



CHAPTER 14

Asset Management Contracting

Introduction

This chapter reviews the types of asset management and disposition contracts used by the Federal Deposit Insurance Corporation (FDIC) and the Resolution Trust Corporation (RTC). The analysis includes a discussion of the evolution, strengths, and weaknesses of those contracts.

Background

During the 1970s and the early 1980s, the FDIC used its internal staff to conduct most of its asset disposition activity. As the number of failures rose and the total volume of assets to be liquidated increased, the FDIC found it more difficult to perform those functions entirely with in-house personnel.

In the mid-1980s the FDIC first began using contractors to manage and dispose of distressed assets with the resolutions of Continental Illinois National Bank and Trust Company (Continental), Chicago, Illinois,¹ and First National Bank and Trust Company of Oklahoma City, Oklahoma City, Oklahoma. By the late 1980s, however, it was standard practice for the FDIC to use contractors for the management and disposition of assets retained from some of the larger bank failures. The RTC, with its large volume of assets, used asset management contractors from the outset.

From 1988 to 1993, the FDIC used 14 asset management contracts to liquidate assets with a book value of more than \$33 billion, or more than 45 percent of the post-resolution assets the FDIC retained for liquidation. The RTC issued 199 Standard Asset

1. See Part II, Case Studies of Significant Bank Resolutions, Chapter 4, Continental Illinois National Bank and Trust Company.

Management and Disposition Agreements (SAMDA) to 91 contractors from 1991 to 1993 to cover assets with a book value of \$48.5 billion.

Continental Illinois National Bank and Trust Company, Chicago, Illinois

On September 26, 1984, the FDIC entered into a five-year assistance agreement with Continental Illinois Corporation, the holding company of Continental. In exchange for assuming Continental's \$3.5 billion debt to the Federal Reserve Bank (Federal Reserve) and providing Continental with an additional \$1 billion in capital, the FDIC received \$1 billion in preferred stock and assets with an unpaid balance of \$5.2 billion. Those assets had a book value of \$4.5 billion at the time of the transaction, and a further write-down to \$3.5 billion was made on the date of the assistance agreement to reflect the assets' troubled status. On the same date, the FDIC and Continental entered into a servicing agreement under which Continental managed the poor-quality assets. While the FDIC owned the assets, Continental set up a special unit called the FDIC Asset Administration (FAA) to manage and dispose of the assets.

About 50 percent of the problem assets were large loans to the energy industry, 20 percent were complex international shipping loans and loans to foreign companies, 20 percent were securities, and approximately 10 percent were commercial mortgages and construction loans secured by large commercial real estate projects from all over the country. As assets were liquidated, portfolio collections² were used first to pay the expenses of administering the pool, which included items such as the administrator's salaries and overhead. Next, collections were applied to the payment of the interest, then the principal, of the Federal Reserve debt.

FAA's asset management staff at its peak totaled more than 250 employees. The FDIC's oversight staff, who were located in the bank, consisted of 7 to 12 specialists who were hired to oversee such areas as oil and gas, owned real estate, and international lending. Another five FDIC employees were accountants and attorneys. An oversight committee composed of FDIC staff reviewed only FAA's asset management and disposition decisions, because the FAA oversight committee had no authority to make disposition decisions. The committee also reviewed FAA's accounting and budgeting systems and processes for accuracy and ensured that FAA complied with the FDIC's policies and procedures.

FAA had unlimited restructuring, settlement, and sales authority on the assets, but there was a capital expenditure limit of \$50,000 per expenditure and an aggregate annual capital expenditure limit of \$100,000 per asset. FAA had no authority to approve indemnifications, and the FDIC field and regional offices had very limited indemnification authority. Because indemnification was a standard feature in international,

2. Portfolio collections were defined as gross collections less authorized asset-related expenses. Continental reported only portfolio collections to the FDIC, so the gross collection amount is unknown.

multi-bank transactions and Continental was, to a large extent, a “banker’s bank” participating in such loans, many workout situations involving indemnifications had to be approved at FDIC headquarters in Washington, D.C. Some problems were encountered in getting a prompt turnaround from FDIC headquarters to obtain the necessary approvals for large workouts involving multiple banks as participants. Consequently, the FDIC decided that when overseeing an asset pool containing large, complex assets such as those at Continental, there were advantages to having more decentralized delegated authority.

The FAA had a “cost-plus” asset management contract, under which the FAA was reimbursed for the cost of its expenses plus incentive compensation, which was based on a tiered scale ranging from 0.6 percent to 2.25 percent of net collections.³ Incentive compensation for the first tier was 0.6 percent times the aggregate net collections between \$250 million and \$1 billion. That percentage increased incrementally through a total of four tiers to 2.25 percent of net collections between \$3 billion and \$3.5 billion.

The incentive fees paid to FAA during the life of the servicing contract were a relatively low \$8 million because of the large interest payments made on the Federal Reserve debt. That amount represents only 0.34 percent in incentive compensation for FAA of the \$2.4 billion in portfolio collections. FAA’s recovery rate (\$2.3 billion in net collections⁴ to \$4.3 billion in book value reductions⁵) was 53 percent. Discounting collections to estimate a net recovery rate (\$1.9 billion in net present value of net collections to \$4.3 billion in book value reductions) results in a recovery rate of 44 percent.⁶

The servicing agreement entered into with Continental was the first of its kind for the FDIC. The FDIC’s experience in this case suggested that the cost of using the private sector to service assets was relatively low and that the contractor’s overall performance was satisfactory. The servicing agreement spared the FDIC from having to hire hundreds of people to manage the \$5.2 billion in distressed assets.

3. Net collections for the purposes of FAA’s incentive compensation were defined as portfolio collections (net of all asset-related expenses) less the administrator’s reasonable direct expenses, such as salaries and overhead, as well as the FDIC’s expenses and interest expenses on the Federal Reserve debt.

4. Net collections here are defined as net collections before interest payments on the Federal Reserve debt over the five-year term of the agreement. As a result, net collections equaled \$2.4 billion in portfolio collections less \$91 million in expenses, which includes administrative expenses (\$70 million), FDIC expenses (\$13 million), and incentive fees (\$8 million).

5. Book value reductions are defined as the decrease in book value of all types of assets resulting from such activities as the collection of loan principal, the sale of an asset, the forgiveness of debt, and the write-off or donation of an asset.

6. Although the original termination of the Continental servicing contract was September 26, 1989, the contract was terminated instead in October 1988, at Continental’s request. The FDIC actually serviced the assets for the last 11 months of the five-year contract. Approximately 85 percent of the net collections within the five-year period were achieved during the four-year period when Continental administered the pool.

First National Bank and Trust Company of Oklahoma City, Oklahoma City, Oklahoma

On July 14, 1986, approximately \$1.5 billion in assets of the failed First National Bank and Trust Company of Oklahoma City were placed in an asset pool under a purchase and assumption transaction. First Interstate Bank, Oklahoma City, the acquiring bank, set up a subsidiary corporation, Consolidated Asset Management Company (CAMCO), to administer and liquidate the \$1.5 billion asset pool.

The CAMCO contract was similar to the FAA contract in that it had a cost-plus feature. The term of the contract was for five years, and the FDIC oversight staff had no authority to make asset disposition decisions. The CAMCO contract was also like the FAA contract because the contractor had unlimited sale and settlement authority, and incentive compensation was based on the dollar volume of net collections. All expenses were paid by the FDIC and netted against collections before the incentive fee was paid.

One difference in the CAMCO contract was that it was between the FDIC and an affiliate of the acquiring bank, rather than with the bank itself. That precedent was followed by other banks that later entered into asset servicing agreements and allowed the “good” bank to further insulate itself from the “bad” bank’s activities. In addition, the percentages that applied to the various tiers of net collections in the incentive compensation formula were higher in the CAMCO contract than those in the FAA contract or in later agreements. As a result, the CAMCO contract was more expensive for the FDIC than was the Continental contract. The higher percentages were included because of the low overall incentive compensation paid to FAA. In this case, though, the percentages proved to be too generous and gave CAMCO fairly high returns. CAMCO received approximately \$31 million in incentive compensation over the course of the contract, which represented about 12 percent of the \$255 million in net collections. Subsequently, the FDIC decided to pursue a more standardized type of asset management agreement to set more appropriate rates of return for asset management contractors. The new type of contract became known as the Asset Liquidation Agreement.

Asset Liquidation Agreements

The Asset Liquidation Agreement (ALA) was a contract between the FDIC and an asset management contractor for the purpose of managing and disposing of distressed assets. It was designed for asset pools with an aggregate book value greater than \$1 billion. Ten ALA contracts were issued between 1988 and 1992 and achieved book value reductions of \$30.5 billion. For the same time period, approximately 45 percent of all the FDIC’s assets were managed by ALA contractors. All of the ALA contracts were completed by the end of 1996; any remaining assets were transferred back to the FDIC when the contracts concluded.

The term of an ALA contract was normally five years with no renewal options. Several contracts were ended early by mutual agreement; the average duration of the 10

ALA contracts was four years and five months. The objective of the ALA was "...the maximization of the present value of net cash flows."

The ALA contract was similar to the FAA and CAMCO contracts in that it was a cost-plus contract in which the FDIC reimbursed the contractor for all operating expenses and overhead, including salaries, benefits, and limited bonuses of the contractor's employees.⁷ The contractor often paid higher bonuses to its employees, but those bonuses were not reimbursable. In addition to the contractor's salaries and overhead, the FDIC reimbursed the contractor for all asset-related expenses. Such expenses included asset searches; foreclosure fees; appraisals; environmental reports; property taxes; and all legal, accounting, and consulting fees related to the management and disposition of the asset pool.

Because of certain companion agreements, acquiring banks of the first eight ALA contracts were able to put additional failed bank assets back to the FDIC through the vehicle of the ALAs if it was determined that the assets should have been classified at the time of the failed bank's resolution. One of the changes made to the "put option" was that in some of the later contracts, the acquirer was penalized for the length of time it took to put back the assets. For example, in the first year there was no penalty, and the FDIC would purchase qualified assets at their book value. During the second year of the contract, however, the FDIC would buy the assets back at a 2 percent discount from book value, and in the third year the FDIC imposed a 5 percent discount.

