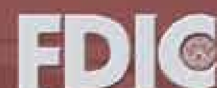
FEDERAL DEPOSIT INSURANCE CORPORATION



Office of Inspector General

Semiannual Report to the Congress

October 1, 2009 – March 31, 2010

The Federal Deposit Insurance Corporation (FDIC) is an independent agency created by the Congress to maintain stability and confidence in the nation's banking system by insuring deposits, examining and supervising financial institutions, and managing receiverships. Approximately 6,558 individuals within seven specialized operating divisions and other offices carry out the FDIC mission throughout the country. According to most current FDIC data, the FDIC insured more than $5.4 trillion in deposits in about 8,000 institutions, of which the FDIC supervised approximately 4,940. Although the balance of the Deposit Insurance Fund declined by $38.1 billion during 2009, the Deposit Insurance Fund's liquidity was enhanced by prepaid assessments and the fund is well positioned to fund resolution activity in 2010 and beyond. Receiverships under FDIC control at year-end 2009 totaled 187, with $41 billion of assets in liquidation.

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FDIC

Inspector General's Statement

My office has faced a challenging workload over the past 6 months. While there are signs of improvement in the economy and financial sector, banks have continued to fail. Under the Federal Deposit Insurance Act, when failures of FDIC-supervised institutions result in a material loss to the Deposit Insurance Fund, currently defined as a loss of the greater of $25 million or 2 percent of the institution's assets at the time of closing, my office is required to perform a comprehensive review. Those material loss reviews (MLR) determine the causes of failure and assess the FDIC's supervision of the institution.

Our principal focus over the past 6 months has been on our heavy MLR workload. We issued a total of 28 MLR reports during the reporting period and had an additional 25 in process at the end of the reporting period. The 28 failures reflect total institution assets of nearly $17 billion and total losses to the Deposit Insurance Fund of $5.1 billion.

About a year ago, we conveyed our observations on MLR trends to the FDIC Audit Committee and the Division of Supervision and Consumer Protection (DSC) based on our early work. That initial communication, in conjunction with results of our MLR work throughout the past two reporting periods, has prompted the Corporation to take very responsive action to address issues we have surfaced and other supervisory matters that senior management believes warrant additional attention.

Over the past 6 months, we have engaged in continuous dialogue with the FDIC Chairman, Vice Chairman, Audit Committee, and DSC senior management regarding the results of our MLR work. Most recently we partnered with staff from DSC in a day-long collaborative forum to discuss MLR issues and the many actions that the Corporation is taking to enhance its supervision and examination processes going forward.

Over this same time frame, we have directed audit resources to the FDIC's receivership and resolution activity resulting from bank failures and the heightened associated risks. In fact, the Corporation was handling 187 receiverships with total assets in liquidation of about $41 billion at the end of the fourth quarter 2009. In that regard, the Corporation is retaining large volumes of assets as part of purchase and assumption agreements with institutions that are assuming the insured deposits of failed institutions. A number of these agreements include shared loss arrangements involving pools of assets worth billions of dollars and that can extend up to 10 years. The Corporation is also using structured sales through public/private partnerships where billions of dollars are at stake. We continued to refine our audit strategy to cover activities such as these during the reporting period in the interest of ensuring proper controls and independent oversight.

Our Office of Evaluations issued the results of its review of the FDIC's loan modification program during the reporting period and made recommendations for enhancements to that program. That office also initiated a joint review with the Department of the Treasury Office of Inspector General (OIG) to examine supervisory events surrounding the failure of Washington Mutual Bank, a $307 billion failure, the largest to date. The joint review analyzed the actions of the primary federal regulator, the Office of Thrift Supervision, and the FDIC's role in monitoring the institution as back-up

regulator and insurer. On April 16, 2010, along with the Department of the Treasury Inspector General, I testified before the Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate, on the results of that work.

Our Office of Investigations continues to play a lead role in the law enforcement community's efforts to combat various types of financial institution and mortgage frauds. Our special agents are called upon by U.S. Attorneys, the Federal Bureau of Investigation, and others to assist in prosecuting white-collar crime that threatens the integrity of the financial services industry. Their success during the reporting period resulted in 32 convictions, 47 indictments/informations, and potential monetary recoveries of more than $61.2 million.

Last July, the House of Representatives passed H.R. 3330, Improved Oversight by Financial Inspectors General Act of 2009, to increase the MLR threshold to $200 million while also requiring some level of review of all bank failures. As I sign this statement, the Senate is considering S. 3217, Restoring American Financial Stability Act of 2010. A section of that legislation includes a provision to establish the MLR threshold at (1) $100 million from September 30, 2009 through December 31, 2010; (2) $75 million for 2011; and (3) $50 million for 2012 and beyond. We are hopeful that a change in the threshold will provide a more meaningful measure of materiality and allow us to be able to resume more discretionary audit, evaluation, and investigative coverage of other important areas of risk at the FDIC.

In closing, I want to acknowledge the dedicated members of the FDIC OIG who persevere in carrying out the Inspector General mission under demanding and extraordinary circumstances. We all appreciate the continued support of our stakeholders—the Corporation, Congress, law enforcement agencies, Inspector General colleagues, and the public as we continue to address the unprecedented challenges facing us.

Jon T. Rymer
Inspector General
April 30, 2010

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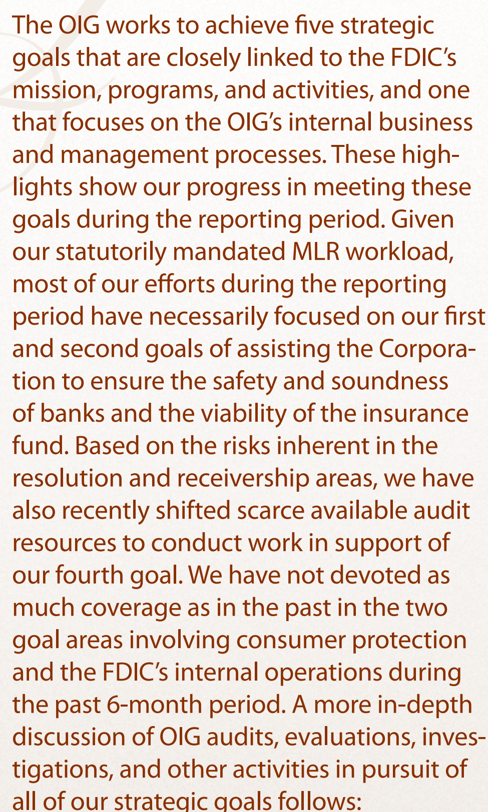
Abbreviations and Acronyms

ADC	acquisition, development, and construction
BSA	Bank Secrecy Act
CAMELS	**C**apital Adequacy, **A**sset Quality, **M**anagement, **E**arnings, **L**iquidity, and **S**ensitivity to Market Risk
CDO	collateralized debt obligation
CIGIE	Council of the Inspectors General on Integrity and Efficiency
CRE	commercial real estate
DCAA	Defense Contract Audit Agency
DIF	Deposit Insurance Fund
DIT	Division of Information Technology
DRR	Division of Resolutions and Receiverships
DSC	Division of Supervision and Consumer Protection
ECIE	Executive Council on Integrity and Efficiency
ECU	Electronic Crimes Unit
FBI	Federal Bureau of Investigation
FDI Act	Federal Deposit Insurance Act
FDIC	Federal Deposit Insurance Corporation
FinCEN	Financial Crimes Enforcement Network
FISMA	Federal Information Security Management Act
GAO	Government Accountability Office
GPRA	Government Performance and Results Act of 1993
HAMP	Home Affordable Modification Program
IG	Inspector General
IRS CID	Internal Revenue Service Criminal Investigations Division
IT	information technology
LMP	loan modification program
LSA	loss share agreement
MLR	material loss review
NIST	National Institute of Standards and Technology
OCC	Office of the Comptroller of the Currency
OI	Office of Investigations
OIG	Office of Inspector General
OTS	Office of Thrift Supervision
PCA	Prompt Corrective Action
PCIE	President's Council on Integrity and Efficiency
WaMu	Washington Mutual Bank

Highlights and Outcomes



The OIG works to achieve five strategic goals that are closely linked to the FDIC's mission, programs, and activities, and one that focuses on the OIG's internal business and management processes. These highlights show our progress in meeting these goals during the reporting period. Given our statutorily mandated MLR workload, most of our efforts during the reporting period have necessarily focused on our first and second goals of assisting the Corporation to ensure the safety and soundness of banks and the viability of the insurance fund. Based on the risks inherent in the resolution and receivership areas, we have also recently shifted scarce available audit resources to conduct work in support of our fourth goal. We have not devoted as much coverage as in the past in the two goal areas involving consumer protection and the FDIC's internal operations during the past 6-month period. A more in-depth discussion of OIG audits, evaluations, investigations, and other activities in pursuit of all of our strategic goals follows:

Strategic Goal 1
Supervision: Assist the FDIC to Ensure the Nation's Banks Operate Safely and Soundly

Our work in helping to ensure that the nation's banks operate safely and soundly takes the form of audits, investigations, evaluations, and extensive communication and coordination with FDIC divisions and offices, law enforcement agencies, other financial regulatory OIGs, and banking industry officials. In early May 2009, we conveyed to the FDIC Audit Committee and DSC our perspectives on the commonalities in the eight MLR reports we had drafted or finalized to date. The Corporation has taken and continues to take a number of actions that address the concerns since that time. We continue a very cooperative working relationship with DSC on these matters.

During the reporting period, we completed 28 MLRs of institutions whose failures resulted in losses to the Deposit Insurance Fund totaling $5.1 billion. In each review, we analyzed the causes of failure and the FDIC's supervision of the institution. Many of our initial MLR observations were confirmed in this more recent work, and we continued to share and supplement our views on trends in the failures and the FDIC's supervision of the institutions during the reporting period. Ongoing work in support of this goal at the end of the reporting period included 25 MLRs of failed FDIC-regulated banks. With respect to investigative work, as a result of cooperative efforts with U.S. Attorneys throughout the country, numerous individuals were prosecuted for financial institution fraud, and we achieved successful results in combating a number of mortgage fraud schemes. Our efforts in support of mortgage fraud and other financial services working groups also supported this goal. Particularly noteworthy results from our casework include the sentencings of two brothers to 57 months and 46 months of incarceration and fines of over $3.2 million for their role in a mortgage fraud scheme. Two defendants also pleaded guilty in a case involving the failure of Omni Bank, Atlanta, Georgia. The first was a former executive vice president who caused materially false statements that overvalued bank assets to be made in Omni's books and records. The second defendant made false

statements to the FDIC and committed identity theft to "short sell" properties mortgaged by the failed bank. Also of note during the reporting period was the guilty plea of Pamrapo Bank, Bayonne, New Jersey, to conspiracy to violate the Bank Secrecy Act, a federal law enacted to prevent banks from being used to facilitate and perpetuate criminal activity such as narcotics trafficking, organized crime, terrorist financing, and other financial crimes.

The Office of Investigations also continued its close coordination and outreach with DSC, the Division of Resolutions and Receiverships (DRR), and the Legal Division by way of attending quarterly meetings, regional training forums, and regularly scheduled meetings with DSC and the Legal Division to review Suspicious Activity Reports and identify cases of mutual interest. (See pages 9-26.)

Strategic Goal 2

Insurance: Help the FDIC Maintain the Viability of the Insurance Fund

Our MLR work fully supports this goal, as does the investigative work highlighted above. In both cases, our work can serve to prevent future losses to the fund by way of findings and observations that can help to prevent future failures, and the deterrent aspect of investigations and the ordered restitution that may help to mitigate an institution's losses. A significant ongoing effort during the reporting period involved our work with the Department of the Treasury OIG to determine the events leading to the need for the FDIC-facilitated transaction involving Washington Mutual Bank (WaMu), including evaluating the Office of Thrift Supervision's supervision of WaMu and the FDIC's supervision and monitoring of WaMu in its role as back-up regulator and insurer. (See pages 27-29.)

Strategic Goal 3

Consumer Protection: Assist the FDIC to Protect Consumer Rights and Ensure Customer Data Security and Privacy

Audits and evaluations can contribute to the FDIC's protection of consumers in several ways. We did not devote substantial resources of this type to specific consumer protection matters during the past 6-month period because most of those resources were devoted to MLR work. Our Office of Investigations, however, supports this goal through its work, particularly by way of its Electronic Crimes Unit (ECU). The ECU responded to instances where fraudulent emails and facsimiles purportedly affiliated with the FDIC were used to entice consumers to divulge personal information and/or make monetary payments. The ECU successfully deactivated 15 fraudulent email accounts, 8 Web sites, and 2 fraudulent facsimile numbers used for such purposes. (See pages 30-32.)

Strategic Goal 4

Receivership Management: Help Ensure that the FDIC Efficiently and Effectively Resolves Failing Banks and Manages Receiverships

We undertook several assignments in this goal area during the reporting period. We issued the results of our assessment of the FDIC's implementation of loan modification programs at various institutions to modify "at-risk" mortgages and the internal controls in place over the program. We made five recommendations for program enhancements, with which the FDIC agreed. Importantly we had also contracted with KPMG to perform a risk assessment and develop audit programs for resolution and receivership activities. We prioritized audit work to address the risks that KPMG identified as well as the OIG's own assessment of vulnerable program areas and began several assignments related to loss share agreements, structured sales, and proforma financial statements as a result. This work will continue in earnest going forward.

From an investigative standpoint, we pursued the case of a former FDIC contract employee at an FDIC receivership who pleaded guilty to disclosing confidential information. We also continued to provide forensic support at bank closings where fraud was suspected and to coordinate with DRR to pursue concealment of assets investigations related to the criminal restitution that the FDIC is owed. (See pages 33-38.)

Strategic Goal 5

Resources Management: Promote Sound Governance and Effective Stewardship and Security of Human, Financial, IT, and Physical Resources

In support of this goal area, we issued our review of the FDIC's information security practices pursuant to the Federal Information Security Management Act (FISMA). We reported that the FDIC had implemented an information security program addressing principal FISMA provisions and other applicable standards. However, we identified certain access control deficiencies that presented a high risk of unauthorized disclosure of sensitive information or compromise of information technology resources. We identified nine steps to strengthen information security controls. We also conducted an audit of controls over FDICconnect, a secure Web site that allows FDIC-insured institutions to conduct business and exchange information with the FDIC and made six recommendations to address security control concerns.

We promoted integrity in FDIC internal operations through ongoing OIG Hotline referrals and coordination with the FDIC's Ethics Office, as warranted. (See pages 39-43.)

Strategic Goal 6

OIG Resources Management: Build and Sustain a High-Quality Staff, Effective Operations, OIG Independence, and Mutually Beneficial Working Relationships

To ensure effective and efficient management of OIG resources, among other activities, we continued realignment of the OIG investigative resources with FDIC regions, hired additional audit staff for resolution and receivership work, and examined staffing plans and budget resources to ensure our office is positioned to handle our increasing workload and risks to the FDIC. We provided our Fiscal Year 2011 budget submission to the House and Senate Committees on Appropriations, Subcommittees on Financial Services and General Government.

We continued to contract with qualified firms to provide audit and evaluation services to the OIG to enhance the quality of our work and the breadth of our expertise. We continued use of the Inspector General feedback form for the Office of Material Loss Reviews, Office of Audits, and Office of Evaluations that focuses on overall assignment quality elements, including time, cost, and value.

We encouraged individual growth through professional development by employing a number of college interns on a part-time basis to assist us, some of whom may be returning permanently under the FDIC's Student Career Experience Program. We also offered opportunities for OIG staff to attend graduate schools of banking to further their expertise and knowledge of the complex issues in the banking industry.

