Audit Report

OIG-10-033

SAFETY AND SOUNDNESS: Material Loss Review of Silverton Bank, N.A.

January 22, 2010

Office of Inspector General

Department of the Treasury

Contents

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Abbreviations

ALLL	allowance for loan and lease losses
CRA	Community Reinvestment Act
CRE	commercial real estate

EIC	examiner-in-charge
FDIC	Federal Deposit Insurance Corporation
FRB Atlanta	Federal Reserve Bank of Atlanta
IT	information technology
MRA	matters requiring attention
OIG	Department of the Treasury Office of Inspector General
OCC	Office of the Comptroller of the Currency
PCA	prompt corrective action
ROE	report of examination
TARP	Troubled Asset Relief Program

January 22, 2010

John C. Dugan
Comptroller of the Currency

This report presents the results of our material loss review of the failure of Silverton Bank, N.A. (Silverton), of Atlanta, Georgia, and of the Office of the Comptroller of the Currency's (OCC) supervision of the institution. OCC closed Silverton and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on May 1, 2009. This review is mandated by section 38(k) of the Federal Deposit Insurance Act because of the magnitude of Silverton's estimated loss to the Deposit Insurance Fund.[1] As of October 31, 2009, FDIC estimated that the loss would be $608.3 million. FDIC also estimated an additional loss of $649.6 million to its Transaction Account Guarantee Program for a total loss of $1.26 billion from Silverton's failure.

Our objectives were to determine the causes of Silverton's failure; assess OCC's supervision of Silverton, including implementation of the prompt corrective action (PCA) provisions of section 38; and make recommendations for preventing such a loss in the future. To accomplish these objectives, we reviewed the supervisory files and interviewed officials at OCC and FDIC. We also reviewed reports of examination (ROE) and interviewed officials of the Federal Reserve Board (FRB), Silverton's primary regulator until August 2007. We conducted our fieldwork from July 2009 through November 2009. Appendix 1 contains a more detailed description of our review objectives, scope, and methodology.

We also include several other appendices to this report. Appendix 2 contains background information on Silverton's history and OCC's supervision processes. Appendix 3 provides a glossary of terms used

[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.

in this report. These terms are underlined in the body of the report and, in the electronic version of the report on our web site, hyperlinked to the glossary. Appendix 4 contains a chronology of significant events related to Silverton's history and OCC's supervision of the institution. Appendix 5 summarizes results of OCC examinations of Silverton from May 2007 through February 2009, including the enforcement action taken against Silverton. Appendix 6 contains Treasury Office of Inspector General (OIG) recommendations from material loss reviews of failed OCC-regulated institutions completed since November 2008.

Results in Brief

The primary cause of Silverton's failure was an excessive concentration in commercial real estate (CRE) loans. Deficient credit risk management processes, combined with the rapid decline in the economic environment, resulted in the deterioration of Silverton's asset quality, including a substantial volume of problem loans and significant loan losses. These loan losses, along with the high cost of funding, significantly diminished earnings and capital, impairing Silverton's ability to successfully implement and sustain its business strategy.

Regarding supervision, OCC approved Silverton's conversion to a nationally chartered bank in August 2007 despite significant weaknesses identified by OCC examiners during a preconversion examination and the declining housing market. We believe that OCC should not have approved Silverton's conversion in August 2007, deferring approval until those weaknesses had been addressed.

Subsequent to the bank's conversion, we believe that OCC could not have done anything significantly different to prevent Silverton's failure and the material loss to the Deposit Insurance Fund. That said, there was a serious lapse in OCC's supervision of Silverton shortly after its conversion and swifter action may have possibly reduced the bank's aggressive growth and amount of loss to the Deposit Insurance Fund. Specifically, an examiner-in-charge (EIC) was not assigned to Silverton for approximately 90 days after the conversion from a Georgia-chartered and Federal Reserve Bank of Atlanta (FRB Atlanta)-regulated bank to a nationally chartered OCC-regulated bank. Additionally, there was a gap of over 17 months between completion of the last full-scope examination of the bank jointly performed by FRB of Atlanta and the State of Georgia and the start of the first full-scope examination by OCC. According to OCC guidance, the full-scope examination should have started within 12 months of the last FRB examination.[2]

While some examination coverage, in the form of the preconversion examination and a targeted examination on asset quality, was provided during the more than 17 month gap between full scope examinations, the late start of the full scope examination was troubling because the EIC for the preconversion examination had recommended that a full-scope examination be started no later than 6 months after the conversion. Once started, the full-scope examination found extensive weaknesses in the operations of the bank, including failure by bank management to address the weaknesses noted by the OCC preconversion examination.

During our material loss review, OCC completed an internal lessons learned review. The reviewers concluded that the decision to approve the conversion was flawed in that (1) identified weaknesses in credit and credit risk management were not given sufficient weight; (2) OCC's perceived capabilities of the bank's management and management commitments to correct the problems and conclusions reached by a December 2006 joint FRB Atlanta and State of Georgia full-scope examination of the bank were granted too much weight; and (3) the bank's management was not compelled to demonstrate its ability and commitment to make necessary improvements to existing operations.

OCC's internal lessons learned review report further states that , among other things, OCC needs to (1) exercise greater caution and be more forceful and persistent regarding the necessity for better and/or different risk management when institutions depart from their original business strategy; (2) ensure objectivity in approving prospective charters, particularly when the bank is to become the largest in a respective field office and significant within a district; (3) validate correction of deficiencies prior to making the final chartering decision; and (4) consider a quality assurance review process over charter conversions. In subsequent discussions, OCC officials stated that they

[2] Comptroller's Handbook, Bank Supervision Process (September 2007)

considered the performance of second level reviews of charter conversions prior to approval as a better approach than an after-the-fact quality assurance review. In this regard, OCC districts have been instructed to have their respective District Supervisory Review Committees perform second-level reviews of charter conversions. This process, however, has not yet been formalized in OCC policy and procedures.

As a final note, there were also certain transactions and events related to this bank that are under further OCC review. We also referred these matters to the Treasury Inspector General Office of Investigations.

