

TO INSTRUCT THE INSPECTOR GENERAL OF THE FEDERAL DEPOSIT INSURANCE CORPORATION TO STUDY THE IMPACT OF INSURED DEPOSITORY INSTITUTION FAILURES, AND FOR OTHER PURPOSES

JULY 26, 2011.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. BACHUS, from the Committee on Financial Services,  
submitted the following

R E P O R T

[To accompany H.R. 2056]

[Including cost estimate of the Congressional Budget Office]

The Committee on Financial Service, to whom was referred the bill (H.R. 2056) to instruct the Inspector General of the Federal Deposit Insurance Corporation to study the impact of insured depository institution failures, and for other purposes, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment is as follows:

Strike all after the enacting clause and insert the following:

**SECTION 1. INSPECTOR GENERAL STUDY.**

(a) **STUDY.**—The Inspector General of the Federal Deposit Insurance Corporation (FDIC) shall conduct a comprehensive study on the impact of the failure of insured depository institutions.

(b) **DEFINITIONS.**—For purposes of this Act—

(1) the term “insured depository institution” has the meaning given such term in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c));

(2) the term “private equity company” has the meaning given the terms “hedge fund” and “private equity fund” in section 13(h)(2) of the Bank Holding Company Act of 1956 (12 U.S.C. 1851(h)(2)); and

(3) the term “paper-loss” means any write down on a performing asset held by an insured depository institution that causes such institution to raise more capital in order to cover the write down.

(c) **MATTERS TO BE STUDIED.**—In conducting the study under this section, the Inspector General shall address the following:

(1) **LOSS-SHARING AGREEMENTS.**—The effect of loss-sharing agreements (LSAs), including—

(A) the impact of loss-sharing on the insured depository institutions that survive and the borrowers of insured depository institutions that fail, including—

- (i) the impact on the rate of loan modifications and adjustments;
- (ii) whether more types of loans (such as commercial (including land development and 1- to 4-family residential and commercial construction

- loans), residential, or small business loans) could be modified with fewer LSAs, or if LSAs could be phased out altogether;
- (iii) the FDIC's policies and procedures for monitoring LSAs, including those designed to ensure institutions are not imprudently selling assets at a depressed value;
- (iv) the impact on the availability of credit; and
- (v) the impact on loans with participation agreements outstanding with other insured depository institutions;
- (B) the FDIC's policies and procedures for terminating LSAs and mitigating the risk of acquiring institutions having substantial assets remaining in their portfolio when the LSAs are due to expire;
- (C) the extent to which LSAs provide incentives for loan modifications and other means of increasing the probability of commercial assets being considered "performing";
- (D) the nature and extent of differences for modifying residential assets and working out commercial real estate under LSAs; and
- (E) methods of ensuring the orderly end of expiring LSAs to prevent any adverse impact on borrowing, real estate industry and the Depositors Insurance Fund.
- (2) PAPER LOSSES.—The significance of paper losses, including—
- (A) the number of insured depository institutions that have been placed into receivership or conservatorship due to paper losses;
- (B) the impact on paper losses of raising more capital;
- (C) the effect of changes in the application of the fair value of real estate accounting rules and other accounting standards;
- (D) whether field examiners are using proper appraisal procedures with respect to paper losses; and
- (E) methods of stopping the vicious downward spiral of losses and write downs.
- (3) APPRAISALS.—
- (A) The number of insured depository institutions placed into receivership or conservatorship due to asset write-downs and the policies and procedures for evaluating the adequacy of an insured depository institution's allowance for loan and lease losses.
- (B) The policies and procedures examiners use for evaluating the appraised values of property securing real estate loans and the extent to which those policies and procedures are followed.
- (C) FDIC field examiner implementation of guidance issued December 2, 2010, titled "Agencies Issue Final Appraisal and Evaluation Guidelines".
- (4) CAPITAL.—
- (A) The factors that examiners use to assess the adequacy of capital at insured depository institutions, including the extent to which the quality and risk profile of the insured institution's loan portfolio is considered in the examiners' assessment.
- (B) The number of applications received by the FDIC from private capital investors to acquire insured depository institutions in receivership, the factors used by the FDIC in evaluating the applications, and the number of applications that have been approved or not approved, including the reasons pertaining thereto.
- (C) The policies and procedures associated with the evaluation of potential private investments in insured depository institutions and the extent to which those policies and procedures are followed.
- (5) WORKOUTS.—The success of FDIC field examiners in implementing FDIC guidelines titled "Policy Statement on Prudent Commercial Real Estate Loan Workouts" (October 31, 2009) regarding workouts of commercial real estate, including—
- (A) whether field examiners are using the correct appraisals; and
- (B) whether there is any difference in implementation between residential workouts and commercial (including land development and 1- to 4-family residential and commercial construction loans) workouts.
- (6) ORDERS.—The application and impact of consent orders and cease and desist orders, including—
- (A) whether such orders have been applied uniformly and fairly across all insured depository institutions;
- (B) the reasons for failing to apply such orders uniformly and fairly when such failure occurs;
- (C) the impact of such orders on the ability of insured depository institutions to raise capital;

