Office of Inspector General

September 2007
Report No. AUD-07-011

FDIC's Dedicated Examiner Program for Large Insured Depository Institutions

AUDIT REPORT

Office of Audits

oig

Office of Audits

oig

Background and Purpose of Audit

The FDIC is responsible for maintaining stability and public confidence in the nation's financial system by examining and supervising financial institutions, insuring deposits, and resolving failed financial institutions and managing receiverships. As of March 31, 2007, the FDIC insured 8,650 depository institutions and was the federal banking agency (FBA) for 5,216 of those institutions, which included state-chartered banks that are not members of the Federal Reserve System, generally known as state non-member banks; state-chartered savings institutions; and state-licensed insured branches of foreign banks.

The FDIC's Division of Supervision and Consumer Protection (DSC) is responsible for the FDIC's Large Insured Depository Institutions (LIDI) Program, which consists of financial institutions with consolidated banking assets that exceed $10 billion. There are 119 insured institutions covered by the LIDI Program, 25 of which are FDIC supervised. The 119 institutions had total assets exceeding $9 trillion and total deposits of $5.6 trillion, which is comprised of both insured and uninsured deposits. To assist the FDIC in assessing the risks associated with the largest institutions in the LIDI program that are not FDIC-supervised, the FDIC and the other FBAs established the Dedicated Examiner (DE) Program in 2002. Currently, the DE Program includes six LIDIs supervised by either the Office of the Comptroller of the Currency (OCC) or the Office of Thrift Supervision (OTS) as shown in the table.

The objective of the audit was to determine whether the DE Program is contributing to the FDIC's efforts to assess and quantify the risks posed by the largest institutions to the Deposit Insurance Fund (DIF).

To view the full report, go to
www.fdicig.gov/2007reports.asp

Report No. AUD-07-011
September 2007

FDIC's Dedicated Examiner Program for Large Insured Depository Institutions

Results of Audit

The FDIC's DE Program is contributing to the FDIC's efforts to assess and quantify the risks to the DIF posed by the largest banks. More specifically, the DE Program has been successful in providing the FDIC with supervisory information related to the operations at the six largest insured institutions and risks associated with those institutions. The DE Program has provided the FDIC with information related to those institutions' organizational and legal structures; international activities; business segments; insured deposits; various types of risks, including credit, market, and interest rate; and supervisory actions and strategies—all of which are important in assessing and mitigating risk to the DIF. FDIC officials indicated that the DE Program has been an effective mechanism through which supervisory, insurance, and resolution-related information is obtained.

Further, the DEs have complied with DSC guidance on reporting information relative to DE Program institutions and have established effective working relationships with the institutions and their respective FBAs—OCC and OTS officials—as well as FDIC officials in the Division of Insurance and Research and Division of Resolutions and Receiverships. These officials generally agreed that the program is useful and working as intended. As of March 31, 2007, the DE Program banks held assets totaling about $4.7 trillion and domestic deposits totaling about $3.0 trillion.

Financial Institutions Included in the FDIC's DE Program

DE Program Financial Institution	Total Assets ($ in millions)	Total Domestic Deposits ($ in millions)	FBA
JPMorgan Chase Bank	$1,224,104	$644,313	OCC
Bank of America	$1,204,472	$760,832	OCC
Citibank	$1,076,949	$690,805	OCC
Wachovia Bank	$518,753	$346,971	OCC
Wells Fargo Bank	$396,847	$313,353	OCC
Washington Mutual Bank	$318,295	$213,337	OTS
Totals	**$4,739,420**	**$2,969,611**	

Source: The FDIC's Institution Directory.

The increasing complexity of the industry and the growing concentration of risk to the DIF in the largest banking organizations are expected to become more pronounced over time and to present greater risk management challenges to the FDIC. The FDIC's DE Program is a significant resource for the FDIC, and the DEs have provided information that has enhanced the FDIC's efforts to identify, monitor, and assess risks for large, complex banks that are not supervised by the FDIC.

Recommendations and Management Response

The report does not contain recommendations. However, the FDIC provided a response stating, in part, that the LIDI and DE Programs are effective tools in understanding and assessing risk to the DIF and that the FDIC will continue to assess means for improving the efficiency and overall effectiveness of these programs.

