

Office of Inspector General



# SEMIANNUAL REPORT TO THE CONGRESS

October 1, 2012 - March 31, 2013

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 7,480 individuals carry out the FDIC mission throughout the country. According to most current FDIC data, the FDIC insured \$7.406 trillion in deposits in 7,083 institutions, of which the FDIC supervised 4,460. As a result of institution failures during the financial crisis, the balance of the Deposit Insurance Fund turned negative during the third quarter of 2009 and hit a low of negative \$20.9 billion by the end of that year. The FDIC subsequently adopted a Restoration Plan, and with various assessments imposed over the past few years, the Deposit Insurance Fund balance steadily increased to a positive \$33 billion as of December 31, 2012. Receiverships under FDIC control as of December 31, 2012 totaled 466, with about \$17 billion in assets.

**FDIC**



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## *Inspector General's Statement*



The Federal Deposit Insurance Corporation (FDIC) and the economy continue to make gradual but steady progress in recovering from the unprecedented financial crisis and the severe recession that followed. The FDIC is currently focusing on the Chairman's priorities of implementing the FDIC's systemic resolution responsibilities under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act); following up on the FDIC's community banking initiatives; and continuing economic inclusion efforts.

Of note for the Office of Inspector General (OIG), during the reporting period, we completed a series of assignments in response to Public Law 112-88, also known as H.R. 2056, requiring that we conduct a comprehensive study on the impact of the failure of insured depository institutions and submit a report, along with recommendations, to the Congress. We issued our report on January 3, 2013, and I testified before the House Financial Services Committee, Subcommittee on Financial Institutions and Consumer Credit, in March 2013 to convey our results. With that work behind us, we have been able to turn attention to other audit and evaluation priorities. These include, for example, examining the operations of the FDIC's Office of Complex Financial Institutions as it addresses the supervisory, insurance, and resolution risks presented to the FDIC by the largest and most complex financial institutions, in keeping with the Dodd-Frank Act. We are also currently examining the FDIC's actions to address consumer protection violations and deficiencies and plan to examine the coordination between the prudential regulators and the Consumer Financial Protection Bureau as they carry out their respective responsibilities. We also intend to review the controls in the internal operations of the FDIC

and its governance activities, including those related to information security practices to help ensure corporate readiness to efficiently and effectively conduct business activities and address emerging risks.

Our criminal investigations of fraud impacting the FDIC and its operations continue to achieve results, with 46 indictments, 66 convictions, and potential monetary benefits of nearly \$172 million during the reporting period. Our caseload includes a number of investigations involving senior bank officials who were trusted insiders in their institutions but who misused their positions. They engaged in fraudulent activities that undermined the integrity of the financial services industry and, in some cases, contributed to the failures of their institutions. We are coordinating closely with the FDIC Legal Division and the Division of Risk Management Supervision on information related to open and closed bank matters that may be of assistance in the Corporation's pursuit of enforcement actions against financial institution-affiliated parties and to receive information from the Legal Division that may be helpful to related OIG investigative efforts. Our goals are compatible—we want to prevent individuals responsible for bank failures and losses to the insurance fund from further involvement in the industry and ensure that they are subject to the criminal sanctions they deserve.

In closing, I would note that at the end of January 2013, I completed my service as Interim Inspector General at the U.S. Securities and Exchange Commission—a position I held at the request of the Chair of the Council of the Inspectors General on Integrity and Efficiency during a period when the Commission was seeking to name a permanent Inspector General. I thank the FDIC Chairman

and the OIG staff for supporting me in that role.

The FDIC faces many challenges ahead. My office is committed to carrying out the OIG's independent oversight mission at the FDIC—in the interest of ensuring the Corporation's success in meeting those challenges.

Jon T. Rymer  
Inspector General  
April 2013

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## Abbreviations and Acronyms

ADC	acquisition, development, and construction
CD	certificate of deposit
CIGFO	Council of Inspectors General on Financial Oversight
CIGIE	Council of the Inspectors General on Integrity and Efficiency
DHS	Department of Homeland Security
DIF	Deposit Insurance Fund
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
DOE	Department of Energy
DOI	Department of the Interior
DRR	Division of Resolutions and Receiverships
ECU	Electronic Crimes Unit
FBI	Federal Bureau of Investigation
FDI Act	Federal Deposit Insurance Act
FDIC	Federal Deposit Insurance Corporation
FISMA	Federal Information Security Management Act of 2002
FOIA	Freedom of Information Act
FRB	Board of Governors of the Federal Reserve System
FSOC	Financial Stability Oversight Council
FY	Fiscal Year
GAO	U.S. Government Accountability Office
GFRS	Governmentwide Financial Report System
GPRA	Government Performance and Results Act of 1993
IG	Inspector General
IRS-CI	Internal Revenue Service, Criminal Investigation Division
IT	Information Technology
OCC	Office of the Comptroller of the Currency
OCFI	Office of Complex Financial Institutions
OIG	Office of Inspector General
OMB	Office of Management and Budget
OTS	Office of Thrift Supervision
RMS	Division of Risk Management Supervision
SAR	Suspicious Activity Report
SIGTARP	Special Inspector General for the Troubled Asset Relief Program
SLA	Shared-Loss Agreement

## 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. As noted in our last semiannual report, the majority of our audit and evaluation resources during the reporting period were devoted to ongoing assignments conducted pursuant to Public Law 112-88, or H.R. 2056, requiring that we conduct a comprehensive study on the impact of the failure of insured depository institutions. Having completed that work and issuing our report on January 3, 2013, we initiated a number of new audits and evaluations during the current reporting period and many of these are in the early stages. A summary of our completed work, along with references to selected ongoing assignments, is presented below.

### **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. During the reporting period, we completed two reports involving supervision issues. One of those, in large part, was in response to H.R. 2056, where we addressed aspects of FDIC examiners' review of an institution's lending and loan review functions, capital adequacy, allowance for loan and lease loss estimates, appraisal programs, loan workouts, and the supervisory enforcement actions that examiners pursue to address identified deficiencies. The other report involved acquisition, development, and construction lending, believed to be a contributing factor to institution failures, when not accompanied by a proper control environment. We also completed 13 failure reviews of institutions whose failures caused losses to the Deposit Insurance Fund of less than the threshold of \$150 million if

failing after January 1, 2012 and determined whether unusual circumstances existed that would warrant an in-depth review in those cases.

Ongoing audit and evaluation work in this goal area at the end of the reporting period included an audit of the FDIC's response to Bank Secrecy Act/anti-money laundering concerns identified at FDIC-supervised institutions and an evaluation of the financial regulatory agencies' programs for pursuing enforcement actions and professional liability claims that we will conduct jointly with other financial regulatory OIGs.

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 also successfully combated a number of mortgage fraud schemes. Our efforts in support of bank fraud, mortgage fraud, and other financial services working groups also supported this goal. Particularly noteworthy results from our casework include the pleas and sentencing of a number of former senior bank officials and bank customers involved in fraudulent activities that undermined the institutions and, in some cases, contributed to the institutions' failure. For example, a former officer of New Frontier Bank pleaded guilty to making false bank entries, misapplication of bank funds, bank fraud, and money laundering.

Also of note during the reporting period were several successful mortgage fraud cases. In one case, the lead figure, a former bank employee, was sentenced to 97 months in prison and ordered to pay \$11.6 million in restitution. Yet another scheme involved multiple attorneys, loan officers from a mortgage brokerage firm, a real estate title closer, and numerous strawbuyers, many of whom are now serving prison terms and required to pay restitution.

The Office of Investigations also continued its close coordination and outreach with the Division of Risk Management Supervision (RMS), the Division of Resolutions and Receiverships, and the Legal Division by way of attending quarterly meetings, regional

training forums, and regularly scheduled meetings with RMS and the Legal Division to review Suspicious Activity Reports and identify cases of mutual interest. We have strengthened our process for regular coordination of enforcement action matters with the Legal Division and RMS, a step that has proven to be mutually beneficial. (See pages 12-25.)

**Strategic Goal 2 – Insurance: Help the FDIC Maintain the Viability of the Insurance Fund**

We did not conduct specific assignments to address this goal area during the reporting period. However, our audit and evaluation work in support of goal 1 fully supports this goal, as does the investigative work highlighted above. In both cases, our work can serve to prevent future losses to the insurance 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 and losses to the Deposit Insurance Fund. (See pages 26-27.)

**Strategic Goal 3 – Consumer Protection: Assist the FDIC to Protect Consumer Rights and Ensure Customer Data Security and Privacy**

We did not devote audit or evaluation resources to specific consumer protection matters during the past 6-month period because for the most part, we continued to devote those resources to completing H.R. 2056 work and covering FDIC activities in the resolution and receivership realms. As of the end of the reporting period, however, we had planned for two assignments in this area. First we are examining the FDIC's actions to address consumer protection violations and deficiencies. Additionally, we are coordinating with OIG counterparts in planning an assignment to examine the progress that the prudential regulators and the Consumer Financial Protection Bureau have made in establishing coordination for the many consumer protection responsibilities that the various parties carry out.

Our Office of Investigations also supports

consumer protection through its work. For example, during the reporting period, as a result of an investigation, an individual posing as an FDIC "broker" was sentenced to 144 months in prison and ordered to pay nearly \$6 million in restitution to his victims for his role in a Ponzi fraud scheme through which he marketed and sold fictitious FDIC-insured certificates of deposit to unsuspecting senior citizen investors.

Also of note, our Electronic Crimes Unit responded to instances where fraudulent emails purportedly affiliated with the FDIC were used to entice consumers to divulge personal information and/or make monetary payments. Working with the Corporation's Division of Information Technology, our investigators seek to protect consumers by dismantling such schemes. In further support of consumer protection, the OIG also continued to respond to a number of inquiries from the public, received both through our Hotline and through other channels. We addressed about 150 such inquiries during the past 6-month period. (See pages 28-30.)

**Strategic Goal 4 – Receivership Management: Help Ensure that the FDIC Efficiently and Effectively Resolves Failing Banks and Manages Receiverships**

We completed one assignment in this goal area during the reporting period. That is, we conducted an audit of the Division of Resolutions and Receiverships' controls for managing, marketing, and disposing of owned real estate and made recommendations to enhance control activities for these processes. Given the Corporation's responsibilities for billions of dollars in owned real estate, strong controls are vital to successful management and disposition activities.

H.R. 2056 work covering this goal area included an assessment of multiple aspects of the FDIC's use of shared-loss agreements from the borrowers' and institutions' perspectives, including the impact on the rate of loan modifications and adjustments, the impact of the availability of credit, and the policies and procedures for terminating the agreements. Other matters reviewed as part of H.R. 2056 related to private investment in insured

depository institutions and the policies and procedures governing such activity. (Results in these areas are discussed in goal 1, Supervision.)

We would also note that in connection with the FDIC's new resolution authority for systemically important financial institutions, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) requires that the FDIC OIG conduct, supervise, and coordinate audits and investigations of the liquidation of any covered financial company by the Corporation as receiver under Title II of the Act. We are taking steps to ensure we are prepared for such an eventuality.

From an investigative standpoint, our Electronic Crimes Unit continued to support investigative activities related to bank closings by providing computer forensic support in ongoing fraud investigations. (See pages 31-34.)

**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, during the reporting period, we issued the results of a billing review of Lockheed Martin in which we identified \$740,784 in questioned costs and made additional recommendations to strengthen contract administration and oversight management controls and practices. We completed our 2012 work in response to the Federal Information Security Management Act and made 14 recommendations to improve the effectiveness of the FDIC's information security program controls. In connection with the Dodd-Frank Act, we issued the results of a fifth coordinated review of the status of the implementation activities of the Joint Implementation Plan prepared by the Board of Governors of the Federal Reserve System, the FDIC, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision. With respect to the governmentwide financial reporting system, we verified that the FDIC's summary general ledger information agreed with summary

information entered into the reporting system for the fiscal year (FY) ended September 30, 2012.

At the end of the reporting period, we were undertaking work in the areas of information technology project management, controls for safeguarding sensitive information submitted under the Dodd-Frank Act, and our 2013 audit of the FDIC's information security management.

We promoted integrity in FDIC internal operations through ongoing OIG Hotline and other referrals and coordination with the FDIC's divisions and offices, including corporate ethics officials, as warranted. (See pages 35-39.)

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

To ensure effective and efficient management of OIG resources, we continued to focus on a number of initiatives to monitor and track OIG spending, particularly costs involved in travel and procurements, and to explore options for a better system to capture data on our investigative cases. We also provided our FY 2014 budget request to the Congress and for subsequent inclusion in the President's budget. This budget reflects \$34.6 million to support 130 full-time equivalents, no increase from our FY 2013 request.

We continued internal quality assurance efforts, including issuing our quality monitoring and analysis summary of the OIG's audit organization for 2012. We oversaw contracts with qualified firms to provide audit and evaluation services to the OIG to supplement our efforts and provide additional subject-matter expertise. We continued use of the Inspector General feedback form for audits and evaluations that focuses on overall assignment quality elements, including time, cost, and value.

We encouraged individual growth through professional development by supporting individuals in our office pursuing certified public accounting and other professional

certifications. Our mentoring program is well underway and seeks to further develop a strong cadre of OIG resources. We also employed interns on a part-time basis to promote their development and assist us in our work. We supported OIG staff members attending graduate schools of banking to further their expertise and knowledge of the complex issues in the banking industry and supported staff taking FDIC leadership training courses.

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; coordination with financial regulatory OIGs, other members of the Inspector General community, other law enforcement officials, and the U.S. Government Accountability Office (GAO). The Inspector General served in key leadership roles as the Chair of the Council of the Inspectors General on Integrity and Efficiency Audit Committee; Vice Chair of the Council of Inspectors General on Financial Oversight, as established by the Dodd-Frank Act; and as a Member of the Comptroller General's Advisory Council on Government Auditing Standards. Senior OIG executives were speakers at a number of professional organization and government forums, for example those sponsored by the Federal Financial Institutions Examination Council, Department of Justice, American Conference Institute, Federal Audit Executive Council, and international organizations sponsored by the State Department. The OIG participated in corporate diversity events and on the Chairman's Diversity Advisory Council. We continued to use our public inquiry intake system to handle communications with the public and maintained and updated the OIG Web site to respond to the public and provide easily accessible information to stakeholders interested in our office and the results of our work.

In the area of risk management, in connection with SAS 99 and the annual audit of the FDIC's financial statements, we provided comments on the risk of fraud at the FDIC to GAO. We provided the OIG's annual assurance

statement to the FDIC Chairman regarding our efforts to meet internal control requirements. We also attended meetings of the Enterprise Risk Committee and other corporate committees to further monitor risks at the Corporation and tailor OIG work accordingly. We shared OIG perspectives with senior FDIC leadership and with the FDIC's Chief Risk Officer, who is charged with assisting the FDIC Board and senior management in identifying risks facing the Corporation and in setting the Corporation's risk management objectives and direction. In keeping with the Reports Consolidation Act of 2000, we monitored areas that we identified as management and performance challenges facing the Corporation for inclusion in its annual report. (See pages 40-46.)

