

Case Study Two: The Resolution Trust Corporation

As President Franklin D. Roosevelt had moved early in his tenure to address home mortgage foreclosures, President George H. W. Bush introduced legislation to strengthen regulation and clean up the thrift industry just two weeks after he took the oath of office. Six months later, on August 9, 1989, he signed the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA). In addition to restructuring the savings and loan industry, FIRREA created a new public-private hybrid entity known as the Resolution Trust Corporation (RTC). Congress and the president created the RTC to take over, manage, and ultimately transfer back to the private sector, failing savings and loan institutions (S&Ls) and their assets.

In a parallel to the HOLC, by the time the RTC was created to tackle the “mess” assigned to it, the S&L industry had been on shaky ground for several years. Beginning in the 1970s, savings and loans took on significant risk that resulted in a rising tide of bankruptcies. The erosion of the housing finance industry threatened the public’s confidence in other sectors of the economy. At the same time, the fed-

eral government’s deposit insurance program for S&Ls (Federal Savings and Loan Insurance Corporation, commonly known as FSLIC) created a significant potential liability for taxpayers. The policy practiced during this period had been forbearance, allowing troubled thrifts to continue by injecting them with capital in the hope that markets would improve (DeGennaro and Thomson 1992; Rom 1996). But in 1989, after one-third of the S&L industry—or 526 savings and loan institutions—had become insolvent and many more were in trouble, the administration and Congress decided that postponing action in the hope that things would improve was no longer an option (Congressional Budget Office, 1993).

The financial crisis in the late 1980s parallels the present banking crisis in several ways. Then, as now, financial institutions were failing because the assets on their books could no longer be trusted, threatening the solvency of financial institutions. And, like the present crisis, there was great uncertainty about the future. How many more thrifts would collapse?

At a Glance The Resolution Trust Corporation

Authorizing legislation:	Financial Institutions Reform, Recovery and Enforcement Act (FIRREA)
Start date:	August 9, 1989
Liquidation date:	December 31, 1995
Number of resolutions:	747
Book value of assets divested:	\$458.5 billion (unadjusted)
Number of depositor accounts protected:	25 million
Total direct and indirect costs of resolving thrift crisis:	\$160 billion (unadjusted)

Sources: Thrift Depositor Protection and Resolution Trust Corporation, 1996; GAO 1996.

Would the problems spread to other types of financial institutions? No one had a clear answer and thus a consensus around what should be done to resolve the crisis was missing in the late 1980s, just as it is today. In light of the uncertainty and lack of consensus, lawmakers pursued a range of solutions that often reflected ideological or partisan differences. And yet, fear that the financial crisis could explode even further was as real in the 1980s as it is today. Staying put and practicing forbearance was not an option. Policy-makers faced the “what should be done” question.

How did policymakers and the RTC understand the problem?

Unlike the one goal that Congress assigned to the HOLC in the Home Owners’ Loan Act, in FIRREA, Congress charged the RTC with a diverse set of mandates that reflected a lack of consensus for how to address the crisis and the diverse interests at stake in the resolution process. In addition to the central goal of stemming the tide of failed thrifts, the RTC was assigned the following responsibilities:

- Manage and prepare thrift institutions for resolution expeditiously
- Maximize the net present return from the sale of troubled thrifts and their assets
- Minimize the losses of these transactions to the government
- Protect local real estate markets by not selling assets below 95 percent of their book value
- Maximize the availability and affordability of homes for low- and moderate-income individuals
- Maximize the opportunity for minority- and women-owned businesses (MWOBs) to participate as contractors, buyers of institutions, and purchasers of assets

Congress thus directed the RTC to pursue a range of economic and social mandates that were somewhat vague (e.g., maximizing the availability and affordability of homes) and at times conflicted with one another (e.g., maximizing net present return while at the same time resolving institutions and assets expeditiously). But like the HOLC, the RTC was given little guidance for how to implement or prioritize the mandates. Instead, it was left up to the RTC to reconcile the conflicting mandates and develop a mission.

Almost five months after FIRREA was enacted, on December 31, 1989, the RTC issued its strategic plan specifying the corporation’s mission and the objective it would use to implement its mission. The mission included three goals:

- Maximize return and minimize loss
- Minimize the impact on local real estate and financial markets
- Assure that housing remained available and affordable for low and moderate income individuals

The strategic plan also laid out a set of objectives for resolving failed thrifts and disposing of assets. (See RTC Objectives box.)

Taken together, the mission and objectives indicate how the RTC understood FIRREA. The RTC would pursue its charge by taking over troubled thrifts, managing them in ways that preserved their value, and then transferring to the private sector the transformed thrifts and their assets as quickly as possible. In the process, the corporation would seek to shield local real estate and financial markets from “dumping” assets by establishing minimum values and, where possible and efficient, the corporation would rely on contracting and private sector expertise to implement its policies.

