



# Office of Inspector General

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## Testimony

Before the Subcommittee on Oversight and  
Investigations  
Committee on Financial Services  
U.S. House of Representatives

## Hearing on the Role of Inspectors General: Minimizing and Mitigating Waste, Fraud and Abuse

Statement of Jon T. Rymer  
Inspector General  
Federal Deposit Insurance Corporation

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**STATEMENT OF JON T. RYMER, INSPECTOR GENERAL**  
**Federal Deposit Insurance Corporation**  
**on**  
**The Role of Inspectors General: Minimizing and Mitigating Waste, Fraud and Abuse**  
  
**Subcommittee on Oversight and Investigations**  
**Committee on Financial Services**  
**United States House of Representatives**

**May 5, 2009**

Mr. Chairman and Members of the Subcommittee:

Thank you for providing me the opportunity to participate in this very important hearing. My name is Jon T. Rymer, and I am the Inspector General (IG) for the Federal Deposit Insurance Corporation (FDIC or the Corporation). As noted in your invitation letter, the purpose of today's hearing is to focus on our ongoing efforts to expose waste, fraud, and abuse, and to specifically examine how mandated Material Loss Reviews (MLR) affect our ability to provide oversight and accountability. We appreciate your interest in the challenges that we, the Inspectors General of the federal financial regulators, are currently facing.

These issues are critical to the ongoing work of my office. As detailed in my testimony, the landscape has not changed from the one we described in our January 2009 letter to Chairman Barney Frank and Ranking Minority Member Spencer Bachus. In short, our predictions have become reality. That is to say, the current volume of MLR work—and the time and resources that this work demands—puts at risk my office's ability to effectively oversee core activities of the FDIC. Expending our scarce resources on these reviews also limits our ability to oversee the new initiatives that the banking agencies are undertaking to deal with the current economic crisis affecting open financial institutions.

My written statement will amplify these points. In response to your questions, we are providing an overview of my office; a discussion of the MLR requirements and coverage as well as the impact these requirements are having on my office's ability to effectively oversee FDIC programs and operations; and information on our investigative efforts to combat fraud, waste, and abuse. I also discuss scenarios of possible relief from the current MLR threshold requirements.

### **Overview of the Office of Inspector General (OIG)**

The FDIC OIG is an independent and objective unit established under the Inspector General Act of 1978, as amended (IG Act). The OIG's mission is to promote the economy, efficiency, and effectiveness of FDIC programs and operations, and protect against fraud, waste, and abuse to assist and augment the FDIC's contribution to stability and public confidence in the nation's financial system. To accomplish this mission, my office conducts audits, evaluations, and investigations to provide objective, fact-based information and analysis to the Congress, the FDIC Chairman, other FDIC officials, and the Department of Justice. Our work is conducted pursuant to the IG Act and in accordance with applicable professional standards.

For fiscal year (FY) 2009, the OIG is operating on a budget of \$27.5 million and an authorized staffing level of 122. We are at an on-board strength of 110 employees and are actively hiring. Three of our component offices—the Office of Audits, Office of Evaluations, and Office of Investigations—perform the bulk of our mission-related work. The other components, including my attorneys and independent management support functions, account for 20 employees.

- The Office of Audits conducts audits and audit-related services designed to promote economy, efficiency, and effectiveness, and to prevent fraud, waste, and abuse in corporate programs and operations. This work is done in compliance with applicable audit standards, including those established by the Comptroller General of the United States. The Office of Audit has 36 employees, and anticipates growing in FY 2010 to an on-board strength of 49.
- The Office of Evaluations evaluates, reviews, studies, or analyzes FDIC programs and activities to provide independent, objective information to facilitate FDIC management decision-making and improve operations. These projects, which are generally limited in scope and may be requested by the FDIC Board of Directors, FDIC management, or the Congress, are conducted in accordance with the IG community's *Quality Standards for Inspections*. The Office of Evaluations currently has 14 employees and anticipates increasing to 17 employees in FY 2010.
- The Office of Investigations carries out a comprehensive nationwide program for the prevention, detection, and investigation of criminal or otherwise prohibited activity that may harm or threaten to harm the operations or integrity of the FDIC and its programs. This office maintains close and continuous working relationships with the Department of Justice; the Federal Bureau of Investigation; other Offices of Inspector General; and federal, state and local law enforcement agencies. The Office of Investigations has an on-board strength of 40 investigative personnel and is planning to grow to 51 in FY 2010.

