Audit Report

OIG-11-081

SAFETY AND SOUNDNESS: Material Loss Review of ebank

July 13, 2011

Office of Inspector General

Department of the Treasury

Contents

Abbreviations

ALLL	allowance for loan and lease losses
C&D order	cease and desist order
EFS	ebank Financial Services, Inc.
FDIC	Federal Deposit Insurance Corporation
FSB	Federal Savings Bank
HELOC	home equity lines of credit
MLR	material loss review
MRBA	matter requiring board attention
OIG	Office of Inspector General
OTS	Office of Thrift Supervision
PCA	prompt corrective action
ROE	report of examination
TFR	thrift financial report

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OIG

Audit Report

The Department of the Treasury
Office of Inspector General

July 13, 2011

John E. Bowman, Acting Director
Office of Thrift Supervision

This report presents the results of our material loss review (MLR) of the failure of ebank of Atlanta, Georgia, and of the Office of Thrift Supervision's (OTS) supervision of the institution. OTS closed ebank and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on August 21, 2009. This review was mandated by section 38(k) of the Federal Deposit Insurance Act because of the magnitude of ebank's estimated loss to the Deposit Insurance Fund.[1] As of March 31, 2011, FDIC estimated the loss to be $46.3 million. FDIC also estimated that ebank's failure would result in a loss of approximately $104,000 to its Transaction Account Guarantee Program.[2]

Our objectives were to determine the causes of ebank'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 such a loss in the future. To accomplish these objectives, we reviewed the supervisory files and interviewed OTS and FDIC officials. We conducted our fieldwork from December 2009 through March 2010. Appendix 1 contains a more detailed description of our review objectives, scope, and methodology. Appendix 2 contains background information on ebank's history and OTS's assessment fees and examination hours.

[1] At the time of ebank's failure, section 38(k) defined a loss as material if it exceeded the greater of $25 million or 2 percent of the institution's total assets. Effective July 21, 2010, section 38(k) now defines a loss as material if it exceeds $200 million for calendar years 2010 and 2011, $150 million for calendar years 2012 and 2013, and $50 million for calendar years 2014 and thereafter (with a provision that the threshold can be raised temporarily to $75 million if certain conditions are met).
[2] Certain terms that are underlined when first used in this report, are defined in, *Safety and Soundness: Material Loss Review Glossary*, OIG-11-065 (April 11, 2011). That document is available on the Treasury Office of Inspector General's (OIG) website at http://www.treasury.gov/about/organizational-structure/ig/Pages/by-date-2011.aspx.

In brief, ebank failed because of significant losses in its land and construction loan portfolios, which depleted the thrift's capital and rendered the thrift insolvent. ebank incurred losses in 9 of its 12 years of existence due largely to failed business strategies and ineffective controls, credit administration, and risk management practices.

With respect to supervision, OTS examiners repeatedly identified deficiencies in ebank's underwriting, credit administration, and risk management practices. OTS cited these deficiencies in reports of examination (ROE) in 2003 and each year thereafter. Although OTS addressed ebank's deficiencies with corrective action recommendations, matters requiring board attention (MRBA), and both informal and formal enforcement actions, we believe OTS should have taken formal enforcement action sooner. OTS appropriately used PCA as ebank's capital declined. Ultimately, the PCA did not prevent ebank's failure.

We are not making any new recommendations in this report. We do, however, reaffirm a prior recommendation from our April 2008 report on NetBank, FSB,[3] that OTS ensure that formal enforcement action is taken when circumstances warrant for thrifts with CAMELS composite ratings of 3. In this regard, OTS revised its enforcement guidance in July 2008 to clarify management expectations and criteria for using informal and formal enforcement actions. In a written response, OTS stated that, in addition to the revised guidance, it has adopted enforcement procedures to ensure compliance and consistency in actions taken among all OTS Regions. OTS's response is provided as Appendix 3. It should be noted that pursuant to P.L. 111-203, the functions of OTS are to transfer to other federal banking agencies on July 21, 2011.