Evolution of the ALA Program

At first, the ALA contracts were negotiated between the FDIC and an asset management organization that was an affiliate of the acquiring bank. Later, ALAs evolved into competitively bid contracts between the FDIC and private-sector contractors who did not have to be affiliated with the acquiring bank.⁸ The ALA program was designed to facilitate the disposition of distressed assets, primarily nonperforming loans and owned real estate, although the pools sometimes contained performing loans.

The first three ALA contracts occurred in 1988 and 1989 and contained the distressed asset pools of the failed First RepublicBanks, MBanks, and Texas American Banks, all of which were in Texas.⁹ The primary difference between those contracts and the ones that followed was that the assuming bank owned and held title to the assets. A

7. The FDIC could deny expenses if it determined that the costs were excessive or improper or if the contractor was found to be negligent. The contractor's nonreimbursable expenses included items that were not directly related to the liquidation, collection, and management of the pool assets, such as severance plans or any employee benefits that the FDIC considered to be excessive.

8. Only three ALA contracts were competitively bid. Those included the First RepublicBanks (AMRESKO) contract and the last two ALA contracts involving seven banks in New Hampshire (BONHAM) and Dollar Dry Dock Bank (JERNE). (See table I.14-2.)

9. See Part II, Case Studies of Significant Bank Resolutions, Chapters 6 and 7, First RepublicBank Corporation and MCorp., respectively.

subsidiary of the assuming bank usually managed the special asset pool. The FDIC paid the assuming bank the difference between the book value and the estimated market value of the failed bank's assets assigned to the pool. When the assets were later sold or settled, the FDIC also paid the assuming bank the difference between the original estimated market value and the actual value obtained on the assets. Likewise, if the sales price of an asset was greater than its original estimated market value in the pool, the difference accrued to the FDIC. Therefore, although the assuming bank held the assets in title, it did not assume all the normal risks of ownership. By having the assuming bank fund the bad assets, the FDIC reduced its initial cash outlay, thereby preserving the liquidity of the bank insurance fund. However, this strategy raised the overall cost of the transactions to the FDIC because the assuming banks had higher funding costs than did the FDIC. After being given adequate sources of liquidity, the FDIC no longer used that type of funding mechanism.

In the first ALA contract with First RepublicBanks, the incentive fee paid to the contractor was tied to a fixed percentage of gross collections on the pool and limited to a gross dollar amount over the life of the contract. It soon became apparent that this type of contract presented some problems, so the FDIC adjusted the incentive formula on the next two contracts by basing the fee on a percentage of net, rather than gross, collections. Net collections were defined as gross collections less all allowable expenses associated with the pool. The use of net collections rather than gross collections forced the contractor for the first time to take into consideration its cost of collections. In the first ALA contract, the contractor had no motivation to reduce its costs because the FDIC reimbursed all of its expenses and the expenses did not affect the contractor's fee.

Another change to the management contract was that the incentive fee percentage decreased over the life of the contract. For example, the contract might pay 3 percent of net collections the first year, 2 percent the second year, 1 percent the third, and so on. The contract was changed to gradually pay a reduced percentage fee to induce the contractor to dispose of the pool more quickly. That change was considered an improvement over the fixed percentage given in the first ALA contract because it rewarded the contractor on the basis of the time value of money. Also, the FDIC eliminated the dollar limitation on total fees collectable since that could be a disincentive to a contractor toward the end of the contract.

The first three contracts also provided an opportunity for an additional incentive fee at the end of the contract if it was proven that the contractor had improved the value of the pool over the earlier "mark-to-market" value. The formula used to determine this value was a complicated one that considered all collections made over the life of the pool and required the valuation of the remaining assets in the pool at the end of the contract. After the first three contracts, that clause was eliminated because there was no evidence that it was effective as an incentive to the contractors to improve collections. It also proved difficult and costly to implement because of the requirement of a mark-to-market valuation on the remaining assets upon termination of the contract.

The fourth through the eighth ALA agreements occurred in quick succession from February to August 1991. There was little structural difference among those five contracts, although the variables used in the incentive fee formula for each contractor were unique. Some primary changes from the first three contracts were that the assets assigned to the contractors were no longer marked to market, and the FDIC, rather than the acquiring bank, owned the assets.

After analyzing the results of the first three contracts, the FDIC also made some major modifications to the way that it calculated the incentive fee. Rather than basing the incentive fee on a decreasing percentage of net collections, the FDIC took the opposite approach and started paying the incentive fee at an *increasing* percentage of net collections. The FDIC realized that it was harder to motivate the contractor from the middle of the contract term to the end, when collections were more difficult to achieve. Also, as the pool decreased in size, fewer assets were generating income, so the incentives needed to be enhanced for the latter period of the contract. Furthermore, since the ALA contracts were all cost-plus contracts, the FDIC needed an additional incentive to ensure that the contractor made every effort to keep its expenses to a minimum.

To address those concerns, the FDIC developed a more complicated incentive fee formula. The new incentive fee was keyed to the ratio of cumulative net collections to the asset pool's gross pool value. The cumulative net collection amount in the incentive fee formula was derived by deducting the funding costs and twice the amount of the contractor's reimbursable expenses from the gross collection amount. The gross pool value was defined as the aggregate book value remaining in the pool. The formula also increased the incentive fee percentage as the ratio of cumulative-net-collections-to-gross-pool-value increased.

The addition of the factor regarding funding costs to the formula had a negative effect on the incentive fee if the pool balance remained at a high level. The contractor therefore had a strong incentive to reduce the pool balance either through collections and sales of nonperforming assets or through writing off the worthless assets in the pool. The doubling of the expense costs in the incentive compensation formula heightened the contractors' awareness of the need to control expenses. The result was that ALA contractors decreased staffing and other expenses fairly quickly as assets were liquidated and the workload declined.

The FDIC made another change to the incentive fee structure because it wanted a strong internal audit function for each of those ALA contracts. In the earlier contracts, it was difficult to direct the contractor to spend funds in that area because the costs attributed to the audits resulted in a reduction in the contractor's incentive fees. To correct this problem, the FDIC deducted audit costs from the contractor's total expenses in the formula that determined the incentive fees.

In the first three contracts, assets could be added to the pools only if they originated at the failed bank that was the source of the initial contract. Although this restriction helped for bookkeeping purposes if the assets were later put back to the FDIC, it proved inflexible and a hindrance to the operation of the ALA program. The later contracts

were changed to allow the FDIC to add additional assets from any source. That provision allowed the FDIC the flexibility to group loans to one borrower even if they originated at different banks. It also allowed the FDIC to add additional assets from a newly failed bank to an existing ALA contract, thereby saving the FDIC the time and expense of bidding out another contract. The option also allowed the FDIC in a later ALA contract to combine assets from a particular geographic area into one pool to better service its loan customers. The knowledge that additional assets could be added to their pools further motivated the contractors to outperform other contractors.

A major change that occurred in the final two (ninth and tenth) ALA contracts was that the asset pools were competitively bid to outside asset management firms. This process was in contrast to the earlier one, in which the contract terms were negotiated with the successful acquirer of the failed institution. After the contracts were competitively bid, the result was lower incentive fees to the contractors. Although it might seem that the FDIC would have made that change from the beginning to lower its costs, there were several reasons that the change occurred toward the end of the ALA program period, rather than at the beginning. At the inception of the ALA program, the FDIC did not believe that a sufficient number of qualified private-sector asset management firms existed to ensure a competitive bidding environment. Because the ALAs were cost-plus contracts covering asset pools with book values of more than \$1 billion, the FDIC needed to have a high level of confidence in the asset management firm that it would select. In addition, the acquiring bank, rather than the FDIC, owned the assets in the first four ALA contracts, which were consummated from late 1988 to early 1991. Because the FDIC did not hold title to the assets, it was not in a position to competitively bid out the asset servicing contracts. By 1992 the FDIC determined that a sufficient number of qualified, experienced ALA contractors and RTC asset management contractors that managed troubled assets existed to provide competition.¹⁰ The FDIC therefore was comfortable about competitively bidding out the last two ALA contracts. Table I.14-1 shows the Bank One New Hampshire Asset Management (BONHAM) fee structure, which is an example of one of the actual ALA compensation schedules.

Oversight and Operational Controls

An on-site oversight staff composed of FDIC employees managed the ALA contractors. The number of oversight staff ranged from 5 to 10 employees, depending on the size of the contract. The duties of the FDIC oversight staff were related primarily to the disposition of assets. An oversight committee was composed of two FDIC employees and one contractor employee. The committee normally had unlimited delegations of authority in asset disposition matters, thus permitting prompt decision making,

10. The RTC Standard Asset Management and Disposition Agreement contractor program is described later in this chapter.

promoting the contractor's credibility in negotiations with borrowers, and enabling the contractor to close transactions expeditiously.

The oversight committee members and the FDIC oversight staff performed many of the same asset management and disposition functions that were normally performed in an FDIC field office, such as reviewing the largest assets to ensure the proper handling of high-profile or sensitive asset-related issues. The FDIC staff also approved the asset management and disposition procedures prepared by the contractor, addressed congressional and media concerns, and reviewed and approved the contractor's annual audit plan, budget, business plans, staffing levels, and salary structure. In addition, the FDIC staff reviewed and analyzed the contractor's overall expenses and collections and monitored the ALA agreement, a task that involved coordinating the interpretation of the contract with other divisions within the FDIC and working with legal staff on asset disposition and litigation issues.

The FDIC's financial compliance oversight function included a review of the contractor's monthly financial reporting packages, appropriate accounting methodologies, compliance with the contract, and audit reports prepared by the contractor's internal audit department. The FDIC's financial compliance staff reviewed the contractor's accounting policies for compliance with receivership accounting requirements and examined the contractor's accounting manuals for compliance with the FDIC's

Table I.14-1

**Bank One New Hampshire (BONHAM)
Incentive Compensation Schedule**

Net Collection Tier *	Contractor's Compensation (%) †
Less than or Equal to Zero	0.0
Greater than Zero to 16%	0.2
Greater than 16% to 25%	0.5
Greater than 25% to 32%	1.0
Greater than 32% to 39%	1.5
Greater than 39% to 43%	2.5
Greater than 43%	4.5

* The net collection tiers represent the ratio of cumulative net collections to gross pool value. These tiered percentage ranges were the same in all of the ALA contracts. The imputed funding cost used in the calculation of net collections was determined by applying the one-year U.S. Treasury constant maturity rate to the average book value of the current month.

† The contractor's compensation represents the percentage of net collections that the contractor would retain at each level. These compensation schedules were bid by or negotiated with the contractor, and they differed in each contracting schedule.