Our office continued to foster positive stakeholder relationships by way of Inspector General and other OIG executive meetings with senior FDIC executives; presentations at Audit Committee meetings; congressional interaction; and coordination with financial regulatory OIGs, other members of the Inspector General commu-

nity, other law enforcement officials, and the Government Accountability Office. The OIG participated in corporate diversity events, and we maintained and updated the OIG Web site to provide easily accessible information to stakeholders interested in our office and the results of our work.

In connection with SAS 99 and the annual financial audit of the FDIC's funds, we provided comments on the risk of fraud at the FDIC to the Government Accountability Office. We provided the OIG's 2009 statement of assurance to the Chairman regarding the OIG's efforts to meet internal control requirements. We also participated regularly at corporate meetings of the National Risk Committee to monitor emerging risks at the Corporation and tailor OIG work accordingly. In keeping with the Reports Consolidation Act of 2000, we shared the OIG's perspectives on risks and related management and performance challenges facing the FDIC for inclusion in the Corporation's annual report. (See pages 44-47.)

Significant Outcomes

(October 2009– March 2010)

Material Loss Review, Audit, and Evaluation Reports Issued	32
Nonmonetary Recommendations	11
Investigations Opened	40
Investigations Closed	18
OIG Subpoenas Issued	10
Judicial Actions:	
Indictments/Informations	47
Convictions	32
Arrests	23
OIG Investigations Resulted in:	
Fines of	$23,600
Restitution of	$39,273,640
Asset Forfeiture of	$21,939,103
Other Monetary Recoveries of	0
Total	**$61,236,343**
Cases Referred to the Department of Justice (U.S. Attorney)	36
Cases Referred to FDIC Management	0
OIG Cases Conducted Jointly with Other Agencies	116
Hotline Allegations Referred	26
Proposed Regulations and Legislation Reviewed	2
Proposed FDIC Policies Reviewed	9
Responses to Requests and Appeals Under the Freedom of Information Act	9

Strategic Goal 1

The OIG Will Assist the FDIC to Ensure the Nation's Banks Operate Safely and Soundly

The Corporation's supervision program promotes the safety and soundness of FDIC-supervised insured depository institutions. The FDIC is the primary federal regulator for approximately 4,940 FDIC-insured, state-chartered institutions that are not members of the Federal Reserve System (generally referred to as "state non-member" institutions). The Department of the Treasury (the Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS)) or the Federal Reserve Board supervise other banks and thrifts, depending on the institution's charter. As insurer, the Corporation also has back-up examination authority to protect the interests of the Deposit Insurance Fund (DIF) for about 3,060 national banks, state-chartered banks that are members of the Federal Reserve System, and savings associations.

The examination of the institutions that it regulates is a core FDIC function. Through this process, the FDIC assesses the adequacy of management and internal control systems to identify, measure, monitor, and control risks; and bank examiners judge the safety and soundness of a bank's operations. The examination program employs risk-focused supervision for banks. According to examination policy, the objective of a risk-focused examination is to effectively evaluate the safety and soundness of the bank, including the assessment of risk management systems, financial condition, and compliance with applicable laws and regulations, while focusing resources on the bank's highest risks. Part of the FDIC's overall responsibility and authority to examine banks for safety and soundness relates to compliance with the Bank Secrecy Act (BSA), which requires financial institutions to keep records and file reports on certain financial transactions. An institution's level of risk for potential terrorist financing and money laundering determines the necessary scope of a BSA examination.

In the event of an insured depository institution failure, the Federal Deposit Insurance (FDI) Act requires the cognizant OIG to perform a review when the DIF incurs a material loss. A loss is considered material to the insurance fund if it exceeds $25 million and 2 percent of the failed institution's total assets. The FDIC OIG performs the review if the FDIC is the primary regulator of the institution. The Department of the Treasury OIG and the OIG at the Board of Governors of the Federal Reserve System perform reviews when their agencies are the primary regulators. These reviews identify what caused the material loss, evaluate the supervision of the federal regulatory agency (including compliance with the Prompt Corrective Action (PCA) requirements of the FDI Act), and generally propose recommendations to prevent future failures. During the past 6-month reporting period, 86 FDIC-insured institutions failed. Thirty-three of these triggered the need for the FDIC OIG to conduct an MLR.

During 2009, the number of institutions on the FDIC's "Problem List" also rose to its highest level in 16 years. As of December 31, 2009, there were 702 insured institu-

tions on the "Problem List," indicating a probability of more failures to come and an increased asset disposition workload. Total assets of problem institutions increased to $403 billion as of year-end 2009. Given these numbers, many challenging institution failures are likely in the months ahead.

The OIG's audits and evaluations are generally designed to address various aspects of the Corporation's supervision and examination activities. Through their investigations of financial institution fraud, the OIG's investigators also play a critical role in helping to ensure the nation's banks operate safely and soundly. Because fraud is both purposeful and hard to detect, it can significantly raise the cost of a bank failure, and examiners must be alert to the possibility of fraudulent activity in financial institutions.

The OIG's Office of Investigations (OI) works closely with FDIC management in DSC and the Legal Division to identify and investigate financial institution crime, especially various types of fraud. OIG investigative efforts are concentrated on those cases of most significance or potential impact to the FDIC and its programs. The goal, in part, is to bring a halt to the fraudulent conduct under investigation, protect the FDIC and other victims from further harm, and assist the FDIC in recovery of its losses. Pursuing appropriate criminal penalties not only serves to punish the offender but can also deter others from participating in similar crimes. Our criminal investigations can also be of benefit to the FDIC in pursuing enforcement actions to prohibit offenders from continued participation in the banking system. When investigating instances of financial institution fraud, the OIG also defends the vitality of the FDIC's examination program by investigating associated allegations or instances of criminal obstruction of bank examinations and by working with U.S. Attorneys' Offices to bring these cases to justice.

The OIG's investigations of financial institution fraud currently constitute about 89 percent of the OIG's investigation caseload. The OIG is also committed to continuing its involvement in interagency forums addressing fraud. Such groups include national and regional bank fraud, check fraud, mortgage fraud, cyber fraud, identity theft, and anti-phishing working groups. Additionally, the OIG engages in industry outreach efforts to keep financial institutions informed on fraud-related issues and to educate bankers on the role of the OIG in combating financial institution fraud.

To assist the FDIC to ensure the nation's banks operate safely and soundly, **the OIG's 2010 performance goals** are as follows:

- Help ensure the effectiveness and efficiency of the FDIC's supervision program.
- Investigate and assist in prosecuting BSA violations, money laundering, terrorist financing, fraud, and other financial crimes in FDIC-insured institutions.

OIG Work in Support of Goal 1

The OIG issued 28 reports during the reporting period in support of our strategic goal of helping to ensure the safety and

OIG Identifies MLR Trends

During the prior reporting period, the OIG identified and shared with the Audit Committee and DSC our perspectives on MLR trends. Our initial observations on the common characteristics of failures were based on six completed and two draft MLR reports.

Based on that early work, we suggested that greater consideration of risk in assigning Capital Adequacy, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk (CAMELS) component and composite ratings in addition to reliance on current financial condition appeared to be needed. Risky behaviors that did not seem to have had a meaningful impact on CAMELS ratings included: pursuit of aggressive growth in commercial real estate and acquisition, development, and construction (ADC) loans; excessive levels of asset concentration with little risk mitigation; reliance on wholesale funding to fund asset growth; ineffective leadership from bank boards of directors and management; inadequate loan underwriting and lack of other loan portfolio and risk management controls, including appropriate use of interest reserves; allowance for loan and lease losses methodology and funding; and compensation arrangements that were tied to quantity of loans rather than quality.

We also identified special issues with regard to "de novo" institutions, and we emphasized the need to monitor business plans closely; consider growth exceeding the plan as a risk to be managed; and ensure that management expertise and operations/ administrative structures kept pace with asset growth. We further observed that PCA did not appear to have prevented failure of the institutions we had reviewed to date. Also, examiners generally had not used the non-capital provisions of PCA to curtail activities that contributed to losses to the DIF.

MLR work over the past year has validated the earlier issues we identified. Other issues contributing to institution failures and losses have surfaced in the 28 material loss reviews conducted during the reporting period. These include, for example, banks that had purchased loan participations—sometimes out-of-territory— in order to rapidly grow the loan portfolio or as a change in strategic business direction. In some cases, the banks did not conduct adequate due diligence or adequately administer these loans after purchase. We have also seen instances of significant losses related to collateralized debt obligations, collateralized mortgage obligations, and government-sponsored enterprise stocks such as Fannie Mae and Freddie Mac preferred stock. In some cases as well, banks had concentrations in large borrowing relationships and may not have properly assessed the borrower's global financial condition, including the impact that problems on projects financed at other institutions might have on the borrower's repayment capacity. With respect to bank Boards and management, we noted in some of our MLRs instances where there was a lack of sufficient expertise or an inability to deal with a sudden change in business strategy, for example purchasing complex credit products without knowledgeable staff on board to handle these products.

The OIG has continued to communicate these and other issues to DSC senior management and staff by way of numerous visits to FDIC regional offices and through constructive meetings and dialogue with DSC representatives throughout the MLR process. Additionally, during the reporting period, in monthly Audit Committee meetings, the OIG presented the results of all completed MLRs, and that forum has continued to focus high-level attention on evolving MLR issues. Chairman Bair also convened a DSC working group that meets regularly for the purpose of addressing emerging supervisory issues. We are committed to continuing to refine our observations on MLR trends and issues and sharing perspectives with FDIC management and other stakeholders.

soundness of the nation's banks. These reports communicated the results of MLRs. Ongoing audit work in support of the goal area as of the end of the reporting period included 25 MLRs to determine the causes for the failures of FDIC-supervised financial institutions and assess the FDIC's supervision of the institutions.

FDIC Actions to Address MLR Trends and Related Supervisory Issues

The FDIC's actions, generally taken to address the recurring characteristics in institution failures, have been manifested in a "Forward Looking Supervision" approach that focuses on lessons learned from the economic crisis, including common risk characteristics noted at problem and failed institutions. DSC recently completed a training initiative on this approach for its entire supervisory workforce. The training emphasizes the rapidly changing financial environment and stresses the importance of considering a financial institution's high-risk practices in addition to the bank's financial condition when assessing risk, assigning CAMELS ratings, and determining when and what type of supervisory or enforcement action to recommend.

In addition to the consideration of risk, the FDIC has established a Corporate Performance Objective related to implementing or requesting a corrective action program for financial institutions in a timely manner, requesting or imposing supervisory and/or enforcement actions for troubled financial institutions, and monitoring financial institutions' compliance with supervisory

and/or enforcement actions and corrective programs. In that connection, in January 2010, DSC issued guidance that defines a standard approach for communicating matters requiring Board attention (e.g., examiner concerns and recommendations) in examination reports. The guidance states that examination staff should request a response from the institution regarding the action that it will take to mitigate the risks identified during the examination and correct noted deficiencies. This approach provides examiners with another tool to hold Board and management accountable for improved performance and should also facilitate effective supervisory follow-up.

The FDIC has also taken specific actions related to conducting interim visitations and accelerating on-site examinations, and enhancing off-site monitoring activities. In addition, the FDIC has extended the de novo period from 3 to 7 years and issued revised guidance related to de novo banks including, but not limited to, the review of de novo bank deposit insurance application processing, reviewing a bank's compliance with its business plan, and determining whether a financial institution has materially deviated from its business plan.

Other DSC actions to address supervisory concerns include communications related to using noncapital aspects of PCA provisions, monitoring exposures to government assistance programs, supervising institutions with significant investments in trust-preferred collateralized debt obligations, and interest rate restrictions.

We will continue to coordinate our MLR work with DSC and monitor actions taken to address supervisory trends and issues.

Material Loss Review Results During the Reporting Period

In accordance with the FDI Act, the audit objectives for each of the 28 reviews we conducted during the reporting period were to (1) determine the causes of the financial institution's failure and resulting material loss to the DIF and (2) evaluate the FDIC's supervision of the institution, including implementation of the PCA provisions of section 38. The overall results of this body of work are discussed below. It is important to note that while we have an obligation to look back and report on the causes of failure and the FDIC's supervision of the failed institutions, our reports also acknowledge in many cases and as appropriate the actions that DSC is taking, as referenced above, to address the issues raised in our MLR reports.

Causes of Failure and Material Loss

Our work during the reporting period showed that most institutions failed because their Boards of Directors and management did not implement effective risk management practices to address rapid growth and significant concentrations in certain loan types—chief among those commercial real estate and acquisition, development, and construction loans. Further, weaknesses in loan underwriting and credit administration practices contributed to many of the failures. Failed institutions often exhibited a growing

dependence on volatile, non-core funding sources, such as brokered deposits, Federal Home Loan Bank advances, and Internet certificates of deposit. In some cases there were failures to manage key risks in the loan portfolio, including individual credit concentrations and loans with high loan-to-value ratios, or to implement effective loan grading systems and methodologies for allowance for loan and lease loss computations.

When the various real estate markets began to deteriorate, generally beginning in 2007, weaknesses in the institutions' risk management practices quickly translated into a rapid and significant deterioration in the asset quality of the institutions' loan portfolios. The associated losses and provisions depleted capital and earnings and significantly impaired the institutions' liquidity. In some cases, these institutions did not have comprehensive liquidity contingency plans in place. In several cases, also contributing to the losses were incentive compensation plans that rewarded loan volume and under which certain bank officers generated the vast majority of poor quality loans. In some instances as well, recommendations that examiners had made earlier went unheeded by bank boards of directors and management. In other cases, actions taken by the Board and management to address examiner concerns were not timely or adequate in preventing an institution's failure.

Importantly, six of the MLRs from the reporting period related to de novo institutions–that is, institutions that for their first 3 years in operation were subject to additional supervisory oversight and regulatory controls, including the development and maintenance of a current business plan and increased examination frequency. We noted in a number of these cases that institutions had deviated from originally approved business plans and engaged in activities that contributed to problems at a later time.

While most of the institutions that were the subject of our MLRs failed, in a general sense, for very similar reasons, it is interesting to note some unique features of certain failures. To illustrate, the following discussion summarizes the causes of failure for selected institutions that we reviewed during the reporting period. These failures are geographically dispersed throughout the United States and caused losses to the DIF ranging from $27 million to $693.8 million.

Strategic Capital Bank, Champaign, Illinois. Estimated loss to the DIF: $172.3 million. Strategic Capital's failure can be attributed to the Board of Directors' and management's speculative and ill-timed growth strategy involving high-risk assets and volatile funding that began subsequent to the completion of the Illinois Department of Financial and Professional Regulation's 2007 on-site examination. Strategic Capital's selection of risk in the fourth quarter of 2007 and the first quarter of 2008 proved to be poor. Further, Strategic Capital's rapid growth strategy was in contravention to long-standing supervisory guidance related to commercial real estate (CRE) concentrations and securities. In a short span of time, market conditions rapidly deteriorated, and Strategic Capital

faced credit downgrades associated with its investment portfolio and encountered escalating loan problems that it had not anticipated. Ultimately, Strategic Capital did not have enough capital to adequately support its new risk profile and could not absorb the losses.

