Managing a $700 Billion Bailout: Lessons from the Home Owners' Loan Corporation and the Resolution Trust Corporation

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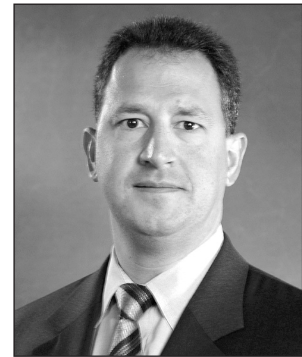
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On behalf of the IBM Center for The Business of Government, we are pleased to present this report, "Managing a $700 Billion Bailout: Lessons from the Home Owners' Loan Corporation and the Resolution Trust Corporation," by Mark K. Cassell of Kent State University and Susan M. Hoffmann of Western Michigan University.

Professors Cassell and Hoffmann observe that the public debate to date over the Troubled Asset Relief Program (TARP) has focused primarily on the *policy* issues involved, with significantly less attention paid to *operational* issues. Their report focuses on the challenges the federal government now faces in implementing a series of financial relief programs. To gain insight into how the federal government might act upon these operational challenges, they took an historical look at how the federal government responded to previous financial crises.

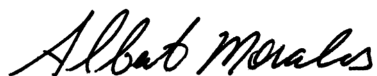
Cassell and Hoffmann present case studies of the Home Owners' Loan Corporation (created in 1933) and the Resolution Trust Corporation (created in 1989). They found clear lessons to be learned from government's experience with both of these organizations. This report analyzes the strengths and shortfalls of these two organizations in order to inform future discussions about what operational capacities the federal government will need to succeed with its current fiscal crisis resolution responsibilities, such as:

- What organizational capabilities or capacities are necessary for any government entity that carries out the present policies?
- What type of expertise, for example, does government need to implement these new responsibilities?
- What are the organizational challenges in carrying out the new tasks?
- What oversight mechanisms will ensure adequate accountability, while at the same time allowing for organizational flexibility?
- How do you unwind the government's role and return financial functions to the private sector once the crisis is over?

The experiences of the Home Owners' Loan Corporation and the Resolution Trust Corporation shed much light into these questions and how government might proceed in the year ahead.

This is the IBM Center's second report in 2009 addressing the nation's financial crisis. Earlier this year, we published a report by Thomas H. Stanton, "Strengthening Government's Ability to Deal with the Financial Crisis," which offered a series of policy-related recommendations to guide future government actions in addressing the financial crisis.

We hope that this particularly timely and informative report, and other related IBM Center reports, will be useful to both the Obama administration and Congress.



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Introduction

As we write this report, the world is struggling with the major financial crisis of this generation. Its depth in the United States is reflected in the increased number of workers in search of employment, the steep decline in economic activity, and the sharp growth in home foreclosures and bankruptcies. *The New York Times*'s grim account underscores the severity of the situation: "The fortunes of the American economy have grown so alarming and the pace of the decline so swift that economists are now straining to describe where events are headed, dusting off a word that has not been invoked since the 1940s: depression" (Goodman 2009).

The federal government has responded with a set of aggressive policies, including the Troubled Asset Relief Program (TARP). Congress approved the TARP during the waning days of President George W. Bush's tenure. The $700 billion in funding it authorized is being used in nine initiatives that aim to provide liquidity to financial institutions, as well as in the "stability" (loan modification) component of the Obama administration's Homeowner Affordability and Stability Plan.

Implementing the TARP entails new responsibilities for the federal government. These new responsibilities include:

- taking major ownership positions in complex financial firms,
- auditing and restructuring troubled financial institutions,
- valuing poorly performing, complex financial assets,
- implementing large scale auctions and securitizations of poorly performing assets,
- knowing when financial institutions are in such dire financial straits that they must be placed under conservatorship, and
- overseeing $75 billion of the TARP funds to modify three to four million of the subprime mortgages at the foundation of the current crisis.

Key Acronyms

EESA	Emergency Economic Stabilization Act of 2008
FDIC	Federal Deposit Insurance Corporation
FHFA	Federal Housing Finance Agency
FIRREA	Financial Institutions Reform Recovery and Enforcement Act
FSLIC	Federal Savings and Loan Insurance Corporation
HOLC	Home Owners' Loan Corporation
RTC	Resolution Trust Corporation
TARP	Troubled Asset Relief Program

The public debate has primarily centered on the size and nature of the TARP—essentially the *policy* involved. Less attention has been paid to *administrative* issues:

- What organizational capabilities or capacities are necessary for any government entity that carries out the policy?
- What type of expertise, for example, does government need to implement these new responsibilities?

- What are the organizational challenges in carrying out the new tasks?
- What oversight mechanisms will ensure adequate accountability while at the same time allowing for organizational flexibility?
- How many employees are needed to implement the new responsibilities?

These are not incidental questions. Scholars note that government often lacks the capacity to implement policies (Pressman and Wildavsky 1984). Failure to achieve policy objectives contributes to public frustration and undermines confidence in government's ability to solve public problems. This report considers the simple but important question:

> What administrative capacities are necessary for government to implement the new responsibilities?

Even under the best of circumstances, challenges confronted by government may be too big or complex to resolve, and present circumstances in U.S. finance are indeed challenging. However, there are examples in U.S. history of dire economic circumstances in which public agencies were created, took on new responsibilities, and defied expectations to satisfactorily resolve serious problems. Their stories offer insights into what administrative arrangements and capacities might best facilitate success in the present crisis.

Looking Back: Learning from Previous Government Experience

The experiences of two historic federal agencies suggest answers to the administrative challenges now facing the federal government in 2009:

- The Home Owners' Loan Corporation (HOLC), created by Congress in 1933 to resolve the foreclosure crisis of the Great Depression
- The Resolution Trust Corporation (RTC), created by Congress in 1989 to resolve the more recent savings and loan crisis

We examine the RTC and HOLC for two reasons. First, the agencies were charged with responsibilities that resemble those taken on by the government in

The Emergency Economic Stabilization Act

The **Emergency Economic Stabilization Act of 2008** (Public Law 110-343) was signed into law by President George W. Bush on October 3, 2008.

