



Office of Inspector General

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Report No. 05-013

Receivership Dividend Payments

AUDIT REPORT

Office of Audits





Receivership Dividend Payments

Results of Audit

DRR has established and implemented adequate controls over the receivership dividend payment process. Specifically, the six receivership dividends we reviewed were properly authorized and adequately supported. Further, DRR ensured that: (1) an approved dividend case existed before declaring the receivership dividend, (2) sufficient cash was available to pay the receivership dividend, (3) no legal or other impediments existed, and (4) required reconciliations were performed before the disbursement of receivership dividend payments. However, we also found that from January 1, 2003 through December 31, 2004, the FDIC issued 18,339 paper checks to receivership dividend recipients. In this regard, the FDIC could achieve savings associated with efficiency gains by moving to an electronic payment method.

Recommendations and Management Response

The report recommends that DRR assess the feasibility of making electronic payments to recipients of receivership dividends and revise the standard interview questionnaire, used by DRR personnel during the receivership closing process, to request recipient bank routing information for future electronic receivership dividend payments.

FDIC management agreed with the recommendations and has planned actions to address them.

Background and Purpose of Audit

The FDIC is responsible for effectively managing receivership operations and ensuring that failed institutions are resolved in the manner that will result in the least cost to the FDIC's deposit insurance funds. The receivership process includes liquidating failed institution assets and distributing any proceeds of the liquidation, in the form of receivership dividends, to the FDIC, uninsured depositors, and general creditors.

The audit scope included 27 open receiverships, which declared 30 receivership dividends from January 1, 2004 through August 31, 2004. We reviewed 6 of the 30 receivership dividends totaling about \$33,750,000, or 11 percent of the total.

The objective of the audit was to determine whether receivership dividends were properly authorized and adequately supported. We reviewed the Division of Resolutions and Receiverships (DRR) policies and procedures established for receivership dividends and related controls in the claims process.

To view the full report, go to www.fdicig.gov/2005reports.asp

Benefits of Using Electronic Fund Transfers

- Reduction of Paperwork and Associated Cost Savings
- More Timely Business Communications
- More Accurate Business Transactions
- More Efficient Business Processes
- Uniform Communications With Vendors
- Improved Client/Vendor Relationship Transactions

Source: The FDIC's EFT Handbook.



DATE: March 22, 2005

MEMORANDUM TO: Mitchell L. Glassman, Director
Division of Resolutions and Receiverships

FROM: Russell A. Rau [Original signed by Stephen M. Beard for Russell A. Rau]
Assistant Inspector General for Audits

SUBJECT: *Receivership Dividend Payments*
(Report No. 05-013)

This report presents the results of the Federal Deposit Insurance Corporation (FDIC) Office of Inspector General's (OIG) audit of receivership¹ dividend payments. The FDIC's Division of Resolutions and Receiverships (DRR) has the primary responsibility for managing the receivership dividend process, which is discussed in detail in the Background section of this report.

The objective of this audit was to determine whether receivership dividends paid by the FDIC were properly authorized and adequately supported. The scope of our audit included six receiverships that made dividend payments from January 1, 2004 through August 31, 2004. Additional details on our objective, scope, and methodology are in Appendix I.

BACKGROUND

The FDIC is responsible for effectively managing receivership operations and ensuring that failed institutions are resolved in the manner that will result in the least cost to the FDIC's deposit insurance funds. As part of the resolution process, the FDIC acts as the receiver or liquidating agent for failed federally insured depository institutions. The receiver distributes any funds realized from its liquidation efforts to the failed institution's creditors and shareholders in accordance with the FDI Act.

The receivership process involves performing the closing function at the failed financial institution, liquidating any remaining institution assets, and distributing any proceeds of the liquidation to the FDIC and to those with approved claims. Upon the failure of a financial institution, depositors are paid to the extent the depositor accounts are insured, while depositors with proven claims against a receivership are issued Receivership Certificates (RC) for any

¹ A receivership is a temporary entity that is established upon the appointment of the FDIC by the appropriate federal or state regulator authority to wind up the business and affairs of a failed financial institution. The FDIC's roles and responsibilities as a receiver are defined by provisions in the Federal Deposit Insurance Act (FDI Act).

uninsured deposits. Further, immediately after its appointment as receiver, the FDIC notifies the failed institution's creditors to submit their claims to the receiver. Claimants may file a proof of claim for unpaid wages, unpaid service provided to the failed institution, or other general claims. Once a claim has been filed, the receiver has 180 days to determine whether the claim should be allowed. If the receiver is not satisfied that the claim has merit, it will be disallowed. Once a claim against the receiver is "proven," the claimant is provided an RC.

