

# Office of Inspector General



Office of Audits  
Report No. AUD-11-005

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**The FDIC's Franchise Marketing of  
AmTrust Bank**

March 2011



## Why We Did the Audit

A key aspect of the FDIC mission is to plan and effectively handle the resolution of failing FDIC-insured institutions and to provide prompt, responsive, and efficient administration of failed financial institutions to ensure that insured depositors are protected and to minimize losses to the Deposit Insurance Fund (DIF). The FDIC Board of Directors has delegated significant authority to the Director, Division of Resolutions and Receiverships (DRR), to conduct the activities required to resolve a failing institution in the least costly manner and manage the resulting receivership. To minimize the negative financial effects of failing and failed insured financial institutions on the DIF, DRR resolves institutions using the least costly resolution method. Further, DRR is to resolve the troubled institution and sell assets in the manner that results in the least cost and highest recovery to the FDIC's insurance funds and other creditors of the failed institution.

The FDIC's Office of Inspector General (OIG) contracted with BDO USA, LLP (BDO) to conduct an audit of the FDIC's franchise marketing of AmTrust Bank, Cleveland, Ohio. The objective of this performance audit was to assess the FDIC's franchise marketing process for AmTrust Bank. We selected AmTrust Bank for the audit because AmTrust was a large bank that failed toward the end of 2010, and the FDIC received bids to acquire the bank from multiple institutions.

## Background

On June 23, 2009, the FDIC Board of Directors approved a failing bank case for AmTrust Bank. On December 4, 2009, the Office of Thrift Supervision closed AmTrust Bank, a federally chartered thrift institution established in 1921, and appointed the FDIC receiver. At closing, AmTrust Bank had a total of 66 branches in Ohio, Florida, and Arizona; total assets of approximately \$13.0 billion; and total deposits of approximately \$8.3 billion. Prior to the bank closing, the Director, DRR, approved a Purchase and Assumption (P&A) Agreement, including loss sharing,<sup>1</sup> with New York Community Bank (NYCB), Westbury, New York, as the least costly transaction on November 25, 2009. The NYCB bid was compared to the liquidation cost of AmTrust Bank as well as to 13 other bids to determine the least costly resolution. The DRR analysis of the bids ranged from a \$2.2 billion cost to the DIF to over \$5 billion.

Under the P&A Agreement, NYCB assumed all of the deposits of AmTrust Bank and purchased, at a discount, AmTrust Bank assets with a book value of about \$9.2 billion. The P&A Agreement included a loss-share transaction on approximately \$6.3 billion of the \$9.2 billion in assets purchased by NYCB. In addition, the FDIC acquired a value appreciation instrument,<sup>2</sup> valued at \$10.7 million, and transferred to NYCB all qualified financial contracts to which AmTrust Bank was a party. The FDIC estimated that the costs of the NYCB acquisition to the DIF would be approximately \$1.6 billion less than if the bank had been liquidated, meaning that the FDIC makes a payout to all insured depositors and liquidates the assets taken into receivership. The FDIC retained approximately \$3.8 billion of assets, consisting mainly of acquisition, development, and construction loans and non-performing loans for later disposition. The FDIC estimated that the cost of AmTrust Bank's failure to the DIF would be \$2.2 billion.

<sup>1</sup> Under loss sharing agreements, the FDIC agrees to absorb a portion of the loss on a specified pool of assets, purchased by an acquiring institution from a failed bank, in order to maximize asset recoveries and minimize FDIC losses by keeping the assets in the private sector. The agreements are also intended to minimize disruption of loan customers.

<sup>2</sup> A debt or equity instrument or obligation issued by an entity that entitles its holders to receive payments that depend primarily on the stock price of the entity.

## Audit Results

Overall, BDO concluded that the franchise marketing process for AmTrust Bank was completed in accordance with the FDIC's resolution policies, procedures, and guidelines for the franchise marketing of failed banks. BDO found that the FDIC had implemented controls designed to ensure that the resolution of AmTrust Bank was managed effectively and potential losses to the DIF were minimized for AmTrust Bank's failure. While these controls are positive, BDO also found that updated and additional internal control procedures and certain control enhancements are warranted. Specifically, DRR's *Resolutions Policy Manual* and the *Least Cost Test Manual* contain outdated information, and certain control procedures were not followed in marketing AmTrust Bank. As a result, estimated liquidation costs for AmTrust Bank were understated due to errors that had not been detected in the estimation process. While the understatement of estimated liquidation costs could impact the determination of the least costly resolution and bid decision, in this case, the winning bid was significantly below the estimated liquidation cost, and there was no impact on the outcome of the bidding. Importantly, however, the nature of the errors made in estimating the liquidation costs could have impacted the bidding process if a misstatement of the costs was not detected and resulted in selecting other than the least costly option. BDO also found that documentation of the bidding and least cost resolution determination processes needed improvement. Further, information security controls for the Least Cost Test (LCT) Model<sup>3</sup> and segregation of duties in the least cost determination process were inadequate to ensure the confidentiality and integrity of related information. Improvements are also needed to ensure that valuation contractors use approved methodologies and assumptions for the valuation analysis. Finally, the FDIC's Division of Administration (DOA) could not provide evidence of confidentiality agreements for some of the contractors processing information related to the franchise marketing process for AmTrust Bank.

Taken together, these deficiencies can lead to (1) increased cost to the DIF as a result of erroneous or incomplete information being used for decision-making in the franchise marketing process, and (2) inconsistent or unfair treatment of bidders. Control deficiencies in information security and contractor oversight related to the failing bank marketing process and failing bank data also make the FDIC vulnerable to data confidentiality and integrity problems.

During and subsequent to the performance of our audit, DRR began remediating some of the findings discussed in this report. Specifically, the DRR *Resolutions Policy Manual*, job aids, and instructions to asset valuation contractors were in the process of being updated, and enhancements have been made to the LCT Model to improve security and the validation of data inputs. In addition, more robust procedures have been implemented over the development and testing of the LCT Model to include improved documentation and approval for LCT Model changes and the related testing processes.

## Recommendations, Management Comments, and OIG Evaluation

BDO recommended that the FDIC update the *Resolutions Policy Manual* and *Least Cost Test Manual* and improve the franchise marketing process by establishing adequate information security controls to ensure the completeness, accuracy, and integrity of the data that is ultimately submitted to the FDIC Board of Directors. BDO also recommended improving the bidding process by establishing procedures for the documentation of the FDIC's approval of potential bidders. In addition, BDO recommended

<sup>3</sup> The LCT Model determines the liquidation value of the failing institution and compares the bids to the liquidation value and to each other.

enhancements related to the methodology and assumptions used in the asset valuation process that would improve the consistency of information provided and help ensure the reliability of the valuation of the failing bank's assets. Finally, BDO recommended that DRR coordinate with DOA to improve contract administration by establishing procedures to ensure that contractor confidentiality agreements are completed and documented for contractors involved in the resolution process. The FDIC concurred with the nine recommendations. The FDIC's planned and completed actions are sufficient to resolve all the recommendations.



**DATE:** March 3, 2011

**MEMORANDUM TO:** Bret D. Edwards, Acting Director  
Division of Resolutions and Receiverships

**FROM:** /Signed/  
Russell A. Rau  
Assistant Inspector General for Audits

**SUBJECT:** *The FDIC's Franchise Marketing of AmTrust Bank*  
(Report No. AUD-11-005)

The subject final report is provided for your information and use. Please refer to the Executive Summary, included in the report, for the overall audit results. Our evaluation of the Division of Resolutions and Receiverships response is incorporated into the body of the report. We have determined that management's corrective actions are sufficient to resolve the recommendations. The recommendations will remain open for reporting purposes until we have determined that agreed-to corrective actions have been completed and are responsive.

If you have questions concerning the report, please contact me at (703) 562-6350 or Lisa Conner, Audit Manager, at (972) 761-2297. We appreciate the courtesies extended to the audit staff.

Attachment

cc: Stephen K. Trout, DRR  
Arleas Upton Kea, DOA  
Daniel H. Bendler, DOA  
James H. Angel, Jr., OERM

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***Part I***

***Report by BDO USA, LLP***

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# Audit Report

The FDIC's Franchise Marketing of  
AmTrust Bank

March 3, 2011



Tel: 301-654-4900  
Fax: 301-654-3567  
[www.bdo.com](http://www.bdo.com)

7101 Wisconsin Ave, Suite 800  
Bethesda, MD 20814

March 3, 2011

Honorable Jon T. Rymer  
Inspector General  
Federal Deposit Insurance Corporation  
3501 Fairfax Drive  
Arlington, VA 22226

**Re: Transmittal of Results of the Audit of *The FDIC's Franchise Marketing of AmTrust Bank*  
(Report No. AUD-11-005)**

Dear Mr. Rymer:

This letter submits our final report representing the results of our performance audit of The FDIC's Franchise Marketing of AmTrust Bank in accordance with Contract Number CORHQ-09-G-0386 dated March 12, 2010. The objective of this performance audit was to assess the FDIC's franchise marketing process for AmTrust Bank. As part of our work, we interviewed key DRR officials responsible for the process and obtained other evidence to accomplish the audit objectives.

We conducted our performance audit in accordance with *Generally Accepted Government Auditing Standards* (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Overall, the franchise marketing process for AmTrust Bank was completed in accordance with the resolution policies, procedures, and guidelines for the franchise marketing of failed banks. We found that the FDIC had implemented controls designed to ensure that the resolution of AmTrust Bank was managed effectively and potential losses to the DIF were minimized for AmTrust Bank's failure. While these controls are positive, updated and additional internal control procedures and certain control enhancements are warranted.

We issued a draft of this report on January 19, 2011. We subsequently met with representatives of the FDIC's Division of Resolutions and Receiverships (DRR) in Washington, D.C. and Office of Inspector General (OIG) representatives to obtain informal feedback on the draft report. Based on the informal feedback received, we made changes to the draft report that we deemed appropriate. On February 28, 2011, the Director, DRR, provided a formal written response to our draft report.



This performance audit did not constitute an audit of financial statements in accordance with GAGAS. BDO was not engaged to and did not render an opinion on the FDIC's internal controls over financial reporting or over financial management systems. BDO cautions that projecting the results of our audit to future periods is subject to the risks that controls may become inadequate because of changes in conditions or because compliance with controls may deteriorate. The information included in this report was obtained from the FDIC on or before September 30, 2010. We have no obligations to update our report or to revise the information contained therein to reflect events and transactions occurring subsequent to September 30, 2010.

Please contact Tom D'Amato at 301-634-4900 if you have any questions or comments regarding this report.

Very truly yours,

A handwritten signature in black ink that reads "BDO USA, LLP". The signature is written in a cursive, slightly slanted style.

