Office of Inspector General

Office of Audits and Evaluations
Report No. EVAL-17-001

FDIC's Efforts to Ensure SLA Recoveries Are Identified and Remitted

December 2016

Office of Inspector General

Executive Summary

FDIC's Efforts to Ensure SLA Recoveries Are Identified and Remitted

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Why We Did The Evaluation

We initiated this evaluation based on the risks associated with assuming institutions (AI) identifying and remitting Shared-Loss Agreement (SLA) recoveries to the FDIC. An increasing number of Commercial SLAs (CSLA) are becoming 5 years old, resulting in the end of SLA loss coverage but not the end of the 8-year recovery period, during which AIs are required to remit a portion of their recoveries to the FDIC.

The objective of this evaluation was to assess the Division of Resolutions and Receiverships' (DRR) efforts to ensure that AIs identify and remit SLA recoveries to the FDIC. To address the objective, we assessed FDIC policies, procedures, and training pertaining to SLA recoveries and DRR's timeliness in identifying assets that AIs are required to report on during the recovery-only period. We also engaged the professional services firm, BDO USA, LLP (BDO) to test a sample of CSLA and Single-Family SLA (SF SLA) assets pertaining to five AIs selected by the Office of Inspector General.[1] BDO assessed whether the AIs identified and remitted applicable recoveries to the FDIC and pursued recoveries on SLA assets similarly to how they pursued recoveries on their non-SLA assets.

Background

The FDIC first introduced SLAs as a part of selected Purchase and Assumption (P&A) transactions in 1991 to reduce the FDIC's immediate cash outlays, provide continuity of banking services to failed bank customers, and move assets into the private sector. Under an SLA, the FDIC[2] enters into a P&A Agreement with an AI to absorb a portion of the loss (typically 80 percent) on a specified pool of assets.

The FDIC provides SLA coverage for single-family (SF) and commercial assets and has provisions for legal termination when SLAs naturally expire.[3] SF SLAs typically cover losses and recoveries for a 10-year period and terminate on the tenth anniversary of the commencement date. CSLAs typically cover an 8-year period and terminate on the eighth anniversary of the commencement date. Typically, the first 5 years of a CSLA covers losses and recoveries and the final 3 years covers recoveries only (referred to as the recovery-only period).

A recovery typically comprises (1) funds paid by the borrower on assets that the AI previously charged off or experienced a loss on and received reimbursement from the FDIC pursuant to an SLA; or (2) gains from the sale of foreclosed property or SLA assets. The FDIC is entitled to share in recoveries on SLA assets charged off for all 10 years on SF SLAs. The FDIC is generally entitled to share SLA recoveries with an AI on SLA assets charged off during the first 5 years of the CSLA and may also receive a share of recoveries on those assets through year 8 of the CSLA. The FDIC is generally not entitled to share in any recoveries with an AI on CSLA assets charged off in years 6 through 8.

[1] This report does not identify the names of the five AIs that we reviewed for confidentiality reasons and because they are open institutions. We separately provided our detailed findings to each AI.
[2] Throughout this report, for ease of reference, "FDIC" refers to the FDIC when acting in its corporate or receivership capacity.
[3] SLA coverage may also apply to securities and subsidiaries.

AIs are required to use their best efforts to maximize SLA recoveries and collections and minimize FDIC losses. If an SLA's loss-sharing percentage is 80 percent, the FDIC would generally reimburse an AI for 80 percent of its losses on SLA assets but would also be entitled to 80 percent of recoveries on SLA assets. When an AI experiences a recovery on an SLA asset, it includes that amount in a certificate that it submits to the FDIC for review. Loss claims are also included on certificates and recovery and loss amounts are netted, resulting in net payments to the FDIC or AI. DRR reviews and approves the certificates for payment.

DRR is responsible for the FDIC's Risk Sharing Asset Management (RSAM) Program, which serves as the primary means of providing SLA program oversight. As a means of evaluating and monitoring AI compliance with SLAs, the FDIC uses third-party contractors to complement its staff.

Evaluation Results

DRR established controls to mitigate risks and help ensure AIs appropriately identify and remit recoveries to the FDIC. These controls include a process for identifying recovery and non-recovery assets and conducting on-site reviews that focus on recoveries. DRR also issued guidance and provided training to DRR employees, AIs, and third-party contractors DRR engages to complement its staff. The guidance and training communicate recovery period procedures and expectations.

At the inception of the recovery-only period for CSLAs, DRR generates a Recovery Asset Workbook, which identifies assets the AI is required to report on during the recovery-only period. We found that DRR timely finalized the majority of the Workbooks that we reviewed.

BDO found no exceptions at three of the five AIs they reviewed. BDO identified an unreported recovery of $16,423 at one AI as a result of an isolated oversight. The AI agreed with the finding and reimbursed the FDIC for the recovery, following BDO's review.

At another AI, BDO found that the AI overpaid the FDIC by $249,937 in recoveries ($257,060 in overpayments minus $7,123 in underpayments). The overpayments pertained to 7 of 68 SLA assets reviewed by BDO and the underpayment pertained to one asset. The net over payment was due to internal control weaknesses and accounting software limitations at the AI. The AI stated that improved internal controls, processes, and software changes that have either been implemented or are underway should prevent similar findings from occurring in the future. BDO also identified an additional SLA asset where the AI may have overpaid the FDIC in recoveries by $19,526. DRR confirmed BDO's findings during an onsite review of the AI in October 2016 and identified an additional $9,072 in overpayments. The AI plans to process adjustments totaling $278,535 to satisfy all OIG and DRR questioned claims.

Recommendations and Management Response

We recommended that DRR assess the progress made by the AI that overpaid the FDIC in implementing changes to ensure accurate identification and reporting of SLA recoveries to the FDIC. We also recommended that DRR review a sample of the AI's SLA certificates to determine whether errors similar to the ones identified by our review are prevalent with other SLA certificates, and take appropriate action. DRR concurred with the report's recommendations and described corrective actions that were responsive.