Like the HOLC, the experience of the RTC illustrates how important it is for an organization to have *the capacity to develop a mission* that, while informed by its authorizing legislation, is determined by the organization itself. The RTC’s experience also underscores the importance of *clear and consistent congressional mandates*. Lacking consensus for how to solve the S&L crisis, it is understandable that a legislative body, answerable to a range of constituents, would ask an organization to pursue a range of mandates. And yet, the RTC’s experience suggests that a clear and consistent signal from Congress, while difficult given the legislative process, enhances the capacity of the organization to deliver what lawmakers want.

What was the legal structure of the RTC?

FIRREA created the RTC as a mixed-ownership government corporation. And, like the HOLC, the RTC’s

RTC Objectives

The objectives for *resolving* thrifts included:

- operating thrifts placed under the RTC's conservatorship in a conservative manner (e.g., stop risky lending),
- giving priority to resolving the 'worst-case' thrifts,
- selecting the least-cost resolution method on a case-by-case basis,
- developing an open and fair bidding process for selling institutions,
- establishing computer systems and recordkeeping for oversight and public information, and
- using private sector entities for the management and disposition of institutions under RTC control (to the extent practicable and efficient).

The objectives for *disposing* of assets included:

- maximizing the net present value of recoveries,
- placing assets under private control for management and disposition to the extent practicable and efficient,
- minimizing the impact of RTC transactions by expeditiously disposing of assets at fair market value while keeping market participants informed, and
- documenting activities related to the management and disposition of assets.

legal identity as a corporation exempted the corporation from civil service and procurement rules. In 1995, the GAO surveyed the RTC to determine which of 15 statutes the corporation believed it was subject to. The RTC reported that it was subject to three of 15 statutes listed by the GAO, partially subject to five others, and not subject at all to the remaining seven statutes (Davison 2005, Fn48). While criticized by some as giving the corporation too much discretion, the legal identity enabled the RTC to solve several difficult administrative problems.

For example, the need to "hit the ground running" meant that the corporation had to staff up quickly. Thousands of new employees needed to be hired and deployed in regional offices around the country. Exemption from civil service rules gave the corporation the *capacity to hire quickly*. At the same time,

the RTC (like the HOLC) was conceived from the start as a temporary entity. FIRREA specified the corporation shut its doors by December 31, 1996. Thus, it needed the ability to not only hire quickly but also the *capacity to wind the corporation down quickly* as the RTC reduced its inventory.

The RTC confronted another problem related to personnel, namely, the *capacity to hire highly qualified and experienced employees*. The crisis demanded the corporation hire individuals who came to the organization with the skills to resolve thrifts and their assets. There was little time for training and socialization in the classic bureaucratic sense. As a government corporation, the RTC could craft compensation packages outside of the traditional government grade system, allowing the corporation to recruit top talent as limited term employees directly into the RTC. The compensation tools also enabled the corporation to tackle the unique problem of motivating employees to work themselves out of a job. If the RTC was to be a temporary entity, it needed to have *the capacity to craft compensation systems that aligned the incentives of the employees with those of the organization*. In practice this meant the ability to use bonuses to reward employees for actions consistent with the goal of resolving institutions and assets quickly.

The RTC's legal identity as a hybrid public/private entity insulated it from a set of private and public sector controls. This too was the subject of criticism, but it gave the corporation *the capacity to act decisively in the context of great uncertainty and public scrutiny*. The RTC was asked to do something no organization (public or private) had ever done on such a scale. Moreover, it was asked to implement its charge with little planning or preparation. Mistakes would inevitably be made, particularly given the sorry state of many of the thrifts' balance sheets. The corporation was also under a media and congressional microscope. Under such a scenario, it would have been understandable (even predictable) for RTC agents to exercise extreme caution and deliberation, to take action only after all contingencies were taken into account. Such a deliberate approach would have slowed the process down and kept the corporation in business indefinitely. And FIRREA made clear that Congress wanted the RTC to act expeditiously to resolve failing thrifts and their assets. It was thus the legal structure that insulated the corporation, shielding it from some traditional

forms of control and giving the bureaucratic space to act deliberately while accepting that mistakes would be made.

How was the RTC funded?

Funding the RTC contrasts sharply with the HOLC story. While the HOLC received adequate resources in a transparent and straightforward way, the RTC's funding was characterized by:

- a complicated system in which funds were allocated from multiple sources, only some of which were recognized in the federal budget; and
- contentious congressional battles prompted by pleas from the RTC to Congress for additional resources.

