



# Audit Report



OIG-11-071

SAFETY AND SOUNDNESS: Failed Bank Review of San Luis Trust Bank, FSB

May 24, 2011

Office of  
Inspector General

Department of the Treasury





DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

OFFICE OF  
INSPECTOR GENERAL

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OIG-11-071

MEMORANDUM FOR JOHN E. BOWMAN  
ACTING DIRECTOR  
OFFICE OF THRIFT SUPERVISION

FROM: Jeffrey Dye /s/  
Director, Banking Audits

SUBJECT: Failed Bank Review of San Luis Trust Bank, FSB, San Luis  
Obispo, California

This memorandum presents the results of our review of the failure of San Luis Trust Bank, FSB (San Luis), located in San Luis Obispo, California. The thrift opened in 1999 and operated from a single retail office. San Luis did not have a holding company. The Office of Thrift Supervision (OTS) closed San Luis and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on February 18, 2011. As of December 31, 2010, San Luis had approximately \$332.6 million in total assets and \$272.2 million in total deposits. On the date of closure, FDIC estimated the loss to the Deposit Insurance Fund for San Luis to be \$96.1 million.

Because the loss to the Deposit Insurance Fund is less than \$200 million, as set forth by section 38(k) of the Federal Deposit Insurance Act (FDIA), we conducted a review of the failure of San Luis that was limited to (1) ascertaining the grounds identified by OTS for appointing the FDIC as receiver and (2) determining whether any unusual circumstances exist that might warrant a more in-depth review of the loss. In performing our review we (1) examined documentation related to the appointment of FDIC as receiver, (2) reviewed OTS reports of examination, and (3) interviewed an OTS examiner.

We conducted this performance audit in February and March 2011 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

## **Causes of San Luis Trust Bank's Failure**

OTS appointed FDIC receiver based on the following grounds: (1) the thrift's assets were less than the thrift's obligations to its creditors and others and (2) the thrift was undercapitalized and failed to submit an acceptable capital restoration plan.

The primary cause of San Luis's failure was its high concentration in construction and land lending which led to the significant deterioration of asset quality and the erosion of capital beginning in 2008. San Luis's inadequate credit administration and deficient board and management oversight also contributed to its failure. Examples of the thrift's inadequate credit administration included improper accounting treatment for impaired loans; failure to identify troubled, collateral dependent loans; inconsistent recognition of nonaccrual loans; untimely recognition of losses; and imprudent structure of loan modifications. San Luis's management and board did not effectively address the concentration and inadequate credit administration issues despite recurring criticisms from OTS. Adverse economic conditions and a depressed real estate market caused further asset quality deterioration and capital erosion which ultimately led to San Luis's failure.

## **Conclusion**

Based on our review of the causes of San Luis's failure and the grounds identified by OTS for appointing FDIC as receiver, we determined that there were no unusual circumstances surrounding the thrift's failure or the supervision exercised by OTS. Accordingly, we have determined that a more in-depth review of the thrift's failure by our office is not warranted.

We provided a draft of this memorandum to OTS management for comment. In its response, OTS stated that the primary causes of San Luis's failure summarized in this memorandum are consistent with the information contained in its reports of examination and documents provided in support of the grounds for receivership. OTS concurred with our assessment that an in-depth review of the bank's failure was not warranted. The response is provided as Attachment 1. A list of the recipients of this memorandum is provided as Attachment 2.

We appreciate the courtesies and cooperation provided to our staff during the audit. If you have any questions, you may contact me at (202) 927-0384 or Theresa Cameron, Audit Manager, at (202) 927-1011.

Attachments

**Office of Thrift Supervision**  
Department of the Treasury

1700 G Street, N.W., Washington, DC 20552 • (202) 906-5650

Thomas A. Barnes  
*Deputy Director, Examinations, Supervision, and Consumer Protection*

April 26, 2011

**MEMORANDUM FOR:** Jeffrey Dye  
Director, Banking Audits  
Office of Inspector General  
U.S. Department of the Treasury

**FROM:** Thomas A. Barnes /s/  
Deputy Director

**SUBJECT:** Draft Failed Bank Review of  
San Luis Trust Bank, FSB  
San Luis Obispo, CA

Thank you for the opportunity to comment on your draft memorandum entitled "Failed Bank Review of San Luis Trust Bank, FSB, San Luis Obispo, California." Because the estimated loss of \$96.1 million to the Deposit Insurance Fund is below the \$200 million threshold set forth in section 38(k) of the Federal Deposit Insurance Act, your office's review of the failure of San Luis Trust Bank, FSB (the Bank) was limited to ascertaining the grounds identified by OTS for appointment of the FDIC as receiver and determining whether any unusual circumstances exist warranting a more in-depth review.

The memorandum summarizes the primary causes of the Bank's failure, which are consistent with the information contained in the OTS Reports of Examination and documents provided in support of the grounds for receivership. Specifically, the memorandum cites high concentrations in construction and land lending, which led to the significant deterioration of asset quality and the erosion of capital beginning in 2008. The Bank's inadequate credit administration and deficient board of director (board) and management oversight also contributed to its failure. We agree with your assessment that management and the board did not effectively address the concentration risks and inadequate credit administration issues despite recurring criticisms from OTS. When adverse economic conditions arose, a declining local real estate market caused further asset quality deterioration and capital erosion that ultimately led to the Bank's failure. Your memorandum identified no unusual circumstances surrounding the Bank's failure or the supervision exercised by OTS warranting a more in-depth review by the Office of Inspector General. Although we have not yet completed our internal failed bank review, based on our preliminary work to date we concur with your memorandum's assessment.

Jeffrey Dye  
Director, Banking Audits  
Office of Inspector General  
April 26, 2011

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We are currently in the process of completing our internal failed bank review. Nothing has come to our attention that warrants a more in-depth review. Our findings are consistent with the findings above.

Thank you again for the opportunity to review and respond to the draft failed bank review of San Luis Trust Bank. OTS appreciates the professionalism and courtesies provided by the staff of the Office of Inspector General in completing this review.

**Department of the Treasury**

Deputy Secretary  
Office of Strategic Planning and Evaluations  
Office of Accounting and Internal Control

**Office of Thrift Supervision**

Acting Director  
Liaison Officer

**Office of Management and Budget**

OIG Budget Examiner