

An Auditor's Perspectives on the Banking Industry

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Introduction

- Overview of presentation
 - IG Concept in the Federal Government
 - The FDIC OIG
 - The FDIC Today
 - Mission
 - Challenges
 - OIG Approach to Addressing FDIC Challenges
 - OIG Priority Audit Work
 - Material Loss Reviews and Other Assignments
 - Questions

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The IG Concept in the Federal Government

- IGs first used in American military during the Revolutionary War
- George Washington charged General von Steuben with providing an independent review of the combat readiness of the Continental Army's troops

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The IG Concept in the Federal Government

- Congressional hearings during the 1960s and 1970s
- Legislation established IG at Department of Health, Education, Welfare in 1976
- IG Act enacted October 12, 1978
 - Created IGs at 12 largest federal agencies
 - Responsible for promoting economy, efficiency, effectiveness, integrity and combating fraud, waste, abuse in federal programs and operations
 - Act amended several times, adding IGs each time

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The IG Concept in the Federal Government

- IG Reform Act enacted October 14, 2008
 - Affirmed independence
 - Enhanced operations
 - Created unified Council of the IGs on Integrity and Efficiency (CIGIE)
- Council of the Inspectors General
 - Over 70 OIGs in Federal Government
 - Supports individual OIGs with reporting, professional development, integrity oversight
 - Committees: Audit, Investigation, Inspection and Evaluation, Human Resources, IT, Legislation, Integrity

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The IG Concept in the Federal Government

- Unique role of independent OIGs in federal agencies
- Conduct audits, evaluations, investigations, other projects to
 - Promote economy, efficiency, effectiveness
 - Detect and prevent fraud, waste, abuse, mismanagement in agency programs
 - Ensure integrity and good government
- Dual reporting requirement
 - Head of the agency
 - Congress

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The FDIC OIG

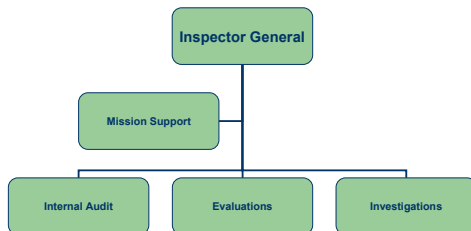
- **FDIC OIG Mission:**

- promote the economy, efficiency, and effectiveness of FDIC programs and operations,
- protect against fraud, waste, and abuse,
- assist and augment the FDIC's contribution to stability and public confidence in the nation's financial system.

- **Environment:** Independence in all matters relating to the audit work: the audit organization and the individual auditor, whether government or public, must be free from personal, external, and organizational impairments to independence, and must avoid the appearance of such impairments of independence.

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The FDIC OIG-Organization



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The FDIC OIG

- Mission Units: Internal Audit, Investigations, Evaluations
- Mission Support: Legal, HR, IT, Budget, Communications
- Authorized FY 2009 staff of 122 located in Arlington, VA; Dallas; Atlanta; Chicago; Kansas City; New York City
- 2010 staffing authorization of 138
- OIG Business Plan strategic goals align with FDIC's main business lines:
 - Supervision
 - Insurance
 - Consumer Protection
 - Receivership Management
 - Resources Management

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Summary Results/Accomplishments for Fiscal Year 2008

- 30 audit and evaluation reports issued
- 76 non-monetary recommendations to FDIC management
- \$440 million in actual and potential monetary benefits (audits and investigations)
- 124 indictments/informations
- 103 convictions
- 73 referrals to the Department of Justice

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The FDIC

- Mission--Confidence and stability of the banking system
 - Protecting insured depositors in over 8,300 institutions
 - Supervising 5,100 financial institutions
 - Managing receiverships
- Governance
 - FDIC Board of Directors
 - Senior FDIC management
- Budget/Organization
 - \$2.24 billion operating budget for 2009 (increase of \$1.03 billion from 2008)
 - Authorized 2009 staffing of 6,269 in Washington, DC headquarters and regional sites (increase of 1,459 positions from 2008)

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FDIC Challenges

- Bank failures
 - Most banks viable--relatively few failures
 - 25 bank failures during 2008, with total assets at failure of \$361.3 billion and estimated losses to the Deposit Insurance Fund of \$18 billion
 - 29 failures in 2009 as of April 30, 2009, with total assets at failure of \$17.7 billion and estimated losses to the DIF of \$3.9 billion

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FDIC Challenges

- Problem Banks
 - 252 institutions on FDIC "Problem Institution List" as of 4th Quarter 2008, with \$159.4 billion in assets (4th Quarter 2006: 50 institutions. 4th Quarter 2007: 76 institutions)
 - FDIC expects bank failures will cost about \$65 billion over the next 5 years

