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Least Cost Decision of Superior Bank and Liquidation of Remaining Receivership Assets

OFFICE OF INSPECTOR GENERAL
DELIVERING QUALITY TIMELINESS VALUE
OFFICE OF AUDITS

CONTENTS

FDIC

Federal Deposit Insurance Corporation
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TO: Mitchell Glassman, Director
Division of Resolutions and Receiverships

FROM: Russell A. Rau [Electronically produced version; original signed by Russell Rau]
Assistant Inspector General for Audits

SUBJECT: Report Entitled *Least Cost Decision of Superior Bank and Liquidation of Remaining Receivership Assets*
(Audit Report No. 02-002)

The Office of Inspector General (OIG) completed an audit of the Federal Deposit Insurance Corporation's (FDIC) decision to place substantially all of the assets, and certain liabilities of a failed institution, Superior Bank, FSB, Hinsdale, IL (Superior), into a conservatorship[1] and of the FDIC's efforts to liquidate[2] Superior's assets that did not transfer to that conservatorship. On July 27, 2001, the Office of Thrift Supervision (OTS) closed Superior and named the FDIC as receiver[3] for the failed institution. Concurrently, OTS chartered a new institution, Superior Federal, FSB (New Superior), and appointed the FDIC as conservator to operate the new institution. The FDIC transferred all of the insured deposits totaling $1.5 billion, substantially all of the assets totaling $2 billion, and certain other liabilities of Superior totaling $300 million to New Superior. Nearly $183 million of Superior's assets did not transfer to New Superior and remained in the FDIC pass-through receivership (PTR) that was created simultaneously with the establishment of New Superior.[4] At the time of Superior's failure, the FDIC estimated that the loss to the Savings Association Insurance Fund (SAIF) would be approximately $426.4 million, under the conservatorship approach for resolving Superior.

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[1] A conservatorship is established when a primary federal regulator appoints a manager, or conservator, to take control of a failing institution to preserve assets and protect depositors. See Glossary (Appendix II) for a more detailed definition.
[2] Liquidation is the process of winding down the business affairs and operations of a failed insured depository institution through the orderly disposition of its assets after it has been placed in receivership.
[3] A receiver is an agent appointed by a failed institution's primary federal regulator to manage the orderly liquidation of the failed institution.
[4] A pass-through receivership is when all deposits, substantially all of the assets, and certain nondeposit liabilities of the original institution instantly "pass through the receiver" to a newly chartered federal mutual association, subsequently known as the "conservatorship." In the case of Superior, the FDIC is the receiver of the assets and liabilities that did not transfer to New Superior, the conservatorship .

The objectives of this audit were to evaluate the: (1) least cost decision for Superior and (2) liquidation of remaining receivership assets that were not transferred to the conservatorship.

Specifically, we reviewed the following:

- Adequacy of data used by the FDIC to make the least cost decision,
- All available resolution options that the FDIC's Division of Resolutions and Receiverships (DRR) considered in determining the least cost to the deposit insurance fund,
- Documentation of the evaluations made and assumptions used by DRR to arrive at the least cost decision, and
- Management and liquidation of assets that were not transferred to the conservatorship in order to minimize losses to the insurance fund.

Appendix I of this report presents additional information on the scope of this audit and the methodology used to answer the objectives. Appendix II of this report contains a glossary of terms that are used throughout the report.

BACKGROUND

Following numerous financial institution failures from the mid-1980s through the early 1990s, the Congress passed the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), codified at 12 USC 1811 et seq., to ensure the stability of the financial banking sector and the deposit insurance funds. Section 141 of FDICIA, codified at 12 USC 1823(c), requires the FDIC to resolve[5] a failed financial institution in the manner that results in the least possible cost to the deposit insurance fund.[6] This section also contains requirements regarding the documentation of the FDIC's resolution decisions.

[5] The term "resolution" means a disposition plan for a failed or failing institution. Resolution is designed to (1) protect insured depositors and (2) minimize the costs to the relevant insurance fund that are expected from covering insured deposits and disposing of the institution's assets.

[6] The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) created the Bank Insurance Fund (BIF), the Savings Association Insurance Fund (SAIF), and the FSLIC Resolution Fund (FRF). It also designated the FDIC as the administrator of these funds. All three funds are maintained separately to carry out their respective mandates. The BIF and the SAIF are insurance funds responsible for protecting insured bank and thrift depositors from loss due to institution failures. The FRF is a resolution fund responsible for winding up the affairs of the former Federal Savings and Loan Insurance Corporation (FSLIC) and liquidating the assets and liabilities transferred from the former Resolution Trust Corporation. The costs to resolve Superior will be paid out of the SAIF, since Superior was a thrift institution.

Section 131 of FDICIA, codified at 12 USC 1831o, incorporated provisions for Prompt Corrective Action (PCA). The PCA provisions of FDICIA establish minimum capital requirements that assist the primary federal regulator (PFR) in the regulation of financial institutions. [7] PCA provisions require more timely intervention by the PFR to preclude failure and to minimize losses to the deposit insurance funds. PCA stratifies institutions into five different capital categories, ranging from the highest group referred to as "well capitalized" to the lowest sector known as "critically undercapitalized."[8] PCA requires that the PFR close an institution within 90 days after determining that the institution is "critically undercapitalized" and does not have an adequate capital restoration plan.

The FDIC's resolution process is triggered upon the PFR's notification to an institution that it is critically undercapitalized. DRR then has up to the 90-day PCA limit to collect information and plan for the resolution. There are no PCA provisions requiring the FDIC to begin the resolution process prior to notification by the PFR.

According to DRR's mission statement, DRR exists to plan and efficiently handle the resolutions of failing FDIC-insured institutions and to provide prompt, responsive, and efficient administration of failing and failed FDIC-insured institutions in order to maintain confidence and stability in the national financial system.[9] DRR is proactive in identifying troubled insured depository institutions, and DRR may begin its resolution efforts, such as valuing assets and identifying potential purchasers of these institutions, before an institution fails. Although PCA does not provide for the resolution process to begin until an institution is notified by the PFR that it is critically undercapitalized, DRR and the FDIC's Division of Supervision (DOS) have recognized that in some cases a failing institution may necessitate closure on an expedited basis. For example, in cases where significant liquidity problems or fraud exist, it may be prudent to promptly close an institution to minimize potential losses to the respective insurance fund. DRR may not have the full 90 days to obtain necessary information to plan for and execute an orderly resolution under these circumstances. To that end, formal procedures have been established by FDIC directive for the collection and sharing of information between DRR and DOS for FDIC-insured institutions that appear likely to fail (failing institutions) before the PFR notifies the institution that it is critically undercapitalized. These formal procedures include provisions that

[7] Primary federal regulators are listed in the following table:

Agency	Type of Institution Regulated
FDIC	State non-member banks and state savings banks insured by BIF
Office of the Comptroller of the Currency (OCC)	National banks
Federal Reserve Board (FRB)	Bank holding companies and state member banks
Office of Thrift Supervision (OTS)	Federal and state savings associations insured by SAIF and thrift holding companies

[8] FDICIA charged each federal banking agency with establishing minimum capital levels for the various capital ratios used to determine an institution's capital position. The FDIC adopted regulations to implement the PCA provisions required by Section 38 of the FDI Act. The PCA regulation is codified at Part 325 Subpart B of the FDIC Rules and Regulations. The specific PCA categories and their definitions are detailed in Appendix VII.

[9] The FDIC insures the deposits of financial institutions and is responsible for resolving all failed institutions, regardless of the failed institution's chartering authority.

DOS staff shall seek the failing institution's consent to allow DRR access to the institution and its records to facilitate the resolution process of a failing institution. DRR has established a similar information sharing arrangement with the Office of the Comptroller of the Currency (OCC).

DRR has developed a Resolutions Policy Manual, which provides guidance for a typical[10] resolution process. DRR's typical resolution process is explained more fully in Appendix III. The typical resolution process is based on having timely and appropriate access to failing institutions before the institution's closing and involves:

- planning and preparing for the resolution process,
- preparing an Information Package (IP),
- conducting the Asset Valuation Review (AVR),
- marketing the failing institution, and
- selecting bids from prospective acquirers.

While onsite at the failing institution, DRR typically values and assesses the failing financial institution’s assets and liabilities and uses this valuation to solicit proposals from approved bidders. DRR analyzes the bids received, conducts a least cost determination, and recommends the least costly resolution strategy to pursue upon the date of failure. DRR prepares a Failing Bank Case to present its recommendations to the FDIC Board of Directors (FDIC Board). The FDIC Board has the ultimate responsibility for determining the least costly transaction. [11]

Superior's Resolution

On July 25, 2001, DRR presented its Failing Bank Case to the FDIC Board for the proposed resolution of Superior. In this document, DRR compared estimated costs of liquidating Superior,[12] as required by FDICIA, to two alternative resolution scenarios in devising its strategy to resolve Superior. These two alternative resolution scenarios were:

- Immediate Receivership and Sale - Superior would be closed and placed into receivership. The insured deposits and marketable assets would be sold in less than 5 days. The estimated cost of this resolution alternative to the insurance fund was $484.6 million.