Causes of ebank's Failure

ebank failed because of significant losses in its land and construction loan portfolios, which consisted of high-risk loans with severe credit quality problems. ebank's losses depleted capital and rendered the thrift insolvent. ebank's board and management tried

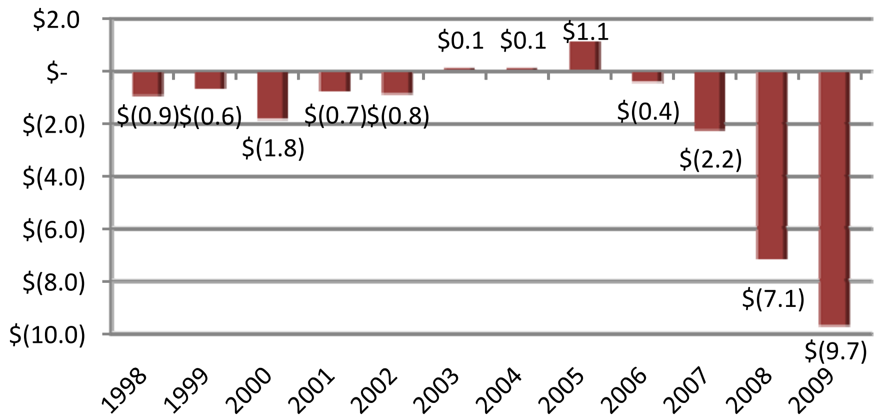
[3] OIG, *Safety and Soundness: Material Loss Review of NetBank, FSB* (OIG-08-032; issued Apr. 23, 2008).

numerous business strategies to become profitable but were unsuccessful. ebank's board and management also failed to implement effective underwriting, credit administration, and risk management practices which allowed for an extremely high-risk loan portfolio and ultimately contributed to ebank's losses.

ebank Incurred Significant Losses Since Inception

ebank sustained losses in 9 of its 12 years of existence, ranging from $421,000 in 2006 to $9.7 million in 2009. Figure 1 shows ebank's income and losses from 1998 through 2009.

Figure 1. ebank Net Income and Losses, 1998 Through 2009 (in millions)



Note: Losses for 2009 are cumulative through August 13, 2009.

Source: OIG analysis of OTS supervision memorandum and internal failed thrift review report on ebank.

Although ebank earned $1.3 million from 2003 through 2005, these modest earnings were not sufficient to offset $24.3 million in losses from other years. In 2005, ebank realized net income of $1.1 million, when it decreased its allowance for loan and lease losses (ALLL) provision from $1.1 million to about $300,000 and received $237,000 in nonrecurring, noninterest income. Management distributed $1 million of the net income in dividends to its holding company in 2006.

From 2006 through 2009, ebank's loan portfolio significantly deteriorated because of poor asset quality, Atlanta's slowing real estate market, and the lack of adequate underwriting and controls. By 2009, ebank's condition had become unsafe, with about $14 million of the thrift's nearly $93 million loan portfolio, or about 15 percent, past due. Much of the deterioration was concentrated in land and construction loans. Weaknesses also existed in ebank's home equity lines of credit (HELOC) and first mortgage single-family loans. The decline in asset quality required ebank in 2006 to steadily increase its ALLL reserve, which reached nearly $5 million by August 2009.

The Board and Management Failed to Establish a Profitable Business Strategy

ebank's board and management attempted numerous business strategies to become profitable.[4] In 1999, contrary to its approved business plan, the board and management pursued an Internet banking strategy that was unsuccessful and costly.[5] In September 1999, OTS assessed $100,000 in civil money penalties[6] because the changes to the thrift's business plan were not approved as required for de novo institutions. ebank then attempted to operate as a traditional community bank, aggressively expanding its commercial real estate, single-family construction, and land loan portfolios. ebank did not, however, establish appropriate loan limits, which resulted in concentrations of high-risk loans.

