Office of Inspector General Semiannual Report to Congress

April 1, 2011 – September 30, 2011

Board of Governors of
the Federal Reserve System

Consumer Financial
Protection Bureau

Message from the Inspector General

On behalf of the Office of Inspector General (OIG) of the Board of Governors of the Federal Reserve System (Board) and the Bureau of Consumer Financial Protection (Bureau), I am pleased to present our *Semiannual Report to Congress* highlighting our accomplishments and ongoing work for the six-month period ending September 30, 2011.

On July 25, 2011, I was appointed the Inspector General of the Board and the Bureau. Since that time, I have made it a priority to meet with Board and Bureau officials to learn more about their operations and share my vision for the OIG. I have been very impressed by the hard-working and dedicated individuals with whom I have met, and I look forward to continuing to engage with all our stakeholders as we look for ways to bring more economy, efficiency, and effectiveness to both the Board and the Bureau.

The OIG is currently engaged in its planning process for next year. We are meeting with agency officials to gain their insight on the most pressing issues they face, which we will factor into our risk assessment of agency programs and activities when deciding which areas to review. Our ongoing work has specifically included the Bureau's startup efforts, and this will continue to be an area of focus for us as we plan for next year.

Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, I am a member of the Council of Inspectors General on Financial Oversight (CIGFO), which comprises the Inspectors General of several financial regulatory agencies and facilitates the sharing of information, with a focus on concerns that may apply to the broader financial sector and ways to improve financial oversight. The CIGFO generally meets quarterly. During this reporting period, the CIGFO issued its first annual report highlighting the concerns and recommendations of the member Inspectors General, as well as issues that may apply to the broader financial sector.

On a separate note, we were recently honored to receive two awards from the Council of the Inspectors General on Integrity and Efficiency. Our report on *The Federal Reserve's Section 13(3) Lending Facilities to Support Overall Market Liquidity: Function, Status, and Risk Management* won an Audit Award for Excellence, and several of our employees are members of an information technology team that won the Barry R. Snyder Joint Award for their collaborative work to make sweeping changes to OIG Federal Information Security Management Act review methodologies to improve agencies' cyber security infrastructures and controls.

I would like to thank all the OIG staff for their continued hard work and dedication, and I look forward to all that we will accomplish in the coming months.

Sincerely,

Mark Bialek

Mark Bialek
Inspector General
October 28, 2011

Semiannual Report to Congress

April 1, 2011 – September 30, 2011

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Highlights

Consistent with our responsibilities under the Inspector General Act of 1978, as amended (IG Act), and the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), we continued to promote the integrity, economy, efficiency, and effectiveness of the programs and operations of the Board of Governors of the Federal Reserve System (Board) and the Bureau of Consumer Financial Protection (Bureau or CFPB). The following are highlights of our work during this semiannual reporting period.

- **Review of the Board's Implementation of the Dodd-Frank Act.** We issued our report on the Board's progress in meeting its responsibilities under the Dodd-Frank Act. We found that the Board has implemented processes and taken significant steps to meet its Dodd-Frank Act responsibilities. The Board has drawn on expertise and resources from across the Federal Reserve System and has established an organizational structure with a senior staff position to coordinate its efforts. It has also developed and implemented the use of project reporting and tracking tools to facilitate management and oversight. The Board has completed studies and rulemakings, issued reports, and reorganized and created offices to meet its Dodd-Frank Act obligations, and Board project teams are continuing work on Dodd-Frank Act requirements, many of which require interagency involvement. Notwithstanding this progress, we identified a number of ongoing management challenges that the Board faces in implementing its substantial Dodd-Frank Act requirements efficiently and effectively.

- **Failed Bank Reviews.** Six Board-supervised banks failed during the reporting period, with total assets of about $3.8 billion and total losses to the Deposit Insurance Fund (DIF) estimated at $1.1 billion. The Dodd-Frank Act raised the materiality threshold for when the Office of Inspector General (OIG) is required to conduct a material loss review—currently losses to the DIF in excess of $200 million—but it also established a requirement to review each bank failure with a non-material loss to determine if unusual circumstances exist that warrant a more in-depth review. During this reporting period, we completed one material loss review and one in-depth review of a failed bank that exhibited unusual circumstances.

- **Review of CFPB Implementation Planning Activities.** Our office and the U.S. Department of the Treasury (Treasury) OIG jointly issued a report on the CFPB's implementation planning activities related to standing up the agency. The review found that the CFPB identified and documented implementation activities critical to standing up the agency's functions and necessary to address certain Dodd-Frank Act requirements. Furthermore, the CFPB developed and was implementing appropriate plans that supported ongoing operations as well as the July 21, 2011, transfer of employees and functions.

- **Summary Analysis of Failed Bank Reviews.** We analyzed failed state member bank reports that we issued between June 2009 and June 2011 to determine the common characteristics, circumstances, and emerging themes related to the cause of the bank failures and the Federal Reserve supervision of the failed institutions. Our analysis yielded a series of common observations, in addition to the economic decline, including (1) management pursuing robust growth objectives and making strategic choices that proved to be poor decisions; (2) rapid loan portfolio growth exceeding the bank's risk management capabilities and/or internal controls; (3) asset concentrations tied to commercial real estate (CRE) or construction, land, and land development (CLD) loans, which increased the bank's vulnerability to changes in the marketplace and compounded the risks inherent in individual loans; and (4) management failing to have sufficient capital to cushion mounting losses.

  As part of our review, we also conducted supplemental research and analysis to understand why certain institutions withstood the financial crisis better than others. We found that lower CRE and CLD concentration levels, strong capital positions, and minimal dependence on non-core funding were key differentiating characteristics. Our research also revealed a correlation between high CLD concentration levels and the likelihood of failure during the recent financial crisis.

- **Investigative Accomplishments**

  Savannah Real Estate Developer Sentenced for Fraud. A Savannah real estate developer was ordered to pay almost $2.4 million in restitution and was sentenced to 52 months in prison and 3 years supervised release in connection with a conspiracy to defraud the First National Bank, Savannah, Georgia, and other banks of over $2 million.

  Agricultural Business Owner Indicted on Fraud Charges. The owner of an Illinois agricultural business was indicted by a federal grand jury on one felony count of loan application fraud, two felony counts of bank fraud, and one felony count of wire fraud. The indictment alleges that the business owner provided false information to Peoples Bank and Trust, a Board-regulated institution, in order to secure a $10 million line of credit.

Introduction

Congress established the OIG as an independent oversight authority within the Board, the government agency component of the broader Federal Reserve System. In addition, the Dodd-Frank Act established the OIG as the independent oversight authority for the Bureau. Within this framework, the OIG conducts audits, investigations, and other reviews related to Board and Bureau programs and operations. By law, the OIG is not authorized to perform program functions.

Consistent with the IG Act, our office, as the OIG for the Board and the Bureau,

- conducts and supervises independent and objective audits, investigations, and other reviews related to Board and Bureau programs and operations;
- promotes economy, efficiency, and effectiveness within the Board and the Bureau;
- helps prevent and detect fraud, waste, abuse, and mismanagement in Board and Bureau programs and operations;
- reviews existing and proposed legislation and regulations and makes recommendations regarding possible improvements to Board and Bureau programs and operations; and
- keeps the Board of Governors, the Director of the Bureau, and Congress fully and timely informed.

Congress has also mandated additional responsibilities that influence the OIG's priorities, to include the following:

Section 38(k) of the Federal Deposit Insurance Act (FDI Act) requires that the OIG review failed financial institutions supervised by the Board that result in a material loss to the DIF and produce a report within six months. The Dodd-Frank Act amended section 38(k) of the FDI Act by raising the materiality threshold, but also by requiring that the OIG report on the results of any nonmaterial losses to the DIF that exhibit unusual circumstances that warrant an in-depth review.

In addition, section 211(f) of the Dodd-Frank Act requires that the OIG review the Board's supervision of any covered financial company that is placed into receivership and produce a report that evaluates the effectiveness of the Board's supervision, identifies any acts or omissions by the Board that contributed to or could have prevented the company's receivership status, and recommends appropriate administrative or legislative action.

Furthermore, section 989E of the Dodd-Frank Act established the Council of Inspectors General on Financial Oversight (CIGFO), which is comprised of the Inspectors General (IGs) of the Board, the Commodity Futures Trading Commission, the Department of Housing and Urban Development, the Treasury, the Federal Deposit Insurance Corporation (FDIC), the Federal Housing Finance

Agency (FHFA), the National Credit Union Administration (NCUA), and the Securities and Exchange Commission (SEC), and the Special IG of the Troubled Asset Relief Program (TARP). The CIGFO is required to meet at least quarterly to share information and discuss the ongoing work of each IG, with a focus on concerns that may apply to the broader financial sector and ways to improve financial oversight. Additionally, the CIGFO is required to issue a report annually that highlights the IGs' concerns and recommendations, as well as issues that may apply to the broader financial sector.

With respect to information technology (IT), the Federal Information Security Management Act of 2002 (FISMA) established a legislative mandate for ensuring the effectiveness of information security controls over resources that support federal operations and assets. Consistent with FISMA's requirements, we perform an annual independent evaluation of the Board's and the Bureau's information security program and practices, including the effectiveness of security controls and techniques for selected information systems.

The USA PATRIOT Act of 2001, Public Law No. 107-56, grants the Board certain federal law enforcement authorities. Our office serves as the external oversight function for the Board's law enforcement program.

Section 11B of the Federal Reserve Act mandates annual independent audits of the financial statements of each Federal Reserve Bank and of the Board. We oversee the annual financial statement audits of the Board, as well as the Federal Financial Institutions Examination Council (FFIEC). The FFIEC is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions by the Board, the FDIC, the NCUA, the Office of the Comptroller of the Currency (OCC), and the CFPB and to make recommendations to promote uniformity in the supervision of financial institutions. Under the Dodd-Frank Act, the Government Accountability Office performs the financial statement audits of the Bureau.

Overview of the OIG's Strategic Plan 2011 – 2015

The following chart represents the structure of the OIG's Strategic Plan, which we recently updated to incorporate, among other things, new requirements under the Dodd-Frank Act, including our responsibilities as the OIG for the Bureau.

Mission

The Office of Inspector General (OIG) conducts independent and objective audits, inspections, evaluations, investigations, and other reviews related to the programs and operations of the Board of Governors of the Federal Reserve System (Board) and the Bureau of Consumer Financial Protection (Bureau). Through this work, the OIG promotes integrity, economy, efficiency, and effectiveness; helps prevent and detect fraud, waste, and abuse; and strengthens the agencies' accountability to Congress and the public.

Vision

The OIG promotes positive change, achieves results, fosters constructive working relationships with stakeholders, and protects the public interest through independent and risk-focused oversight of Board and Bureau programs and operations.

Values

Independence – Integrity – Excellence – Professionalism
Empowerment – Diversity – Public Interest

Goal 1

Enhance Economy, Efficiency, and Effectiveness; Limit Risk; Detect and Prevent Fraud and Abuse; and Ensure Compliance in the Federal Reserve Board's Programs and Operations

Objectives

1. Continue to oversee Board governance.
2. Review the Board's functions related to monetary policy and financial stability.
3. Assess the Board's responsibilities related to supervision and regulation.
4. Review the Board's oversight of the Federal Reserve Banks' operations.
5. Evaluate the Board's consumer and community affairs programs.
6. Conduct investigations of possible fraud, waste, abuse, and misconduct associated with Board programs and operations.