- Conservatorship - Superior would be closed, placed into receivership, and most of the assets, secured liabilities, and insured deposits would immediately pass through the receivership to a newly chartered mutual savings bank that is then placed in conservatorship. The FDIC

[10] DRR also refers to its typical resolution process as its "normal" resolution process.
[11] Under 12 USC 1819(a), the FDIC has the power… “To exercise by its Board of Directors, or duly authorized officers or agents, all powers specifically granted by the provisions of this Act, and such incidental powers as shall be necessary to carry out the powers so granted.”
[12] The cost to the SAIF is defined as the cost of paying off the insured deposits of Superior as of the date of closing, offset by the estimated net amount the FDIC expected to receive from the disposition of the assets on the books of Superior at the time the institution was closed. In this case, DRR estimated the cost to liquidate Superior to be $524.8 million.

would fund the operations of the conservatorship, up to $1.5 billion through its life, which is anticipated to be as long as 6 months. The conservator (FDIC) would offer the insured deposits in a deposit sale or by branch. Assets under this scenario would be sold piecemeal. In addition, the FDIC Board would appoint a chief executive officer to run the conservatorship. The estimated cost to the insurance fund for this resolution alternative was $426.4 million.[13]

DRR recommended the conservatorship approach as the least costly option for resolving Superior, and the FDIC Board agreed with the recommendation. The FDIC Board also approved a PTR transaction structure. Specifically, the OTS (the PFR for Superior) appointed the FDIC as receiver for Superior simultaneous to OTS's appointment of FDIC as conservator of New Superior. The PTR retained $183 million, or approximately 8 percent of the total $2.4 billion in assets held by Superior at the time of its failure. These retained assets consist primarily of receivables from subsidiaries, four banking branches plus furniture and fixtures, and owned real estate.

RESULTS OF AUDIT

The FDIC Board made its least cost decision to place Superior in conservatorship primarily on DRR's recommendation and the information presented in the Failing Bank Case. DRR's Failing Bank Case for Superior Bank presented two resolution alternatives to the FDIC Board, namely, conservatorship and immediate receivership and sale, that were compared to the cost of liquidating Superior. However, the projected losses to the deposit insurance fund for these options were not supported by complete financial analyses. In the case of Superior, DRR did not complete the IP or an AVR, two critical activities that enable DRR to solicit bids from potential acquirers and compare the offers for determining the least costly resolution strategy. DRR did not have sufficient information to develop other possible resolution alternatives for Superior prior to presenting the Failing Bank Case to the FDIC Board. DRR's access to Superior was limited partly based on the fact that Superior's owners were in the process of implementing an OTS-approved capital restoration plan that purported to address the capital problems at Superior. Ultimately, Superior's owners did not implement this approved plan, causing OTS to notify Superior, under PCA, that it was critically undercapitalized on July 24, 2001. As a result, complete information on a range of resolution alternatives was not available to the FDIC to make the least cost decision for Superior's resolution.

Under PCA, the formal resolution process begins upon the PFR's notification to an institution that it is critically undercapitalized. If the FDIC had waited until the date of OTS's notification to Superior to start the formal resolution process, then DRR would have had only 1 day to gather and analyze information to support the least cost recommendation that it presented to the FDIC Board on July 25, 2001.

With regard to the documentation of the evaluations used to arrive at the least cost decision for

[13] While this cost was estimated, the final cost of resolving Superior will be affected by the actual recoveries on the assets and claims less expenses.

Superior, DRR adequately documented the asset and receivership liability claim balances and the deposit premium estimates used in the Failing Bank Case. However, DRR did not adequately document the assumptions used to estimate the loss on Superior’s $2.4 billion in assets, a loss value that was instrumental in projecting the cost of Superior’s failure to the deposit insurance fund in the Failing Bank Case.

DRR does not have guidance for determining the least costly resolution for large financial institutions in situations where DRR cannot complete the IP or AVR before the institution is closed. DRR's current guidance focuses primarily on how to prepare an estimate of the least cost transaction for a failing institution when an IP and AVR have been completed. Therefore, DRR's current guidance was not applicable to the Superior resolution, because as discussed above as well as later in our report, an IP and AVR were not completed prior to Superior's closure.

DRR has made improvements to its resolution process in the last few years. DRR developed information-sharing arrangements with the OCC and DOS that have facilitated DRR's early access to failing institutions. DRR also included in its 2002 Strategic Plan an objective to document and retain appropriate background information concerning unique situations encountered from each resolution for future DRR reference or for presentation purposes. DRR can further improve its resolution process to better ensure the quality and completeness of information presented to the FDIC Board for decision-making purposes in situations where DRR cannot complete the IP and AVR.

In evaluating DRR's efforts to liquidate the remaining assets in the PTR, we noted that DRR has made progress in preparing these assets for sale. DRR anticipates continuing its sales efforts with estimated completion dates for some activities extending into the second quarter of calendar year 2002. Appendix IV of this report includes a discussion of DRR’s efforts to prepare the PTR assets for sale. We will continue to track DRR’s progress and will report the results of our review in this area in our ongoing audit of the marketing and final resolution of New Superior.

IMPROVEMENTS ARE NEEDED TO ENHANCE THE RESOLUTION PROCESS

DRR's Failing Bank Case for Superior Bank did not contain complete information. Additionally, DRR did not adequately document the assumptions used to estimate the $753 million loss on liquidating Superior’s $2.4 billion in assets, a loss value that was instrumental in projecting the total cost of Superior’s failure to the deposit insurance fund. Contrary to the expectations of senior officials from both the FDIC and the OTS, Superior's owners did not ultimately implement a capital restoration plan in accordance with PCA by July 23, 2001, the expiration date. In anticipation of Superior's imminent failure, DRR began to prepare the Failing Bank Case on July 22, 2001 and presented the least cost recommendation to the FDIC Board just 3 days later on July 25, 2001. DRR officials stated that although they began to gather and analyze data in late-March 2001 for the purpose of planning for an orderly resolution in the event that Superior would fail, they had been unable to complete the analyses used in the Failing Bank Case. According to DRR, only a limited number of DRR staff were granted access by OTS to Superior’s records and personnel, and key information was not made available to DRR, both of which hampered DRR's ability to complete the analyses. Under PCA, the resolution process begins upon the PFR's notification to an institution that it is critically undercapitalized. If the FDIC had waited for the date of OTS's notification to Superior to start the formal resolution process, DRR would have had 1 day to gather and analyze information to support the least cost recommendation at the July 25, 2001 FDIC Board meeting.

Further, DRR does not have guidance for handling the resolution of a large (over $100 million in assets) financial institution where an IP or AVR cannot be completed. Finally, DRR does not have a formal information sharing arrangement with OTS. Such an arrangement could have enhanced DRR's ability to gather sufficient information on Superior for the purpose of gaining earlier and full access to Superior. Earlier and full access would have helped DRR plan and prepare for a more orderly resolution, fully develop other resolution options for the FDIC Board's consideration, and present complete information to the FDIC Board for decision-making purposes.

In effect, the FDIC could not consider other resolution options, which may have been less costly to the SAIF. When DRR is limited in considering all possible resolution alternatives or unable to fully document its least cost recommendation, the FDIC is at risk for not fully complying with FDICIA, and the quality of the least cost decision-making process is compromised.

Least Costly Resolution Alternative and Level of Documentation Requirements

FDICIA, as codified at 12 USC 1823(c), requires the FDIC to evaluate alternatives and choose the resolution method that is least costly of all possible resolution methods to the deposit insurance fund. This law also requires that in making the least cost decision, the FDIC must document that evaluation and the assumptions on which the evaluation is based. Id. (See Appendix V for the specific FDICIA requirements.) The statute does not prescribe the level of documentation that is required or the timing of when the documentation to support the least cost decision should be prepared. However, our review of this statute indicated that there is nothing to prevent the FDIC from forming its own written policy that would specify the degree of support necessary to document its least cost resolution decisions.

In a 1992 report entitled *FDIC Documentation of CrossLand Savings, FSB, Decision Was Inadequate* (GAO/GGD-92-92), the General Accounting Office (GAO) recognized that unique facts and circumstances surrounding each resolution case could alter the amount and type of support underlying each resolution decision. Nonetheless, the GAO developed general documentation criteria that would aid the FDIC in ensuring the adequacy of support for the FDIC Board's evaluation and its assumptions. FDIC senior management did not object to GAO's general documentation criteria at the time. GAO's criteria are as follows:

- Documentation should be clear, consistent, concise, and complete so that an outside observer can identify and understand the estimated cost of each option, including the assumptions and discount rates used.
- Data sources for the cost evaluations should be clearly identified so that cost figures can be traced to their source.

- Assumptions integral to the cost evaluations should be documented and supported. In particular, each assumption should be (1) clearly identified and (2) supported by empirical data, or in the absence of such data, by judgment based on relevant experience. This support should be explicitly described in the documentation and, where appropriate, the source(s) used in making the assumption should be identified.
- If there is uncertainty about the validity of an assumption that materially affects the cost evaluation results, some effort to gauge that uncertainty should be made and documented by showing a range of possible outcomes.

Failing Bank Case for Superior Bank

The FDIC Board based its multi-million dollar decision to place Superior into conservatorship primarily on DRR's recommendation and the information presented by DRR in its Failing Bank Case. DRR's basis for this recommendation was that a conservatorship strategy would allow maximum time to market and preserve the value of Superior's primary assets. In its Failing Bank Case for Superior, DRR presented two resolution options, conservatorship and immediate receivership and sale, that were compared to the cost of liquidation in its Cost Test Summary. The Cost Test Summary showed the comparison of the total costs to the deposit insurance fund under each of these scenarios. However, DRR's financial analyses to support the estimated loss under each option were based on a partially completed IP and AVR, which diminished the quality of the information presented to the FDIC Board regarding the total estimated cost to the FDIC to resolve Superior.

According to the Failing Bank Case, in devising a strategy for the least cost resolution of Superior, DRR staff had actually considered an additional resolution alternative, the "normal resolution process". Although the normal resolution process was included in the narrative discussion as a resolution alternative, DRR was doubtful of Superior's ability to maintain liquidity during the subsequent 90-day period that DRR would need to collect sufficient information to complete the normal resolution process. Therefore, DRR did not include typical resolution alternatives that are used under the normal resolution process in its Cost Test Summary that it presented to the FDIC Board for its decision on the least cost resolution.