Receivership dividends are distributions of cash to allowed claimants of the failed institution. The cash is generated through the liquidation of receivership assets. Net proceeds from collection efforts are invested by the receivership and accumulated, pending payment of administrative expenses, preferred and secured claims, and dividend distributions. The intent of the FDIC's receivership dividend policy is to distribute cash in the form of dividends to allowed claimants as sufficient cash accumulates in the receivership rather than to hold all cash until final termination of the receivership.

The order of priority in which allowed claimants receive dividends is governed by FDI Act section 11(d) as amended by the Omnibus Budget Reconciliation Act, enacted on August 10, 1993. Specifically, for all receiverships (the failed institution can be a bank or thrift or a state or federally chartered institution), established after August 10, 1993, dividends are paid in the following order of priority:

1. Administrative expenses of the receiver.
2. Deposits (with the FDIC as subrogee for insured depositors being on a par with uninsured depositors).
3. Other general or senior liabilities of the institution.
4. Any subordinated obligations.
5. Any obligation of commonly controlled depository institutions for cross-guaranty assessments under 12 United States Code § 1815(e)(2)(C).
6. Shareholder and/or member claims.

As a result of the Act, deposit liabilities of the institution have priority over all claims except the administrative expenses of the receiver.

Authority to pay dividends is requested by DRR personnel through documented cases approved by the FDIC official with the appropriate delegated authority. Actual payment of a dividend is usually done by the issuance of a check to uninsured depositors and other allowed claimants, though payment by wire is also possible.

FDIC guidance regarding the receivership dividend payment process is principally contained in the *FDIC Claims Procedures Manual* and the *Accounting Operations Manual*.

RESULTS OF AUDIT

DRR has established and implemented adequate controls over the receivership dividend payment process. Specifically, the six receivership dividends we reviewed were properly authorized and adequately supported. Further, DRR ensured that: (1) an approved dividend case existed before declaring the receivership dividend, (2) sufficient cash was available to pay the receivership dividend, (3) no legal or other impediments existed, and (4) required reconciliations were performed before the disbursement of dividend payments to approved recipients. However, we also found that the FDIC generally paid receivership dividends by paper check rather than electronically. In this regard, the FDIC could achieve savings associated with efficiency gains by moving to an electronic payment method.

DRR's Use of Paper Checks in the Dividend Payment Process

Generally, DRR made receivership dividend payments by check rather than electronically. Specifically, from January 1, 2003 through December 31, 2004, the FDIC issued 18,339 checks to uninsured depositors to pay receivership dividends.² Presently, the FDIC does not require the use of electronic payments, nor does DRR routinely request electronic payment routing information from receivership dividend payment recipients. As a result, the payment process is not as efficient, cost-effective, or secure as it could be, nor is the process consistent with current industry practices.

DRR does not require receivership dividend recipients to receive payments electronically; rather, DRR offers the recipients voluntary use of electronic payments. We discussed the feasibility of using electronic payments for receivership dividend payments, and DRR told us that there is no standard question on the claims interview questionnaire regarding whether recipients would like their receivership dividend payments electronically. However, during interviews with DRR Asset Claims personnel, claimants are given the option of receiving receivership dividend payments electronically.

DRR is researching alternatives for making receivership dividend payments—including electronic payments. Specifically, DRR contracted with International Business Machines Corporation (IBM) to perform an independent assessment of the FDIC's insurance claims process, as part of DRR's Claims Process Reengineering Project. As part of the assessment, IBM was tasked with developing potential options for increasing the capacity of the claims function. IBM's report entitled, *Federal Deposit Insurance Corporation Claims Processing Analysis: Discovery Phase Report*, dated June 17, 2002, which was prepared under the contract, suggested that the FDIC consider reengineering the claims process to incorporate more automation and multiple means of disbursing checks. DRR's Asset Claims continues to work on

² The FDIC could not readily provide information on the number of checks written in comparison to the number of electronic payments made to receivership dividend recipients for our audit period. However, the FDIC provided information on the number of checks issued starting in January 2003. Accordingly, we used that information in our report.

the Claims Process Reengineering Project and is taking many of IBM's recommendations under consideration.

The FDIC performed a study in 1998 related to issuing payments by check rather than electronically, which concluded that deposit payoffs would be more costly if made by electronic funds transfer (EFT) rather than by check. The study report entitled, *Deposit Payoff Analysis—Payment by Check vs. EFT*, was prepared by the Division of Finance's (DOF) Cash Management Section. The report discussed deposit payoff checks, which generally represent large one-time payments to insured depositors, in contrast to receivership dividend payments, which are paid periodically throughout the life of the receivership.