## Significant Outcomes

(October 2012–March 2013)

Audit and Evaluation Reports Issued	7
Questioned Costs	\$740,784
Nonmonetary Recommendations	27
Investigations Opened	43
Investigations Closed	38
OIG Subpoenas Issued	4
<b>Judicial Actions</b>	
Indictments/Informations	46
Convictions	66
Arrests	28
<b>OIG Investigations Resulted in:</b>	
Fines of	\$45,000
Restitution of	\$145,302,654
Asset Forfeitures of	\$26,562,679
<b>Total</b>	<b>\$171,910,333</b>
Cases Referred to the Department of Justice (U.S. Attorneys)	38
Cases Referred to FDIC Management	0
Proposed Regulations and Legislation Reviewed	11
Proposed FDIC Policies Reviewed	8
Responses to Requests Under the Freedom of Information Act (FOIA) or Privacy Act (including one FOIA appeal)	11

## 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 4,460 FDIC-insured, state-chartered institutions that are not members of the Board of Governors of the Federal Reserve System (FRB)—generally referred to as "state non-member" institutions. Historically, the Department of the Treasury [the Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS)] or the FRB has supervised other banks and thrifts, depending on the institution's charter. The winding down of the OTS under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) resulted in the transfer of supervisory responsibility for about 60 state-chartered savings associations to the FDIC, and these institutions are considered small and have been absorbed into the FDIC's existing supervisory program. About 670 federally chartered savings associations were transferred to the OCC. As insurer, the Corporation also has back-up examination authority to protect the interests of the Deposit Insurance Fund (DIF) for 2,623 national banks, state-chartered banks that are members of the FRB, and those savings associations now regulated by the OCC.

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, 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 Bank Secrecy Act examination.

The passage of the Dodd-Frank Act brought about significant organizational changes to the FDIC's supervision program. That is, the FDIC Board of Directors approved the establishment of an Office of Complex Financial Institutions (OCFI) and a Division of Depositor and Consumer Protection, and the Division of Supervision and Consumer Protection became the Division of Risk Management Supervision (RMS). OCFI is focusing on overseeing bank holding companies with more than \$100 billion in assets and their corresponding insured depository institutions. OCFI is also responsible for non-bank financial companies designated as systemically important by the Financial Stability Oversight Council, of which the FDIC is a voting member. OCFI and RMS coordinate closely on all supervisory activities for insured state non-member institutions that exceed \$100 billion in assets, and RMS is responsible for the overall Large Insured Depository Institution program.

Prior to passage of the Dodd-Frank Act, in the event of an insured depository institution failure, the Federal Deposit Insurance (FDI) Act required the cognizant OIG to perform a review when the DIF incurs a material loss. Under the FDI Act, a loss was considered material to the insurance fund if it exceeded \$25 million and 2 percent of the failed institution's total assets. With the passage of the Dodd-Frank Act, the loss threshold was increased to \$200 million through December 31, 2011, \$150 million for losses that occur for

the period January 1, 2012 through December 31, 2013, and \$50 million thereafter. 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 FRB perform reviews when their agencies are the primary regulators. These reviews identify what caused the material loss and evaluate the supervision of the federal regulatory agency (including compliance with the Prompt Corrective Action requirements of the FDI Act), and generally propose recommendations to prevent future failures. Importantly, under the Dodd-Frank Act, the OIG is now required to review all losses incurred by the DIF under the thresholds to determine (a) the grounds identified by the state or federal banking agency for appointing the Corporation as receiver and (b) whether any unusual circumstances exist that might warrant an in-depth review of the loss. Although the number of failures continues to decline, the OIG will conduct and report on material loss reviews and in-depth reviews of failed FDIC-supervised institutions, as warranted, and continues to review all failures of FDIC-supervised institutions for any unusual circumstances.

The number of institutions on the FDIC's "Problem List" as of December 31, 2012 was 651, indicating a possibility of more failures to come and an additional asset disposition workload. Total assets of problem institutions were \$233 billion. Importantly, however, the number of institutions on the Problem List and corresponding assets continues to trend downward.

While the OIG's audits and evaluations 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 works closely with FDIC management in RMS and the Legal Division to identify and investigate financial institution crime, especially various types of bank 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 historically constitute about 90 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, when possible, the OIG engages in industry and other professional outreach efforts to keep financial institutions and others informed on fraud-related issues and to educate them 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 **2013 performance goals** are as follows:

- Help ensure the effectiveness and efficiency of the FDIC's supervision program.
- Investigate and assist in prosecuting Bank Secrecy Act violations, money laundering,



terrorist financing, fraud, and other financial crimes in FDIC-insured institutions.

## OIG Work in Support of Goal 1

The OIG issued two reports during the reporting period in support of our strategic goal of helping to ensure the safety and soundness of the nation's banks. The first report, our comprehensive report in response to H.R. 2056, takes a close look at a number of supervisory or examination practices affecting insured depository institutions, among other things. A second report we issued examines acquisition, development, and construction loan concentrations—oftentimes a major contributing cause of institution failures—to identify factors that may have helped certain banks mitigate the risks historically associated with these types of concentrations during periods of economic stress.

From an investigative perspective, in support of ensuring the safety and soundness of the nation's banks, we have pursued cases involving fraud in both open and closed institutions. Results of such selected cases are described below. As in the past, we also discuss a number of our mortgage-fraud related investigations. Importantly, our results would not be possible without the collaboration and assistance of our colleagues at the FDIC and our law enforcement partners throughout the country.

### Comprehensive Study on the Impact of the Failure of Insured Depository Institutions

As we discussed in our last semiannual report, our most recent priority has been work conducted in connection with Public Law 112-88, or H.R. 2056. On January 3, 2012, President Obama signed H.R. 2056, as amended. This legislation required that the FDIC Inspector General conduct a comprehensive study on the impact of the failure of insured depository institutions and submit a report to the Congress not later than 1 year after the date of enactment. The report was to contain the results of the study and any recommendations. The legislation further

required that the FDIC Inspector General and the Comptroller General appear before the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives after publication of the study to discuss the results. The scope of the study, as defined in the legislation, was to include institutions regulated by the FDIC, FRB, and OCC.

In response to the legislation, our office initiated a series of assignments to address the issues outlined in H.R. 2056. In doing so, we addressed over 30 topics that fell under one of the following eight matters:

- Shared-loss agreements (SLA),
- Significance of losses at institutions that failed,
- Examiner implementation of appraisal guidelines,
- Examiner assessment of capital adequacy and private capital investment in failing institutions,
- Examiner implementation of loan workout guidance,
- Application and impact of formal enforcement orders,
- Impact of FDIC policies on investments in institutions, and
- The FDIC's handling of private equity company investments in institutions.

We issued a 200+ page report in January 2013, and the Inspector General subsequently testified, as called for in the law, before the House Financial Services Committee, Subcommittee on Financial Institutions and Consumer Credit, on March 20, 2013.

By way of context for the observations and recommendations that we made, our report noted that the financial crisis had devastating impacts on the banking industry, businesses, communities, and consumers. At the time of our review, over 400 institutions had failed and several of the country's largest institutions had required government intervention to remain solvent. Commercial real estate collateral values had fallen by

more than 42 percent. Construction starts remained partially complete and continued to detract from the quality of neighborhoods and home values. Trillions of dollars of household wealth had vanished, and almost 18 million loans had faced foreclosure since 2007. Unemployment peaked at 10 percent in October 2009 and remained stubbornly high at the time of our study.

We reported that events leading to the financial crisis and subsequent efforts to resolve it involved the dynamic interplay of laws passed by the Congress, regulatory rules, agency-specific policies and practices, and the real estate and financial markets in ways that are continuing to play out. In that regard, our study indicated the following:

- The markets drove behaviors that were not always prudent. Banks expanded lending to keep pace with rapid growth in construction and real estate development, rising mortgage demands, and increased competition. Many of the banks that failed did so because management relaxed underwriting standards and did not implement adequate oversight and controls. For their part, many borrowers who engaged in commercial or residential lending arrangements did not always have the capacity to repay loans and pursued many construction projects without properly considering the risks involved. Ultimately, these loans created significant losses for the institutions involved and often left the FDIC with the challenge of managing and disposing of troubled assets.
- In response to unprecedented circumstances, the regulators generally fulfilled their supervisory and resolution responsibilities as defined by statutes, regulations, accounting standards, and interagency guidance in place at the time. In addition, the regulators reacted to a rapidly changing economic and financial landscape by establishing and revising supervisory policies and procedures to address key risks facing the industry. While not a focus of this study, our report does acknowledge, however, material loss review findings that showed the FRB, OCC, and FDIC could have provided

earlier and greater supervisory attention to troubled institutions that failed. For its part, among other initiatives associated with resolutions, the FDIC reinstated the use of SLAs with acquiring institutions and took steps to promote private capital investments in failing institutions.

We provided a detailed presentation of our findings and conclusions for each of the topics under the law's eight matters. In addressing these matters, we also made the following observations:

- The FDIC's resolution methods—including the SLAs that we studied—were market-driven. Often, failing banks with little or no franchise value and poor asset quality did not attract sufficient interest from viable bidders to enable the FDIC to sell the banks without a loss-share guarantee. The FDIC used SLAs to keep failed bank assets in the banking sector, support failed bank asset values, and preserve the solvency of the DIF. The FDIC has established controls over its SLA monitoring program, which help protect the FDIC's interests, promote loan modifications, and require equal treatment of SLA and legacy loans. We did find, however, that the FDIC should place additional emphasis on monitoring commercial loan extension decisions to ensure that acquiring institutions do not inappropriately reject loan modification requests as SLAs approach termination. In addition, we concluded that the FDIC needed to formulate a better strategy for mitigating the impact of impending portfolio sales and SLA terminations on the DIF so that the FDIC will be prepared to address the potentially significant volume of asset sale requests.
- The majority of community banks failed as a result of aggressive growth, asset concentrations, poor underwriting, and deficient credit administration coupled with declining real estate values. These factors led to write-downs and charge-offs on delinquent and non-performing real estate loans as opposed to examiner-required write-downs or fair value accounting losses.
- The regulators have longstanding policies

for classifying problem assets, monitoring appraisal programs, assessing capital adequacy, evaluating commercial real estate loan workouts, and administering enforcement actions, when warranted. The regulators also have processes and controls, training programs, and job aids to help ensure examiner compliance and consistency. We found that examiners generally followed relevant policies and implemented them appropriately. For example, examiners usually did not classify as loss loans that the institution claimed were paying as agreed without justification, nor did they question or reduce the appraised values of assets securing such loans. However, examiners did not always document the procedures and steps that they performed to assess institutions' appraisal and workout programs. We also noted that the regulators had different approaches to enforcement actions, particularly related to non-problem banks.

- The FDIC has investment-related policies in place to protect the DIF and to ensure the character and fitness of potential investors. These policies are largely based in statute. By their nature, such policies are going to have an impact on investments in institutions. The FDIC approved most change-in-control and merger applications, although approval rates were lower for states such as California, Florida, and Nevada that were heavily impacted by the financial crisis. The FDIC has policies and procedures for certain aspects of the review of private capital investors, and the FDIC generally followed those policies. Purchases of failed institutions by private capital investors accounted for 10 percent of total failed bank assets acquired. Finally, we identified instances where the FDIC did not accept proposed open bank investments and instead closed an institution. However, in each case, we found that the FDIC identified concerns with the proposed investment related to safety and soundness issues, proposed management, or proposed business plans, or determined that the proposed transaction would not present the least loss option to the DIF.

While the regulators generally implemented their policies appropriately, our study identified certain areas for improvement and issues warranting management attention. In the interest of strengthening the effectiveness of certain supervisory activities and helping ensure the success of the FDIC's ongoing resolution efforts, we made seven recommendations. Five were addressed specifically to the FDIC and two were directed to the three regulators. These recommendations involved the following areas:

- **SLA Program.** We made recommendations related to developing additional controls for monitoring acquiring institutions' commercial loan modification efforts and developing a more formal strategy for mitigating the impact of impending portfolio sales and SLA terminations on the DIF.
- **Appraisals and Workouts.** We made several recommendations related to clarifying how examiners should review institutions' appraisal programs and strengthening examiner documentation requirements to more clearly define examination methodologies and procedures performed to assess institutions' appraisal and workout programs. These recommendations should help to assure agency management that examiners are consistently applying relevant guidance.
- **Enforcement Orders.** We recommended that the regulators study differences between the types of enforcement actions that are used by the regulators and the timing of such actions to determine whether there are certain approaches that have proven to be more effective in mitigating risk and correcting deficiencies that should be implemented by all three regulators.

The regulators concurred with our recommendations and proposed actions that adequately address the intent of our recommendations.

#### **Acquisition, Development, and Construction Loan Concentrations Study**

We issued the results of our study of FDIC-supervised institutions with significant

acquisition, development, and construction (ADC) loan concentrations that did not fail during the recent economic downturn. ADC loans are considered the riskiest type of commercial real estate lending. During the recent financial crisis, FDIC analysis shows that failed institutions had concentrations of ADC loans to total assets that were roughly three times the average of concentrations of non-failed institutions.

Our objective was to study the characteristics and supervisory approaches for FDIC-supervised institutions that had significant ADC loan concentrations in December 2007 and were not considered to be problem banks as of April 2011. In initiating this study, we were interested in identifying factors that may have helped banks mitigate the risks historically associated with ADC concentrations during periods of economic stress.

To evaluate the characteristics of the banks included in our study, we reviewed key financial ratios for the FDIC-supervised institutions meeting the criteria of our study—generally in satisfactory condition and having concentrations that regulators considered to be significant—and the 214 FDIC-supervised institutions that failed between January 2007 and April 2011. Doing so allowed us to compare and contrast the two groups. We also contacted bank officials for a sample of the institutions and discussed their strategies for managing ADC concentrations and factors, which in their view, allowed their institutions to remain fundamentally sound or to successfully overcome the risk and losses associated with the concentrations. To evaluate the FDIC's supervisory approach, we reviewed the supervisory documents, including any enforcement actions taken, for a sample of banks that we refer to as "turnaround" banks. That is, banks with significant ADC concentrations in December 2007, some level of supervisory concern between 2007 and 2010, and improved supervisory ratings as of April 2011.

We identified 436 institutions that met our criteria of having an ADC concentration of 100 percent or greater as of December 2007 and were in satisfactory condition as

of April 2011. We focused attention on a sample of 18 of those institutions that had ADC concentrations of 300 percent or more. We took this approach because, in our view, the experience of these 18 institutions was unique and allowed us to readily compare their practices to those institutions with ADC concentrations that failed. Notably, we did not identify a significant number of banks with high concentrations in 2007 that were in satisfactory condition in 2011. We believe this is reflective of how difficult it is for institutions with exceedingly high ADC concentrations to mitigate the concentration risk during an economic downturn. Perhaps not surprisingly, bankers we interviewed characterized the Board's and management's risk appetite to be conservative or moderate. These same bankers implemented many of the key elements of the risk management framework that regulators have said are needed to manage ADC concentrations. Additionally, bankers we spoke to indicated that they limited speculative lending, loan participations, and out-of-area lending. Finally, a number of bankers were quick to point out that their market areas were less impacted by the economic decline. As a result of these factors, banks in our study did not experience significant losses from their ADC portfolio and managed to maintain stable capital positions even with a steep and prolonged economic decline.