Integrity Bank, Jupiter Florida. Estimated loss to the DIF: $36.9 million. Integrity failed primarily because of ineffective oversight by the institution's Board and management. Turnover and extended vacancies in the positions of President and Chief Executive Officer and Senior Lending Officer during the short life of the institution contributed to the weak oversight. In addition, the Board and management did not effectively manage the risks associated with the institution's heavy concentration in ADC loans. Weak ADC loan underwriting and administration, particularly with respect to out-of-territory loan participations acquired from Integrity-Alpharetta, Georgia, were contributing factors in Integrity-Jupiter's failure. The lack of effective Board and management oversight, together with a significant concentration in risky ADC loans, made the institution vulnerable when the Florida and Georgia real estate markets began to decline in 2007. Notably, a Board dispute that began in 2007 over control of the institution presented a significant distraction when the Board's undivided attention was needed on the institution's deteriorating financial condition. By 2008, the quality of Integrity-Jupiter's loan portfolio had become critically deficient, with additional deterioration continuing into 2009. The associated losses and provisions depleted Integrity-Jupiter's capital, rendering the institution insolvent. The Florida Office of Financial Regulation closed Integrity-Jupiter on July 31, 2009 because the institution was unable to raise sufficient capital to support its operations or find a suitable acquirer.

First Bank of Beverly Hills, Calabasas, California. Estimated loss to the DIF: $394 million. First Bank failed because its Board and management did not adequately manage the risks associated with the institution's heavy concentrations in CRE and ADC loans and investments in mortgage backed securities. In the fall of 2006, First Bank initiated an aggressive ADC lending program that focused on rapidly growing real estate markets in California and Nevada. As part of its ADC lending program, First Bank purchased approximately $117 million in loan participations without performing proper due diligence and originated over $70 million in loans without adequate underwriting and administration. In addition, First Bank maintained a high liquidity risk profile in the years leading to its failure because it relied almost exclusively on costly and potentially volatile wholesale funding sources consisting primarily of brokered deposits and Federal Home Loan Bank borrowings to support its real estate lending and investing activities.

First Bank's concentrations in CRE and ADC loans, coupled with its heavy reliance on wholesale funding sources, made the institution particularly vulnerable when its primary lending markets began to deteriorate in early 2007. Further, First Bank's

Board paid dividends in 2007 that resulted in negative retained earnings and a reduction of capital at a time when the institution had an elevated risk profile. By 2008, weaknesses in First Bank's risk management practices had translated into a significant decline in the quality of the institution's loan portfolio and mortgage backed securities. The losses and provisions associated with this decline depleted the institution's earnings and capital, and significantly impaired its liquidity position. The California Department of Financial Institutions closed First Bank because it was unable to raise sufficient capital to support its operations or find a suitable acquirer.

Great Basin Bank of Nevada, Elko, Nevada. Estimated loss to the DIF: $39.4 million. Great Basin failed because its Board did not ensure that bank management identified, measured, monitored, and controlled the risk associated with the institution's lending activities. Specifically, Great Basin's Board and management failed to adequately assess the risk associated with expanding the loan portfolio through purchases of out-of-territory participation loans, particularly from 2006 through 2008. The bank also lacked effective risk management controls for its CRE loan portfolio. Additionally, poor risk management practices negatively impacted the bank's ability to effectively manage operations in a declining economic environment.

The weaknesses in Great Basin's loan portfolio were exacerbated by a downturn in the bank's market area and out-of-territory locations. Declining earnings, resulting from high provision expenses for deterioration in the loan portfolio, severely eroded the bank's capital. Additionally, losses associated with Federal National Mortgage Association securities contributed to inadequate capital levels and reduced earnings. The Nevada Financial Institution Division closed Great Basin due to the bank's Significantly Undercapitalized position.

Founders Bank, Worth Illinois, and Rock River Bank, Oregon, Illinois. Estimated loss to the DIF: $173 million and $27 million, respectively. Founders and Rock River were part of a complex chain banking organization consisting of nine FDIC-insured institutions under the collective control of the Lyle Campbell family and their related interests (referred to as the Campbell Group). All of the institutions within the Campbell Group were considered affiliates based on section 23A of the Federal Reserve Act made applicable to insured nonmember banks by section 18(j) of the FDI Act, which establishes certain requirements, restrictions, and prohibitions with regard to transactions among the banks.

Founders and Rock River failed primarily because their Boards and management did not effectively manage the risk associated with significant investments in risky collateralized debt obligations (CDO). Between the fourth quarter of 2005 and July 2007, Founders and Rock River purchased approximately $41 million and $7.7 million, respectively, in CDOs without establishing and implementing appropriate risk management controls. Of note, neither institution performed appropriate pre-purchase analysis or established formal

investment policies that addressed CDOs before investing in these securities. In addition, the institutions did not establish prudent limits on their CDO investments, nor did they effectively monitor or manage the securities after purchase. When the downturn in the banking industry occurred in 2008, the CDOs quickly lost value and became illiquid, threatening the viability of both institutions. Also contributing to the failures of Founders and Rock River was a deterioration in the institutions' CRE and ADC loan portfolios. Both institutions had CRE concentrations that included out-of-area ADC loan participations for which the institutions had not performed proper due diligence. Weaknesses in the ADC loan participations, together with a concentration in CRE loans, made both institutions vulnerable to a sustained downturn in the real estate market. Although not a primary cause of failure, Founders and Rock River also funded poorly underwritten loans to insiders of the Campbell Group and to outside officers of the failed Strategic Capital Bank that added to the institutions' losses. The Illinois Department of Financial and Professional Regulation closed Founders and Rock River because the institutions were operated in an unsafe and unsound manner and were unable to raise sufficient capital to provide adequate protection for their depositors.

Mutual Bank, Harvey, Illinois. Estimated loss to the DIF: $693.8 million. Mutual Bank's Board and management failed to provide the necessary oversight to effectively manage the risks associated with an aggressive growth strategy centered in CRE and ADC lending that included out-of-area loan participations and brokered loans. This growth, in turn, depended upon increasingly volatile funding sources, including an extensive reliance on brokered and large time deposits, which became restricted as economic conditions deteriorated. Overall risks were exacerbated by the bank's poor loan underwriting and credit administration and excessive and inappropriate use of interest reserves. In addition, staffing in key operational areas did not keep pace with the continued growth and complexity of the institution's loan portfolio. According to examiners, also contributing to the failure was the bank President's considerable influence over the bank's growth strategy and operations and a compensation agreement that provided an incentive to pursue increased risk and growth. Declining earnings, resulting from the deteriorating loan quality in the bank's portfolio, severely eroded the institution's capital. Further evidence to the cause of Mutual Bank's failure can be seen in certain financial indicators. Specifically, between the 2007 and 2008 examinations, the bank's adversely classified assets increased from $54 million to $300 million; loans related to property foreclosures increased from $477,000 to $19.2 million, an increase of almost 4,000 percent; and net charge-offs of CRE loans increased from $8 million at year-end 2007 to $57 million by year-end 2008. Ultimately, the Illinois Department of Financial and Professional Regulation closed Mutual Bank in July 2009 due to insufficient capital to support the bank's operations.

American Southern Bank, Kennesaw, Georgia. Estimated loss to the DIF: $41.7 million. American Southern, a de novo institution, failed because its Board of Directors and management materially deviated from its business plan by pursuing a strategy of growth centered in ADC lending, while excessively relying on wholesale funding sources to fund that growth. Further, American Southern management did not exercise proper oversight of the bank's significant concentrations in ADC loans. The weaknesses in American Southern's loan portfolio were accentuated by a downturn in the bank's market area. Declining earnings resulting from the deteriorating quality of loans in American Southern's ADC loan portfolio severely eroded the bank's capital. In turn, the bank's liquidity became deficient as wholesale funding sources that American Southern used to fund its asset growth were restricted.

Westsound Bank, Bremerton, Washington. Estimated loss to the DIF: $106.4 million. Westsound failed because its board of directors and management did not implement risk management practices commensurate with rapid asset growth and a loan portfolio with significant concentrations in higher-risk ADC loans. Specifically, weak loan underwriting and credit administration practices associated with ADC concentrations became apparent as the local real estate market deteriorated. As loan losses related to the ADC loans were recognized, capital eroded and liquidity became strained. A contributing factor to the losses was an inadequately designed and monitored incentive compensation program under which one bank official generated the vast majority of the poor quality loans. Westsound's viability was also impacted by negative publicity associated with a shareholder lawsuit filed in October 2007, which prompted depositors to leave the bank. The state's Department of Financial Institutions ultimately negotiated a return of the bank's charter with Westsound's Board and management before the bank became critically undercapitalized or experienced a liquidity crisis, and closed the institution on May 8, 2009.

The FDIC's Supervision of the Failed Institutions

We reported quite consistently in the 28 MLRs issued during the reporting period that the FDIC, in conjunction with other cognizant state banking authorities, provided ongoing supervision of the institutions by way of risk management examinations, visitations, and other offsite monitoring activities. Consistently, FDIC examiners identified and reported on management weaknesses associated with concentrations and other risky practices and made recommendations for improvements to address those weaknesses. However, examiners did not always ensure that bank management effectively responded to such recommendations, and frequently concluded that the institutions' overall financial condition was sound and management was appropriately managing additional risks associated with high concentrations and other risky practices. We pointed out that in retrospect, more

proactive supervisory action at earlier examinations may have been prudent given the risks associated with the various activities of the failed institutions. With the benefit of hindsight, our reports identified critical junctures in the institution's supervisory history where additional attention could have been paid to the risks that were present or emerging. We reported that earlier and more proactive supervisory action may have influenced the institutions' Boards and management to constrain their risk-taking, thereby mitigating, to some extent, the losses incurred by the DIF.

With respect to the de novo institutions, we concluded that coverage of de novo business plan deviations could have been improved. In that regard, as referenced earlier, the Corporation took steps to extend the de novo period and revised its guidance related to monitoring of business plans.

With regard to PCA, we determined that the FDIC had properly implemented applicable PCA provisions of section 38 based on the supervisory actions taken. However in many cases, PCA's effectiveness in mitigating the losses to the DIF was limited because PCA is a lagging indicator, and did not always require action until an institution was at serious risk of failure.

Successful OIG Investigations Uncover Financial Institution Fraud

As mentioned previously, the OIG's Office of Investigations' work focuses largely on fraud that occurs at or impacts financial institutions. The perpetrators of such crimes can be those very individuals entrusted with governance responsibilities at the institutions—directors and bank officers. In other cases, individuals providing professional services to the banks, others working inside the bank, and customers themselves are principals in fraudulent schemes.

The cases discussed below are illustrative of some of the OIG's most important investigative success during the reporting period. These cases reflect the cooperative efforts of OIG investigators, FDIC divisions and offices, U.S. Attorneys' Offices, and others in the law enforcement community throughout the country.

About 41 percent of our financial institution fraud cases address the increased incidence of mortgage fraud. Other cases during the reporting period involve bank fraud, obstructing the examination of a financial institution, embezzlement, identity theft, conspiracy to commit BSA violations, and money laundering. The OIG's success in all such investigations contributes to ensuring the continued safety and soundness of the nation's banks.

Successful Mortgage Fraud Cases

Our office has successfully investigated a number of mortgage fraud cases over the past 6 months, several of which are described below. Perpetrators of these mortgage schemes are receiving stiff penalties and restitution orders. Our involvement in such cases is supplemented by our participation in a growing number of mortgage fraud task forces. Mortgage fraud has continued to take on new characteristics in

the current economic crisis as perpetrators seek to take advantage of an already bad situation. Such illegal activity can cause financial ruin to homeowners and local communities. It can further impact local housing markets and the economy at large. Mortgage fraud can take a variety of forms and involve multiple individuals. We work these and other cases based on a variety of excellent sources of referral and with partners both internal and external to the FDIC, as shown in the write-ups that follow.

Unlicensed Real Estate Agent and Two Attorneys Sentenced for Mortgage Fraud

During the reporting period, an unlicensed real estate agent and two attorneys were sentenced in the United States District Court for the Eastern District of New York for their involvement in a mortgage fraud scheme. The unlicensed real estate agent was sentenced to one month of imprisonment, 60 months of probation, and 500 hours of community service. The attorneys were sentenced to 6 months of imprisonment and 36 months of probation. Each defendant was ordered to pay restitution in the amount of $5.1 million for their involvement with other individuals who were charged with conspiracy to commit bank fraud in a May 2008 indictment.

According to the indictment, the unlicensed agent and other individuals recruited "straw buyers" with good credit ratings to purchase residential properties located in Brooklyn, Queens, and the Bronx by promising that, among other things, rental incomes from the properties would ensure that the purchasers would never have to make payments on the mortgages or take possession of the houses. Once the buyers were signed up, loan officers generated false documents for the buyers to support inflated income and asset statements in the mortgage application.

While the so-called buyers were being recruited, the unlicensed agent identified run-down properties on sale within the range of $250,000 to $500,000. Then, another individual signed sales contracts to buy these properties, but by the time of the closings, he had assigned his rights to purchase the properties to the straw buyers for fees totaling up to $600,000. The straw buyers' mortgages - which had been secured through fraudulently inflated financial statements - covered both the sales prices and the assignment fees. The banks and mortgage companies, however, were never made aware of the assignments or the true market value of the purchased properties. The mortgage proceeds were wired into the attorneys' trust accounts and subsequently distributed to others involved in the scheme.

Source: *New York Mortgage Fraud Working Group, and multiple Suspicious Activity Reports.* ***Responsible Agencies:*** *The investigation was conducted by the FDIC OIG and the Federal Bureau of Investigation (FBI). Prosecuted by the U.S. Attorney's Office, Eastern District of New York.*

Two Brothers Sentenced for Their Roles in a Mortgage Fraud Scheme

On February 26, 2010, in the Northern District of Texas, a mortgage loan broker was sentenced to 57 months of incarceration followed by 36 months of supervised release. He was ordered to pay $1,614,177 in restitution and a $100 special assess-

ment. The defendant's brother received a sentence of 46 months of incarceration followed by 36 months of supervised release. He was also ordered to pay $1,614,177 in restitution and a $100 special assessment. Both brothers previously pleaded guilty to count one of an indictment charging conspiracy to commit bank fraud. A third individual was also previously sentenced in this case for his role in preparing fraudulent residential real estate appraisal reports.

The first defendant worked as a mortgage loan broker and owner of United Mortgage Finance Company. His brother recruited "straw borrowers" and participated in other overt acts with the defendant in a conspiracy to defraud several banks and mortgage companies, including Fremont Investment and Loan, an FDIC-regulated institution.

The mortgage loan broker completed false and fraudulent loan applications on behalf of straw borrowers. The mortgage loan applications contained material false information concerning the borrowers' employment, income, and assets. These loan applications were submitted to multiple lenders on or near the same date to prevent each lender from detecting multiple properties being purchased simultaneously in the name of the straw borrowers. After the properties were purchased, false mechanic's liens were filed on the properties, which enabled the conspirators to receive large disbursements from the title companies when the properties were later sold to other straw borrowers at inflated prices.

With respect to the third conspirator, he had prepared residential real estate appraisal reports using the stolen identity of a licensed real estate appraiser to support the value of real estate property involved in this scheme. He was never a licensed real estate appraiser. He worked as an apprentice for a real estate appraiser and attempted to obtain his own appraisal license but had failed the licensing examination on multiple attempts.

Source: *Texas Department of Insurance and the FBI.*
Responsible Agencies: *Joint investigation by the FDIC OIG and FBI. Prosecuted by the U.S. Attorney's Office for the Northern District of Texas.*

Former Mortgage Broker and Closing Agents in Jackson, Mississippi Convicted for Mortgage Fraud

On March 22, 2010, a former mortgage broker was convicted on 33 of 35 counts of wire fraud, conspiracy to commit wire fraud, money laundering, and conspiracy to commit money laundering. On the same day, two business associates, both closing agents, were convicted on all 34 counts of the same offenses.

The mortgage broker and other conspirators brokered 40 fraudulent mortgage loans totaling over $9 million for various investors. These mortgage loan applications contained false verifications of employment, false residential lease agreements, fraudulent statements of income and liabilities, and false creditor invoices. In addition, the closing statements indicated the investors made down payments to purchase the properties when, in fact, they provided no down payment. Finally the closing state-

ments disclosed various charges that were supported by fraudulent invoices.