BDO USA, LLP

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## **EXECUTIVE SUMMARY**

The Federal Deposit Insurance Corporation (FDIC) Office of Inspector General (OIG) contracted with BDO USA, LLP (BDO) to conduct a performance audit of FDIC's franchise marketing process for AmTrust Bank, Cleveland, Ohio. AmTrust Bank failed on December 4, 2009. To protect depositors, the FDIC entered into a Purchase and Assumption (P&A) Agreement<sup>1</sup> with New York Community Bank (NYCB) to purchase \$9.2 billion in assets and assume all deposits totaling \$8.3 billion from AmTrust Bank. Within the FDIC, the Division of Resolutions and Receiverships (DRR) is responsible for the resolution of failed financial institutions, including the marketing of the failed institution and coordinating the transition of the failed bank to the acquiring institution upon failure. The franchise marketing process involves collecting information on the assets, liabilities, and franchise value of a failing insured depository institution, developing and implementing marketing strategies, soliciting and accepting bids for the sale of the institution, determining which bid is least costly to the Deposit Insurance Fund (DIF), and working with acquiring institutions through the failing institution closing process. The P&A Agreement with NYCB was determined to be the least costly resolution strategy for AmTrust Bank and resulted in an estimated savings of \$1.6 billion over the cost of liquidation of the failed bank.

The objective of this performance audit was to assess the FDIC's franchise marketing process for AmTrust Bank. As part of our work, we interviewed key DRR officials responsible for the process and obtained other evidence to accomplish the audit objectives. Our audit work covered DRR compliance with the FDIC's policies, procedures, standards, and guidelines during the franchise marketing process of AmTrust Bank. A detailed discussion of our objective, scope, and methodology is included in Appendix I of this report. The primary criteria for the performance audit are the FDIC DRR policies, procedures, standards, and guidelines for the franchise marketing of failed banks, primarily included in the Resolutions Policy Manual (RPM)<sup>2</sup> and the Least Cost Test (LCT) Manual.

Overall, the franchise marketing process for AmTrust Bank was completed in accordance with the resolution policies, procedures, and guidelines for the franchise marketing of failed banks. We found that the FDIC had implemented controls designed to ensure that the resolution of AmTrust Bank was managed effectively and potential losses to the DIF were minimized for AmTrust Bank's failure. While these controls are positive, updated and additional internal control procedures and certain control enhancements are warranted. Specifically, the RPM and the LCT Manual contain outdated information, and certain control procedures were not followed in marketing AmTrust Bank. Consequently, information related to liquidation costs was inaccurate, and the bidding process and the least costly resolution determination process were incomplete. Further, internal controls related to information technology and the segregation of duties were inadequate to ensure the confidentiality and integrity of this information.

The DRR franchise marketing process could be improved by establishing procedures and controls for the review of the LCT Model<sup>3</sup> to ensure completeness and accuracy and integrity of the data that is ultimately submitted to

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<sup>1</sup> A P&A transaction occurs when a healthy institution (generally referred to as the acquiring or assuming institution) purchases some or all of the assets of a failed bank or thrift and assumes some or all of the institution's liabilities, including insured deposits.

<sup>2</sup> DRR Circular 7100.1, *The Resolutions Policy Manual*, issued October 15, 2004, reaffirms the RPM, which contains the policies and guidelines that apply to all staff in the Franchise and Asset Marketing Branch in both Washington, D.C., and Dallas, Texas. These policies and guidelines encompass the resolution process for a potentially failing financial institution up to the date the institution fails.

<sup>3</sup> The LCT Model determines the liquidation value of the failing institution and compares the bids to the liquidation value and to each other.

the FDIC Board of Directors. DRR could improve the bidding process for acquiring institutions by establishing procedures for the documentation of regulatory approval of potential bidders. Further, enhancements related to the methodology and assumptions used in the asset valuation process would improve the consistency of information provided and ensure the reliability of the valuation of the failing bank's assets. Additionally, DRR could improve contract administration by establishing procedures to ensure that confidentiality agreements from contractors are maintained.

Taken together, these deficiencies can lead to increased cost to the DIF as a result of inaccurate and incomplete information for the franchise marketing process. During and subsequent to the performance of our audit, DRR began remediating some of the findings discussed in this report. Specifically, the DRR RPM, job aids, and instructions to the valuation contractors were in the process of being updated, and enhancements have been made to the LCT Model to improve security and the validation of data inputs. In addition, more robust procedures have been implemented over the development and testing of the LCT Model to include improved documentation and approval for LCT Model changes and the related testing processes.

We performed this audit from April 2010 through September 2010 in accordance with the *Generally Accepted Government Auditing Standards* (GAGAS) issued by the Comptroller General of the United States and with audit policies and procedures established by the FDIC OIG. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Additionally, we used the Government Accountability Office's (GAO) November 1999 publication *Standards for Internal Control in the Federal Government* as a guide for performing the audit. The Glossary in Appendix II contains definitions of the terms used in this report, and Appendix III contains a listing of acronyms used in the report.

This performance audit did not constitute an audit of financial statements in accordance with GAGAS. BDO was not engaged to and did not render an opinion on the FDIC's internal controls over financial reporting or over financial management systems. BDO cautions that projecting the results of our audit to future periods is subject to the risks that controls may become inadequate because of changes in conditions or because compliance with controls may deteriorate.

## **BACKGROUND**

### **FDIC Mission**

The FDIC is an independent agency created through the Banking Act of 1933. Its mission is to contribute to the stability and public confidence in our nation's financial system by insuring deposits, examining and supervising financial institutions, and managing receiverships. In its role as federal deposit insurer, and in cooperation with the other federal and state regulatory agencies, the FDIC promotes the safety and soundness of insured depository financial institutions by identifying, monitoring, and addressing risks to the DIF.

A key aspect of the FDIC mission is to plan and effectively handle the resolution of failing FDIC-insured institutions and to provide prompt, responsive, and efficient administration of failed financial institutions in order to ensure that insured depositors are protected and to minimize losses to the DIF. The FDIC Board of Directors has delegated significant authority to the Director DRR to conduct the activities required to resolve a failing institution in the least costly manner and manage the resulting receivership. To minimize the negative financial effects of failing and failed insured financial institutions on the DIF, DRR uses the least costly resolution method to resolve institutions. DRR's Franchise and Asset Marketing Branch (FAMB) should resolve the troubled institution and sell assets in the manner that results in the least cost and highest recovery to the FDIC's insurance funds and other creditors of the failed institution.

### **Overview of AmTrust Bank**

On June 23, 2009, the FDIC Board of Directors approved a failing bank case for AmTrust Bank. On December 4, 2009, the Office of Thrift Supervision (OTS) closed AmTrust Bank, a federally chartered thrift institution established in 1921, and appointed the FDIC receiver. At closing, AmTrust Bank had a total of 66 branches in Ohio, Florida, and Arizona and had total assets of approximately \$13.0 billion and total deposits of approximately \$8.3 billion. Prior to the bank closing, the Director, DRR, by authority of the FDIC Board of Directors, approved an all-deposit modified whole bank P&A bid with loss share<sup>4</sup> from NYCB, Westbury, New York, as the least costly transaction on November 25, 2009. On November 25, 2009, the Director approved the winning bid, which was selected from 14 bids received from 5 bidders. DRR Washington received the bids and a bid summary report from DRR in Dallas. These bids were compared to the liquidation cost of AmTrust Bank as well as to the other bids to determine the least costly resolution. The DRR analysis of the bids ranged from a cost of about \$2.2 billion to over \$5 billion to the DIF.

Under the P&A Agreement, NYCB assumed all of the deposits of AmTrust Bank and purchased approximately \$9.2 billion in assets of AmTrust Bank at a discount of \$425 million. The P&A Agreement also included a loss-share transaction on approximately \$6.3 billion of the \$9.2 billion in assets purchased by NYCB. In addition, the FDIC acquired a value appreciation instrument valued at \$10.7 million and transferred to NYCB all qualified financial contracts to which AmTrust Bank was a party. NYCB's acquisition of all the deposits and certain assets was deemed the least costly resolution for the DIF compared to alternatives. The FDIC estimated that the costs to the DIF of the NYCB acquisition would be approximately \$1.6 billion less than if the bank had been liquidated, meaning that the FDIC makes a payout to all insured depositors and liquidates the assets taken into receivership.

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<sup>4</sup> Under loss sharing agreements, the FDIC agrees to absorb a portion of the loss on a specified pool of assets, purchased by an acquiring institution from a failed bank, in order to maximize asset recoveries and minimize FDIC losses by keeping the assets in the private sector. The agreements are also intended to minimize disruption of loan customers.

The FDIC retained approximately \$3.8 billion of assets, consisting mainly of acquisition, development, and construction loans and non-performing loans for later disposition. The FDIC estimated the cost of AmTrust Bank's failure to the DIF would be \$2.2 billion.

### **Overview of the Franchise and Asset Marketing Process**

The FDIC Improvement Act of 1991<sup>5</sup> (FDICIA) included a provision that requires the FDIC to use the least costly alternative for the deposit insurance fund when resolving a failing institution. Under the FDICIA, the FDIC must analyze all bids received and provide to the FDIC Board of Directors a comparison of those bids in relation to the liquidation of the failing institution. The winning bid is selected by comparing all bids and choosing the one with the least cost to the DIF.

The FDIC Board of Directors authorizes DRR, through the approval of the failing bank case, to evaluate alternative methods for resolving a failing institution, using reasonable and prudent business judgment. DRR responsibilities for resolving failing financial institutions includes the marketing of the failing institution and coordinating the transition to an acquiring institution if the institution fails. The FAMB's resolution specialists in Washington, D.C., and in the Field Operations Branch in Dallas, Texas, perform resolution responsibilities. The responsibility is administered through the resolution and receivership processes.

The resolution process involves collecting information on the assets, liabilities, and franchise value of a failing insured depository institution, developing marketing strategies, soliciting and accepting bids for the sale of the institution, determining which bid is least costly to the DIF, and working with acquiring institutions through the closing process.

The receivership process involves performing the closing function at the failed institution; liquidating any failed institution assets not purchased by the acquiring institution; and distributing any proceeds of the liquidation to the failed institution's customers who had uninsured deposit amounts and, if there are sufficient funds, to other creditors, with approved claims.

The goals of the resolution and receivership processes are to:

- Provide depositors timely access to their insured funds.
- Resolve failing institutions in the least costly manner.
- Manage receiverships to maximize net return in order to fulfill the FDIC's statutory obligation to all creditors of the receivership.<sup>6</sup>

The RPM defines the overall resolution policies and general procedures. Related manuals, such as the LCT Manual, contain detailed instructions for specific resolution tasks. The procedures described in the RPM apply to typical resolution activities such as planning and preparing for the resolution project, preparing the information package, conducting the asset valuation review, marketing the failing institution to qualified bidders, and selecting the winning bid. Personnel may be required to use tools and methods not specified in the RPM; however, any deviations from the RPM must be thoroughly documented. The LCT Manual provides (1) procedures for performing the LCT as a method to analyze and compare bids submitted for failing

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<sup>5</sup> The FDIC Improvement Act of 1991 mandated a least-cost resolution method and prompt resolution approach to problem and failing banks.

<sup>6</sup> The Federal Deposit Insurance Act, 12 United States Code (U.S.C.) 1823 (d) (3) requires the Corporation to maximize the net-present-value return from the sale or disposition of such asset and minimize the amount of any loss realized in the resolution of cases.

institutions and (2) detailed descriptions on the use of the LCT Model to determine the least costly resolution of a failing institution.

