OTS Outlines Reasons for Superior Bank Failure and Suggests Remedies

WASHINGTON - Office of Thrift Supervision Director Ellen Seidman detailed the history of the failed Superior Bank for the Senate Banking Committee today. "I sincerely believe that this failure was the responsibility of those who owned and managed the institution and related parties," Ms. Seidman said. However, she stressed that investigations into the failure are still underway by OTS, FDIC, Treasury Inspector General and the General Accounting Office.

In her testimony, she suggested a number of steps to enhance the regulatory process and mitigate the risk of similar failures. OTS closed the Hinsdale, Ill.-based institution on July 27 and appointed the FDIC as conservator and receiver. Superior became critically undercapitalized -- defined as tangible equity capital less than two percent of total assets -- after the bank's owners failed to implement a capital restoration plan that OTS approved on May 24 this year.

Superior, which had assets of $1.8 billion as of June 30, 2001, became critically undercapitalized largely due to incorrect accounting treatment and aggressive assumptions for valuing complicated financial instruments known as residuals. "The risk from a concentration in residuals at Superior was exacerbated by a faulty accounting opinion by the institution's external auditors that caused capital to be significantly overstated, and by management and board recalcitrance in acting on regulatory recommendations, directives and orders," Ms. Seidman said.

The bank was owned 50 percent by the Pritzker family of Chicago and 50 percent by the Dworman family of New York.

Ms. Seidman told the committee that the health of the nation's thrift industry remains strong, but the possibility of bank failures can never be completely eliminated. She outlined a number of important ways in which the possibility of failure might be reduced. The federal banking agencies have been working on a proposed regulation regarding securitization that would increase risk-based capital levels for residuals and may also limit the percentage of residuals that an institution may carry. The agencies are hopeful that a final rule will be implemented quickly that will help to reduce the risk presented by institutions such as Superior.
She also asked Congress to strengthen the Prompt Corrective Action statute, which is designed to help regulators deal with problem institutions, by adding a risk-based capital standard to the section dealing with critically undercapitalized institutions. She noted, however, that since its adoption in 1991 the track record of PCA has been very good. "In many ways, PCA has served its purpose well," she said. "Since 1996, there have been only three thrift failures other than Superior, resulting in combined total losses to the SAIF of less than $24 million. At the same time, we have successfully dealt with any number of institutions in potential trouble, by recapitalizations, management and board changes, mergers and acquisitions, and voluntary liquidations."

The accounting treatment of residuals is inherently complex, and the resulting valuations can be volatile, she said. OTS has been concerned that protracted disputes about proper accounting treatment -- particularly of instruments such as subprime residuals -- may impair regulators' ability to take quick action. Ms. Seidman asked Congress to grant federal bank regulators the power to resolve disputes with accountants that could result in a drop in an institution's capital rating. She also asked that accountants be required to consult with bank regulators generally on the impact of proposed accounting treatments on depository institutions.

She raised questions about accountant independence, and expertise in complex areas such as subprime residuals, and suggested Congress and professional accounting organizations consider steps to address weaknesses in the current system. In some cases, accountants are auditing the same instruments on which they performed valuations.

Ms. Seidman conceded that there is a need for better coordination and information sharing between the primary banking regulatory agencies and the FDIC both on the issue of promulgating appropriate regulations to address issues such as the treatment of residuals and with respect to the supervision of individual institutions. However, she noted that FDIC and OTS worked together closely in the supervision of Superior.

Ms. Seidman's testimony is available on the OTS's website, at [www.ots.treas.gov](http://www.ots.treas.gov).


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The Office of Thrift Supervision (OTS), a bureau of the U.S. Treasury, regulates and supervises the nation's thrift industry. OTS's mission is to ensure the safety and soundness of thrift institutions and to support their role as home mortgage lenders and providers of other community credit and financial services. For copies of news releases or other documents visit the OTS web page at [www.ots.treas.gov](http://www.ots.treas.gov).