Source: FDIC/BONHAM ALA contract dated February 12, 1992.

requirements. In addition, they tried to find ways to reduce expenses and fees that were paid by the FDIC; this task involved a review of the contractor's cost allocation methods.

The FDIC's oversight staff inspected the contractor's files, monitored goals against actual results, reviewed portfolio sale cases, and followed up on problems noted in previous site visitations. They also reviewed owned real estate sales and the real estate appraisal process and analyzed property management procedures, lease agreements, and the property tax abatement process. Although the number of FDIC oversight staff was limited, they had sufficient authority to serve as a check-and-balance system for the ALA contractor and to provide direction on how the FDIC wanted the assets to be liquidated. For instance, the FDIC oversight staff approved the salaries of the contractor and also comprised the majority on the oversight committee that determined which expenses were reimbursed, approved or disapproved asset settlements and sales, and either removed assets from a pool or approved the addition of new assets.

Sources of Assets for the Asset Liquidation Agreements

Table I.14-2 summarizes the sources of assets assigned to the ALA program, as well as other pertinent information.

Financial Performance of the ALA Program

Table I.14-3 summarizes the performance of the FDIC's 10 ALA contracts from the inception of the program in November 1988 through June 30, 1996.

Table I.14-2

Sources of Assets Assigned to ALA Contractors

(\$ in Billions)

Failed Bank	Number of Receiver-ships	Date of Failure	Total Assets at Failure	Assuming Bank	Servicing Contracts	Book Value of Assets Assigned to Servicer
First Republic-Banks	41	July 29, 1988	\$33.4	NCNB Texas, National Bank	AMRESKO, a subsidiary of NCNB Texas	\$12.0
MBanks	20	March 28, 1989	15.7	Bank One, Texas, N.A.	Bonnet, a subsidiary of Bank One	4.2
Texas American Banks	24	July 20, 1989	4.7	Team Bank, N.A.	FAMCO, a subsidiary of Team Bank	1.3

Table I.14-2

Sources of Assets Assigned to ALA Contractors

(\$ in Billions)

Continued

Failed Bank	Number of Receiver-ships	Date of Failure	Total Assets at Failure	Assuming Bank	Servicing Contracts	Book Value of Assets Assigned to Servicer
Bank of New England, N.A., Connecticut Bank & Trust Co., and Maine National Bank	3	January 6, 1991	22.0	Fleet Bank of Massachusetts, N.A.	RECOLL, a subsidiary of Fleet	7.5
Maine Savings Bank	1	February 1, 1991	1.2	Fleet Bank of Maine	RECOLL, a subsidiary of Fleet	0.5
Goldome	1	May 31, 1991	8.7	Manufacturers and Traders Trust Company *	Niagara Asset, a subsidiary of Key Bank Niagara Port, a subsidiary of Key Bank	0.6 1.1
CityTrust and Mechanics and Farmers Savings Bank	2	August 9, 1991	3.1	Chase Manhattan Bank of Connecticut, N.A.	CARC, a subsidiary of Chase Manhattan Bank of Connecticut	1.5
Seven banks in New Hampshire †	7	October 10, 1991	4.4	First New Hampshire Bank and New Dartmouth Bank	BONHAM, a subsidiary of Bank One	1.7
Dollar Dry Dock Bank (and other Connecticut banks)	4	Various in 1991 and 1992	6.0	Emigrant Savings Bank (and others)	JERNE, a third-party contractor	1.5
Totals	103		\$99.2		10	\$31.9

* Later purchased by Key Bank, Buffalo, New York.

† Three of these failed banks, which were Dartmouth Bank, New Hampshire Savings Bank, and Numerica Savings Bank, FSC, were acquired by New Dartmouth Bank. The other four failed banks were acquired by First New Hampshire Bank and included Amoskeag Bank, Nashua Trust Company, Bank Meridian, N.A., and BankEast. (Both New Dartmouth Bank and First New Hampshire Bank entered into loss sharing assistance agreements with the FDIC on October 10, 1991 as well. See Chapter 7, Loss Sharing, for additional information.)

Source: FDIC Division of Resolutions and Receiverships.

ALA Program Recovery Rates and Expense Ratios

Table I.14-4 is a summary of the book value reductions, gross collections, expenses, and net collections of the ALA program.

Strengths and Weaknesses of the ALA Program

The use of ALA contracts played a key role in the FDIC's approach to the management and disposition of bank assets that it received from bank failures in the late 1980s and early 1990s. The ALA contracts provided a means for the FDIC to handle the high volume of assets it received from the largest banks that failed. From 1988 to 1992, the FDIC contracted on 10 occasions with outside asset management companies to service \$32 billion of assets from failed banks. Those assets represented approximately 45 percent of the residual assets of failed banks that remained with the FDIC during those years. Although the ALA contract is compared later in this chapter to the two other types of asset management contracts that the FDIC and RTC used, the following is a brief overview of some of the strengths and weaknesses of the ALA program.

As an alternative to building up its permanent staff for a short period of time (approximately three to five years), the FDIC was able to contract out the management of the assets. The contractors could hire staff more quickly than the FDIC could, and the ALA fee schedule provided the contractor with a strong incentive to maximize the recovery on the pool assets. Because of the effect of the doubling of expenses on the incentive fee, the contractors were conscious of their staffing costs and therefore downsized quickly as the asset pools were reduced.

The full delegated authority given to the on-site oversight committee was an important factor in timely decision making concerning the assets. To ensure that this authority was not abused, the FDIC assigned some of its most experienced personnel to the oversight committees. The FDIC also set up a review function to ensure that the actions of the oversight committee were reasonable and that those of the contractors were consistent with FDIC policies and procedures.

By eliminating the internal audit costs from the formula that determined the contractors' incentive fees, the FDIC emphasized the importance of the contractors' use of strong internal controls. Because the pools of assets contained a total of more than \$30 billion, it was important for standards to be in place to guard against the potential for waste, fraud, and abuse. The FDIC's Office of the Inspector General audited the large contracts annually and, for the most part, concluded that adequate controls were in place.

As additional ALA contracts were established, the FDIC was able to improve portions of the ALA structure as the FDIC learned from its experience with previous contracts. Primarily, the changes that were made to the standard ALA contract refined the way incentive fees were calculated to improve the quality of the contractor's performance.

Table I.14-3

ALA Program Financial Performance Summary
Inception of Contract through June 30, 1996
(\$ in Millions)

Contractor (Failed Bank)	Term of Contract	Book Value (plus Mark- to-Market) Reductions	Gross Collections	Total Expense	Net Collections*	Total Expenses/ Gross Collections (%)	Net Collections/ Book Value Reductions (%)
AMRESCO (FirstRepublic Banks)	Nov. 1988 to Feb. 1995	\$11,818 [†] (\$9,145)	\$8,553	\$1,449	\$7,104	16.9	60.1 (77.7)
Bonnet (MBanks)	Jan. 1990 to Dec. 1994	4,179 [†] (3,177)	3,570	591	2,979	16.6	71.3 (93.8)
FAMCO (Texas American Banks)	Feb. 1990 to Jan. 1994	1,318 [†] (980)	1,082	145	937	13.4	71.1 (95.6)
RECOLL (Maine Savings Bank)	Feb. 1991 to Aug. 1995	435	367	72	295	19.6	67.8
RECOLL (Bank of New England)	June 1991 to Dec. 1995	6,450	4,200	634	3,566	15.1	55.3
Niagara Asset (Goldome)	June 1991 to Sept. 1995	607	465	89	376	19.1	61.9
Niagara Port (Goldome)	Aug. 1991 to Mar. 1995	1,035	1,184	81	1,103	6.8	106.6 [‡]
CARC (CityTrust, Mechanics & Farmers Savings Bank)	Aug. 1991 to Mar. 1995	1,429	826	123	703	14.9	49.2
BONHAM (Various New Hampshire banks)	Mar. 1992 to June 1996	1,704	1,107	166	941	15.0	55.2
JERNE (Dollar Dry Dock Bank and other Connecticut banks)	June 1992 to June 1996	1,509	835	96	739	11.5	49.0
Totals		\$30,484	\$22,189	\$3,446	\$18,743	15.5%	61.5%

* Net collections are defined here as gross collections minus total expenses.

† This book value is an estimate of the original book value of this pool that entered the ALA program on a "mark-to-market" basis. The mark-to-market pool values are shown in parentheses for these contractors; mark-to-market valuations were not required for the other seven ALA pools.

‡ Net collections were considerably higher than average due to the type of assets in the portfolio. The pool consisted of marketable subsidiaries and performing consumer loans with above-market rates.

Source: FDIC Division of Resolutions and Receiverships financial performance report dated June 30, 1996.

The ALA contracts also allowed the FDIC to add and subtract assets without adjusting the incentive fee formula. That feature was important because many additions were made to the contracts because of the put process. It was especially advantageous in New Hampshire, where the assets from 7 failed banks were initially placed into the BONHAM pool; ultimately, assets from a total of 15 banks that had failed in New Hampshire were managed in that pool. The FDIC also could pull assets out of the pool if it felt that the assets could be managed better either in-house or by another contractor.

The cost-plus aspect of the contracts made it easy for the FDIC to direct the contractors to perform additional services that might not have been anticipated in the original contract. For example, after the ALA contracts were created, the FDIC instituted its Affordable Housing Program. Although that program cost the contractors more to administer those assets than others in their portfolio did, the additional expense was not an issue because the ALA contract covered the cost.

A number of weaknesses in the earlier contracts were resolved in later contracts as a result of the changes described above regarding the incentive fee formula. As shown later in this chapter, in the comparison of the types of asset management contracts the FDIC

Table I.14-4

**Financial Performance of ALA Program
Inception of Program through June 30, 1996**

(\$ in Millions)

Book Value of Assets Assigned to Program		\$31,991
Book Value Remaining at End of Agreements		<u>1,507</u>
Book Value Reductions		\$30,484
<hr/>		
Gross Collections		\$22,189
Less: Expenses		
Incentive Fees	\$532	
Reimbursable Expenses	<u>2,914</u>	
		<u>\$3,446</u>
Net Collections		\$18,743
<hr/>		
NPV of Net Collections*		\$16,432
<hr/>		
Ratios (%):		
Incentive Fees/Gross Collections		2.4
Reimbursable Expenses/Gross Collections		13.1
Total Expenses/Gross Collections		15.5
Gross Collections/Book Value Reductions		72.8
Net Collections/Book Value Reductions		61.5
NPV of Net Collections/Book Value Reductions		53.9

* The calculation of net present value (NPV) of net collections used a 6 percent annual discount factor and assumed that collections were received evenly over the life of the contract.

