Audit Report

OIG-10-017

SAFETY AND SOUNDNESS: Material Loss Review of Omni National Bank

December 9, 2009

Office of Inspector General

Department of the Treasury

Contents

Audit Report 1

Results in Brief 2

Causes of Omni National Bank's Failure 6
Omni Pursued an Aggressive Growth Strategy 7
Omni's Underwriting and Credit Administration of Commercial Real Estate Loans Were Unsound 10
Overvalued Redevelopment OREO Delayed Recognition of Losses 14
Redevelopment Lending Practices Are Under OCC Review 16

OCC's Supervision of Omni National Bank 16
OCC's 2003-2007 Examinations Identified Problems at Omni but No Heightened Level of Supervisory Concern 18
Quarterly Monitoring Was Not Performed During 2007 20
OCC's January 2008 Examination Identified Omni as Critically Deficient With Inadequate Management Oversight and Controls Over Lending 20
OCC Took Formal Action Against Omni Nearly 9 Months After Examiners Determined That Such Action Was Likely Required 23
OCC's Implementation of PCA Was Timely, Based on Original Call Report Submissions 25
OCC's Lessons-Learned Review Is Not Yet Complete 27
Other Supervisory Matter-No Official EIC Rotation Policy Exists for Midsized and Community Banks 27

Recommendations 28

Appendices

Appendix 1: Objectives, Scope, and Methodology 32
Appendix 2: Background 35
Appendix 3: Glossary of Terms 39
Appendix 4: Chronology of Significant Events. 46
Appendix 5: OCC Omni National Bank Examinations, Significant Issues, and Enforcement Actions 49
Appendix 6: Prior OIG Material Loss Review Recommendations 55
Appendix 7: Management Comments 57
Appendix 8: Major Contributors to This Report 60
Appendix 9: Report Distribution 61

Abbreviations

ADC	assistant deputy comptroller
ANB	ANB Financial, National Association
ARV	after repaired value
CEO	chief executive officer
DSRC	District Supervision Review Committee
EIC	examiner-in-charge
FDIC	Federal Deposit Insurance Corporation
MRA	matter requiring attention
OCC	Office of the Comptroller of the Currency
OIG	Office of Inspector General
OREO	other real estate owned
PCA	prompt corrective action
redevelopment division	Community Development Lending Division
ROE	report of examination

OIG

Audit Report

The Department of the Treasury
Office of Inspector General

December 9, 2009

John C. Dugan
Comptroller of the Currency

This report presents the results of our review of the failure of Omni National Bank (Omni), headquartered in Atlanta, Georgia, and of the Office of the Comptroller of the Currency's (OCC) supervision of the institution. OCC closed Omni and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on March 27, 2009. Section 38(k) of the Federal Deposit Insurance Act mandated this review because of the magnitude of Omni's loss to the Deposit Insurance Fund.[1] As of October 31, 2009, FDIC estimated that the loss to the deposit insurance fund would be $288.2 million. FDIC also estimated that Omni's failure resulted in a loss of $0.9 million to its Transaction Account Guarantee Program.

Our objectives were to determine the cause of Omni's failure and assess OCC's supervision of the bank, including implementation of the prompt corrective action (PCA) provisions of section 38(k). To accomplish these objectives, we reviewed the supervisory files and interviewed key OCC and FDIC officials. Our fieldwork was conducted from April 2009 through October 2009. Appendix 1 contains a more detailed description of our material loss review objectives, scope, and methodology.

We also include several other appendices in this report. Appendix 2 contains background information on Omni and OCC's supervision and enforcement processes. Appendix 3 provides a glossary of terms used in this report. These terms are underlined and, in the

[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.

electronic version of the report on our Web site, hyperlinked to the glossary. Appendix 4 contains a chronology of significant events related to the bank's history and OCC's supervision of the institution. Appendix 5 provides bank examination results and information on enforcement actions. Appendix 6 shows the Treasury Office of Inspector General (OIG) recommendations from material loss reviews of failed OCC-regulated institutions completed since November 2008.

Results in Brief

Omni failed because of significant losses suffered in commercial real estate loans primarily originated within its Community Development Lending Division (referred to in this report as the redevelopment division).[2] OCC estimated that Omni's net operating losses exceeded $14 million in both 2007 and 2008. Omni pursued an aggressive growth strategy beginning in 2003. Its total assets grew by over $768 million from 2003 through 2008, in large part from its increased number and high concentration of commercial real estate loans. During this period, the bank received significant capital injections from the bank's holding company and expanded geographically, to seven states.

While pursuing this growth, Omni's board of directors and management did not adequately control concentration risk or ensure that adequate internal controls over lending were implemented, leading to deficient underwriting, credit administration, and appraisal practices. Weak controls and deficient practices resulted in the origination of high-risk loans, overvalued other real estate owned (OREO), and large losses. The most problematic loans in the commercial real estate loan portfolio were the short-term redevelopment loans made to investors for the purchase and rehabilitation of housing in lower-income areas. These conditions were exacerbated by the decline in the real estate market and borrowers' inability to obtain outside financing to pay off Omni loans as they matured.

[2] Omni's redevelopment lending division was a subset of the bank's commercial lending division.

It should also be noted that the redevelopment division engaged in questionable lending practices related to the use of straw borrowers, possible misuse of escrow funds intended for repairs, and improper appraisal practices. These practices were under investigation by OCC at the time of our material loss review. Nonetheless, we referred these matters and related documentation to the Treasury Inspector General's Office of Investigations.

Until 2008, OCC's examinations of Omni were not adequate and allowed the bank's risky lending practices to continue unabated. OCC's reports of examination (ROE) for the four examinations of Omni conducted from 2003 to 2007 resulted in CAMELS composite ratings of 2 for the institution. The ROEs concluded that the board and management adequately supervised the bank and had implemented sound risk management practices. The ROEs included few matters requiring attention (MRA), and noted few management oversight issues. In December 2007, OCC assigned a new examiner-in-charge (EIC) to Omni who had more experience with problem banks. Shortly thereafter, in January 2008, OCC began a full-scope examination of Omni. OCC's ROE for this examination, which was issued in September 2008, downgraded Omni's CAMELS composite rating to 5 and concluded that the board and management had not effectively managed growth or the bank's highly complex risk profile. Omni was found to have severe management and control deficiencies not identified in prior ROEs.

In February 2008, the EIC identified that formal enforcement action was likely needed against Omni but OCC did not enter into a consent order with the bank until October 2008. When we asked about the length of time it took to implement the consent order, OCC officials stated there was (1) a need to develop sufficient findings and legal support for enforcement action and (2) no immediate need to stop the unsafe and unsound lending practices, since the bank had ceased redevelopment lending. Had the bank not already stopped the unsafe and unsound activity, OCC would have used a temporary cease and desist order to force the bank to do so. They said that an enforcement action may have been more appropriate in earlier years, but the prior examinations did not fully uncover the problems at the bank. OCC officials wanted the 2008 consent order to be forward looking and require actions that could rehabilitate the bank. Officials noted that throughout 2008, examiners were on-site to observe the bank's activities and prevent Omni from doing further harm to its condition. Also, OCC officials said that formal enforcement actions are timed to coincide with the release of ROEs because ROEs provide the justification for such actions. However, we believe this approach caused unnecessary delay and that enforcement action was needed in early 2008, when OCC began to uncover the bank's problems.

In 2008, once Omni reported that its capital level fell below well-capitalized, OCC appropriately used its authority under PCA. Specifically, in August 2008, OCC notified the bank that it was adequately capitalized based on the June 30, 2008, Consolidated Report of Condition and Income (call report) submission. This level of capital prohibited Omni from accepting or renewing brokered deposits without a waiver from FDIC. OCC also acted forcefully against the bank in November 2008 and February 2009 when call reports submitted identified changes in Omni's capital status. That said, Omni's disagreement with its external auditor and OCC over the valuation of OREO along with other financial reporting deficiencies delayed PCA by approximately 6 months and filing of accurate call reports for up to 1 year.

Recommendations

We recommend that OCC (1) review its processes to ensure that more timely enforcement action is taken once the need for such action is identified; (2) impress upon each EIC the importance of completing all activities in annual supervisory cycles, including quarterly monitoring; and (3) implement a policy for EIC rotation for midsize and community banks.

Management Response

In a written response, OCC agreed that there were shortcomings in its supervision of Omni and concurred with our second and third recommendations. OCC agreed that periodic monitoring is integral to effective supervision and will continue to reinforce this expectation to examining staff at upcoming management meetings and the next national conference call with examining staff. OCC also agreed that as part of sound supervision, there is benefit to formalizing a rotation policy for midsize and community banks. In that regard, OCC is developing a parallel policy (to its large bank rotation policy) covering portfolio managers and examiners in charge in midsize and community banks. Pending completion of a formal policy and procedures manual update, OCC plans to emphasize this message through district management meetings, future examiner conference calls, and as other opportunities arise.

OCC did not agree with our first recommendation, to review its processes to ensure that more timely enforcement action is taken once the need for such action is identified. OCC agrees that timeliness is a major determinant in the effectiveness of enforcement action, but believes the timing of the October 2008 consent order was in compliance with its policy. OCC stated that appropriate enforcement action would have been taken immediately had Omni not already ceased redevelopment lending and other deficient lending practices. In addition, OCC said its examiners were onsite on a continuous basis, observing the bank's activities. OCC said the completion of its ROE in September 2008 provided the thorough documentation necessary to legally support an enforcement action. Following completion of the ROE, OCC said the consent order was promptly in place 3 weeks later. OCC also said that our position that an informal enforcement action was warranted would not have complied with its own enforcement policy and would have sent a message that the bank's condition was not as serious as OCC suspected.

OCC's full response is provided as appendix 7.

<u>OIG Comment</u>

We consider OCC's planned actions with respect to the two recommendations with which OCC concurs, to be responsive to our recommendations.

For the recommendation with which OCC does not concur, we continue to believe that more timely enforcement action was needed. For example, OCC said in its response that soon after the January 2008 examination began, redevelopment lending and other deficient lending practices had already ceased, and thus immediate action was not necessary. Yet, financial records we reviewed showed redevelopment lending continued during this period, albeit at a reduced level. While the quality of these redevelopment loans may have been better than prior loans (we reviewed a sample of these redevelopment loans and found them performing, as of March 27, 2009, when Omni was closed), OCC's examiners also told us they did not review the redevelopment lending division in 2008. We believe that the lack of an examination of this division during 2008 raises questions about the extent to which OCC could comment on redevelopment lending practices.

Further, OCC issued an ROE in January 2009 for an examination that began in September 2008. This ROE confirmed deficient lending practices found in credit administration and underwriting evident in the prior examination continued through 2008. As a result, we believe OCC should have considered taking action immediately. While OCC was concerned that an informal enforcement action could send the bank the message that the bank's condition was not as serious as suspected, we believe it would be a stronger message to the bank than not taking enforcement action for another 9 months.

That said, OCC asserts that current policies are sufficient to ensure that timely enforcement action is taken. Accordingly, while we continue to believe OCC's enforcement actions with respect to Omni were slow, we accept its position with respect to its current processes and consider the recommendation closed. We will, however, continue to assess the timeliness of enforcement actions as we proceed on future material loss reviews.

