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THE ROLE OF INSPECTORS GENERAL: MINIMIZING AND MITIGATING WASTE, FRAUD, AND ABUSE

HEARING

BEFORE THE

SUBCOMMITTEE ON
OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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THE ROLE OF INSPECTORS GENERAL: MINIMIZING AND MITIGATING WASTE, FRAUD, AND ABUSE

Tuesday, May 5, 2009

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON OVERSIGHT
AND INVESTIGATIONS,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2 p.m., in room 2128, Rayburn House Office Building, Hon. Dennis Moore [chairman of the subcommittee] presiding.

Members present: Representatives Moore of Kansas, Lynch, Driehaus, Grayson; Biggert, Lee, and Paulsen.

Chairman MOORE OF KANSAS. This hearing of the Subcommittee on Oversight and Investigations of the House Financial Services Committee will come to order. Our hearing this afternoon is entitled, "The Role of Inspectors General: Minimizing and Mitigating Waste, Fraud, and Abuse."

We will begin our first subcommittee hearing of the year with members' opening statements up to 10 minutes per side, and then we will receive testimony from our 3 witnesses. After that, members will each have up to 5 minutes to question the witnesses.

Without objection, all members' opening statements will be made a part of the record. I now recognize myself for up to 5 minutes for an opening statement.

There have been a few signs recently that our economy may be slowly nearing the bottom of the decline. I believe our economy will eventually stabilize, recover, and grow once again, but despite a few glimmers of hope, my constituents remain anxious and I share their concern.

In March, the U.S. economy lost 663,000 more jobs, bringing the unemployment rate to 8½ percent, the highest since November 1983. Since the recession began in December 2007, a total of 5.1 million Americans have lost their jobs. That is nearly double the entire population of my home State of Kansas.

Last Friday, regulators shut down 3 more banks, bringing the total number of U.S. banks that have failed in the past 17 months to 57. The FDIC has estimated that one of those banks, Silverton Bank in Georgia and the biggest bank to fail this year, will cost the Deposit Insurance Fund $1.3 billion.

There are some painful lessons that we need to learn from this financial crisis so we can strengthen the rules and improve the

oversight of our broken financial sector. In addition to modernizing the regulatory structure to prevent another financial meltdown, Congress must ensure there is tough oversight and transparency of the extraordinary actions the Federal Government has taken to the stabilize the financial sector.

Some examples include the Treasury Department's use of $700 billion in TARP funds, the FDIC's debt guarantee program, and the Federal Reserve's intervention with AIG and their $1 trillion TALF program. To that end, I appreciated the opportunity to work recently with Ranking Member Biggert, Congressman Driehaus and Congressman Paulsen of the subcommittee to enact our Special Inspector General of TARP, or SIGTARP, bill that President Obama signed into law on April 24th.

Just last month, the SIGTARP reported that he has already launched 20 criminal investigations. He previously indicated he did not have the staff he needed to track down every lead. The new law gives the SIGTARP stronger oversight over the TARP program as well as the expanded authority he requested to hire the necessary auditors and investigators to provide tough oversight.

This afternoon, the Oversight and Investigations Subcommittee will have the Inspectors General from Treasury, the Federal Reserve Board, and FDIC testify about their ongoing efforts to expose and eliminate waste, fraud, and abuse. For example, the Treasury's Office of Inspector General reported investigations leading to 13 arrests and nearly $400,000 in court-ordered fines, restitution, and recoveries during a 6-month period last year.

The FDIC's Office of Inspector General reported investigations leading to 61 convictions and nearly $353 million in fines, restitution, and other monetary recoveries.

As a former District Attorney for 12 years, and the chairman of this Oversight and Investigations Subcommittee, one of my top priorities is to make sure that our Inspectors General have all the tools and resources they need to continue this important oversight work.

One issue of concern I would like to focus on today is material loss reviews, or MLRs, which are required to be completed by the Inspectors General whenever a failed bank costs the Deposit Insurance Fund over $25 million.

In January, our three witnesses wrote Chairman Frank expressing their request that Congress raise the MLR threshold from $25 million to between $300 million to $500 million. In addition to a higher threshold, they suggested a requirement for failed banks falling below the new threshold that an initial assessment still be taken to ensure that unusual or potentially significant situations are not missed.

I was disturbed to learn recently that the failure of Washington Mutual, the largest failure in U.S. history, did not trigger a mandated material loss review because there was no cost to the Deposit Insurance Fund, given that JPMorgan Chase acquired the institution after it failed. I understand the voluntary review is underway, but we need to update the MLR system so that a review of a bank failure like WaMu would be required.

I was also disturbed to read the Inspectors General's letter to Chairman Frank claiming that without a modernized MLR system

the current system would limit their ability to effectively oversee many of the new and significant programs and initiatives that the Federal banking agencies are undertaking to address current economic conditions. We must address this problem.

I look forward to hearing the testimony from our witnesses discussing this MLR concern and then working with members of our committee on both sides, Republicans and Democrats, to quickly address this concern so we can provide the best oversight effort possible.

I now recognize for 5 minutes the ranking member of this subcommittee, my colleague and friend from Illinois, Mrs. Biggert.

Mrs. BIGGERT. Thank you, Chairman Moore, and thank you for holding this important hearing.

I would like to start by thanking today's witnesses and their staffs for tackling waste, fraud, and abuse in our regulatory and financial system, which I believe is at the heart of our financial crisis.

A couple of years ago, the Chicago Tribune published a series of articles that revealed that gangs in the Chicago area were increasingly turning to mortgage fraud. They found it more lucrative than selling drugs. It turns out the gangs were not alone. Everyone, it seemed, was in on the act. In March, the U.S. Attorney in Chicago, Patrick Fitzgerald, brought mortgage fraud indictments against two dozen players, brokers, accountants, loan officers, processors, and attorneys.

Mortgage fraud comes in all sizes and shapes. Scam artists inflate appraisals, flip properties, and lie about information, including income and identity on loan applications. Some use the identity of deceased people to obtain mortgages, and other desperate thieves bilk the most vulnerable homeowners and seniors in dire financial straights out of their homes and home equity.

Let's face it; I think this is the tip of the iceberg. And as we in Congress work to get the economy back on track and credit flowing again we have to address what was at the root of the mortgage meltdown in the first place, and that, I believe, is mortgage fraud.

As Inspectors General of three of the most important banking regulators, today's witnesses, I think, hold key positions to investigate mortgage fraud and really get to the bottom of the turmoil that plagues today's financial markets. What went wrong, who broke the law, were the laws enforced, were the laws and regulations adequate to restore confidence in our markets and address any failing in our system of regulation, including enforcement? We must determine the answers to these questions.

On that note, it is important that our financial Inspectors General have the resources to do their jobs. That is why today we will examine the role and capability of the Fed, Treasury, and the FDIC Inspectors General. In addition, we will focus on a provision in current law that requires IGs to review and report on any failed banks that cost $25 million or more material loss to the Deposit Insurance Fund.

I think we will hear from today's witnesses that the material loss review is that the lower end of the threshold make up the bulk of their cases, but don't result in significant findings beyond what was revealed when an institution closed. However, we will hear that

these low end of the threshold cases take up considerable time and resources. Due to the high level of bank failures and more on the way, this MLR requirement with the current threshold level promises to become increasingly burdensome to the IGs and to continue to divert them from other important work, including oversight of TARP and other Federal financial assistance programs, aiding law enforcement in its efforts to crack down on illegal behavior and identifying failing of financial regulators, regulations, and laws.

For example, today's Wall Street Journal indicated that some banks may be disproportionately laden with commercial real estate loans and other banks need to increase capital to have enough of a cushion for anticipated losses.

The sooner we get back to the root of these matters, the sooner we can get financial institutions off of the Federal dole and our financial markets and economy back on track.

I would like to conclude by reiterating my continued commitment to working on these matters. In the past, I worked on the FDIC Enforcement Enhancement Act, and recently, the Fight Fraud Act. For two Congresses, I introduced a bill, the Stop Mortgage Fraud Act, to increase Federal law enforcement funding to investigate and prosecute mortgage fraud. In addition, I supported reforms of numerous financial services regulations and programs, and I and others here today care deeply about getting this right.

So with that, I look forward to working with my colleagues and look forward to hearing from today's witnesses. I yield back.

Chairman MOORE OF KANSAS. Thank you. I recognize the gentleman from Massachusetts, Mr. Lynch, for 3 minutes.

Mr. LYNCH. Thank you, Mr. Chairman. Thank you for holding this very important hearing, as well as Ranking Member Biggert for her work on this as well. I would like to thank our witnesses, not only for the good work that you do every day, but also for your willingness to come before the subcommittee and help us with our work.

There is a natural alliance, I think, between our Inspectors General and the Oversight Subcommittee. We each search for transparency and we each hope to inject accountability, I think, to the governmental process and make sure that the various efforts of government are carried out properly. But part of our problem that we address here is really part of a larger problem, which is the complexity in some of these issues, and I know with each of you, you are dealing with some of these new financial iterations that are extremely difficult to follow. We on the Oversight Subcommittee have had a difficult time getting information back from our TARP expenditures and just some of the dealings between the Federal Reserve and the SEC with some of these so-called rescued companies.

It is part of a larger problem for the reason that while technology has changed drastically at lightning speed, and industries are rebuilt continuously, we in government are still operating with the same set of rules basically, and you are really our eyes and ears out there. We got rid of the powdered wigs, but that is about all we have done to update our response to some of the changes around us.

And so what I would like to hear today is, since we are partners in this, how we might better allow you to do the job you need to do, and also how we might better equip you and support your efforts out there. Rather than just throwing out criticisms because things aren't going the way we want, we should really be working in a better way with our Inspectors General to accomplish the job that we all want to have done.

So I would be really interested in hearing your thoughts on that, how we can do it better, and how Congress can be more helpful.

Mr. Chairman, I yield back the balance of my time.

Chairman MOORE OF KANSAS. Thank you. Next, I recognize the gentleman from Ohio, Mr. Driehaus, for 2 minutes.

Mr. DRIEHAUS. Thank you, Mr. Chairman, and I just want to echo your comments. Obviously, this is a very important hearing, and I want to thank the Inspectors General for the tremendous work that you already do. I know a tremendous amount is being asked of you, especially at this time, and we, as Mr. Lynch has said, are very concerned about making sure that we get it right. We share a common goal in trying to get to the bottom of any fraud and abuse that might be occurring. And so I am very interested also in hearing your testimony.

I think at some point, Mr. Chairman, we are going to break here for votes, and then I will be doing special orders on the Floor. However, I do have several questions that I would like to either submit to you in writing that I might get answers to or hopefully ask if I am still here.

I am particularly interested in following up, as the chairman noted, from your letter to Chairman Frank in January in terms of increasing the threshold for material loss reviews. I am very sympathetic to that request. I understand it is about allocation of resources and appropriate allocation of resources. However, I think there are questions about how you might still identify fraud that exists in those cases that fall below the threshold and how we might be ensuring consumers that they are still safe as we move forward.

So I would like to further discuss that, and I hope in your testimony you will spend a little bit of time talking about any increase in that threshold and what that means in terms of ongoing investigations, as well as how you might otherwise identify fraud for those institutions falling below the threshold.

Thank you, Mr. Chairman.

Chairman MOORE OF KANSAS. I thank the gentleman, and I am pleased to introduce the witnesses for this afternoon's hearing. First, we will hear from Eric Thorson, Inspector General for the Department of the Treasury. Mr. Thorson was sworn into office on August 12, 2008. Before joining Treasury, Mr. Thorson worked at the Small Business Association, where he also served as Inspector General. He previously served as the Chief Investigator for the Senate Finance Committee and Chief Investigator for the Senate Permanent Subcommittee on Investigations. Mr. Thorson also served as Deputy Assistant Secretary and Acting Assistant Secretary of the Air Force and earned the Distinguished Flying Cross during his service as an Air Force pilot.

Our second witness is Beth Coleman, Inspector General for the Board of Governors of the Federal Reserve System. She was appointed Inspector General for the Board, effective May 6, 2007. Ms. Coleman joined the Board's Office of Inspector General in 1989 as a Senior Auditor and worked her way up. In 2004, she was appointed the Assistant Inspector General for Communications and Quality Assurance. Prior to joining the Board's Office of Inspector General, she was employed by the Government Accountability Office.

And finally, we are also glad to have with us Jon Rymer, Inspector General for the Federal Deposit Insurance Corporation. After being appointed by former President George W. Bush and confirmed by the Senate, Mr. Rymer was sworn into office July 5, 2006. From 1981 through 1997, Mr. Rymer was a bank executive at two different banks and also was employed by the accounting firm of KPMG to provide internal auditing, assurance processes, and process improvement guidance. Mr. Rymer has served for 28 years in the active and reserve components of the United States Army. His awards include the Meritorious Service Medal (with Oak Leaf Cluster) and the Humanitarian Service Medal.

Without objection, your written statements will be made a part of the record. You will each be recognized for a 5-minute statement summarizing your written testimony.

Mr. Thorson, you are recognized for 5 minutes, sir.

STATEMENT OF ERIC M. THORSON, INSPECTOR GENERAL, U.S. DEPARTMENT OF THE TREASURY

Mr. THORSON. Chairman Moore, Ranking Member Biggert, and members of the subcommittee, I want to thank you for the opportunity to be here this afternoon. I know we all appreciate the subcommittee's interest in this important topic.

It is a privilege to appear before you with my colleagues Jon Rymer and Beth Coleman. Over the years, our respective Offices have forged strong bonds in addressing numerous matters of mutual interest and what I consider one of the best professional working relationships between agencies in the Federal Government.

Our Office provides independent audit and investigative oversight of the Department of the Treasury, which includes numerous departmental offices as well as the eight non-IRS bureaus. Our oversight includes the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS), Treasury's two financial institution regulators.

The material loss review requirement was enacted as a part of the FDIC Improvement Act of 1991 following on the heels of the S&L crisis. It calls for the IG of the appropriate regulator for a failed bank to perform a review within 6 months when the failure results in a material loss to the Deposit Insurance, that material loss being defined as the greater of $25 million, or 2 percent, of the banks assets. That threshold has not changed since 1991.

In conducting an MLR, the OIG ascertains the causes of the failure, assesses the regulator's supervision, and makes recommendations in an effort to prevent similar failures in the future. Material loss reviews are some of the most resource intensive audits performed by my Office.

MLRs can also lead to other important areas of work. Last year, for example, during our review of IndyMac, we learned that a senior OTS official had approved the backdating of a capital infusion made in May so that the thrift could report its condition as well capitalized in March of 2008. Less than 4 months later, IndyMac failed, costing the fund some $10 million. As a result of our inquiry into this matter, OTS removed the regulator who had approved the IndyMac backdating contribution.

As a result of further investigation, we found another instance of backdating, one that found that OTS, the regulator itself, had directed the bank to take such action. The Acting Director of OTS has been placed on administrative leave, pending a Departmental review.

Last January, as you mentioned, my colleagues and I sent you a letter recommending that the Congress consider raising the threshold from $25 million to between $300- and $500 million. In that letter, we also summarized the tremendous demands that the current threshold has placed on our office in light of the current economic crisis.

The concerns we expressed in January are just as compelling now as they were then. Since September of 2007, 16 OCC and OTS banks and thrifts have failed that met the material loss review threshold, and we are obviously concerned that this unfortunate trend could continue.

To meet the material loss review requirements, we had to shift nearly all of our discretionary audit resources to this work. We have either shut down or indefinitely deferred most of our audits in other Treasury high-risk programs. This includes work in Treasury's anti-money laundering and terrorist financing programs.