In discussing the immediate receivership and sale resolution scenario in the Failing Bank Case, DRR explained that it would market and sell the insured deposits and marketable assets within 5 days of the institution's closure. However, DRR further explained that the risk associated with an immediate receivership and sale method would be that the full potential value of the deposit franchise would not be realized. DRR stated that because of the imminence of the failure, there would be insufficient time for a potential bidder to conduct adequate due diligence to determine the value of the franchise and to develop a strategy for investing $1.5 billion in cash that the bidder would immediately receive from its purchase of Superior's deposits. Additionally, DRR was concerned that the sheer size of Superior's deposit franchise would limit the total pool of potential bidders available to bid on Superior. DRR included the estimated cost of an immediate receivership and sale in its evaluation of resolution alternatives in the Failing Bank Case's Cost Test Summary, but did not recommend it as the least costly course of action.

DRR's Resolutions Policy Manual states that significant preplanning is necessary to successfully resolve a failing institution in the least costly manner. Developing an IP and performing an AVR are two critical activities that enable the FDIC to market a failing financial institution in order to obtain bids to be used in determining least costly resolution approaches. Therefore, to be successful, DRR needs to complete the IP and AVR before the institution is closed, so that DRR has sufficient information regarding the sale of assets to make an informed least cost recommendation at closing. In the case of Superior, DRR completed the IP on August 1, 2001, 5 days after Superior’s closure and 1 week subsequent to presenting the Failing Bank Case to the FDIC Board for its resolution decision. DRR based the estimated cost to liquidate Superior and the costs of the resolution alternatives on preliminary asset valuations and input from FDIC staff instead of a completed AVR.

In reviewing the transcripts of FDIC Board meetings where Superior's resolution was discussed, there was no indication that the FDIC Board disagreed with DRR's assumptions and cost estimates in making its decision that conservatorship was the least costly resolution for Superior. Although DRR said it presented the FDIC Board with the best information that it had at the time, DRR also acknowledged to the FDIC Board that the data in its Failing Bank Case most likely contained a margin of error and was incomplete. For example, DRR estimated that the cost of liquidation for Superior was $524.8 million, but DRR noted in its Failing Bank Case that it had not reviewed and assigned losses to all balance sheet accounts in making the estimates. To further illustrate, DRR resolutions staff did not complete valuations for the servicing assets in Superior's New York facility, which represented about one-half of Superior's assets. DRR officials told us that DRR had to quickly complete its analyses and prepare the Failing Bank Case because action needed to be taken to close the institution due to its critically undercapitalized state and liquidity problems. Therefore, DRR did not have complete information to develop all possible resolution alternatives to make the least cost recommendation for Superior's resolution. When DRR is limited in considering all possible resolution options, the FDIC is at risk for not fully complying with the FDICIA least cost determination requirements, and the quality of the least costly decision-making process is compromised.

Documentation of the Elements of the Cost Test Summary

DRR adequately documented, in its Failing Bank Case, its source for the asset and receivership liability/claim balances and the deposit premium that it anticipated receiving upon the sale of the deposit franchise. However, DRR did not have complete documentation to support the assumptions used to estimate the loss on assets, a loss value that was instrumental in projecting the cost of Superior’s failure to the deposit insurance fund.

DRR recommended the least cost resolution method in a format referred to as the Cost Test Summary, an attachment to the Failing Bank Case that shows the estimated loss to the insurance fund for each of the resolution alternatives considered. Appendix VI of our report presents a general discussion of the process that DRR used to develop the Cost Test Summary for Superior's resolution and describes how the estimated loss to the insurance fund was determined for the conservatorship option.

We traced the gross assets and the receivership claims noted in the Cost Test Summary to Superior's general ledger and concluded that the amounts in the Cost Test Summary agreed to Superior's general ledger. We also traced DRR's estimates for the deposit premiums for each alternative considered to DRR's analysis of historical deposit premiums received in FDIC resolutions since 1999 as well as to completed branch sales conducted in the private sector. We concluded that the documentation to support DRR's estimated deposit premium was adequate and in compliance with FDICIA.

However, DRR did not adequately document the asset loss estimates used in the Cost Test Summary. DRR resolutions staff estimated that the loss on $2.4 billion in assets would approximate $753 million. Because DRR was not able to complete the AVR process, the loss assumptions made for Superior's assets were based on the professional judgment of DRR resolutions staff and preliminary analysis of certain asset data, rather than the statistically valid assumptions and file reviews that would be included in a completed AVR process.

Table 1 shows the breakdown of the estimated loss and the OIG's basis for determining that the estimated loss was not adequately supported.

Table 1: Explanation for Unsupported Estimated Loss Amount

Estimated Loss Amount	Percentage of Total Loss Estimate	Explanation
$491 million	65%	Loss estimates for single-family mortgage loans, residual interests, and mortgage servicing rights were based on staff estimates that were documented in a memorandum but were not fully supported by data or analysis.
$261 million	34%	Loss estimates for certain assets[14] were supported by a spreadsheet, but DRR could not support the numbers found on the spreadsheet with data or analysis.
$ 1 million	1%	Loss estimate for receivables was not supported by either staff estimates or a spreadsheet.
$753 million	100%	Total Loss Amount Presented to the FDIC Board

Source: OIG Analysis

A DRR Resolutions and Receiverships Specialist assigned to Superior prepared a memorandum to the file on July 30, 2001, 5 days after the Failing Bank Case was submitted to the FDIC Board. DRR provided this memorandum as its documentation of the process used to develop the estimates. According to the memorandum, DRR staff estimated the losses for single-family mortgage loans, residual interests, and mortgage servicing rights. DRR assigned loss

[14] The asset categories were: deferred taxes; loans to subsidiaries; advances to trusts; corporate advances; capital origination costs; FSLIC disputed; pipeline, clearing, and loans in process; escrow advances; investment in CFR97; deferred principal payments; other advances; miscellaneous; institution premises and equipment; and prepaid expenses .

percentages ranging from 30 percent to 50 percent to each of these three categories of assets, which totaled nearly $491 million. The memorandum did not include any information, such as historical analysis, discussion based on previous experiences, or any explanation supporting how DRR staff arrived at these loss percentages.

The file memorandum stated that loss estimates for certain other assets, totaling $261 million, were based on preliminary AVR results as presented in a spreadsheet attached to the memorandum. The DRR specialist who works with the RAVEN system told us that there was no “preliminary” AVR information since RAVEN will not accept incomplete data. Neither the DRR specialist who works with the RAVEN system nor the IP/AVR Team Leader was able to verify the numbers presented in the spreadsheet. While these numbers were carried forward to the Cost Test Summary, the documentation to support the loss estimate on these assets was incomplete.

Further, there was one asset, receivables, for which the loss estimate included in the spreadsheet did not agree with the loss estimate used in the Cost Test Summary. DRR was unable to provide an explanation for the difference. The difference, approximately $1 million, was immaterial to the results of the Cost Test Summary. When DRR is unable to fully document its least cost recommendation, the FDIC is at risk for not fully complying with FDICIA documentation requirements.

DRR’s Request for Full Access to Superior Prior to Its Closure

In late March 2001, DRR began its initial planning for involvement at Superior even though the institution was not notified by OTS that it was critically undercapitalized. DRR worked out an arrangement with DOS for two staff members to initially start working from the FDIC's Chicago South Field Office to begin gathering information about Superior under the information sharing agreement that it had with DOS. DRR's March 2001 determination that it needed to begin contingency planning for a potential failure of Superior was derived based on the projections that Superior would be at best critically undercapitalized after the OTS/DOS examination that was in progress. DOS had been sharing information with DRR about Superior since early March 2001. While in the FDIC's Chicago South Field Office, DRR became increasingly concerned that until a complete resolution crew could be onsite at Superior, DRR would not be able to complete the process required for an orderly resolution. Therefore, on April 19, 2001, DRR staff held a conference call with officials from DOS and OTS. During that call, the following points were discussed:

- DRR explained to OTS the resolution process and the general time requirements for DRR to complete the process required for an orderly resolution;
- DRR requested full access for a complete resolution team to be onsite at Superior;[15]
- DRR requested that its resolution process be able to run parallel to the OTS/DOS examination so that if the institution were found to be insolvent at the conclusion of the

[15] Although DRR staff told us that ideally, they would have preferred assigning 28 resolutions personnel to Superior, our review of OTS's notes from that conference call indicate that DRR requested 15 resolutions personnel to be assigned at the beginning of the process.

examination, DRR would be prepared for a more rapid resolution (as opposed to the usual 90 days); and

- DRR requested information about the fixed assets of the institution and the activity performed at each location in order to prepare the IP.

OTS stated that DRR would only be allowed to start the formal resolution process if Superior reflected a critically undercapitalized position in its quarterly financial statement that was due for submission on April 30, 2001. OTS's position was based on the legal requirement found under the PCA provisions of FDICIA which state that the resolution process shall begin when an institution becomes critically undercapitalized. See 12 USC 1831o(h). OTS was concerned that Superior's officers could leave the employment of the institution and could testify in future legal proceedings that OTS caused the failure. Instead of granting access for a complete resolution team, OTS granted access for three DRR resolutions staff on April 23, 2001 to begin gathering additional information to prepare for on-site work with a complete resolution team even though Superior was not deemed to be critically undercapitalized by OTS, under PCA. On May 7, 2001, OTS allowed access for three more DRR staff, bringing the total DRR staff size to six.