Recommendations

We are recommending that OCC promptly assign an EIC and ensure continuous supervisory coverage of converted institutions, to include the timely initiation of the first full-scope examination after conversion. Additionally, OCC should ensure that appropriate actions are taken to amend or reinforce OCC guidance in response to the lessons learned review of the Silverton failure. In particular, OCC should (1) determine that banks seeking conversion to a national charter satisfactorily address significant deficiencies identified by OCC or prior regulators before approval and (2) formalize the process for second level reviews of charter conversions.

Management Response

In its written response to this report, OCC acknowledged that stronger controls are needed to ensure the clarity of its charter conversion process and the implementation of examination requirements for newly converted banks. OCC is in the process of planning and taking steps to address our recommendations. Those steps being taken and planned as outlined in OCC's response are responsive to our recommendations. The response, however, did not identify estimated dates for completing planned actions, which OCC will need to develop and record in the Joint Audit Management Enterprise System (JAMES), the Department of the Treasury's audit recommendation tracking system. OCC's response is discussed in more detail in the Recommendations section of this report. The response is provided as Appendix 6.

Causes of Silverton's Failure

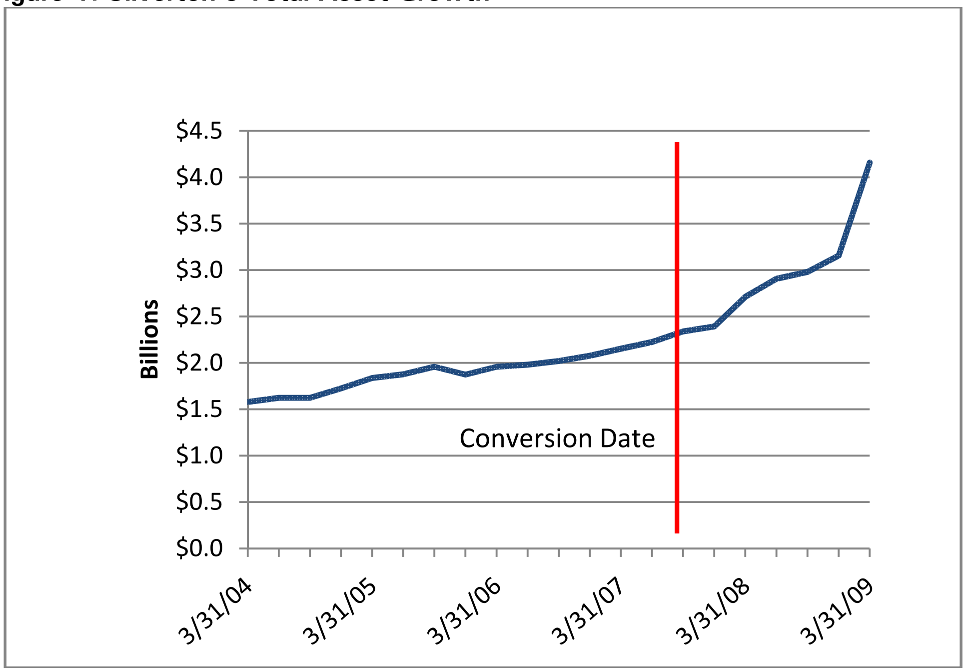
Silverton's board and management grew, and then were unable to manage, high-risk concentrations in CRE loans. Deficient credit risk management processes, combined with the decline in the economic environment, resulted in the deterioration of Silverton's asset quality, a substantial volume of problem loans, and significant loan losses. These loan losses, along with the high cost of funding, significantly diminished earnings and capital, impairing Silverton's ability to sustain its business strategy.

Silverton's Asset Growth Accelerated After Conversion

The bank's total assets grew from $2.0 billion as of December 31, 2006, to $3.2 billion as of December 31, 2008. As shown in the figure, although Silverton had been growing steadily over time, the rate of its growth increased rapidly after converting to a national bank charter in August 2007. Also adding to the increase in assets was an increase in loans, particularly CRE loans.

The figure also reflects an increase in asset size to $4.2 billion as of March 31, 2009—a 32 percent increase in the first quarter of 2009. The increase in assets is attributable in part to an expansion of the bank's liquidity--the added funds were principally in the form of cash, non-interest due from banks, and Federal Funds Sold.

Figure 1. Silverton's Total Asset Growth



Source: Call reports for Silverton.

Silverton's Growth in CRE Concentrations Was High-Risk

OCC provides guidance to examiners as to when institutions' CRE loan assets reach concentration levels representing concentration risk requiring further analysis. Such institutions are those for which:

- total reported loans for construction, land development, and other land represent 100 percent or more of the institution's total capital; or
- total CRE loans represent 300 percent or more of the institution's total capital, and the outstanding balance of the institution's CRE loan portfolio has increased by 50 percent or more during the prior 36 months.

Silverton's CRE loan assets as a percentage of capital significantly exceeded these supervisory benchmarks before and after its conversion to a national bank. The bank's CRE loans grew from $681 million as of December 31, 2006, to $1.2 billion, as of December 31, 2008. The ratio of the CRE loan balance as a percentage of capital went from 369 percent as of December 31, 2006, to 507 percent as of December 31, 2008. The ratio went as high as 1,279 percent as of March 31, 2009, as the bank's capital began to significantly erode due to loan losses and decreased earnings.

Silverton funded its high level of loan growth with federal funds purchased (the bank's primary source of funding), client bank demand deposits, and brokered deposits.[3] In 2007, Silverton primarily relied on federal funds purchased and secondarily on brokered deposits for funding its loan growth. In 2008, however, the bank's federal funds purchased decreased by $668 million, to $1.3 billion as of December 31, 2008; and decreased even further, to $738 million as of March 31, 2009, because fewer funds were available due to the weak economy and negative earnings of certain of its client banks. In 2008, Silverton's brokered deposits increased by $937 million, to $1.0 billion as of December 31, 2008; and increased even further to $1.4 billion as of March 31, 2009. The bank's 2008 increase in brokered deposits was inconsistent with the 2008 budget forecasts it had provided to OCC, which stated that the bank's total time deposits (including brokered deposits) would not exceed $110 million.[4] According to OCC, these original budget projections were based on anticipated normal operations, so deviation from them was not surprising given the difficulties the bank developed and the actions that were necessary to address them.

