



Audit Report



OIG-12-045

SAFETY AND SOUNDESS: Material Loss Review of Lydian Private Bank

March 21, 2012

Office of
Inspector General

DEPARTMENT OF THE TREASURY

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Abbreviations

FDIC	Federal Deposit Insurance Corporation
MRBA	matter requiring board attention
OCC	Office of Comptroller of the Currency
OIG	Office of Inspector General
OTS	Office of Thrift Supervision
PCA	prompt corrective action
ROE	report of examination
TFR	thrift financial report

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*The Department of the Treasury
Office of Inspector General*

March 21, 2012

John G. Walsh
Acting Comptroller of the Currency

This report presents the results of our material loss review of the failure of Lydian Private Bank (Lydian), of Palm Beach, Florida, and the former Office of Thrift Supervision's (OTS) supervision of the institution. OTS regulated Lydian until July 21, 2011, when the Office of the Comptroller of the Currency (OCC) assumed regulatory responsibility for federal savings associations pursuant to P.L. 111-203.

OCC closed the thrift and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on August 19, 2011. Section 38(k) of the Federal Deposit Insurance Act mandated this review because of the magnitude of the thrift's estimated loss to the Deposit Insurance Fund.^{1,2} As of December 31, 2011, FDIC estimated that loss at \$292.1 million.

The objectives of our review were to determine the causes of the thrift's failure; assess OTS's supervision of the thrift, including implementation of the prompt corrective action (PCA) provisions of section 38; and make recommendations for preventing any such loss in the future. We also assessed OCC's implementation of PCA provisions of section 38 from July 21, 2011, through the bank's closure on August 19, 2011. To

¹ Effective July 21, 2010, section 38(k) defines a loss as material if it exceeds \$200 million for calendar years 2010 and 2011, \$150 million for calendar years 2012 and 2013, and \$50 million for calendar years 2014 and thereafter (with a provision that the threshold can be raised temporarily to \$75 million if certain conditions are met).

² Certain terms that are underlined when first used in this report, are defined in *Safety and Soundness: Material Loss Review Glossary*, OIG-11-065 (April 11, 2011). That document is available on the Treasury Office of Inspector General's (OIG) website at <http://www.treasury.gov/about/organizational-structure/ig/Pages/by-date-2011.aspx>.

accomplish these objectives, we reviewed the supervisory files and interviewed former OTS and current OCC officials involved in the regulatory enforcement matters. We also interviewed personnel at FDIC's Division of Resolutions and Receivership. Appendix 1 contains a more detailed description of our objectives, scope, and methodology. Appendix 2 contains background information on Lydian and OTS's supervision of the institution.

In brief, our review found that Lydian failed primarily because of (1) a high-risk concentration in nontraditional mortgages, including option adjustable rate mortgages (ARM) and (2) a dominant chief executive officer (CEO) and deficient board of directors' oversight and governance. Regarding supervision, OTS did not take timely enforcement action to address Lydian's high concentration in nontraditional mortgages and deficient board oversight and governance.

As of the date of this report, there are multiple open investigations by various agencies related to questionable activities by the thrift. As these matters have not been concluded, we were unable to assess the extent that these activities might have contributed to Lydian's failure or if OTS's supervisory response to the activities was appropriate. We also referred certain matters to the Treasury Inspector General's Office of Investigations.

In light of the fact that OTS functions transferred to other federal banking agencies on July 21, 2011, we are not making any recommendations as a result of our material loss review of Lydian.

We provided OCC with a draft of this report for its review. In a written response, which is included as Appendix 3, OCC did not provide specific comments on the report contents.

Causes of Lydian Private Bank's Failure

Lydian failed primarily because of its high concentration in nontraditional mortgages, including option ARMs. In addition,

Lydian had a dominant CEO and its board of directors' oversight and governance was deficient.

High Concentration in Nontraditional Mortgages

OTS defined a concentration as a group of similar types of assets that, when aggregated, exceeded 25 percent of the association's core capital plus allowances for loan and lease losses (ALLL). Prior to 2007, Lydian focused its growth strategy on originating and purchasing high-risk nontraditional mortgages but did not appropriately manage the associated risks. As of December 31, 2005, and March 31, 2007, Lydian's nontraditional mortgages represented 918 and 874 percent, respectively, of core capital plus ALLL. Of those loans, option ARMs represented 255 and 450 percent, respectively, of core capital plus ALLL.