The Act, also known as EESA, created the **Troubled Asset Relief Program (TARP)** and a series of subsequent housing and capital investment programs for financial institutions. The TARP program authorized the Department of the Treasury to establish programs to stabilize the U.S. financial system and prevent a systematic collapse. The TARP program has nine components:

- A capital assistance program
- A consumer and business lending initiative
- A making home affordable program
- A public-private investment program
- Regulatory reform
- A capital purchase program
- An asset guarantee program
- A targeted investment program
- An automotive industry financing program

The **"Making Home Affordable Program"** includes three components:

- The Home Affordable Refinance Program for responsible homeowners suffering from falling home prices
- The Home Affordable Modification Program
- Support of low mortgage rates by strengthening confidence in Fannie Mae and Freddie Mac

The **"Home Affordable Modification Program"** has three components:

- $75 billion from TARP for a loan modification program to reach three to four million homeowners by shared effort with lenders to reduce mortgage payments and providing incentives to servicers and borrowers
- $2 billion from the Department of Housing and Urban Development for neighborhood stabilization program grants for innovative programs that reduce foreclosure
- $1.5 billion to provide renter assistance, reducing homelessness and avoiding entry into shelters

the current crisis. The RTC was created during the midst of what was then described as the worst financial crisis since the Great Depression. As with certain financial institutions in the current crisis, savings and loans in the 1980s were severely undercapitalized. Congress created the RTC to stem the rising tide of failures by seizing control of failing thrifts, shutting them down, and selling institutions and assets back into the private sector. The HOLC was also charged with addressing a problem familiar to policymakers today: a crisis in home mortgage foreclosures. Today one in ten homeowners is in arrears or foreclosure, and new policies are charging the federal government to help defaulting homeowners. The HOLC was asked to do just that in 1933.

A second reason to look carefully at the RTC and HOLC is that both succeeded in their core tasks. The RTC took over and resolved 747 thrift institutions (nearly 40 percent of the savings and loan industry), with assets in excess of $465 billion in 1989 dollars (Cassell 2002). The HOLC originated new mortgages for three years, which resulted in the HOLC ultimately owning 20 percent of the residential mortgages in the United States. HOLC was deemed successful in refinancing distressed homeowners while breaking even financially for taxpayers. And both agencies managed what few thought possible of public organizations: They shut their doors after completing their tasks.

Given their accomplishments, it is not surprising that in 2008 policymakers called for the creation of an RTC- or HOLC-like entity. In an editorial in the *Wall Street Journal*, then presidential candidate Hillary Clinton proposed "[a] new Home Owners' Loan Corporation (HOLC), to launch a national effort to help homeowners refinance their mortgages. The original HOLC, launched in 1933, bought mortgages from failed banks and modified the terms so families could make affordable payments while keeping their homes. The original HOLC returned a profit to the Treasury and saved one million homes. We can save roughly three times that many today (p. A19)."

Clinton's view was shared by policy experts from academia (Koppel and Goetzmann 2008), Blinder (2008) and Stelzer (2008), think tanks (Pollack 2008), and private consultants (Salsman 2008). The chair of the President's Economic Recovery Advisory Board, Paul Volcker, former Treasury Secretary Nicholas Brady, and former Comptroller of the Currency Eugene A. Ludwig argued, in a column in the *Wall Street Journal* (2008, p. A27), for a new RTC that would buy bad debt, restore liquidity to the financial system, and gain the flexibility to work with financially stressed homeowners to avert foreclosures.

A number of previous studies have examined the histories of the HOLC and RTC. The goal in this paper is not to retell these histories comprehensively, but to focus on aspects of the stories–framed here as questions–that highlight features which, in retrospect, turn out to have shaped performance. These organizational strengths and shortfalls can inform the debate policymakers should currently be having over what administrative capacities government needs to succeed with its current crisis resolution responsibilities.

Oversight of the "Making Home Affordable Program"

Many federal agencies are charged with implementing and overseeing the program:

- The Department of the Treasury oversees the entire program
- The Federal Housing Finance Agency is the conservator of the program
- Fannie Mae and Freddie Mac are responsible for monitoring compliance by servicers
- Federal Deposit Insurance Corporation and the Department of Housing and Urban Development both play roles in overseeing the program
- The Federal Housing Administration and the Department of Veterans Affairs have authority to provide claims in the event of bankruptcy or voluntary modification

Lessons from the Home Owners' Loan Corporation and The Resolution Trust Corporation

Each financial crisis is of course unique. It would be simplistic to suggest the federal government reconstitute the RTC or HOLC. The RTC and HOLC do, however, offer successful examples of government agencies taking on new responsibilities similar to those presently at hand. By considering their stories—their administrative strengths and shortcomings—we identify 10 organizational features and capabilities that facilitated success and timely liquidation. These features warrant consideration in 2009.

Lesson One: A temporary, dedicated administrative entity was key.

The HOLC and RTC were both government corporations, though some other type of administrative entity could be equally effective. In each case, a single administrative entity proved a key organizational feature for several reasons. First, using an entity dedicated to the resolution task facilitated focusing on that task and developing the remaining organizational capacities we highlight in its service. Secondly, the arrangement was efficient by virtue of concentrating resources—expertise and money—within a single organization rather than distributing them thinly across multiple agencies. Third, each entity was effective due in large measure to centralized, coherent policy direction, even though implementation was decentralized. Finally, a single entity in each case facilitated accountability. Congress knew whom to ask for answers.

In the case of the TARP, which includes two very different kinds of programmatic charges, the clear focus characteristic of HOLC and RTC would require two separate administrative entities:

- **Entity One:** dedicated to dealing with financial institutions' asset problems
- **Entity Two:** focused on assisting home owners through mortgage modifications

Lesson Two: Clear formulation of the critical task is crucial.

James Q. Wilson, longtime dean of public administration scholars, views an organization's critical task as "those behaviors which, if successfully performed ... enable the organization to manage its critical environmental problem" (1989, p. 25). Critical tasks are not goals or even mandates, which may be vague and inconsistent. Instead, the critical task is what an organization needs to do to cope with the complexities and challenges of its environment. When the definition of the critical task is widely accepted, it becomes the mission of the organization.

The HOLC quickly came to view its critical task as helping distressed homeowners while minimizing taxpayers' risk. Successfully straddling the horns of that dilemma took time, thus HOLC's eighteen-year life. RTC, on the other hand, viewed its critical task as the resolution of failed thrift institutions and sale of their assets as quickly as possible. RTC closed up shop after just five and a half years.

Lesson Three: Autonomy and discretion are needed in performing critical tasks.

Once a crisis resolution entity identifies its critical task, it must be free from micromanagement. That does not mean undermining public accountability. Instead, permitting an organization autonomy and discretion recognizes that it is only in implementing the task in the field that relevant aspects of the environment become clear, and how to perform the task given that environment.

Both HOLC and RTC developed understandings of how to deal with the problems assigned to them that varied at the margins from what Congress initially foresaw. Both agencies explained themselves to Congress repeatedly throughout their lifetimes, and Congress typically supported them with leeway to reframe the task and additional money.

Lesson Four: Flexibility to adapt in the field is essential.

In addition to autonomy and discretion, an entity charged with implementing crisis resolution responsibilities needs the related capacity to be flexible, both in how it does its job and in how it is organized to do the job. Flexibility in performing the critical task means being able to change tactics in response to environmental changes and new information. Indeed, one should expect that such shifts will be necessary. Unanticipated at the outset, HOLC found that new loans to homeowners required intensive hands-on servicing to avoid defaulting again, and even so, found itself managing foreclosed houses across the U.S.