The FDIC normally begins its formal resolution process upon contact from the troubled institution's chartering authority, advising the FDIC of the bank's expected failure. Once the FDIC receives notification, the FDIC coordinates with the primary federal regulator of the failing institution to obtain information on the institution's assets and liabilities to support the Failing Bank Board Case (Board Case).<sup>7</sup> FDIC staff contact the chief executive officer of the failing institution to discuss logistics, address senior management's involvement in the resolution activities, and request loan and deposit data from the institution or its data processing servicer.

After the FDIC receives the requested information from the failing institution, the Marketing Specialist (MS) begins developing the marketing strategy<sup>8</sup> by analyzing the failing institution's value based on the:

- types and quality of assets and liabilities in the information provided by the institution;
- location of the banking facilities, local competition, economic conditions, and causes of failure;
- extent of the problems per the primary federal regulator, failing institution liquidity, stability of its core deposits and deposit mix, institution's leases to identify any impediments to marketing them; and
- any other attribute that may add to the franchise value.

The MS will then determine the type of marketing to offer to potential acquirers. The FDIC's primary marketing strategy is a whole bank P&A with or without loss share. Once the marketing strategy is approved by DRR management, a team of FDIC resolution specialists may visit the institution to gather additional information. The FDIC then values assets of the institution, determines the resolution options to be offered, and prepares an information package for potential bidders to access through a secured Website. Based on recommendations by the Director, DRR, the FDIC Board of Directors approves the resolution options to be used for the failing institution.

Once the necessary information has been gathered and possible resolution options are approved, the FDIC begins marketing the failing institution as widely as possible to encourage competition among prospective bidders. A list of prospective bidders, which are primarily existing financial institutions, is assembled based on initial criteria that include a prospective bidding institution's overall condition, size, and capital level; business plan; geographic market; and minority-owned status. The FDIC also considers the institution's safety and soundness rating, as well as the ratings pertaining to information technology, anti-money laundering, consumer compliance, and community reinvestment. The resulting list of potential bidders will then be notified of a potential acquisition opportunity. Private investors that do not already control a bank charter may become potential bidders if they obtain clearance from a chartering authority, satisfy any holding company requirements, and are in the process of obtaining deposit insurance.

After executing a confidentiality agreement with the FDIC, all qualified bidders gain access to the information package on a secure Website, which includes financial data on the institution, legal documents, descriptions of the resolution options being offered, the due diligence process, and the bidding process. The FDIC bidding options available to bidders typically include an option to assume only insured deposits or all deposits.<sup>9</sup>

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<sup>7</sup> The Failing Bank Board Case is jointly prepared by the DRR and Division of Supervision and Consumer Protection (DSC) and presented to the FDIC Board of Directors. The main purpose of the Board Case is to delegate authority to the DRR to resolve the bank. Effective February 13, 2011, DSC was renamed the Division of Risk Management Supervision (RMS).

<sup>8</sup> The overall goal of marketing the institution is to develop and analyze a variety of marketing options to arrive at a strategy that encourages competition among potential acquirers and results in the least costly resolution of the failing institution.

<sup>9</sup> These are customer accounts that are held by the failing institution.

Additionally, the FDIC advises the bidders about the types and amounts of assets that could pass to an acquiring institution; the assets the FDIC plans to retain; the terms of the asset sale, such as loss share agreements and optional asset pools;<sup>10</sup> and other significant conditions that are part of the proposed resolution method.

Interested bidders may also perform on-site due diligence, coordinated and monitored by the FDIC, to inspect the books and records of the failing institution for assessing the value of the franchise. This process ensures that each bidder is well informed about the circumstances of the failing institution. Bidders submit their proposal(s) to the FDIC by a specific bid deadline, which is generally 1 week prior to the scheduled closing. Bids consist of two parts: (1) the premium the bidder is willing to pay for the failing institution's deposits, and (2) the amount the bidder is willing to pay to acquire the failing institution's assets.

The FDIC analyzes all bids to determine whether they conform to the bidding instructions and assesses the cost of each bid to the DIF. The FDIC determines the least costly resolution transaction by evaluating all possible resolution alternatives and computing costs on a net-present-value basis. The FDIC is required by law<sup>11</sup> to use a realistic discount rate and document any assumptions used in the evaluation, including any assumptions related to interest rate, asset recovery rates, asset holding costs, and payment of contingent liabilities. The least costly determination and the Cost Test Summary (CTS) are included in the Bid Approval Memo (BAM).

Once the least costly resolution is determined and approved, the FDIC notifies the successful acquiring institution, all unsuccessful bidders, and the acquiring institution's chartering authority. The acquiring institution's chartering authority, the RMS, and the primary federal regulator make the final regulatory decisions about the transaction to ensure the winning bidder meets all necessary regulatory capital requirements. The FDIC then arranges for the acquiring institution to sign the appropriate legal documents before the institution's closure.

The chartering authority closes the institution and appoints the FDIC as receiver. The FDIC, as receiver, then begins settling the closed institution's affairs. Generally, this includes balancing the accounts of the institution immediately after closing, transferring certain assets and liabilities to the acquiring institution, and determining the payment due to the acquiring institution, if any.

In a P&A transaction, the acquiring institution usually reopens the failed institution the next business day, with the customers of the failed institution automatically becoming customers of the acquiring institution with access to their insured deposits (or all deposits, depending on the nature of the transaction). If the FDIC cannot arrange for an acquiring institution to assume the insured deposits, the FDIC will take steps to give insured depositors access to their funds as soon as possible. In some cases, the FDIC will arrange for insured depositors to be paid, usually by check or through a paying agent (such as another insured institution).

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<sup>10</sup> Under certain transaction structures, the FDIC will segregate assets of the failing institution into pools, each containing similarly situated assets. The prospective acquiring institution may submit a bid to purchase one or more of the pools, specifying the price bid for each pool to be acquired.

<sup>11</sup> The Federal Deposit Insurance Act, 12 U.S.C. 1823 (c)(4) requires the Corporation to (i) evaluate alternatives on a present-value basis, using a realistic discount rate; (ii) document the evaluation and the assumptions on which that evaluation is based; (iii) retain such documentation for not less than 5 years; (iv) treat Federal tax revenues that the United States Government would forego as the result of a proposed transaction, to the extent reasonably ascertainable, as if such revenues were foregone by the relevant deposit insurance fund; (v) determine the costs of providing any assistance and the costs of liquidation as of the dates prescribed in subparagraph (C) of Section 13(c)(4); and (vi) determine the cost of liquidating any insured depository institution in default, for purposes of comparing such cost with the costs of providing any assistance, in the manner prescribed in subparagraph (D) of Section 13(c)(4).

## **RESULTS OF AUDIT**

### **FINDING A: FRANCHISE AND ASSET MARKETING POLICIES, PROCEDURES, AND GUIDELINES**

Overall, the franchise marketing process for AmTrust Bank was completed in accordance with the resolution policies, procedures, and guidelines for the franchise marketing of failed banks. We found that the FDIC had implemented controls designed to ensure that the resolution of AmTrust Bank was managed effectively and potential losses to the DIF were minimized for the AmTrust Bank failure. While these controls are positive, additional internal control procedures for the process and certain control enhancements are warranted. Specifically:

- The RPM and the LCT Manual contain outdated information and procedures. As a result, the RPM and LCT Manual did not reflect new systems or roles and responsibilities used in determining the least costly resolution strategy. DRR should update the RPM and LCT Manual where appropriate. Table 1, below, shows when DRR's policies, procedures, and guidelines for franchise marketing were last updated.
- DRR relied on the expertise of its contractors to develop asset valuation assumptions and on the experience of its employees to follow appropriate policies, procedures, and guidelines during the process. DRR did not provide sufficient guidance for the methodology and assumptions used by its contractors for the AmTrust Bank asset valuation to ensure consistency with other bank failure information and did not document the review process over the asset valuation report.
- The MS did not obtain documented approval from the regulators (FDIC, OTS, and Office of the Comptroller of the Currency (OCC)), as required by the RPM, for two of the five bids received for AmTrust Bank.
- The liquidation values of the premises and equipment, securities, accrued interest, prepaid expenses and other assets of AmTrust were based on historical bank failure data. The liquidation values can be unreliable if the manual does not reflect current financial statistical data. In the case of AmTrust Bank, the historical bank failure data was applied to about \$1.3 billion of the \$13.0 billion (9.7 percent) total assets of AmTrust Bank.

GAO's *Standards for Internal Controls in the Federal Government* states that policies and procedures are an integral part of an organization's operations and are a key control for ensuring that management's directives are carried out. In addition, Circular 4010.3, *FDIC Enterprise Risk Management System*, dated as of September 25, 2006 requires divisions and offices to maintain current policies and procedures. Without current policies and procedures, the FDIC has less assurance that its franchise marketing process is being implemented consistently, in accordance with management's direction, and produces an accurate result with the least costly resolution to the DIF.

**Table 1: Status of Key Franchise and Asset Marketing Resolution Policies, Procedures, and Guidelines**

Policies, Procedures, and Guidelines	Last Updated
RPM	
1. <i>Planning and Preparing for the Resolution Project</i>	January 2006
2. <i>Preparing the Information Package and Conducting the Asset Valuation Review</i>	October 2004
3. <i>Marketing the Failing Institution</i>	October 2004
4. <i>Selecting Bids</i>	October 2004
LCT Manual	May 2008

Source: BDO analysis of the DRR's RPM and LCT Manual.

### ***Resolutions Policy Manual***

The RPM provides procedures and guidelines for typical resolution activities. However, the RPM does not reflect current statutory definitions, information system references, and roles and responsibilities related to the four key resolution functions noted in Table 1. As a result, the RPM procedures and guidelines could not be followed in all cases for the franchise marketing of AmTrust Bank and are not applicable to DRR's current asset marketing process.

DRR did not provide sufficient guidance related to the AmTrust Bank asset valuation contractor regarding which methodology and assumptions to use to ensure consistency with other bank failure information and did not document the review process over the asset valuation report. The valuation contractor was engaged by DRR to perform a valuation of the AmTrust Bank loan portfolio and the AmTrust Bank mortgage servicing rights. GAO's *Standards for Internal Control in the Federal Government* states that policies and procedures are an integral part of an organization's operations and a key control for ensuring that management's directives are carried out. Further, the standards state that internal control should be designed to assure that ongoing monitoring occurs in the course of normal operations. Monitoring controls include regular management and supervisory activities. DRR relied on the expertise of its contractors to develop asset valuation assumptions and the experience of its employees to determine report review activities over the valuation contractor's report. The asset valuation review report is used to determine values for asset pools to be offered in a resolution and is instrumental in determining the least cost resolution for the institution. The internal control review procedures should be completed and should include a review of the asset valuation methodologies used by the contractor. Without consistent approaches to the preparation and review of the asset valuation report, DRR has increased the risk that the least costly transaction will not be properly determined.

Controls related to documenting regulatory bid approval of all bidders for AmTrust Bank could be improved. Specifically, the MS did not obtain documented approval from the regulators (FDIC, OTS, and OCC), as required by the RPM, for all the bids received for AmTrust Bank. DRR received bids from five banks for AmTrust Bank, but documentation of regulatory approval was available for only three banks. The MS receives the regulators' approvals for received bids either through email or telephone conversations. The absence of documentation of regulatory approval can result in a bidder that does not meet the bidder qualifications.