Causes of Omni National Bank's Failure

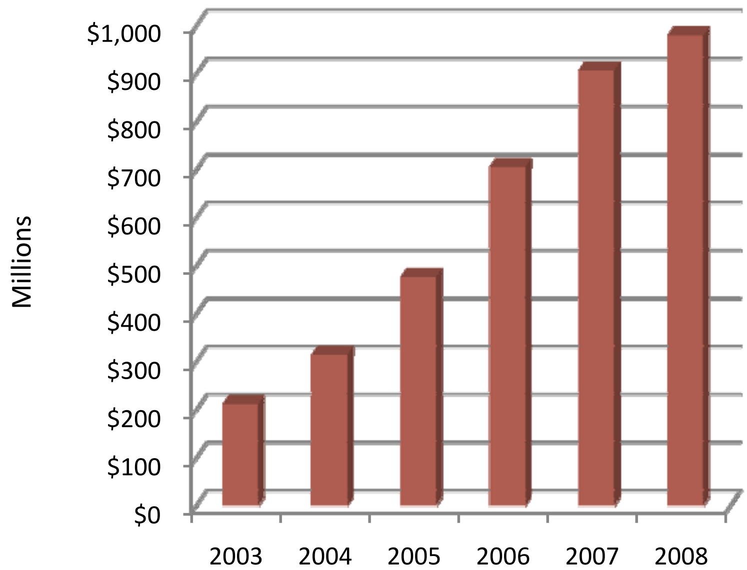
The primary cause of Omni's failure was the significant losses in its commercial real estate loan portfolio, largely originated in the redevelopment division. Omni's management pursued an aggressive growth strategy designed to increase the assets of the bank, but did not adequately control concentration risk or ensure that adequate internal controls were implemented in commercial real estate lending. This led to aggressive and overly liberal lending practices that included deficient underwriting, credit administration, and appraisal practices. OCC estimated that Omni's net operating losses exceeded $14 million in both 2007 and 2008.

The most problematic loans in the commercial real estate loan portfolio were the short-term rehabilitation loans made to investors for the purchase and rehabilitation of housing in lower-income areas. Omni also overvalued OREO from foreclosed redevelopment loans, resulting in the filing of inaccurate call reports. These conditions were exacerbated by the decline in the real estate market and borrowers' inability to obtain outside financing to pay off Omni loans as they matured.

Omni Pursued an Aggressive Growth Strategy

Beginning in 2003, Omni's board and management began to aggressively grow the bank. From 2003 to 2006, Omni's assets grew from $212 million to $706 million, an average annual growth rate of almost 50 percent. While Omni's rate of growth slowed after 2006, the bank's assets increased to $980 million by the end of 2008. Overall, Omni's assets grew by over $768 million from 2003 through 2008. Figure 1 illustrates Omni's assets from 2003 through 2008.

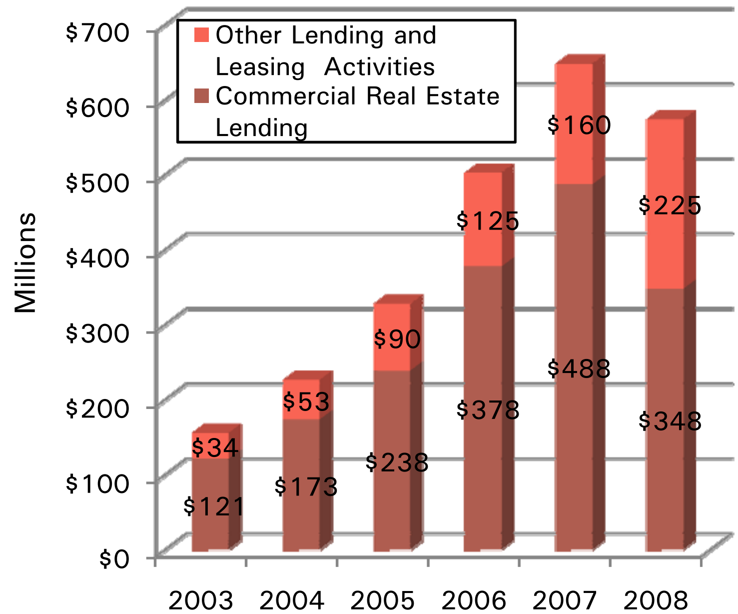
Figure 1. Asset Growth of Omni National Bank



Source: OIG analysis of Omni National Bank call reports.

Omni's aggressive growth was largely concentrated in commercial real estate, including redevelopment loans. Figure 2 shows the growth in the various components of the bank's loan portfolio from 2003 through 2008. The largest loan portfolio during the period was commercial real estate, which includes redevelopment loans. In 2007, when the loan portfolio reached its highest value, the $488 million in commercial real estate loans represented 75 percent of the total loan portfolio. The remaining 25 percent represented Omni's consumer and residential lending, along with the bank's leasing activities.

Figure 2. Growth and Composition of Omni National Bank' Loan Portfolio



Source: OIG analysis of OCC-provided data.

During this period, Omni also expanded geographically, with 12 banking or loan production offices covering seven states—Alabama, Florida, Georgia, Illinois, North Carolina, Pennsylvania, and Texas. Omni's growth actually exceeded its internal targets. For example, Omni's 2005-2007 capital plan estimated a 19 percent average growth rate, while the actual growth rate for those years averaged 42 percent.

Brokered deposits were a large source of funds for Omni from 2003 through 2008. By December 31, 2007, Omni's brokered deposits totaled $442 million, or 48 percent of the bank's assets. Over the next 6 months, Omni increased brokered deposits by over $120 million to maintain liquidity throughout 2008.

Omni's Underwriting and Credit Administration of Commercial Real Estate Loans Were Unsound

Omni's management did not establish proper controls over commercial real estate loan underwriting and credit administration. Omni originated loans without verifying key financial data, did not properly manage interest reserves, allowed loan officers to have direct contact with appraisers, and maintained insufficient controls over loan withdrawals. Omni also relied on property appreciation to protect its interest in redevelopment loans, rather than borrower ability to repay. In addition, Omni's appraisal deficiencies often resulted in redevelopment properties being overvalued. When significant volumes of these loans defaulted, the bank incurred large losses.

Weaknesses in Commercial Real Estate Lending

Significant control weaknesses existed in Omni's commercial real estate lending. Initial loan credit analyses often lacked verification of key financial figures supporting cash flow, contingent liabilities, and liquidity. Financial statements obtained from borrowers often lacked sufficient detail to fully assess borrower repayment capacity. In the ROE for the examination begun in January 2008, OCC reported that Omni was overly aggressive in its origination of commercial real estate loans, including origination of loans with no or protracted repayment terms and loans that inappropriately used interest reserves. OCC examiners told us that while interest reserves can be appropriate for some construction-type projects, Omni also used interest reserves on raw land and speculative loans, for which OCC has deemed interest reserves to be inappropriate.[3]

Omni did not have systems and processes to identify, manage, and control the use of interest reserves in commercial lending. During the January 2008 examination, bank management was initially unable to produce a list of loans made using interest reserves or the amount of each commitment. The bank subsequently provided a listing, but OCC considered the accuracy of the information to be

[3] OCC Committee on Bank Supervision, *Internal Guidance and Summary of Key Principles of Commercial Real Estate* (Apr. 9, 2008).

suspect. One examiner noted that the bank's inadequate reporting mechanisms made it difficult to trust most of its financial reports.

In 2007, Omni contracted for an internal audit of the bank's commercial lending functions. The internal audit found that withdrawals for large commercial real estate construction loans were often approved by the same loan officer who performed the progress inspection. The internal audit also found over 2,000 underwriting exceptions (including 1,300 deemed critical) relating to loan collateral and inconsistencies in the reporting of past due and nonaccrual loan data. The internal audit found these practices to be high risk.

The 2007 decline in the real estate market compounded Omni's problems. As large commercial real estate loans matured, many borrowers were unable to sell properties to pay off their loans. Omni often rolled debts over to new loans, capitalizing unpaid interest into the new loan principal and establishing new interest reserves to continue funding borrower interest installments. Omni's flawed practices associated with appraisals supporting these loans raised serious questions about the collateral protection and potential exposures Omni faced.

<u>Reliance of Redevelopment Loans on Property Appreciation</u>

Omni's underwriting of redevelopment loans, a subset of its commercial real estate lending activities, relied extensively on the anticipated appreciation in property values and placed far less emphasis on the borrower's credit-worthiness or ability to repay the loan.

Examples of redevelopment loans originated by Omni with no consideration of borrower credit-worthiness included

- a loan to a borrower made days after he was released from prison after serving time for mortgage fraud,
- a loan to a borrower with negative income for 2 consecutive years, and
- a $309,000 loan to a real estate agent who had been employed for only 30 days, in which the loan proceeds were to be used,

in part, to cover past-due interest payments on redevelopment loans for a different borrower.

According to the OCC Comptroller's Handbook, a loan is generally considered unsound if

- its liquidation depends on the sale of the underlying real estate,
- the amount of the loan is large relative to the fair value of the property, and
- the borrower's ability to repay is questionable.[4]

Omni's deficient redevelopment lending practices, including appraisals discussed later in this report, resulted in loans that met all three of these criteria for unsoundness.

Many of the properties associated with Omni's deficient underwriting practices were ultimately foreclosed. Many of these foreclosed properties were then sold with new Omni-financed redevelopment loans within the same month so that Omni could avoid recording the properties in month-end OREO balances. Each time a foreclosed property was sold with a new Omni loan, the amount of the new loan was larger to cover the costs of the prior loan, thereby increasing the bank's exposure to loss. In some cases, properties were foreclosed and sold multiple times for higher amounts to avoid losses and mask the bank's condition.

Each subsequent sale of foreclosed property normally included additional funds for property repairs. Often the new loans were made without updated appraisals to support the higher loan amounts. As it had with the original redevelopment loans, the bank relied on appreciation in property value to support the higher loan amounts, rather than borrower ability to repay. From September 2006 to September 2007, 169 foreclosed properties were sold to new borrowers who obtained new Omni redevelopment loans, totaling more than $25 million, for these properties. The new loans constituted almost 15 percent of the bank's redevelopment loan portfolio.

[4] OCC, Comptroller's Handbook, "Real Estate Loans" (section 213).

The 2007 decline in real estate values and the freeze in the sub-prime credit market exposed Omni's unsafe and unsound reliance on property appreciation. Omni borrowers were unable to sell rehabilitated properties at prices sufficient to pay off outstanding redevelopment loans because the properties were overvalued or the purchasers did not qualify for financing. Being unable or unwilling to repay obligations, many borrowers defaulted on redevelopment loans.

At the same time, Omni could no longer foreclose and finance the sale of properties to new borrowers at amounts sufficient to cover defaulted loans. As a result, Omni faced a significant number of defaults as redevelopment loans matured. In 2008, Omni's OREO portfolio included over 600 properties from foreclosed redevelopment loans. The only way Omni could sell the properties was at deep discounts. In March 2008, however, Omni's chief executive officer (CEO) directed bank managers to refrain from selling foreclosed properties at discounted prices because it would force the bank to recognize significant losses. Consequently, the properties remained in Omni's OREO inventory at inflated values.

Deficient Appraisal Practices

OCC's January 2008 examination determined that Omni's real estate appraisal practices were not in compliance with the Uniform Standards of Professional Appraisal Practice and 12 C.F.R. Part 34. OCC identified systemic violations in appraisals ordered prior to 2007 and in many ordered in 2007. Among the violations were allowing direct contact between Omni loan officers and appraisers and allowing loan officers to order and review completed appraisals. At times, loan officers also provided appraisers with the values needed to support the loans and negotiated with appraisers to obtain these values.