The option ARM loan portfolio predominately consisted of mortgage loans originated by Lydian in 2005 during the peak of the real estate market as well as loans purchased by Lydian in January 2007 that had been originated by Countrywide Home Loans, Inc.³ The portfolio consisted mainly of loans secured by properties in California and Florida, and contained many stated income and negative amortizing loans.

Lydian's significant concentration in nontraditional mortgages and lack of adequate concentration risk management practices led to asset quality deterioration beginning in 2007. Its adversely classified assets, which were primarily option ARM loans, increased from 4.4 percent to 38.2 percent of core capital plus ALLL from March 31, 2007, to June 30, 2008. As a result, Lydian recorded loan loss provisions of \$41 million, \$88 million, and \$54 million in 2008, 2009, and 2010, respectively. These substantial loan loss provisions caused

³ The Countrywide loans purchased by Lydian principally consisted of loans originated in 2005 and 2006 that were secured primarily by residential properties in California and Florida and underwritten with alternative documentation. In early 2008, Lydian determined that the stated income was often two or three times borrowers' income reported to the Internal Revenue Service. In November 2008, Lydian sued Countrywide, alleging that certain mortgage loans should have been repurchased due to underwriting misrepresentations. The matter was settled in May 2009 whereby Countywide agreed to repurchase \$12 million in loans. An additional net settlement of \$11 million was reached in October 2009.

continued erosion of capital and ultimately Lydian fell to the critically undercapitalized PCA capital category in May 2011.

Dominant CEO/Chairman and Deficient Board Oversight and Governance

The OTS Handbook stated that one reason a bank can become troubled is the domination of the board by one director or officer. It also stated that the board of directors is responsible for (1) establishing and maintaining appropriate committees, (2) hiring and retaining skilled and experienced executive officers; and (3) ensuring that board meeting minutes represent a complete and accurate record.

Lydian's board of directors (1) allowed the CEO/chairman of the board to heavily influence the operations of the thrift, (2) did not maintain appropriate committees, (3) approved the hiring of inexperienced key personnel, (4) was unable to retain executive officers; and (5) did not maintain accurate and detailed board minutes.

According to OTS examiners, Lydian's CEO/chairman of the board had a dominating influence over the operations of the thrift. A board-approved policy granted loan approval authority to the CEO/chairman in combination with one of two other senior officers, up to the thrift's legal lending limit. The policy did not require the prior approval of the loan committee or the board. As a result, the CEO approved several large speculative loans and questionable loan modifications without board disclosure or approval. In 2009, OTS examiners noted that the CEO exerted considerable influence on the activities of the thrift and holding company enterprise through his management positions and ownership interest in Lydian's holding company.

In his role as chairman of the board, Lydian's CEO did not ensure that the board met its basic responsibilities in overseeing the affairs of the thrift as evidenced by the lack of appropriate committees. Lydian's credit risk management was the responsibility of the chairman (prior to becoming both chairman and CEO) and the CEO, who were the only two members of the credit committee. This committee did not maintain minutes or

regularly provide lists of classified assets to the board. In its 2008 report of examination (ROE), OTS examiners criticized the institution's asset classification process because it was informal and consisted primarily of meetings between the CEO and the thrift's chief operating officer (COO). OTS examiners did not consider this an appropriate forum to discuss and approve classifications. Furthermore, OTS examiners downgraded approximately \$23 million in classified assets in 2008, which nearly doubled the amount of classified assets identified by the thrift. At the recommendation of OTS, Lydian established a formal asset classification committee in April 2009. However, this committee still did not provide appropriate disclosures and monitoring reports to the board. It also did not maintain proper documentation of its problem loans.

Lydian's board approved the hiring of individuals who lacked the necessary independence, skills, and experience, and the board was unable to retain key members of senior management, as was evident by frequent turnover. In 2008, OTS recommended Lydian hire a chief credit officer to strengthen the management infrastructure as it relates to risk management and financial reporting. In response, the board approved the appointment of an existing executive vice president as the chief credit officer in 2009. However, this individual lacked independence since he was actively involved in many of the approvals and modifications for large commercial loans.

