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Report to the Chairman, Committee on
Banking, Finance and Urban Affairs
House of Representatives

April 1992

FAILED THRIFT

Lengthy Government Control of Sunbelt Savings Bank



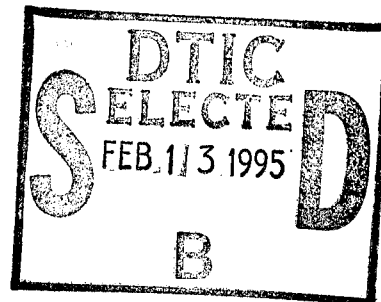
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General Government Division

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April 28, 1992

The Honorable Henry B. Gonzalez
Chairman, Committee on Banking,
Finance and Urban Affairs
House of Representatives



Dear Mr. Chairman:

This report responds to your concerns about the government's lengthy control and management of Sunbelt Savings, Federal Savings Bank. It discusses why Sunbelt has remained under government control since August 1988 and what some of the costs and benefits of this control have been. For your convenience, appendixes I through V provide the details of our objectives, scope, and methodology and answers to your specific questions.

Background

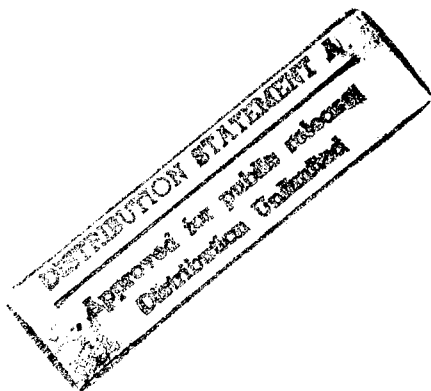
Sunbelt was created in August 1988 by the Federal Home Loan Bank Board (FHLBB) to consolidate and stabilize eight failed Texas thrifts. (See app. VI for data on these thrifts.) Sunbelt was to be operated as a mutual savings bank under government control because, unlike the 14 other FHLBB consolidations of failed thrifts in Texas, it was not sold to an acquirer.¹ To enable Sunbelt to operate until it could be sold, the Federal Savings and Loan Insurance Corporation (FSLIC)—a unit of FHLBB—provided a 10-year assistance agreement, which it estimated would cost about \$11 billion.

Sunbelt's assistance agreement was similar to those FSLIC entered into with other assisted thrifts.² Sunbelt received an interest-bearing note equal to the amount by which its liabilities exceeded its assets (negative net worth). As subsequently adjusted following independent audits of the eight thrifts, the note was for about \$2.3 billion.³ The note raised Sunbelt's capital to zero and it never rose much beyond that.

¹FHLBB's plan to revitalize the Texas thrift industry was to consolidate failing thrifts in groups and sell them under assistance agreements to acquirers. (See Resolving Texas Thrift Problems, GAO/T-GGD-89-10, Mar. 11, 1989.)

²FSLIC entered into a total of 96 assistance agreements in 1988 and 1989. Earlier reports have discussed the government's management of these agreements. See Failed Thrifts: FDIC Oversight of 1988 Deals Need Improvement (GAO/GGD-90-93, July 1990) and Failed Thrifts' Assets: RTC's Oversight of 1988 Deals Needs Improvements (GAO/GGD-91-116, August 1991).

³The audits adjusted the premerger negative net worth of the eight thrifts—about \$4.7 billion—by reversing their reserves for losses on loans and real estate.



The agreement also gave Sunbelt capital loss and yield maintenance coverage on poor-quality assets (known as covered assets), which constituted almost 90 percent of its assets, excluding the FSLIC note. Capital loss coverage guaranteed that whenever Sunbelt disposed of a covered asset for less than the recorded value (usually historical cost) of the asset, it would be paid the difference. Yield maintenance coverage guaranteed that Sunbelt's covered assets, many of which were not earning assets, would collectively yield a specified rate. The rate varied in accordance with the year of the agreement and with the Texas cost of funds—the average cost of deposits and borrowings of Texas thrifts as determined by the Federal Home Loan Bank (FHLBank) of Dallas. If the covered assets did not earn as much as the specified yield, Sunbelt would be paid the difference.

In December 1988, Sunbelt sold \$1.25 billion of covered assets to FSLIC to meet the qualified thrift lender test⁴ and thus qualify for certain benefits. One benefit enabled Sunbelt to be taxed as a thrift institution rather than as a bank. Another benefit enabled Sunbelt to meet a large part of its liquidity needs by borrowing from the FHLBank of Dallas. In exchange for the assets, FSLIC gave Sunbelt a 10-year promissory note, referred to as an asset purchase note, which earned the same designated spread over the Texas cost of funds as the yield subsidy for covered assets. Though these assets were sold to FSLIC, it contracted with Sunbelt to provide all services relating to the management and disposition of this \$1.25 billion in assets as if they were covered assets of Sunbelt under the terms of the assistance agreement.

The locus of responsibility for managing all FSLIC assistance agreements has shifted twice. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) abolished FSLIC in August 1989 and assigned responsibility for oversight and management of the assistance agreements to the Federal Deposit Insurance Corporation (FDIC). It also named FDIC manager of the newly established FSLIC Resolution Fund (FRF), which was to pay FSLIC's obligations under the agreements. Many of the FSLIC managers and staff responsible for the creation and management of the agreements were simultaneously moved to FDIC.

⁴At that time, the test required a thrift to maintain at least 60 percent of its asset portfolio in qualifying assets, such as residential real estate, certain business property, and liquid assets. A thrift failing to meet the test was subject to lower limits on the amount it could borrow from its district FHLBank.