Although DRR was permitted to be onsite at Superior, all information requests were to go through OTS to Superior, and DRR staff was not permitted to deal directly with Superior personnel. According to DRR personnel, the pace of receipt of information from the institution was slow. Further, OTS placed limitations on the type of information that DRR could request from Superior personnel. For instance, OTS did not grant DRR's request for the information on fixed assets and the activities performed at each of Superior's locations for marketing purposes, citing that a request of this nature could alert Superior's management and employees that the resolution process had begun.

While OTS was discussing access issues with DRR, OTS and the FDIC were working with Superior's owners on a plan to recapitalize the institution (capital restoration plan). OTS approved the capital restoration plan on May 24, 2001, and Superior's owners were required to implement the plan no later than July 23, 2001.[16] DRR's staffing at Superior remained at six until July 23, 2001, 4 days prior to the failure, and 1 day prior to OTS's notification to Superior that it had failed to implement the capital restoration plan, and was considered "critically undercapitalized" for purposes of the PCA provisions of FDICIA.

During the time that the six DRR personnel were onsite at Superior, DRR was able to begin preparing the IP and the AVR. However, neither of these documents was completed before the institution failed. DRR officials told us that they explained to OTS that resolutions staff had previously worked in numerous financial institutions with bank examiners during the course of their bank examinations and could work jointly with the examiners with direct access to institution personnel without disruption to bank operations. Further, DRR staff explained to OTS that there had been numerous times where DRR had performed its entire resolution process by the time an institution had consummated a recapitalization, and in those cases the institution

[16] Although the FDIC expressed concern over several aspects of the capital restoration plan, and conveyed these concerns to OTS prior to OTS's approval of the plan, the FDIC did not object to the OTS's approval of the final plan.

never failed. In order to determine whether DRR's assertion could be substantiated, we reviewed DRR’s on-site resolution activities for 22 financial institutions (excluding Superior) from January 2000 to October 2001 to determine the number of occurrences where the troubled financial institution did not fail. We found that 12 of the 22 institutions (55 percent) for which DRR performed on-site resolution work did not subsequently fail. Assets for the 12 institutions totaled $5.1 billion. Of the 10 institutions that ultimately did fail, only one was an OTS-regulated institution, with assets totaling $34 million.

From May 2001 through the date of Superior's failure, the six DRR resolutions staff identified Superior’s assets and liabilities, attempted to balance and reconcile accounts among multiple general ledgers, gathered information for the IP, and began the valuation process for the asset files located in Chicago. This process was complicated because Superior only prepared quarterly financial statements. Having quarterly financial statements instead of daily or monthly financial statements made it difficult to reconcile financial transactions to arrive at Superior's current financial position. DRR submitted its documentation request through the DOS/OTS examiners upon entering the institution. However, according to DRR staff, the information that was received by DRR required direct clarification from institution staff due to the complexities of the institution's operations and assets. Because DRR was denied direct access to Superior's staff, DRR instead pursued clarification and follow-up through an intermediary, which, according to DRR, was cumbersome. DRR did not obtain a complete list of the properties utilized by the institution for its activities, complete an organization chart of the institution and its affiliates, or determine the activities performed between the entities and the locations of each. Further, DRR resolutions staff did not begin the valuation process for the loan servicing assets in Superior's New York facility, which represented about one-half of Superior's assets.

Additionally, DRR could not complete the following tasks of the AVR process:

- Verify the accuracy and completeness of the electronic download of loan information received from Superior;
- Select a statistical sample of loans for which to perform an AVR;
- Review asset files for the sampled loans since the loan files were housed in New York; or
- Obtain information on each loan's book value, appraised value, income data, and note terms.

According to DRR, the resolution team did not complete these valuation activities because of the limitations placed on DRR by OTS. DRR explained that OTS officials did not specifically deny DRR physical access to Superior’s New York facility, but because OTS officials limited the number of DRR staff to six, it was more efficient for the six staff to continue working in Chicago to prepare the IP. The IP is the first priority task in the resolution process and is needed for the marketing of a failing institution.

OTS was not obligated to allow DRR to begin the resolution process when DRR first requested access in April 2001, yet OTS permitted access with limitations. At that time OTS had not notified Superior that it was critically undercapitalized. Once OTS did notify Superior of its capital insolvency, as required by PCA, a rapid resolution was necessary due to Superior's inability to maintain liquidity. Under PCA, the formal resolution process begins upon the PFR's notification to an institution that it is critically undercapitalized. If the FDIC had waited until the date of OTS's notification to Superior to start the formal resolution process, then DRR would have had 1 day to gather and analyze information to support the least cost recommendation that it presented at the July 25, 2001 FDIC Board meeting.

The Supervisory Resolutions and Receiverships Specialist, DRR, told us that, had the OTS not limited the number of staff, DRR ideally would have assigned a team of 22 resolutions staff to Superior’s New York facility to prepare the IP and AVRs in addition to the 6 staff working in Chicago. We analyzed DRR’s on-site resolution activities at 22 financial institutions to determine whether DRR’s request for 28 staff to work onsite at Superior was logical and consistent with other resolution cases handled by DRR in the past. DRR was able to complete the required financial analyses (IP and AVRs) for 12 of the 22 institutions while onsite at the institution. On average, DRR demonstrated that it completed the financial analyses for the 12 institutions with a staff of 11 people working onsite. The average asset balance for these 12 institutions was $18 million. Given the size of Superior, DRR’s request for a full staff of 28 resolutions personnel to complete the required financial analyses for an orderly resolution of a failing institution with $2.4 billion in assets appears to be logical.

On May 3, 2001, DRR resolutions personnel formally communicated their concerns regarding the need for a complete resolution team to be onsite at Superior to the Director, DRR. The Director, DRR said he communicated the concern to FDIC senior management officials at subsequent meetings, which led to discussions with the FDIC Director. During our interview with the FDIC Director, he stated that at the time he was not unduly concerned that DRR did not get the access to Superior that it had requested. He noted that both OTS and the FDIC were relying on the owners of Superior to implement the capital restoration plan.

Through our interviews with DRR and OTS senior officials, we learned that DRR and OTS define “access” to a failing financial institution differently. DRR views access as having a sufficient number of staff, commensurate with the size and complexity of the institution, working onsite at the institution to review appropriate records and obtain additional information from institution personnel in order to plan for the orderly resolution of the failing institution. OTS, at least in the case of Superior, felt that it had granted DRR access to Superior when OTS agreed to allow 3 DRR staff into the institution under temporary examiner designations on April 23, 2001, 3 months before OTS closed the institution.

We discussed DRR’s assertion of limited access to Superior with the Managing Director, Supervision, OTS (OTS Managing Director) who told us that OTS did not deny DRR access to the institution, including Superior’s New York facility. The OTS Managing Director recognized that OTS did set limitations on the number of DRR staff allowed to work onsite at Superior, but his recollection was that DRR had accepted the limitation and was getting the information that it needed. Thus, the OTS Managing Director did not believe that OTS denied DRR access to Superior. The Director, DRR, told us that DRR did not have the full, unfettered access to Superior’s records and personnel that DRR needed to adequately prepare for resolving the institution. The Director, DRR further expressed the view that filtering documentation to DRR, limiting DRR's contact with Superior personnel, and restricting the size of DRR's resolution team are actions that do not constitute granting "access" to an institution for the purposes of conducting resolution activities.

Appropriateness of DRR's Policies and Procedures for Superior's Resolution

DRR does not have sufficient guidance to meet the least cost requirement and develop a Cost Test Summary in situations where an IP and AVR cannot be completed prior to an institution's closure. In situations where complete IP/AVR information is not available to DRR because of liquidity or fraud concerns, DRR's current policy is to follow the Research Model which uses data from the institution's Call Reports and standard loss coefficients to estimate the loss on assets. However, DRR guidance states that the Research Model is not appropriate for institutions with more than $100 million in assets. Superior was in this category, with assets totaling $2.4 billion.

As explained in the Least Cost Test Manual, the least cost test is used to analyze and compare bids submitted for failing institutions. While FDICIA does require DRR to choose the least costly resolution scenario, (see 12 USC 1823(c)) the law does not require the use of the Least Cost Test model (LCT model). There is no guidance in the Least Cost Test Manual about situations in which neither the Research Model nor the LCT model is appropriate.

In September 1998, the FDIC developed a Large Bank Contingency Plan (the Plan) in an effort to provide a strategy for resolving a large institution, defined as having assets over $1 billion. The Plan states that the resolution should be the least costly alternative to the insurance fund and assumes that any failing institution with $1 billion or more in assets would, in most cases, result in the creation of a bridge bank in order for the FDIC to have adequate time to analyze and evaluate the bank's assets and liabilities. The Plan further states that for failing savings associations, the FDIC would use the conservatorship approach for resolving the institution. The Plan includes a provision that the resolution team should complete the IP/AVR process for the failing institution to determine the resolution structure to be used. However, the Plan does not provide guidance on how to determine whether a bridge bank or a conservatorship is the least costly alternative in situations where the IP/AVR process cannot be completed.

During the course of our audit, DRR initiated a project to combine its Bridge Bank Manual and the Conservator's Operating Manual to establish policies and procedures for bridge banks and conservatorships for the purpose of resolving failing financial institutions. We reviewed both manuals and determined that neither manual provides guidance on how to determine the least costly alternative in situations where the IP/AVR process cannot be completed. The Conservator's Operating Manual provides guidance for operating a conservatorship after the conservatorship has been established. The Bridge Bank Manual includes provisions for establishing, operating, and selling a bridge bank. Although the Bridge Bank Manual discusses the least cost analysis to be performed to determine the probable cost of a bridge bank, the manual directs that in situations where an AVR is not available, the Research Model should be used to determine the estimated market value of the assets. However, as previously mentioned, the use of the FDIC’s Research Model is not appropriate for large institutions with total assets over $100 million. Therefore, DRR's policies and procedures in place are not appropriate for determining the least costly alternative for financial institutions in situations where the IP/AVR process cannot be completed for institutions with assets over $100 million. In its effort to combine the Bridge Bank Manual and the Conservator’s Operating Manual, DRR should address this lack of guidance.