RTC too, unexpectedly found itself with a large inventory of real assets throughout the country which required management and sale. Along with implementation tactics, the organizational structure of the entity has to be flexible. As their tactics shifted, HOLC and RTC articulated a more decentralized implementation structure than originally anticipated. The critical task should drive the organizational structure, not the other way around.

Lesson Five: The temporary administrative entities must understand and be responsive to market conditions.

Like the RTC and HOLC's critical tasks, TARP initiatives require government to operate and intervene in private markets, while avoiding harm to markets and not replacing them. This is tricky business: if markets were not in disarray, the organization would not exist. Moreover, what works in one locale may do harm in another, and what benefits stakeholders in a financial institution with global, national or super-regional interests may damage the interests of locally-focused financial institutions. Accordingly, administrative policymakers must understand how national, regional and local markets operate and how the organization's actions affect those markets. HOLC and RTC both consciously walked this tightrope; maintaining balance required decentralized implementation and centralized policy direction.

Lesson Six: Government must have the expertise to hit the ground running in responding to a financial crisis.

The TARP, like the HOLC and RTC, was created in a crisis environment. As in the cases of HOLC and RTC, there is increasing consensus that government lacks adequate in-house human resources to implement the new responsibilities. Direct hires from the private sector and private contractors are thus essential to timely performance of the critical task. The HOLC and RTC used both approaches to harness private expertise. Areas where contractors' expertise can be particularly important are in law, auditing, asset management, asset appraisals, and housing finance.

Lesson Seven: Government must have the ability to effectively monitor and manage contractors.

Capacity to effectively manage contractors and monitor private partners in implementation rises in importance with every dollar spent on external private support. In HOLC, appraisal practice was a key to effectively assisting homeowners, supporting markets, and protecting taxpayers. While HOLC hired an army of contract appraisers who knew local markets, the valuation method was developed by HOLC, contractors were trained by HOLC, and contractors' reports were reviewed by HOLC employees.

HOLC's advancements to appraisal practice set the standard in the U.S. for decades. RTC, on the other hand, suffered challenges to its legitimacy as contractors hired subcontractors, and important valuation and disposition decisions were made without review or standardized documentation.

Thus, given the large role contractors will likely play in implementing the new responsibilities, it is essential that a new resolution entity be able to oversee and manage the performance and payment of contractors. *Subcontracting public authority* should be avoided. In practice this means having enough public sector employees with the necessary expertise to effectively manage contractors, even if the organization has to hire and train them. Secondly, given the

scale of the need for contractors, an information technology system must be in place to effectively monitor the hiring and performance of contractors.

Lesson Eight: Government must have sufficient financial and personnel resources to complete the task.

Public entities charged with implementing the new financial institution-focused and home owner assistance-focused responsibilities must have the financial and human resources to carry out the critical tasks. Without adequate financial resources to finish the job, government is likely to be ineffective and may be diverted from the critical task. Uncertainty about adequate funding, for example, delayed resolutions in the RTC and made planning within the RTC difficult. Without adequate in-house personnel, contractors and private financial stakeholders will define the critical task in terms of their own values. Private firms' understandings of the critical task are likely to result in:

- doing the job in a way that costs more than if an entity with taxpayers' interests uppermost drives implementation decisions, and
- short term solutions that do not last.

Lesson Nine: Government must have exit strategies.

The agencies must adopt strategies to ensure they will work themselves out of a job. At the same time there is a trade-off between the risk that an organization established to address a crisis becomes entrenched, and the risk that the entity dissolves itself too rapidly to ensure that its impact is lasting and taxpayers are fairly treated. Mandated by Congress to wind down rapidly, RTC successfully resolved the S&L crisis, but at significant taxpayer cost. Without a specific sunset date, HOLC resisted pressure from some quarters to liquidate until it had ensured stability for its borrowers over the long haul, and earned enough money on its assets to about break even for taxpayers.

Lesson Ten: There must be clear and transparent oversight.

Finally, administrative entities charged with implementing the TARP must be governed by clear, transparent oversight structures. Clarity requires that a single governing oversight board have authority over each entity's budget and policy direction. HOLC reported to the old Federal Home Loan Bank Board. The clear line of accountability, coupled with the substantive expertise of the Board in housing finance, supported HOLC's legitimacy. RTC, on the other hand, struggled to establish clear oversight structures, and its ability to oversee the actions of a largely private-sector work force was hampered by the absence of an effective information technology system to track assets and employees. Transparency requires establishment of an information technology data collection system to track the actions taken by public employees and private contractors, along with regular audits and reporting by the Inspector General and Government Accountability Office.

Case Study One: Home Owners' Loan Corporation

Congress created the Home Owners' Loan Corporation (HOLC) in June 1933 to bring the depression-era home mortgage foreclosure crisis to heel. By that time, the tragedy had been unfolding for three to four years and foreclosures had accelerated to a pace of about 1,000 per day (Federal Home Loan Bank Board 1941, cited in Wright, 2005, p.239). About half of U.S. mortgage debt was in default (Wright, 2005, p. 240).

Policymakers' charge to the new corporation was clear: assist home owners facing foreclosure. President Roosevelt had asked for legislation "to protect small home owners from foreclosure and to relieve them of a portion of the burden of excessive interest and principal payments" (Roosevelt, 1933, p.135). Congress responded with the Home Owners' Loan Act "to provide emergency relief with respect to home mortgage indebtedness, to refinance home mortgages [and] to extend relief to the owners of homes occupied by them" (Home Owners' Loan Act of 1933). C. Lowell Harriss, who chronicled the HOLC under contract to the National Bureau of Economic Research, notes that a financial loss to the Treasury was expected in pursuing this mandate, but the authorizing statute was designed to limit that loss (p.12). Contemporary commentators referred to the HOLC as a relief organization, and to its "philanthropic" purpose (Ervin, 1937).

In the field, HOLC came to understand its critical task as assisting distressed homeowners while minimizing taxpayers' exposure. An organization's "critical task" is defined as its central work, pursued in a

At a Glance
The Home Owners' Loan Corporation

Authorizing legislation:	Home Owners' Loan Act of 1933
Start date:	June 13, 1933
Liquidation date:	March 31, 1951
Initial lending period:	June 13, 1933 to June 12, 1936
Number of applications received:	1,886,491
Number of mortgages refinanced:	1,017,821
Value of mortgages refinanced:	$3.1 billion (unadjusted)
Proportion of U.S. residential mortgages owned:	About 20 percent
Number of foreclosures of HOLC mortgages:	194,134
Total borrowing authorized:	$4.75 billion (unadjusted)
Total borrowing used:	$3.49 billion (unadjusted)
Surplus returned to Treasury:	$14.1 million (unadjusted)

Source: *C. Lowell Harriss,* History and Policies of the Home Owners' Loan Corporation, *New York, National Bureau of Economic Research, 1951 and Home Loan Bank Board,* Final Report to the Congress of the United States Relating to the Home Owners' Loan Corporation, *Washington, D.C., 1952.*

way that recognizes and addresses crucial environmental constraints. When there is agreement throughout the organization on how the critical task is understood, that task is the organization's mission. A mission, in this sense, offers managers and personnel a normative reference when they have to determine what to do in a particular situation, and how to do it. HOLC had a clear mission.