TABLE OF CONTENTS

TABLES

ACRONYMS

CM	**Case Manager**
DE	**Dedicated Examiner**
DIF	**Deposit Insurance Fund**
DIR	**Division of Insurance and Research**
DRR	**Division of Resolutions and Receiverships**
DSC	**Division of Supervision and Consumer Protection**
FBA	**Federal Banking Agency**
FRB	**Board of Governors of the Federal Reserve System**
GAO	**Government Accountability Office**
LIDI	**Large Insured Depository Institution**
NRC	**National Risk Committee**
OCC	**Office of the Comptroller of the Currency**
OIG	**Office of Inspector General**
OTS	**Office of Thrift Supervision**
RAC	**Risk Analysis Center**
RD	**Regional Director**
RO	**Regional Office**
U.S.C.	**United States Code**

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

Office of Audits
Office of Inspector General

DATE: September 13, 2007

MEMORANDUM TO: Sandra L. Thompson, Director
Division of Supervision and Consumer Protection

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

SUBJECT: *FDIC's Dedicated Examiner Program for Large Insured Depository Institutions*
(Report No. AUD-07-011)

This report presents the results of the subject FDIC Office of Inspector General (OIG) audit. The FDIC's Division of Supervision and Consumer Protection (DSC) is responsible for the FDIC's Large Insured Depository Institutions (LIDI)[1] Program, which has the primary objective to assess and quantify the risks posed by large institutions (those with consolidated banking assets exceeding $10 billion) from a deposit insurer's perspective. To assist the FDIC in assessing the risks associated with the largest institutions in the LIDI Program, the FDIC and the other federal banking agencies (FBA) established the Dedicated Examiner (DE) Program in 2002. That program currently includes five financial institutions supervised by the Office of the Comptroller of the Currency (OCC) and one supervised by the Office of Thrift Supervision (OTS). The DE Program was established to obtain real-time access to information about the risks and trends in the largest insured institutions that are not supervised by the FDIC.

Table 1 shows the financial institutions insured by the FDIC and how they relate to the FDIC's insurance and supervisory responsibilities and its large bank programs.

Table 1: FDIC-Insured Depository Institutions and Large Bank Programs

	Number of Institutions	Total Assets ($ in millions)	Total Deposits* ($ in millions)
Total FDIC Insured	8,650	$12,149,058	$8,009,738
Total FDIC Supervised	5,216	$2,239,837	$1,676,420
LIDI FDIC Insured	119	$9,072,444	$5,665,043
LIDI FDIC Supervised	25	$668,479	$465,834
DE FDIC Insured	6	$4,739,420	$2,969,611

Source: OIG review of FDIC Institution Directory data and the FDIC's *Statistics At a Glance*, as of March 31, 2007.
* Total deposits depicted include FDIC-insured and uninsured amounts.

[1] Although LIDI companies are primarily organized as holding companies, the LIDI program also includes unit banks and thrifts that meet the size thresholds and includes FDIC-supervised and non-FDIC supervised financial institutions.

The objective of the audit was to determine whether the DE Program is contributing to the FDIC's efforts to assess and quantify the risks posed by the largest institutions to the Deposit Insurance Fund (DIF). We conducted this performance audit in accordance with generally accepted government auditing standards. Appendix I of this report discusses our audit objective, scope, and methodology in detail.

BACKGROUND

The FDIC is responsible for maintaining stability and public confidence in the nation's financial system by examining and supervising financial institutions, insuring deposits, and resolving failed financial institutions and managing receiverships. These responsibilities are shared among the FDIC's three major business lines—DSC, the Division of Insurance and Research (DIR), and the Division of Resolutions and Receiverships (DRR). Generally, DSC is responsible for the safety and soundness of FDIC-supervised insured depository institutions, protecting consumers' rights, and promoting community investment initiatives by the institutions. DSC is also responsible for operating a number of supervisory and risk assessment programs to evaluate risks presented by large, complex banks as discussed later in this report. DIR is responsible for providing the public with a sound deposit insurance system by (1) providing comprehensive statistical information on banking; (2) identifying and analyzing emerging risks; (3) conducting research that supports sound deposit insurance, banking policy, improved risk assessment, and consumer protection; and (4) assessing the adequacy of the DIF and implementing an effective and fair risk-based premium system. Finally, the resolutions and receivership management functions of DRR ensure that recovery to creditors of receiverships is achieved in the least costly manner for all failed insured depository institutions.

Monitoring of Large Insured Depository Institutions

Given the growing concentration of the FDIC's financial risk in a smaller number of institutions, DSC's supervisory and analysis processes have expanded for large banks, particularly through its Large Bank Supervision Branch. DSC's large-bank supervision activities can be categorized into three general areas: (1) direct supervision and risk assessment of state nonmember banks; (2) monitoring and risk assessment of national, state member, and thrift institutions; and (3) policy development. DSC's Large Bank Supervision Branch coordinates the DE Program, LIDI Program, and Large State Nonmember Bank Supervisory Program.[2] In addition, the Large Bank Supervision Branch reviews and aggregates data on large banks to identify trends and emerging risks and communicates these trends and risks to the FDIC's Board of Directors and senior management, the other FBAs, and DSC staff. At large institutions where the FDIC is not

[2] The 25 institutions included in this program represent all of the LIDIs that are directly supervised by the FDIC.

the primary FBA, DSC case managers (CM)[3] and DEs are the primary points of contact with the FBAs to assist the FDIC in monitoring risks.

