PANEL 2

Asset Disposition

Introduction

John Bovenzi, Director
Division of Resolutions and Receiverships, FDIC

Our afternoon panel will focus on asset disposition. The moderator of that panel is Sandra Thompson, who is the Assistant Director of Asset Marketing at the FDIC. In this position she oversees the marketing and sales activity for the FDIC's asset inventory. Prior to assuming this position in March of 1997, Ms. Thompson was manager of securitization and mortgage-backed securities administration and was responsible for the administration of FDIC and RTC securities and equity partnership transactions. Ms. Thompson worked at the RTC from September of 1990 until its closing in December of 1995, and was assistant vice president of securitization management and directed the securitization and equity partnership programs for over $54 billion in loans and other assets. Prior to joining RTC, Ms. Thompson was an investment banker at Goldman Sachs & Company, where she worked on mortgage-backed securitizations for banks, thrifts and insurance companies. She holds a Bachelors in Business Administration in Finance from Howard University, and as you can see from all this, is extremely knowledgeable about a wide range of asset disposition activities that have gone on at FDIC and RTC. We're glad to have her moderating this panel. If you would welcome Sandra Thompson, we'll turn it over to her.

Sandra Thompson, Assistant Director, Asset Marketing
Division of Resolutions and Receiverships, FDIC

Good afternoon. I must tell you that it was very difficult to prepare remarks for this panel's discussion. There are so many issues that should be addressed and each one deserves an appropriate amount of time and consideration. How do you really explain the magnitude of what was done? How do you put into the proper context that during the crisis the government sold over $1 trillion in assets without exacerbating the very problem it was supposed to solve? Do you explain that during the crisis the government acquired and had to sell assets that it never owned before, such as junk bonds, oil drilling rigs, energy and agricultural loans, derivatives, undeveloped land, environmentally impaired assets and subsidiaries? Or, do you talk about the fact that the government owned assets in all 50 states, Puerto Rico and the Virgin Islands, and had no central computer system? Do you discuss that at the height of the crisis, the FDIC and the RTC together owned over $126 billion in assets? How do you sell this many assets in a depressed market when you're mandated to obtain the highest possible price? Do you sell quickly or do you take your time? Do you talk about how soon you learn that you can't use the same marketing strategies that worked well when you sold the $100 million in assets, when you have $100 billion? Do you sell using in-house staff, or do you hire private contractors? Should the assets be sold from headquarters, or should you open sales offices around the country? How do you level the playing field so as to give equal opportunities to small investors and large investors, to community banks and Wall Street firms, to majority-, minority- and woman-owned firms? How can you ever describe the pressures of the extreme governmental and public scrutiny? How do you value your portfolio? Do you estimate projected collections or do you value initial cash flows? Do you sell assets with government guarantees, or do you offer seller financing? Do you sell with reps and warranties, or do you sell as-is? Which sales methods work best? Do you sell real estate through brokers, sealed bids, or auctions? Do you sell loans using bulk sales, securitizations, or equity partnerships? How do you ensure that your affordable housing program is effective? How do you explain that the government took the crisis personally, that many of the sales strategies were created only after we found out how some smart investor received a great deal from the not-so-smart government? How can you describe the feeling you get when you sell a package of loans for 70 cents on the dollar, only to later find out that your buyer repackaged and sold the same loans for 90 cents on the dollar?

How do you feel when the country reads daily, and in detail, of the huge profits investors receive when they buy assets you are responsible for selling? How do you explain that because of the crisis, assets were sold that had never been sold before? Because of the crisis, new markets were created for delinquent and defaulted loans. Because of this crisis, structures were developed that aligned incentives between buyer and seller. Because of the crisis, there is a commercial securitization market. Because of the crisis, partnerships were formed between the public and private sector. How do you make it clear that old strategies were enhanced and new strategies were developed, and that often trial and error dictated the evolution of the innovative methods that were used by the FDIC and the RTC to sell assets?

I'm not sure if all of these questions will be answered today, but this distinguished panel will address many of them.

Dr. Lawrence White will begin our discussion. Dr. White is currently a Professor of Economics at New York University, Stern School of Business, and from 1986 through 1989, he served as a member of the Federal Home Loan Bank Board. Dr. White is the author of numerous books and articles, including the *S&L Debacle: Public Policy Lessons for Bank and Thrift Regulation*.

Following Dr. White will be attorney Hubert Bell, owner of the Law Offices of Hubert Bell in Austin, Texas. Mr. Bell previously worked as acting general counsel for the Texas Banking Department, where he was directly involved in bank and regulatory matters during the late 80s. Mr. Bell will also talk about the asset that wasn't on the corporation's balance sheet—professional liability suits.

Following Mr. Bell will be David Cooke, currently a Director at the Barents Group, formerly an advisor to the Agency for International Development, the Treasury Department, The World Bank, and the International Monetary Fund. He was also formerly president of the Commercial Mortgage Asset Corporation and, prior to that, David Cooke was the executive director for the Resolution Trust Corporation from 1989 through 1992.

Following Mr. Cooke will be Ted Samuel, former Chairman and CEO of the Niagara Portfolio Management Corporation, where his company managed the liquidation of over $2 billion of assets from Goldome Bank. Mr. Samuel was also an Executive Vice President with NationsBank, where his group managed the first asset liquidation agreement for the FDIC. Mr. Samuel was also instrumental in developing many of the structures that were used to sell assets at the RTC.

Winding up the presentation will be Diana Reid, a Managing Director of Credit Suisse First Boston. Ms. Reid joined the First Boston Corporation in 1983 as a Vice President, where she was responsible for forming and trading their mortgage capital group.

Now, I would like to begin the panel's discussion with Dr. Larry White.

Dr. Lawrence White, Professor of Economics
Stern Business School, New York University

Thank you, Sandra. I'm very pleased to be here this afternoon. The FDIC is to be greatly congratulated on having this conference and on doing the studies. I can't claim that I've read every word in them, but I have scanned and skimmed them, and they are very impressive. They are going to be a very valuable resource for historians, and for others who want to learn from the experience of the 80s and the 90s. The men and women who are responsible for these studies really are to be commended.

Now, as a number of the speakers this morning reminded us, there was a world before the RTC, and that is what I'm going to be talking about.

As Sandra mentioned, I was one of the board members of the Federal Home Loan Bank Board from November of 1986 until August of 1989, when the Congress of the United States legislated me out of existence. They probably would have liked to have done more serious things to me than that, but that is all they could do.

I want to make a number of points about the experience of the agency in terms of asset disposition during the time I was there, and (as best I can tell) during the years before.

Let me start by saying that the agency was ill-prepared for the wave of S&L failures that began in 1985. This is not meant to be a slam at the men and women at the agency. I constantly had great respect for their expertise, for how much they did in a comparatively small amount of time with a comparatively small amount of resources.

But, the industry of the 1980s was a very different industry than it had been in the 1960s and the 70s. Jim Montgomery: with all due respect, the industry of the 60s and 70s was a very sleepy industry. And, the agency was geared to that industry of the 60s and the 70s. Even the wave of interest-rate-generated failures of the early 1980s, the interest rate mismatch, the borrowing short and lending long problems of the industry of the early 80s, had really not prepared the agency for the wave of problems that engulfed it in the middle and late 80s.

Now, asset disposition, which is what this panel is about, was really a neglected area at the agency. The major action was in making deals via whole bank resolutions. This was an efficient way of disposing assets. The disposition of assets on a one-by-one individual basis out of a receivership was laborious, it was time-consuming, and quite honestly it was outside the leadership's expertise. I, for sure, didn't know a whole lot about disposing of assets, about selling real estate. I didn't even know a lot about deal making, but at least I felt I could guide the process of deal making and worry about incentives and good stuff like that. I didn't have a clue about selling real estate, except one clue that I'll mention later on.

Whole bank resolution was strongly favored. It was the way to preserve the firm's going-concern value, any firm-specific capital that might still be there in the institution, and it was the way of keeping assets in the hands of those who were most likely to manage and dispose of them in an effective manner.

As most of the people in this room know or will remember, assets were acquired by the agency when an institution was liquidated—i.e., when there was a transfer of deposit accounts only, or when there was an insured deposit payout, or when we transferred most of the assets of an institution but there were some assets that were so "stinky" that the acquirer said, "I don't want them—you keep them." Either way, we would end up with those assets. If my memory serves me correctly, as of year-end 1987, we had about $7 billion of these mostly stinky assets owned by the agency, ranging from single-family homes to commercial properties to mortgages to loans in foreclosure to securities. Almost by definition, these remaining assets were going to be the stinky assets because the good assets were the ones that either we could transfer with the S&L at the time of disposal, or we could sell them pretty readily, pretty quickly.