- (D) the impact of such orders on the ability of insured depository institutions to extend or modify credit to existing and new borrowers; and
- (E) whether individual insured depository institutions have improved enough to have such orders removed.
- (7) FDIC POLICY.—The application and impact of FDIC policies, including—
  - (A) the impact of FDIC policies on the investment in insured depository institutions, especially in States where more than 10 such institutions have failed since 2008;
  - (B) whether the FDIC fairly and consistently applies capital standards when an insured depository institution is successful in raising private capital; and
  - (C) whether the FDIC steers potential investors away from insured depository institutions that may be in danger of being placed in receivership or conservatorship.
- (8) PRIVATE EQUITY COMPANIES.—The FDIC’s handling of potential investment from private equity companies in insured depository institutions, including—
  - (A) the number of insured depository institutions that have been approved to receive private equity investment by the FDIC;
  - (B) the number of insured depository institutions that have been rejected from receiving private equity investment by the FDIC; and
  - (C) the reasons for rejection of private equity investment when such rejection occurs.
- (d) REPORT.—Not later than one year after the date of the enactment of this Act, the Inspector General shall submit to Congress a report—
  - (1) on the results of the study conducted pursuant to this section; and
  - (2) any recommendations based on such study.
- (e) COORDINATION BETWEEN FDIC IG, TREASURY IG, AND FEDERAL RESERVE IG.—In carrying out this section, the Inspector General of the FDIC shall consult with the Inspectors General of the Treasury and of the Federal Reserve System, and such Inspectors General shall provide any documents or other material requested by the Inspector General of the FDIC in order to carry out this section.

#### SEC. 2. FUNDING.

The FDIC shall make available from the portion of the FDIC budget allocated to management expenses, sums allowing the FDIC Inspector General to complete this study.

#### SEC. 3. GAO STUDY.

- (a) STUDY.—The Comptroller General of the United States shall carry out a study on the following:
  - (1) The causes of high levels of bank failures in states with 10 or more failures since 2008.
  - (2) The procyclical impact of fair value accounting standards.
  - (3) The causes and potential solutions for the “vicious cycle” of loan write downs, raising capital, and failures.
  - (4) An analysis of the community impact of bank failures.
  - (5) The feasibility and overall impact of loss share agreements.
- (b) REPORT.—Not later than the end of the 1-year period beginning on the date of the enactment of this Act, the Comptroller General shall issue a report to the Congress on the study carried out pursuant to subsection (a).

#### PURPOSE AND SUMMARY

The purpose of H.R. 2056 is to instruct the Inspector General of the Federal Deposit Insurance Corporation (FDIC) to investigate and report on the impact of the procedures used by the FDIC to resolve failed depository institutions. In addition, H.R. 2056 instructs the Government Accountability Office (GAO) to analyze underlying economic causes and effects of the high level of bank failures since 2008. Both the Inspector General of the FDIC and the GAO must make reports to Congress on the results of their respective studies no later than one year after enactment of H.R. 2056.