Another area where we are deferring work is whether offshore operations of U.S. banking institutions are being effectively supervised. Also, we should be looking at OTS's role in supervising large financial institution holding companies such as AIG and GE Capital. I consider our oversight of such high-risk programs to be truly urgent.

Based on all these factors, I endorse your amendment to S. 383 to increase the threshold for material loss reviews to $400 million. I also support, as a prudent measure, the amendment's proposal that we look at all losses over a 6-month period for the purpose of determining if any warrant an in-depth review. This provides us with the flexibility to perform a review whenever we feel it is necessary, despite the size of the loss.

In conclusion, I would like to take 1 minute to acknowledge Dennis Schindel, Marla Freedman, and Bob Taylor, who are with me this afternoon. It is under their strong leadership and expertise that our excellent audit staff have been able to timely complete the many MLRs that I have mentioned earlier. These achievements are possible only through the dedication of these fine people, and I am very proud of them for that.

This concludes my testimony, and I will be happy to answer any questions.

[The prepared statement of Inspector General Thorson can be found on page 56 of the appendix.]

Chairman MOORE OF KANSAS. Thank you, sir.

Ms. Coleman?

STATEMENT OF ELIZABETH A. COLEMAN, INSPECTOR GENERAL, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Ms. COLEMAN. Chairman Moore, Ranking Member Biggert, and members of the subcommittee, I appreciate the opportunity to testify today about the ongoing oversight efforts of my Office, including how material loss reviews affect our efforts to strengthen oversight and accountability to the Congress and the public.

As you are aware, the Federal Reserve System, the Nation's central bank, consists of the Board of Governors in Washington, D.C., the 12 Reserve Banks, the Federal Open Market Committee, and several advisory groups. While the Board is an agency of the Federal Government, the Reserve Banks combine public and private elements.

Consistent with the IG Act, my Office conducts independent audits, inspections, evaluations, and investigations of Board programs and operations to promote economy, efficiency, and effectiveness and to prevent and detect fraud, waste, and abuse.

Currently, about 75 percent of our audit resources focus on mandated work, which includes contracting for the annual financial statement audit of the Board and reviewing failed State Member Banks that result in a material loss to the Deposit Insurance Fund. In fact, about 40 percent of our audit resources are working on 3 material loss reviews, and we are we are just beginning a fourth. If the current pace of State Member Bank failures continues, and materiality threshold remains at $25 million, our workload will be heavily concentrated on material loss reviews at a time when actions related to the current economic crisis demand our full attention.

My colleagues and I endorse the legislation proposed by Chairman Moore to increase the material loss threshold and to provide the IGs with needed flexibility to ensure that bank failures receive appropriate attention, while meeting our strategic objectives.

In light of the financial crisis, the subcommittee has asked about oversight of the Federal Reserve System. As the IG for the Board, we are authorized to audit or investigate any Board program or operation, and our work spans the Board's mission areas. While we are not authorized to directly review Reserve Banks, we can assess how well the Board carries out its general program oversight and supervision of the Reserve Banks, and review any Board-delegated function conducted by a Reserve Bank.

The Federal Reserve has taken a number of actions to address the current economic crisis. The Office of Inspector General is reviewing these actions. We are auditing the Board's role in the TARP Capital Purchase Program and have initiated a broad review to identify risks in the Federal Reserve's new lending facilities. Furthermore, we are conducting a review of the Federal Reserve's consolidated supervision of bank and financial holding companies.

Our criminal investigators are leading and participating in a number of multi-agency investigations. For example, they have joined a nationwide effort by the FBI and the United States Attorney's Office to investigate and prosecute mortgage-related crimes in

the States considered hotspots for such crimes. Most recently, we referred information to the Detroit Mortgage Fraud Task Force, and we are working with the FBI on a south Florida mortgage fraud case.

I have joined other financial regulatory IGs on the TARP IG Council and have also coordinated with SIGTARP in forming the Term Asset-Backed Securities Loan Facility Task Force, a proactive effort to prevent and detect fraud and abuse in the TALF.

Additional oversight of the Federal Reserve System is provided in a variety of ways. The Board contracts for an annual independent financial statement audit of the Reserve Banks, including an evaluation of internal controls over financial reporting. The independent public accounting firm also audits the financial statements of the consolidated limited liability companies that the Federal Reserve established in 2008.

The Reserve Banks are also subject to Board oversight and each Reserve Bank has a general auditor who reports to the audit committee of that bank. Furthermore, GAO, which is the investigative arm of Congress, has audit jurisdiction over the entire Federal Reserve System (both the Board of Governors and the Reserve Banks) and SIGTARP has audit cognizance over TARP-related activities pertaining to the Federal Reserve.

While our Office and GAO share oversight functions in certain areas, we also have noteworthy distinctions, particularly in the area of monetary policy. Our Office is authorized to audit the monetary policy programs and operation of the Board with potential limitations under specifically defined circumstances. While GAO has greater authority to directly audit the Reserve Banks, legislation precludes it from auditing all monetary policy matters and actions. Currently, GAO is conducting about 20 reviews of the Federal Reserve System, which includes 17 congressional requests.

Maintaining Federal Reserve independence, particularly in monetary policy matters, remains critical in assessing whether GAO's audit coverage should be expanded to include the areas that are currently restricted. According to the legislative history on the Federal Reserve Act, "it cannot be too emphatically stated that the committee regards the Federal Reserve Board as a distinctly nonpartisan organization whose functions are to be wholly divorced from politics."

In closing, Chairman Moore, I would like to thank you, Ranking Member Biggert, and the subcommittee for your interest in the Inspector General's oversight role. I would also like to thank my colleagues from the Treasury and FDIC for their ongoing professional coordination on material loss reviews and other issues of common interest. My Office takes its mission and authority very seriously and remains committed to promoting integrity, efficiency, and effectiveness.

I would be pleased to respond to any questions you may have.

[The prepared statement of Inspector General Coleman can be found on page 28 of the appendix.]

Chairman MOORE OF KANSAS. Thank you, Ms. Coleman. And finally, Mr. Rymer, if you would like to testify, you have 5 minutes, sir.

STATEMENT OF JON T. RYMER, INSPECTOR GENERAL, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. RYMER. Thank you, Mr. Chairman, Ranking Member Biggert, and members of the subcommittee. Thank you for the opportunity you have provided us to participate in this very important hearing. We appreciate your interest in the challenges that the IGs of the Federal financial regulators face.

Briefly, I would like to speak for a moment about the condition of the banking industry. As you know, there are 8,300 FDIC-insured financial institutions in the U.S. banking system. The FDIC is the primary regulator for 5,100 of the State nonmember banks.

It is important to note that the vast majority of these institutions remain viable, notwithstanding the current economic crisis. However, banks have been failing, and we are experiencing a dramatic upswing in a number of those failures. In 2008 alone, 25 institutions failed. During the first 4 months of this year, another 29 institutions have failed. In total, this amounts to an over $21 billion loss to the Deposit Insurance Fund.

Next, I would like to talk for a moment about our MLR coverage. As I detailed in my written statement, the landscape has not changed from the one we described in the letter to Chairman Frank we sent back in January 2009. In short, our predictions have become reality. The current volume of MLR work and the time and resources this work demands puts at risk my Office's ability to effectively oversee core activities at the FDIC. Expending our scarce resources on these reviews also limits our ability to oversee the new initiatives that the banking agencies are undertaking.

My Office of Audits is principally responsible for performing MLRs. Each MLR usually involves a team of 2 or 3 auditors and takes around 2,000 staff-hours to complete. We have 36 auditors in our Office. To supplement the Office of Audits, we have temporarily reassigned a number of staff from other OIG component offices to carry out our mandatory workload.

We currently have 20 MLRs underway; we have completed 6, and we will issue 3 more this month. At this level, we are at capacity, and assuming no further increase in failures, we can manage this workload through September of this year.

As IG, my first priority is to complete all statutory requirements. An equally important priority includes the audit and evaluation coverage of the FDIC's new and expanded programs, which include receivership and resolution activity. This activity involves all the business processes associated with selling an entity and winding up its business. We will be looking at controls FDIC has in place over the contracting and legal services functions and the loss share provisions to ensure compliance with all related terms.

The Temporary Liquidity Guarantee Program is a new program that was established to help address unprecedented disruptions in the credit markets. Shortly after the program was established, we performed, with the use of an independent professional services firm, a risk assessment on key aspects of the internal controls of the program.

As part of the TARP's Capital Purchase Program, the FDIC was responsible for processing applications from FDIC-supervised banks. We performed a review of the program and found that the

FDIC had established effective controls for application processing, and the Corporation was in compliance with the Treasury's guidelines.

We have other work, however, that needs to be done. We believe there is a need for audit and evaluation coverage of loan modification programs the FDIC had entered into and oversight of the WaMu and IndyMac failures. There will be additional work as well on the Legacy Loan Program that is currently being developed. The Public-Private Investment Program was announced 6 weeks ago by the Department of the Treasury, and the FDIC was tasked with establishing the Legacy Loan Program as part of the Public-Private Investment Program. The Chairman of the FDIC has requested that we, along with the Special Inspector General for the TARP, review the preliminary control structures that are being designed into the program.

Unfortunately, difficult work decisions have been made and there are certain areas of work we are having to defer.

In conclusion, given our resource limitations, I will continue to review and evaluate our work to provide the most appropriate coverage of the FDIC programs and operations while maintaining our statutory responsibilities. Based on the number of problem banks, we anticipate the number of MLRs required to be completed will continue to grow. Depending on the level of this growth, my office may not be able to keep up. Considering our other statutory responsibilities and the high-risk activities I have just noted, we are challenged to provide sufficient oversight.

Thank you again, and I look forward to answering any questions you may have.

[The prepared statement of Inspector General Rymer can be found on page 42 of the appendix.]

Chairman MOORE OF KANSAS. I thank the gentleman, Mr. Rymer, and we will now turn to members' questions. I recognize myself for 5 minutes.

While it seems the intent of Congress nearly 2 decades ago was to prioritize the work of IGs by putting in place a $25 million threshold in material loss reviews, it does not appear that standard has kept up with the times and is restricting the ability of our IGs to investigate higher priority items.

Starting with Mr. Thorson, your testimony underscores the need to adjust the MLR requirements. You can focus on oversight priorities like the public debt programs, payment systems, and the Office of Thrift Supervision's regulation or lack of supervision of AIG. Would adding flexibility to the MLR—and I think you maybe already answered this in your comments earlier—requirements permit you to do strong oversight of the other priorities as well?

Mr. THORSON. We included a table in our statement that showed the difference it would make in changing the threshold, and I believe from a difference of 16 going back to January of 2007 to 6. So it would give us a great deal of flexibility to be able to redirect some of our assets to be able to pick up some of the normal audits—I call them normal for what our Department normally would be experiencing. So for us, it would make quite a difference.

Chairman MOORE OF KANSAS. Thank you, sir. Mr. Rymer, do you have any comments?

Mr. RYMER. Yes, sir, I would agree with Mr. Thorson. I think we provided a table as well. The table would indicate that raising the threshold to $100 million would provide significant relief for us, reducing the number of MLRs required at the moment from 29 to 18. At the $400 million, the level that was originally discussed, that would put us down to three.

Mr. Chairman, if I could just go on just a moment and give the committee some comfort in the fact that even if the thresholds are raised, and noting some of the concerns raised earlier about potentially not investigating fraud in closed banks, let me give you the assurance that regardless of whether we are performing an MLR, we respond to any suspicious activity, either as entered through FinCEN or noted by our bank examiners when a bank closes. So those banks, even if they are not subject to an MLR, will certainly, if there is suspicious activity or suspected fraud in the bank, be reviewed by our Office of Investigation.

Chairman MOORE OF KANSAS. Thank you, sir. Ms. Coleman, do you have any comments?

Ms. COLEMAN. Yes. I recognize that in raising the threshold, a lot of the banks that the Federal Reserve supervises are generally the smaller commercial banks. In fact, about 90 percent of the State Member Banks under our jurisdiction are really less than $1 billion, so clearly, raising the threshold would pretty significantly reduce the number of MLRs that we are currently conducting.

Nevertheless, having the ability to have the resources that we have dedicated to that area would really help us in terms of taking a more in-depth look at some of the broad areas that we are looking at, the lending facilities and clearly the bank and financial holding companies.

Chairman MOORE OF KANSAS. Thank you.

Ms. Coleman, someone suggested that given the Federal Reserve's recent use of emergency 13.3 powers, and the scale of the facilities it has established during the financial crisis, Congress should eliminate restrictions on the GAO from doing a complete audit of the Fed, but others have expressed strong reservations about that approach and say that by granting GAO such sweeping oversight by the Fed, Congress would be jeopardize the independence necessary for the Fed to conduct monetary policy without fear of political pressure.

I appreciate your testimony, but to get to the heart of this matter, Ms. Coleman, should Congress grant you more oversight authority of the Federal Reserve System perhaps given your oversight of the Federal Reserve Banks instead of just the Board? Is your Office better equipped to provide strong oversight while balancing the need of the Fed's independence?

Ms. COLEMAN. Actually, the Office of Inspector General and GAO do share responsibility in certain areas, and I think that is to the advantage of the system. I would say that the Inspector General for the Board, with the authority that we currently have, is able to do quite a bit of oversight regarding Federal Reserve programs and operations. We are able to look at the Fed's oversight at the Reserve Banks and go out and collect the information that we need.

Nevertheless, you are correct in pointing out that we are not able to directly go out to audit a Federal Reserve Bank, and I certainly would be willing to spend some time with the committee to talk about possible options in that area.

We do have one restriction on our jurisdiction, which I would also like to bring to your attention. The Chairman can restrict our work in certain areas in policy and policy deliberations, if he determines it is necessary to prevent the disclosure of deliberations or policy decisions that would significantly harm the economy or market behavior. But if that restriction is used, the Chairman would have to send a letter detailing the reasons to the Inspector General, who would then forward the letter to Congress. So I think there are some good protections that would come into play.

Chairman MOORE OF KANSAS. Thank you.

I recognize the vice chair, Mrs. Biggert, for 5 minutes.

Mrs. BIGGERT. Thank you, Mr. Chairman. I think this is for all of you, my first question. What are the potential negative ramifications, if any, of increasing the MLR trigger? It seems like most testimony mentions that with the lower threshold level reviews they result in no significant findings beyond what was found at closing of the institution, but why did the institutions close in the first place and was it a failure of management, a failure of regulators to initiate prompt corrective action measures? What would be the negatives?

Mr. THORSON. As long as we have the flexibility to look at any of the bank failures regardless of the loss to the fund, I don't really see any negatives. If it were precluding us from doing a certain MLR or one that for some reason stood out to us as important, then that would be a big negative. But we will still have the ability and the right to go in and do one any time. So I don't really see that there is any negative in raising this at all. It just becomes more our discretion.

Mrs. BIGGERT. Yes. So it is kind of if you get the feeling that there is something wrong here that you need to investigate, you would have the flexibility?

Mr. THORSON. Right.

Mrs. BIGGERT. Inspector Coleman, do you have any other—

Ms. COLEMAN. I think that the proposal that the committee presented does include some provisions that would involve taking a look at all failures at a certain level of review, which I think would give us enough information to make a determination as to whether or not the failure was as a result of perhaps the conditions in that particular geographic area; for example, a concentration in commercial real estate or if there were other issues. If we see indications of fraud perhaps or other areas that raise our concern, we certainly would feel free to begin a review at that point.

Mrs. BIGGERT. Inspector Rymer?

Mr. RYMER. Yes, ma'am. I would agree with my colleagues that we do have the discretion to conduct an evaluation or an audit of any activity of the FDIC. And as I mentioned a moment ago, I think we would certainly look at, at a very high level at least, every failure to determine if there were unique circumstances; for example, if there were fraud involved in the institution, particularly by senior officials in the bank.

