Audit Report

OIG-10-036

SAFETY AND SOUNDNESS: Material Loss Review of First Bank of Idaho

February 16, 2010

Office of Inspector General

Department of the Treasury

Contents

Abbreviations

ALLL	allowance for loan and lease losses
C&D	cease and desist
FDIC	Federal Deposit Insurance Corporation
FHLB	Federal Home Loan Bank

FRB	Federal Reserve Board
MRBA	matters requiring board attention
OTS	Office of Thrift Supervision
PCA	prompt corrective action
ROE	report of examination

February 16, 2010

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Office of Thrift Supervision

This report presents the results of our review of the failure of First Bank of Idaho, of Ketchum, Idaho, and the Office of Thrift Supervision's (OTS) supervision of the institution. OTS closed the thrift and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on April 24, 2009. 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] As of December 31, 2009, FDIC estimated that the loss would be $174.6 million. FDIC also estimated that the thrift's failure resulted in a loss of $4.7 million to the Transaction Account Guarantee Program.

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. To accomplish these objectives, we reviewed the supervisory files and interviewed key officials involved in the regulatory enforcement matters. We conducted fieldwork at OTS's headquarters in Washington, D.C.; OTS's regional offices in Daly City, California, and Seattle, Washington; and FDIC's office in Irvine, California. We also interviewed personnel at FDIC's Division of Supervision and Consumer Protection. Appendix 1 contains a more detailed description of our objectives, scope, and methodology.

This report contains several other appendices. Appendix 2 contains background information on First Bank of Idaho and OTS's thrift supervision processes. Appendix 3 is a glossary of terms used in this report (when first used in the text, the terms are underlined

[1] Section 38(k) defines a loss as material if it exceeds the greater of $25 million or 2 percent of the institution's total assets.

and hyperlinked to the glossary). Appendix 4 is a chronology of significant events related to First Bank of Idaho and OTS's supervision of the thrift. Appendix 5 contains significant examination results and information on enforcement actions. Appendix 6 contains Treasury Office of Inspector General (OIG) recommendations from material loss reviews of failed OTS-regulated institutions completed since April 2008.

Results in Brief

First Bank of Idaho failed primarily because of (1) significant loan delinquencies and losses incurred on construction and land loans and (2) inadequate capital relative to the risk levels of its loans. These loans were concentrated in resort areas that experienced severe declines when the real estate market deteriorated. Starting in 2008, First Bank of Idaho became reliant on brokered deposits and federal borrowings due to its unstable funding structure that included an unusually high amount of uninsured deposits. As the condition of the thrift deteriorated, First Bank of Idaho faced restrictions on its acceptance of brokered deposits and its access to federal borrowings became limited. The losses in high-risk loans combined with the thrift's inability to obtain reliable funding created a liquidity crisis that prompted OTS to close the thrift.

OTS's supervision of First Bank of Idaho did not prevent a material loss to the Deposit Insurance Fund. OTS identified credit concentrations early on at the thrift but did not adequately address the risk associated with them. OTS took enforcement action against the thrift only after the concentrations became problematic. In addition, OTS reached supervisory judgments on two matters in 2006 that were inconsistent with First Bank of Idaho's rising risk profile. As to the first matter, OTS did not take exception to the thrift lowering its target risk-based capital ratio from 11 percent to 10.5 percent. As to the second matter, OTS upgraded the thrift's CAMELS composite rating to 1. OTS also did not identify the thrift's improper use of interest reserves prior to its March 2009 examination. We referred the thrift's inappropriate use of interest reserves to the Treasury Inspector General's Office of Investigations.

In accordance with its policy, OTS conducted an internal failed bank review of First Bank of Idaho and determined that the thrift's failure was primarily caused by a severe liquidity crisis that culminated in April 2009. In its review, OTS concluded that the root cause of the First Bank of Idaho's failure was a severe decline in asset quality that began in 2008. The decline was related to the thrift's high concentration of higher-risk loan types—primarily land and construction loans in its relatively isolated market areas. The review identified four areas of weaknesses in OTS's supervision of First Bank of Idaho related to the thrift's concentrations in higher-risk loan areas. Our material loss review affirmed OTS's internal findings and the need for corrective action.

We are recommending that OTS ensures (1) action is taken on its internal failed bank review of First Bank of Idaho and (2) examiners sufficiently consider a thrift's risk profile when deciding whether to allow the thrift to lower its internal capital targets and when determining the thrift's CAMELS ratings.

In a written response, OTS concurred with our recommendations and plans to implement them by the end of the second quarter of 2010. OTS also stated that it has taken action pursuant to its internal failed bank review of First Bank of Idaho. This action included issuing on October 30, 2009, CEO Letter No. 325, "Guidance on Prudent Commercial Real Estate Loan Workouts" to remind examiners to appropriately review commercial real estate loans, including loans supported by interest reserves. We consider OTS's planned actions and timeframe to be responsive to our recommendations. OTS's response is provided as Appendix 7.

Causes of First Bank of Idaho's Failure

First Bank of Idaho failed because of significant loan delinquencies and losses incurred on construction and land loans. The thrift maintained a large concentration of construction and land loans, which grew throughout the life of the thrift. These loans were concentrated in resort areas in Idaho and Wyoming, which experienced severe real estate market declines. The thrift also did not maintain adequate capital relative to the risk level of its loans. Losses resulting from high-risk loans, combined with the thrift's inability to obtain reliable funding sources, created a liquidity crisis in 2009 that led OTS to close the thrift.

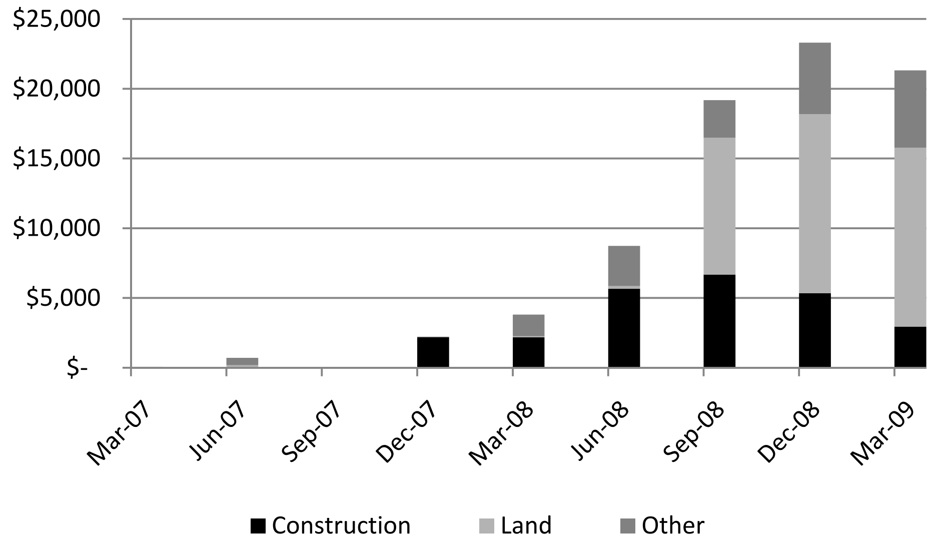
High Concentrations in Construction and Land Loans

OTS defines a concentration as a group of similar types of assets or liabilities that, when aggregated, exceeds 25 percent of a thrift's risk-based capital (core capital plus allowance for loan and lease losses (ALLL). Concentrations pose risk to an institution because negative events affecting overly concentrated groups of assets can have a highly detrimental impact on the institution. First Bank of Idaho maintained high concentrations in construction and land loans in its portfolio.

First Bank of Idaho grew primarily by increasing its construction and land loans. As of June 30, 2005, land loans were 227 percent of risk-based capital and construction loans were 73 percent of risk-based capital. The thrift continued to focus on these types of loans and by March 31, 2009, land loans were approximately 255 percent of risk-based capital and construction loans were 135 percent of risk-based capital.

Starting in late 2007, construction and land loans were First Bank of Idaho's largest group of nonperforming loans. From December 2007 through December 2008, nonperforming construction and land loans increased from $2.2 million to $18.2 million. Figure 1 illustrates the impact of construction and land loans on the makeup of the thrift's nonperforming loans from March 2007 through March 2009. While First Bank of Idaho reported net income of $5.3 million for 2007, it incurred a net loss of $4.2 million for 2008. The net loss in 2008 resulted from the thrift's need to allocate $10.4 million to its ALLL. First Bank of Idaho reported income of $329,000 for the quarter ended March 2009, but OTS noted that the thrift's earnings were insufficient to support operations and to maintain adequate capital. OTS also noted that further asset quality deterioration would require the thrift to increase allowances throughout 2009 and that the thrift projected a loss for the full year.

Figure 1. First Bank of Idaho's Nonperforming Loans, by Quarter and Type (in thousands)



Source: Analysis of OTS's 5-Quarter Uniform Thrift Performance Report for First Bank of Idaho.

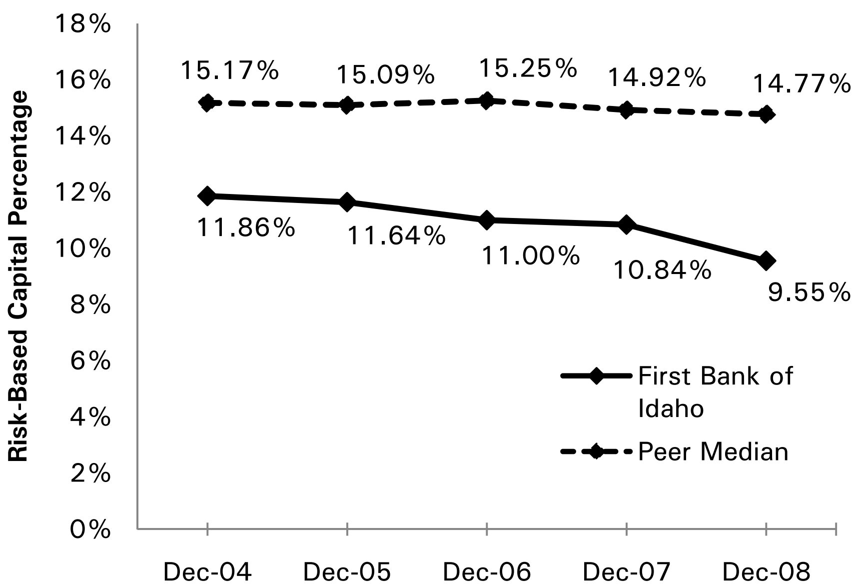
Decline in Real Estate Values

First Bank of Idaho's loans were concentrated in the upscale resort areas of Wood River Valley and Teton Valley in Idaho, and Jackson Hole, Wyoming. In late 2007, the real estate markets in these areas began to undergo a severe downturn along with the deterioration in the housing market across the country. The thrift's markets experienced a combination of overbuilding, significant sales and value declines, and a build-up of multiyear inventories of unsold land lots. Furthermore, the thrift's lending was concentrated in resort areas with a significant amount of discretionary housing, such as vacation homes and second homes. As the economy declined along with the housing market, personal wealth also declined. As a result, less discretionary income was available to purchase or pay debt service on vacation and second homes.