Asset disposition was clearly a major problem for the agency. First, the agency was a poor manager of assets, which was a special problem for asset categories like residential real estate that required active management. This point was really driven home to me in May of 1989, relatively late in my tenure. I had volunteered to go on the Phil Donohue Show. Using 20/20 hindsight, I'm not sure it was such a great idea because I really got my backside handed to me on a platter. But, at the time I thought that I should try to go out, tell the story as best I could.

In preparing for that appearance, I was briefed by the FSLIC staff on a wide range of topics and issues. In fact, on the show I wasn't asked about anything that I was briefed on. But one of the things that I was briefed on was some residential real estate that the FSLIC had owned in Chicago since 1983. This was 1989! I asked, "why do we own this stuff? Why do we still own it six years later?" I was given a story, I tucked it away, and I decided that I needed to find out more.

After licking my wounds and trying to heal the verbal bruises inflicted by Phil Donohue, I went back to the agency and started finding out more about our asset disposition process. We weren't doing deals anymore in the spring of 1989. That had been taken out of our hands. We were just putting sick thrifts into conservatorships at that point, and the RTC was going to do all the deals. So, it was now time to find out about asset disposition.

I learned that for a piece of acquired real estate, it looked like we did the right thing. After acquiring it, we would get an appraisal. Then a sales person would have some flexibility. He or she could go below the appraisal and sell at a price as low as 90 percent of the appraisal. So far, so good. But why, six years later hadn't we sold this particular piece of property?

Then I realized that our procedures weren't flexible enough. The appraisal might not have been an accurate appraisal at the time, or the market might have fallen away between the time that the appraisal was done and when real estate was really being marketed. So, I asked, "what happens next?" Well, after awhile we would get another appraisal, but often we would go back to the same appraiser, and that appraiser might be reluctant to change the appraisal value because that might indicate that he or she had made a mistake the first time around. And so, we would get stuck with these problems of unsold and poorly managed real estate.

It was then that I had my first and only insight with respect to asset disposal. I realized that since we were bad managers of this stuff, we shouldn't be holding onto it. What we needed to do was to forget about going back for appraisals. Instead we should set some kind of time limits: perhaps six months for a single-family residence and nine months for a multi-family residence, and a year for some kinds of commercial property. If we hadn't sold a piece of property within the time limits, then we should start dropping the price. Give the sales person flexibility down to 80 percent. If three months after that we still hadn't sold it, drop the floor to 70 percent. Just keep dropping the price until the property is sold.

At that point, I started working with the staff of the agency: sitting down in their offices, talking to them, trying to plant the seeds of this idea—of giving the sales people a reasonable chance to sell a piece of property, but if it didn't sell, just keep dropping the floor price until it did.

I realized that this idea wouldn't take hold immediately. But, I was extremely pleased when I read in the newspapers about a year and a half later that Bill Seidman announced that exactly this plan—of periodically dropping the floor price—was going to be put into place. Of course, a lot of the newspapers described Bill's plan as a fire sale, as giving the properties away. They didn't understand it. I think that is an indication of just how much damage the "dead hand" of historically based, backward-looking accounting has done, of how much influence it still has on the way most of the world perceives things, rather than thinking in terms of markets and current market prices. But, I was very pleased that Bill stuck to the plan, which helped move the real estate.

Back to my points. Besides being a poor manager of assets, the agency was a poor seller of assets. It was difficult to acquire high-quality expertise at civil service salaries and the absence of commissions, bonuses, etc. Government salary structures limited greatly what we could do. Again, that is not meant to be a criticism of the men and women we had on the staff. They did very well. But, they had their limitations, and the salary structure—the absence of commissions, the absence of bonuses, and similar incentives that would be natural in a private-sector setting—clearly put limitations on what we could do.

The incentive structure was a major problem. Our inability to provide financing was a problem. And, when I got to the agency in 1986, the one effort that had been made to try to deal with these personnel problems, expertise problems and incentive problems—the Federal Asset Disposition Association (FADA)—was in the process of foundering and basically turned out to be not very useful, because of political and bureaucratic insensitivities on the part of the leadership of the FADA.

I look back on all of this and I conclude that selling real estate is inevitably going to be a problem in this kind of environment. It is just too easy to be criticized regardless of the strategy pursued. Sandra just mentioned all the ways that a government staff person can get criticized in carrying out a transaction. Either you've sold too cheap and somebody else is making huge profits, or you've held it too long and the market has fallen away and why didn't you sell sooner? It is a large problem. It leads to an unfortunate but realistic conclusion: the management and sales of real estate in a political fish bowl ain't easy. I have a lot of respect for the men and women of the FSLIC and then the RTC who, despite all these problems, managed to do quite a credible job.

Thank you very much.

Hubert Bell, Jr., Attorney/CPA
The Law Offices of Hubert Bell, Jr.

I'm pleased to be here today and participate in this symposium. As Sandra indicated, I will discuss those assets that generally do not appear on the books of the failed institution. Rather, they represent intangible-like assets of a receivership estate. When the FDIC or FSLIC closed an institution, it succeeded to a number of rights, titles, privileges, and claims that are generally referred to as professional liability claims. These assets, or claims under civil law, are pursued since any recoveries are used to help offset the losses that may have been caused by the misconduct of directors, officers, accountants, or appraisers who provided services for the institution.

Professional liability claims can be quite complex and contentious, and generally require a number of years to pursue before any recovery is achieved by the receiver. I also will discuss today my involvement in that process—the conversion process—that is the identification and conversion of those assets into dollars. I will also talk about what happened in Texas and some of the problems that the industry faced there during the crisis years. I plan to spend most of the time, however, talking about the conversion process and prosecution of director and officer liability cases on behalf of the FDIC and RTC.

I began my career in the banking regulatory industry as an administrative law judge in Texas. At the time, Jim Sexton was the Commissioner. One of my duties or responsibilities was to conduct bank charter hearings on applicants who had filed applications for bank charters. That was at a time when there were investors who still wanted a charter. That changed over time.

We were required to hold a hearing on each charter application. Our procedure was somewhat different than the OCC's. Regardless of whether the application was contested, we were required to conduct a hearing and my job was to conduct those hearings. There were certain standards that had to be met, such as the likelihood of profitability, adequacy of capital, good faith of the applicant, requisite experience, ability and integrity of the applicant to assure success of the institution, and a public necessity must have existed for the new institution.

I have several charts that I want to show you which graphically illustrate how the industry declined and the resulting economic impact of that decline. Chart 1 shows the increase in the number of financial institutions in the state of Texas and how that picture changed over time. It is also important to note that Texas did not have branch banking until 1987. So, all the banks were independent, free-standing, chartered institutions. You can see the increase in charters from 808 state charters and 627 national charters in 1979, to a high of 896 state charters and 1,076 national charters in 1986. As I understand it, the OCC's view on granting bank charters at that time was basically to allow the free market system to work. If an applicant had the necessary capital, the application fee, and was of good character, then the charter was granted. This might account for the lower percentage increase in the number of charters for state banks as compared with national banks during the economic boom times in Texas.

You can also see the decline in the total number of banks over the years from a high of 1,972 in 1986 to the present number of only 840 banks, with nearly an equal number of state and national charters.

Lawyers played a prominent role in assisting the FDIC and RTC in managing the crisis. Lawyers were involved in identifying potential claims, as well as in the process of converting these identified claims to some actual monetary benefit for the receivership estates. The next chart I'll show you illustrates the number of legal matters handled by the FDIC during the crisis years. Chart 2 shows that there was a high of 65,000 matters handled in 1988, with a high average asset value of $43.3 million occurring in 1991. In addition, the professional liability section of the FDIC and RTC was required to use outside counsel extensively during this period.

Now, to move on to the Texas experience. In most communities, certainly in Texas and probably throughout the country, the most paramount, dominant structure in a city is generally the bank building. It would appear that it is the most stable industry in the city, but that generally is not the case. Banks are institutions that are not able to withstand major macroeconomic shocks in our economic system. I will show you the results of a study that sort of reflects that as well. There was a study performed which compared the financial characteristics of banks that failed with those that survived during the height of the problem years. That study revealed that those institutions that survived were those that generally had a higher equity-to-asset ratio and a lower loan-to-asset ratio. So, banking institutions that may appear to be very stable and secure are actually quite sensitive to changes in our system because of these very low and sensitive margins.