During FY 2008, my office issued 30 audit and evaluation reports, containing 76 non-monetary recommendations to FDIC management; referred 73 cases to the Department of Justice for prosecutorial consideration; and realized 124 indictments/informations and 103 convictions through the courts. Overall, our work resulted in \$440 million in actual and potential monetary benefits.

## **MLR Requirements**

Mr. Chairman, as you noted, today's hearing focuses on the statutory requirement for detailed reviews by my office and the offices of my IG colleagues at the Department of the Treasury and Federal Reserve Board when certain federally insured institutions fail. In 1991, the Congress amended the Federal Deposit Insurance Act, after the failures of about 1,000 banks between 1986 and 1990 had resulted in billions of dollars in losses to the Bank Insurance Fund.<sup>1</sup> Section

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<sup>1</sup> Effective March 31, 2006, deposit insurance for banks and savings and loan associations was consolidated into the Deposit Insurance Fund. As of December 31, 2008, the FDIC insured approximately \$4.8 trillion in deposits in all federally-insured depository institutions in the United States.

38(k) requires that the IG of the agency charged with supervising the failed institution conduct a review (a “material loss review” or MLR) when the estimated loss becomes material, i.e., the loss is estimated to exceed the greater of \$25 million or 2 percent of the institution’s total assets at the time the FDIC was appointed receiver.

MLRs are intended to independently determine why the institution failed and evaluate the supervision of the institution. Section 38(k) was added to ensure that the regulators learn from any weaknesses in the supervision of banks whose failures cause material losses and make improvements, as needed, in the supervision of depository institutions, including the agency’s implementation of section 38 of the Federal Deposit Insurance Act pertaining to Prompt Corrective Action (PCA).<sup>2</sup> The 1991 Act also required that an MLR be completed within 6 months after it becomes apparent that a material loss has been incurred as a result of an institution’s failure.

My Office of Audits is principally responsible for performing MLRs. For each MLR of an FDIC-supervised institution, a team of 2-3 professionals reviews and analyzes examination and visitation reports prepared by FDIC and state examiners, FDIC-maintained bank records and correspondence, FDIC-prepared reports relating to the bank’s closure, records of the bank’s external and internal auditors, and pertinent FDIC and interagency policies. The MLR team also interviews responsible FDIC officials in both headquarters and the field, including the examiners who participated in the examinations and the managers who monitored the activities of the bank before it failed, officials from the state regulator, and independent public accountants to discuss their historical perspective of the institution, its examinations, state banking laws, and other activities regarding the overall supervision of the bank.

To supplement the Office of Audits’ existing staffing levels, we have temporarily reassigned a number of staff from other OIG component offices to carry out this mandatory workload. For example, we have returned individuals previously detailed to our Office of Investigations to perform forensic accounting support for ongoing criminal investigations, and detailed staff with appropriate backgrounds from our Office of Management, to join MLR teams. Needless to say, the work that these individuals were formerly doing for their respective offices is no longer being accomplished. Moreover, we have assigned Office of Evaluations staff to MLR teams, but believe that, for the most part, the Corporation is better served if that staff provides coverage of the new FDIC programs and activities described below.

Because an MLR involves an assessment of supervisory activity and can lead to recommendations that would affect bank supervision, my office does not plan to contract out for this work. Specifically, my office is concerned about a potential conflict of interest when professional services firms that have clients in the banking industry are involved in making recommendations associated with bank supervision. At this time, we are not using contractors to perform specific tasks directly related to ongoing MLRs, but we may need to revisit that issue should increased workload dictate.

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<sup>2</sup> The PCA provisions establish a system of restrictions and mandatory supervisory actions that are triggered by an institution’s capital levels and intended to address institutions that are not well capitalized.