In 2002, ebank established a joint mortgage banking venture with a mortgage company in Columbia, Maryland. OTS, which had directed ebank to delay this action, determined the venture constituted an inappropriate charter rental[7] and directed ebank to end it. In 2006, ebank shifted from residential construction lending to consumer and HELOC lending, establishing ebank Mortgage, a subsidiary to market first and second mortgages. ebank Mortgage was dissolved in 2008 after continual losses. OTS also found growing problems with ebank's HELOC portfolio, including loans

[4] ebank opened as Commerce Bank in August 1998 and was renamed ebank in October 1999.
[5] The high administrative costs from the failed Internet strategy affected ebank for a number of years.
[6] Formal enforcement actions used to impose fines for violations of laws or regulations.
[7] A contractual arrangement between an FDIC-insured institution and an uninsured institution where the uninsured institution assumes little risk and reaps the benefits of the insured institutions charter.

with loan-to-value ratios exceeding 90 percent and loans tied to higher-risk jumbo mortgages.[8]

According to OTS officials, ebank often took on different lending products at inopportune times, in pursuit of higher earnings, and did not tailor operations to fit available capital. ebank's business strategies resulted in high general and administrative expenses, which, combined with declining net interest margins, offset core income in all years except 2004 and 2005. These conditions depleted ebank's capital, despite periodic capital injections.

The Board and Management Did Not Implement Effective Controls, Credit Administration, and Risk Management Practices

OTS's examinations of ebank performed from 2003 through 2009 found that the board and management had failed to implement effective controls, credit administration, and risk management practices over the thrift's lending. Despite repeated criticism by OTS and assurances from the board and management, ebank's deficient lending practices went uncorrected. These deficiencies resulted in a portfolio of poor quality, high-risk loans which increased ebank's losses.

OTS repeatedly criticized ebank for violating the loans-to-one-borrower regulation, which limits the total loans and extensions of credit to one borrower. Despite ebank's assurances that the violations would be corrected and controls implemented, OTS identified violations from 2004 through 2009. OTS's 2009 ROE reported that not only had ebank failed to correct a previous violation of the loans-to-one-borrower regulation, it made the condition worse by acquiring three additional loans totaling $900,000 made to the same borrower.

OTS's Supervision of ebank

OTS conducted timely full-scope examinations of ebank and provided oversight through limited scope field visits and off-site

[8] Jumbo mortgage loans pose a higher risk for lenders because they are usually originated for luxury homes that are more difficult to sell at full price in the event of a default.

monitoring. From 2003 through 2009, examiners repeatedly identified problems with ebank's underwriting, credit administration, and risk management practices, and never assigned ebank a CAMELS composite rating better than a 3, meaning that OTS always had some degree of supervisory concern with the institution. Some uncorrected deficiencies went back to 2000 when a new management team took over ebank. Through 2006, OTS addressed ebank's deficiencies with corrective action recommendations, MRBAs, and informal enforcement actions. OTS took formal enforcement action in 2007 and 2009. We believe OTS should have taken formal enforcement action years earlier.

Table 1 summarizes the results of OTS's safety and soundness examinations of ebank from 2003 through 2009.

Table 1: Summary of OTS's Safety and Soundness Examinations of and Enforcement Actions Against ebank

		Examination Results			
Examination start date and type	**Total assets (in $ millions)**	**CAMELS rating**	**No. of MRBAs**	**No. of recommendations/ corrective actions**	**Enforcement actions**
4/30/2003 (full-scope)	$96.8	3/333323	2	11	None
7/13/2004 (full-scope)	$112.2	3/233323	3	8	Board resolution (informal enforcement action) 12/20/2004
10/11/2005 (full-scope)	$147.0	3/233221	4	11	Notice of deficiency (informal enforcement action) 3/9/2006 (see Note)
12/29/2006 (full-scope)	$138.5	3/233322	3	9	Cease and desist order (formal enforcement action) 6/4/2007
12/10/2007 (field visit)	N/A	N/A	None	None	None
3/3/2008 (full-scope)	$141.7	4/444432	7	11	Cease and desist orders (ebank Financial Services, and