Ultimately, the HOLC provided new mortgages to a million American families, becoming the owner of one in five residential mortgages in the U.S.—at no cost to taxpayers. The corporation succeeded in straddling the horns of its dilemma as it saw it—*help* homeowners, but do not expose taxpayers to excessive risk.

How did policymakers understand the home mortgage foreclosure problem?

The Home Owners' Loan Act implies that policymakers viewed the structure of home mortgages as a fundamental aspect of the problem, and intended the HOLC to address the crisis by means of the structure of its new mortgages. In the period leading up to the depression, a mainstream "straight" first mortgage was typically for forty to sixty percent of value, with a term of three to five years; interest only was paid. It was taken for granted that refinancing would be available when the mortgage ballooned at the end, and reliance on the upward trend in home values to justify the loan amount—rather than realistic assessment of borrowers' ability to pay–was widespread. There were big second mortgages with onerous terms (President's Conference, 1931). The parallels to the foreclosure crisis of 2007-2008 are clear. The folly of policymakers since 1980 who forgot or ignored what was learned then about the structure of a mortgage that works for regular working people is stunning.

By the onset of the depression, mutually-owned building and loans (later called S&Ls) had already been making mortgages that amortized fully over terms as long as eleven years. But with widespread unemployment and plunging residential real estate values, even building and loan mortgages were in arrears by 1933. Widespread defaults on amortizing S&L mortgages provide another painful and obvious parallel to circumstances in 2009: the deteriorating economy and sharply declining home values have generated a second wave of defaults among holders of responsibly underwritten conventional mortgages who are now unemployed or find themselves "upside down" on their remaining mortgage obligation.

The Home Owners' Loan Act pushed the S&L mortgage model further, specifying that new mortgages extended by HOLC would amortize over up to 15 years and bear interest at a rate not to exceed 5 percent. An amendment in 1939 permitted extension of the term to 25 years and reduced the rate for all borrowers to 4 1/2 percent.

What was the legal structure of the HOLC?

The organization Congress created to implement this approach to the foreclosure crisis—the Home Owners' Loan Corporation—was a government corporation. This form is well-suited to the public's purpose when the service or product to be provided by government can reasonably be divided among clients and priced, as for example in the Federal Deposit Insurance Corporation (FDIC) and TVA. It permitted the organization to design and use its own personnel and procurement systems to enhance organizational flexibility if deemed necessary by HOLC. HOLC's authorizing statute stipulated that it would be liquidated "when its purposes have been accomplished." It was thus clear from the beginning that HOLC was a temporary organization. The statute did not, however, include a sunset date.

How was the HOLC funded?

The HOLC was capitalized at $200 million—paid in by the Treasury with a non-interest-bearing loan from the Reconstruction Finance Corporation–and authorized to issue bonds which it would exchange for home owners' old mortgages and for cash as needed. Initially, HOLC had authority to issue up to $2 billion in bonds at up to 4 percent interest, with interest only guaranteed by the government. Early statutory amendments increased the limit to $4.75 billion, and provided for guarantee of principal as well as interest to improve the prospects of a market for the bonds. Ultimately, HOLC did not need all of its bonding authority: Congress had provided enough money to do the job.

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

HOLC's governance structure was straightforward. Its board of directors was the Federal Home Loan Bank (FHLBank) Board, which reported to standing congressional authorizing committees of jurisdiction and appropriations subcommittees. The record indicates that the Federal Home Loan Bank Board (and the wartime agency that temporarily held its jurisdiction) was hands-on in policy direction of the HOLC throughout its eighteen-year life (Home Loan Bank Board, 1952; Harriss, 1951). The board made policy choices regarding structure and staffing, as well as how it would operate. Policy regarding operations was translated into forms and field manuals that were distributed and used throughout the country, shaping work by personnel and contractors.

The FHLBank Board itself was only a year old when HOLC was created in 1933. It was the regulator in the new Federal Home Loan Bank System, an institutional creation of the Hoover administration designed to increase liquidity for home mortgage lenders and correct problematic home financing practices over the long run. Modeled on the Federal Reserve, the FHLBank System (the System) included the Federal Home Loan Bank Board and 12 regional Federal Home Loan Banks. FHLBanks were bankers' banks; they made conservatively collateralized loans (advances) to their member financial institutions—S&Ls, savings banks and insurance companies. Members used these loans to make new home mortgages and for liquidity in the face of depositors' withdrawal pressure. Incentives in the System were designed to move member institutions toward longer term, fully amortizing mortgages and improved, standardized appraisal practices. The System was self-funding, authorized to issue debt securities as the source of funds for loans to members, that debt to be serviced through proceeds from operations. Each separate FHLBank was capitalized and owned cooperatively by its respective member institutions, though initially the federal government paid in some of the capital.

As the foreclosure crisis had gained steam, pressure was placed on the infant Federal Home Loan Banks to address defaulting mortgages. A provision requiring FHLBanks to refinance the mortgage of any home owner in distress who could not find another source of funds had been inserted into the Federal Home Loan Bank Act on the Senate floor, and in the 1932 congressional races, incumbent candidates for Congress made big promises about what FHLBanks would do. Thus it is not surprising that as FHLBanks were organizing themselves in the latter half of 1932 and early 1933, they were deluged with applications for mortgages—not only for homes, but for farms and apartment buildings. But these new institutions were not designed for direct lending: they had no mechanisms and nothing like the requisite level of resources to resolve the foreclosure crisis.

In 1933, hearings were held in Congress on a bill to terminate the Federal Home Loan Banks, which were charged with being Hoover creations that helped financial institutions rather than hard-pressed people. Held-over Hoover administrators and new Roosevelt appointees to the Federal Home Loan Bank Board defended the FHLBanks. Based on experience with defaulting home owners in the field and their expertise in home ownership finance more generally, they explained the empirical dynamics of the unfolding foreclosure crisis and why Federal Home Loan Banks could not resolve it. They urged that FHLBanks not be terminated because they were designed to address the *long term problem* with the structure of home ownership financing. An appropriate solution to the *short term crisis* would have to look different. Angry committee members, and less angry ones, backed off to give Federal Home Loan Bank Board managers an opportunity to work with the Roosevelt administration on the outline of a program and an implementation platform designed to fit the scope and nature of the immediate foreclosure problem (U.S. Senate, 1933a; 1933b).