Source: FDIC Division of Resolutions and Receiverships financial performance report dated June 30, 1996.

and the RTC used, the biggest disadvantage to using the ALA contract probably would have been its overall cost. Although the FDIC made adjustments to the fee formulas, the cost-plus aspect of the contract still placed a large portion of the burden of ensuring cost efficiencies on the FDIC rather than on the contractor.

Regional Asset Liquidation Agreements

At the beginning of 1992 the FDIC created a Regional Asset Liquidation Agreement (RALA) that was used for problem assets of smaller institutions. The RALA contract excluded the cost-plus feature that had been used in the ALA program. RALA contractors were reimbursed only for limited and defined asset-related expenses.¹¹

Four RALA contracts, all of which contained asset pools with less than \$500 million in book value, were issued to private-sector contractors from November 1992 to June 1993. Although the RALA contract was designed primarily to liquidate nonperforming loans, performing loans represented more than one-third of the book value of RALA program assets. Book value reductions of \$1.2 billion were achieved in the RALA program, and all assets assigned to RALA contractors had been liquidated or transferred back to the FDIC by the end of 1996.

Structure of the RALAs

The original term of a RALA was four years, with a single one-year renewal option. However, the average duration of the four RALA contracts was three years and one month. The objective of the RALA, as with the ALA, was "...the maximization of the present value of the net cash flows."

The RALA contract contained a performance fee structure that was composed of three elements: management, disposition, and incentive fees. A model was developed before any RALA contracts were issued that projected a breakdown of the three fee types as a percentage of total fees and as a percentage of gross collections. (See table I.14-5.)

The management fee was designed to offset the overhead costs that were borne by the contractor rather than by the FDIC. The RALA contract allowed for payment of a monthly management fee equal to 1.25 percent (annualized) of the gross collections expected during the remainder of the contract.¹² Therefore, as pool assets were sold or

11. The asset-related expenses of a RALA contract consisted of the cost of appraisals, title reports, asset searches, lien searches, advertising, insurance, third-party inspections, court costs, and certain outside counsel legal fees. Additional costs that were considered asset-related included all owned real estate operating and liquidation expenses (including real estate property operating expenses), real estate taxes, property insurance, mortgage interest, property management fees, accounting and auditing fees, leasing commissions, and marketing and selling expenses.

12. The management fee was paid monthly at a fixed percentage of the current targeted cash value (CTCV) of the pool. The CTCV was an estimate of gross collections expected during the remainder of the contract. The management fee was fixed at an annual rate of 1.25 percent, or 0.104 percent on a monthly basis, times the CTCV.

Table I.14-5

Projected Mix of Fees in RALA Compensation Model

Type of Fee	Projected Allocation of Total Fees (%)	Projected Percentage of Gross Collections
Management Fee	25	1.25
Disposition Fee	60	3.00
Incentive Fee	15	0.75
Totals	100%	5.00%

Source: FDIC Division of Resolutions and Receiverships.

settled and the gross collections projected during the remainder of the contract decreased, the monthly management fee decreased accordingly.

The disposition fee was designed to be the primary income generator for the contractor. The FDIC decided to pay the contractor an increasing percentage of net collections as overall collections increased. The estimate of the aggregate gross collections expected from the disposition of the asset pool was referred to as the initial targeted cash value (ITCV). The disposition fee was based on collections relative to the ITCV. The model disposition fee structure is shown in table I.14-6.

The contractor was rewarded with increasing percentages of net collections as cumulative net collections approached the ITCV. That reward was designed to motivate the contractor to attain the highest possible recovery rates on assigned pool assets, because the higher percentages could be reached only by achieving higher cumulative net collections-to-ITCV ratios.

By including net collections in the disposition fee formula, the FDIC encouraged the contractor to minimize asset-specific reimbursable expenses. In calculating net collections, all reimbursable expenses, as well as the management fees paid to the contractor, were deducted from gross collections.

The third portion of the contractor's fee was the incentive fee. Table I.14-7 shows the manner in which the incentive fee was calculated for each of the RALA contracts. The incentive fee was similar to the disposition fee in that it rewarded the contractor for reaching higher levels of the total pool value. It was different in that it tied the contractor's performance to reaching certain goals within specified periods of time.

In addition, the RALA contract permitted the FDIC to withhold incentive fees until certain disposition goals of the contract were achieved, thereby motivating the contractor to dispose of all assets in a pool as soon as possible. The FDIC could retain one-half of the earned incentive fees until the contractor had disposed of almost all of the pool's assets. The retained fees were available for release on a prearranged schedule, from partial release when 90 percent of the asset pool was liquidated to full release when

Table I.14-6

Model RALA Disposition Fee Structure

Percentage of Net Collections	To Be Applied to:
2.6	the first 37% of initial targeted cash value (ITCV)
4.6	the next 23% of ITCV
6.4	the next 18% of ITCV
11.2	the next 15% of ITCV
16.2	any net collections thereafter

Source: FDIC Division of Resolutions and Receiverships.

the contractor had liquidated more than 98 percent of the asset pool. The provision was designed to motivate the contractor to remain focused on liquidating the total portfolio of assets. The withholding of fees therefore helped to align the contractor's responsibilities with those of the FDIC.

Each of the RALA contracts was competitively bid out before a contractor was selected. The FDIC provided the models shown in tables I.14-5 through I.14-7 to bidders after the pools were established. In addition, the FDIC provided the bidders with its estimate of the ITCV of the pool. The bidding process allowed the contractor to change two of the variables in the RALA compensation model (the ITCV and the disposition fee percentages) in an effort to win the contract. The bidders performed due diligence on the pool of assets and then either accepted the FDIC's ITCV or determined their own estimate of the ITCV. (Three of the four winning bidders used the FDIC's suggested ITCV number, and one of the four, Real Estate Recovery, bid an ITCV amount that was greater than the FDIC's number.) The higher the contractor established the ITCV, the harder it was to reach the higher level tranches of the incentive fee and the disposition fee. Similarly, the bidder could change the disposition fee percentage. The lower the percentage, the lower the overall disposition fee. After the bids were received, the FDIC would analyze the terms of the bids and the effects of the proposed variables to determine the winning bid.

Competition among the bidders resulted in much lower disposition fees than were provided to the bidders from the original model. Table I.14-8 shows the actual fee schedules for each of the four contractors, along with the fee schedule projected in the original model.

Actual Versus Expected Fees Paid to RALA Contractors

The total fees actually paid to RALA contractors during the life of the RALA program were 4.5 percent of gross collections, which was under the 5 percent projected in the

Table I.14-7

RALA Incentive Fee Structure

Percentage of Net Collections	In Excess of the Following Percentage of ITCV	Achieved Within the Following Number of Months of the Contract
4.5	33	12
5.0	54	24
9.0	70	36

Source: FDIC Division of Resolutions and Receiverships.

RALA compensation model. In that respect, the model worked as intended. However, the distribution of fees actually paid differed from what had been expected in the compensation model. For example, actual management fees as a percentage of total fees generated under the RALA contracts exceeded the model's expectations by 18 points, the percentage of actual disposition fees was 43 points less than anticipated, and the percentage of actual incentive fees surpassed incentive fees projected in the model by 25 points. (See table I.14-9.)

Two factors accounted for the differences between the targeted fees in the model and the distribution of fees actually paid to RALA contractors. First, assumptions for targeted rates of collection were built into the compensation model. Those projected rates were 40 percent in the first year of the contract, 25 percent in the second year, 20 percent in the third year, and 15 percent in the final year. The contractors actually disposed of their assets more quickly than was projected in the model, thus resulting in higher incentive fees and lower management fees. On average, the total disposition of assets occurred 12 months before the contractual end of the agreement.

Second, the bidding process permitted the contractor to change two of the parameters of the model, the initial targeted cash value and the disposition fee. In bidding for the RALA contracts, three of the winning bidders used the FDIC's suggested ITCV, while the fourth winning bidder proposed a higher ITCV than that of the FDIC. All four winning contractors bid disposition fees that were well below the FDIC's projected rates in the RALA model, which resulted in lower disposition fees than was originally anticipated.

Oversight and Operational Controls

An oversight team composed entirely of FDIC employees managed the RALA contractors and was responsible for handling individual contracts. (Originally, a separate oversight committee monitored each RALA contract.) However, after the first year of operation the FDIC decided that one group of its oversight personnel could effectively control and over-

Table I.14-8

**RALA Disposition Fee Schedule
Projected Model Versus Actual Contractor's Bid Fee Percentages**

Net Collections	RALA Model (%)	Real Estate Recovery Bid (%)	CSW Associates Bid (%)	Northcorp Bid (%)	Aldrich, Eastman & Waltch Bid (%)
Up to 37% of ITCV	2.60	0.25	2.25	0.75	0.25
Greater than 37% to 60% of ITCV	4.60	0.50	3.00	0.95	0.50
Greater than 60% to 78% of ITCV	6.40	0.75	4.75	1.05	0.75
Greater than 78% to 93% of ITCV	11.20	1.50	6.00	1.50	1.25
Greater than 93% of ITCV	16.20	5.00	8.00	1.95	1.75

Source: FDIC Division of Resolutions and Receiverships

Table I.14-9

**Actual Versus Projected Contractor Fees in RALA Program
Inception Through December 31, 1996**

Type of Fee	Allocation of Total Fees		Percentage of Gross Collections	
	Projected (%)	Actual (%)	Projected (%)	Actual (%)
Management Fee	25	43	1.25	2.10
Disposition Fee	60	17	3.00	0.70
Incentive Fee	15	40	0.75	1.70
Total	100	100	5.00	4.50

Source: FDIC Division of Resolutions and Receiverships.

see all four RALA contracts from one location. The primary oversight staff for all four RALA contracts consisted of six FDIC employees during most of the existence of the RALA program. The RALA oversight committee was delegated limited authority. For instance, the RALA oversight committee had \$5 million of settlement approval authority, whereas the ALA oversight committee had unlimited settlement approval authority.

Financial Performance of the RALA Program

The performance of all RALA contractors from inception of the agreements (November 1992) through June 30, 1996, is shown in table I.14-10.