The system that funded the RTC was the product of compromise between a Democratic-controlled Congress and a Republican administration (Davison 2006a and 2006b). The politics of the funding system were further complicated by the Gramm-Rudman-Hollings (GRH) deficit reduction law. GRH set limits on the deficit and mandated spending cuts if the budget exceeded those deficit limits.

The Bush administration plan, proposed by Treasury Secretary Nicholas Brady, was to provide the RTC with \$50 billion. The funds would be raised through the sale of bonds by another government corporation known as the Resolution Funding Corporation (RefCorp). Using RefCorp as a funding vehicle would keep the cost of the resolution off-budget and thus avoid invoking the GRH deficit limits.

Democrats in Congress opposed this approach and preferred that the funds come from the Treasury Department and be reflected in the budget. Their reasoning was three-fold. First, pushing for on-budget financing was a way to embarrass the Bush administration. Second, RefCorp bonds would carry a higher interest rate than Treasury bonds and Democrats argued correctly that using RefCorp as the funding vehicle would unnecessarily increase the cost of the resolution. And finally, opponents of the Bush plan saw it as a dangerous precedent that would encourage future administrations to avoid budget targets.

The battle over the RTC's funding mechanism was extremely contentious and yielded a complicated

compromise. The RTC would receive \$50 billion in funding, of which \$18.8 billion came from Treasury on-budget borrowing for the current year, 1989. Because it was registered for the current fiscal year, the Treasury's outlay avoided triggering GRH. The remaining \$31.2 billion would be off-budget and come from two sources: \$30 billion would be raised by issuing bonds through RefCorp, and an additional \$1.2 billion would be covered by the Federal Home Loan Bank's retained earnings (the "pound of flesh" extracted from the FHLBanks for the S&L debacle). Later in separate legislation, Congress allowed the RTC to borrow funds directly from Treasury (the Federal Financing Bank) to cover the corporation's administrative and operational costs known as "working capital." Thus, the RTC was funded by at least four different mechanisms. In addition to a complicated funding system, the RTC suffered from inadequate resources to implement its charge.

At the start of the resolution process, the administration estimated that the resolution of failed thrifts would cost \$50 billion. The estimate was flawed in two important respects. First, it severely underestimated the size of the thrift losses including the amount needed to finish paying for losses incurred by FSLIC. And second, the cost estimate only calculated losses in terms of the difference between the amount the government would need to fulfill its guarantee for insured deposits and the net amount it would recover from disposing of assets. Missing from the administration's calculation of costs was "working capital," the administrative costs associated with carrying out the resolution operation which included holding, maintaining, and servicing assets prior to their sale. FIRREA lacked a mechanism for raising working capital.

As a result, the RTC was consistently underfunded and a pattern was established early on. Faced with delaying the resolution process because of a lack of funds, the corporation appeared before Congress to ask for additional funds to continue operating. A battle would ensue between the administration and enraged Congressional Democrats who were upset over being asked to again fund the RTC. Democrats used the funding requests as opportunities to embarrass the administration and draw attention to (often very real) managerial problems within the RTC. Ultimately, Congress would approve additional

funds, though not enough to complete the job. In exchange, Congress would extract managerial reforms from the corporation. Lacking sufficient funds, the RTC would be forced to appear before Congress again and the pattern would repeat itself.

After the initial \$50 billion in FIRREA, Congress approved another \$30 billion in additional funds through the RTC Funding Act passed in March 1991. Eight months later, in November 1991, Congress passed the RTC Refinancing, Restructuring and Improvement Act that made an additional \$25 billion in loss funds available to the RTC, but required the corporation to use the money by April 1, 1992. The RTC could not spend all of the money by April 1, so the corporation needed to request additional resources or have the deadline removed. Congress refused to approve additional funds and the RTC nearly stopped all resolution operation in the third quarter of 1992. Finally in 1993, Congress passed the RTC Completion Act that appropriated an additional \$18.3 billion for the RTC: the first \$10 billion was made immediately available to the RTC and an additional \$8.3 billion would be available only after the Treasury secretary certified that statutory management reforms had been implemented. Beyond these legislative loss authorizations, the RTC was also allowed to borrow up to \$125 billion (later increased to \$160 billion) from the Federal Financing Bank to cover working capital.

The RTC's experience with funding underscores the importance of adequate funding. FIRREA should have included a mechanism to raise working capital to cover the operation of the organization and manage the resolutions. A clear lesson from the experience is that an organization charged with such an important task should be given the resources to administer the job. Underestimating thrift losses by the administration and the unwillingness of Congress to make an open-ended commitment to cover the losses are both understandable.

The \$50 billion loss estimate in 1989 was based on a moving target. It was difficult to predict at that time how large the thrift losses would become. From Congress' perspective, it was precisely because the overall losses were unknown that members (and Democrats in particular) were unwilling to give the corporation discretion to spend without checks. Yet, the lesson is that while funding requests gave

Congress leverage over the corporation, the delays in funding delayed the resolution process and likely increased its cost.