Instead of eliminating the Federal Home Loan Bank Board, the resulting Home Owners' Loan Act of 1933 directed the Board to create the Home Owners' Loan Corporation to take on the problem and to be its board of directors. What is important about this episode, for the current situation, is that Congress made a clear assignment of responsibility for its foreclosure resolution program to one regulator. That regulator, young as it was, was the regulator in the government with the most expertise in home ownership finance at that time. Moreover, the

Federal Home Loan Bank was part of a network of home financing organizations that extended into local communities across the country.

How did the HOLC do its job and what kinds of expertise were tapped?

The Home Owners' Loan Act takes up only eight pages in the *Statutes at Large*, and only four of them are about the HOLC. (The remaining four authorize a federal S&L charter.) The statute provided for the HOLC's funding, as described above, and made the Federal Home Loan Bank Board its board of directors. Programmatically, it limited the value of homes eligible for refinancing in order to confine assistance to owners of moderate and middle value homes. The nature of the new mortgages was specified: HOLC's mortgages would be the first lien, have a maximum term of 15 years, and a maximum interest rate of 5percent. (In 1939, the Meade-Barry Act permitted extending the term to 25 years and reducing the interest rate to 4.5 percent.) Cash could be advanced for taxes, repair and expenses of the loan. Loans on the same general terms could be made on homes that had already been foreclosed or surrendered within two years prior to origination of the loan (Home Owners' Loan Act of 1933).

Beyond these bare bones (money to work with, direction about whom to help, and what a mortgage should look like), "there was very little conception as to how the organization would operate, what its problems would be, or how long it would last" (Harriss, p. 11). According the Federal Home Loan Bank Board's first annual report, "the act made no provision for the method of administration" (1933, p.47). Specifics of how to do the job, and how to organize to do the job, were left to the discretion of managers.

Aspects of the job (functions)

The critical task, as the HOLC came to see it, was to help distressed home owners while not exposing taxpayers to excessive risk. The main functions this job entailed were loan origination, appraisal, loan servicing, foreclosure, property management and sales, and finally, liquidation of the organization. (This classification of functions and statistics throughout this section are from Harriss [1951] and the Home Loan Bank Board [1952]).

The prominence of the various functions changed over HOLC's short life. Most mortgage origination occurred in the first two years of HOLC. During that period, the reinvention of U.S. appraisal practice accompanied large scale loan origination. Loan servicing began as soon as the first HOLC loans closed and extended throughout its life. While foreclosure activity peaked in the early years and trailed off dramatically, the property management and sales responsibility it entailed required significant attention for a much longer period. The way each function was handled developed under fire, and the size of the total workload peaked early and declined gradually.

The Home Owners' Loan Act provided that mortgages could be refinanced for three years. Accordingly, work in the field was initially dominated by screening applications and *originating mortgages*. Applications were accepted from June 1933 to November 1934, and again for 30 days ending July 27, 1935. Net of tens of thousands of clearly ineligible applications for loans on business properties, farms and apartment buildings, HOLC received 1,886,491 applications for $6.2 billion. Harriss estimates that 4.8 million (45 percent) of the country's 10.5 million nonfarm owner-occupied 1-4 family dwellings were mortgaged in 1930. Owners of 40 percent of these applied for HOLC aid. At the end of the three-year original lending period, HOLC had made 1,017,821 loans totaling $3.1 billion and averaging about $3,000. The corporation held mortgages on 20 percent of the owner-occupied residences in the United States, distributed across all 48 states, Hawaii, Alaska, Puerto Rico and the District of Columbia.

While most loan origination occurred during the original lending period, origination continued at a reduced level as HOLC refinanced some of its own borrowers when they defaulted again, and provided financing to purchasers of HOLC foreclosures.

Appraisal policy was a key factor in HOLC's success. Administrative policymakers invented the methodology as the corporation tackled its critical task of helping home owners in distress while limiting taxpayer exposure. The challenge was that Congress had limited lending to 80 percent of value. Thus lower appraisals would mean that fewer defaulting home owners could be helped (because

their existing mortgages exceeded value) and former lenders would have to compromise more. Higher appraisals would mean more situations could be addressed, but expose HOLC, thus taxpayers, to greater risk. The dilemma was the corporation's to tackle because though Congress's specific loan-to-value limit seemed clear on its face, there was no way to determine just what "value" meant in the context: present market values were far askew from "normal" values before the crisis and what they might be when the market stabilized.

The HOLC devised a formula for valuation based on the average of:

- market value at the time of appraisal,
- cost of a similar lot at the time of appraisal plus buildings, less depreciation, and
- capitalization of a reasonable rental value over 10 years.

The formula resulted in generous valuations, higher than current market value. This permitted the corporation to help more homeowners, but required hard work down the line, in the servicing phase, to limit loss. It also helped buttress prices in local markets. For borrowers who stayed the course, market value of their properties typically rose comfortably above the loan amount within a few years.

Training in HOLC's appraisal method was required of fee appraisers as well as the corporation's own full-time appraisal personnel. Because appraisal practice before the depression had not been standard and was frequently shoddy, HOLC's approach became widespread and influenced appraisal standards for decades. The questionable appraisal practices that re-emerged in the 2004-2007 period, along with reliance on assumed ever-increasing value to carry the loan, would be familiar to those confronted with the foreclosure crisis in 1933.

The corporation's need for appraisal expertise continued beyond the original three-year lending period, though the volume was less in succeeding years. HOLC continued to stress good appraisals in order to protect taxpayers as it made loans for improvements ("reconditioning") in some cases, and foreclosed and resold properties.

As HOLC's *loan servicing* function developed, it turned out to be part loan servicing, a big part social work, and part enforcement. Initially, the plan was for loans to be serviced from the central office in Washington, in pursuit of efficiency. That plan did not last long as it became apparent that servicing would have to be hands-on. Borrowers were people in financial distress; it is not surprising that most of them were found to need some level of ongoing attention despite new HOLC mortgages. In 1934, the second year of HOLC's existence, loan servicing was decentralized. Regional offices were established, where closed loans were sent. Loan accounts were actively managed: they were reviewed regularly and delinquencies were pursued through correspondence and personal visits by field representatives.

Field representatives were full-time HOLC staff; their objective was to keep the borrower in the home and restore the mortgage to performing status. Exercising considerable discretion within established rules, they worked with borrowers to determine what was interfering with ability to repay and how to solve problems. HOLC staff reviewed family budgets; assisted families in collecting pensions, debts and insurance claims; helped the unemployed find jobs and the over-housed find renters for rooms in their homes or sell part of the property; and facilitated placement of foster children with borrower families, to provide income. When it made sense, HOLC provided additional financing and other help to improve the home for increased rental value.

Real estate taxes and assessments proved a major problem for borrowers: 40 percent of HOLC borrowers were delinquent on these obligations one or more years from 1933 through 1937. HOLC often paid these arrearages and increased the home owner's loan. HOLC also devised a service—and encouraged borrowers to use it—whereby borrowers made monthly installment payments to HOLC to cover their property taxes and home owners insurance.