By December 31, 2008, the bank's declining asset quality caused its total risk-based capital ratio to fall below the 11 percent required by its conversion approval, to 10.85 percent. By March 31, 2009, only 3 months later, the ratio had dropped to 4.74 percent. On April 3, 2009, OCC notified Silverton's board that Silverton was considered to be in the critically undercapitalized category for PCA purposes. As a result, the bank was no longer able to renew or obtain new brokered deposits.[5] Further worsening Silverton's capital situation was the fact that its holding company, which had provided Silverton with capital injections totaling approximately $41.5 million in 2008, stopped

[3] Federal funds purchased by Silverton were obtained from excess balances in its correspondent bank customer accounts. For Silverton, this type of funding was a long-term, variable-rate form of funding similar to core deposits at a traditional commercial bank.
[4] A time deposit is a deposit held by a financial institution for a fixed period (such as a certificate of deposit) or any other deposit that a customer can withdraw only by giving advance notice. Brokered deposits consist of time deposits.
[5] 12 C.F.R. § 337.6 prohibits banks deemed critically undercapitalized from accepting, renewing, or rolling over brokered deposits and restricts the effective yield banks can offer on deposits.

injecting capital into the bank in 2009. As noted in an examination of Silverton's holding company completed in April 2009 by FRB Atlanta, the holding company was no longer a financial resource for the bank because of a high level of debt and corresponding cash needs. Without being able to rebuild its capital levels, much less support its operations, Silverton by March 31, 2009, was in an extremely unsafe and unsound condition and its viability was in imminent danger.

Ineffective Controls Over High CRE Concentration

When concentrations in CRE or other real estate exist, sound credit risk management systems and maintenance of appropriate capital levels are critical. An appropriate credit risk management system in such circumstances would include strong underwriting standards and policies and procedures to monitor and manage risks inherent in increased concentrations in real estate. Although OCC guidance does not provide quantifiable limits on banks' CRE lending, it does describe risk management practices an institution is expected to have in place to pursue CRE lending in a safe and sound manner.[6] According to the guidance, institutions should address the following key elements in establishing a risk management framework that effectively identifies, monitors, and controls CRE concentration risk:

- board and management oversight
- portfolio management
- management information systems
- market analysis
- credit underwriting standards
- portfolio stress testing and sensitivity analysis
- credit risk review function

Silverton's board and management failed to implement the risk management processes necessary to control the bank's growth and concentration levels and to maintain adequate capital levels. In a May 2007 preconversion examination conducted after Silverton applied to become a national bank, OCC found several weaknesses in this regard that it identified as <u>matters requiring attention</u> (MRA) in a July 20, 2007, letter to the bank. The MRAs discussed the appropriate level of oversight needed to develop credit risk management and strategic

[6] OCC Bulletin 2006-46, Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices (Dec. 6, 2006).

planning processes, and the need to enhance these processes to address the bank's increasing risk profile. In addition, after Silverton became a national bank (in August 2007), OCC discussed the need for Silverton to address these weaknesses in; (1) an ROE dated February 10, 2009, for a full-scope examination started in June 2008; (2) a consent order dated February 26, 2009; and (3) a letter downgrading Silverton's CAMELS rating dated March 24, 2009. However, the bank failed to resolve these weaknesses.

The following describes the weaknesses OCC examiners found in their 2008 full-scope examination relating to the key elements cited in OCC guidance for establishing an effective risk management framework for CRE lending.

Board and management oversight. OCC examiners concluded that Silverton's condition was deficient and that oversight by Silverton's board and management was inadequate for the bank's high and increasing risk profile, resulting in losses and depletion of capital. The examiners criticized the bank's board and management for credit risk management practices that were unsafe and unsound, citing the board's failure to establish acceptable concentration limits and its unlimited appetite for CRE loans in an effort to serve its client banks by purchasing loan participations from them. OCC examiners further noted that the board failed to meet its duty to promptly remove the bank's chief credit officer.[7] It was not until problem loans became excessive that management took action and terminated the chief credit officer in September 2008. The examiners also found that various functions lacked sufficient staffing levels and expertise, including credit administration, risk management, problem loan management, and loan review, and that Silverton's capital planning and budgeting in 2008 were excessively optimistic.

Portfolio management. OCC examiners noted that the board failed to diversify the bank's loan portfolio or consider the risk associated with excessive concentrations. The examiners also found that Silverton's board and management ignored the need for sound credit risk management practices when purchasing loans from its client banks and did not take action to implement processes for handling problem loans when problem loans sharply increased in 2008.

[7] The February 2009 ROE stated that the chief credit officer "dominated the credit culture and managed through intimidation, creating a corrosive credit environment."

Market analysis. OCC noted that the bank's market analysis needed to be improved and that its reports did not identify concentrations by line of business or by geographic location. OCC examiners also found that Silverton's board and management did not adopt an appropriate methodology for calculating the allowance for loan and lease losses (ALLL). Generally, additional reserves should have been set aside to compensate for potential losses for high-risk loans and high concentrations in riskier loans. Rather than basing the allowance on analysis of the current real estate market, Silverton's board and management based it on the bank's historical losses. Because Silverton had experienced low loan losses prior to the drastic decline in the real estate market, its ALLL estimate was unreasonably low.

Management information systems. OCC examiners found that Silverton's systems and procedures to address problem loans were weak and resulted in the bank's slow reaction to the sharp increase in problem loans. For example, high loan-to-value loans reported to the board totaled 52 percent of capital as of June 30, 2008, but because of inaccurate reporting the total amount of these riskier loans was likely understated and very likely far exceeded 100 percent of capital.[8]

Underwriting standards. OCC examiners concluded that the Silverton's asset quality was deficient and that its credit risk was high and increasing. They identified numerous unsafe and unsound underwriting and monitoring practices, such as:

- inadequate underwriting on half of the loans OCC reviewed. Issues included high loan-to-values, excessive terms or amortization,[9] no required curtailments, no or inadequate appraisals, and the inappropriate use of interest reserves;
- delayed credit renewals because of the lack of appraisals and financial information;
- incomplete analyses of borrowers' cash flows subsequent to the funding of loans; and

[8] 12 C.F.R. 34, Subpart D states the aggregate amount of all loans in excess of the supervisory loan-to-value should not exceed 100 percent of total capital. Moreover, within the aggregate limit, total loans for all commercial, agricultural, multifamily or other non-1-to-4 family residential properties should not exceed 30 percent of total capital.
[9] Excessive terms and amortization negatively impact the borrower and include such things as significantly higher interest rates, minimum interest only payments, and negative amortization.