In January 1991, the responsibility for managing the assistance agreements and the personnel that had been fulfilling that function for FDIC were transferred to the Resolution Trust Corporation (RTC).⁵ On April 26, 1991, RTC was named conservator of Sunbelt. On February 6, 1992, RTC held a bidders' conference, at which it explained to the private sector the options for bidding on Sunbelt's deposits and a limited amount of its assets.

Sunbelt has been supervised and examined by FHLBB and, since FIRREA, its successor for such functions, the Office of Thrift Supervision (OTS). While under government control, Sunbelt operated in direct competition with privately held depository institutions.

Results in Brief

The lengthy period of government control of Sunbelt resulted from a variety of factors. These included a lack of funding to liquidate it before the passage of FIRREA, transfers of responsibility and staff from FSLIC to FDIC and then to RTC, and a belief by responsible agency officials that Sunbelt's management was competent and operating in a manner that would not appreciably increase the ultimate resolution costs.

We cannot determine how much money the government may have saved or lost by not resolving Sunbelt earlier because the necessary data are not presently available. However, when Sunbelt is finally resolved, RTC is required to prepare a resolution cost estimate. At that time, it should have sufficient data to meaningfully compare this estimate with that of an earlier liquidation.

Some of the costs of operating Sunbelt could have been avoided, however. Most significantly, the money Sunbelt borrowed from the FHLBank of Dallas to help fund its liquidity needs cost the government about \$53 million more than if it had been provided through comparable Department of the Treasury borrowings. Further, expenses authorized by FSLIC and FDIC to operate and improve Sunbelt as a going concern in anticipation of selling it as a whole thrift⁶ may not be fully recovered.

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⁵RTC was established by FIRREA and has as its primary responsibility resolving all thrifts that are placed in receivership or conservatorship between January 1, 1989, and September 30, 1993.

⁶As used by the responsible FSLIC and FDIC officials, this term generally meant the assumption of liabilities by a single acquirer. That acquirer would either purchase or contract to manage all or most of the assets.

Delays in Resolution of Sunbelt

FSLIC Strategy Was Shaped by Lack of Market Interest and Funds

FSLIC did not resolve the eight thrifts subsequently consolidated as Sunbelt because no eligible acquirer came forward, and it did not have the \$7.4 billion it estimated was initially needed in a liquidation to pay off insured deposits. Moreover, FSLIC determined that on a present value basis, consolidating the thrifts into one institution and operating it under a 10-year assistance agreement would cost about \$400 million less than liquidating the eight thrifts.⁷ FSLIC also believed it could realize the full value of the thrifts if they were consolidated, downsized, and prepared for sale within a year.

To prepare Sunbelt for sale, FSLIC directed Sunbelt management to consolidate branches, resolve litigation cases, consolidate loan participations among the eight failed thrifts, and reduce the size of the institution. Before FSLIC could complete its goal of selling Sunbelt, however, FIRREA transferred responsibility for FSLIC obligations to FDIC.

FDIC Plans Never Materialized

FDIC planned to sell Sunbelt by December 31, 1990, but its strategy for doing so was slow to evolve and its goal was not met. Initially, FDIC needed many months to assimilate its new responsibilities and begin developing the systems for monitoring and making payments on the 96 assistance agreements entered into by FSLIC in 1988 and 1989, as well as meeting other FSLIC obligations. FSLIC officials who had been overseeing the assistance agreements were transferred to FDIC, which eased the transition.

FDIC officials began to take specific actions in late spring 1990 preparatory to resolving Sunbelt. For example, they initiated talks with Treasury officials to arrange for the needed resolution funds and hired a contractor to review and value Sunbelt assets. By the fall of 1990, FDIC officials had obtained permission from FDIC's board of directors to sell the thrift and agreement from Treasury to make the needed funds available, if it was resolved by year-end. This did not happen.

⁷On a present value basis, FSLIC estimated it would cost about \$6 billion to operate the thrifts under a 10-year assistance agreement and about \$6.4 billion to liquidate them. FSLIC also estimated the cash basis cost of the agreement over its 10-year life at about \$11 billion. Documentation supporting the development of these estimates is not available.

High-level concerns surfaced in late fall 1990 as to whether or not FDIC and RTC should each continue to have responsibilities related to the FSLIC assistance agreements. The issue stemmed from a FIRREA mandate that required RTC to study and pursue ways to reduce the costs of these agreements. Toward the end of 1990, RTC was ready to go forward with actions recommended by the study with funds appropriated for this purpose by Congress. These actions included paying off FSLIC notes, writing down covered asset values and paying for the losses, and entering into negotiations with acquirers of the assisted thrifts. The study also recommended that Sunbelt be resolved as soon as possible.

FDIC officials told us that although they had developed a bid package for Sunbelt by late November 1990 and were preparing for a bidders' conference in early 1991, they delayed further efforts to market the thrift until the issue of responsibility for the FSLIC assistance agreements was resolved. The issue was discussed at a joint FDIC/RTC Board of Directors meeting in December 1990, but no firm decision was reached. On January 16, 1991, however, RTC's Chairman announced that responsibility for the agreements was being consolidated in RTC. As a result, FDIC's oversight responsibilities and the FDIC (formerly FSLIC) officials and staff who were working with the assistance agreements were transferred to RTC in January 1991.

OTS Delays Transfer to RTC

OTS officials held off on closing capital-deficient Sunbelt and placing it in RTC conservatorship because they—like FDIC officials—had confidence in Sunbelt's management and were aware of FDIC's plans to market and resolve the thrift. When these plans did not materialize, OTS transferred Sunbelt to RTC in April 1991. Sunbelt was closed and reopened under an OTS-provided charter as Sunbelt Federal, Federal Savings Bank.