Goal 2

Enhance Economy, Efficiency, and Effectiveness; Limit Risk; Detect and Prevent Fraud and Abuse; and Ensure Compliance in the Bureau of Consumer Financial Protection's Programs and Operations

Objectives

1. Address current and emerging issues related to the governance, transfer of functions, and internal operations of the Bureau.
2. Review the Bureau's processes for formulating and issuing rules, orders, and guidance implementing federal consumer financial law.
3. Assess the Bureau's implementation of its supervision and enforcement activities.
4. Identify and review key aspects of the Bureau's role in establishing and implementing financial education programs for consumers of financial services and products.
5. Evaluate the Bureau's functions related to collecting data, researching trends, and tracking and publishing market information on consumer financial products and services.
6. Conduct work on the Bureau's approach to collecting, researching, and responding to consumer complaints.
7. Conduct investigations of possible fraud, waste, abuse, and misconduct associated with Bureau programs and operations.

Goal 3

Enhance the Efficiency and Effectiveness of the OIG's Operations and Communications

Objectives

1. Enhance human resources management.
2. Continue to enhance internal communications.
3. Further expand external communications.
4. Continue to improve our business processes.
5. Further strengthen our technology infrastructure.

Audits & Attestations
Financial/Performance Audits
Attestation Engagements

Inspections & Evaluations
Inspections/Program Evaluations
Best Practice Reviews

Investigations
Criminal/Civil/Administrative Cases

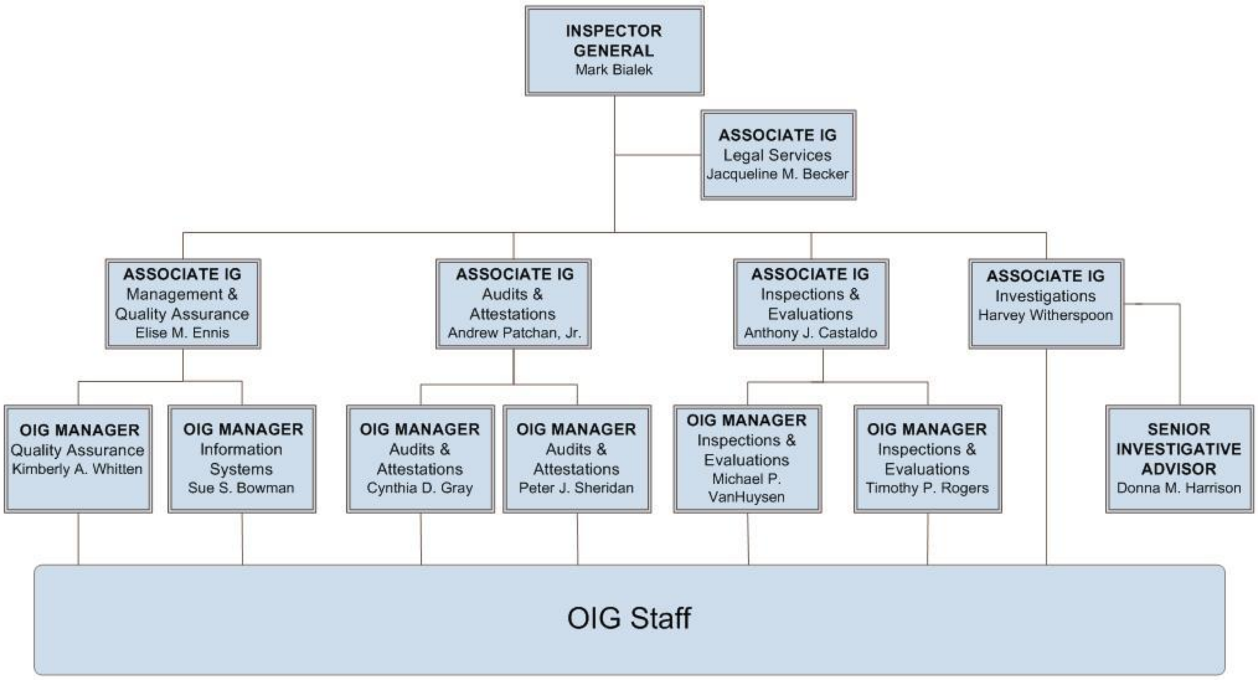
Legal Services
Counsel to Inspector General
Program/Project Legal Support
Congressional & Media Liaison
Legislative & Regulatory Review

Management & Quality Assurance (QA)
Semiannual and Other Reports
QA and Peer Review
Routine Activities
Internal Operations

Organization Chart

OFFICE OF INSPECTOR GENERAL

(July 2011)



OIG Staffing

Auditors (including Information Technology)	**53**
Investigators	**15**
Legal	**6**
Administrative and Hotline	**6**
Information Systems Analysts	**5**
Total Authorized Positions	**85**

Audits and Attestations

The Audits and Attestations program assesses aspects of the economy, efficiency, and effectiveness of Board and Bureau programs and operations. For example, Audits and Attestations conducts audits of (1) the Board's financial statements and financial performance reports; (2) the efficiency and effectiveness of processes and internal controls over agency programs and operations; (3) the adequacy of controls and security measures governing agency financial and management information systems and the safeguarding of assets and sensitive information; and (4) compliance with applicable laws and regulations related to agency financial, administrative, and program operations. As mandated by the IG Act, OIG audits and attestations are performed in accordance with the *Government Auditing Standards* established by the Comptroller General. The information below summarizes OIG work completed during the reporting period and ongoing work that will continue into the next semiannual reporting period.

COMPLETED AUDIT WORK AT THE BOARD

Audit of the Board's Implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act

During this period, we completed an audit of the Board's implementation of the Dodd-Frank Act. The Dodd-Frank Act was enacted in response to the financial crisis and charged the Board with significant responsibilities, including the development of complex rulemakings, many in conjunction with other federal financial regulatory agencies. We conducted this audit to assess (1) the efficiency and effectiveness of the Board's processes for identifying, tracking, and overall managing its responsibilities under the act and (2) the Board's progress in implementing key requirements of the act.

Overall, we found that the Board has implemented processes and taken significant steps to meet its Dodd-Frank Act responsibilities. The Board has drawn on expertise and resources from across the Federal Reserve System and has over 300 staff members working on its implementation projects. The Board has established an organizational structure with a senior staff position to coordinate its efforts and developed and implemented the use of project reporting and tracking tools to facilitate management and oversight. Building on these efforts, the Board has completed studies and rulemakings, issued reports, and reorganized and created offices to meet its Dodd-Frank Act obligations, and Board project teams are continuing work on Dodd-Frank Act requirements, many of which require interagency involvement.

Notwithstanding this progress, we identified that the Board faces a number of ongoing management challenges in implementing its substantial Dodd-Frank Act requirements efficiently and effectively, including (1) managing the overall workload volume and complexity; (2) collaborating and coordinating actions with other financial regulatory agencies that share responsibilities for a number of rules, studies, and other Dodd-Frank Act provisions; (3) obtaining and analyzing voluminous public comments on rulemakings; (4) meeting statutory deadlines; and (5) establishing an organizational structure and recruiting and integrating new staff. In addition to these challenges, we identified opportunities to improve the use of the Board's project reporting and tracking tool, and we made a recommendation designed to enhance project monitoring and reporting.

We noted that some of these challenges have had adverse impacts on project completion early in the Board's implementation process. Of the 13 projects having statutory deadlines that fell within the period of our fieldwork, 6 missed their deadlines. Two of these 6 projects stem from a single proposed rulemaking that generated over 11,000 comments. The other four projects were delayed due to interagency operational challenges, including one project that the Board approved about one week prior to its deadline. While these projects represent a small percentage of the Board's overall Dodd-Frank Act implementation responsibilities through 2013, they are reflective of the challenges that the Board faces in its ongoing implementation efforts. As the bulk of the Board's Dodd-Frank Act work lies ahead, leveraging lessons learned from challenges experienced during its early implementation activities can help guide the Board in efficiently and effectively carrying out Dodd-Frank Act requirements going forward.

In their comments on our draft report, the Board's General Counsel and the Special Advisor to the Board for Regulatory Reform Implementation summarized the management structure and processes employed to meet the ongoing challenges of implementing the Dodd-Frank Act. In addition, they indicated that the report's recommendation would be addressed by reviewing existing policies related to the project reporting and tracking tool and by clarifying guidance. Prior to issuing our final report, we were notified that this guidance had been clarified and approved and that appropriate staff had been instructed to incorporate it in their activities.

Security Control Review of the Visitor Registration System

During this reporting period, we also completed a security control review of the Board's Visitor Registration System (VRS). VRS is listed as a major application on the Board's FISMA inventory. VRS allows Board employees to register Board visitors; provides administrative users the ability to manage registered visitors, run reports, and manage access roles; and provides law enforcement officers who use it the ability to sign visitors in and out, print badges, and manage visitors. Our objectives were to (1) evaluate the effectiveness of selected security controls and techniques for protecting VRS from unauthorized access, modification, or destruction and (2) ensure compliance with the Board's information security program.

Overall, our review of VRS found that, in general, controls are adequately designed and implemented. For those control families where control objectives were not met, we identified the aspect of the control that was deficient or where improvements could be made, and we highlighted recommended action. In comments on a draft of our report, the Board's Chief Operating Officer and the Director of the Board's Management Division generally agreed with our recommendations and outlined corrective actions.

FOLLOW-UP ACTIVITIES AT THE BOARD

Follow-up of the Audit of Blackberry and Cell Phone Internal Controls

Our 2009 report on the *Audit of Blackberry and Cell Phone Internal Controls* contained three recommendations designed to improve existing controls used to manage and account for Blackberrys and cell phones. Specifically, we recommended that the Director of IT (1) ensure that all entries to and transactions made in the Secure Inventory Closet (SIC) are recorded in the SIC transaction log, perform a monthly reconciliation of the "Badge Access" log, and analyze how the SIC security camera can be positioned to closely monitor actions by IT personnel regarding devices stored in the SIC; (2) ensure that individuals with responsibility for storing and removing devices from the SIC do not have full access to the equipment database; and (3) determine what additional procedures are needed to ensure the prompt return of devices that are no longer in use, such as when employees separate from the Board, and coordinate efforts with the Management Division to receive notification of upcoming employee separations. Based on our follow-up work, we concluded that the actions taken by the Board were sufficient to warrant closing the second and third recommendations. The first recommendation remains open because the IT division still plans to relocate the SIC to a larger area that will allow for a surveillance camera to capture device-related activities.

ONGOING AUDIT WORK AT THE BOARD

Audit of the Board's Financial Statements for the Year Ending December 31, 2011, and Audit of the Federal Financial Institutions Examination Council's Financial Statements for the Year Ending December 31, 2011

We contract for an independent public accounting firm to annually audit the financial statements of the Board and the FFIEC. (The Board performs the accounting function for the FFIEC.) The accounting firm, currently Deloitte & Touche LLP, performs the audits to obtain reasonable assurance that the financial statements are free of material misstatement. The OIG oversees the activities of the contractor to ensure compliance with generally accepted government auditing standards and Public Company Accounting Oversight Board auditing standards related to internal controls over financial reporting.