In 1937, the corporation began extending loans for defaulting borrowers. The terms varied from case to case in the effort to give a new psychological start to borrowers who were struggling, but appeared sincere in the effort to keep their homes.

Most of the loans made in the initial three-year refinancing period defaulted again at some point. Congress had said nothing about *foreclosure* in the authorizing statute, though foreclosure is implicit in the statutory requirement for first liens. How to handle foreclosure was up to the Federal Home Loan Bank Board and HOLC managers.

As long as it appeared that a borrower wanted to keep the home and intended to pay the loan, HOLC continued to invest time, effort, and even additional financing. According to Harriss, there are case files in which 12 or 20 home visits are reported. Seventy percent of foreclosures were on loans that were more than a year delinquent, and foreclosed loans often totaled more than the original loan because HOLC had advanced additional funding for taxes and improvements. But when it was clear that a borrower simply did not intend to pay or, less often, just could not, HOLC foreclosed.

The decision to foreclose was made by corporation personnel—HOLC regional managers, based on reports and recommendations by the corporation's loan servicers. Foreclosure operations were directed by HOLC regional office legal departments, usually with local attorneys hired on a fee basis to handle local court proceedings.

Of the one million loans made in the initial three-year refinancing period, 200,000—one in five—were foreclosed (or voluntarily transferred to HOLC, 18 percent of the 200,000). Most foreclosures occurred early on: half were made by December 1937 and three-fourths by June 1939. After June 1942, the rate of foreclosure became negligible.

Foreclosure resulted in a *property management and sales* operation on an unprecedented scale. By June 1937, HOLC had effective control of over 70,000 properties, enough to house over a quarter of a million people. At the peak in 1938 and 1939, HOLC owned or was in process of acquiring over 103,000 properties.

To avoid depressing local markets, HOLC administrative policymakers decided early on that properties would not be rushed to sale, but also would not be held for speculation. The policy was to sell homes as soon as a reasonable price could be garnered. This entailed a massive program of property maintenance and rental in the meantime. HOLC's rental policy also aimed at sensitivity to local markets, and units were sometimes left vacant to avoid depressing local rents. By 1940, in response to congressional pressure, HOLC was selling properties sooner than corporation managers may have otherwise. On total gross sales of $738 million, HOLC lost about $337 million.

Contract property manager/brokers were used extensively in the rental and sales operations, under supervision of property management divisions in regional HOLC offices.

By 1943, 10 years after its creation, HOLC was on financially firm ground. Its inventory of properties under management and for sale had declined, and its loans were of good quality. The corporation was winding itself down by encouraging borrowers to accelerate payment or to prepay without penalty, but HOLC was not selling its loans.

Pressure to sell the good loans—mostly from the S&L industry—increased. HOLC resisted for a while, arguing to Congress that they were liquidating in any event, and hasty sale would prevent HOLC from repaying taxpayers. But by 1948, the HOLC's long-standing policy of encouraging borrowers to prepay their loans without penalty had been so successful that servicing was not cost-effective in many areas. The decision was made to speed up *liquidation*—encouragement to prepay was stepped up, and remaining loans were sold in statewide bulk lots. When HOLC closed its doors in 1951, the small profit returned to the Treasury—the exact amount dependent on assumptions used to calculate corporation costs—meant the corporation approximately broke even for taxpayers.

Structure and staffing

HOLC's success depended upon how managers and personnel understood and performed the aspects of the job, *how they did the work,* and upon how public managers *structured and staffed the organization* to do the work. They strove for efficiency within the constraint that effectiveness in helping homeowners was primary.

HOLC administrative leaders revised structure and staffing over the life of the corporation in response to early lessons in the field about how to effectively assist homeowners, changing proportions of the various functions in the workload, and changing overall size of the workload. This management flexibility was facilitated by Congress, which left decisions about staffing and structure to the FHLBank Board and HOLC managers.

Structurally, the HOLC was characterized throughout its lifetime by strong central policy direction and decentralized interpretation and implementation.

As soon as the Home Owners' Loan Act passed in 1933, the Federal Home Loan Bank Board selected a small staff for a home office in Washington. They divided the U.S. into six administrative districts, each with an assistant general manager in the Washington office. The board also immediately set about appointing a state manager to head a state office in each of the 48 states, Hawaii, Puerto Rico and the District of Columbia. State offices fleshed out the organization within the state, reaching into every county to appoint at least one fee attorney and one fee appraiser. They also set up district and sub-district offices within their states such that at the peak, November 1934, applications were being accepted at 408 state, district and sub-district office locations across the county. The intent was to make the loan application process broadly accessible. Loan approval, though, was at the state office.

Initially, the plan was to then turn loans over to Washington for servicing, in pursuit of efficiency. That plan was scrapped within months, with realization that hands-on servicing would be crucial if homeowners were to be helped. Efficiency took a back seat to effectiveness as servicing moved to the states. Eleven regional field offices were created in 1934—inserted between the central Washington office and the states—to supervise the state offices. Regional offices interpreted policy made in Washington through regional lenses, and permitted considerable discretion to state offices.

The regional offices turned out to be a key in efficient contraction of the corporation. When loan servicing did eventually become more routine, state offices were abolished over a two year period, 1940 through 1942, and their functions transferred up to the regional offices. Some of the district and sub-district offices remained—close to the ground in locations with lots of HOLC activity—and reported directly to the regional offices. As corporation contraction continued, regional offices were gradually consolidated, beginning with absorption of the Boston regional office into the New York office in 1939, and ending as Chicago's outstanding activity was merged into New York in 1947.

With regard to *staffing*, the Home Loan Bank Board's *Final Report* to Congress on the HOLC reports that at its peak in November 1934, the corporation directly employed 18,049 people in field offices and 2,762 in the Home Office (p. 9). Managers had fleshed out the organization as quickly as possible, hiring and training a core of line employees for field offices. The workforce expanded with the workload, and was reduced aggressively as the work and the corporation contracted. When the corporation was liquidated in 1951, federal employees were separated "under the reduction in force procedures or by transfer to other agencies, by resignation, or by retirement" (p. 10).

Status as a government corporation permitted HOLC to operate outside of federal civil service policy, for a while at least. In early years HOLC employees were paid less than civil service scales—depression-era unemployment levels surely facilitated that approach. Gradually Congress brought all HOLC employees under civil service.

As far as we can tell from the record (comprised of reports by the corporation to Congress and Harriss's interpretation of those reports), line employees were well-trained, shared corporation leaders' understanding of the critical task, and exercised discretion within the parameters of their own functions.