- excessive exception levels. Financial statement exceptions were identified in 30 percent of relationships, collateral exceptions in 40 percent of relationships, and underwriting exceptions in 50 percent of relationships.

OCC examiners also noted unsafe and unsound underwriting and credit administration practices had led to an increase in the number of problem loans. From September 30, 2007, to March 31, 2008, Silverton's adversely classified loans increased from 18 percent to 55 percent of Tier 1 capital plus ALLL. Total classified assets increased from $237 million (86 percent of Tier 1 capital plus ALLL) as of June 30, 2008, to $295 million (118 percent of Tier 1 capital plus ALLL) as of December 31, 2008. The increasing number of problem loans resulted in significant losses and lower earnings and ultimately in the failure of Silverton when it was unable to sustain its capital at acceptable levels.

Portfolio stress testing and sensitivity analysis. OCC examiners found that multi-variable stress testing was not performed on 19 of 29 loans.

Credit risk review function. OCC examiners found that Silverton's board and management failed to establish appropriate credit risk management systems when their business strategy called for aggressive growth and expansion. For example, OCC examiners noted that concentration information lacked a formal analysis of the risks in CRE concentrations or triggers for changes in underwriting or borrower selection.

Economic Downturn

By 2007, there were clear indications that the economy as a whole and the real estate market in particular were in decline. Before 2007, the banking industry had experienced strong financial performance and success. In its February 2009 ROE, OCC noted the bank was imprudent in its decision to follow its existing growth and expansion plans given the significant decline in the real estate market that was occurring. The board and management either chose to ignore or failed to acknowledge the indicators of a declining real estate market; and when they could no longer ignore it, it was too late for any changes to make a material difference.

Summary

In summary, board and management failed to implement adequate controls and manage the dangers associated with the high-risk growth in CRE concentrations. When conditions worsened, the bank incurred substantial losses and was unable to sustain its capital at acceptable levels, at which time the bank became critically undercapitalized for PCA purposes and noncore funding sources (i.e., brokered deposits) became unavailable. Deeming the bank in unsafe and unsound condition, OCC closed Silverton on May 1, 2009, and appointed FDIC as receiver.

OCC's Supervision of Silverton

OCC approved Silverton's conversion to a nationally chartered bank despite significant weaknesses identified by OCC examiners during a preconversion examination and the declining housing market. We believe that OCC should have deferred approval until those weaknesses were addressed.

Subsequent to the bank's conversion, we believe that OCC could not have done anything significantly different to prevent Silverton's failure and the material loss to the Deposit Insurance Fund. That said, there was a serious lapse in OCC's supervision of Silverton shortly after its conversion and swifter action may have possibly reduced the bank's aggressive growth and amount of loss to the Deposit Insurance Fund. Specifically, an EIC was not assigned to Silverton for approximately 90 days after the bank's charter was converted from a state member bank charter (FRB Atlanta-regulated institution) to a national bank charter (OCC-regulated institution).

In addition there was a gap of over 17 months between completion of the last full-scope examination of the bank by FRB Atlanta and the start of the first full-scope examination by OCC. According to OCC guidance, the full-scope examination should have started within 12 months of the last FRB Atlanta examination.

While examination coverage was provided to some extent during the 17 month period through the preconversion examination and an April 2008 targeted examination on asset quality, the late start of the full-scope examination was troubling because the EIC for the preconversion examination had recommended that a full-scope examination be started no later than 6 months after the conversion. Once started, the full-scope examination found extensive weaknesses in the operations of the bank, including failure by bank management to address the weaknesses noted by the OCC preconversion examination and the April 2008 targeted examination.

During our material loss review, OCC completed an internal lessons learned review. The review concluded that the decision to approve the conversion was flawed.

Summary of OCC's Silverton Supervisory Actions

The following table summarizes OCC's examinations of Silverton and related enforcement actions from 2007 to 2009. Appendix 5 provides further detail on the results of these examinations.

Table 2. Summary of OCC's Silverton Examinations and Enforcement Actions

		Examination Results			
Date started/Type of Exam[a]	**Assets (billions)**[b]	**CAMELS rating**	**Number of MRAs**	**Number of recommendations or suggestions**	**Enforcement actions**
5/14/2007 Preconversion examination	$2.1	2/222222	3	0	None
4/24/2008 Targeted examination	$2.7	2/232222	0	0	None
6/2/2008 Full-scope examination	$3.1	4/444442	5	0	Consent order issued February 26, 2009
2/2/2009[c] Targeted examination	$3.1	5/555552	0	0	None

Source: OCC ROEs and consent order.
[a] An examination cycle begins with the transmittal of the ROE. See appendix 2, Types of Examinations Conducted by OCC, for additional information about OCC examinations.
[b] Asset amounts are as of December 31.
[c] The February 2, 2009, targeted examination was directed by OCC's Special Supervision Division.

OCC Approved Silverton's Conversion to a National Bank Even Though Its Preconversion Examination Revealed Significant Weaknesses

Silverton was converted to a national bank on August 17, 2007. The bank was under OCC's supervision for less than 2 years before it failed. Because of significant weaknesses identified by OCC examiners during the preconversion examination and the declining housing market in 2007, we believe that OCC should not have approved the conversion in August 2007, deferring approval until the weaknesses identified had been satisfactorily addressed and their resolutions had been validated.