Table 1: Summary of OTS's Safety and Soundness Examinations of and Enforcement Actions Against ebank

Examination start date and type	Total assets (in $ millions)	Examination Results: CAMELS rating	No. of MRBAs	No. of recommendations/ corrective actions	Enforcement actions
					ebank) 2/27/2009 Prompt corrective action directive 6/30/2009
10/6/2008 (field visit)	N/A	N/A	None	None	None
7/2/2009 (off-site review)	N/A	5/554543	None	None	None
7/6/2009 (full-scope)	$144.7	5/554544	5	7	None

Note: The notice of deficiency directed ebank to submit a safety and soundness compliance plan.

Source: OTS ROEs and enforcement actions.

OTS Repeatedly Identified Problems with Underwriting, Credit Administration, and Risk Management Practices

OTS repeatedly identified problems with ebank's underwriting, credit administration, and risk management practices. These problems were often found to be uncorrected from prior examinations and were reflected in the thrift's CAMELS composite and management component ratings. OTS's 2003 examination was the third consecutive time that OTS assigned ebank a composite rating of 3 and the fourth consecutive time that ebank's management was assigned a component rating of 3. OTS continued to assign ebank these same ratings for the next three full-scope examinations, despite uncorrected problems.

At the time of the 2003 examination, OTS guidance stated that formal enforcement action was presumed for thrifts with repeated composite ratings of 3, weak management, or a board and management unwilling or unable to take appropriate corrective measures.[9] Enforcement action, however, was not taken following

[9] OTS Regulatory Handbook, Section 370, Enforcement Actions (June 2003). OTS Examiner Handbook, Section 080, Administration (July 2008) superseded Section 370, requiring that formal enforcement

the 2003 examination, even though ebank's condition had declined to adequately capitalized as of June 30, 2003. The OTS Supervisory Action Committee waived enforcement action on August 14, 2003. According to the memorandum recommending the waiver, OTS supervisory officials believed that ebank's condition, though troubled, was not deteriorating rapidly enough to warrant formal action. OTS officials also believed ebank's compliance with an OTS instruction to close a Maryland loan production office and its acknowledgement that new capital was needed had demonstrated ebank's willingness to take corrective action. ebank was to obtain new capital and be well-capitalized by September 30, 2003, and raise substantial capital or sell the thrift by June 30, 2004.

Although ebank was well-capitalized on September 30, 2003, the thrift once again fell to adequately capitalized on December 31, 2003. OTS informed ebank management that thrifts with repeated CAMELS composite 3 ratings normally call for enforcement action and that it was more difficult to defer enforcement action when the institution is adequately capitalized. Capital infusions totaling $3 million from ebank's holding company, ebank Financial Services, Inc. (EFS), during the first six months of 2004 allowed the thrift to restore its well-capitalized status.

OTS Delayed Taking Formal Enforcement Action

Through 2006, OTS attempted to address ebank's problems with corrective action recommendations, MRBAs, and two informal enforcement actions—a board resolution in 2004 and a notice of deficiency with directive for submission of a safety and soundness compliance plan[10] in 2006. OTS imposed the requirement for a board resolution following the 2004 examination when examiners found that ebank had still not established effective loan or concentration limits and had failed to correct previously identified weaknesses in its loan administration practices. OTS's 2005

action also be considered when a thrift's management is assigned a rating of 3 or below or the thrift is not in compliance with prior commitments to take corrective action.