## **Institution Failures and MLR Coverage**

As of December 31, 2008, over 8,300 FDIC-insured financial institutions made up the banking system, and the FDIC was the primary federal regulator for nearly 5,100 of them. These FDIC-insured and supervised institutions are state-chartered and are not members of the Federal Reserve System (generally referred to as “state non-member” institutions). It is important to note that the vast majority of these institutions remain viable, notwithstanding the current economic crisis.

However, banks have been failing, and we are experiencing a dramatic upswing in the number of these failures, particularly among institutions of a size that are typically regulated by the FDIC. In 2008 alone, 25 institutions failed, with total assets at failure of \$361.3 billion and total losses to the Deposit Insurance Fund (DIF or the Fund) of approximately \$17.9 billion. During the first 4 months of 2009, another 29 institutions have failed, with total assets at failure of \$14.7 billion and an estimated loss to the DIF of about \$3.9 billion.

As of April 30, 2009, the FDIC OIG had 20 MLRs underway. These reviews are labor-intensive. Our experience to date tells us that each MLR requires about 2,000 staff hours. At our current staffing levels, we are able to conduct approximately 20 MLRs at any one time. With our current inventory of MLRs, we are at our capacity and can, assuming no other failures, effectively manage the workload through September 2009. However, with 252 institutions on the problem bank list, as of the end of December 2008, we are concerned that additional failures will occur and will preclude us from meeting our statutory responsibilities.

To date, we have issued six MLR reports and will issue three more this month. These MLRs cover institutions whose failures caused losses to the Fund ranging from \$32 million to \$1.4 billion. As required by law, in each of the issued or about-to-be-issued reports, we identify the causes for the institution’s failure and resulting loss to the DIF, and assess the FDIC’s supervision of the failed institution, including implementation of the PCA provisions.

Section 38(k) also requires the OIG to make recommendations for preventing losses from future failures. Rather than offering recommendations on individual MLRs, my office will be summarizing our observations on the major causes, trends, and common characteristics of failures resulting in material losses to the DIF in separate reports or other communications. We decided early on in the process that our recommendations will be more effective and useful to all concerned if they are based on several reports rather than an individual MLR. We are in the process of sharing our observations to date with the FDIC, and then plan to provide additional coverage through summary reports and other means, as resources allow.

## **MLR Impact on the OIG’s Coverage of Other Programs and Initiatives**

In January 2009, the IGs of the federal financial regulators sent a letter to the leadership of the House Financial Services Committee requesting relief from the current \$25 million MLR threshold. Over 17 years ago when this threshold was established, a \$250 million institution was considered large, and a 10-percent loss rate on failure was viewed as substantial. Today, nearly one-third, or over 2,600 institutions, have assets in excess of \$250 million, and the projected loss

rates on the current failures are frequently in excess of 25 percent of total assets. In light of the current economic environment, the \$25 million threshold no longer serves as a reasonable measure of materiality or a meaningful trigger point for an OIG review of a failed financial institution. Further, as mentioned in our letter, the MLRs at the lower end of the loss threshold provide little, if any, new perspectives or insights regarding the causes of the failure or supervision of the institutions themselves beyond what we initially discern at the time of closure.

In two separate reports,<sup>3</sup> the Government Accountability Office (GAO) suggested that the Congress consider whether the MLR requirement was a cost-effective mean of achieving the requirement's intended benefit. As a matter for congressional consideration, GAO noted that amending the requirement would be more desirable because it would allow IGs to continue their bank supervision work as well as provide them with greater flexibility in managing their resources. GAO did not propose a threshold in either report but noted that OIG resource management flexibility was important.

Over the last 9 months, we have stretched our resources to the maximum extent possible and are feeling this tension in all aspects of our work. Our first priority is to satisfy our statutory requirements for conducting MLRs, as discussed above, and other mandated work, including an evaluation of information security practices in accordance with the Federal Information Security Management Act of 2002, and Federal Information Systems Controls Audit Manual-related work in connection with GAO's financial statement audit of the Deposit Insurance and Federal Savings and Loan Insurance Corporation Resolution Funds.