RTC Prepares to Resolve Sunbelt

Shortly after being named conservator, RTC replaced Sunbelt's board of directors with an RTC managing agent. A conservatorship operating plan for the thrift was then developed that called for Sunbelt to continue to be managed as a whole institution preparatory to resolution by reducing its size and operating costs while maintaining franchise value. In the fall of 1991, however, a new plan was approved that, in essence, called for many of Sunbelt's assets to be separated from the thrift for disposal under various RTC programs prior to its resolution.

In January 1992, RTC terminated Sunbelt's assistance agreement retroactive to June 30, 1991, and secured approval to finance Sunbelt's resolution. RTC formally initiated the resolution process on January 21, 1992, with the announcement of a bidders' conference to be held on February 6, 1992. At the conference, RTC officials offered potential bidders numerous options, such as purchasing all of Sunbelt's deposits, purchasing branch clusters and individual branches, and purchasing a small amount of consumer loans. RTC officials plan to evaluate the bids received, compare them to its liquidation cost estimate, and select the least costly resolution option. They expect Sunbelt to be resolved on April 10, 1992.

Costs and Benefits of Lengthy Government Control

We cannot determine with precision the financial impact of the 3-1/2-year delay in resolving Sunbelt for several reasons. Chief among these is that the ultimate cost of Sunbelt's resolution will not be known until after all its assets are sold, which may take years. However, when RTC resolves the thrift, it is required to prepare an estimate of the total resolution cost. RTC should then be in a position to estimate the financial cost—if any—of the delay in resolving Sunbelt.

The government has, in effect, owned Sunbelt since it was established in August 1988. While under government control, Sunbelt's management unwound loan participations among the eight thrifts, obtained asset appraisals, cleaned up asset files, and settled litigation. It also started selling poor-quality assets. Although FDIC cannot provide data on the changes in Sunbelt's guaranteed assets by type, Sunbelt reported that between August 1988 and April 1991 (when it was transferred to RTC), it sold about \$529 million (book value) of owned real estate and reduced its loan portfolio by \$665 million, primarily through foreclosure. Sunbelt also reduced the number of branches acquired from the 8 thrifts from 139 to 102, which it estimated resulted in an annual cost savings of \$2.9 million.

FSLIC and FDIC officials told us that Sunbelt's asset management and liquidation efforts were satisfactory. In fact, an FDIC senior official said he has no reason to believe his agency could have done a better job. Also, RTC managing agents told us they found that Sunbelt generally had been operated in a satisfactory manner. We have no basis for independently determining whether FSLIC and its successors would have recovered more or less for the assets, after expenses, than Sunbelt's management did.

FSLIC and FDIC approved certain expenses to develop Sunbelt as a going concern, which was consistent with their marketing strategy for selling

Sunbelt as a whole thrift. These expenses would not have been necessary if the thrift had been liquidated in 1988. Some, however, may have helped lower Sunbelt's operating costs. For example, \$6.4 million was spent for advertising to attract deposits and build consumer confidence, which helped Sunbelt reduce its cost of funds.⁸

Sunbelt also spent approximately \$2.6 million for an on-line system to upgrade its oversight capabilities for multifamily, real-estate-owned assets. The system connected Sunbelt's asset management staff directly to its multifamily property managers. Because the system's value is greatly diminished when separated from the assets and RTC does not expect to sell the assets to a single acquirer, it may not recover the full cost of this investment. Another example of a going concern expense that may not be recovered in full is the \$5.5 million spent for leasehold improvements.

On the other hand, Sunbelt was authorized to expend funds to create a mortgage servicing subsidiary (Sunbelt National Mortgage Corporation) by consolidating five mortgage banking subsidiaries it inherited when it was established. Sunbelt National Mortgage Corporation reported a net profit of \$1.4 million during 1990 on loan production of \$458 million and income derived from servicing loans for other institutions. At the end of 1990, it was servicing 94,717 loans with a book value of \$4.8 billion. We understand the subsidiary will be offered for sale in its entirety, thus the costs expended to develop it into a profitable operation may be realized.

Some costs associated with the government's operation of Sunbelt, however, need not have been incurred. For example, we estimate that the government could have saved about \$53 million if it had advanced appropriated funds to Sunbelt starting shortly after the passage of FIRREA. Instead, Sunbelt was required to borrow a significant portion of the cash it needed to operate from the FHLBank of Dallas. The interest paid for these FHLBank advances, to the extent it exceeded Treasury borrowing costs and applicable advance prepayment penalties, represents a \$53 million cost that could have been avoided.

⁸Sunbelt reduced brokered deposits by \$1.1 billion between August 1988 and December 1989. To further reduce Sunbelt's cost of funds, in mid-1990 RTC transferred to Sunbelt about \$2 billion in insured deposits from two failed thrifts—Gill Savings of Hondo, Texas, and Bexar Savings Association of San Antonio, Texas. From the quarter ending March 31, 1989, to the quarter ending March 31, 1991, Sunbelt reported that its cost of funds went from 47 basis points higher to 10 basis points lower than the Texas cost of funds.

FSLIC estimated that in 1988 it would cost \$6.4 billion on a present value basis to liquidate the eight thrifts merged as Sunbelt. No subsequent liquidation estimate is available. We do know, however, that as of September 30, 1991, the government had put cash totaling \$6.1 billion into Sunbelt. An additional amount (about \$3.5 billion as of November 30, 1991) will be needed at resolution to honor Sunbelt's deposits, but this outlay may be largely recovered from the sale of its assets.

When RTC resolves Sunbelt, it plans to prepare a total resolution cost estimate and should then have the data needed to make a meaningful comparison of this estimate with the estimated cost of an earlier liquidation.