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FDIC
Federal Deposit Insurance Corporation
3501 Fairfax Drive, Arlington, VA 22226

Office of Audits and Evaluations
Office of Inspector General

DATE: December 6, 2016

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

/Signed/

FROM: E. Marshall Gentry
Assistant Inspector General for Evaluations

SUBJECT: Evaluation of the *FDIC's Efforts to Ensure SLA Recoveries Are Identified and Remitted* (Report No. EVAL-17-001)

This report presents the results of the subject evaluation. We initiated this evaluation based on the risks associated with assuming institutions (AI) identifying and remitting Shared-Loss Agreement (SLA) recoveries to the FDIC. The objective of our evaluation was to assess DRR's efforts to ensure that AIs identify and remit SLA recoveries to the FDIC.

To address our objective, we assessed FDIC policies, procedures, and training pertaining to SLA recoveries and DRR's timeliness in finalizing Recovery Asset Workbooks.[4] We also engaged the professional services firm, BDO USA, LLP (BDO), to test a sample of Commercial SLA (CSLA) and Single-Family SLA (SF SLA) assets pertaining to five AIs selected by the OIG (herein referred to as AIs 1 - 5).[5] BDO assessed whether the AIs identified and remitted applicable recoveries to the FDIC and pursued recoveries on SLA assets similarly to how they pursued recoveries on non-SLA assets. The evaluation scope covered the inception of each AI's applicable Purchase and Assumption Agreement (P&A Agreement) through December 31, 2015. Information about the five AIs is noted in Table 1.

Table 1: AIs Selected for Review

AI	Inception of P&A Agreement	Type of SLA Reviewed	Initial SLA Asset Balance (approximately)
1	2011	CSLA	$300 million
2	2009	CSLA	$2 billion
3	2009	CSLA	$3 billion
4	2009	SF SLA	$6 billion
5	2010	CSLA	$1 billion

Source: OIG-generated based on AI P&A Agreements and FDIC records.

[4] Certain terms are underlined when first used in this report and defined in Appendix 2, *Glossary of Terms*.
[5] This report does not identify the names of the five AIs that we reviewed for confidentiality reasons and because they are open institutions. We separately provided our detailed findings to each AI.

Appendix 1 of this report includes additional details on our objective, scope, and methodology; Appendix 2 contains a glossary of key terms; Appendix 3 contains a list of acronyms; Appendix 4 contains the Corporation's comments on this report; and Appendix 5 contains a summary of the Corporation's corrective actions.

Background

The FDIC first introduced SLAs as a part of selected P&A transactions in 1991 to reduce the FDIC's immediate cash outlays, provide continuity of banking services to failed bank customers, and move assets into the private sector. Under an SLA, the FDIC[6] enters into a P&A Agreement with an AI to absorb a portion of the loss (typically 80 percent) on a specified pool of assets. The FDIC's Division of Resolutions and Receiverships (DRR) is responsible for the FDIC's Risk Sharing Asset Management (RSAM) Program, which serves as the primary means of providing SLA program oversight. As a means of evaluating and monitoring AI compliance with SLAs, the FDIC uses third-party compliance monitoring contractors (CMCs) to complement its staff.

The FDIC provides SLA coverage for single-family (SF) and commercial assets and has provisions for legal termination when SLAs naturally expire.[7] SF SLAs typically cover losses and recoveries for a 10-year period and terminate on the tenth anniversary of their commencement date. CSLAs typically cover an 8-year period and terminate on the eighth anniversary of the commencement date. Typically, the first 5 years of a CSLA covers losses and recoveries and the final 3 years covers recoveries only (referred to as the recovery-only period).

In general, a recovery typically comprises (1) funds paid by the borrower on assets that the AI or failed bank previously charged off or experienced a loss on and received reimbursement from the FDIC pursuant to an SLA; or (2) gains from the sale of foreclosed property or SLA assets. The FDIC is entitled to share in recoveries on SLA assets charged off for all 10 years on SF SLAs. The FDIC is generally entitled to share SLA recoveries with an AI on SLA assets charged off during the first 5 years of the CSLA and may also receive a share of recoveries on those assets through year 8 of the CSLA. The FDIC is generally not entitled to share in any recoveries with an AI on CSLA assets charged off in years 6 through 8.

AIs are required to use their best efforts to maximize SLA recoveries and collections and minimize FDIC losses. SLA loss-sharing and recovery percentages are specified in the SLA. If an SLA's loss-sharing percentage is 80 percent, the FDIC would generally reimburse an AI for 80 percent of its losses on SLA assets but would also be entitled to 80 percent of recoveries on SLA assets. When an AI experiences a recovery on an SLA asset, it includes that amount in a certificate that it submits to the FDIC for review. Loss claims are also included on certificates and recovery and loss amounts are netted, resulting in net payments to the FDIC or AI. DRR reviews and approves the certificates for payment.

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[6] Throughout this report, for ease of reference, "FDIC" refers to the FDIC when acting in its corporate or receivership capacity.
[7] SLA coverage may also apply to securities and subsidiaries.

Table 2 shows historical information about SLAs and recoveries. The FDIC entered into 304 SLAs from November 2008 through September 30, 2016, with an initial asset base of $216.5 billion.[8] As of September 30, 2016, FDIC recoveries totaled $5.1 billion, representing 15 percent of the $34.1 billion in FDIC SLA payments.

Table 2: SLA Statistics: November 2008 - September 30, 2016

Category	Amount ($ in thousands)
Number of SLAs	304
Initial Assets Subject to Loss Sharing	$216,456,705
Remaining Assets Subject to Loss Sharing	$22,328,839
FDIC's Loss-Share Payments	$34,050,905
Recoveries Remitted to FDIC	$5,060,275
FDIC Net Payments (Payments – Recoveries)	$28,990,630

Source: Division of Finance (DOF) Loss Sharing Summary Report as of September 30, 2016.

