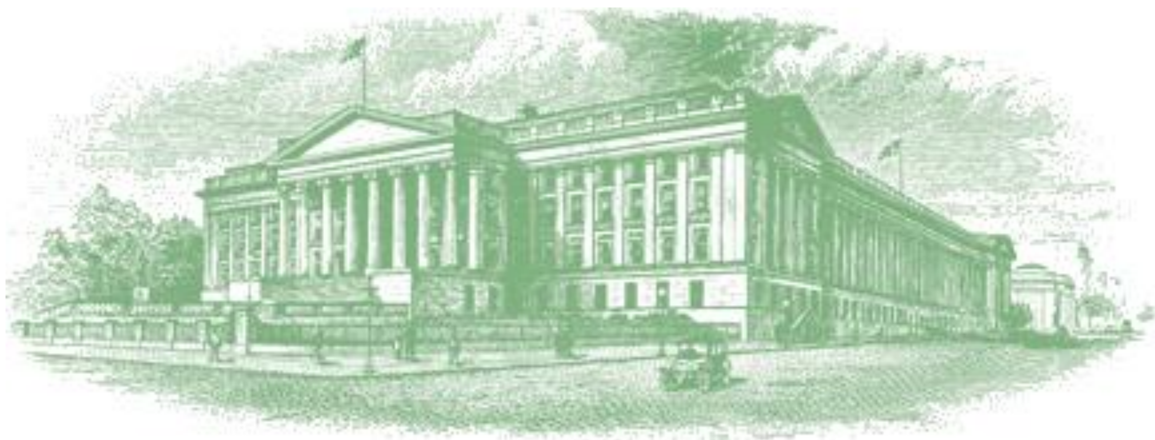
Audit Report



OIG-14-046

SAFETY AND SOUNDNESS: Failed Bank Review of Slavie Federal Savings Bank, Bel Air, Maryland

September 15, 2014

Office of Inspector General

Department of the Treasury

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

September 15, 2014

OIG-14-046

MEMORANDUM FOR THOMAS J CURRY
COMPTROLLER OF THE CURRENCY

FROM: Jeffrey Dye /s/
Director, Banking Audits

SUBJECT: Failed Bank Review of Slavie Federal Savings Bank, Bel Air, Maryland

This memorandum presents the results of our review of the failure of Slavie Federal Savings Bank (Slavie). Established as a mutual savings bank in 1900, Slavie converted to a stock institution with a mutual holding company structure in 2004. Slavie was wholly owned by SFSB, Inc. Slavie Bancorp MHC, a mutual holding company, owned 55 percent of the stock of SFSB. The remaining 45 percent of SFSB's stock was held by other shareholders including the bank's employee stock option plan. The bank's home office and one branch were located in Bel Air and Baltimore, Maryland, respectively. OCC closed Slavie and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on May 30, 2014. As of March 31, 2014, the bank had approximately $140.1 million in assets. As of July 31, 2014, FDIC estimated the loss to the Deposit Insurance Fund to be $6.6 million.

Because the loss to the Deposit Insurance Fund is less than $50 million, as set forth by section 38(k) of the Federal Deposit Insurance Act (FDIA), we conducted a review of the failure of Slavie 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 and (2) interviewed OCC examination personnel.

We performed our audit fieldwork from June to August 2014. 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.

Cause of Slavie Federal Savings Bank's Failure

OCC appointed FDIC receiver based on the following grounds: (1) the bank had experienced substantial dissipation of assets or earnings due to unsafe or unsound practices, (2) the bank was in an unsafe or unsound condition to transact business, (3) the bank's unsafe or unsound practices or conditions were likely to cause insolvency or substantial dissipation of assets or earnings, (4) the bank's unsafe or unsound practices or conditions were likely to weaken the institution's condition, (5) the bank's unsafe or unsound practices or conditions were likely to seriously prejudice the interests of the Deposit Insurance Fund, (6) the bank had 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, (7) the bank was undercapitalized and had no reasonable prospect of becoming adequately capitalized, and (8) the bank was undercapitalized and had failed to submit a capital restoration plan acceptable to the OCC within the time prescribed.

The primary cause of Slavie's failure was its loan growth strategy that resulted in significant concentrations in investor-owned residential real estate, commercial real estate, and land development loans in the bank's local market areas. Bank management pursued this strategy without commensurate risk management and credit administration practices, underwriting standards, or adequate capital to protect the bank from a prolonged period of deteriorating asset quality. Beginning in 2007, in an attempt to increase the bank's earnings, the board and management's lending strategy shifted from mainly single family primary residence loans to a focus on growth in its investor-owned residential real estate, commercial real estate, and land development loan portfolios. Between 2007 and 2009, the bank rapidly expanded these portfolios during a period of weakening economic conditions and accelerating deterioration in the residential real estate market. Slavie's board and management failed to adopt concentration guidelines for these portfolios until after the bank had established significant concentrations. The board and management's lax oversight and failure to adjust timely or effectively to changing economic conditions and the declining local real estate market resulted in the deterioration of the bank's asset quality, increased concentrations in investor-owned residential real estate, commercial real estate, and land development loans, as well as decreased earnings and capital. The problems created by the board and management's unsafe or unsound growth strategy were severe and led to the depletion of the bank's capital.

Conclusion

Based on our review of the causes of Slavie'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. 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 Slavie's failure 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.

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 at (202) 927-1011.

Attachments

Office of the
Comptroller of the Currency

MEMORANDUM

To: Jeffrey Dye, Director, Banking Audits

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

Date: August 22, 2014

Subject: Response to Failed Bank Review of Slavie Federal Savings Bank

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The Office of the Comptroller of the Currency (OCC) has received and reviewed the Treasury Office of Inspector General (OIG) draft report titled "Failed Bank Review of Slavie Federal Savings Bank (Slavie)" located in Bel Air, Maryland. The loss to the Deposit Insurance Fund is less than $50 million. Therefore, as set forth by section 38(k) of the Federal Deposit Insurance Act, the OIG conducted a review of the failure of Slavie that was limited to: (1) ascertaining the grounds identified by the OCC for appointing the Federal Deposit Insurance Corporation (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 and (2) interviewed OCC examination personnel.

The OIG conducted the audit from June to August 2014 in accordance with generally accepted government auditing standards. Those standards require that the OIG plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the OIG findings and conclusions. The OIG believes that the evidence obtained provides a reasonable basis for the findings and conclusions.

The OIG concluded the primary cause of Slavie's failure was its loan growth strategy that resulted in significant concentrations in investor-owned residential real estate, commercial real estate, and land development loans in the bank's local market areas. Bank management pursued this strategy without commensurate risk management and credit administration practices, underwriting standards, or adequate capital to protect the bank from a prolonged period of deteriorating asset quality. We agree.

The OIG determined that there were no circumstances surrounding the bank's failure that would necessitate an in-depth review. The OCC has no concerns with the determination.

If you need additional information, please contact Toney Bland, Senior Deputy Comptroller for Midsize and Community Bank Supervision, at 202-649-5420.

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