The audits include examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. The audits also include an assessment of the accounting principles used and significant estimates made by management, as well as an evaluation of the overall financial statement presentation. To determine the auditing procedures necessary to express an opinion on the financial statements, the auditors will review the Board's and the FFIEC's internal controls over financial reporting. The auditors will also express an opinion on the effectiveness of the Board's internal controls over financial reporting based on the *Government Auditing Standards* and the Public Company Accounting Oversight Board standards. As part of obtaining reasonable assurance that the financial statements are free of material misstatement, the auditors also will perform tests of the Board's and the FFIEC's compliance with certain provisions of laws and regulations, since noncompliance with these provisions could have a direct and material effect on the determination of the financial statement amounts. The audit reports will be issued in the next reporting period.

Audit of the Board's Information Security Program

We began our annual audit of the Board's information security program and practices. This audit is being performed pursuant to FISMA, which requires that each agency IG conduct an annual independent evaluation of the agency's information security program and practices. Our specific audit objectives, based on the act's requirements, are to evaluate the effectiveness of security controls and techniques for selected information systems and to evaluate compliance by the Board with FISMA and related information security policies, procedures, standards, and guidelines. In accordance with revised reporting requirements, our FISMA review includes an analysis of the Board's security-related processes in the following areas: risk management, continuous monitoring, plans of action and milestones, account and identity management, remote access, security configuration management, security training, contractor oversight, contingency planning, incident response and reporting, and capital planning. We expect to complete this project and issue our final report in the next reporting period.

Audit of the Board's Government Travel Card Program

During the reporting period, we began an audit of the Board's government travel card program. The Board participates in the General Services Administration's SmartPay program to obtain and issue government travel cards to its employees. Our objectives are to assess whether controls (1) are designed and operate effectively to provide reasonable assurance that cards are properly issued, administered, and controlled; (2) act to detect and prevent unauthorized or fraudulent transactions in a timely manner; and (3) are adequate to ensure proper use of the cards in accordance with the Board's policy and procedures. During this period, we completed our fieldwork. We anticipate discussing our results with management and issuing our final report in the next reporting period.

Security Control Review of the Board's Public Website

We issued for Board comment a draft report on our security control review of the Board's public website (Pubweb). Pubweb is listed as a major application on the Board's FISMA inventory for the Office of Board Members. Pubweb provides the public with information about the mission and work of the Board. Our audit objectives were to evaluate the effectiveness of selected security controls and techniques for protecting Pubweb from unauthorized access, modification, or destruction; and to ensure compliance with the Board's information security program. We expect to issue our final report in the next reporting period.

Security Control Review of the National Remote Access Services

We issued for Board comment a draft report on our security control review of the Federal Reserve System's National Remote Access Services (NRAS). The Board and the 12 Federal Reserve Banks use NRAS for remotely accessing Board and Federal Reserve Bank information systems. Our objectives were to evaluate the effectiveness of selected security controls and techniques to ensure that the Board maintains a remote access program that is generally compliant with FISMA requirements. We expect to issue our final report in the next reporting period.

Security Control Review of FISMA Assets Maintained by the Federal Reserve Bank of Richmond

We completed the fieldwork and began drafting our report on a security control review of two Lotus Notes applications listed on the Board's FISMA inventory and maintained by the Federal Reserve Bank of Richmond (FRB Richmond). The two database applications are used by FRB Richmond to support bank examinations. Our objectives are to (1) evaluate the effectiveness of selected security controls and techniques for protecting the two Lotus Notes applications from unauthorized access, modification, or destruction and (2) ensure compliance with the Board's information security program. We plan to complete this review and issue the final report in the next reporting period.

Audit of the Management Division's Internal Control Processes

We began an initial data gathering and scoping effort on the Management Division's internal control processes. The Management Division is responsible for many important functions that support Board operations, including human resources, facilities management, finance, and law enforcement protection. Establishing and maintaining effective internal controls is key to accomplishing agency missions, achieving program results, and complying with applicable laws and regulations. Once we have completed our scoping effort, we will define our specific objectives, scope, and methodology and will issue a formal notification announcing the audit to the Board.

Audit of the Board's Continuity/Disaster Recovery Program for Its Information Systems

We began an audit of the Board's continuity/disaster recovery program for its information systems. Our overall objective is to determine if the Board is maintaining a program that is generally consistent with related National Institute of Standards and Technology (NIST) and Office of Management and Budget (OMB) FISMA guidance. To accomplish this objective, we plan to develop a tailored control assessment program based on the Contingency Planning family of information security controls in NIST Special Publication 800-53, *Recommended Security Controls for Federal Information Systems*. We plan to focus on the infrastructure, but will also review contingency plans and test results for a sample of information systems. We expect to complete our review during the next reporting period.

Security Control Review of the Federal Reserve System's Office of Employee Benefits' Information Systems

We began a security control review of the Federal Reserve System's Office of Employee Benefits' (OEB's) information systems. Our overall objective is to determine if the OEB and its contractors are maintaining a program that is generally consistent with related NIST and OMB FISMA guidance. Our specific control review objective is to evaluate the adequacy of control techniques for protecting Board data in the information systems from unauthorized access, modification, or destruction. We will use the Board's Information Security Program and related NIST FISMA guidance as criteria.

Audit of the Board's Progress in Developing Enhanced Prudential Standards and Monitoring of Potential Systemic Risks

We completed the fieldwork and began report drafting on an audit of the Board's Division of Banking Supervision and Regulation's (BS&R's) implementation of applicable provisions of the Dodd-Frank Act. The act gave the Board important new authorities to support financial stability, including the responsibility for developing enhanced prudential standards for supervising large bank holding companies with total consolidated assets of $50 billion or more and systemically important non-bank financial companies identified by the Financial Stability Oversight Council (FSOC).

The objectives of this audit are to assess BS&R's approaches to (1) developing enhanced prudential standards for large bank holding companies, including standards that would apply to any non-bank financial company that the FSOC identifies as systemically important, and (2) monitoring potential systemic risks, including emerging mortgage foreclosure-related issues. We plan to complete this review in the next reporting period.

Multi-disciplinary Work at the Board

Inquiry into Allegations of Inappropriate Political Interference

During this reporting period, we completed fieldwork and began drafting the report on our inquiry into allegations of inappropriate political interference with Federal Reserve System officials, resulting in hidden transfers of resources to facilitate crimes during the Watergate scandal in the 1970s and to Iraq for weapon purchases during the 1980s. These allegations were raised by a member of Congress during the February 2010 Humphrey-Hawkins hearing before the House Committee on Financial Services. We initiated our inquiry in response to a request to the Board for an investigation of the allegations from the then Chairman of the House Committee on Financial Services, which the Board referred to our office. We expect to complete this project and issue the final report in the next reporting period.

Inspections and Evaluations

The Inspections and Evaluations program encompasses OIG inspections, program evaluations, enterprise risk management activities, process design and life-cycle evaluations, and legislatively-mandated reviews of failed financial institutions that the Board supervises. Inspections are generally narrowly focused on a particular issue or topic and provide time-critical analysis that cuts across functions and organizations. In contrast, evaluations are generally focused on a specific program or function and make extensive use of statistical and quantitative analytical techniques. Evaluations can also encompass other preventive activities, such as reviews of system development life-cycle projects and participation on task forces and workgroups. OIG inspections and evaluations are performed according to the *Quality Standards for Inspection and Evaluation* issued by the Council of the Inspectors General on Integrity and Efficiency (CIGIE).

COMPLETED INSPECTION AND EVALUATION WORK AT THE BOARD

Failed Bank Reviews

Section 38(k) of the FDI Act requires that the IG of the appropriate federal banking agency complete a review of the agency's supervision of a failed institution and issue a report within six months of notification from the FDIC IG when the projected loss to the DIF is material. Under section 38(k) of the FDI Act, as amended, a material loss to the DIF is defined as an estimated loss in excess of $200 million. Pursuant to the Dodd-Frank Act, this threshold applies if the loss occurs between January 1, 2010, and December 31, 2011.

The material loss review provisions of section 38(k) require that the IG

- review the institution's supervision, including the agency's implementation of prompt corrective action (PCA);
- ascertain why the institution's problems resulted in a material loss to the DIF; and
- make recommendations for preventing any such loss in the future.

The Dodd-Frank Act also establishes specific requirements for bank failures that result in losses below the materiality threshold. In these situations, the IG must review the failure to determine, among other things, whether the loss exhibits unusual circumstances that warrant an in-depth review. In such cases, the IG must prepare a report in a manner consistent with the requirements of a material loss review. Pursuant to the Dodd-Frank Act, the IG must semiannually report the dates when each such review and report will be completed. If it is determined that a loss did not involve unusual circumstances, the IG is required to provide an explanation of its determination in the above mentioned semiannual report. The OIG has included its report on nonmaterial loss bank failures in this *Semiannual Report to Congress* (see pages 27 and 28).

As shown in the table below, during this reporting period we issued two reports on failed state member banks: one where the loss to the DIF exceeded the materiality threshold, and the other where the loss did not meet the materiality threshold, but presented unusual circumstances. These two banks had total assets of approximately $2.7 billion and total losses estimated at $284.8 million, or approximately 10.6 percent of total assets.

Failed Bank Reviews Completed during the Reporting Period

State Member Bank	Location	Federal Reserve Bank	Asset size (in millions)	DIF Projected Loss (in millions)	Closure Date	FDIC IG Notification Date[a]
Pierce Commercial Bank	Tacoma, WA	San Francisco	$ 217.8	$ 24.8	11/05/2010	N/A[b]
First Community Bank	Taos, NM	Kansas City	$2,460.0	$260.0	01/28/2011	02/24/2011

a. Date that our office received notification from the FDIC IG that the projected loss to the DIF would be material.
b. Pierce Commercial Bank did not meet the materiality threshold; however, we determined that the bank's failure presented unusual circumstances that warranted an in-depth review.

Review of the Failure of Pierce Commercial Bank

Pierce Commercial Bank (Pierce) began operations on December 8, 1997, as a de novo state member bank headquartered in Tacoma, Washington. Pierce was supervised by the Federal Reserve Bank of San Francisco (FRB San Francisco), under delegated authority from the Federal Reserve Board, and by the Washington Department of Financial Institutions (State). The State closed Pierce on November 5, 2010, and named the FDIC as receiver. According to the FDIC, the bank's total assets at closing were $217.8 million and its failure resulted in an estimated $24.8 million loss to the DIF. While the loss to the DIF did not meet the standards for materiality, we conducted an in-depth review after determining that Pierce's failure presented unusual circumstances because of fraud allegations associated with the bank's mortgage lending activities.

Pierce failed because its Board of Directors and management did not adequately control the risks associated with the bank's residential mortgage lending activities. Specifically, the Board of Directors and senior management allowed the mortgage banking division—PC Bank—to operate independently without appropriate oversight and failed to conduct adequate strategic planning or implement robust internal controls. PC Bank pursued an originate-to-distribute business model that involved originating residential mortgages to be sold in the secondary market. Although this business model appeared to transfer the credit risk associated with mortgage loans to investors, Pierce remained exposed to the risk that investors could demand that the bank repurchase loans or reimburse investors for losses, subject to certain conditions. Examiners ultimately uncovered possibly fraudulent activity at PC Bank related to employees misrepresenting borrower financial information and steering customers into loans for which they were not qualified. These practices led to the bank incurring losses resulting from significant investor repurchase and indemnification demands.