Another example of unusual circumstances in the failure, as Ms. Coleman mentioned, could include concentrations of particular types of lending, out-of-territory lending, or generating wholesale deposits. A number of the issues, though, we really have already looked at and gathered information from the 20 MLRs that we have ongoing. Thus far, we have really learned a lot, particularly as to the causes of some of the small bank failures.

Mrs. BIGGERT. Well, are the existing laws and regulations missing the mark? Are they too prescriptive and not giving regulators enough flexibility to shift resources and adapt to market conditions? There is no problem? You have the flexibility now?

Mr. RYMER. Yes, ma'am, we do. We do. Whether it is an MLR or other programs that the FDIC is involved in, I have the flexibility to audit or evaluate any of those programs.

Mrs. BIGGERT. And you think that the regulators are expert enough? You know, when we look back and with all of these things that we have seen, particularly with hedge funds and the credit default swaps, we kind of wonder with all these new products whether the regulators were expert enough. Are they expert enough now to be able to judge whether there is a problem or if there is any corruption?

Mr. THORSON. One of the things that we want to do is—we look at the MLRs as really they are looking backwards in time. And one of the things that would address what you are talking about is trying to make sure that they begin to take on a more perspective nature, that the regulators basically start to look for emerging risks in financial markets and other products. And this is really what happened here with the subprime mortgage crisis, is that we would have liked to have been involved in looking and seeing how they are doing their work currently so that we know whether they are better prepared to head off these kinds of risks.

Mrs. BIGGERT. Do you think we need to look at the controls and concentrations of certain types of loans, like the commercial mortgage loans that were mentioned in today's Wall Street Journal? Anybody had time to see that?

Mr. RYMER. Yes, ma'am, I can speak to that. I think we have seen concentrations in the half dozen MLRs we have completed. We will be doing subsequent work on identifying loan concentrations, particularly in commercial real estate development loans and some of the interest reserve processes that have been going on, in particular in the de novo banks, or the new banks.

In my view, although we haven't completed the work yet, there are certainly indications that concentrations in young banks or de novo banks can lead to problems. And not just on the loan side, but we also see similar things when generating wholesale deposits and allowing banks to grow very rapidly without market deposits, and then those deposits essentially being used to fund high concentrations in commercial loans. That is something we definitely need to look at.

Mrs. BIGGERT. Thank you. I yield back.

Chairman MOORE OF KANSAS. Thank you. We have been advised that votes will be called sometime between 2:45 and 3:00 p.m., and I believe there were 3 votes. I was saying to the members that I

would like us to go for another 7 or 8 minutes after votes are called and that will give us plenty of time still to get over there.

Mr. Lynch, you are recognized for 5 minutes.

Mr. LYNCH. Thank you, Mr. Chairman.

Mr. Thorson, one of the other hats I wear in Congress is I am the co-chair of the Task Force on Terrorist Financing and Nonproliferation, so I work directly with FinCEN, the Financial Crimes Enforcement Network. In my humble opinion, those folks are doing some of the most wonderful work on behalf of our country. They get very little credit for the work that they do. I work with them in Afghanistan, I work with them in Jordan, helping to stand up the new financial intelligence unit there. I work with them; they just cut the ribbon on the new financial intelligence unit in Morocco. Those folks are doing unbelievable work on behalf of this country. I have regularly tried to increase funding to the Financial Crimes Enforcement Network because I see the work that they are doing.

How does this—in your position, do you get to review their contributions? I know there are some changes here that you have looked at, some deferments that have had to occur. Is this effort diminishing the ability of FinCEN to do its job?

Mr. THORSON. As I mentioned, we have pretty much tabled everything other than MLRs in our office, specifically with FinCEN and dealing with their responsibilities under the Bank Secrecy Act and the PATRIOT Act. FinCEN relies a lot on Treasury and other non-Treasury agencies to do their work. We want to be able to take a look at what they are doing and how they are doing it. Previous audits and even congressional hearings have shown that there have been regulatory gaps in the detection of violations and also enforcement action against financial institutions for Bank Secrecy Act and related violations. We would like to be involved in that. We would like to pick up that work that we have sort of left behind for a while.

Mr. LYNCH. That would be helpful, I think, not only to FinCEN, but also to some of the other responsibilities within Treasury, you know, the opposite of thrift supervision and some others. There is a real patchwork of coverage and there are some gaps as you have noticed. I am just very, very concerned about resources being so limited in that very important area. If we don't get the suspicious activity reports, if we don't get the cash transaction reports, and if those reports aren't analyzed, as well as all the other data we get in, that is really the basis of a lot of operations that choke-off or at least limit the ability of terrorists to use legitimate financial systems to conduct their business, and I think that is a huge issue for us.

So I just want to sound the alarm on behalf of FinCEN that if they are not going to get the money they need to do their job, then it may be happening away from the spotlight—

Mr. THORSON. Right.

Mr. LYNCH. —but it greatly affects—you know, it will be one of those situations where after something happens, we will read about the fact that this system wasn't allowed to conduct the oversight that it was mandated to because of unbalanced funding priorities. So I am worried about this.

Mr. THORSON. Your point is a very good one, and people could misunderstand as well. You know, why are you looking at failed banks as opposed to things like you are describing that clearly relate to anti-terrorism? We have to prioritize the office based on those things that are mandated, such as the financial audit of the Department, those kind of things we have no choice in.

Mr. LYNCH. Yes.

Mr. THORSON. The other is that, of course, in doing those things, we are not there to strictly just to try and find fault with them. The truth is in everything we do and all the bureaus that we look at we are trying to help the Department and to be a positive influence in their work. So it really has two different aspects of it. But clearly, the prioritization is one that we feel is a bit out of kilter right now because we just don't have a choice in what it is we are going to do.

Mr. LYNCH. I appreciate that, and I am not blaming anyone. I realize if there is anybody to blame, it is probably us up here. We have priorities that are set sometimes by public opinion or the newspaper headlines, and so I appreciate the struggle that you are having.

Thank you, Mr. Chairman. I yield back.

Chairman MOORE OF KANSAS. Thank you. The gentleman from New York, Mr. Lee, is recognized for 5 minutes.

Mr. LEE. Thank you, Mr. Chairman. I appreciate that you have a monumental task ahead of you in terms of trying to protect the taxpayer. It is one of the reasons I am here as well. I came from the private sector, and I look at these numbers sometimes and my concern is I think people get numb to them because at a $25 million threshold, that is an awful lot of money, and to actually create that kind of money as a profit itself is astronomical. To make 5 percent net profit on $25 million, you have to have $500 million in sales. That is an awful lot of money. And my concern here is we are now talking about raising this threshold before you look at an MLR to $400- or 500 million. I just frankly think that is too high a threshold. If we look at the inflation rate over the last 16 or 17 years, even using 4 percent, I can't up come up with a number higher than potentially $100 million that you would even look at. I would like to hear some of your basis. My concern is that we keep throwing good dollars after bad. And I know you are short staffed here, but I would like to hear your thoughts if you are short staffed. Do you use a different method; instead of using 2,000 hours to go after or to look at a bank failure, do you use a lesser amount if it is a smaller dollar amount? If it is $25 million, do you use 1,000 hours? I mean, trying to get creative on the approach?

And also, there was a comment from Mr. Rymer in terms of private auditors for work currently being done by the MLR team; there are concerns due to potential conflicts of interest. But I would be curious to hear if you exhausted all opportunities to look outside of potentially even regional firms that may not have a conflict of interest rather than to continue to grow the Federal ranks here.

So with that, maybe Mr. Rymer could start.

Mr. RYMER. Yes, sir. Those are very good questions. The $300- to $500 million figure was arrived at based on GAO's determination of materiality within the Deposit Insurance Fund. That num-

ber was $500 million. So that is where the starting point came from.

But let me explain a little bit about my reluctance to use—I think you really asked two questions. One was the 2,000 hours, and are there opportunities to perform an "MLR lite." Yes, sir, we explored that actually when we started with these. The first one or two were in the 2,500 to 3,000 hour range. So we are very conscious of trying to do them more efficiently and more effectively. We have experimented with doing these, rather than GAO yellow book audits, with doing them in our Office of Evaluations to see if we can squeeze down the time. And I think we can improve, but I don't really see, given yellow book requirements and professional standards, getting much below 1,500 hours with those.

Your second question was the potential use of perhaps smaller regional accounting firms. That is something we have considered and there are opportunities even to use other auditing agencies within the Federal Government that are not IGs that we can use as well. So we believe largely, particularly the bigger banks, that determining the cause of failure is something that I feel more comfortable having government auditors do, but there are opportunities for us to do some of the other work with contract firms, and we are doing that.

Mr. LEE. What do you think is a minimal level you would be able to work with on an MLR standpoint, a threshold?

Mr. RYMER. Minimal level, anything would be an improvement, sir, but I think I would feel comfortable with anything around $200 million.

Ms. COLEMAN. I would just like to add on to what Inspector General Rymer noted.

In our Office, we have, as I mentioned, three MLRs and we are just adding on a fourth, and we have a relatively small audit staff. What we have done is to try and keep our teams fairly small, only 2 or 3 people. We are actually leveraging them to work on a couple of MLRs at one time.

In addition, I compliment Tony Castaldo, our Assistant Inspector General for Inspections and Evaluations. He and his team have come up with, I think, a pretty good way to array the data, to gather information, so that we can look at it fairly quickly, look across the data, and get what we think are very good data points that we need.

Nevertheless, even with those efficiencies, we are still finding that if the pace of these MLRs continues, I think that it will be increasingly difficult for us to carry on our other statutory work while also completing these material loss reviews.

And in terms of the actual threshold, a minimum threshold, because a lot of our State Member Banks that we supervise are relatively small, I would agree with Inspector General Rymer that $200 million, I think, would be a reasonable threshold, and coupled with the fact that we would still look at closures below that threshold when we feel it is warranted. And we actually have, in our past, looked at a very small bank, but we did so because we thought it was warranted by the amount of the failure, even for a small bank, and the fact that fraud was very much involved.

Chairman MOORE OF KANSAS. The gentleman yields back.

Next, I will recognize Mr. Driehaus for 5 minutes.

Mr. DRIEHAUS. Thank you, Mr. Chairman.

Just to follow up on the conversation that we are having regarding this potential "MLR Lite" issue, you know, whether the threshold is $300 million or $200 million, could we identify certain characteristics that might be evident in a cursory review that would indicate that further review needs to take place?

I guess some of the concern that I am hearing and when I look at raising the threshold is that there is a tremendous amount of subjectivity involved, in terms of whether or not we go forward with the full MLR if the loss is below the threshold. And I guess I am wondering, is there some way where we can add some objectivity to this by identifying certain characteristics in the language that would trigger a more thorough review?

So I realize that you still have the discretion to conduct material loss reviews if, in fact, it falls below the threshold. But are there characteristics that might be present that we could be more explicit about in the language in the bill as we move forward?

Ms. COLEMAN. I would almost encourage the committee to consider having us take a risk-focused approach. That is something that we are very familiar with on a lot of our audit work and inspections and evaluations, where you take an initial look at any topic and, based on your knowledge and experience in that area, identify factors that you think would point to potential areas that warrant further review. And I think that a lot of our auditors and evaluators are all experienced in that type of model and could work, you know, fairly quickly to identify areas.

So, from that perspective, that would allow us to look at things that one might not normally see when you are looking at these reviews, so it kind of gives you a broader definition of areas. It could include any factors that seemed out of the norm for an institution of that particular size.

Mr. DRIEHAUS. I assume that is what is done, you know, in order to determine whether or not an institution falling below the threshold is worthy of a full investigation. I assume that type of analysis is already done.

I guess the question is, how do we make that a little less subjective and a little more objective when it comes to the criteria that we put forward in legislation and whether or not that is necessary? Do you prefer the flexibility? Do you prefer the subjectivity? Or would you prefer more specific guidelines along the lines of, you know, the characteristics involved in a risk-focused review?

Mr. THORSON. I think we would prefer the flexibility, but I will give you, I hope, what is a pretty good reason for that.

The people who do these and who go into these banks and look at their documents, the supervisory memo, the legal memo, etc., and review them, they are really very good at this. So, to give us the flexibility of doing that helps a great deal, because the people who are going to be actually doing the work are not going to miss much, is what I am really saying. And we would be able to trust their judgment on whether or not there is something here.

And that would be—really, the depth of the review is going to, of course, depend upon the complexity of how the bank was structured, how the loss shapes up. But the situation really becomes one

of the ability of the people who are actually doing the work to recognize what it is they are looking for, to spot something that would get their attention, and then, no matter what the amount of the loss was, above or below the threshold, we would be making decision to go in and look at it.

And that is a very nice convenience to have. But you should also feel some reliance on the fact that the people who do this work are really excellent at what they do.

Mr. RYMER. Yes, sir, if I could just offer one suggestion. Rather than becoming overly prescriptive, perhaps, with something that is more rules-based, it may be an option in any contemplated legislation that you have something along the idea that the IG be required to report to the Congress why they elected not to do a review.

That might be something that we would incorporate in, say, our semiannual reports by listing the bank that failed along with the IG's rationale for electing not to do a review of that failure.

Mr. DRIEHAUS. Thank you, Mr. Chairman.

Chairman MOORE OF KANSAS. Thank you.

And next, Mr. Paulsen is recognized for 5 minutes.

Mr. PAULSEN. Thank you, Mr. Chairman, and thank you, also, for holding this hearing.

I know the folks on the panel before us play a very, very important role in terms of the importance of the current financial crisis that has been gripping the country, with your powers and review.

I wanted to just ask a couple of questions. Mr. Thorson, your Office has conducted some of the initial audit work for the TARP program prior to the Special Inspector General for TARP being appointed to oversee the program.

Can you tell the committee anything about how you are coordinating now with SIGTARP, that Office, in terms of ensuring effective oversight of the TARP program in general and some of the more complex components that might apply to that?

Mr. THORSON. I am sorry. Are you asking about the coordination between the SIGTARP and our Office? Is that what you are asking?

Mr. PAULSEN. Correct.

Mr. THORSON. For the most part, I think it is pretty well-defined. I think there are areas where it gets a little bit cloudy. And, for our part, we feel that when it comes especially to the area of whatever—the Department itself, the employees, the regulators, and those kind of things, and the bureaus that we oversee, I would say that is a fairly clear line.

Part of it gets—when I mention it gets a little cloudy, it is only because of the fact that one jurisdiction is defined by a block of money and our jurisdiction is defined by the Department that we serve. But, for the most part, it works fine.

Mr. PAULSEN. Okay. And then just to follow up a little bit, too, when auditing now, have you done anything with the Office of Thrift Supervision in regard to their admitted failed oversight of the AIG Financial Products subsidiary?

Mr. THORSON. I am sorry. What was the last part?

Mr. PAULSEN. Just in terms of oversight with AIG, have you done anything with regard to the Office of Thrift Supervision, with regard to their admitted failed oversight of AIG in general?

Mr. THORSON. Well, one of the things that I mentioned earlier was we would like to be able to look at, for instance, OTS's role and the piece of AIG that they oversee, as well as something—you know, the large ones like GE Capital. But we have not been able to do that at this point.

Mr. PAULSEN. Okay. Would you plan on conducting or undertaking an audit, then, in regard to AIG in particular?

Mr. THORSON. Depending on how our workload shapes up, that is definitely something we would like to do and that has been planned.

But, again, as I mentioned before, a lot of this work, especially MLRs, is mandated, and we really have no real flexibility in how we do them. Because, right now, it is pretty much taking all of the audit resources we have.

Mr. PAULSEN. Thank you.