The paragraphs below describe our audit results related to three of the four key resolution functions.

#### *Planning and Preparing for the Resolution Project*

The RPM refers to the Bank Insurance Fund and the Savings Association Insurance Fund; however, these funds have been replaced by the DIF. In addition, certain roles and responsibilities within the RPM are either outdated or no longer applicable, such as the Risk Analysis and Value Estimation (RAVEN) operator.

#### *Preparing the Information Package and Conducting the Asset Valuation Review*

The RPM refers to the RAVEN system, a program used to assist in the preparation of the Information Package and Asset Valuation Review, that is no longer in use by DRR.

The FDIC now uses valuation contractors extensively for failing bank asset valuations. While an asset valuation review report was obtained for AmTrust Bank, enhancements to the internal controls over the contractor valuation process could provide for the consistency of the valuation methods within DRR. For AmTrust Bank, the contractor was not required to follow asset valuation assumptions and methodologies consistent with other failing bank valuations. RPM Chapter III, *Conducting the Asset Valuation Review*, contains asset valuation review procedures and processes. The RPM does not contain specific methodologies to be followed by DRR. According to the RPM, assumptions should be based on actual liquidation practices and experience in the location of the failing institution's assets. The FAMB Analysis and Evaluation Section provides benchmark data for loans in the National Assumptions Reference Library (NARL), located on the FDIC Intranet. The valuation contractor should use the NARL to determine whether additional or local assumptions are needed for a specific institution's assets. The task order issued to the valuation contractor did not require use of the guidance in the RPM.

The RPM states that it may be necessary for the FDIC to hire a contractor to provide valuations for complex assets or assets for which the FDIC does not have the valuation expertise or technology. Utilizing outside contractors raises the risk of inconsistency in valuation methodologies, sources of information, and assumptions used in determining asset values among contractors if such requirements for consistency are not explicitly stated in the contractor's statement of work. Further, different valuation contractors engaged to perform various asset or liability valuations could have differing procedures or processes in place to determine the valuations and derive their support from different sources. Consistent methodology would improve DRR's assurance that the contractor valuations can be relied upon to accurately reflect asset values during the franchise marketing process.

DRR did not document its review of the asset valuation report received from the valuation contractor. RPM Chapter III, *Conducting the Asset Valuation Review*, requires an asset valuation review. However, the review process outlined in the RPM is outdated and references systems, documents, and job aids that are no longer being used. DRR developed an unofficial asset valuation report review checklist to document review procedures over work performed by asset valuation contractors but did not complete the checklist for AmTrust Bank. The completion of a review checklist is an important control function to help ensure that the contractor's report meets DRR requirements.

### *Selecting Bids*

DRR did not have documented regulatory approval for 2 of the 5 banks that submitted a total of 14 bids for AmTrust Bank. The RPM, section V.1, and section 22 of the *Marketing Coach Job Aid* state that the MS must obtain regulatory approval for the bids received. We found that, in practice, the MS obtains approval for bidders from the appropriate regulator of each potential bidder either orally or in written communication. For AmTrust Bank, the MS obtained documented approval of three banks through email from the regulatory agencies and received oral approval (by telephone) for the other two banks, but documentation of that communication was unavailable for our review.

Compensating controls exist that would prevent this lack of documentation of approval from the regulators leading to the award of a bid to a bank that was not approved. However, this lack of documentation can lead to a bank that was not approved and does not have the proper liquidity and capital requirements<sup>12</sup> bidding on the assets of the failing institution.

In addition, the manual has not been updated to reflect recent regulatory changes associated with the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act),<sup>13</sup> which will eliminate the OTS, and any reference to the OTS will need to be removed from the policy. Up-to-date policies, procedures, and guidelines are an important internal control for ensuring that processes are repeatable and consistent. Further, disciplined policies help reduce operational risk associated with changes in staff, use of term employees, and contractor personnel.

### *Least Cost Test Manual*

The LCT Manual provides a detailed description of procedures to determine the least costly resolution of a failing institution. However, the LCT Manual did not reflect the current DRR business model, liquidation value determination, roles and responsibilities, and statutory requirements. As a result, the LCT Manual procedures and guidelines could not be followed in all cases for determining the least costly resolution of AmTrust Bank.

The LCT Manual establishes a process for using the LCT Model and determining the least costly resolution of a failing institution. The financial information is also used in the Board Case. A DRR resolution specialist in Washington, D.C., prepares the Board Case for the FDIC Board of Director's approval. The Board Case gives DRR authority to determine the least costly resolution of the failing institution to the DIF.

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<sup>12</sup> FDIC Circular 6371.1, *Bidders List Preparation and Clearance Process*, dated December 20, 2004, requires that the potential bidders have a composite rating of 1 or 2 and possess sufficient resources in relation to the proposed acquisition. Circular 6371.1, also requires that the resultant institution have a Total Risk-Based Capital Ratio equal to or greater than 8 percent, a Tier 1 Risk-Based Capital Ratio equal to or greater than 4 percent, and a management rating of 2 or better.

<sup>13</sup> The Dodd-Frank Wall Street Reform and Consumer Protection Act, dated July 21, 2010 was enacted to promote the financial stability of the United States by improving accountability and transparency in the financial system, to end "too big to fail," to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and other purposes. The Dodd-Frank Act will reallocate savings and loan holding company supervision to the Federal Reserve, Federal savings institution supervision to the OCC, and State savings institution supervision to the FDIC.

The paragraphs below describe our audit results related to the LCT Manual.

#### *Liquidation Value Determination*

The LCT Manual contains outdated loss coefficients<sup>14</sup> to be used in determining the liquidation values of the premises and equipment, securities, accrued interest, prepaid expenses and other assets of the failing institution. The liquidation values can be unreliable if the manual does not reflect current financial statistical data. According to the RPM, assumptions should be based on actual liquidation practices and experience in the location of the failing institution's assets.

#### *Roles and Responsibilities*

The LCT Manual refers to certain employees by name within DRR. The LCT Manual should refer to employee position titles to ensure that the manual does not require frequent changes due to employee changes.

#### *Statutory Changes*

The LCT Manual states that escrow accounts for taxes and insurance, usually found in other liabilities are insured up to \$100,000; however, due to the recent passage of the Dodd-Frank Act, this amount is now set at \$250,000. Due to the lack of frequent updates, this change has not been made to the LCT Manual. The LCT Manual should reflect the latest statutory developments.

By updating policies and procedures, the FDIC could improve assurance that the least costly transaction is being determined consistent with management's direction and reliable information is provided in the Board Case for the FDIC Board of Director's approval and the Director DRR. Up-to-date policies, procedures, and guidelines are an important internal control for ensuring that processes are repeatable and consistent. Further, disciplined policies help reduce operational risk associated with changes in staff and use of term employees and contractor personnel.

**Recommendations:** *We recommend that the Director, DRR:*

- 1. Update the RPM and LCT Manual where appropriate. As part of this effort, define the frequency with which the manuals will be reviewed for possible updates.*
- 2. Provide instructions and guidance for methods and assumptions to be consistently used by the valuation contractors.*
- 3. Implement procedures to ensure that regulatory approval of bidders is documented and maintained.*
- 4. Formalize a checklist for the DRR reviewer's use in assessing whether the asset valuation conclusions reached by the valuation contractor are reasonable.*

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<sup>14</sup> Loss coefficients are expected losses on assets that are based on historical statistical analysis of failed banks for general asset categories. The current loss coefficients being used by the DRR are based on historical bank failure data from 1990 to 2003.

## **FINDING B: LEAST COST TEST MODEL**

The LCT Manual establishes a process for using the LCT Model in determining the least costly resolution of a failing institution. We found that the LCT Model and its related LCT Template lack a number of important controls such as password protection to ensure the integrity of the information, documented approval of changes to either the program or current version of the LCT Model, and the segregation of duties between the programmer making changes to the LCT Template and the testing of those changes. Due to an increase in the number of scenarios in which the template is now being used by DRR, program changes were required for the least cost test spreadsheet to include unique situations. Appropriately controlled access rights are required to protect the confidentiality, integrity, and availability of the resource and all associated data. Also, the presence of well-constructed, frequently changed passwords is required to limit access to corporate data to only those users who have a need to know the password. Maintaining the segregation of duties between the person making changes to the LCT Template and the person testing the changes is required to reduce the risk of errors to the template. Overall, the lack of internal control procedures to limit access to the LCT Model, the lack of segregation of duties between the programmer making changes to the LCT Model and the testing of those changes, and the lack of documentation of the approval of changes to the LCT Model could contribute to a loss in the integrity of the formulae within the LCT Model. These control deficiencies could lead to increased cost to the DIF if the least costly resolution is not selected as a result of inaccurate information. Details on each of these areas follow.

### ***Password Protection***

The LCT Template is used to create the LCT Model, which is then used by resolution specialists to enter institution and bid information and arrive at the least cost determination. The LCT Template is located on a specific drive on the FDIC network, and access to the drive is limited to DRR. According to the LCT Manual, the LCT Template is protected from changes and alterations by a password and can be opened only as a read-only file. The read-only file is then saved to a sub-folder usually named for the failing institution. However, we noted that once the template is used to create the LCT Model for each resolution, this password protection is lost and not reinstated to ensure the integrity of the information within the file.

### ***Approval of Changes***

In accordance with the LCT Manual, suggestions for changes to the LCT Model should be directed to the point of contact within DRR and the Associate Director of Resolution Strategy. As stated in the LCT Manual, the Associate Director should be responsible for approving all changes before they are made. Once the changes are approved, the point of contact within DRR will email the LCT Model changes to the programmer and the programmer's supervisor. The programmer must obtain the password from the point of contact before making changes. The point of contact within DRR tracks the change process and tests the changes for approval. After the changes are approved, the point of contact changes the password. The point of contact within DRR uses a spreadsheet to document all changes to the LCT Model and retains all correspondence concerning the changes. Due to an increase in the number of scenarios in which the template is now being used by DRR, program changes were required for the least cost test spreadsheet to include unique situations.

### ***Segregation of Duties over Program Changes***

We found no evidence of formal documentation of the testing over program changes to ensure changes to the LCT Model are operating properly. The programmer had direct control over the LCT Model to make changes. The lack of segregation between the development and testing of changes can affect the operation of the LCT Model. User testing, performed by the MS, allows for the evaluation of the functionality of the LCT Model. Overall, strengthening the information technology access, change, separation of duties, and approval controls can help ensure the integrity of the LCT Model and the least costly decision.

***Recommendation:*** *We recommend that the Director, DRR:*

- 5. Test and update the LCT Model's information security access, change, separation of duties, and approval controls, and implement or document that procedures established are being followed to maintain integrity of controls.*

## **FINDING C: LEAST COST TEST RESULTS FOR AMTRUST BANK**

We reviewed the bid analysis for all bids received for AmTrust Bank and confirmed DRR's determination of a P&A Agreement with NYCB as the least costly resolution in accordance with the RPM and LCT Manual. However, controls over information entered into the LCT Model for asset valuation percentages<sup>15</sup> and asset bid discounts could be enhanced. Specifically, the resolution specialist used incorrect percentages to value the assets at the then market value for eight of the asset groups. The resolution specialist rounded the asset discount value from a bid received which led to an incorrect cost determination. These errors were not detected because the resolution specialist did not complete the Qualified Bidder and LCT checklists required by the RPM and LCT Manual, respectively. In addition, the CTS submitted to the Board of Directors or Director, DRR, could be enhanced to provide additional disclosure of information for decision making.