To leverage resources and expertise, we will continue to work jointly with the other financial regulatory IGs. For example, we loaned two experienced auditors to the Department of the Treasury OIG to assist with the MLR of IndyMac Bank, F.S.B. This arrangement not only paid dividends for the Treasury OIG, but our auditors were also able to share their experiences with our staff to enhance our ability to conduct MLRs going forward. In addition, we are beginning to discuss the possibility of a joint MLR with the Federal Reserve OIG, should circumstances warrant. Finally, in anticipation of the expanded MLR workload, my office along with the other financial OIGs conducted a 4-day training conference to refresh our employees' knowledge of the bank supervision, closing, and MLR processes.

While the conduct of MLRs is our primary focus, another priority includes the efforts by my Office of Evaluations to review, at a high, risk-based level, key activities and new programs and initiatives undertaken by the FDIC and others. To accomplish these reviews, we are being creative in our staffing arrangements and are employing the expert services of contractors to fill the gaps. Provided below are examples of the work we are doing, albeit at the "30,000-foot level."

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<sup>3</sup> *INSPECTORS GENERAL: Mandated Studies to Review Costly Bank and Thrift Failures* (GAO/GGD-95-126), dated July 31, 1995; and *INSPECTORS GENERAL: Mandated Studies to Review Costly Bank and Thrift Failures* (GAO/GGD-97-4), dated November 7, 1996.

## **Resolution and Receivership Activity**

Planning and efficiently handling the resolutions of failing FDIC-insured institutions is a core FDIC mission. The resolution process involves all the business processes associated with selling an entity and winding up its business activities. The receivership process involves closing the failed bank; liquidating any remaining assets; satisfying creditors; and distributing any proceeds. Without question, the Corporation needs to ensure that receivership and resolution processes, negotiations, and decisions made regarding failed or failing institutions are marked by fairness, transparency, and integrity.

The FDIC's resolution and receivership activity has increased substantially and is expected to grow. Based on preliminary data, as of the end of 2008, the number of receiverships had grown to 41, with assets in liquidation totaling \$15 billion, reflecting a 46 percent and 1,623 percent increase, respectively, over the previous year. This upswing occurred, in part, because 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. Adding into the equation large, complex failures and facilitated transactions, such as IndyMac Bank (estimated \$10.7 billion loss to the Fund) and Washington Mutual Bank (\$299 billion in assets), and the loss share provisions that involve pools of assets worth billions of dollars and extend up to 10 years, such as Citigroup (\$306 billion in loans and securities) further complicates the FDIC's resolution mission. As discussed below, the FDIC extensively utilizes contractors in connection with its resolution activities. The use of contractors affords the FDIC with a great deal of flexibility in its planning and operations, but also creates vulnerabilities against which the agency must remain vigilant.

As history has shown, the FDIC will be disposing of these assets over an extended period of time, and the associated risks will present themselves to the Corporation for years to come. An effective governance structure, strong controls and appropriate contracting and contractor oversight mechanisms will be critical to the success of these activities.

The resolution and receivership activity is a vulnerable area where independent oversight and review are essential. Although more coverage is called for, we are, at present, conducting two evaluations in areas where we believe FDIC has the most exposure. One evaluation will identify and evaluate controls in place over the contracting and legal services functions to address the risks presented by a significant increase in resolution and receivership-related contracting activity. A second evaluation will cover the loss share provisions, including those in the assistance agreements with Citigroup and Bank of America, to ensure compliance with all related terms, such as those involving asset eligibility and institution management of guaranteed assets.

## **New FDIC Programs and Activities**

A number of new programs and activities that were established in response to the economic downturn pose substantial short- and long-term risk, including reputational risk, to the FDIC. These initiatives are very large in scale, and the FDIC has been taking steps to address the associated risks, including setting governance and supervisory controls. With the evolving nature of these initiatives, controls are, in many cases, still under development.