Inadequate Capital Levels

Although First Bank of Idaho was considered well-capitalized under PCA requirements until March 9, 2009, when the thrift fell to adequately-capitalized, its capital levels were nevertheless inadequate because of its significant exposure to loans with higher levels of credit risk. According to section 120 of the OTS Examination Handbook, thrifts that engage in higher-risk activities require more capital, especially if the activities are conducted at significant concentration levels. Until January 2006, when OTS approved First Bank of Idaho's request to lower its risk-based capital target to 10.5 percent, the thrift maintained risk-based capital at 11 percent, based on an agreement with OTS. However, First Bank of Idaho's risk-based capital levels, even at the targeted 11 percent level, was consistently below the levels of its peer median, despite its significantly higher-risk assets. Figure 2 shows First Bank of Idaho's total risk-based capital compared to its peer median level from December 2004 to December 2008. Further, the thrift's assets in the 100 percent risk-weighted asset category were always well above the peer median.[2]

Figure 2 Risk-Based Capital Levels of First Bank of Idaho and Its Peers



Source: Analysis of OTS's 5-Quarter Uniform Thrift Performance Report for First Bank of Idaho.

Unstable Funding Structure

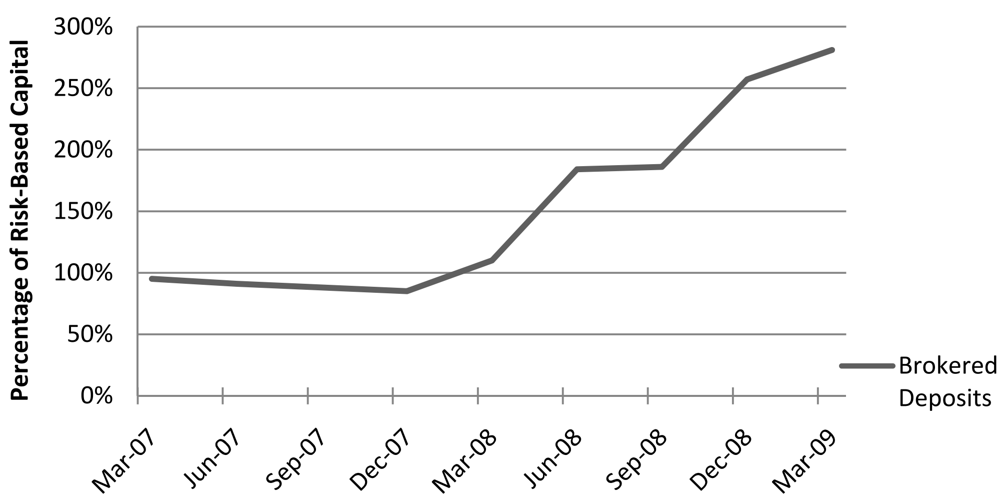
First Bank of Idaho's funding structure was historically dominated by core deposits. The thrift held brokered deposits to supplement its core

[2] An adverse variance from a peer median is not a basis by itself for regulatory action, but does point to a possible elevated risk. We are presenting this information to provide additional perspective on First Bank of Idaho's capital level over time, especially in light of the high-risk nature of its assets.

deposits but they were not a significant source of funding for the thrift. However, throughout its life, First Bank of Idaho reported unusually high levels of uninsured deposits.[3] By the end of the third quarter of 2007, 55 percent of the thrift's total deposits were uninsured deposits.

During 2008, however, First Bank of Idaho experienced a shift in its funding structure. First Bank of Idaho management attempted to reduce the cost of funds by reducing the interest rates it paid on deposits. As a result, deposits began flowing out of the thrift, with particularly large reductions in money market deposit accounts and uninsured account balances. First Bank of Idaho became more reliant on brokered deposits and borrowing from the Federal Reserve Bank (FRB) of San Francisco and the Federal Home Loan Bank (FHLB) of Seattle to fund its operations. As the thrift's total assets increased, core deposits declined and brokered deposits and federal borrowings increased. Figure 3 details First Bank of Idaho's increasing reliance on brokered deposits.

Figure 3. Brokered Deposit Growth, by Quarter (as a percentage of risk-based capital)



Source: Analysis of OTS's 5-Quarter Uniform Thrift Performance Report for First Bank of Idaho.

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[3] FDIC insurance covers various types of deposits including checking and savings accounts, money market deposit accounts and certificates of deposit that are received at FDIC-insured institution. Before October 3, 2008, deposits at FDIC-insured institutions were insured up to $100,000 per depositor. Currently, the insured limit for deposits is $250,000 per depositor. Deposits above these FDIC insurance limits are considered uninsured deposits.

On March 9, 2009, after filing an amended December 31, 2008, thrift financial report, First Bank of Idaho's PCA status fell to adequately capitalized. OTS issued a troubled condition letter that restricted the thrift from accepting, renewing, or rolling over any brokered deposits without prior written approval from FDIC. On March 25, 2009, following OTS's downgrade of the thrift's CAMELS composite rating to 4 on March 9, 2009, FRB reduced its line of credit to First Bank of Idaho and changed other terms for its borrowing from FRB. First Bank of Idaho was also unable to obtain an increase in its line of credit from FHLB because FHLB was in the process of reviewing the collateral the thrift provided to obtain the increase.

First Bank of Idaho's high concentrations in construction and land loans that became nonperforming led to the restrictions on brokered deposits and federal borrowings, and combined with high levels of depositor withdrawals, created a liquidity crisis for First Bank of Idaho. The thrift was unable to fund its day-to-day operations and meet depositor demands. First Bank of Idaho was closed on April 24, 2009.

OTS's Supervision of First Bank of Idaho

OTS's supervision of First Bank of Idaho did not prevent a material loss to the Deposit Insurance Fund. OTS identified credit concentrations early on at the thrift but did not adequately address the risk associated with them. OTS prescribed corrective action to address First Bank of Idaho's high credit concentrations in 2008, only after those concentrations became problematic. In addition, OTS reached supervisory judgments on two matters in 2006 that were inconsistent with First Bank of Idaho's rising risk profile. As to the first matter, OTS did not take exception to the thrift lowering its target risk-based capital ratio from 11 percent to 10.5 percent. As to the second matter, OTS upgraded the thrift's CAMELS composite rating to 1.

Table 1 summarizes the results of OTS's safety and soundness and limited examinations from 2005 until its closure.[4] Appendix 5 provides details of matters requiring board attention (MRBA), corrective actions, and other issues noted during the examinations.

[4] OTS conducted its examinations and performed off-site monitoring of First Bank of Idaho in accordance with the timeframes prescribed in the OTS Examination Handbook.

Table 1. Summary of OTS's Examinations and Enforcement Actions for First Bank of Idaho

		Examination Results			
Date started/ completed	**Assets (in (millions)**	**CAMELS rating**	**Number of MRBAs**	**Number of corrective actions**	**Enforcement actions**
8/29/2005 9/19/2005	$337	2/222111	0	0	None
8/7/2006 8/29/2006	$351	1/221111	0	4	None
3/3/2008 5/15/2008	$441	2/222111	3	4	None
9/29/2008 10/16/2008 (Limited exam)	$477	3/332321	-	-	OTS and First Bank of Idaho enter into a memorandum of understanding on 12/23/2008.
2/20/2009 3/9/2009 (Limited exam)	$492	4/443441	-	-	OTS issues a troubled condition letter on 3/9/2009.
3/23/2009 (Not completed)*	$492	N/A	-	-	None
4/9/2009 4/9/2009 (Limited Exam)	NA	5/443451	-	-	OTS issues a cease and desist order on 4/6/2009. The thrift's board consented to the order.

* First Bank of Idaho was put in receivership before the examination was finished.

OTS Did Not Take Forceful and Timely Actions to Address Unsafe Concentrations in High-Risk Lending Areas

In their reports of examination (ROE), OTS examiners identified First Bank of Idaho's increasing concentrations in higher-risk lending. However, they did not take timely action to limit the concentration growth. As stated earlier, OTS defines a concentration as a group of similar assets or liabilities that, when aggregated, exceeds 25 percent of a thrift's risk-based capital (core capital plus ALLL). In June 2005, First Bank of Idaho's construction and land loans represented a combined concentration of 301 percent of risk-based capital. First Bank of Idaho continued making these higher-risk loans; by March

2009, construction and land loans represented 390 percent of risk-based capital.

In the 2005 and 2006 ROEs, OTS examiners identified First Bank of Idaho's credit concentrations and acknowledged the increased risk associated with them. However, OTS did not take strong supervisory action to address the concentrations. OTS's assessments of the concentrations in the ROEs were typically informational in nature; until the ROE for the March 2008 examination, none of the ROEs included corrective actions, MRBAs, or limitations to address the risk associated with the concentrations. Instead, OTS relied on the ability of the thrift's management to identify and monitor these risks.

OTS's ROEs stated that First Bank of Idaho had policies, procedures, and limits on each portfolio to minimize the risks of the concentrations on the thrift's operations. However, our review of the policies and procedures found that the thrift restricted concentration growth to a percentage of total loans but did not restrict growth to a percentage of capital, which is how OTS measures concentrations. Because capital serves as a buffer against unexpected losses, measuring concentrations as a percentage of capital provides a better indication of their potential impact on an institution. Furthermore, based on our review of the thrift's records, we did not find underlying analyses or other documentation to support First Bank of Idaho's determination of its concentration limits for the different loan types. When we asked OTS examiners why they did not elevate their concern about First Bank of Idaho's risky lending strategy and high credit concentrations, they cited the thrift's lack of loss history and the capabilities of its management.