Strengths and Weaknesses of the RALA Program

The RALAs were relatively easy to manage and proved to be more cost-effective than either the ALA or later Standard Asset Management and Disposition Agreement programs. However, it is important to keep in mind that the RALA program was assigned only \$1.2 billion in assets, compared with almost \$32 billion in the ALA program and more than \$48 billion in the SAMDA program. The following briefly summarizes the strengths and weaknesses of the RALA program.

The RALA program's main strength was that its costs were lower than the other contracting programs used by the FDIC and the RTC.¹³ The RALA contract was not a cost-plus contract, which meant that the FDIC reimbursed the RALA contractor for asset-related expenses but did not pay for the contractor's overhead. That arrangement made it easier for the FDIC to control the expenses of a RALA contractor than those of an ALA contractor and provided the RALA contractor with a greater incentive to control their overhead costs because those costs directly affected the contractor's profitability. In addition, less oversight or monitoring was needed because the FDIC was not reimbursing all of the contractor's expenses.

Another feature of the RALA program that controlled costs was the requirement for competitive bidding by the prospective contractors, resulting in disposition fees that were much lower than anticipated. Also, the FDIC paid the contractor its incentive fees only if certain collection goals were attained within prescribed time frames. That constraint accelerated the disposition of the assets, which in turn reduced expenses.

The establishment of the ITCV at the inception of the RALA contract improved the contractor's performance. The ITCV was used by the contractor as a motivational tool to attain its disposition goals (which directly affected its compensation fees) and also by the FDIC to track the contractor's progress. That built-in incentive structure decreased the need for the FDIC to undertake a great deal of contractor oversight.

13. The RTC Standard Asset Management Disposition Agreement contractor program is described later in this chapter.

Table I.14-10

Financial Performance of RALA Contractors Inception Through June 30, 1996

(\$ in Millions)

	Real Estate Recovery	CSW Associates	Northcorp	Aldrich, Eastman & Waltch	Totals
Inception Date	11/2/92	12/8/92	2/12/93	6/1/93	
Termination Date	9/30/95	12/31/96	9/30/96	11/30/94	
Initial Number of Assets	221	893	791	550	2,455
Initial Book Value of Assets	\$450	\$148	\$314	\$267	\$1,179
Percentage Liquidated as of June 30, 1996	100	91	97	100	98
Initial Targeted Cash Value (ITCV)	\$378	\$104	\$235	\$210	\$927
Book Value Reductions	\$450	\$135	\$304	\$267	\$1,156
Gross Collections	\$296	\$96	\$197	\$205	\$794
Less: Expenses					
Management Fees	8	2	5	2	17
Disposition Fees	1	3	2	1	7
Incentive Fees	2	2	3	5	12
Reimbursable Expenses	5	4	3	3	15
Subtotal	<u>\$16</u>	<u>\$11</u>	<u>\$13</u>	<u>\$11</u>	<u>\$51</u>
Net Collections	<u>\$280</u>	<u>\$85</u>	<u>\$184</u>	<u>\$194</u>	<u>\$743</u>
NPV of Net Collections	\$260	\$77	\$168	\$187	\$692
Ratios (%):					
Gross Collections/ITCV	78.3	92.3	83.8	97.6	85.7
Total Fees/Gross Collections	3.7	7.3	5.1	3.9	4.5
Reimbursed Expenses/Gross Collections	1.7	4.2	1.5	1.5	1.9
Total Expenses/Gross Collections	5.4	11.5	6.6	5.4	6.4
Net Collections/Book Value Reductions	62.2	63.0	60.5	72.7	64.3
NPV of Net Collections/Book Value Reductions	57.8	57.0	55.3	70.0	59.9

Source: FDIC Division of Resolutions and Receiverships financial performance report dated June 30, 1996.

Another strength of the RALA contract was that the FDIC was permitted to retain a portion of the incentive fees owed to the contractor until certain goals of the contract were met. Also, the RALA contract was clearly written and required few modifications during the four-year history of the RALA program. Thus, few disputes occurred between the FDIC and the contractor; when there were disagreements, most issues could be resolved at the oversight level.

The RALA program's biggest weakness was its lack of flexibility. For example, once the asset pools and the ITCVs were established at the beginning of the contract, the FDIC could not add or subtract assets from the contractor's portfolio. Also, for the RALA compensation model to work properly, an accurate estimate of the ITCV had to be made, because the disposition and incentive fees were contingent upon that figure. If the ITCV was not properly estimated, the contractor could find that there was insufficient compensation for its staff to perform in the manner expected by the FDIC. The contract had no provision to adjust the ITCV after the contract had been bid out. That weakness was especially important in the case of a large pool which normally contains assets with greater book values that are more complex and difficult to value. Therefore, the establishment of a reliable ITCV at the beginning of a large contract is more uncertain.

The RALA contract was less flexible than the ALA contract also because it required the contractors to complete services that may not have been anticipated at the inception of the contract. Because the contractors were not reimbursed for their indirect costs, they were reluctant to provide such services. The FDIC therefore faced some resistance when requesting additional reports or requesting the contractors to endorse programs, such as the FDIC's Affordable Housing Program, that raised the contractors' costs. The ALA contractors were more willing to accept changes because their costs were passed on to the FDIC.

Standard Asset Management and Disposition Agreements (SAMDA)

The SAMDA was a contract between the RTC and a private-sector contractor to manage, collect, and dispose of distressed assets in portfolios of all sizes. Two versions of the SAMDA were created. The first was known as SAMDA I, which began in August 1990, and the second was called SAMDA II, which started in April 1991.¹⁴

A total of 199 SAMDA contracts, of which 160 were SAMDA I and 39 were SAMDA II, were issued to 91 different contractors. The contracts were similar to the FDIC's RALAs in that the SAMDA contracts allowed for the payment of a management fee, a disposition fee, and an incentive fee. In addition, both types of contracts did not

14. Unless specified, references to SAMDA contracts apply to both the SAMDA I and the SAMDA II versions.

reimburse the contractor for its overhead expenses, but did pay for asset-specific expenses. One difference between the SAMDA and RALA contracts was that the RTC required the SAMDA contractor to engage subcontractors for 12 different services, the cost of which was reimbursed by the RTC.¹⁵

In January 1992 an amendment to the existing SAMDA contracts called the Standard Asset Management Amendment (SAMA) was introduced. The SAMA reduced the scope of work from asset management and disposition to asset management only. The SAMA was used in any new contracts issued from January 1992 forward.

At the sunset of the RTC on December 31, 1995, the RTC's interest in all active SAMDA contracts, which included 16 active contracts with \$2.7 billion in remaining assets, was assigned to the FDIC. From the inception of the SAMDA program through December 31, 1996, book value reductions of \$46.4 billion were achieved. Table I.14-11 summarizes the main differences among the SAMDA I, the SAMDA II, and the SAMA.

Evolution of the SAMDA Program

Even before RTC was created, FDIC management assigned to work on the thrift crisis recognized that contractors would have to supplement internal staff in managing and disposing of assets acquired from failed thrifts. By November 1989, the initial RTC research, asset disposition, and contracting units were researching various asset management and disposition agreements used by the FDIC, the FSLIC, and other organizations. And, by February of 1990, RTC management had decided that contractors would be used to manage and dispose of nonperforming assets, service performing assets, and assist in other specific tasks. Work then commenced on developing a standard asset management and disposition contract for nonperforming assets. The first contract was let in August 1990.

The RTC was required by the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) of 1989 to use contractors. The act specified that the RTC had to hire private-sector contractors for the disposition of assets if such services were available, practicable, and efficient.¹⁶ Several other legal provisions further complicated the RTC's asset management and disposition task. For example, a challenging mission statement in FIRREA required the RTC to "...manage and resolve institutions...and dispose of any residual assets in a manner that: (1) maximizes return and minimizes loss; (2) minimizes the impact on local real estate and financial markets; and (3) maximizes the preservation of the availability and affordability of residential property for low- and moderate-income individuals." FIRREA also contained a general requirement that the RTC "...identify properties with natural, cultural, recreational or scientific

15. The RTC's 12 mandatory subcontracting services included appraisal services, brokerage services for owned real estate sales and leasing, property management, title work, construction subcontracting, environmental consulting, and surveying services.

16. 12 U.S.C., section 1441a(b)(10)(A)(ii).

Table I.14-11

Summary of the Major Differences Between the SAMDA I, SAMDA II, and SAMA Programs

Program	Number of Contracts	Inception Date of Program	Types of Fees Paid to Contractor*	Unique Feature of Fee Determination
SAMDA I	160	Aug. 1990	Management, disposition, and incentive fees	Disposition and incentive fees tied to individual asset sales
SAMDA II	39	Apr. 1991	Management, disposition, and incentive fees	Disposition fees tied to performance of entire asset pool
SAMA	NA [†]	Jan. 1992	Management and incentive fees only	NA [†]
Total	199			

* The management and disposition fees were bid by the contractor and varied among the SAMDAs, whereas the incentive fee structure was fixed by the RTC within the contract itself.

† Not applicable, as the SAMA was an amendment to the SAMDA structure, not a separate contract type itself.

Source: FDIC Division of Resolutions and Receiverships.

values of special significance.”¹⁷ In practical terms, that requirement meant that the RTC had to work closely with conservation agencies on the disposition of environmentally and historically significant properties. Finally, FIRREA and the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act (RTCRRIA) of 1991 mandated the RTC to promote the use of minority- and women-owned businesses (MWOBs) as contractors.

By April 1991, the RTC initiated a major revision to the SAMDA contract, even though two minor revisions to the standard form had already been made. This time, many provisions were revised, but the most significant involved changing the focus on compensation from an individual asset basis to a portfolio basis and how the contract fees were bid. This contract became known as SAMDA II.

The second major change to the SAMDA structure came in January 1992 with the SAMA. By this point, national multi-asset sales had become the RTC’s preferred asset disposition method. Because of this change in disposition strategy, the RTC introduced the optional SAMA, which eliminated the contractor’s responsibilities to dispose of assets in designated pools. This permitted the RTC to have nonperforming assets

17. 12 U.S.C., section 1441a(b)(12)(F).

managed by contractors on a decentralized basis and to continue with its strategy of centralized multi-asset sales.