As for the involvement of the two closing agents, a father and son, they were doing business as Loan Closing and Title Services, Inc., and they closed the mortgage loans and helped divert the money to the other parties based on the fraudulent invoices. The trial in the case lasted 4 weeks, and the jury returned a verdict after deliberating for 2 days. Two of the other conspirators pleaded guilty to conspiracy to commit wire fraud prior to the trial and each testified during the trial.

Sentencing for the former mortgage broker and the closing agents is scheduled for July 16, 2010, but a hearing for the mortgage broker will be held prior to that time to determine whether he will be remanded to custody prior to sentencing. He tampered with two jurors during the trial. Sentencings for others involved in the scheme are scheduled for a later date.

Source: *Suspicious Activity Report/FBI.* ***Responsible Agencies:*** *Joint investigation by the FDIC OIG, FBI, and Internal Revenue Service (IRS) Criminal Investigations Division (CID). Prosecuted by the U.S. Attorney's Office, Southern District of Mississippi.*

Mortgage Broker Found Guilty

On March 11, 2010, a mortgage broker was found guilty in the United States District Court for the Eastern District of New York of conspiracy to commit bank and wire fraud.

According to the earlier indictment, the defendant, together with others, owned and operated a licensed mortgage brokerage operation called New Generation Funding. As a licensed mortgage brokerage, New Generation Funding's role was to gather information from prospective borrowers, including their income, assets, liabilities, and credit worthiness, and then present this information to various mortgage lenders in an effort to induce them to lend money to the borrowers. New Generation Funding coordinated all aspects of the deals and conducted closings to finalize the transactions. The mortgage broker, who was also a licensed attorney, served as the settlement agent, representing the mortgage lenders at many of the closings of loans brokered by New Generation Funding.

An investigation of New Generation Funding was initiated when two mortgage lenders, Fremont and Long Beach, stopped doing business with New Generation Funding in late 2005 because of an unusually high rate of defaults on loans that New Generation Funding was handling. The mortgage lenders' audits of the mortgage loan applications submitted by New Generation Funding revealed a pattern of fraud and led the lenders to contact law enforcement.

This investigation revealed numerous false statements in loan applications submitted by New Generation Funding. These false statements included, among other things, false employment information, grossly inflated income, fraudulent identity documents, failure to disclose other liabilities, and grossly inflated assets. In most cases, such fraudulent information was used by a single buyer to purchase multiple properties, with each property's loan being funded by a different mortgage lender who

was not informed about the other nearly-simultaneously acquired loans.

Source: *Suspicious Activity Reports.* ***Responsible Agencies:*** *The FDIC OIG and the FBI. Prosecution is being handled by the U.S. Attorney's Office, Eastern District of New York.*

Other Bank Fraud Case Results

Guilty Pleas in Omni National Bank Case

During the reporting period, two defendants pleaded guilty for their roles in a bank fraud involving the failed Omni National Bank, Atlanta, Georgia. Omni National Bank was an OCC-regulated institution until it was closed by the OCC on March 27, 2009. On that date, the FDIC was appointed receiver. The first defendant was a former executive vice president of Omni, who pleaded guilty to causing materially false entries that overvalued bank assets to be made in the books, reports, and statements of Omni. The second defendant was a bank customer who pleaded guilty to making false statements to the FDIC and aggravated identity theft in an attempt to "short sell" properties mortgaged by the failed bank.

Before takeover by the FDIC on March 27, 2009, Omni was headquartered in Atlanta with branch offices in Birmingham; Tampa; Chicago; Fayetteville, North Carolina; Houston; Dallas; and Philadelphia. Omni borrowed Fed Funds at low rates to make high-interest, short-term loans to borrowers with less than stellar credit and often no steady employment or formal education. These Omni borrowers were supposed to purchase and rehab distressed properties for prompt resale or Section 8 rental in inner-city neighborhoods. Borrowers were expected to do most of the rehab themselves within a few months of the loan, and qualify for a loan to purchase a second property only when the first property was sold, or ready for sale. Omni, its regulators, and investors relied on the expected increased value of the property after rehab to be well in excess of the loan amount.

The former Omni executive vice president was the second largest bank shareholder and head of Omni's Community Redevelopment Lending Department from 2000 through October 12, 2007. To keep non-performing loans current on paper, the former executive vice president and others at Omni failed to disclose many exceptions to their policies and procedures which resulted in Omni being exposed to a greater risk of loss. Practices that went unreported included: diversion of loan proceeds escrowed for rehab; excessive credit concentrations to a single borrower; funding additional loans for Omni foreclosures at ever-increasing amounts; and failing to create sufficient reserves for those questionable loans or to properly record them on Omni's books and records.

The former executive vice president and others were well aware that none of the foreclosed properties could be sold on the open market for the amount of the outstanding Omni loans. A number of foreclosures were never disclosed on the Omni books as required, and some properties were resold up to five times at ever-increasing amounts. The actions of the former executive vice president and others

at Omni resulted in an overvaluation of bank assets, which in turn misled Omni's outside auditors, the OCC, the FDIC, the Securities and Exchange Commission, and Omni shareholders. Such practices contributed to over 500 foreclosures and an additional 500 non-performing loans, which resulted in at least $7 million in losses to the FDIC. The Department of Housing and Urban Development Section 8 Program and its tenants also suffered, because many of the Omni-funded distressed properties were not rehabbed, but rather, stood vacant or were inhabited by squatters for years, corrupting other Section 8 properties and the community.

Another individual involved in a fraud was a bank customer who pleaded guilty to charges of making false statements to the FDIC and aggravated identity theft. The bank customer obtained millions of dollars in loans from Omni before Omni's failure and takeover by the FDIC. Beginning in October 2009, when he was facing foreclosure on 14 different properties, the customer asked the FDIC to forgive $2.2 million in Omni loan payoffs and allow him to "short sell" two properties each to seven new purchasers at greatly reduced amounts. A "short sale" occurs when a lender agrees to the sale of property — on which the current owner has defaulted — to a third party for less than the full amount due on the loan. Lenders are willing to accept short sales as a means of reducing their losses on bad loans and assisting the distressed property owner. In this case, the customer attempted to arrange short sales in the names of people whose identities had been stolen, and he submitted forged and counterfeited sales contracts and loan commitment letters to the FDIC in support of the sales. The bank customer was arrested before he could complete these sales and ruin the credit of the persons whose identities he had stolen. He could receive a maximum sentence of up to 30 years in prison and a fine of up to $1 million for the false statements crime, as well as a mandatory consecutive sentence of 2 years in prison and a fine up to $250,000 for the aggravated identity theft.

Source and Responsible Agencies: *These cases are being investigated by Special Agents of a Mortgage Fraud Task Force formed for Omni-related cases, made up of the Department of Housing and Urban Development OIG, the U.S. Postal Inspection Service, the FDIC OIG, the Office of the Special Inspector General for the Troubled Asset Relief Program, and the FBI. Assistant United States Attorneys for the Northern District of Georgia are prosecuting the case.*

Pamrapo Savings Bank of New Jersey Pleads Guilty to Conspiracy to Commit BSA Violations and Forfeits $5 Million

Pamrapo Savings Bank S.L.A., a wholly-owned subsidiary of Pamrapo Bancorp Inc., based in Bayonne, N.J., pleaded guilty on March 29, 2010 in U.S. District Court for the District of New Jersey to conspiracy to violate the BSA and has agreed to forfeit $5 million to the United States. The BSA is a federal law enacted to prevent banks from being used to facilitate and perpetuate criminal activity, such as narcotics trafficking, organized crime, terrorist financing and other financial crimes.

According to the criminal information filed in U.S. District Court in Trenton, N.J.,

Pamrapo Savings Bank conspired with others to conceal its customers' illegal or suspicious activities by failing to file currency transaction reports and suspicious activity reports and by willfully failing to maintain adequate anti-money laundering programs. Pamrapo Savings Bank admitted that it willfully violated the BSA to avoid the expenses associated with compliance, despite federal and state banking regulators telling Pamrapo Savings Bank as early as 2004 that its BSA and anti-money laundering programs contained serious and systemic deficiencies in critical areas required under the law.

Specifically, Pamrapo Savings Bank admitted during its guilty plea that it unlawfully failed to file currency transaction reports and suspicious activity reports related to approximately $35 million in illegal and suspicious financial transactions, including more than $5 million in structured currency transactions. The bank acknowledged that its willful failure to maintain adequate BSA and anti-money laundering programs resulted in numerous and repeated violations of the law.

In one specific example outlined in court documents, from approximately March 2005 to September 2006, a co-conspirator cashed approximately 586 checks worth a total of $3.2 million, payable to "cash" at multiple branches of Pamrapo Savings Bank. Each check was under $10,000, thus structured to evade the bank's obligation to file currency transaction reports. Ultimately, according to the court documents, Pamrapo Savings Bank willfully failed to file a suspicious activity report related to these known and repeated violations of the BSA. In addition, Pamrapo Savings Bank admitted that it made false and misleading statements to bank regulators, including OTS, to prevent regulatory oversight and enforcement of its deficient BSA compliance programs.

OTS assessed a $5 million civil money penalty against Pamrapo Savings Bank for violations of the BSA, which will be deemed satisfied by the $5 million forfeiture. The Financial Crimes Enforcement Network (FinCEN) of the Department of the Treasury is also investigating Pamrapo Savings Bank for noncompliance with the BSA and may impose additional civil money penalties.

As a result of its guilty plea, Pamrapo Savings Bank faces no less than one but not more than 5 years of probation and a statutory maximum fine equal to the greatest of $500,000, twice the gross amount of any financial gain that any persons derived from the offense, or twice the gross amount of any financial loss sustained by any victims of the offense. The court scheduled sentencing for May 6, 2010.

Source: *Based on a request for assistance from the IRS CID and the U.S. Attorney for the District of New Jersey.* ***Responsible Agencies:*** *The case was investigated by IRS CID, FDIC OIG, FBI, OTS, FinCEN, and the Bayonne Police Department's Special Investigation Unit. The case was prosecuted by the Criminal Division's Asset Forfeiture and Money Laundering Section and Assistant U.S. Attorney of the U.S. Attorney's Office Strike Force in Newark, New Jersey.*

Former Loan Officer Sentenced for Receiving Gifts for Procuring Loans

On November 18, 2009, a former loan officer at Herrin Security Bank was

sentenced after previously pleading guilty to a two-count indictment. Both counts charged in the indictment were for the receipt of commissions or gifts for procuring loans in connection with his activity at the bank. The defendant was sentenced to 30 days of federal incarceration for both counts, to run concurrently, to be followed by 3 years of supervised release. He was ordered to pay restitution in the amount of $51,511 to Herrin Security Bank and also ordered to pay a $100 special assessment fee.

As part of this scheme, in May 2007, a borrower at Herrin Security Bank closed on two loans in the amount of $303,560. The loan proceeds were used to consolidate the borrower's other loans. Many of his loans were not current with the bank. In exchange, the former loan officer asked the borrower to write two checks to pay off personal loans that the former loan officer had with other individuals. The borrower wrote two checks, one in the amount of $12,200 and the other for $3,311. As a result of the fraudulent scheme, the bank incurred a loss of $283,225 on the two loans that the borrower had earlier obtained from the bank.

Source: *FBI.* ***Responsible Agencies:*** *Joint investigation by the FDIC OIG and the FBI. Prosecuted by the U.S. Attorney's Office, Southern District of Illinois.*

Former Glencoe State Bank Executive Sentenced

On October 7, 2009, the former executive vice president of Glencoe State Bank was sentenced to serve 18 months in federal prison followed by supervised release for 3 years, forfeiture of his residence and boat, restitution of $325,459, and a special assessment of $100.

By way of background, according to information provided by the Special Activities Case Manager for DSC, during an examination started on February 17, 2009, being conducted jointly by the FDIC and Oklahoma State Banking Department (SBD), the Oklahoma SBD received a call from a confidential source. The source claimed that the former executive vice president had been embezzling money from the certificates of deposit and bank accounts of a bank customer in excess of $1 million.

On May 6, 2009, a federal grand jury in Oklahoma City, Oklahoma, returned a four-count indictment charging the defendant with embezzlement and misapplication of bank funds, making false statements to the FDIC, and obstructing the examination of a financial institution. On April 1, 2009, the defendant confessed to OIG agents regarding six occasions when he provided altered documents to examiners conducting the examination of Glencoe State Bank. On July 2, 2009, the former bank executive pleaded guilty to the charges against him.

Source: *Based on a request for assistance from the FDIC's DSC, Dallas, Texas.* ***Responsible Agencies:*** *FDIC OIG and U.S. Attorney for the Western District of Oklahoma.*

Keeping Current with Mortgage Fraud Activities Nationwide	
The FDIC OIG participates in the Department of Justice's Operation Malicious Mortgage and in the following mortgage fraud working groups throughout the country. We benefit from the perspectives, experience, and expertise of all parties involved in combating the growing incidence of mortgage fraud schemes.	
National Bank Fraud Working Group	National Mortgage Fraud Working Sub-group.
Northeast Region	Long Island Mortgage Fraud Task Force; Eastern District New York Mortgage Fraud Task Force; the Northern Virginia Real Estate Fraud Initiative Working Group, Manassas, Virginia; Maryland Mortgage Fraud Task Force; the New England Mortgage Fraud Working Group.
Southeast Region	Middle District of Florida Mortgage and Bank Fraud Task Force, Southern District of Florida Mortgage Fraud Working Group, Northern District of Georgia Mortgage Fraud Task Force, Eastern District of North Carolina Bank Fraud Task Force, Northern District of Alabama Financial Fraud Working Group.
Midwest Region	Illinois Mortgage Fraud Task Force, Dayton Area Mortgage Fraud Task Force, Cincinnati Area Mortgage Fraud Task Force, St. Louis Mortgage Fraud Task Force, Kansas City Mortgage Fraud Task Force, Detroit Mortgage Fraud Task Force.
Southwest Region	Seattle Mortgage Fraud Working Group, FBI Seattle Mortgage Fraud Task Force, Mortgage Fraud Task Force for the Southern District of Mississippi, Oklahoma City Financial Crimes Suspicious Activity Report Review Work Group, North Texas Mortgage Fraud Working Group, Eastern District of Texas Mortgage Fraud Task Force, Texas Attorney General's Residential Mortgage Fraud Task Force, Houston Mortgage Fraud Task Force, Los Angeles Mortgage Fraud Working Group.

Strong Partnerships with Law Enforcement Colleagues

The OIG has partnered with various U.S. Attorneys' Offices throughout the country in bringing to justice individuals who have defrauded the FDIC or financial institutions within the jurisdiction of the FDIC, or criminally impeded the FDIC's examination and resolution processes. The alliances with the U.S. Attorneys' Offices have yielded positive results during this reporting period. Our strong partnership has evolved from years of hard work in pursuing offenders through parallel criminal and civil remedies resulting in major successes, with harsh sanctions for the offenders. Our collective efforts have served as a deterrent to others contemplating criminal activity and helped maintain the public's confidence in the nation's financial system.

During the reporting period, we partnered with U.S. Attorneys' Offices in the following states: Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin.

We also worked closely with the Department of Justice; FBI; other OIGs; other federal, state, and local law enforcement agencies; and FDIC divisions and offices as we conducted our work during the reporting period.