We also found that the supervisory approach and level of supervisory attention for 23 turn-around banks we sampled were generally consistent with the FDIC's supervisory practices and policies and similar to the approach for banks that ultimately failed. That is, as economic conditions declined and banks' financial condition began to weaken, the FDIC's supervisory attention increased and supervisory actions were pursued. However, we observed that the approach yielded a better outcome—stable or improved examination ratings—because turn-around banks were responsive to supervisory actions and guidance and maintained or secured capital needed to absorb losses in response to regulatory demands.

More specifically, we found that some institutions with ADC concentrations were able to weather the recent financial crisis without experiencing a corresponding decline in their overall financial condition. The factors that contributed to their survival validate the point that regulators have emphasized and reiterated for years—a well-informed and active Board, strong management, sound credit administration and underwriting practices, and adequate capital are important in managing ADC concentrations in a safe and sound manner. In addition, the banks in our study did not rely on brokered deposits to fund growth, and geographic location factored into the degree of ADC loan losses. Ultimately, the strategic decisions and disciplined, values-based practices and actions taken by the Boards and management helped to mitigate and control the institutions' overall ADC loan risk exposure and allowed them to react to a changing economic environment. Unlike many failed banks that saw their capital evaporate rapidly because of the losses associated with their ADC portfolios, the banks in our study experienced comparatively fewer losses and were able to maintain stable capital positions.

Our report notes that the FDIC has to date, and must continue to make certain, that lessons learned associated with ADC concentrations become ingrained in day-to-day supervisory activities and that placing greater emphasis on risk management practices for institutions with elevated risk profiles is sustained regardless of the health of the economy or banking industry or the political appetite for financial regulation. We did not make recommendations in this report; however, we trust that the analysis and conclusions of our study will benefit the Corporation and assist in management's continuous efforts to have an efficient and effective supervisory program that protects depositors and the DIF.

#### Failed Bank-Related Work

To a far lesser extent than during the height of the financial crisis, we continued to conduct

reviews of failed FDIC-supervised institutions. We did not conduct any material loss reviews during the reporting period—that is reviews of institutions causing material losses to the DIF, as defined by the Dodd-Frank Act. We did, however, complete 13 failed bank reviews of failed institutions with losses to the DIF of less than the threshold outlined in the Dodd-Frank Act. These reviews are listed in appendix 2. None of these reviews identified unusual circumstances warranting additional OIG work.

#### 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.

A number of our cases during the reporting period involve bank fraud, wire fraud, embezzlement, identity theft, and mortgage fraud. Many involve former senior-level officials and customers at financial institutions who exploited internal control weaknesses and whose fraudulent activities harmed the viability of the institutions and ultimately contributed to losses to the DIF. The OIG's success in all such investigations contributes to ensuring the continued safety and soundness of the nation's banks.

#### Successful Bank Fraud Cases

##### Multiple Subjects Sentenced for Bank Fraud

During the reporting period, the owner of an investment firm and a mortgage company

was sentenced to serve 78 months in prison to be followed by 5 years of supervised release for his role in a bank fraud and money laundering scheme. He was also ordered to pay restitution of \$2,612,083. Others involved in the scheme were also sentenced during the reporting period.

From approximately October 2006 through January 2008, in the course of operating the investment firm, he and others made oral and written misrepresentations to various financial institutions in order to obtain loans to fund their business operations. He and his co-conspirators created fraudulent contractor invoices, used checks from closed bank accounts, and checks that were never actually negotiated to fraudulently obtain a total of \$2.2 million for the purported purpose of rehabilitating homes for resale.

From approximately October 2005 through January 2007, in order to reduce the debt of the investment firm and qualify to purchase more property, friends and family were recruited to purchase some of the "rehabilitated" properties from the firm. These properties were intended for investment or rental purposes, but in most cases the borrower would not have qualified to purchase the properties. To ensure that the "investors" qualified to purchase the properties, the investment firm used the mortgage company as the broker to falsify loan applications and other supporting documents to obtain 51 loans totaling approximately \$6.6 million.

Others involved also received stiff penalties for their roles in the bank fraud and money laundering scheme, as follows:

- The investment firm's director of operations was sentenced to 15 months in prison to be followed by 5 years of supervised release. He was also ordered to pay restitution of \$1,380,414.
- A loan officer and former president of the mortgage company was sentenced to 24 months in prison to be followed by 2 years of supervised release.
- Another loan officer of the mortgage company was sentenced to 15 months in

prison to be followed by 1 year of supervised release.

The actions of the owner of the firm and the mortgage company, along with the actions of co-conspirators impacted multiple financial institutions, including some that eventually failed.

**Source:** FDIC Division of Resolutions and Receiverships (DRR). **Responsible Agencies:** This was a joint investigation by the FDIC OIG, the Federal Bureau of Investigation (FBI), and the Internal Revenue Service, Criminal Investigation Division (IRS-CI). This case was prosecuted by the U.S. Attorney's Office for the District of Kansas.

#### Banker Sentenced

On January 16, 2013, a former senior operations manager with Minnesota Bank, Marshall, Minnesota, was sentenced to 24 months in prison to be followed by 5 years of supervised release. She was also ordered to pay \$1,013,018 in restitution.

From 1998 until June 2012, the former banker embezzled more than \$1 million from the institution by taking funds from customers' certificates of deposit. She created fictitious certificates of deposit documents, 1099-INT statements, and account summary statements to conceal her actions. In her plea agreement, she admitted that she embezzled the money for her personal use, primarily to pay off shopping debts. The bank ultimately repaid the customers who had been victimized by the scheme by paying out more than \$1 million.

**Responsible Agencies:** The FDIC OIG conducted the investigation with assistance from the FBI and the Marshall Police Department. The case is being prosecuted by the U.S. Attorney's Office for the District of Minnesota.

#### Former Bank Officer and Customer Sentenced in Bank Bribery Case

Two men were sentenced for their roles related to bribing a bank officer in order to obtain a bank loan. One of the individuals—a banker at ANB Financial, N.A., Fayetteville, Arkansas, was sentenced to 24 months in prison, 3 years of supervised release, and ordered to pay a \$10,000 fine. The second individual, a businessman, was sentenced to 14 months in prison, 3 years of supervised release, and fined \$10,000.

According to documents filed in the case, the businessman—a manager of a sports management firm—conspired with the officer of ANB Financial, N.A., to pay the ANB bank official \$60,000 in order to obtain approval of a \$6,200,000 loan in order to develop eight acres of land. Additionally, the bank officer misapplied \$82,500 out of the loan proceeds of the sports management firm to an aviation company for the rental of a private jet aircraft. The \$60,000 bribe was paid in Las Vegas, Nevada, after the bank officer and businessman traveled there on the chartered plane.

The events related to the bribery transpired during 2007, and ANB later failed on May 9, 2008.

On July 31, 2012, the bank officer pleaded guilty to one count of misapplication of bank funds and one count of conspiracy to solicit funds with the intent to influence a business transaction with a financial institution. On that same day, the businessman pleaded guilty to one count of conspiracy to pay a bribe to a bank officer in order to influence a business transaction with a financial institution.

*Source: Request for assistance from the United States Attorney's Office for the Western District of Arkansas and referral from DRR. Responsible Agencies: The FDIC OIG conducted the investigation with assistance from the FBI. The case was prosecuted by the U.S. Attorney's Office, Western District of Arkansas.*

### Former Officer of New Frontier Bank Pleads Guilty

A former officer of the now defunct New Frontier Bank pleaded guilty in February 2013 to making false bank entries, misapplication of bank funds, bank fraud, and money laundering. New Frontier Bank was closed on April 10, 2009, by the Colorado Division of Banks, and the FDIC was appointed receiver.

While employed at New Frontier Bank, the former officer made a false entry in connection with the collateral for a \$5,583,500 loan to two individuals. He failed to disclose that a certificate of deposit valued at \$106,759 that the two individuals had pledged as collateral, in fact belonged to another individual. He also did not disclose that he would benefit

personally from the loan. The former officer misapplied approximately \$662,045 of bank funds. In 2008, he devised and participated in a bank fraud scheme to raise capital by making loans totaling \$20,145,979 to eight bank customers in order for them to use \$4,310,215 of the loan proceeds to purchase shares of bank stock; however, he failed to disclose how the loan proceeds would be used and did not disclose the deteriorating condition of the bank to its customers. The former officer also deposited \$160,000 into his own account at the bank.

Each of the counts against the former officer carries a penalty of not more than 30 years in federal prison and a fine of up to \$1,000,000. He also faces one count of money laundering. If convicted of money laundering he faces not more than 20 years in federal prison and a fine of up to \$500,000, or twice the value of the property involved in the transaction, whichever is greater.

*Responsible Agencies: This is a joint investigation with the FDIC OIG, FBI, and IRS-CI. The case is being prosecuted by the U.S. Attorney's Office for the District of Colorado.*

### Business Owner Sentenced for Commercial Loan Fraud

On March 14, 2013, the owner of an agricultural business was sentenced to serve 14 months in prison to be followed by 60 months of supervised release and was ordered to pay restitution of \$9,861,986 for his role in a commercial loan fraud scheme. The restitution allocation is \$7,889,589 to Peoples Bank & Trust Co., Troy, Missouri, and \$1,972,397 to the FDIC as receiver for Corn Belt Bank and Trust Company, Pittsfield, Illinois. Corn Belt Bank was closed on February 13, 2009; Peoples Bank & Trust Co. is regulated by the FRB.

In May 2008, the business owner knowingly submitted false information regarding his company's accounts receivable in order to obtain financing from Peoples Bank & Trust Co. for a \$10 million line of credit of which Corn Belt Bank purchased a 20-percent participation. Peoples Bank & Trust Co. had the business owner execute a security agreement pledging his company's accounts receivable

as collateral for the loan. He reported that the accounts receivable totaled in excess of \$10.5 million when, in fact, he knew that the report included speculative and unearned business for which no receivable was due to his business. The business owner defaulted on the loan in September 2008. In January 2009, he informed the banks that only approximately \$100,000 of his company's accounts receivable was collectible.

*Source: Referral from the FDIC DRR. Responsible Agencies: This investigation was conducted by the FDIC OIG and the FBI. The investigation was prosecuted by the U.S. Attorney's Office for the Eastern District of Missouri.*

### Hampton Roads Businessman Sentenced to 168 Months for Elaborate Bank and Tax Fraud Involving the Bank of the Commonwealth

A Hampton Roads businessman was sentenced to 168 months in prison and 3 years of supervised release for carrying out elaborate and sophisticated fraud schemes that contributed to the failure of the Bank of the Commonwealth and defrauded investors and the government of millions of dollars. The businessman was also ordered to pay restitution of \$32,020,067 jointly and severally with his co-defendant—a business partner, whose actions are also discussed below. He had pleaded guilty on July 12, 2012 to conspiracy to commit wire fraud and conspiracy to commit bank fraud.

According to court records, from January 2008 through August 2011, he and his business partner performed favors for insiders at the Bank of the Commonwealth in exchange for preferential lending treatment and assisted insiders in concealing the extent of the bank's non-performing assets by purchasing bank-owned property.

At the time the bank failed on September 23, 2011, he and his business partner were the bank's largest lending relationship—together, the partners guaranteed approximately \$41 million in loans. Almost all of these loans were on an interest-only basis, and the two men were regularly permitted to overdraw their accounts. According to court

records, the businessman obtained loans simply by sending an e-mail to a bank insider asking for money to purchase a Hummer or beach-front property.

Court records indicate that in November 2008, the bank sent an application to the Federal Reserve requesting approximately \$28 million from the Troubled Asset Relief Program (TARP). Based on concerns about the health of the bank, the Federal Reserve later requested that the bank withdraw its TARP application, which the bank did.

In July 2010, the bank entered into an agreement with the Federal Reserve and other regulators that specifically prohibited the bank from extending, renewing, or restructuring any loans to specific troubled borrowers, which included the businessman and his business partner.

In addition to the fraudulent conduct involving the Bank of the Commonwealth, the businessman was sentenced for a separate scheme aimed at illegally profiting from historic rehabilitation tax credits. In this scheme, he and his business partner systematically falsified invoices for large construction projects and used them to apply for federal and state historic tax credits. They had no personal use for the tax credits, but they instead sold them to investors in need of reducing their own tax liability.

In total, corporate investors paid the two businessmen approximately \$8.7 million for illegitimate tax credits. As a result, the federal government suffered a loss of approximately \$6.2 million and the Commonwealth of Virginia suffered a loss of approximately \$6.3 million.

The businessman's partner pleaded guilty for his role in these fraud schemes on April 12, 2012, and was sentenced on September 26, 2012, to 138 months in prison.

*Source: This investigation was initiated based on a request for assistance from the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) and the FBI. Responsible Agencies: This is a joint investigation with the FDIC OIG, FBI, IRS-CI, and SIGTARP. The case is being prosecuted by the U.S. Attorney's Office for the Eastern District of Virginia.*

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### North Carolina Developer Pleads Guilty in Real Estate Investment Fraud Scheme

On March 18, 2013, a North Carolina developer pleaded guilty to conspiracy to commit bank and wire fraud. A number of his co-conspirators previously pleaded guilty and are awaiting sentencing.

The developer and others conspired to make false statements on various HUD-1 statements and residential real estate appraisal reports associated with properties purchased or sold by him, his company, or other affiliated investors or entities. The developer operated various real estate companies. Through these companies, he solicited investors and promised them financial gain through the purchase, renovation, and resale of distressed residential real estate primarily located in low-income neighborhoods. He was able to carry out his real estate investment fraud with the assistance of a licensed real estate appraiser and two employees of one of his companies, one of whom was a closing attorney. He and his co-conspirators falsified and manipulated data to ensure that the real estate mortgage loans were approved and funded by lenders. By generating false appraisal documents, the co-conspirators were able to receive over \$7 million in loan proceeds in connection with the purchase and sale of the properties. The scheme resulted in lenders issuing loans that ultimately defaulted.

During the course of the alleged scheme, as stated in the indictment, the developer lived lavishly, residing in a multi-million-dollar mansion, driving expensive vehicles including a Bentley, traveling extensively, and paying himself large sums of money. He is alleged to have abruptly left North Carolina for Florida in 2004, where he continued to market his services under new company names.

Based upon the developer's statements and representations to investors, various individuals collectively invested approximately \$10 million with him and his companies. Additionally, banks and lenders disbursed approximately \$20 million in loans, leaving investors holding millions in debt. The

indictment alleged that his scheme left various neighborhoods in North Carolina and Virginia blighted with boarded up and dilapidated homes, many of which were ultimately demolished as uninhabitable.

**Responsible Agencies:** Joint investigation by the FDIC OIG, HUD OIG, U.S. Postal Inspection Service, and FBI. The case is being prosecuted by the U.S. Attorney's Office for the Eastern District of North Carolina.