To confirm that the RTC was following the best course of action for the disposition of assets through multi-asset sales instead of individual asset sales, it did a study. The study, conducted in December 1992, measured gross and net proceeds from multi-asset sales against gross and net proceeds obtained from the sales of individual assets.¹⁸ The study concluded that the gross proceeds obtained from multi-asset portfolio sales were not significantly different from the gross proceeds (as a percentage of book value) received from similar assets that were disposed of individually in the SAMDA program. However, after all direct and indirect expenses were included, the net recovery from multi-asset portfolio sales was significantly higher than from individual asset sales because of a faster disposition rate and shorter holding periods, which resulted in lower expenses. The conclusion reinforced the RTC's decision about the increasing emphasis on the use of multi-asset sales and reducing interest in individual asset restructures and sales, which had been the specialties of SAMDA contractors.

Overall, the SAMDA program worked well. As the pool of assigned assets diminished, one-year extension periods were replaced with six-month extensions, and many contracts were allowed to expire. Any remaining assets were transferred to other SAMDA contracts. At the beginning of 1995, which was the RTC's last year of existence, 53 of the 199 SAMDA contracts were still active. Because no new assets were being placed into the program and many asset pools were a small fraction of their original inventory, it was more economical for the RTC to use fewer contractors. Therefore, the RTC decided to either consolidate SAMDA assets to the best-qualified contractors or bring them in-house in preparation for the consolidation of the RTC into the FDIC at the end of 1995. During 1995, 37 SAMDA contracts were allowed to expire, and 16 SAMDA contracts remained active at the RTC's sunset date of December 31, 1995, that were transferred to the FDIC for ongoing management. More than 95 percent of the assets assigned to SAMDA contractors were sold or settled during the life of the SAMDA program.

Structure of the SAMDA Contract

The initial term of most SAMDA contracts was three years with two one-year extension options. When available, additional assets were added to the initial pool of assigned assets, and most of the assets assigned to SAMDA contractors were sold or settled within two years. The average duration of all SAMDA contracts was approximately three years and three months. The general goal of a SAMDA contractor was "...to achieve the expeditious sale of the portfolio of assets at the highest net present value in a manner that

18. The study was called the Hard-to-Sell Asset Review Project and was published by the RTC Asset Management and Sales Division.

minimizes detrimental effects of such sales on local real estate and financial markets and enhances the national stock of low- and moderate-income properties.” A SAMDA contractor had to comply with all applicable RTC regulations, policies, procedures, and directives. Furthermore, the contractor was required to act as a fiduciary for the assets under the agreement.

One objective of the SAMDA contract was to provide contractors with sufficient flexibility to manage and dispose of RTC assets without having to seek approval from RTC staff for routine matters or transactions. Also, the contract was designed to enable the RTC to properly control the asset management and disposition process, to ensure that a contractor's efforts were consistent with the policies and procedures of the RTC. Another objective of the SAMDA program was to make sure that adequate records and reporting were established for review and audit. The program also sought to establish an incentive compensation structure that would motivate the contractor to maximize net collections and reward the contractor for collections earlier, rather than later, in the contract's term. Those objectives reflected several of the RTC's goals, which included minimizing its internal staff through the use of private-sector contractors and expeditiously returning assets to the private sector to minimize the cost of resolving the savings and loan crisis.

A SAMDA contractor assumed responsibility for all assigned assets, including the preparation of a preliminary plan for administering the assigned assets and the preparation of an asset management and disposition plan, or AMDP, for each asset in the portfolio. The contractors also managed and serviced the assets and were charged with disposing of the assets in a manner that maximized the net recovery. After the AMDP was approved, the SAMDA contractors generally pursued a compromise and settlement strategy with borrowers for nonperforming loans. If that strategy failed, the collateral was acquired through foreclosure or repossession, and then sold.

For owned real estate assets, SAMDA contractors generally listed the properties with real estate brokers, negotiated sales, arranged for approval of sales, and helped the RTC to close sales. SAMDA contractors were restricted from conducting multi-asset sales, although many of the contractors contributed assets to RTC multi-asset sales events. Each contractor received limited delegations of authority to take asset-related actions, such as entering into a settlement or selling a property. Asset disposition decisions that were beyond the authority of a SAMDA contractor were approved at the appropriate level of RTC delegated authority.

SAMDA I Series

The SAMDA I series contract provided for the payment of a management fee, a disposition fee, and an incentive fee. In their bid, prospective contractors would specify a dollar amount that would be their monthly management fee for the initial pool of assets. The monthly management fee was then divided by the sum of the estimated recovery values (ERVs)¹⁹ of the assets in the initial pool to obtain a percentage relationship. The result-

ing percentage was applied each month against the current month's remaining ERVs to determine the actual management fee to be paid to the contractor. For example, if the fixed monthly bid management fee was \$20,000 and the ERV of the initial pool of assets was \$12 million, then the result would be 0.167 percent. That percentage would then be multiplied by the current month's remaining ERV to obtain the monthly management fee to be paid to the contractor. The result was a proportional reduction in the monthly management fee as the volume of assets declined.

Like the management fee, prospective contractors also bid a disposition fee, although this was expressed as a percentage of net cash collections (all asset specific gross cash received less expenditures) arising from each asset. The disposition fee payable was a function of the bid amount and the relationship between net collections and the asset's ERV. This disposition fee payment schedule is shown in table I.14-12.

The third SAMDA I fee was the incentive fee, which was designed to motivate a contractor to dispose of assets earlier rather than later. The incentive fee percentages were fixed by the RTC contract and were not subject to bid by the contractor. The incentive fee was 20 percent of the earned disposition fee if the asset was disposed of during the first contract year and 10 percent if the asset was disposed of during the second contract year. Incentive fees could only be earned if assets were disposed of during the first two years of the contract.

Additionally, to minimize the prospect of the contract expiring with high-carrying cost assets remaining, the RTC retained 15 percent of all disposition fees payable as a holdback. From this holdback, the RTC deducted all cash expenditures incurred from contract inception for any assets remaining in the portfolio on expiration.

SAMDA II Series

The SAMDA II contract also provided for payment of a management fee, disposition fee, and incentive fee. Unlike the SAMDA I contract, however, prospective contractors bid only one number (known as the "contractor's bid"), which in turn was used to calculate all fees paid under the contract.

The management fee, expressed on an annual basis as a percentage of the estimated value of the asset portfolio, was set to be one-fourth of the effective disposition fee rate. RTC management believed that this ratio would sufficiently motivate contractors to dispose of assets rather than hold them to earn management fees. Because this structure caused the earning of significant fee income not to coincide with the occurrence of a contractor's internal expenses, however, the management fee in the SAMDA II contract was paid at a 50 percent higher rate during the first six months of the contract. Accordingly, the additional management fee income covered the additional expenses incurred

19. The RTC's estimated recovery value (ERV) was the sum of the net present value of the future cash flows for all assets in the pool. An ERV was determined for each asset entering the SAMDA I program when the asset pool was formed; that value was normally used throughout the life of the asset.

Table I.14-12

SAMDA I Disposition Fee Payment Schedule

Disposition Fee Payable (Expressed as a Percentage of the Fee Bid)	Net Collections/ERV Ratio (%)
25	0 to 50
50	51 to 90
100	91 to 110
150	Greater than 110

Source: FDIC Division of Resolutions and Receiverships.

with a new portfolio, such as producing asset management and disposition plans and developing reporting and information systems. This provision was added to allow contractors with little working capital—generally minority- or women-owned firms—to competitively bid for contracts.

Unlike the SAMDA I series, disposition fees in the SAMDA II contract were based on the collection of cash during a particular time period and not upon the occurrence of an event, such as an asset sale. The determination of disposition fees varied because it used a cumulative ratio of the net proceeds of the pool (NPP) to the total recovery value of the pool (RVP). The NPP was defined as gross cash receipts less all expenses, such as earned management fees, all costs associated with mandatory subcontracts,²⁰ taxes assessed against the assets in the pool, costs to insure owned real estate assets, imputed carrying costs, and legal fees. The RVP was the sum of the ERVs of all assets remaining in the pool.

The disposition fee schedule for the SAMDA II contract was designed to provide increasing incentive compensation as the NPP realized by the contractor increased in relation to the RVP. Accordingly, for every additional dollar collected beyond 50 percent of the initial RVP, the contractor was compensated at increasingly higher rates not just for each future cash receipt, but for all previous collections.

One of the expenses factored into the calculation of the NPP was an imputed carrying cost assessment. That assessment was calculated using an annual interest rate of 7 percent that was applied to the remaining RVP of the pool on a monthly basis. The result was that the imputed carrying cost offset the management fee as an incentive to carry an asset. That feature was designed to motivate the contractor to sell the assets as quickly as possible in order to maximize the NPP.

20. Reimbursable asset-related expenses in both SAMDA I and II contracts included the costs of the 12 mandatory subcontractors, data processing system conversion costs, asset file reproduction costs, RTC-mandated reports, asset-related legal costs, other reasonable legal costs that were not asset-related, and other costs "related to RTC-mandated activities" that were authorized in writing. One of the 12 mandatory subcontracting categories, "Property Management, Maintenance, and Leasing," included owned real estate operating expenses, property taxes, property insurance, leasing commissions, and tenant improvements.

The SAMDA II contract also provided for the payment of an incentive fee. The incentive fee increased the NPP (used in the calculation of the disposition fee) by 20 percent for assets disposed of in the first contract year and by 10 percent for assets disposed of in the second contract year. As in the SAMDA I contract, incentive fees could be earned only if assets were disposed of during the first two years of the contract.

Oversight and Operational Controls

The SAMDA oversight manager was an RTC employee who oversaw the SAMDA contractor. The oversight manager monitored the contractor's technical performance and was expected to ensure that the contractor performed and completed all services required by the contract in a cost-effective and timely manner. In addition to day-to-day monitoring, the oversight manager reviewed the SAMDA contractors quarterly through informal site visitations and semi-annually on a formal basis with a team of reviewers. Also, the RTC Office of Contractor Oversight and Surveillance and the RTC Office of the Inspector General performed periodic formal reviews or audits.

A major drawback to efficiently controlling operations within the SAMDA program was the lack of a complete and fully integrated management information system. The RTC's contractor information system did not capture all necessary asset data, and the recording of asset data was incomplete and sometimes inaccurate. Accounting for asset sales was delayed at times for up to 12 months and was insufficiently monitored for accuracy. Some contractors were paid disposition fees on sold assets by estimating sales expenses rather than by providing proper sales documentation. Although the RTC initially tried to use its contractor information system as a full informational database for management reporting and accounting control, it was in reality effective only as a cash management system, because of system implementation and data integrity problems.