The next chart that I want to show you, Chart 3, shows the number of bank failures in Texas during the crisis years. 1986 was the worst year since the Great Depression for the nation's banking system. There were a total of 138 bank failures and 26 of those failures were in Texas, which represented about 18.8 percent of the total. However, the collapse in the real estate market in 1987 and 1988 had an even more pronounced effect on Texas banks. Out of the 184 total bank failures in the nation in 1987, Texas accounted for 50, comprising about 27 percent of the total bank failures.

As the real estate market worsened in the state, so did the number of bank failures. As a result of the real estate problems, total bank failures, again, set a record of 200 for the year 1988, and of that 200, 133 or 56 percent of those institutions were Texas banks.

Also, I have a chart, Chart 4, that shows the same or similar type of results or statistics for savings and loans in the state. In 1988, 205 thrifts failed in the U.S. and 90 (nearly 44 percent) of those failed thrifts were in Texas. Another 127 Texas thrifts failed during 1990 and 1991, representing nearly 23 percent of the total number of thrift failures nationwide during that same two-year period.

Most of the problems in Texas were due to the decline in the oil and gas industry, as well as the collapse in the Texas real estate market which was precipitated to some degree by the Tax Reform Act of 1996. There was considerable over-investment by a number of real estate developers and speculators.

Also during this period, you have to remember that deregulation, certainly in the S&L industry, as well as the phasing out of Regulation Q helped to create an environment that led to the resulting problems.

Now, I'm going to move on to the director and officer liability area. Ultimately, a bank's management and its board of directors and their cumulative decisions are responsible for the success or failure of an institution. Regulators play a role in this, but they certainly are not responsible for the primary success or failure of the bank. Another study was performed of the failures of banks during the crisis period which showed that, out of the banks that were resolved, 90 percent of those institutions had some type of management-driven weaknesses. That seems to be a high percentage, but from my involvement with director and officer liability cases, that is probably not too high. Also, that same study showed that, out of the total number of banks resolved, one-third of those institutions were plagued by fraud or abuse. I would say in Texas, certainly from my experience, the problems caused by insider abuse probably approached the 50 percent level, as opposed to 33 percent.

I recently had the opportunity to talk with both the former banking commissioner of Texas and the current banking commissioner. They both felt that those are fairly accurate numbers.

Directors and officers of financial institutions have three fiduciary duties. First is the duty of care. Second is the duty of loyalty. Third is the duty of obedience. The duty of care requires that directors and officers conduct the business of the bank with prudence and good judgment. It is sort of an ordinary, prudent-man standard.

The duty of loyalty requires that the directors and officers of the institution conduct the affairs of the bank with honesty and integrity, and they are forbidden from engaging in transactions that would place their interest at a higher level than the interests of the bank.

The third duty mentioned, the duty of obedience, is the duty to obey the law.

Some of these standards, over the years, in Texas as well as in other states, were relaxed as state legislatures enacted laws to lower the standard of care required by directors and officers of institutions in an effort to protect them from actions brought by the FDIC and RTC. Some of those states even passed laws that applied only to financial institutions. Texas was one of those states, and not only did Texas pass a law that applied only to financial institutions, they enacted a law that applied only to lawsuits brought by the RTC and FDIC. In addition, they retroactively abolished the cause of action for breach of the basic duty of care, simple negligence, and they made this new standard applicable to cases already pending in Texas.

Needless to say, there were a number of challenges based on constitutional grounds that the law was somewhat discriminatory and should not stand. The Texas legislature in the next session made some changes to that statute before this issue was fully adjudicated.

In wrapping up, I want to show you the final chart, Chart 5, which depicts the results of the activities of the FDIC and RTC during this period. The professional liability recoveries from January 1986 to December 1996 by the FDIC exceeded $2.5 billion. The costs for outside counsel during that same period was about $444 million. Also, during that period, the RTC collected over $1.5 billion, with associated costs of $466 million. So, from a return on investment standpoint, I would say that the activities and efforts they put forth were remarkably successful.

Thank you.

David Cooke, Director
Barents Group, L.L.C.

Hello. I'm David Cooke and it's certainly an honor and privilege to be here today. I was delighted when I was asked to be here today and talk a little bit about the RTC experience. I've been gone for six years so it really is an out-of-body experience for me. I'm trying to recall as much as I can. When I was asked to make a presentation by Sandra Thompson and John Bovenzi, "I said, I've been gone for a long time. What specifically would you like me to talk about?" I was told you should talk about some of the issues and concerns that you had. The more I thought about it, the more excited I became. There were a lot of things happening back then. There were funding issues. There were legislative issues. There were debates—don't sell too fast or too slow. There were contracting issues—hire these guys, don't hire those guys. The more I thought about it, the more excited I got. Sandra said, "you know Dave, that is going to fit in really great and I really want you to do it. But, make sure you stay within 10 minutes—preferably 6–7!" So, I will try to go quickly.

From my perspective, the way the RTC began was influenced by a lot of things. It was influenced by the law that created it. It was a complex law. The governance of the RTC was confusing. The political environment was hostile, unforgiving and impatient. I can't help but think back to some of the early testimonies and just how hostile the environment was to members of the savings and loan industry. Just a few years ago, it was a "good life" with Jimmy Stewart, and now the sentiment had changed.

Another factor that influenced the RTC was, of course, the FDIC. The FDIC, I've got to say, was essential and supportive. We could not have done it without them. But, the FDIC had its own capacity problems and to be honest with you, they weren't ready for the workload either. I vividly remember the first RTC board meeting when Danny Wall, former head of the Bank Board said, "you guys don't know what you're getting into." About six or seven days later, I thought, yeah, he's right—what am I doing here?

This reminds me of another story. I had been with the FDIC for years and some of you out there know that. At the time the RTC was being conceived, I was Deputy to Chairman Seidman. He had been interviewing people to take over the top RTC position. One day in July, I asked him, how's it going? He says I'm interviewing this guy and that guy but I'm not really sure they're right. They all seemed pretty impressive to me. He said, you ought to think about taking the job. I thought he was kidding, to be honest with you. I said, yeah right. The next week, he said, well, have you thought about taking the job? Of course, this was quite an honor and I said, can I think about it overnight? So, I went home, thought about it, came in the next morning feeling pretty good. So, I go in to see him and I say, well Bill, do you really think I am the best guy for the job? He says, no I don't, but you know the people, you know the issues and you're here. So, with that word of encouragement…I went to the first board meeting where Danny Wall was saying you don't know what you're getting into. Then I had this Congressman tell me I was going down a slippery slope. So, I began to think this may have been a big career mistake.

The RTC was also influenced by the private sector. We had private sector guys running to and running from the RTC. There were people running to the RTC because they wanted to get work. They wanted to advise us how to sell assets. They wanted to do due diligence. They wanted to help run the back room operations of the thrifts. And, there were people running from the RTC that were afraid they were going to be sued by the RTC. That issue caused a bit of a problem in the early days as well.

Also influencing how the RTC acted were the assets—we had an awful lot of assets that came in very early—and the funding issues.

As far as the law, at first, it looks like a pretty good law. You had to maximize recoveries. You want to minimize the disruption to the marketplace. No fire sales. Use the private sector wherever feasible and close up operations in seven years. I can tell you seven years seems a long way out. So, everything seemed fine.

However, there were some other provisions in the legislation that we really had not dealt with before. There were provisions that said make sure you don't sell to any professional who has caused problems, who has caused a loss. That was a problem because anybody with thrift experience might be sued to get some money back with professional liability suits. So, immediately we had some problems in contracting—who can we contract with.

There were other provisions—give certain preferences to women and minority groups in the contracting arena and in the institution sales and later in some asset sales. At the FDIC, where the core of us came from at the beginning—we didn't have any experience in working those issues and they were very, very politically sensitive. There were also provisions to give preferences to certain low income groups in buying housing—again something we had no experience with whatsoever. So, it made us realize that we had to do some different things.

The law also provided us with what I think is a unique governance structure, which I thought was probably not going to be duplicated again, but it might be. In some countries, believe it or not, a structure like the RTC may be the answer for people looking to absolve themselves of responsibility in the process.