And, Ms. Coleman, I was going to ask too—Neil Barofsky, the SIGTARP Inspector General, essentially has reported that several components of that program do pose significant risks for waste, fraud, and abuse. Do you think the recently created Fed holding companies, in general, the lending facilities, could also pose any significant risks for waste, fraud, and abuse that have not been discovered?

Ms. COLEMAN. Well, first of all, I did want to mention that we are coordinating with SIGTARP on several fronts, including the Inspector General Council for TARP. We also have joined forces with him in creating the TALF Task Force, which is a proactive effort to get ahead of any fraud, waste, and abuse in one of the Federal Reserve's largest programs, which is the Term Asset Liquidity Facility, the TALF.

In addition, I would say that we are currently conducting fairly high-level reviews of all of the Federal Reserve's lending facilities. This is really to gather information to identify specific areas of risk. So I would probably be in a better position after we complete some of that work to respond to your question about the lending facilities as well as the bank and financial holding company area.

Because we are, in part, with the other mandated work that we have ongoing and the fact that we are working in the MLRs, we are looking at these areas at a fairly high level, with the intent of getting additional resources and zeroing in more to look at the internal controls more specifically.

Mr. PAULSEN. Thank you.

And I will yield back in just a second, but, Mr. Chairman, I want to thank you for holding this hearing, because I think as much flexibility as we can provide to these Inspectors General is really critical to ensuring not only the confidence of consumers and those in the financial sector but also of getting down to the real nuts and bolts of where some of the problems lie.

Thank you. I yield back.

Chairman MOORE OF KANSAS. Thank you, sir.

And finally, Mr. Grayson, you have 5 minutes, sir.

Mr. GRAYSON. Thank you very much, Mr. Chairman.

Inspector General Coleman, you are the Inspector General for the Federal Reserve, right?

Ms. COLEMAN. That is correct.

Mr. GRAYSON. Okay. Have you done any investigations concerning the Federal Reserve's role in deciding not to save Lehman Brothers, which led to shockwaves that went through the entire financial system?

Ms. COLEMAN. In that particular area—you know, I don't generally comment on specific investigations. But we do not currently have an investigation in that particular area.

Mr. GRAYSON. All right. What about the $1 trillion-plus in expansion of the Federal Reserve's balance sheet since last September? Have you conducted any investigations regarding that?

Ms. COLEMAN. Right now we have a—we call it a "review." The term "investigation" may have different connotations. So we actually are conducting a fairly high-level review of the various lending facilities collectively, which would include the TALF, a variety of the different programs that are in process. We are looking at them at a fairly high level to identify risk.

Mr. GRAYSON. Well, I understand that, but we are talking about events that started unfolding 8 months ago. Have you reached any conclusions about the Fed expanding its balance sheet by over $1 trillion since last September?

Ms. COLEMAN. We have not yet reached any conclusions.

Mr. GRAYSON. Do you know who received that money?

Ms. COLEMAN. For the—? We are in the process right now of doing our review, and—

Mr. GRAYSON. Right. But you are the Inspector General. My question is specifically, do you know who received that $1 trillion-plus that the Fed extended and put on its balance sheet since last September? Do you know the identity of the recipients?

Ms. COLEMAN. I do not. No, we have not looked at that specific area at this particular point on those reviews.

Mr. GRAYSON. What about Bloomberg's report that there are trillions of dollars in off-balance-sheets transactions that the Federal Reserve has entered into since last September? Are you familiar with those off-balance-sheet transactions?

Ms. COLEMAN. You know, I think it may be important at this point, too, just to bring up a certain aspect related to our jurisdiction and just to clarify, perhaps, some of my earlier comments.

We are the Inspector General for the Board of Governors, and we have direct oversight over Board programs and operations and are also able to look at Board-delegated functions to the Reserve Banks as well as the Board's oversight and supervision of the Reserve Banks. We do not have jurisdiction to directly go out and audit Reserve Bank activities specifically.

Nevertheless, in our lending facilities project, for example, we are looking at the Board's oversight over the program and to the extent that extends out to the Federal Reserve Bank of New York.

Mr. GRAYSON. Well, I have a copy of the Inspector General Act here in front of me. And it says, among other things, that it is your responsibility to conduct and supervise audits and investigations relating to the programs and operations of your Agency.

Ms. COLEMAN. That is correct.

Mr. GRAYSON. So I am asking you, if your Agency has, in fact, according to Bloomberg, extended $9 trillion in credit, which, by the way, works out to $30,000 for every single man, woman, and child in this country, I would like to know, if you are not responsible for investigating that, who is?

Ms. COLEMAN. We, actually—we have responsibility for the Federal Reserve Board's programs and operations, audits—to conduct audits and investigations in that area.

In terms of who is responsible for investigating—would you mind repeating the question one more time?

Mr. GRAYSON. What have you done to investigate the off-balance-sheet transactions conducted by the Federal Reserve, which, according to Bloomberg, now total $9 trillion in the last 8 months?

Ms. COLEMAN. I will have to look specifically at that Bloomberg article. I don't know if I have actually seen that particular one.

Mr. GRAYSON. That is not the point. The question is, have you done any investigation or auditing of off-balance-sheet transactions conducted by the Federal Reserve?

Ms. COLEMAN. At this point, we are at the very—we are conducting our lending facility project at a fairly high level and have not gotten to a specific level of detail to really be in a position to respond to your question.

Mr. GRAYSON. Have you conducted any investigation or auditing of the losses that the Federal Reserve has experienced on its lending since last September?

Ms. COLEMAN. We are still in the process of conducting that review. Until we actually, you know, go out and gather the information, I am not in a position to really respond to the specific question.

Mr. GRAYSON. So are you telling me that nobody at the Federal Reserve is keeping track on a regular basis of the losses that it incurs on what is now a $2 trillion portfolio?

Ms. COLEMAN. I don't know if—you are telling me that there—you are mentioning that there are losses. I am just saying that we are not—until we actually look at the program and have the information, we are not in a position to say whether there are losses or to respond in any other way to that particular point.

Mr. GRAYSON. Mr. Chairman, my time is up, but I have to tell you honestly, I am shocked to find out that nobody at the Federal Reserve, including the Inspector General, is keeping track of this.

Chairman MOORE OF KANSAS. I thank the gentleman.

And I want to thank our witnesses for the testimony here today. This hearing gives us a better sense of the oversight work being done by these Inspectors General and the importance of their work to expose waste, fraud, and abuse. We need to address the concerns discussed today, of the concern on MLR requirements and how to improve it for stronger oversight.

The Chair notes that some members may have additional questions for this panel. And, sir, if you have additional questions, you are certainly welcome to submit those in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

The hearing is adjourned, and I thank the witnesses.

[Whereupon, at 3:15 p.m., the hearing was adjourned.]

A P P E N D I X

May 5, 2009

Subcommittee on Oversight and Investigations
House Financial Services Committee
May 5, 2009

"The Role of Inspectors General: Minimizing and Mitigating Waste, Fraud and Abuse"

Opening Statement from Chairman Dennis Moore [KS-03]

There have been a few signs recently that our economy may be slowly nearing the bottom of the decline. There's no doubt in my mind that our economy will eventually stabilize, recover and grow once again. But despite a few glimmers of hope, my constituents remain anxious, and I share their concern.

In March, the U.S. economy lost 663,000 more jobs, bringing the unemployment rate to 8.5%, the highest since November 1983. Since the recession began in December 2007, a total of 5.1 million Americans have lost their job. That's nearly double the entire population of my home state of Kansas. Last Friday, regulators shut down three more banks, bringing the total number of U.S. banks that have failed in the past 17 months to 57. The FDIC has estimated that one of those banks -- Silverton Bank in Georgia and the biggest bank to fail this year -- will cost the Deposit Insurance Fund $1.3 billion.

There are some painful lessons that we need to learn from this financial crisis so we can strengthen the rules and improve the oversight of our broken financial sector. In addition to modernizing the regulatory structure to prevent another financial meltdown, Congress must ensure there is tough oversight and transparency of the extraordinary actions the federal government has taken to stabilize the financial sector. Some examples include the Treasury Department's use of $700 billion in TARP funds, the FDIC's Debt Guarantee Program and the Federal Reserve's intervention with AIG and their $1 trillion TALF program.

To that end, I appreciated the opportunity to work recently with Ranking Member Biggert, Congressman Driehaus and Congressman Paulsen of this subcommittee to enact our Special Inspector General of TARP, or SIGTARP, bill that President Obama signed into law on April 24th.

Just last month, the SIGTARP reported that he has already launched 20 criminal investigations. He previously indicated he did not have the staff he needed to track down every lead. The new law gives the SIGTARP stronger oversight over the TARP program, as well as the expanded authority he requested to hire the necessary auditors and investigators to provide tough oversight.

This afternoon, I'm pleased to have the Inspectors General from Treasury, the Federal Reserve Board and the FDIC testify about their ongoing efforts to expose and eliminate waste, fraud and abuse. For example, the Treasury's Office of Inspector General reported investigations leading to 13 arrests and nearly $400,000 in court-ordered fines, restitution and recoveries during a six month period last year. The FDIC's Office of Inspector General reported investigations leading to 61 convictions and nearly $353 million in fines, restitution and other monetary recoveries.

As a former District Attorney for 12 years and the Chairman of the Oversight and Investigations Subcommittee, one of my top priorities is to make sure our Inspectors General have all the tools and resources they need to continue this important oversight work.

One issue of concern I'd like to focus on today is Material Loss Reviews, or MLRs, which are required to be completed by Inspectors General whenever a failed bank costs the Deposit Insurance Fund over $25 million. In January, our three witnesses wrote Chairman Frank expressing their request that Congress raise the MLR threshold from $25 million to $300 million to $500 million.

In addition to a higher threshold, they suggested adding a requirement that for failed banks falling below the new threshold, an initial assessment still be taken to "ensure that unusual or potentially significant situations are not missed."
I was disturbed to learn recently that the failure of Washington Mutual, the largest failure in U.S. history, did not trigger a mandated Material Loss Review because there was no cost to the Deposit Insurance Fund given JPMorgan Chase acquired the institution after it failed.

I understand a voluntary review is underway, but we need to update the MLR system so that a review of a bank failure like WaMu would be required.

I was also disturbed to read the Inspectors General letter to Chairman Frank claiming that without a modernized MLR system, the current system would limit their "ability to effectively oversee many of the new and significant programs and initiatives that the Federal banking agencies are undertaking to address current economic conditions."

We must address this problem. I look forward to hearing the testimony from our witnesses, discussing this MLR concern, and then working with Members of our committee to quickly address this concern so we can provide the best oversight effort possible.

Testimony Before the
Subcommittee on Oversight and Investigations
Committee on Financial Services
U.S. House of Representatives

For Release at 2 p.m. EST
Tuesday, May 5, 2009

"The Role of Inspectors General: Minimizing and Mitigating Waste, Fraud, and Abuse"

Statement of

Elizabeth A. Coleman

Inspector General
Board of Governors of the
Federal Reserve System

May 5, 2009

Chairman Moore, Ranking Member Biggert, and Members of the Subcommittee on Oversight and Investigations, House Committee on Financial Services, I appreciate the opportunity to testify today about the ongoing efforts of the Office of Inspector General (OIG) of the Board of Governors of the Federal Reserve System (Board) in minimizing and mitigating waste, fraud, and abuse, including how the mandated material loss reviews (MLRs) affect our efforts to strengthen oversight and accountability to the Congress and the public.

Overview of the Federal Reserve System

The Federal Reserve System—the nation's central bank—consists of the Board of Governors in Washington, D.C., the twelve Federal Reserve Banks with their twenty-five Branches distributed throughout the nation, the Federal Open Market Committee (FOMC), and three advisory groups—the Federal Advisory Council, the Consumer Advisory Council, and the Thrift Institutions Advisory Council. The System was created in 1913 by Congress to establish a safe and flexible monetary and banking system, and to maintain a broad perspective on economic activity in all parts of the country. Over the years, Congress has given the Federal Reserve more authority and responsibility for achieving broad national economic and financial objectives. The Federal Reserve is "independent within government."

While the Board is an agency of the federal government, the Federal Reserve Banks combine public and private elements. The twelve Reserve Banks serve as the "operating arms" of the central banking system. Each Reserve Bank has its own board of nine directors chosen from outside the Bank, as provided by law. The boards of the Reserve Banks are intended to represent a cross-section of banking, commercial, agricultural, industrial, and public sector interests within the Federal Reserve District. In 2008, the twelve Reserve Banks collectively had about 19,000 authorized positions and a budget of $3.067 billion. The network of twelve banks and their branches carry out a variety of System functions, including operating payment systems, distributing the nation's currency and coin, and supervising and regulating member banks and bank holding companies.

The Board's OIG: Mission, Staffing, and Priorities

The Board's OIG was voluntarily established in July 1987, and became a statutory OIG pursuant to the passage of the Inspector General Act Amendments of 1988, which amended the Inspector General Act of 1978 (IG Act). Consistent with the IG Act, as amended, our office conducts independent and objective audits, inspections, evaluations, and investigations of the Board's programs and operations to promote economy, efficiency and effectiveness, and to prevent and detect fraud, waste, and abuse. Our work spans the Board's mission areas, including supervision and regulation, oversight of Reserve Banks, and management of the Board's financial resources, human resources, facilities, security, and information technology resources. To achieve our mission, the OIG issued a Strategic Plan for 2008 – 2011 that sets a results-oriented, risk-focused vision for our office centered on three primary goals: meet our statutory and legislatively-mandated requirements, target areas of greatest risk, and enhance the OIG's internal operations and communications.

The Federal Reserve OIG is faced with various strategic challenges, as our office carries out its legislatively-mandated responsibilities, while addressing significant and rapid changes in the financial sector. We continue to build our staff resources and expand our expertise to meet these new demands. Currently, we have thirty-seven authorized positions: twenty-three auditors, five investigators, three information technology staff, three attorneys, and three administrative staff members. A 20 percent budget increase was just approved in April, bringing our authorized staffing level for the remainder of 2009 to 45 positions: twenty-nine auditors, six investigators, four attorneys, three information technology staff, and three administrative staff members. This budget increase also includes funding for external consulting expertise and anticipated travel expenses. With these additions, our two-year, operating budget for 2008-2009 is about $14 million, or $7 million per year. We will reassess our needs later this year in preparation for the Board's 2010 to 2011 budget cycle, and will determine what further staffing and contracting budget increases are required to effectively and efficiently carry out our mission under the IG Act.

Balancing Priorities: Growing Mandatory Requirements

One of the greatest challenges facing our office is to effectively balance our workload to address critical issues, including the current financial crisis, in light of increasing statutory requirements. Currently, about 75 percent of our audit resources focus on mandatory work required by statute. Each year, the OIG contracts for and oversees the annual financial statement audits of the Board and the Federal Financial Institutions Examination Council, a formal, interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions. Furthermore, we are required to

- review failed depository institutions supervised by the Board that result in a material loss to the Deposit Insurance Fund, pursuant to Section 38(k) of the Federal Deposit Insurance Act (typically referred to as material loss reviews);
- perform an annual independent evaluation of the Board's information security program and practices, including the effectiveness of controls for selected information systems pursuant to the Federal Information Security Management Act (FISMA); and
- serve as the External Oversight Function for the Board's law enforcement program pursuant to the USA PATRIOT Act of 2001.

A significant and growing portion of our mandatory work centers on the Federal Reserve's role as the primary regulator of about 860 State Member Banks (SMB)--state-chartered, federally-insured commercial banks that are members of the Federal Reserve System. Section 38(k) of the Federal Deposit Insurance Act (FDIA) requires that we review failed SMBs that result in a material loss to the Deposit Insurance Fund (DIF). Under the current law, a loss is considered material if it is estimated to exceed $25 million or 2 percent of the institution's total assets. We are required to produce a report that includes possible suggestions for improvement in the Board's banking supervision practices within six months of the date that it becomes apparent that the loss will meet the materiality threshold.

