Office of Inspector General

March 2005
Supplement to Audit Report No. 04-035
Dated September 13, 2004

Repurchases of Superior Federal, FSB, Loan Assets Sold to Beal Bank

This supplement contains copies of correspondence between the Office of Inspector General (OIG) and the Division of Resolution and Receivership (DRR) subsequent to the issuance of Audit Report No. 04-035, dated September 13, 2004. The intent of this supplement is to show resolution of recommendations that were unresolved at the time the OIG issued the final report.

Office of Audits

OIG

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I. OIG Assessment of Audit Committee Final Action and DRR Corrective Action

FDIC

Federal Deposit Insurance Corporation
801 17th Street NW, Washington, DC 20434

Office of Audits
Office of Inspector General

DATE: March 15, 2005

MEMORANDUM TO: Mitchell L. Glassman, Director
Division of Resolutions and Receiverships

FROM: Russell A. Rau
Assistant Inspector General for Audits

SUBJECT: OIG Assessment of Final Action of the Audit Committee and DRR Corrective Action Related to OIG Report Entitled, *Repurchases of Superior Federal, FSB, Loan Assets Sold to Beal Bank* (Report No. 04-035, dated September 13, 2004)

At a January 18, 2005 Audit Committee meeting, the Committee determined that the Division of Resolutions and Receiverships (DRR) could and should make improvements in documenting its business decisions, including those related to due diligence performed in relation to the terms and conditions under which assets are sold. The Committee instructed DRR to amend its policies and procedures accordingly.

DRR's subsequent policy revision to the *Bridge Bank Manual* states that bridge bank policies should include procedures for documenting business decisions and must be appropriately distributed to bridge bank management and FDIC personnel working with the bridge bank. As a result of the Audit Committee's determinations and DRR's policy revision, we consider the report's two recommendations to be resolved, dispositioned, and closed.

cc: James H. Angel, Jr., OERM
Susan Whited, DRR

II. Report of Final Action of the Audit Committee

FDIC
Federal Deposit Insurance Corporation
550 17th Street, NW, Washington, DC 20429

Office of the Vice Chairman

John M. Reich • Vice Chairman

202/898-3888
FAX 202/898-3778

DATE: February 7, 2005

MEMORANDUM TO: Donald E. Powell, Chairman
Patricia Black, Acting Inspector General

FROM: John M. Reich, Vice Chairman and
Chairman, FDIC Audit Committee

SUBJECT: Report of Final Action of the Audit Committee:
re: OIG Audit: *Repurchases of Superior Federal, FSB, Loan Assets Sold to Beal Bank* (Report No. 04-035):

At the FDIC Audit Committee meeting held on Friday, September 17, 2004, the Committee received the Office of Inspector General (OIG) Audit Report on *Repurchases of Superior Federal, FSB, Loan Assets Sold to Beal Bank.*[1] The audit focused on loan sale transactions executed between New Superior and Beal Bank. The primary objectives of the OIG audit were to determine whether the Division of Resolutions and Receivership (DRR) adequately:

1) developed loan sales agreements;
2) conducted due diligence;
3) prepared loan sale cases; and
4) processed loan sale repurchases related to the sales of New Superior's loan assets.

OIG's field audit work took place in Washington, DC and Dallas from December, 2003 through March, 2004. In addition, during the last seven months, OIG and DRR staffs have exchanged extensive information as part of an effort to resolve differences of opinion between OIG and DRR management. Draft audit reports became final with the audit report dated September 13, 2004. Since that time, DRR management -- to counter the findings expressed in the report -- has continued to develop additional information for OIG staff.

A central point of disagreement between DRR management and OIG is the inference that DRR exercised inadequate due diligence in its loan packaging, pre-pricing, and in its decision to develop and utilize non-standard Loan Servicing Agreements (LSA's) that contained representations and warranties which were more comprehensive than those included in the FDIC's standard LSA.

[1]As background, on July 27, 2001, the Office of Thrift Supervision (OTS) closed Superior Bank, FSB (Old Superior) and named the FDIC as receiver for the failed institution. Concurrently, the OTS chartered a new institution, New Superior, and appointed the FDIC as conservator to operate the institution. FDIC's policies regarding the operations of a conservatorship are contained in DRR's *Bridge Bank Manual*, revised May 24, 2004. During the conservatorship period (July 27, 2001 until May 31, 2002), New Superior sold residential mortgage loans to Beal Bank through three separate sales. This audit report evaluated DRR's handling of those transactions.

Following a lengthy discussion of this audit report and the issues presented, the Audit Committee tabled further consideration of the report to provide additional time for OIG and DRR staffs to reach consensus on the disputed audit findings and recommendations. During the Audit Committee meeting held on December 9, 2004, the parties reported to the Committee that they were unable to reach a consensus on the outstanding issues.

Subsequently, as Chairman of the Audit Committee, I met with representatives of both OIG and DRR on multiple occasions to hear their positions on audit findings and recommendations to which DRR management has not agreed.

After considering all available information provided during a meeting of the Audit Committee held on January 18, 2005, the Committee determined that, although improvements can and should be implemented by DRR in documentation and the documenting of its decisions, which should include due diligence performed in relation to the terms and conditions under which assets are sold, and DRR is hereby instructed to amend its policies accordingly; furthermore the Committee was unable to conclude that DRR did not exercise reasonable due diligence in its actions relating to loan packaging, pre-pricing, and in the development of its representations and warranties.

cc: James Gilleran
John Bovenzi
Steve App
Jodey Arrington
Mitchell Glassman
James Angel