Where was the RTC located in the government and how was it governed?

A web of institutions governed the RTC. And as with its funding mechanism, political compromise, rather than administrative planning, helps to explain why arrangements were complicated. The president initially proposed a three member Oversight Board, consisting of the secretary of the Treasury, the attorney general, and the chairman of the Federal Reserve Board. The board would have broad powers to govern all aspects of the RTC's activity. The administration also proposed that the FDIC serve as the RTC's primary manager. The rationale for the plan was relatively simple: the RTC was going to cost taxpayers significant sums of money and the administration wanted to keep the corporation on a tight leash. The plan met with immediate opposition.

The GAO questioned whether a board, consisting of the heads of major agencies, could effectively oversee the operation of RTC's resolution activity. The FDIC was also highly critical of the proposal since the plan gave the FDIC all the operational responsibility but none of the authority. The tension over FDIC's responsibility and authority as RTC manager would remain a consistent theme during much of the RTC's existence.

The compromise that came out of Congress as part of FIRREA was a two-board governing structure. Congress established a five-member Oversight Board that resembled the president's initial plan. It included the Treasury secretary as chair and the chairman of the Federal Reserve, but replaced the attorney general with the secretary of Housing and Urban Development and added two additional independent members to be selected by the president and confirmed by the Congress. The Oversight Board was charged with providing the RTC with broad policy guidance, budgets, direction and ensuring oversight and accountability. Noticeably absent from the Oversight Board was the FDIC chairman.

Beneath the Oversight Board was a Board of Directors (also known as the RTC Board). The Board

of Directors was responsible for the day-to-day operations of the corporation. It was charged with approving the RTC organizational structure, approving and submitting funding requests and staffing recommendations to the Oversight Board, authorizing staff to enter into thrifts, and approving policies and guidelines for RTC operations. The RTC Board was identical to the Federal Deposit Insurance Corporation Board of Directors, and de facto made the FDIC the primary manager of the RTC. A chief executive director of the RTC was appointed by the RTC Board to implement the decisions. Thus the line of command went up from the executive director, who reported to the RTC Board which, in turn, reported to the Oversight Board. In addition, the RTC was also governed by several advisory boards. FIRREA established six regional advisory boards to advise the corporation on asset disposition policies.

In inventing this byzantine structure, Congress sought to:

- reduce some of the administration's power over the RTC,
- clarify the responsibilities and authorities of the FDIC and the Oversight Board, and
- increase the legitimacy of the RTC by expanding the number of actors that oversaw the corporation.

The two-board structure, however, created more confusion than clarity. At its core, a major problem centered on the tension between the Department of Treasury's desire to closely oversee the corporation, and FDIC's desire to exercise the authority and discretion it felt it needed to manage the RTC. First, the governing structure separated planning and decision making from operations. The RTC board (FDIC Board) was charged with administering the clean-up operation, but could not participate in strategic planning of how to conduct it. The chair of the RTC Board, after all, was missing from the Oversight Board. Second, the RTC board had little budgetary control over its operation. FIRREA and subsequent legislation funded the RTC, but the RTC Board had to go to the Oversight Board for funds that Congress approved. This reduced the RTC's capacity to quickly respond as the situation on the ground changed. Resolutions were held up, for example, as the RTC Board waited for approval from the Oversight Board for funding. Finally, the governance structure required the RTC to

effectively be responsible to four agencies (Treasury, HUD, the Federal Reserve, the FDIC), a set of advisory boards, and Congress. The multitude of formal principals increased confusion in the RTC and undermined communication between executives, managers and staff (Seidman 1993; Kettl 1991).

Over time, Congress took steps to address many of the governance problems. The RTC Refinancing, Restructuring, and Improvement Act of 1991 (P.L. 102-233) replaced the Oversight Board with a more limited and less intrusive Thrift Depositor Protection Oversight Board (TDPO), which included the secretary of the Treasury and the chairman of the Federal Reserve Board, but not the secretary of Housing and Urban Development. The law also removed the FDIC board from its role as the RTC's board. The RTC's Chief Executive Officer now reported to the TDPO and indeed, was a member of the TDPO, which improved communication and eased tensions between Treasury and the FDIC.

The experience with RTC's governance structure underscores two points. First, managerial structures matter and where possible, those charged with the operation of the corporation (in this case the FDIC) should also have a formal role in governing it. Second, to the extent that governing structures were a problem, they point to an inherent tension that exists with agencies designed to operate with discretion while using significant taxpayer dollars.

How did the RTC do its job and what types of expertise were tapped?