DRR completed the LCT for AmTrust Bank and determined that there would be a cost of approximately \$3.7 billion to the DIF in the event of liquidation. The cost was determined through the use of data from the Balance Sheet of AmTrust Bank as well as asset valuations of several asset pools and the use of loss coefficients based on historical losses to the insurance funds for bank failures from 1990 to 2003. Our analysis of the asset valuations identified that two components, asset valuation percentages and asset discounts, that were used to derive the asset valuations contained errors, as discussed below. Using incorrect asset valuation percentages and discount values could lead to increased cost to the DIF.

### ***Asset Valuation Percentage***

During our testing of data entered into the LCT Model, we noted that the specialist used incorrect asset valuation percentages for eight of the asset groups. The correct asset valuation percentages were available in the valuation report. The use of the correct asset valuation percentages would have decreased the estimated value of the asset groups by about \$85 million, resulting in a liquidation cost estimate that was about \$85 million more than the liquidation cost estimate used in determining the least cost resolution. Therefore, the incorrect valuation percentages did not affect the least cost determination for AmTrust Bank. In addition, the specialist also incorrectly calculated the estimated loss for one asset group and "other assets" by transposing a number when entering the accrued interest balance. Similar to the asset valuation percentages, the correct calculation of the value of "other assets" would have increased the liquidation cost estimate. Nevertheless, the transposition error did not impact the least cost determination for AmTrust Bank.

The human input errors affecting the liquidation value computation did not affect the bid information or the bid process for AmTrust Bank. The liquidation value is used to compare the cost of liquidation by the FDIC to the cost of the bids received. Although, the manual input errors did have a significant effect on the liquidation value, in this instance, the errors did not have an effect on the selection of the winning bid.

### ***Asset Discount Value***

The resolution specialist entered a rounded instead of exact asset discount value for the bid from Bank D into the LCT Model. As identified in Table 2 below, the bid received from Bank D had an asset discount value of \$1,760,413,000. However, the resolution specialist entered an asset discount value of \$1,760,000,000 when performing the LCT Model. Accordingly the Bank D bid was overstated by \$413,000 during the bid analysis process. In this case, the rounding error did not have an effect on the bid evaluations, winning bid selection, or

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<sup>15</sup> Asset valuation percentages are based on an asset valuation review that compares the book value of assets to the estimated recovery values to help determine the projected net loss to the FDIC. The asset valuation percentages are used to determine the asset discount on the assets valued.

LCT, but using incorrect asset discount values could lead to an improper conclusion on the LCT and an increased cost to the DIF.

**Table 2: Bank D Bid Compared to Amount Entered Into the LCT Model**

<u>Description</u>	<u>Value</u>
Asset discount value from Bank D bid	\$ 1,760,413,000
Bank D asset discount value used in LCT Model calculation	1,760,000,000
<b>Asset discount value overstatement for Bank D bid</b>	<b>\$ 413,000</b>

*Source: Analysis of Bank D Bid on AmTrust Bank.*

### ***LCT and Qualified Reviewer Checklists***

The asset valuation percentages and asset discount value data entry errors were not detected because the LCT and Qualified Reviewer checklists were not completed for AmTrust Bank, and the information in the LCT Model was not verified for accuracy and completeness. The RPM requires the completion of the Qualified Reviewer checklist for each failed institution, and the LCT Manual requires that an LCT Checklist be completed by the specialist. According to DRR personnel, the LCT and Qualified Reviewer checklists were not completed because the resolution specialists relied on their years of experience in completing the LCT Model.

The LCT checklist is to be completed for each failing institution. For example, the checklist identifies the procedures to set up and complete the LCT Model. The procedures include: copying the template file to create the working LCT Model file; modifying the LCT Model file to conform with the recommended marketing strategy for the failing institution’s deposits, facilities, loan asset pools, loss share arrangements, and other liabilities and assets; and verifying the failing institution’s financial data, FDIC asset valuation data, and individual bid data inputs into the LCT Model. The LCT Manual requires that the resolution specialist complete, sign, and include the checklist in the failed institution’s asset marketing file.

The LCT Manual also requires the completion of a Qualified Reviewer Checklist, which requires the qualified reviewer to verify and trace the information in the LCT Model to ensure the completeness and accuracy of that information. The qualified reviewer is someone within DRR who is not familiar with the failing bank case but knowledgeable about the resolution process. According to the LCT Manual, once the AmTrust Bank case was finished and ready to be distributed to FDIC senior management, the qualified reviewer was supposed to conduct a review of the LCT and other components of the Board Case for consistency, clarity, and accuracy. The qualified reviewer must also verify that the LCT Model has not been modified when compared to the then-current template to ensure the integrity of the information entered into the LCT Model. The qualified reviewer is required to sign on the signature page of the BAM supporting the resolution recommendation.

### ***Cost Test Summary (CTS) and Bid Approval Memorandum***

The LCT Model produces the CTS, which compares the liquidation costs to the winning bid and the second-best bid. The CTS is included in the BAM submitted to the Director, DRR, for approval. The AmTrust Bank BAM included a description of the failing institution; the reason for the bank failure; and a discussion of the winning and the second-best bids, the CTS, and a summary of all bids received. The CTS could be enhanced to provide additional financial institution and bid information to facilitate decision making.

Specifically we noted the following in the AmTrust Bank CTS included in the BAM:

- An amount was labeled in the CTS for deposit payout to AmTrust depositors in the state of Ohio, when that amount actually represented the Ohio deposits and significant liabilities owed to additional creditors, including Federal Home Loan Bank advances. This can lead to a misrepresentation of the facts and the non-approval of a winning bidder by the Board of Directors or their delegate.
- Explanations were not provided for each item reported (such as Assets under Loss Share, Assets Passed with no Loss Share, Assets Retained, Initial Payment, etc.) in the CTS and the summary of bid information. This can lead to a misrepresentation of the facts and the non-approval of a winning bidder by the Board of Directors or their delegate.
- The format of the information presented in the CTS did not allow for a clear understanding of the differences between bids and the determination of the winning bidder. For example, the two top bids received included a loss share agreement; however, loss share payments were shown for only one bidder, and there was no reason given for the other bidder showing a zero loss share payment. Clear, distinct explanations of the information provided in the CTS will enhance the effects and differences between the two highest bids for the user, whether it is the Director, DRR, or the FDIC Board of Directors.

Overall, errors and the lack of clear explanations and information in the CTS could lead to the selection of a bid that does not represent the least loss to the FDIC.

***Recommendations:*** *We recommend that the Director, DRR:*

6. *Implement procedures to ensure the LCT and Qualified Reviewer checklists are completed to verify the completeness and accuracy of the information included in the LCT Model.*
7. *Expand informational disclosures to define and explain account descriptions contained in the CTS included in the BAM.*

## **FINDING D: BUSINESS INFORMATION SYSTEMS**

While comprehensive procedures existed for the collection and the distribution of data obtained from the failing institution during the AmTrust Bank franchise marketing process, internal control procedures could be improved to administer and manage access rights to database management systems.

Business Information Systems (BIS), an organizational unit within FAMB, supports the franchise marketing process by providing data processing services related to the failing institution. The BIS professionals work closely with the MS and team leader in gathering financial information related to the failing institution and distributing the data to DRR secure Websites for analysis by the resolution team and valuation specialist and in supporting financial institution bidding activities. The BIS professionals use contractors to assist with their procedures. In accordance with FDIC Circular 4010.3, the FDIC DRR has operating procedures for BIS that are current and appropriately documented, with reasonable controls incorporated into their procedures. However, enhanced management of administrative access rights would prevent the access of financial information by unauthorized users which could affect the integrity and accuracy of the information provided to DRR and bidding institutions.

### ***Access to Databases and Systems***

The FDIC granted an excessive number of user's administrative access rights to the database management system. Administrative access rights allow users to bypass many of the database management system controls over user activities. The FDIC granted these powerful access rights to 62 users for the structured query language main database containing the AmTrust Bank data download. The access permissions were granted primarily due to contractors being grouped together and given access as a group. In addition, the FDIC has established procedures governing the provisioning of user access accounts across all systems and databases; however, user access to the main database and SharePoint® Website is not rescinded in a timely manner after a bank closing. FDIC Directive 1360.15, *Access Control for Information Technology Resources*, dated February 27, 2009, states that access controls shall be implemented whenever an information technology (IT) resource owner requires that access to the IT resource must be restricted to a limited set of users or that different users require different types of access. Also, access to IT resources shall be provided for legitimate business use only after proper authorization has been provided when required. Based on inquiries with the FDIC's BIS and Division of Information Technology teams, we determined that the user access lists provided during the audit were the same as of the date of the AmTrust Bank closing, which evidenced that no user access had been rescinded after the closing. Access should be removed if the job responsibilities of the user change, if the user transfers to a different organization, or if the user no longer requires access for any other reason. Appropriate restriction of user access rights in accordance with FDIC policy and the timely rescission of user access after a bank closing will help prevent unauthorized data changes.

***Recommendation:*** *We recommend that the Director, DRR:*

8. *Implement a pre- and post-closing procedure to evaluate all access, including administrative access rights, and restrict access rights to reduce the potential for unauthorized data access changes.*

## **FINDING E: CONTRACT ADMINISTRATION**

The FDIC uses contractors to assist with asset valuation and data integrity throughout the franchise marketing process. Although the FDIC requires confidentiality agreements for contractors and their key professionals, for AmTrust Bank, confidentiality agreements could not be provided for two of the five key personnel identified in the Basic Ordering Agreement. In addition, the FDIC could not locate the confidentiality agreement for the primary contractor entity responsible for handling all the electronic data from the failing institution but executed a new agreement on September 20, 2010, following our inquiry. The Division of Administration (DOA) is responsible for the maintenance of confidentiality agreements. The missing documents can be attributed to the lack of procedures for tracking and maintaining confidentiality agreements. Consequently, the FDIC has less assurance that the contractors performing services under FDIC contracts have agreed to protecting and safeguarding sensitive information.

### ***Tracking and maintaining confidentiality agreements for certain contractors***

During our testing of contractor requirements related to the franchise marketing of AmTrust Bank, the FDIC could not provide evidence that the BIS contractor company signed the required confidentiality agreement before commencement of their engagement on AmTrust Bank. The FDIC obtained a company confidentiality agreement after our inquiry into the existence of an agreement. In addition, there was no record of confidentiality agreements, FDIC Form 3700-46, signed by the BIS contractor for two of the five key personnel identified in the Basic Ordering Agreement. Signature of the contractor on Form 3700-46 acknowledges that the contractor has read FDIC Circular 1360.9, *Protecting Sensitive Information*, dated April 30, 2007. This circular documents the FDIC policy on protecting sensitive information collected and maintained by the FDIC and provides guidance for safeguarding the information.

Without completed confidentiality agreements, the FDIC cannot ensure that FDIC contractors have agreed to protecting and safeguarding sensitive information as prescribed by FDIC Circular 1360.9.