In addition, inadequate credit risk management and weak underwriting made the bank's commercial loan portfolio susceptible to declining economic conditions. Although Pierce received $6.8 million in TARP funds under the Treasury's Capital Purchase Program (CPP) in January 2009, mounting losses resulting from investor repurchase and indemnification demands and commercial loan portfolio deterioration due to declining economic conditions eliminated the bank's earnings, depleted capital (including the TARP funds), and eventually led to the bank's failure.

With respect to supervision, FRB San Francisco complied with the safety and soundness examination frequency guidelines and conducted regular off-site monitoring for the time frame we reviewed, 2003 to 2010. Our analysis of FRB San Francisco's supervision indicated that examiners missed several opportunities to conduct the detailed testing necessary to more accurately assess the bank's risk profile. While it is not possible to determine whether detailed testing would have resulted in earlier detection of the fraud, such testing likely would have identified the control weaknesses that created an opportunity for fraudulent activity.

We also believe that FRB San Francisco did not sufficiently assess the risk associated with the bank's recourse obligations or closely supervise its off-balance sheet reserve to mitigate the risk associated with the bank's secondary market credit activities in accordance with Supervision and Regulation Letter 97-21, *Risk Management and Capital Adequacy of Exposures Arising from Secondary Market Credit Activities*. In our opinion, FRB San Francisco was late to identify these risks, and the expenses associated with addressing investor repurchase and indemnification demands ultimately contributed to the bank's failure.

In late November 2008, Pierce's holding company applied for TARP funds under the CPP, and FRB San Francisco evaluated the application. We believe that FRB San Francisco complied with the process outlined in the Treasury guidance for banks that had not been examined during the previous six months and the limited decision-making criteria available at the time. However, as discussed below, the evaluation might have had different results if examiners had appropriately identified Pierce’s risk profile earlier and taken stronger supervisory action sooner.

In our opinion, FRB San Francisco had multiple opportunities to conduct detailed testing consistent with expectations in the *Commercial Bank Examination Manual* (CBEM). If FRB San Francisco had acted on those opportunities sooner, it would have likely resulted in (1) a more accurate assessment of the bank’s risk profile and (2) earlier CAMELS composite and component rating downgrades, such as the downgrades issued during the July 2009 safety and soundness examination once examiners realized the extent of the bank’s weaknesses. Because the time span during which these opportunities presented themselves coincided with the bank’s growth period, earlier detection might have mitigated the loss to the DIF and resulted in the CAMELS composite rating downgrades necessary to preclude the bank from receiving TARP CPP funds. Nevertheless, it is not possible to determine whether alternative supervisory action might have prevented the failure.

Although the failure of an individual institution does not necessarily provide sufficient evidence to draw broad-based conclusions, we believe that Pierce’s failure offers lessons learned that can be applied to supervising banks with similar characteristics and circumstances. Pierce’s failure demonstrates the importance of (1) examiners appropriately identifying key risks early; (2) examiners timely conducting detailed testing of new business activities consistent with CBEM expectations; (3) active Board of Directors and management oversight of the bank’s business activities; and (4) banks incorporating secondary market credit activities into overall risk management systems, including setting adequate minimum internal standards for allowances or liabilities for losses, capital, and contingency funding. This failure also demonstrates that recurring weaknesses with strategic planning, compliance with laws and regulations, and internal controls can indicate broader corporate governance and risk management deficiencies.

The Director of BS&R concurred with our conclusions, lessons learned, and recommendations. The Director said that he planned to implement our recommendations concerning the need to reinforce the corporate governance principles outlined in the CBEM and cross-referencing guidance addressing secondary market asset sales.

Material Loss Review of First Community Bank

First Community Bank (First Community) was established in Taos, New Mexico, in 1922 and became a state member bank in 1938. First Community was supervised by the Federal Reserve Bank of Kansas City (FRB Kansas City), under delegated authority from the Federal Reserve Board, and by the State of New Mexico Financial Institutions Division (State). On January 28, 2011, the State closed First Community and appointed the FDIC as receiver. On February 24, 2011, the FDIC IG notified us that First Community's failure would result in an estimated loss to the DIF of $260 million, or 10.6 percent of the bank's $2.46 billion in total assets at closing.

First Community failed because its Board of Directors and management did not adequately control the risks associated with the bank's aggressive growth strategy, which resulted in a CRE loan concentration, particularly in construction, land, and land development CLD loans. The bank expanded into new markets by merging with multiple banks between 2001 and 2007. This strategy resulted in the bank developing significant concentrations in CRE and CLD loans that made First Community particularly vulnerable to real estate market declines. The Board of Directors' and management's failure to adequately manage the bank's CRE and CLD credit risk, coupled with weakening real estate markets, led to rapid asset quality deterioration. Mounting losses depleted the bank's earnings and eroded capital, which prompted the State to close First Community and appoint the FDIC as receiver.

With respect to supervision, FRB Kansas City complied with the examination frequency guidelines for the timeframe we reviewed, 2005 through 2011, and conducted regular off-site monitoring. Our analysis of FRB Kansas City's supervision of First Community revealed that examiners identified the bank's fundamental weaknesses, including having high concentrations in CRE and CLD loans and having a dominant Chief Executive Officer (CEO) and an "insider" Board of Directors (that is, it was comprised of senior bank officials). However, we believe that examiners should have held bank management accountable for failing to develop and implement appropriate CRE risk management practices in a timely manner and that First Community's high concentration in CRE and CLD loans warranted stronger criticism during an August 2007 examination, potentially including component rating downgrades. Also, in our opinion, the bank's insider board and dominant CEO operating model also warranted more supervisory criticism prior to an August 2009 examination. While we believe that FRB Kansas City had opportunities for earlier and more forceful supervisory action, it is not possible for us to predict the effectiveness or impact of any corrective measures that might have been taken by the bank. Therefore, we cannot evaluate the degree to which an earlier or alternative supervisory response would have affected First Community's financial deterioration or the ultimate cost to the DIF.

We believe that First Community's failure highlights several lessons learned that can be applied when supervising banks with similar characteristics. In our opinion, banks with a dominant CEO, an aggressive growth strategy, and high CRE and CLD loan concentrations require heightened supervisory attention. In particular, First Community's failure illustrates (1) the potential for a dominant CEO coupled with an insider board to be slow to react to recent regulatory guidance and dynamic market conditions; (2) the risks associated with the use of mergers to implement an aggressive growth strategy to expand into new markets; and (3) the importance of timely implementing a robust credit risk assessment program designed to identify and control CRE and CLD concentrations.

The Director of BS&R concurred with our observations and lessons learned.

Summary Analysis of Failed Bank Reviews

This report analyzed failed state member bank reports that the OIG issued between June 29, 2009, and June 30, 2011, to determine the common characteristics, circumstances, and emerging themes related to (1) the cause of the bank failures and (2) Federal Reserve supervision of the failed institutions. Our analysis yielded a series of common observations. We also conducted supplemental research and analysis to understand why certain institutions withstood the financial crisis better than others.

With respect to the cause of the state member bank failures, the majority of the reports cited common themes. In addition to the economic decline that triggered asset quality deterioration and significant losses at each of the failed banks, the common themes included (1) management pursuing robust growth objectives and making strategic choices that proved to be poor decisions; (2) rapid loan portfolio growth exceeding the bank's risk management capabilities and/or internal controls; (3) asset concentrations tied to CRE or CLD loans, which increased the bank's vulnerability to changes in the marketplace and compounded the risks inherent in individual loans; and (4) management failing to have sufficient capital to cushion mounting losses. Additionally, the reports revealed certain practices that contributed to specific failures, such as risky funding strategies and incentive compensation programs that inappropriately encouraged risk taking.

With respect to the supervision of the failed state member banks, many of the reports noted that examiners identified key safety and soundness risks, but did not take sufficient supervisory action in a timely manner to compel the Boards of Directors and management to mitigate those risks. In many instances, examiners eventually concluded that a supervisory action was necessary, but that conclusion came too late to reverse the bank's deteriorating condition.

In our supplemental research and analysis comparing failed banks to those that withstood the financial crisis, we found that lower CRE and CLD concentration levels, strong capital positions, and minimal dependence on non-core funding were key differentiating characteristics. Our research also revealed a correlation between high CLD concentration levels and the likelihood of failure during the recent financial crisis.

Based on our mandate to assess the bank failures to determine how losses to the DIF might be avoided in the future and our assessment of the emerging themes from the failures we reviewed, we recommended that the Director of BS&R

- supplement current examiner training programs with case studies from the recent failures;
- develop standard examination procedures to evaluate compensation arrangements; and
- provide supplementary guidance on CRE concentrations.

We also suggested that the Director of BS&R

- continue to work with the other federal banking agencies to identify opportunities to enhance PCA;
- define the appropriate supervisory response for highly concentrated state member banks that continue to pursue aggressive growth strategies; and
- encourage and take appropriate steps to implement a supervisory approach that requires strong and consistent supervisory action during stable economic periods.

Response to a Congressional Request Regarding the Economic Analysis Associated with Specified Rulemakings

During this reporting period, we received a letter from the minority members of the Senate Committee on Banking, Housing, and Urban Affairs requesting that we review the economic analysis that the Board performed supporting five Dodd-Frank Act rulemakings. To respond to the members' request, we (1) interviewed more than 30 Board employees who worked on the respective rulemaking teams; (2) reviewed supporting documentation from each of the 5 rulemaking teams; and (3) developed and circulated a questionnaire to determine the qualifications of Board staff who performed economic analysis.

We determined that a number of key statutes provide the Board with rulemaking authority, but generally do not require economic analysis as part of the Board's rulemaking activities. The Dodd-Frank Act did not mandate that an economic or cost-benefit analysis support the five rulemakings, but the Dodd-Frank Act required each of the respective rulemakings to address certain substantive considerations. In addition, the Paperwork Reduction Act and the Regulatory Flexibility Act required the Board to conduct narrowly tailored evaluations of each rulemaking's paperwork burden and effect on small entities, respectively.

We found that the Board routinely reviews economic data to monitor changing economic conditions and conducts the quantitative economic analysis necessary to satisfy statutory requirements and, on a discretionary basis, to support the rulemaking. Further, we determined that the Board generally sought public input for its rulemaking activities and typically reevaluates the effectiveness of its existing regulations every five years. We concluded that the Board generally followed a similar approach for the five rulemakings we reviewed and that the rulemakings we reviewed complied with the Paperwork Reduction Act, the Regulatory Flexibility Act, and applicable Dodd-Frank Act requirements described in our report.

Our analysis yielded the following findings that resulted in recommendations. First, the Board's policy statement on rulemaking procedures had not been recently updated and, although rulemaking staff were cognizant of the Board's rulemaking practices, none of the staff members cited the policy statement. Second, our review of the Federal Register indicated that the notices associated with the respective rulemakings typically provided insight into the general approaches and data used in the economic analysis; however, in some cases, the Board's internal documentation did not clearly outline the work steps underlying the economic analysis. We recommended that the Board (1) update the Rulemaking Procedures Policy Statement and broadly disseminate it to all employees involved in rulemaking activities; and (2) consider establishing documentation standards for rulemaking economic analysis to help ensure reproducibility on an internal basis. In a response to our draft report, the Board stated that the two recommendations would be adopted.