Large Insured Depository Institutions Program. Assessment of the FDIC's insurance risk at large institutions, and the large bank sector as a whole, is the cornerstone of the FDIC's large bank supervision activities. The primary objective of the LIDI Program is to assess and quantify the risks posed by large institutions from a deposit insurer's perspective. The risk assessment process, which provides a framework for coverage of each large institution, is based on a combination of information obtained from the institution and the associated FBA, supervisory activities, market data, and publicly-available information.

Dedicated Examiner Program. On January 29, 2002, the FDIC implemented an interagency agreement entitled, *Coordination of Expanded Supervisory Information Sharing and Special Examinations*, with the FBAs. The agreement's stated objectives are to:

> establish fundamental expectations for enhanced coordination and cooperation of supervisory efforts by the federal banking agencies (FBA) to ensure that the FDIC is able to fulfill its responsibilities to protect the DIF in the most efficient and least burdensome manner possible;
>
> confirm the FBAs' understanding regarding examinations, reports, meetings, examination personnel, and other supervisory information the FDIC will have access to related to FDIC responsibilities; and
>
> confirm the FBAs' understanding of the general circumstances under which the FDIC will conduct Special Examinations[4] of insured financial institutions.

The interagency agreement (1) established parameters regarding the FDIC's participation in examination activities for deposit insurance purposes, (2) permitted the FDIC to establish onsite examiners at the eight largest financial institution holding companies that are not supervised by the FDIC, and (3) allowed the FDIC to establish the DE Program. Due to two mergers that occurred in 2004, there are now six LIDIs in the DE Program (see Table 2 on the following page).

---

[3] CM responsibilities include, but are not limited to:

- serving as the primary point of contact for banks assigned to a DSC regional office,
- providing input and guidance to regional office management regarding supervisory plans for those banks,
- completing all reporting requirements for LIDIs assigned to the regional office,
- reviewing and processing applications, and
- managing issues for DE Program institutions other than those related to risk to the DIF.

DEs do not perform typical CM responsibilities, including those associated with the review and processing of applications for deposit insurance and reports of examination or drafting routine correspondence.

[4] The FDIC is authorized under 12 United States Code (U.S.C.) §1820(b)(3) to conduct "Special Examinations" of insured depository institutions that represent a heightened risk to the DIF when the FDIC Board of Directors deems such an examination necessary to determine the condition of the insured depository institutions for insurance purposes.

Table 2: Financial Institutions Included in the FDIC's DE Program

DE Program Financial Institution	Total Assets as of March 2007 ($ in millions)	Total Domestic Deposits as of March 2007 ($ in millions)	FBA
JPMorgan Chase Bank	$1,224,104	$644,313	OCC
Bank of America	$1,204,472	$760,832	OCC
Citibank	$1,076,949	$690,805	OCC
Wachovia Bank	$518,753	$346,971	OCC
Wells Fargo Bank	$396,847	$313,353	OCC
Washington Mutual Bank	$318,295	$213,337	OTS
Totals	**$4,739,420**	**$2,969,611**	

Source: The FDIC's Institution Directory.

Under the terms of the interagency agreement, the FDIC will rely on the results of work conducted by the FBAs in assessing the condition of DE Program institutions. The agreement also covers other areas, including:

- FDIC participation in Special Examinations of financial institutions that present heightened risk to the DIF (institutions that are undercapitalized or receive a composite rating[5] of 3, 4, or 5) and

- information sharing between the FDIC and the three other FBAs, including access to supervisory personnel and information, risk assessments, supervisory plans, reports of examination, and other documents related to selected LIDIs.

Under the program, a DE is assigned to each of the six largest LIDIs to serve as the FDIC's central point of contact for supervisory, insurance, and resolutions matters and overall risk assessment. The DEs work within the FBAs' existing supervisory programs to avoid, to the fullest extent possible, any increase in regulatory burden or duplication of effort to assist the FDIC in protecting the DIF. Additionally, the DEs work closely with DSC's Large Bank Supervision Branch to assess ongoing risk posed by the institutions.

Appendix II of this report provides additional details on the interagency agreement's provisions that relate to large institutions and the DE Program.

Risks Associated with the Largest Financial Institutions

Analyses of emerging risks and trends in the financial industry or economy identified through the DE Program and other large bank supervisory programs are reviewed by the FDIC's Risk

[5] Each financial institution is assigned a composite rating based on these component factors: the adequacy of **C**apital, the quality of **A**ssets, the capability of **M**anagement, the quality and level of **E**arnings, the adequacy of **L**iquidity, and the **S**ensitivity to market risk (CAMELS). Composite ratings are assigned based on a 1 to 5 numerical scale where a 1 indicates the highest rating, while a 5 indicates the highest degree of supervisory concern.