Strategic Goal 2

The OIG Will Help the FDIC Maintain the Viability of the Insurance Fund

Federal deposit insurance remains a fundamental part of the FDIC's commitment to maintain stability and public confidence in the Nation's financial system. With enactment of the Emergency Economic Stabilization Act of 2008, the limit of the basic FDIC deposit insurance coverage was raised temporarily from $100,000 to $250,000 per depositor, through December 31, 2009. Coverage of up to $250,000 was subsequently extended through December 31, 2013. Estimated insured deposits based on the current limit rose to $5.4 trillion as of December 31, 2009. A priority for the FDIC is to ensure that the DIF remains viable to protect depositors in the event of an institution's failure. To maintain sufficient DIF balances, the FDIC collects risk-based insurance premiums from insured institutions and invests deposit insurance funds.

The DIF has suffered from the failures of the past. Losses from failures in 2008 totaled $37.0 billion and from failures in 2009 totaled $35.8 billion. I n September 2009, the FDIC's DIF balance – or the net worth of the fund – fell below zero for the first time since the third quarter of 1992. The fund balance of about negative $20.9 billion as of December 31, 2009 reflects a $44 billion contingent loss reserve that has been set aside to cover estimated losses over the next year. Just as banks reserve for loan losses, the FDIC has to set aside reserves for anticipated closings over the next year. Combining the fund balance with this contingent loss reserve showed total DIF reserves with a positive balance of $23.1 billion.

The FDIC, in cooperation with the other primary federal regulators, proactively identifies and evaluates the risk and financial condition of every insured depository institution. The FDIC also identifies broader economic and financial risk factors that affect all insured institutions. The FDIC is committed to providing accurate and timely bank data related to the financial condition of the banking industry. Industry-wide trends and risks are communicated to the financial industry, its supervisors, and policymakers through a variety of regularly produced publications and ad hoc reports. Risk-management activities include approving the entry of new institutions into the deposit insurance system, off-site risk analysis, assessment of risk-based premiums, and special insurance examinations and enforcement actions. In light of increasing globalization and the interdependence of financial and economic systems, the FDIC also supports the development and maintenance of effective deposit insurance and banking systems world-wide.

Primary responsibility for identifying and managing risks to the DIF lies with the FDIC's Division of Insurance and Research, DSC, and DRR. To help integrate the risk management process, the FDIC established the National Risk Committee (NRC), a cross-divisional body. Also, a Risk Analysis Center monitors emerging risks and recommends responses to the NRC. In addition, a Financial Risk Committee focuses on how risks impact the DIF and financial reporting.

While smaller bank failures take their toll on the DIF, large banks can pose unique risks to the fund, as illustrated by the failure of IndyMac Federal Savings Bank in July 2008, for example, which caused an estimated $10.7 billion loss to the DIF. Over recent years, the consolidation of the banking industry has resulted in fewer and fewer financial institutions controlling an ever expanding percentage of the Nation's financial assets. The FDIC has taken a number of measures to strengthen its oversight of the risks to the insurance fund posed by the largest institutions, and its key programs include the following:

- Large Insured Depository Institution Program,
- Dedicated Examiner Program,
- Shared National Credit Program, and
- Off-site monitoring systems.

The FDIC Board of Directors closely monitors the viability of the DIF. In February 2009, the FDIC Board took action to ensure the continued strength of the fund by imposing a one-time emergency special assessment on institutions as of June 30, 2009. On two occasions, the Board also set assessment rates that generally increase the amount that institutions pay each quarter for insurance and made adjustments to widen the rate band. The Corporation had adopted a restoration plan in October 2008 to increase the reserve ratio to the 1.15 percent designated threshold within 5 years. In February 2009, the Board voted to extend the restoration plan horizon to 7 years and in September 2009 extended the time frame to 8 years. As of December 31, 2009, the reserve ratio was negative 0.39 percent.

To further bolster the DIF's cash position, the FDIC Board approved a measure on November 12, 2009 to require insured institutions to prepay 3 years' worth of deposit insurance premiums – about $45.7 billion – at the end of 2009. The intent of this measure was to provide the FDIC with the funds needed to carry on with the task of resolving failed institutions in 2010 and beyond, but without accelerating the impact of assessments on the industry's earnings and capital. The Corporation will face challenges going forward in its ongoing efforts to replenish the DIF and implement a deposit insurance premium system that differentiates based on risk to the fund.

To help the FDIC maintain the viability of the DIF, **the OIG's 2010 performance goal** is as follows:

- Evaluate corporate programs to identify and manage risks in the banking industry that can cause losses to the fund.

We would note that the OIG's work referenced in Goal 1 also fully supports the goal of helping the FDIC maintain the viability of the DIF. Each institution for which we conduct an MLR, by definition, causes a substantial loss to the DIF. The OIG's MLR work is designed to help prevent such losses in the future. Similarly, investigative activity described in Goal 1 fully supports the strategic goal of helping to maintain the viability of the DIF. The OIG's efforts often lead to successful prosecutions of fraud in

financial institutions and/or fraud that can cause losses to the fund.

OIG Work in Support of Goal 2

Ongoing Work in This Goal Area

At the end of the reporting period, we were concluding a joint review with the Department of the Treasury OIG related to the failure of Washington Mutual Bank (WaMu). WaMu was the largest bank failure in the history of the United States, but because the resolution structure resulted in no loss to the DIF, the threshold for conducting an MLR was not triggered. Given the size, the circumstances leading up to the resolution, and the non-DIF losses (i.e., loss of shareholder value), we initiated a review with the Department of the Treasury OIG to determine the events leading to the need for the FDIC-facilitated transaction. We evaluated the OTS's supervision of WaMu, including implementation of PCA provisions of section 38, and the FDIC's supervision and monitoring of WaMu in its role as back-up regulator and insurer. This evaluation is the first to comprehensively analyze the supervisory efforts of the OTS and the FDIC with respect to a single failure. Results of this work will be presented in our next semiannual report.

Strategic Goal 3:
The OIG Will Assist the FDIC to Protect Consumer Rights and Ensure Customer Data Security and Privacy

Consumer protection laws are important safety nets for Americans. The U.S. Congress has long advocated particular protections for consumers in relationships with banks. For example:

- The **Community Reinvestment Act** encourages federally insured banks to meet the credit needs of their entire community.
- The **Equal Credit Opportunity Act** prohibits creditor practices that discriminate based on race, color, religion, national origin, sex, marital status, or age.
- The **Home Mortgage Disclosure Act** was enacted to provide information to the public and federal regulators regarding how depository institutions are fulfilling their obligations towards community housing needs.
- The **Fair Housing Act** prohibits discrimination based on race, color, religion, national origin, sex, familial status, and handicap in residential real-estate-related transactions.
- The **Gramm-Leach Bliley Act** eliminated barriers preventing the affiliations of banks with securities firms and insurance companies and mandated new privacy rules.
- The **Truth in Lending Act** requires meaningful disclosure of credit and leasing terms.
- The **Fair and Accurate Credit Transaction Act** further strengthened the country's national credit reporting system and assists financial institutions and consumers in the fight against identity theft.

The FDIC serves a number of key roles in the financial system and among the most important is its work in ensuring that banks serve their communities and treat consumers fairly. The FDIC carries out its role by providing consumers with access to information about their rights and disclosures that are required by federal laws and regulations and examining the banks where the FDIC is the primary federal regulator to determine the institutions' compliance with laws and regulations governing consumer protection, fair lending, and community investment. As a means of remaining responsive to consumers, the FDIC's Consumer Response Center investigates consumer complaints about FDIC-supervised institutions and responds to consumer inquiries about consumer laws and regulations and banking practices.

Turmoil in the credit and mortgage markets has presented regulators, policymakers, and the financial services industry with serious challenges. The Chairman is committed to working with the Congress and others to ensure that the banking system remains sound and that the broader financial system is positioned to meet the credit needs of the economy, especially the needs of creditworthy households that may experience distress. Another important priority is financial literacy. The FDIC Chairman has promoted expanded opportunities for the underserved banking population in the United States to enter and better

understand the financial mainstream.

Consumers today are also concerned about data security and financial privacy. Banks are increasingly using third-party servicers to provide support for core information and transaction processing functions. Of note, the increasing globalization and cost saving benefits of the financial services industry are leading many banks to make greater use of foreign-based service providers. The obligations of a financial institution to protect the privacy and security of information about its customers under applicable U.S. laws and regulations remain in full effect when the institution transfers the information to either a domestic or foreign-based service provider.

Every year fraud schemes rob depositors and financial institutions of millions of dollars. The OIG's Office of Investigations can identify, target, disrupt, and dismantle criminal organizations and individual operations engaged in fraud schemes that target our financial institutions or that prey on the banking public. OIG investigations have identified multiple schemes that defraud depositors. Common schemes range from identity fraud to Internet scams such as "phishing" and "pharming."

The misuse of the FDIC's name or logo has also been identified as a scheme to defraud depositors. Such misrepresentations have led depositors to invest on the strength of FDIC insurance while misleading them as to the true nature of the investment products being offered. These depositors have lost millions of dollars in the schemes. The OIG has been a strong proponent of legislation to address such misrepresentations. The Emergency Economic Stabilization Act of 2008, signed by the former President on October 3, 2008, contained provisions that address this issue.

Investigative work related to such fraudulent schemes is ongoing and will continue. With the help of sophisticated technology, the OIG continues to work with FDIC divisions and other federal agencies to help with the detection of new fraud patterns and combat existing fraud. Coordinating closely with the Corporation and the various U.S. Attorneys' Offices, the OIG helps to sustain public confidence in federal deposit insurance and goodwill within financial institutions.

To assist the FDIC to protect consumer rights and ensure customer data security and privacy, **the OIG's 2010 performance goals** are as follows:

- Contribute to the effectiveness of the Corporation's efforts to ensure compliance with consumer protections at FDIC-supervised institutions.
- Support corporate efforts to promote fairness and inclusion in the delivery of products and services to consumers and communities.
- Conduct investigations of fraudulent representations of FDIC affiliation or insurance that negatively impact public confidence in the banking system.

OIG Work in Support of Goal 3

During the reporting period, we did not devote audit or evaluation resources

directly to this goal area. However, investigative work related to misrepresentation of FDIC insurance or affiliation, and protection of personal information supported this strategic goal area, as described below.

Office of Investigations Works to Curtail Misrepresentation of FDIC Insurance or Affiliation

Unscrupulous individuals sometimes attempt to misuse the FDIC's name, logo, abbreviation, or other indicators to suggest that deposits or other products are fully insured. Such misrepresentations induce the targets of schemes to trust in the strength of FDIC insurance while misleading them as to the true nature of the insurance investments being offered. Abuses of this nature not only harm consumers, they can also erode public confidence in federal deposit insurance.

During the reporting period, the OIG's Electronic Crimes Unit (ECU) investigated two new instances of Web sites that falsely advertised FDIC insurance. In both cases, the ECU was able to have the Web site deactivated or the reference to FDIC insurance removed. In addition, the ECU continued to pursue an investigation involving a scam where banks are requested to send confidential information by fax to an entity purported to be the FDIC. The faxes go to a service that converts them to email and sends the information to free, untraceable email addresses. During the reporting period, the ECU had two fax numbers deactivated. The ECU has previously had 10 fax numbers associated with this scam deactivated.

OIG's Electronic Crimes Unit Responds to Fraudulent E-mail Activities

Identity theft also continues to become more sophisticated, and the number of victims is growing. Identity theft includes using the Internet for crimes such as "phishing" emails and "pharming" Web sites that attempt to trick people into divulging their private financial information. Schemers pretend to be legitimate businesses or government entities with a need for the information that is requested. The ECU responds to such scams involving the FDIC and the OIG. During the reporting period, the ECU responded to allegations of fraudulent emails that represented they were from the FDIC and had 15 fraudulent email accounts deactivated. The ECU also arranged for the shut-down of a Skype number that was being used as part of a scam that misrepresented that it was from the FDIC.

The ECU opened four new cases related to phishing Web sites involving the FDIC. In three of the new cases, the ECU was able to have the fraudulent Web sites deactivated. The ECU continues to investigate the fourth new phishing case. The ECU was also able to have three other fraudulent FDIC-related phishing Web sites deactivated that were part of previously opened cases.

Strategic Goal 4

The OIG Will Help Ensure that the FDIC Efficiently and Effectively Resolves Failing Banks and Manages Receiverships

The FDIC protects depositors of insured banks and savings associations. In the FDIC's history, no depositor has experienced a loss on the insured amount of his or her deposit in an FDIC-insured institution due to a failure. One of the FDIC's most important roles is acting as the receiver or liquidating agent for failed FDIC-insured institutions. The success of the FDIC's efforts in resolving troubled institutions has a direct impact on the banking industry and on taxpayers.

DRR's responsibilities include planning and efficiently handling the resolutions of failing FDIC-insured institutions and providing prompt, responsive, and efficient administration of failing and failed financial institutions in order to maintain confidence and stability in our financial system.

- The **resolution process** involves valuing a failing federally insured depository institution, marketing it, soliciting and accepting bids for the sale of the institution, considering the least costly resolution method, determining which bid to accept, and working with the acquiring institution through the closing process.
- The **receivership process** involves performing the closing function at the failed bank; liquidating any remaining assets; and distributing any proceeds to the FDIC, the bank customers, general creditors, and those with approved claims.

The FDIC's resolution and receivership activities pose tremendous challenges. As indicated by the trends in mergers and acquisitions, banks have become more complex, and the industry is consolidating into larger organizations. As a result, the FDIC has been called upon to handle failing institutions with significantly larger numbers of insured deposits than it has had to deal with in the past. The sheer volume of all failed institutions, big and small, poses tremendous challenges and risks to the FDIC.

As noted earlier, 140 institutions failed during 2009, with total assets at failure of $171.2 billion and total estimated losses to the DIF of approximately $35.8 billion. During 2009, the number of institutions on the FDIC's "Problem List" also rose to its highest level in 16 years. As of December 31, 2009, there were 702 insured institutions on the "Problem List," indicating a probability of more failures to come and an increased asset disposition workload. Total assets of problem institutions increased to $403 billion as of year-end 2009. As of the end of December 2009, DRR was managing 187 active receiverships, with assets totaling about $41 billion.

Of special note, the FDIC is retaining large volumes of assets as part of purchase and assumption agreements with institutions that are assuming the insured deposits of failed institutions. A number of the purchase and assumption agreements include loss share agreements (LSA) with other parties that involve pools of assets worth billions of dollars and that can extend up to 10 years. From a dollar standpoint, the FDIC's exposure is staggering: as of December 31, 2009, the Corporation was party to 93 LSAs related to closed institutions, with initial covered assets in excess of $122.4 billion. Because

the assuming institutions are servicing the assets and the FDIC is reimbursing a substantial portion of the related losses and expenses, there is significant risk to the Corporation. Additionally, the FDIC is increasingly using structured sales transactions to sell assets to third parties that are not required to be regulated financial institutions. Such arrangements need to be closely monitored to ensure compliance with all terms and conditions of the agreements at a time when the FDIC's control environment is continuing to evolve.

It takes a substantial level of human resources to handle the mounting resolution and receivership workload, and effectively administering such a complex workforce is challenging. The Corporation has established temporary satellite offices on the East Coast, West Coast, and in the Midwest to resolve failed institutions and manage resulting receiverships. DRR staffing grew from approximately 400 employees at the start of 2009 to a year-end staffing level of 1,153 full-time equivalents. The FDIC Board of Directors approved a further increase in the Division's staffing to 2,310 for 2010. Most of these new employees have been hired on non-permanent appointments with terms of up to 5 years. Additionally, over $1.8 billion will be available for contracting for receivership-related services during 2010, and by the end of 2009, DRR already employed over 1,500 contractor personnel.

While OIG audits and evaluations address various aspects of resolution and receivership activities, OIG investigations benefit the Corporation in other ways. That is, in the case of bank closings where fraud is suspected, our Office of Investigations sends case agents and computer forensic special agents from the ECU to the institution. ECU agents use special investigative tools to provide computer forensic support to OI's investigations by obtaining, preserving, and later examining evidence from computers at the bank.