Status of the Transfer of Office of Thrift Supervision Functions

Title III of the Dodd-Frank Act established provisions for the transfer of authority from the Office of Thrift Supervision (OTS) to the OCC, the FDIC, and the Board within one year after the July 21, 2010, date of enactment. Under Title III, the Board was to receive the functions and rulemaking authority for consolidated supervision of savings and loan holding companies and their non-depository subsidiaries.

The Dodd-Frank Act required that, within 180 days after its enactment, the OTS, the OCC, the FDIC, and the Board jointly submit a plan (Joint Implementation Plan) to Congress and the IGs of the Treasury, the FDIC, and the Board that detailed the steps each agency would take to implement the Title III provisions. The Joint Implementation Plan was submitted to Congress and the IGs on January 25, 2011. The Dodd-Frank Act required that the IGs conduct a review to determine whether the implementation plan conformed to the Title III provisions of the Joint Implementation Plan.

On March 28, 2011, the IGs jointly issued a report concluding that the actions described in the Joint Implementation Plan generally conformed to the provisions of Title III. In April 2011, in response to the IGs' report, the Joint Implementation Plan was amended to expand on the protections for transferred OTS employees.

Title III requires the IGs to report on the status of implementing the Joint Implementation Plan every six months following the issuance of the initial IG report. Accordingly, the IGs issued a status report on September 28, 2011, that concluded that the Board, the FDIC, the OCC, and the OTS have substantially implemented the actions in the Joint Implementation Plan that were necessary to transfer OTS functions, employees, funds, and property to the Board, the FDIC, and the OCC, as appropriate. However, certain elements of the plan are ongoing or were not yet required to be completed as provided in Title III. The Board stated in its written comments that it agreed with the conclusion that the Board's part of the plan complied with Title III.

Evaluation of Prompt Regulatory Action Implementation

The OIGs of the Board, the FDIC, and the Treasury conducted a review of the prompt regulatory action (PRA) provisions of the FDI Act. The PRA provisions of the FDI Act (section 38, PCA, and section 39, standards for safety and soundness) require federal financial regulators to institute a system of regulatory actions when an institution fails to meet minimum capital levels or certain safety and soundness standards. These provisions were intended to increase the likelihood that regulators would respond promptly and forcefully to minimize losses to the DIF when federally insured banks fail. Our work focused on the following objectives:

- Determining the purpose of and circumstances that led to the PRA provisions (FDI Act sections 38 and 39) and lessons learned from the savings and loan crisis in the 1980s;
- Evaluating to what extent PCA and the safety and soundness standards were a factor in bank failures and problem institutions during the current crisis;
- Assessing whether these provisions prompted federal regulators to act more quickly and more forcefully to limit losses to the DIF, in light of findings and lessons learned from the savings and loan crisis and regulators' use of PRA provisions in the current crisis; and
- Determining whether there are other non-capital measures that provide a leading indication of risks to the DIF that should be considered as part of the PRA provisions.

We found that PRA provisions were appropriately implemented and helped strengthen oversight to a degree. More specifically, we found that

- Regulators implemented PCA appropriately;

- Inherent limitations associated with PCA's capital-based framework and the sudden and severe economic decline impacted PCA's effectiveness;

- Regulators identified deficiencies prior to declines in PCA capital categories;

- Regulators used other enforcement actions to address safety and soundness concerns before undercapitalization, but after financial decline occurred;

- Regulators made limited use of section 39 to address asset quality and management deficiencies identified; and

- Critically undercapitalized institutions were closed promptly, but overall losses were significant.

To improve the effectiveness of the PRA framework and to meet the section 38 and 39 goals of identifying problems early and minimizing losses to the DIF, we recommended that the FDIC, the Board, and the OCC agency heads review the matters for consideration presented in this report and work through the FSOC to determine whether the PRA legislation or implementing regulations should be modified. The matters for consideration were (1) develop specific criteria and corresponding enforcement actions for non-capital factors, (2) increase the minimum PCA capital levels, and (3) continue to refine the deposit insurance system for banks with assets under $10 billion to assess greater premiums commensurate with risk-taking.

Each of the agency responses to our draft report and the identified planned actions addressed the intent of the recommendation. The Board's written response concurred with the general findings in the report and noted that the Board

- has initiated a process that addresses the OIGs' recommendation to develop criteria and corresponding enforcement actions for non-capital factors;

- will continue to consider the recommendation noted in the OIGs' report to increase the minimum PCA capital levels; and

- will defer to the FDIC on changes in deposit insurance premiums, but the Board will submit views if solicited by the FDIC.

FOLLOW-UP ACTIVITIES AT THE BOARD

Follow-up on the Inspection of the Board's Law Enforcement Unit

Our March 2009 *Report on the Inspection of the Board's Law Enforcement Unit* contained two recommendations to enhance the Law Enforcement Unit's (LEU's) internal control environment by disposing of obsolete ammunition and establishing standard forms for custody transfers involving weapons or ammunition to be destroyed. We have reviewed the LEU's actions in response to our recommendations and have determined that the efforts taken are sufficient to close them both.

ONGOING INSPECTION AND EVALUATION WORK AT THE BOARD

Failed Bank Reviews

Section 38(k) of the FDI Act, as amended by the Dodd-Frank Act, requires that the OIG review the supervision of failed banks when the losses to the DIF are above the materiality threshold or are at or below the threshold but exhibit unusual circumstances warranting an in-depth review. A $200 million threshold applies to losses that occur between January 1, 2010, and December 31, 2011. As discussed below, we are currently conducting five failed bank reviews. These banks had total assets of approximately $3.6 billion and total losses estimated at $1.1 billion, or approximately 30 percent of total assets.

Legacy Bank

On March 11, 2011, the Wisconsin Department of Financial Institutions closed Legacy Bank (Legacy), headquartered in Milwaukee, Wisconsin. At closure, the FDIC reported that Legacy had $190.4 million in total assets as of December 31, 2010. As of March 11, 2011, the FDIC estimated that the cost of the failure to the DIF would be $43.5 million, which did not meet the materiality threshold as defined under section 38(k) of the FDI Act. However, we have determined that Legacy's failure presents unusual circumstances warranting an in-depth review because (1) examiners concluded that the bank's CEO engaged in an unsafe and unsound banking practice and (2) the bank received $5.5 million in funds from the Treasury's CPP under the TARP. We expect to issue our report by December 31, 2011.

The Park Avenue Bank

On April 29, 2011, the Georgia Department of Banking and Finance closed The Park Avenue Bank (Park Avenue), headquartered in Valdosta, Georgia. At closure, the FDIC reported that Park Avenue had approximately $953.3 million in total assets as of December 31, 2010. On May 27, 2011, the FDIC IG notified our office that the FDIC had estimated a $326.1 million loss to the DIF, which exceeds the statutory threshold requiring us to conduct a material loss review. As such, we have initiated a material loss review and plan to issue our report by November 27, 2011.

First Chicago Bank and Trust

On July 8, 2011, the Illinois Department of Financial and Professional Regulation closed First Chicago Bank and Trust (First Chicago), located in Chicago, Illinois. At closure, the FDIC reported that First Chicago had $950.8 million in total assets. On August 22, 2011, the FDIC IG notified our office that the FDIC had estimated a $284.3 million loss to the DIF, which exceeds the statutory threshold requiring us to conduct a material loss review. As such, we have initiated a material loss review and plan to issue our report by February 22, 2012.

Bank of Whitman

On August 5, 2011, the Washington Department of Financial Institutions closed Bank of Whitman (Whitman), headquartered in Colfax, Washington. At closure, the FDIC reported that Whitman had $548.6 million in total assets as of June 30, 2011. On August 5, 2011, the FDIC estimated that the cost of the failure to the DIF would be $134.8 million, which did not meet the materiality threshold as defined under section 38(k) of the FDI Act. However, we have determined that Whitman's failure presents unusual circumstances warranting an in-depth review because, among other factors, (1) senior bank officials allegedly colluded with other banks in a scheme designed to increase capital; and (2) a borrower with whom Whitman had a substantial relationship was allegedly involved in a Ponzi scheme, which may have involved the use of bank funds. Whitman was cited for several violations of Washington's legal lending limit, including loans made to this borrower. We expect to issue our report by June 2012.

Bank of the Commonwealth

On September 23, 2011, Bank of the Commonwealth, Norfolk, Virginia, was closed by the Virginia State Corporation Commission. At the time of the closure, the FDIC reported that Bank of the Commonwealth had total assets of $985.1 million. The FDIC estimates that the failure will result in a $268.3 million loss to the DIF, which exceeds the statutory threshold requiring us to conduct a material loss review. As such, we have initiated a material loss review and plan to issue our report by April 2012.

Review of the Board's Oversight of the Next Generation $100 Note (Currency) Production

On October 1, 2010, the Board announced a delay in the issue date of the redesigned Next Generation $100 note originally scheduled for February 10, 2011. Pursuant to the Federal Reserve Act, the Board is authorized to issue Federal Reserve notes, which are produced by the Treasury's Bureau of Engraving and Printing. The Bureau of Engraving and Printing identified a problem with sporadic creasing of newly printed $100 notes. We are conducting a concurrent review with the Treasury OIG. Our work is focused on the following objectives:

- Assess the Board's oversight of the design and production of the $100 notes;
- Review the actions taken to address the current printing problems and the controls initiated to minimize the likelihood of future printing problems; and
- Assess plans for the disposition of the $100 notes that have already been printed.

We have completed our fieldwork and expect to issue the report during the next reporting period.

Inspection of the Board's Protective Services Unit

During this period, we initiated an inspection of the Board's Protective Services Unit (PSU), the organization that ensures the physical security of the Chairman of the Board of Governors. The USA PATRIOT Act of 2001 granted the Board certain federal law enforcement authorities, and the regulations implementing this authority designated the OIG as the External Oversight Function for the Board's law enforcement programs. We are performing this inspection to fulfill our External Oversight Function responsibility. The objective of this inspection is to provide reasonable assurance that the PSU is in compliance with applicable laws, regulations, policies, and procedures.

Information on Nonmaterial Losses to the Deposit Insurance Fund, as Required by the Dodd-Frank Act

The FDI Act, as amended by the Dodd-Frank Act, requires the IG of the appropriate federal banking agency to report, on a semiannual basis, certain information on financial institutions that incurred nonmaterial losses to the DIF and that failed during the respective six-month period. As shown in the table on the next page, three failed state member banks had losses to the DIF that did not meet the materiality threshold, which currently is a loss in excess of $200 million. Cumulatively, these institutions had total assets of approximately $929 million and losses estimated at $186.5 million, or 20 percent of total assets.

When bank failures result in nonmaterial losses to the DIF, the IG is required to determine (1) the grounds identified by the federal banking agency or the state bank supervisor for appointing the FDIC as receiver,[1] and (2) whether the losses to the DIF present unusual circumstances that would warrant an in-depth review. If no unusual circumstances are identified, the IG is required to provide an explanation of its determination.

We reviewed each of the three state member bank failures to determine if the resulting loss to the DIF exhibited unusual circumstances that would warrant an in-depth review. In general, we considered a loss to the DIF to present unusual circumstances if the conditions associated with the bank's deterioration, ultimate closure, and supervision were not addressed in any of our prior bank failure reports or involved potential fraudulent activity. To make this determination, we analyzed key data from the five-year period preceding the bank's closure. This data generally comprised Federal Reserve Bank and state examination schedules; Reports of Examination, including CAMELS ratings and financial data; informal and formal enforcement actions and other supervisory activities, such as visitations; and PCA determinations. As shown in the table on the next page, we determined that losses to the DIF for one of the three state member banks exhibited unusual circumstances warranting an in-depth review.