Given the scope, scale, and dollar magnitude associated with these activities, we have done or are beginning to conduct work, at a high level, to ensure that effective controls, governance, transparency, and accountability are imbedded in the new programs the Corporation undertakes on its own or in coordination with the Department of the Treasury and other financial regulatory agencies. At this point, we are looking to provide a broad-brush look and some preliminary assessments with the ultimate goal, should resources permit, of coming back to conduct more extensive reviews. Provided below are examples of this work:

**Temporary Liquidity Guarantee Program.** The FDIC established the Temporary Liquidity Guarantee Program in October 2008 to help address unprecedented disruptions in credit markets and the resultant effects on the ability of financial institutions to fund themselves and make loans to creditworthy borrowers. This program, which is entirely funded by industry fees, has two components: (1) a temporary guarantee of newly issued senior unsecured debt for eligible banks, thrifts, and certain holding companies and (2) a temporary unlimited guarantee of funds in noninterest-bearing transaction accounts at FDIC-insured institutions. Debt guarantees can go out as many as 3 years (December 2012) under the current program, and guarantees on the noninterest-bearing accounts extend until the end of the year. As of February 2009, the FDIC guaranteed about \$269 billion in outstanding debt and had assessed approximately \$5.5 billion in fees. In addition, the FDIC reported, as of December 2008, more than half a million deposit accounts have received over \$680 billion in additional FDIC coverage through the transaction account guarantee.

Shortly after this program was established, my office, using the expertise of an independent professional services firm, performed a risk assessment on the program's key internal controls and procedures established to implement and oversee the program. We recently briefed FDIC managers on the results of our assessment, discussed program risk areas warranting continued management attention, and plan to issue a management letter summarizing the results of our assessment. Should resources become available, we plan to revisit this program to conduct a more in-depth review to assess the effectiveness of the program's controls and systems.

**Capital Purchase Program.** Under the Department of the Treasury's Troubled Asset Relief Program (TARP) Capital Purchase Program (CPP), the FDIC is responsible for processing applications from those FDIC-supervised institutions interested in participating in the program and forwarding approval recommendations to the Department of the Treasury. The CPP authorizes the Treasury to purchase up to \$250 billion of senior preferred shares from qualifying insured depository institutions. As of April 24, 2009, the FDIC had received 1,712 applications from FDIC-supervised institutions requesting \$34.3 billion in TARP funding. The FDIC had recommended 785 applications to Treasury for approval, of which 587 received awards. A total of 831 applicants had withdrawn from CPP consideration.

Given the attention and sense of urgency associated with this program, my office initiated an evaluation to assess the FDIC's process and controls associated with reviewing applications from FDIC-supervised institutions and forwarding approval recommendations. In our review, we found that the FDIC had established controls for reviewing CPP applications that provide reasonable assurance that the Corporation is complying with Treasury's CPP guidance. In February 2009, the Corporation issued examination procedures for monitoring compliance with CPP award provisions, which will allow the FDIC to measure institutions' success in deploying



TARP capital and ensure that the funds are used in a manner consistent with the intent of the Congress. We issued our report in March 2009.

**Loan Modification Programs.** The FDIC implemented a Loan Modification Program at IndyMac Federal Bank, F.S.B., and the implementation of a similar program has been a condition of several large FDIC-facilitated institution sales. The goal of these programs is to achieve affordable and sustainable mortgage payments for borrowers and increase the value of distressed mortgages by rehabilitating them into performing loans. Other institutions have agreed to implement loan modification programs as part of their financial stability agreements with the FDIC and other financial regulatory agencies.

Our initial plans for reviewing these loan modification programs changed with the sale of IndyMac Federal Bank in March 2009. Currently, my office plans to assess the FDIC's efforts for monitoring implementation of loan modification programs at institutions such as CitiBank and US Bank. We will also be looking at the former IndyMac Federal Bank program to evaluate the controls that were in place to detect and prevent participation in the program by those who obtained their initial loan under fraudulent pretenses.