In addition to its staff of direct federal employees, HOLC used a large number of *contractors*, including appraisers, inspectors, attorneys, and "reconditioning" personnel on a fee-for-service basis, as well as contract property managers and sales brokers. The number varied widely over HOLC's 18-year life. Harriss relied on a 1937 hearing before a congressional appropriations subcommittee to tally up contract employment to that point, which would have

been approximately the peak: "… it is known that up to 1937 about 5,000 different fee appraisers and inspectors had been used, that [HOLC] had 2,399 contract management brokers, 2,638 contract sales brokers (many brokers serving in both capacities), and 9,800 approved sales brokers…. At the same time, the number of fee attorneys totaled about 8,000 (p. 150)." This would be about 26,000 people, about 25 percent more than peak line staff.

The availability of contract local expertise was instrumental in rapidly handling the initial flood of loan applications and originations, but loan approvals were made in the HOLC's state offices. Contractors also did much of the work in the foreclosure, property management and property sales functions that came a little later in the corporation's life. Ease in ending relationships with contractors as the functions for which they were needed declined in importance is obviously helpful in pursuit of efficiency. Reducing the number of fee personnel also appears to have benefited effectiveness: Harriss reports that "as the volume of the work declined, the HOLC found that fee personnel tended to lose interest; more supervisory effort was needed to maintain standards, and the Corporation often found it better to rely on salaried personnel" (n. 16, p. 151).

Harriss's history and the Home Loan Bank Board's final report to Congress both include detailed descriptions of how HOLC did its work. This record indicates that contractors' contributions, while crucial and large, fed into processes such that review, discretion, and final decisions were in the hands of line personnel and managers in district and state offices. For example, loan applications always included appraisals and sometimes estimates of needed repairs as well, and both were often provided by local experts on a fee basis. Yet appraisals by fee appraisers were reviewed at least once, possibly twice by corporation appraisers and fee appraisers were trained by the HOLC. All applications were reviewed and accepted or rejected at district offices. Loans were closed at HOLC state and district offices pursuant to policy direction by the Federal Home Loan Bank Board and using forms approved by the board. While local attorneys on a fee basis handled local court proceedings in foreclosures, only HOLC staff decided when it was time to give up on a loan and pursue foreclosure.

What were understood at the time to be the major strengths and weaknesses of the HOLC?

Despite criticism from some quarters that the HOLC did not provide refinancing for all applicants, the corporation was widely regarded as successful in its relief effort, helping home owners keep their homes and stopping the tide of foreclosures. By 1937, the press highlighted the likelihood of financial success as well, anticipating that the corporation would return the taxpayers' investment (Ervin, 1937). Writing in 1951, the year the corporation liquidated, sociologist Rosalind Tough points further, to broad social benefits: the HOLC bailed out not only homeowners, but also banks, and helped cities and towns by paying homeowners' taxes (1951, p. 325-26).

The HOLC also made several contributions to practical aspects of home finance. Foremost among them, the corporation improved and standardized appraisal practices, setting the standard followed in the U.S. for several decades. It devised loan servicing procedures that were efficient for a nation-wide lender, including advances in technology. To help borrowers, the HOLC also initiated the service of escrowing property tax and home owners insurance.

Case Study Two: The Resolution Trust Corporation

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

In a parallel to the HOLC, by the time the RTC was created to tackle the "mess" assigned to it, the S&L industry had been on shaky ground for several years. Beginning in the 1970s, savings and loans took on significant risk that resulted in a rising tide of bankruptcies. The erosion of the housing finance industry threatened the public's confidence in other sectors of the economy. At the same time, the federal government's deposit insurance program for S&Ls (Federal Savings and Loan Insurance Corporation, commonly known as FSLIC) created a significant potential liability for taxpayers. The policy practiced during this period had been forbearance, allowing troubled thrifts to continue by injecting them with capital in the hope that markets would improve (DeGennaro and Thomson 1992; Rom 1996). But in 1989, after one-third of the S&L industry—or 526 savings and loan institutions—had become insolvent and many more were in trouble, the administration and Congress decided that postponing action in the hope that things would improve was no longer an option (Congressional Budget Office, 1993).

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

At a Glance
The Resolution Trust Corporation

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

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

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

How did policymakers and the RTC understand the problem?

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

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

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

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

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

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

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

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

What was the legal structure of the RTC?

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

RTC Objectives

The objectives for *resolving* thrifts included:

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

The objectives for *disposing* of assets included:

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

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

For example, the need to "hit the ground running" meant that the corporation had to staff up quickly. Thousands of new employees needed to be hired and deployed in regional offices around the country. Exemption from civil service rules gave the corporation the *capacity to hire quickly*. At the same time, the RTC (like the HOLC) was conceived from the start as a temporary entity. FIRREA specified the corporation shut its doors by December 31, 1996. Thus, it needed the ability to not only hire quickly but also the *capacity to wind the corporation down quickly* as the RTC reduced its inventory.

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

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

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

How was the RTC funded?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

In inventing this byzantine structure, Congress sought to:

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

The two-board structure, however, created more confusion than clarity. At its core, a major problem centered on the tension between the Department of Treasury's desire to closely oversee the corporation, and FDIC's desire to exercise the authority and discretion it felt it needed to manage the RTC. First, the governing structure separated planning and decision making from operations. The RTC board (FDIC Board) was charged with administering the clean-up operation, but could not participate in strategic planning of how to conduct it. The chair of the RTC Board, after all, was missing from the Oversight Board. Second, the RTC board had little budgetary control over its operation. FIRREA and subsequent legislation funded the RTC, but the RTC Board had to go to the Oversight Board for funds that Congress approved. This reduced the RTC's capacity to quickly respond as the situation on the ground changed. Resolutions were held up, for example, as the RTC Board waited for approval from the Oversight Board for funding. Finally, the governance structure required the RTC to effectively be responsible to four agencies (Treasury, HUD, the Federal Reserve, the FDIC), a set of advisory boards, and Congress. The multitude of formal principals increased confusion in the RTC and undermined communication between executives, managers and staff (Seidman 1993; Kettl 1991).

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

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

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

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

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

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

Aspects of the job (functions)

The RTC divided its task into three separate stages:

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

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

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

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

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

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

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

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

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

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

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

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

Resolutions required expertise in assessing the resolution options, marketing the institutions, and selling the institutions—typically through some type of auction. Just as investors and the federal government today struggle to value the assets held by banks, the problem of asset valuation for the RTC was enormous. Poor record keeping and a lack of markets for many of the assets compounded the problem. The RTC faced two additional hurdles. FIRREA required that the assets not sell below 95 percent of their book value. This put pressure on the corporation to determine a value for the asset even when there was no market. And second, the RTC and Congress were acutely aware that delays in resolving thrifts and selling assets would be costly because franchises and assets would deteriorate in value, and depositors would close their accounts. For these reasons, the RTC ended up keeping most of the assets of thrift institutions regardless of what type of resolution was conducted forcing a final stage (GAO 1992).