H.R. 2056 instructs the Inspector General of the FDIC to address the following: (1) the effect of loss-sharing agreements; (2) the significance of paper losses (i.e., asset write downs that force depository institutions to raise more capital); (3) the consistency of procedures used by examiners for appraising collateral values; (4) the

factors examiners consider when assessing capital adequacy; (5) the success of FDIC field examiners in implementing FDIC guidelines for commercial real estate workouts; (6) the impact of cease and desist orders on troubled institutions; (7) the FDIC's procedures for evaluating potential private investment in insured depository institutions; and (8) the impact of the FDIC's policies on private investment in insured depository institutions.

H.R. 2056 further instructs the GAO to address the causes of the recent rash of bank failures and to evaluate the impact of these failures on local communities. Also, to address the impact of fair value accounting, the GAO must suggest potential solutions for the cyclical nature of asset write downs and depository institution failures.

#### BACKGROUND AND NEED FOR LEGISLATION

After a six-year period in which only 35 banks failed nationwide, the pace of bank failures increased dramatically in the past two years: 140 institutions failed in 2009, while 157 failed in 2010. These failures have been concentrated in certain states; since 2008, ten states have had more than ten bank failures. The rash of bank failures has led some to question whether the FDIC's procedures for resolving troubled banks are appropriate in light of current economic conditions and whether these procedures have been consistently applied in the wake of the financial crisis.

H.R. 2056, introduced by Representative Westmoreland, addresses these concerns by directing the Inspector General of the FDIC and the GAO to thoroughly study and report on a wide range of policies and procedures used by the FDIC in its supervision of troubled and failing institutions.

#### HEARINGS

The Subcommittee on Financial Institutions and Consumer Credit held a legislative hearing on July 8, 2011 entitled "Legislative Proposals Regarding Bank Examination Practices." The following witnesses testified:

- Mr. James H. McKillop, President and CEO, Independent Bankers Bank of Florida on behalf of the Independent Community Bankers of America
- Mr. Michael Whalen, President and CEO, Heart of America Group
- Professor Simon Johnson, Ronald A. Kurtz Professor of Entrepreneurship at the Massachusetts Institute of Technology's Sloan School of Management
- Mr. George French, Deputy Director, Division of Risk Management Supervision, Federal Deposit Insurance Corporation
- Ms. Jennifer Kelly, Senior Deputy Comptroller for Mid-Size/Community Bank Supervision, Office of the Comptroller of the Currency

#### COMMITTEE CONSIDERATION

The Committee on Financial Services met in open session on July 20, 2011 and ordered H.R. 2056, as amended, favorably reported to the House by voice vote.

## COMMITTEE VOTES

Clause 3(b) of rule XIII of the Rules of the House of Representatives requires the Committee to list the record votes on the motion to report legislation and amendments thereto. There were no record votes taken on amendments or in connection with ordering H.R. 2056 reported to the House. A motion by Chairman Bachus to report the bill, as amended, to the House with a favorable recommendation was agreed to by voice vote.

During consideration of H.R. 2056, the following amendment and motion were considered by the Committee:

1. An amendment offered by Messrs. Westmoreland and Scott of GA and Mrs. Maloney, no. 1, to make technical changes, to require a separate study by the U.S. Comptroller General, and to require participation and coordination from the Inspectors General of the Treasury and Federal Reserve System with the Inspector General of the FDIC in completing the study, was agreed to by voice vote.

2. A motion offered by Mr. Bachus to move the previous question on H.R. 2056 was agreed to by voice vote.

## COMMITTEE OVERSIGHT FINDINGS

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the Committee has held hearings and made findings that are reflected in this report.

## PERFORMANCE GOALS AND OBJECTIVES

Pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee establishes the following performance related goals and objectives for this legislation:

The purpose of H.R. 2056 is to instruct the Inspector General of the Federal Deposit Insurance Corporation (FDIC) to investigate and report on the impact of the procedures used by the FDIC to resolve failed depository institutions. In addition, H.R. 2056 instructs the Government Accountability Office (GAO) to analyze underlying economic causes and effects of the high level of bank failures since 2008. Both the Inspector General of the FDIC and the GAO must make reports to Congress on the results of their respective studies no later than one year after enactment of H.R. 2056.