Efficiency and Cost-Benefit of Using Electronic Payments

According to the Check Conversion Education Coalition (CCEC) and the National Automated Clearing House Association (NACHA), the U.S. Department of the Treasury (Treasury) has found electronic payments to be cost-effective and time-saving. The CCEC is a membership organization consisting of leading financial institutions, government agencies, and Automated Clearing House operators. NACHA, a trade group promoting uniform rules and standards for Automated Clearing House associations, has reported that Treasury's Financial Management Service currently issues over 840 million payments annually on behalf of federal agencies, of which 425 million are electronic payments. Treasury has stated that direct deposit (a form of electronic payment) is a safer and more reliable method for making benefit payments and estimated that converting checks to electronic payments would save the federal government more than \$100 million each year. In addition to the potential cost savings, CCEC and NACHA stated that the benefits of using electronic payments may include more timely payments to recipients and more secure transactions.

In 1996, a Senior Analyst with the Federal Reserve Bank of Minneapolis reported that the cost to the payer of processing a paper check was about \$1.40 a check, while the payer's cost for an electronic transaction was about \$.80. Therefore, there was a reported savings of \$.60 per transaction (or a 43 percent savings) by making electronic payments as opposed to using a paper check.

Additional support for the use of electronic payment methods is contained in legislation enacted in 1996. Specifically, a provision of the Omnibus Consolidated Rescissions and Appropriations Act of 1996 requires that various federal payments be made by EFT and that recipients of such payments provide the paying agency with information to enable the agency to make those payments by EFT. This legislation was related to another legislative proposal, the purpose of which was to promote economy and efficiency in disbursing funds and to eliminate crime regarding the issuance of Treasury checks. Although receivership dividend payments are not within the scope of this legislation, the FDIC has implemented steps to reach the goal of increasing its use of electronic payments. One such step was the FDIC's development of the *EFT Handbook*, dated August 1998. The benefits identified in the handbook for using EFT are shown on the next page.

Potential Savings Related to the FDIC's Increased Use of Electronic Payments

We could not reasonably estimate the monetary benefit to the FDIC if receivership dividend payments are made electronically. Specifically, DRR could not provide us with an estimate of the number of current receivership dividend recipient payments that the FDIC could convert to electronic payments. Further, neither DRR nor DOF could provide us with adequate information to determine the FDIC's cost of issuing paper checks as compared to the cost of making payments electronically. When such information is available and savings can be determined, we will report the monetary benefit associated with this finding.

Benefits of Using EFT

(1) Reduction of paperwork and associated cost savings:
Reduces paper stocking and storage
Eliminates check printing and equipment
Provides on-line data storage
Automatic reconciliation
Reduced Technician workload
High productivity without increasing staff
(2) More timely business communications:
Rapid exchange of business data
Payments sent and received more efficiently and effectively
Elimination of mail charges, courier services
(3) More accurate business transactions:
Elimination or reduction of data entry
Reduced errors and improved error detection
Faster reporting
(4) More efficient business processes
(5) Uniform communications with all vendors
(6) Improved client/vendor relationships transactions

Source: EFT Handbook.

CONCLUSION AND RECOMMENDATIONS

We recognize that potential cost savings are subject to many variables, including the number of receivership dividend recipients, the administrative cost of obtaining the bank account information necessary to establish the electronic payment, and the FDIC's cost of issuing paper checks as compared to electronic payments. Nevertheless, the potential exists for the FDIC to increase the efficiency and security of its receivership dividend payment process by expanding its use of electronic payments. Therefore, DRR should consider the feasibility of making receivership dividend payments electronically as opposed to paper check.

We recommend that the Director, DRR:

- (1) Assess the feasibility of making electronic payments to recipients of receivership dividends.
- (2) Revise the standard interview questionnaire used by DRR Asset Claims employees during the receivership closing process to request recipient bank routing information for future electronic receivership dividend payments.

CORPORATION COMMENTS AND OIG EVALUATION

On March 15, 2005, the Director, DRR, provided a written response to a draft of this report. The response is presented in its entirety in Appendix II of this report. The Director concurred with

both recommendations. The Director's response to the recommendations is summarized in Appendix III of this report. Our analysis of the response follows.

DRR management agreed with recommendation 1 to assess the feasibility of making electronic payments to recipients of receivership dividends. DRR stated that it is a strong advocate of E-Commerce and has a history of leveraging technology. Additionally, DRR is an integral member of the New Financial Environment (NFE) implementation team. NFE software will contain an E-commerce module. Dividend and all receivership payments will be considered for EFT after NFE implementation.