### OIG 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 often the result of our participation in a growing number of mortgage fraud task forces. Mortgage fraud has taken on new characteristics in the recent economic crisis as perpetrators seek to take advantage of an already bad situation, as illustrated in several mortgage fraud cases described below. 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. The following examples illustrate the nature of these fraudulent activities and the actions taken to stop them.

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### Sentencings in Multimillion Dollar Mortgage Fraud Case

From 2004 to 2009, the president and owner of a Long Island-based mortgage brokerage firm, along with other co-conspirators engaged in a massive mortgage fraud scheme. The co-conspirators in the scheme included attorneys, loan officers from the firm, a real estate title closer, and straw buyer recruiters. As part of the scheme, the co-conspirators arranged home sales between straw buyers who posed as home buyers, but who had no intention of living in, or paying for, the mortgaged properties, and homeowners, often people in financial distress, who were willing to sell their homes. One defendant was paid approximately \$300,000 by

the co-conspirators to act as a straw buyer to obtain at least 10 mortgages. The mortgage firm's loan officers obtained mortgage loans for the sham deals by submitting fraudulent applications to banks and lenders, and using fraudulent representations about the straw buyers' net worth, employment, income, and their plans to live in the properties. In support of the loan applications, co-conspirators created false documents, including fake W-2s and pay stubs, and provided false verifications of employment falsely claiming to employ some of the straw buyers.

The attorney co-conspirators falsified documents given to lenders in order to obtain home equity lines of credit, or second mortgages, on properties purchased through straw buyers. The attorneys also submitted false statements to the lenders about how they were distributing the loan proceeds, and made huge illicit payments, typically totaling tens of thousands of dollars or more per transaction, from the loan proceeds to members of the conspiracy, including each other. Some members of the conspiracy funneled fraud proceeds through shell corporations, which they owned and controlled, and periodically also used these shells to quickly resell or flip properties to other straw purchasers at higher prices in order to obtain new mortgages on the same property, restarting the fraudulent scheme. As a result of the fraud, scores of mortgages went into default and many of the properties went into foreclosure. The scheme involved over 100 residential mortgage loans valued at more than \$58 million.

The president and owner pleaded guilty for his role in the scheme during the previous semiannual reporting period. During the current reporting period, a number of the co-conspirators were sentenced, as follows:

- A loan officer was sentenced to serve 13 months in prison to be followed by 3 years of supervised release. In addition, he was ordered to pay restitution in the amount of \$753,834.
- Another loan officer was sentenced to serve one year in prison to be followed by 3 years

of supervised release. In addition, a money judgment in the amount of \$626,316 was entered against him pursuant to a consent order of forfeiture.

- An attorney was sentenced to 5 years of supervised release. A money judgment in the amount of \$6,554,842 was also entered against her pursuant to a preliminary order of forfeiture.
- Another attorney was sentenced to serve 3 years in prison to be followed by 2 years of supervised release and was ordered to pay restitution of \$3,802,250.
- A third attorney was sentenced to serve 2 years in prison to be followed by 3 years of supervised release. In addition, a money judgment in the amount of \$7,606,500 was entered against him pursuant to a consent order of forfeiture.
- An individual who claimed to be an attorney, but who had been disbarred previously, was sentenced to serve 46 months in prison to be followed by 5 years of supervised release; restitution will be ordered at a later date.

**Source:** This investigation was initiated based on a referral from the FBI through the Mortgage Fraud Task Force.  
**Responsible Agencies:** This is a joint investigation with the FDIC OIG, FBI, and HUD OIG. The case is being prosecuted by the U.S. Attorney's Office for the Southern District of New York.

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### Former Bank Employee and Co-Conspirators Sentenced in Mortgage Fraud Scheme

In late March 2013, four defendants were sentenced in Miami, Florida, for their roles in a mortgage fraud scheme that impacted multiple banks in Florida. The ring leader, a former bank employee, was sentenced to serve 97 months in prison to be followed by 3 years of supervised release and was ordered to pay restitution of \$11,627,564. Three other individuals were sentenced for their roles. One was sentenced to serve 13 months in prison to be followed by 3 years of supervised release and was ordered to pay restitution of \$408,689. Another was sentenced to 3 years of probation, including 6 months of electronic monitoring/home confinement, and was

ordered to pay restitution of \$250,902. The third individual, the former bank employee's father, was sentenced to 2 years of supervised release and was ordered to pay restitution of \$67,600.

The former employee of Bank of America, Great Florida Bank, and First Citizens Bank & Trust Company organized a scheme to enrich himself and his co-conspirators by acquiring loans for unqualified borrowers and/or individuals who lacked the appropriate collateral required for obtaining home equity lines of credit. He facilitated the completion of fraudulent loan applications via the use of altered or completely fictitious earning statements for borrowers, fraudulent verifications of deposit or income, and the presentation of inaccurate asset information on the uniform residential loan applications, which were submitted to the lending institutions involved. Many of the applicants did not even own the property for which they acquired the home equity lines of credit. He further enriched himself by guaranteeing

loan approvals to applicants in exchange for kickbacks that were made directly to him through one of several shell companies that were organized by either him or the co-conspirators. Several companies were established for the purpose of diverting and managing the illicitly obtained bank proceeds.

**Source:** This investigation was initiated under the Miami Mortgage Fraud Task Force Initiative. **Participating Agencies:** This joint investigation was conducted by FDIC OIG and the FBI-Miami Division. The case is being prosecuted by the U.S. Attorney's Office for the Southern District of Florida.

### 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 geographic areas: Alabama, Arizona, Arkansas, California, Colorado, District of Columbia, Florida, Georgia, Illinois, Iowa, Kansas, Kentucky, Louisiana, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Nebraska, Nevada, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, West Virginia, Wisconsin, and Puerto Rico.

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.

### Keeping Current with Criminal Activities Nationwide

The FDIC OIG participates in the following bank fraud, mortgage fraud, and other working groups and task forces throughout the country. We benefit from the perspectives, experience, and expertise of all parties involved in combating criminal activity and fraudulent schemes nationwide.

<b>OIG Headquarters</b>	National Bank Fraud Working Group--National Mortgage Fraud Working Sub-group.
<b>New York Region</b>	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; Maine Suspicious Activity Report (SAR) Review Team; Maryland Mortgage Fraud Task Force; the New England Mortgage Fraud Working Group; Philadelphia Mortgage Fraud Working Group; DC National SAR Review Team.
<b>Atlanta Region</b>	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.
<b>Kansas City Region</b>	St. Louis Mortgage Fraud Task Force; Kansas City Mortgage Fraud Task Force; Kansas City Financial Crimes Task Force; Minnesota Inspector General Council meetings; Kansas City SAR Review Team; Springfield, Missouri SAR Review Team; Nebraska SAR Review Team; Iowa Mortgage Fraud Working Group.
<b>Chicago Region</b>	Illinois Mortgage Fraud Working Group; Dayton Area Mortgage Task Force; Illinois Fraud Working Group; Indiana Bank Fraud Working Group; Central District of Illinois SAR Review Team; Northern District of Illinois SAR Review Team; Detroit SAR Review Team; Financial Investigative Team, Milwaukee, Wisconsin.
<b>San Francisco Region</b>	FBI Seattle Mortgage Fraud Task Force, Fresno Mortgage Fraud Working Group for the Eastern District of California, Sacramento Mortgage Fraud Working Group for the Eastern District of California, Sacramento SAR Working Group, Los Angeles Mortgage Fraud Working Group for the Central District of California.
<b>Dallas Region</b>	SAR Review Team for Northern District of Mississippi, SAR Review Team for Southern District of Mississippi, Oklahoma City Financial Crimes SAR 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, Austin SAR Review Working Group.
<b>Electronic Crimes Unit</b>	Washington Metro Electronic Crimes Task Force, Botnet Threat Task Force, High Technology Crime Investigation Association, Cyberfraud Working Group, Council of the Inspectors General on Integrity and Efficiency IT Subcommittee.

## 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. Such coverage was subsequently extended through December 31, 2013, and the Dodd-Frank Act made permanent the increase in the coverage limit to \$250,000. It also provided deposit insurance coverage on the entire balance of non-interest bearing transaction accounts at all insured depository institutions until December 31, 2012. A priority for the FDIC is to ensure that the DIF remains viable to protect all insured depositors. To maintain sufficient DIF balances, the FDIC collects risk-based insurance premiums from insured institutions and invests deposit insurance funds.

Since year-end 2007, the failure of FDIC-insured institutions has imposed total estimated losses of nearly \$87 billion on the DIF. The sharp increase in bank failures over the past several years caused the fund balance to become negative. The DIF balance turned negative in the third quarter of 2009 and hit a low of negative \$20.9 billion in the following quarter.

In the aftermath of the financial crisis, FDIC-insured institutions continue to make gradual but steady progress. Commercial banks and savings institutions insured by the FDIC reported aggregate net income of \$37.6 billion in the third quarter of 2012, a \$2.3 billion (6.6 percent) improvement from the \$35.2 billion in profits the industry reported in the third quarter of 2011. This was the 12th consecutive quarter that earnings had registered a year-over-year increase. Also noteworthy with respect to the viability of

the fund was the decline in the number of banks on the FDIC's "Problem List" from 813 in the fourth quarter of 2011 to 651 in the fourth quarter of 2012. The fourth quarter marked the seventh consecutive quarter that the number of problem banks had fallen. As noted earlier, total assets of "problem" institutions also declined year-over-year between 2011 and 2012 from \$319 billion to \$233 billion. Eight insured institutions failed during the fourth quarter—the smallest number of failures in a quarter since the second quarter of 2008, when there were two.

In light of such progress, the DIF balance has continued to increase. During the fourth quarter of 2012, the DIF balance increased by \$7.8 billion, from \$25.2 billion to \$33.0 billion. Over the twelve consecutive quarters since the beginning of 2010, the fund balance has increased a total of \$53.8 billion.

While the fund is considerably stronger than it has been, the FDIC must continue to monitor the emerging risks that can threaten fund solvency in the interest of continuing to provide the insurance coverage that depositors have come to rely upon.

The FDIC has also implemented the Dodd-Frank Act requirement to redefine the base used for deposit insurance assessments as average consolidated total assets minus average tangible equity rather than an assessment based on domestic deposits. The FDIC does not expect this change to materially affect the overall amount of assessment revenue that otherwise would have been collected. However, as Congress intended, the change in the assessment base will generally shift some of the overall assessment burden from community banks to the largest institutions, which rely less on domestic deposits for their funding than do smaller institutions. The result will be a sharing of the assessment burden that better reflects each group's share of industry assets. The FDIC estimated that

aggregate premiums paid by institutions with less than \$10 billion in assets would decline by approximately 30 percent, primarily due to the assessment base change.

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.

Responsibility for identifying and managing risks to the DIF lies with the FDIC's Division of Insurance and Research, RMS, Division of Resolutions and Receiverships, and OCFI. The FDIC's Office of Corporate Risk Management also plays a key role in identifying risks. To help integrate the risk management process, the FDIC established the Enterprise Risk Committee, a cross-divisional body. Also, a Risk Analysis Center monitors emerging risks and, along with Regional Risk Committees, reports to the Enterprise Risk Committee.

Over recent years, the consolidation of the banking industry 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 have included the Large Insured Depository

Institution Program, Dedicated Examiner Program, Shared National Credit Program, and off-site monitoring systems.

Importantly, with respect to the largest institutions, Title II of the Dodd-Frank Act will help address the notion of "Too Big to Fail." The largest institutions will be subjected to the same type of market discipline facing smaller institutions. Title II provides the FDIC authority to wind down systemically important bank holding companies and non-bank financial companies as a companion to the FDIC's authority to resolve insured depository institutions.

To help the FDIC maintain the viability of the DIF, the OIG's **2013 performance goal** is as follows:

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

### OIG Work in Support of Goal 2

We did not complete work specifically related to this goal area during the reporting period. We would note, however, that the OIG's work referenced in goal 1 fully supports the goal of helping the FDIC maintain the viability of the DIF. For example, each institution for which we conduct a material loss review, in-depth review, or a failed bank review by definition, causes a loss to the DIF. The OIG's failed bank 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, with restitution paid back to the FDIC when possible, and/or deterrence of fraud that can cause losses to the fund.

## 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. The following are but a sampling of Acts seeking to protect consumers:

- **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 mandates 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.

Currently and going forward, the FDIC is experiencing and implementing changes related to the Dodd-Frank Act that have direct bearing on consumer protections. The Dodd-Frank Act established the Consumer Financial Protection Bureau within the FRB and transferred to this bureau the FDIC's examination and enforcement responsibilities over most federal consumer financial laws for insured depository institutions with over \$10 billion in assets and their insured depository institution affiliates. Also during early 2011, the FDIC established a new Division of Depositor and Consumer Protection, responsible for the Corporation's compliance examination and enforcement program as well as the depositor protection and consumer and community affairs activities that support that program.

Historically, turmoil in the credit and mortgage markets has presented regulators, policymakers, and the financial services industry with serious challenges. The FDIC has been 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 has promoted expanded opportunities for the underserved banking population in the United States to enter and better understand the financial mainstream.

Economic inclusion continues to be a priority for the FDIC, and a key focus going forward will be on serving the unbanked and underbanked in our country.

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. The FDIC seeks to ensure that financial institutions protect the privacy and security of information about customers under applicable U.S. laws and regulations.

Every year fraud schemers attempt to rob consumers 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 consumers. Common schemes range from identity fraud to Internet scams such as "phishing" and "pharming."

The misuse of the FDIC's name or logo has been identified as a common scheme to defraud consumers. Such misrepresentations have led unsuspecting individuals to invest on the strength of FDIC insurance while misleading them as to the true nature of the investment products being offered. These consumers have lost millions of dollars in the schemes. 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 **2013 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. We would note, however, that we initiated two new assignments related to consumer protection. First, we are examining the FDIC's actions to address consumer protection violations and deficiencies. Additionally, we are coordinating with OIG counterparts in planning an assignment to examine the progress that the prudential regulators and the Consumer Financial Protection Bureau have made in establishing coordination for the many consumer protection responsibilities that the various parties carry out. Our investigative work involving misrepresentation of FDIC insurance or affiliation and protection of personal information supported this strategic goal area. Further, in response to an increase in the number of consumer inquiries in our public inquiry system, the OIG has referred a number of matters either to the FDIC's Consumer Response Center or to other entities offering consumer assistance on banking-related topics. These efforts are discussed below.

#### Office of Investigations Works to Prevent Misrepresentations of FDIC 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 or somehow connected to the FDIC. Such misrepresentations induce the targets of schemes to trust in the strength of FDIC insurance or the FDIC name while misleading them as to the true nature of the investments or other offerings. Abuses of this nature not only harm consumers, they can also erode public confidence in federal deposit insurance. As discussed below, during the reporting period, an individual received a harsh sentence for his role in a Ponzi scheme involving misrepresentation of FDIC affiliation that victimized senior citizens.