Beginning in 2010, to increase the incentive for AIs to pursue recoveries, some P&A Agreements allowed AIs to retain 50 percent of the recovery amounts on assets fully charged off by the closed bank prior to the AI's acquisition, even if the loss-sharing provision was 80 percent. The FDIC referred to these assets as zero balance assets. In late 2011, the FDIC changed its overall policy so that zero balance assets were no longer included as SLA assets and instead retained by the FDIC, as receiver.

Prior OIG Work. In a February 2012 OIG evaluation, we found that additional FDIC guidance was needed to mitigate the risk that AIs were not reporting recoveries to the FDIC.[9] At that time, DRR had not issued formal guidance outlining how DRR and CMCs should review an AI's portfolio to determine if the AI was reporting recoveries. We also found that the FDIC was not initially tracking AI recoveries associated with zero balance assets. Accordingly, we recommended that DRR issue additional guidance on how to evaluate whether AIs were sufficiently pursuing and reporting recoveries.

DRR addressed the prior OIG recommendation by revising the CMC statement of work (SOW) in June 2012. The revised SOW further specified CMC responsibilities to assess AI loss mitigation efforts on SLA assets and ensure AIs were reporting recoveries and collections on charged off assets (including zero balance assets) to the FDIC. The revised SOW required CMCs to sample test (1) certificates with recoveries to ensure AIs accurately calculated, timely reported, and adequately supported recoveries; and (2) zero balance assets for possible recoveries. DRR revised the CMC SOW several times since June 2012, with each revision addressing CMC responsibilities to assess AI efforts to maximize recoveries. Additionally, DRR issued guidance to AIs, CMCs, and its staff on ensuring recoveries are identified and reported.

[8] The FDIC had not executed any SLAs from September 2013 through September 30, 2016.
[9] *Evaluation of the FDIC's Monitoring of Shared-Loss Agreements*, EVAL-12-002, February 2012.

Evaluation Results

DRR established controls to mitigate risks and help ensure AIs appropriately identify and remit recoveries to the FDIC. These controls include a process for identifying recovery and non-recovery assets and conducting on-site reviews that focus on recoveries. DRR also issued guidance and provided training to DRR employees, AIs, and CMCs. The guidance and training communicate recovery period procedures and expectations.

At the inception of the recovery-only period for CSLAs, DRR generates a Recovery Asset Workbook, which identifies assets the AI is required to report on during the recovery-only period. We found that DRR timely finalized the majority of Workbooks that we reviewed.

BDO found no exceptions at three of the five AIs tested. BDO identified an unreported recovery of $16,423 at AI-3 as a result of an isolated oversight. The AI agreed with the finding and reimbursed the FDIC for the recovery, following BDO's review.

At AI-5, BDO found that the AI overpaid the FDIC by $249,937 in recoveries ($257,060 in overpayments minus $7,123 in underpayments). The overpayments pertained to 7 of 68 SLA assets reviewed by BDO and the underpayment pertained to one asset. The net over payment was due to internal control weaknesses and accounting software limitations at the AI. The AI stated that improved internal controls, processes, and software changes that have either been implemented or are underway, should prevent these findings from occurring in the future. BDO also identified an additional SLA asset where the AI may have overpaid the FDIC in recoveries by $19,526.

DRR confirmed BDO's findings during an onsite review of AI-5 in October 2016 and identified an additional $9,072 in overpayments. The AI plans to process adjustments totaling $278,535 to satisfy all OIG and DRR questioned claims in its December 31, 2016 certificate.

We are recommending that DRR assess the progress made by AI-5 in implementing changes to ensure accurate identification and reporting of SLA recoveries to the FDIC. We are also recommending that DRR review a sample of the AI's SLA certificates to determine whether errors similar to the ones identified by our review are prevalent with other SLA certificates, and take action, as appropriate.

DRR Has Implemented Controls to Mitigate Risks Associated with AI Reimbursement of SLA Recoveries

One risk associated with SLA recoveries is that an AI will not track, report, and remit recoveries to the FDIC, as required. Other risks include an AI's failure to use their best efforts to maximize recoveries as required by the SLA or an AI delaying efforts to pursue recoveries until after an SLA terminates.

To address these risks, DRR established processes and controls to help ensure that AIs remit recoveries. Specifically, DRR:

- **Established a Process for Reviewing Claim Certificates.** DRR established a multi-step process for examining and validating certificates submitted by AIs. Certificates are not processed until they are validated and approved by RSAM specialists, who monitor AI compliance with SLAs.

- **Established a Process to Identify Recovery and Non-recovery CSLA Assets.** Within 90 days following the last shared-loss quarter, DRR's goal is to work with the AI to identify and agree upon a final list of CSLA assets the AI is required to report on during the recovery-only period. As part of this process, DRR may communicate with the AI to gain a better understanding of the AI's efforts to maximize recoveries. The agreed-upon assets are included in a Recovery Asset Workbook, which becomes the basis for future certificate filings. These assets include all remaining CSLA assets, which are categorized as recovery and non-recovery assets.

  Recovery assets comprise assets for which the AI may incur recovery expenses and must share recoveries with the FDIC. DRR has defined specific characteristics of recovery assets such as those with charge-offs, covered losses, and owned real estate (ORE).

  Non-recovery assets include assets for which the AI had not submitted SLA claims and had no recoveries due to the FDIC. An AI is prohibited from claiming recovery expenses on these assets. Nevertheless, AIs must continue to report loss, recovery, and expense activity unless they meet certain exceptions. The purpose of this reporting requirement is to allow DRR staff to monitor the AI's management of the assets during the life of the CSLA.