The OIG also coordinates closely with DRR on concealment of assets cases. In many instances, the FDIC debtors do not have the means to pay fines or restitution owed to the Corporation. However, some individuals do have the means to pay but hide their assets and/or lie about their ability to pay. OI works closely with both DRR and the Legal Division in aggressively pursuing criminal investigations of these individuals.

To help ensure the FDIC efficiently and effectively resolves failing banks and manages receiverships, **the OIG's 2010 performance goals** are as follows:

- Evaluate the FDIC's plans and systems for managing bank resolutions.
- Investigate crimes involved in or contributing to the failure of financial institutions or which lessen or otherwise affect recoveries by the DIF, involving restitution or otherwise.

OIG Work in Support of Goal 4

During the reporting period, the OIG conducted an evaluation of the FDIC's Loan Modification Program as carried out under certain LSAs with assuming institutions. We also planned a number of new assign-

ments involving resolution and receivership activities. Additionally, we pursued an investigation involving a former FDIC contract employee at an FDIC receivership. These efforts are briefly discussed below.

The FDIC's Loan Modification Program

The recent financial crisis has resulted in dramatic increases in home mortgage defaults and foreclosures, and imposed significant costs on borrowers, lenders, mortgage investors, and neighborhoods. In response, the FDIC developed a loan modification program (LMP) at IndyMac Federal Bank, FSB, an FDIC conservatorship, to place borrowers into affordable mortgages while achieving an improved return for bankers and investors over foreclosure. Since November 2008, the FDIC has required institutions assuming FDIC failed bank assets to implement some form of LMP on single-family assets acquired under LSAs. We conducted an evaluation of (1) the extent to which the FDIC has required LMP implementation at assuming institutions and (2) the internal controls over the program and how those controls compare to the Department of the Treasury's (Treasury) Home Affordable Modification Program (HAMP), including controls established to detect and prevent program fraud.

By way of background, in 2008, the FDIC initiated a systematic and streamlined approach to loan modifications at IndyMac Federal Bank, FSB, by turning troubled loans into performing loans and, thereby, avoiding unnecessary and costly foreclosures. The FDIC's LMP required that a successful loan modification candidate result in a (1) positive net present value as opposed to a foreclosure option and (2) monthly payment representing no more than 31 percent of the borrower's gross monthly income. The FDIC's LMP process has to be straightforward and efficient in order to modify a large number of "at-risk" mortgages in a short period of time.

In February 2009, the Obama Administration announced The Homeowner Affordability and Stability Plan, a $75 billion federal program designed to provide for a sweeping LMP targeted at borrowers who are at risk of foreclosure. The plan tasked Treasury with developing and implementing uniform guidance for the government's loan modification efforts. Treasury announced its HAMP in March 2009, which built on the work of Congressional leaders and the FDIC's LMP efforts.

The FDIC frequently enters in LSAs with institutions that assume failed bank assets. These LSAs require the assuming institution to implement some form of LMP on the acquired single-family loans. Through December 31, 2009, the FDIC had entered into 86 LSAs for single-family loans totaling $53.2 billion. The FDIC's LMP is the default program for LSAs; however, assuming institutions have the option of using HAMP or another LMP acceptable to the FDIC. Three large assuming institutions, representing 50 percent of total single-family LSA assets as of December 31, 2009, are implementing Treasury's HAMP.

We evaluated loan modification activity for the eight largest LSAs, representing 97

percent of the single-family assets under LSAs as of July 31, 2009. Through December 31, 2009, the assuming institutions had completed 4,348 modifications and had 6,492 modifications in process. Collectively, the eight LSAs had a total of 24,853 single-family loans that had been delinquent longer than 60 days or were in foreclosure. FDIC officials noted that it is important to consider single-family portfolio characteristics when assessing the success of an assuming institution's LMP. Such characteristics include the type of loan portfolio (e.g., non-traditional or subprime); the number of second lien loans, non-owner occupied loans, or loans in bankruptcy; and the proportion of delinquent loans that are actually eligible for modification.

The FDIC may also enter into public-private partnerships with private sector investors, which require the purchasers to implement some form of LMP or retain single-family assets in FDIC receiverships. With respect to receivership assets, the FDIC encourages, but does not require, servicers to pursue loan modifications due to the temporary nature of the FDIC's ownership of those assets. The FDIC may issue guidance for pursuing loan modifications of receivership assets in the future.

President Obama's strategy for restructuring or refinancing millions of at-risk mortgages tasked Treasury with developing uniform guidance for loan modifications and required agencies such as the FDIC to seek to apply uniform guidance to loans that the agency owns or guarantees. We evaluated the FDIC's LMP program against Treasury's HAMP program. While certain important characteristics of the FDIC's LMP are consistent with HAMP, we identified other areas where the FDIC's LMP program attributes and controls could be strengthened, related to:

- The agreement with the assuming institution to follow the FDIC's LMP and LMP guidelines and program details;
- FDIC LMP loan underwriting, file documentation, and certain reporting requirements;
- Requirements for the assuming institution to develop an internal control program to monitor program compliance and to detect loan modification fraud; and
- The FDIC's plans for the independent monitoring of assuming institutions to ensure program compliance.

In comparing the FDIC's LMP to Treasury's HAMP, we acknowledged that HAMP was a much broader program aimed at modifying millions of mortgages. Accordingly, did not suggest that the FDIC's program should be identical to HAMP; rather, our report discussed certain program principles and attributes that could be strengthened in the FDIC LMP program to help ensure program success. We also acknowledged that the FDIC's LMP was a relatively new program and that DRR was still in the process of implementing program controls.

We made five recommendations to enhance program controls related to: the LMP agreement with the assuming institution and LMP guidelines; underwriting and clarifying information collection

requirements for fair housing purposes; assuming institution internal control programs; and FDIC compliance monitoring of assuming institutions. FDIC management concurred with each recommendation and proposed responsive actions to be completed by June 30, 2010.

OIG Audit Work Focuses on New Resolution and Receivership Challenges

The OIG contracted with KPMG to conduct a risk assessment of resolution and receivership activities at the FDIC. From September through November 2009, KPMG assessed processes within the FDIC's resolution and receivership business units and assigned risk categories of critical, high, moderate and low. KPMG did not include either LSAs or structured sales specifically in their assessment due to conflicts of interest created by contracts with DRR. The OIG assessed these latter areas. Overall, the OIG and KPMG conducted numerous meetings with DRR management to discuss inherent risks and risk mitigation activities.

We used the KPMG and OIG risk information to determine initial areas for audit coverage as part of our risk-based planning process. We also met with the Government Accountability Office (GAO) on its coverage of key areas as part of the annual audit of the FDIC financial statements. Going forward, we will also consider any coverage of DRR-related work by the Office of Enterprise Risk Management. All of this input has provided information to support audit prioritization and develop audit programs. We provided a briefing to the Vice Chairman and FDIC Director Curry related to the OIG's assessment of risk in DRR and the OIG's planned audit coverage of these risks.

Currently our work is focusing on the following areas:

Loss Share Agreements: Under such agreements, the FDIC agrees to absorb a portion of the loss on a specified pool of assets in order to maximize asset recoveries and minimize losses to the FDIC. We are evaluating loss share provisions to ensure compliance with all related terms, such as those involving asset eligibility and institution management of guaranteed assets. Concerning LSAs, 7 purchasers hold about 75 percent of the covered assets with holdings of each exceeding $5 billion. Our initial coverage is focused on three of the seven and at least one smaller LSA. Our coverage will include commercial and single-family loans and securities included in LSAs.

Structured Sales: Structured asset sales are the sale of asset pools through public/private partnerships that use the asset management expertise of the private sector while retaining for the FDIC a participation interest in all future cash flows. The FDIC, acting on behalf of failed bank receiverships, completed 6 structured asset sales in 2009, covering a total of 10,399 assets with a book value of approximately $10 billion. We plan several audits to assess private sector firms' compliance with the structured asset sales agreements.

Proforma Financial Statements: The FDIC closing process for failed financial institutions includes preparation of proforma financial statements. The primary focus

of proforma is to produce an accurate adjusted statement of financial condition (balance sheet) of the failed institution through the date of closing. The proforma financial statements are the basis for opening balances of both the FDIC as the receiver and the assuming or acquiring institution, as appropriate. It is from this set of financial statements, based on the terms of the legal documents, that the assets and liabilities are divided between the receivership and the acquiring institution. The proforma audit coverage will focus on ensuring that failed institution assets are properly allocated to the receivership and purchaser in accordance with the applicable purchase and assumption agreement.

The OIG's Electronic Crimes Unit Responds to Bank Closings

The ECU responded to five bank closings during the reporting period. At these closings, ECU agents collected electronic evidence from 170 computers. The ECU also collected electronic evidence related to the institutions' network files and email accounts. The OIG uses forensic software that can process large amounts of data, search for key words, sort information by date or name, identify falsified documents, and find other relevant information that can provide evidence of fraudulent activities. This electronic evidence is analyzed and provided to FDIC OIG agents working fraud cases related to the failed financial institutions.

OIG Investigation Reveals Former FDIC Contract Employee Disclosed Confidential Information

On March 23, 2010, in the United States District Court for the District of Kansas, a former FDIC DRR contract employee at Columbian Bank and Trust (CBT) pleaded guilty for violating Title 18 USC §1905, Disclosure of Confidential Information. Columbian Bank and Trust was an FDIC-regulated institution prior to its failure on August 28, 2008.

Commencing in August 2008 and continuing until she was removed from the bank in July 2009, the defendant used her position as a contract employee for the FDIC's DRR to obtain information regarding the potential sale of troubled loans and assets by the FDIC, following the failure of CBT. Based on her work as a former loan processor for CBT, she also attempted to profit by brokering various defaulted loans in FDIC receivership to outside investors. During the brokering process, she provided confidential information such as customer loan files, tax documents, and other financial documents belonging to the FDIC to outside parties.

During the course of this investigation, the defendant provided a signed sworn statement acknowledging she knowingly violated federal law by releasing confidential information belonging to the FDIC through her position as a contract employee for the FDIC DRR.

Source: *Investigation initiated based on information provided by an anonymous source.* ***Responsible Agencies:*** *The FDIC OIG conducted the investigation with assistance from the United States Secret Service. The case was prosecuted by the U.S. Attorney's Office for the District of Kansas.*

Strategic Goal 5:

The OIG Will Promote Sound Governance and Effective Stewardship and Security of Human, Financial, IT, and Physical Resources

The FDIC must effectively manage and utilize a number of critical strategic resources in order to carry out its mission successfully, particularly its human, financial, information technology (IT), and physical resources.

Human Resources: Of particular note, FDIC staffing levels have increased dramatically. The Board approved a 2010 FDIC staffing level of 8,653, reflecting an increase from 7,010 positions in 2009. These staff—mostly temporary, and including a number of rehired annuitants—will perform bank examinations and other supervisory activities to address bank failures, and, as mentioned previously, an increasing number will be devoted to managing and selling assets retained by the FDIC when a failed bank is sold. The FDIC has opened three new temporary Satellite Offices (East Coast, West Coast, and Midwest) for resolving failed financial institutions and managing the resulting receiverships.

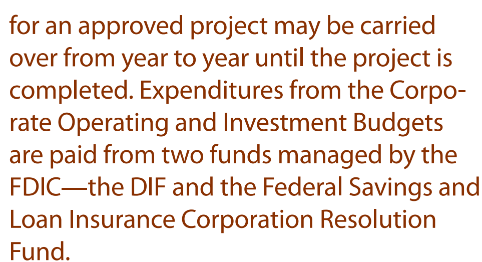
As referenced earlier, the Corporation's contracting level has also grown significantly, especially with respect to resolution and receivership work. As a good steward, the FDIC must ensure it receives the goods and services purchased with corporate funds and have effective contractor oversight controls in place as well.

In an age of identity theft risks, an important human capital management responsibility at the FDIC is to maintain effective controls to protect personal employee-related information that the Corporation possesses. The appointment of a chief privacy officer and implementation of a privacy program have been positive steps in addressing that challenge. Further, the FDIC has established a process for conducting privacy impact assessments of its information systems containing personally identifiable information that is consistent with relevant privacy-related policy, guidance, and standards.

Financial Resources: The Corporation does not receive an annual appropriation, except for its OIG, but rather is funded by the premiums that banks and thrift institutions pay for deposit insurance coverage, the sale of assets recovered from failed banks and thrifts, and from earnings on investments in U.S. Treasury securities.

To support increases in FDIC and contractor resources, the Board approved a nearly $4.0 billion 2010 Corporate Operating Budget, approximately $1.4 billion higher than for 2009. The operating budget provides resources for the operations of the Corporation's three major programs or business lines—Insurance, Supervision, and Receivership Management—as well as its major program support functions (legal, administrative, financial, IT, etc.). The FDIC's operating expenses are largely paid from the insurance fund, and consistent with sound corporate governance principles, the Corporation's financial management efforts must continuously seek to be efficient and cost-conscious.

In addition to the Corporate Operating Budget, the FDIC has a separate Investment Budget that is composed of individual project budgets approved by the Board of Directors for major investment projects. Budgets for investment projects are approved on a multi-year basis, and funds



for an approved project may be carried over from year to year until the project is completed. Expenditures from the Corporate Operating and Investment Budgets are paid from two funds managed by the FDIC—the DIF and the Federal Savings and Loan Insurance Corporation Resolution Fund.

IT Resources: At the FDIC, the Corporation seeks to leverage IT to support its business goals in insurance, supervision and consumer protection, and receivership management, and to improve the operational efficiency of its business processes. Along with the positive benefits that IT offers comes a certain degree of risk. In that regard, information security has been a long-standing and widely acknowledged concern among federal agencies. The Federal Information Security Management Act (FISMA) requires each agency to develop, document, and implement an agency-wide information security program to provide adequate security for the information and information systems that support the operations and assets of the agency. Section 522 of the Consolidated Appropriations Act of 2005 requires agencies to establish and implement comprehensive privacy and data protection procedures and have periodic third-party reviews performed of their privacy programs and practices.

Physical Resources: The FDIC is headquartered in Washington, D.C., but conducts much of its business in six regional offices and in field offices throughout the United States. Additionally, as referenced earlier, three new temporary satellite offices have been established on the East and West coasts and in the Midwest. Ensuring the safety and security of the human and physical resources in all of these offices is a fundamental corporate responsibility that is directly tied to the Corporation's successful accomplishment of its mission. The FDIC needs to be sure that its emergency response plans provide for the safety and physical security of its personnel and ensure that its business continuity planning and disaster recovery capability keep critical business functions operational during any emergency.

Corporate Governance and Risk Management: The FDIC is managed by a five-person Board of Directors, all of whom are appointed by the President and confirmed by the Senate, with no more than three being from the same political party. The Board includes the Comptroller of the Currency and the Director of OTS. Given the relatively frequent changes in the Board make-up, it is essential that strong and sustainable governance and communication processes are in place throughout the FDIC and that Board members possess and share the information needed at all times to understand existing and emerging risks and make sound policy and management decisions.

Enterprise risk management is a key component of governance. The FDIC's numerous enterprise risk management activities need to consistently identify, analyze, and mitigate operational risks on an integrated, corporate-wide basis. Additionally, such risks need to be communicated throughout the Corporation and the

relationship between internal and external risks and related risk mitigation activities should be understood by all involved. To further enhance risk monitoring efforts, the Corporation has established six new Program Management Offices to address risks associated with such activities as loss share agreements, contracting oversight for new programs and resolution activities, the systemic resolution authority program, and human resource management concerns. These new offices and the contractors engaged to assist them will require additional oversight mechanisms to help ensure their success.