In cases where the IP/AVR process cannot be used, DRR should incorporate into its written policies GAO's general documentation criteria specifying the support necessary to adequately document its least cost resolution recommendations made to the FDIC Board. Additionally, DRR should ensure that all documentation is prepared prior to the presentation of the least cost recommendation to the FDIC Board.

Value of Information Sharing Arrangement with DOS and the Office of the Comptroller of the Currency

The FDIC issued Circular 7000.1, *DOS/DRR Information Sharing for Failing Institutions*, on December 3, 1999, to establish formal procedures between DOS and DRR for collecting and sharing information on insured financial institutions that appear likely to fail and to maintain open communication between DOS and DRR. Circular 7000.1 includes a requirement that DOS provide DRR staff timely, relevant access to failing institution information routinely and ad hoc when warranted by a specific situation or case, such as a projection that an institution will soon become critically undercapitalized.

By issuance of a memorandum dated August 31, 2000, from the Deputy Director, Franchise and Asset Marketing Branch, DRR implemented a pilot program with the OCC to facilitate information sharing and grant DRR early access to the books and records of failing financial institutions regulated by the OCC. DRR invited OTS to participate in the pilot program, but according to DRR, OTS was not receptive to a formal arrangement with DRR for information sharing.

DRR initiated the pilot program for information sharing with the OCC due to the benefits derived from DRR’s information exchange agreement with DOS. DRR stated that the implementation of Circular 7000.1 helped it gain access to failing bank information earlier than it had in the past, resulting in improved resolution planning and ultimately lower cost transactions. The OCC issued a memorandum dated August 16, 2000 to its District and Large Bank Deputy Comptrollers, Assistant Deputy Comptrollers, Large Bank Examiners-In-Charge, and all examining personnel outlining the provisions of the information access pilot program with DRR. The memorandum provides that, for any national bank rated a “4” or “5”, or where OCC examiners anticipate assigning a composite CAMELS rating of “4” or “5”, the OCC will invite DRR to join the examiners prior to the completion of the examination at the bank to gather preliminary resolution information.

In its August 16, 2000 memorandum, the OCC acknowledged that DRR generally received access to a failing national bank’s information at the time the bank was notified that it was critically undercapitalized or when otherwise authorized by the OCC. This typically provided DRR with 90 days to collect sufficient information and complete the resolution preparation process. However, the OCC recognized that liquidity, fraud, or other circumstances could necessitate closure of a bank on an expedited basis, resulting in little or no time for DRR to obtain needed information or otherwise prepare for the institution's closing. In such circumstances, an early understanding by DRR of an institution's corporate structure, type of accounting system, location of records, asset and liability structure, and nature of subsidiaries, can help facilitate the resolution process. Accordingly, to accommodate DRR's unique information needs, the OCC entered into the pilot program with DRR.

In situations where institutions must be closed in an expedited manner, resolution options may be limited, resulting in few, if any, bids for the franchise, delays in making insured depositors' funds available, and higher costs to the deposit insurance fund. Delays in resolving failed financial institutions could also affect the public's confidence in the insurance fund. If DRR and OTS had established an arrangement for information sharing similar to the arrangements DRR has with DOS and OCC, DRR might have had sufficient information to plan and execute a more orderly resolution for Superior prior to its closure.

DRR's Initiatives for Improving the Resolution Process

DRR's 2002 Strategic Plan (DRR Strategic Plan) outlines the mission and goals that DRR will seek to achieve during 2002. One goal for DRR's resolutions program is to value, manage, and market assets of failed institutions and their subsidiaries in a timely manner to maximize net return. To enable DRR to meet this goal, DRR's objective is to develop a program and procedures to implement a "Lessons Learned" addendum to its Resolutions Policy Manual. Completion of this objective would allow DRR to document and retain appropriate background information concerning unique situations encountered from each resolution for future reference or presentation purposes. For example, DRR could document information regarding the resolution strategies that worked or the type of data needed when dealing with a failing institution that has a credit card portfolio or a large amount of subprime loans.

DRR developed an action plan that calls for establishing a working group by January 31, 2002, and updating the Resolutions Policy Manual by November 30, 2002. DRR should use the lessons learned from the Superior resolution, particularly in the area of timely and appropriate access to failing institution information, as it updates its guidance.

RECOMMENDATIONS

We recommend that the Director, DRR:

(1) Pursue a formal information sharing agreement with OTS so that DRR can gather information necessary to plan for an orderly resolution and provide the FDIC Board with complete and reliable information on which to base its least cost decision.

(2) Ensure that all assumptions used to estimate the loss to the insurance fund and used by the FDIC Board for decision-making purposes are documented in accordance with FDICIA, as

well as the general documentation guidance prescribed by the GAO and provided within this report, and that this documentation is prepared in advance of the Board's decision.

(3) Develop internal policies and procedures that would provide DRR with guidance on how to prepare a Cost Test Summary when the LCT model or Research Model is not applicable.

(4) Include lessons learned from the Superior resolution, especially in the area of timely and appropriate access to a financial institution's information, in DRR's proposed Lessons Learned study concerning unique situations encountered from DRR's resolution activities.

CORPORATION COMMENTS AND OIG EVALUATION

The Deputy Director, DRR, provided a written response, dated January 29, 2002, to the draft report. The response is presented in Appendix VIII to this report.

The Corporation generally concurred with all four recommendations. These recommendations will remain undispositioned and open for reporting purposes.

In its response, DRR made the following comment regarding the $400 million loss estimate for residual interests that was included in the $491 million referred to in Table 1 of our report:

> "DRR's Washington's Capital Markets Group prepared a loss estimate on Superior's residual assets. This analysis was documented thoroughly and used by DRR analysts in preparing the least-cost test."

During our fieldwork, we reviewed DRR's analysis referred to in DRR's response. This analysis showed an estimated loss rate that differed from the 50 percent estimated loss rate that DRR documented in the Cost Test Summary. Further, the value of the residual interests changed between the time that the analysis was completed and the time that the Cost Test Summary was prepared. During the draft report review phase of our audit, DRR explained that this analysis formed the basis of DRR's estimation of the loss on residual interests for purposes of the least cost test analysis. However, DRR did not provide us with any documentation to support how the results of that analysis factored into the 50 percent loss estimate reported for the residual interests in the Cost Test Summary.

SCOPE AND METHODOLOGY

Scope

Our work included the evaluation of the least cost resolution recommendation for the resolution of Superior Bank, FSB (Superior) that was made by DRR on July 25, 2001 and the documentation to support that recommendation. The Office of Thrift Supervision (OTS) closed Superior on July 27, 2001. Our work also included an evaluation of the liquidation of those assets that were not transferred to the conservatorship and remained with the pass-through receivership (PTR). At the time of its failure, Superior had assets totaling nearly $2.4 billion. Of that amount, approximately $2.2 billion was transferred to the conservatorship while the remainder transferred to the PTR.

We relied on DRR's Information Package (IP) to determine the validity of asset and liability balances used in the least cost test. DRR used information from Superior's general ledgers to prepare the IP. We did not perform a formal reliability assessment of the computer-processed data in Superior's general ledger. We verified that the information in the IP agreed to the general ledgers. We did not find errors that would preclude the use of the IP to meet the audit objectives or that would change the conclusions in the report.

Methodology

To gain an understanding of the various resolution methods and to obtain an overview of the resolutions process, we reviewed:

- *Managing the Crisis: The FDIC and RTC Experience* - a publication dated August 1998 that documents the results of a study conducted by the FDIC on the banking crises of the 1980s and 1990s;
- Resolutions Policy Manual - a DRR manual dated April 18, 2001 that provides overall resolution policies and general procedures for "typical" resolution activities;
- Large Bank Contingency Plan - an FDIC manual dated September 10, 1998 that provides the FDIC with a plan for resolving a large failing institution with assets over $1 billion and assumes that any large failing financial institution with assets of $1 billion or more will in most cases result in the creation of a bridge bank in order for the FDIC to have adequate time to analyze and evaluate the bank's assets and liabilities; and
- Bridge Bank Manual - an FDIC manual dated November 30, 1995 that documents guidelines for management and operation of bridge banks.

We reviewed the Resolution Trust Corporation's Conservator's Operating Manual dated January 1992 to determine the extent of guidance that is provided for establishing a conservatorship as a least cost decision. The Assistant Director, Institution Sales, DRR, told us that the January 1992 version is the most recent edition of the manual.

To determine whether DRR considered all possible resolution methods in determining the least costly resolution for Superior, we:

- Reviewed the Failing Bank Case, dated July 25, 2001,
- Reviewed relevant FDIC Board Meeting minutes, and
- Interviewed DRR officials to obtain their input into the decision-making process.

To evaluate whether DRR adequately documented the evaluations made and assumptions used to arrive at the least cost decision, we:

- Obtained a copy of the Cost Test Summary, an attachment to the Failing Bank Case, dated July 25, 2001 and compared the asset and liability balances to Superior's general ledger and to the Information Package;
- Reviewed DRR's documentation to support the assumptions used to estimate the expected deposit premium and the loss on asset estimates for the resolution alternatives considered. This documentation consisted primarily of historical analysis, memoranda to the file, and an electronic spreadsheet that listed loss estimates assigned to specified asset categories; and
- Tested DRR's historical analysis of deposit premiums actually received to determine whether the results of the analysis were reasonable.

