Office of Inspector General

Executive Summary

The FDIC's Shared-Loss Agreement with Banco Popular de Puerto Rico, San Juan, Puerto Rico

Report No. AUD-12-001
October 2011

Why We Did The Audit

On April 30, 2010, the Office of the Commissioner of Financial Institutions of the Commonwealth of Puerto Rico closed Westernbank Puerto Rico, Mayaguez, Puerto Rico (Westernbank), and appointed the FDIC as receiver. The FDIC's Division of Resolutions and Receiverships (DRR) has been delegated primary responsibility for resolving a failed financial institution and managing the resulting receivership. To protect depositors, the FDIC entered into a Purchase and Assumption (P&A) Agreement with Banco Popular de Puerto Rico, San Juan, Puerto Rico (Banco Popular). The FDIC also entered into two Shared-Loss Agreements (SLA) with Banco Popular – one for commercial loans and one for single family loans - covering $8.77 billion in assets from Westernbank.

The objectives of this audit were to (1) assess Banco Popular's compliance with the terms of the commercial loan SLA and (2) describe DRR's oversight of the Banco Popular SLA.

Background

A common resolution method that the FDIC uses for resolving failed institutions is a P&A transaction, wherein an acquiring institution (AI) purchases some or all of the assets and assumes some or all of the liabilities of a failed institution. An SLA is a means to facilitate P&A transactions. Under the SLA, the FDIC agrees to absorb a portion of the loss on a specified pool of assets in order to maximize asset recoveries and minimize losses. Loss sharing reduces the immediate cash needs of the FDIC, provides greater operational efficiency for failed bank customers, and facilitates moving assets quickly into the private sector. Typically, the FDIC absorbs a significant portion (generally 80 percent) of loss on the SLA portfolios, and AIs absorb the remaining loss.

This audit addressed Banco Popular's commercial loan SLA with the FDIC, under which Banco Popular acquired 43,873 commercial assets totaling $7.8 billion. Under the SLA, the FDIC pays Banco Popular 80 percent of the incurred losses, as reported on the loss claim certificates, in accordance with the SLA. As of June 30, 2011, Banco Popular had submitted three commercial shared-loss certificates totaling $699 million.

Audit Results

Overall, we found that Banco Popular has acted proactively to facilitate compliance with the commercial loan SLA and cooperated with the FDIC in managing its commercial shared-loss portfolio. Nonetheless, we identified questioned claims related to:

- accrued interest on non-accrual loans,
- estimated costs in charge-off calculations,
- recoveries on charged-off loans,
- unsupported reimbursable expenses, and
- unsupported loss claims.

These questioned claims represent 3.8 percent of the total claims that we audited. Some of the questioned claims appear to be errors attributable to Banco Popular management's initial unfamiliarity with the failed bank's recordkeeping systems and/or certain aspects of the FDIC's SLA terms and process. Banco Popular officials agreed with our findings, have adjusted systems and audit processes to ensure correct calculation of costs and charge-offs and are continuing to work to identify supporting documentation regarding unsupported expenses and loss claims.

We made five recommendations for the FDIC to disallow the questioned claims. We provided detailed information about those questioned claims to DRR in our non-public audit report. We plan to report $16.6 million as questioned costs (of which $6.7 million are unsupported costs) in our next *Semiannual Report to the Congress*. The amount ultimately disallowed by the FDIC could decrease if Banco Popular submits appropriate supporting documentation.

With respect to DRR's oversight of the Banco Popular SLA, the division has established an approach that involves three primary components:

- ongoing communication between the bank and DRR specialists assigned to monitor and facilitate the bank's compliance;
- a validation, review, and approval process for shared-loss certificates filed by Banco Popular; and
- on-site reviews conducted by DRR contractors to evaluate the bank's overall SLA compliance.

DRR has also taken program-wide steps that facilitate its oversight of the Banco Popular SLA, including: establishing procedures for oversight of SLAs; conducting information-sharing sessions with AIs, oversight staff, and contractors; and establishing a database for tracking AIs' compliance with SLAs.

Management Comments

The Director, DRR, provided a written response, dated October 13, 2011, to a draft of this report. In the response, the Director agreed with our five recommendations. DRR's planned and completed actions are responsive to the recommendations, and all of the recommendations are resolved.

Because this report includes confidential information, we do not intend to publicly release the report in its entirety.