- **Conducts On-site Reviews.** AIs are subject to periodic reviews by CMCs and/or DRR throughout the life of an SLA. CMC reviews focus primarily on loss claims at the inception of an SLA and increasingly shift in focus to recovery efforts as SLAs age. When AIs enter the CSLA recovery-only period, CMC reviews focus heavily on recoveries. The reviews also assess AI accounting functions for applying and reporting funds to the FDIC and staff roles and responsibilities.

- **Assigns a DRR RSAM Specialist and CMC Technical Monitor to AIs.** The RSAM specialist oversees the AI, reviews certificate filings, and assesses AI efforts to identify and pursue recoveries. The CMC Technical Monitor coordinates with the CMC, oversees the CMC's work, and ensures the CMC complies with the SOW.

- **Monitors the Status of CSLA Assets During the Recovery-only Period.** Six different reports are created in DRR's Resolution Transaction Submission Portal (RTSP) system after a CSLA enters the recovery-only period. These reports show the maturity dates of the assets, whether they are accrual or non-accrual assets, whether the related borrowers were subject to any legal judgments, the disposition of ORE assets, and AI expenses associated with recoveries. This information allows DRR to better understand how the AI is managing the assets and enables DRR to more readily understand the likelihood of AI collections on the assets. The reports may also prompt DRR staff to inquire about an

AI's efforts to collect on outstanding balances.

- **Monitors AI Recovery Rates and Compares AI Performance to Its Peers.** DRR developed reports that compare charge-off, recovery, and other portfolio statistics among AIs with similar SLA portfolios. The reports also identify AIs with recovery rates that are significantly above or below those of its peers.

DRR also developed performance goals related to SLA recoveries. DRR established and met the following goal in 2014:

> *Design a comprehensive recovery period strategy and develop a recovery monitoring and reporting process for all stakeholders to ensure we have an integrated approach to monitor agreements during the recovery period.*

To achieve this goal, DRR further defined the roles and responsibilities of applicable program staff, issued additional guidance on recovery monitoring for DRR staff and AIs, updated the CMC SOW to require proportionately larger sample testing on recovery assets as CSLAs age, enhanced its RTSP system for tracking SLA data to support monitoring assets with potential recoveries, designed a communication strategy to raise awareness across program participants, and enhanced the recovery process based on lessons learned.

DRR Issued Guidance and Provided Training Pertaining to SLA Recoveries

DRR issued guidance and provided training to communicate recovery period procedures to DRR employees, CMCs, and AIs.

Guidance. In 2013 and 2014, DRR issued three job aids to its staff that provided instructions on reconciling recovery assets, finalizing Recovery Asset Workbooks, and monitoring AIs during the recovery-only period through DRR or CMC reviews.

In March 2014, DRR provided AIs with answers to questions about the recovery-only period. The answers addressed matters such as reporting deadlines and how to submit documentation supporting recoveries and related expenses.

In May 2014, DRR issued a memorandum to AIs reiterating that the management and servicing standards applicable to the first 5 years of the CSLA continue through the last 3 years.

In April 2015, DRR distributed guidance to AIs, CMCs, and its own staff that clarified how AIs should report recoveries to the FDIC. The guidance further clarified how AIs should report recovery data in certificates, and emphasized that AIs are required to continue reporting on assets classified as both recovery and non-recovery assets, follow usual and prudent business and banking practices, and use their best efforts to maximize recoveries.

Training and Conferences. DRR further reinforced its guidance through training and other communications, as described in Table 3.

Table 3: Training and Conferences Pertaining to SLA Recoveries

Training	Date	Summary
Recovery Period Training	2014	DRR employee training on monitoring SLA assets during the recovery-only period and ensuring proper reporting by AIs.
Asset Reporting Guidance	June 2014	DRR employee training on SLA assets AIs are required to report on to the FDIC.
Recovery Training	June 2014	DRR employee training on calculating recoveries, generating Recovery Asset Workbooks, monitoring AIs during the recovery-only period, reviewing certificates, and changes to the CMC SOW.
Recovery Asset Workbook Overview Training	July 2014	AI and DRR employee training on identifying recovery assets, reporting requirements, and timelines for completing Recovery Asset Workbooks.
Asset Reporting Guidelines Training	February 2015	AI and DRR employee training on recovery asset reporting, including RTSP workflow enhancements.
Final Recovery Monitoring Training	April 2015	DRR employee training on recovery risk management and loss mitigation.
Shared-Loss Program Conference and Webinar	October 2015	AI and CMC conference and webinar outlining DRR's expectations during the recovery-only period, including the goal to maximize recoveries and continue reporting on assets classified as both recovery and non-recovery assets during the entire term of the SLA.

Source: OIG analysis of DRR training presentations.