**Large Bank Failures.** The failures of IndyMac Bank and Washington Mutual Bank (WaMu) were historic, each for their own reasons. As such, we believed that an independent analysis of the activities of the regulators involved was in the public's best interest. IndyMac Bank's failure in July 2008 was the third largest in the history of the United States. Because this institution was supervised by the Office of Thrift Supervision, the IG at the Department of the Treasury conducted the MLR. However, we believe it is important to determine the role that the FDIC played as back-up regulator and deposit insurer. In this evaluation, we are focusing on determining when the FDIC became aware of the IndyMac Bank problem; what the Corporation knew and how it knew it; and what actions the Corporation took given its knowledge of the risks posed by IndyMac Bank. We expect to issue this report within the next month.

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, circumstances leading up to the resolution, and non-Fund losses (i.e., loss of shareholder value), we are working jointly with the Treasury OIG to determine the events leading to the need for the FDIC-facilitated transaction. Specifically, our joint work will evaluate the Office of Thrift Supervision's supervision of WaMu, including implementation of PCA provisions of section 38, if required; evaluate the FDIC's supervision and monitoring of WaMu in its role as insurer; and assess the FDIC's resolution process for WaMu. We anticipate issuing this report in the fall 2009.

**Legacy Loan Program.** On March 23, 2009, the Department of the Treasury and the FDIC were tasked with establishing the Legacy Loan Program as part of the Public-Private Investment Program. The Legacy Loan Program is being created to (1) remove troubled loans and other assets from banks and attract private capital to purchase eligible loan assets from participating banks through FDIC debt guarantees and Treasury equity co-investment, (2) address the uncertainty about the value of these assets, which makes it difficult for banks to raise capital and

secure stable funding to support lending to households and businesses, and (3) in coordination with the other components of the financial recovery package, clean up bank balance sheets so that banks can once again provide the lending to further the recovery of the economy. At present, the FDIC is responsible for providing oversight for the formation, funding, and operation of public-private investments funds that will purchase the loans and other assets from the depository institutions, and is working to develop the program and staff operations related to the formation, funding, and operations of these funds.

If the Corporation is successful in establishing this major new program, we anticipate multiple transactions, involving hundreds of billions of dollars, and related indebtedness, which will be guaranteed by the FDIC. The Chairman of the FDIC has requested that we, working with the Special Inspector General for the TARP, review preliminary control structures currently being designed to meet these challenges. The size and importance of this program will demand substantial resources, now and in the future, to provide sufficient oversight.

### **Work Being Deferred**

Unfortunately, difficult workload decisions have to be made, and other assignments, necessary to provide oversight of the ongoing operations and programs of the Corporation, are being deferred until resources permit. As a result, our opportunities to promote sound governance and effective stewardship in internal operations have been limited and will remain so unless we can free up some of our existing resources. Provided below are some examples of the projects we will be unable to initiate in the foreseeable future.

**Oversight of the Increase in FDIC Core Business Processes.** The FDIC is growing in various ways. The FDIC increased its staffing to over 6,200 positions, reflecting an increase of nearly 1,500 positions. These staff—mostly temporary—will perform bank examinations and other supervisory activities to address bank failures, including managing and selling assets retained by the FDIC when a failed bank is sold. The Board also approved opening a temporary West Coast Satellite Office for resolving failed financial institutions and managing the resulting receiverships. Additional satellite offices are also being considered.

Further, contracting activities are escalating dramatically. In 2008, the FDIC awarded approximately \$652 million in contracts. With increased resolution and receivership workload, the level of FDIC contracting for various business activities will increase significantly, and effective controls must be in place and operational. Rapidly hiring and training so many new staff along with expanded contracting activity will place heavy demands on the Corporation's human resources and information technology staff and other administrative operations. At this time, we do not anticipate providing sufficient independent, in depth reviews of these critical core processes unless resources become available.