OTS noted that Lydian had frequent turnover in both senior management and the board of directors. For example, Lydian had four different chief financial officers (CFO) between 2007 and 2011, and the board had a number of changes in membership as well as vacancies from 2006 to 2011. In May 2010, the treasurer was promoted to CFO to replace a CFO who resigned. However, the newly promoted CFO lacked the depth and expertise necessary for the position, as was evidenced by continued accounting errors, delays in providing OTS requested information, and his inability to explain accounting issues to OTS. Lydian also hired an executive vice president of operations and technology in 2010 that had no prior banking experience. In 2011, OTS examiners noted that

changes in the board and management's membership negatively affected Lydian's operations and financial reporting.

From 2004 through 2009, Lydian repeatedly did not comply with matters requiring board attention (MRBA) issued by OTS that directed Lydian's board and management to improve the documentation of board minutes. OTS noted that significant bank developments, detailed financial results, and board approvals were not consistently recorded in the board minutes.

In a cease and desist (C&D) order dated September 16, 2010, OTS noted that Lydian had engaged in unsafe or unsound practices including operating without experienced and qualified management and staff and inadequate board supervision. During their 2011 examination, OTS examiners noted that the corporate governance remained a serious supervisory concern as OTS's review disclosed several instances of noncompliance with the C&D order and the earlier memorandum of understanding (MOU).⁴ The board and management failed to comply with enforcement documents, remedy the thrift's declining financial condition, or correct the thrift's unsafe or unsound practices, which substantially dissipated Lydian's assets and earnings and depleted the thrift's capital.

OTS's Supervision of Lydian Private Bank

OTS's supervision of Lydian did not prevent a material loss to the Deposit Insurance Fund. OTS did not take timely enforcement action to address Lydian's (1) unsafe and unsound concentration in nontraditional mortgages or (2) deficient board oversight and governance.

Table 1 summarizes the results of OTS's full-scope safety and soundness and limited-scope examinations of Lydian from 2006 until the thrift's closure.⁵ In general, an MRBA, although not an

⁴ A memorandum of understanding, an informal enforcement action, is a commitment by a thrift to OTS in which the thrift agrees to correct a violation of law, regulation, or an unsafe or unsound practice.

⁵ OTS conducted its examinations and performed off-site monitoring of Lydian in accordance with the timeframes prescribed in the OTS Examination Handbook.

enforcement action, is a stronger supervisory response than a corrective action.

Table 1: Summary of OTS's Examinations and Enforcement Actions for Lydian
Examination Results

Date started/ completed	Assets (in billions)	CAMELS rating	Number of MRBAs	Number of corrective actions	Enforcement actions
2/21/2006 5/31/2006 Full-scope examination	\$1.6	2/222222	4	6	None
4/23/2007 7/16/2007 Full-scope examination	\$1.8	2/222222	4	6	None
8/4/2008 12/1/2008 Full-scope examination	\$1.9	3/333322	7	26	MOU (5/21/2009)
2/2/2009 2/23/2009 Limited- scope examination	\$2.1	3/333322	0	3	None
12/14/2009 5/5/2010 Full-scope examination	\$2.1	4/344422	5	26	Troubled Condition Letter (7/2/2010) C&D Order (9/16/2010) Civil Money Penalty (12/21/2010)
10/25/2010 11/24/2010 Limited- scope examination	\$1.9	4/344422	0	0	None
4/4/2011 5/27/2011 Full-scope examination	\$1.8	5/555554	13	30	PCA Directive (8/18/2011)

Source: OTS.

OTS Did Not Take Timely Enforcement Action to Address Lydian's Concentration in Nontraditional Mortgages

OTS New Directions 6-14, issued November 2006, stated that OTS examiners should develop an effective supervisory response for financial institutions that have material exposure to specific risk concentrations and promptly initiate appropriate corrective or supervisory action when necessary. It also stated that examiners may instruct the association to discontinue activities that lead to a specific high-risk concentration when proper oversight and controls are not in place. The Interagency Guidance on Nontraditional Mortgage Product Risks, issued October 2006, stated that concentrations that are not effectively managed will be subject to elevated supervisory attention and potential examiner criticism to ensure timely remedial action.