MLRs of failed banks alone require a high percentage of OIG's audit resources. Each review involves a significant amount of data gathering and analysis, along with visits to Federal

Reserve Banks, the Federal Deposit Insurance Corporation's (FDIC) Division of Resolutions and Receivership, and the offices of State Banking Commissioners. Currently, nine staff members, almost 40 percent of our audit staff resources, are assigned to three MLRs. A fourth SMB failed in April, and we are shifting additional resources to this MLR because the projected losses exceed the current $25 million materiality threshold. The following table provides an overview of our current MLRs.

State Member Bank	Total Assets (reported at the time of closure)	FDIC Projected Loss to the DIF	Date of Closure
First Georgia Community Bank	$237.5 million	$72.2 million	December 2008
County Bank	$1.7 billion	$135 million	February 2009
Riverside Bank of the Gulf Coast	$539 million	$201.5 million	February 2009
Michigan Heritage Bank	$184.6 million	$71.3 million	April 2009

We are able to accommodate the current MLR workload through efficiencies gained by keeping teams relatively small (three or four staff members) to the extent possible, given the complexity of the work, and assigning each staff to work on more than one MLR. We are also leveraging information technology resources to streamline our data gathering and analysis efforts. If the current pace of State Member Bank failures continues and the materiality threshold remains at $25 million, our workload will be heavily concentrated on MLRs at a time when actions related to the current economic crisis demand our full attention.

Balancing Priorities: Addressing the Economic Crisis

The Federal Reserve has implemented a number of programs intended to support the liquidity of financial institutions and foster improved conditions in financial markets, and the OIG has initiated work to specifically address these actions and related aspects of the current economic crisis. First, we are reviewing the Board's role in a prominent Troubled Asset Relief Program (TARP) program: the Board's processing of applications from Board-supervised institutions for TARP funding under the Capital Purchase Program (CPP). In general, financial

institutions request participation in the CPP by submitting an application to the appropriate federal banking agency, which reviews the application prior to Treasury's decision on whether a CPP request should be approved or denied. We are coordinating this work with the Government Accountability Office (GAO) and the FDIC OIG, as well as the Special Inspector General for TARP (SIGTARP). A public report on this audit will be issued this summer.

Second, we have initiated a broad review of the Board's oversight of the Federal Reserve's new lending facilities and special programs. In response to the financial crisis, the Board has approved the creation of various new lending facilities, such as the Term Asset-Backed Securities Loan Facility and the Commercial Paper Funding Facility. In addition, the Board has acted to provide loans to depository institutions, bank holding companies, securities dealers, and limited liability companies. Many of these new lending facilities and special programs have been established pursuant to the Board's authority under section 13(3) of the Federal Reserve Act, to authorize Federal Reserve Banks, in unusual and exigent circumstances, to extend credit to individuals, partnerships, and corporations that are unable to obtain adequate credit accommodations from other banking institutions. The objectives of this review are to obtain and analyze information on the various Federal Reserve lending facilities and special programs, and to identify risk areas for more detailed review. In addition, we are actively coordinating with SIGTARP on its TARP-related audits and investigations that also involve certain Federal Reserve programs.

Third, we have recently begun a review of the Federal Reserve's consolidated supervision of bank holding companies and financial holding companies. We are initially focusing on supervisory actions that address risk management issues facing holding companies, such as capital planning and capital adequacy, firm-wide risk identification, residential lending, counterparty credit risk, and commercial real estate concentrations. We will also address supervisory challenges that have emerged as a result of the current financial crisis, and review the Board's plans for supervising large financial firms that are in the process of becoming bank holding companies.

Fourth, our investigators are continuing to conduct criminal, civil, and administrative investigations to detect and prevent fraud, waste, and abuse in Board-related programs and operations. Our current ongoing criminal investigative activities involve leading or participating in a number of multi-agency investigations on a variety of topics, such as alleged bank fraud, terrorist financing, money laundering, and mortgage fraud. In addition, we continue to address allegations of wrongdoing related to the Board's programs and operations. We are participating in a nationwide effort by the FBI and the United States Attorney's Office to investigate and prosecute mortgage-related crimes. Joint federal and state task forces have been established in most of the states considered hotspots for such crimes. Most recently, we referred information related to mortgage fraud to the Detroit Mortgage Fraud Task Force and have been contacted by the FBI to assist with a South Florida mortgage fraud case. Both cases are a result of ongoing investigative activity related to the program and operations of the Federal Reserve Board. We plan to work these cases jointly with the FBI and will continue to coordinate with the appropriate task force offices.

Finally, our long-standing coordination with other financial regulatory IGs has taken on added significance during the current economic crisis and has been very effective in optimizing our coverage of important issues, while avoiding overlap and duplication of effort. For example, we joined other financial regulatory IGs to participate in the "TARP IG Council" to facilitate effective communication and coordination among those entities whose oversight responsibilities relate to or affect the Troubled Asset Relief Program. In addition, the Board's OIG has coordinated with the SIGTARP in forming the Term Asset-Backed Securities Loan Facility (TALF) Task Force. The TALF is a Federal Reserve program in which the Federal Reserve Bank of New York will make loans that are secured by asset-backed securities. In the event of default, TARP funds will provide a certain level of credit protection to the TALF.

The TALF Task Force is a proactive effort to prevent and detect fraud or abuse in the TALF. In addition to the Board's OIG and the SIGTARP, the TALF Task Force comprises the Federal Bureau of Investigation, the Financial Crimes Enforcement Network, U.S. Immigration and Customs Enforcement, the Internal Revenue Service, the Securities and Exchange Commission (SEC), and the U.S. Postal Inspection Service. Representatives from each agency

participate in regular briefings about the TALF program. On March 27, 2009, the TALF Task Force held its first meeting during which the Federal Reserve Bank of New York's Compliance Section gave a detailed briefing of the TALF program. After the briefing, members of the task force met to devise strategies to identify areas of fraud vulnerability within the program. In a subsequent meeting on April 27, 2009, the SEC Compliance Section provided training on Hedge Funds and Securitization. The TALF Task Force will meet on a regular basis to coordinate investigative efforts and to provide training for agents and analysts with respect to the complex issues surrounding the program.

Balancing Priorities: Planning Future Work

Looking ahead, we are concerned that an increase in the number of MLRs would not only require us to shift resources from the important ongoing work related to the financial crisis, but would also significantly reduce our ability to initiate work in other emerging areas. For example, additional risk areas for possible audit and evaluation include detailed reviews of the Board's oversight of the internal controls over each of the Federal Reserve Systems' new lending facilities; the Board's roles and responsibilities for the Capital Assistance Program under the TARP; the Board's analysis of the systemic financial risk posed by large financial services companies, and the processes for responding to such risk; the Board's efforts to improve supervision over subprime lenders; the Board's supervision over de novo state member banks; and the Federal Reserve's examination practices for detecting violations of Regulation O, which restricts loans to bank's executive officers, directors, and principal shareholders.

Raising the Materiality Threshold Increases Flexibility

My colleagues and I are appearing before you today because we believe that the current threshold, which has been in effect for about 25 years, no longer provides a reasonable "materiality" benchmark for triggering an MLR of failed financial institutions. Congress enacted section 38(k) of the FDIA to ensure that regulators learn from weaknesses associated with supervising institutions that resulted in costly failures, and possibly avoid such failures in the future. Our experience from conducting six reviews of failed financial institutions over the past

fifteen years reveals that MLRs can provide insights into the effectiveness of bank supervision, and point to potential improvements in supervisory processes, policies, and procedures. As we are actively conducting the current reviews, however, we are discovering clear and repetitive patterns regarding the cause of SMB failures, consistent with what was initially discerned at the time of the closure. In addition to providing limited new insights into the cause of the failure, the current $25 million threshold is leading to a disproportionate concentration of staff resources in one issue area, which affects our ability to cover other highly relevant emerging issues.

The proposed legislation that has been offered by Chairman Moore provides IGs with the flexibility required to continue meeting the intent of Section 38(k), while managing staff and other resources to ensure that other strategic objectives are fulfilled. Among other things, the legislation raises the MLR threshold to $400 million, thereby ensuring that the most substantial failures will continue to be reviewed. With respect to failures that do not meet the new threshold, the legislation provides IGs with the flexibility to conduct a review and prepare a report when warranted by unusual circumstances. We have, in the past, initiated a review of a financial institution with losses below even the $25 million threshold, when we believed it was warranted by unusual circumstances. We reviewed the failure of the Bank of Ephraim back in late 2005 because the failure involved fraud and, in our view, the projected loss, totaling 10 percent of the institution's assets, was relatively high.

We endorse the proposed legislation, and believe that it provides a reasonable approach to resolving the problems created by the current MLR threshold. We look forward to working with the Committee as it continues to develop a more efficient and effective legislative framework for conducting MLRs.

Oversight of the Federal Reserve System

In light of the financial crisis and the Board's related actions concerning lending facilities established under Section 13(3) of the Federal Reserve Act, this Subcommittee has asked about oversight of the Federal Reserve System, including the role of our office in providing this oversight. We must ensure that these unprecedented actions are subject to objective and

independent oversight, while protecting and preserving the independence of the nation's central bank. To achieve this delicate balance requires understanding the current oversight of the Federal Reserve, the guiding principle of independence, and the authority of the OIG and GAO.

The Current Oversight Framework

The current oversight framework for the Federal Reserve is closely related to the structure of the Federal Reserve System which includes, as noted earlier, the Board of Governors in Washington, D.C., and the twelve Federal Reserve Banks with their twenty-five Branches distributed throughout the nation. The IG Act defines our role as the Inspector General for the Board of Governors. Pursuant to the IG Act, we may conduct audits related to any Board program or operation, including any Board delegated function conducted by a Federal Reserve Bank. This work includes assessing how well the Board carries out its general program oversight and supervision of the Reserve Banks. The OIG also contracts for and oversees the annual independent financial statement audit of the Board, which includes a report on compliance and on internal control over financial reporting in accordance with government auditing standards. Each OIG audit, inspection, and evaluation report—as well as informative summaries of any restricted report on specific information technology or other security-related processes or controls—are available on our public website at http://www.federalreserve.gov/oig/. In addition, we provide a complete summary of our work—including completed investigations and our legal and regulatory review—in our semiannual reports to Congress.

The Board contracts for the annual independent financial statement audit of the Reserve Banks, including an evaluation of internal controls over financial reporting. Each Reserve Bank publishes its audited financial statements, and the Board of Governors publishes the audited combined Reserve Bank financial statements and the Board's financial statements in its annual report to Congress. The independent public accounting firm also audited the financial statements of the consolidated limited liability companies (LLC) that the Federal Reserve established in 2008, and each of its reports are available on the Board's public website. The Reserve Banks, including the consolidated LLCs, are subject to oversight by the Board.

Each Reserve Bank has a General Auditor, who reports to the audit committee of the Bank's board of directors. This internal audit function is responsible for identifying risks and assessing the effectiveness of the Reserve Bank's risk management, control, and governance processes. As noted above, the Reserve Banks are subject to general supervision by the Board and, in certain matters, the Board's specific authorization or approval. The Board's oversight includes (1) assessing whether Reserve Bank strategies, objectives, and other matters are reasonable and consider all significant and relevant issues and (2) monitoring and reviewing ongoing operations and the implementation of major initiatives.

Furthermore, GAO has audit jurisdiction over the entire Federal Reserve System (both the Board of Governors and the Reserve Banks), as set forth in the Federal Banking Agency Audit Act. Moreover, SIGTARP has audit cognizance over TARP-related activities pertaining to the Federal Reserve.

Independence: A Guiding Principle

The Federal Reserve Act, which created the Board, was carefully crafted by the Congress to control monetary policy free from political influence. The legislative history of the Act and the writings of most economic scholars have reiterated the importance of this independence throughout history. This view was memorialized by Carter Glass, one of the primary framers of the Federal Reserve Act, on Page 43 of the House Report on the original Act. The Report states, "It cannot be too emphatically stated that the Committee regards the Federal Reserve Board as a distinctly nonpartisan organization whose functions are to be wholly divorced from politics."

To achieve the objective of independence, the Federal Reserve Act includes specific provisions designed to separate the Board from political pressure. The Banking Acts of 1933 and 1935 added provisions that gave the Board independence from the executive and legislative branches. These provisions help to ensure that the Board is independent within the federal government to a much greater extent than most other independent agencies. Section 10 of the Act provides that the Governors of the Federal Reserve Board are appointed by the President, with Senate confirmation, to serve fourteen-year, staggered terms. These terms are the longest

statutory tenure in government, other than that of the Comptroller General, and are meant to span the timeframe of several administrations. The Federal Reserve Act also precludes the President from removing a Governor other than for cause. To further provide a high degree of independence from the executive branch, unlike most other government entities, no other officers or employees of the Board are politically appointed. Moreover, the provisions of the Federal Reserve Act insulate the Board from the influence of the legislature. Section 10 of the Act provides that the Board has independent authority to employ, set salaries, and exempt Board employees from the classified civil service. In addition, the operations and expenses of the Board are to be paid through assessments levied on the Federal Reserve Banks, as opposed to Congressional appropriations.

Authority of the OIG and GAO

While our office and GAO share oversight functions in certain areas, we also have certain noteworthy distinctions. The IG Act defines our role as the Inspector General for the Board of Governors. As such, the OIG may conduct audits and investigations related to any Board program or operation, including any Board-delegated function conducted by a Federal Reserve Bank. While we are not authorized to directly audit the Reserve Banks, our jurisdiction does include assessing how well the Board carries out its general program oversight and supervision of the Reserve Banks.

The Board's OIG is also authorized to audit and investigate the monetary policy programs and operations of the Board. However, this access can be limited, in part, by section 8G(g)(3) of the IG Act. These provisions state that the Board's IG may be placed under the direction and control of the Chairman of the Federal Reserve Board, if such control is necessary to prevent the disclosure of any information concerning decisions or deliberations on policy matters, the disclosure of which could reasonably be expected to have a significant influence on the economy or market behavior, or if such disclosure would constitute a serious threat to national security. In these cases, the agency head has the ability to prohibit such an audit or investigation, if the agency head determines that such prohibition is necessary to prevent significant impairment to the national interests of the United States. If such authority is

exercised, the Chairman is required to provide his reasons, in writing, to the Board's IG, and the IG must then transmit a copy of these reasons to the relevant Congressional committees within thirty days of receipt. This provision has never been used by a Chairman of the Federal Reserve Board.

Under the Federal Reserve Act, the FOMC is an entity that is separate and distinct from the Board of Governors. In addition, the operations of the FOMC are not considered a "Board program or operation" for purposes of the IG Act. While we are not authorized to audit the FOMC's operations, our office may audit Board programs that support the FOMC. For example, the Board's IG can audit the use of Board funds, facilities, or personnel supporting the FOMC.

The Federal Banking Agency Audit Act, 31 U.S.C. 714, authorizes the GAO to audit both the Board and the Federal Reserve Banks. GAO may also carry out an onsite examination of an open insured bank or bank holding company, but only if the appropriate agency has consented in writing. However, under this Act, GAO is precluded from conducting an audit of the Board or the Reserve Banks concerning: (1) transactions for or with a foreign central bank, government of a foreign country, or non-private international financing organization; (2) deliberations, decisions, or actions on monetary policy matters, including discount window operations, reserves of member banks, securities credit, interest on deposits, and open market operations; (3) transactions made under the direction of the FOMC; and (4) a part of a discussion or communication among or between members of the Board and officers and employees of the Federal Reserve System related to these areas.