To promote sound governance and effective stewardship and security of human, financial, IT, and physical resources, **the OIG's 2010 performance goals** are as follows:

- Evaluate corporate efforts to manage human resources and operations efficiently, effectively, and economically.
- Promote integrity in FDIC internal operations.
- Promote alignment of IT with the FDIC's business goals and objectives.
- Promote IT security measures that ensure the confidentiality, integrity, and availability of corporate information.
- Promote personnel and physical security.
- Promote sound corporate governance and effective risk management and internal control efforts.

OIG Work in Support of Goal 5

Given the need to devote most all of the OIG's resources to the conduct of MLRs and other pressing priorities, the OIG was not able to commit substantial resources to work in this strategic goal area during the reporting period. We did, however, issue a comprehensive report pursuant to FISMA. Additionally, we completed an audit of FDICconnect, one of the most widely used Web-based applications at the FDIC. Both of these assignments are discussed below. In another assignment related to the Corporation's data submissions through the governmentwide financial report system as of September 30, 2009, we verified that the FDIC's summary account information agreed with the FDIC's general ledger accounts and was accurately entered into the governmentwide financial report system, and that year-end data submitted agreed with the FDIC's December 31, 2008 audited financial statements.

The FDIC's Information Security Program

FISMA requires federal agencies, including the FDIC, to have annual independent evaluations by agency Inspectors General of their information security program and practices and to report the results of the evaluation to the Office of Management and Budget. We contracted with KPMG to perform an audit to fulfill the requirements for the 2009 independent evaluation. The audit was designed to determine the effectiveness of the FDIC's information security program and practices, including the FDIC's compliance with FISMA and related

information security policies, procedures, standards, and guidelines.

KPMG reported that the FDIC has established a corporate-wide information security program, including policies and procedures, addressing the principal provisions of FISMA and the standards and guidelines of the National Institute of Standards and Technology (NIST). The FDIC had also implemented a number of important security control improvements following KPMG's 2008 evaluation, such as encrypting mainframe and server backup tapes, developing a multi-year strategy for generating and reviewing audit logs for the FDIC's portfolio of information systems, and restricting access to security logs from network devices. Additional control improvements were underway at the close of the audit.

KPMG did, however, identify a number of security program control families warranting management attention. Most notably, KPMG identified access control deficiencies within the FDIC's internal network similar to those identified in the 2008 FISMA evaluation that presented a high risk of unauthorized disclosure of sensitive information or compromise of IT resources. While the FDIC took prompt action to address the specific access control vulnerabilities identified during the audit, priority management attention in this area continues to be warranted.

The report identifies nine steps that the Corporation can take to strengthen its information security controls. These steps address such areas as: Enterprise Architecture; Risk Assessment; Planning; Certification, Accreditation, and Security Assessments; Physical and Environmental Protection; Configuration Management; Identification and Authentication; Access Control; and Audit and Accountability. In many cases, the FDIC was already working to improve security controls in these areas during KPMG's audit.

Audit of FDICconnect

FDICconnect is a Web-based application that allows FDIC-insured financial institutions to conduct business and exchange sensitive information (including privacy data) with the FDIC, other federal regulatory agencies, and state banking departments. FDICconnect is one of the most widely used Web-based applications at the FDIC.

We contracted with KPMG to assess the FDIC's IT security controls over FDICconnect that are designed to ensure the confidentiality, integrity, and availability of the system. Specifically, the audit assessed selected IT security controls pertaining to the core functionality and selected business transactions of FDICconnect. KPMG used security standards and guidelines issued by NIST as its principal criteria in performing the audit.

KPMG found that the FDIC had established and implemented a number of important information security controls over FDICconnect that are designed to ensure the confidentiality, integrity, and availability of the system. Such controls include written information security policies and procedures

in substantially all of the areas that KPMG reviewed; key planning documents, such as an application security plan, contingency plan, and configuration management plan; and strong network perimeter security controls that include firewalls, an intrusion detection system, and monthly scanning of FDICconnect servers to detect missing security patches and other security vulnerabilities. Further, the Division of Information Technology (DIT) had certified and accredited FDICconnect using a methodology consistent with NIST security standards and guidelines.

KPMG did identify several security control deficiencies warranting management attention. Specifically, DIT needed to strengthen its configuration management controls for FDICconnect by ensuring that source code in the production computing environment and the FDIC's corporate software repository are consistent and properly documented. DIT also needed to review certain FDICconnect user accounts and disable or delete accounts that are no longer needed. Further, DIT needed to update the security plan and contingency plan for FDICconnect to address changes in the application's technology and functionality. KPMG's report contained five recommendations to address these security control deficiencies.

KPMG made one additional recommendation intended to improve the FDIC's Risk Management methodology to help ensure that risks associated with electronic transactions involving the Internet are fully considered. FDIC management concurred with the recommendations, and its actions and planned actions were responsive.

Defense Contract Audit Agency Audits (DCAA) of FDIC Contractors

The OIG engaged DCAA to provide audit services on a reimbursable basis. DCAA issued three incurred cost audit reports on contractors who are doing business with the FDIC. Additional information on this work is presented in Table XII on page 56.

Former FDIC Employee Sentenced in Bribery Case

The OIG handles investigations of FDIC employee cases to ensure the integrity of the FDIC's internal programs and operations. During the reporting period, a former FDIC employee was sentenced in the Eastern District of Virginia relating to his guilty plea to a criminal information charging him with payment of a gratuity, in violation of Title 18, U.S.C., section 201(c)(1)(A). He was sentenced to 2 years of probation and 6 months of home detention and electronic monitoring. He was also fined $7,500 and an assessment of $100. The former employee received a bribe of approximately $16,000 in return for the award of a contract to an outside company. The Chief Executive Officer who owned the company also pleaded guilty to paying a gratuity to a government official. He was fined $5,000, sentenced to 4 months of home confinement and placed on 24 months of supervised release. This investigation was initiated based on a referral from the FBI to the OIG.

Strategic Goal 6:
OIG Resources Management:
Build and Sustain a High-Quality Staff, Effective Operations, OIG Independence, and Mutually Beneficial Working Relationships

While the OIG's audit, evaluation, and investigation work is focused principally on the FDIC's programs and operations, we have an obligation to hold ourselves to the highest standards of performance and conduct. We seek to develop and retain a high-quality staff, effective operations, OIG independence, and mutually beneficial working relationships with all stakeholders. Currently, a major challenge for the OIG is ensuring that we have the resources needed to effectively and efficiently carry out the OIG mission at the FDIC, given a sharp increase in the OIG's statutorily mandated work brought about by numerous financial institution failures, and in light of the new activities and programs that the FDIC has undertaken to restore public confidence and stability in the financial system.

To ensure a high-quality staff, we must continuously invest in keeping staff knowledge and skills at a level equal to the work that needs to be done, and we emphasize and support training and development opportunities for all OIG staff. We also strive to keep communication channels open throughout the office. We are mindful of ensuring effective and efficient use of human, financial, IT, and procurement resources in conducting OIG audits, evaluations, investigations, and other support activities, and have a disciplined budget process to see to that end.

To carry out our responsibilities, the OIG must be professional, independent, objective, fact-based, nonpartisan, fair, and balanced in all its work. Also, the Inspector General (IG) and OIG staff must be free both in fact and in appearance from personal, external, and organizational impairments to their independence. The OIG adheres to the Quality Standards for Federal Offices of Inspector General, issued by the former President's Council on Integrity and Efficiency (PCIE) and the Executive Council on Integrity and Efficiency (ECIE). Further, the OIG conducts its audit work in accordance with generally accepted Government Auditing Standards; its evaluations in accordance with PCIE Quality Standards for Inspections; and its investigations, which often involve allegations of serious wrongdoing that may involve potential violations of criminal law, in accordance with Quality Standards for Investigations established by the former PCIE and ECIE, and procedures established by the Department of Justice.

Strong working relationships are fundamental to our success. We place a high priority on maintaining positive working relationships with the FDIC Chairman, Vice Chairman, other FDIC Board members, and management officials. The OIG is a regular participant at Audit Committee meetings where recently issued MLR, audit, and evaluation reports are discussed. Other meetings occur throughout the year as OIG officials meet with division and office leaders and attend and participate in internal FDIC conferences and other forums.

The OIG also places a high priority on maintaining positive relationships with the Congress and providing timely, complete, and high quality responses to congressional inquiries. In most instances, this

communication would include semiannual reports to the Congress; issued MLR, audit, and evaluation reports; information related to completed investigations; comments on legislation and regulations; written statements for congressional hearings; contacts with congressional staff; responses to congressional correspondence; and materials related to OIG appropriations.

The FDIC OIG is a member of the Council of the Inspectors General on Integrity and Efficiency (CIGIE), an organization created by the IG Reform Act of 2008. We fully support and participate in CIGIE activities and coordinate closely with representatives from the other the financial regulatory OIGs. Additionally, the OIG meets with representatives of the GAO to coordinate work and minimize duplication of effort and with representatives of the Department of Justice, including the FBI and U.S. Attorneys' Offices, to coordinate our criminal investigative work and pursue matters of mutual interest.

The FDIC OIG has its own strategic and annual planning processes independent of the Corporation's planning process, in keeping with the independent nature of the OIG's core mission. The Government Performance and Results Act of 1993 (GPRA) was enacted to improve the management, effectiveness, and accountability of federal programs. GPRA requires most federal agencies, including the FDIC, to develop a strategic plan that broadly defines the agency's mission and vision, an annual performance plan that translates the vision and goals of the strategic plan into measurable objectives, and an annual performance report that compares actual results against planned goals.

The OIG strongly supports GPRA and is fully committed to applying its principles of strategic planning and performance measurement and reporting to our operations. The OIG's Business Plan lays the basic foundation for establishing goals, measuring performance, and reporting accomplishments consistent with the principles and concepts of GPRA. We are continuously seeking to better integrate risk management considerations in all aspects of OIG planning—both with respect to external and internal work.

To build and sustain a high-quality staff, effective operations, OIG independence, and mutually beneficial working relationships, **the OIG's 2010 performance goals** are as follows:

- Effectively and efficiently manage OIG human, financial, IT, and physical resources.
- Ensure quality and efficiency of OIG audits, evaluations, investigations, and other projects and operations.
- Encourage individual growth and strengthen human capital management and leadership through professional development and training.
- Foster good client, stakeholder, and staff relationships.
- Enhance OIG risk management activities.

A brief listing of OIG activities in support of these performance goals follows.

Effectively and Efficiently Manage OIG Human, Financial, IT, and Physical Resources	
1	Continued realignment of the OIG's resources to address the need for additional investigative coverage in FDIC regions, sufficient resources for material loss review assignments, additional audit coverage for resolution and receivership work in the Dallas region, and adequate staffing for the OIG's human resources function.
2	Provided the FDIC OIG's fiscal year 2011 budget submission to the House and Senate Committees on Appropriations, Subcommittees on Financial Services and General Government.
3	Coordinated with the Division of Administration to accommodate an influx of contractor staff on-site in OIG office space and to ensure adequate physical security of contractors and OIG staff alike.
4	Continued to partner with DIT to ensure the security of OIG information in the FDIC computer network infrastructure.

Ensure Quality and Efficiency of OIG Audits, Evaluations, Investigations, and Other Projects and Operations	
1	Completed two internal quality control reviews of OIG audit-related activities: (1) a review of contractor technical monitoring and (2) a follow-up review of data reliability for calculating assignment costs. Office of Audits also issued an annual quality monitoring summary and analysis for 2009.
2	Coordinated with Railroad Retirement Board OIG regarding that office's upcoming peer review of the audit operations of the FDIC OIG.
3	Awarded contracts to qualified firms to provide audit and evaluation services to the OIG to enhance the quality of our work and the breadth of our expertise as we conduct material loss reviews, audits, and evaluations, and closely monitored contractor performance.
4	Continued use of the IG's feedback form to assess time, cost, and overall quality and value of MLRs, audits, and evaluations.
5	Relied on OIG Counsel's Office to provide legal advice and counsel to teams conducting MLRs, resolution and receivership work, and other audits and evaluations, and to support investigations of fraud and other criminal activity, in the interest of ensuring legal sufficiency and quality of all OIG work.
6	Spearheaded the IG community's audit peer review training program for OIGs government-wide to ensure a consistent and effective peer review process for the federal audit function.

Encourage Individual Growth and Strengthen Human Capital Management and Leadership Through Professional Development and Training	
1	Continued to support members of the OIG attending long-term graduate banking school programs sponsored by Stonier, the Southeastern School of Banking at Vanderbilt University, and the University of Wisconsin to enhance OIG staff expertise and knowledge of the banking industry.
2	Employed college interns on a part-time basis in the OIG to provide assistance to the OIG.
3	Arranged for a number of part-time college interns to proceed to the Student Career Experience Program, under which they are eventually offered permanent employment by the OIG pending successful completion of college coursework.
4	Continued implementation of the IG community's introductory auditor training sessions designed to provide attendees with an overall introduction to the community and enrich their understanding of fundamental aspects of auditing in the federal environment.

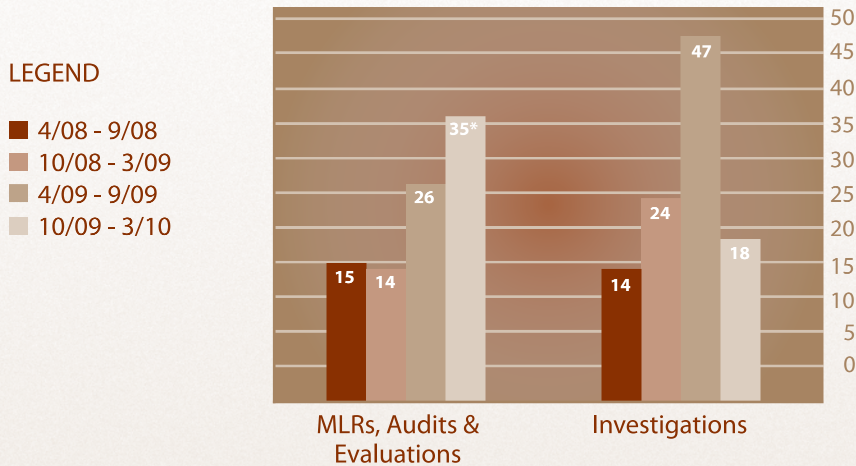
Foster Good Client, Stakeholder, and Staff Relationships	
1	Maintained congressional working relationships by briefing various Committee staff on issues of interest to them; providing our Semiannual Report to the Congress for the 6-month period ending September 30, 2009; notifying interested congressional parties regarding the OIG's completed material loss review, audit, and evaluation work; attending or monitoring FDIC-related hearings on issues of concern to various oversight committees; and coordinating with the Corporation's Office of Legislative Affairs on issues of mutual interest.
2	Communicated with the FDIC Chairman, Vice Chairman, Director Curry, and other senior FDIC officials through the IG's regularly scheduled meetings with them and through other forums.
3	Participated in numerous outreach efforts with such external groups as the Conference of State Bank Supervisors, the Federal Financial Institutions Examination Council, and Association of Certified Fraud Examiners to provide general information regarding the OIG and share perspectives on issues of mutual concern and importance to the financial services industry.
4	Held quarterly meetings with FDIC Directors and other senior officials to keep them apprised of ongoing OIG reviews and results.
5	Kept DSC, DRR, the Legal Division, and other FDIC program offices informed of the status and results of our investigative work impacting their respective offices. This was accomplished by notifying FDIC program offices of recent actions in OIG cases and providing OI's quarterly reports to DSC, DRR, the Legal Division, and the Chairman's Office outlining activity and results in our cases involving closed and open banks.
6	Participated at FDIC Audit Committee meetings to present the results of significant completed MLRs, audits, and evaluations for consideration by Committee members.
7	Reviewed nine proposed or revised corporate policies relating to security, training and development, equal employment opportunity, and administration. These included the personnel security policy for FDIC contractors, the Corporation's policy on equal opportunity employment, and procedures for the non-asset defensive litigation review committee.
8	Supported the IG community by having the IG serve as Chair of the CIGIE Audit Committee and coordinating the activities of that group, including introductory auditor and peer review training; attending monthly CIGIE meetings and participating in Inspection & Evaluation Committee and Council of Counsels to the IGs meetings; providing resource assistance to other OIGs; and providing support to the IG community's investigative meetings.
9	Met regularly with representatives of the OIGs of the federal banking regulators (Board of Governors of the Federal Reserve System, Department of the Treasury, National Credit Union Administration, Securities and Exchange Commission, Farm Credit Administration, Commodity Futures Trading Commission, Federal Housing Finance Agency, and Export-Import Bank) to discuss audit and investigative matters of mutual interest and leverage knowledge and resources.