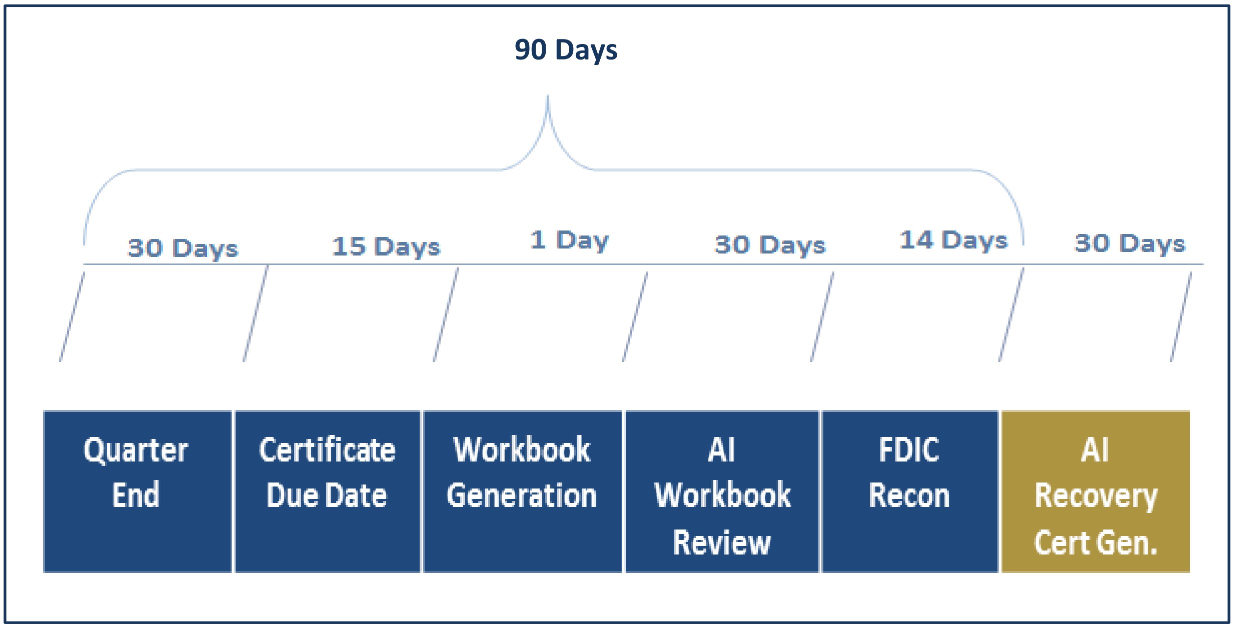
DRR Timely Finalized the Majority of CSLA Recovery Asset Workbooks Reviewed

A DRR job aid dated September 22, 2014, states that AI Recovery Asset Workbooks should be finalized within 90 days following the AI's last shared-loss quarter (typically the last quarter of year 5 for a CSLA). DRR finalized the majority of the Workbooks we reviewed within this 90-day timeframe. The job aid also provides that an AI's first recovery certificate should be filed within 120 days of the AI's last shared-loss quarter. If Workbook finalization is delayed, the first recovery certificate may also be delayed because AIs generally file this certificate after Workbook finalization. The majority of AIs timely submitted their first CSLA recovery certificate to the FDIC.

The initial Workbook is automatically generated by RTSP following the completion of the final shared-loss certificate. DRR and the AI review and reconcile the assets in the Workbook and ultimately agree on which assets to include in the final Workbook. DRR then finalizes the Workbook in RTSP. DRR automated the Workbook finalization process in September 2015. Prior to this date, the finalization process was largely manual.

The timeline below shows DRR's expected timeframes to finalize Workbooks and receive an AI's first recovery certificate.

Figure: Recovery Asset Workbook Finalization Timeframe



Source: DRR guidance.

We reviewed all Workbooks that were initiated as of September 22, 2014—the date DRR's applicable job aid took effect—and finalized as of December 31, 2015. A total of 126 Workbooks met our criteria. On average, it took DRR 92 days to finalize the Workbooks. Table 4 shows selected statistics from our findings.

Table 4: Timeframes for Finalizing Recovery Asset Workbooks

Information about Workbooks	Number
Workbooks Reviewed	126
Average Number of Days to Finalize Workbooks	92 days
Median Number of Days to Finalize Workbooks	82 days
Workbooks Finalized within 90 days	84 (67%)
Workbooks Finalized in 91 –120 days	22 (17%)
Workbooks Finalized in more than 120 days	20 (16%)

Source: OIG analysis of RTSP data.

DRR informed us that delays in finalizing Workbooks were generally due to the large effort on behalf of DRR and AIs to reconcile certain assets, especially older SLA assets that had loss claims prior to 2011, when DRR had not assigned each SLA asset with an FDIC asset identification number. We noted one Workbook with an exceptionally long finalization timeframe (280 days). A DRR official said finalization was delayed due to an arbitration agreement with the AI, which took a long time to settle. The arbitration agreement gave the AI an additional shared-loss quarter before beginning the recovery period. Excluding this

Workbook from our analysis, it took DRR an average of 91 days to finalize the Workbooks.

We also analyzed whether AIs timely filed their first recovery certificate with DRR. We considered a first recovery certificate to be timely if the AI filed it (1) within 120 days of each AI's last shared-loss quarter or (2) within 30 days of the Workbook finalization date. In making this determination we reviewed recovery certificate filing timeframes associated with 114 of the 126 Workbooks. We excluded 12 Workbooks from our review because the related CSLAs were terminated before the first recovery certificates were finalized. We found that AIs timely filed 75 of 114 first recovery certificates (66 percent) with the FDIC. AIs filed 38 of the remaining 39 first recovery certificates late, but within 90 days of the Workbook finalization dates. One AI filed its first recovery certificate 148 days late because of a legal matter between the FDIC and AI.

Because Workbooks must generally be finalized before AIs file their first recovery certificate, DRR should continue its efforts to finalize Workbooks in 90 days or less. Workbooks finalized in this timeframe correlate to timely recovery certificate filings and therefore timely submission of recoveries to the FDIC. We are not making a related recommendation regarding these matters because we concluded that Workbooks and first recovery certificates were generally finalized or filed on time and there was only a minimal impact when they were late.

AIs Generally Remitted Applicable Recoveries to the FDIC

BDO assessed AI compliance with P&A Agreement requirements for remitting SLA asset recoveries for the five AIs. Specifically, BDO selected and reviewed 306 SLA assets, ranging from 33 to 72 SLA assets per AI plus five non-SLA assets per AI to determine if the AIs pursued recoveries on SLA and non-SLA assets in a similar manner.[10] Appendix 1 describes BDO's sampling methodology and shows the number of assets BDO sampled at each AI. Table 5 summarizes BDO's observations.