The March 2008 ROE included OTS's first corrective action to address First Bank of Idaho's concentration levels.[5] OTS stated that management needed to enhance its concentration risk reporting and aggressively monitor its land loans, especially in the Ketchum and Teton regions of Idaho and Wyoming. However, OTS's corrective action did not require the thrift to lower concentration levels, only to improve its monitoring and reporting of its concentrations. OTS did recommend that the thrift set limits for land loans for the Wood River

[5] Corrective actions are included in ROEs to address deficiencies and violations found during the examination. They are communicated to the institution with the expectation that the problems they address will be corrected by the next examination.

and Teton Valley markets of Idaho and Wyoming but did not elevate the recommendation to a corrective action or a MRBA. At this time, First Bank of Idaho's construction and land loans were 374 percent of risk-based capital.

First Bank of Idaho also did not perform stress testing or sensitivity analysis on its construction and land portfolios to provide a more accurate assessment of its risk exposure to high credit and geographic concentrations. OTS guidance on commercial real estate (CRE) concentration risks, which also applies to construction and land development loans, states that an institution with CRE concentration risk should perform portfolio-level stress tests or sensitivity analysis to quantify the impact of changing economic conditions on asset quality, earnings, and capital.[6] In the March 2008 ROE, OTS encouraged the thrift's management to consider stress testing but did not require that it be done.

Regardless of First Bank of Idaho's prior loss history, we believe that greater supervisory action prior to 2008 was warranted, to address the thrift's concentrations in higher-risk lending, including requiring First Bank of Idaho to lower its concentrations in construction and land loans by either restricting further lending in those areas or by requiring the thrift to increase its capital levels. OTS should also have required that First Bank of Idaho monitor, report, and restrict concentration growth relative to its risk-based capital.

During our interviews, various OTS examination staff acknowledged that earlier supervisory action should have been taken to address the thrift's concentrations in construction and land loans.

OTS Actions Were Not Consistent With First Bank of Idaho's Risk Profile

OTS Allowed First Bank of Idaho to Lower Its Internal Capital Targets

In January 2006, OTS allowed First Bank of Idaho to lower its internal capital target to 10.5 percent of risk-based capital, which was inconsistent with the thrift's risk profile and with OTS's findings in the prior examination. Based on an earlier voluntary

[6] OTS, Concentrations in Commercial Real Estate (CRE) Lending, Sound Risk Management Practices (Dec. 14, 2006).

agreement with OTS, First Bank of Idaho had an internal capital target of 11 percent for risked-based capital and 7 percent for Tier 1 capital. As noted earlier, the thrift consistently met the internal capital targets. However, section 120 of the OTS Examination Handbook states that a thrift's level of capital is adequate when it meets regulatory requirements and is commensurate with the thrift's risk profile. In addition, the handbook states that the various capital requirements assume that a thrift primarily engages in traditional, relatively low-risk activities and that higher-risk activities require more capital, especially if the activities are conducted at significant concentration levels.

In August 2005, First Bank of Idaho submitted to OTS a request to lower its 11 percent risk-based capital target to 10.5 percent, and on January 19, 2006, OTS approved the request. However, this approval was inconsistent with the guidance in the OTS Examination Handbook and with OTS's findings in the 2005 ROE, which noted the thrift's high-risk lending strategy, high levels of credit concentrations, and inability to maintain its 11 percent capital target during the review year. Given First Bank of Idaho's high-risk lending strategy, its geographic concentrations, and lower capital levels compared with the median levels of its peers, we believe that OTS should not have approved reduction of the thrift's internal risk-based capital target.

When we asked OTS examiners why they approved the thrift's request, they responded that they were comfortable with First Bank of Idaho's management at the time. Some examiners added that market conditions at the time of the approval were good and that the new target was still above the PCA well-capitalized requirement of 10 percent. However, starting in 2008, the thrift's capital base proved insufficient to offset the write downs caused by the deterioration of the quality of its construction and land loans.

OTS Upgraded First Bank of Idaho's CAMELS Composite Rating

In its 2006 ROE, OTS upgraded First Bank of Idaho's CAMELS composite rating to 1, which was inconsistent with the thrift's rising risk profile and its capital levels that were below the median levels of its peers. As discussed earlier, First Bank of Idaho held high concentrations of credit in high-risk loan types and maintained below-average capital levels throughout its history. OTS conducted an examination in August 2005 that resulted in a CAMELS composite 2 rating for the thrift. The 2005 ROE made note of the thrift's credit concentrations and high-risk lending strategy. OTS conducted an examination in August 2006 that came to similar conclusions. The ROE for that examination stated that First Bank of Idaho's concentrations in high-risk loan types had grown and that capital levels had remained relatively the same. It further stated that the thrift's credit risk profile was higher because of growing geographic and borrower concentrations in CRE, construction, land, and commercial business loans.

First Bank of Idaho's risk profile during the period covered by the August 2006 examination was increasing, and all of the CAMELS component ratings for the thrift in the 2006 ROE remained the same as the 2005 ratings, except for the management rating, which OTS upgraded from 2 to 1. OTS's examination staff said that raising the CAMELS management component rating caused the thrift's CAMELS composite rating to rise from 2 to 1. However, given First Bank of Idaho's high credit concentrations, its high-risk lending strategy, and its lower capital levels, we find it hard to understand the logic behind raising the component rating in this case.

OTS Did Not Timely Identify First Bank of Idaho's Inappropriate Use of Interest Reserves

During the March 2009 examination of First Bank of Idaho, OTS discovered that the thrift was restructuring problem loans by extending maturity dates and granting separate lines of credit providing interest reserves to service the debt until maturity. During this review, OTS found that the thrift had made $39.1 million of loans, all with similar attributes. They were nonperforming loans for real estate projects that had been modified to extend their term for 3 years and had advances of interest reserves in the form of a draw-down line of credit to carry the payments for the 3-year period. According to OTS, First Bank of Idaho management acknowledged that this use of thrift-provided interest reserves to carry nonperforming loans was inappropriate restructuring and said that the thrift had ceased the practice in mid-2008.

OTS reviewed seven of these loans, totaling $20.8 million, to determine if any of them should be placed in nonaccrual status,[7] what the proper classification should be, and whether the loans were impaired.[8] OTS found that six of the seven sampled loans required downgrades: two should have been placed in nonaccrual status, one was impaired, and three needed risk rating downgrades.[9] These six loans totaled nearly $16 million.

Although we could not determine from our review of OTS's workpapers for its 2008 and 2009 examinations how long First Bank of Idaho had been restructuring problem loans by extending maturity dates and providing interest reserves to service them, OTS's internal failed bank report stated that the thrift began these practices in mid-2007 and that it was evident that loan delinquency was being masked. We interviewed a former First Bank of Idaho senior employee who said that the thrift commonly used interest reserves to carry construction and land development loans. These practices understated asset quality deterioration and overstated interest income and capital. The OTS Examination Handbook states that for development and construction projects, an institution's policy should establish standards for the acceptability of and limits on the use of interest reserves.[10] Our review of First Bank of Idaho's written policies found that its construction lending policy included the methodology for calculating interest reserves but did not evaluate the appropriateness of extending lines of credit as interest reserves or set limits on refreshing existing interest reserve accounts.

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[7] According to section 260 of the OTS Examination Handbook, Asset Quality, institutions should report loans as nonaccrual when payments are contractually past due 30 days or more and full payment of principal and interest is not expected.
[8] According to the Statement of Financial Accounting Standards No. 114, Accounting by Creditors for Impairment of a Loan, a loan is impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement.
[9] According to section 260 of the OTS Examination Handbook, Asset Quality, loans are to be assigned to one of the following three categories based on risk: pass, special mention, and classified. Pass indicates that the loan is not classified and considered well protected by the current worth and paying capacity of the obligor. Special mention indicates that the loan has potential weakness that deserves management's close attention. Classified is an adverse rating given when a loan is not well-protected by the current worth and paying capacity of the obligor and has well-defined weaknesses that make collection questionable or improbable.
[10] OTS Examination Handbook, section 213, Asset Quality.

The March 2008 ROE and the related workpapers did not address the thrift's use of thrift-provided interest reserves to carry acquisition, development, and construction loans. When we asked why they did not address this issue during the examination, OTS's examination staff said that they would have looked for these practices but that they did not find them in the loans in their review sample. However, with First Bank of Idaho's construction and land loan concentrations at 123 percent and 251 percent of risked-based capital, respectively, as of December 31, 2007, OTS should have been more alert to the risk factors associated with large concentrations in these lending areas. At that time, OTS should have reviewed First Bank of Idaho's policies related to use of interest reserves and determined whether the thrift was appropriately granting interest-reserve lines of credit associated with its construction and land development loans.

We referred the inappropriate use of interest reserves to carry nonperforming loans to the Treasury Inspector General's Office of Investigation.

OTS Internal Failed Bank Review Identified Areas Needing Improvement

In accordance with its policy, OTS staff completed an internal review of First Bank of Idaho's failure. The review identified the causes of the thrift's failure and assessed OTS's supervision in its August 2, 2009, internal failed bank review report. OTS determined that the thrift's failure was primarily caused by a severe liquidity crisis that culminated in April 2009. The report stated that the root cause of the failure was the severe decline in asset quality at the thrift that began in 2008, which was related to the thrift's high concentration of higher-risk loan types—primarily land and construction loans—in its relatively isolated market areas.

The review identified the following four weaknesses in OTS's supervision of First Bank of Idaho:

- Before 2008, OTS did not limit the thrift's concentrations or require sufficient capital to support the risk resulting from the concentrations.

- Although the thrift established internal concentration limits in 2004, the limits were based on a percentage of assets instead of capital. OTS did not address this issue.

- Although OTS ROEs consistently identified First Bank of Idaho's increasing concentrations in higher-risk loan areas, OTS took no corrective actions and imposed no restrictions to address these concentrations until its March 2008 examination of the thrift.

- In light of the increase in the thrift's level of concentration risk to very significant levels, OTS could have pursued regulatory action but did not do so.

The internal review also made three recommendations:

1. Examiners should obtain the results of the most recent FHLB and FRB onsite loan file reviews from bank management and assess and comment on the steps taken by management to address documentation exceptions provided to them.

   This recommendation was made to remind examiners to review recent FHLB and FRB loan review reports to determine if the thrift's loan files are in good order and that noted deficiencies are addressed. FHLB and FRB review loan files used as collateral for credit extensions to thrifts. FHLB found that First Bank of Idaho's loan files had a high level of documentation deficiencies which slowed down the qualification process and reduced the amount of available collateral during a time when the thrift needed a great deal of alternative funding in a short amount of time.