[10] An informal enforcement action used to notify a thrift of its failure to satisfy safety and soundness standards set forth in Appendix A to 12 C.F.R. Part 570, and requiring a safety and soundness compliance plan specifying corrective measures to be taken.

examination found that, while ebank had established limits on high-risk loans, it failed to comply with the board resolution and fully correct problems identified in the 2004 examination. Notwithstanding this, OTS assigned ebank a composite rating of 3 for the fifth consecutive examination and issued a second informal enforcement action, a notice of deficiency in March 2006, which directed ebank to submit a safety and soundness compliance plan by April 9, 2006.

In June 2007, OTS issued its first formal enforcement action, a cease and desist (C&D) order, to address ebank's problems and its failure to comply with prior enforcement actions. In June 2008, OTS found that ebank's condition had continued to deteriorate, assigned a composite rating of 4, and determined that a new C&D order was needed requiring ebank to hold increased capital. OTS also decided to issue a C&D order to ebank's holding company, ebank Financial Services, Inc. (EFS). However, OTS did not issue these C&D orders until February 2009.

According to OTS officials, the C&D orders were delayed for several reasons.[11] First, OTS needed to have the ebank and EFS boards returned to their previous composition because the boards had been completely restructured on July 3, 2008, without OTS approval (OTS approval was required as ebank and EFS had been designated troubled institutions). The ebank and EFS boards were returned to their previous composition on July 25, 2008, and October 27, 2008, respectively. Second, it took some time for OTS legal staff to draft and finalize the associated documents. This delay was due, we were told, to legal staff spending a lot of their time on applications received under the Troubled Asset Relief Program.

OTS examiners defended the supervisory approach they used for ebank. They stated that the thrift was able to obtain capital when needed and, for the most part, remained well-capitalized. The examiners also stated that in some cases they believed that problems had been corrected by ebank management but subsequent examinations disclosed that management's efforts were ineffective and failed to fully correct the deficiencies. ebank's

[11] OTS policy directives OTS New Directions 09-11 (May 2009) and 09-11a (August 2009) now require formal enforcement actions be issued and effective within 60 days of approval.

inability to correct problems was identified and reflected in its CAMELS ratings.

Although a waiver of enforcement action was approved by the Supervisory Action Committee, we believe OTS had sufficient cause to take formal enforcement action in 2003 when repeat problems were identified, management was considered weak, and the thrift was assigned its third consecutive composite 3 rating. ebank's board and management were never strong, often relied on capital injections to maintain capital levels, and were unable or unwilling to correct deficiencies. ebank's ability to restore its well-capitalized position in 2004 was based on capital infusions more than corrective measures taken by the board and management. The memorandum recommending waiver of enforcement action stated that ebank had been unable to attract and retain sufficient capital to safely grow the asset base in order to overcome the high overhead expenses. Furthermore, OTS documentation supporting the 2007 C&D order concluded that many of ebank's deficiencies were the same as when a new management team took over ebank in 2000, confirming that some deficiencies were never corrected by the board and management.

OTS Appropriately Used Prompt Corrective Action

The purpose of PCA is to resolve the problems of insured depository institutions at the point at which there is the least possible long-term cost to the Deposit Insurance Fund. PCA requires federal banking agencies to take action when an institution's capital drops to undercapitalized or below. PCA also gives regulators flexibility to supervise institutions based on criteria other than capital levels to help reduce deposit insurance losses caused by unsafe and unsound practices. Furthermore, the Federal Deposit Insurance Act prescribes additional supervisory restrictions applicable to less than well-capitalized (e.g., adequately capitalized) thrifts before PCA is mandated.

OTS took the following supervisory and PCA actions as ebank's capital levels fell:

- When ebank fell to adequately capitalized based on the March 31, 2008, thrift financial report (TFR), OTS issued a troubled condition letter on May 1, 2008, notifying ebank of certain supervisory restrictions and of a downgrade to the thrift's CAMELS composite rating.

