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Statement of the Shadow Financial Regulatory Committee

on

The Activities of the Resolution Trust Corporation

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The savings and loan (S&L) disaster has been officially estimated to have a present-value cost of around $100 billion. The way that failed S&Ls' assets are disposed of could impose substantial additional costs on taxpayers. The Committee believes that the impending losses and potential scandals can be reduced by having the Resolution Trust Corporation (RTC) sell the failed S&Ls and their assets as quickly and efficiently as possible.

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The Committee is disappointed by the slow pace at which the RTC is able to resolve S&L insolvencies. Nearly all case resolutions so far have involved liquidations or deposit transfers. These approaches require large amounts of cash payments to depositors or to the institutions assuming these deposits, while most assets of the failed S&Ls remain with the RTC.

If these forms of insolvency resolution remain the standard, the RTC will soon exhaust its working capital, even if the $50 billion provided by Financial Institution Reform, Recovery and Enforcement Act (FIRREA) were sufficient to cover the ultimate loss. We believe that the RTC should have sufficient cash resources so that it can make optimal decisions as to the type of case resolution procedure used.

It is a flaw in FIRREA that sufficient working capital is not provided for. Limiting the RTC's working capital is not a satisfactory way to establish accountability for its decisions. The lowest-cost way to raise the needed funds is through borrowings of the U.S. Treasury. Any other source of financing will be more expensive to taxpayers. Further, if lack of cash causes the RTC to delay case resolution or to
choose inferior methods of case resolution, the ultimate cost to taxpayers will be even higher.

While deposit transfers and liquidations should be available options for case resolution, it should be recognized that these approaches result in S&L assets remaining in the RTC's portfolio. We believe that, in general, the value of such assets is more likely to be fully realized if they become privately owned. Case resolutions should involve the sale of the failed institutions' assets and attendant risks to private parties. The RTC's overriding concern should be to foster an effective and competitive market for these assets.

Potential buyers should be provided with extensive information in standard formats about the properties to be sold and reports of the terms of sale for those that were sold. We believe that the secrecy with which the FSLIC insisted on carrying out its Southwest Plan played a heavy role in the criticism it received and the suspicion of its actions. Full public disclosure is likely to produce the best results for taxpayers and best protect the credibility of the RTC. This means disclosure of RTC's methodology for selecting winning bids, the terms of losing bids as well as winning bids, and, at least after the sale, the bid package.

While markets for S&L assets may not be perfect, neither are the incentives nor information available to government-program managers perfect. Indeed, past experience suggests that the second set of problems is considerably greater in asset management programs. Furthermore, the unfolding HUD scandal demonstrates clearly the potential for corruption when government officials have discretion over billions of dollars of resources. When properties are under government management for long periods, as might be the case with the RTC, the likelihood for bribery and other forms of fraud is too great to be accepted.

The RTC has expressed an interest in doing both "whole thrift" transactions, whereby all assets and the attendant risks are transferred to the acquirer, and "clean thrift" transactions whereby only the deposits and "good" assets are transferred. There may be no best way to structure all sales of insolvent thrifts. The RTC should be encouraged to experiment with different approaches. However, such experimentation should generally avoid the RTC's keeping the risks or allowing purchasers to shift the risks back to the government should events turn out badly. Such transactions privatize only the favorable outcomes.