The governance provisions of the RTC legislation attempted to separate policy from operations. We had an oversight board in the early days, a very demanding one which was later revised. It set policies and approved budgets and you had the RTC/FDIC board which ran operations and never the twain shall meet. We also had advisory boards to give us advice. So, the lines of accountability were clearly blurred. There were times when we would go to one board to be told you've got to go talk to the other board, and the other board would say you've got to go back to that board on some very sensitive issues.

In the structure that was set up, we had lots of people involved in the process, giving us advice. There were not as many committed to actually doing it, other than a lot of people we recruited. This reminds me of the story of the difference between involvement and commitment that a colleague once told me. He said, it is like having ham and eggs for breakfast. The chicken is involved but the pig is committed. So, not to refer to us as a bunch of pigs, but we were definitely committed to the process.

The early emphasis in the RTC's establishment, most of the time and attention was just focused on building the staff, the infrastructure and in setting up policies. We had all these issues dealing with contracting and how you run a conservatorship. There were a lot of things consuming a lot of time. It was a big job, which Bill Roelle knows better than anybody here—getting control of all these S&Ls. The FDIC started taking over the conservatorships in early 1989, as Larry White mentioned, the RTC was created on August 9th or 10th. From that day forward—we became really responsible for what happened to those institutions.

There were lots of issues on the basic approach—which was, let's package these institutions up and sell them to healthy banks. We started trying what was known as a whole bank sale where we tried to find some bank that would, at a certain price, take on a lot of the assets except for the really "stinky" assets, as Larry White called them. I think we called them "opportunity" assets. That may have been a difference in the sales strategy between the RTC and the Bank Board.

A lot of time was focused on how are we going to manage all this real estate and these low quality loans, nonperforming, subperforming, potentially nonperforming—all these loans that we felt that we couldn't sell. We found out that we couldn't sell a lot of those loans, even the ones that we thought we could sell.

The political emphasis at that time when we started centered on concerns about the RTC dumping assets and disrupting markets. People would come in and say, my God, you're going to destroy the market in Arizona, you're going to destroy the market in Texas, so make sure you don't do it. We knew the appraisals that were on the books for these assets in the beginning were totally unrealistic. We knew we had to get more realistic—that means we need to lower appraisals on these properties to sell them. We spent lots of time meeting with members of Congress and state and local representatives that were very concerned that we were going to disrupt the financial markets, the asset markets, the credit flow. We always would have some borrower who felt that we were being unreasonable.

Things started to change though. Some of the factors that started to influence that change was that banks took only the best assets. That was despite the fact that we offered them price discounts. We offered them put-back options and generally they would put them back after they had been cherry picked and they would put them back late. I remember we used to get the reports looking at how many assets had been sold. We would originally count things we sold with put-backs as a sale, and then we would keep our fingers crossed that at the expiration of the put period that they would actually keep them and for some assets they did, but for too many of the harder to sell, they didn't.

Well, since we couldn't get the banks to buy them, we needed funding to carry the asset inventory. We had two types of funds that we used to preach about. We had loss funds and what we called working capital. We needed money to carry the assets. If we wanted to get rid of the conservatorship, close it down, sell off the good assets and sell off the deposit liabilities to somebody else, we needed to have funds. We needed to have cash in effect to fund us holding onto the assets in inventory.

The legislation simply did not address that funding need at all. It only talked about loss funds. So, very early on we ran into a brick wall. We couldn't do any more transactions because we couldn't fund the closing. The S&Ls had to be kept in conservatorship longer and longer and longer. I don't remember what the average worked out to, but it was getting pretty long and that meant we had more and more control problems. We had to deal with the liquidity problems of the institutions and we had to regularly preach about what the cost of this delay was. We had some very creative thinkers in our Department of Research that would put together some really convincing numbers.

Eventually things changed when Treasury funding was arranged after about six months. Treasury would lend us money to carry these inventories. The good news was the pace of S&L sales picked up dramatically. That was an exciting time at RTC. Over three months we sold lots of S&Ls. Paul Ramey and Sherwin Koopmans and Bill Roelle were setting off whistles and having contests—it was an exciting time—it was a happy mood. But, people started to get concerned now about all these assets coming in and Treasury borrowings being scored, since it was a budget outlay. They didn't have to go through the appropriations process, but the impact was negative. So, there was growing discontent.

Also, a growing asset inventory meant increasing market interest. Then criticism started to increase about the pace of sales and the way we were handling assets with our standardized asset management and disposition contracts. We knew that we had some problems with incentives in those contracts, and we were in the midst of revising them when due to a policy change decreed by Chairman Seidman, we stopped looking to the asset managers for the disposition phase.

Other things also influenced the change in direction. The oversight board did direct the RTC to experiment with structured transactions and equity participations. They said why don't you try some new things. Interestingly, they had been resistant to do some things, like seller financing. But, they eventually changed that position to where they approved of seller financing and then were asking us why weren't we using it more often than we were.

Another factor of influence was the FDIC chairman. While we were just working on an experiment for the oversight board, he said we should just go ahead and do a big bulk sale. I remember when he called me into his office and he said, Dave, you know, if we only sell a million dollars a day it is going to take like three trillion years to sell them all. Then I said, "that is a good point Bill, but you know we are selling more than a million dollars a day." But the next thing I know we are going to a public meeting, with the oversight board, and Bill is saying, "if we only sold a million dollars a day . . . ." and so now it's in the media. Chairman Seidman says it will take years to get rid of the assets.

So, people were saying you guys were trying to build a bureaucracy—you're going to be here forever. So, immediately we started to switch to become more large-sales oriented.

Some of the things that were done by the RTC that I think were really commendable were the development of the standard sales agreements, due diligence procedures, appraisal guidelines, and instructions to appraisers—many of these things were controversial. Almost every step that seems standard now was a big, agonizing debate at one point. Providing market oriented reps and warrants—who provides the warranty? Is it just going to be the receivership? How far does it go? What are you doing to the government? There was a lot of anxiety over that. Creation of sales centers, the 800 sales lines, which were quickly swamped, publishing calendars of upcoming sales—and lots of other new things were done in the area of asset sales.

Not to exceed my time, I just want to make a couple comments of some things that I thought were particularly memorable to me. At the time, everything was important, but some of the things that I remember about securitization and whether or not to do securitization. Our first securitization transaction was junk bond securities. We went to the board and they approved it. It was the first one. Later, we went back to the board and said, well, we would now like to do securitization of mortgages. The board members were really concerned about their own liability and delayed it several months. But finally, a law was passed that said the board would not have to worry about that liability and it went through. Securitization was very successful—and I believe it worked out very well.

Another big issue that I recall was whether or not we should re-underwrite a lot of these loans. If we re-underwrite the loans, we can make them look better and we can package them better in securitizations. When I left, and I think it ended this way, the decision came down to say we might be opening Pandora's box. There may be truth that a lot of mortgages that were potentially nonperforming that we decided to restructure might have opened up the flood gates for others and we might have done things to the loans that might actually have made them less attractive—so, we decided not to. However, that is an issue and I do a fair amount of international stuff and the re-underwriting of loans is a big issue, particularly when you start dealing with industrial companies and not primary real estate assets.

Another thing, real estate auction, major real estate auctions, auctions of nonperforming assets, I was delighted to see that those things took off and were flying so well. Our first big real estate auction was a major disaster. It didn't go off, as a matter of fact. We ended up in litigation with the auctioneer company. But, because of those mistakes, and that was the nice thing, the people at the RTC were really, maybe we were under a lot of pressure, but we were willing to try just about anything. It wasn't real clear who would tell us we could or couldn't either because it was a confusing structure. So, we would try different things and we would get through stuff a little bit along the way but we would do all right in the final end. I know in the final one they did, the processes really got streamlined and the FDIC has also helped streamline. They've done some of the same procedures so everybody is to be congratulated.

The Derived Investment Value (DIV) was another thing developed by the RTC, with the help of consultants that are, now are competitors of the company that I work for, I won't give them any credit. But there were consultants that helped develop that scheme. And DIV basically analyzed cash flows and resulted in giving values that were much lower, closer to what an investor might consider an asset worth. I remember some of the early transactions—I think it was Tom Horton—I said, Tom, how did you do? He said, great Dave, we got 75 percent of value. I said, that is really great and I'm thinking of appraisal values. He said, no Dave, it is a DIV which is only about 70 percent of the appraisal value or whatever. So, it did work. We let the market speak.