H.R. 2056 instructs the Inspector General of the FDIC to address the following: (1) the effect of loss-sharing agreements; (2) the significance of paper losses (i.e., asset write downs that force depository institutions to raise more capital); (3) the consistency of procedures used by examiners for appraising collateral values; (4) the factors examiners consider when assessing capital adequacy; (5) the success of FDIC field examiners in implementing FDIC guidelines for commercial real estate workouts; (6) the impact of cease and desist orders on troubled institutions; (7) the FDIC's procedures for evaluating potential private investment in insured depository institutions; and (8) the impact of the FDIC's policies on private investment in insured depository institutions.

H.R. 2056 further instructs the GAO (1) to address the causes of the recent rash of bank failures, (2) to evaluate the impact of these failures on local communities, and (3) to address the impact of fair value accounting with suggestions on potential solutions for the cy-

clical nature of asset write downs and depository institution failures.

NEW BUDGET AUTHORITY, ENTITLEMENT AUTHORITY, AND TAX  
EXPENDITURES

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee adopts as its own the estimate of new budget authority, entitlement authority, or tax expenditures or revenues contained in the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

COMMITTEE COST ESTIMATE

The Committee adopts as its own the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

CONGRESSIONAL BUDGET OFFICE ESTIMATES

Pursuant to clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the following is the cost estimate provided by the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974:

JULY 26, 2011.

Hon. SPENCER BACHUS,  
*Chairman, Committee on Financial Services,  
House of Representatives, Washington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 2056, a bill to instruct the Inspector General of the Federal Deposit Insurance Corporation to study the impact of insured depository institution failures, and for other purposes.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Dan Hoople.

Sincerely,

DOUGLAS W. ELMENDORF.

Enclosure.

*H.R. 2056—A bill to instruct the Inspector General of the Federal Deposit Insurance Corporation to study the impact of insured depository institution failures, and for other purposes*

H.R. 2056 would direct the Government Accountability Office (GAO) and the Inspector General of the Federal Deposit Insurance Corporation (FDIC) to study and report to the Congress on several matters relating to bank failures. Expenses of the FDIC are classified as direct spending; therefore, pay-as-you-go procedures would apply. However, CBO estimates that any costs incurred by the Inspector General would be offset by premiums collected from insured depository institutions, resulting in no net effect on direct spending over the next five years. Enacting this legislation would not affect revenues. CBO estimates that any additional cost to GAO would also be insignificant.

The bill contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act and would not affect the budgets of state, local, or tribal governments.

H.R. 2056 would direct the Inspector General of the FDIC to conduct a study on several matters relating to bank failures, including: loss-share agreements, accounting methodologies, factors used to assess the adequacy of bank capital, and agency policies and procedures. The Inspector General would be required to report to the Congress no later than one year after enactment. Resources to conduct such a study would be derived from the Deposit Insurance Fund.

The legislation also would direct the GAO to conduct a study on the causes of certain bank failures, the impact of bank failures on communities, the effectiveness of loss-share agreements, and fair value accounting standards. The GAO would report findings and recommendations to the Congress no later than one year after enactment. CBO estimates that completing this study would cost less than \$500,000 in 2012, subject to the availability of appropriated funds.

The CBO staff contact for this estimate is Dan Hoople. The estimate was approved by Theresa Gullo, Deputy Assistant Director for Budget Analysis.

#### FEDERAL MANDATES STATEMENT

The Committee adopts as its own the estimate of Federal mandates prepared by the Director of the Congressional Budget Office pursuant to section 423 of the Unfunded Mandates Reform Act.

#### ADVISORY COMMITTEE STATEMENT

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

#### APPLICABILITY TO LEGISLATIVE BRANCH

The Committee finds that the legislation does not relate to the terms and conditions of employment or access to public services or accommodations within the meaning of the section 102(b)(3) of the Congressional Accountability Act.

#### EARMARK IDENTIFICATION

H.R. 2056 does not contain any congressional earmarks, limited tax benefits, or limited tariff benefits as defined in clause 9 of rule XXI.

#### SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

##### *Section 1. Inspector General study*

This section defines the terms “insured depository institution,” “private equity company,” and “paper-loss.” It requires the FDIC’s Inspector General to study eight issues raised by bank failures.