1. Typically, the state closes state member banks and appoints the FDIC as receiver.

Nonmaterial State Member Bank Failures, April 1, 2011, through September 30, 2011[a]

State Member Bank	Location	Asset size (millions)	DIF Projected Loss (millions)	Closure Date	OIG Summary of State's Grounds for Receivership	OIG Determination
LandMark Bank of Florida	Sarasota, FL	$ 271.1	$ 34.4	07/22/2011	Insolvent	No unusual circumstances noted
Virginia Business Bank	Richmond, VA	$ 93.6	$ 17.3	07/29/2011	At or near insolvency	No unusual circumstances noted
Bank of Whitman	Colfax, WA	$ 564.3	$134.8	08/05/2011	Unsafe condition	Unusual circumstances identified; report to be issued by 06/30/2012 (see page 25)

a. The asset size and DIF projected loss included in the table were provided in the official notification from the FDIC OIG following each bank's closure. These numbers may subsequently change.

Bureau of Consumer Financial Protection

The Dodd-Frank Act established the Bureau as an independent entity within the Federal Reserve System and designated our office as the Bureau's OIG. The Bureau's statutory purpose is to implement and, as applicable, consistently enforce federal consumer financial law to ensure that all consumers have access to markets for financial products and services and that these markets are fair, transparent, and competitive. On July 21, 2011, certain authorities transferred from other agencies to the Bureau. The following are highlights of our Bureau-related oversight activities during the last six months.

COMPLETED WORK

Review of CFPB Implementation Planning Activities

On July 15, 2011, our office and the Treasury OIG jointly issued a report on the CFPB's implementation planning activities related to standing up the agency. The review's objective was to assess the CFPB's efforts to (1) identify mission-critical activities and legislative mandates; (2) develop and execute a comprehensive implementation plan and timeline for mission-critical activities and legislative mandates; and (3) communicate its implementation plan and timeline to certain key stakeholders.

Our review found that the CFPB identified and documented implementation activities critical to standing up the agency's functions and necessary to address certain Dodd-Frank Act requirements. Furthermore, the CFPB developed and was implementing appropriate plans that supported ongoing operations as well as the July 21, 2011, transfer of employees and functions. We reported the status of the CFPB's implementation progress for certain activities as follows:

- As of June 17, 2011, 19 of the CFPB's 35 assistant director or equivalent positions had been filled. According to the CFPB, the agency also had hired a Regional Director for its San Francisco office and was in the process of recruiting leaders for its Washington, DC; Chicago; and New York offices.

- As of June 30, 2011, the CFPB offered transfers to 349 employees from other federal regulatory agencies. As of that date, 172 employees had accepted the CFPB's offers, and CFPB officials were waiting for additional responses to their offers.

- On February 13, 2011, the CFPB developed an interim pay structure to implement a payroll system. On May 8, 2011, the agency refined its pay structure, which comprises 9 pay bands consisting of 18 pay ranges.

- According to CFPB documents, the agency plans to continue using Treasury's Bureau of the Public Debt Administrative Resource Center to provide for its financial management. The CFPB also plans to continue relying on Treasury's infrastructure for its general support systems, such as email. Contractors provide additional information technology support.

- According to CFPB officials, starting on July 21, 2011, CFPB expected to take website inquiries and phone calls from consumers, initiate the complaint inquiry process, and begin case management for tracking complaints. However, the agency plans to initially only process complaints related to credit cards. According to a CFPB timeline, the agency plans to process complaints concerning other consumer financial products over the course of the next year.

We also reported that the CFPB communicated its planning and implementation of standup activities to internal stakeholders and provided information to other consumer regulatory agencies regarding its transfer planning. Nevertheless, we concluded that CFPB's operational success will depend, in part, on its ability to effectively execute its plans. As part of our ongoing oversight efforts, we plan to continue to monitor the progress of CFPB's implementation activities.

ONGOING WORK

In addition to conducting specific audits and evaluations, we routinely monitor CFPB activities and conduct regular meetings with CFPB officials and management. This effort primarily focuses on CFPB's budget, funding, and staffing; supervision of financial institutions and other entities; and strategic planning and coordination with federal and state agencies. This ongoing oversight is an integral part of our audit and evaluation planning to identify areas that pose the greatest risks to the economy, efficiency, and effectiveness of CFPB operations. Among other things, our work will focus on reviews of the CFPB's funding and procurement, consumer response activities, supervisory program, operational and administrative infrastructure, and information security pursuant to FISMA.

Evaluation of the CFPB's Contract Solicitation and Selection Process

The CFPB established a procurement function and has been entering into contracts for goods and services. Accordingly, we are conducting an evaluation of certain aspects of the CFPB's contracting process. The evaluation's objective is to determine whether the CFPB's contract solicitation and selection processes and practices are compliant with applicable rules established by the Federal Acquisition Regulation. We plan to focus on a specific contract type, which we will select after an assessment of the CFPB's overall contracting activities to date.

Audit of the CFPB's Information Security Program

During this reporting period, we initiated an audit of the CFPB's information security program and practices. The audit will be performed pursuant to FISMA, which requires that each agency IG conduct an annual independent evaluation of the agency's information security. Based on FISMA's requirements, our specific audit objectives are to evaluate (1) the CFPB's compliance with FISMA and related information security policies, procedures, standards, and guidelines and (2) the effectiveness of security controls and techniques for a subset of the CFPB's information systems.

Evaluation of the CFPB's Consumer Response Center

On July 21, 2011, the CFPB's Consumer Response Center began accepting complaints regarding credit cards through its website and toll-free number, according to the agency. The CFPB plans to process complaints about other consumer financial products over the course of the next year. As part of our office's oversight responsibilities, we will be assessing certain aspects of the CFPB's Consumer Response Center. Our objectives are to (1) evaluate the process the CFPB has established to receive, track, and respond to consumer complaints, (2) assess the CFPB's coordination with federal and state regulatory agencies regarding the processing and referral of complaints, and (3) determine the extent to which the CFPB is assessing its performance when responding to consumer complaints.

Investigations

The Investigations program conducts criminal, civil, and administrative investigations related to Board and Bureau programs and operations. The OIG operates under statutory law enforcement authority granted by the U.S. Attorney General, which vests our special agents with the authority to carry firearms, make arrests without a warrant, seek and execute search and arrest warrants, and seize evidence. Our special agents engage in joint task force and other criminal investigations involving matters such as bank fraud, mortgage fraud, money laundering, and other financially-related crimes impacting federally-regulated financial institutions. OIG investigations are conducted in compliance with the CIGIE's *Quality Standards for Investigations*.

INVESTIGATIVE ACTIVITIES

During this reporting period, we opened 10 cases, closed 11 cases, and ended the period with 38 investigations in progress. Due to the sensitivity of these investigations, we only report on concluded and ongoing activities that have resulted in criminal, civil, or administrative action. The following summaries highlight our significant investigative activity during this semiannual reporting period.

Savannah Real Estate Developer Sentenced to over Four Years in Prison for Conspiring to Defraud First National Bank and Others

On August 15, 2011, a Savannah real estate developer was sentenced to 52 months in prison in connection with a conspiracy to defraud the First National Bank, Savannah, Georgia, and other banks of over $2 million. In addition to his prison sentence, the developer was ordered to pay almost $2.4 million in restitution and to serve three years supervised release. The OIG initiated this investigation based on allegations that First National Bank and First National Corporation, a Board-regulated bank holding company, may have falsely approved and funded several commercial loans to nominee borrowers to help mask delinquent loans that were impacting the bank's financial position.

According to the evidence presented during the sentencing and guilty plea hearings, the Savannah real estate developer, acting on behalf of two businesses, entered into loan agreements with First National Bank and other banks for the purchase and development of areas within downtown Savannah. During a two-year period, the real estate developer submitted dozens of fictitious subcontractor invoices to First National Bank for work that had not been performed. As a result, the real estate developer fraudulently received over $1 million to which he was not entitled. In an effort to prevent the loans from becoming delinquent, the developer conspired with others, including employees of First National Bank, to arrange over $1 million in nominee loans, the proceeds of which were not for the benefit of the borrowers, but for the benefit of the developer and his co-conspirators.

This investigation was conducted jointly by the United States Attorney's Office for the Southern District of Georgia, the U.S. Secret Service, the FDIC OIG, the Treasury OIG, and the Board OIG.

Owner of Illinois Agricultural Business Indicted on Fraud Charges

On September 29, 2011, the owner of an Illinois agricultural business was indicted by a federal grand jury on one felony count of loan application fraud, two felony counts of bank fraud, and one felony count of wire fraud. The OIG initiated this investigation after receiving information alleging loan fraud at Peoples Bank and Trust (Peoples Bank), a Board-regulated institution.

According to the indictment, between 2006 and 2008, the business owner obtained a substantial amount of financing from Corn Belt Bank, an FDIC-regulated institution. In May 2008, when Corn Belt Bank was no longer able to provide sufficient financial support, the owner arranged for financing with Peoples Bank, which included a $10 million line of credit. The purposes of the loan associated with the line of credit included financing the business' operations and paying off a prior loan from Corn Belt Bank. Corn Belt Bank purchased a 20 percent participation in the new loan. In February 2009, Corn Belt Bank was placed into receivership.

The indictment alleges that the business owner provided false information to Peoples Bank in order to secure the $10 million line of credit. As part of the loan process, the owner provided fraudulent reports regarding the financial position of his business and the status of collateral, including his accounts receivable, so that Peoples Bank would approve and fund the $10 million line of credit. The indictment further alleges that, after the line of credit was approved and funded, the owner continued to provide false information to Peoples Bank. Ultimately, the business defaulted on the loan, resulting in a loss of most of the $10 million Peoples Bank loaned to the business.

The investigation was conducted jointly by the United States Attorney's Office for the Eastern District of Missouri, the Federal Bureau of Investigation, the FDIC OIG, and the Board OIG.

Individual Sentenced for Trafficking in Counterfeit Goods

During this reporting period, a second individual who was previously indicted entered a guilty plea to 1 count of trafficking in counterfeit goods and was sentenced to 12 months and 1 day in prison, with 3 years supervised release and

18 months home detention. The individual was required to pay a fine of $15,000 and a special assessment of $100. The court also seized property owned by the individual in the amount of $657,865. As was previously reported, the OIG initiated its investigation based on a request for assistance from the United States Postal Inspection Service concerning alleged money laundering and structured deposits by two subjects. During this investigation, OIG special agents worked closely with Postal Inspectors, analyzing financial transactions in support of the money laundering violations.

The investigation determined that, over a one-year period, the subjects deposited approximately $1 million of Postal Money Orders into bank accounts at various financial institutions, including several Board-regulated institutions. Information developed during the investigation revealed that the subjects were aware of the Postal Money Order purchasing requirements and patterned their purchases to avoid detection.

In December 2009, a federal grand jury indicted the subjects on charges of money laundering and trafficking in counterfeit goods. The indictment charged that the subjects knowingly conducted financial transactions affecting interstate and foreign commerce with the structured purchase of 636 Postal Money Orders valued at $579,865, which involved the proceeds from the unlawful sale of counterfeit merchandise throughout the United States.