#### Phoenix Man Sentenced for Role in Ponzi Scheme

On November 27, 2012, an individual falsely representing himself as being affiliated with the FDIC was sentenced for his role in operating a \$6.3 million Ponzi scheme through which he posed as an “FDIC Broker” and marketed and sold fictitious FDIC-insured certificates of deposit (CDs) to senior citizen investors, many of whom lived in Arizona. He was ordered to serve 144 months in prison to be followed by 5 years of supervised release. He was also ordered to pay restitution totaling \$5,913,998 to his victims. As reported in an earlier semiannual report, he previously pleaded guilty to mail fraud and false personation of an FDIC officer or employee.

From July 2000 through June 2011, he marketed and sold fictitious brokered CDs to senior citizen investors while representing himself as an “FDIC Broker.” He solicited investors through senior newspaper advertisements and fliers, and he acted primarily under the assumed names of BankNet, Nationwide Banknet Services, Capital One Custodial Services, and WWI. No investor funds were used to purchase CDs, but funds were actually used for personal expenses and for purported “interest” and “principal” payments on fraudulent CDs sold to other victim investors. Many of the elderly or retired Arizonans who fell prey to the scheme invested substantial retirement savings.

*Source: Maricopa County Sheriff's Office, Surprise, Arizona. Responsible Agencies: This was a joint investigation with the Maricopa County Sheriff's Office. The case is being prosecuted by the U.S. Attorney's Office for the District of Arizona.*

#### Electronic Crimes Unit Responds to Email and Other Schemes

The Electronic Crimes Unit (ECU) continues to work with agency personnel and an FDIC contractor to identify and mitigate the effects of phishing attacks through emails claiming to be from the FDIC. These schemes persist and seek to elicit personally identifiable and/or financial information from their victims. The nature and origin of such schemes vary and in many cases, it is difficult to pursue the perpetrators, as they are quick to cover their cyber tracks, often continuing to originate their schemes from other Internet addresses.

#### OIG's Inquiry Intake System Responds to Public Concerns and Questions

The OIG's inquiry intake system supplements the OIG Hotline function. The Hotline continues to address allegations of fraud, waste, abuse, and possible criminal misconduct. However, over the past several years, our office has continued to receive a large number of public inquiries ranging from media inquiries to requests for additional information on failed institutions to pleas for assistance with mortgage foreclosures to questions regarding credit card companies and banking practices. These inquiries come by way of phone calls, emails, faxes, and other correspondence. The OIG makes every effort to acknowledge each inquiry and be responsive to the concerns raised. We coordinate closely with others in the Corporation through the FDIC's Public Service Provider working group and appreciate their assistance. We handle those matters within the OIG's jurisdiction and refer inquiries, as appropriate, to other FDIC offices and units or to external organizations. During the past 6-month period, we addressed approximately 150 such matters.

## Strategic Goal 4: The OIG Will Help Ensure that the FDIC Efficiently and Effectively Resolves Failing Banks and Manages Receiverships

challenges and risks to the FDIC.

Perhaps the most fundamental reform under the Dodd-Frank Act is the new resolution authority for large bank holding companies and systemically important non-bank financial companies. The FDIC has historically carried out a prompt and orderly resolution process under its receivership authority for insured banks and thrifts. The Dodd-Frank Act gave the FDIC a similar set of receivership powers to liquidate failed systemically important financial firms. As noted earlier, OCFI is the FDIC office responsible for such activity.

In addition to the future challenges associated with exercising this new resolution authority, the Corporation is currently dealing with a daunting resolution and receivership workload. According to the FDIC, as of year-end 2012, during the crisis 465 institutions failed, with total assets of \$680 billion. Estimated losses resulting from the failures total approximately \$87 billion. With 651 institutions on the FDIC's “Problem List,” more failures could occur and the FDIC's corresponding asset disposition workload would likewise increase.

Franchise marketing activities are at the heart of the FDIC's resolution and receivership work. The FDIC pursues the least costly resolution to the DIF for each failing institution. Each failing institution is subject to the FDIC's franchise marketing process, which includes valuation, marketing, bidding and bid evaluation, and sale components. The FDIC is often able to market institutions such that all deposits, not just insured deposits, are purchased by the acquiring institution, thus avoiding losses to uninsured depositors.

Of special note, through purchase and assumption agreements with acquiring institutions, the Corporation has entered into 290 SLAs involving about \$212.7 billion in assets.

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.

The FDIC's Division of Resolutions and Receiverships' (DRR) 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 earlier trends in mergers and acquisitions, banks over the past years have become more complex, and the industry has consolidated 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 dealt with in the past. The sheer volume of all failed institutions, big and small, has posed

Under these agreements, the FDIC agrees to absorb a portion of the loss—generally 80-95 percent—which may be experienced by the acquiring institution with regard to those assets, for a period of up to 10 years. In addition, the FDIC has entered into 34 structured asset sales to dispose of about \$26 billion in assets. Under these arrangements, the FDIC retains a participation interest in future net positive cash flows derived from third-party management of these assets.

Other post-closing asset management activities continue to require much FDIC attention. FDIC receiverships manage assets from failed institutions, mostly those that are not purchased by acquiring institutions through purchase and assumption agreements or involved in structured sales. The FDIC is managing 466 receiverships holding about \$17 billion in assets, mostly securities, delinquent commercial real-estate and single-family loans, and participation loans. Post-closing asset managers are responsible for managing many of these assets and rely on receivership assistance contractors to perform day-to-day asset management functions. Since these loans are often sub-performing or nonperforming, workout and asset disposition efforts are more intensive.

The FDIC increased its permanent resolution and receivership staffing and significantly increased its reliance on contractor and term employees to fulfill the critical resolution and receivership responsibilities associated with the ongoing FDIC interest in the assets of failed financial institutions. Now, as the number of financial institution failures continues to decline, the Corporation is reshaping its workforce and adjusting its budget and resources accordingly. The FDIC closed the temporary West Coast Office and the Midwest Office in January 2012 and September 2012, respectively, and plans to close the East Coast Office in 2014. In this connection, authorized staffing for DRR, in particular, has fallen from a peak of 2,460 in 2010 to 1,463 proposed for 2013, which reflects a reduction of 393 positions from 2012 and 997 positions over 3 years. As for DRR contractor funding, it too

has fallen from a peak of \$1.34 billion in 2010 to \$456.7 million proposed for 2013, a reduction of \$318.6 million from 2012 and \$884.9 million (66 percent) over 3 years. Still—the significant surge in failed-bank assets and associated contracting activities will continue to require effective and efficient contractor oversight management and technical monitoring functions.

While OIG audits and evaluations address various aspects of resolution and receivership activities, OIG investigations benefit the Corporation in other ways. For example, in the case of bank closings where fraud is suspected, our Office of Investigations may send 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 OIG investigations by obtaining, preserving, and later examining evidence from computers at the bank.

The OIG also coordinates with DRR on concealment of assets cases that may arise. 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. The Office of Investigations works with both DRR and the Legal Division in pursuing criminal investigations of these individuals.

To help ensure the FDIC efficiently and effectively resolves failing banks and manages receiverships, the OIG's **2013 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, in response to H.R. 2056, we completed varied assignments involving certain resolution and

receivership activities. For example, and as captured in our discussion of this work under goal 1, earlier, H.R. 2056 included areas of interest related to SLAs, significance of losses at failed institutions, and capital adequacy and investment in both open and closed institutions. We also completed a separate assignment involving the Corporation's controls for managing, marketing, and disposing of owned real estate, as described below. Efforts of our ECU as they relate to bank closings are described as well.

#### **DRR's Controls for Managing, Marketing, and Disposing of Owned Real Estate Assets**

As noted above, the FDIC's DRR is responsible for liquidating assets in receivership. As of December 1, 2011, the FDIC owned 1,398 Owned Real Estate (ORE) assets with a book value of approximately \$1.2 billion (5 percent of total receivership assets). From January 1, 2011 to November 30, 2011, the FDIC sold 2,259 ORE assets, with a book value over \$1.5 billion and a sales price of approximately \$620 million. During the reporting period, we issued the results of an audit to assess control activities associated with DRR's processes for managing, marketing, and disposing of ORE assets.

When a bank fails, the FDIC establishes a receivership to liquidate the assets of the failed financial institution. In most cases, these assets include ORE, such as single-family homes, condominiums, office buildings, hotels, and undeveloped land, among other types of property. The FDIC acquires ORE initially because it is on the books of the failed bank and therefore becomes an asset of the receivership. Once the receivership is established, the FDIC acquires ORE through the foreclosure process on non-performing loans. ORE may also be discovered during the term of the receivership because, for example, the ORE asset was not appropriately included on the books of the failed bank or as the result of a settlement during litigation related to the bank's failure.

To facilitate the process of liquidating ORE assets, DRR uses the services of two

nationwide ORE contractors to assist in the acquisition, management, marketing, and final disposition of all types of ORE assets. DRR also assigns one of its Resolution and Receivership Specialists (Account Officers) to monitor contractor management, marketing, and disposition efforts. The contractor maintains all original asset files and updates management and marketing information on each property. This information is available to DRR Account Officers through the contractor's Web site.

We reported that DRR has established a number of important control activities for managing, marketing, and disposing of ORE assets, and DRR has provided Account Officers adequate guidance to facilitate DRR's monitoring of contractors. Specifically, we reviewed contractor Web sites and discussed the status of the 25 active ORE assets in our sample with DRR officials and determined, among other positive features, that:

- Environmental Assessments had been conducted and documented.
- Current appraisals had been conducted and the results documented.
- Property tax information was obtained and documented on the contractor's Web site. Tax payments had been made or were being reviewed in accordance with the Asset Resolution Manual.
- Property and liability insurance coverage was properly obtained.
- Congressional inquiries and consumer complaints were being tracked and addressed.

With respect to our sample of 30 inactive assets (sold, written-off, or otherwise disposed of), we reviewed sales documentation and accounting entries and determined the following:

- Sales Cases were based on current appraisals.
- Approved Sales Cases were documented in the FDIC Automated Corporate Tracking System.
- Sales data and settlement information were

properly recorded in DRR's Communication, Capability, Challenge, and Control (4C) System.

- Sales proceeds were properly recorded in the appropriate receivership accounting records.
- Postings to the 4C System and to the receivership accounting records were made in a timely manner, generally within 15 days of settlement.

Our report suggests, however, that DRR could strengthen ORE control activities, and we made three recommendations related to monitoring budgets and costs, maintaining property inspection reports, and transferring responsibility for assets. Enhanced procedures in these areas could promote efficiencies and consistency in DRR's management, marketing, and disposition of ORE assets. Our report also includes an observation regarding weaknesses in ORE Budget Case documentation that DRR was working to address.

Management concurred with all three of the report's recommendations and described completed and planned corrective actions, which are responsive to the recommendations.

#### **Electronic Crimes Unit Supports Closed Bank Investigations**

The ECU continued to support the OIG's Office of Investigations by providing computer forensic assistance in ongoing fraud investigations. To ensure it remains well positioned to do so, the ECU upgraded its computer forensic lab. The ECU has incorporated a network and centralized storage for its electronic evidence. The network approach allows the ECU to more effectively use its forensic programs. The processing of electronic evidence can become extremely resource-intensive when processing large number of files such as those containing emails. The new network uses the available resources more efficiently. Further, the volume of electronic evidence collected by the ECU has grown exponentially over the last couple of years. Over the last 4 years, the ECU has collected and processed over 67 terabytes

of electronic evidence.

During the reporting period, the ECU participated in a search warrant of a bank president's office prior to the closing of the bank. The ECU collected electronic evidence from the president's office during the warrant and from the bank during the closing. The case involves allegations related to the Bank Secrecy Act and money laundering.

In another case, the ECU received 18 computers previously seized by the U.S. Secret Service in a joint case with the FDIC OIG. Because the Secret Service would not be able to image and analyze the computers in a timely manner, the ECU volunteered to conduct the forensic analyses of the computers.

## **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 and economically 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. These resources have been stretched during the past years of the recent crisis, and the Corporation will continue to face challenges as it returns to a steadier state of operations. New responsibilities, reorganizations, and changes in senior leadership and in the make-up of the FDIC Board have affected the FDIC workforce substantially over the past few years. Efforts to promote sound governance and effective stewardship of its core business processes and the IT systems supporting those processes, along with attention to human and physical resources, will be key to the Corporation's success in the months ahead.

As the number of financial institution failures continues to decline, the Corporation is reshaping its workforce and adjusting its budget and resources accordingly. The FDIC closed the West Coast Office and the Midwest Office in January 2012 and September 2012, respectively, and plans to close the East Coast Office in April 2014. In this connection, as noted earlier, authorized staffing for DRR, in particular, has fallen from a peak of 2,460 in 2010 to 1,463 proposed for 2013, which reflects a reduction of 393 positions from 2012 and 997 positions over 3 years. DRR contractor funding also has fallen from a peak of \$1.34 billion in 2010 to \$456.7 million proposed for 2013, a reduction of \$318.6 million from 2012 and \$884.9 million (66 percent) over 3 years. Still, the significant surge in failed-bank assets and associated contracting activities will continue to require effective and efficient contractor oversight management and technical monitoring functions.

With the number of troubled FDIC-supervised institutions also on the decline, the

FDIC has reduced authorized nonpermanent examination staff as well. Risk management staffing has declined from a peak of 2,237 in 2011 to 1,966 proposed for 2013, a reduction of 271 nonpermanent positions. The number of compliance examination staff as well has begun to decline, though not as much—from a peak of 572 in 2012 to 522 proposed for 2013, a reduction of 50 nonpermanent positions.

To fund operations, the Board of Directors approved a \$2.68 billion Corporate Operating Budget for 2013, 18.2 percent lower than the 2012 budget. In conjunction with its approval of the 2013 budget, the Board also approved an authorized 2013 staffing level of 8,026 employees, down from 8,713 previously authorized, a net reduction of 687 positions, with further reductions projected in 2014 and future years. The FDIC's operating expenses are paid from the DIF, and consistent with sound corporate governance principles, the Corporation's financial management efforts must continuously seek to be efficient and cost-conscious, particularly in a governmentwide environment that is facing severe budgetary constraints.

As conditions improve throughout the industry and the economy, the Corporation and staff are adjusting to a new work environment and workplace. The closing of the two temporary offices and the plans for closing the third can disrupt current workplace conditions. These closings can also introduce risks, as workload, responsibilities, and files are transferred and employees depart to take other positions—sometimes external to the FDIC. Fewer risk management and compliance examiners can also pose challenges to the successful accomplishment of the FDIC's examination responsibilities. Further, the continued staffing of OCFI, with hiring from both internal and external sources will continue to require attention—with respect to

on-boarding, training, and retaining staff with requisite skills for the challenging functions of that office. For all employees, in light of a transitioning workplace, the Corporation will seek to sustain its emphasis on fostering employee engagement and morale. Its new Workplace Excellence Program is a step in that direction.