**Other Business Plan Projects.** Due to the resources required by our MLR work, increased resolution activity, and new programs and initiatives, our efforts to provide coverage in

other FDIC core areas, which had been planned during our FY 2008-2009 business planning cycle, have been postponed. These areas include:

- ***Receivership Management Audits.*** Coverage of the FDIC's closing process and its management of assets received from failed financial institutions, including financial reporting of failed institutions and receiverships' sales activities.
- ***In-depth, Systematic Coverage of the FDIC's Supervision and Consumer Protection Programs.*** The FDIC's Supervision and Consumer Protection programs promote the safety and soundness of FDIC-supervised insured depository institutions, protect consumers' rights, and promote community investment initiatives by FDIC-supervised insured depository institutions.
- ***In-depth, Systematic Coverage of the FDIC's Insurance Program.*** The FDIC insures bank and savings association deposits to help ensure stability and public confidence in the nation's financial system. The DIF must remain viable to protect insured depositors if an institution fails.

## **Scenarios of Threshold Relief**

In our January letter, my colleagues and I proposed that increasing the MLR threshold would better serve the Congress by providing the OIGs with increased flexibility to refocus scarce resources to the wide-ranging programs and initiatives that the agencies are now managing, while continuing to ensure that significant failures receive an appropriate, in-depth review. At that time, we recommended modifying the threshold for a material loss to an amount between \$300 and \$500 million. To ensure that unusual or potentially significant situations are not missed, we also recommended that language be added that would allow the OIG to initiate an MLR of an institution with a projected loss below the increased threshold, should circumstances warrant. I continue to believe that an increase in the threshold is appropriate and necessary, and should be accompanied by such a provision.

Provided below is an analysis of the total MLR workload from January 1, 2007 to the present, under different threshold scenarios. As evidenced in the table, a relatively modest increase of the threshold up to \$100 million would dramatically reduce the FDIC OIG's workload by over one-third. Raising the threshold to \$200 million would have an even greater impact on our MLR workload by reducing it by two-thirds. We would defer to the Congress to arrive at the threshold most appropriate and the language that will allow for the flexibility that would be needed to initiate MLRs below a newly set threshold.

**Number of Material Loss Reviews Required for Institution Failures from 1/1/2007 to 4/27/2009 at Current and Proposed Threshold Levels\***

Responsible OIG	Current Material Loss Threshold	Proposed Material Loss Thresholds				
	\$25 million**	\$100 Million	\$200 Million	\$300 Million	\$400 million	\$500 million
FDIC	29	18	10	4	3	3
Federal Reserve	4	2	1	0	0	0
Treasury – OCC	7	3	3	2	2	2
Treasury – OTS	8	6	3	3	3	3
<b>TOTALS</b>	<b>48</b>	<b>29</b>	<b>17</b>	<b>9</b>	<b>8</b>	<b>8</b>

\* Based on available loss estimates as of 4/27/09.

\*\* An additional threshold is that the material loss must also exceed 2% of the institution's assets at the time the FDIC was appointed receiver. All of the MLRs required from 1/1/2007 to date have also met this threshold.

## **Resources Going Forward**

A crucial theme throughout my testimony has been “as resources become available.” Earlier this year, we began to address the increased workload issue by requesting \$37.9 million to fund operations for FY 2010, which is an increase of 38 percent above our FY 2009 budget. A budget of \$37.9 million will fund an authorized staffing level of 138, an increase of 13 percent above our FY 2009 level, and provide for additional contractor resources.

With the FY 2010 funds, we plan to hire a combination of employees on permanent and temporary appointments to provide needed coverage as well as contract for expert services to augment our work. For FY 2010, we do not believe that we could effectively acclimate or manage a higher staffing level, but we will be reevaluating our needs when preparing our FY 2011 budget. Should we get relief from the current MLR threshold, we would be in a position to deploy our resources differently.

## **Investigative Efforts to Fight Fraud, Waste, and Abuse**

As referenced in the beginning of the statement, I have three component offices that perform the bulk of the IG mission-related work. My Office of Investigations conducts investigations of fraud and other criminal activity in or affecting FDIC-regulated financial institutions, closed institutions and receiverships, and other FDIC-related programs and operations. This office is comprised of federal law enforcement officers, including both field special agents and computer forensic special agents, who conduct these investigations throughout the country and operate a headquarters-based electronic crimes unit and computer forensic lab. The OIG's resources extend beyond its staff as it continues to work closely and partner with the FDIC, Department of Justice, Federal Bureau of Investigation, and other federal and state law enforcement organizations.