Lydian's aggressive lending strategy prior to 2007 resulted in a significant concentration in nontraditional mortgages. As mentioned above, as of December 31, 2005, the value of Lydian's nontraditional mortgages represented 918 percent of core capital plus ALLL and of those loans, option ARMs represented 255 percent of core capital plus ALLL. OTS issued an MRBA in its May 2006 ROE directing that the board establish limitations in Lydian's nontraditional mortgage portfolio. The thrift responded in an August 2006 letter stating that the board would consider portfolio limitations for nontraditional mortgages once it believed that it had the relevant information over a period of time sufficient to enable it to determine what, if any, limitations were necessary. In November 2006, OTS accepted this response but again suggested the board establish reasonable limitations. Lydian then proceeded to purchase a pool of option ARMs in the amount of \$243 million in January 2007. By March 2007, Lydian's nontraditional mortgage portfolio was \$1.1 billion and its option ARMs had increased by 96 percent since December 2005. In its 2007 ROE, OTS noted but did not object to the thrift's 2007 budget projections to increase its option ARMs by another 40 percent or \$215 million, despite repeated risk management criticisms. Lydian began exiting the mortgage

market in June 2007 and the nontraditional mortgage portfolio began to significantly deteriorate.

OTS issued an MRBA in 2006 instructing the thrift to develop effective management information systems to monitor and manage credit risks within Lydian's nontraditional mortgage portfolio. OTS issued an MRBA in 2007 and a corrective action in 2008 instructing Lydian to account for the nontraditional mortgage risks in its ALLL methodology. Due to these significant risks, OTS instructed Lydian in a 2009 MRBA to risk-weight all payment option ARMs at 100 percent for risk-based capital purposes.

Despite the existing high concentration in nontraditional products and criticisms of the thrift's credit and concentration risk management, OTS did not require Lydian to set limits on its nontraditional mortgage concentration prior to the thrift substantially increasing the concentration in 2007. OTS did not take enforcement action until May 2009, after Lydian had already ceased its nontraditional mortgage lending. At that time, OTS entered into an MOU instructing the thrift to develop a strategy to reduce the concentration in the nontraditional mortgage portfolio and to adopt prudent internal concentration limits.

A former OTS assistant regional director told us that OTS could have established limits on the option ARM loan concentration and that OTS was too late in understanding the true risks within that portfolio. A former OTS examiner told us that OTS should have enforced limits on the option ARM loans.

OTS Did Not Take Timely Enforcement Action to Address Lydian's Deficient Board Oversight and Governance

The OTS handbook stated that in reviewing executive officers' performance, examiners need to determine that sound corporate governance policies and a strong system of internal controls exist. It also stated that an institution warranted a 3 CAMELS composite rating if it exhibited a combination of weaknesses that range from moderate to severe, and risk management practices were less than satisfactory. If board performance

needed improvement or risk management practices were less than satisfactory and problems and significant risks were inadequately identified, measure, monitored, or controlled, the handbook stated an institution's CAMELS management component warranted a 3 rating. The handbook also provided examples of when OTS would consider taking formal enforcement action, including when (1) the thrift's controls and policies exhibit significant problems, (2) the board does not take corrective action, and (3) the association does not maintain satisfactory books and records.

As early as 2002 and continuing to 2011, OTS repeatedly noted problems with Lydian's policies, ALLL methodology, board meeting minutes, and thrift financial reports (TFR).⁶ Additionally, OTS examiners stated they had problems receiving timely access to Lydian's records during examinations. However, OTS did not downgrade Lydian's CAMELS management component and the composite rating to 3 until the 2008 examination, and did not take formal enforcement action until September 2010 when it issued the C&D order.

In addition to the problems identified by examiners discussed above, OTS e-mails we reviewed revealed that OTS received a 2008 anonymous letter from a former Lydian employee. The letter alleged that "several executive officers responsible for the financial well being of the bank left because the board chairman was mismanaging the finances with irresponsible desperation." When we asked what action OTS took in response to the letter, several former OTS employees had vague recollections of the letter but did not recall doing anything to address it.

Several former OTS employees stated OTS should have taken stronger enforcement action sooner instead of waiting until May 2009 to issue an MOU.

⁶ OTS required Lydian to re-file several TFRs from 2002 through 2011 and to restate its 2008 and 2009 audited financial statements due to aggressive and erroneous accounting methods. Lydian's external auditors reported a material weakness in Lydian's internal control over financial reporting in 2009. A former OTS examiner stated that during examinations, Lydian did not always provide financial information in a timely manner.