Analysis Center (RAC)[6] and the FDIC Board of Directors as part of the semiannual risk case presentation and are incorporated into numerous FDIC publications and written reports. The insurance risk exposure associated with large, complex financial institutions to the FDIC and the DIF is significant, considering that as of March 31, 2007, the total insured and uninsured deposits of the six DE Program financial institutions totaled about $3.0 trillion and the balance of the DIF totaled $50.7 billion. In addition, according to the FDIC's *2007 Annual Performance Plan*, the six DE Program institutions account for about 45 percent of the banking industry's total assets.

Notably, the FDIC is not the FBA for most of the large, complex institutions it insures and does not supervise any of the DE Program banks. However, the FDIC is responsible for insuring those institutions and would be responsible for resolving the failure of a DE Program bank. As shown in Table 3, as of March 31, 2007, 119 LIDIs held assets totaling about $9 trillion. Of those 119 institutions, only 25 institutions, with assets totaling about $668 billion and deposits totaling about $466 billion, were supervised by the FDIC.

Table 3: Analysis of Large Insured Depository Institutions

Financial Institution FBA	Number of Supervised Institutions	Total Assets as of March 2007 ($ in millions)	Total Deposits ($ in millions)
FDIC	25	$668,480	$465,835
FRB	21	$1,040,465	$717,704
OTS	28	$1,173,907	$687,866
OCC	45	$6,189,592	$3,793,638
Totals	**119**	**$9,072,444**	**$5,665,043**

Source: The FDIC's Institution Directory.

RESULTS OF AUDIT

The FDIC's DE Program is contributing to the FDIC's efforts to assess and quantify the risks to the DIF posed by the largest banks. More specifically, the DE program has been successful in providing the FDIC with supervisory information related to the operations at the six largest insured institutions and mitigating risks associated with those institutions. The DE Program has provided the FDIC with information related to those institutions' organizational and legal structures; international activities; business segments; insured deposits; various types of risks, including credit, market, and interest rate; and supervisory actions and strategies—all of which are important for assessing risk to the DIF. FDIC officials indicated that the DE Program has been an effective mechanism through which supervisory, insurance, and resolution-related information is obtained.

[6] The RAC was established in 2003 to provide information about current and emerging risk issues and to coordinate the FDIC's risk management activities from DSC, DIR, and DRR. The RAC is staffed with employees on detail from DSC, DIR, and DRR and uses an interdivisional approach to monitor and analyze risks to the DIF and to the banking system. The RAC is directed by the National Risk Committee (NRC), which was also established in 2003. The NRC consists of senior FDIC managers and is chaired by the FDIC's Deputy to the Chairman and Chief Operating Officer.

Further, the DEs have complied with DSC guidance on reporting information relative to DE Program institutions and have established effective working relationships with the institutions and their respective FBAs—OCC and OTS officials—as well as bank management and FDIC officials in DSC, DIR, and DRR. These officials generally agreed that the program is useful and working as intended.

DE Program Contributions to the FDIC's Efforts to Assess and Quantify Risks

The DE Program serves as a means for the FDIC to obtain information on issues that could significantly impact large, complex institutions and increase risks to the DIF. In addition, the DE Program provides (1) information on the supervisory processes at the largest, complex financial institutions that the FDIC does not supervise and (2) the full-time focus of one FDIC examiner for each institution in the program.

The DEs use supervisory information, internal institution information, and external sources to evaluate risks and assign an offsite rating[7] and overall risk profile indicator[8] for each of the six banking organizations in the program. The DEs collaborate with each institution's FBA and other FDIC offices to evaluate the condition of large banks and to identify systemic risks. More specifically, the DEs:

- participate in FBA-targeted reviews[9] and examination activities;
- access selected financial institution systems for data analysis with FBA and bank management knowledge and approval;
- attend certain financial institution management meetings that include, but are not limited to, audit, asset quality, economic capital, Basel II,[10] operational risks, and credit card operations and bank board of directors and executive management meetings;

---

[7] On a quarterly basis, the DEs analyze the DE Program banks' risks to the DIF and assign a rating to each bank in the DE Program based on information obtained from the FBA, the financial institution, and publicly-available data. FDIC offsite ratings are based on the DE's review of fundamental areas, including the consolidated financial condition and trends and the assessment of the banking company's risk management. The offsite ratings are assigned on a scale from "A" to "E", with "A" indicating a low level of concern regarding risk to the DIF and "E" indicating a serious concern regarding risk to the DIF. The risks are based on probable characteristics that may apply to the institutions.

[8] The overall risk profile indicator (a risk rating) is assigned to DE Program banks to characterize the expected change in the banking company's aggregate risk profile over the next 12 months. The risk profile is described as increasing, stable, or decreasing and characterizes expected risk movement rather than anticipated changes in the offsite rating.