Conclusions

We understand the reasons for the government's lengthy delay in resolving Sunbelt. We recognize that before FIRREA was enacted, funding was not available to liquidate the institution. We also acknowledge that shifting responsibilities for Sunbelt among FSLIC, FDIC, and RTC contributed to the delay. Nevertheless, we also believe that following the passage of FIRREA, FDIC and RTC could have determined sooner whether or not there was serious market interest in the whole thrift and then promptly implemented an appropriate resolution strategy.

Because of the uniqueness and size of the Sunbelt consolidation and the length of time the institution has been under government control, we believe it is important for Congress to know what effect, if any, the delay in resolving Sunbelt may have had on the ultimate cost of its resolution. After it resolves Sunbelt, RTC should have the data available to make such an estimate. The results of this comparison may also assist RTC—and FDIC—in assessing the impact of lengthy government control under private sector management of failed depository institutions pending their final resolution.

Recommendation

We recommend that RTC's Chief Executive Officer instruct his staff to compare RTC's total resolution cost estimate with the estimated cost of an earlier liquidation to calculate whether there was a financial cost of the delay in resolving Sunbelt and, if so, the extent of such cost.

Agency Comments

We provided a draft of this report to FDIC, RTC, and OTS for comment. FDIC and RTC informed us that they had no comments. OTS stated in its response that the report is fair and accurate (see app. VIII).

As arranged with the Committee, we are sending copies of this report to other interested Committees, agencies, and the public. Major contributors to this report are listed in appendix IX. If you have any questions about the report, please call me on (202) 275-8678.

Sincerely yours,



Craig A. Simmons
Director, Financial Institutions
and Markets Issues

Contents

Letter	1
Appendix I Objectives, Scope, and Methodology	12
Appendix II FHLBB/FSLIC Sunbelt Actions	13
Appendix III Compliance and Oversight of Sunbelt	15
Appendix IV OTS Names Sunbelt Conservator	19
Appendix V RTC Efforts to Resolve Sunbelt	22
Appendix VI Data on the Eight Thrifts Before Consolidation as Sunbelt as of August 19, 1988	25

Appendix VII Balance Sheet Data on Sunbelt for Selected Dates	26
Appendix VIII Comments From the Office of Thrift Supervision	27
Appendix IX Major Contributors to This Report	28

Abbreviations

FDIC	Federal Deposit Insurance Corporation
FHLBank	Federal Home Loan Bank
FHLBB	Federal Home Loan Bank Board
FIRREA	Financial Institutions Reform, Recovery, and Enforcement Act of 1989
FSLIC	Federal Savings and Loan Insurance Corporation
FRF	FSLIC Resolution Fund
OTS	Office of Thrift Supervision
RTC	Resolution Trust Corporation

Objectives, Scope, and Methodology

The Chairman of the House Committee on Banking, Finance and Urban Affairs expressed concerns that Sunbelt had operated under an FSLIC assistance agreement since August 1988 and yet was—after nearly 3 years of FSLIC and FDIC control—put into RTC’s conservatorship program. He asked us to explore FHLBB and FDIC efforts to market Sunbelt; determine its compliance with the assistance agreement; determine whether or not oversight by FHLBB/FSLIC, FDIC, and OTS met their requirements; determine the basis for OTS’ decision to place Sunbelt in RTC conservatorship; and discuss options and RTC plans to resolve Sunbelt. His specific questions are in appendixes II through V. The Chairman also asked us to address issues related to the cost and benefits of government control of Sunbelt to the extent that available data permitted.

To address the Chairman’s concerns, we

- reviewed FHLBB documents, including board of directors’ minutes and data pertaining to the 1988 assistance agreements;
- reviewed the FSLIC-Sunbelt assistance agreement and forbearance letter and FSLIC and FDIC documents related to their oversight of the assistance agreement;
- reviewed OTS examination reports and pertinent documents;
- reviewed Sunbelt financial data, audit reports, manuals, and other documents;
- reviewed FDIC and, where available, RTC management and resolution plans for Sunbelt and related board minutes;
- interviewed current and former officials of FHLBB, FSLIC, the FHLBank of Dallas, FDIC, OTS, and Sunbelt; and
- interviewed RTC managing agents and officials with respect to Sunbelt’s condition and RTC’s management of Sunbelt.

Our work was done primarily in Washington, D.C., and Dallas, Texas, from July to December 1991. The review was done in accordance with generally accepted government auditing standards.

GAO provided a draft of this report to FDIC, RTC, and OTS for comment. FDIC and RTC informed us that they had no comments. OTS’ response is reprinted as app. VIII.

FHLBB/FSLIC Sunbelt Actions

Question 1: Describe FHLBB and FSLIC efforts, if any, taken to sell old Sunbelt and the other seven thrifts individually or as a package before and after the consolidation. Describe the purpose of the consolidation.

Sunbelt Savings Association was part of FHLBB's 1988 Southwest Plan to resolve insolvent thrifts in the Southwest—primarily in Texas—by consolidating them and selling the resulting groups to acquirers, typically with 10-year assistance agreements. The basic purpose of the plan, developed in part because FSLIC lacked the funds to liquidate insolvent thrifts, was to create a viable thrift industry in Texas. In 1988, 79 Texas thrifts, in 14 groups, were sold under this plan.

FHLBB marketed a Southwest Plan package containing eight Texas thrifts, of which Sunbelt was the largest. Before consolidation, the eight thrifts had combined assets of about \$4.3 billion, liabilities in excess of \$8.9 billion, and a negative net worth of nearly \$4.7 billion. (See app. VI.) The liabilities included about \$7.6 billion in deposits and \$1 billion in secured advances from the FHLBank of Dallas. FHLBB packaged the thrifts primarily because they had participated as lenders in many of the same projects, had branches in similar locations, and were driving up interest rates by competing against each other for deposits. It also sought to reduce losses at the eight thrifts, which totaled as much as \$2.4 million a day in early 1988.