Earlier Larry White mentioned a variation of the Filene's basement sale. I remember that. Bill Seidman actually called it the Filene's basement sale and people did see it as a fire sale. But by then, everybody's attitudes were changing. In the early days of the RTC, we were visited in the chairman's office, even before RTC, by people from Arizona and Texas, and they were coming and saying, please do not sell these assets. Do not destroy the market. Those same people came in about a year later and said, please sell those assets. The market is all clogged up. Nobody wants to buy anything. They all saw this big weight that the government is holding.

Seller financing was an issue that the RTC finally worked out. That was a very, very controversial issue, considering how sparingly it was eventually used. I don't think it was more than just a few billion dollars in the end, but it was so controversial, I think it was one of the major factors why the first president of the oversight board staff decided not to stay, because he was a big supporter that we should provide it.

Certainly, the structured transactions the RTC built, the end-deals and the equity participations, those were really break-throughs. I think the RTC and the FDIC did a tremendous job doing it. Sometimes I find myself in my idle moments thinking back though. You look back on the process because you hear things when you leave—you hear things through people on the private-sector side. You hear things from people in other countries. I guess I don't know—it would be interesting to see—did we go too fast? Did we leave too much on the table, or is the pace more important than the price, because the faster the pace the faster you unclog that clog, but at a price to do it? I still think about it from time to time. I don't know that we would have handled it any differently, really. Maybe just some of the lessons we learned the first year or so we would avoid them.

Anyway, thank you very much.

Ted Samuel, Former Chairman and Chief Executive Officer
Niagara Asset Corporation
Niagara Portfolio Management Corporation

Good afternoon and I'm delighted to be invited to this meeting. I believe my role here is to represent the perspective of the private-sector contractor. I will attempt to discuss briefly some of the concepts and the evolution of the crisis resolution, as opposed to the details.

First, it is very difficult in 1998 on a spring day, with interest rates at 6 percent and the Dow Jones somewhere around 9,000, to portray the climate of 1989. However, 1989 was a much different story.

- Interest rates were very high and had a huge effect on nonperforming assets. High interest rates were incorporated in appraisal capitalization rates as well as in present value rates.
- For many borrowers, particularly in the real estate sector, there was no alternative financing available.
- The country was hostile. I was in Texas—it was really hostile in Texas. I was not from Texas either. There was an attitude of anger and suspicion at both the borrowers and the lenders.
- Confidence in the financial system hung in the balance. It was a crisis in Texas.

The crisis first involved me when I arrived at First RepublicBank. The bank had failed and its problem assets of over $10 billion created a large potential drain on the FDIC fund. There were about 300,000 items under special asset management. There were about 1,000 employees. They were angry employees. They were angry at possibly no longer being employees. They were angry at me because I was from North Carolina—Ohio really.

The crisis we faced in this climate was immediate, material and real. The resolution of the crisis became a riddle which had objectives and constraints.

The objectives were fairly simple to write down. Liquidate large numbers of poorly understood assets quickly and for cash. Those objectives were reinforced by the asset liquidation agreement, under which we worked.

The constraints to asset management fell into several broad categories. First, let's talk about the large numbers—300,000 items, mostly small loans and consumer loans. They presented a certain chaotic element to asset management and administration.

Second—poorly understood assets. Initially, we didn't know what we had. We didn't know what we were attempting to manage or sell. This was perhaps the biggest problem of all. These loans were not made or documented to ever be transferred anywhere. One of my biggest shocks came while walking down the street with Jim Irwin shortly after arriving at the FirstRepublic Special Asset Bank. I was in charge of the real estate problem loan portfolio. I said to Jim, "Okay I'm here—I'd like my list of assets." There was a pause. There was a long pause. He said, well, we don't have one. It took me six months to get a list of assets. I'm sure that was repeated time after time at other institutions and at the RTC.

Third, after a brief period of collections funded by alternative sources, we ran into a logjam as our borrowers could not raise money. Other banks were not lending money. No one was lending money. We needed cash from those assets. The FDIC needed cash. We reached an impasse.

We concluded that in addition to our traditional collection activities, we needed another vehicle to solve the riddle. The traditional methods failed for several reasons. First, the time requirements to resolve large asset volumes were unacceptable. Second, cash collections were difficult, as refinancing was not available for many of our borrowers. Third, fairness and wisdom dictated restructuring debt in many cases as opposed to demanding a cash settlement from our borrowers. Fourth, the market was imperiled by requiring cash for asset sales, particularly real estate owned sales. Fifth, fair market values were not attainable quickly for cash collections or sales. And, sixth, real estate sales took too much time and did not close.

We began to focus on bulk or pooled sales as a solution. In theory, bulk or pooled sales would quickly generate cash, sell large volumes, allow restructurings at the borrower level, and not destroy individual markets. However, several theoretical and practical impediments remained. The first one, which continued, was that we did not know what we were selling.

I'm going to take a minute and talk about something fundamental to the whole process and that is appraisals. Appraisals were crucial requirements for asset resolutions. One of my earlier experiences at the former FirstRepublic was being told that we simply could not get appraisals because there were no more appraisers available. Appraisals tended to come in high on the first go-around because the appraisals were based on prior sales when property values had fallen 30 to 40 percent due to future projections. This required at least a second round of appraisals. One logistical problem with appraisals is the need to give the appraiser good property information. Of course, we didn't have that information. The time requirements for this expanded geometrically. We just slogged our way through the appraisal issues.

In retrospect, I believe some of the information problems we encountered could have been reduced through the judicious use of representations and warranties, particularly in conjunction with bulk sales. In my opinion, buyers will accept the additional work of researching certain asset issues following closing, provided they are protected from what they find. They will accept this work without significantly discounting bid prices. Note that I believe work can be transferred but not risk. If I were to hold up a loan file and told you it contained a first mortgage and asked you to bid on it, you may bid with your implied understanding of what it was. If I said "maybe" it is a first mortgage, your bid would be considerably different. We started with the "maybe" first mortgage.

Fortunately, over the years, we expanded sale representations and warranties which encouraged effective sales. Transferring loan review work through expanded representations and warranties would have significantly sped up the sale process had they been used earlier. As it was, we experienced significant delay in an attempt to avoid representations or warranties which did nothing to remove risk or improve value.

The second remaining problem for loan sales was to satisfy the fair market value requirement. Our global assignment was to recover the highest net present value, but fair market value inevitably crept in. We satisfied the fair market value requirement by demonstrating several things.

First, we demonstrated fairness by subjecting all bidders to the same rules, by providing all bidders with reasonable representations and warranties, by providing relatively affordable small and stratified pools, by providing the same information to all the bidders, and by providing competitive bidding with broad marketing.

Second, we needed to demonstrate, in addition to obtaining appraisals, that sales were at market values. We demonstrated obtaining market values by widely marketing, by advertising sales, by widening the market through providing financing, and by profit-sharing arrangements and equity participations. I am in favor of equity participations because whatever the assets were worth, we shared in those values. Hopefully, values were being enhanced by the buyers' efforts.

In addition, we developed new concepts of net recovery values, such as the Derived Investment Value (DIV), which allowed for realistic valuation. Still, we had an appraisal-timing problem that didn't go away and slowed us down.

Okay, so the theory worked. Bulk sales could meet objectives, but would they work? Would they close? Was there a wide enough and deep enough market?

First, we needed deals to close. We had a good deal of experience with deals that did not close. The reason they did not close was that we did not require prior due diligence. Requiring prior due diligence was key to these programs working. When people bid, they bought. At first, people were reluctant to bid. People may have bid low, but they bought.

The second key element was representations and warranties. We improved the representations and warranties so that the bid risk structures were appropriate to the assets being sold.

The final element was the depth of the market. In short, would we get a price which met our fair market value test? The first deals closed and investors noticed the attractive prices. You can always count on competitive greed. Bidders and prices increased substantially. A viable market was born. Asset sale prices began exceeding our expectations and then our belief. Competitive bidding worked. Reasonably priced funds were raised to fund troubled assets. The crisis, from my standpoint, stabilized.

A by-product of bulk sales is that it changed the temperament of the problem and the crisis. When you're a bank or liquidator and you collect 70 percent of a loan, you feel you've lost no matter how good your collection. You still feel you've lost. In the bulk sale environment, profits are made and it changed the entire temperament. All of a sudden, there is an optimism about workouts and prospects for the future. We saw that happen in Texas. People recognized an opportunity. Then they bid the opportunity up to very competitive levels.

We finished our job and went home and interest rates fell and we were invited to symposiums and lived happily ever after.