We selected a judgmental sample of estimated losses on assets to verify against supporting documentation. Our sample was designed to test a high percentage of the asset balances as well as to cover a high percentage of the total asset loss estimate. Our sample included the following asset categories:

- Single-family mortgage loans;
- Residual interests;
- Mortgage servicing rights;
- Capital origination costs; and
- Pipeline, Clearing, and Loans in Process.

In order to establish our criteria, we reviewed provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) that pertain to:

- Prompt corrective action, 12 USC 1831o, (See Appendix VII), and
- Least cost resolution, 12 USC 1823(c), (See Appendix V).

We reviewed an audit report issued by the United States General Accounting Office (GAO) regarding the FDIC's decision to place an institution into conservatorship and determined whether GAO offered additional guidance to the FDIC regarding compliance with the least cost decision-making process (GAO/GGD-92-92 dated July 7, 1992).

To determine whether DRR had adequate internal policies established to assist in the least cost decision-making process, we interviewed DRR officials responsible for preparing the input to the Cost Test Summary, and we reviewed the following guidance generated within DRR:

- Resolutions Policy Manual as of April 2001
- Least Cost Test Manual as of June 2001, and
- Large Bank Contingency Plan dated September 1998.

We reviewed DRR's Strategic Plan for 2002 to determine whether DRR had established any goals or developed an action plan related to the resolution process.

We analyzed DRR's resolution caseload for the period January 2000 through October 2001, to determine the:

- average staff size assigned to resolutions,
- average time that DRR needed to complete the IP and AVR in order to plan and prepare for orderly resolutions, and
- number of occurrences where the institutions did not fail.

To determine whether DRR had adequate internal policies established to assist in the liquidation of the assets that remained in the PTR, we reviewed the DRR's Asset Disposition Manual, which is a compilation of best business practices that is used as guidance for a variety of asset categories. We interviewed DRR staff responsible for preparing the PTR assets for liquidation and determined whether DRR's actions were in compliance with its policy.

In order to gain an understanding of DRR's efforts to gain earlier access into Superior, we reviewed correspondence and interviewed officials from OTS and DRR - headquarters, and resolutions personnel from DRR-Dallas. We also interviewed the FDIC Director regarding his views related to DRR's access to Superior.

We performed our work at the FDIC's and OTS's offices in Washington, D.C. and at Superior's headquarters in Oakbrook Terrace, Illinois from August 2001 through November 2001. On January 22, 2002, we met with OTS officials to discuss our draft report presentation of DRR's request for access to Superior and the extent to which OTS granted DRR access to Superior's records and personnel. We held an exit conference with DRR on January 22, 2002 to discuss findings and recommendations in our draft report. We conducted the audit in accordance with generally accepted government auditing standards.

GLOSSARY

Asset Valuation Review (AVR)
Process that estimates the value of assets to the FDIC as Receiver of the failing institution. The AVR compares the book value of assets to the estimated recovery values to help determine the projected net loss to the FDIC.

Bridge Bank
A resolution strategy available to the FDIC, under authority provided by the Competitive Equality Banking Act, where a temporary banking structure is established for large banks with complex financial structures that are in danger of failing. A national bank chartered by the Office of the Comptroller of the Currency and controlled by the FDIC, a bridge bank is designed to take over the operations of a failing bank and maintain banking services for the customers. A temporary bridge structure provides the FDIC time to take control of a failed bank's business, stabilize the situation, and determine an appropriate permanent resolution. It also enables the FDIC to gain sufficient flexibility for reorganizing and marketing the institution. Bridge banks operate in a similar manner with conservatorships and have the same purpose. See 12 USC 1821(n).

CAMELS Rating
The FDIC and other financial institution regulators use the Uniform Financial Institutions Rating System (UFIRS) to evaluate a bank's performance. Areas of finance, management, and compliance are evaluated and given a numerical rating of "1" through "5", with "1" having the least concern and "5" having the greatest concern. The performance areas, identified by the CAMELS acronym, are: Capital Adequacy, Asset Quality, Management, Earnings, Liquidity and Sensitivity to Market Risk.

Capital Restoration Plan
Under the PCA provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), as codified at 12 USC 1831o, a capital restoration plan is required for institutions deemed to be undercapitalized by the appropriate regulatory agency. The plan shall specify the steps the insured depository institution will take to become adequately capitalized; the levels of capital to be attained during each year in which the plan will be in effect; how the institution will comply with the restrictions or requirements then in effect under the PCA provisions; and the types and levels of activities in which the institution will engage.

Conservator
A person or entity, including a government agency, appointed by a regulatory authority to operate a troubled financial institution in an effort to conserve, manage, and protect the troubled institution's assets until the institution has stabilized or has been closed by the chartering authority. See 12 USC 1821(c).

Conservatorship
A legal procedure and resolution strategy available to the FDIC, under authority provided by FIRREA, for the interim management of financial institutions. Under the pass-through receivership method, after the failure of a savings institution, a new institution is chartered and placed under agency conservatorship; the new institution assumes certain liabilities and purchases certain assets from the receiver of the failed institution. Under a straight conservatorship, the FDIC may be appointed conservator of an open, troubled institution. The conservator assumes responsibility for operating the institution on an interim basis in accordance with applicable laws of the federal or state authority that chartered the new institution. Under a conservatorship, the institution's asset base is conserved pending the resolution of the conservatorship. See 12 USC 1831o(h).

Critically Undercapitalized
The most severe category within the PCA used to describe the capital adequacy of an institution. For an institution to be deemed critically undercapitalized, the tangible capital to total assets ratio is equal to or less than 2 percent. See 12 USC 1831o.

Deposit Premium
The amount a bidder is willing to pay above the value of an institution's insured deposits.

Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA)
Legislation that established the Resolution Trust Corporation and the Oversight Board of the RTC as instrumentalities of the United States. Enacted by Congress on August 9, 1989, FIRREA revised the structure of the deposit insurance system creating a new Bank Insurance Fund (BIF) and a Savings Association Insurance Fund (SAIF), both of which were to be administered by the FDIC. FIRREA gave the FDIC the authority to appoint itself as sole conservator or receiver of any insured state depository institutions, provided certain criteria were met. See 12 USC 3332 et seq.

Information Package (IP)
The Information Package provides a description, in financial terms, of the failing institution's assets, liabilities, and business on a specific date with supporting schedules. This product, developed by DRR, Franchise Marketing, is used as a marketing tool to help potential acquirers decide if they are interested in a transaction with the FDIC to resolve a failing institution.

Least Cost Resolution
A determination required under 12 USC 1823(c) for the FDIC to implement the resolution alternative that is determined to be least costly to the relevant deposit insurance fund of all possible resolution alternatives, including liquidation of the failed institution.

Liquidation
The winding down of the business affairs and operations of a failed insured depository institution through the orderly disposition of its assets after it has been placed in receivership.

Office of the Comptroller of the Currency (OCC)
A bureau within the U.S. Treasury Department, established in 1863. The OCC charters, regulates, and supervises national banks, which can usually be identified because they have the word "national" or "national association" in their names. It also supervises the federal branches and agencies of foreign banks.

Office of Thrift Supervision (OTS)
The office within the U.S. Department of the Treasury that has responsibility for the overall supervision, regulation, and examination of federally chartered thrift institutions.

Pass-Through Receivership (PTR)
Method used by the OTS to transfer the assets and liabilities of a failed thrift to a newly chartered institution placed in conservatorship. Under this method, the OTS closes the institution, appoints a receiver, and passes the assets and liabilities of the failed thrift to the new institution, which is then placed in conservatorship.

Prompt Corrective Action (PCA)
A provision of FDICIA, which amended the Federal Deposit Insurance Act by adding section 38, codified at 12 USC 1831o. It establishes a framework for taking prompt supervisory actions against insured banks that are not adequately capitalized. The following categories are used to describe capital adequacy, in order of severity: (1) Well Capitalized, (2) Adequately Capitalized, (3) Undercapitalized, (4) Significantly Undercapitalized, and (5) Critically Undercapitalized. Unless other action is determined to be appropriate, the primary regulator is required to close an institution that is "critically undercapitalized" and unable to provide an adequate capital restoration plan. The FDIC, as insurer, is required to resolve the institution in a manner least costly to the deposit insurance fund.

Risk Analysis and Value Estimation (RAVEN)
A Microsoft® Visual FoxPro®[17] application used to statistically sample assets for valuation pricing as part of the AVR process. RAVEN generates the IP and AVR reports.

Receiver
An agent (in the instance of a failed institution, the FDIC) appointed by a failed institution's primary regulator to manage the orderly liquidation of a failed institution. See 12 USC 1821(c).

Receivership
The legal procedure for winding down the affairs of an insolvent institution. See 12 USC 1831o(h).

[17] Microsoft ® and Visual FoxPro® are either registered trademarks or trademarks of Microsoft Corporation in the United States and/or other countries.

Research Model
Created by the Division of Research and Statistics in the 1980s to estimate the loss in the assets of a failing bank using historical statistical analysis of general asset categories. General loss coefficients for the asset categories were developed but are not appropriate for use with large institutions with total assets over $100 million or for institutions where fraud is discovered. Estimates are based on Call Report data and can only be used to give the Board a rough estimate of the potential loss.

Residual Interests
These interests represent claims on the cash flows resulting from the securitization process that remain after all obligations to investors and any related expenses have been paid, which normally include funds to build reserves and pay loan losses, servicing fees, and liquidation expenses. When the loans for the pools originate, they bear a stated interest rate. The securities are issued to investors at a lower rate than the stated rate on the loans. The difference between the rate that the loans are paying versus what the pools are paying to investors is called the residual.

Resolution
A disposition plan for a failed or failing institution. It is designed to (1) protect insured depositors and (2) minimize the costs to the relevant insurance fund that are expected from covering insured deposits and disposing of the institution's assets. Resolution methods include purchase and assumption transactions, insured deposit transfer transactions, and straight deposit payoffs.