FHLBB did not receive an acceptable bid from eligible acquirers and did not have the cash to liquidate the eight thrifts. Therefore, it consolidated them on August 19, 1988, in a new federal mutual savings and loan association called Sunbelt Savings, Federal Savings Bank. Sunbelt was considered a bridge thrift, or stabilization, and was under FSLIC control. To manage it, FSLIC selected the team that had been operating the former Sunbelt Savings Association for the past 2 years. The team's charge was to shrink Sunbelt to its core business and manage the assets until outside capital could be attracted and it could be sold, presumably in the coming year, at full value. Sunbelt was never capitalized and, from the outset, operated with capital close to, or less than, zero.

To enable Sunbelt to operate, FSLIC entered into a 10-year assistance agreement with it that was similar to those entered into with outside acquirers of other Southwest Plan groups. The major components of the agreement were as follows:

- A 10-year FSLIC note was provided that covered the aggregate negative net worth of the consolidated institutions. After the final audit of the eight associations, the note was set at approximately \$2.3 billion. The note paid interest quarterly at a designated spread (50 basis points) over the Texas cost of funds.¹
- Capital losses (the difference between an asset's book value and sales price) and certain related expenses on covered assets were reimbursed. Covered assets included real estate owned, land and construction loans, and nonperforming mortgage loans. After certain accounting adjustments, covered assets had a book value of \$5.5 billion.
- Yield maintenance coverage was provided on the covered assets at an interest rate equal to the Texas cost of funds plus a premium that declined over the years. The premium started, in the first year, at 220 basis points and declined, by the 10th year, to 135 basis points.
- Certain claims against the closed institutions were indemnified.

Former FSLIC officials told us that FSLIC made no further efforts to market or otherwise resolve Sunbelt. With the passage of FIRREA in August 1989, responsibility for oversight of all the FSLIC assistance agreements and for meeting FSLIC's assistance agreement obligations passed to FDIC as manager of the FSLIC Resolution Fund.

¹The assistance agreement provided for the interest rate to be tied to the higher FHLBank of Dallas advance rate if the promissory note was pledged as collateral for an FHLBank advance, which it subsequently was.

Compliance and Oversight of Sunbelt¹

Question 2: Determine if Sunbelt Savings, Federal Savings Bank, was operated in compliance with the assistance agreement, business plan, supervisory or other agreements related to operations or management, and any forbearances.

Question 3: Determine if oversight of Sunbelt Savings, Federal Savings Bank by FHLBB/FSLIC, FDIC, and OTS met applicable agency policies and procedures.

We found that Sunbelt essentially complied with the terms of its assistance agreement and other requirements. Also, RTC managing agents told us they found that Sunbelt generally had been operated in a satisfactory manner. Sunbelt did not, however, submit the required litigation summaries and as a result did not, in our opinion, demonstrate that it minimized legal expenses. We also found that the federal agencies followed their applicable policies and procedures, except that FDIC did not review Sunbelt's litigation and asset plans within the specified time frames.

During May and June 1989, FSLIC officials had raised serious questions about certain operational and management techniques employed by Sunbelt management. Specifically, they said the inadequacy of staff assigned to basic operations, such as accounting, electronic data processing, asset management, and legal, indicated that Sunbelt was not being properly managed. However, these officials advised us that Sunbelt management promptly and satisfactorily resolved the concerns.

The assistance agreement required Sunbelt to submit numerous reports and plans to FSLIC (and subsequently to FDIC and RTC) to facilitate oversight. These included litigation summaries, plans, and budgets; various asset plans, summaries, and budgets; and a business plan. FDIC reported that Sunbelt had submitted over 14,000 reports and plans during the first 2 years of the agreement.

All FSLIC assistance agreements mandated such detailed and voluminous reporting to help protect the government's interest. These reports and plans required extensive review and approval. Even though Sunbelt's management was installed under the government's control and was operating according to a government-approved plan, Sunbelt still had to meet these requirements.

¹The responses to these two questions have been consolidated to prevent unnecessary duplication.

Litigation Plans and Summaries

Before their merger, the 8 thrifts were involved in about 3,000 legal matters, of which at least 1,584 were pending lawsuits. Many of these legal matters involved disputes between the eight thrifts. The matters were being handled by over 114 outside law firms. At consolidation, FSLIC selected one of these law firms to handle Sunbelt's legal work.

The assistance agreement required Sunbelt to submit quarterly litigation summaries beginning no later than August 1989. The summaries were to include, by case, an approved litigation budget, litigation expenses to date, and the difference between the two. The summaries were to be used to manage litigation costs and ensure that actual expenses did not exceed approved budgeted amounts.

Sunbelt did not begin submitting litigation summaries until June 1990. When it did, according to the responsible FDIC official, the summaries did not contain accurate cumulative expense data by individual case because Sunbelt had difficulty tying its litigation expenses of about \$35 million to specific cases. The same official—then assigned to RTC—advised Sunbelt in March 1991 that it would not be reimbursed for legal expenses until it could demonstrate adequate case management and reporting capability for each case.

Through September 30, 1991, RTC withheld reimbursements for \$10.3 million of the \$35 million, primarily because legal expenses exceeded budgets. A review by RTC's legal division determined that approximately \$9 million of the disputed costs should be reimbursed, based on the reasonableness of the individual legal expense. However, the responsible RTC official believes that because Sunbelt was not accurately tracking litigation expenses by case, it could not know whether the value of the potential recovery justified the amount of legal fees incurred.

The assistance agreement also required Sunbelt to submit litigation plans for all significant litigation.² Each plan was to provide the background, legal issues, potential exposure, time frames, cost/benefit analysis, recommendations, strategy, and budget. The plans were to be approved within 60 days of receipt.

