountability, coupled with the substantive expertise of the Board in housing finance, supported HOLC's legitimacy. RTC, on the other hand, struggled to establish clear oversight structures, and its ability to oversee the actions of a largely private-sector work force was hampered by the absence of an effective information technology system to track assets and employees. Transparency requires establishment of an information technology data collection system to track the actions taken by public employees and private contractors, along with regular audits and reporting by the Inspector General and Government Accountability Office.