***Recommendation:*** *We recommend that the Director, DRR:*

- 9. Coordinate with the DOA to implement procedures for the tracking and maintenance of DRR contractor confidentiality agreements.*

## **APPENDIX I**

### ***OBJECTIVE, SCOPE, AND METHODOLOGY***

#### **Objective**

The objective of this performance audit was to assess the FDIC's franchise marketing process for AmTrust Bank. Specifically, we assessed the reliability of and compliance with the FDIC's policies, procedures, standards, and guidelines for the franchise marketing of AmTrust Bank. To accomplish the objectives, BDO:

- Assessed the FDIC DRR's franchise marketing process and program results for AmTrust Bank.
- Assessed the FDIC DRR's overall internal control policies and general procedures for conducting the overall franchise marketing process for AmTrust Bank in accordance with applicable provisions of the RPM.
- Assessed the FDIC DRR's policies and procedures for asset valuations, including the related oversight and monitoring of contractors involved in the valuation of AmTrust Bank, and the review of the bank valuations by the DRR valuation expert in accordance with applicable DRR guidelines.
- Assessed FDIC DRR's policies and procedures for conducting the bidding process for AmTrust Bank in accordance with applicable sections of the RPM, and Marketing Coach and Team Leader Job Aids.
- Assessed FDIC DRR's policies and procedures for conducting the least cost test for AmTrust Bank that determines the winning bid in accordance with the LCT Manual and the least costly resolution strategy of AmTrust Bank to minimize the loss to the DIF.
- Assessed the completeness and accuracy of the failing institution data compiled by the FDIC BIS team.
- Assessed the completeness and accuracy of the BIS-generated deliverables, as well as the interfaces of the deliverables throughout the resolution process.

We conducted this performance audit from April 2010 through September 2010 in accordance with GAGAS. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

#### **Scope and Methodology**

Our procedures covered the processes followed during the franchise marketing process of AmTrust Bank. Specifically, the audit covered the following:

- Tested the compliance with overall internal control policies and general procedures by walkthrough procedures, which included either one or a combination of inquiry, observation, verification, or re-computation.
- Reviewed the contractor selection process, FDIC oversight and monitoring procedures of the contractors utilized, user/contractor access controls for sensitive information, and the final deliverable that aligns with the DRR Contractor Statement of Work.

- Determined whether the models, methodologies, and assumptions used by the valuation contractor are in accordance with FDIC guidelines, reviewed the controls over the determination of the value of AmTrust Bank, evaluated the effect of uninsured depositors on the valuation process, and assessed approvals of valuation deliverables and reasonability testing of the end results provided by the valuation contractor.
- Determined the reasonability of the values of the whole bank assets, liquidation values, and assets transferred and kept within the FDIC. In addition, we reviewed the valuation of the loans and other assets performed by the valuation specialist and determined the reasonability of other failed bank assets, liabilities, and intangible/intrinsic values, if any, not performed by the valuation contractor.
- Tested the controls surrounding the LCT, including worksheets utilized in the process. Specifically, we determined whether:
  - a. an LCT was conducted and performed timely;
  - b. the LCT Model is operating as designed;
  - c. the source data entered agrees to the source documents (AmTrust Bank financial data and bid information);
  - d. all resolution options were considered and properly evaluated;
  - e. the documentation of evaluations and assumptions was sufficient;
  - f. the procedures and rationale for the structure of the franchise sale and pre-set resolution were sound;
  - g. the authorization of the resolution decision with the lowest-cost option was given;
  - h. the Board Case development, content, and approvals were complete;
  - i. there was a comparison to actual sale results and whether the actual loss share component results are comparable to the estimate used in the valuation;
  - j. the LCT results estimate the actual impact to the DIF.
- Reviewed the process for the selection and approval of bidders, the exclusion of prohibited purchasers, and the receipt of bidder confidentiality agreements. We reviewed the authorization for marketing AmTrust Bank and determined whether the marketing strategy was developed in accordance with policies and procedures and whether approvals of the marketing strategy were obtained. Additionally, we reviewed the process for the establishment of the secure bidder Website, management of sensitive information, and whether archiving policies were achieved.
- Assessed and tested controls over data retrieval, dispersion, and storage as considered necessary. This includes controls over data postings to the various systems and the data integrity during the data extraction and delivery process performed by DRR.
- Evaluated the integrity of the AmTrust Bank data imported by the FDIC BIS team and reviewed the data for completeness and accuracy. Also evaluated the interfaces between the initially imported AmTrust Bank data and the various secure Website destinations.

## **APPENDIX II**

### **GLOSSARY OF TERMS**

<b><u>Term</u></b>	<b><u>Definition</u></b>
<b>Asset Valuation Review</b>	Process that estimates the value of assets to the FDIC as receiver of the failing institution. The asset valuation review compares the book value of assets to the estimated recovery values to help determine the projected net loss to the FDIC.
<b>Bid List</b>	List of qualified potential acquiring institutions provided to the FAMB by the Division of Risk Management Supervision. These potential acquiring institutions are invited to bid on the failing institution.
<b>Call Report</b>	Consolidated reports of condition and income submitted quarterly by an institution to the FDIC (for national and state non-member banks) or to the appropriate Federal Reserve Bank (for state member banks).
<b>Confidentiality Agreement</b>	Agreement between the FDIC and potential acquiring institutions and contractors, acknowledging the confidentiality of the failing institution's Information Package and other documents and procedures related to the resolution of the failing institution.
<b>Information Package</b>	Product developed by Franchise Marketing as a marketing tool, which provides a snapshot of the failing institution's assets, liabilities, and business on a specific date. It is comprised of two parts. The first part is a summary-level detail of assets and liabilities that are available for acquisition along with a summary of terms and various transactions being offered. The first part is provided to potential bidders. The second part provides specific detail of assets and liabilities, including items being excluded from the transaction. Both parts are provided to the FDIC Closing Team and other regulatory agencies to assist in preparation for a resolution.
<b>Least Cost Test</b>	An analysis of the bids received to determine the resolution alternative that will result in the least cost to the DIF.
<b>Least Cost Test Manual</b>	The Least Cost Test Manual provides a detailed description of how to use the LCT Model, which is used to determine the least costly resolution of a failing institution.
<b>Loss Share Agreement</b>	An agreement entered into by and between the FDIC, as receiver for a failed institution, and an acquiring institution whereby a pool of problem assets is sold to an acquiring institution under an agreement that the FDIC will share a portion of the losses. This structure allows the FDIC to reduce the immediate cash outlays for a P&A transaction and maximize asset recoveries.

<b><u>Term</u></b>	<b><u>Definition</u></b>
<b>Office of the Comptroller of the Currency</b>	Chartering agency for national banks and of the U.S. Treasury. OCC approval is required by law in connection with the organization of new national banks, the conversion of state-chartered banks into national banks, and consolidations or mergers involving national banks. In a failing bank situation, the OCC declares national banks insolvent, closes the institution, and appoints the FDIC as receiver.
<b>Office of Thrift Supervision</b>	The office within the U.S. Treasury Department that has responsibility for the overall supervision, regulation, and examination of federally chartered thrift institutions.
<b>Optional Asset Pools</b>	Under certain transaction structures, the FDIC will segregate assets of the failing institution into pools containing similarly situated assets. The prospective acquiring institution may submit a bid to purchase one or more of the pools, specifying the price bid for each pool to be acquired.
<b>Purchase and Assumption Agreement</b>	The agreements executed between the receiver, buyer, and seller of the failing institution.
<b>Qualified Financial Contracts</b>	Those qualified financial contracts that are defined in 12 U.S.C. 1821(e)(8)(D) to include securities contracts, commodity contracts, forward contracts, repurchase agreements, and swap agreements and any other contract determined by the FDIC to be a qualified financial contract as defined in that section.
<b>Qualified Reviewer</b>	Designated resolution specialist with responsibility to review the least cost determination. The qualified reviewer is someone within DRR who is not familiar with the case but knowledgeable about the resolution process.
<b>Receiver</b>	An agent (in the instance of a failed institution, the FDIC) appointed by a failed institution's primary regulator to manage the orderly liquidation of the failed institution.
<b>Resolutions Policy Manual</b>	The manual focuses on the overall resolution policies and general procedures. Detailed instructions for specific tasks are referenced throughout the manual.
<b>Servicing Pool</b>	A portfolio of assets often composed of assets with similar characteristics.
<b>Uninsured Deposits</b>	Amounts on deposit with a financial institution that are in excess of the amounts insured by the DIF.
<b>Value Appreciation Instrument</b>	A debt or equity instrument or obligation issued by an entity that entitles its holders to receive payments that depend primarily on the stock price of the entity.

### **APPENDIX III**

#### **ACRONYMS USED IN THE REPORT**

<b><u>Acronym:</u></b>	<b><u>Explanation:</u></b>
BAM	Bid Approval Memorandum
BDO	BDO USA, LLP
BIS	Business Information Systems
CTS	Cost Test Summary
DIF	Deposit Insurance Fund
DOA	Division of Administration
DRR	Division of Resolutions and Receiverships
DSC	Division of Supervision and Consumer Protection
FAMB	Franchise and Asset Marketing Branch
FDIC	Federal Deposit Insurance Corporation
FDICIA	Federal Deposit Insurance Corporation Improvement Act
GAGAS	Generally Accepted Government Auditing Standards
GAO	Government Accountability Office
IT	Information Technology
LCT	Least Cost Test
MS	Marketing Specialist
NARL	National Assumptions Reference Library
NYCB	New York Community Bank
OCC	Office of the Comptroller of the Currency
OIG	Office of Inspector General
OTS	Office of Thrift Supervision
P&A	Purchase and Assumption
RAVEN	Risk Analysis and Value Estimation
RMS	Division of Risk Management Supervision
RPM	Resolutions Policy Manual
U.S.C.	United States Code

***Part II***

***Management Comments and OIG Evaluation***

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## MANAGEMENT COMMENTS AND OIG EVALUATION

DRR provided a written response, dated February 28, 2011, to the draft of this report. Management's response is presented in its entirety beginning on page II-2. Management agreed with the nine BDO recommendations.

A summary of management's comments on the recommendations begins on page II-9. DRR's planned and completed actions are responsive to BDO's recommendations, and all of the recommendations are resolved. The recommendations will remain open until we determine that the agreed-to corrective actions have been completed and are responsive.

## MANAGEMENT COMMENTS



**Federal Deposit Insurance Corporation**

550 17th Street NW, Washington, D.C. 20429-9990

Division of Resolutions and Receiverships

DATE: February 28, 2011

TO: Russell A. Rau  
Assistant Inspector General for Audits

/Signed/  
FROM: Bret D. Edwards, Acting Director  
Division of Resolutions and Receiverships

SUBJECT: Response to Draft Audit Report Entitled, *The FDIC's Franchise Marketing of AmTrust Bank (Assignment No. 2010-032)*

This memorandum is in response to the recommendations in the subject draft audit report dated January 19, 2011.

The Division of Resolutions and Receiverships (DRR) has been working to strengthen internal controls in the Franchise Marketing process as a result of GAO's 2009 Financial Statement audit. Many of the recommendations included in the subject report are similar to those cited by GAO and have already been corrected or are in the process of being corrected.