Alleged Threat Against the Federal Reserve Board

In November 2010, the OIG initiated an investigation into alleged threatening communications by a Board employee. According to the information received, the Board employee threatened to blow up the Board's building. The employee made the threat in the presence of other Board and Reserve Bank employees. Based on the information disclosed during the course of the investigation, the Board terminated the employee due to the serious nature of the statements made and the threat posed to Board personnel and facilities.

INVESTIGATIVE STATISTICS

Summary Statistics on Investigations during the Reporting Period

Investigative Actions	Number
Investigative Caseload	
Investigations Open at End of Previous Reporting Period	39
Investigations Opened during Reporting Period	10
Investigations Closed during Reporting Period	11
Total Investigations Open at End of Reporting Period	38
Investigative Results for Reporting Period	
Referred to Prosecutor	7
Joint Investigations	35
Referred for Audit	0
Referred for Administrative Action	0
Oral and/or Written Reprimands	1
Terminations of Employment	1
Arrests	0
Suspensions	0
Debarments	0
Indictments	1
Criminal Information	0
Convictions	1
Monetary Recoveries	$0
Civil Actions (Fines and Restitution)	$0
Criminal Fines, Restitution, and Forfeitures	$3,069,438

HOTLINE ACTIVITIES

To report fraud, waste, abuse, or mismanagement related to the programs or operations of the Board or the Bureau, individuals may contact the OIG Hotline by mail, telephone, fax, or email. Hotline staff analyzes all incoming complaints and, as appropriate, coordinates with OIG and/or other federal and Reserve Bank staff. During this reporting period, the Hotline received 181 complaints.

The OIG continued to receive a significant number of complaints involving suspicious solicitations invoking the Federal Reserve name. One of these types of schemes, known as the "Grant Award" scam, occurs when an individual receives a solicitation, purportedly from a representative of the Board or a Federal Reserve Bank, falsely claiming that the individual has been awarded a large sum of money. Hotline staff continues to advise all individuals that these scams, as well as similar "phishing" and "advance fee" scams, are solicitations that attempt to obtain the personal and/or financial information of the recipient and that neither the Board nor the Federal Reserve Banks endorse or have any involvement in them. As appropriate, the OIG may investigate these complaints. During this reporting period, several complaints involving victims of such scams who incurred monetary losses were referred to the OIG's Investigations program for appropriate action. Hotline staff is continuing to monitor and analyze these types of complaints, as well as work with Federal Reserve Bank staff to assess these fraudulent scams.

A number of other Hotline complaints were from individuals wanting to file non-criminal consumer complaints against financial institutions or mortgage companies. After analysis of these complaints, Hotline staff typically refers the complainant to the consumer group of the appropriate federal regulator for the institution involved, such as the Federal Reserve Consumer Help group or the Customer Assistance Group of the OCC. Other Hotline complaints were from individuals seeking advice or information regarding consumer protections and Board regulations. Such inquiries are referred to the appropriate Board or Bureau offices and other federal or state agencies.

Summary Statistics on Hotline Activities during the Reporting Period

Hotline Complaints	Number
Complaints Pending from Previous Reporting Period	1
Complaints Received during Reporting Period	181
Total Complaints for Reporting Period	182
Complaints Resolved during Reporting Period	180
Complaints Pending	2

Legal Services

The Legal Services program serves as the independent legal counsel to the IG and the OIG staff. The Legal Services staff provides comprehensive legal advice, research, counseling, analysis, and representation in support of OIG audits, investigations, inspections, evaluations, and other professional, management, and administrative functions. This work provides the legal basis for the conclusions, findings, and recommendations contained within OIG reports. Moreover, Legal Services keeps the IG and the OIG staff aware of recent legal developments that may affect the activities of the OIG, the Board, and the CFPB.

In accordance with section 4(a)(2) of the IG Act, the Legal Services staff conducts an independent review of newly enacted and proposed legislation and regulations to determine their potential effect on the economy and efficiency of the Board's and the CFPB's programs and operations. During this reporting period, Legal Services reviewed 30 legislative and 14 regulatory items.

Communications and Coordination

While the OIG's primary mission is to enhance the economy, efficiency, and effectiveness of Board and Bureau programs and operations, we also coordinate externally and work internally to achieve our goals and objectives. Externally, we regularly coordinate with and provide information to Congress and congressional staff. We also are active members of the broader IG professional community and promote collaboration on shared concerns. Internally, we consistently strive to enhance and maximize efficiency and transparency in our infrastructure and day-to-day operations. Within the Board, the Bureau, and the Federal Reserve System, we continue to provide information about the OIG's roles and responsibilities. In addition, we participate in an advisory capacity on various Board work groups. Highlights of our activities follow.

Congressional Coordination and Testimony

The OIG has been communicating and coordinating with various congressional committees on issues of mutual interest. During the reporting period, we provided 17 responses to congressional members and staff.

Council of Inspectors General on Financial Oversight

Consistent with the Dodd-Frank Act, the CIGFO is required to meet at least quarterly to facilitate the sharing of information among the IGs and to discuss the ongoing work of each IG, with a focus on concerns that may apply to the broader financial sector and ways to improve financial oversight. The Treasury IG chairs the CIGFO. The Dodd-Frank Act authorizes the CIGFO, by a majority vote, to convene a working group to evaluate the effectiveness and internal operations of the FSOC. In addition, the CIGFO is required to produce an annual report that includes a section of individual reports under the "exclusive editorial control" of each CIGFO member highlighting concerns and recommendations that may apply to the broader financial sector. The annual report must also include a summary of general observations of CIGFO members focusing on measures that should be taken to improve financial oversight. The CIGFO issued its first annual report on July 21, 2011. It included a discussion of current and pending joint projects of CIGFO members and an overview of FSOC's compliance with statutory requirements—FSOC had either met or was on target to meet all requirements to date. The report included sections, developed by each IG and under his or her exclusive editorial control, that established a baseline of oversight activity conducted by each IG from the beginning of the current financial crisis through July 14, 2011.

Council of the Inspectors General on Integrity and Efficiency and IG Community Involvement

The IG serves as a member of the CIGIE. Collectively, the members of the CIGIE help improve government programs and operations. The CIGIE provides a forum to discuss government-wide issues and shared concerns. The IG also serves as a member of CIGIE's Legislation Committee and Inspection and Evaluation Committee. The Legislation Committee is the central point of information regarding legislative initiatives and congressional activities that may affect the community. The Inspection and Evaluation Committee provides leadership for the inspection and evaluation community's effort to improve agency program effectiveness by maintaining professional standards, leading the development of protocols for reviewing management issues that cut across departments and agencies, promoting the use of advanced program evaluation techniques, and fostering awareness of evaluation and inspection practice in OIGs.

The Associate IG for Legal Services serves as the Vice Chair of the Council of Counsels to the IG, and her staff attorneys are members of the council. In addition, the Associate IG for Audits and Attestations serves as chair of the IT Committee of the Federal Audit Executive Council and works with audit staff throughout the IG community on common IT audit issues.

We were recently honored to receive two awards from the CIGIE. Our report on *The Federal Reserve's Section 13(3) Lending Facilities to Support Overall Market Liquidity: Function, Status, and Risk Management* won an Audit Award for Excellence, and several of our employees are members of an information technology team that won the Barry R. Snyder Joint Award for their collaborative work to make sweeping changes to OIG Federal Information Security Management Act review methodologies to improve agencies' cyber security infrastructures and controls.

Financial Regulatory Coordination

To foster cooperation on issues of mutual interest, including issues related to the current financial crisis, the IG meets periodically with the IGs from other federal financial regulatory agencies: the FDIC, the Treasury, the NCUA, the SEC, the Farm Credit Administration, the Commodity Futures Trading Commission, the Pension Benefit Guarantee Corporation (PBGC), the Export-Import Bank, and the FHFA. In addition, the Associate IG for Audits and Attestations and the Associate IG for Inspections and Evaluations meet with their financial regulatory agency OIG counterparts to discuss various topics, including bank failure material loss review best practices, annual plans, and ongoing projects. We also coordinate with the Government Accountability Office regarding financial regulatory and other related issues.

OIG Information Technology

During this reporting period, we enhanced the OIG's intranet website hosted on the Board's server to better share information with Board employees. Furthermore, we created a secure internal intranet website for OIG staff to share their projects, skills, ideas, and training. This is an ongoing project that will evolve to continuously meet our business needs.

Consistent with the requirements of FISMA, we recently completed our second bi-annual contingency test in coordination with the Board's IT division. In addition, we are in the process of selecting an independent contractor to conduct the 2011 security review of the OIG's IT infrastructure. This review will be completed before the end of the next reporting period. We are also in the process of replacing our investigative case management software, which we anticipate completing before the end of the next reporting period.

We continue to represent the OIG as a member of the Board's Information Security Committee, Information Technology Advisory Group, NIST Transition Workgroup, and Continuity of Operations Plan Working Group, as well as CIGIE's Chief Information Officer Working Group. We also have regularly attended other IT working groups where we can exchange knowledge and experience.

Appendixes

Appendix 1a
Audit, Inspection, and Evaluation Reports Issued to the Board with Questioned Costs during the Reporting Period[a]

Reports	Number	Dollar Value
For which no management decision had been made by the commencement of the reporting period	0	$0
That were issued during the reporting period	0	$0
For which a management decision was made during the reporting period	0	$0
(i) dollar value of recommendations that were agreed to by management	0	$0
(ii) dollar value of recommendations that were not agreed to by management	0	$0
For which no management decision had been made by the end of the reporting period	0	$0
For which no management decision was made within six months of issuance	0	$0

a. Because the Board is primarily a regulatory and policymaking agency, our recommendations typically focus on program effectiveness and efficiency, as well as strengthening internal controls. As such, the monetary benefit associated with their implementation typicallyis not readily quantifiable.

Appendix 1b
Audit, Inspection, and Evaluation Reports Issued to the Bureau with Questioned Costs during the Reporting Period[a]

Reports	Number	Dollar Value
For which no management decision had been made by the commencement of the reporting period	0	$0
That were issued during the reporting period	0	$0
For which a management decision was made during the reporting period	0	$0
(i) dollar value of recommendations that were agreed to by management	0	$0
(ii) dollar value of recommendations that were not agreed to by management	0	$0
For which no management decision had been made by the end of the reporting period	0	$0
For which no management decision was made within six months of issuance	0	$0

a. Because the Bureau is primarily a regulatory and policymaking agency, our recommendations typically focus on program effectiveness and efficiency, as well as strengthening internal controls. As such, the monetary benefit associated with their implementation typically is not readily quantifiable.

Appendix 2a
Audit, Inspection, and Evaluation Reports Issued to the Board with Recommendations that Funds Be Put to Better Use during the Reporting Period[a]

Reports	Number	Dollar Value
For which no management decision had been made by the commencement of the reporting period	0	$0
That were issued during the reporting period	0	$0
For which a management decision was made during the reporting period	0	$0
(i) dollar value of recommendations that were agreed to by management	0	$0
(ii) dollar value of recommendations that were not agreed to by management	0	$0
For which no management decision had been made by the end of the reporting period	0	$0
For which no management decision was made within six months of issuance	0	$0

a. Because the Board is primarily a regulatory and policymaking agency, our recommendations typically focus on program effectiveness and efficiency, as well as strengthening internal controls. As such, the monetary benefit associated with their implementation typically is not readily quantifiable.