As you know, GAO is a legislative branch agency that serves as the "investigative arm of Congress" and the "Congressional watchdog." It performs a substantial number of audits within the Federal Reserve System each year. These audits relate to the many functions performed by the Federal Reserve that have little direct relation to monetary policy. As of March 31, 2009, the Board reports that GAO had twenty engagements underway, seventeen of which were initiated by Congress.

Clearly, maintaining Federal Reserve independence, particularly in monetary policy matters, is a critical factor in assessing whether GAO's audit coverage should be expanded to include the areas that are currently restricted. The legislative history (Senate Report 723) of the Federal Banking Agency Act states that, "the Federal Reserve Board must be able to independently conduct the Nation's monetary policy and thus [the Act] excludes monetary policy deliberations, decisions or implementation from GAO audit." Federal Reserve independence continues to be an important consideration today.

Our office is uniquely positioned to conduct independent audits of the Federal Reserve. Congress' original decision to establish the Board's IG as a designated federal entity appointment versus a Presidential appointment was well-founded, considering the Board's independence and unique mission. Congress took a very measured and careful approach in establishing OIGs at designated federal entities (DFE) including the Board and, with the recent passage of the IG Reform Act, has continued to ensure the independence of DFE IGs. Over many years, our audits, inspections, evaluations, and investigations have been conducted without any regard to political influence, in full compliance with the IG Act and applicable standards.

Finally, our office currently has jurisdiction over the Board's oversight and supervision of the lending facilities that GAO is currently restricted from reviewing. We also actively coordinate with SIGTARP, as it audits and investigates TARP-related funding of certain Federal Reserve lending facilities. Our office is an independent, non-partisan, external audit entity that brings a depth of first-hand experience to the table.

Closing

In closing, Chairman Moore, I would like to thank you and the Subcommittee for holding this hearing on the role of Inspectors General in minimizing and mitigating waste, fraud, and abuse. Our office takes its mission and authority very seriously and remains committed to promoting integrity, efficiency, and effectiveness in the Board of Governors of the Federal Reserve System. I would be happy to respond to any questions that you or other members of the Subcommittee may have.

Office of Inspector General

For Release on
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May 5, 2009

Testimony

Before the Subcommittee on Oversight and Investigations
Committee on Financial Services
U.S. House of Representatives

Hearing on the Role of Inspectors General: Minimizing and Mitigating Waste, Fraud and Abuse

Statement of Jon T. Rymer
Inspector General
Federal Deposit Insurance Corporation

STATEMENT OF JON T. RYMER, INSPECTOR GENERAL
Federal Deposit Insurance Corporation
on
The Role of Inspectors General: Minimizing and Mitigating Waste, Fraud and Abuse

Subcommittee on Oversight and Investigations
Committee on Financial Services
United States House of Representatives

May 5, 2009

Mr. Chairman and Members of the Subcommittee:

Thank you for providing me the opportunity to participate in this very important hearing. My name is Jon T. Rymer, and I am the Inspector General (IG) for the Federal Deposit Insurance Corporation (FDIC or the Corporation). As noted in your invitation letter, the purpose of today's hearing is to focus on our ongoing efforts to expose waste, fraud, and abuse, and to specifically examine how mandated Material Loss Reviews (MLR) affect our ability to provide oversight and accountability. We appreciate your interest in the challenges that we, the Inspectors General of the federal financial regulators, are currently facing.

These issues are critical to the ongoing work of my office. As detailed in my testimony, the landscape has not changed from the one we described in our January 2009 letter to Chairman Barney Frank and Ranking Minority Member Spencer Bachus. In short, our predictions have become reality. That is to say, the current volume of MLR work—and the time and resources that this work demands—puts at risk my office's ability to effectively oversee core activities of the FDIC. Expending our scarce resources on these reviews also limits our ability to oversee the new initiatives that the banking agencies are undertaking to deal with the current economic crisis affecting open financial institutions.

My written statement will amplify these points. In response to your questions, we are providing an overview of my office; a discussion of the MLR requirements and coverage as well as the impact these requirements are having on my office's ability to effectively oversee FDIC programs and operations; and information on our investigative efforts to combat fraud, waste, and abuse. I also discuss scenarios of possible relief from the current MLR threshold requirements.

Overview of the Office of Inspector General (OIG)

The FDIC OIG is an independent and objective unit established under the Inspector General Act of 1978, as amended (IG Act). The OIG's mission is to promote the economy, efficiency, and effectiveness of FDIC programs and operations, and protect against fraud, waste, and abuse to assist and augment the FDIC's contribution to stability and public confidence in the nation's financial system. To accomplish this mission, my office conducts audits, evaluations, and investigations to provide objective, fact-based information and analysis to the Congress, the FDIC Chairman, other FDIC officials, and the Department of Justice. Our work is conducted pursuant to the IG Act and in accordance with applicable professional standards.

For fiscal year (FY) 2009, the OIG is operating on a budget of $27.5 million and an authorized staffing level of 122. We are at an on-board strength of 110 employees and are actively hiring. Three of our component offices—the Office of Audits, Office of Evaluations, and Office of Investigations—perform the bulk of our mission-related work. The other components, including my attorneys and independent management support functions, account for 20 employees.

- The Office of Audits conducts audits and audit-related services designed to promote economy, efficiency, and effectiveness, and to prevent fraud, waste, and abuse in corporate programs and operations. This work is done in compliance with applicable audit standards, including those established by the Comptroller General of the United States. The Office of Audit has 36 employees, and anticipates growing in FY 2010 to an on-board strength of 49.

- The Office of Evaluations evaluates, reviews, studies, or analyzes FDIC programs and activities to provide independent, objective information to facilitate FDIC management decision-making and improve operations. These projects, which are generally limited in scope and may be requested by the FDIC Board of Directors, FDIC management, or the Congress, are conducted in accordance with the IG community's *Quality Standards for Inspections*. The Office of Evaluations currently has 14 employees and anticipates increasing to 17 employees in FY 2010.

- The Office of Investigations carries out a comprehensive nationwide program for the prevention, detection, and investigation of criminal or otherwise prohibited activity that may harm or threaten to harm the operations or integrity of the FDIC and its programs. This office maintains close and continuous working relationships with the Department of Justice; the Federal Bureau of Investigation; other Offices of Inspector General; and federal, state and local law enforcement agencies. The Office of Investigations has an on-board strength of 40 investigative personnel and is planning to grow to 51 in FY 2010.

During FY 2008, my office issued 30 audit and evaluation reports, containing 76 non-monetary recommendations to FDIC management; referred 73 cases to the Department of Justice for prosecutorial consideration; and realized 124 indictments/informations and 103 convictions through the courts. Overall, our work resulted in $440 million in actual and potential monetary benefits.

MLR Requirements

Mr. Chairman, as you noted, today's hearing focuses on the statutory requirement for detailed reviews by my office and the offices of my IG colleagues at the Department of the Treasury and Federal Reserve Board when certain federally insured institutions fail. In 1991, the Congress amended the Federal Deposit Insurance Act, after the failures of about 1,000 banks between 1986 and 1990 had resulted in billions of dollars in losses to the Bank Insurance Fund.[1] Section

[1] Effective March 31, 2006, deposit insurance for banks and savings and loan associations was consolidated into the Deposit Insurance Fund. As of December 31, 2008, the FDIC insured approximately $4.8 trillion in deposits in all federally-insured depository institutions in the United States.

38(k) requires that the IG of the agency charged with supervising the failed institution conduct a review (a "material loss review" or MLR) when the estimated loss becomes material, i.e., the loss is estimated to exceed the greater of $25 million or 2 percent of the institution's total assets at the time the FDIC was appointed receiver.

MLRs are intended to independently determine why the institution failed and evaluate the supervision of the institution. Section 38(k) was added to ensure that the regulators learn from any weaknesses in the supervision of banks whose failures cause material losses and make improvements, as needed, in the supervision of depository institutions, including the agency's implementation of section 38 of the Federal Deposit Insurance Act pertaining to Prompt Corrective Action (PCA).[2] The 1991 Act also required that an MLR be completed within 6 months after it becomes apparent that a material loss has been incurred as a result of an institution's failure.

My Office of Audits is principally responsible for performing MLRs. For each MLR of an FDIC-supervised institution, a team of 2-3 professionals reviews and analyzes examination and visitation reports prepared by FDIC and state examiners, FDIC-maintained bank records and correspondence, FDIC-prepared reports relating to the bank's closure, records of the bank's external and internal auditors, and pertinent FDIC and interagency policies. The MLR team also interviews responsible FDIC officials in both headquarters and the field, including the examiners who participated in the examinations and the managers who monitored the activities of the bank before it failed, officials from the state regulator, and independent public accountants to discuss their historical perspective of the institution, its examinations, state banking laws, and other activities regarding the overall supervision of the bank.

To supplement the Office of Audits' existing staffing levels, we have temporarily reassigned a number of staff from other OIG component offices to carry out this mandatory workload. For example, we have returned individuals previously detailed to our Office of Investigations to perform forensic accounting support for ongoing criminal investigations, and detailed staff with appropriate backgrounds from our Office of Management, to join MLR teams. Needless to say, the work that these individuals were formerly doing for their respective offices is no longer being accomplished. Moreover, we have assigned Office of Evaluations staff to MLR teams, but believe that, for the most part, the Corporation is better served if that staff provides coverage of the new FDIC programs and activities described below.

Because an MLR involves an assessment of supervisory activity and can lead to recommendations that would affect bank supervision, my office does not plan to contract out for this work. Specifically, my office is concerned about a potential conflict of interest when professional services firms that have clients in the banking industry are involved in making recommendations associated with bank supervision. At this time, we are not using contractors to perform specific tasks directly related to ongoing MLRs, but we may need to revisit that issue should increased workload dictate.

[2] The PCA provisions establish a system of restrictions and mandatory supervisory actions that are triggered by an institution's capital levels and intended to address institutions that are not well capitalized.

Institution Failures and MLR Coverage

As of December 31, 2008, over 8,300 FDIC-insured financial institutions made up the banking system, and the FDIC was the primary federal regulator for nearly 5,100 of them. These FDIC-insured and supervised institutions are state-chartered and are not members of the Federal Reserve System (generally referred to as "state non-member" institutions). It is important to note that the vast majority of these institutions remain viable, notwithstanding the current economic crisis.

However, banks have been failing, and we are experiencing a dramatic upswing in the number of these failures, particularly among institutions of a size that are typically regulated by the FDIC. In 2008 alone, 25 institutions failed, with total assets at failure of $361.3 billion and total losses to the Deposit Insurance Fund (DIF or the Fund) of approximately $17.9 billion. During the first 4 months of 2009, another 29 institutions have failed, with total assets at failure of $14.7 billion and an estimated loss to the DIF of about $3.9 billion.

As of April 30, 2009, the FDIC OIG had 20 MLRs underway. These reviews are labor-intensive. Our experience to date tells us that each MLR requires about 2,000 staff hours. At our current staffing levels, we are able to conduct approximately 20 MLRs at any one time. With our current inventory of MLRs, we are at our capacity and can, assuming no other failures, effectively manage the workload through September 2009. However, with 252 institutions on the problem bank list, as of the end of December 2008, we are concerned that additional failures will occur and will preclude us from meeting our statutory responsibilities.

To date, we have issued six MLR reports and will issue three more this month. These MLRs cover institutions whose failures caused losses to the Fund ranging from $32 million to $1.4 billion. As required by law, in each of the issued or about-to-be-issued reports, we identify the causes for the institution's failure and resulting loss to the DIF, and assess the FDIC's supervision of the failed institution, including implementation of the PCA provisions.

Section 38(k) also requires the OIG to make recommendations for preventing losses from future failures. Rather than offering recommendations on individual MLRs, my office will be summarizing our observations on the major causes, trends, and common characteristics of failures resulting in material losses to the DIF in separate reports or other communications. We decided early on in the process that our recommendations will be more effective and useful to all concerned if they are based on several reports rather than an individual MLR. We are in the process of sharing our observations to date with the FDIC, and then plan to provide additional coverage through summary reports and other means, as resources allow.

MLR Impact on the OIG's Coverage of Other Programs and Initiatives

In January 2009, the IGs of the federal financial regulators sent a letter to the leadership of the House Financial Services Committee requesting relief from the current $25 million MLR threshold. Over 17 years ago when this threshold was established, a $250 million institution was considered large, and a 10-percent loss rate on failure was viewed as substantial. Today, nearly one-third, or over 2,600 institutions, have assets in excess of $250 million, and the projected loss

rates on the current failures are frequently in excess of 25 percent of total assets. In light of the current economic environment, the $25 million threshold no longer serves as a reasonable measure of materiality or a meaningful trigger point for an OIG review of a failed financial institution. Further, as mentioned in our letter, the MLRs at the lower end of the loss threshold provide little, if any, new perspectives or insights regarding the causes of the failure or supervision of the institutions themselves beyond what we initially discern at the time of closure.

In two separate reports,[3] the Government Accountability Office (GAO) suggested that the Congress consider whether the MLR requirement was a cost-effective mean of achieving the requirement's intended benefit. As a matter for congressional consideration, GAO noted that amending the requirement would be more desirable because it would allow IGs to continue their bank supervision work as well as provide them with greater flexibility in managing their resources. GAO did not propose a threshold in either report but noted that OIG resource management flexibility was important.

Over the last 9 months, we have stretched our resources to the maximum extent possible and are feeling this tension in all aspects of our work. Our first priority is to satisfy our statutory requirements for conducting MLRs, as discussed above, and other mandated work, including an evaluation of information security practices in accordance with the Federal Information Security Management Act of 2002, and Federal Information Systems Controls Audit Manual-related work in connection with GAO's financial statement audit of the Deposit Insurance and Federal Savings and Loan Insurance Corporation Resolution Funds.

To leverage resources and expertise, we will continue to work jointly with the other financial regulatory IGs. For example, we loaned two experienced auditors to the Department of the Treasury OIG to assist with the MLR of IndyMac Bank, F.S.B. This arrangement not only paid dividends for the Treasury OIG, but our auditors were also able to share their experiences with our staff to enhance our ability to conduct MLRs going forward. In addition, we are beginning to discuss the possibility of a joint MLR with the Federal Reserve OIG, should circumstances warrant. Finally, in anticipation of the expanded MLR workload, my office along with the other financial OIGs conducted a 4-day training conference to refresh our employees' knowledge of the bank supervision, closing, and MLR processes.

While the conduct of MLRs is our primary focus, another priority includes the efforts by my Office of Evaluations to review, at a high, risk-based level, key activities and new programs and initiatives undertaken by the FDIC and others. To accomplish these reviews, we are being creative in our staffing arrangements and are employing the expert services of contractors to fill the gaps. Provided below are examples of the work we are doing, albeit at the "30,000-foot level."

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[3] *INSPECTORS GENERAL: Mandated Studies to Review Costly Bank and Thrift Failures* (GAO/GGD-95-126), dated July 31, 1995; and *INSPECTORS GENERAL: Mandated Studies to Review Costly Bank and Thrift Failures* (GAO/GGD-97-4), dated November 7, 1996.

Resolution and Receivership Activity

Planning and efficiently handling the resolutions of failing FDIC-insured institutions is a core FDIC mission. The resolution process involves all the business processes associated with selling an entity and winding up its business activities. The receivership process involves closing the failed bank; liquidating any remaining assets; satisfying creditors; and distributing any proceeds. Without question, the Corporation needs to ensure that receivership and resolution processes, negotiations, and decisions made regarding failed or failing institutions are marked by fairness, transparency, and integrity.