Table 5: AI Review Observations

Observations	AI-1	AI-2	AI-3	AI-4	AI-5
The AI's management of SLA assets appeared consistent with its management of non-SLA assets, as required by the SLA.	Yes	Yes	Yes	Yes	Yes
The AI timely submitted quarterly certificates to the FDIC.	Yes	Yes	Yes	Yes	Yes
The AI properly remitted funds to the FDIC via wire.	Yes	Yes	Yes	Yes	Yes
The SLA assets and related balances selected for review were accurately accounted for in the AI's P&A Agreement.	Yes	Yes	Yes	Yes	Yes
The AI performed a detailed reconciliation of activities related to SLA assets on a monthly basis.	Yes	Yes	Yes	Yes	Yes
Source documentation in the AI's loan files and transaction histories supported SLA certificates.	Yes	Yes	Yes *	Yes	Yes *

* AI source documentation supported SLA certificates except for sampled assets where BDO had findings, as noted below.
Source: OIG-generated based on BDO's observations from the five AIs.

[10] BDO used a combination of statistical and judgmental sampling to select the assets reviewed. As a result, BDO's testing results were not projectable to any of the overall SLA portfolios reviewed.

BDO found no exceptions at three of the five AIs. BDO identified an unreported recovery of $16,423 at AI-3 as a result of an isolated oversight. The AI agreed with the finding and reimbursed the FDIC for the recovery, following BDO's review.

At AI-5, BDO found that the AI overpaid the FDIC by $249,937 in recoveries ($257,060 in overpayments minus $7,123 in underpayments). The overpayments pertained to 7 of 68 SLA assets reviewed by BDO and the underpayment pertained to one asset. The net over payment was due to internal control weaknesses and accounting software limitations at the AI. The AI stated that improved internal controls, processes, and software changes that have either been implemented or are underway, should prevent similar findings from occurring in the future. The recovery findings were from certificates filed from 2010 through 2013. BDO also identified an additional SLA asset where the AI may have overpaid the FDIC in recoveries by $19,526.

We informed DRR of our findings associated with AI-5 and in October 2016, DRR's CMC reviewed the SLA assets referred to above as part of an on-site review at the AI. DRR confirmed BDO's findings and identified an additional $9,072 in overpayments. The AI plans to process adjustments totaling $278,535 to satisfy all OIG and DRR questioned claims in its December 31, 2016 certificate.

Recommendations

We recommend that the Director, DRR:

1. Assess the progress that AI-5 made in implementing changes to ensure accurate identification and reporting of SLA recoveries to the FDIC.

2. Review a sample of SLA certificates in connection with AI-5 to determine if errors similar to the ones identified by our review exist with other SLA certificates, and take action, as appropriate.

Corporation Comments and OIG Evaluation

The Director, DRR, provided a written response dated November 22, 2016, to a draft of this report. The response is presented in its entirety in Appendix 4. In its response, DRR concurred with both report recommendations and plans to implement them in February and March 2017. A summary of the Corporation's corrective actions is presented in Appendix 5. We consider management's response sufficient to resolve the recommendations.

Objective, Scope, and Methodology

Objective and Scope

Our evaluation objective was to assess DRR's efforts to ensure that AIs identify and remit SLA recoveries to the FDIC. The OIG and BDO performed work to address this objective. The OIG assessed FDIC policies, procedures, and training pertaining to SLA recoveries. The OIG also assessed DRR's timeliness in finalizing Recovery Asset Workbooks. BDO assessed AI compliance with requirements in P&A Agreements pertaining to recoveries on SLA assets for the five AIs discussed in this report. The scope of the evaluation covered the inception of each AI's P&A Agreement governing the SLA reviewed through December 31, 2015. Three of the five SLAs reviewed by BDO were in the recovery-only period during BDO's review.

Methodology

The majority of recoveries are associated with CSLA assets. However, recoveries are also present on SF SLA assets, although the likelihood of a recovery and the recovery amounts are generally less than those associated with CSLA assets. As a result, our evaluation assessed recoveries pertaining to CSLA assets for four of the five AIs reviewed. The dollar value of the SF SLA assets associated with AI-4 comprised 99.9 percent of the portfolio. As such, our evaluation assessed recoveries pertaining to SF SLA assets for AI-4.

The OIG and/or BDO:

- Assessed DRR policies, procedures, guidance, training materials, and CMC SOWs for ensuring compliance with SLA recovery provisions.
- Tested DRR's timeliness in finalizing Recovery Asset Workbooks within its established 90-day timeframe.
- Tested compliance with SLA recovery provisions in the P&A Agreement applicable to each AI selected by reviewing a sample of assets at each AI.
- Assessed each AI's policies and procedures for ensuring compliance with SLA recovery provisions.
- Interviewed DRR, CMC, and AI officials.

We conducted this evaluation from January through August 2016, in accordance with the Council of the Inspectors General on Integrity and Efficiency's *Quality Standards for Inspection and Evaluation*. We performed our work at the FDIC's offices in Arlington, Virginia, at BDO's offices, and at office locations of the five AIs in various states.

Objective, Scope, and Methodology

Sampling

Selection of five SLAs for testing. The five SLAs the OIG selected for testing resulted from receiverships with remaining SLA asset balances of at least $200 million (for SF SLAs and CSLAs combined) based on DOF's Loss Sharing Summary Report as of November 30, 2015. According to this report, a total of 23 receiverships met this threshold. We selected this threshold to reduce the possibility of an SLA early termination during or shortly after our evaluation. At the time of our selections, an AI could be eligible for an early termination if its combined SLA asset balances were $200 million or less ($100 million per SLA and $200 million combined for SF and CSLA portfolios). On May 5, 2016, the combined threshold was raised to $400 million or less.[11]

Of the 23 receiverships that met our threshold, we identified 14 potential receiverships for review. To identify these receiverships, we considered charge-off and recovery rates, and the geographic locations of the failed banks. We shared the 14 potential selections with DRR and requested feedback. DRR preferred that we review certain receiverships, which represented various portfolio sizes, asset types, years when loans were made, and geographic locations. The receiverships that we selected met our selection criteria and DRR's preferences.