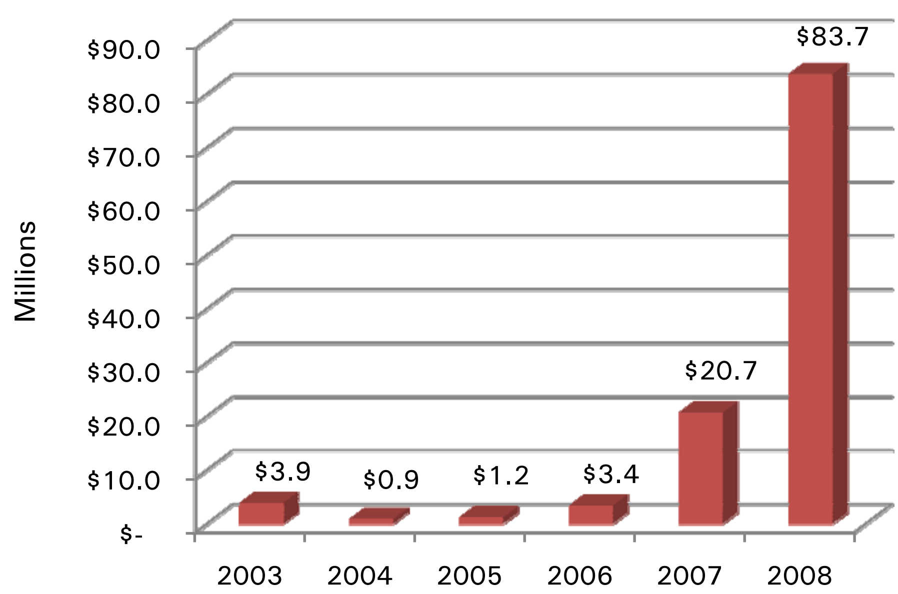
The volume of loans and the uniqueness of Omni's redevelopment product led to the bank's sometimes using properties with prior redevelopment loans as comparable properties in appraisals. In other cases, the properties used as comparables were from distant locations or were more valuable than the property being appraised. In other words, the comparable properties were not comparable.

In 2007, Omni initiated new appraisal processes that centralized the ordering and review of appraisals for the entire bank. OCC believed that the new processes corrected many of the bank's deficiencies. The damage, however, was already done because prior deficient appraisals were not corrected.

Overvalued Redevelopment OREO Delayed Recognition of Losses

At the end of 2006, Omni's OREO balance was $3.4 million, but it increased to $21 million by the end of 2007 and to $84 million by the end of 2008. Approximately 86 percent of the OREO balance for these 2 years was the result of foreclosed redevelopment loans. During this period, redevelopment properties included in OREO increased from about 200 at the end of 2007 to over 600 by the end of 2008. Figure 3 shows Omni's OREO balances from 2003 to 2008.

Figure 3. Omni National Bank OREO, 2003-2008



Source: OIG analysis of Omni call reports. The balances for 2007 and 2008 reflect adjustments required by OCC.

Federal regulations require banks to substantiate the value of each OREO parcel by obtaining either an appraisal or, under certain circumstances, an evaluation.[5] In addition, OCC guidance requires that OREO should be accounted for individually at the lower of the property's fair value or the bank's cost.[6]

Omni recorded OREO using a methodology based on the after repaired value (ARV) of each property adjusted downward for the estimated cost of repairs and selling expenses. Omni's methodology resulted in properties being recorded in OREO at amounts above market value. Omni did not obtain required appraisals or evaluations at the time of foreclosure to support the recorded OREO value.

The external auditor conducting the audit of the 2007 consolidated financial statements of Omni's holding company concluded that the bank's methodology based on the ARV resulted in the overstatement of OREO by an estimated 32.5 percent. Omni's CEO opposed the external auditor's position.[7]

In August 2008, OCC required Omni to write down OREO properties by 32.5 percent that were not considered substantially complete. OCC also instructed Omni to refile call reports back through December 31, 2007, to reflect the adjusted OREO values. Omni's CEO continued to oppose the additional write-down of OREO, informing OCC that these adjustments would impair the bank's capital and lead to its failure. Nevertheless, Omni refiled its call reports back to December 31, 2007, to reflect increases to the allowance for loan and lease losses provision due to the OREO write-downs. Omni's updated loan loss provisions totaled $30 million for 2007 and $12 million for 2008.[8] The refiled call report for December 31, 2007, also showed that Omni was only

[5] 12 C.F.R § 34.85.
[6] OCC, Comptroller's Handbook, "Other Real Estate Owned" (section 219).
[7] Ultimately, Omni's holding company, Omni Financial Services Incorporated, never produced audited financial statements for 2007. It also did not file an annual report for 2007 with the Securities and Exchange Commission. The failure to file an annual report resulted in the holding company's stock being delisted from the NASDAQ Stock Market.
[8] OCC was unable to provide definitive loan loss provision adjustments attributed to revalued OREO due to other adjustments included by the bank in refiled call reports and the overall poor quality of the bank's accounting records.

adequately capitalized at that date. The original call report showed that the bank was well-capitalized.

Redevelopment Lending Practices Are Under OCC Review

In October 2007, Omni's CEO initiated an internal bank investigation of the redevelopment division. The investigation disclosed several questionable lending practices that reportedly took place in the division.[9] These practices, including the use of straw borrowers, the possible misuse of escrow funds intended for repairs, and improper appraisal practices were under investigation by OCC at the time of our material loss review. We also referred these matters and related documentation to the Treasury Inspector General's Office of Investigations.

OCC's Supervision of Omni National Bank

OCC's supervision of Omni National Bank was inadequate and likely led to greater losses to the deposit insurance fund. Although OCC performed timely full-scope examinations as prescribed in internal guidelines, it was not until the examination begun in January 2008 that OCC fully identified Omni's lack of management controls and oversight, uncontrolled asset growth, and high-risk unsafe and unsound lending practices. These conditions, however, had existed for several years. Had OCC identified these unsafe and unsound practices in earlier examinations, effective action could have been taken to prevent the significant losses faced by the bank.

During the early stages of the 2008 examination, the EIC promptly identified the likely need for enforcement action. OCC officials stated there was (1) a need to develop sufficient findings and legal support for enforcement action and (2) no immediate need to stop the unsafe and unsound lending practices, since the bank had ceased redevelopment lending. According to those same officials, had the bank not already stopped the unsafe and unsound activity,

[9] OCC was notified by Omni's CEO about the internal bank investigation into possible improprieties in the redevelopment division. OCC officials believe the notification about the internal bank investigation was made sometime in October 2007 but could not provide a specific date. The CEO presented the results of the internal bank investigation to Omni's board of directors in March 2008.

OCC would have used a temporary cease and desist order to force the bank to do so. OCC's implementation of the consent order was delayed to allow OCC to identify the true condition of the bank and provide support for the formal enforcement action. OCC's efforts to rescue the bank were unsuccessful. In hindsight, according to OCC, formal enforcement action would have been most beneficial years earlier, but prior year examinations did not provide a sufficient basis for taking such action earlier.

In July 2008, OCC transferred the supervision of Omni to the Special Supervision Division in Washington, D.C.[10] In August 2008, OCC notified Omni that based on the June 30, 2008, call report, it was in the adequately capitalized category and subject to PCA-required restrictions on accepting and renewing brokered deposits. Although OCC took PCA action promptly based on the June 30, 2008, call report, Omni had been filing misleading call reports showing inflated capital levels for at least the two prior quarters. Omni delayed refiling fully corrected call reports until January 2009. Had Omni filed accurate call reports for these quarters, the bank would have been deemed less than well-capitalized as of December 31, 2007, and been subject to PCA-required restrictions on accepting brokered deposits sooner.

In September 2008, OCC assigned the bank a CAMELS composite rating of 5 and in October 2008 imposed a consent order on the bank. The consent order included specific capital requirements for Omni and appropriate PCA-required restrictions based on the bank's known capital levels.

As another supervisory matter, we noted that the EIC for Omni before the examination that started in January 2008 had been assigned to four consecutive examination cycles for the bank. OCC officials stated that guidelines followed call for rotating EICs every 3 to 5 years, however, OCC currently lacks a specific EIC rotation policy for community and midsized banks.

[10] The role of the Special Supervision Division is to supervise problem banks through rehabilitation or through other resolution processes such as the sale, merger, or liquidation of such institutions.

Table 1 summarizes the results of OCC's full-scope safety and soundness examinations of Omni and enforcement actions taken.[11] Appendix 5 contains details of MRAs, corrective actions, and other issues noted during the examinations.

Table 1: Summary of OCC's Omni National Bank Examinations and Enforcement Actions

		Examination Results			
Date started	**Assets ($millions)[a]**	**CAMELS rating**	**Number of MRAs**	**Number of corrective actions**	**Enforcement actions**
06/09/2003	$212	2/222221	3	3	None
01/18/2005	$315	2/222121	1	3	None
02/16/2006	$476	2/222221	1	1	None
02/05/2007	$706	2/222122	1	8	None
01/07/2008	$907	5/555542	2	7	Consent order executed 10/07/2008
09/08/2008	$980	5/555544	N/A[b]	4	Consent order remained in place

Source: OCC ROEs and Omni call reports.
[a] Amounts are as of December 31 of each year.
[b] No MRAs were included in the ROE for this examination. The scope of the examination was limited to an assessment of the bank's viability and amount of capital needed for compliance with the October 7, 2008, consent order.

OCC's 2003-2007 Examinations Identified Problems at Omni but No Heightened Level of Supervisory Concern

Based on its examinations of Omni from 2003 through 2007, OCC assigned Omni CAMELS composite ratings of 2. Omni also received CAMELS component ratings of 2 for management. Overall, OCC concluded that the board and management adequately supervised the bank's affairs and had sound risk management practices in place.

The ROEs for the examinations conducted during this period did identify some issues, but only the ROE's for the examinations conducted in 2003 and 2005 hinted at issues that would later

[11] OCC conducted its examinations in accordance with the timeframes prescribed by OCC policy.

become significant factors in Omni's demise. MRAs included in the ROE for the 2003 examination criticized the bank for the following:

- Weak credit administration, including inadequate exception tracking and reporting and a loan policy that needed enhancement
- Liquidity management and <u>contingency funding plans</u> that needed improvement
- Lack of a full information technology audit, risk assessment, and business resumption plan

The 2003 ROE also cited violations of law relating to two instances in which Omni did not obtain required appraisals. In one case, Omni failed to obtain an appraisal for an $800,000 loan secured by multiple properties. In the other case, no appraisal or internal valuation document was found to substantiate the $175,000 value assigned to a property in OREO.

The ROE for the next examination, which began in January 2005, included one MRA concerning ongoing credit administration deficiencies, citing the bank's high number of <u>loan exceptions</u> and its failure to obtain and analyze annual financial statements from borrowers. OCC concluded that the credit administration deficiencies were the same issues reported in the prior ROE.

The one MRA included in the ROE for the examination that began in January 2006, criticized the bank for having an inadequate contingency funding plan. OCC found that the plan lacked detail and did not contain a narrative description of events that could trigger a disruption of operations. OCC also noted that this was a repeat issue, although it was not included as a prior MRA.