Early in 2010, the Closed Bank Financial Risk Committee was established to quantify risks to the insurance fund that are posed by the resolution of failed insured institutions and failed institutions' assets. The committee meets quarterly and is comprised of senior management from DRR, Division of Insurance and Research (DIR), Division of Finance (DOF) and Division of Risk Management Supervision (RMS). In addition, DRR created various Job Aids and implemented new committees and review procedures for least cost test and asset valuations. In October 2010, a new statement of work for the asset valuation contract was issued. The new statement of work provides more detail, better guidance and clearer instruction regarding methodology and deliverables. An FA Asset Valuation Review Group and the Resolution Strategy Committee were established to enhance the quality of the valuations and to provide a mechanism for approving both the asset valuation and the resolution strategy developed for each failing institution. In May 2010, Business Information Systems (BIS) implemented a role-based security model for all new SharePoint sites and developed a plan to restrict the number of users with administrative rights to the database management system. Beginning in July, 2010, BIS began performing periodic security reviews to reduce the number of people with access over time.

DRR agrees with all recommendations in the draft report and is committed to implementing the recommendations in a timely manner.

**OIG Audit Recommendation 1:** Update the RPM and LCT Manual where appropriate. As part of this effort, define the frequency with which the manuals will be reviewed for possible updates.

**DRR Response:** DRR agrees with this recommendation. The Resolutions Policy Manual and Least Cost Test Manual have been combined (i.e. Resolution Manual) and updated.

In addition, the Franchise Marketing Job Aids have been updated. The Resolutions Manual has been vetted in accordance with our internal processes and with the Legal Division and was presented to DRR's Senior Management Oversight Committee (SMOC) on February 10, 2011. DRR anticipates that the Resolutions Manual will be approved by March 31, 2011. The Resolution Manual will be reviewed and updated, if necessary, on an annual basis. The Job Aids will be updated as needed with a complete review performed annually.

DRR would like to note that the use of outdated liquidation loss coefficients for non-loan and non-ORE assets was the best information available at the time of the least cost analysis was performed for AmTrust. The Research Model's loss coefficients were last updated for failures through 2003 using general ledger data through 2005. In 2007, DIR reviewed the data and determined that there was an insufficient amount of new data to update their model. DIR plans to review this data in 2011 to determine if there is a sufficient amount to update the model.

**OIG Audit Recommendation 2:** Provide instructions and guidance for methods and assumptions to be consistently used by the valuation contractors.

**DRR Response:** DRR agrees with this recommendation and the work to complete it was finished in 2010. During the third quarter of 2008, due to rapidly changing conditions in the financial markets the FDIC altered its pre-failure asset valuation methodology. Previously, the FDIC utilized internal staff employing the methodology detailed in the SAVE manual. Recognizing that this methodology no longer adequately reflected market conditions and did not produce accurate valuation results, DRR began to utilize valuation advisors who could provide valuation estimates that more accurately reflected the changes that had occurred in the financial marketplace. In 2010, DRR formally updated the SAVE manual referencing the use of valuation contractors and providing general procedural guidance. Initially, valuation contractors were also operating under contract terms that provided very broad guidance regarding valuation methodology. Beginning in October 2010, asset valuation contractors have been operating under new contract terms that contain a more structured statement of work than what was previously in place. The new statement of work provides more detail, better guidance, and clearer instructions regarding methodology, formatting, and deliverables. Contractors are now required to submit a spreadsheet containing multiple worksheets, each with their own specific information requirements. The contractors are now required to provide detail on their pricing methodology, assumptions, and file review notes in the narrative portion of their written report.

**OIG Audit Recommendation 3:** Implement procedures to ensure that regulatory approval of bidders is documented and maintained.

**DRR Response:** DRR agrees with this recommendation. Franchise Marketing procedures call for all regulatory approvals to be documented, and in the case of the AmTrust transaction, they were documented in the Marketing Specialist notes. To improve the

documentation supporting verbal confirmations received from the primary federal regulators of failing financial institutions, DRR will include additional steps in the procedures for documenting regulatory approval. The Marketing Specialist will ask the regulators to email confirmation that the bidders are cleared to bid. If a confirmation is not received and the regulator verbally cleared the bidder, then the Marketing Specialist will email the regulator confirming the phone conversation when the regulator cleared the bidder. After bid acceptance, the Marketing Specialist ensures that the winning bid was approved by FDIC's RMS and the chartering authority. The Marketing Specialist will continue to obtain written confirmation that the winning bid is approved by the appropriate regulators as is the current practice. The expected completion date for updating the Job Aid is April 30, 2011.

**OIG Audit Recommendation 4:** Formalize a checklist for the DRR reviewer's use in assessing whether the asset valuation conclusions reached by the valuation contractor are reasonable.

**DRR Response:** DRR agrees with this recommendation and the work to complete it was finished in 2010. Beginning in June 2010, DRR has significantly strengthened its valuation review process. A Job Aid was approved in October 2010. A Vertical Review Team has been established that formally reviews both the spreadsheet information and the narrative for each asset valuation report using a Vertical Review Checklist (Checklist). The Checklist includes reviews of the pricing methodology, assumptions, cumulative loss distribution, mathematical calculations, completeness, and a comparison of the spreadsheet and the narrative for supporting justification. A member of the Vertical Review Team signs each Checklist upon its completion. Approximately 100 Checklists have been reviewed and approved by signature since June 2010.

While the Vertical Review Team is completing its review, the AVR is sent to the FA Asset Valuation Review Group for a broader, more horizontal review. The review includes a comparison with previous AVR results, with other valuation contractors, and across geographic locations, looking for any outlier valuations that appear to be outside normal ranges given the specific asset types in question. The Checklist and Job Aids are referenced in the updated Resolutions Manual. The AVR deliverables as well as completed checklists are now all retained in 4C.

**OIG Audit Recommendation 5:** Test and update the LCT Model's information security access, change, separation of duties, and approval controls, and implement or document that procedures established are being followed to maintain integrity of controls.

**DRR Response:** DRR agrees with this recommendation and has implemented procedures to improve controls in this area. There are two primary Excel files that are used in the least cost analysis. The first is the LCT file that is used to determine the liquidation value and the cost of any non-loss share transactions. A second file, the Loss Share Worksheet, is used to determine the cost of loss share bids. Both spreadsheets are maintained on a secured drive that only Franchise Marketing staff can access.

Procedures for accessing, changing, approving, and testing over both of these files have been implemented. These procedures will be documented into a new Job Aid which is scheduled to be completed by April 30, 2011.

**OIG Audit Recommendation 6:** Implement procedures to ensure the LCT and Qualified Reviewer checklists are completed to verify the completeness and accuracy of the information included in the LCT Model.

DRR Response: DRR agrees with this recommendation and the work to complete it was finished in 2010. As a result of the findings contained in the GAO's 2009 financial statement audit report, Franchise Marketing implemented new review procedures in June 2010, to verify that the LCTs completed for failed banks were complete and accurate. The new review procedures were approved by the Deputy Director, DRR on July 29, 2010, and consist of the following: (1) a peer review utilizing a Qualified Reviewers Checklist (QRC); (2) the Manager, Franchise Marketing, reviews 100 percent of the LCTs and indicates evidence of review by signing the bid approval memo; (3) a post-closing review by Franchise Marketing staff using the QRC.

Franchise Marketing also conducted post-closing reviews on all 2010 failures using the newly implemented QRC. Any errors that are discovered during the post-closing review and impact the cost to the FDIC are corrected and promptly sent to Division of Finance so it can be reflected in the Corporation's books and records.

DRR would like to note that six of the eight errors that the OIG reported were errors related to rounding the AVR loss percentage provided by the contractor. The Analyst assigned to AmTrust rounded the AVR loss percentages in accordance with current LCT instructions.

**OIG Audit Recommendation 7:** Expand informational disclosures to define and explain account descriptions contained in the CTS included in the BAM.

DRR Response: DRR agrees with this recommendation. Although DRR cannot expand the descriptions contained in the CTS, DRR plans to provide better explanation in the Bid Approval Memorandum when there are account descriptions that deviate from the standard transactions being offered such as with nonconforming bids or as new structures are being introduced into the resolution process. The Director of DRR and the Board of Directors are familiar with these terms from the monthly Board Meetings and routine briefings.

The CTS is an excel spreadsheet that is used to present the results of the least cost analysis and therefore does not provide the flexibility for a description of every line item. Line items on the CTS that differ from the standard description will be revised to reflect the appropriate description or a footnote will be added to the CTS. Franchise Marketing will add a step to the Bid Approval-Least Cost Test Instructions checklist that requires the Analysts to expand informational disclosures that define and explain account

descriptions in the narrative of the Bid Approval Memorandum, as deemed necessary. DRR expects to complete the update to the Job Aid by April 30, 2011.

**OIG Audit Recommendation 8:** Implement a pre- and post-closing procedure to evaluate all access, including administrative access rights, and restrict access rights to reduce the potential for unauthorized data access changes.

**DRR Response:** DRR agrees with this recommendation. The following changes have been or are in the process of being implemented to improve our security posture.

To aid in administration of the BIS SharePoint server, we have added a new SharePoint security group (i.e. "BIS Collaboration Space Owners NLB") with access to all standard bank project data except areas containing sensitive Large Bank information. Members of this group are able to assist with security maintenance without access to sensitive Large Bank information.

Starting in May 2010, BIS has implemented a role-based security model for all new SharePoint sites. The roles are defined by a combination of departmental and functional responsibilities. This approach improves the management and reporting of access requests for Administrators and makes it easier for those requesting access to select targeted access to bank information. DRR's Business Program Management Section is currently updating DRR's SharePoint governance policy, which include the above mentioned role-based security model and is expected to be completed by April 30, 2011.

In conjunction with the implementation of role-based security for SharePoint mentioned above, BIS developed a plan to restrict the number of users with administrative rights to the database management system. The cornerstone of the plan is the creation of a new user role in the database management system with access to perform specific database functions. The role will be limited to table-level permissions including SELECT, INSERT, UPDATE and DELETE and database permissions such as CREATE TABLE. Limiting the activities the role can perform in this way will prevent non-administrative users from altering database membership. DRR anticipates that the new user role approach will be fully implemented by June 30, 2011, which includes defining permissions, testing the new roles, implementing in the production database and monitoring.

Beginning in July 2010, BIS began performing periodic security reviews corresponding with Critical Bank Project Milestones noted below to reduce the number of people with access over time. This is consistent with the sound application of the concept of least privilege for systems access. At the time of the reviews, non-essential user access to the database system and SharePoint information is restricted. Eventually (i.e. post-close plus 1 year), only BIS Administrators will retain access to the bank information on both the database management system and SharePoint.

Critical Bank Project Milestones:

1. Post-Close + 60 Days: Site-specific security group users are removed except for Legal, Investigations, & Managers. Global security groups remain.
2. Post-Close + 90 Days: Users are removed from the Managers site-specific security group, leaving Legal and Investigations. Global security groups remain.
3. Post-Close + 1 Year: All site-specific Legal and Investigations security group users are removed. All global access groups are removed except for BIS SharePoint Administrators.

**OIG Audit Recommendation 9:** Coordinate with the DOA to implement procedures for the tracking and maintenance of DRR contractor confidentiality agreements.