FDIC officials told us that up to February 1990, litigation plans were not approved in a timely manner because of their large number and the limited

²FSLIC determined that Sunbelt cases with potential recovery or liability in excess of \$100,000 or cases that were extremely sensitive in nature required litigation plans.

staff reviewing them. The officials said that only 281 of the estimated 600 to 800 required litigation plans had been approved. Sunbelt's General Counsel told us that many settlements had been delayed because the plans were not approved in a more timely manner. In February 1990, however, the responsibility for plan approval was transferred from Washington, D.C., to Dallas, which FDIC and Sunbelt officials said resulted in more timely approvals.

Asset Plans

The assistance agreement required Sunbelt to submit annual plans for assets having a book value of at least \$5 million or an expected loss of \$1 million or more. FDIC subsequently lowered these requirements to \$1 million and \$300,000, respectively. The plans were to describe Sunbelt's proposed disposition action, such as restructuring or foreclosing a loan, writing down the asset to market value, or selling the asset. The plans were also to include appraisal information, property descriptions, disposition alternatives, and budgets for expected expenses.

Although asset plan approval was required within 60 days of receipt, FSLIC and its successors often did not meet this time frame. A July 23, 1991, asset plan status report prepared by an RTC contractor showed that of 1,741 asset plans received during the prior 3 years, 904 had been approved and 330 had been returned to Sunbelt for revision, but 507 had not been acted on. Of these 507, 36 plans had been received in 1989, 116 in 1990, and 355 in 1991.

While Sunbelt could implement asset plans before their approval, the actions were subject to subsequent review. Sunbelt officials told us that to ensure they were working within the terms of the assistance agreement, they often would not expend funds without some prior approval from FSLIC or its successors. Sunbelt therefore submitted additional requests to perform specific actions on individual assets. Although the officials told us this added process caused an administrative burden, they could not document an impact on asset disposition.

Forbearances

FHLBB approved five forbearances for Sunbelt on May 30, 1989,³ that were to expire upon the acquisition of Sunbelt by another entity or the termination of the assistance agreement, whichever happened first.

³Sunbelt was created in August 1988. We found no documents explaining why issuing forbearances took over 9 months.

Forbearances were granted to Sunbelt for (1) excess equity risk investments; (2) excess investments in service corporations; (3) investments, activities, or operations inconsistent with the Home Owners' Loan Act of 1933; (4) activities of service corporations; and (5) exceeding limitations on loans to one borrower. All of these forbearances were restricted to assets acquired from the eight failed thrifts. Sunbelt was not given a capital forbearance.

Sunbelt was required to submit reports to FHLBB and its successor as thrift supervisor—OTS—outlining its disposal of or phaseout of the specified types of activities for which forbearances were granted. Sunbelt completed the required reports through December 31, 1990. A Sunbelt official told us the thrift did not submit subsequent reports because OTS had advised Sunbelt that the reports were no longer necessary because Sunbelt was being transferred to RTC.

Business Plan

In the summer of 1989, Sunbelt submitted its required 3-year business plan to the FHLBank of Dallas and FSLIC for the period July 1, 1989, through June 30, 1992. The plan forecasted expected operating results and was to be used to monitor their achievement, thus serving as a communication tool for Sunbelt's management (including its directors) and federal officials. The plan anticipated aggregate net losses over the 3 years of \$58.7 million.

OTS and FDIC reviewed and analyzed the business plan and approved it. Sunbelt subsequently reported variances between its financial results and the business plan to its board of directors and FDIC, then RTC, on a quarterly basis. FSLIC and later FDIC officials also attended Sunbelt board of directors meetings. In addition, an on-site federal examiner also monitored the institution's significant operations, activities, and business planning.

Examinations of Sunbelt were made by the FHLBank of Dallas and then OTS during 1989 and 1990 to assess the safety, soundness, and operating results of Sunbelt. In its February 26, 1990, examination, OTS reported that although Sunbelt's overall condition was unsatisfactory because of its inadequate capital position and continuing operating losses, management's performance was satisfactory.

OTS Names Sunbelt Conservator

Question 4: Determine the basis for OTS' decision to place Sunbelt in receivership and name RTC conservator of the new Sunbelt Federal.

OTS, the federal thrift supervision and chartering agency, closed Sunbelt on April 26, 1991; chartered a new federal mutual named Sunbelt Federal, Federal Savings Bank; merged the closed Sunbelt into Sunbelt Federal; and named RTC its conservator. OTS did so at that time because Sunbelt (1) was seriously capital deficient, (2) was operating at a loss and projecting future losses, and (3) had not been marketed to the private sector and had no prospect of gaining an infusion of needed capital short of further government assistance.

Since inception, Sunbelt has lacked the capital needed to satisfy regulatory requirements. FSLIC created it as a bridge thrift to manage the assets and honor the liabilities of the eight failed thrifts until it could be resolved, but FSLIC only brought its net worth up to zero. Sunbelt's capital never grew much beyond that. As of October 31, 1989, for example, its regulatory capital of \$972,000 was dramatically short of meeting minimum requirements by about \$663 million.

Sunbelt got \$2.04 billion in government assistance payments from inception to December 31, 1990, but incurred losses of \$49.3 million in that period. Further, its 3-year business plan, developed in the summer of 1989, projected continuing losses during 1990, 1991, and 1992. The losses resulted primarily because the terms of the assistance agreement were set at a level that did not yield a break-even operation. In addition, Sunbelt did not receive interest on the assistance agreement funds it was due from the government, which Sunbelt estimated resulted in an annual income loss of about \$20 million.