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

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

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

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

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

Under the contracting plans, RTC asset specialists in regional offices pooled large numbers of assets by type and placed them into a portfolio. Real estate assets were divided into categories such as single-family homes and retail properties. Loans were further subdivided by categories according to the underlying collateral. Once they were organized by type, RTC's management reviewed and approved the portfolios for solicitation of bids from approved contractors. The contractors selected managed and disposed of the assets, and received payments for both activities, though incentives were built into the contracts to dispose of the assets.

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

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

Structure and staffing

Structure

The RTC was organized functionally into two broad units:

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

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

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

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

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

Staffing

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

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

Staffing—Limited-Term Employees

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

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

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

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

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

Staffing—Contracting and Contractors

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

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

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

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

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

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

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

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

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

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

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

Applying What Was Learned from The HOLC And RTC Experience

Home Owners' Loan Corporation

The HOLC was widely regarded as successful in its time, even though home mortgage foreclosures had been permitted to mount for three years and the situation achieved crisis proportions before federal policymakers acted decisively. That seems hopeful now, given the parallel slow start since the current foreclosure problem emerged in 2007.

HOLC's story suggests the importance of a temporary administrative entity with one clear job to do, discretion to make choices about how to do it and how to organize itself, and flexibility to revise those arrangements as circumstances change and the organization learns more. In contrast, the current TARP-funded mortgage modification program is quite specific about mechanisms. The government can expect that some of those administrative mechanisms are likely to function in unexpected ways that may require change.

As with the HOLC in its time, private partners are needed today in an undertaking this large, but those partners must be monitored closely by public employees. It is not realistic to expect that private partners view their sole mission as assisting distressed home owners or protecting taxpayer interests. Financial incentives for servicers and lenders built into the current mortgage modification program indicate that policymakers in 2009 understand that private partners will not look out for homeowners unprodded. It is critical to recognize further that private partners are not responsible to taxpayers for effectiveness and efficiency with the money they are given. Bearing the onus for substantive program accountability—Do those mortgage modifications stand up over the long run? —along with ensuring procedural accountability on the part of participating financial institutions is the government's responsibility. It will require that an organization with adequate personnel, expertise, money, and information systems supervise and monitor program actions by private partner institutions.

Lessons Learned from the HOLC and RTC Case Studies

- **Lesson One:** A temporary, dedicated administrative entity was key.
- **Lesson Two:** Clear formulation of the critical task is crucial.
- **Lesson Three:** Autonomy and discretion are needed in performing critical tasks.
- **Lesson Four:** Flexibility to adapt in the field is essential.
- **Lesson Five:** The temporary administrative entities must understand and be responsive to market conditions.
- **Lesson Six:** Government must have the expertise to hit the ground running in responding to a financial crisis.
- **Lesson Seven:** Government must have the ability to effectively monitor and manage contractors.
- **Lesson Eight:** Government must have sufficient financial and personnel resources to complete the task.
- **Lesson Nine:** Government must have exit strategies.
- **Lesson Ten:** There must be clear and transparent oversight.

Finally, HOLC's story included a clear, straightforward governance structure. The regulator was the (relatively) permanent agency in the government with the most extensive expertise in home ownership finance at the time. Perhaps HOLC could have succeeded with its overseers in the Treasury, but then, as now, Treasury had a lot on its plate in resolving a broader crisis.

In 2009, the two agencies that more closely parallel the Federal Home Loan Bank Board which could serve as the policy governing board for the TARP homeowners stability initiative are the Federal Housing Finance Agency (FHFA) and the Federal Housing Finance Board (FHFB). The FHFA is the new regulatory agency created in 2008 to govern Fannie Mae and Freddie Mac, along with the Federal Home Loan Banks. The FHFB is the Federal Home Loan Bank regulator created in 1989 in FIRREA, and tucked under FHFA in 2008.

The FHFB has a good track record, and oversees a decentralized system, boding well for capacity to appreciate local market conditions. FHFA is newer and does not yet have a track record, though Congress's creation of this agency represents an effort to consolidate expertise in the regulation of housing finance. The Obama administration's "Making Homes Affordable Program" does charge the FHFA with monitoring the loan modification program and serving as the program's conservator (Department of the Treasury, 2009). The HOLC experience also suggests that while monitoring is important and FHFA is a good organizational home for it, this is not enough. The ability to intervene and change course in response to changes on the ground is also important.

Resolution Trust Corporation

Just as policymakers today struggle to define the proper role of the federal government in the current crisis, lawmakers in the 1980s struggled to craft a solution to the thrift crisis that threatened to undermine the entire economic system. And, while it is disheartening to have to again confront the problems of a vulnerable and failing financial system, the experience of the RTC is reassuring in that it suggests the federal government can play a constructive role in solving systemic problems that plague financial institutions today.

The experience of the RTC demonstrates the utility of creating a separate strategic entity to accomplish specific goals, under specific time constraints, and with the freedom and autonomy to define the critical tasks necessary to get the job done.

Discretion and autonomy enabled the RTC to adapt its structure and approach to changing circumstances. After it became clear the RTC could not simply sell failing thrifts as whole institutions, the organization adjusted to become an asset manager and asset sales operation. Its decentralized structure enabled it to identify and respond quickly to changing market conditions.

The RTC also illustrates the opportunities and challenges associated with a reliance on private sector professionals and private markets. The corporation was able to hit the ground running because it purchased expertise from the private sector. Accounting, law, asset management, asset valuation, and marketing were tasks that were farmed out to armies of private professionals. Contractors enabled the RTC to deploy resources where they were needed most, and to increase and reduce staffing as inventory changed. However, the RTC also illustrates that reliance on private markets and contractors places a premium on an agencies' capacity to understand markets, monitor and manage contracts, and have in place effective computerized information systems that can track assets and contractor performance. Without such capacity, the organization runs the risk of costing taxpayers money and allowing private third parties (rather than government employees) to shape the mission of the organization. Such lessons are particularly important for the current moment given the Obama administration's reliance on private actors to rescue financial institutions.

A further lesson of the RTC is that an entity charged with implementing such a difficult task should be given the necessary financial and personnel resources to implement the task. Moreover, the resources should be included in the federal budget and be appropriated through a clear and transparent mechanism.

Finally, the RTC illustrates how important it is to for oversight structures to be clear and transparent. The current TARP policies and programs dispersed responsibility and authority across a wide range of

federal agencies. The RTC experience suggests that such a wide dispersal of responsibility while understandable also warrants reconsideration. The RTC suffered under the weight of two governing boards composed of representatives of multiple federal agencies. Strategic and operational responsibilities were severed by the dual board structure reducing effective communication and oversight.

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Dr. Cassell's work has also appeared in *Public Administration Review*, *International Public Management Journal*, *Social Science Quarterly,* and *Governance: An International Journal of Policy, Administration and Institutions*. He currently has a book forthcoming from SUNY Press (with Susan M. Hoffmann) on mission expansion in the Federal Home Loan Bank System.

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