2. Because high levels of uninsured deposits may contribute to the volatility in an institution's funding structure, greater supervisory and examination attention should be devoted to reviewing the characteristics of high levels of uninsured deposits. OTS should revise preliminary examination response kit documents to request details about a thrift's high level of uninsured deposits.[11]

[11] A preliminary request report kit, also known as a PERK, is a package OTS sends to financial institutions before the start of an onsite examination. It includes, among other things, forms and instructions to the institution for gathering various information and documents and asks that the institution have basic information ready upon the arrival of the examination staff.

3. Examiners should be reminded to closely review loans supported by interest reserves. They should give particular attention to practices where depleted interest reserves are replenished by providing additional loan funds or additional loans.

OTS concluded that concentration deficiencies noted during its review of First Bank of Idaho's failure were substantially the same issues noted in its other failed bank reviews conducted in 2009 and in Treasury Office of Inspector General audit reports of failed Treasury-regulated financial institutions. The report stated that OTS adequately addressed the concentration issues with its July 9, 2009, release of CEO Letter No. 311, Risk Management: Asset and Liability Concentrations.

Based on our review of the examination records and reports and interviews with OTS staff, we affirm OTS's internal findings and the need for corrective action. In addition, we agree that CEO Letter No. 311 re-emphasizes important risk management practices with respect to concentration issues. However, we believe it is too early to tell if the CEO letter adequately addressed the concentration issues.

OTS Implemented Prompt Corrective Action In Accordance With Requirements

The purpose of PCA is to resolve the problems of insured depository institutions at the least possible long-term loss to the deposit insurance fund. According to PCA requirements, federal banking agencies are to take certain actions when an institution's capital drops to certain levels. Under PCA, regulators also have flexibility to discipline institutions based on criteria other than capital levels to help reduce deposit insurance losses caused by unsafe and unsound practices.

We concluded that OTS used its authority under PCA in accordance with PCA requirements. First Bank of Idaho's capital levels fell from well-capitalized to adequately-capitalized on March 9, 2009, after the thrift filed an amended thrift financial report for December 31, 2008. The original report used an estimated loan loss because the thrift had not received all of the final appraisals by the report's due date. First Bank of Idaho used estimates to evaluate its loan losses and for increasing ALLL for the original, unamended report. With that report, First Bank of Idaho maintained its well-capitalized status. The thrift's external accountants determined that the thrift had to recognize additional losses and increase the ALLL before they would certify its financial statements. First Bank of Idaho's amended thrift financial report filed on March 9, 2009, recognized the additional losses and lowered the thrift to adequately capitalized status. OTS notified First Bank of Idaho of its lower capital status and that it was considered to be in troubled condition through a troubled condition letter issued that same day.

The troubled condition letter also informed First Bank of Idaho of the restrictions associated with its capital level decline and troubled condition status, which included restrictions on growth, severance pay, dividends, and brokered deposits. In addition, it required the thrift to notify OTS of any changes of directors or senior executive officers and restricted the thrift from entering into, renewing, extending, or revising any employment contracts related to compensation or benefits of its directors or senior executive officers. Furthermore, OTS downgraded First Bank of Idaho's CAMELS composite rating to 4.

OTS began a full-scope, comprehensive examination of First Bank of Idaho on March 23, 2009. At that time, staff from FDIC's Division of Resolutions and Receiverships went onsite at First Bank of Idaho to begin planning for a possible resolution. OTS issued a cease and desist order on April 6, 2009, and began closely monitoring the thrift's liquidity. The cease and desist order required that First Bank of Idaho do the following:

1. Meet and maintain Tier 1 core and total risk-based capital ratio minimums of 8 percent and 12 percent by June 30, 2009.
2. Develop and submit a contingency plan acceptable to the OTS regional director to achieve a merger with or acquisition by another banking institution or banking institution holding company or voluntary dissolution if the bank is unable to meet the capital requirements or when requested to do so by the regional director.
3. Provide a business plan to address capital preservation and enhancement strategies commensurate with the risk profile of the bank that provides detailed strategies to achieve and sustain profitability, detailed strategies to stress test and adjust earnings forecasts based on operating results, economic conditions and credit quality of the loan portfolio, and detailed pro forma balance

sheets and income statements for a 3-year period beginning with the quarter ending March 31, 2009.
4. Immediately cease originating construction, land acquisition, and land development loans.
5. Revise and submit the classification of assets policy to OTS for review and comment.
6. Develop and submit a written comprehensive liquidity plan for review and approval by OTS and provide liquidity reports as requested by OTS.

OTS received a liquidity and cash flow analysis from the thrift's chief financial officer on April 7, 2009, and the analysis showed that First Bank of Idaho would not be able to meet its liquidity needs over the next 15 days. OTS appropriately downgraded the thrift's CAMELS composite rating to 5 on April 9, 2009. OTS closed First Bank of Idaho on April 24, 2009, 46 days after the thrift's capital status fell from well-capitalized to adequately capitalized.

Recommendations

Our material loss review of First Bank of Idaho is the eighth such review we have performed of failed OTS-regulated financial institutions during the current financial crisis. Appendix 6 lists the prior completed material loss reviews of OTS-regulated financial institutions and our associated recommendations. OTS management agreed with the prior recommendations and has taken or is taking corrective actions to address them.

As a result of our material loss review of First Bank of Idaho, we recommend that the Director of OTS do the following:

1. Ensure that recommendations from OTS's internal review of the First Bank of Idaho failure are implemented and that the conclusions from the review are taken into account going forward. The recommendations are (a) examiners should obtain the results of the most recent FHLB and FRB onsite loan file reviews from bank management and assess and comment on the steps taken by management to address documentation exceptions provided to them, (b) OTS should revise preliminary examination response kit documents to request details about a thrift's high level of uninsured deposits, and (c) examiners

should be reminded to closely review loans supported by interest reserves. In regards to the review of loans supported by interest reserves, OTS should ensure that examiners determine whether any extensions of the loan maturity date and use of interest reserves were appropriate.

2. Ensure that examination staff sufficiently considers a thrift's risk profile when deciding whether to allow a thrift to lower its internal capital targets and when determining the thrift's CAMELS ratings.

Management Response

OTS concurred with our recommendations and stated that the recommended actions would be implemented by the end of the second quarter of 2010. OTS also stated that it has taken action pursuant to its internal failed bank review of First Bank of Idaho. This action included issuing on October 30, 2009, CEO Letter No. 325, "Guidance on Prudent Commercial Real Estate Loan Workouts" to remind examiners to appropriately review commercial real estate loans, including loans supported by interest reserves.

OIG Comment

We consider OTS's planned actions and timeframe to be responsive to our recommendations.

* * * * *

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 J. Mathai, Audit Manager, at (202) 927-0356. Major contributors to this report are listed in appendix 8.

Jeffrey Dye
Audit Director

Our objectives were to determine the causes of First Bank of Idaho's failure and assess its supervision by the Office of Thrift Supervision (OTS). We conducted this material loss review of First Bank of Idaho in response to our mandate under section 38(k) of the Federal Deposit Insurance Act.[12] This section provides that if a 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 provisions of section 38; and
- makes recommendations for preventing any such loss in the future.

Section 38(k) defines a loss as material if it exceeds the greater of $25 million or 2 percent of the institution's total assets. The law also requires the inspector general to complete the report within 6 months after it becomes apparent that a material loss has been incurred.

We initiated a material loss review of First Bank of Idaho when we were notified by the Federal Deposit Insurance Corporation (FDIC) Office of Inspector General on June 24, 2009, that FDIC had recorded a loss estimate to the Deposit Insurance Fund of $186.1million as a result of the thrift's failure. As of December 31, 2009, the loss estimate was $174.6 million. FDIC also estimated that the thrift's failure resulted in a loss of $4.7 million to the Transaction Account Guarantee Program.

To accomplish our review, we conducted fieldwork at OTS's headquarters in Washington, D.C.; its Western Region Office in Daly City, California; its field office in Seattle, Washington; and at FDIC's office located in Irvine, California. We also interviewed officials of FDIC's Division of Supervision and Consumer

[12] 12 U.S.C. § 1831o(k).

Protection. We conducted our fieldwork from June 2009 through September 2009.

To assess the adequacy of OTS's supervision of First Bank of Idaho, 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. Specifically, we performed the following work:

- We determined that the period covered by our audit would be from July 1, 2004, through the thrift's failure on April 24, 2009. This period included three full-scope safety and soundness examinations prior to OTS's March 2009 designation of First Bank of Idaho as a troubled institution and three limited-scope examinations during 2008 and 2009.

- We reviewed OTS's supervisory files and records for First Bank of Idaho from 2004 through 2009. 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 condition, and the regulatory action used by OTS to compel thrift 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 with OTS officials and examiners to obtain their perspectives on the thrift's condition and the scope of the examinations. We also interviewed FDIC officials who were responsible for monitoring First Bank of Idaho for federal deposit insurance purposes and a former thrift senior employee.

- We selectively reviewed First Bank of Idaho's documents that had been taken by FDIC and inventoried by FDIC Division of Resolutions and Receivership personnel. We identified from FDIC's inventory list those 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 actions based on its internal guidance and the requirements of the Federal Deposit Insurance Act, as amended by 12 U.S.C. § 1820(d).

- We reviewed OTS's internal failed bank review report of First Bank of Idaho dated August 2, 2009, and interviewed the OTS review team to discuss their findings and conclusions.

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.

First Bank of Idaho History

First Bank of Idaho was established as a state-chartered bank on March 31, 1997, and opened its first branch in Ketchum, Idaho. In March 2001, the thrift changed its charter to a stock savings bank and its name to First Bank of Idaho, FSB. This change allowed the thrift to operate in other states. First Bank of Idaho was a wholly owned subsidiary of Sun Valley Bancorp and operated seven banking locations surrounding the resort communities of Wood River Valley, Idaho; Teton Valley, Idaho; and Jackson, Wyoming. In the Teton Valley, Idaho, and Jackson, Wyoming, markets, the thrift conducted business as First Bank of the Tetons. The thrift's home office was in Ketchum, Idaho.

First Bank of Idaho's business model centered on commercial real estate (CRE) loan transactions. This model created loan fees and annual portfolio turnover that resulted in very strong profit levels during strong real estate markets. However, the model did not require borrowers to maintain a full banking relationship with the thrift. As a result, the thrift used noncore funding for a portion of the loan funding and primarily focused on asset growth. As economic and real estate conditions changed, it became apparent in the fourth quarter of 2008 that the thrift's business model was not performing well. Asset quality began to deteriorate in 2007. In 2008, the thrift's nonperforming construction loans increased by $3.2 million, its nonperforming CRE loans increased by $2.5 million, and its nonperforming land development loans increased by $12.8 million. Total nonperforming loans increased 763 percent in 2008.