From the time it was created by FIRREA, OTS was aware of Sunbelt's inadequate capital and projected operating losses. OTS confirmed these problems in an August 1989 examination. In March 1990, OTS' Dallas office recommended that Sunbelt be transferred to RTC. OTS headquarters, however, decided to leave Sunbelt under FDIC control. Officials told us that Sunbelt's resolution was not a high priority because it was a stabilized institution under government control and it was a competently managed thrift. Further, the officials said, they wanted to give FDIC time to develop a strategy for Sunbelt's resolution.

FDIC officials told us that although they planned to resolve Sunbelt by the end of 1990, a strategy for doing so was slow to evolve. They said that with

the passage of FIRREA, FDIC became responsible for administering all of FSLIC's assistance agreements, and it was mid-1990 before FDIC was able to assimilate its new (mostly former FSLIC) staff and workload and address needed accounting and management information systems. The officials were aware, however, that there was some investor interest in Sunbelt because Sunbelt's president had provided a list of 13 potential acquirers.

FDIC began to develop a strategy for marketing Sunbelt during the summer of 1990. It hired a public accounting firm to estimate the market value of Sunbelt's assets, held informal discussions with at least two potential acquirers, and initiated various studies, such as resolution cash-flow projections and estimates of the amount of money the government could save if it prepaid Sunbelt's negative net worth note. In mid-September, an FDIC senior executive wrote to the FDIC board of directors asking it to authorize FDIC's marketing and sale of Sunbelt.

At an October 2, 1990, FDIC board of directors meeting, this official discussed his proposed strategy for marketing Sunbelt and stated that Treasury officials told him they would make available through December 31, 1990, the \$5.3 billion in FRF appropriations estimated as necessary to resolve Sunbelt.¹ Basically, FDIC's strategy was to market Sunbelt for sale as a whole institution. It planned to prepay Sunbelt's negative net worth note and pay Sunbelt the difference between the book and estimated market value of its assets, with Sunbelt using the cash to pay off high-cost advances from the FHLBank of Dallas. These actions would make Sunbelt a significantly smaller thrift, thus reducing the amount of capital needed, which FDIC thought should increase the number of potential acquirers. The board authorized FDIC to proceed with its marketing plans.

During the last few months of 1990, as FDIC staff were moving toward a January 1991 bidders' conference on Sunbelt, some events occurred that raised the issue of whether FDIC or RTC should be responsible for FSLIC's 1988 assistance agreements. The FIRREA-mandated RTC study of ways to restructure, modify, and renegotiate the assistance agreements had been completed, and RTC was prepared to implement the study's recommendations. Further, Congress had appropriated \$22 billion to FRF in part to reduce the cost of the deals.

¹Congress provided for sources of funds to meet FRF's needs from August 1989 through fiscal year 1990. Apparently, it was decided not to fund Sunbelt's resolution in fiscal year 1990 with these funds. In the fall of 1990, Congress approved \$22 billion for fiscal year 1991 to be used for FRF obligations, including the reduction of the costs of the assistance agreements.

The issue of responsibility for the FSLIC assistance agreements was discussed at a joint FDIC/RTC board of directors meeting in December 1990, but no firm decision was reached. On January 16, 1991, however, RTC's Chairman (who was also FDIC's Chairman) announced that responsibility for the agreements was being consolidated in RTC. Consequently, FDIC's oversight responsibilities and the officials working with the assistance agreements were transferred to RTC. FDIC officials told us that as a result of the uncertainty in late 1990 about whether they or RTC had responsibility for Sunbelt's resolution, they ceased their efforts to market the thrift.

OTS, recognizing that FDIC had not marketed Sunbelt by year-end as planned and that RTC would be responsible for Sunbelt's resolution, initiated efforts in January 1991 to transfer Sunbelt to RTC. These efforts culminated on April 26, 1991, when OTS placed Sunbelt in receivership; chartered Sunbelt Federal Savings, Federal Savings Bank, to take its place; and named RTC conservator of the new institution.

RTC Efforts to Resolve Sunbelt

Question 5: Discuss the options and approach RTC is taking to resolve Sunbelt.

RTC formally initiated the resolution process for Sunbelt on January 21, 1992, by announcing that it would hold a bidders' conference on February 6, 1992, in Dallas, Texas. At the conference, RTC officials offered potential investors numerous options, such as purchasing all of Sunbelt's deposits, purchasing branch clusters and individual branches, and purchasing a small amount of consumer loans. RTC officials plan to evaluate the bids received, compare them to its liquidation cost estimate, and select the least costly resolution option. They told us that Sunbelt will be resolved on April 10, 1992.

RTC's initial involvement with Sunbelt came as a result of its FIRREA-mandated study of ways to reduce the cost of FSLIC's 1988 assistance agreements. The contractor RTC hired to study Sunbelt recommended in the summer of 1990 that, among other actions, Sunbelt's negative net worth note be prepaid to reduce the government's cost of operating Sunbelt.¹ The contractor also recommended that Sunbelt be resolved as soon as possible.

The FDIC officials and staff responsible for managing FSLIC's assistance agreements were transferred to RTC on January 16, 1991. They brought with them a developed strategy to offer Sunbelt for sale in its entirety. Assets, including poor-quality loans and owned real estate, would pass to an acquirer under an arrangement in which FDIC retained some of the risk or would be managed under contract by the acquirer. They had put together a bid package for Sunbelt and were prepared to hold a bidders' conference.

This whole thrift strategy, however, ran counter to RTC's approach to resolving thrifts. Early in its existence, RTC found that there was limited interest in whole thrift sales under the conditions it offered, and the few such bids that were received for thrifts were more costly than liquidation. As its strategy evolved over time, RTC discovered that it could generally resolve failing thrifts faster and at less cost by selling their deposits and the bulk of their assets in discrete packages.