**DRR Response:** DRR agrees with this recommendation with respect to non-key personnel; and we note that DOA issued policy addressing non-key personnel that is consistent with the OIG's recommendation. On September 15, 2010, DOA issued Interim Acquisition Policy Memorandum (IAPM) 2010-02, entitled Obtaining Confidentiality Agreements from Non-Key Personnel, to revise APM 5.104(b) to reflect the immediate need for requiring confidentiality agreements for non-key personnel in situations where contractor personnel were performing in high risk roles. With this revision, the policy continues to reflect the requirement that the Contracting Officer (CO) obtain the confidentiality agreements from an authorized representative from the contractor along with any key personnel. It further requires that "when the program office and Contracting Officer jointly determine it is in the best interest of FDIC, all or certain categories of non-key personnel may be required to sign confidentiality agreements." On February 7, 2011, the Assistant Director of Contract Oversight, DRR, sent a global email to DRR Oversight Managers reminding them of their responsibilities regarding the request, receipt, and filing of the confidentiality agreements for non-key personnel. The email also included a copy of IAPM 2010-02.

With respect to key personnel, the appropriate procedures for tracking and maintenance of contractor confidentiality agreements are the responsibility of the CO and have been implemented. The Acquisition Policy Manual 5.104(b), the accompanying Procedures, Guidance, and Instructions, and IAPM 2010-02 address the requirements for obtaining confidentiality agreements from contractor and associated personnel. Furthermore, to address its responsibilities, DOA hired additional personnel, which made significant improvements to the process of uploading and tracking required contract documents in the CEFile.

Under the Procurement and Payment Delegations of Authority issued by the FDIC Board of Directors pursuant to Resolution No. 072865, adopted December 7, 2004, DOA has sole authority to develop policy for contracting (other than for Legal services). Accordingly, DRR has determined that the improvement in DOA's controls has

addressed the OIG's concerns regarding confidentiality agreements, and we see no need to request DOA revise its current policies.

cc: Ron Bieker, DRR  
Pamela Farwig, DRR  
Gail Patelunas, DRR  
Herb Held, DRR  
Bill Ostermiller, DRR  
James Angel, OERM  
Steve Trout, DRR  
Howard Cope, DRR

## SUMMARY OF MANAGEMENT’S COMMENTS ON THE RECOMMENDATIONS

This table presents management’s response to the recommendations in the report and the status of the recommendations as of the date of report issuance.

Rec. Number	Corrective Action: Taken or Planned	DRR Completion Date	Monetary Benefits	Resolved: <sup>a</sup> Yes or No	Open or Closed <sup>b</sup>
1.	DRR agreed with the recommendation. The RPM and LCT Manual have been combined as the <i>Resolutions Manual</i> . DRR anticipates that the <i>Resolutions Manual</i> will be approved by March 31, 2011. The <i>Resolutions Manual</i> will be reviewed and updated annually, if necessary.	March 31, 2011	\$0	Yes	Open
2.	<p>DRR agreed with this recommendation and completed corrective actions in 2010. In June 2010, DRR formally updated the <i>Standard Asset Value Estimation (SAVE) Manual</i> referencing the use of valuation contractors and providing general procedural guidance.</p> <p>Initially, valuation contractors were operating under contract terms that provided very broad guidance regarding valuation methodology. As of October 2010, asset valuation contractors have been operating under new contract terms that contain a more structured statement of work than was previously in place. The new statement of work provides more detail, better guidance, and clearer instructions regarding methodology, formatting, and deliverables. Contractors are now required to submit specific information in a multi-page spreadsheet format. In addition, contractors are now required to provide detail on their valuation methodology, assumptions, and file review notes in the narrative portion of their written report.</p>	October 2010 <sup>c</sup>	\$0	Yes	Open

Rec. Number	Corrective Action: Taken or Planned	DRR Completion Date	Monetary Benefits	Resolved: <sup>a</sup> Yes or No	Open or Closed <sup>b</sup>
3.	<p>DRR agreed with this recommendation. To improve the documentation supporting verbal confirmations received from the primary federal regulators of failing institutions, DRR will include additional steps in the procedures for documenting regulatory approval. The MS will ask the regulators to email confirmation that the bidders are cleared to bid. If a confirmation is not received and the regulator verbally cleared the bidder, the MS will email the regulator confirming the phone conversation when the regulator cleared the bidder. The expected completion date for updating the corresponding Job Aid is April 30, 2011.</p>	April 30, 2011	\$0	Yes	Open
4.	<p>DRR agreed with this recommendation and completed corrective action in 2010. DRR’s response states that DRR strengthened the valuation review processes beginning in June 2010. A Job Aid was approved in October 2010. A Vertical Review Team has been established that formally reviews both the spreadsheet information and the narrative for each asset valuation report, using a Vertical Review Checklist. Approximately 100 of these checklists have been reviewed and approved since June 2010.</p> <p>Additionally, the results of the Asset Valuation Review are sent to the DRR’s Asset Valuation Review Group for review. This review includes “a comparison with previous AVR [Asset Valuation Review] results, with other valuation contractors, and across geographic location, looking for any outlier valuations that appear to be outside normal ranges.”</p> <p>The Vertical Review Checklist and Job Aids are referenced in the updated <i>Resolutions Manual</i>, and the Asset Valuation Review deliverables as well as completed checklists are now retained in the Communication, Capability, Challenge, and Control (4C) System.</p>	October 2010 <sup>c</sup>	\$0	Yes	Open

Rec. Number	Corrective Action: Taken or Planned	DRR Completion Date	Monetary Benefits	Resolved: <sup>a</sup> Yes or No	Open or Closed <sup>b</sup>
5.	<p>DRR agrees with this recommendation and has implemented procedures to improve controls in this area. Procedures for accessing, changing, approving, and testing over both the LCT file and the Loss Share Worksheet have been implemented. These procedures will be documented in a new Job Aid, which is scheduled to be completed by April 30, 2011.</p>	April 30, 2011	\$0	Yes	Open
6.	<p>DRR agreed with this recommendation and completed corrective action in 2010. As a result of the findings contained in the GAO's 2009 financial statement audit report, DRR's Franchise Marketing implemented new review procedures in June 2010 to verify that the LCTs completed for failed banks were complete and accurate. The new review procedures were approved by the Deputy Director, DRR, on July 29, 2010, and consist of the following: (1) a peer review utilizing a Qualified Reviewers Checklist; (2) the Manager, Franchise Marketing, reviews 100 percent of the LCTs and indicates evidence of review by signing the BAM; and (3) a post-closing review by Franchise Marketing staff using the Qualified Reviewers Checklist.</p> <p>In addition, Franchise Marketing conducted post-closing reviews on all 2010 failures, using the newly implemented Qualified Reviewers Checklist. Any errors that are discovered during the post-closing review and impact the cost to the FDIC are corrected and promptly sent to the FDIC's Division of Finance to be reflected in the Corporation's books and records.</p>	July 29, 2010 <sup>c</sup>	\$0	Yes	Open

Rec. Number	Corrective Action: Taken or Planned	DRR Completion Date	Monetary Benefits	Resolved: <sup>a</sup> Yes or No	Open or Closed <sup>b</sup>
7.	<p>DRR agreed with this recommendation. DRR stated that the descriptions contained in the CTS cannot be expanded, but DRR plans to provide better explanation in the BAM when there are account descriptions that deviate from the standard transactions being offered such as with nonconforming bids or as new structures are being introduced into the resolution process. DRR's response states that the Director, DRR, and Board of Directors are familiar with bid terms from the monthly Board Meetings and routine briefings.</p> <p>According to DRR, the CTS is an Excel spreadsheet that is used to present the results of the least cost analysis and therefore does not provide the flexibility for a description of every line item. Line items on the CTS that differ from the standard description will be revised to reflect the appropriate description, or a footnote will be added to the CTS. Franchise Marketing will add a step to the Bid Approval-Least Cost Test Instructions Checklist that requires the Analysts to expand informational disclosures that define and explain account descriptions in the narrative of the BAM, as deemed necessary. DRR expects to complete the update to the related Job Aid by April 30, 2011.</p>	April 30, 2011	\$0	Yes	Open

Rec. Number	Corrective Action: Taken or Planned	DRR Completion Date	Monetary Benefits	Resolved: <sup>a</sup> Yes or No	Open or Closed <sup>b</sup>
8.	<p>DRR agreed with this recommendation. According to DRR, the following changes have been made or are in the process of being implemented to improve security.</p> <ul style="list-style-type: none"> <li>- To aid in administration of the BIS SharePoint server, DRR added a new SharePoint security group with access to all standard bank project data except areas containing sensitive Large Bank information.</li> <li>- In May 2010, BIS implemented a role-based security model for all new SharePoint sites. DRR's Business Program Management Section is currently updating DRR's SharePoint governance policy, which includes the role-based security model and is expected to be completed by April 30, 2011. In conjunction with the implementation of role-based security for SharePoint mentioned above, BIS developed a plan to restrict the number of users with administrative rights to the database management system by creating a new role in the system with access to perform specific database functions. Limiting the activities the new role can perform will prevent non-administrative users from altering database membership. DRR anticipates that the new user role approach will be implemented by June 30, 2011.</li> <li>- In July 2010, BIS began performing periodic security reviews corresponding with Critical Bank Project Milestones to reduce the number of people with access over time. At the time of each review, non-essential user access to the database system and SharePoint information is restricted.</li> </ul>	June 30, 2011	\$0	Yes	Open

Rec. Number	Corrective Action: Taken or Planned	DRR Completion Date	Monetary Benefits	Resolved: <sup>a</sup> Yes or No	Open or Closed <sup>b</sup>
9.	<p>DRR agreed with this recommendation. DRR noted that on September 15, 2010, DOA issued policy addressing non-key personnel that is consistent with the OIG’s recommendation. The policy addresses the immediate need for requiring confidentiality agreements for non-key personnel in situations where contractor personnel were performing in high-risk roles. On February 7, 2011, the Assistant Director of Contract Oversight, DRR, sent a global email to DRR Oversight Managers, reminding them of their responsibilities regarding the request, receipt, and filing of the confidentiality agreements for non-key personnel.</p> <p>DRR determined that improvement in DOA’s controls have addressed the OIG’s concerns regarding confidentiality agreements for contractors and key personnel. With respect to key personnel, the appropriate procedures for tracking and maintaining contractor and key personnel confidentiality agreements are the responsibility of the Contracting Officer and have been implemented. Furthermore, to address its responsibilities, DOA hired additional personnel which made significant improvements to the process of uploading and tracking required contract documents in the Contract Electronic File.</p>	February 7, 2011 <sup>c</sup>	\$0	Yes	Open

<sup>a</sup> Resolved – (1) Management concurs with the recommendation, and the planned, ongoing, and completed corrective action is consistent with the recommendation.  
(2) Management does not concur with the recommendation, but alternative action meets the intent of the recommendation.  
(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.

<sup>b</sup> Once the OIG determines that the agreed-upon corrective actions have been completed and are responsive to the recommendations, the recommendations can be closed.

<sup>c</sup> DRR comments indicate that these four recommendations have been implemented, and they will be closed once we determine the corrective actions have been completed and are responsive.