In December 2008, First Bank of Idaho's holding company engaged an investment-banking firm to help obtain financing or to assist in the sale of the thrift. The investment banking firm marketed the thrift to potential investors, which generated interest but no definitive agreement. During this time, First Bank of Idaho was facing a liquidity crisis. Therefore, to boost liquidity, the thrift attempted to sell $4 million of participations and up to $20 million of other assets. These sales did not materialize, and the thrift faced substantial liquidity constraints. As of April 22, 2009, the thrift's total available liquidity was $22.6 million, including approximately $12.6 million in cash and cash equivalents and additional borrowing capacity of approximately $9.5 million with the Federal Reserve Bank of San Francisco and Federal Home Loan Bank of Seattle. The thrift was projected to exhaust this liquidity in 8 business days. On April 24, 2009, the Office of Thrift Supervision (OTS) closed the thrift.

Appendix 4 contains a chronology of significant events in the history of First Bank of Idaho.

Types of Examinations Conducted by OTS

OTS conducts various types of examinations, including safety and soundness, compliance, and information technology.

OTS conducts full-scope examinations of insured thrifts once every 12 or 18 months. During a full-scope examination, examiners conduct an onsite examination and rate all CAMELS components. OTS then assigns the thrift a CAMELS composite rating based on its assessment of the overall condition and level of supervisory concern

OTS uses the 12-month cycle until the thrift's management has demonstrated its ability to operate the institution in a safe and sound manner and has satisfied all conditions imposed at the time of its charter approval. The 18-month examination interval applies to insured thrifts that have total assets of $500 million or less that

- received a CAMELS composite rating of 1 or 2 and a Compliance rating of 1 or 2 for their most recent examination;
- received a CAMELS management component rating of 1 or 2 for their most recent examination;
- are well-capitalized;
- are not currently subject to a formal enforcement proceeding or order by OTS or the Federal Deposit Insurance Corporation; and
- have not undergone a change in control during the 12-month period since completion of the last full-scope examination.

Enforcement Actions Available to OTS

OTS performs various examinations of thrifts that result in the issuance of reports of examinations (ROE) identifying areas of concern. OTS uses informal and formal enforcement actions to address violations of laws and regulations and to address unsafe and unsound practices.

Informal Enforcement Actions

When a thrift's overall condition is sound, but it is necessary to obtain written commitments from a thrift's board of directors or management to ensure that it will correct identified problems and weaknesses, OTS may use informal enforcement actions. OTS commonly uses informal actions for problems in well- or adequately-capitalized thrifts and thrifts with a composite rating of 1, 2, or 3.

Informal actions notify a thrift's board and management that OTS has identified problems that warrant attention. A record of informal action is beneficial in case formal action is necessary later.

If a thrift violates or refuses to comply with an informal action, OTS cannot enforce compliance in federal court or assess civil money penalties for noncompliance. However, OTS may initiate more severe enforcement action against a noncompliant thrift. The effectiveness of informal action depends in part on the willingness and ability of a thrift to correct deficiencies that OTS notes.

Informal enforcement actions include supervisory directives, memoranda of understanding, and board resolutions.

Formal Enforcement Actions

If informal tools do not resolve a problem that has been identified, OTS is to use formal enforcement tools.

Formal enforcement actions are enforceable under the Federal Deposit Insurance Act. They are appropriate when a thrift has significant problems, especially when there is a threat of harm to the thrift, depositors, or the public. OTS is to use formal enforcement actions when informal actions are considered inadequate, ineffective, or otherwise unlikely to secure correction of safety and soundness or compliance problems.

OTS can assess civil money penalties against thrifts and individuals for noncompliance with a formal agreement or final orders. OTS can also request a federal court to require the thrift to comply with an order. Unlike informal actions, formal enforcement actions are public.

Formal enforcement actions include cease and desist orders, civil money penalties, and prompt corrective action directives.

OTS Enforcement Guidelines

Considerations for determining whether to use informal action or formal action include:

- the extent of actual or potential damage, harm, or loss to the thrift because of the action or inaction;
- whether the thrift has repeated the illegal action or unsafe or unsound practice;
- the likelihood that the conduct may occur again;
- the thrift's record for taking corrective action in the past;
- the capability, cooperation, integrity, and commitment of the thrift's management, board of directors, and ownership to correct identified problems;
- the effect of the illegal, unsafe, or unsound conduct on other financial institutions, depositors, or the public;
- the examination rating of the thrift;
- whether the thrift's condition is improving or deteriorating; and
- the presence of unique circumstances.

Adversely classified asset	An asset rated as substandard, doubtful, or loss. Substandard assets are inadequately protected by the current worth and paying capacity of the obligor or of the collateral pledged, if any. A doubtful asset has all the weaknesses of a substandard asset with the added characteristic that the weaknesses make collection or liquidation in full questionable and improbable. A loss asset is considered uncollectible and of such little value that continuation as a bankable asset is not warranted.
Allowance for loan and lease losses	An estimate of uncollectible amounts that is used to reduce the book value of loans and leases to the amount that is expected to be collected. It is established in recognition that some loans in the institution's overall loan and lease portfolio will not be repaid.
Board resolution	A document designed to address one or more specific concerns identified by the Office of Thrift Supervision (OTS) and adopted by a thrift's board of directors.
Brokered deposit	Any deposit that is obtained, directly or indirectly, from a deposit broker. The bank or thrift solicits deposits by offering rates of interest that are significantly higher than the rates offered by other insured depository institutions in its normal market area. Use of brokered deposits is limited to well-capitalized insured depository institutions and, with a waiver from the Federal Deposit Insurance Corporation (FDIC), to adequately capitalized institutions. Undercapitalized institutions are not permitted to accept brokered deposits. (See 12 U.S.C. § 1831(f) and 12 C.F.R. 337.6.)
CAMELS	An acronym for performance rating components for financial institutions: capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risk. Numerical values range from 1 to 5, with 1 being the best rating and 5 being the worst.

Capital restoration plan	A plan submitted to the appropriate federal banking agency by an undercapitalized insured depository institution. A capital restoration plan specifies the steps the insured depository institution is to take to become adequately capitalized, the levels of capital to be attained during each year in which the plan is in effect, how the institution is to comply with the restrictions or requirements then in effect, the types and levels of activities in which the institution is to engage, and any other information that the federal banking agency may require.
Cease and desist order	A type of formal enforcement action. A cease and desist order issued by OTS normally requires the thrift to correct a violation of a law or regulation, or an unsafe or unsound practice. OTS may issue a cease and desist order in response to violations of federal banking, securities, or other laws by thrifts or individuals or if it believes that an unsafe and unsound practice or violation is about to occur.
Commercial real estate loan	A loan for real property where the primary or significant source of repayment is from rental income associated with the property or the proceeds of the sale, refinancing, or permanent financing of the property. Commercial real estate loans include construction and real estate development loans, land development loans, and commercial property loans (such as for office buildings and shopping centers).
Compliance	The part of a financial institution examination that includes an assessment of how well the institution manages compliance with consumer protection and public interest laws and regulations, including the Bank Secrecy Act.
Concentration	As defined by OTS, a group of similar types of assets or liabilities that, when aggregated, exceed 25 percent of a thrift's core capital plus allowance for loan and lease losses. Concentrations may include direct,

	indirect, and contingent obligations or large purchases of loans from a single counterparty.
Concentration risk	Risk in a loan portfolio that arises when a disproportionate number of an institution's loans are concentrated in one or a small number of financial sectors, geographical areas, or borrowers.
Core capital	Tier 1 capital consisting primarily of stockholder's equity.
Division of Resolutions and Receiverships	A division within the FDIC that is charged with resolving failing and failed financial institutions, including ensuring that depositors have prompt access to their insured funds.
Federal Home Loan Bank System	A system of 12 regional cooperative banks created by Congress from which member institutions borrow funds to finance housing, economic development, infrastructure, and jobs. The system provides liquidity to member institutions that hold mortgages in their portfolios and facilitates the financing of mortgages by making low-cost loans, called advances, to members. Advances with a wide variety of terms to maturity, from overnight to long-term, are available to members and are collateralized. Advances are designed to prevent any possible loss to Federal Home Loan Banks, which also have a super lien (a lien senior or superior to all current and future liens on a property or asset) when institutions fail. To protect their position, Federal Home Loan Banks have a claim on any of the additional eligible collateral in a failed institution. In addition, the FDIC has a regulation that reaffirms the priority of Federal Home Loan Banks, which can demand prepayment of advances when institutions fail.
Field visit	A visit conducted to review specific areas of concern that OTS has about an institution.

Formal agreement	A type of formal enforcement action authorized by statute. Formal agreements are generally more severe than informal actions and are disclosed to the public. Formal actions are also enforceable through the assessment of civil money penalties.
Full-scope examination	Examination activities performed during the supervisory cycle that (1) are sufficient in scope to assign or confirm an institution's CAMELS composite and component ratings; (2) satisfy core assessment requirements; (3) result in conclusions about an institution's risk profile; (4) include onsite supervisory activities; and (5) generally conclude with the issuance of a report of examination.
Generally accepted accounting principles	A widely accepted set of rules, standards, and procedures for reporting financial information established by the Financial Accounting Standards Board.
Impairment	Decline in fair value of a loan below the amortized cost basis.
Information technology examination	An examination that includes review and evaluation of the overall management of information systems used by a thrift and of the effectiveness of the internal audit and security functions for those systems.
Interest reserve	An account established by the lender to periodically advance funding to pay interest charges on the outstanding balance of a loan.
Matter requiring board attention	A practice noted during an OTS examination of a thrift that deviates from sound governance, internal control, and risk management principles. The matter, if not addressed, may adversely affect the thrift's earnings or capital, risk profile, or reputation or may result in substantive noncompliance with laws or regulations, internal policies or processes, supervisory guidance, or conditions imposed in writing in connection with the

	approval of any application or other request by the institution. Although matters requiring board attention are not formal enforcement actions, OTS requires that thrifts address them. A thrift's failure to do so may result in a formal enforcement action.
Nonaccrual assets	A loan in which interest accruals have been suspended because full collection of principal is in doubt or interest payments have not been made for a sustained period of time.
Nonperforming loans	Loans that are not earning income and for which (1) payment of principal and interest is no longer anticipated, (2) principal or interest is 90 days or more delinquent, or (3) the maturity date has passed and payment in full has not been made.
Participation loan	A loan made by more than one lender and serviced by one of the participants. Participation loans make it possible for large borrowers to obtain bank financing when the amount borrowed exceeds the legal lending limit of an individual bank.
Prompt corrective action	A framework of supervisory actions for insured institutions that are not adequately capitalized. It was intended to ensure that action is taken when an institution becomes financially troubled in order to prevent a failure or minimize resulting losses. These actions become increasingly severe as an institution falls into lower capital categories. The capital categories are well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. (See 12 U.S.C. § 1831o.) The prompt corrective action minimum requirements are as follows:

Capital Category	Total Risk-Based		Tier 1/ Risk-Based		Tier 1/ Leverage
Well-capitalized[a]	10% or greater	and	6% or greater	and	5% or greater
Adequately capitalized	8% or greater	and	4% or greater	and	4% or greater (3% for 1-rated)
Undercapitalized	Less than 8%	or	Less than 4%	or	Less than 4% (except for 1-rated)
Significantly undercapitalized	Less than 6%	or	Less than 3%	or	Less than 3%
Critically undercapitalized	Has a ratio of tangible equity to total assets that is equal to or less than 2 percent. Tangible equity is defined in 12 C.F.R. § 565.2(f).				