[9] The FBAs develop annual supervisory strategies for their DE Program institutions, outlining the supervisory focus for the institution, including areas of bank operations that the FBA will target for review and examine during the year. Areas of bank operations may include, but are not limited to, allowance for loan and lease losses, Bank Secrecy Act/Anti-Money Laundering compliance, Basel II implementation, credit derivatives, credit risk ratings, hedge funds, and shared national credits.

[10] The objective of Basel II, *International Convergence of Capital Measurement and Capital Standards: A Revised Framework*, is to more closely align regulatory capital with risk in large or multinational banks. U.S. regulators expect that about 11 banking organizations, which account for about 50 percent of U.S. banking assets, will be required to implement Basel II.

- respond to specific requests from FDIC headquarters and regional offices, for example requests for information related to hedge funds, and collateralized debt obligations; and

- report to DSC headquarters and regional offices on significant events, issues, and challenges related to the DE institutions, and submit information on the risk profiles for the institutions.

Potentially heightened insurance risks identified through the DE and other large bank supervision programs are reported to FDIC senior executives, who determine an appropriate course of action.

Additionally, the FDIC has issued the following DE Program guidelines. The related DE responsibilities are listed in Table 4 on the next page:

- Regional Directors (RD) Memorandum, *Dedicated Examiner Program Guidelines*, May 2, 2003;

- RD Memorandum, *Large Insured Depository Institutions (LIDI) Process Redesign*, January 20, 2004; and

- RD Memorandum, *Large Insured Depository Institution Risk Monitoring Program*, February 2, 2006.

We interviewed the DEs and reviewed reports and information (described later in this report) that the DEs provided to DSC management regarding their respective financial institutions. As shown in Table 4, we determined that the DEs are complying with DSC guidance to provide specific risk-related information to FDIC management.

Table 4: DE Compliance with DSC Guidance

Dedicated Examiner Responsibilities	Complied
The "✓" indicates that the DEs complied with DSC guidance.	
Develop and submit various written analytical reports:	
• Quarterly Executive Summary Report	✓
• Annual Business Profile	✓
• Annual Risk Assessment Plan	✓
• Ad Hoc Reports	✓
Provide periodic presentations for the RAC	✓
Attend quarterly formal meetings at FDIC headquarters	✓
Use FDIC corporate specialists such as credit specialists, capital market specialists, Basel representatives, and statisticians to assist with targeted examinations or special projects	✓
Store documents related to the DE Program banks on DSC's Large Bank secure Website	✓
Communicate with FBA and financial institution personnel	✓
Develop and submit an FDIC Risk Assessment Plan to the regional office for approval (for companies with total assets exceeding $50 billion, or those that intend to opt-in for Basel II)	✓
Establish regular communication with FBA examination staff	✓
Assess legal entity information to ensure the FDIC's mission critical information needs are met in the areas of insured deposit information and resolutions-related information	✓
Work with the FBAs to:	
• identify FBA reports and institution-generated reports that will be useful in the analysis of key risk areas;	✓
• identify selected supervisory activities that are mutually beneficial to participate in and that will increase the DEs' understanding of issues relevant to FDIC risk assessment needs;	✓
• gain an understanding of their assessment of the institution's Basel II qualification and ongoing validation efforts and supervisory procedures designated to evaluate related systems and processes; and	✓
• make Basel II data available for the purpose of comparing risk estimates with those of other institutions to measure consistency and identify outliers and other risk trends posed by the institution.	✓

Source: OIG review of DSC guidance and DE analytical reports.

Analytical Reports and Information

As shown in Table 4 earlier, the DEs develop and submit various written analytical reports to FDIC management. The DEs submit standard reports to DSC to assist in identifying, monitoring, and assessing the overall risk associated with the DE Program banks. For example, in addition to providing an overall offsite rating and risk rating, the DEs' *Quarterly Executive Summary Report* provides information on a DE Program bank that includes, but is not limited to, the following.

Examples of Information Included in DE Quarterly Executive Summary Reports

✓ Corporate overview	✓ Market agency ratings
✓ Risk profile	✓ Enforcement actions
✓ Supervisory program	✓ Earnings
✓ Economic capital	✓ Credit, market, and interest rate risk
✓ Implementation of Basel II	✓ Derivatives

Source: DE Program Quarterly Executive Summary Reports.

Annual business profiles prepared by the DEs provide additional information on DE Program banks, such as information on business segments; legal entities and subsidiaries; significant events, such as acquisitions and mergers, strategies, and business plans; and an overview of the bank's management.

The FDIC's *Annual Risk Assessment Plan* for each DE Program financial institution outlines information, including, but not limited to:

- assessment of safety and soundness issues;
- bank management's view of the institution's associated risk;
- FBA and, if applicable, Board of Governors of the Federal Reserve System (FRB) supervisory coverage;
- risk to the DIF and risk-related premium analysis;
- insured deposit growth projection;
- resolutions considerations;
- determination of deposit insurance issues;
- marketability of assets;
- assessment of legal entities;
- Basel II implementation;
- international exposures; and
- DE activities.