The RTC confronted a difficult set of problems. If a thrift failed, the government was forced to pay out depositors—up to \$100,000 each—or transfer their accounts to a new institution that purchased the failed thrift. The government then had to recoup some of the lost funds by selling thrift assets, but was forced to share the proceeds with the institution's uninsured creditors.

While FIRREA gave the corporation a set of general mandates, the RTC figured out—in light of these constraints—which congressional mandates to give priority and which to deemphasize. The mandates given priority became the RTC's critical task. In

short, the practical challenges were similar to those confronting the Obama administration in the current crisis, namely, negotiating the concerns of depositors, creditors, and the taxpayer.

Aspects of the job (functions)

The RTC divided its task into three separate stages:

- **Conservatorship**, in which the institutions were taken over, managed and downsized by the RTC
- **Resolution**, in which institutions were sold
- **Receivership**, in which assets that remained after resolution were managed and ultimately sold in bulk

Conservatorship. In the first stage, the Office of Thrift Supervision (OTS) or a state regulator declared a thrift to be insolvent or operating in an unsafe and unsound manner. The OTS or state regulator designated the thrift to be taken over and placed in conservatorship, and assigned the RTC to be administrator of the conservatorship. Such operations were akin to financial SWAT teams comprised of CPAs who descended on troubled thrifts late on Friday afternoons. The stealth operations were designed to prevent runs by depositors and prevent thrift employees from stealing or destroying financial records. In conservatorship, the RTC replaced the management of the failed thrift with a new team headed by a Managing Agent.

The new management teams audited thrifts to determine what assets and liabilities existed, their value, and whether the legal documentation underlying the accounts and holdings was in order. At the same time the goals of the new management were to:

- keep thrifts open for business to assure depositors and maintain as much value in the thrift as possible; and
- implement a plan to downsize the institution and prepare it for purchase.

A large number of assets were taken off the RTC's books in the conservatorship program through asset sales, markdowns and discounting; and allowing assets such as securities to mature.

The RTC's conservatorship operations were complicated by several factors. First, many of the institu-

tions were large, complex financial entities, and due-diligence audits were often hampered by poor recordkeeping and missing documentation. Second, the RTC often needed the original managers of the failed thrift to aid government agents in sorting out the complicated web of business operations. Yet, these same managers were often quite hostile toward the government takeover and, in some cases, were responsible for the very activities that brought down the thrift. And finally, audits required that the assets on the books of thrifts be valued. However, book value (value on the thrifts' books) was typically over-stated, and with no market for many of the assets, valuation was difficult. The RTC estimated the value of particular assets using historic recovery rates for various categories. This made asset values highly uncertain.

Significant managerial and technical expertise was required to implement the conservatorship stage of the resolution process. The FDIC had some capacity given its history of taking over failed banks. However the size, complexity and the sheer number of failed thrifts forced the FDIC to rely on private sector hires to manage the consolidation of the conservatorship operations, conduct due-diligence audits and appraisals, and manage and sell assets.

Resolution. After thrifts had been audited and placed under new management, the RTC chose a method for resolving the institution by estimating the cost of the various resolution options and choosing the option determined to be least costly to the taxpayer. Resolution occurred after the government satisfied the claims of insured depositors either by transferring deposits to another institution or paying out depositors' claims. The corporation typically had several options.

One resolution option was to sell the thrifts as whole entities: the buyer would purchase and assume ownership (P&A) of some or all of the assets, liabilities, and the franchise. Each part of the thrift had potential value. The assets included real estate, mortgages, and financial assets. Liabilities included a base of depositors or customers that had value. And the franchise itself had potential value in terms of its charter, network of branches, name recognition, and depositor loyalty. Under a P&A, the RTC paid buyers of the failed thrift the difference in value between the assets purchased and the liabilities assumed. One type of

P&A resolution is the “whole bank” sale, in which the acquirer purchases all assets and liabilities.

Liquidation was an alternative resolution method to P&A. If the RTC believed it would have to take too great a discount on the assets to conduct a P&A, the corporation could close the institution down, pay off depositors, and dispose of assets later. The costs of an Insured Deposit Payout (“IDP”) or Insured Deposit Transfer (“IDT”) approach are immediate and severe since depositors are paid out immediately, franchise value is lost, and any money recovered through the sale occurs later. Alternatively, the RTC could auction the deposits and some of the franchise. The institution would still be closed but the RTC would capture some of the franchise value and value associated with deposits. In short, the RTC was forced to compare the costs of three different alternative forms of resolutions: P&A, IDP, and IDT.