From an IT perspective, amidst the heightened activity in the industry and economy, the FDIC has engaged in massive amounts of information-sharing, both internally and with external partners. This is also true with respect to sharing of highly sensitive information with other members of the Financial Services Oversight Council formed pursuant to the Dodd-Frank Act. FDIC systems contain voluminous amounts of critical data. The Corporation needs to protect against cyber-threats and ensure the integrity, availability, and appropriate confidentiality of bank data, personally identifiable information, and other sensitive information in an environment of increasingly sophisticated security threats and global connectivity. In a related vein, continued attention to ensuring the physical security of all FDIC resources is also a priority. 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.

Finally, a key component of corporate governance at the FDIC is the FDIC Board of Directors. With confirmations of the FDIC Chairman and Vice Chairman, along with appointments of others to fill Board positions over the past year, the Board is now operating at full strength. The Board will likely face challenges in leading the organization, accomplishing the Chairman's priorities, and coordinating with the other regulatory agencies on issues of mutual concern and shared responsibility. Enterprise risk management is a related aspect of governance at the FDIC. Notwithstanding a stronger economy and financial services industry, the FDIC's enterprise risk management activities need

to be attuned to emerging risks, both internal and external to the FDIC, and the Corporation as a whole needs to be ready to take necessary steps to mitigate those risks as changes occur and challenging scenarios present themselves.

To promote sound governance and effective stewardship and security of human, financial, IT, and physical resources, the OIG's **2013 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

During the reporting period, we completed four assignments in support of this goal area. We conducted a review of invoices submitted by Lockheed Martin for data management services. We completed our 2012 work in connection with the Federal Information Security Management Act. We joined the Treasury and FRB OIGs in our fifth joint review related to the transfer of OTS personnel and functions to the OCC, FRB, and FDIC, pursuant to the Dodd-Frank Act. Finally, we reported on the FDIC's data submissions through the governmentwide financial report system. These reviews are summarized below.

#### Review of Invoices Submitted by Lockheed Martin

In fulfilling its responsibilities as receiver for failed FDIC-insured financial institutions, the FDIC retains electronically stored institution information and documentation to meet its fiduciary requirements, resolve legal issues,

and provide ongoing customer service. To accommodate the enormous data conversion and storage demands associated with the large number of institution failures in recent years, the FDIC entered into a contract with Lockheed Martin Services, Inc. for data management services. The contract requires Lockheed to provide the FDIC with a standard method of maintaining failed institution data, including secure data migration, conversion, cataloging, indexing, storage, security, and retrieval.

We engaged Reed & Associates, CPAs, Inc. to audit Lockheed's invoices to determine whether charges that the FDIC paid to Lockheed were adequately supported, allowable under the terms and conditions of the contract, and reasonable. The audit covered payments made during the period November 1, 2008 through May 31, 2011. The audit also included an assessment of compliance with a provision in the contract requiring Lockheed, its employees, and its subcontractor employees to execute confidentiality agreements with the FDIC to mitigate the risk of unauthorized disclosure of sensitive information.

The FDIC procures services under the contract through task orders that may be awarded on either a firm fixed price or time and materials basis. Under firm fixed price task orders, the FDIC pays Lockheed an agreed-upon amount or service rate for satisfactory performance that covers the contractor's costs and expenses (direct and indirect) as well as any profit, fees, or markups. The FDIC awards firm fixed price task orders to procure such things as data storage and data center maintenance and system monitoring and reporting. Under time and materials task orders, the FDIC compensates Lockheed for actual productive work at the hourly rates specified in the contract; reimburses Lockheed for necessary travel and per diem expenses that do not exceed the limitations in the FDIC Contractor Travel Reimbursement Guidelines; and pays reasonable amounts for materials that Lockheed has been invoiced. The FDIC awards time and materials task orders to procure

such services as the capture and migration of data from failed institutions to Lockheed's data center and the imaging and indexing of hardcopy documents. When appropriate, Lockheed uses credit invoices to reimburse the FDIC for overcharges that are identified during the firm's internal reviews and reconciliations of labor, travel, materials, and other charges.

The contract, which became effective on November 1, 2008, has an initial 3-year base period of performance and two 2-year option periods, for a total potential period of performance of 7 years. As of May 31, 2011, the FDIC had awarded 78 task orders with a total value of \$327,872,811 under the contract. As of the same date, the FDIC had paid 8,902 invoices totaling \$158,352,966. The contract has no ceiling price.

Overall, charges paid to Lockheed that Reed reviewed were adequately supported, allowable under the terms and conditions of the contract, and reasonable. Specifically, all \$8,310,150 of the firm fixed price costs reviewed were adequately supported, consistent with the rates approved in the contract, and reasonable. Accordingly, Reed did not question any firm fixed price costs. In addition, Reed did not question any of the \$121,476 in credits that it reviewed. However, the firm did identify a total of \$740,784 in questioned costs pertaining to other categories of reviewed charges. In summary, Reed questioned:

- \$140,079 (or about 2 percent) of the \$7,020,304 in time and materials costs reviewed,
- \$123,014 in costs resulting from the misclassification of a subcontractor employee's labor category, and
- \$477,691 in unallowable indirect costs that Lockheed applied to travel expenses.

Reed also found that confidentiality agreements were not consistently executed and maintained for contractor and subcontractor employees assigned to the contract. Finally, the report included an observation pertaining to the FDIC's oversight management of the contract.

The report contains six recommendations. Three of the recommendations are aimed at recovering unallowable and unsupported questioned costs that were charged by Lockheed and paid under the contract. The remaining three recommendations are intended to enhance the FDIC's contract administration and oversight management controls and practices. Management concurred with all six of the report's recommendations and described completed and planned corrective actions to address each recommendation.

#### **FISMA**

The Federal Information Security Management Act of 2002 (FISMA) requires federal agencies, including the FDIC, to perform annual independent evaluations of their information security programs and practices and to report the evaluation results to the Office of Management and Budget (OMB). FISMA states that the independent evaluations are to be performed by the agency Inspector General (IG), or an independent external auditor as determined by the IG. The objective of this performance audit was to evaluate 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.

Key to achieving the FDIC's mission of maintaining stability and public confidence in the nation's financial system is safeguarding the sensitive information, including personally identifiable information, that the FDIC collects and manages in its role as federal deposit insurer and regulator of state non-member financial institutions. As an employer, an acquirer of services, and a receiver for failed institutions, the FDIC also obtains considerable amounts of sensitive information from its employees, contractors, and failed institutions. Further, the FDIC has begun collecting sensitive information, such as resolution plans for systemically important financial institutions, pursuant to its responsibilities under the Dodd-Frank Act. Implementing

proper controls over this information is critical to mitigating the risk of a negative financial impact upon insured institutions or an unauthorized disclosure that could lead to identity theft, consumer fraud, and potential legal liability or public embarrassment for the Corporation.

We evaluated the effectiveness of the FDIC's information security program and practices by designing audit procedures to assess consistency between the FDIC's security controls and FISMA requirements, OMB policy and guidelines, and applicable National Institute of Standards and Technology standards and guidelines in the areas covered by Department of Homeland Security (DHS) questions. DHS is the agency exercising primary responsibility within the Executive Branch for the operational aspects of federal agency cybersecurity with respect to the federal information systems that fall within the scope of FISMA. We were required to submit our responses to the DHS questions through OMB's FISMA reporting platform—CyberScope—by November 15, 2012.

Our report pointed out that management attention was warranted in several security control areas, particularly Plan of Action and Milestones, Contractor Systems, and Risk Management. Specifically, planned actions to address a large number of high- and moderate-risk security vulnerabilities were significantly past their scheduled completion dates on Plan of Action and Milestones, limiting the FDIC's assurance that sensitive information and IT resources are adequately protected. In addition, risk in the area of Contractor Systems remained elevated due to the FDIC's continued heavy reliance on contractors to support bank resolution and receivership activities. While the FDIC had developed a risk-based strategy and formal methodology for assessing risks associated with Contractor Systems, significant work remained to apply the methodology to all of the FDIC's outsourced information service providers. With respect to Risk Management, our report describes an approach that the FDIC can take to help ensure that business-led application

development efforts are incorporated into the FDIC's risk management framework and IT governance processes.

We made 14 recommendations to improve the effectiveness of the FDIC's information security program controls. FDIC management concurred with all of the recommendations.

#### **Joint Review Conducted by the OIGs of the Department of the Treasury, Board of Governors of the Federal Reserve System, and the FDIC**

We issued a report presenting the results of the fifth joint review by the Department of the Treasury (Treasury), the FRB, and FDIC OIGs of the transfer, pursuant to Title III of the Dodd-Frank Act, of the functions, employees, funds, and property of the former OTS to the FRB, the FDIC, and the OCC. In accordance with Title III of the Dodd-Frank Act, the transfer occurred in July 2011. The Dodd-Frank Act further requires that we, jointly with the Department of the Treasury and the FRB OIGs, provide a written report on the status of the implementation of the Plan every 6 months until the Plan is implemented.

This most recent reporting cycle focused primarily on additional certifications for certain transferred OTS examiners and collection of supervisory assessments by the FRB. The last report, issued September 26, 2012, identified no ongoing issues concerning the FDIC's implementation of the Plan. In addition, we were not advised of any new issues regarding the Plan, nor did Treasury OIG identify a need for any expanded or new audit work impacting the FDIC, since the last report was issued. Accordingly, our office did not perform field work related to the Plan as part of this audit. The report contains no recommendations and did not require a formal response from FDIC management. Corporation officials did, however, express general agreement with the audit results during the reporting process.

#### **Governmentwide Financial Report System**

Many federal agencies, including the FDIC, were required to provide financial

information for the fiscal year (FY) ended September 30, 2012, to the Department of the Treasury for inclusion in the annual Financial Report of the United States Government. The Treasury Financial Manual describes the roles of agency Chief Financial Officers and IGs in processing such information through the Treasury's automated financial reporting tool—the Governmentwide Financial Report System (GFRS).

We conducted an audit to verify whether the FDIC's summary general ledger information agreed with summary information entered into the GFRS for the FY ended September 30, 2012. This audit did not constitute a financial audit. (GAO is responsible for auditing the financial statements of the FDIC.) As such, we did not render an opinion on the FDIC's internal controls over financial reporting or over its financial management systems.

We verified that the FDIC's summary general ledger information agreed with summary information entered into the GFRS for the FY ended September 30, 2012. As part of our work, we verified that the FDIC's data submissions in the GFRS for the year ended December 31, 2011 agreed with the Corporation's audited financial statements. In that regard, the GAO expressed an unqualified opinion on the financial statements of the funds administered by the FDIC in its April 2012 report entitled, *Financial Audit: Federal Deposit Insurance Corporation Funds' 2011 and 2010 Financial Statements* (Report No. GAO-12-416). In addition, we submitted copies of requisite reports and representation letters to the Treasury, GAO, OMB, and Department of Justice in accordance with the *Treasury Financial Manual*.

Our report contained no recommendations, and the Director, Division of Finance, elected not to provide a written response.

## 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. A major challenge for the OIG over the past few years has been 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, the FDIC's substantial resolution and receivership responsibilities, and now its new resolution authorities under the Dodd-Frank Act. All of these warrant vigilant, independent oversight.

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 IG and OIG staff must be free both in fact and in appearance from personal, external, and organizational impairments to their independence. As a member of the Council of the Inspectors General on Integrity and Efficiency (CIGIE), the OIG adheres to the *Quality Standards for Federal Offices of Inspector General*. Further,

the OIG conducts its audit work in accordance with generally accepted government auditing standards; its evaluations in accordance with Quality Standards for Inspection and Evaluation; 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 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 FDIC Board meetings and at Audit Committee meetings where recently issued 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 audit and evaluation reports; responses to other legislative mandates; information related to completed investigations; comments on legislation and regulations; written statements for congressional hearings; contacts with congressional staff; responses to congressional correspondence and Member requests; and materials related to OIG appropriations.

The OIG fully supports and participates in CIGIE activities, and the FDIC IG currently serves as Chair of its Audit Committee. We coordinate closely with representatives from the other financial regulatory OIGs. In this regard, as noted earlier in this report,

the Dodd-Frank Act created the Financial Stability Oversight Council and further established the Council of Inspectors General on Financial Oversight (CIGFO). This Council facilitates sharing of information among CIGFO member IGs and discusses ongoing work of each member IG as it relates to the broader financial sector and ways to improve financial oversight. CIGFO may also convene working groups to evaluate the effectiveness of internal operations of the Financial Stability Oversight Council. The Treasury IG chairs the CIGFO and the FDIC IG is currently serving as Vice Chair.

The IG is a member of the Comptroller General's Advisory Council on Government Auditing Standards. Additionally, the OIG meets with representatives of the U.S. Government Accountability Office (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 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 continuously seek to 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 2013 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 on the next page.

<b>Effectively and Efficiently Manage OIG Human, Financial, IT, and Physical Resources</b>	
<b>1</b>	Provided the OIG's FY 2014 budget proposal to the Congress for subsequent inclusion in the President's budget. This budget requests \$34.6 million to support 130 full-time equivalents, reflecting no change from our FY 2013 budget, based on corporate workload assumptions of bank failures and resolution activity expected in calendar year 2013 and beyond.
<b>2</b>	Continued to monitor, track, and control OIG spending, particularly as it relates to OIG travel-related expenses and use of procurement cards.
<b>3</b>	Pursued options for a new investigative case management system, and worked to better track audit and evaluation assignment costs and to manage audit and evaluation records located on shared drives or SharePoint sites.
<b>4</b>	Engaged a contractor to review and update the OIG's records and information management program and practices to ensure an efficient and effective means of collecting, storing, and retrieving needed information and documents.
<b>5</b>	Continued using our inquiry intake system to capture and manage inquiries from the public, media, Congress, and the Corporation, in the interest of prompt and more effective handling of such inquiries. Participated with the FDIC's group of Public Service Providers to share information on inquiries and complaints received, identify common trends, and determine how best to respond to public concerns.
<b>6</b>	Engaged a contractor to assist with redesign of the OIG's Intranet site to provide a more useful, efficient work tool for all OIG staff.
<b>7</b>	Planned longer-range OIG personnel/recruiting strategies to ensure a strong, effective complement of OIG resources going forward and in the interest of succession planning.

<b>Ensure Quality and Efficiency of OIG Audits, Evaluations, Investigations, and Other Projects and Operations</b>	
<b>1</b>	Continued to implement the OIG's Quality Assurance Plan for October 2010–March 2013 to ensure quality in all audit and attestation engagement work and evaluations, in keeping with government auditing standards and Quality Standards for Inspection and Evaluation. As part of that plan, issued our annual Quality Monitoring and Analysis Summary of the OIG Audit Organization for 2012 and issued a Quality Control Review of the OIG's Assignment Planning Efforts.
<b>2</b>	Oversaw 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 audits and evaluations, and closely monitored contractor performance.
<b>3</b>	Continued use of the IG's feedback form to assess time, cost, and overall quality and value of audits and evaluations.
<b>4</b>	Relied on OIG Counsel's Office to provide legal advice and counsel to teams conducting audits and evaluations, and to support investigations of financial institution fraud and other criminal activity, in the interest of ensuring legal sufficiency and quality of all OIG work.
<b>5</b>	Coordinated with State Department OIG staff to provide needed information for that office to carry out a peer review of our audit organization.
<b>6</b>	Coordinated the IG community's audit peer review activities for OIGs governmentwide as part of our leadership of the CIGIE Audit Committee to ensure a consistent and effective peer review process and quality in the federal audit function.
<b>7</b>	Reviewed and updated a number of OIG internal policies related to audit, evaluation, investigation, and management operations of the OIG to ensure they provide the basis for quality work that is carried out efficiently and effectively throughout the office and made substantial progress converting and transferring all such policies to a new automated policies and procedures repository for use by all OIG staff.
<b>8</b>	Monitored and participated in the Corporation's Plain Writing Act initiative to ensure quality products and OIG compliance with the intent of the Act.