The DEs also submit various ad hoc reports to assist DSC in assessing risks posed by the DE Program banks. Those reports have included information related, but not limited to, nontraditional mortgages, collaterized debt obligations, and hedge funds.

Further, the DEs present information at Large Bank Supervision Branch meetings, RAC presentations, National and Regional Risk Committee meetings, and briefings to the FDIC Chairman and Vice Chairman. The reports DEs provide assist DSC in evaluating the unique risks that are posed by the six largest insured institutions and provide ongoing information and expanded analyses of emerging risk issues associated with the DE banks as they arise. We reviewed the most recent standardized reports prepared by the six DEs and attended one DE's presentation to the RAC and determined that the DEs complied with appropriate DSC guidance on DE responsibilities in this area.

In addition to obtaining supervisory information, the DEs obtain information from the FBAs that can assist DIR and DRR in identifying and monitoring insurance and resolution issues. To illustrate, the DEs regularly provide information to DIR to assist with deposit insurance pricing and to DRR on deposit growth forecasts. Further, DRR regional managers meet with DEs to discuss resolution considerations. In addition, DEs have included resolution considerations in their presentations and standard reports. Such considerations relate to insured deposit determination issues, diverse and liquid assets, complex information technology operations, non-bank affiliate businesses, and the number of countries with which the bank has international business. DRR is in the process of providing additional guidance to DSC and the DEs on the type of information it needs for resolution preparedness purposes.

Conclusion

The increasing complexity of the industry and the growing concentration of risk to the DIF in the largest banking organizations are expected to become more pronounced over time and to present greater risk management challenges to the FDIC. These changes in the banking industry will have significant operational implications for the FDIC's three major business lines and pose increased risk to the DIF because of the potential for significant losses that may result from the failure of a single large institution. In response to these challenges, the FDIC has been augmenting its supervisory and surveillance efforts to manage insurance risk. The FDIC's DE Program is a significant resource for the FDIC, and the DEs have provided information that has enhanced the FDIC's efforts to identify, monitor, and assess risks for large, complex banks, which are not supervised by the FDIC. The DE Program has been an effective mechanism through which supervisory, insurance, and resolution-related information is obtained.

CORPORATION COMMENTS

The Director, DSC, provided a written response to a draft of this report on September 6, 2007. DSC's response is presented in its entirety in Appendix III of this report. The Director stated that access to insured depository institution data is critical to the FDIC's mission and that the LIDI and DE Programs are effective tools in better understanding and assessing risk. The Director also stated that the division will continue to assess means for improving the efficiency and overall effectiveness of these programs.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

The objective of this audit was to determine whether the FDIC's DE Program is contributing to the FDIC's efforts to assess and quantify the risks posed by the largest institutions to the DIF. We conducted this performance audit from November 2006 through July 2007 in accordance with generally accepted government auditing standards. 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

To achieve our audit objective, we:

- Obtained an understanding of (1) the DE Program and its relation to other FDIC branches and programs such as the LIDI program and (2) the FDIC's and DEs' relationship and coordination with FBAs for financial institutions in the DE program.

- Obtained an understanding of guidance related to the DE Program including: (1) Interagency Agreement, *Coordination of Expanded Supervisory Information Sharing and Special Examinations*, March 28, 2002; (2) DSC RD Memorandum, *Dedicated Examiner Program Guidelines*, May 2, 2003; RD Memorandum, *Large Insured Depository Institutions (LIDI) Process Redesign*, January 20, 2004; RD Memorandum *Large Insured Depository Institution Risk Monitoring Program,* February 2, 2006, and other examiner guidance; (3) FDIC *Case Managers Procedures Manual*; and (4) FDI Act authorities and applicable regulations.

- Interviewed DSC officials in Washington, D.C., and selected regional/field offices and the six DEs assigned to the six financial institutions in the DE Program.

- Interviewed (1) DIR personnel to determine whether the division is obtaining information from DSC to assess the risk to the insurance fund and determine appropriate insurance assessments; (2) DRR personnel to determine whether the division is obtaining information from DSC to plan for a possible large bank failure; and (3) FBA officials in Washington, D.C., and examination staff for the DE Program banks.

- Reviewed analytical and summary reports prepared by DEs, DE work papers, and other pertinent documentation.

- Coordinated with the FDIC Office of the Ombudsman.

Internal Controls

We evaluated the effectiveness of controls in place for the DE Program. These controls included the policies and procedures for complying with the 2002 Interagency Agreement and other guidance that the FDIC has issued to DEs.

Reliance on Computer-based Data

We did not rely on computer-based data to answer the audit objective. Therefore, we did not test or validate the accuracy of computer-based data that the FDIC maintained on financial institutions included in the DE Program.