The FDIC's resolution and receivership activity has increased substantially and is expected to grow. Based on preliminary data, as of the end of 2008, the number of receiverships had grown to 41, with assets in liquidation totaling $15 billion, reflecting a 46 percent and 1,623 percent increase, respectively, over the previous year. This upswing occurred, in part, because the FDIC is retaining large volumes of assets as part of purchase and assumption agreements with institutions that are assuming the insured deposits of failed institutions. Adding into the equation large, complex failures and facilitated transactions, such as IndyMac Bank (estimated $10.7 billion loss to the Fund) and Washington Mutual Bank ($299 billion in assets), and the loss share provisions that involve pools of assets worth billions of dollars and extend up to 10 years, such as Citigroup ($306 billion in loans and securities) further complicates the FDIC's resolution mission. As discussed below, the FDIC extensively utilizes contractors in connection with its resolution activities. The use of contractors affords the FDIC with a great deal of flexibility in its planning and operations, but also creates vulnerabilities against which the agency must remain vigilant.

As history has shown, the FDIC will be disposing of these assets over an extended period of time, and the associated risks will present themselves to the Corporation for years to come. An effective governance structure, strong controls and appropriate contracting and contractor oversight mechanisms will be critical to the success of these activities.

The resolution and receivership activity is a vulnerable area where independent oversight and review are essential. Although more coverage is called for, we are, at present, conducting two evaluations in areas where we believe FDIC has the most exposure. One evaluation will identify and evaluate controls in place over the contracting and legal services functions to address the risks presented by a significant increase in resolution and receivership-related contracting activity. A second evaluation will cover the loss share provisions, including those in the assistance agreements with Citigroup and Bank of America, to ensure compliance with all related terms, such as those involving asset eligibility and institution management of guaranteed assets.

New FDIC Programs and Activities

A number of new programs and activities that were established in response to the economic downturn pose substantial short- and long-term risk, including reputational risk, to the FDIC. These initiatives are very large in scale, and the FDIC has been taking steps to address the associated risks, including setting governance and supervisory controls. With the evolving nature of these initiatives, controls are, in many cases, still under development.

Given the scope, scale, and dollar magnitude associated with these activities, we have done or are beginning to conduct work, at a high level, to ensure that effective controls, governance, transparency, and accountability are imbedded in the new programs the Corporation undertakes on its own or in coordination with the Department of the Treasury and other financial regulatory agencies. At this point, we are looking to provide a broad-brush look and some preliminary assessments with the ultimate goal, should resources permit, of coming back to conduct more extensive reviews. Provided below are examples of this work:

Temporary Liquidity Guarantee Program. The FDIC established the Temporary Liquidity Guarantee Program in October 2008 to help address unprecedented disruptions in credit markets and the resultant effects on the ability of financial institutions to fund themselves and make loans to creditworthy borrowers. This program, which is entirely funded by industry fees, has two components: (1) a temporary guarantee of newly issued senior unsecured debt for eligible banks, thrifts, and certain holding companies and (2) a temporary unlimited guarantee of funds in noninterest-bearing transaction accounts at FDIC-insured institutions. Debt guarantees can go out as many as 3 years (December 2012) under the current program, and guarantees on the noninterest-bearing accounts extend until the end of the year. As of February 2009, the FDIC guaranteed about $269 billion in outstanding debt and had assessed approximately $5.5 billion in fees. In addition, the FDIC reported, as of December 2008, more than half a million deposit accounts have received over $680 billion in additional FDIC coverage through the transaction account guarantee.

Shortly after this program was established, my office, using the expertise of an independent professional services firm, performed a risk assessment on the program's key internal controls and procedures established to implement and oversee the program. We recently briefed FDIC managers on the results of our assessment, discussed program risk areas warranting continued management attention, and plan to issue a management letter summarizing the results of our assessment. Should resources become available, we plan to revisit this program to conduct a more in-depth review to assess the effectiveness of the program's controls and systems.

Capital Purchase Program. Under the Department of the Treasury's Troubled Asset Relief Program (TARP) Capital Purchase Program (CPP), the FDIC is responsible for processing applications from those FDIC-supervised institutions interested in participating in the program and forwarding approval recommendations to the Department of the Treasury. The CPP authorizes the Treasury to purchase up to $250 billion of senior preferred shares from qualifying insured depository institutions. As of April 24, 2009, the FDIC had received 1,712 applications from FDIC-supervised institutions requesting $34.3 billion in TARP funding. The FDIC had recommended 785 applications to Treasury for approval, of which 587 received awards. A total of 831 applicants had withdrawn from CPP consideration.

Given the attention and sense of urgency associated with this program, my office initiated an evaluation to assess the FDIC's process and controls associated with reviewing applications from FDIC-supervised institutions and forwarding approval recommendations. In our review, we found that the FDIC had established controls for reviewing CPP applications that provide reasonable assurance that the Corporation is complying with Treasury's CPP guidance. In February 2009, the Corporation issued examination procedures for monitoring compliance with CPP award provisions, which will allow the FDIC to measure institutions' success in deploying

TARP capital and ensure that the funds are used in a manner consistent with the intent of the Congress. We issued our report in March 2009.

Loan Modification Programs. The FDIC implemented a Loan Modification Program at IndyMac Federal Bank, F.S.B., and the implementation of a similar program has been a condition of several large FDIC-facilitated institution sales. The goal of these programs is to achieve affordable and sustainable mortgage payments for borrowers and increase the value of distressed mortgages by rehabilitating them into performing loans. Other institutions have agreed to implement loan modification programs as part of their financial stability agreements with the FDIC and other financial regulatory agencies.

Our initial plans for reviewing these loan modification programs changed with the sale of IndyMac Federal Bank in March 2009. Currently, my office plans to assess the FDIC's efforts for monitoring implementation of loan modification programs at institutions such as CitiBank and US Bank. We will also be looking at the former IndyMac Federal Bank program to evaluate the controls that were in place to detect and prevent participation in the program by those who obtained their initial loan under fraudulent pretenses.

Large Bank Failures. The failures of IndyMac Bank and Washington Mutual Bank (WaMu) were historic, each for their own reasons. As such, we believed that an independent analysis of the activities of the regulators involved was in the public's best interest. IndyMac Bank's failure in July 2008 was the third largest in the history of the United States. Because this institution was supervised by the Office of Thrift Supervision, the IG at the Department of the Treasury conducted the MLR. However, we believe it is important to determine the role that the FDIC played as back-up regulator and deposit insurer. In this evaluation, we are focusing on determining when the FDIC became aware of the IndyMac Bank problem; what the Corporation knew and how it knew it; and what actions the Corporation took given its knowledge of the risks posed by IndyMac Bank. We expect to issue this report within the next month.

WaMu was the largest bank failure in the history of the United States, but because the resolution structure resulted in no loss to the DIF, the threshold for conducting an MLR was not triggered. Given the size, circumstances leading up to the resolution, and non-Fund losses (i.e., loss of shareholder value), we are working jointly with the Treasury OIG to determine the events leading to the need for the FDIC-facilitated transaction. Specifically, our joint work will evaluate the Office of Thrift Supervision's supervision of WaMu, including implementation of PCA provisions of section 38, if required; evaluate the FDIC's supervision and monitoring of WaMu in its role as insurer; and assess the FDIC's resolution process for WaMu. We anticipate issuing this report in the fall 2009.

Legacy Loan Program. On March 23, 2009, the Department of the Treasury and the FDIC were tasked with establishing the Legacy Loan Program as part of the Public-Private Investment Program. The Legacy Loan Program is being created to (1) remove troubled loans and other assets from banks and attract private capital to purchase eligible loan assets from participating banks through FDIC debt guarantees and Treasury equity co-investment, (2) address the uncertainty about the value of these assets, which makes it difficult for banks to raise capital and

secure stable funding to support lending to households and businesses, and (3) in coordination with the other components of the financial recovery package, clean up bank balance sheets so that banks can once again provide the lending to further the recovery of the economy. At present, the FDIC is responsible for providing oversight for the formation, funding, and operation of public-private investments funds that will purchase the loans and other assets from the depository institutions, and is working to develop the program and staff operations related to the formation, funding, and operations of these funds.

If the Corporation is successful in establishing this major new program, we anticipate multiple transactions, involving hundreds of billions of dollars, and related indebtedness, which will be guaranteed by the FDIC. The Chairman of the FDIC has requested that we, working with the Special Inspector General for the TARP, review preliminary control structures currently being designed to meet these challenges. The size and importance of this program will demand substantial resources, now and in the future, to provide sufficient oversight.

Work Being Deferred

Unfortunately, difficult workload decisions have to be made, and other assignments, necessary to provide oversight of the ongoing operations and programs of the Corporation, are being deferred until resources permit. As a result, our opportunities to promote sound governance and effective stewardship in internal operations have been limited and will remain so unless we can free up some of our existing resources. Provided below are some examples of the projects we will be unable to initiate in the foreseeable future.

Oversight of the Increase in FDIC Core Business Processes. The FDIC is growing in various ways. The FDIC increased its staffing to over 6,200 positions, reflecting an increase of nearly 1,500 positions. These staff—mostly temporary—will perform bank examinations and other supervisory activities to address bank failures, including managing and selling assets retained by the FDIC when a failed bank is sold. The Board also approved opening a temporary West Coast Satellite Office for resolving failed financial institutions and managing the resulting receiverships. Additional satellite offices are also being considered.

Further, contracting activities are escalating dramatically. In 2008, the FDIC awarded approximately $652 million in contracts. With increased resolution and receivership workload, the level of FDIC contracting for various business activities will increase significantly, and effective controls must be in place and operational. Rapidly hiring and training so many new staff along with expanded contracting activity will place heavy demands on the Corporation's human resources and information technology staff and other administrative operations. At this time, we do not anticipate providing sufficient independent, in depth reviews of these critical core processes unless resources become available.

Other Business Plan Projects. Due to the resources required by our MLR work, increased resolution activity, and new programs and initiatives, our efforts to provide coverage in

other FDIC core areas, which had been planned during our FY 2008-2009 business planning cycle, have been postponed. These areas include:

- ***Receivership Management Audits.*** Coverage of the FDIC's closing process and its management of assets received from failed financial institutions, including financial reporting of failed institutions and receiverships' sales activities.

- ***In-depth, Systematic Coverage of the FDIC's Supervision and Consumer Protection Programs.*** The FDIC's Supervision and Consumer Protection programs promote the safety and soundness of FDIC-supervised insured depository institutions, protect consumers' rights, and promote community investment initiatives by FDIC-supervised insured depository institutions.

- ***In-depth, Systematic Coverage of the FDIC's Insurance Program.*** The FDIC insures bank and savings association deposits to help ensure stability and public confidence in the nation's financial system. The DIF must remain viable to protect insured depositors if an institution fails.

Scenarios of Threshold Relief

In our January letter, my colleagues and I proposed that increasing the MLR threshold would better serve the Congress by providing the OIGs with increased flexibility to refocus scarce resources to the wide-ranging programs and initiatives that the agencies are now managing, while continuing to ensure that significant failures receive an appropriate, in-depth review. At that time, we recommended modifying the threshold for a material loss to an amount between $300 and $500 million. To ensure that unusual or potentially significant situations are not missed, we also recommended that language be added that would allow the OIG to initiate an MLR of an institution with a projected loss below the increased threshold, should circumstances warrant. I continue to believe that an increase in the threshold is appropriate and necessary, and should be accompanied by such a provision.

Provided below is an analysis of the total MLR workload from January 1, 2007 to the present, under different threshold scenarios. As evidenced in the table, a relatively modest increase of the threshold up to $100 million would dramatically reduce the FDIC OIG's workload by over one-third. Raising the threshold to $200 million would have an even greater impact on our MLR workload by reducing it by two-thirds. We would defer to the Congress to arrive at the threshold most appropriate and the language that will allow for the flexibility that would be needed to initiate MLRs below a newly set threshold.

Number of Material Loss Reviews Required for Institution Failures from 1/1/2007 to 4/27/2009 at Current and Proposed Threshold Levels*

Responsible OIG	Current Material Loss Threshold	Proposed Material Loss Thresholds				
	$25 million**	**$100 Million**	**$200 Million**	**$300 Million**	**$400 million**	**$500 million**
FDIC	29	18	10	4	3	3
Federal Reserve	4	2	1	0	0	0
Treasury – OCC	7	3	3	2	2	2
Treasury – OTS	8	6	3	3	3	3
TOTALS	**48**	**29**	**17**	**9**	**8**	**8**

* Based on available loss estimates as of 4/27/09.

** An additional threshold is that the material loss must also exceed 2% of the institution's assets at the time the FDIC was appointed receiver. All of the MLRs required from 1/1/2007 to date have also met this threshold.

Resources Going Forward

A crucial theme throughout my testimony has been "as resources become available." Earlier this year, we began to address the increased workload issue by requesting $37.9 million to fund operations for FY 2010, which is an increase of 38 percent above our FY 2009 budget. A budget of $37.9 million will fund an authorized staffing level of 138, an increase of 13 percent above our FY 2009 level, and provide for additional contractor resources.

With the FY 2010 funds, we plan to hire a combination of employees on permanent and temporary appointments to provide needed coverage as well as contract for expert services to augment our work. For FY 2010, we do not believe that we could effectively acclimate or manage a higher staffing level, but we will be reevaluating our needs when preparing our FY 2011 budget. Should we get relief from the current MLR threshold, we would be in a position to deploy our resources differently.

Investigative Efforts to Fight Fraud, Waste, and Abuse

As referenced in the beginning of the statement, I have three component offices that perform the bulk of the IG mission-related work. My Office of Investigations conducts investigations of fraud and other criminal activity in or affecting FDIC-regulated financial institutions, closed institutions and receiverships, and other FDIC-related programs and operations. This office is comprised of federal law enforcement officers, including both field special agents and computer forensic special agents, who conduct these investigations throughout the country and operate a headquarters-based electronic crimes unit and computer forensic lab. The OIG's resources extend beyond its staff as it continues to work closely and partner with the FDIC, Department of Justice, Federal Bureau of Investigation, and other federal and state law enforcement organizations.

We currently have about 175 active investigations, most of which involve open or closed institutions. Based on our estimates, the potential fraud in these investigations exceeds

$11.3 billion. The work focuses primarily on bank crimes, such as embezzlement or money laundering, or various types of fraud, including mortgage, securities, wire, and mail, which occur at or impact financial institutions.

As expected, our investigative workload, particularly in the failed banks, is increasing. Where fraud is suspected in a bank about to be closed, our agents, including those with computer forensic expertise, participate during the closing. While on site, the OIG uses its special investigative tools to provide computer forensic support by obtaining, preserving, and later examining evidence from computers at the bank. After the institution fails and many times even before the failure, our investigators, working under the legal direction of an Assistant United States Attorney, and sometimes in conjunction with other federal and/or state and local investigative agencies, are investigating the criminal misconduct identified in connection with the bank failure with the goal of prosecuting those engaged in criminal behavior and seeking restitution to the DIF.

Mortgage fraud, which is one of the fastest growing white-collar crimes, is a significant subset of our investigative workload. About 40 percent of our active investigations are mortgage fraud-related, and that percentage continues to grow. These cases involve false representations, property flipping, straw buyers, stolen identities, inflated appraisals, foreclosure schemes, and seller assistance scams, and represent potential losses of $7.5 billion. Our investigations typically focus on industry professionals, such as mortgage brokers, senior executives, appraisers, attorneys, loan officers, and accountants, who perpetuate the fraud. They can also extend into more complex crime rings involving networks of individuals. While the investigations can occur nationwide, they tend to be concentrated in the "booming" growth areas of the early to mid-2000's, such as Atlanta, Southern Florida, New York/New Jersey, and Southern California. Our work in this area is supplemented by our participation in over 20 mortgage fraud task forces nationwide and other financial institution fraud working groups.