Seriously, proper credit must be given to several additional factors. First, I worked under asset liquidation agreements, and those agreements delegated authority through oversight committees. The oversight committees were extremely important to us. I admit when I arrived in Dallas there was a great deal of animosity between my staff and the FDIC staff. This probably resulted from anger and disappointment at being part of a failed bank, with a failed career. Nonetheless, over a period of time, this animosity was largely dispelled to the credit of the oversight committees. They did great work, used common sense, were locally available, and key to the success.

Second, incentives based on cash collections for both the private contractors and their employees played a large role. This kept our focus and our enthusiasm as we worked ourselves out of jobs and careers. It was highly effective down to the lowest employee level. It made my job of managing much, much easier than I told the oversight committee. Never underestimate the value of management by incentives.

To summarize, I would recommend the following in the future: (1) Avoid large numbers of small assets. Make acquiring banks take them and if that is not possible, sell them immediately. The administration of small assets was one of our greatest difficulties; (2) Sell loans in bulk competitive bids with financing and retain a profits interest, particularly in difficult to value transactions; (3) Use firm sale contracts with prior due diligence and representations and warranties; (4) Delegate authority; (5) Provide incentives to servicers; (6) Provide seller financing for all large sales of loans or REO; (7) Place less emphasis on cash collections from primary borrowers, and; (8) Transfer work to investors through representations and warranties.

In closing, what did our efforts accomplish with the bulk sales solution? We broadened recovery methods. We lowered the cost of funds and refinanced billions of dollars of assets. We changed the temperament of collections from losing to winning, and we saved time and expense. Make no mistake, there were mistakes made—I know because I made some. However, criticism that bulk sales, at least the ones we sold, sold cheap, is simply false. The Dow Jones stocks sold cheap. Bonds sold cheap. I believe that the average buyer of our pools would have done approximately as well had they purchased almost any mutual fund in 1990.

Finally, make no mistake, I believe that asset dispositions were handled very well overall. In 1990, I drafted, but did not send, an editorial regarding the difficulties facing the RTC and the FDIC. The opening line was, "Hercules and Solomon on their best day could not resolve the problems confronting the RTC and FDIC to everyone's satisfaction." I still believe that. I also believe that I worked with many outstanding people in both the public and private sectors and I'm proud of our joint success. Thank you.

Diana Reid, Managing Director/Senior Advisor
Credit Suisse First Boston

My name is Diana Reid and I am a managing director with the investment banking firm of Credit Suisse First Boston. I want to thank Sandra for inviting me to join you today. I am honored to be the lone investment banker at this gathering.

Sandra asked me to speak about the variety of roles that Wall Street played in the RTC and FDIC's crisis management. Among the Wall Street firms, there was a wide range of participation in RTC activities. Some Wall Street firms had very little involvement with the RTC crisis management; they decided not to commit the infrastructure, resources, and time; or just didn't have the capability among their product areas. Others had the capability, but decided it was not a long-term product line. Others among the Wall Street firms did commit significant time and resources to the effort. The commitment or the amount of involvement had a wide range of risk appetites. Some firms focused completely on the advisory work and fee-based assignments. Some firms focused on the principal opportunities. Some firms focused on both.

What I'm going to speak about today is what Credit Suisse First Boston did and what we did not do, and how we made those choices.

One personal note I'd like to share is how I got involved with First Boston's effort. Think back to the situation in 1989 and 1990. I've worked at First Boston since 1983, as Sandra noted, and what I focused on was credit risk classes of assets; the newer, more difficult-to-sell ABS (asset backed securities) and MBS (mortgage back securities). So, when the RTC and the FDIC came along with bulk sales, I was asked by my manager to get involved and identify the investors for these assets. At that time, real estate was in the news, not in positive articles such as appear today; but every day there was something else negative about thrift assets or real estate that appeared in the papers. So, my assignment was to find investors for an asset class with a negative taint.

Let me walk you through the evolution of CSFB's involvement in the RTC's asset disposition. The first aspect we got involved in, in the very early years, was advising our institutional clients, major banks and thrifts on their whole bank purchases. We were not initially involved in the government advisory business; we were helping our clients figure out a strategy to purchase some of the banks and thrifts that were for sale. Sometimes we would provide them financing for such acquisitions. We would take some risk, and we would arrange financing for their purchases. In one case, we provided a valuation of all of the assets of a large thrift that a bank was purchasing so that the bank could quickly purchase those assets, value them and securitize them. So, CSFB's first involvement was advising our traditional client base on how to purchase some of the thrifts and banks that were for sale.

The second phase in CSFB's participation was to become an advisor to the RTC on various issues, primarily the bulk sale advisory work. So, before we took any principal risk, we became an advisor and began to understand what the issues were with the assets. What the assets were and what the process of securitization or sale might entail. So, CSFB would receive a fee, which we had competitively submitted and been chosen through an auction process, and we would receive that fee for assisting the RTC in coordinating all of the information gathering, overseeing the due diligence advisors, developing a marketing strategy (which was probably one of the most challenging tasks), figuring out who would be the possible bidders for these assets, putting together an organized book to send out to the potential bidders, working with those bidders on their due diligence, and then running an auction. That was an exciting task—running those auctions. On our first of several bulk sales, I remember sitting with the RTC staff and the CSFB team, being so excited when we would finally receive bids that were at or above the threshold price that the RTC had set. It was terrific to have found multiple investors to bid competitively for the assets in such a different environment.

CSFB completed many advisory assignments. But remember, at that time, we weren't risking any of our own money. We allocated a lot of time, resources, infrastructure, sometimes even some new systems design, and we were receiving a fee for that work. CSFB completed such advisory assignments on residential loans, multi-family loans, commercial property loans, performing loans, and nonperforming loans; for the range that the RTC was managing, we would act as advisor on those bulk sales. Only after we had completed such advisory assignments, assisting the RTC in selling billions of dollars of assets through bulk sales, did CSFB decide that we would also risk some principal and become a bidder in certain bulk sales.

So, then CSFB's role became the investor in certain loans. Sometimes we would securitize them. Other times we would sell them "as-is," maybe in different groupings or individually. Sometimes we would meet with the borrowers and restructure the loans before we then re-offered them to other investors. Sometimes we entered into joint ventures with asset managers who were much more familiar with a certain location, real estate market or property type than we were, to ensure that we didn't make mistakes bidding from New York City on assets that were located in Texas or California.

So, CSFB became bidders for these assets. But, there was a range of risks taken. We profited on many portfolios. We lost money on a few portfolios. At times we underestimated the cost of servicing, modifying or working out the very small loans or residential loans. That was where the most difficulty occurred. But, overall, CSFB saw it as an opportunity to combine our knowledge of asset valuation, risk taking and securitization.

The next step began with the securitization programs. This is really where Wall Street contributed significantly. After all, securitization is our primary business. We at CSFB took a great deal of pride in being a founder and leader of asset-backed and mortgage-backed securities/markets. We knew those markets very well. This was an area that we acted as advisor to the FDIC and the RTC, and also played a leading role as an underwriter of those securities. This was, to me, definitely the most satisfying of all of the projects that I worked on for the RTC. Beginning with residential loans and then to multi-family, and then to commercial, and then to the combination of commercial and multi-family. CSFB participated as advisor on the securitization of nonperforming loans, but not as securities underwriter. We did participate on the equity tranches of some transactions, as principal.

The securitization program was one of the most significant innovations of the RTC and has contributed to today's active and healthy CMBS (commercial mortgage backed securities) market. Its results are still seen in the market today. The RTC forced the securities underwriters to innovate, find new investors, and to create new credit enhancement structures.

The other product that Wall Street broadly participated in was funds. For the nonperforming loans, the equity partnerships, the nonperforming pools in securitizations, many firms established funds. Morgan Stanley, Goldman Sachs, and CSFB were really the dominant players in investing our own money as well as raising third-party funds in limited partnership structures and using those limited partnerships to bid on some of these nonperforming assets. That is a big on-going business today in different types of assets with different types of sellers, but is certainly one of the main legacies of the RTC experience.