- On February 10, 2009, OTS notified ebank of mandatory PCA restrictions when the thrift fell to undercapitalized based on the TFR for December 31, 2008.[12] OTS required ebank's management to submit a capital restoration plan by March 16, 2009, and adhere to PCA mandated restrictions. OTS disapproved ebank's capital restoration plan on May 26, 2009, and notified the thrift that it was significantly undercapitalized.

- OTS issued a prompt corrective action directive[13] to ebank on June 30, 2009; notified ebank that it was critically undercapitalized on August 3, 2009; and closed the thrift on August 21, 2009.

We concluded that OTS took PCA in accordance with section 38(k). However, those actions were unsuccessful in preventing ebank's failure.

OTS's Internal Review of ebank

In accordance with its policy, OTS completed an internal review of the ebank failure and issued a report in March 2010 which stated that ebank's failure resulted primarily from credit losses within the thrift's construction and land loan portfolios, along with the lack of a clear, consistent, and effective business strategy. ebank's high general and administrative expenses hindered the thrift's profitability even before asset quality problems surfaced. ebank's losses depleted capital and rendered the thrift insolvent. The internal review also concluded that more timely and stronger enforcement action by OTS should have been taken to address repeat deficiencies and more restrictive concentration limits should

[12] ebank had fallen to undercapitalized 6 months earlier, based on the June 30, 2008 TFR. OTS did not take action because ebank obtained additional capital and was no longer considered undercapitalized when the thrift's TFR was filed on July 30, 2008.
[13] A formal enforcement action establishing a capital-based supervisory scheme with increasingly stringent restrictions associated with declining capital levels.

have been established to specifically address higher-risk loan products.

Recommendations

We are not making any new recommendations in this report, but are reaffirming a recommendation made in a previous MLR of an OTS-regulated thrift.

Specifically, in our April 2008 MLR report on NetBank, FSB, we reported that formal enforcement action should have been taken sooner. We recommended that the Director of OTS re-emphasize to examiners that for 3-rated thrifts, formal enforcement action is presumed warranted when certain circumstances identified in OTS's examination handbook are met. The failure of ebank was another case where a stronger supervisory response by OTS was warranted earlier. The OTS internal review of ebank's failure reached a similar conclusion.

In response to the NetBank FSB MLR report, OTS revised its examination handbook with respect to enforcement actions.[14] The revised guidance clarified management's expectations, specified that informal enforcement action is presumed for thrifts with a composite rating of 3, and that formal enforcement action be considered if one or more compelling factors are identified, such as poor management. We did not, as part of this MLR of ebank, assess whether this guidance was implemented in an effective manner.

[14] OTS Regulatory Bulletin 37-23, July 18, 2008, implemented changes to enforcement action guidelines in the OTS Examination Handbook. The bulletin replaced Section 370, Enforcement Actions, with updated guidance included in Section 080 of the Examination Handbook.

* * * * * *

We would like to extend our appreciation to OTS for the cooperation and courtesies extended to our staff during the audit. If you have any questions, please contact me at (617) 223-8640 or Kenneth Dion, Audit Manager, at (617) 223-8641. Major contributors to this report are listed in appendix 4.

/s/
Donald P. Benson
Audit Director

We conducted this material loss review of ebank, of Atlanta, Georgia, in response to our mandate under section 38(k) of the Federal Deposit Insurance Act.[15] This section provides that if the Deposit Insurance Fund incurs a material loss with respect to an insured depository institution, the inspector general for the appropriate federal banking agency is to prepare a report to the agency that

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

At the time of ebank's failure, on August 21, 2009, section 38(k) defined a loss as material if it exceeded the greater of $25 million or 2 percent of the institution's total assets. We initiated a material loss review of ebank based on the loss estimate by the Federal Deposit Insurance Corporation (FDIC). As of March 31, 2011, FDIC estimated that the loss to the Deposit Insurance Fund from ebank's failure would be $46.3 million.[16] FDIC also estimated that ebank's failure resulted in a loss of approximately $104,000 to its Transaction Account Guarantee Program.