OTS's and OCC's Use of Prompt Corrective Action

The purpose of PCA is to resolve problems of insured depository institutions with the least possible long-term loss to the Deposit Insurance Fund. PCA requires federal banking agencies to take certain actions when an institution's capital drops below certain levels. PCA also gives regulators flexibility to supervise institutions based on criteria other than capital levels.

Lydian reported that its capital level was undercapitalized on May 2, 2011, with the filing of TFR for the quarter ended March 31, 2011, TFR. In addition, on May 13, 2011, Lydian filed an amended TFR for the quarter ended December 31, 2010,⁷ also putting it in the PCA undercapitalized category as of that date. On May 20, 2011, OTS notified Lydian in writing of its undercapitalized status, relevant PCA restrictions, and requirement to file a capital restoration plan by June 16, 2011. Lydian reported that its capital level was critically undercapitalized in an amended TFR for the quarter ended March 31, 2011, filed on May 26, 2011. On June 3, 2011, OTS notified Lydian in writing of its critically undercapitalized status and additional mandatory PCA provisions. Lydian submitted a capital restoration plan, which was later rejected by OTS because the plan did not sufficiently develop the steps the thrift would take to become adequately capitalized.

Subsequent to the transfer of certain OTS authorities to OCC on July 21, 2011, OCC issued a PCA directive to Lydian on August 18, 2011, based on the determination that the directive was necessary to resolve the institution at the least possible long-term cost to the Deposit Insurance Fund. Because of Lydian's failure to submit a viable capital restoration plan and the substantial dissipation of Lydian's assets and earnings, OCC placed Lydian into receivership. We consider OTS and OCC's use of PCA to be appropriate.

⁷ The December 31, 2010, TFR originally showed the bank as well-capitalized. There were two amendments to this TFR with the second amendment showing the bank to be undercapitalized.

Concluding Remarks

Our material loss review revealed two deficiencies in OTS's supervision of Lydian. OTS should have taken more timely enforcement action to address (1) an unsafe and unsound concentration in nontraditional mortgages, and (2) Lydian's deficient board oversight and governance. Pursuant to P.L. 111-203, the functions of OTS transferred to other federal banking agencies on July 21, 2011. Accordingly, we are not making any recommendations to OCC as a result of our material loss review of Lydian.

It should be noted that we reported on high concentrations and a lack of strong supervisory response in a number of our material loss reviews of both OTS- and OCC-regulated failed financial institutions. To provide more direction on concentration limits, OCC updated its Concentrations of Credit handbook in December 2011 to emphasize the importance of risk management practices, maintaining adequate capital, and to encourage financial institutions to revisit existing concentration policies. While we believe the guidance was better than what had been available to banks and examiners previously, it is too soon to tell whether the guidance will be effective at controlling risky concentrations going forward.

* * * * *

We appreciate the courtesies and cooperation provided to our staff during the audit. If you wish to discuss the report, you may contact me at (202) 927-0384 or Theresa Cameron, Audit Manager, at (202) 927-1011. Major contributors to this report are listed in appendix 4.

/s/
Jeffrey Dye
Audit Director

We conducted a material loss review of Lydian Private Bank (Lydian) of Palm Beach, Florida, in response to our mandate under section 38(k) of the Federal Deposit Insurance Act.⁸ This section provides that if the Deposit Insurance Fund incurs a material loss with respect to an insured depository institution, the inspector general for the appropriate federal banking agency is to prepare a report to the agency that

- ascertains why the institution's problems resulted in a material loss to the insurance fund;
- reviews the agency's supervision of the institution, including its implementation of the prompt corrective action (PCA) provisions of section 38; and
- makes recommendations for preventing any such loss in the future.

At the time of Lydian's failure on August 19, 2011, section 38(k) defined a loss as material if it exceeded \$200 million during calendar years 2010 and 2011. The law also requires the inspector general to complete the report within 6 months after it becomes apparent that a material loss to the Deposit Insurance Fund has been incurred. We initiated this material loss review of Lydian based on the loss estimate by the Federal Deposit Insurance Corporation (FDIC), which was \$293.2 million at the time of closing. As of December 31, 2011, FDIC estimated that the loss would be \$292.1 million.