The RTC’s initial resolution method of choice was “whole banks” which had historically been used by the FDIC and FSLIC. The short-term costs of such a strategy are high since the government is forced to cover the full value of the deposit liabilities and take a discount on the institution’s assets. The method, however, captures the value of the franchise and, in theory, minimizes the time assets and liabilities sit in government hands. Whole bank sales, however, proved unsuccessful. There was little interest in the failed thrifts, particularly if it meant purchasing assets of uncertain value. As a result, the RTC was forced to accept a more limited form of P&A in which only some of the assets were transferred to the buyers, leaving the corporation with the remaining (typically more troubled) assets. To address the concerns of buyers and increase assets sold as part of the resolution, the RTC developed a “put option” in March 1990 that gave buyers the right to return assets six to 18 months after purchase at full book value. While criticized by some, the “put” program is an example of the RTC responding relatively quickly with a new program as their assumptions about the value of thrift institution assets changed.

Resolutions required expertise in assessing the resolution options, marketing the institutions, and selling the institutions—typically through some type of auction. Just as investors and the federal government today struggle to value the assets held by banks, the problem of asset valuation for the RTC was enor-

mous. Poor record keeping and a lack of markets for many of the assets compounded the problem. The RTC faced two additional hurdles. FIRREA required that the assets not sell below 95 percent of their book value. This put pressure on the corporation to determine a value for the asset even when there was no market. And second, the RTC and Congress were acutely aware that delays in resolving thrifts and selling assets would be costly because franchises and assets would deteriorate in value, and depositors would close their accounts. For these reasons, the RTC ended up keeping most of the assets of thrift institutions regardless of what type of resolution was conducted forcing a final stage (GAO 1992).

Receivership. Upon resolution, an old thrift and its legal obligations were transferred to a receivership, which was to maintain and dispose of remaining assets, while reconciling remaining claims against the thrift. Proceeds from the sale of assets were used to pay off the claims of creditors, including the RTC, and to cover costs of receivership.

The enormity of the receivership function largely caught the RTC off guard. The corporation had assumed that it could transfer most of the failed thrift assets to the private sector in conservatorship and through the resolution process. Yet, even with the “put” option, most of the assets stayed with the RTC after resolution. This outcome presents an obvious parallel with HOLC, which found itself in possession of residential real estate—a quarter-million homes—located across the United States. Reasons for this unexpected outcome provide parallels with factors in the current crisis.

First, by definition, failed thrifts typically held troubled assets: this is why they were insolvent. These included a high percentage of delinquent loans and real estate that had lost value. Thrift managers compounded the problem by selling off the best assets just prior to and during conservatorship as a way to consolidate. Second, the government faced depressed market conditions (few buyers) and high information costs associated with due diligence. This is similar to the current financial crisis as banks and investors attempt to determine the value of assets where no markets exist. And finally, interested buyers of the assets knew that if they waited until the assets were placed in receivership, they could receive a better price.

The volume of assets in receivership forced the RTC to adjust its asset disposition strategy and to enhance its capacity as an asset manager. Initially, the RTC sought to dispose of assets by retailing them directly to buyers. Bids were solicited for each asset and it was sold to the highest bidder. The disadvantage of this approach quickly became apparent. An army of staff would be needed to provide information to each potential buyer, market each asset, and conduct the auctions. It was simply not feasible. The RTC responded to the challenge by developing a whole set of sales options: sell large quantities of assets to a handful of buyers through bulk sales; pool large numbers of assets and turn them over to private contractors to market on consignment; and securitize real assets. Although these practices were often criticized by the GAO and others for underselling the assets, wholesale disposition of assets was an important innovation that enabled the RTC to reduce its holding of poor quality assets quickly. As the HOLC before it had provided financing to purchasers of its foreclosures, the RTC developed a seller-financing program in December 1990. This served to increase the pace of the asset sales and broaden the market of potential buyers.

In addition to driving major modification in its asset disposition strategy, the unexpected quantity of assets in receivership challenged the RTC to develop its asset management capacity in ways it never expected. By the end of 1990, \$8 billion worth of assets were in receivership; a year later, it was \$60 billion worth; and in 1992, the corporation had \$83 billion in assets in receivership. The bulk of these assets were poorly performing loans, and residential and commercial real estate. These had to be managed before sale to prevent further decline in value. The poor state of the documentation underlying the assets made managing them particularly daunting and time consuming. While much of the RTC staff, particularly in regional offices, was devoted to managing assets, the reality was that the corporation also needed contractors.

Under the contracting plans, RTC asset specialists in regional offices pooled large numbers of assets by type and placed them into a portfolio. Real estate assets were divided into categories such as single-family homes and retail properties. Loans were further subdivided by categories according to the underlying collateral. Once they were organized by type, RTC's management reviewed and approved

the portfolios for solicitation of bids from approved contractors. The contractors selected managed and disposed of the assets, and received payments for both activities, though incentives were built into the contracts to dispose of the assets.