Our objectives were to determine the causes of ebank's failure; assess ebank's supervision by the Office of Thrift Supervision (OTS), including implementation of the PCA provisions of section 38; and make recommendations for preventing such a loss in the future. To accomplish our review, we conducted fieldwork at OTS headquarters in Washington, D.C., and at its Southeast Region office in Atlanta, Georgia. We interviewed headquarters and field office personnel. We also interviewed officials at FDIC's Division of Supervision and Consumer Protection regional office in Atlanta, Georgia, and officials from FDIC's Division of Resolutions and Receiverships in Dallas, Texas. While in Atlanta, we reviewed

[15] 12 U.S.C. § 1831o(k).
[16] The original loss estimate was $63 million at closing. FDIC decreased this amount to $46.3 million as of March 31, 2011, based on revised estimates.

selected ebank records in FDIC's possession at Stearns Bank, N.A., the institution that purchased the majority of ebank's assets after the thrift was closed. We conducted our fieldwork from December 2009 through March 2010.

To assess the adequacy of OTS's supervision of ebank, we performed the following work:

- We reviewed OTS supervisory files and records for ebank from 2003 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 OTS used to compel thrift management to address deficient conditions. We also reviewed OTS's report on its internal review of ebank's failure. 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 OTS's supervision of ebank with OTS officials, examiners, and attorneys to obtain their perspective on the thrift's condition, the scope of the examinations, and supervisory actions taken.

- We interviewed personnel with FDIC's Division of Resolutions and Receiverships who were involved in the receivership and asset resolution process and personnel with FDIC's Division of Supervision and Consumer Protection concerning FDIC's role as backup regulator for ebank.

- We interviewed several former ebank employees now employed by Stearns Bank concerning ebank's lending practices and operational procedures.

- We assessed OTS's actions based on its internal guidance and the requirements of the Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.).

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.

History of ebank

ebank began operations as Commerce Bank in 1998, in Atlanta, Georgia, to engage in retail banking, home mortgages, real estate development, and consumer lending. Commerce Bank was wholly owned by Southeast Commerce Holding Company. Commerce Bank was renamed ebank in 1999, as part of a revised business plan focused on Internet banking operations. The holding company was renamed ebank.com, Inc., in 1999 and was subsequently renamed ebank Financial Services, Inc., in 2003.

OTS Assessments Paid by ebank

OTS funds its operations in part through semiannual assessments on thrifts. OTS determines each institution's assessment by adding together three components reflecting the size, condition, and complexity of an institution. OTS computes the size component by multiplying an institution's total assets, as reported on its thrift financial report, by the applicable assessment rate. The condition component is a percentage of the size component and is imposed on institutions that have a 3, 4, or 5 CAMELS composite rating. OTS imposes a complexity component if (1) a thrift administers more than $1 billion in trust assets; (2) the outstanding balance of assets fully or partially covered by recourse obligations or direct credit substitutes exceeds $1 billion, or (3) the thrift services over $1 billion of loans for others. OTS calculates the complexity component by multiplying set rates by the amounts by which a thrift exceeds each threshold. Table 2 shows the assessments that ebank paid to OTS from 2005 through 2009.

Table 2: Assessments Paid by ebank to OTS 2005–2009

Billing Period	Examination Rating	Amount Paid
1/1/2005–6/30/2005	3	$28,068
7/1/2005–12/31/2005	3	$28,112
1/1/2006–6/30/2006	3	$34,974
7/1/2006–12/31/2006	3	$34,562
1/1/2007–6/30/2007	3	$34,395
7/1/2007–12/31/2007	3	$35,841
1/1/2008–6/30/2008	3	$36,717
7/1/2008–12/31/2008	4	$50,712
1/1/2009–6/30/2009	4	$49,990
7/1/2009–12/31/2009	5	$51,354

Source: OTS.