[a] To be well-capitalized, a bank also cannot be subject to a higher capital requirement imposed by the Office of Thrift Supervision.

Risk-based capital — The sum of Tier1 plus Tier 2 capital.

Risk-weighted asset — An asset rated by risk to establish an institution's minimum capital requirements. To weight assets by risk, an institution must assess the risk associated with the loans in its portfolio. Assets are risk-weighted in to four standard categories: 0 percent, 20 percent, 50 percent, and 100 percent, with the highest risk assets in the 100 percent category. Institutions whose portfolios hold more risk have higher capital requirements.

Safety and soundness — The part of an examination that includes a review and evaluation of each of the component CAMELS ratings (see explanation of CAMELS, above).

Stress testing — Analysis that estimates the effect of economic or other changes on key performance measures, such as losses, delinquencies, and profitability. Key variables used in stress testing may include interest rates, FICO score distributions, asset values, growth rates, and unemployment rates.

Subordinated debt	Debt that is either unsecured or has a lower priority than that of another debt claim on the same asset or property. Subordinated debt is also called junior debt.
Tangible equity	Total assets minus intangible assets minus total liabilities.
Tier 1 capital	Common shareholder's equity (common stock, surplus, and retained earnings), noncumulative perpetual preferred stock, and minority interests in the equity accounts of consolidated subsidiaries.
Tier 2 capital	Subordinated debt, intermediate-term preferred stock, cumulative and long-term preferred stock, and a portion of the allowance for loan and lease losses.
Thrift financial report	A financial report that thrifts are required to file quarterly with OTS. The report includes detailed information about the institution's operations and financial condition and must be prepared in accordance with generally accepted accounting principles. The thrift financial report is similar to the call report required of commercial banks.
Transaction Account Guarantee Program	A component of the FDIC's Temporary Liquidity Guarantee Program. The Temporary Liquidity Guarantee Program was established in October 2008 as part of a coordinated effort by the FDIC, the Department of the Treasury, and the Federal Reserve to address unprecedented disruptions in credit markets and the resultant inability of financial institutions to fund themselves and make loans to creditworthy borrowers. The Temporary Liquidity Guarantee Program has two distinct components: (1) the Debt Guarantee Program and (2) the Transaction Account Guarantee Program. The FDIC guarantees certain senior unsecured debt issued by participating entities under the Debt Guarantee Program and all funds held in qualifying noninterest-bearing transaction accounts at participating insured depositary institutions under

	the Transaction Account Guarantee Program. Originally scheduled to expire on December 31, 2009, the Transaction Account Guarantee Program was extended in August 2009 until June 30, 2010. Participating insured depositary institutions pay an assessment fee for the additional guarantee.
Troubled condition	A condition in which a thrift meets any of the following criteria: (1) OTS notifies it in writing that it has been assigned a composite CAMELS rating of 4 or 5. (2) It is subject to a capital directive, a C&D order, a consent order, a formal written agreement, or a prompt corrective action directive relating to its safety and soundness or financial viability. (3) OTS informs it in writing of its troubled condition based on information available to OTS. Such information may include current financial statements and reports of examination.
Wholesale funding	Funding obtained by financial institutions through such sources as federal funds, public funds, FHLB advances, the Federal Reserve's primary credit program, foreign deposits, and brokered deposits.

The following chronology describes significant events in the history of First Bank of Idaho, FSB, including examinations conducted, major problems identified, and enforcement actions taken by the Office of Thrift Supervision (OTS).

3/31/1997	The institution is established as a state-chartered bank under the name First Bank of Idaho.
8/11/1998	First Bank of Idaho establishes a branch office in Bellevue, Idaho.
6/30/1999	First Bank of Idaho reorganizes.
7/1/1999	First Bank of Idaho's holding company, Sun Valley Bancorp (SVB), is formed.
7/12/1999	First Bank of Idaho establishes a branch office in Hailey, Idaho.
3/19/2001	First Bank of Idaho changes its (1) name to First Bank of Idaho, FSB; (2) institution class to OTS-supervised savings bank; (3) organization type to stock savings bank; (4) primary regulatory agency from the Federal Deposit Insurance Corporation (FDIC) to OTS.
6/12/2001	OTS begins a safety and soundness examination that is completed on July 18, 2001, which results in CAMELS composite and component ratings of 2/222222.
6/18/2001	First Bank of Idaho establishes a branch office in Jackson, Wyoming, and begins accepting deposits under the name First Bank of Idaho, doing business as First Bank Advisors.
2/5/2002	OTS waives a condition of charter approval based on the commitment by First Bank of Idaho's board of directors to maintain core and total risk-based capital ratios of at least 7 percent and 11 percent, respectively, and to keep capital adequate in relation to risk.
7/29/2002	OTS begins a safety and soundness examination that is completed on September 4, 2002, which results in CAMELS composite and component ratings of 3/323322. The exam lists several corrective actions relating to deficiencies in all CAMELS component areas.

11/18/2002 OTS conducts a field visit and concludes that substantial improvements in addressing concerns from the July 29, 2002, examination have been made.

8/18/2003 OTS begins a safety and soundness examination that is completed on September 15, 2003, which results in an upgraded CAMELS composite rating of 2 and component ratings of 222221. Capital improved due to infusions by the holding company.

8/30/2004 OTS begins a safety and soundness examination that is completed on September 24, 2004, which results in CAMELS composite and component ratings of 2/222221. As of June 30, 2004, the thrift's risk-based capital ratio is below the 11 percent target set forth in the OTS conditions of approval, but corrective actions are in place.

12/31/2004 First Bank of Idaho's assets grew 19.1 percent to $286.2 million during 2004. Brokered deposits and borrowings constituted 22.8 percent of funding.

8/29/2005 OTS begins a safety and soundness examination that is completed on September 19, 2005, which results in CAMELS composite and component ratings of 2/222111. Again, OTS notes significant growth. Capital was enhanced by infusions from the holding company.

12/31/2005 According to OTS's internal failed bank review, First Bank of Idaho's assets grew 16.9 percent, to $334.7 million during 2005. Core deposits represent 68 percent of total deposits, and wholesale funding declines to 17.5 percent of funding.

1/19/2006 OTS approves First Bank of Idaho's request to lower its internal risk-based capital target from 11 percent to 10.5 percent.

8/7/2006 OTS begins a safety and soundness examination that is completed on August 29, 2006, which results in an upgraded CAMELS composite rating of 1 and component ratings of 221111. The report notes that capital and asset quality are satisfactory.

12/31/2006 First Bank of Idaho's assets grew 22.5 percent, to $409.9 million. Core deposits represent 68 percent of deposits, and brokered deposits and borrowings total 15.5 percent of funding. Nonperforming assets total 0.63 percent of assets.

2/28/2008 First Bank of Idaho's president/CEO resigns. An interim CEO is hired on a 6-month contract or until a qualified permanent replacement is found.

3/3/2008 OTS begins a safety and soundness examination that is completed on May 15, 2008, which results in a CAMELS composite rating of 2 and component ratings of 222111. OTS notes that asset quality has deteriorated.

3/31/2008 First Bank of Idaho's land and construction loans total 369 percent of risk-based capital. Nonperforming assets total 0.92 percent of assets. Core deposits are 70.2 percent of total deposits, and brokered deposits and borrowings increase to 27.8 percent of funding.

6/12/2008 First Bank of Idaho notifies OTS about a potential loss of $1 million on a substandard loan. Subsequent quarterly monitoring of the June 30 thrift financial report and discussions with the thrift reveal material deterioration in credit quality. OTS schedules an onsite field visit for September 2008.

6/30/2008 Land and construction loans total 371 percent of risk-based capital. Nonperforming assets total 1.83 percent of assets. Core deposits decline to 64 percent of deposits, and brokered deposits and borrowings increase to 30.2 percent of funding.

9/29/2008 OTS begins a limited-scope examination. The examination is completed on October 16, 2008, and results in a downgraded CAMELS composite rating of 3 and component ratings of 332321. OTS's findings confirm that the thrift's financial condition has deteriorated and that enforcement action should be pursued.

9/30/2008 Land and construction loans total 362 percent of First Bank of Idaho's risk-based capital, and nonperforming assets equal 4.05 percent of its total assets. The thrift's risk-based capital ratio is 10.69 percent; its core deposits equal 64 percent of total deposits; and brokered deposits and borrowings increase to 35.6 percent of funding.

12/23/2008 OTS enters into a memorandum of understanding with First Bank of Idaho that includes (1) that the board develop, adopt, and submit a comprehensive business plan that includes meeting tier 1 core and total risk-based capital ratio minimums of 8 percent and 12 percent, respectively; (2) a prohibition of any dividends or capital distributions without prior notification to OTS; (3) a requirement to maintain an adequate allowance for loan and lease losses; (4) a requirement to hire an independent consultant to conduct a comprehensive review of the thrift's asset quality and to provide a report containing findings and recommendations for asset quality improvements; (5) a requirement for the board to adopt a classified asset reduction plan and submit quarterly variance reports to OTS; (6) a requirement to limit construction and land acquisition lending, including extending the maturity or replenishing existing interest reserve accounts on such loans and limiting the thrift from making new extensions of credit to borrowers whose loans are classified or have been written off; and (7) a requirement that the board adopt a written liquidity and funds management contingency plan.