The one MRA included in the ROE for the examination that began in February 2007 criticized Omni for failing to perform a Bank Secrecy Act/anti-money laundering risk assessment. OCC also reported that the board and management failed to provide proper oversight of the independent testing conducted on Omni's Bank Secrecy Act/anti-money laundering program and did not review the results reported by an external contractor.

Although OCC assessed Omni's redevelopment division in the examinations performed from 2003 through 2006, no MRAs associated with the division's practices were included in the ROEs. The examination that began in February 2007 included a review of redevelopment loans, but the division's operations were not assessed. The ROEs for the examinations conducted in 2003 to 2007 did note that Omni's risk exposure from redevelopment loans was high; however, the ROEs also stated that the bank had sound risk management procedures in place to mitigate the risk posed by the redevelopment loans. As discussed below, OCC later found that this was not the case.

Quarterly Monitoring Was Not Performed During 2007

The Comptrollers Handbook states that quarterly monitoring or periodic monitoring activities are a key component of supervision by risk. The timing of the activities is to be risk-based and driven by supervisory objectives rather than predetermined calendar dates.

According to a Southern District internal review, OCC did not schedule monitoring activities of Omni for the first quarter of 2007. The internal review also noted that monitoring activities for the next two quarters were not performed. Officials in OCC's field office confirmed that quarterly monitoring was not performed during 2007. We believe that the lack of quarterly monitoring was significant because 2007 was a critical period in the decline of Omni. Given the importance of periodic monitoring, we believe that OCC's failure to perform these activities constitutes deficient oversight of Omni during 2007.

OCC's January 2008 Examination Identified Omni as Critically Deficient With Inadequate Management Oversight and Controls Over Lending

OCC's Atlanta field office performed an analysis of Omni's Uniform Bank Performance Report for the quarter ending September 30, 2007, which revealed asset quality deterioration and significant increases in Omni's past due and nonperforming assets. The field office determined that Omni was a troubled institution and notified the Southern District office, which placed the bank on OCC's watch list in December 2007.

OCC began an examination of Omni on January 7, 2008, under a newly assigned EIC. The assistant deputy comptroller (ADC) for OCC's Atlanta field office stated that he assigned the new EIC because she was a higher-level examiner than the previous EIC and had experience with problem banks.

The examination initially focused on Omni's commercial real estate lending practices. Although OCC was notified of possible improprieties in Omni's redevelopment division, the ADC and the EIC believed that the bank's other commercial real estate lending activities, which had larger loans, posed a higher risk to the bank. Soon after starting the examination, however, the examiners identified significant deterioration in the bank's condition and found that problems in the redevelopment division were more severe than had been characterized by Omni's CEO. In a February 2008 meeting, the EIC informed the CEO that the bank should expect a downgrade to at least a CAMELS composite rating of 3 and said she believed that OCC would likely take formal enforcement action.

As OCC's examination progressed, Omni's condition continued to deteriorate. On July 9, 2008, the Atlanta field office proposed to the District Supervision Review Committee (DSRC) for the Southern District that Omni's CAMELS composite rating be downgraded to 4 and that a consent order be implemented. DSRC approved the proposed actions on July 9, 2008. Shortly thereafter, OCC's Southern District decided to transfer supervision of Omni to OCC's Special Supervision Division. That transfer was completed on July 18, 2008, and the Special Supervision Division assumed responsibility for issuing the ROE.

The Special Supervision Division determined that Omni's condition continued to deteriorate and had become more critical, warranting a further downgrade. Accordingly, the ROE for this examination, issued on September 15, 2008, assigned a CAMELS composite rating of 5 to Omni. In the ROE, OCC concluded that Omni was critically deficient and that unsafe and unsound practices threatened the bank's survival. These unsafe and unsound practices included

- inadequate internal control systems,

- ineffective risk management processes, and
- inadequate supervision of management in the commercial and redevelopment lending functions.

Among other things, the ROE noted that Omni's classified assets had risen to 131 percent of capital and that special mention assets represented another 41 percent. Because Omni was unable to identify all of its problem loans, OCC concluded that the full extent of the bank's problems was not known at the time the ROE was issued.[12]

The September 15, 2008, ROE also cited Omni for multiple violations of law. The significant violations included Omni's failure to

- report OREO balances accurately,
- implement adequate Bank Secrecy Act procedures to monitor customer activity,
- obtain a required appraisal for a loan relationship,
- ensure that appraiser independence requirements were met,
- obtain updated appraisals or evaluations on OREO holdings, and
- ensure that the annual independent audit report was completed.

Regarding the deficient conditions noted in the bank during OCC's examination begun in January 2008, the EIC for the examinations conducted from 2003 through 2007 stated that in retrospect OCC could have taken a stronger position on the bank earlier and not allowed Omni to become overly concentrated in real estate lending. The EIC also stated that he now believed that the bank had never fully corrected the credit administration deficiencies cited in the ROE for the examination begun in January 2008 that appeared to be repeat credit administration issues noted in the ROE's for the examinations conducted in 2003 and 2005.

[12] Banks must rate the risks of loans according to the severity of any problems and maintain management information systems for monitoring the risk ratings. The regulatory agencies use common categories for risk-rating problem loans.

OCC Took Formal Action Against Omni Nearly 9 Months After Examiners Determined That Such Action Was Likely Required

There were “red flags” associated with Omni for a number of years, but they had not been identified as significant matters of concern in prior ROEs. These red flags included excessive growth, a risky product line and clientele, and geographic expansion. We believe that had OCC identified these problems earlier, enforcement action could have been taken and may have made a difference for this bank.

That said, in February 2008, the EIC informed Omni that she believed the bank’s condition warranted a downgrade and formal enforcement action and in March 2008, the ADC informed the OCC’s Southern District office that a downgrade to a CAMELS composite rating of 3 along with a recommendation for a cease and desist order was likely. OCC, however, did not implement a consent order until October 7, 2008.[13]

When we asked about the length of time it took to implement the consent order, OCC officials stated that there was no immediate need to stop unsafe and unsound practices since the bank had ceased redevelopment lending and other deficient lending practices, which they considered to be the root cause of the bank’s problems. Had the bank not already stopped the unsafe and unsound activity, OCC would have used a temporary cease and desist order to force the bank to do so. OCC officials also noted that examiners were on-site observing the bank’s activities to prevent Omni from any unsafe and unsound lending that could further harm its condition.

OCC officials stated that to take formal enforcement action, OCC must be able to introduce into evidence sufficient findings and legal support to prove the circumstances on which the action is based. Absent exigent circumstances, the ROE is typically used to document the findings and legal support. In this regard, the ROE for the 2008 examination was completed on September 15, 2008, and the consent order was taken within 3 weeks. In the case of Omni, as with most enforcement actions taken against national banks,

[13] The consent order required that Omni address deficiencies in management, capital, asset quality, earnings, and liquidity within specified timeframes.

OCC also wanted the consent order to be a forward looking document requiring actions that could rehabilitate the bank.

According to OCC officials, the ROE was delayed because of the continued deterioration of the bank and Omni's inability to provide accurate financial information to examiners, a situation we agree was a problem. Examiners also needed time to fully gather necessary evidence to support the ROE and ultimately the consent order. As discussed above, very soon after the start of the 2008 examination, the examiners believed Omni should be assigned a CAMELS composite rating of 3. As conditions deteriorated further and additional deficiencies were uncovered, examiners concluded that the bank's CAMELS composite rating should be further downgraded to a 4 which required that the case be presented to DSRC. After the DSRC decision, the Southern District office transferred supervision of the bank to the Special Supervision Division in OCC's headquarters. As a result of the bank's continuing deterioration, the Special Supervision Division concluded that a further downgrade to a CAMELS composite rating of 5 was necessary.

We asked whether informal enforcement action was considered. OCC officials stated in the case of Omni, informal action was not necessary. The bank's significant problems identified during the 2008 examination resulted from unsafe and unsound lending that the bank had ceased in late 2007. Accordingly, the officials believed that there was nothing that OCC needed to do immediately to prevent further harm. We find it unusual that OCC would take a position that, absent a formal enforcement action early on, it did not see a benefit to enter into a memorandum of understanding or take other action earlier to make clear its expectations. While examiners may have been on-site watching the bank, Omni was still under the control of the same board and executive leadership that allowed the redevelopment division to operate in an unsafe and unsound manner for so many years.

We acknowledge OCC's need to develop sufficient support to determine appropriate enforcement action and defend that action. We also understand the considerable judgment that is involved. However, in the case of Omni, it took nearly 9 months from the time OCC first identified that formal enforcement action was needed to the time the consent order was implemented. We believe the supervisory process used to issue the Omni consent order was slow and points to a need for OCC to reassess its process.

OCC's Implementation of PCA Was Timely, Based on Original Call Report Submissions

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

OCC implemented PCA as described below based on Omni's call report submissions for June 30, 2008, September 30, 2008, and December 31, 2008. We concluded that the actions taken on these submissions were timely and in accordance with PCA requirements.

- On August 4, 2008, OCC notified Omni that it was adequately capitalized based on the bank's June 30, 2008, call report. This was the first call report filed by Omni that showed the bank as less than well-capitalized. As required by PCA, OCC's notice prohibited the bank from accepting or renewing brokered deposits unless it obtained a waiver from FDIC.

- On November 4, 2008, OCC notified Omni that it was undercapitalized based on the bank's September 30, 2008, call report. OCC directed Omni to submit an acceptable capital restoration plan. OCC rejected Omni's capital restoration plan, submitted on December 15, 2008, because it was based on unrealistic assumptions, did not adequately address how deficiencies would be corrected, and did not include a guarantee and pledge of assets from Omni's holding company.

- On February 4, 2009, OCC notified the bank that it was significantly undercapitalized based on the December 31, 2008, call report. OCC once again directed Omni to submit an acceptable capital restoration plan and also informed Omni that it must comply with PCA-required restrictions on the payment of dividends and management fees.

Omni refiled its December 31, 2007, call report on July 30, 2008, as directed by OCC, to reflect a write-down of the OREO balance and other adjustments. The revised call report resulted in the bank being classified as adequately capitalized as of December 31, 2007. Had Omni filed an accurate call report for December 31, 2007, Omni would have been designated adequately capitalized 6 months sooner. This designation would have prevented Omni, under PCA, from accepting brokered deposits without an FDIC waiver beginning in February 2008. Instead, Omni continued accepting brokered deposits during that time totaling over $120 million in the first 6 months of 2008. Omni's ability to obtain these brokered deposits may have increased the loss to the deposit insurance fund.

OCC was aware that Omni would again need to refile call reports for December 31, 2007, March 31, 2008, and June 30, 2008, due to additional OREO write-downs. In August 2008, OCC directed the bank to refile the corrected call reports and considered but did not impose civil money penalties for Omni's failure to comply. OCC's Special Supervision Division officials told us that the bank was allowed more time to complete the OREO revaluation because the process was more complex than originally anticipated and a large number of properties were involved.

We believe that OCC should have been more forceful with Omni in the matter of refiling the call reports. In August 2008, OCC confirmed that Omni's OREO was overstated and directed the bank to refile call reports. According to OCC's August 2008 documentation, the bank had sufficient information available in May 2008 to refile the call reports. OCC's documentation also showed that OCC officials suspected that Omni's CEO was delaying refiling the call reports. The CEO continued to disagree with the OREO valuation methodology recommended by the external auditor and OCC. The CEO informed OCC that the methodology resulted in inaccurately low values and if Omni was required to make these adjustments, the bank's capital would be impaired and the bank could fail. It was not until January 2009 that Omni included the final adjustments for OREO in refiled call reports dating back to December 31, 2007.