Resolution Trust Corporation (RTC)
An entity established in 1989 by FIRREA to oversee the resolution of insolvent thrifts and to dispose of assets acquired from the failed thrifts in the wake of the thrift crisis of the 1980s. The RTC operated from August 9, 1989, to December 31, 1995.

Standard Asset Value Estimation (SAVE) Methodology
Developed by an inter-divisional task force, established in 1995, a set of Corporation-wide, common methodologies with respect to asset valuation. These value estimates are used in the least cost test and the sale of assets at resolution, asset management and disposition decisions, and for financial reporting. The SAVE Methodology contributes to the FDIC's mission goals of insuring deposits and managing receiverships through the employment of a singular, valid, legitimate, and defensible valuation method. In addition, its use enhances period-to-period and purpose-to-purpose comparability and analysis of asset value estimates.

Standard Asset Value Estimation (SAVE) Methodology Board: In March 1999, DRR established a SAVE Methodology Board. This policy group has jurisdiction over the SAVE Methodology and is intended to serve as an on-going body to direct and support the periodic review and assessment of issues related to its maintenance and implementation throughout the various asset valuation processes in the Corporation. The objective of the board is to enhance and maintain the asset valuation methodology, including assumptions, in a manner that is responsive to market structure and organizational needs. When necessary, the board will aid in process design. The SAVE Methodology Board consists of members from senior management of DRR, Division of Finance, and Division of Insurance. The board reports to the DRR Director and the three (3) Washington Deputy Directors who have authority to approve major policy changes in this area.

Uninsured Deposit
The portion of any deposit of a customer at an insured depository institution that exceeds the applicable FDIC insurance coverage for the depositor at that institution.

DRR'S RESOLUTION PROCESS
(From DRR's Resolutions Policy Manual))

Four major functions occur in a typical resolution of a failing institution:

- Planning and preparing for the resolution project,
- Preparing the IP and conducting the AVR,
- Marketing the failing institution, and
- Selecting bids.

These resolution activities normally occur before the primary regulator closes the failing institution, so that DRR can analyze the failing institution and plan for an orderly resolution. This process works best when DRR has sufficient access to failing institution information before the closing. A typical resolution due to a financial institution's capital insolvency will extend for a period of 90 days or less, following notification from the chartering authority, or the primary federal regulator. PCA provisions of FDICIA require the appropriate federal banking authority or the FDIC to close an institution within 90 days after determining that it is "critically undercapitalized" and does not have an adequate capital restoration plan in place. See 12 USC 1831o. (Appendix VII).

Once the resolution period has begun, DRR requests an electronic download of the failing institution's loan and deposit databases that is entered into DRR's Risk Analysis and Evaluation Estimation (RAVEN) system before the start of on-site resolution work. RAVEN contains the valuation assumptions used by DRR for each class of assets in a failing institution. These assumptions are developed by the Standard Asset Value Estimation (SAVE) Methodology Board, established in 1999 as an inter-divisional project to develop Corporation-wide, common methodologies with respect to asset valuation. This ensures that categories of assets are valued consistently from resolution to resolution. Once the failing institution's loan information is loaded into RAVEN and validated by DRR, this information is used to develop the samples used to complete the AVR.

The AVR process carefully documents the valuation of the assets of a failing institution. Assumptions are used to create valuation estimates where detailed information is not readily available and may be used to validate the data in the asset files. Given time, staffing, and space constraints, it is usually not possible or desirable to value all assets of a failing institution. Consequently, the resolution team values a representative sample of the loans to provide a statistically valid sample of the entire portfolio of loans. This asset information is then used to complete the balance sheet information for the Least Cost Test (LCT).

The IP is a prospectus that provides a snapshot description, in financial terms, of the failing institution's assets, liabilities, and business on a specific date with supporting schedules. The IP is also used to provide the liability section of the balance sheet for the LCT. Information for the

IP is generally requested from the failing institution prior to DRR’s arrival and is in addition to the electronic downloads needed for the AVR. Both the IP/AVR Team Leader and the Marketing Specialist assigned to the resolution are required to review and agree to the data in the IP before it is submitted to the Manager, Franchise and Asset Marketing, or Supervisory Resolution Specialist for approval.

Once the IP and AVR are complete, DRR schedules an opportunity for interested potential acquirers to learn more about the failing institution, transactions offered, legal documents, bid acceptance, and regulatory approval process. DRR currently uses a secured Web site to present this information. During the due diligence period,[18] DRR sets the bid deadline and notifies potential acquirers. All bids are evaluated for the least cost transaction. DRR analyzes the bids received, conducts a least cost determination, and recommends the least costly resolution strategy to pursue.

DRR developed an LCT model, which determines the liquidation value of a failing institution and compares bids to the liquidation value and to each other to determine the least costly resolution method as required by FDICIA. The LCT model uses data from the IP and AVR to value the assets and liabilities, selects from among the multiple bid combinations submitted for a failing institution’s deposits and asset pools, and compares the resulting analysis with the cost of liquidating the financial institution. The LCT model also estimates the additional costs of resolving the financial institution’s liabilities in the bid combinations being compared.

In cases where complete IP/AVR information is not available to DRR because of liquidity or fraud concerns, the FDIC developed the Research Model which uses data from the institution’s Call Reports and historical loss percentages to calculate the loss on each asset category. DRR guidance states that the Research Model is not appropriate for institutions with more than $100 million in assets. The Research Model was based on historical statistical analysis performed on failed banks and loss coefficients for general asset categories for smaller banks, which were the majority of past failures, and did not include data related to any failed institutions where fraud was discovered.

[18] Due diligence is the bidder's on-site inspection of the books and records of the institution and the bidder's assessment of the value of the assets and liabilities.

DRR HAS MADE PROGRESS IN LIQUIDATING PASS-THROUGH RECEIVERSHIP ASSETS

DRR has made some progress in liquidating assets that remained in the PTR. The PTR retained $182.6 million of Superior assets, representing approximately 8 percent of total assets held by Superior at closing. These assets consist of:

- $114.8 million in receivables from subsidiaries ($77.5 million) and Coast to Coast Financial Corporation ($37.3 million);
- $46.4 million for four owned branches and furniture, fixtures, and equipment on leased premises in New York, Chicago, and other locations;
- $10 million of investment in subsidiaries;
- $9.3 million in other assets; and
- $2.1 million in owned real estate single-family properties.

The $77.5 million receivable from subsidiaries represents unsecured loans from Superior Bank. DRR has not found any evidence that these loans are secured and suggests that this amount is not collectable since the subsidiaries are insolvent. DRR plans to research these receivables further before a determination is made to write these receivables off as a total loss. DRR expects to get full recovery of the $37.3 million receivable from Coast to Coast Financial.

Included in the PTR are the institution's premises and furniture and fixtures that total $46.4 million. DRR offered these assets to the winning bidder of the insured deposits as part of its efforts to sell the deposit franchise. On October 31, 2001, the FDIC announced approval of the sale of the branches and deposits of New Superior. The terms of the sale provided the assuming institution with a 90-day option to purchase any of the bank-owned facilities, furniture, fixtures, and equipment at fair market value. An option was also given to assume leases.

The $10 million of investment in subsidiaries consists primarily of equity in Lyons Funding. DRR does not believe this amount is collectible and anticipates that this amount will be written off.

DRR's Asset Disposition Manual contains procedures for managing and disposing owned real estate, including establishing budgets, arranging for on-site management of the property, developing and implementing a marketing strategy, and preparing the property for sale. The PTR retained 29 single-family properties valued at approximately $2.1 million. For 28 of these properties, DRR has established budgets, ordered new appraisals and title commitments, and contracted with FDIC brokers and property managers.[19] As of October 18, 2001, the FDIC had sold three properties and had contracts pending on two additional properties. DRR is working to resolve title and legal issues on the remaining properties. Once these issues are resolved, DRR

[19] The remaining property was an in-substance foreclosure in which the sale was confirmed by the Court in October 2001.

plans to list the properties with brokers and attempt to dispose of them through the market. Any properties not sold through a broker during the initial 180-day listing period will be included in a sealed bid sale in the second quarter of 2002. DRR originally intended to have all of these properties on the market and to have conducted a sealed bid sale by the fourth quarter of 2001. However, given the title and legal issues, the FDIC has been unable to accomplish this.

The PTR also retained various other assets totaling $9.3 million. This amount consists of miscellaneous receivables, prepaid expenses, and deferred taxes that are being administered by DRR.

Because DRR is making sufficient progress on the liquidation of PTR assets, we are not making any recommendations at this time. We will continue to track DRR's progress and will report these results in our ongoing audit of the marketing and final resolution of New Superior.

FEDERAL DEPOSIT INSURANCE CORPORATION IMPROVEMENT ACT OF 1991
LEAST COST RESOLUTION

Section 141 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), codified at 12 USC 1823(c), discusses the least cost resolution and the documentation requirements of the least cost determination. Relevant excerpts follow:

(4) Least-cost resolution required -

(A) In general. - Notwithstanding any other provision of this Act, the Corporation may not exercise any authority under this subsection or subsection (d), (f), (h), (i), or (k) of this section with respect to any insured depository institution unless
  - (i) the Corporation determines that the exercise of such authority is necessary to meet the obligation of the Corporation to provide insurance coverage for the insured deposits in such institution; and
  - (ii) the total amount of the expenditures by the Corporation and obligations incurred by the Corporation (including any immediate and long-term obligation of the Corporation and any direct or contingent liability for future payment by the Corporation) in connection with the exercise of any such authority with respect to such institution is the least costly to the deposit insurance fund of all possible methods for meeting the Corporation's obligation under this section.

