



PANDEMIC RESPONSE ACCOUNTABILITY COMMITTEE

TOP CHALLENGES FACING FEDERAL AGENCIES:

COVID-19 Emergency Relief and Response Efforts

As reported by Offices of Inspector General across government

This document contains the Federal Deposit Insurance Corporation (FDIC) Office of Inspector General's identification of the top challenges facing the FDIC in light of the COVID-19 pandemic.

The full report is available at: <https://oversight.gov/report/prac/top-challenges-facing-federal-agencies-covid-19-emergency-relief-and-response-efforts>

FEDERAL DEPOSIT INSURANCE CORPORATION

The Federal Deposit Insurance Corporation (FDIC) plays a critical role in maintaining the stability of the nation's financial system and ensuring the safety and soundness of its supervised financial institutions. To accomplish its mission, the FDIC examines most of the financial institutions in the country (approximately 3,400 of the 5,300 banks) and manages the resolution and receivership of failed banks. The FDIC also manages the Deposit Insurance Fund (over \$110 billion at the end of December 2019) and insures approximately \$7.8 trillion in customer deposit accounts.

In recent weeks (March to May 2020), more than 33 million American workers filed for unemployment compensation (14.7 percent unemployment rate in April 2020), and more than 4 million small businesses in the United States sought economic relief under the CARES Act. As a result, many financial experts are forecasting an economic downturn, whereby borrowers may experience difficulty in repaying loans to banks. Such hardships may cause significant economic pressures upon the financial institutions of this country.

Based on its oversight experience and a review of other relevant materials, the FDIC OIG identified three primary challenges facing the FDIC:

- Ensuring the FDIC's readiness for crises (including modeling potential effects on financial institutions and conducting examinations remotely).
- Resolving financial institutions (including executing off-site bank resolutions and receiverships and resolving large, complex institutions pursuant to Dodd-Frank Act responsibilities).¹
- Guarding against financial fraud and cybercrimes at banks.

Ensuring the FDIC's Readiness for Crises

The FDIC must be prepared for a broad range of crises that could impact the banking system. In an April 2020 report on the FDIC's readiness for crises, the OIG identified seven best practices that could be used by the FDIC in its crisis readiness framework: (1) Policy and Procedures, (2) Plans, (3) Training, (4) Exercises, (5) Lessons Learned, (6) Maintenance, and (7) Assessment and Reporting.²

While this report was not conducted in response to the current pandemic, the OIG found that the FDIC should fully establish the seven elements of crisis readiness. Although the FDIC maintains certain policies and procedures, and conducts some training and simulated exercises, the OIG found that the FDIC:

1. Did not have a documented Agency policy and did not have documented procedures to provide for a consistent crisis readiness planning process.
2. Should develop an Agency-wide all-hazards readiness plan as well as Agency-wide hazard-specific readiness plans, as needed.
3. Did not train personnel to understand the content of crisis readiness plans.
4. Should document the important results of all readiness plan exercises.
5. Did not have a documented process to monitor implementation of lessons learned.

¹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 (2010).

² FDIC OIG, *The FDIC's Readiness for Crises* (EVAL-20-004, April 7, 2020).

6. Should establish a central repository of plans to facilitate periodic maintenance.
7. Should regularly assess and report on Agency-wide progress on crisis readiness plans and activities to the FDIC Chairman and senior management.

The OIG made 11 recommendations for the FDIC to improve its crisis readiness planning. The FDIC has actions underway to address these recommendations.

With respect to the current pandemic crisis, the FDIC represented that it has supplemented its existing staff and contractors and prioritized its workload to focus on mission-essential matters. In addition, the FDIC has reconstituted its Resource Management Committee to focus attention on emerging needs.

Modeling Potential Effects on Financial Institutions

Given the variables and uncertainty related to the current pandemic as well as the dynamic and fluid nature of the economic situation, the FDIC faces challenges in forecasting the economic impact of the pandemic and its financial effects on banks. According to the FDIC, its economists and financial analysts have developed analyses to assess the potential effects of the downturn with respect to liquidity and credit quality. Such insights into troubled or failing institutions would help the FDIC to plan accordingly, supplement resources, and allocate supervisory staff appropriately.