Significant Weaknesses Identified in Preconversion Examination

OCC guidance outlines the application process and decision criteria for approval of the conversion of institutions to nationally chartered banks.[10] In determining whether to approve an application for conversion, OCC considers the applying institution's

- condition and management, including compliance with regulatory capital requirements;
- conformance with statutory criteria;
- adequacy of policies, practices, and procedures that parallel OCC's minimum policies and procedures; and
- Community Reinvestment Act (CRA) record of performance.

OCC may deny an institution's conversion application because of

- safety and soundness issues;
- inadequate capital;
- financial condition concerns;
- significant CRA or compliance concerns;
- ownership issues;
- inconsistency with applicable laws, regulations, or OCC policy;
- attempted circumvention of supervisory action by the applicant's current regulator; or
- failure by the applicant to provide requested information that would allow OCC to make an informed decision.

[10] Comptroller's Licensing Manual, Conversions (April 2004).

The guidance also states that if significant weaknesses exist in financial and managerial factors, the conversion normally will be denied.

Silverton was granted conditional approval on August 7, 2007, despite significant weaknesses identified during OCC's May 2007 preconversion examination. These weaknesses were detailed in a July 2007 OCC letter to the bank and are discussed below.

Credit risk management. Examiners viewed Silverton's credit risk profile as high because of its loan mix, credit concentrations, loan types, growth, geographic distribution, and level of management oversight. Examiners raised concerns because Silverton did not have appropriate credit risk management processes in place to monitor and control these risks. Specifically, they cited the inadequate qualifications of the bank's chief credit officer, lack of a senior-level officer responsible for oversight of the lending function, and minimal staffing of the bank's risk management department. The examiners also noted that Silverton had no executive- or board-level committee to oversee lending and that credit reports presented to the board did not provide adequate details.

OCC examiners told us that at the time of conversion, Silverton's board and management had a strong appetite for risk and that the bank's risk management systems were weak. In addition, examiners said that, contrary to safe and sound practices, Silverton's board and management failed to establish concentration limits and had unlimited appetites for CRE loans. The examiners also said they were concerned at the time of conversion that Silverton was planning to continue its aggressive growth strategy without proper risk management tools in place. Silverton's aggressive growth strategy, coupled with its lack of appropriate risk management, should have alerted OCC to the risks of approving the bank's conversion to a nationally chartered institution.

Strategic planning. Noting the bank's high rate of growth, OCC directed Silverton to revisit its strategic plan to ensure that its growth and expansion plans were appropriate for its increasing risk profile, to address its lack of specific business plans, and to improve credit risk management systems that were inadequate for the bank's growth and expansion plans.

Capital planning. OCC directed Silverton to develop a more comprehensive capital plan, including a thorough analysis of the impact of its growth plans and qualitative risk factors on capital adequacy.

OCC examiners told us that Silverton's board and management had begun to address these supervisory concerns through newly created processes. These processes had not yet been implemented when the conversion application was pending and therefore their effectiveness was unknown. As discussed above, OCC nevertheless approved the conversion, without validating that Silverton's management had taken action that addressed the weaknesses identified during the preconversion examination. In this respect, the OCC placed too much reliance on the bank's historically positive financial performance, prior examination results, and the representations and cooperation of management and the board of directors (comprised entirely of bank CEOs of owner-institutions).

Conversion Approval Process

To determine the rationale behind the approval of conversion for Silverton given the deficiencies identified in the preconversion examination, we interviewed OCC officials and staff with the relevant OCC components involved in the approval process.

We were told that the authority to approve most conversion applications is delegated by the OCC headquarters licensing division to the district licensing division. However, when significant concerns are identified in the conversion application process, district licensing staff is required to discuss these issues with the headquarters licensing division. In these situations headquarters staff may provide feedback, but decision authority remains with the district. Further, in making its decision on an application, district licensing staff consult with the supervisory staff including the district deputy comptroller, field office assistant deputy comptroller, and appropriate field staff. When there is disagreement among the district licensing and/or supervision parties or when significant issues exist, the conversion application is automatically forwarded to the headquarters licensing division for decision. For Silverton, OCC followed these procedures in that the Southern District licensing division conferred with headquarters licensing staff, the Southern District deputy comptroller, the Atlanta assistant deputy comptroller and various field staff before making its decision on the conversion application.[11]

While some parties we interviewed had reservations about the conversion, none, in the end, objected to the approval of the conversion. It was with this consensus that the Southern District licensing division approved the conversion. OCC officials and staff cited several factors for why they thought the conversion was acceptable including that they felt the issues facing the bank were manageable from a supervisory standpoint. The assistant deputy comptroller stated that an area of comfort was that Silverton had a great track record, was a 2-rated bank by FRB Atlanta with "1 rated" asset quality and "strong" credit risk management. The official also told us that he understood that while Silverton had some flaws, he did not expect the type of collapse in the housing market and downturn in the economy that eventually occurred.

Housing Market Decline

In mid-2007, the U.S. housing market had shown signs of weakening as housing prices started to decline. This was an important consideration in reviewing Silverton's conversion. A portion of Silverton's assets were made up of residential construction loans. Also, the bank held bank stock loans and holding company loans of other banks in the Atlanta area that were tied to the housing market. From a funding standpoint the bank relied heavily on federal funds from other member banks. Accordingly, Silverton was especially affected by the condition of the banks to which it was lending.

We believe that OCC should have given greater weight to these market events in its decision to approve Silverton's application to become a nationally chartered bank. The OCC preconversion examiners had questioned whether it was prudent to bring Silverton into the national banking system when the real estate market was in

[11] Prior to its conversion to a national bank, Silverton had not been subject to CRA. Consequently, as a part of the conversion process Silverton was also required to submit its proposal for complying with CRA to the OCC headquarters consumer compliance division. In turn, OCC compliance staff communicated with the bank regarding specific criteria and procedures for future CRA compliance.

decline; however, in the end, the examiners did not object to the approval of the charter.

Postconversion, There Was a Serious Lapse in OCC's Supervisory Coverage

OCC's Birmingham field office, at the time a satellite office of the Atlanta field office, conducted the preconversion examination of Silverton. Shortly after Silverton's conversion to a national bank on August 17, 2007, OCC made the Birmingham satellite office an independent field office. With this change, Silverton was no longer within the boundaries covered by the Birmingham field office and the supervisory responsibilities for Silverton were therefore reassigned to the Atlanta field office.

