



# Audit Report



OIG-11-032

SAFETY AND SOUNDNESS: Failed Bank Review of Los Padres Bank

November 16, 2010

Office of  
Inspector General

Department of the Treasury



OFFICE OF  
INSPECTOR GENERAL

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

November 16, 2010

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

FROM: Michael J. Maloney /s/  
Director, Fiscal Service Audits

SUBJECT: Failed Bank Review of Los Padres Bank

This memorandum presents the results of our review of the failure of Los Padres Bank (Los Padres), of Solvang, California. Los Padres opened in 1983 as a state-chartered savings association known as Santa Ynez Valley Savings and Loan Association. The bank changed its name to Los Padres Savings Bank in 1987 and converted to a federally chartered savings bank in 1993. The name changed to Los Padres Bank in 1998. Los Padres had 11 branches located in the central coast area of California and 3 branches in the Phoenix/Scottsdale, Arizona, area. The bank's holding company, Harrington West Financial Group, Inc., formed in 1995 and acquired the bank in 1996. The Office of the Thrift Supervision (OTS) closed Los Padres and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on August 20, 2010. As of June 30, 2010, the bank had \$870.4 million in total assets. FDIC estimated that the loss to the Deposit Insurance Fund is \$8.7 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, we conducted a review of the failure of Los Padres 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 for the 5-year period before the thrift failure, and (3) interviewed OTS examination personnel.

We conducted this performance audit during September 2010 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 Los Padres' Failure**

The primary causes of Los Padres' failure were (1) high concentrations in commercial real estate, commercial/industrial loans, land loans, and non-agency mortgage backed securities; (2) ineffective board and management; and (3) inadequate internal asset reviews. Los Padres' losses were attributed to significant provisions for escalating levels of problem assets and declining real estate values, along with other than temporary impairment losses from deterioration in the investment portfolio. Inadequate risk management and internal asset review exacerbated the situation, as management failed to identify problem loans and recognize losses in a timely manner.

## **Conclusion**

Based on our review of the causes of Los Padres' 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 Los Padres' failure summarized in this memorandum are consistent with the information contained in its reports of examination and documents in support of the grounds for receivership. 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) 927-6512 or Susan Roy, Audit Manager, at (202) 927-5746.

Attachments



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

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

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November 3, 2010

**MEMORANDUM FOR:** Michael J. Maloney  
Director, Fiscal Service Audits  
Office of Inspector General  
U.S. Department of the Treasury

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

**SUBJECT:** Draft Failed Bank Review of  
Los Padres Bank

Thank you for the opportunity to comment on your draft memorandum entitled "Failed Bank Review of Los Padres Bank." Because the estimated loss of \$8.7 million to the Deposit Insurance Fund is below the \$200 million threshold set forth in section 38(k) of the Federal Deposit Insurance Act, the review of the failure of Los Padres Bank was limited to ascertaining the grounds identified by OTS for appointment of a receiver and determining whether any unusual circumstances exist warranting a more in-depth review.

The memorandum summarizes the primary causes of Los Padres' failure, which are consistent with the information contained in the OTS Reports of Examination and documents in support of the grounds for receivership. Specifically, the memorandum cites the high concentrations in commercial real estate, commercial/industrial loans, land loans, and non-agency mortgage backed securities; ineffective board and management; and inadequate internal asset reviews. Los Padres' losses were attributed to significant provisions for escalating levels of problem assets and declining real estate values, along with other than temporary impairment losses from deterioration in the investment portfolio. The memorandum identified no unusual circumstances surrounding the failure or the supervision exercised by OTS warranting a more in-depth review by the Office of Inspector General.

Thank you again for the opportunity to review and respond to the draft review of Los Padres Bank. OTS appreciates the professionalism and courtesies provided by the staff of the Office of Inspector General.

**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