**Encourage Individual Growth and Strengthen Human Capital Management and Leadership Through Professional Development and Training**

- 1** Continued to support members of the OIG attending graduate banking school programs to enhance the OIG staff members' expertise and knowledge of the banking industry.
- 2** Employed interns on a part-time basis in the OIG to provide assistance to the OIG.
- 3** Represented the CIGIE Audit Committee in the Office of Personnel Management's initiative to close skills gaps associated with six mission-critical positions, including the auditor 511 positions.
- 4** Continued involvement in 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. Devoted resources to teaching or facilitating various segments of the training.
- 5** Enrolled OIG staff in several different FDIC Leadership Development Programs to enhance their leadership capabilities.
- 6** Launched the OIG's Mentoring Program to pair mentors and mentorees as a means of developing and enriching both parties in the relationship and enhancing contributions of OIG staff to the mission of the OIG.
- 7** Sponsored lunch-time Webinars on a variety of topics relevant to the OIG in the interest of providing additional opportunities for professional development for OIG staff.

**Foster Good Client, Stakeholder, and Staff Relationships**

- 1** Maintained congressional working relationships by briefing and communicating with various Committee staff on issues of interest to them; providing our Semiannual Report to the Congress for the 6-month period ending September 30, 2012; notifying interested congressional parties regarding the OIG's completed 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.  
Of note during this reporting period was the IG's testimony before the Committee on Financial Services, Subcommittee on Financial Institutions and Consumer Credit, U.S. House of Representatives on matters related to our work in response to Public Law 112-88.
- 2** Communicated with the Chairman, Vice Chairman, FDIC's internal Director, other FDIC Board Members, the Chief Financial Officer, 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 Federal Audit Executive Council, the American Conference Institute, Department of Justice, international visitors hosted by the FDIC, and the Federal Financial Institutions Examination Council 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 Division Directors and other senior officials to keep them apprised of ongoing OIG reviews, results, and planned work.

- 5** Kept RMS, 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 Office of Investigations' quarterly reports to RMS, DRR, the Legal Division, and the Chairman's Office outlining activity and results in our cases involving closed and open banks. Coordinated closely with the Legal Division on matters pertaining to enforcement actions and professional liability cases.
- 6** Participated at FDIC Audit Committee meetings to present the results of completed audits, evaluations, and related matters for consideration by Committee members.
- 7** Reviewed eight proposed or revised corporate policies related to, for example, the FDIC's privacy program, the FDIC's workers compensation program, and the Corporation's acceptable use policy for IT resources. Made suggestions to increase clarity and specificity of these and other draft policies.
- 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 advising on the introductory auditor training and oversight of the community's audit peer review process and scheduling; attending monthly CIGIE meetings and participating in Investigations Committee, Council of Counsels to the IGs, and Professional Development Committee meetings; and commenting on various legislative matters through the Legislative Committee.
- 9** Communicated with representatives of the OIGs of the federal banking regulators and others (FRB, Department of the Treasury, National Credit Union Administration, Securities and Exchange Commission, Farm Credit Administration, Commodity Futures Trading Commission, Federal Housing Finance Agency, Export-Import Bank, SIGTARP, Department of Housing and Urban Development) to discuss audit and investigative matters of mutual interest and leverage knowledge and resources. Participated on CIGFO, as established by the Dodd-Frank Act, with the IGs from most of the above-named agencies, a Council on which the FDIC IG currently serves as Vice Chair. Formed part of the CIGFO Working Group reviewing the designation of financial market utilities as systemically important.
- 10** Responded to questions sent to the FDIC OIG, among other OIGs, from the Chairman and the Ranking Member, Committee on Oversight and Government Reform, U.S. House of Representatives, regarding recommendations made to the FDIC and the working relationship the OIG has with FDIC management to improve efficiency and reduce waste.
- 11** Formed the OIG's Workplace Excellence Council, in keeping with the Corporation's model of the same. Convened the OIG group to explore means of ensuring excellence in the OIG's internal operations and activities.
- 12** Coordinated with the Department of Justice and U.S. Attorneys' Offices throughout the country in the issuance of press releases announcing results of cases with FDIC OIG involvement and routinely informed the FDIC's Office of Communications and Chairman's office of such releases.
- 13** Coordinated with others in the Corporation with respect to revising the corporate directive on Cooperation with the OIG.
- 14** Named the OIG Counsel to the IG as the Whistleblower Protection Ombudsman, in keeping with the Whistleblower Protection Act of 2012, and coordinated with FDIC parties to ensure that the Corporation's related training and informational materials are adequate.

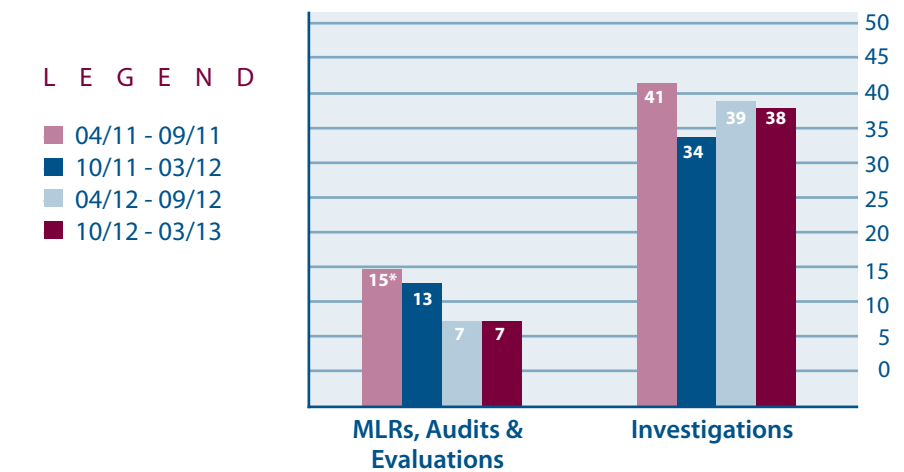


Enhance OIG Risk Management Activities	
1	Completed initial risk-based OIG planning efforts for audits, evaluations, and investigations during 2013 and beyond, taking into consideration the goals of, and risks to, FDIC corporate programs and operations and those risks more specific to the OIG. Issued the 2013 Business Plan reflecting OIG work for the fiscal year.
2	Attended FDIC Board Meetings, Enterprise Risk Committee meetings, corporate planning and budget meetings, and other senior-level management meetings to monitor or discuss emerging risks at the Corporation and tailor OIG work accordingly.
3	Provided the OIG's 2012 assurance letter to the FDIC Chairman, 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, OMB A-123, and other key legislation.
4	Continued to monitor the management and performance challenge areas that we identified at the FDIC, in accordance with the Reports Consolidation Act of 2000 as we conducted audits, evaluations, and investigations: Carrying Out New Resolution Authority, Resolving Failed Institutions and Managing Receiverships, Ensuring and Maintaining the Viability of the DIF, 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.
5	Provided the OIG's perspectives on the risk of fraud at the FDIC. We did so in response to GAO's responsibility under Statement of Auditing Standards No. 99, Consideration of Fraud in Financial Statement Audits.

### Cumulative Results (2-year period)

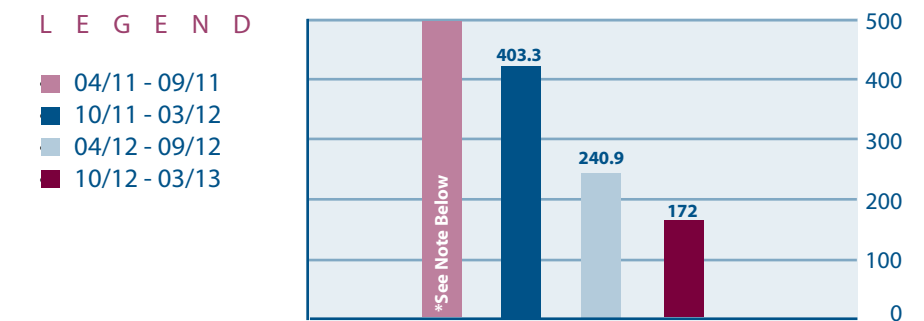
Nonmonetary Recommendations	
April 2011 – September 2011	13
October 2011 – March 2012	17
April 2012 – September 2012	21
October 2012 – March 2013	27

### Products Issued and Investigations Closed



\*Includes two audit-related memoranda.

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



\*For the period 04/11 - 09/11, fines, restitution, and monetary recoveries resulted in \$3.7 billion.

## Reporting Requirements

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Note: Evaluation report statistics are included in this report as well, in accordance with the Inspector General Reform Act of 2008.

### Review of Legislation and Regulations

The FDIC OIG's review of legislation and regulations during the past 6-month period involved the following activities:

OIG Counsel's Office monitored and reviewed proposed legislation that might affect the Inspector General community, particularly measures that would change the role that IGs play in annually evaluating their respective agencies' information security systems, as is required by FISMA and bills that could affect the types of disclosure or redactions that the OIG may have to make with respect to OIG documents that are responsive to FOIA requests. Examples of legislation reviewed include the following:

- Draft legislation that would require OIGs to review agency expenditure data for accuracy, completeness, compliance with standards, etc. Counsel's Office assisted in incorporating comments from other agencies and from the FDIC OIG, for consideration by a committee of CIGIE, and subsequently to Congressional staff members for further action.
- H.R. 1163, the *Federal Information Security Amendments Act of 2013*, which would eliminate the current statutory obligation for OIGs to evaluate annually their agencies' respective information security program; in 2012, Counsel's Office reviewed S. 3414, the *Cybersecurity Act of 2012*, which would have changed the OIGs' reporting requirements to, in essence, once every 2 years and would have made some changes to the scope and methodology of the OIGs' evaluations.
- H.R. 1211, the *FOIA Oversight and Implementation Act of 2013*.
- H.R. 313, the *Government Spending Accountability Act of 2013*, regarding government conference expenses, etc.

Counsel's Office determined whether recent statutory enactments applied to the OIG, and to the extent the enactments were applicable, assisted the OIG in implementing them. These enactments included Public Law 112-88, a statute that required the FDIC OIG and GAO to study and report on various matters regarding the failure of financial institutions; the Dodd-Frank Act (Public Law 111-203); the Whistleblower Protection Enhancement Act of 2012 (Public Law 112-199); the Government Charge Card Abuse Prevention Act (Public Law 112-194); and the Reducing Over-Classification Act (Public Law 111-258).

Counsel's Office was mindful of the implications of two statutes (Public Laws 112-207 and 112-178) involving (1) required reporting of certain financial interests by certain agency employees (FDIC and FDIC OIG) and (2) the effect on the OIG should its FY 2013 appropriations lapse, respectively.

### Significant Recommendations from Previous Semiannual Reports on Which Corrective Actions Have Not Been Completed

This table shows the corrective actions management has agreed to implement but has not completed, along with associated monetary amounts. In some cases, corrective actions may be different from the initial recommendations made in the audit reports. However, the OIG has agreed that the planned actions meet the intent of the initial recommendations. The information in this table is based on (1) information supplied by the FDIC's Corporate Management Control (CMC), Division of Finance and (2) the OIG's determination of closed recommendations. Recommendations are closed when (a) CMC notifies the OIG that corrective actions are complete or (b) in the case of recommendations that the OIG determines to be particularly significant, after the OIG confirms that corrective actions have been completed and are responsive. CMC has categorized the status of these recommendations as follows:

#### Management Action in Process: (two recommendations from one report)

Management is in the process of implementing the corrective action plan, which may include modifications to policies, procedures, systems, or controls; issues involving monetary collection; and settlement negotiations in process.

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

Report Number, Title, and Date	Significant Recommendation Number	Brief Summary of Planned Corrective Actions and Associated Monetary Amounts
<b>Management Action In Process</b>		
AUD-12-009 <b>Corus Construction Venture, LLC Structured Asset Sale</b> April 5, 2012	1	Review the manner in which management fees are calculated under structured asset sale agreements and determine whether it is in the Corporation's best interest for management fees to be paid on nonaccrued and capitalized interest. Based on the results of this review, revisit prior management fees billed by ST Residential to ensure they were allowable and clarify the terms of future structured asset sale agreements to more clearly define the manner in which management fees are calculated.
	2	Disallow \$6,258,151 in servicing expenses that were deducted from the collections of funds received from the liquidation of assets during the period covered by the audit. (Questioned Costs of \$3,754,891, which is 60 percent of \$6,258,151.)  DRR engaged a compliance monitoring contractor to conduct a comprehensive review of servicing expenses to determine the amount to be disallowed.