DRR suggested we not review SLAs pertaining to certain AIs because the AIs were facing issues that DRR believed could impact our review. These issues included ongoing litigation with the FDIC regarding SLA provisions or AIs that underwent extensive DRR compliance reviews just prior to our evaluation.

Assets Selected for Testing. BDO considered SLA assets to be eligible for testing if they had charge offs and/or recoveries. BDO used statistical sampling to obtain an asset sample from each AI's eligible assets. BDO's statistical sampling methodology employed a 95-percent confidence interval,[12] 5-percent desired precision level,[13] and 5-percent expected incidence rate.[14] After employing statistical sampling, BDO judgmentally replaced certain assets based on feedback from DRR or the make-up of each AI's SLA assets. BDO also judgmentally selected SLA consumer and zero balance assets if applicable.

Given its combination of statistical and judgmental sampling, BDO's testing results were not projectable to any of the overall SLA portfolios reviewed. Table 6 shows SLA assets selected for each AI.

[11] The FDIC endeavors to terminate early those SLAs that result in estimated savings to the FDIC rather than waiting until the SLA's expiration date as defined in the P&A agreement.
[12] A confidence interval gives an estimated range of values which is likely to include an unknown population parameter, the estimated range being calculated from a given set of sample data.
[13] A desired precision level represents the allowable or acceptable error rate.
[14] The expected incidence rate represents the estimated rate of errors in the population.

Objective, Scope, and Methodology

Table 6: SLA Assets Selected for Review

Eligible and Selected SLA Assets	# SLA Assets	Covered Losses	Charge-offs	Recoveries
AI-1: Eligible	62	$27,593,839	$36,124,511	$11,602,540
AI-1: Selected	33	$19,439,508	$28,454,724	$11,514,721
AI-1: Percent	53%	70%	79%	99%
AI-2: Eligible	889	$457,247,926	$486,596,760	$149,443,505
AI-2: Selected	67	$31,599,522	$34,582,558	$10,982,318
AI-2: Percent	8%	7%	7%	7%
AI-3: Eligible	697	$413,333,360	$428,650,657	$85,854,496
AI-3: Selected *	66	$62,192,529	$65,869,375	$9,673,119
AI-3: Percent	9%	15%	15%	11%
AI-4: Eligible	6,814	$433,065,847	$165,623,841	$21,720,782
AI-4: Selected	72	$4,856,624	$1,309,615	$301,087
AI-4: Percent	1%	1%	1%	1%
AI-5: Eligible	1,071	$115,339,662	$110,854,372	$23,555,147
AI-5: Selected *	68	$4,143,590	$4,785,129	$1,587,177
AI-5: Percent	6%	4%	4%	7%

* In addition to the assets shown in the table, BDO judgmentally selected and tested five SLA consumer assets for AI-3 and AI-5 and five SLA zero balance assets for AI-5. The other AIs did not have eligible consumer and/or zero balance assets.
Source: OIG-generated based on BDO sample selection data.

BDO also judgmentally selected five non-SLA assets per AI to assess each bank's efforts to pursue recoveries on their non-SLA assets in comparison to their SLA assets.

Glossary of Terms

Term	Definition
Assuming Institution (AI)	A healthy bank or thrift institution that purchases some or all of the assets and assumes some or all of the liabilities of a failed institution in a P&A transaction.
Certificate	A document, signed by an officer of the purchaser involved in, or responsible for, the administration and servicing of the shared-loss loans in such form and detail as specified in the SLAs. AIs are required to file SF SLA certificates with the FDIC on a monthly basis and CSLA certificates on a quarterly basis.
Commercial Shared-Loss Agreement (CSLA)	An SLA that typically covers an 8-year period with the first 5 years for losses and recoveries with the final 3 years for recoveries only. The FDIC pays the AI when the assets are charged off or written down according to established regulatory guidance or when the assets are sold.
Purchase and Assumption Agreement (P&A Agreement)	A legal document governing the resolution transaction between the FDIC in its corporate and receivership capacities and an AI. P&A Agreements may include specific shared-loss exhibits that govern the operations and obligations of the FDIC and the AI with regard to the SLAs.
Recovery	A recovery typically comprises (1) funds paid by the borrower on assets that the AI or failed bank previously charged off or experienced a loss on and received reimbursement from the FDIC pursuant to an SLA; or (2) gains from the sale of foreclosed property or SLA assets.
Recovery Asset	Any asset on which the possibility of a recovery exists, even if the asset experienced a terminal event such as a sale.
Recovery Asset Workbook	A listing of CSLA recovery and non-recovery assets, based on a specific defined logic, that AIs are required to report on during the recovery period.
Resolution Transaction Submission Portal (RTSP)	An outsourced system developed by Midland Loan Services, a PNC Real Estate business. RTSP is a repository of SLA claims for AIs covered by SLAs. RTSP verifies certificates containing claims submitted by AIs, tracks the claim submission data, creates payment vouchers, and stores payment approvals and documentation.
Shared-Loss Agreement (SLA)	A financial arrangement wherein the FDIC agrees to absorb a portion of the loss on a specified pool of assets sold to an AI. An SLA includes an estimated loss for the final resolution of the shared-loss assets.
Single-Family Shared-Loss Agreement (SF SLA)	An SLA that typically covers a 10-year period. The FDIC provides coverage for losses associated with the following single-family mortgage events: (1) modification, (2) short sale, (3) sale of foreclosed property, and (4) charge offs pertaining to some second lien loans. Loss coverage also applies to loan sales, provided that prior approval of the sale was obtained by the FDIC. The FDIC pays the AI when a loss is incurred associated with one of the four single-family loss events.
Statement of Work (SOW)	A description of the work to be performed by a contractor, including deliverables and technical details.
Terminal Event	An event that results in an SLA asset no longer being covered by the SLA. Terminal events apply to an SLA asset sale, an SLA asset paid in full, an SLA asset with no prior claims that is refinanced through the origination of a new loan, and an SLA asset that was managed in a way that violated the SLA.