Compliance With Laws and Regulations

We concluded that there are no specific laws or regulations that mandate a DE or LIDI program. Each of the programs falls under the general authority to conduct examinations under Sections 9 and 10(b) of the Federal Deposit Insurance Act.[11] Further, we concluded that although the interagency statement of policy on examination coordination applies to the DE Program, as outlined in the March 2002 examination guidance, that statement of policy does not have a specific legal requirement but, rather, is based on interagency coordination.

Government Performance and Results Act

Based on our review of the FDIC's *2007 Annual Performance Plan*, the *2007 Corporate Performance Objectives*, the *2005-2010 Strategic Plan*, and DSC divisional goals and objectives, we concluded that the FDIC has established performance measures that relate to large insured depository institutions, in general, and to the DE Program, in particular. Those performance measures include coordination with DIR and DRR and with FBAs regarding assessing risk to the DIF for LIDI and DE banks. Specifically, the FDIC has established goals to:

- Enhance the effectiveness of the FDIC's current risk management and compliance supervisory programs.
- Restructure the existing LIDI analysis program to enhance the usefulness of the supervisory, insurance pricing, and resolution information it produces.
- Identify and address risks to the DIF by assessing the insurance risks in 100 percent of insured depository institutions and adopt appropriate strategies.
- Enhance the FDIC's ability to insure, supervise, and resolve large and/or complex insured institutions.

---

[11] Section 9 is codified to 12 United States Code (U.S.C.) §1819(a) and Section 10 is codified to 12 U.S.C. §1820(b). Notes to the Federal Deposit Insurance Improvement Act require improved examinations (12 U.S.C. 3355), but there is no specific requirement for the LIDI or DE Programs.

- Develop and conduct simulation testing of resolution templates for complex business lines or strategies that would be encountered in a large institution failure. Begin development of institution-specific resolution plans based on those templates for the LIDIs.

- Publish a Notice of Proposed Rulemaking by December 31, 2007, to enhance the FDIC's ability to make deposit claims determinations in conjunction with the resolution of a large bank failure.

- Ensure, on an ongoing basis, that the FDIC has the necessary skills in its workforce to effectively address current and emerging safety and soundness and compliance risks.

- Develop a process for risk-scoping institutions with total assets greater than $10 billion that is based upon supervisory, insurance, and resolution needs. Use this process as a basis for assigning responsibilities among examiners, CMs, examination specialists, and DEs.

- Identify proposed supervisory criteria to determine when the LIDIs require a DE, and secure OCC agreement on these criteria.

Fraud and Illegal Acts

The nature of the audit objective did not require that we assess the possibility for fraud and illegal acts. However, throughout the audit, we were alert to the possibility of fraud and illegal acts, no instances came to our attention.

Prior Coverage

The FDIC OIG and the Government Accountability Office (GAO) have issued audit reports that relate to the assessment of risk in large insured depository institutions. Table 5, on the next page, provides a synopsis of the prior FDIC and GAO audit coverage of the assessment of risk in large financial institutions.

Table 5: Synopsis of Prior Coverage

Follow-up Audit of the FDIC's Use of Special Examination Authority and DOS's Efforts to Monitor Large Bank Insurance Risks, Report No. 02-004, dated February 20, 2002.	
Objective	To assess the progress that the FDIC made since the issuance of the OIG's previous memorandum on special examination authority and to make recommendations that might improve the Corporation's effectiveness in working with the other federal regulators.
Results	The FDIC had not always been able to promptly secure permission to participate in examinations of banks supervised by the OCC and OTS. The audit identified three situations in which regulators turned down FDIC requests to participate in scheduled safety and soundness examinations. The OIG recommended that the Director, Division of Supervision (now DSC), (1) pursue an amendment to Section 10(b)(3) of the FDI Act (12 U.S.C. section 1820(b)(3)) to vest special examination authority with the FDIC Chairman, in consultation with the appropriate primary federal regulator; (2) seek a revised Board delegation that vests special examination authority with the FDIC Chairman, in consultation with the appropriate primary federal regulator, as an interim measure, pending a legislative amendment; and (3) work to develop agreements with the other bank regulatory agencies to provide the FDIC with the timely information and access to megabanks necessary to carry out the Corporation's responsibilities as the insurer.
Risk-Focused Bank Examinations—Regulators of Large Banking Organizations Face Challenges, GAO/GGD-00-48, dated January 24, 2000.	
Objective	The GAO studied the risk-focused approaches used by the FRB and OCC. The objectives were to (1) describe the general characteristics of the regulators' risk-focused approach to examinations of large, complex banks, explaining how they differ from past examination practices; (2) compare the implementation of the FRB's and OCC's risk-focused examination approaches; and (3) identify the challenges faced by both agencies as they continued to implement their examination programs for large, complex banks.
Results	The GAO concluded that regulators face a number of challenges as they continue to implement their examination programs for large, complex banks. One key challenge, inherent in the design of the risk-based program, is how to identify the aspects of bank operations where examiners' attention should be concentrated. A second challenge is maintaining an awareness of industry-wide risk in an institution-specific examination program. Another is ensuring that examiners' risk assessments are not overly influenced by the bank's risk-management systems on which they must rely. Finally, both the FRB and OCC recognize that maintaining sufficient staffing numbers and expertise to examine increasingly large, complex banks continues to be a major challenge.
Financial Market Regulation: Agencies Engaged in Consolidated Supervision Can Strengthen Performance Measurement and Collaboration, GAO-07-154, dated March 15, 2007.	
Objective	The GAO reviewed the consolidated supervision programs at the FRB, OTS, and Securities and Exchange Commission to (1) describe policies and approaches that U.S. consolidated supervisors use to oversee large and small holding companies; (2) review the management of the consolidated supervision programs, including use of program objectives and performance measures; and (3) evaluate how well consolidated supervisors are collaborating with other supervisors and each other in their activities. In conducting this study, GAO reviewed agency policy documents and supervisory reports and interviewed agency and financial institution officials.
Results	The GAO recommended that the three agencies direct their staffs to develop a set of clear and consistent objectives and related performance measures specific to consolidated supervision and collaborate more systematically with each other and with other supervisors. The agencies generally agreed with these recommendations.