OCC Lessons-Learned Review Is Not Yet Complete

According to OCC headquarters officials, an internal lessons-learned review of the failure of Omni was in process but had not been completed at the time of our review. The purpose of the review is to assess both the causes of the failure and OCC's supervision of the bank.

Other Supervisory Matter – No Official EIC Rotation Policy Exists for Midsized and Community Banks

OCC's lessons-learned review for ANB Financial, National Association (ANB), noted that the EIC responsible for supervision of that bank had been in place for three consecutive examinations.[14] OCC stated in its lessons-learned report that, in hindsight, the rotation of the EIC for the next cycle would have been advisable. In the case of Omni, one EIC was responsible for oversight of the bank for four consecutive supervisory cycles, from 2003 through 2007.

The Comptrollers Handbook states that EICs are to be rotated periodically to ensure that their supervisory perspective remains objective. According to OCC Southern District and Headquarters officials, no formal policy has been established that set specific time-frames for the rotation of EICs for midsized and community banks. They stated that the general guideline followed is for EICs to be rotated on a 3-to-5 year basis.

As noted in the ANB lessons-learned review, rotating EICs is an opportunity for OCC to gain a fresh perspective on a bank and to ensure regulatory objectivity. EIC rotation is an area that we believe warrants more formal OCC policy guidance.

[14] OCC closed ANB and appointed FDIC as receiver on May 9, 2008. The estimated loss to the deposit insurance fund of the failure was $819 million as of October 31, 2009. We performed a material loss review of the ANB failure and issued our report on November 25, 2008 (*Safety and Soundness: Material Loss Review of ANB Financial, National Association*; OIG-09-013). OCC's lessons learned review of ANB was not completed at the time we issued our report on the material loss review.

Recommendations

Our material loss review of Omni is the sixth such review we have performed of a failed OCC-regulated financial institution during the current financial crisis. Appendix 6 lists the other five material loss reviews and our associated recommendations. OCC management agreed with the prior recommendations and has taken or is taking corrective actions to address them.

Based on our material loss review of Omni, we recommend that the Comptroller of the Currency do the following:

1. Review OCC processes to ensure that more timely enforcement action is taken once the need for such action is identified.

   Management Response

   OCC did not concur with this recommendation. OCC agrees that timeliness is a major determinant in the effectiveness of enforcement action, but believes the timing of the October 2008 consent order was in compliance with its policy. OCC stated that appropriate enforcement action would have been taken immediately had Omni not already ceased redevelopment lending and other deficient lending practices. In addition, OCC said its examiners were onsite on a virtual continuous basis, observing the bank's activities. OCC said the completion of its ROE in September 2008 provided the thorough documentation necessary to legally support an enforcement action. Following completion of the ROE, OCC said the consent order was promptly in place 3 weeks later. OCC also said that our position that an informal enforcement action was warranted would not have complied with its own enforcement policy and would have sent a message that the bank's condition was not as serious as OCC suspected.

   OIG Comment

   We continue to believe that more timely enforcement action was needed. For example, OCC said in its response that soon after the January 2008 examination began, redevelopment lending and other deficient lending practices had already ceased, and thus immediate action was not necessary. Yet, financial records we reviewed showed redevelopment lending continued during this period, albeit at a reduced level. While the quality of these redevelopment loans may have been better than prior loans (we reviewed a sample of these redevelopment loans and found them performing, as of March 27, 2009, when Omni was closed), OCC's examiners also told us they did not review the redevelopment lending division in 2008. We believe that the lack of an examination of this division during 2008 raises questions about the extent to which OCC could comment on redevelopment lending practices.

Further, OCC issued an ROE in January 2009 for an examination that began in September 2008. This ROE confirmed deficient lending practices found in credit administration and underwriting evident in the prior examination continued through 2008. As a result, we believe OCC should have considered taking action immediately. While OCC was concerned that an informal enforcement action could send the bank the message that the bank's condition was not as serious as suspected, we believe it would be a stronger message to the bank than not taking enforcement action for another 9 months.

That said, OCC has asserted that its current policies are sufficient to ensure that timely enforcement action is taken. Furthermore, in the case of Omni, OCC officials agreed that because prior examinations were deficient, OCC had to effectively build the case against the bank. This approach delayed enforcement action that clearly needed to be taken as quickly as possible. However, we accept OCC's assertion that current policies are sufficient and consider the recommendation closed. We will continue to assess the timeliness of OCC's enforcement actions as we proceed on future material loss reviews.

2. Impress upon examiner staff the importance of completing all activities in annual supervisory cycles, including quarterly monitoring. In this regard, supervisors should ensure that quarterly monitoring activities are scheduled and carried out.

Management Response

OCC concurred with this recommendation. OCC agreed that periodic monitoring is integral to effective supervision and will continue to reinforce this expectation to examining staff at upcoming management meetings and the next national conference call with examining staff.

OIG Comment

We consider OCC's planned action to be responsive to our recommendation. OCC did not identify the specific timeframe for the actions. OCC will need to establish completion dates for these actions in the Department of the Treasury, Joint Audit Management Enterprise System.

3. Implement a policy for EIC rotation for midsize and community banks.

Management Response

OCC concurred with this recommendation. OCC agreed that as part of sound supervision, there is benefit to formalizing a rotation policy for midsize and community banks. In that regard, OCC is developing a parallel policy (to its large bank rotation policy) covering portfolio managers and examiners in charge in midsize and community banks. Pending completion of a formal policy and procedures manual update, OCC plans to emphasize this message through district management meetings, future examiner conference calls, and as other opportunities arise.

OIG Comment

We consider OCC's planned action to be responsive to our recommendation. OCC did not identify the specific timeframe for the actions. OCC will need to establish completion dates for these actions in the Department of the Treasury, Joint Audit Management Enterprise System.

* * * * * *

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 (617) 223-8640 or Kenneth Dion, Audit Manager, at (617) 223-8641. Major contributors to this report are listed in appendix 7.

/s/
Donald P. Benson
Audit Director

We conducted this material loss review of Omni National Bank (Omni), Atlanta, Georgia, in response to our mandate under section 38(k) of the Federal Deposit Insurance Act.[15] 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, which shall

- ascertain why the institution's problems resulted in a material loss to the insurance fund;
- review the agency's supervision of the institution, including implementation of the Prompt Corrective Action provisions of section 38; and
- make 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 Omni based on the loss estimate by the Federal Deposit Insurance Corporation (FDIC). As of October 31, 2009, FDIC estimated that the loss to the deposit insurance fund would be $288.2 million. FDIC also estimated that Omni's failure resulted in a loss of $0.9 million to its Transaction Account Guarantee Program.

Our objectives were to determine the cause of Omni's failure and assess the bank's supervision by the Office of the Comptroller of the Currency (OCC). To accomplish our review, we conducted fieldwork at OCC headquarters in Washington, D.C., its district office in Dallas, Texas, and its field office in Atlanta, Georgia. We also performed work and interviewed officials at FDIC's Division of Resolutions and Receiverships in Dallas, Texas, and at the Omni National Bank Receivership operated by FDIC in Atlanta, Georgia.

[15] 12 U.S.C. § 1831o(k).

To assess the adequacy of OCC's supervision of Omni, we determined (1) when OCC first identified safety and soundness problems at Omni, (2) the gravity of the problems, and (3) the supervisory response OCC took to get the bank to correct the problems. We also determined whether OCC (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. We performed the following work:

- We determined that the time period covered by our audit would be June 9, 2003, through Omni's failure on March 27, 2009. This period included five full-scope safety and soundness examinations and one targeted safety and soundness examination. The targeted examination was completed after OCC assigned the bank a CAMELS composite rating of 5. We also reviewed OCC supervisory files and records for Omni for the same time period. 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 OCC used to assess the bank's condition, and the regulatory action OCC used to compel bank 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 OCC's supervision of Omni with OCC officials, examiners, and attorneys to obtain their perspective on the bank's condition and the scope of the examinations.

- We interviewed personnel with FDIC's Division of Resolutions and Receiverships who were involved in the receivership and asset resolution process, which was conducted after Omni's closure and FDIC's appointment as receiver.

- We interviewed Omni's former president and chief financial officer concerning the bank's methodology for valuing other real estate owned.

- We assessed OCC's actions based on its internal guidance and the requirements of the Federal Deposit Insurance Act (12 U.S.C. §1820(d).

We conducted our fieldwork from April 2009 through October 2009. 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.

Omni National Bank History and Corporate Structure

Omni Financial Services Incorporated (OFSI), a private redevelopment lender in Atlanta, Georgia, commenced operations in 1992. OFSI was approved as a bank holding company by the Board of Governors of the Federal Reserve System in March 2000. At the same time, OFSI acquired United National Bank, a troubled minority-owned bank in Fayetteville, North Carolina. In February 2001, United National Bank was renamed Omni National Bank (Omni). Omni offered consumer and business lending services, with a focus on community redevelopment lending. Omni's redevelopment lending division originated loans primarily in low- and moderate-income neighborhoods in inner cities. Omni's headquarters moved to Atlanta, Georgia, in July 2005.
At its peak, Omni had 12 banking or loan production offices covering 7 states including Alabama, Florida, Georgia, Illinois, North Carolina, Pennsylvania, and Texas.

OFSI stock began to be traded on the NASDAQ Stock Market on September 29, 2006. The holding company obtained $33 million in capital from an initial public stock offering and was publicly traded until July 22, 2008. Portions of the funds obtained through OFSI's initial public stock offering were used to infuse capital into Omni. As of December 31, 2006, OFSI's directors and employees owned approximately 57.8 percent of the holding company's common stock, with the bank's chief executive officer and executive vice president of the redevelopment lending division being the primary shareholders of the holding company. At the time of its failure on March 27, 2009, Omni had approximately $937 million in assets.

Appendix 4 contains a chronology of significant events regarding Omni and OFSI.

Types of Examinations Conducted by OCC

The Office of the Comptroller of the Currency (OCC) conducts various types of bank examinations, including safety and soundness, compliance, and information technology.

OCC must schedule full-scope, onsite examinations of insured banks once during a 12-month cycle. All de novo banks are subject to the 12-month examination cycle. The 12-month cycle should continue until the bank has had two full-scope, on-site examinations and achieved stability with regard to earnings, core business operations, and management.

OCC may extend the examination interval to 18 months for insured banks with total assets of $500 million[16] or less that

- for the most recent examination received a CAMELS composite rating of 1 or 2,
- for the most recent examination received a CAMELS Management component rating of 1 or 2,
- are well-capitalized,
- are not currently subject to a formal enforcement proceeding or order by OCC, the Federal Deposit Insurance Corporation (FDIC), or the Federal Reserve System; and
- have not undergone a change in control during the 12-month period since completion of the previous full-scope, onsite examination.

OCC also performs targeted safety and soundness examinations, which can include assessment of CAMELS ratings along with other specific review objectives disclosed in the report of examination.