Number of OTS Staff Hours Spent Examining ebank

Table 3 shows the number of examination hours expended by OTS on full-scope and limited-scope examinations from 2003 through 2009.

Table 3: Number of OTS Staff Hours Spent on Examining ebank, 2003–2009

Examination Start Date and Type		Examination Hours
4/30/2003	full-scope	752
7/13/2004	full-scope	1,244
10/11/2005	full-scope	920
12/29/2006	full-scope	962
12/10/2007	limited-scope	184
3/3/2008	full-scope	1,470
10/6/2008	limited-scope	78
7/6/2009	full-scope	864

Source: OTS, Examination Activity Hours Detail Report.

Office of Thrift Supervision
Department of the Treasury

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

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July 6, 2011

MEMORANDUM FOR: Donald P. Benson
Audit Director
Department of the Treasury, Office of Inspector General

FROM: Thomas A. Barnes /s/
Deputy Director

SUBJECT: Draft Audit Report on the Material Loss Review (MLR) of ebank

Thank you for the opportunity to comment on the draft Material Loss Review Report (Report) for ebank prepared by the Department of the Treasury Office of Inspector General (OIG). The stated objectives of the Report were to determine the causes of ebank's failure; to assess the Office of Thrift Supervision's (OTS) supervision of the bank, including implementation of the Prompt Corrective Action (PCA) provisions of section 38 of the Federal Deposit Insurance Act; and to make recommendations for preventing future losses. The Report concluded that ebank failed because of significant losses in the bank's land and construction portfolios, and lesser weaknesses in its home equity lines of credit and first mortgage single family loans. Management failed to implement effective underwriting, credit administration and risk management practices, and to establish a profitable business strategy, which contributed to ebank's losses. Net losses caused capital levels to erode and the bank became insolvent.

The Report notes that OTS repeatedly identified significant problems at ebank, which OTS initially addressed through corrective action recommendations, MRBAs and informal enforcement actions. However, despite uncorrected problems and repeated adverse examination ratings from 2003 onward, OTS did not take a formal enforcement action against ebank until June 2007, when an Order to Cease and Desist became effective. The Report does not make any new recommendations but reaffirms a previous recommendation that the Director of OTS re-emphasize that formal enforcement action is presumed warranted for 3-rated thrifts when certain circumstances are present, in accordance with OTS enforcement policy, as revised in July 2008.

We acknowledge the reaffirmed recommendation in the Report. As noted, OTS issued a revised enforcement action policy under cover of Regulatory Bulletin (RB) 37-23, dated July 18, 2008. The enforcement action policy was incorporated in OTS Examinations Handbook Section 080 and requires, among other things, that formal action be considered for CAMELS composite 3

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rated institutions when there is uncertainty of management's ability or willingness to take appropriate corrective actions, the Management component is rated 3 or below, the thrift is not in compliance with prior commitments, its overall condition is rapidly deteriorating, and/or a composite 3 rating has continued for two examinations after informal action has been taken. In addition, OTS has adopted enforcement procedures that require all recommendations regarding enforcement actions against an institution, including recommendations for no further action, be brought to the OTS Washington Enforcement Review Committee for determination in order to ensure compliance and consistency among all OTS Regions. We believe the policies and procedures that OTS has put in place fully address the recommendation contained in the Report.

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

Boston Audit Office

Kenneth Dion, Audit Manager
Kenneth O'Loughlin, Auditor-in-Charge
Alex Taubinger, Auditor
Maryann Costello, Auditor

Washington, DC

Gerald Kelly, Referencer

Department of the Treasury

Deputy Secretary
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

U.S. Senate

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

Chairman and Ranking Member
Committee on Finance

U.S. House of Representatives

Chairman and Ranking Member
Committee on Financial Services

Federal Deposit Insurance Corporation

Acting Chairman
Inspector General

U.S. Government Accountability Office

Comptroller General of the United States