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FDIC Challenges

- Deposit Insurance Fund Balance
 - 4th Quarter 2008: \$19 billion
 - 4th Quarter 2007: \$52 billion
 - 4th Quarter 2006: \$50 billion
- Steps to Maintain Viability
 - Assessments
 - Reserve ratio restoration plan

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FDIC Challenges

- Mounting Resolution and Receivership Activities
- New Programs/Responsibilities
 - Temporary Liquidity Guarantee Program (TLGP)
 - Troubled Asset Relief Program (TARP) Capital Purchase Program
 - Loan Modification Programs

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FDIC Challenges

- Large Bank Failures
 - IndyMac
 - Washington Mutual
- Legacy Loan Program as part of Public-Private Investment Program
- Core Business Processes

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FDIC OIG Approach to Addressing Challenges

- Internal to the OIG
 - Leveraging Resources and Working Smart
- Working Relationships and Partnerships
 - FDIC
 - Other financial regulatory OIGs
 - IG Community at-large
 - GAO, OMB, CIO Council
 - Professional Associations
- Congressional Support and Interest
 - Appropriations
 - Oversight Committees

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OIG Priority Audit Issue: Material Loss Reviews (MLR)

- Requirement
 - Federal Deposit Insurance Act
 - Material Loss: A loss is material if it exceeds the greater of \$25 million or 2 percent on an institution's total assets at time the FDIC is appointed receiver
 - IG of appropriate federal banking agency makes written report
 - Ascertains why the institution's problems caused a loss to the Deposit Insurance Fund
 - Reviews agency supervision of the institution, including implementation of Prompt Corrective Action provisions
 - Makes recommendations to prevent future losses

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Material Loss Reviews

- Responsibilities
 - FDIC – state banks that are not members of Federal Reserve System and state savings banks
 - Federal Reserve Board – state member banks
 - Department of the Treasury OIG – national banks and Office of Thrift Supervision-supervised savings institutions

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Material Loss Reviews

- Current FDIC OIG MLR Inventory
 - 30 required during 2008 & 2009
 - 6 Completed
 - The remainder ongoing
- Other Financial Regulatory OIGs
 - Federal Reserve: 4 required (2008 & 2009)
 - Treasury: 15 required (2008 & 2009)

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Approach to MLRs

- Review, in accordance with Generally Accepted Government Auditing Standards
 - Institution records, including board meeting minutes, correspondence, policies, procedures, internal controls, legal issues, classified assets, financial transactions
 - Audits by independent public accountants, other internal/external audits and reviews

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Approach to MLRs

- Federal examination results, reports of examination, other supervisory activities
- State examination results and supervisory actions
- Actions taken by related financial institutions, holding companies, affiliates, subsidiaries, third-party servicers

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Approach to MLRs

- Issue draft report for comment
- Incorporate supervisory banking agency comments
- Issue final report within 6 months of loss determination
- Provide results to
 - Supervisory banking agency (FDIC management and Audit Committee)
 - State banking officials
 - Comptroller General
 - Congressional parties
 - The public

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MLR Findings and Trends

- Consideration of Risk in CAMELS Ratings in Addition to Current Financial Condition
 - Aggressive asset growth with concentrations in high-risk commercial real estate and acquisition, development, and construction loans
 - Reliance on wholesale funding sources to fund asset growth
 - Inconsistent leadership from bank Boards of Directors and management

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MLR Findings and Trends

- Inadequate Loan Underwriting and Lack of Other Loan Portfolio and Risk Management Controls
- Use of Interest Reserves
- Allowance for Loan and Lease Losses Methodology and Funding
- Compensation Arrangements

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MLR Findings and Trends

- Examiners can improve use of supervisory tools
- Special issues exist regarding supervision of "de novo" institutions
- Prompt Corrective Action (PCA) does not appear to have prevented failures of institutions we have reviewed

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Next Steps for MLRs

- Summary reports
 - Look at issue more in-depth
 - Make recommendations based on more than one instance
- Change in threshold?
 - Joint letter
 - Testimony

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Other Audit Activity

- Federal Information Security Management Act and FISCAM Reviews
- New Programs
 - Loss Share Agreements
 - TLGP
 - TARP
 - Legacy Loan Program
 - Washington Mutual
 - Resolution/Receivership Activity
 - Contracting Activity
 - FDIC Core Business Processes

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Conclusion

- Summary
- Questions
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