As a result of competing priorities, resource constraints, and poor communication between the preconversion and postconversion OCC staff, there was a serious lapse in the supervision of Silverton. Specifically, the Atlanta field office did not assign an EIC to Silverton until 90 days after the conversion because of competing demands on resources. Due to this gap in supervision, there was a protracted delay in the formulation of a supervisory strategy for future Silverton examinations. These 90 days were a crucial period in the supervision of the bank, because as the housing market started to deteriorate, so did Silverton. In January 2008, the EIC began reviewing problem loans, assessing lending area risk, and developing the OCC supervisory strategy. The supervisory strategy was approved in early April 2008. The bank's deterioration was reflected in OCC's April 2008 targeted examination of the bank's asset quality, completed in September 2008, which downgraded Silverton's CAMELS asset quality rating from 2 to 3.

The Comptroller's Handbook, Bank Supervision Process, states that the examination frequencies prescribed by 12 USC 1820(d) apply to banks that have been newly converted to a national charter. In this regard, a converted national bank must receive a full-scope, on-site examination within 12 months from the date of its last full-scope examination by a federal banking agency (FDIC, Office of Thrift Supervision, or the Federal Reserve Board).

Our interviews with OCC examiners revealed that there was a lack of communication between the EIC for the preconversion examination and the EIC assigned after conversion. The EIC for the preconversion examination had recommended that a full-scope examination be started in the first quarter of 2008, but one was not begun until June 2008. Although the April 2008 targeted examination inquired into the bank's progress in addressing the MRAs from the preconversion examination, OCC did not validate the actions taken until the June 2008 full-scope examination, which did not start until nearly a year after the preconversion examination and over 17 months from the last joint FRB Atlanta and State of Georgia full scope examination completed in December 2006.

OCC's 2008 full-scope examination found that none of the MRAs in the preconversion ROE had been corrected. The examination identified additional significant deficiencies in the bank's operation which resulted in a downgrade of the bank's CAMELS composite rating to a 4. In a letter dated December 29, 2008, OCC informed Silverton that it was deemed to be in troubled condition and that its supervision was being transferred to OCC's Special Supervision Division.[12]

We believe in the case of Silverton, a significant-sized institution, the gap in supervision, timing of the examinations, lack of validation of the actions taken by the bank to address the preconversion MRAs, and the ineffective transition and communication between the two EICs culminated in what we consider to be a breakdown in the supervisory process and an absence of adequate controls to prevent such an occurrence. Some in OCC management, including the Southern District deputy comptroller, agreed that it would have been desirable to have the EIC who conducted the preconversion examination continue to be assigned to Silverton despite the reorganization. Given Silverton's rapid deterioration, we believe that while it is unlikely that a smoother transition between the two EICs (or retaining the same EIC) would have prevented the bank's failure, it might have reduced the continued growth in CRE loans, and in turn, the loss to the Deposit Insurance Fund.

[12] Under 12 U.S.C. § 1831i, once OCC designates a bank as in troubled condition, the bank is required to notify OCC at least 90 days before the adding or replacing a member of the board of directors or employing any senior executive officer. OCC may then issue a notice of disapproval or remain silent on the proposal. The bank is also prohibited from entering into an agreement to make golden parachute payments to an institution affiliated party.

Transfer of Supervision to the Special Supervision Division Was Orderly and the Division's Use of Enforcement Action and PCA Was Appropriate

At the conclusion of the full-scope examination, in December 2008, OCC had significant regulatory concerns about Silverton. OCC found that the bank's condition was deficient and that board and management oversight was inadequate for Silverton's high and increasing risk profile, resulting in losses and depletion of capital. Following review by the Southern District Supervisory Review Committee, OCC transferred supervision of Silverton to its Special Supervision Division, which directed overall supervision of the bank from December 29, 2008, until it was closed on May 1, 2009.

On February 26, 2009, Silverton's board agreed to enter into a consent order with OCC that contained 13 articles, 10 of which required action by Silverton within specified time limits. The consent order required the bank to address deficiencies in its capital plan, concentrations of credit, criticized assets, loan portfolio management, its strategic plan, its staffing plan, brokered deposits, liquidity, and ALLL. The consent order also included a requirement that Silverton's board adopt a code of ethics to ensure that Silverton's interest was to be put ahead of individual board members' interests or those of their respective institutions. As part of a capital plan, Silverton was required to achieve and maintain a total risk-based capital ratio of 11 percent (the same total risk-based capital ratio required as a condition in the approval of its national bank charter) and a leverage ratio of 8 percent by June 30, 2009. These ratios are higher than those for the well-capitalized standard. Silverton failed to meet the mandated capital ratios.

Silverton's call report for the period ended March 31, 2009, disclosed that the bank's <u>tangible equity ratio</u> had fallen to 1.19 percent. As a result, on April 3, 2009, OCC notified Silverton that it was deemed critically undercapitalized for PCA purposes and directed Silverton to submit an acceptable <u>capital restoration plan</u> by April 16, 2009. This plan was to address how Silverton would comply with the requirements of the consent order. OCC determined that the plan, received on April 18, 2009, was unacceptable because it did not contain the required information.

We concluded that the Special Supervision Division did its best to address Silverton's problems under the circumstances. However, because conditions at Silverton had already deteriorated rapidly before its supervision was transferred, the division could do little to rehabilitate the bank. We also concluded that OCC took appropriate enforcement action and properly implemented PCA in reclassifying the bank's capital level.

OCC's Internal Lessons-Learned Review

OCC completed an internal lessons-learned review of Silverton's failure in August 2009. The objectives of the review were to evaluate the accuracy and comprehensiveness of the preconversion examination conclusions and assess the effectiveness of bank supervision after the conversion of the institution to a national bank.

The internal review concluded that the decision to approve the conversion was flawed in that identified weaknesses in credit and credit risk management were not given sufficient weight; OCC's perceived capabilities of the bank's management and management commitments to correct the problems and conclusions reached by a December 2006 FRB Atlanta/State of Georgia full-scope examination of the bank were granted too much weight; and the bank's management was not compelled to demonstrate its ability and commitment to make necessary improvements to existing operations.