Conducting Examinations Remotely

The Federal Deposit Insurance Act requires on-site, full-scope examinations of every FDIC-insured financial institution at least once during each 12-month period (with certain limited exceptions).³ In March 2020, pursuant to the presidential declaration of a National Emergency and in accordance with mitigation guidance from federal, state, and local officials, the FDIC mandated telework for its staff and continued all examination activities off-site. Prior to the current pandemic crisis, the FDIC stated that it had conducted approximately 40 percent of its safety-and-soundness examinations off-site and approximately 60 percent of its consumer-compliance examinations off-site.

Current social distancing guidelines place an unexpected reliance on information technology systems to conduct FDIC examinations. Although the FDIC frequently swaps data with banks through file exchange systems, these systems will come under additional stress due to the increased data flow and volume. Such dependence on remote off-site examinations also places a greater emphasis and focus on information security protocols and the reliability of the FDIC's information systems.

Resolving Financial Institutions

Executing Off-Site Bank Resolutions and Receiverships

When a financial institution fails, the FDIC is responsible for facilitating the transfer of the institution's insured deposits to an assuming institution or paying insured depositors directly. The FDIC's goal is to provide customers with access to insured deposits within 1 or 2 days. Carrying out this responsibility during the pandemic presents challenges because this activity requires FDIC personnel to be present at the failed bank's offices and branches. In April 2020, the FDIC changed its processes and now deploys a small on-site team (with a health and safety officer available for consultation) that relies on conferencing software, scanning, and file exchange platforms. The FDIC must ensure that its on-site employees have an adequate supply of personal protective equipment and are trained on its proper use. Also, the FDIC will need to reevaluate such procedures in light of the current pandemic environment.

Resolving Large, Complex Institutions Pursuant to Dodd-Frank Act Responsibilities

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) was enacted and contained provisions regarding the Orderly Liquidation of large, complex financial companies known as systemically important financial institutions (SIFI). These provisions allow for liquidation of a bank where its bankruptcy would have serious

³ 12 C.F.R. § 337.12 (2018).

adverse consequences on the financial stability of the United States, and where there is no private-sector alternative to prevent default.

Pursuant to this Dodd-Frank Act authority, the FDIC is appointed as a receiver to carry out the liquidation of SIFIs. As receiver, the FDIC may take steps to transfer or sell assets, create bridge financial organizations to assume assets or liabilities, and approve claims against the company to be paid. To help fund this liquidation process, the Dodd-Frank Act includes a separate fund created by the U.S. Department of the Treasury to cover administrative costs of liquidation. Because the federal government has never invoked these Orderly Liquidation provisions, the FDIC may face challenges in executing the novel provisions of Orderly Liquidation under the Dodd-Frank Act. Further, social distancing guidelines may hinder the FDIC's coordination and execution of the Orderly Liquidation processes.

Guarding against Financial Fraud and Cybercrimes at Banks

The economic shocks associated with the Savings and Loan crisis (late 1980s to early 1990s) and the recent financial crisis (2008 to 2013) uncovered certain fraudulent activity committed by banks, bankers, customers, and other related parties, such as bank fraud, bribery, embezzlement, investment schemes, obstruction of bank examinations, and falsification of bank records and reports.

Financial institutions may face a recurrence of such threats and risks to their operations. Through the CARES Act and subsequent law, the federal government, at present, has injected more than \$2.4 trillion in stimulus funding into the economy, including approximately \$670 billion in guaranteed loans to small businesses under the Paycheck Protection Program. Of this amount, approximately \$30 billion is set aside for mid-sized banks and credit unions, and another \$30 billion is set aside for small banks and credit unions. Based on our prior experience, we have seen that the guaranteed-loan programs (such as the Paycheck Protection Program) may lead to an increased risk of financial fraud and criminal activity, because the fraudsters know that such loans are backed by the U.S. government. The FDIC may face challenges in ensuring the proper level of supervision and examination scrutiny for guaranteed loan portfolios at supervised institutions.

In addition, during this pandemic crisis, customers and financial institutions are increasingly dependent on remote mobile and online banking services, which may increase the risk of cybercrimes, such as phishing and email fraud. The FDIC has issued publications to assist consumers in using mobile and online banking services and to raise awareness regarding such threats. Further, banks' use of third-party service providers to support technology systems may increase cybersecurity risk at institutions. The FDIC must ensure that banks secure and protect multiple avenues of digital interconnections, because a cyber incident at one digital juncture has the potential to infect other institutions in the banking system.

The OIG notes that these challenges will require continued attention and vigilance by the FDIC for the foreseeable future, and hopes that this document will be informative for the American people to learn about the operations of the FDIC and understand the challenges it faces.

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