During a full-scope examination, examiners conduct an onsite examination and rate all CAMELS components. The six components are Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk (CAMELS). OCC then assigns each bank a composite rating based on its assessment of the overall condition and level of supervisory concern. The rating scale ranges from 1 to 5, with a rating of 1 indicating the strongest performance and risk management practices relative to the bank's size, complexity, and risk profile and the level of least supervisory concern. A rating of 5 indicates the most critically deficient level of performance; inadequate risk management practices relative to the bank's size, complexity, and risk profile; and the greatest supervisory concern. The CAMELS rating system is common to all banks. Generally, each CAMELS component rating reflects

[16] On September 21, 2007, OCC finalized an interim rule that raised the asset total ceiling for 18-month examination cycles from $250 million to $500 million for qualified, well-managed banks.

examination findings and an examiner’s assessment of the bank’s performance in each of the six components.

Enforcement Actions Available to OCC

OCC bank examinations result in the issuance of reports of examination which identify areas of concern. Both informal and formal enforcement actions are available to OCC to address violations of laws and regulations and to address unsafe and unsound practices.

Informal Enforcement Actions

When a bank’s overall condition is sound, but it is necessary to obtain written commitments from its management or board of directors to ensure that they correct identified problems and weaknesses, OCC may use informal enforcement actions. Informal enforcement actions provide a bank with more explicit guidance and direction than a report of examination normally contains but are generally not legally binding. OCC commonly uses informal actions for problems in banks that are well- or adequately capitalized or have a composite rating of 1, 2, or 3.

Informal actions notify management and a bank’s board that OCC has identified problems that warrant attention. A record of informal action is useful in case formal action is necessary later.

Informal enforcement actions include commitment letters, memoranda of understanding, and safety and soundness plans ordered pursuant to 12 CFR Part 30. Commitment letters and memoranda of understanding contain specific bank commitments to take corrective actions in response to problems or concerns identified by OCC. Part 30 safety and soundness plans, which banks must submit to OCC for approval, outline steps a bank will take and timeframes to correct identified deficiencies. OCC is not legally required to publicly disclose informal enforcement actions.

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

Formal Enforcement Actions

Formal enforcement actions are enforceable under the Federal Deposit Insurance Act. They are appropriate when a bank has significant problems, especially when there is a threat of harm to the bank, depositors, or the public. OCC 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.

Formal enforcement actions include cease and desist orders (including consent orders), civil money penalties, and Prompt Corrective Action directives. Unlike informal actions, formal enforcement actions are made public.

OCC can assess civil money penalties against banks and individuals for noncompliance with formal enforcement actions and can also request a federal court to require a bank to comply with an order.

OCC Enforcement Guidelines

OCC enforcement guidelines call for consideration of the following factors in determining whether to use informal action or formal action to address issues found by examiners:

- the overall condition of the bank;
- the nature, extent, and severity of the bank's problems and weaknesses;
- the commitment and ability of bank management to correct the identified deficiencies; and
- the existence of previously identified but unaddressed problems or weaknesses.[17]

[17] OCC Bank Supervision Operations—Enforcement Action Policy (PPM 5310-3).

After repaired value	An estimate of what real property would sell for if it was repaired and in average condition for the area. After repaired values relate to redevelopment or rehabilitation projects.
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.
Brokered deposit	Any deposit that is obtained, directly or indirectly, from a deposit broker. The bank 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)
Call report	A quarterly report of income and financial condition that banks file with their regulatory agency. The contents of a call report include consolidated detailed financial information on assets, liabilities, capital, and loans to executive officers, as well as income, expenses, and changes in capital accounts.
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.
Commercial real estate loans	Loans 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, land development, and commercial properties such as office buildings and shopping centers.
Concentration (of credit)	A situation where direct, indirect, or contingent obligations exceed 25 percent of a bank's capital structure.
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.
Consent order	The title given by the Office of the Comptroller of the Currency (OCC) to a cease and desist order, which is entered into and becomes final through the board of directors’ execution, on behalf of the bank, of a stipulation and consent document. Its provisions are set out in article-by-article form and prescribe restrictions and remedial measures necessary to correct deficiencies or violations in the bank in order to return it to a safe and sound condition.
Contingency funding plan	A cash flow projection and comprehensive funding plan that forecasts funding needs and funding sources under various market scenarios.

De novo bank	A newly chartered bank that has been open for less than 3 years.
District Supervision Review Committee	An OCC committee in each district that ensures that OCC bank supervision and enforcement policies are applied effectively and consistently. Each committee advises the deputy comptroller for its district on bank supervision and enforcement cases by providing recommendations on supervisory strategies and enforcement actions.
Division of Resolutions And Receiverships	A division within FDIC that is charged with resolving failing and failed financial institutions, including ensuring that depositors have prompt access to their insured funds.
Evaluation	A valuation required by appraisal regulations for transactions that qualify for appraisal threshold exemptions.
Full-scope examination	Examination activities performed during the supervisory cycle that (1) are sufficient in scope to assign or confirm a bank's CAMELS composite and component ratings; (2) satisfy core assessment requirements; (3) result in conclusions about a bank's risk profile; (4) include on-site supervisory activities; and (5) generally conclude with the issuance of a report of examination.
Interest reserve	An account established to allow a lender to periodically advance loan funds to pay interest charges on the outstanding balance of a loan. Interest reserves are often used for construction and development loans.
Loan exceptions	Conditions applicable to a loan that are contrary to a bank's written loan policy, procedures or underwriting guidelines or where documentation needed to legally enforce the loan agreement are missing.

Loan production office	A banking office that takes loan applications and arranges financing for corporations and small businesses but does not accept deposits. Loan applications are subject to approval by the lending institution.
Matter requiring attention	A bank practice noted during an examination that deviates from sound governance, internal control, and risk management principles, which may adversely affect the bank's earnings or capital, risk profile, or reputation if not addressed. It may also result in substantive noncompliance with laws and regulations, internal policies or processes, OCC supervisory guidance, or conditions imposed in writing in connection with the approval of any application or other request by a bank. Matters requiring attention are not enforcement actions, but failure by a bank's board and management to address a matter requiring attention could lead to an enforcement action.
NASDAQ Stock Market	The National Association of Securities Dealers Automated Quotation stock market. The NASDAQ Stock Market was developed in 1971 as the first electronic stock exchange in the world, used to trade over the counter stocks.
Order of Investigation	OCC administrative action initiating an investigation of a bank for possible insider abuse, mortgage fraud, manipulation of records, violation of laws, and unsafe and unsound banking practices. The action grants OCC's Enforcement and Compliance Division authority to issue subpoenas and take sworn statements.
Other real estate owned	Real properties that a bank has acquired that do not constitute its banking facilities. Such properties include real estate acquired in full or partial satisfaction of a debt previously contracted and are subject to specific holding periods, disposition requirements, and appraisal requirements.

Problem bank report	A report prepared by OCC's Special Supervision/Fraud Division with input from district and field offices. The report includes all banks supervised by the Special Supervision Division and all other banks with a CAMELS composite rating of 3, 4, or 5.
Prompt corrective action	A framework of supervisory actions, set forth in 12 U.S.C. § 1831o, for insured banks 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 a bank falls into lower capital categories. The capital categories are well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. 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] Banks that are subject to higher capital requirements imposed by OCC cannot be classified as well-capitalized.

Redevelopment loan	Real estate construction loan originated to support the restoration of low-to-moderate-income neighborhoods. Omni National Bank's redevelopment loans were originated by the bank's Community Development Lending division.

Safety and soundness examination	The part of an examination that includes a review and evaluation of each CAMELS component rating (see explanation of CAMELS above).
Straw borrower	An individual used to serve as a cover for a questionable transaction. The true identity or motivation of the actual borrower is kept secret to obtain loan approval because the actual borrower may not qualify for the loan.
Targeted examination	A bank examination that does not fulfill all of the requirements of a statutory full-scope examination. Targeted examinations may focus on one particular product, function, or risk, or they may cover specialty areas.
Transaction Account Guarantee Program	Component of FDIC's Temporary Liquidity Guarantee Program. FDIC established the Temporary Liquidity Guarantee Program 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 is composed of two distinct components: (1) the Debt Guarantee Program and (2) the Transaction Account Guarantee Program. Pursuant to the Debt Guarantee Program, FDIC guarantees certain senior unsecured debt issued by participating entities. Pursuant to the Transaction Account Guarantee Program, FDIC guarantees all funds held in qualifying noninterest-bearing transaction accounts at participating insured depositary institutions. Originally scheduled to expire on December 31, 2009, FDIC extended the Transaction Account Guarantee Program in August 2009 until June 30, 2010. Participating insured depositary institutions pay an assessment fee for the additional FDIC guarantee.

Uniform Bank Performance Report	An analytical tool created by the Federal Financial Institutions Examinations Council to help supervise and examine financial institutions. A UBPR is produced quarterly for each commercial bank that is supervised by the Board of Governors of the Federal Reserve System, FDIC, or OCC. The performance and composition data in the report are presented in the form of ratios, percentages, and dollar amounts and are computed mainly from call reports submitted by the bank. The UBPR also provides comparisons of an individual bank's performance and balance sheet structure with those of similarly sized banks.
Washington Supervision Review Committee	An OCC headquarters committee that ensures OCC bank supervision and enforcement policies are applied effectively and consistently. The committee advises the senior deputy comptrollers for bank supervision operations on bank supervision and enforcement cases by providing recommendations on supervisory strategies and enforcement actions.
Watch list	A listing of banks within each OCC district that merit close attention. Banks on OCC's watch lists have CAMELS composite ratings of 1 or 2 and limited weaknesses that are not pervasive enough to be designated as problem banks.
Wholesale funding	Funding obtained by financial institutions through such sources as federal funds, public funds, Federal Home Loan Bank advances, the Federal Reserve's primary credit program, foreign deposits, brokered deposits, and deposits obtained through the Internet or certificate of deposit listing services.

The following chronology describes significant events in the history of Omni National Bank (Omni), including examinations conducted and enforcement actions taken by the Office of the Comptroller of the Currency (OCC). Appendix 5 contains additional information on the results of examinations, including any significant safety and soundness matters requiring attention, and recommended actions.

Date	Event
1992	Omni Financial Services, Incorporated (OFSI), commences operations as a private redevelopment lender in Atlanta, Georgia.
3/7/2000	The Board of Governors of the Federal Reserve System approves OFSI's application to become a bank holding company through its acquisition of United National Bank.
2/15/2001	United National Bank's name is changed to Omni National Bank. The bank's headquarters are located in Fayetteville, North Carolina.
1/2/2002	OCC begins a full-scope examination of Omni resulting in the 2001 report of examination (ROE). The bank receives a CAMELS composite rating of 2 as a result of the examination.
6/9/2003	OCC begins a full-scope examination of Omni (2003 ROE). The bank's CAMELS composite rating remains a 2 as a result of the examination.
10/21/2003	The operating subsidiary Omni Appraisal Services LLC is established in Atlanta, Georgia.
6/24/2004	Omni acquires Premier Community Bank in Venice, Florida, and opens a de novo branch in Tampa, Florida.
1/18/2005	OCC begins a full-scope examination of Omni (2004 ROE). The bank's CAMELS composite rating remains a 2 as a result of the examination.
6/21/2005	Omni National Bank establishes a branch in Oak Park, Illinois.
7/1/2005	Outstanding shares of Georgia Community Bancshares stock are acquired by OFSI. Georgia Community Bancshares is merged into Omni National Bank. The bank's headquarters are moved from Fayetteville, North Carolina to Atlanta, Georgia.
2/16/2006	OCC begins a full-scope examination of Omni (2005 ROE). The bank's CAMELS composite rating remains a 2 as a result of the examination.
9/29/2006	OFSI stock begins to be traded on the NASDAQ Stock Market.
2/5/2007	OCC begins a full-scope examination of Omni (2006 ROE). The bank's CAMELS composite rating remains a 2 as a result of the examination.
7/2/2007	Omni acquires Wilson State Bank in Texas.
12/4/07	Omni is added to OCC's bank watch list.
1/7/2008	OCC begins a full-scope examination of Omni (2007 ROE).
4/29/2008	Omni re-files call report for quarter ending December 31, 2007.
7/9/2008	OCC's Southern District Supervision Review Committee approves the Atlanta, Georgia, field office recommendations of a CAMELS composite 4 rating for the bank and the implementation of a consent order.
7/10/2008	The Southern District Supervision Review Committee requests concurrence from the Washington Supervision Review Committee to cite the bank for Bank Secrecy Act/anti-money laundering violations and implementation of a consent order.