We currently have about 175 active investigations, most of which involve open or closed institutions. Based on our estimates, the potential fraud in these investigations exceeds

\$11.3 billion. The work focuses primarily on bank crimes, such as embezzlement or money laundering, or various types of fraud, including mortgage, securities, wire, and mail, which occur at or impact financial institutions.

As expected, our investigative workload, particularly in the failed banks, is increasing. Where fraud is suspected in a bank about to be closed, our agents, including those with computer forensic expertise, participate during the closing. While on site, the OIG uses its special investigative tools to provide computer forensic support by obtaining, preserving, and later examining evidence from computers at the bank. After the institution fails and many times even before the failure, our investigators, working under the legal direction of an Assistant United States Attorney, and sometimes in conjunction with other federal and/or state and local investigative agencies, are investigating the criminal misconduct identified in connection with the bank failure with the goal of prosecuting those engaged in criminal behavior and seeking restitution to the DIF.

Mortgage fraud, which is one of the fastest growing white-collar crimes, is a significant subset of our investigative workload. About 40 percent of our active investigations are mortgage fraud-related, and that percentage continues to grow. These cases involve false representations, property flipping, straw buyers, stolen identities, inflated appraisals, foreclosure schemes, and seller assistance scams, and represent potential losses of \$7.5 billion. Our investigations typically focus on industry professionals, such as mortgage brokers, senior executives, appraisers, attorneys, loan officers, and accountants, who perpetuate the fraud. They can also extend into more complex crime rings involving networks of individuals. While the investigations can occur nationwide, they tend to be concentrated in the “booming” growth areas of the early to mid-2000’s, such as Atlanta, Southern Florida, New York/New Jersey, and Southern California. Our work in this area is supplemented by our participation in over 20 mortgage fraud task forces nationwide and other financial institution fraud working groups.

In addition, the Office of Investigations is involved in stopping fraud schemes that rob depositors and FDIC-insured financial institutions of millions of dollars. The OIG has an ongoing effort to identify, target, disrupt, and dismantle criminal organizations engaged in such schemes that target financial institutions and prey on the banking public. These schemes range from identity theft to Internet scams, such as “phishing” and “pharming.” With the help of sophisticated technology, the OIG continues to work with the FDIC and other federal agencies to help with the detection of new fraud patterns and combat existing fraud.

Finally, this office works closely with the FDIC to identify individuals who have already committed financial institution crimes and are trying to avoid their obligations by concealing their assets. In many instances, the FDIC debtors who have been ordered to pay fines or restitution to the Corporation may not have the means to fulfill this obligation. However, some individuals do have the means but hide their assets or lie about their ability to pay. The OIG works closely with the FDIC in pursuing criminal investigations of these individuals.

## **Concluding Remarks**

Unprecedented events and turmoil in the economy and financial services industry have impacted our operations. Given our resource limitations, I continue to review and reevaluate our risk-based decisions to provide the most appropriate coverage of FDIC programs and operations while maintaining our statutory responsibilities. Over the last 9 months, my office has stretched and leveraged its resources and has employed creative ways (i.e., reassigning staff, awarding contracts, refining auditing techniques, etc.) to accomplish its current workload. Based on the number of problem banks, we anticipate the number of required MLRs, based on current thresholds, will continue to grow. Depending on the level of this growth, my office may not be able to keep up. Considering our other statutory responsibilities and the high-risk activities I have detailed above, we are challenged to provide sufficient oversight. This level of exposure provides reason for concern, and without relief from the statutory MLR thresholds, the level of oversight could be further diminished.

Thank you again for allowing me to testify today. I appreciate the Subcommittee's interest in our work and look forward to continue to effectively and efficiently conduct work on behalf of the Congress, the FDIC, and the American public. This concludes my testimony. I welcome the opportunity to answer any questions that you might have.