The August 2009 report on the internal lessons-learned review made the following observations concerning events leading to Silverton's failure.

Preconversion

- When institutions depart from their original business strategy (e.g., from a bankers' bank to a commercial bank), OCC needs to exercise greater caution and be more forceful and persistent regarding the necessity for better and/or different risk management.[13]

[13] With respect to this lesson-learn observation, OCC headquarters supervisory officials stated that while they agree that converting banks planning to change their business strategy should receive close scrutiny,

- OCC needs to be careful to ensure, and in effect challenge, its objectivity in the review process for approving prospective charters, particularly when an entity is to become the largest in a respective field office and significant within a district.[14] OCC should consider the following questions:
    a) Is the decision being overly influenced by maintaining staffing levels and/or providing opportunities for band VI positions?
    b) What subtle pressures exist regarding OCC's appetite for taking on new and/or larger entities?
    c) Is there a perception that unless a bank's condition, business plan or risk controls are so obvious a concern, that charter approval is more than likely?
- When appropriate, as in this case, OCC needs to consult with its credit policy/risk analysis division, subject matter experts, or perhaps other business lines (e.g. large bank supervision) prior to conversion, to simply request the views and opinions of other OCC constituents. Such views/opinions may have also prompted reassessment or expansion of the scope of the preconversion examination so as to more fully evaluate unique risks, potential outlier metrics, etc.
- The need for due diligence and solicitation of opinion should have become more obvious to the assistant deputy comptroller and district deputy comptroller as the preconversion examination team had already begun considering the issues raised and the size and business focus of the institution, a higher level review should be required. This may involve consultation with existing district supervisory review committees.
- Preconversion conditional approval letter - OCC must exercise greater review and care in language that is stated in writing. The preconversion letter in the case of Silverton was "too soft". Words such as "favorable" and phrases such as "We would like you to…" were inconsistent with the substantive and detailed nature of the MRAs expressed in the same letter.
- Validation of correction of deficiencies should have postponed the final chartering decision.

Silverton's business strategy did not materially change. We agree with OCC that in Silverton's case, its business strategy did not materially change.

[14] From Silverton's August 2007 conversion through March 2009, OCC collected fees from southern district banks totaling $64.3 million. Silverton paid $739,400 during that period, which was 1.1 percent of the total fees paid by southern district banks and the eighth-largest amount paid by a southern district bank.

- In addition to conditional approval letters, consider using such tools as "Operating Agreements" on institutions which pose greater and/or unique risks.
- Consideration should be given to a quality assurance review of:
    a) preconversion examination procedures – the depth and scope should be commensurate with the unique risks of the institution.
    b) protocol/policy, when a conversion would result in the largest bank in a particular field office.
    c) resource allocation, both in terms of number of and experience of personnel must be better communicated and prioritized, in relation to the significance of size and inherent risk of the subject institution.
    d) Licensing's review/role in chartering activity.
    e) Transition of supervision (pre and post conversion).

<u>Postconversion</u>

- Effective communications are more critical:
    a) When transition of supervision occurs among EICs from different field offices
    b) When it involves the largest bank in the field office which has delegated supervisory responsibility.
- Communication voids did, in fact, occur which ultimately led to the protracted delay in specific follow-up on previously identified MRAs.
- Formality of transition of supervision from the pre to post conversion process needs greater discipline. It would have been advisable for the affected offices to coordinate and facilitate mandatory meetings to ensure effective and efficient "hand-off" of supervisory responsibility (i.e. this did not occur).
- As credit related deterioration became increasingly more pronounced and resolution of previously identified deficiencies became more questionable, it is incumbent upon the supervisory office to reach-out and seek assistance in a more timely manner (e.g., subject matter experts, the Special Supervision Division, etc.)

Based on our review of the examination records and reports and our interviews with OCC staff, we generally affirm OCC's internal findings and the need for corrective action. At the audit exit conference, OCC officials stated that they considered the performance of second level reviews of charter conversions prior to approval as a better approach than an after-the-fact quality assurance review. In this regard, the Senior Deputy Comptroller for Midsize and Community Bank Supervision stated that OCC districts have been instructed to have their respective District Supervisory Review Committees perform second-level reviews of charter conversions. This new process, however, has not yet been formalized in OCC policy and procedures.

Recommendations

Our material loss review of Silverton is the eighth such review we have performed of a failed OCC-regulated financial institution during the current financial crisis. Appendix 6 lists the other seven material loss reviews and our associated recommendations. With one exception noted in the appendix, OCC management agreed with the prior recommendations and has taken action or is taking corrective actions to address them.

As a result of our material loss review of Silverton, we recommend that the Comptroller of the Currency

1. ensure that after a charter conversion an EIC is promptly assigned and supervisory coverage of the institution is continuous, to include the timely initiation (within no more than 12 months of the full-scope examination by the prior regulator) of the first full-scope examination after conversion.

   Management Response

   OCC acknowledges the need for timely assignment of an EIC to provide continuous supervision of a newly converted national bank. To ensure the responsible supervisory office timely appoints an EIC when a charter conversion is effective, OCC plans to revise the Comptroller's Licensing Manual to include specific language calling attention to this requirement.

   OCC also noted that its Comptroller's Licensing Manual outlines the key policies and application process for conversions to national bank charters, including a section on post-conversion supervisory activities, which provides the following guidance for the timing and scope of examinations of newly converted national banks:

"All converted *insured* national depository institutions, including converted insured trust banks, must receive full-scope examinations as prescribed by 12 USC 1820(d). Generally, an *insured* converted national bank must receive a full-scope examination within 12 months from the date of its last full-scope examination conducted by a federal banking agency or its last examination by its state regulator, if the examination met Federal Financial Institutions Examination Council (FFIEC) guidelines. The time period may be extended to 18 months from its last examination if the bank meets the standard statutory criteria for such an extension. The timing of the first full-scope examination may be influenced by whether a conversion examination was performed, if increased risks, concerns, or weaknesses are disclosed or if the converted bank is pursuing a nontraditional strategy."