With respect to recommendation 2, DRR stated that if EFT proves to be cost-effective, DRR will revise the standard questionnaire to include the recipient's bank routing information should the recipient prefer dividend payments through EFT.

Management's planned actions are responsive to both recommendations. The recommendations are resolved but will remain undispositioned and open until we have determined that agreed-to corrective actions have been completed and are effective.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of the audit was to determine whether receivership dividends paid by the FDIC were properly authorized and adequately supported. We reviewed DRR's policies and procedures established for receivership dividends and related procedures in the claims process. The audit scope included 27 open receiverships, which declared 30 receivership dividends from January 1, 2004 through August 31, 2004. The 30 dividends resulted in about \$315 million in dividend payments over the period. We reviewed 6 of the 30 receivership dividends totaling about \$33,750,000, or 11 percent of the total.

To accomplish our objective and to gain an understanding of internal controls over receivership dividend payments, we reviewed the following DRR documents:

- *FDIC Claims Procedures Manual*
- *Resolutions Handbook*
- *EFT Handbook*
- *Accounting Operations Manual*
- *Dividends Processing Users Manual*
- *Receivership Liability System User Manual*

We also reviewed previously issued OIG reports³ related to the audit objective, DRR Internal Review reports, and IBM's *Federal Deposit Insurance Corporation Claims Processing Analysis: Discovery Phase Report*. We interviewed key personnel in the following DRR organizational units: Asset Claims, Receivership Oversight, Receivership Operations, Accounting Operations, and Internal Review. We documented the receivership dividend payment process, identified key controls in the process, and tested those controls. More specifically, we conducted tests of the dividend payment process for six receivership dividends and evaluated the extent of procedures performed to ensure that receivership dividend payments had been properly authorized and supported. To test the accuracy of procedures conducted, we traced receivership dividend payments to supporting documentation, performed reconciliations, and verified that appropriate approvals had been obtained before payment was made.

We tested the accuracy of the payments made by tracing the RCs to the dividend payment amounts and by recalculating and verifying the amounts that the FDIC, as the largest recipient of receivership dividends, received.

Finally, we reviewed and analyzed laws and regulations applicable to the audit objective, and we used the Internet to research information related to the federal government's use of electronic payments.

³ We reviewed the following OIG reports: *Review of the FDIC's Strategy for Managing Improper Payments* (Audit Report No. 02-022, June 14, 2002); *Internal Control over Receivables from Failed Insured Depository Institutions* (Audit Report No. 03-026, March 28, 2003); *Internal Control over Receivership Receipts* (Audit Report No. 03-024, March 27, 2003); and *Insurance Determination Claims Process* (Audit Report No. 03-041, September 17, 2003).

Computer-processed data was not significant to our findings, conclusions, and recommendations; therefore, we were not required to perform assessments of computer-processed data. We did, however, use computer-processed data as background information in identifying a universe of receivership dividends from which to select our sample.

We performed our work at the FDIC's offices in Washington, D.C., and Dallas, Texas, from August through November 2004 in accordance with generally accepted government auditing standards.

MANAGEMENT RESPONSE TO THE RECOMMENDATIONS

This table presents the management response on the report recommendations and the status of the recommendations as of the date of report issuance.

Rec. Number	Corrective Action: Taken or Planned/Status	Expected Completion Date	Monetary Benefits	Resolved: ^a Yes or No	Dispositioned: ^b Yes or No	Open or Closed ^c
1	DRR is an integral member of the New Financial Environment (NFE) implementation team. NFE software will contain an E-commerce module. DRR will consider dividend and all receivership payments for EFT after NFE implementation.	December 31, 2005	N/A	Yes	No	Open
2	If EFT proves to be cost-effective, DRR will revise the standard interview questionnaire to include the recipient's bank routing information should the recipient prefer dividend payments through EFT.	December 31, 2005	N/A	Yes	No	Open

^a Resolved – (1) Management concurs with the recommendation and the planned corrective action is consistent with the recommendation.
 (2) Management does not concur with the recommendation, but planned alternative action is acceptable to the OIG.
 (3) Management agrees to the OIG monetary benefits, or a different amount, or no (\$0) amount. Monetary benefits are considered resolved as long as management provides an amount.

^b Dispositioned – The agreed-upon corrective action must be implemented, determined to be effective, and the actual amounts of monetary benefits achieved through implementation identified. The OIG is responsible for determining whether the documentation provided by management is adequate to disposition the recommendation.

^c Once the OIG dispositions the recommendation, it can then be closed.