In addition, the Office of Investigations is involved in stopping fraud schemes that rob depositors and FDIC-insured financial institutions of millions of dollars. The OIG has an ongoing effort to identify, target, disrupt, and dismantle criminal organizations engaged in such schemes that target financial institutions and prey on the banking public. These schemes range from identity theft to Internet scams, such as "phishing" and "pharming." With the help of sophisticated technology, the OIG continues to work with the FDIC and other federal agencies to help with the detection of new fraud patterns and combat existing fraud.

Finally, this office works closely with the FDIC to identify individuals who have already committed financial institution crimes and are trying to avoid their obligations by concealing their assets. In many instances, the FDIC debtors who have been ordered to pay fines or restitution to the Corporation may not have the means to fulfill this obligation. However, some individuals do have the means but hide their assets or lie about their ability to pay. The OIG works closely with the FDIC in pursuing criminal investigations of these individuals.

Concluding Remarks

Unprecedented events and turmoil in the economy and financial services industry have impacted our operations. Given our resource limitations, I continue to review and reevaluate our risk-based decisions to provide the most appropriate coverage of FDIC programs and operations while maintaining our statutory responsibilities. Over the last 9 months, my office has stretched and leveraged its resources and has employed creative ways (i.e., reassigning staff, awarding contracts, refining auditing techniques, etc.) to accomplish its current workload. Based on the number of problem banks, we anticipate the number of required MLRs, based on current thresholds, will continue to grow. Depending on the level of this growth, my office may not be able to keep up. Considering our other statutory responsibilities and the high-risk activities I have detailed above, we are challenged to provide sufficient oversight. This level of exposure provides reason for concern, and without relief from the statutory MLR thresholds, the level of oversight could be further diminished.

Thank you again for allowing me to testify today. I appreciate the Subcommittee's interest in our work and look forward to continue to effectively and efficiently conduct work on behalf of the Congress, the FDIC, and the American public. This concludes my testimony. I welcome the opportunity to answer any questions that you might have.

STATEMENT OF HON. ERIC M. THORSON

INSPECTOR GENERAL

DEPARTMENT OF THE TREASURY

BEFORE THE HOUSE COMMITTEE ON FINANCIAL SERVICES

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

MAY 5, 2009

Chairman Moore, Ranking Member Biggert, and Members of the Subcommittee, thank you for the opportunity to appear before you this afternoon on the threshold requirement for the initiation of a material loss review after a financial institution has failed. I appreciate the Subcommittee's interest in this important topic.

I will begin with some background about my office. We provide independent audit and investigative oversight of the Department of the Treasury which includes numerous departmental offices, programs and operations, as well as the 8 non-Internal Revenue Service bureaus. Our oversight includes Treasury's financial institution regulators—the Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS). In addition to bank and thrift regulation, we provide oversight of Treasury's programs and operations to combat money laundering and terrorist financing, manage federal collections and payments systems, manage and account for the public debt, maintain government-wide financial accounting records, manufacture the Nation's currency and coins, collect revenue on alcohol and tobacco products and regulate those industries, and provide domestic assistance through the Community Development Financial Institutions Fund and international assistance through multilateral financial institutions. Our current on-board staffing level is 104 which breaks down as follows: 64 personnel in our Office of Audit and 21 personnel in our Office of Investigations. The remaining 19 personnel include my deputy, my legal counsel, our administrative support staff, and me. Our fiscal year 2009 budget appropriation is $26.1 million.

I do want to add that Treasury is unique among federal agencies in that it has two other Inspectors General. The Treasury Inspector General for Tax Administration provides audit and investigative oversight of IRS, and the Special Inspector General provides audit and investigative oversight of the Troubled Asset Relief Program.

Since the enactment of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), Inspectors General are required to perform material loss reviews, frequently referred to as MLRs, of failed banks. Specifically, when a financial institution fails and causes a material loss to the Deposit Insurance Fund (DIF), the Inspector General for the regulator of that failed institution must

complete within 6 months a review that ascertains the causes of the failure, assesses the regulator's supervision (including the use of the Prompt Corrective Action provisions in FDICIA), and makes recommendations to prevent similar failures in the future. Currently, a material loss is defined as the greater of $25 million or 2 percent of the institution's assets. That dollar threshold has not changed since 1991.

Material loss reviews are some of the most resource-intensive audits performed by our office. Among other things, the work entails looking at the regulator's examination reports and exam documentation going back to at least 1 exam cycle before problems at the failed institution began. In some cases this has required that we go back as far as 10 years. We also interview the examiners and their supervisors in the field office, regional or district office, and headquarters about the supervision exercised over the institution. Additionally, we interview officials and staff at the Federal Deposit Insurance Corporation (FDIC) as to the causes of the failure and we look at pertinent bank records in the possession of the FDIC. This is a thumbnail sketch of the kind of work performed on all MLRs. That said, where necessary, we expand certain areas of work given the unique circumstances of each failure. For example, one recent failure, IndyMac Bank, FSB, required that we review a number of loan files to get a better understanding of the issues related to the nature of loan products offered by the thrift as well as underwriting and appraisal practices.

Beginning with the failure of NetBank in September 2007, 20 Treasury-regulated (OCC or OTS) banks and thrifts have failed during the current economic crisis as of May 1, 2009. Sixteen (16) of those failed institutions met the material loss review threshold. The estimated loss for those 16 failures totals approximately $16.8 billion. To date, we have completed 6 reviews and have 10 others in progress. Additionally, while it does not meet the criteria for an MLR, we have also initiated a joint project with FDIC's Office of Inspector General to review the federal supervision of Washington Mutual Bank. Specifically, in September 2008, FDIC facilitated the sale of Washington Mutual Bank to JP Morgan Chase in an open bank transaction that resulted in no loss to the DIF. Given Washington Mutual's size (combined assets of $307 billion), circumstances leading up to the FDIC-facilitated transaction, and non-DIF losses, Inspector General Rymer and I believe that a review of OTS and FDIC supervision is warranted.

To provide perspective to our current workload, for the first 16 years after FDICIA was enacted, our office was tasked with 5 required MLRs. Furthermore, before NetBank's demise in September 2007, it had been 5 years since we had last been required to perform an MLR. And, until now, there was only one time, in 2001 and 2002, where we were required to perform concurrent MLRs. By all measures, the current number of institutions requiring MLRs by our office is unprecedented. The size of the losses -- $10.7 billion for IndyMac and $1.4 billion for Downey – are

unprecedented as well. Furthermore, we are concerned that this unfortunate trend could continue.

To meet our material loss review requirements, we have shifted practically all of our discretionary audit resources to this work. That means that we have either shut down or indefinitely deferred nearly all critical audits in other Treasury high-risk programs. I will discuss a few exceptions to that statement before discussing the work we have had to stop and defer.

The first exception deals with a situation that came to our attention during our recent material loss review of IndyMac. Specifically, in its review of IndyMac, the Securities and Exchange Commission came across a workpaper prepared by IndyMac's independent auditor which indicated that a senior OTS official approved a capital contribution to be backdated to a previous quarter so that the thrift would maintain its well-capitalized position for that quarter. Less than 4 months later, IndyMac failed. Because of its potential significance to our material loss review, the workpaper was provided to our office through FDIC Inspector General Rymer. Our auditors and investigators followed-up and confirmed the events happened as described in the workpaper. Through this work, we also learned that OTS permitted, and in one case directed, other thrifts to backdate capital contributions. As a result of our inquiry into this matter, OTS removed the senior official involved with the IndyMac backdated capital contribution. That individual has since retired from federal service. As a result of another backdating, the one directed by OTS, the Acting Director of OTS was placed on administrative leave pending a Departmental review. We are currently wrapping up the results of the broader audit of OTS's involvement with the backdated capital contributions. So far, including the two backdated capital contributions already discussed, OTS has identified to us six institutions where backdating occurred.

Another exception deals with the enormous spending authorized by the American Recovery and Reinvestment Act of 2009 and the need to ensure accountability and transparency in the use of those funds to achieve their intended purpose. As you know, the Inspector General community has been called upon to provide vigorous oversight over the Recovery Act funds, with my office being no exception. In fact, I am one of 10 Inspectors General who serve on the Recovery Accountability and Transparency Board. The Board, established under the Recovery Act, coordinates and conducts oversight of funds distributed under the act in order to prevent fraud, waste, and abuse. Toward this end, I have dedicated a small cadre of auditors to work in conjunction with the Treasury Inspector General for Tax Administration to advise the Department on setting up proper controls and safeguards for more than $4 billion in new grant programs for low-income housing and energy property that are in lieu of tax credits. I see this as one of the highest priorities of my office. However, it is a delicate balancing act to properly resource our mandated work related to failed banks while providing appropriate coverage to Recovery Act oversight at the same time.

Examples of work that we shut down include the following audits in Treasury's anti-money laundering and terrorist financing mission:

- an assessment of the quality of suspicious activity reports filed by financial institutions with the Financial Crimes Enforcement Network
- the events that led to the failed FinCEN effort to develop the BSA Direct system
- OCC's Bank Secrecy Act examination program for private banking services operated by national banks (a prior audit in 2001 identified weaknesses in the examination coverage of this high risk area for money laundering)
- a review of the Treasury Executive Office for Asset Forfeiture's national seized property contract, which had been requested by Treasury management.

An example of work we have deferred in this mission area is an assessment of the effectiveness of FinCEN's memoranda of understanding with financial institution regulators to share information—these memoranda are critical to FinCEN's Bank Secrecy Act administration responsibilities as it does not have direct line authority over these regulators.

In addition to work we have had to shut down or deferred in the area of anti-money laundering, chronic resource challenges have made it difficult for us to provide adequate oversight coverage of several other Treasury high-risk areas for a number of years. For example, we have not conducted any recent performance audits of public debt programs or Treasury payments systems. These programs and systems involve trillions of dollars. This gives us serious concern because with the current financial crisis facing our nation, other recently enacted legislation also demands our vigorous oversight. An example of such recently enacted legislation, in addition to the new $4 billion Recovery Act programs that were discussed above, is the Housing and Economic Recovery Act of 2008. Through that legislation Treasury has taken on an important role to complement the Federal Housing Finance Agency's September 2008 decision to place Fannie Mae and Freddie Mac in conservatorship. Specifically, Treasury did three things. First, Treasury agreed to purchase senior preferred stock in the companies as necessary to ensure each company maintains a positive net worth. Second, it established a new secured lending credit facility that will be available to the two companies, as well as the Federal Home Loan Banks, for short-term loans. And third, to further support the availability of mortgage financing, Treasury initiated a temporary program to purchase new mortgage backed securities issued by the companies. The financial commitment to Fannie and Freddie is significant and involves hundreds of billions of dollars.

We are also mindful that the wave of bank failures that started in 2007 underscore the need for increased prospective reviews in the area of banking regulation. A

material loss review is a backward look at the quality of supervision as it relates to a failed institution under review. There is no question that this work provides important information to the Department, OCC and OTS, and the Congress about supervisory processes and where they need to be strengthened. That said, we believe that it is also important, if not more so, for regulators to address emerging risks in financial markets and products. The subprime mortgage crisis is a costly lesson that serves to remind us that regulators need to anticipate, recognize, and control business practices that create unreasonable risk. That brings to mind another area that we would like to look at but cannot at this time is OTS's supervisory role with respect to American International Group (AIG) and other large, complex global financial institutions. My office needs to be positioned to inform and assist the regulatory process through independent and forward looking reviews.

Having discussed the challenges of our office in meeting our oversight responsibilities, I also want to take this opportunity to bring to the Subcommittee's attention that our fiscal year 2009 appropriations enacted in March of this year provided us with an additional $6.8 million for material loss reviews and other important work. We appreciate the support and confidence of the Congress in providing us with that additional funding to help meet our mandated workload. In that regard, we are aggressively recruiting staff to stand up two new audit divisions that will be dedicated to MLR and as resources permit, other banking and Recovery Act work. We expect to have all positions filled in early fiscal year 2010 and when done we should be in a much better position to address our mandated work and other oversight challenges discussed above. However, I do want to add the caveat that the numbers and complexities of expected bank failures still to come are not known. So, in the short term, we may find it difficult, if not impossible, to complete all MLRs within the mandated timeframe if several more concurrent MLRs come due in a short period of time.

Before I comment on Chairman's Moore's proposed amendment to S. 383, I would like to finish my discussion of our resource challenges by recognizing the hard work done by my staff to complete timely MLRs, and concurrently meet our financial audit mandates under the Chief Financial Officers Act and Government Management Reform Act as well as our review requirements under the Federal Information Systems Management Act. These achievements were possible only through the dedication of a fine group of people and their willingness to put in long hours and make other sacrifices to get the job done. I am truly proud of our office in this regard.

With respect to the Chairman's proposal, I endorse increasing the threshold for material loss to between $300 million and $500 million, which is in line with the threshold of $400 million in S. 383. In January 2009, Inspectors General Coleman and Rymer and I signed joint letters to the Committee on Financial Services and the Senate Committee on Banking, Housing and Urban Affairs suggesting that

Congress consider increasing the thresholds for conducting MLRs and that doing so would better serve our offices and the Congress, and still meet the intent of FDICIA. We recommended in our letter modifying the threshold for a material loss to increase from $25 million to somewhere between $300 and $500 million. We also recommended language that would allow the OIG to undertake an MLR of an institution with a projected loss below the increased threshold, should circumstances (e.g., new, non-conventional financial products or indications of fraud) warrant.

Looking at our current inventory of in-progress MLRs, had the threshold of material loss been somewhere from $300 million to $500 million, it would have had the effect of reducing the number of required MLRs drastically. This change would allow our office to free up resources to re-focus efforts on other risky programs and initiatives that Treasury and its bureaus are now dealing with.

I am providing the following table showing the numbers of MLRs that would be required by our office for the total universe of failed banks and thrifts since January 1, 2007, through April 30, 2009, at various thresholds, ranging from the current threshold of $25 million up to $500 million.

Table: Threshold Analysis of Treasury-Regulated Failed Institutions Requiring an MLR

	Treasury Regulator		
Threshold Amount	**OCC**	**OTS**	**Total**
$25 million (Current)	8	8	16
$100 million	4	6	10
$200 million	4	3	7
$300 million	3	3	6
$400 million (Proposed)	3	3	6
$500 million	3	3	6

Note: The threshold analysis is based on the latest available loss estimates by FDIC as of May 1, 2009.

Furthermore, under the proposed amendment, we would also be required every 6 months to review all losses incurred by the DIF from bank failures and determine, for losses that are under the $400 million threshold, whether there might be unusual circumstances about the failure that would warrant an in-depth review. I think this is a very prudent measure given the threshold increase under consideration.

In closing, I again want to express my appreciation for the Subcommittee's interest in this topic. Our office fully supports the effort to increase the MLR threshold and I believe the amendment represents a practical solution. I would also like to point out the excellent relationship I have with Inspectors General Rymer and Coleman. Over

the years, our respective offices have forged strong bonds in addressing numerous matters of mutual interest. For example, soon after FDICIA was enacted, we developed a common methodology for conducting MLRs and implemented through a memorandum of understanding a mechanism for coordinating MLR work in our respective agencies as necessary. As I mentioned above, FDIC OIG and my office are working together on a joint review of the Washington Mutual failure. We were also assisted on our material loss review of IndyMac by two FDIC OIG personnel. Also, just last February, our offices co-hosted a week long MLR training conference for our auditors and investigations at FDIC. These are just a few examples of what I consider one of the best professional working relationships between agencies in the federal government.

This concludes my testimony; I would be pleased to answer any questions the Subcommittee may have.