"Necessity is the mother of invention" is an apt quote to summarize the RTC experience. Sandra and her staff forced the Wall Street professionals to be creative, to invent new solutions. Three such examples: In an early residential loan securitzation, we were faced with selling several hundred million dollars in loans indexed to the 11th District Cost of Funds index. One of the healthy California thrifts had just attempted to do a much smaller transaction with a similar pool of adjustable rate mortgage; and it had taken them several weeks to clear the market, i.e., find enough investors to purchase all the securities. So, I was, needless to say, a little bit worried about a much larger deal clearing the market. What we created was a "cross-index" feature that proved popular with investors and profitable for the RTC, as well. We issued the bonds using LIBOR and we proved to the rating agencies (and we proved to the RTC who was holding the residual), and to the investors that there was enough cash flow in the transaction to support this feature.

The multi-family securitization of 1991-M5 was the first time we had looked at balloon maturity extensions. If you looked at the underlying asset value of the multi-family properties versus the loan on a property, all the loans were about 100 percent of property value and re-financing was not as liquid as it is today. We came up with an "extension" scenario that gave the investors comfort that the securities would perform well. We gave the rating agencies comfort that the securities could support that rating, and also introduced servicer flexibility so that at the balloon maturity the borrower was not forced into foreclosure.

In commercial real estate transactions, the "excess apply" structure was one that I'm most proud of having helped execute. The RTC kept the residual value and paid off early the highest yielding components of the financing. The structure allowed us to attract new investors to those securitizations.

I'd like to conclude my remarks with a list of what the RTC experience has created in the fixed-income securities market. First and foremost, I believe that traders and the fixed-income departments on Wall Street are more capable today of selling securities with a complex story. There were many trading desks and many firms that did not have the expertise nor take the time to sell securities that had complex stories. The RTC experience pushed us all to develop skills that we would not have otherwise had. So, there is a lot more complexity in structured transactions, which allows issuers to create offerings tailored to their current needs.

Second, there exists today a commercial mortgage-backed securities market. There wasn't one in 1990. The CMBS market really developed because the RTC proved there were investors out there to support it. The CMBS market has provided liquidity to the real estate market, and that liquidity has been a factor behind the real estate recovery of this decade. The RTC created the early CMBS market, forced the setting of standards of due diligence and focused the rating agencies on this market.

Third, the street today is more willing to take principal risk for assets that can be placed into securitizations. There are more firms today willing to look at unusual assets and commit their own capital.

Fourth, the enhancement of systems and financial modeling is not one that most people recognize. But very advanced financial engineering was required to model many of the RTC transactions which introduced new structural twists, new asset types, and new credit enhancement methods. I remember when we were structuring 1991-M5, one weekend in the financial engineering room we had 15 computer programmers who had been working 12 to 16 hour days for about three weeks to upgrade the systems so that we could model, provide analysis, answer investor questions, and value the residual that the RTC would retain on this transaction. We believed we had one of the best systems on the street before M5, but we still had to enhance and improve that system. Most of the Wall Street firms have vastly improved financial engineering models today if they were involved in the RTC process.

Thompson: Before we start the question and answer period, I would like to pose a question to any one of the panelists who would care to address it. That is that there is a lot of debate about whole loan sales or the government selling assets while retaining an equity interest. Do you think the government should retain an equity interest in asset sales?

Samuel: I believe the answer depends on the type of assets being sold. If the assets are well understood with a defined market providing full market value, then sell without equity participation. In cases of poorly understood assets or difficult to value assets then equity participation is beneficial.

Thompson: David Cooke, why didn't the government sell assets using government guarantees?

Cooke: That was an issue of some discussion. The feeling was if you could put a full faith and credit guarantee behind an asset, you could sell anything. So, what's the point. Actually there were some asset categories where at one time we thought it might make sense because the market was being irrational. But, as the opponents to that approach said, and thinking about it, I think they're right—if we slap the full faith and credit of the U.S., we don't really need you to go around and try to sell it. So, it was decided not to. But again, some of the representations and warranties, especially some of the early reps and warranties that went on some of the early securitization deals, I recall, seemed to be getting awful close to a full faith guarantee because reps given by the RTC were, in effect, backed by full faith and credit. But I think the whole view was very cautious not to do anything to prolong the government's involvement in those assets, and I think it was probably for the best.

White: The names of the programs might have been a little different, the particular twists might have been a little different, but the same fundamental problems were present. David, you had the advantage of more development in capital markets, better technology; you could do stuff that we weren't capable of. But, on the issue of guarantees or financing, basically there was a strong sentiment in the FSLIC that said, let's just get rid of this stuff. We don't want it coming back to us. We want it out of here. That was a very strong sentiment.

Thompson: Based on your remarks on progress that we had with FADA, do you think we would have been better served in just hiring a private contractor to just sell everything, as opposed to trying to sell it ourselves?

White: There is no right answer to that. It's all an issue of monitoring, of structuring contracts, of incentives. In principle, by having the private sector rather than the public sector, you are not subject to the limitations of salaries, of not being able to offer bonuses, of not being able to hire the necessary expertise at the government civil service rates. On the other hand, if you get the contract wrong with a private-sector contractor, they're going to take advantage of it. If you provide too rich an incentive to manage rather than to sell, they'll manage the hell out of those assets and they won't sell them. If you provide not enough incentive for management, they'll dump stuff that ought to be managed before it's sold. So, getting those contract terms right is terrifically important and terrifically difficult. There is no good or right answer.

I think the FADA was a creative effort to try to bring private-sector expertise, salaries, and incentives into the tent while still retaining a decent amount of oversight and control on the part of the federal agency. But, as I said, it fell apart because of inadequate sensitivities to the bureaucratic niceties of the government sector, the unfamiliarity of the private-sector people in trying to deal with the public sector.

Smith: I'm Ed Smith with Banc One Mortgage Capital Markets, and I have a question for Mr. Bell, if you will. If you measure recoveries of these claims in terms of actual cash dollars as opposed to judgment amounts, how would you compare that with the cost of seeking those recoveries?

Bell: I'm not sure if I have the statistics to completely answer your question, but I think most of those recoveries that were reflected on the chart would be actual dollar recoveries, either from proceeds from insurance companies or actual cash settlements with the defendants in the case, and not simply judgments.

Kroener: Bill Kroener, General Counsel of the FDIC. The long-term, ten-year numbers, total costs on total recoveries, are just about four to one recoveries as against cost. That is for both the RTC and the FDIC for the PLS program as a whole. We track these numbers fairly carefully and regularly and that is the overall number for the ten-year period. Obviously, there are amplitudes within the period.

Thompson: Any more questions?

Cooke: Maybe I could ask a question on that issue, if you don't mind. I'm just not sure how something turned out. When I was at the RTC, we used to say, we have 100,000 pieces of litigation and some of it was claims against people that borrowed money. It was all varieties. But if you looked at the dollar amounts, some of them were very small. And, there was a consideration about why don't we just go and auction off all these claims. And I remember, this was a very difficult thing to do. I'm not talking about loan judgments, and stuff like that. I'm talking about litigation cases, small dollar cases.

But, it was something like, as I recall, 75 percent of the number was less than $25,000 in claims. I thought, why can't we just get rid of that? Did anybody ever do that? I left in 1992. Or, do we still have 100,000 small claims?

Smith: I'm Jack Smith, Deputy General Counsel for the FDIC. That was a public policy issue that came up from time-to-time and the resolution was you can't take those restitution orders, which are $2 billion outstanding, and you can't take those PLS claims and auction them off to the public because there is a concept of public prosecution in those kinds of claims. So you can't just discount them. Sometimes, a particular defendant, for example, Don Dixon, went bankrupt and he lost a lot of money for us, as you will recall. People thought, well, we'll just auction off his claim because he's never going to have any money again. But, believe it or not Don Dixon has come back and he is making money down in Florida and we think we're going to get a million dollars out of him there. So, you don't just give up on those kinds of claims.

Bell: If I could add to that—I would think with the uncertainty of litigation, it would be fairly difficult to market those types of claims because there are a number of defenses that the defendants would use in defense of the action that would be brought. One defense would be bankruptcy, another would be the statute of limitations, mitigation of damages, and other issues that could make the actual litigation very risky for a purchaser of those type of claims.

Cooke: It was yesterday and was an economic issue at the time, it seemed like. Small things, get rid of them as fast as you can. We always would—I know the legal divisions would always work to do a cost-benefit analysis. What is the probability of getting it. It seemed to me that the majority of the claims just made it where it made sense to go forward. That is probably unfair because it had probably been just the ones I saw. It seemed the probability of winning and the probability of getting anything in judgment—it would work out that the amount of the expected recovery was always enough for the expected cost.