Financial Performance of the SAMDA Program

The information presented in table I.14-13 is a summary of the performance of the SAMDA program from its inception through December 31, 1996.

The entire SAMDA program from inception through December 31, 1996, resulted in gross collections of \$23.3 billion, which represents 50 percent of book value reductions and 92 percent of the ERV of the assets sold. Total expenses of \$4.4 billion resulted in an overall expense-to-collection ratio of 19 percent. Net collections of \$18.9 billion accounted for a recovery rate (ratio of net collections to book value reductions) of 41 percent and a net recovery rate (ratio of net present value of net collections to book value reductions) of 37 percent.

Strengths and Weaknesses of the SAMDA Program

The RTC was formed in August 1989 and was ultimately charged with resolving 747 financial institutions with \$402.6 billion in assets. Because of the need to dispose of a large volume of distressed assets and FIRREA's mandate to use asset management contractors from the private sector, the RTC developed the SAMDA program. The following details the strengths and weaknesses of the program.

One strength of the SAMDA program was that it allowed the RTC to manage and dispose of a large volume of distressed assets through the use of outside contractors so that it did not have to significantly expand its work force. In addition, SAMDA contractors generally had sufficient delegated authority to make most of the asset disposition decisions. A relatively small number of asset disposition cases had to be approved by higher delegated authority levels.

The SAMDA contracts and a SAMA allowed the RTC to use private-sector contractors to manage a large volume of distressed assets, while the RTC disposed of them via multi-asset sales transactions. Furthermore, the SAMDA contracts contained targeted disposition time frames by asset type.

One weakness of the SAMDA program was that too many different contractors (91 in all) were operating under the program, a good number of which were small, start-up companies. Having so many parties (both contractors and internal oversight staff) involved in the program significantly contributed to the need for numerous contract interpretations, the RTC's difficulty in achieving effective oversight, and problems in internal operations, such as audits, fee payments, and systems integration.²¹ Also, performance was inconsistent because many of the start-up companies did not have established track records.

The delayed development of the RTC's contractor information system and its implementation difficulties resulted in the system being generally ineffective either as an accounting and inventory control system or as a management information system for measuring the performance of contractors. It was effective mainly as a cash management system.

One weakness of the SAMDA I contract was that it keyed the payment of disposition and incentive fees to the sale of assets individually. That sometimes caused the contractor to concentrate on the larger assets and neglect the lower valued or hard-to-sell assets.

Another drawback of the SAMDA program was that it was originally designed for a different asset disposition strategy than the one the RTC eventually pursued. The

21. The SAMDA contracts collectively required more than 260 official interpretations of various provisions of the contract during their life span. Most of the issues were related to the SAMDA I contract. Those interpretations generally pertained to the meaning of certain contract language, inconsistencies between actual policy and the language in the contract, and issues involving functional responsibilities, such as the obligations of the contractor after contract termination or fee calculations that differed under certain conditions.

Table I.14-13

Summary of SAMDA Activity Inception Through December 31, 1996

(\$ in Millions)

Total Number of SAMDA Contracts		199
Number of Assets at Inception		100,344
Book Value of Assets Assigned to Program:		
Loans	\$26,937	
Owned Real Estate	19,031	
Other Assets	<u>2,509</u>	
		\$48,477
Less: Book Value Remaining on 12/31/96		<u>2,052</u>
Book Value Reductions, Inception through 12/31/96		\$46,425
Estimated Recovery Value of Assets Settled		\$25,255
Gross Collections*		
Less: Expenses		\$23,293
Management Fees	\$400	
Disposition/Incentive Fees	300	
Reimbursable Expenses	<u>3,739</u>	
		<u>4,439</u>
Net Collections*		\$18,854
NPV of Net Collections*		\$17,369
Ratios (%):		
Gross Collections/Book Value Reductions		50.2
Gross Collections/ERV		92.2
Total Fees/Gross Collections		3.0
Reimbursable Expenses/Gross Collections		16.1
Total Expenses/Gross Collections		19.1
Net Collections/Book Value Reductions*		40.6
NPV of Net Collections/Book Value Reductions*		37.4

* Collections exclude all loan payments made prior to 1993. In addition, collections for all assets withdrawn for sale by the RTC were imputed at the lesser of 90 percent of an asset's ERV or its derived investment value (DIV).

Source: RTC Asset Management System.

change in direction had a significant impact on the operations of the program and resulted in increasing the cost of administering the program. The SAMDA I contract did not contemplate that RTC staff would be selling the assets that were transferred into the SAMDA program. Many SAMDA contractors received disposition fees for SAMDA assets that the RTC later included in multi-asset sales initiatives.

Another problem was that receivership assets were often stratified by type, then distributed to various Washington-based multi-asset sales programs. Asset pools often consisted of like assets from one or more receiverships, and the RTC usually did not create

geographically concentrated portfolios. The result was that many SAMDA contractors had portfolios with geographically diverse assets, which tended to cause inefficiencies in the management and disposition of such portfolios. In addition, in some cases, the RTC's inadequate information systems were severely challenged by the task of providing a full accounting back to the appropriate receivership.

One element that proved expensive was the RTC's requirement that SAMDA contractors engage subcontractors for certain areas of expertise. The reimbursable fees for the subcontractors were, in the aggregate, five times as much as the fees paid to SAMDA contractors. Also, it was difficult for the RTC to control the subcontractors, mainly because of the privacy of the contractual relationship between the SAMDA contractors and their subcontractors. The expenses of the SAMDA program probably would have been lower if the RTC had not mandated the 12 categories of subcontracting.

The SAMDA I compensation formula may not have provided a strong enough incentive for contractors to dispose of assets quickly. Furthermore, the ERV, a key element of the contractor's compensation formula, was not calculated in a consistent manner throughout the RTC.

Finally, the administration of the SAMDA program varied throughout the RTC. In addition, there were frequent changes in the oversight staff, sometimes resulting in insufficient control over the change of key SAMDA contractor personnel.

Summary of the Three Contracting Programs

Table I.14-14 summarizes the main features of the three asset management programs.

Asset Management Contract Financial Summary

A summary of the 213 ALA, RALA, and SAMDA contracts of the FDIC and the RTC is shown in table I.14-15. It includes such items as portfolio mix, gross collections, and net collections.

ALAs Versus RALAs

It is difficult to compare the recoveries of the ALA and RALA programs because they had very different combinations of asset types and because the starting market value of their asset pools was not known.²² A direct comparison is further hindered by the fact that an expense history by asset type is not available for either program.

22. Although the RALA contract did have an ITCV, it represented the sum of all future cash flows, not a market value.

The expense ratios and the recovery rates of the RALA program are better than those of the ALA program (as shown in table I.14-15). However, the significant differences in asset composition, asset volume, and regional and macroeconomic conditions prevailing when the contracts were in effect make a true comparison between the two programs difficult. If the market values of each of the pools had been accurately determined at the start of each program, it would have been somewhat easier to compare the results of the ALAs and RALAs. That was not done, though, so overall conclusions on financial performance are difficult to draw.

The asset pools of the ALAs and RALAs were reviewed for distinctive features that could affect the recovery results. One of the ALA pools for Goldome, known as the Niagara portfolio, consisted mainly of readily marketable operating subsidiaries and performing consumer loans with above-market rates. In the RALA program, one of the pools, known as the Aldrich, Eastman and Waltch (AEW) portfolio, contained a significant number of performing mortgages that were readily marketable and would not incur the usual disposition costs.

The overall expense-to-collection ratio of the RALA program was 6.4 percent, which was less than half of the 15.5 percent ratio for the ALA program. However, owned real estate made up 15 percent of the assets in the ALA program, whereas no owned real estate was included in the RALA program.²³ Although the net collections-to-book value reductions ratios show that the ALA and RALA programs were somewhat similar at 61.5 percent and 64.3 percent, respectively, the net present value effect on the figures widens the gap to 53.9 percent and 59.9 percent. That finding seems to indicate that the RALA program performed more effectively because of its ability to keep costs low through the use of the ITCV and by deleting the cost-plus feature that had been used in the ALAs.

Although significant differences exist between the two programs, some broad observations can be made. For instance, the ALA contracts seemed to work well with larger asset pools and were adaptable when assets were transferred in or out of the contractor's portfolios; however, the ALA contracts required extensive oversight. The structure of the RALAs controlled costs more effectively than the ALAs did, primarily because RALA contractors paid for their own overhead and because the ITCV established at the beginning of the contract helped the FDIC to monitor the contractors and also allowed the contractors to monitor themselves. Although the changes to the later RALA program improved the performance of contractors, the changes resulted in a loss of flexibility, because the RALAs did not allow for changes in the asset pools or the ITCV.

23. Although the RALA pools originally did not have owned real estate, a minimal number of properties were acquired through foreclosure.

Table I.14-14

Summary of the Structures of the Contractor Programs

Program	Number of Contracts	Asset Source	Types of Assets	Term of Contract	Fees Paid to Contractor	Cost Reimbursement
ALA	10	Large failed commercial banks (for asset pools over \$1 billion in book value)	Performing and nonperforming loans, owned real estate, and subsidiary assets (owned real estate was 15% of assigned assets)	5 years	Incentive fee	All reasonable pool-related expenses (cost-plus)
RALA	4	Small failed commercial banks (for asset pools under \$500 million in book value)	Primarily nonperforming loans, some performing loans (no owned real estate at inception of contracts)	4 years, plus one optional 1-year extension	Management, disposition, and incentive fees	Pass-through of asset-specific expenses, excluding overhead of contractor
SAMDA	199	Failed S&Ls controlled by the RTC (various sized asset pools)	Primarily nonperforming loans and owned real estate (which was 39% of initially assigned assets)	3 years, with three 1-year renewal options	Management, disposition, and incentive fees *	Pass-through of asset-specific expenses, excluding overhead of contractor

* A majority of the SAMDA contracts were later amended with the SAMA provision that eliminated the disposition fee.

Source: FDIC Division of Resolutions and Receiverships.

SAMDAs Versus ALAs and RALAs

As shown in table I.14-15, the recovery rate (ratio of net-collections-to-book-value-reductions) of the SAMDA program was 41 percent, as compared to 62 percent for the ALAs and 64 percent in the RALAs. The net recovery rate (ratio of net-present-value-of-net-collections-to-book-value-reductions) for the SAMDA program was 37 percent, in contrast to 54 percent for the ALAs and 60 percent for the RALAs. However, a much higher portion of total assets consisted of owned real estate, and nonperforming loans were a higher percentage of the loan portfolio in the SAMDA program than in the other two programs. The overall quality of SAMDA assets was therefore lower than that of the ALA and RALA assets.