Our objectives were to determine the causes of Lydian's failure; assess the former Office of Thrift Supervision's (OTS) supervision of Lydian, including implementation of the PCA provisions of section 38; and make recommendations for preventing such a loss in the future. The OTS regulatory functions for federal savings associations transferred to the Office of the Comptroller of the Currency (OCC) on July 21, 2011, prior to Lydian's closing on August 19, 2011. Due to OCC's limited supervisory involvement with Lydian, our assessment of its supervision focused on PCA. To accomplish

⁸12 U.S.C. § 1831o(k).

our review, we conducted fieldwork at OCC's headquarters in Washington, D.C., and its Southern District Field Office in Miami, Florida. We also conducted interviews of former OTS employees in Atlanta, Georgia, and officials of FDIC's Division of Resolutions and Receivership. We conducted our fieldwork from August through December 2011.

To assess the adequacy of OTS's supervision of Lydian, we determined (1) when OTS first identified the thrift's safety and soundness problems, (2) the gravity of the problems, and (3) the supervisory response OTS took to get the thrift to correct the problems. We also assessed whether OTS (1) might have discovered problems earlier; (2) identified and reported all the problems; and (3) issued comprehensive, timely, and effective enforcement actions that dealt with any unsafe or unsound activities. In addition, we assessed whether OCC's implementation of PCA provisions of section 38 was timely. Specifically, we performed the following work:

- We determined that the period covered by our audit would be from February 21, 2006, through the thrift's failure on August 19, 2011. This period included five full-scope safety and soundness examinations and two limited-scope examinations of Lydian.
- We reviewed OTS's supervisory files and records for Lydian from 2006 through 2011 and OCC's 2011 supervisory files and records for Lydian. We analyzed examination reports, supporting workpapers, and related supervisory and enforcement correspondence. We performed these analyses to gain an understanding of the problems identified, the approach and methodology OTS used to assess the thrift's and holding company's condition, and the action used by OTS to compel thrift and holding company management to address deficient conditions. We did not conduct an independent or separate detailed review of the external auditor's work or associated workpapers other than those incidentally available through the supervisory files.
- We interviewed and discussed various aspects of the supervision of the thrift and holding company with former

OTS officials and examiners and OCC officials to obtain their perspectives on the thrift's and holding company's condition and the scope of the examinations.

- We selectively reviewed Lydian's documents that had been taken by FDIC and inventoried by FDIC Division of Resolutions and Receivership personnel. From FDIC's inventory list, we identified documents for our review that were most likely to shed light on the reasons for the thrift's failure and OTS's supervision of the institution.
- We assessed OTS's and OCC's actions based on its internal guidance and the requirements of the Federal Deposit Insurance Act.⁹

We conducted this performance audit 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.

⁹ 12 U.S.C. § 1811 et seq.

Lydian Private Bank History

Lydian Private Bank (Lydian) was a federal savings association chartered on April 6, 2000. Lydian was originally named VirtualBank, and began operations as an internet bank with a significant mortgage banking operation headquartered in Palm Beach, Florida. The thrift's primary funding source was Internet deposits. In June 2002, the thrift changed its name to Lydian Private Bank and revised its business strategy to include private banking and wealth management. Lydian Holding Company, a non-diversified savings and loan holding company, owned 79 percent of the thrift.

In addition to its main office in Palm Beach, Lydian had five branches located in Palm Beach Gardens, North Palm Beach, Coral Gables, Sarasota, and Tampa, Florida. Lydian ceased its mortgage lending operations in mid-2007 and focused on private banking and wealth management services along with commercial and consumer lending. In 2007, Lydian began to incur large losses on its nontraditional mortgage loans that were primarily secured by property in declining real estate areas (California and Florida). These losses resulted in asset quality deterioration which led to capital erosion.

Lydian Holding Company filed an application for funds under the Capital Purchase Program of the Troubled Asset Relief Program (TARP) on November 18, 2008, but withdrew the application on September 14, 2009.