The first matter to be studied pertains to loss-sharing agreements. The study is directed to address: (1) the impact of loss-sharing agreements on the insured depository institutions that survive and the borrowers of those institutions that fail; (2) the FDIC’s policies and procedures for terminating loss-sharing agreements and mitigating the risk of acquiring institutions having substantial

assets remaining in their portfolio when the agreements are near expiration; (3) the extent to which loss-sharing agreements provide incentives for loan modifications and other means of increasing the probability of commercial assets being considered “performing”; (4) the nature and extent of differences for modifying residential assets and working out commercial real estate under loss-sharing agreements; and (5) methods of ensuring the orderly wind-down of expiring loss-sharing agreements to prevent any adverse impact on borrowing, real estate, and the Deposit Insurance Fund.

The second matter to be studied pertains to paper losses. The study is directed to address: (1) the number of insured depository institutions that have been placed into receivership or conservatorship due to paper losses; (2) the impact that raising more capital could have on paper losses; (3) the effect of changing the application of fair value of real estate accounting rules and other accounting standards; (4) whether field examiners are using proper appraisal procedures with respect to paper losses; and (5) methods of stopping losses and write downs.

The third matter to be studied pertains to appraisals. The study is directed to address: (1) the number of insured depository institutions placed into receivership or conservatorship due to asset write-downs and the policies and procedures for evaluating the adequacy of an insured depository institution’s allowance for loan and lease losses; (2) the policies and procedures examiners use for evaluating the appraised values of property securing real estate loans and the extent to which those policies and procedures are followed; and (3) FDIC field examiner implementation of guidance issued December 2, 2010, titled “Agencies Issue Final Appraisal and Evaluation Guidelines.”

The fourth matter to be studied pertains to capital, and is required to address: (1) the factors that examiners use to assess the adequacy of capital at insured depository institutions; (2) the number of applications received and approved by the FDIC from private capital investors to acquire insured depository institutions in receivership and the factors used in evaluating the applications; and (3) the policies and procedures associated with the evaluation of potential private investments in insured depository institutions and whether they are followed.

The fifth matter to be studied pertains to workouts, and is required to address the success of FDIC field examiners in implementing FDIC guidelines regarding workouts of commercial real estate loans, including whether field examiners are using correct appraisals and whether there is a difference in implementation between residential and commercial workouts.

The sixth matter to be studied pertains to the application and impact of consent orders and cease and desist orders. The study is directed to address: (1) whether these orders have been applied uniformly and fairly across all insured depository institutions; (2) the reasons for failing to apply uniform and fair orders when failures occur; (3) the impact of those orders on the ability of insured depository institutions to raise capital; (4) the impact of the orders on insured depository institutions’ ability to extend or modify credit to existing and new borrowers; and (5) whether individual insured depository institutions have improved enough to have the orders removed.

The seventh matter to be studied pertains to the application and impact of FDIC policies, including: (1) their impact on the investment in insured depository institutions, especially in states where more than ten such institutions have failed since 2008; (2) whether the FDIC fairly and consistently applies capital standards when such institutions are successful in raising private capital; and (3) whether the FDIC steers potential investors away from insured depository institutions that may be in danger of being placed in receivership or conservatorship.

The eighth and final matter to be studied pertains to the FDIC's handling of potential private equity investment in insured depository institutions, including the number of insured depository institutions that have been (1) approved to receive private equity investment by the FDIC and (2) rejected from receiving private equity investment by the FDIC and the reasons for those rejections.

The FDIC Inspector General is required to submit the results of the study and any recommendations to Congress within a year of the bill's enactment. The Inspector General is also required to consult with the Inspectors General of the Treasury and of the Federal Reserve System, and they are required to provide any documents or other material requested by the FDIC Inspector General in order to carry out this section.

#### *Section 2. Funding*

This section requires the FDIC to make available from its management expenses such sums as necessary to allow the FDIC Inspector General to complete the study.

#### *Section 3. GAO study*

This section requires the GAO to carry out a study on the following: (1) the causes of high levels of bank failures in states with ten or more failures since 2008; (2) the procyclical impact of fair value accounting standards; (3) the causes and potential solutions for the cycle of loan write downs, capital raises, and failures; (4) an analysis of the community impact of bank failures; and (5) the feasibility and overall impact of loss-share agreements.

The GAO is required to submit a report on this study to Congress within a year of the bill's enactment.