Appendix 2b
Audit, Inspection, and Evaluation Reports Issued to the Bureau with Recommendations that Funds Be Put to Better Use during the Reporting Period[a]

Reports	Number	Dollar Value
For which no management decision had been made by the commencement of the reporting period	0	$0
That were issued during the reporting period	0	$0
For which a management decision was made during the reporting period	0	$0
(i) dollar value of recommendations that were agreed to by management	0	$0
(ii) dollar value of recommendations that were not agreed to by management	0	$0
For which no management decision had been made by the end of the reporting period	0	$0
For which no management decision was made within six months of issuance	0	$0

a. Because the Bureau is primarily a regulatory and policymaking agency, our recommendations typically focus on program effectiveness and efficiency, as well as strengthening internal controls. As such, the monetary benefit associated with their implementation typically is not readily quantifiable.

Appendix 3a
OIG Reports to the Board with Recommendations that Were Open during the Reporting Period[a]

Report Title	Issue Date	Recommendations: No.	Mgmt. Agrees	Mgmt. Disagrees	Status of Recommendations: Last Follow-up Date	Closed	Open
Evaluation of Service Credit Computations	08/05	3	3	–	03/07	1	2
Security Control Review of the Central Document and Text Repository System (Non-public Report)	10/06	16	16	–	09/09	14	2
Audit of the Board's Payroll Process	12/06	7	7	–	03/10	3	4
Security Control Review of the Internet Electronic Submission System (Non-public Report)	02/07	13	13	–	09/09	12	1
Audit of the Board's Compliance with Overtime Requirements of the Fair Labor Standards Act	03/07	2	2	–	03/08	1	1
Review of Selected Common Information Security Controls (Non-public Report)	03/08	6	6	–	09/11	6	–
Security Control Review of the FISMA Assets Maintained by FRB Boston (Non-public Report)	09/08	11	11	–	09/11	10	1
Evaluation of Data Flows for Board Employee Data Received by OEB and its Contractors (Non-public Report)	09/08	2	2	–	03/11	1	1
Audit of the Board's Information Security Program	09/08	2	2	–	11/10	1	1
Control Review of the Board's Currency Expenditures and Assessments	09/08	6	6	–	03/10	5	1
Audit of Blackberry and Cell Phone Internal Controls	03/09	3	3	–	09/11	2	1
Inspection of the Board's Law Enforcement Unit (Non-public Report)	03/09	2	2	–	07/11	2	–
Security Control Review of the Audit Logging Provided by the Information Technology General Support System (Non-public Report)	03/09	4	4	–	09/11	3	1
Audit of the Board's Processing of Applications for the Capital Purchase Program under the Troubled Asset Relief Program	09/09	2	2	–	–	–	2
Audit of the Board's Information Security Program	11/09	4	4	–	11/10	2	2
Security Control Review of the Lotus Notes and Lotus Domino Infrastructure (Non-public Report)	06/10	10	10	–	–	–	10
Audit of the Board's Information Security Program	11/10	3	3	–	–	–	3
Security Control Review of the Internet Electronic Submission System (Non-public Report)	12/10	6	6	–	–	–	6

a. A recommendation is closed if (1) the corrective action has been taken; (2) the recommendation is no longer applicable; or (3) the appropriate oversight committee or administrator has determined, after reviewing the position of the OIG and division management, that no further action by the agency is warranted. A recommendation is open if (1) division management agrees with the recommendation and is in the process of taking corrective action, or (2) division management disagrees with the recommendation and we have referred or are referring it to the appropriate oversight committee or administrator for a final decision.

Appendix 3a—*continued*
OIG Reports to the Board with Recommendations that Were Open during the Reporting Period

Report Title	Issue Date	Recommendations			Status of Recommendations		
		No.	Mgmt. Agrees	Mgmt. Disagrees	Last Follow-up Date	Closed	Open
Review of the Joint Implementation Plan for theTransfer of Office of Thrift Supervision Functions	03/11	1[b]	1	–	09/11	1	–
Audit of the Board's Transportation Subsidy Program	03/11	3	3	–	–	–	3
Response to a Congressional Request Regarding the Economic Analysis Associated with Specified Rulemakings	06/11	2	2	–	–	–	2
Review of the Failure of Pierce Commercial Bank	09/11	2	2	–	–	–	2
Security Control Review of the Visitor Registration System (Non-public report)	09/11	10	10	–	–	–	10
Audit of the Board's Implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act	09/11	1	1	–	–	–	1
Summary Analysis of Failed Bank Reviews	09/11	3	3	–	–	–	3
Evaluation of Prompt Regulatory Action Implementation	09/11	1[b]	1	–	–	–	1

b. This recommendation was directed jointly to the OCC, the FDIC, and the Board.

Appendix 3b
OIG Reports to the Bureau with Recommendations that Were Open during the Reporting Period

		Recommendations			Status of Recommendations		
Report Title	Issue Date	No.	Mgmt. Agrees	Mgmt. Disagrees	Last Follow-up Date	Closed	Open
(None)	-	-	-	-	-	-	-

There are no OIG reports to the Bureau with open recommendations.

Appendix 4a
Audit, Inspection, and Evaluation Reports Issued to the Board during the Reporting Period

Title	Type of Report
Reviews of Bank Failures	
Material Loss Review of First Community Bank	Evaluation
Review of the Failure of Pierce Commercial Bank	Evaluation
Summary Analysis of Failed Bank Reviews	Evaluation
Information Technology Audits	
Security Control Review of the Visitor Registration System (Non-public Report)	Audit
Program Audits and Evaluations	
Response to a Congressional Request Regarding the Economic Analysis Associated with Specified Rulemakings	Evaluation
Status of the Transfer of Office of Thrift Supervision Functions	Evaluation
Audit of the Board's Implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act	Audit
Evaluation of Prompt Regulatory Action Implementation	Evaluation

Total Number of Audit Reports: 2
Total Number of Inspection and Evaluation Reports: 6

Full copies of these reports are available on our website at
http://www.federalreserve.gov/oig/default.htm

Appendix 4b
Audit, Inspection, and Evaluation Reports Issued to the Bureau during the Reporting Period

Title	Type of Report
Program Audits and Evaluations	
Review of CFPB Implementation Planning Activities	Evaluation

Total Number of Audit Reports: 0
Total Number of Inspection and Evaluation Reports: 1

Full copies of these reports are available on our website at
http://www.federalreserve.gov/oig/default.htm

Appendix 5
OIG Peer Reviews

Government auditing and investigative standards require that our audit and investigative units each be reviewed by a peer OIG organization every three years. Section 989C of the Dodd-Frank Act amended the IG Act to require that OIGs provide in their semiannual reports to Congress specified information regarding (1) peer reviews of their respective organizations and (2) peer reviews they have conducted of other OIGs. The following information is provided to address the Dodd-Frank Act requirements.

- During the reporting period, the PBGC OIG began a peer review of our audit organization's quality control system in place for the period April 1, 2010, through March 31, 2011. The review is focused on whether our system of quality control was suitably designed and whether we are complying with the quality control system, in order to provide us with reasonable assurance of conforming with applicable professional standards. The review is ongoing, so a final report on the results of the review has not been issued. We will report the results of PBGC's review in our next semiannual report to Congress. No peer review recommendations are pending from any previous peer reviews of our audit organization.

- The last peer review of the OIG's Investigations program was completed in March 2008 by the U.S. Government Printing Office OIG. No recommendations from this or any prior peer reviews are pending.

- We did not conduct any peer reviews of other OIGs during this reporting period.

Copies of our peer review reports are available on our website at http://www.federalreserve.gov/oig/peer_review_reports.htm.

Appendix 6
Cross-References to the IG Act

Indexed below are the reporting requirements prescribed by the IG Act with the contents of this report.

Section	Source	Page(s)
4(a)(2)	Review of legislation and regulations	37
5(a)(1)	Significant problems, abuses, and deficiencies	None
5(a)(2)	Recommendations with respect to significant problems	None
5(a)(3)	Significant recommendations described in previous semiannual reports on which corrective action has not been completed	None
5(a)(4)	Matters referred to prosecutorial authorities	35
5(a)(5);6(b)(2)	Summary of instances where information was refused	None
5(a)(6)	List of audit, inspection, and evaluation reports	50-51
5(a)(7)	Summary of particularly significant reports	None
5(a)(8)	Statistical table of questioned costs	43-44
5(a)(9)	Statistical table of recommendations that funds be put to better use	45-46
5(a)(10)	Summary of audit, inspection, and evaluation reports issued before the commencement of the reporting period for which no management decision has been made	None
5(a)(11)	Significant revised management decisions made during the reporting period	None
5(a)(12)	Significant management decisions with which the Inspector General is in disagreement	None
5(a)(14), (15), and (16)	Peer review summary	52

Table of Acronyms and Abbreviations

Board	Board of Governors of the Federal Reserve System
BS&R	Division of Banking Supervision and Regulation
Bureau	Bureau of Consumer Financial Protection
CBEM	*Commercial Bank Examination Manual*
CEO	Chief Executive Officer
CFPB	Bureau of Consumer Financial Protection
CIGFO	Council of Inspectors General on Financial Oversight
CIGIE	Council of the Inspectors General on Integrity and Efficiency
CLD	Construction, Land, and Land Development
CPP	Capital Purchase Program
CRE	Commercial Real Estate
DIF	Deposit Insurance Fund
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
FDI Act	Federal Deposit Insurance Act
FDIC	Federal Deposit Insurance Corporation
FFIEC	Federal Financial Institutions Examination Council
FHFA	Federal Housing Finance Agency
First Chicago	First Chicago Bank and Trust
First Community	First Community Bank
FISMA	Federal Information Security Management Act of 2002
FRB Kansas City	Federal Reserve Bank of Kansas City
FRB Richmond	Federal Reserve Bank of Richmond
FRB San Francisco	Federal Reserve Bank of San Francisco
FSOC	Financial Stability Oversight Council
IG	Inspector General
IG Act	Inspector General Act of 1978, as amended

Table of Acronyms and Abbreviations

IT	Information Technology
Legacy	Legacy Bank
LEU	Law Enforcement Unit
NCUA	National Credit Union Administration
NIST	National Institute of Standards and Technology
NRAS	National Remote Access Services
OCC	Office of the Comptroller of the Currency
OEB	Office of Employee Benefits
OIG	Office of Inspector General
OMB	Office of Management and Budget
OTS	Office of Thrift Supervision
Park Avenue	The Park Avenue Bank
PBGC	Pension Benefit Guaranty Corporation
PCA	Prompt Corrective Action
Peoples Bank	Peoples Bank and Trust
Pierce	Pierce Commercial Bank
PRA	Prompt Regulatory Action
PSU	Protective Services Unit
Pubweb	Public Website
SEC	Securities and Exchange Commission
SIC	Secure Inventory Closet
TARP	Troubled Asset Relief Program
Treasury	U.S. Department of the Treasury
VRS	Visitor Registration System
Whitman	Bank of Whitman

Inspector General Hotline
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1-800-827-3340

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Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
MS-300
Washington, DC 20551

or visit our hotline web page at:
http://www.federalreserve.gov/oig/oig_hotline.htm