Source: FDIC OIG and GAO reports related to the assessment of risk in large insured depository institutions and consolidated supervision.

PROVISIONS OF THE 2002 INTERAGENCY AGREEMENT RELATED TO LARGE INSTITUTIONS

On March 28, 2002, the FDIC issued an RD Memorandum entitled, *Coordination of Expanded Supervisory Information Sharing and Special Examinations*, which outlines the parameters for interagency coordination related to large insured institutions, including the DE Program banks. The interagency agreement contains the following provisions related to large insured institutions, in general, and DE Program banks, in particular.

- On an ongoing basis, the OCC, FRB, and OTS will provide the FDIC with access to supervisory personnel and information, including risk assessments, supervisory plans, reports of examination and other documents related to LIDIs. Similarly, the FDIC will provide access to the same types of supervisory information, if any, to the OCC, FRB and OTS.

- On at least a quarterly basis, representatives of the OCC, FRB, and OTS will meet with representatives of the FDIC to discuss the risk profile, current condition, and status of identified supervisory matters requiring attention of all LIDIs.

- In addition, the FDIC will establish a dedicated examiner program with respect to the eight largest banking organizations (collectively as “Largest Banks,” individually as an “Assigned Institution”). The DE Program will work within existing supervisory programs of the appropriate Agencies so as to avoid, to the fullest extent possible, any increase in regulatory burden or duplication of effort.

- The person designated as dedicated examiner will be the FDIC’s primary point of contact with Agency supervisory personnel as it relates to the supervision of the Assigned Institution. Agency supervisory personnel are expected to keep the dedicated examiner informed of all material developments in the supervision of the Assigned Institution and will invite the dedicated examiner to observe and participate in certain examination activities to ensure the FDIC has an understanding of the supervisory issues and risk management structure of the Assigned Institution.

- The FDIC will fully participate in the review and assessment of the risk of the credits within the Shared National Credit Program in LIDIs and other depository institutions.

- When the Agencies agree that participation by the FDIC is appropriate to evaluate the risk of a particular banking activity to the deposit insurance funds, the FDIC dedicated examiner and other staff, as appropriate, should participate with the appropriate Federal banking agency in selected supervisory reviews of that activity, including meetings with bank management relating to those reviews. In the event Agencies’ staff cannot agree, the respective Agencies’ representatives to the FFIEC Supervision Task Force will determine whether FDIC participation is appropriate. In the event the two representatives cannot agree, the Chairman of the FDIC and the principal of the relevant Agency (or the Governor that is a member of the FFIEC in the case of the FRB) will resolve the dispute.

CORPORATION COMMENTS

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990

Division of Supervision and Consumer Protection

DATE: September 6, 2007

TO: Russell A. Rau
Assistant Inspector General for Audits

FROM: Sandra L. Thompson [signed Deputy Director John M. Lane for]
Director

SUBJECT: Response to Draft Report Entitled: ***FDIC's Dedicated Examiner Program for Large Insured Depository Institutions*** **(2007-004)**

The FDIC Division of Supervision and Consumer Protection (DSC) is pleased that you found our Dedicated Examiner Program and Large Insured Depository Institution Program to be successful in assessing risk to the Deposit Insurance Fund. Access to insured depository institution data is critical to the FDIC's mission, and we are believe these Programs have proven to be an effective tool in better understanding and assessing risk, particularly with regard to institutions that are not directly supervised by the FDIC. We will continue to assess means for improving the efficiency and overall effectiveness of these Programs going forward.