OTS Assessments Paid by Lydian Private Bank

OTS funded its operations in part through semiannual assessments on savings associations. OTS determined each institution's assessment by adding together three components reflecting the size, condition, and complexity of an institution. OTS computed the size component by multiplying an institution's total assets as reported on the thrift financial report by the applicable assessment rate. The condition component was imposed on institutions that had a 3, 4, or 5 CAMELS composite rating. OTS imposed a complexity component if (1) a thrift administered more than \$1 billion in trust assets; (2) the

outstanding balance of assets fully or partially covered by recourse obligations or direct credit substitutes exceeded \$1 billion, or (3) the thrift serviced over \$1 billion of loans for others. OTS calculated the complexity component by multiplying set rates times the amounts by which an association exceeds each particular threshold. Table 2 shows the amounts that Lydian paid from 2006 through 2011.

Table 2: Assessments Paid by Lydian to OTS, 2006–2011

Billing Period	Exam Rating	Amount Paid
1/1/2006-6/30/2006	2	\$138,634
7/1/2006-12/31/2006	2	151,165
1/1/2007-6/30/2007	2	172,240
7/1/2007-12/31/2007	2	191,212
1/1/2008-6/30/2008	2	194,215
7/1/2008-12/31/2008	2	190,638
1/1/2009-6/30/2009	3	291,282
7/1/2009-12/31/2009	3	301,476
1/1/2010-6/30/2010	3	305,216
7/1/2010-12/31/2010	4	383,714
1/1/2011-6/30/2011	4	377,030

Source: OTS.

Number of OTS/OCC Staff Hours Spent Examining Lydian

Table 3 shows the number of OTS staff hours spent examining Lydian from 2006 to 2011. In addition, OCC spent 381 hours examining Lydian on the last examination, but there were no assessments paid to OCC by Lydian because OCC was not the primary regulator at the time of the examination.

Appendix 2
Background

Table 3: Number of OTS Hours Spent Examining Lydian, 2006-2011

Examination Start Date	Number of Examination Hours
2/21/2006	1,141
4/23/2007	945
8/4/2008	2,204
2/2/2009	92
12/14/2009	2,334
10/25/2010	384
4/4/2011	2,941

Source: OTS.

○

MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

To: Jeffrey Dye, Director, Banking Audits

From: John Walsh, Acting Comptroller of the Currency /s/

Date: March 20, 2012

Subject: Response to Material Loss Review of Lydian Private Bank

We have received and reviewed your draft report titled "Material Loss Review of Office of Thrift Supervision Regulated-Lydian Private Bank (Lydian)." This review is mandated by section 38(k) of the Federal Deposit Insurance Act because of the magnitude of the bank's estimated loss to the Deposit Insurance Fund at the time of its failure. Your objectives were to determine the causes of Lydian's failure; assess OTS's supervision of the bank, including implementation of the prompt corrective action (PCA) provisions of section 38; and make recommendations for preventing such a loss in the future. To accomplish these objectives, you reviewed the supervisory files and interviewed former OTS and current OCC and FDIC officials.

You concluded that the primary causes of Lydian's failure were a high concentration in nontraditional mortgages, a dominant chief executive officer/chairman and deficient board oversight and governance.

You also concluded that OTS did not take timely enforcement action to address Lydian's concentration in nontraditional mortgages and to address Lydian's deficient board oversight and governance. OTS and OCC's use of PCA was appropriate.

Your report does not contain any recommendations.

Thank you for this information and the opportunity to review and comment on your draft report. If you need additional information, please contact Jennifer Kelly, Senior Deputy Comptroller for Midsize and Community Bank Supervision, at 202-874-5020.

Appendix 4
Major Contributors to This Report

Theresa Cameron, Audit Manager
Dana Duvall, Auditor-in-Charge
Patrick Gallagher, Auditor
Jen Ksanznak, Auditor
Tim Cargill, Referencer

Department of the Treasury

Deputy Secretary of the Treasury
Office of Strategic Planning and Performance Management
Office of the Deputy Chief Financial Officer, Risk and Control
Group

Office of the Comptroller of the Currency

Acting Comptroller of the Currency
Liaison Officer

Office of Management and Budget

OIG Budget Examiner

U.S. Senate

Chairman and Ranking Member
Committee on Banking, Housing, and Urban Affairs

Chairman and Ranking Member
Committee on Finance

U.S. House of Representatives

Chairman and Ranking Member
Committee on Financial Services

Federal Deposit Insurance Corporation

Acting Chairman
Inspector General

U.S. Government Accountability Office

Comptroller General of the United States