Auditors and Congress criticized the contractor program, citing cases of unearned fees and poor documentation. Nonetheless, the asset management program succeeded in giving the RTC the capacity to manage and sell tens of billions of dollars worth of assets. In addition, the corporation developed a rational and accountable process for putting the asset management contracts to bid.

Overall, RTC's experience resolving 747 thrifts and their assets points to several important capacities that enabled the corporation to implement its charge. First, *the corporation had to be flexible in adjusting to unexpected conditions*. In each stage of the resolution process, the situation on the ground was different from what managers had expected. In response, the RTC had to make adjustments and redefine its tasks. Mistakes were made. What was important is that the RTC *had the autonomy to change its procedures* as it learned from mistakes. Finally, the RTC showed a *remarkable ability to be innovative*. The corporation used ideas and lessons from the private sector and applied them to a public context without undermining the accountability of the process.

Structure and staffing

Structure

The RTC was organized functionally into two broad units:

- **Resolutions and Operations.** This unit was responsible for administering conservatorships and resolution activities, for investigating professional liability concerns, and later, for policies related to pooling securities and marketing them.
- **Asset Management.** This unit was charged with administering the disposition of assets in receiverships and was responsible for promoting the sale of single- and multifamily housing to low- and moderate-income individuals and nonprofits, and creating opportunities for minority- and women-owned businesses to participate in RTC contracts.

Dividing the RTC's work along these two broad functional lines gave it the capacity to separate tasks associated with conservatorships from receivership operations.

The RTC overcame the geographical challenge of resolving thrifts located across the country by adopting a decentralized structure that included 15 consolidated field offices and four regional offices located in areas where the corporation had concentrations of assets. The regional offices were located in Atlanta, Dallas, Denver, and Kansas City, Missouri. Each regional office had from three to five consolidated offices under its jurisdiction. The regional offices were mainly charged with managing and disposing of assets, and managing contract operations. The consolidated field offices were equipped with sizeable marketing teams and asset specialists whose primary responsibility was managing and selling assets. A headquarters in Washington, DC (symbolically adjacent to the FDIC, OTS and the White House) managed the entire operation, and provided information to the RTC Board, the Oversight Board, and Congress. The central office also resolved the very largest and politically most sensitive thrifts. Nevertheless, 85 percent of RTC personnel were deployed across the country to the regional and consolidated field offices.

The decentralized structure sometimes led to tension between the central administration, regional and consolidated field offices. Communication problems also occurred between conservatorship and asset disposition units in the corporation. However just as regional offices increased the capacity of the HOLC, the RTC's decentralized structure enabled the corporation to:

- oversee the conservatorship operations on the ground throughout the duration of the resolution process,
- develop and apply an understanding of regional and local markets to the challenges of managing and disposing of poor quality assets, and
- oversee the work of contractors hired to manage assets, conduct appraisals and handle legal and accounting work because of close proximity to failed thrifts.

Staffing

The RTC was staffed with a combination of public sector professionals borrowed from other govern-

ment agencies and private sector professionals. The public employees included transfers from the FDIC (the designated manager of the RTC) and former employees of the Federal Savings and Loan Insurance Corporation (FSLIC) which was dissolved under FIRREA. Former FSLIC employees had had experience resolving thrifts during the 1980s prior to FIRREA. And FIRREA had also charged the FDIC with managing the FDIC, and thus FDIC transfers initially occupied the leadership positions of the RTC. However, the RTC was never conceptualized as a traditional government entity.

FIRREA specified that the RTC's existence be limited to six years. To be able to staff up quickly, though workers knew from the beginning that the corporation would wind down soon, RTC relied on two types of private sector professionals: temporary staff hired as limited-term employees; and contractors hired by the RTC to perform specific tasks. Using contractors as much as possible was mandated in FIRREA.

Staffing—Limited-Term Employees

A major proponent of the strategy to use temporary employees from the private sector was Albert Casey, hired as CEO of the RTC. Casey had formerly been CEO of American Airlines. In 1993 he testified before Congress that three-quarters of the RTC's staff of 5,000 were temporary limited grade employees who, while distinct from government grade employees, were still hired into the corporation on temporary termed contracts. A year later in 1994, there were 6,371 employees of whom 4,382 were temporary hires.

Private sector hires were particularly important once the RTC shifted its strategy from selling whole banks to managing and selling assets. The FDIC—the primary manager of the RTC—lacked the expertise to manage assets and institutions, and had little experience holding bulk auctions and securitizations. Limited-term employees replaced FDIC employees as managing agents in the conservatorships. And throughout the corporation, professionals with backgrounds in financial management, banking and housing finance were hired directly into the organization.