(B) Determining least costly approach. - In determining how to satisfy the Corporation's obligations to an institution's insured depositors at the least possible cost to the deposit insurance fund, the Corporation shall comply with the following provisions:
  - (i) Present-value analysis; documentation required. - The Corporation shall -
    - (I) evaluate alternatives on a present-value basis, using a realistic discount rate;
    - (II) document that evaluation and the assumptions on which the evaluation is based, including any assumptions with regard to interest rates, asset recovery rates, asset holding costs, and payment of contingent liabilities; and
    - (III) retain the documentation for not less than 5 years.

DRR'S DEVELOPMENT OF THE COST TEST SUMMARY FOR SUPERIOR BANK

Using Superior's general ledger information, DRR determined that gross assets from the institution totaled nearly $2.4 billion, which included cash and securities. Using preliminary valuations and staff estimates, DRR determined that the estimated loss on the sale of those assets was approximately $753 million. (To learn more about the tools that DRR typically uses to value assets in order to estimate the loss and to document the valuation process, please refer to Appendix III where DRR's resolution process is discussed.)

In the narrative discussion section of the Failing Bank Case, DRR described the assumptions used to develop its estimates of deposit franchise premium. DRR estimated that the deposit franchise premium received would be between 5 percent and 10 percent of Superior's core deposit base at the end of the conservatorship period (anticipated to be as long as 6 months). At the time of the Failing Bank Case, DRR estimated the core deposit base at approximately $1.38 billion. This would have given an estimated range of deposit franchise premium of between $69 million and $138 million. In its Cost Test Summary, however, DRR used a middle figure of 8 percent, or $110 million, as the estimated deposit premium and added it to net assets.

DRR estimated that the costs to operate the deposit franchise during the 6-month conservatorship period would be $9 million, and offset those costs with the expected premium to arrive at the net deposit premium amount of $101 million.

DRR added the net deposit premium to the amount of gross assets (less the estimated losses) and determined that the amount of assets available for distribution to the receivership claimants totaled $1.7 billion. ($1.60 billion plus $101 million).

The Distribution of Claims/Losses section of the Cost Test Summary apportions the assets available for distribution to each of the receivership claim groups, based on the claimants' loss position. Secured and preferred creditors are in first position for distribution of assets. The FDIC and uninsured depositors are in second position and share on a pro rata basis. General creditors are in third position. If Superior had subordinated creditors, they would have been in last position. After the assets were distributed, the FDIC (i.e., SAIF) was left with an estimated loss on its claim totaling $426.4 million.

The FDIC's Total Cost for each resolution alternative is compared on the Cost Test Summary, and the resolution alternative having the least cost to the deposit insurance fund is presented. DRR estimated that the loss to the deposit insurance fund under the conservatorship resolution method would be $426.4 million, the least costly alternative compared to liquidation or an immediate receivership and sale.

FEDERAL DEPOSIT INSURANCE CORPORATION IMPROVEMENT ACT OF 1991 PROMPT CORRECTIVE ACTION

Section 38 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), codified at 12 USC 1831o, requires prompt corrective action to protect the deposit insurance funds. Relevant excerpts from Section 38 are found below:

(a) Resolving Problems To Protect Deposit Insurance Funds.

(1) PURPOSE. The purpose of this section is to resolve the problems of insured depository institutions at the least possible long-term loss to the deposit insurance fund.

(2) PROMPT CORRECTIVE ACTION REQUIRED. Each appropriate Federal banking agency and the Corporation (acting in the Corporation's capacity as the insurer of depository institutions under this Act) shall carry out the purpose of this section by taking prompt corrective action to resolve the problems of insured depository institutions.

(b) DEFINITIONS. For purposes of this section:

(1) CAPITAL CATEGORIES.--

(A) WELL CAPITALIZED. An insured depository institution is "well capitalized" if it significantly exceeds the required minimum level for each relevant capital measure.

(B) ADEQUATELY CAPITALIZED. An insured depository institution is "adequately capitalized" if it meets the required minimum level for each relevant capital measure.

(C) UNDERCAPITALIZED. An insured depository institution is "undercapitalized" if it fails to meet the required minimum level for any relevant capital measure.

(D) SIGNIFICANTLY UNDERCAPITALIZED. An insured depository institution is "significantly undercapitalized" if it is significantly below the required minimum level for any relevant capital measure.

(E) CRITICALLY UNDERCAPITALIZED. An insured depository institution is "critically undercapitalized" if it fails to meet any level specified under subsection (c)(3)(A).

(c) CAPITAL STANDARDS

(3) CRITICAL CAPITAL

(A) AGENCY TO SPECIFY LEVEL.

(i) LEVERAGE LIMIT. Each appropriate Federal banking agency shall, by regulation, in consultation with the Corporation, specify the ratio of tangible equity to total assets at which an insured depository institution is critically undercapitalized.

(ii) OTHER RELEVANT CAPITAL MEASURES. The agency may, by regulation, specify for 1 or more other relevant capital measures, the level at which an insured depository institution is critically undercapitalized.

(h) Provisions Applicable to Critically Undercapitalized Institutions.

(3) Conservatorship, receivership, or other action required.

(A) IN GENERAL. The appropriate Federal banking agency shall, not later than 90 days after an insured depository institution becomes critically undercapitalized

(i) appoint a receiver (or, with the concurrence of the Corporation, a conservator) for the institution; or

(ii) take such other action as the agency determines, with the concurrence of the Corporation, would better achieve the purpose of this section, after documenting why the action would better achieve that purpose.

FDIC
Federal Deposit Insurance Corporation
Washington, DC 20429 Division of Resolutions and Receiverships

January 29, 2002

MEMORANDUM TO: Russell A. Rau
Assistant Inspector General for Audits

FROM: James R. Wigand, Deputy Director [Electronically produced version; original signed by James R. Wigand]
Franchise and Asset Marketing Branch
Division of Resolutions and Receiverships

SUBJECT: Response to OIG Draft Report Entitled *Least Cost Decision of Superior Bank and Liquidation of Remaining Receivership Assets* (Assignment No. 2001-721)

Thank you for the opportunity to respond to your draft report. This memorandum will serve to respond to the issues and recommendations outlined in the draft OIG Audit Report.

Recommendation #1

Pursue a formal information sharing agreement with the OTS so that DRR can gather information necessary to plan for an orderly resolution and provide the FDIC Board with complete and reliable information on which to base its least cost decision.

Response:

DRR agrees with the recommendation. In the past, DRR has attempted to formalize a sharing agreement with OTS similar to agreements established with DOS and the OCC. DRR will continue to pursue the sharing agreement with OTS and will schedule an initial meeting with OTS by March 31, 2002 and attempt to formalize an agreement by May 31, 2002.

Recommendation #2

Ensure that all assumptions used to estimate the loss to the insurance fund and used by the FDIC Board for decision-making purposes are documented in accordance with FDICIA, as well as the general documentation guidance prescribed by the GAO and provided within this report, and this documentation is prepared in advance of the Board's decision.

Response:

DRR agrees with the recommendation and will explore ways to modify the Research Model so it can be used for larger banks when a complete AVR is not available. (See Response for Recommendation #3.)

The OIG report states that the assumptions used in making the decision were fully documented (i.e. expected premium and future operating loss.) The projected loss on assets was staff's best estimate given the limited time, and as OIG pointed out, was not fully supported. It should be noted that the same level of asset losses was used in the least cost analysis for each resolution alternative and therefore, had no impact on the relative cost of each resolution alternative.

Due to circumstances described in the report, DRR had very limited time available to estimate the loss to the insurance fund and prepare the FDIC Board case for Superior. Although DRR did not have a completed AVR, DRR was able to estimate loss for a significant portion of the assets at Superior. DRR's staff, who has significant experience in liquidating assets, provided these loss estimates. Due to the time constraints, DRR analysts preparing the least cost test relied on the information obtained from DRR's on-site staff (either by phone or email) in order to provide the FDIC Board with its best estimate of loss. Additionally, DRR's Washington's Capital Markets Group prepared a loss estimate on Superior's residual assets. This analysis was documented thoroughly and used by DRR analysts in preparing the least-cost test.

Recommendation #3

Develop internal policies and procedures that would provide DRR with guidance on how to prepare a Cost Test Summary when the LCT model or Research Model is not applicable.

Response:

DRR agrees with the recommendation and will explore ways to modify the Research Model so it can be used for larger banks when a complete AVR is not available. DRR currently has internal policies and procedures that provide DRR with guidance on how to prepare an estimate of the least cost transaction for a failing institution. However, DRR procedures had excluded using the Research Model for large institutions with assets over $100 million or for institutions where fraud was suspected. One of DRR's greatest concerns regarding the Research Model limitations is because the prediction error increases as the size of the bank increases. DRR will take the following actions:

1) *Meet with DRS to explore methods of developing new loss coefficients that are applicable to large banks and take into consideration special problems in the bank (i.e. residuals, credit cards, etc.) by March 31, 2002.*
2) *Modify and complete testing of the Research Model by May 31, 2002.*
3) *Document assumptions used to determine loss coefficients and changes in procedures by May 31, 2002.*
4) *Meet with OIG to review documentation and new procedures by June 14, 2002.*
5) *Revise Research Model available for use in Resolution cases by June 30, 2002.*

Recommendation #4

Include lessons learned from the Superior resolution, especially in the area of timely and appropriate access to a financial institution's information in DRR's proposed Lessons Learned study concerning situations encountered from DRR's resolution activities.

Response:

DRR agrees with the recommendation. This is a current project in DRR's strategic plan for 2002 and is scheduled to be complete by year-end 2002.

cc: Mitchell L. Glassman