Given the significant differences in the asset mix and asset quality among the three programs, the only fair way to compare recoveries would be to compare the net recovery

Table I.14-15

Summary of Contractor Financial Performance Inception Through December 31, 1996

(\$ in Millions)

	ALAs	RALAs	SAMDAs	Totals
Number of Assets	84,610	2,455	100,344	187,409
Book Value of Assets in Program:				
Performing Loans	\$4,091	\$440	\$0	\$4,531
Nonperforming Loans	19,900	760	26,937	47,597
Owned Real Estate	4,800	0	19,031	23,831
Other Assets	3,200	10	2,509	5,719
Total	\$31,991	\$1,210	\$48,477	\$81,678
Book Value Reductions	\$30,484	\$1,156	\$46,425	\$78,065
Gross Collections	\$22,189	\$794	\$23,293 [†]	\$46,276
Expenses:				
Management Fees	0	17	400	417
Disposition/Incentive Fees	532	19	300	851
Reimbursable Expenses	2,914	15	3,739	6,668
Total Expenses	\$3,446	\$51	\$4,439	\$7,936
Net Collections	\$18,743	\$743	\$18,854 [†]	\$38,340
NPV of Net Collections [*]	\$16,432	\$692	\$17,369 [†]	\$34,493
Ratios (%):				
Gross Collections/Book Value Reductions	72.8	68.7	50.2	59.3
Total Fees/Gross Collections	2.4	4.5	3.0	2.7
Reimbursed Expenses/Gross Collections	13.1	1.9	16.1	14.4
Total Expenses/Gross Collections	15.5	6.4	19.1	17.1
Net Collections/Book Value Reductions	61.5	64.3	40.6 [†]	49.1
NPV of Net Collections/Book Value Reductions	53.9	59.9	37.4 [†]	44.2

* The net present value calculations (NPV) used the average one-year U. S. Treasury constant maturity rate during the term of the contracts and assumed that net collections were received evenly during the term of the contract.

† Collections exclude all loan payments made prior to 1993. In addition, collections for all assets withdrawn for sale by the RTC were imputed at the lesser of 90 percent of the asset's ERV or its derived investment value (DIV).

Source: ALA and RALA data is from the FDIC Division of Resolutions and Receiverships financial performance report dated June 30, 1996. SAMDA data is from the RTC Asset Management System as of December 31, 1996.

values to the starting market values of the pool. Unfortunately, that comparison is not possible because of the differences in asset valuation methodology among the three programs. The assets of the SAMDA program were appraised with a different asset valuation technique, which was ERV, than the techniques used in the ALA and RALA programs, which were gross cash recovery and ITCV, respectively. Without a standard

asset valuation methodology, one cannot fairly compare the effectiveness of the three programs.

The expense-to-collection ratio of the SAMDA program was 19 percent in comparison to 16 percent for the ALAs and 6 percent for the RALAs, as shown in table I.14-15. However, the comparison of the expense ratios does not consider or adjust for the differing asset quality and types among the three programs. The large quantity of owned real estate in the SAMDA program was a major reason for the 19 percent expense-to-collection ratio when the collections and expenses of the SAMDA program are further segregated by asset type. An analysis of the SAMDA program's expense ratios and recovery rates by asset type is shown in table I.14-16.

As shown in table I.14-16, although the expense-to-collection ratio of the total SAMDA program was 19.1 percent, the expense-to-collection ratio for all non-real estate assets was 9.5 percent. This table also shows that owned real estate sales represented 40 percent of the book value reductions, but accounted for 70 percent of the asset disposition expenses.

The 9.5 percent expense-to-collection ratio associated with non-real estate SAMDA assets was substantially lower than the 15.5 percent expense ratio of the ALA program and was approximately 3 percentage points higher than the expense ratio of the RALA program. (See table I.14-15). More than one-third of the assets in the RALA program were performing loans, but there were almost no performing loans in the SAMDA program. Although the disposition costs of nonperforming loans were not tracked in any of the three programs, such costs are known to be substantially higher than those for performing loans. The reason for those higher costs is mainly the time and effort needed

Table I.14-16

**Performance of SAMDA Contractors
Inception Through December 31, 1996**
(*\$ in Billions*)

	Owned Real Estate Assets	Non-Real Estate Assets	Total Assets
Book Value Reductions	\$18.7	\$27.7	\$46.4
Gross Collections	\$9.6	\$13.7	\$23.3
Less: Expenses	3.1	1.3	4.4
Net Collections	\$6.5	\$12.4	\$18.9
Ratios (%):			
Gross Collections/Book Value Reductions	51.3	49.5	50.2
Total Expenses/Gross Collections	32.3	9.5	19.1
Net Collections/Book Value Reductions	34.8	44.8	40.6

Source: RTC Asset Management System.

to explore compromise and settlement options, initiate foreclosure, and take other legal actions needed to protect the receivership's interests.

In summary, although the recovery rate of the SAMDA program is substantially lower and its expense-to-collection ratio is much higher than the other two programs, its lower quality of assets may have accounted for most of those differences. Because the market values were not determined for the original portfolios in each of the programs, it is impossible to make fair comparisons regarding their effectiveness.

Contractor Versus In-House Asset Management and Disposition Strategies

The FDIC has used private-sector contractors in addition to in-house staff to manage and dispose of distressed assets since the mid-1980s. When determining the suitability of contracting for such services, the FDIC considers whether using contractors would provide it with the best financial benefit.

The Federal Deposit Insurance Corporation Improvement Act (FDICIA) of 1991 required the use of private-sector contractors when such needed services were available in the private sector and when the FDIC determined that the use of such contractors was "...practical, efficient, and cost-effective." The main factors the FDIC used when deciding whether to use contractors included the projected cost of available alternatives and the collection revenues projected under various alternatives. Staffing flexibility was also an important factor, as was the availability of asset-specific expertise. Other factors were a desire to service assets locally (thereby lessening customer disruption) and consideration of certain characteristics that were specific to an individual asset pool.

The FDIC has tracked the cost of the disposition of failed bank assets by year of failure since 1986. Included in this information are the asset disposition expenses for the FDIC's in-house asset management and disposition activities and those for the FDIC's asset management and loan servicing contractors. (See table I.14-17.)

As shown in table I.14-17, from 1991 through 1995, the cumulative asset disposition expense-to-collection ratio for ALA and RALA contractors was 14 percent, which was approximately 2 percent less than the ratio for FDIC's in-house asset disposition activities. Legal expenses and accounting costs are included in both in-house and contractor asset disposition expenses in these calculations. However, the expense-to-collection ratios of the ALA and RALA programs are understated because there were certain "soft costs" included in the administration of the ALAs and RALAs that were not included in their asset disposition expenses. Those included some costs of contractor oversight, contractor audits and reviews, Washington headquarters support, and general receivership administrative expenses. The hidden costs of the ALA and RALA programs partially offset the 2 percent difference between the expense-to-collection ratios. Therefore, the expense-to-collection ratio for in-house disposition activity was close to the expense-to-collection ratio of the FDIC's asset management contractors during this time period.

Table I.14-17

Asset Disposition Expenses-to-Collections Ratios 1991 Through 1995

(\$ in Millions)

Asset Management Entity	Asset Disposition Expenses	Gross Collections	Asset Disposition Expenses/Gross Collections (%)
In-House	\$2,412	\$14,886	16.2
Contractors:			
ALA and RALA Contractors	2,421	17,137	14.1
National Loan Servicing Contractors	70	2,534	2.8
Subtotals	2,491	19,671	12.7
Totals	\$4,903	\$34,557	14.2

Source: FDIC Division of Finance.

Conclusion

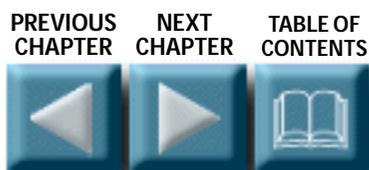
Both the FDIC and the RTC needed to use the expertise of private-sector contractors for asset management during the 1980s and early 1990s when a huge volume of assets from failed banks inundated the agencies. The contractors enabled the FDIC and the RTC to dispose of more than \$78 billion in original book value of distressed assets from 1985 to 1996. The hiring of contractors for a relatively short period of time (three to five years) gave the agencies great flexibility to tailor the needs of an asset pool to the particular expertise of the private sector asset manager while preserving a core staff of FDIC and RTC employees. Once a manageable level of distressed assets was reached, the contracts either expired under their terms or were terminated, and the agencies moved the assets back in-house to be managed by FDIC and RTC personnel.

Contracting by the FDIC and the RTC evolved over time because of the type and quality of the underlying assets, the current goals and needs of the two agencies at the time each contract was entered into, and the lessons learned by the agencies from experience with prior contracts. For example, modifications from earlier contracts better aligned the interests of the contractors with those of the FDIC and the RTC. In addition, the FDIC and the RTC learned that better results were obtained when they located their oversight staff as close to the assets (and the contractor) as possible, especially during the first 12 to 18 months of the asset management contract. The agencies also found that the more stable the continuity of the oversight staff was, the better the contracting process worked. That was true for most of the ALA and RALA contracts under the FDIC, but not for many SAMDA contracts with the RTC. Finally, to enable the FDIC to effectively measure and track a contractor's performance, the FDIC found that the estimated market value of the original asset pool should be determined at the inception

of the contract. A standardized asset valuation methodology needs to be instituted and consistently applied to asset pools at the inception of all asset management contracts.²⁴

Although it cannot be said that one type of asset management contract worked better than another type, the private-sector contractors generally performed well under any type of contract when they were given the proper incentives. By the end of 1996, all of the assets assigned to ALA, RALA, and SAMDA contractors had been sold, settled, or transferred back to the FDIC.

24. The FDIC is in the process (as of early 1998) of fully incorporating a standard asset valuation estimation (SAVE) methodology into all of its business operations. The SAVE methodology will be used from the time a financial institution fails until the receivership is terminated.



Affordable housing was considered an area in which the nation could glean social benefit from the financial crisis by providing an opportunity for low- to moderate-income households to realize their dream of home ownership or to improve their standard of living at affordable rent levels.