In many cases, those hired as temporary employees had worked previously in the very thrifts that had become insolvent. And, then as now, there was controversy surrounding the employment of managers

who may have had a role in promoting the risky behavior that brought down the thrifts. The RTC did not have a written policy on hiring persons from failed thrifts, but rather relied on hiring standards from the Office of Personnel Management. In addition, the Investigation Branch of the RTC conducted background checks on job applicants whose government grade positions would be above Grade 12. Applicants who indicated prior thrift or banking experience were checked against databases of the OTS, FDIC and Office of Comptroller of the Currency to determine any involvement in criminal activities. In short, the corporation took steps to ensure that those criminally involved with thrift problems were not hired.

As in the HOLC fifty years earlier a large pool of unemployed financial professionals gave the RTC access to capacity in all aspects of its asset management and disposition operations, and facilitated effective performance.

Staffing—Contracting and Contractors

The RTC relied heavily on contractors to manage and dispose of assets, conduct appraisals, and represent the corporation in legal actions, entering into more than 100,000 contracts. According to its own estimates, RTC spent four times more on the salaries of external contractors than on its own employees. Cynics commented in the early 1990s that the RTC was a jobs program for lawyers, asset managers and accountants. Between 1992 and 1995, the corporation paid more than \$1 billion in fees and expenses for legal fees alone. (GAO 1993).

Yet just as limited-term employees enabled the RTC to quickly increase its capacity, the use of contractors was a crucial tool for rapidly gaining specialized expertise. Given the size of the task charged to the RTC and the statutory mandate for speed, it is unlikely the task could have been done without contracting for services. Congress recognized this in FIRREA by requiring the organization to use contractors if the services were available in the private sector and RTC determined such services were practical and efficient [12 U.S.C. 1441a(b)(11)(A)(ii)]. At the same time, Congress, the FDIC and government auditors recognized the potential oversight and accountability problems that might arise.

The RTC established clear rules and procedures for using contractors early on, adopting ethical standards and standards of competence for contractors on February 6, 1990. Entities wishing to contract with the RTC completed a Contractor Registration Request, disclosing information about its capability, expertise, potential conflicts of interest, and any past ethical or legal problems. Once past this initial fitness and integrity screen, contractors were entered into a database that RTC staffers could search by service area, capabilities, expertise, and minority- and women-owned businesses (MWOB) status. To further reduce the likelihood of favoritism and conflicts of interest, the RTC used a “random” system for selecting contractors. Under the system, 10 to 20 qualified contractors were chosen from the database, and two lists were developed—one of MWOB firms and another that included all other firms. The corporation used a formula to select from each of the lists, spreading the contracts out to many firms. Authority to enter into contracts was controlled hierarchically and tightly. Each level—field, regional, and headquarters—was able to approve contracts up to a specified dollar limitation. The larger the amounts, the higher the level of approval required. *The RTC thus balanced its heavy dependence on contractors with clear rules and procedures that kept conflict of interest problems largely in check.*

Government auditors and scholars identified four broad areas of vulnerability in the RTC use of contractors:

- Weak information systems
- Inadequate capacity to manage contracts
- Weak oversight of subcontractors
- Excessive regulations (GAO, 1992a, 1992b, 1992c)

Information systems are difficult to develop for large complicated organizations under any circumstances, and the RTC had no preparation and faced enormous time pressure. Lack of an effective IT system to track assets undermined the RTC’s capacity overall, but especially hurt the corporation’s capacity to oversee the actions of contractors (GAO, 1992a).

The lack of effective information systems exacerbated the challenge of managing contracts. Scholars of privatization and contracting underscore that the

capacity to monitor and manage contracts is critical for government; without such capacity the benefits of contracting can be undermined (Kettl 1989; Cooper 2003). For the RTC, the problem of contract management and monitoring was acute and led to several scandals documented by the GAO and the press. The GAO reported that only 125 contract oversight managers across the 15 field offices were responsible for managing the bulk of the contracting activity.

A third vulnerability in the contracting system was weak oversight of subcontractors, particularly for asset management. Many of the major asset management contractors employed by the RTC subcontracted out their work. Lack of staff to monitor contracts and weak regulations governing subcontractor exacerbated the problems of overseeing and monitoring subcontractor activity.

Finally, requiring too much information from contractors can be as problematic as requiring too little. One way the RTC compensated for its lack of contract monitoring capacity was by asking contractors for excessive amounts of information. The GAO, for example, noted that asset management contractors were required to provide up to 27 standard reports, twenty of which were monthly. One contractor reported to the GAO that his firm's monthly reports averaged 600 pages.

Contracting with private sector firms for specific services was a critical tool for the RTC. Given the political and administrative pressure to act rapidly, the corporation's failure to develop an adequate contracting and contract monitoring system should not come as a surprise. The experience highlights a mistake that should not be made again.