¹The note was prepaid in installments between February and April 1991, using FRF-appropriated funds. Sunbelt used the proceeds to pay off some of its high-cost FHLBank advances.

Nonetheless, an RTC senior official told us that during the first 4 months of 1991 he met informally with investors who had previously expressed interest to FDIC in purchasing Sunbelt as a whole thrift. He said he found that the investors wanted to negotiate agreements that involved large amounts of financial assistance from the government. He further told us that when he advised the investors that RTC required competitive bids and that it would not provide lucrative assistance agreements, the investors lost interest in purchasing Sunbelt as a whole thrift.

When RTC was named conservator of Sunbelt on April 26, 1991, it replaced Sunbelt's board of directors with its own managing agent. As required by RTC policy, the managing agent developed a conservatorship operating plan. The plan, covering the period May 1991 through April 1992, essentially called for Sunbelt management to continue to downsize the thrift and prepare it for resolution in a way that could support a whole thrift marketing strategy.

RTC's efforts to develop a strategy for selling Sunbelt as a whole thrift ceased, it appears, by August 1991. In early July, Sunbelt's president and many top managers left, which, according to an RTC official, may have lessened the interest of some investors in the thrift. In August, the official reported that he had talked with some potential investors and found that although they were interested in some of Sunbelt's assets, they had little or no interest in purchasing Sunbelt as a whole thrift.

A resolution strategy that involved selling Sunbelt's assets in discrete pieces was prepared in September 1991 and approved in November. The strategy essentially called for the immediate marketing of readily saleable assets, while simultaneously dividing the remaining assets into marketable pools and preparing them for sale and/or disposition through various RTC programs.

RTC reported that it reduced Sunbelt's total assets by about \$2.2 billion between the time Sunbelt was placed in its conservatorship program and December 31, 1991. Included in that amount is the FSLIC asset purchase note of \$1.25 billion, which was paid off using FRF-appropriated funds. RTC also sold \$231 million of owned real estate and foreclosed on approximately \$132 million of loans.

As a step in preparing Sunbelt for resolution, RTC hired a contractor to provide a current valuation of Sunbelt's assets as of June 30, 1991. It needed this valuation to prepare a liquidation cost estimate for Sunbelt,

which it plans to use as a baseline against which to compare bids received for Sunbelt. RTC generally must liquidate a thrift if that is the least costly method of resolution.

To further prepare it for resolution, in January 1992 RTC terminated Sunbelt's assistance agreement retroactive to June 30, 1991. RTC will fund all of Sunbelt's operating losses occurring after April 26, 1991, from funds appropriated to RTC; FRF will fund all of Sunbelt's losses up to that date and all assistance agreement costs through June 30, 1991. RTC officials told us they expect Sunbelt to be resolved on April 10, 1992.

Data on the Eight Thrifts Before Consolidation as Sunbelt as of August 19, 1988

Dollars in Millions			
Association	Assets	Liabilities	Net worth
Federated Savings and Loan Association	\$145.0	\$167.1	(\$22.0)
First City Savings Association	214.8	296.7	(81.9)
Independent American Savings Association	777.1	1,668.8	(891.7)
Multibanc Savings Association	178.0	246.1	(68.1)
Summit Savings Association	177.7	351.2	(173.5)
Sunbelt Savings Association of Texas	1,938.8	3,909.8	(1,971.0)
Texana Savings and Loan Association	74.7	82.9	(8.1)
Western Federal Savings and Loan Association	757.7	2,206.5	(1,448.9)
Total^a	\$4,263.9	\$8,929.1	(\$4,665.1)

^aTotals may not add due to rounding.

Source: Audited financial statements as required by the assistance agreement to establish premerger financial values.

Balance Sheet Data on Sunbelt for Selected Dates

Dollars in Millions					
Date ^a	Assets ^b		Liabilities ^c		Net worth
9/30/88	\$8,784		\$8,783		\$1
	Covered	\$5,784	FHLBank advances	\$1,451	
	Other	3,000	Deposits	7,077	
8/31/89	\$9,064		\$9,055		9
	Covered	4,227	FHLBank advances	4,967	
	Other	4,837	Deposits	3,757	
6/30/90	\$10,011		\$10,017		-6
	Covered	3,756	FHLBank advances	4,536	
	Other	6,255	Deposits	5,010	
4/30/91	\$5,829		\$5,902		-73
	Covered	3,229	FHLBank advances	1,470	
	Other	2,600	Deposits	4,192	
9/30/91	\$4,053		\$4,181		-129 ^d
	Covered	3,033	FHLBank advances	188	
	Other	1,020	Deposits	3,869	

^aDates were selected as follows:

9/30/88—Earliest identification of covered assets.

8/31/89—Month-end following passage of FIRREA.

6/30/90—Reflects transfer by RTC of deposit liabilities from two failed Texas thrifts and compensatory cash.

4/30/91—Month-end following appointment of RTC as conservator.

9/30/91—Recent available data.

^bFSLIC promissory notes and the FSLIC assistance agreement receivable are shown as other assets.

^cMonth-end totals include other liabilities.

^dDoes not add due to rounding.

Source: Unaudited financial statements provided by the institution.

Comments From the Office of Thrift Supervision



Office of Thrift Supervision
Department of the Treasury

Timothy Ryan
Director

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April 2, 1992

Mr. Richard L. Fogel
Assistant Comptroller General
General Government Division
Washington, D.C. 20548

RE: Failed Thrift: Lengthy Government Control of
Sunbelt Savings Bank

Dear Mr. *Drak* Fogel:

This is in response to your March 6, 1992 letter concerning the subject report. We believe the report is fair and accurate, and we have no further comment.

Sincerely,

Ti
Timothy Ryan

Major Contributors to This Report

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