Enhance OIG Risk Management Activities	
1	Held component office meetings to assess emerging issues and risk areas impacting the FDIC and the banking and financial services industry as a whole. Determined which assignments to add and/or modify in our Fiscal Year 2010 Business Plan.
2	Participated regularly at corporate meetings of the National Risk Committee to monitor emerging risks at the Corporation and tailor OIG work accordingly.
3	Provided OIG perspectives on the risk of fraud at the FDIC to the GAO. We did so in response to GAO's responsibility under Statement of Auditing Standards No. 99, Consideration of Fraud in Financial Statement Audits.
4	Provided the FDIC Chairman the OIG's 2009 assurance letter, under which the OIG provides assurance that it has made a reasonable effort to meet the internal control requirements of the Federal Managers' Financial Integrity Act, Office of Management and Budget A-123, and other key legislation.
5	Provided the OIG's assessment of the management and performance challenges facing the FDIC, in accordance with the Reports Consolidation Act of 2000. We identified the following overall areas of challenge: Restoring and Maintaining Public Confidence and Stability in the Financial System; Resolving Failed Institutions and Managing Receiverships; Ensuring the Viability of the Insurance Fund; Ensuring Institution Safety and Soundness Through an Effective Examination and Supervision Program; Protecting and Educating Consumers and Ensuring an Effective Compliance Program; and Effectively Managing the FDIC Workforce and Other Corporate Resources.

Cumulative Results (2-year period)

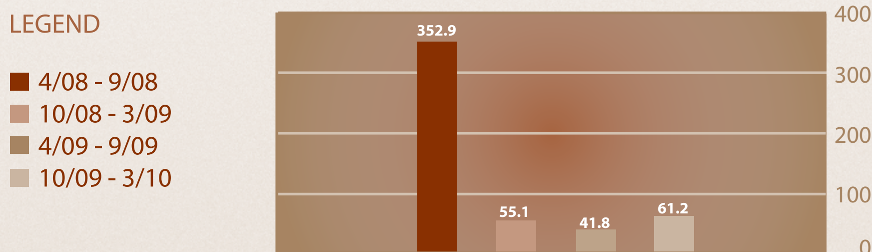
Nonmonetary Recommendations	
April 2008 – September 2008	24
October 2008 – March 2009	28
April 2009 – September 2009	12
October 2009 – March 2010	11

Products Issued and Investigations Closed



* Includes three audit or evaluation memoranda

Fines, Restitution, and Monetary Recoveries Resulting from OIG Investigations (in millions)



Reporting Requirements

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* Evaluation report statistics are shown on pages 53, 54, and 55 in accordance with the IG Reform Act of 2008.

Information Required by the Inspector General Act of 1978, as Amended

Review of Legislation and Regulations

The OIG's review of legislation and regulations during the reporting period focused principally on several legislative proposals involving the FDIC, as discussed below:

H.R. 4173, Wall Street Reform and Consumer Protection Act of 2009, passed the House on December 11, 2009, and was received in the Senate and referred to the Senate Committee on Banking, Housing, and Urban Affairs on January 20, 2010. There are three sections in this bill that could impact the FDIC OIG, as follows:

- Section 1220 relates to the Department of the Treasury and FDIC OIG's involvement with the implementation plan for the transfer of responsibilities from the OTS to the OCC and the FDIC.
- Section 1611 involves the establishment of a Special Deputy Inspector General within the existing FDIC OIG to oversee the dissolution should the FDIC be appointed as receiver for a financial company.
- Section 1703 establishes a Council of Inspectors General on Financial Oversight and the Council's responsibilities for providing additional oversight of the financial regulatory system.

The FDIC OIG worked with congressional staff on these provisions and provided extensive comments on Sections 1611 and 1703.

The FDIC OIG also worked with the Senate Committee on Banking, Housing, and Urban Affairs regarding MLR threshold relief. S. 3217, Restoring American Financial Stability Act of 2010, includes provisions that provide relief from the current threshold. As the Senate continues to consider this bill, the FDIC OIG is working with staff to adjust the timeframes associated with these provisions.

The FDIC OIG also coordinates with others in the IG community through the CIGIE's Legislative Committee in responding to legislation impacting the IG community as a whole.

Table I: Significant Recommendations from Previous Semiannual Reports on Which Corrective Actions Have Not Been Completed

There are no significant recommendations from previous semiannual reports on which corrective actions have not been completed.

Table II: Audit Reports Issued by Subject Area

Audit Report		Questioned Costs		Funds Put to Better Use
Number and Date	Title	Total	Unsupported	
Supervision				
MLR-10-001 October 5, 2009	Material Loss Review of FirstCity Bank, Stockbridge, Georgia			
MLR-10-002 October 23, 2009	Material Loss Review of Cape Fear Bank, Wilmington, North Carolina			
MLR-10-003 October 23, 2009	Material Loss Review of New Frontier Bank, Greeley, Colorado			
MLR-10-004 November 5, 2009	Material Loss Review of First Bank of Beverly Hills, Calabasas, California			
MLR-10-005 December 2, 2009	Material Loss Review of Westsound Bank, Bremerton, Washington			
MLR-10-006 December 2, 2009	Material Loss Review of American Southern Bank, Kennesaw, Georgia			
MLR-10-007 December 4, 2009	Material Loss Review of Strategic Capital Bank, Champaign, Illinois			
MLR-10-008 December 4, 2009	Material Loss Review of Great Basin Bank of Nevada, Elko, Nevada			
MLR-10-009 December 4, 2009	Material Loss Review of America West Bank, Layton, Utah			
MLR-10-010 December 16, 2009	Material Loss Review of Bank of Lincolnwood, Lincolnwood, Illinois			
MLR-10-011 January 6, 2010	Material Loss Review of MetroPacific Bank, Irvine, California			
MLR-10-012 January 6, 2010	Material Loss Review of Southern Community Bank, Fayetteville, Georgia			
MLR-10-013 January 6, 2010	Material Loss Review of Cooperative Bank, Wilmington, North Carolina			
MLR-10-014 January 21, 2010	Material Loss Review of the Bank of Wyoming, Thermopolis, Wyoming			
MLR-10-015 January 21, 2010	Material Loss Review of Mirae Bank, Los Angeles, California			
MLR-10-016 January 22, 2010	Material Loss Review of Millennium State Bank of Texas, Dallas, Texas			
MLR-10-017 February 12, 2010	Material Loss Review of First Piedmont Bank, Winder, Georgia			
MLR-10-018 February 12, 2010	Material Loss Review of Temecula Valley Bank, Temecula, California			

Table II: Audit Reports Issued by Subject Area (continued)

Audit Report		Questioned Costs		Funds Put to Better Use
Number and Date	Title	Total	Unsupported	
Supervision				
MLR-10-019 February 12, 2010	Material Loss Review of Founders Bank, Worth, Illinois and Rock River Bank, Oregon, Illinois			
MLR-10-020 February 12, 2010	Material Loss Review of the Six Bank Subsidiaries of Security Bank Corporation, Macon, Georgia			
MLR-10-021 February 26, 2010	Material Loss Review of Mutual Bank, Harvey, Illinois			
MLR-10-022 February 26, 2010	Material Loss Review of Integrity Bank, Jupiter, Florida			
MLR-10-023 March 10, 2010	Material Loss Review of First Coweta Bank, Newnan, Georgia			
MLR-10-024 March 10, 2010	Material Loss Review of First State Bank, Sarasota, Florida			
MLR-10-025 March 25, 2010	Material Loss Review of Affinity Bank, Ventura, California			
MLR-10-026 March 25, 2010	Material Loss Review of Mainstreet Bank, Forest Lake, Minnesota			
MLR-10-027 March 25, 2010	Material Loss Review of First State Bank, Flagstaff, Arizona			
MLR-10-028 March 25, 2010	Material Loss Review of InBank, Oak Forest, Illinois			
Resources Management				
AUD-10-001 November 10, 2009	Independent Evaluation of the FDIC's Information Security Program - 2009			
AUD-10-002 December 11, 2009	Information Technology Security Controls over FDICconnect			
AUD-10-003 January 6, 2010	Verification of the FDIC's Data Submissions through the Government-wide Financial Report System as of September 30, 2009			
Totals for the Period		**$0**	**$0**	**$0**

Table III: Evaluation Reports Issued

Evaluation Reports & Memoranda		Questioned Costs		Funds Put to Better Use
Number and Date	Title	Total	Unsupported	
Receivership Management				
EVAL-10-001 February 4, 2010	FDIC's Loan Modification Program			
Totals for the Period		**$0**	**$0**	**$0**

Table IV: Audit Reports Issued with Questioned Costs

	Number	Questioned Costs	
		Total	Unsupported
A. For which no management decision has been made by the commencement of the reporting period.	0	0	0
B. Which were issued during the reporting period.	0	0	0
Subtotals of A & B	**0**	**0**	**0**
C. For which a management decision was made during the reporting period.	0	0	0
(i) dollar value of disallowed costs.	0	0	0
(ii) dollar value of costs not disallowed.	0	0	0
D. For which no management decision has been made by the end of the reporting period.	0	0	0
Reports for which no management decision was made within 6 months of issuance.	0	0	0

Table V: Evaluation Reports Issued with Questioned Costs

Number		Questioned Costs	
		Total	Unsupported
A. For which no management decision has been made by the commencement of the reporting period.	0	0	0
B. Which were issued during the reporting period.	0	0	0
Subtotals of A & B	**0**	**0**	**0**
C. For which a management decision was made during the reporting period.	0	0	0
(i) dollar value of disallowed costs.	0	0	0
(ii) dollar value of costs not disallowed.	0	0	0
D. For which no management decision has been made by the end of the reporting period.	0	0	0
Reports for which no management decision was made within 6 months of issuance.	0	0	0

Table VI: Audit Reports Issued with Recommendations for Better Use of Funds

	Number	Dollar Value
A. For which no management decision has been made by the commencement of the reporting period.	0	0
B. Which were issued during the reporting period.	0	0
Subtotals of A & B	**0**	**0**
C. For which a management decision was made during the reporting period.	0	0
(i) dollar value of recommendations that were agreed to by management.	0	0
- based on proposed management action.	0	0
- based on proposed legislative action.	0	0
(ii) dollar value of recommendations that were not agreed to by management.	0	0
D. For which no management decision has been made by the end of the reporting period.	0	0
Reports for which no management decision was made within 6 months of issuance.	0	0

Table VII: Evaluation Reports Issued with Recommendations for Better Use of Funds

	Number	Dollar Value
A. For which no management decision has been made by the commencement of the reporting period.	0	0
B. Which were issued during the reporting period.	0	0
Subtotals of A & B	**0**	**0**
C. For which a management decision was made during the reporting period.	0	0
(i) dollar value of recommendations that were agreed to by management.	0	0
- based on proposed management action.	0	0
- based on proposed legislative action.	0	0
(ii) dollar value of recommendations that were not agreed to by management.	0	0
D. For which no management decision has been made by the end of the reporting period.	0	0
Reports for which no management decision was made within 6 months of issuance.	0	0

Table VIII: Status of OIG Recommendations Without Management Decisions

During this reporting period, there were no recommendations more than 6 months old without management decisions.

Table IX: Significant Revised Management Decisions

During this reporting period, there were no significant revised management decisions.

Table X: Significant Management Decisions with Which the OIG Disagreed

During this reporting period, there were no significant management decisions with which the OIG disagreed.

Table XI: Instances Where Information Was Refused

During this reporting period, there were no instances where information was refused.

Table XII: Defense Contract Audit Agency Audits of FDIC Contractors

The DCAA provided audit services to the FDIC on a reimbursable basis. The DCAA provided the following information during this period on reports involving FDIC contract activities.

DCAA Audit Reports Issued▲

During the period, the DCAA issued 3 incurred cost audit reports on contractors who do business with the FDIC. Corrective actions taken in response to DCAA audit report recommendations usually result from negotiations between the contractors doing business with the FDIC and the FDIC contracting officer with cognizant responsibility. The FDIC contracting officer responsible for administering the contract negotiates recoveries with the contractor after deciding whether to agree to or reject the questioned costs and recommendations for funds to be put to better use. The following table shows the amounts of questioned costs and funds to be put to better use included in DCAA reports issued during the semiannual reporting period and the amounts that were agreed to during the reporting period related to those reports.

Amount Examined	Questioned Costs◆		Funds Put to Better Use	
	Reported	Agreed to by FDIC	Reported	Agreed to by FDIC
$19,172,811	$73,049	$26,783	$0	$0

▲ The schedule represents DCAA contract audit assignments completed during the 6-month period ended March 31, 2010.

◆ Questioned costs represent costs that DCAA has questioned because they do not comply with rules, regulations, laws, and/or contractual terms.

Congratulations and Farewell

Ed Slagle retired from the OIG's Office of Investigations after more than 32 years of federal service. His career began in 1978 as a tax technician at the Internal Revenue Service and then progressed to service as a wage and hour compliance specialist at the Department of Labor. Later he became an investigator for labor and pension issues at the Department of Labor. In 1984 he transferred to the Veterans Administration as a criminal investigator, a position he held until 1991 when he joined the Resolution Trust Corporation (RTC) OIG as a criminal investigator in Kansas City. He later transferred to the RTC OIG's Atlanta office, and upon the RTC's sunset, transitioned to the FDIC OIG in Atlanta where he worked with distinction for nearly 15 years, most recently as that office's Special Agent in Charge.

While maintaining a full case load, Ed also served as an outstanding representative of the OIG and a highly effective supervisor over the past several years. He developed and fostered constructive working relationships with FDIC regional management, U.S. Attorneys' Offices, and fellow law enforcement groups. As evidence of his strong leadership skills, he also took on the mentoring role for three new agents in the Office of Investigations and used his vast experience in teaching and developing these new investigators—all in the interest of ensuring a first-class cadre of investigators in the FDIC OIG.

OIG Hotline

The Office of Inspector General (OIG) Hotline is a convenient mechanism employees, contractors, and others can use to report instances of suspected fraud, waste, abuse, and mismanagement within the FDIC and its contractor operations. The OIG maintains a toll-free, nationwide Hotline (1-800-964-FDIC), electronic mail address (IGhotline@FDIC.gov), and postal mailing address. The Hotline is designed to make it easy for employees and contractors to join with the OIG in its efforts to prevent fraud, waste, abuse, and mismanagement that could threaten the success of FDIC programs or operations.

To learn more about the FDIC OIG and for more information on audit and evaluation reports discussed in this Semiannual Report, visit our Web site: http://www.fdicig.gov