Crocker: Don Crocker. Is it fair to say that the receiver's powers that were given under FIRREA had a significant impact that increased the recoveries that the RTC and the FDIC achieved during the four- or five-year period of the crisis?

Cooke: I would think it had to have a positive impact on recoveries. I don't know what it did in a more broad concept. If you're talking about the receivership powers—the superpowers—the special powers to deal with the burdensome contracts, and there were others, proved to be very helpful to have. But, there are questions and I don't know if anybody focuses on them any more about the fairness of it. Was the government given too much power? Some of my friends at the FDIC tell me that there are some, even within the FDIC, that wonder about how powerful should a receivership be? I don't know. You probably have a view on that. What do you think?

Comment: Lots of people besides the taxpayers and the receiver's powers had a huge adverse impact on third parties to the benefit of the funds and that no longer would be supported by a court under due process or condemnation or a variety of other legal theories and that is why these current lawsuits on the Supreme Court have been authorized on the net worth issue—the regulatory net worth issue—which is important because there is no longer a war so there is no longer authority to be using war powers.

White: And there were also long-run incentive issues. Do individuals and institutions change their contracting arrangements because of the possibility that, when a receiver comes in, he or she will take harsh measures?

Cooke: The RTC, its job was to maximize recoveries and it had these special powers. What we find ourselves doing is using those powers to the absolute maximum because they would say, hey look, we are supposed to maximize recoveries and I guess the most memorable one was an irate call I got from a Senator from New York about the position on rent control being taken by the RTC. I don't know where that ended up. To be honest with you, I've been gone for a number of years and I haven't really followed it. But from the RTC standpoint, our job was to try to get as much as we could, and as many powers as Congress gave us, we were inclined to use. I don't remember anybody saying, well, gee, I don't think we should use it. It was more or less, well, we ought to use it because we've got it. Because if we don't, people will say, why aren't you using it? But you're right. Maybe times have changed.

In other countries that you go in and you talk about the scope of powers given the FDIC and the RTC, and basically some people you're just cutting out the of court process and it is something that in some of the markets I go in, they just can't conceive cutting out the judicial process as much. It is a hard sell because we do have a due process here in our own structure.

Thompson: Ted, we've spoke in quite extensive terms about securitizations and equity partnerships, but quite honestly, the failed bank assets were really cleaner and the FDIC used a lot of different disposition strategies to try to sell assets. They sold them individually. They used bulk sales. Can you talk a little bit about what you did as an asset liquidation manager for Goldome in particular?

Samuel: I can try. We employed everything from individual asset sales to bulk sales of large quantities of assets. We also managed 34 Goldome subsidiaries that ranged from insurance companies to Goldome Credit Corporation, a major secondary finance lender. We employed the most practical approach at the moment for the issue. In the subsidiaries, we were the board of directors. Speed is essential in dealing with operating companies. The subsidiaries were sold off, one-by-one, in separate transactions.

When we received a homogenous group of assets with decent data, we sold them in the secondary market. In one case, they were quickly turned around and securitized. That sale and securitization paved the way for later securitizations.

We considered securitizing those assets ourselves, but frankly the process and the representations and warranties needed to securitize were farther than we chose to go. In retrospect, I think we left a little money on the table, maybe 4–5 percent of the transaction. But, it was a very good transaction for us and it had some very difficult issues for the eventual purchaser.

McFarland: My name is Beverly McFarland and I'm with the Beverly Group. I would like to address a question to Ms. Thompson and Mr. White. Of all of the methodologies used to dispose of assets around the United States, which do you feel, perhaps some research has been accomplished, had the highest net yield? Securitization, auctions, direct sales by the sales center, bulk sales, the SAMDA contractors, and how did the SAMDA contractors come out?

White: I'm the wrong guy. I don't have those answers. Often the assets are such different types that the different channels must be used. I'm not sure how we would even address the issue and provide you with the answer. But, I'm the wrong guy.

Thompson: I'm the wrong girl. No, actually there were different sales strategies that were used for different types of assets, and different methods worked best depending on the market. Whole loan sales worked really well at certain points in time for residential mortgage loans. Securitization works well when you have a certain dollar threshold because there are expenses that are associated with each type of transaction. We've looked or tried to look at the SAMDA contracts and also the SAMA, ALA and RALA contracts, and it really is an evolutionary concept and all of these methods worked well for what they were supposed to do. As we learned and as we grew, we refined these methods to try to get to the point where we are today. So, it is really hard for me to put in context which worked best because you're looking at different points in time and different asset categories. So, I think they all worked well and I think the government benefited from the mistakes that were made because we refined the strategies that were used to sell assets over the years.

Reid: Just to add one point to your question, perhaps to help you re-think the question you're asking. Each time CSFB acted as an underwriter on a securitization, one of the last tasks we would perform before offering it to investors was to review the information and present to the RTC the indicative pricing of what that pool would sell for if we were to sell it "as-is," as whole loans with no credit enhancement, instead of in a securitization. Usually that is a fairly complex analysis, but there are two elements to it that I think really are important to add in when you're comparing what you would get for selling a pool of whole loans and what you get through a securitization. It is not only the cash raised on the day of closing, because on a whole loan sale, that is all the cash you're going to see. That is the total amount of cash you will see out of that sale. Typically in the RTC transactions, the RTC held on to a residual interest, not an equity participation like some of the later deals, but a residual interest. If the assets performed better than the expectations (or base case) then there would be money left over at the end of the transaction and that would go back to the RTC. So, when you are comparing purely a bulk sale with a securitization, you have to look at both the cash raised on the day you closed, as well as the total cash to the RTC after considering the residual interest.

Meyer: Jim Meyer from the FDIC. Ted, as you reached the end of your contracts with the FDIC, etc., what were some of the challenges you faced as you reached the end and did your incentive structures hold, and what advice do you have for us as we clean up the bottom of the barrel, basically?

Samuel: I'm delighted to say that at the end of our contract, we had almost nothing left. Our incentive contract had a sliding scale which started at one percent and went to about 15–20 percent. That provided great incentive for us to resolve almost everything.

I assume there are other cases when there are many assets left. In those cases, I think the FDIC should either extend the servicing agreement to facilitate final collections or bulk sales or transfer the assets to a consolidating servicer.

Gilbert: Gary Gilbert, America's Community Bankers. This is for anyone on the panel who would like to respond. I was wondering if there are any unique problems in disposing either through a securitization process or otherwise, small business loans, particularly those that are not collateralized or poorly collateralized?

Reid: From a securitization standpoint, I believe there was one securitization done quite a few years ago by Chrysler Finance. The statement of how difficult it is to determine the long-term repayment probability of small business loans is that that transaction was a split-rated transaction, which in securitization indicates that the rating agencies do not agree on what the repayment to bond holders will be. Small business loans are a difficult asset class to value because you can view them purely as corporate loans to corporations that are not in the Fortune 500 or you can view them as business loans where it is also a real estate venture, in effect, because they are occupying the entire building and running a business out of it. So, in the case of foreclosure/non-payment, if the small business fails, the lender is left with a property and a business. Can you find an alternative buyer or use for the property to re-coup your loan?

Samuel: I think small business loans are among the most difficult to collect. They are particularly difficult if the collection objective is fast cash. They generally have no collateral. They fit very well in financed bulk sales with an equity participation which gives buyers of those packages time to work with the small business people over a longer period of time.

Question: In the Texas situation, how pervasive was fraud where you found that assets were basically worth nothing and you couldn't collect anything at all?

Bell: In general or with respect to insider deals and pursuing claims related to professional misconduct—I'm asking for clarification of your question.

Question: How much of it was really, when you actually went in there, did you find that the assets were fraudulent and they had been made either by people who were dishonest or borrowers who were dishonest, and the assets themselves were worth nothing?

Bell: Okay, I follow your question. Very few of the cases that we prosecuted for the FDIC and RTC involved actual fraud, that is those cases that I directly participated in. We saw a number of cases where there was substantial insider abuse and favorable treatment given to insiders, but not very many cases where there were sham transactions or where a director received some benefit and actually provided nothing in return. We didn't see very many of those type cases. But, I have seen studies that indicate in about one-third of the cases overall, and I assume those include S&Ls and commercial banks as well, where they saw some fraud that was about one-third. Also in Texas I've heard reports that fraud may have risen to the level of at least 50 percent.

Thompson: I think we're just about ready to take a break so that we can be back at 4:00 p.m. to hear our featured speaker, John Heimann. I want to thank my panelists very much and thank you all for participating.

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