12/31/2008 First Bank of Idaho's quarterly loss of $5.6 million results in the decline of its risk-based capital ratio to 9.55 percent, reducing the thrift's prompt corrective action capital category to adequately capitalized. Nonperforming assets total 4.9 percent of total assts. Land and construction loans total 402 percent of risk-based capital. Core deposits fall to 59 percent of deposits, while brokered deposits and borrowings increase to 40.3 percent of funding. The thrift's annual asset growth was 10.9 percent.

1/28/2009 OTS's discussions with First Bank of Idaho indicate that the thrift's asset quality has deteriorated significantly. First Bank of Idaho's correspondent banks cancel credit lines. OTS initiates the process for receiving daily liquidity monitoring reports.

2/17/2009 First Bank of Idaho submits a business plan and a classified asset reduction plan to OTS in accordance with the December 23, 2008, memorandum of understanding.

2/20/2009 OTS begins a limited-scope examination, which results in a downgraded CAMELS composite rating of 4 and composite ratings of 443441. OTS notes increasing levels of classified assets, large operating losses, and dim prospects for additional capital. Enforcement actions are recommended.

3/2/2009 The OTS Western Region enforcement committee agrees to pursue formal enforcement actions against the thrift.

3/9/2009	First Bank of Idaho's risk-based capital ratio declines to 9.71 percent, or adequately capitalized, as of December 31, 2008, in accordance with a revised thrift financial report that the institution filed on March 9, 2009. OTS downgrades the thrift's liquidity and composite ratings to 4, based on continuing asset quality deterioration.
3/9/2009	OTS issues a troubled condition letter to (1) notify the thrift that it is adequately capitalized pursuant to the prompt corrective action framework; (2) impose a growth restriction; (3) require notice and approval for change of director or senior officer; (4) limit severance and indemnification payments; (5) require notice to and nonobjection of OTS for senior executive officer and director employment contracts and compensation arrangements; (6) prohibit the thrift's entry into contracts outside the normal course of business without OTS nonobjection; (7) prohibit capital distributions without prior OTS nonobjection; and (8) notify the thrift that it is subject to the brokered deposit and interest rate restrictions set forth at 12 C.F.R § 337.6.
3/23/2009	OTS begins a safety and soundness examination. The examination is not completed and a report is not issued because First Bank of Idaho is closed and put in receivership before the examination could be finished.
3/25/2009	The Federal Reserve Bank of San Francisco reduces its credit line to First Bank of Idaho from $140 million to $80 million.
3/26/2009	The Federal Reserve Bank of San Francisco notifies First Bank of Idaho of restrictions on its borrowing rate, effective April 2, 2009.
3/31/2009	First Bank of Idaho's risk-based capital is 9.67 percent, and its nonperforming assets represent 4.77 percent of total assets. Land and construction loans total 390 percent of risk-based capital. Core deposits total 53 percent of deposits, and brokered deposits and borrowings increase to 43.2 percent of funding.
4/6/2009	The boards of SVB and First Bank of Idaho execute Stipulation and Consent to Issuance of Orders to Cease-and-Desist.
4/9/2009	OTS conducts an offsite review. First Bank of Idaho's cash flow analysis submitted on April 8, 2009, showed that the thrift would be unable to meet its liquidity needs over the next 15 days. OTS downgrades First Bank of Idaho's CAMELS composite rating to 5.

4/10/2009	Senior OTS supervisory officials meet with the First Bank of Idaho board by telephone to obtain a consent agreement. The thrift's board holds a special meeting and resolves to consent to OTS's appointment of a conservator or receiver for the thrift.
4/10/2009	The cease and desist order is made public.
4/17/2009	First Bank of Idaho advises OTS that deposit outflows are averaging $4 million a day and that its internal cash flow forecast indicates few options available to prevent a funding shortfall by April 23, 2009.
4/23/2009	The OTS Western Region recommends that the OTS Director appoint FDIC as receiver for First Bank of Idaho.
4/24/2009	OTS closes First Bank of Idaho, and FDIC is appointed as receiver of the thrift. U.S. Bank, National Association, acquires all First Bank of Idaho deposits and certain assets.

This appendix lists the Office of Thrift Supervision's (OTS) full scope safety and soundness examinations of First Bank of Idaho beginning August 2005 until the thrift's failure in April 2009 and provides information on the significant results of those examinations. Also listed are three limited scope examinations OTS performed during 2008 and 2009. These limited examinations did not include matters requiring board attention or corrective actions. Generally, matters requiring board attention represent the most significant items requiring corrective action found by the examiners.

Date examination started/ended	CAMELS rating	Assets (in millions)	Significant safety and soundness matters requiring board attention, corrective actions, recommendations and other issues cited in reports of examinations and limited examination reports	Formal Enforcement Action
8/29/2005 9/19/2005	2/222111	$337	<u>Matters requiring board attention</u> • None <u>Corrective actions</u> • None <u>Other issues</u> • Capital adequacy: The thrift's total risk-based capital ratio fell below the internal 11.0 percent target in the third quarter of 2004, but was raised above the target in the following quarter after the thrift issued stock to raise capital. • Concentrations: Commercial real estate loans are identified as a concentration at 230.4 percent of core capital. • Concentrations: Land loans are identified as a concentration at 222.1 percent of core capital. • Concentrations: Commercial business loans are identified as a concentration at 108.8 percent of core capital. • Concentrations: Brokered deposits are identified as a concentration at 167.5 percent of core capital. • Management/Administration: OTS suggested to management that they	None

Date examination started/ended	CAMELS rating	Assets (in millions)	Significant safety and soundness matters requiring board attention, corrective actions, recommendations and other issues cited in reports of examinations and limited examination reports	Formal Enforcement Action
			continue to review all compliance policies on an ongoing basis to ensure that it reflects changing compliance requirements, cover current operating practices and is user friendly.	
8/07/2006 8/29/2006	1/221111	$351	<u>Matters requiring board attention</u> • None <u>Corrective actions</u> • Asset quality: Management should increase their efforts to improve credit administration and loan documentation. • Asset quality: The board should enhance its appraisal policy to ensure that independence is maintained in the appraisal process. • Asset quality: Management should ensure that appraisals are performed in accordance with board approved policies. • Asset quality: Management should ensure that loan participation purchases are conducted in accordance with board approved policies. <u>Other issues</u> • Capital adequacy: The thrift's non-homogeneous assets (commercial real estate, commercial, construction and land loans) increased to $222.4 million, or 63.3 percent of total assets, increasing the thrift's concentration of credit in higher risk loans. • Earnings: OTS stated that management should continue to closely monitor the rising general and	None

Date examination started/ended	CAMELS rating	Assets (in millions)	Significant safety and soundness matters requiring board attention, corrective actions, recommendations and other issues cited in reports of examinations and limited examination reports	Formal Enforcement Action
			administrative expenses to ensure overall profitability does not become negatively impacted as the bank continues to grow. • Concentrations: Commercial real estate loans are identified as a concentration at 228.2 percent of core capital. • Concentrations: Land loans are identified as a concentration at 261.9 percent of core capital. • Concentrations: Commercial business loans are identified as a concentration at 83.9 percent of core capital. • Concentrations: Brokered deposits are identified as a concentration at 127.2 percent of core capital.	
3/03/2008 5/15/2008	2/222111	$441	Matters requiring board attention • Management: Provide OTS with an update of the thrift's progress with hiring a chief executive officer (CEO)/president. • Management: Submit a copy of strategic plan to OTS. • Management: Provide OTS with notification of action taken regarding loan to insider. Corrective actions • Asset quality: Management needs to enhance its concentration risk reporting, and aggressively monitor its land loans especially in the Teton and Ketchum regions. • Asset quality: Management needs to continue its efforts to ensure that loan covenants are enforced. • Asset quality: Management should ensure that appraisals are performed in accordance with board approved	None

Date examination started/ended	CAMELS rating	Assets (in millions)	Significant safety and soundness matters requiring board attention, corrective actions, recommendations and other issues cited in reports of examinations and limited examination reports	Formal Enforcement Action
			policies. If the Sage Capital, LLC loan is not refinanced outside the thrift a compliant appraisal should be ordered and the credit classification rating reviewed. • Management/Administration: Update the conflict of interest and Regulation O policies. <u>Other issues</u> • Management/Administration: Prior to the start of the examination, First Bank of Idaho's president and CEO resigned. • Capital adequacy: The thrift's non-homogeneous assets (commercial real estate, commercial, construction and land loans) increased to $309 million, or 70.1 percent of total assets, increasing the thrift's concentration of credit in higher risk loans. • Asset quality: During the examination, OTS recommended that the thrift enhance its concentration risk management as found in the OTS guidance on commercial real estate concentrations issued in the December 14, 2006, Interagency Policy Statement. • Asset quality: Watch list and special mention credits increased by 92 percent. • Asset quality: Loans graded substandard or worse increased from $1.4 million to $5.7 million, or 307 percent. • Concentrations: Land loans are identified as a concentration at 252.2 percent of risk-based capital. • Concentrations: Construction loans	

Date examination started/ended	CAMELS rating	Assets (in millions)	Significant safety and soundness matters requiring board attention, corrective actions, recommendations and other issues cited in reports of examinations and limited examination reports	Formal Enforcement Action
			are identified as a concentration at 123.7 percent of risk-based capital. • Concentrations: Non-homogenous loans are identified as a concentration at 696.5 percent of risk-based capital.	
9/29/2008 10/16/2008 (Limited Examination)	3/332321	$477	A limited scope onsite examination was conducted to determine the impact of the weakening local economy on the thrift's financial condition. The limited scope included review of asset quality, capital, earnings, and liquidity management. Based on OTS's findings, the thrift was downgraded form a composite 2 to 3. OTS noted significant deterioration in asset quality and significant increases in classified assets and non-homogeneous loan concentrations. OTS recommended entering in to a memorandum of understanding (MOU) with First Bank of Idaho and provided the proposed memorandum with the report of examination.	MOU
2/20/2009 3/09/2009 (Limited Examination)	4/443441	$492	OTS conducted a comprehensive, limited offsite review of the thrift's December 31, 2008, regulatory financial reports and business plan. OTS downgraded the thrift to a composite 4, primarily due to the increasing volume of severity of classified assets. First Bank of Idaho filed an amended thrift financial report on March 9, 2009, reflecting a fall from well-capitalized to adequately-capitalized. OTS notified the thrift's board of directors of the ratings downgrade, its fall to adequately-capitalized status, and	None

Date examination started/ended	CAMELS rating	Assets (in millions)	Significant safety and soundness matters requiring board attention, corrective actions, recommendations and other issues cited in reports of examinations and limited examination reports	Formal Enforcement Action
			troubled condition status in a March 9, 2009 letter.	
4/09/2009 4/09/2009 (Limited Examination)	5/443451	NA	OTS conducted a comprehensive, limited examination of the thrift which resulted in the downgrade of its composite rating from 4 to 5. OTS noted that the thrift's liquidity had fallen to a critically deficient level which threatened its continued viability. OTS informed the thrift's board of directors that failure was highly probable and that it must take immediate action to improve its liquidity level. OTS issued cease and desist orders to the thrift and its holding company on April 6, 2009. Both cease and desist orders were consented to by the board of directors.	Cease and Desist Order

Source: OIG analysis of OTS reports of examinations for First Bank of Idaho.

