Audit Report

OIG-12-051

SAFETY AND SOUNDNESS: Failed Bank Review of SCB Bank

May 9, 2012

Office of Inspector General

DEPARTMENT OF THE TREASURY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

May 9, 2012

OIG-12-051

MEMORANDUM FOR THOMAS J. CURRY
COMPTROLLER OF THE CURRENCY

FROM: Susan Barron /s/
Director, Banking Audits

SUBJECT: Failed Bank Review of SCB Bank, Shelbyville, Indiana

This memorandum presents the results of our review of the failure of SCB Bank (SCB), located in Shelbyville, Indiana, and the former Office of Thrift Supervision's (OTS) supervision of the institution. OTS regulated SCB 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.

SCB was an insured federal stock savings association established in 1891. It operated one main office and three branches in Shelby County, Indiana. OCC closed SCB and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on February 10, 2012. As of December 31, 2011, SCB had approximately \$182.6 million in total assets. At that time, FDIC estimated the loss to the Deposit Insurance Fund to be \$33.9 million.

Because the loss to the Deposit Insurance Fund is less than \$150 million, as set forth by section 38(k) of the Federal Deposit Insurance Act, we conducted a review of the failure of SCB that was limited to (1) ascertaining the grounds identified by OCC 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 bank's failure, and (3) interviewed OCC personnel.

We performed our fieldwork during February and March 2012. 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.

Causes of SCB's Failure

OCC appointed FDIC as receiver based on the following grounds: (1) SCB had experienced a substantial dissipation of assets or earnings due to unsafe or unsound practices, (2) the bank incurred or was likely to incur losses that would deplete all or substantially all of its capital and there was no reasonable prospect for it to become adequately capitalized without federal assistance, (3) the bank's unsafe or unsound practices or conditions were likely to seriously prejudice the interests of the Deposit Insurance Fund, and (4) the bank was critically undercapitalized.

The primary cause of SCB's failure was its aggressive growth strategy that focused on higher risk (1) loans including commercial real estate loans, commercial loans, home equity lines of credit; and (2) investments in non-agency collateralized mortgage obligation (CMO) securities.[1] SCB's lack of sufficient capital, inadequate credit risk management, and inadequate credit administration practices also contributed to its failure. The bank's higher risk loans and investment in non-agency CMOs were primarily funded by higher cost wholesale funds, including volatile brokered deposits and advances from the Federal Home Loan Bank. Management and the board also failed to adjust quickly or effectively to changing economic conditions and as a result, SCB's asset quality deteriorated, classified asset levels increased, and capital and earning declined, ultimately leading to SCB's failure.

Conclusion

Based on our review of the causes of SCB's failure and the grounds identified by OCC for appointing FDIC as receiver, we determined that there were no circumstances surrounding the bank's failure that would necessitate an in-depth review. In making this determination, we took into consideration that the federal savings association functions of OTS, SCB's regulator until July 2011, transferred to OCC. We provided a draft of this memorandum to OCC management for comment. In its response, OCC stated that it agreed with our conclusion as to the causes of the failure of SCB and that it had no concerns with our determination that an in-depth review of the bank's failure is not warranted. The response is provided as Attachment 1. A list of the recipients of this memorandum is provided as Attachment 2.

---

[1] A non-agency CMO is a type of financial debt vehicle that is not sponsored by a Government-Sponsored Enterprise such as Fannie Mae. Legally, a CMO is a special purpose entity that is wholly separate from the institution(s) that create it. The entity is the legal owner of a set of mortgages, called a pool. Investors in a CMO buy bonds issued by the CMO, and they receive payments according to a defined set of rules.

We appreciate the courtesies and cooperation provided to our staff during the audit. If you have any questions, you may contact me at (202) 927-5776 or Amni Samson, Audit Manager, at (202) 927-0264.

Attachments

MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

To: Susan Barron, Director, Banking Audits

From: Thomas J. Curry, Comptroller of the Currency /s/

Date: May 4, 2012

Subject: Response to Failed Bank Review of SCB, Shelbyville, Indiana

We have received and reviewed your draft report titled "Failed Bank Review of SCB Bank, Shelbyville, Indiana (SCB)." The loss to the Deposit Insurance Fund is less than $150 million, therefore, as set forth by section 38(k) of the Federal Deposit Insurance Act, you conducted a review of the failure of SCB that was limited to: (1) ascertaining the grounds identified by the OCC 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. Your report presents the results of your review of SCB's failure and the former Office of Thrift Supervision's (OTS) supervision of the institution. In performing your review you: (1) examined documentation related to the appointment of FDIC as receiver, (2) reviewed OTS reports of examination for the five year period before the bank's failure, and (3) interviewed OCC personnel.

You conducted your audit during February and March 2012 in accordance with generally accepted government auditing standards. Those standards require that you plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for your findings and conclusions. You believe that the evidence obtained provides a reasonable basis for your findings and conclusions.

You concluded that the primary cause of SCB Bank's failure was its aggressive growth strategy that focused on higher risk (1) loans including commercial real estate loans, commercial loans, home equity lines of credit; and (2) investments in non-agency collateralized mortgage obligation (CMO) securities. We agree.

You determined that there were no unusual circumstances surrounding the bank's failure or the supervision exercised by the OCC and the former OTS. As a result, you determined that a more in-depth review of the bank's failure by the OIG is not warranted. We have no concerns with your determination.

Thank you for 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.

Department of the Treasury

Deputy Secretary
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

Comptroller of the Currency
Liaison Officer

Office of Management and Budget

OIG Budget Examiner