Acronyms

Acronym	Explanation
AI	Assuming Institution
BDO	BDO USA, LLP
CMC	Compliance Monitoring Contractor
CSLA	Commercial Shared-Loss Agreement
DOF	Division of Finance
DRR	Division of Resolutions and Receiverships
FDIC	Federal Deposit Insurance Corporation
ORE	Owned Real Estate
P&A Agreement	Purchase and Assumption Agreement
RSAM	Risk Sharing Asset Management
RTSP	Resolution Transaction Submission Portal
SF SLA	Single-Family Shared-Loss Agreement
SLA	Shared-Loss Agreement
SOW	Statement of Work

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FDIC

Federal Deposit Insurance Corporation
3701 N. Fairfax Drive, Arlington, VA 22203 Division of Resolutions and Receiverships

November 22, 2016

TO: E. Marshall Gentry
Assistant Inspector General for Evaluations
Office of Inspector General

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

SUBJECT: Management Response to Draft Report Entitled, *Evaluation of the FDIC's Efforts to Ensure SLA Recoveries Are Identified and Remitted (Assignment No. 2016-008)*

The Federal Deposit Insurance Corporation (FDIC) has completed its review of the Office of Inspector General's (OIG) draft report entitled *Evaluation of the FDIC's Efforts to Ensure SLA Recoveries Are Identified and Remitted (Assignment No. 2016-008)* dated November 9, 2016. We appreciate the OIG's observations and recommendations to ensure assuming institutions accurately identify and remit SLA recoveries to the FDIC.

In its report, the OIG states that DRR established controls to mitigate risks and help ensure AIs appropriately identify and remit recoveries to the FDIC. We agree with the OIG about the need to address certain issues identified during the course of the evaluation, especially and including the internal controls and processes used by AI-5. We also agree with the OIG's recommendation that DRR review a sample of AI-5's Certificates to determine whether errors similar to the ones identified by the OIG evaluation are prevalent with other AI-5 Certificates.

Below is a description of DRR's specific corrective actions for each OIG recommendation.

Recommendation 1: Assess the progress that AI-5 made in implementing changes to ensure accurate identification and reporting of SLA recoveries to the FDIC.

DRR Response: DRR concurs with this recommendation.

Corrective Action: On October 27, 2016, DRR completed onsite fieldwork as part of the annual compliance review for AI-5. As recommended by the OIG, DRR incorporated specific test steps and procedures into the review plan to evaluate AI-5's policies, procedures and related software updates. One of the purposes of this review was to confirm that AI-5 had improved its internal controls and processes, as well as its software management, to ensure that recoveries are identified and remitted in compliance with the SLA. The review found no instances of deviation from the enhanced policies and procedures.

We are in the process of writing the review report. The timeline for completion of the report is typically 50 days from the end of fieldwork, allowing time for the AI to review the report and provide a response that will be incorporated in the final report. In addition, the work.

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papers will be reviewed and finalized during this time. DRR will provide supporting documentation to the OIG by February 15, 2017.

Completion Date: February 15, 2017.

Recommendation 2: Review a sample of SLA certificates in connection with AI-5 to determine if errors similar to the ones identified by our review exist with other SLA certificates, and take action, as appropriate.

DRR Response: DRR concurs with this recommendation.

Corrective Action: As recommended by the OIG, DRR expanded routine sampling in our compliance review of AI-5, referenced above. The review created a certainty stratum in the sample, which included the eight assets identified by the OIG for further evaluation.

In addition to the OIG's observation totaling $249,937, the compliance review identified an additional claim that AI-5 calculated incorrectly, increasing the amount due to AI-5 by $9,072, for a total of $259,009.

The OIG report references a ninth asset, in which AI-5 overstated the recovery by $19,526. The compliance review validated the OIG's determination of an overstated recovery in the amount of $19,526. AI-5 plans to process adjustments in the amount of $278,535 to satisfy all OIG and DRR questioned claim amounts in its December 31, 2016 certificate.

The December 31, 2016 certificate from AI-5 containing the referenced adjustments is due to the FDIC on January 31, 2017. Certificate processing typically occurs within 15 days. Once the certificate is processed, DRR will provide supporting documentation by March 15, 2017.

Completion Date: March 15, 2017.

Summary of the Corporation's Corrective Actions

This table presents the corrective actions taken or planned by the Corporation in response to the recommendations in the report and the status of the recommendations as of the date of report issuance.

Rec. No.	Corrective Action: Taken or Planned	Expected Completion Date	Monetary Benefits	Resolved:[a] Yes or No	Open or Closed[b]
1	On October 27, 2016, DRR completed onsite fieldwork as part of an annual compliance review for AI-5. DRR evaluated AI-5's policies, procedures, and related software updates. DRR's review found no instances of deviation from AI-5's enhanced policies and procedures. DRR will provide supporting documentation to the OIG after finalizing the AI's compliance report.	February 15, 2017	No	Yes	Open
2	On October 27, 2016, DRR completed onsite fieldwork as part of an annual compliance review for AI-5. DRR expanded its routine sampling and reviewed SLA assets pertaining to AI-5 that were noted in this evaluation. DRR confirmed the OIG's findings and had one additional finding, which will be reflected in the AI's December 2016 SLA certificate. DRR will provide supporting documentation to the OIG after processing this certificate.	March 15, 2017	No	Yes	Open

[a] 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.

[b] Recommendations will be closed when (a) Corporate Management Control notifies the OIG that corrective actions are complete or (b) in the case of recommendations that the OIG determines to be particularly significant, when the OIG confirms that corrective actions have been completed and are responsive.