Date	Event
7/17/2008	Omni is added to OCC's problem bank report.
7/18/2008	OCC notifies Omni of its troubled condition designation pursuant to 12 U.S.C. § 1831i and 12 C.F.R. § 5.51 and that supervision of the bank has been transferred to the Special Supervision Division in Washington, D.C. OFSI receives notice from the NASDAQ hearings panel acknowledging the holding company's request to be delisted. Trading of OSFI's common stock will be suspended effective on July 22, 2008. OSFI's delisting will become effective 10 days after NASDAQ files a Form 25 with the Securities and Exchange Commission.
7/30/2008	Omni re-files call reports for quarters ending December 31, 2007 and March 31, 2008. The call report shows the bank is adequately capitalized for Prompt Corrective Action (PCA) purposes as of December 31, 2007.
8/4/2008	OCC sends Omni a letter notifying the bank of its adequately capitalized status for PCA purposes based on the call report for the quarter ending June 30, 2008. The letter informs the bank that it is prohibited from accepting or renewing brokered deposits unless it obtains a waiver from the Federal Deposit Insurance Corporation.
8/20/2008	OCC's senior deputy comptroller approves an Order of Investigation of Omni's redevelopment lending practices.
9/8/2008	OCC begins a targeted examination of Omni (2008 ROE). Objectives of examination are to assess the bank's viability and quantify how much capital the bank will need to comply with the minimum capital requirements included in a planned consent order.
9/15/2008	OCC issues the 2007 report of examination on Omni. OCC downgrades the bank's CAMELS composite rating to a 5 and recommends implementation of a consent order.
10/7/2008	Omni enters into a consent order with OCC.
10/30/2008	Omni re-files call reports for quarters ending December 31, 2007, March 31, 2008, and June 30, 2008.
11/4/2008	OCC notifies Omni that the bank is undercapitalized for PCA purposes based on the call report for the quarter ending September 30, 2008. Omni is required to submit an acceptable capital restoration plan by December 15, 2008.
12/12/2008	Omni sells four branches in North Carolina to Capital Bank to increase capital.
12/15/2008	Omni submits a capital restoration plan to OCC
1/22/2009	Omni re-files call reports for quarters ending December 31, 2007, March 31, 2008, and June 30, 2008.
1/30/2009	OCC notifies Omni that the capital restoration plan submitted is unacceptable because it is based on unrealistic assumptions, does not address how deficiencies will be corrected and fails to include a pledge of assets from the holding company. Omni re-files call report for quarter ending September 30, 2008.
2/4/2009	OCC notifies Omni of its significantly undercapitalized status for PCA purposes based on the call report for the quarter ending December 31, 2008.

Date	Event
2/27/2009	OCC issues the 2008 report of examination. Omni's composite CAMELS rating remains a 5.
3/27/2009	OCC closes Omni and appoints the Federal Deposit Insurance Corporation as receiver. The loss to the Deposit Insurance Fund caused by this failure is estimated to be $290 million.
5/11/2009	The Federal Deposit Insurance Corporation's estimate of the loss to the Deposit Insurance Fund due to Omni's failure is now $228.9 million, or 24.4 percent of the bank's assets.
10/31/2009	The Federal Deposit Insurance Corporation's estimated loss to the Deposit Insurance Fund due to Omni's failure is now $288.2 million and the loss to the Transaction Account Guarantee Program is $0.9 million.

This appendix summarizes the Office of the Comptroller of the Currency's (OCC) safety and soundness and targeted examinations of Omni National Bank (Omni) from June 2003 through September 2008 and provides information on the significant results of those examinations. We list the following items from the reports of examination (ROE): (1) matters requiring attention and (2) other issues. Generally, matters requiring attention represent the most significant items requiring corrective action and are more serious.

<table>
<tr><th>Date examination started</th><th>CAMELS rating</th><th>Assets ($Millions)</th><th>Significant safety and soundness corrective actions and other issues cited in ROEs</th><th>Enforcement action</th></tr>
<tr><td>6/9/2003</td><td>2/222221</td><td>$211.6</td><td><u>Matters requiring attention</u>
• Credit administration:
o Reduce the high level of credit administration weaknesses.
o Enhance exceptions tracking and reporting.
o Expand loan policy to address loans to affiliates, other real estate owned (OREO), and retail credit charge-offs.
• Liquidity management:
o Strengthen liquidity management reports.
o Implement an effective contingency funding plan.
• Information technology:
o Establish a corporate-wide business resumption plan.
o Perform a full technology audit.
o Perform a full risk assessment.

<u>Other issues/recommendations</u>
• Calculate concentrations as a percentage of the bank's capital structure, not total loans.
• Expand scope of external review to OREO.
• Include assessment of exceptions in loan review.
• Violations cited:
o 12 U.S.C. § 1828(o)--Real Estate Lending.
o 12 C.F.R. 34.43(a) and 12 C.F.R. 34.43 (a)(1)—Appraisals required; transactions requiring a state-</td><td>None</td></tr>
</table>

Date examination started	CAMELS rating	Assets ($Millions)	Significant safety and soundness corrective actions and other issues cited in ROEs	Enforcement action
			certified or licensed appraiser. o 12 U.S.C. § 29--Power to hold real property.	
1/18/2005	2/222121	$315.5	**<u>Matters requiring attention</u>** • Credit administration—Lack of financial information and reviews: o Implement a plan for reducing the high level of lending relationships without adequate financial information. o Establish guidelines for obtaining and maintaining adequate financial information on new loans as well as renewals and modifications. o Develop a process and criteria for performing annual credit reviews. **<u>Other issues/recommendations</u>** • Implement guidelines for performing annual reviews for certain credit relationships. • Implement a liquidity planning process immediately. • Expand the contingency funding plan analysis of reasonable and realistic disruptions.	None
2/16/2006	2/222221	$476.7	**<u>Matters requiring attention</u>** • Establish an adequate contingency funding plan. **<u>Other issues/recommendations</u>** • Enhance the U.S. Patriot Act customer identification program risk assessment process by assigning risk ratings to customers.	None
2/5/2007	2/222122	$705.9	**<u>Matters requiring attention</u>** • Improve deficient Bank Secrecy Act/ anti-money laundering risk assessment and oversight. **<u>Other issues/recommendations</u>** • Validate the simulation model to enhance the interest rate risk	None

Date examination started	CAMELS rating	Assets ($Millions)	Significant safety and soundness corrective actions and other issues cited in ROEs	Enforcement action
			measurement system. • Determine acceptable concentration limits on certain exposures. • Strengthen Internal Audit oversight to do the following: o Ensure that auditor and third-party reviews identify and communicate the root cause of deficiencies. o Place accountability on an individual to address deficiencies. o Follow up on any unresolved deficiencies requiring management's attention. o Ensure that the "draft" report, management responses, and final audit report are timely. o Present all third-party reviews to the audit committee or the board of directors. o Ensure that audit committee minutes reflect meeting discussions.	
1/7/2008	5/555542	$906.6	**Matters requiring attention** • Rectify inadequate board and management oversight. The consent order to be implemented by OCC will address board and management oversight concerns and require timely corrective actions. • Improve unsatisfactory Bank Secrecy Act compliance program. **Other issues/recommendations** • Enhance the control environment to ensure accurate and efficient risk monitoring by taking steps that include the following: o Strengthen major policies, particularly lending policy. o Develop clear and consistent operating procedures. o Develop a clearly defined system of management and employee accountability. o Establish control systems to enforce	Omni entered into a consent order on 10/7/2008

Date examination started	CAMELS rating	Assets ($Millions)	Significant safety and soundness corrective actions and other issues cited in ROEs	Enforcement action
			strict performance standards. o Hold management accountable for ensuring bank practices are centralized. o Enforce operating procedures and board risk tolerances. • Re-file the 12/31/2007, 3/31/2008, and 6/30/2008 call reports to reflect OREO write-downs. • Violations cited: o 12 U.S.C. § 161 Reports to Comptroller of the Currency. o 12 C.F.R. § 21.21(C)(1) - Procedures for monitoring Bank Secrecy Act Compliance. o 12 C.F.R. § 22.9(c) - Notice of flood hazards and availability of Federal disaster relief assistance. o 12 C.F.R § 34.43(a) Appraisals; appraisals required; transactions requiring a state-certified or licensed appraiser. o 12 C.F.R. § 34.44 Appraisals; minimum appraisal standards. o 12 C.F.R. § 34.85 OREO; appraisal requirements. o 12 C.F.R. § 363.4(a)—Filing and notice requirements; annual reporting. o 31 C.F.R. § 103.29(A)(1) and 31 C.F.R. § 103.29(B)(1) Cash purchases of bank checks and drafts, cashier's checks, money orders and traveler's checks. **<u>Consent order requirements</u>** • Establish a compliance committee. • Submit a 3-year strategic plan. • Maintain new minimum capital ratios and submit a written capital plan. • Identify a qualified chief credit/senior loan officer candidate. • Develop a comprehensive liquidity	

Date examination started	CAMELS rating	Assets ($Millions)	Significant safety and soundness corrective actions and other issues cited in ROEs	Enforcement action
			management program. • Ensure adherence to written credit policies. • Revise and ensure adherence to written lending policies. • Revise and ensure adherence to written construction loan underwriting policies. • Implement and ensure adherence to commercial real estate concentration management program. • Obtain satisfactory credit information on all loans as needed and ensure proper collateral documentation is maintained on all loans. • Employ qualified bank officials to timely identify problem loans. • Maintain an adequate program for the allowance for loan and lease losses. • Take immediate action to protect the bank's interest in criticized assets. • Develop and implement an independent appraisal review and analysis process. • Implement and adhere to an OREO management program. • Revise and strengthen Bank Secrecy Act and anti-money laundering programs. • Ensure the audited 2007 financial statements are published. • Ensure adherence to an independent internal audit program. • Ensure all violations of laws are corrected. • Submit administrative appeals and extension requests in writing.	
9/8/08	5/555544	$979.6	**Matters requiring attention** None identified. The objective of this examination was to assess the bank's	None

Date examination started	CAMELS rating	Assets ($Millions)	Significant safety and soundness corrective actions and other issues cited in ROEs	Enforcement action
			viability and determine the amount of capital required to achieve compliance with the planned Consent Order. **Other issues/recommendations** • Improve credit administration practices. • Improve real estate appraisal process. • Improve identification and management of problem loans to prevent continued erosion of the bank's earnings and capital. • Modify the allowance for loan and lease losses methodology to comply with accounting guidance and minimum documentation requirements. **Violations cited:** • 12 C.F.R. § 34.43—Calculate Appraisals. • 12 C.F.R. § 34.44(b and c)—Minimum appraisal standards. • 12 C.F.R. § 34.45(b)(2)—Appraiser independence.	