**Table II: Audit and Evaluation Reports Issued by Subject Area**

Report		Questioned Costs		Funds Put to Better Use
Number and Date	Title	Total	Unsupported	
<b>Supervision</b>				
EVAL-13-001 October 31, 2012	Acquisition, Development, and Construction Loan Concentration Study			
EVAL-13-002 January 3, 2013	Comprehensive Study on the Impact of the Failure of Insured Depository Institutions			
<b>Resolution and Receivership Management</b>				
AUD-13-001 October 5, 2012	DRR's Controls for Managing, Marketing, and Disposing of Owned Real Estate Assets			
<b>Resources Management</b>				
AUD-13-002 October 11, 2012	Invoices Submitted by Lockheed Martin Services, Inc., under the FDIC's Data Management Services Contract	\$740,784	\$137,958	
AUD-13-003 November 5, 2012	Independent Evaluation of the FDIC's Information Security Program – 2012			
AUD-13-004 February 4, 2013	The FDIC's Data Submissions through the Governmentwide Financial Report System as of September 30, 2012			
AUD-13-005 February 4, 2013	Status of the Transfer of Office of Thrift Supervision Functions			
<b>Totals for the Period</b>		<b>\$740,784</b>	<b>\$137,958</b>	

**Table III: Audit and 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.	1	\$740,784	\$137,958
<b>Subtotals of A &amp; B</b>	<b>1</b>	<b>\$740,784</b>	<b>\$137,958</b>
C. For which a management decision was made during the reporting period.	1	\$740,784	\$137,958
(i) dollar value of disallowed costs.	1	\$740,784	\$137,958
(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 IV: Audit and 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
<b>Subtotals of A &amp; B</b>	<b>0</b>	<b>\$0</b>
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 V: Status of OIG Recommendations Without Management Decisions**

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

**Table VI: Significant Revised Management Decisions**

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

**Table VII: Significant Management Decisions with Which the OIG Disagreed**

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

**Table VIII: Instances Where Information Was Refused**

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

## Appendix 2: Information on Failure Review Activity

(required by the Dodd-Frank Wall Street Reform and Consumer Protection Act)

**FDIC OIG Review Activity for the Period October 1, 2012 through March 31, 2013 (for failures causing losses to the DIF of less than \$150 million from January 1, 2012 through December 31, 2013)**

Institution Name	Closing Date	Estimated Loss to DIF (Dollars in millions)	Grounds Identified by the State Bank Supervisor for Appointing the FDIC as Receiver	Unusual Circumstances Warranting In-Depth Review?	Reason for In-Depth Review	Due Date or Date Issued
<b>Failure Review Activity – Updated from Previous Semiannual Report</b>						
<b>Reviews Completed During the Reporting Period or Pending/Ongoing as of the End of the Reporting Period</b>						
Covenant Bank & Trust (Rock Spring, Georgia)	3/23/12	\$35	The bank was unable to meet the requirements of the Consent Order, including, but not limited to, the required levels of capital.	No	N/A	N/A
Premier Bank (Wilmette, Illinois)	3/23/12	\$67.1	The bank's capital was impaired. Further, the bank was operating in an unsound condition and conducting its business in an unsafe and unsound manner.	No	N/A	N/A
First Capital Bank (Kingfisher, Oklahoma)	6/8/12	\$7.6	The bank failed to maintain adequate capital and engaged in unsafe and unsound practices.	No	N/A	N/A
Farmers' and Traders' State Bank (Shabonna, Illinois)	6/8/12	\$10.9	The bank's capital was impaired, and the bank was in an unsound condition and conducting its business in an unsafe and unsound manner.	No	N/A	N/A
Putnam State Bank (Palatka, Florida)	6/15/12	\$39.1	The bank was insolvent.	No	N/A	N/A
Security Exchange Bank (Marietta, Georgia)	6/15/12	\$36.0	The bank was unable to meet the requirements of a Cease and Desist Order, including, but not limited to, the required minimum levels of capital, and the bank's capital was at a level that caused it to be <i>Critically Undercapitalized</i> .	No	N/A	N/A
Farmers Bank of Lynchburg (Lynchburg, Tennessee)	6/15/12	\$30.3	The bank's capital was impaired and the bank was in an unsound condition, operating in an unsound manner, and unable to continue its normal operations.	No	N/A	N/A
Montgomery Bank and Trust (Ailey, Georgia)	7/6/12	\$75.2	The bank was unable to meet certain requirements of a Cease and Desist Order, including, but not limited to, the requirements for minimum levels of capitalization and adequate liquidity.	No	N/A	N/A
Glasgow Savings Bank (Glasgow, Missouri)	7/13/12	\$8 thousand	The insolvency of the bank was inevitable and there was no prospect for recovery or recapitalization.	No	N/A	N/A
The Royal Palm Bank of Florida (Naples, Florida)	7/20/12	\$13.5	*			

\* Failure review pending or ongoing as of the end of the reporting period.

**FDIC OIG Review Activity for the Period October 1, 2012 through March 31, 2013 (for failures causing losses to the DIF of less than \$150 million from January 1, 2012 through December 31, 2013)**

Institution Name	Closing Date	Estimated Loss to DIF (Dollars in millions)	Grounds Identified by the State Bank Supervisor for Appointing the FDIC as Receiver	Unusual Circumstances Warranting In-Depth Review?	Reason for In-Depth Review	Due Date or Date Issued
Georgia Trust Bank (Buford, Georgia)	7/20/12	\$20.9	The bank was unable to meet certain requirements of the Consent Order, including, but not limited to, the requirements for minimum levels of capitalization.	No	N/A	N/A
First Cherokee State Bank (Woodstock, Georgia)	7/20/12	\$36.9	Economic conditions and the financial condition of the bank did not permit it to meet certain requirements of a Cease and Desist Order, including, but not limited to, the requirements for minimum levels of capitalization.	No	N/A	N/A
Heartland Bank (Leawood, Kansas)	7/20/12	\$3.1	*			
Jasper Banking Company (Jasper, Georgia)	7/27/12	\$58.1	*			
Waukegan Savings Bank (Waukegan, Illinois)	8/3/12	\$19.8	*			
First Commercial Bank (Bloomington, Minnesota)	9/7/12	\$65.9	*			
First United Bank (Crete, Illinois)	9/28/12	\$50.7	The bank was conducting its business in an unsafe and unsound manner.	No	N/A	N/A
Excel Bank (Sedalia, Missouri)	10/19/12	\$40.9	*			
GulfSouth Private Bank (Destin, Florida)	10/19/12	\$36.1	The bank was imminently insolvent.	No	N/A	N/A
NOVA Bank (Berwyn, Pennsylvania)	10/26/12	\$91.2	*			
Heritage Bank of Florida (Lutz, Florida)	11/2/12	\$65.5	*			
Hometown Community Bank (Braselton, Georgia)	11/16/12	\$36.7	*			
Community Bank of the Ozarks (Sunrise Beach, Missouri)	12/14/12	\$12.4	*			
Westside Community Bank (University Place, Washington)	1/11/13	\$26.8	*			
1st Regents Bank (Andover, Minnesota)	1/18/13	\$16.2	*			
Covenant Bank (Chicago, Illinois)	2/15/13	\$21.8	*			
Frontier Bank (LaGrange, Georgia)	3/8/13	\$51.6	*			

\* Failure review pending or ongoing as of the end of the reporting period.

## Appendix 3: Peer Review Activity

(required by the Dodd-Frank Wall Street Reform and Consumer Protection Act)

Section 989C of the Dodd-Frank Act contains additional semiannual reporting requirements pertaining to peer review reports. Federal Inspectors General are required to engage in peer review processes related to both their audit and investigative operations. In keeping with Section 989C, the FDIC OIG is reporting the following information related to its peer review activities. These activities cover our role as both the reviewed and the reviewing OIG and relate to both audit and investigative peer reviews.

### Audit Peer Reviews

On the audit side, on a 3-year cycle, peer reviews are conducted of an OIG audit organization's system of quality control in accordance with the *CIGIE Guide for Conducting External Peer Reviews of the Audit Organizations of Federal Offices of Inspector General*, based on requirements in the *Government Auditing Standards* (Yellow Book). Federal audit organizations can receive a rating of pass, pass with deficiencies, or fail.

- The FDIC OIG was the subject of a peer review of its audit organization during a prior reporting period. The Railroad Retirement Board OIG conducted the review and issued its system review report on September 21, 2010. In the Railroad Retirement Board OIG's opinion, the system of quality control for our audit organization in effect for the year ended March 31, 2010, had been suitably designed and complied with to provide our office with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. We received a peer review rating of pass.

The report's accompanying letter of comment contained five recommendations that, while not affecting the overall opinion, were designed to further strengthen the system of quality control in the FDIC OIG Office of Audits.

All actions taken in response to the Railroad Retirement Board's recommendations were completed by February 23, 2011.

This peer review report (the system review report and accompanying letter of comment) is posted on our Web site at [www.fdicig.gov](http://www.fdicig.gov)

### FDIC OIG Peer Review of the Smithsonian Institution OIG

The FDIC OIG completed a peer review of the audit operations of the Smithsonian Institution (SI), and we issued our final report to that OIG on September 21, 2011. We reported that in our opinion, the system of quality control for the audit organization of the SI OIG, in effect for the 15-month period ended March 31, 2011, had been suitably designed and complied with

#### Definition of Audit Peer Review Ratings

**Pass:** The system of quality control for the audit organization has been suitably designed and complied with to provide the OIG with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.

**Pass with Deficiencies:** The system of quality control for the audit organization has been suitably designed and complied with to provide the OIG with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects with the exception of a certain deficiency or deficiencies that are described in the report.

**Fail:** The review team has identified significant deficiencies and concludes that the system of quality control for the audit organization is not suitably designed to provide the reviewed OIG with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects or the audit organization has not complied with its system of quality control to provide the reviewed OIG with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.

to provide the SI OIG with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. The SI OIG received a peer review rating of pass.

As is customary, we also issued a Letter of Comment, dated September 21, 2011, that set forth findings and recommendations that were not considered to be of sufficient significance to affect our opinion expressed in the system review report. We made 11 recommendations, with which the SI OIG agreed. SI OIG indicated it would complete all corrective actions related to the findings and recommendations no later than March 31, 2012. Our findings and recommendations related to the following areas: standards followed on desk reviews, statements of independence for referencers, disciplinary mechanism for reporting personal impairments, reviews of continuing professional education data, reporting whether audit results can be projected, internal quality assurance program enhancements, and SI OIG's letter related to the annual financial statements audit. SI OIG has posted its peer review report (the system review report and accompanying letter of comment) on its Web site at [www.si.edu/oig/](http://www.si.edu/oig/).

In our semiannual report as of March 31, 2012, we reported that the SI OIG reported completed actions on 4 of our 11 recommendations. SI OIG was also updating its audit manual to reflect the FY 2011 revision to government auditing standards and recommendations from our peer review. As of the end of September 2012, SI OIG reported that actions on all recommendations in our peer review report had been completed.

### Ongoing FDIC OIG Audit Peer Review Activity

In April 2013, the State Department OIG and the FDIC OIG signed a memorandum of understanding for the State Department OIG to commence a peer review of our audit organization. We anticipate completion of that review by September 30, 2013, and will report the results in our next semiannual report.

### Investigative Peer Reviews

Quality assessment peer reviews of investigative operations are conducted on a 3-year cycle as well. Such reviews result in a determination that an organization is "in compliance" or "not in compliance" with relevant standards. These standards are based on *Quality Standards for Investigations* and applicable

Attorney General guidelines. The Attorney General guidelines include the *Attorney General Guidelines for Offices of Inspectors General with Statutory Law Enforcement Authority* (2003), *Attorney General Guidelines for Domestic Federal Bureau of Investigation Operations* (2008), and *Attorney General Guidelines Regarding the Use of Confidential Informants* (2002).

- In 2009, the FDIC OIG was the subject of a peer review conducted by the Department of the Interior (DOI) OIG. DOI issued its final report to us on September 9, 2009. In DOI's opinion, the system of internal safeguards and management procedures for the investigative function of the FDIC OIG in effect for the period October 1, 2007 through September 30, 2008, was in compliance with the quality standards established by CIGIE and the Attorney General guidelines. These safeguards and procedures provided reasonable assurance of conforming with professional standards in the conduct of FDIC OIG investigations. DOI issued a letter of observations but made no recommendations in that letter.
- The FDIC OIG conducted a peer review of the investigative function of the National Aeronautics and Space Administration (NASA) OIG during June through August 2011. We issued our final report to NASA OIG on November 10, 2011. We reported that, in our opinion, the system of internal safeguards and management procedures for the investigative function of the NASA OIG in effect for the period ending December 31, 2010 was in full compliance with the quality standards established by CIGIE and Attorney General Guidelines. We also issued a letter of observations but made no recommendations in that letter.

- During the last reporting period, the Department of Energy (DOE) OIG conducted a peer review of our investigative function. DOE OIG issued its final report on the quality assessment review of the investigative operations of the FDIC OIG on July 31, 2012. DOE OIG reported that in its opinion, the system of internal safeguards and management procedures for the investigative function of the FDIC OIG in effect for the year ending June 22, 2012, was in compliance with quality standards established by CIGIE and the applicable Attorney General guidelines. These safeguards and procedures provided reasonable assurance of conforming with professional standards in the planning, execution, and reporting of FDIC OIG investigations.

## Congratulations and Farewell



### Ken Copeland

Ken Copeland, Audit Specialist, retired after nearly 42 years of federal service. His career began in 1970 when he joined the U.S. General Accounting Office, now the Government

Accountability Office, as an accountant. In 1979, he transferred to the OIG at the former ACTION – which, in 1993, was merged with the Commission on National and Community Service to form the Corporation for National and Community Service. In 1983, he joined the FDIC's Office of Corporate Audits and Internal Investigations, which later became the FDIC OIG.

During his tenure, Ken experienced two periods of financial crisis in our country, and in the face of each, he contributed to important OIG audit efforts to promote economy, efficiency, and effectiveness in FDIC programs and operations. Most recently, he played a key role with respect to failed bank reviews required under the Dodd-Frank Act. Also of note, while working in the OIG, he helped develop and foster constructive working relationships within our office and with other offices in the FDIC.



### Mike Schuster

Mike Schuster, Special Agent, retired from the FDIC after more than 25 years of federal service. He began his investigative career in 1987 at the Customs Service of the U.S.

Department of the Treasury in McAllen, Texas. In March 2003, along with others, he was part of a transfer of staff to Immigration and Customs Enforcement, Department of Homeland Security, in Dallas. Subsequently, he joined the FDIC OIG's Dallas office where he served with distinction as a Special Agent since 2004.

Mike was instrumental in investigating a variety of matters to help ensure integrity--from missing FDIC equipment to the 2008 failure of IndyMac Federal Bank. He also led the successful investigation and prosecutions of a number of embezzlement schemes committed by former bank officers, a California case involving money laundering and trafficking of counterfeit goods, a review of mortgage fraud allegations against the Association of Community Organizations for Reform Now (ACORN), and a mortgage fraud case perpetrated against IndyMac.

Over the years, he presented at seminars sponsored by the Federal Financial Institutions Examination Council; spoke at meetings of the Arkansas, Texas, and Tennessee Bankers' Associations; and shared perspectives on Bank Fraud and Money Laundering at the FDIC Dallas Regional Examiner Conference. He also played an important leadership role as a Director for the Dallas Chapter of the Association of Certified Fraud Examiners and served as an Adjunct Professor of Accounting at both Northwood University and Texas A&M University-Commerce.



### Nancy Cipolla

Nancy Cipolla, Senior Writer-Editor, retired from the FDIC after more than 27 years of federal service. She began her service at the Department of Defense OIG in 1985 and advanced

steadily in that office over the years in her career as an Editor. In 1998, she joined the OIG at the National Aeronautics and Space Administration, where she continued to work as an Editor for more than 5 years. In 2003, she joined the FDIC OIG as a Senior-Writer Editor.

During her tenure in the FDIC OIG, she helped establish editorial standards and ensure the quality of the Office of Audits' written products. In the midst of the financial crisis, in particular, she was instrumental in the successful issuance of the OIG's first material loss reviews and later the OIG's reports involving the FDIC's resolution and receivership activities. She also took part in reviewing the products that independent public accounting firms provided to the OIG in support of OIG audits, thus ensuring that those products also reflected the high standards of the FDIC OIG. Nancy developed and later posted on the OIG's Intranet site helpful guidance and numerous sample documents that the staff could use as models as they proceeded through the auditing and writing phases of their assignments. These were, and will continue to be, invaluable tools for the 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 ([OIGHotline@FDIC.gov](mailto:OIGHotline@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 complete copies of audit and evaluation reports discussed in this Semiannual Report, visit our Web site: <http://www.fdicig.gov>

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