We have completed seven mandated material loss reviews of failed thrifts since April 2008, starting with the material loss review of NetBank, FSB. This appendix provides our recommendations to the Office of Thrift Supervision (OTS) resulting from these reviews. OTS management concurred with the recommendations and has taken or planned corrective actions that are responsive to the recommendations. In certain instances, the recommendations address matters that require ongoing OTS management and examiner attention.

Report Title	Recommendations to OTS Director
Safety and Soundness: Material Loss Review of NetBank, FSB, OIG-08-032 (Apr. 23, 2008) OTS closed NetBank and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on September 28, 2007. At that time, FDIC estimated that NetBank's failure would cost the Deposit Insurance Fund $108 million.	Ensure that the recommendations/lessons learned from OTS's internal assessments of the NetBank failure, as described on pages 21 and 28 of that report, are implemented. Re-emphasize to examiners that for 3-rated thrifts, formal enforcement action is presumed warranted when certain circumstances identified in the OTS Examination Handbook are met. Examiners are also directed to document in the examination files the reason for not taking formal enforcement action in those circumstances. Establish in policy a process to assess the causes of thrift failures and the supervision exercised over the institution and to take appropriate action to address any significant supervisory weaknesses or concerns identified.
Safety and Soundness: Material Loss Review of IndyMac Bank, FSB, OIG-09-032 (Feb. 26, 2009) OTS closed IndyMac on July 11, 2008, and named FDIC as conservator. As of May 8, 2009, FDIC estimated that IndyMac's failure would cost the Deposit Insurance Fund $10.7 billion.	Ensure that action is taken on the lessons learned and recommendations from the OTS internal review of the IndyMac failure. Caution examiners that assigning composite CAMELS ratings of 1 or 2 to thrifts with high-risk, aggressive-growth business strategies needs to be supported with compelling, verified mitigating factors. Such mitigating factors should consider things such as the institution's corporate governance, risk management controls, allowance for loan and lease losses methodologies, concentration limits, funding sources, underwriting standards, and capital levels and whether the mitigating factors are likely to be sustainable in the long-term. Another important factor that should be considered is the extent to which the thrift offers nontraditional loan products (regardless of whether loans are sold or retained) that have not been stress-

Report Title	Recommendations to OTS Director
	tested in difficult financial environments and whether the thrift can adequately manage the risks associated with such products. OTS should re-examine and refine as appropriate its guidance in this area.
Safety and Soundness: Material Loss Review of Ameribank, Inc., OIG-09-036 (Apr. 7, 2009) OTS closed Ameribank and appointed FDIC as receiver on September 19, 2008. As of December 31, 2008, FDIC estimated that Ameribank's failure would cost the Deposit Insurance Fund $33.4 million.	Remind examiners of the risks associated with rapid growth in high-risk concentrations. Remind examiners to conduct more thorough loan sampling from the portfolio if they identify a rapid increase in concentration. Remind examiners of the examination guidance for thrift third-party relationships, with particular attention to the assessment of the risk the relationship may pose to the thrift's safety and soundness. Assess the need for guidance requiring risk assessment of construction rehabilitation account loans as an integral part of assessing the thrift's overall risk. Ensure that the recommendations and the lessons learned from OTS's internal assessment of the Ameribank failure are implemented.
Safety and Soundness: Material Loss Review of PFF Bank and Trust, OIG-09-038 (June 12, 2009) OTS closed PFF and appointed FDIC as receiver on November 21, 2008. As of May 8, 2009, FDIC estimated that PFF's failure would cost the Deposit Insurance Fund $729.6 million.	Ensure that the recommendations from OTS's internal assessment of the PFF failure are implemented and that the lessons learned from the assessment are taken into account going forward. In this regard, OTS should do the following: • Direct examiners to closely review and monitor thrifts that refuse to establish appropriate limits of concentrations that pose significant risk and pursue corrective action when concentration limits are not reasonable. • Formally communicate the guidance in ND Bulletin 06-14 as to OTS's expectation that concentration measurements and limits be set as a percentage of capital, not just as a percentage of total assets or loans. • Formally communicate the need for a sound internal risk management system that includes stress testing, regular periodic

Report Title	Recommendations to OTS Director
	monitoring, and other risk management tools for higher-risk concentrations.
Safety and Soundness: Material Loss Review of Downey Savings and Loan, FA, OIG-09-039 (June 15, 2009) OTS closed Downey and appointed FDIC as receiver on November 21, 2008. As of May 8, 2009, FDIC estimated that Downey's failure would cost the Deposit Insurance Fund $1.4 billion.	Ensure that the recommendations from OTS's internal assessment of the Downey failure are implemented and that the lessons learned from the assessment are taken into account going forward. In this regard, OTS should do the following: • Direct examiners to closely review and monitor thrifts that refuse to establish appropriate limits of concentrations that pose significant risk and pursue corrective action when concentration limits are not reasonable. • Assess the need for more guidance for examiners on determining materiality of concentrations and determining appropriate examiner response to high-risk concentrations, including when to impose absolute limits to prevent excessive concentration. • Formally communicate the need for a sound internal risk management system that includes stress testing, regular periodic monitoring, and other risk management tools for higher-risk concentrations. • Formally communicate the guidance in ND 06-14 as to OTS's expectation that concentration measurements and limits be set as a percentage of capital, not just as a percentage of assets or loans.
Safety and Soundness: Material Loss Review of Suburban Federal Savings Bank, OIG-09-047 (Sept. 11, 2009) OTS closed Suburban and appointed FDIC as receiver on January 30, 2009. As of August 14, 2009, FDIC estimated that Suburban's failure would cost the Deposit Insurance Fund $126 million.	Ensure that the recommendations from OTS's internal assessment of the Suburban failure are implemented and that the lessons learned from the assessments are taken into account going forward. Ensure that regional offices more closely monitor and scrutinize the amendments to thrift financial reports made by institutions for accuracy and consider appropriate action where chronic errors are found, including enforcement action and assessment of civil money penalties. Have regional offices ensure that examiners conduct timely and adequately scoped field visits to determine whether thrifts with repeat

Report Title	Recommendations to OTS Director
	problems have taken appropriate corrective action. In the event that the field visits find that corrective action has not been taken, examiners should be instructed to elevate the supervisory response, including the taking of enforcement action when necessary.
Safety and Soundness: Material Loss Review of American Sterling Bank, OIG-10-011 (November 24, 2009) OTS closed American Sterling Bank and appointed FDIC as receiver on April 17, 2009. As of October 31, 2009, FDIC estimated that American Sterling Bank's failure would cost the Deposit Insurance Fund $41.9 million.	Ensure that the recommendations from OTS's internal review of the ASB failure are implemented and that the lessons learned from the review are taken into account going forward. Remind supervisory and examination staff of the importance of requiring thrifts to hold capital, as required by federal banking regulations, to mitigate their recourse exposure on sold loans. Remind supervisory and examination staff to properly scrutinize capital contributions made to thrifts, especially noncash capital contributions. Ensure supervisory and examination staff take forceful action to mitigate losses whenever a thrift's line of business incurs losses that threaten the viability of this institution.

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John E. Bowman
Acting Director

February 3, 2010

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

FROM: John E. Bowman /s/
Acting Director

SUBJECT: Draft Audit Report on the Material Loss Review of
First Bank of Idaho

Thank you for the opportunity to comment on your draft audit report entitled "Material Loss Review of First Bank of Idaho". The report focuses on the causes of the failure of First Bank of Idaho (FBI) and the oversight responsibility of the Office of Thrift Supervision (OTS) for FBI.

The Inspector General's report on FBI includes two recommendations for OTS. The report recommends that the Director of OTS take the following actions:

1. Ensure that recommendations from OTS's internal review of the First Bank of Idaho failure are implemented and that the conclusions from the review are taken into account going forward. The recommendations are (a) examiners should obtain the results of the most recent FHLB and FRB onsite loan file reviews from bank management and assess and comment on the steps taken by management to address documentation exceptions provided to them, (b) OTS should revise preliminary examination response kit documents to request details about a thrift's high level of uninsured deposits, and (c) examiners should be reminded to closely review loans supported by interest reserves. In regards to the review of loans supported by interest reserves, OTS should ensure that examiners determine whether any extensions of the loan maturity date and use of interest reserves were appropriate.

2. Ensure that examination staff sufficiently considers a thrift's risk profile when deciding whether to allow a thrift to lower its internal capital targets and when determining the thrift's CAMELS ratings.

OTS concurs with the recommendations of the Material Loss Review and will ensure the recommended actions will be implemented by the end of the second quarter of 2010.

The agency has already taken action pursuant to its internal failed bank review. These actions include issuing on October 30, 2009, CEO Letter No. 325 "Guidance on Prudent Commercial Real Estate Loan Workouts" to remind examiners to appropriately review commercial real estate loans, including loans supported by interest reserves.

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

Jeffrey Dye, Audit Director
Jaideep Mathai, Audit Manager
Amnoiphorn Samson, Auditor in Charge
John B. Gauthier, Auditor
Michelle Littlejohn, Referencer

Department of the Treasury

Office of Strategic Planning and Performance Management
Office of Accounting and Internal Control

Office of Thrift Supervision

Acting Director
Liaison Officer

Office of Management and Budget

OIG Budget Examiner

United States 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

Chairman
Inspector General

U.S. Government Accountability Office

Acting Comptroller General of the United States