Source: OIG analysis of OCC Reports of Examination.

Since November 2008, we have completed five mandated material loss reviews of failed banks regulated by the Office of the Comptroller of the Currency (OCC) in addition to our review of Omni National Bank. This appendix provides our recommendations to the OCC resulting from these reviews. OCC management concurred with the recommendations and has taken or planned corrective actions that are responsive to them. In certain instances, the recommendations address matters that require ongoing OCC management and examiner attention.

Report Title	**Recommendations to the Comptroller of the Currency**
Safety and Soundness: Material Loss Review of ANB Financial, NA, OIG-09-013 (Nov. 25, 2008) OCC closed ANB Financial and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on May 9, 2008. At that time, FDIC estimated that ANB Financial's failure would cost the Deposit Insurance Fund $214 million. FDIC's estimated cost to the Deposit Insurance Fund associated with ANB Financial's failure increased to $819 as of October 31, 2009.	Re-emphasize to examiners that they must closely investigate an institution's circumstances and alter the supervisory plan if certain circumstances exist as specified in OCC's Examiner's Guide to Problem Bank Identification, Rehabilitation, and Resolution. Re-emphasize to examiners that formal enforcement action is presumed warranted when certain circumstances specified in OCC's Enforcement Action Policy (PPM 5310-3) exist. Examiners should also be directed to document in the examination files the reason for not taking formal enforcement action if those circumstances do exist. Reassess guidance and examination procedures in the Comptroller's Handbook related to bank use of <u>wholesale funding</u> with a focus on heavy reliance on brokered deposits and other nonretail deposit funding sources for growth. Establish in policy a "lessons-learned" process to assess the causes of bank failures and the supervision exercised over the institution and to take appropriate action to address any significant weaknesses or concerns identified.
Safety and Soundness: Material Loss Review of First National Bank of Nevada and First Heritage Bank, NA, OIG-09-033 (Feb. 27, 2009) OCC closed First National Bank of Nevada and First Heritage Bank on July 25, 2008, and appointed FDIC as receiver. As of December 31, 2008, FDIC estimated a loss to the Deposit Insurance Fund of $706 million for First National Bank of Nevada and $33 million for First	Re-emphasize to examiners the need to ensure that banks take swift corrective actions in response to examination findings. Re-emphasize to examiners OCC's policy on the preparation of supervision workpapers. (That is workpapers are to be clear, concise, and readily understood by other examiners and reviewers).

Report Title	Recommendations to the Comptroller of the Currency
Heritage Bank.	
Safety and Soundness: Material Loss Review of the National Bank of Commerce, OIG-09-042 (Aug. 6, 2009) OCC closed the National Bank of Commerce and appointed FDIC as receiver on January 16, 2009. As of June 30, 2009, FDIC estimated that the bank's failure would cost the Deposit Insurance Fund $92.5 million.	Conduct a review of investments by national banks for any potential high-risk concentrations and take appropriate supervisory action. Reassess examination guidance regarding investment securities, including [government-sponsored enterprise] securities.
Safety and Soundness: Material Loss Review of Ocala National Bank, OIG-09-043 (Aug.26, 2009) OCC closed Ocala National Bank and appointed FDIC as receiver on January 30, 2009. As of August 7, 2009, FDIC estimated that the bank's failure would cost the Deposit Insurance Fund $99.6 million.	Caution examiners and their supervisors that it is incumbent that they support and document CAMELS ratings, including those that did not change from prior examinations, and support decisions not to take enforcement action. Remind examiners that it is prudent to expand examination procedures for troubled or high-risk banks to review the appropriateness of (a) dividends and (b) payments to related organizations, particularly when the dividends or payments may benefit bank management and board members. OCC should reassess and revise examination guidance related to when expanded reviews of dividends and related organizations should be performed.
Safety and Soundness: Material Loss Review of TeamBank, National Association OIG-10-001 (Oct.07, 2009) OCC closed TeamBank, National Association and appointed FDIC as receiver on March 20, 2009. As of September 18, 2009, FDIC estimated that the bank's failure would cost the Deposit Insurance Fund $98.4 million.	Emphasize to examiners that matters requiring attention are to be issued in reports of examination in accordance with the criteria regarding deviations from sound management and noncompliance with laws or policies listed in the Comptroller's Handbook. Emphasize to examiners the need to (a) adequately assess the responsibilities of a controlling official (chief executive officer/president, for example) managing the bank to ensure that the official's duties are commensurate with the risk profile and growth strategy of the institution; (b) review incentive compensation and bonus plans for executives and loan officers; and (c) ensure that banks conduct transactional and portfolio stress testing when appropriate.

MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

To: Donald P. Benson, Audit Director

From: John C. Dugan, Comptroller of the Currency /s/

Date: December 3, 2009

Subject: Response to Material Loss Review of Omni National Bank, Atlanta, Georgia

We have received and reviewed your draft report titled "Material Loss Review of Omni National Bank." Your overall objectives were to determine the cause of the failure of Omni National Bank (Omni), and assess the OCC's supervision of the bank, including implementation of the Prompt Corrective Action provisions of section 38(k).

You concluded that Omni failed because of significant losses within its commercial real estate loan portfolio, specifically construction and land development loans largely originated within its Community Development Lending division. Your report also reflects your view that the OCC's examinations of Omni were not adequate prior to 2008, and that the OCC's enforcement action should have been more timely.

We agree that there were shortcomings in the OCC's supervision of Omni and are taking the following measures to the address two of the recommendations included in your report.

Completion of All Activities in Annual Supervisory Cycles including Quarterly Monitoring

Periodic monitoring is an important aspect of effective bank supervision. The Comptroller's Handbook_for *Community Bank Supervision* specifically addresses the important role of periodic monitoring:

> Periodic monitoring, which is a key element of the OCC's supervisory process, is designed to identify changes in the bank's condition and risk profile and to review the bank's corrective action on issues identified during previous supervisory activities. The depth and scope of monitoring activities also varies based on the bank's size, risk profile, and condition, but in all cases examiners complete some level of activities quarterly. By monitoring community banks, examiners can modify supervisory strategies in response to changes in a bank's risk profile, and respond knowledgeably to bank management's questions. Periodic monitoring makes supervision more effective and on-site activities more focused.

Further, the Comptroller's *Bank Supervision Process* Handbook includes the following:

> Ongoing monitoring allows the OCC to respond promptly to risks facing individual banks and the industry as a whole. Monitoring is essential to the supervision of all banks. It allows resources to be redirected to areas of increasing or emerging risk. Monitoring also provides a better focus for onsite examination activities.
>
> In monitoring a bank, examiners:
> - Identify current and prospective issues that affect the bank's risk profile or overall condition.
> - Determine how to focus future supervisory strategies.
> - Measure the bank's progress in correcting deficiencies.
> - Communicate with management regarding areas of concern, if any.

As these excerpts from our written policies illustrate, periodic monitoring is integral to the effective supervision of national banks and we will continue to reinforce this expectation to our examining staff. OCC senior management will discuss the importance of meaningful periodic monitoring activities at upcoming management meetings, as well as during the next national conference call with our examining staff.

Policy for Rotation of Examiners in Charge

The Comptroller's *Bank Supervision Process* Handbook states that personnel selected for portfolio manager, Midsize Examiner in Charge (EIC), and Large Bank EIC assignments are to be rotated periodically to ensure their supervisory perspective remains objective. For Large Banks, this expectation has been formally articulated in PPM 5000-38 (Revised) "Large Bank EIC Rotation." We see the benefit of formalizing this tenet of sound supervision for midsize and community banks. To that end, senior managers are currently working with Human Resources staff to develop a parallel policy covering portfolio managers and EICs in midsize and community banks. Pending the completion of a formal PPM, we will emphasize this message through district management meetings, future examiner conference calls, and as other opportunities arise.

Processes to Ensure More Timely Enforcement Action

You also recommend that the OCC review its processes to ensure that more timely enforcement action is taken once the need for such action is identified. The OCC certainly agrees that timeliness is a major determinant in the effectiveness of enforcement action. In fact, our formal Enforcement Action Policy (Policy) states, "The OCC will take enforcement actions as soon as practical once the need for such action has been identified, including during an examination when circumstances warrant." In the case of Omni, we believe the timing of the October 2009 consent order was in compliance with the Policy. Although OCC staff has thoroughly discussed this matter with OIG auditors, the facts that support our opinion are worth reiterating.

2

Although it was apparent soon after the 2008 examination began that some sort of formal enforcement action would be warranted, there was no need to take such an action to stop unsafe and unsound practices. Certainly, if Omni had not already ceased redevelopment lending and other deficient lending practices, the OCC would have immediately taken strong action – likely a Temporary Cease and Desist Order – to force the bank to do so. In addition, OCC examiners were on-site, on a virtually continuous basis, observing the bank's activities. Had any unsafe or unsound activity been detected, the OCC would have immediately taken appropriate enforcement action. As noted in your review, the bank's condition steadily worsened throughout the first nine months of 2008. This deterioration occurred as a consequence of the bank's prior lending activities; it did not occur because of actions taken while our examiners were continuously on-site during the examination. In fact, the deterioration required us to maintain our continuous presence and refine the scope and depth of our examining activities. This in turn resulted in several changes to the bank's CAMELS ratings during the time prior to the examination's conclusion. Upon its completion in September 2008, the Report of Examination provided the thorough documentation of examination findings necessary to provide sufficient legal support for an enforcement action. Following the completion of the ROE, the consent order was promptly in place three weeks later.

You indicated that, "We find it unusual that OCC would take a position that, absent a formal enforcement action early on, it did not see a benefit to enter into a memorandum of understanding or take other action earlier to make clear its expectations." Entering into a memorandum of understanding with the bank, when it was suspected that formal action was warranted, would not have complied with our Enforcement Policy and, in fact, would have sent the message that the bank's condition was not as serious as we suspected. As the Informal Enforcement Action section of the OCC's Enforcement Policy indicates, "When a bank's overall condition is sound, but it is necessary to obtain written commitments from a bank's board of directors to ensure that identified problems and weaknesses will be corrected, the OCC may use *informal* enforcement actions." Our Enforcement Policy also indicates that, "A bank with strong management and a generally positive assessment can be considered for an informal enforcement action, if circumstances suggest that the remedial measures are immediately forthcoming." Given that the EIC suspected, based on early but incomplete findings, that formal action would be necessary, it would not only have been in noncompliance with our Enforcement Action policy to pursue a memorandum of understanding (an informal action) as you have suggested, but may well have delayed the imposition of formal action.

Again, I agree that it is absolutely critical that enforcement actions are timely. I do not agree, however, that the facts of this case support a conclusion that the OCC process used to issue the consent order, in response to the 2008 examination findings, was slow and requires review.

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

3

Boston Audit Office

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

Washington, DC

Deborah Harker, Referencer

Department of the Treasury

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

Office of the Comptroller of the Currency

Comptroller of the Currency
Senior Advisor-OIG/GAO Liaison

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

United States 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