OCC further stated that the final sentence of this section above is intended to address circumstances where examinations should be performed in less than the 12 or 18 month time period, but acknowledge that the sentence could be misinterpreted. OCC plans to clarify this requirement.

<u>OIG Comment</u>

OCC's planned actions meet the intent of our recommendations. OCC will need to establish an estimated completion date for its planned actions to revise the Comptroller's Licensing Manual, and record that date in JAMES.

2. ensure that appropriate actions are taken to amend or reinforce OCC guidance in response to the lessons learned review of the Silverton failure.

   <u>Management Response</u>

   OCC is in the process of shifting responsibility for performing lessons learned reviews of bank failures to its Ombudsman. The Ombudsman will also work with bank supervision management to ensure that appropriate actions are taken in response to findings of the lessons learned reviews.

OIG Comment

OCC's planned actions meet the intent of our recommendations. OCC will need to establish an estimated completion date for its planned actions, to include the actions to be taken in response to the Silverton lessons learned review, and record that date in JAMES.

In particular to the lessons learned review, we recommend that OCC

3. ensure that banks seeking conversion to a national charter address all significant deficiencies identified by OCC or prior regulators before approval; and

   Management Response

   OCC stated that the Comptroller's Licensing Manual currently requires that licensing staff review the results of any conversion examination and comments from the supervisory office, discuss and resolve any matters identified in the examination report with the supervisory office, and send any response from the converting bank's management to the supervisory office. OCC further stated in its response that as was the case with Silverton, there are often significant issues, identified by OCC or prior regulators, that a converting bank must address before its application can be approved. OCC plans to revise its Comptroller's Licensing Manual to include a more thorough description of the procedures that should be followed to determine whether banks seeking conversion satisfactorily address significant deficiencies before charter conversion is approved.

   OIG Comment

   OCC's planned actions meet the intent of our recommendations. OCC will need to establish an estimated completion date for its planned actions to modify the Conversions booklet, and record that date in JAMES.

4. formalize the process for second level reviews of charter conversions.

Management Response

OCC plans to formalize the process of performing second level reviews of charter conversion proposals prior to recommending approval of the application. OCC Deputy Comptrollers will amend their respective Supervisory Review Committee charters to include this responsibility.

OIG Comment

OCC's planned actions meet the intent of our recommendations. OCC will need to establish an estimated completion date for its planned actions to modify the Conversions booklet, and record that date in JAMES.

* * * * *

We appreciate the courtesies and cooperation provided to our staff during the audit. If you wish to discuss the report, you may contact me at (202) 927-5776 or Lisa E. DeAngelis, Audit Manager, at (202) 927-5621. Major contributors to this report are listed in appendix 8.

/s/
Susan L. Barron
Audit Director

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

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

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

We initiated a material loss review of Silverton based on the loss estimate by the Federal Deposit Insurance Corporation (FDIC). As of October 2, 2009, FDIC estimated that the loss to the Deposit Insurance Fund from Silverton's failure would be $608.3 million.

Our objectives were to determine the causes of Silverton's failure; assess the Office of the Comptroller of the Currency's (OCC) supervision of Silverton, including implementation of the PCA provisions of section 38; and make recommendations for preventing such a loss in the future. To accomplish our objectives, we conducted fieldwork at OCC's headquarters in Washington, DC, its southern district office in Dallas, Texas, and its field office and Silverton's former headquarters in Atlanta, Georgia. We also interviewed FDIC and FRB officials. We conducted our fieldwork from July 2009 through November 2009.

[15] 12 U.S.C. § 1831o(k).

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

- We determined that the time period relating to OCC's supervision of Silverton covered by our audit would be from May 2007 through Silverton's failure on May 1, 2009. This period included a preconversion examination prior to Silverton's conversion from a state-chartered institution to a national banking association, and two targeted examinations and one safety and soundness examination performed subsequent to becoming a national banking association.

- We reviewed OCC's preconversion examination report and supporting documentation, and related correspondence. We performed this review to gain an understanding of any issues identified and the approach and methodology OCC used to assess the bank's condition and subsequent approval of the bank for a national charter.

- We analyzed OCC's postconversion reports of examination, supporting supervisory documentation, and related supervisory correspondence. We also assessed the regulatory action OCC used to compel bank management to address deficient conditions identified during examinations. 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 Silverton's supervision with OCC officials, examiners, and an attorney to obtain their perspective on the bank's condition and the scope of the examinations.

- We interviewed FDIC officials responsible for monitoring Silverton for federal deposit insurance purposes.

- We interviewed Federal Reserve Bank of Atlanta (FRB Atlanta) officials responsible for supervision of the bank before its conversion to a national banking association in 2007. We also reviewed reports of examination prepared by the FRB Atlanta for The Bankers Bank, the name Silverton was known by prior to its conversion to a national charter, to gain an understanding of its assessment of the bank's condition.

- We interviewed officials from FDIC's Division of Supervision and Consumer Protection who were involved in the supervision and closing of Silverton.

- We assessed OCC's actions based on its internal guidance and requirements of the Federal Deposit Insurance Act.[16]

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.

[16] 12 U.S.C. § 1811 et seq.

History of Silverton Bank, N.A.

Georgia Bankers Bank was chartered as a commercial with the State of Georgia in 1986. Its authority was limited by articles of incorporation to providing banking services to depository financial institutions, and its primary regulator was the Federal Reserve Bank of Atlanta. In 1994, the bank changed its name to The Bankers Bank. In August 2007, the bank converted from a state-chartered to a nationally chartered bank, and the Office of the Comptroller of the Currency (OCC) became its primary regulator. According to OCC, the bank wanted to become a national chartered bank so that it could be more aggressive with its growth and expand in more areas.

Effective January 1, 2008, the bank changed its name to Silverton Bank, N.A. (Silverton). Silverton was wholly owned by Silverton Financial Services, Inc., a one-bank holding company. As of December 2008, over 400 depository institutions and depository institution holding companies owned the outstanding shares of Silverton Financial Services, Inc. Silverton's assets were approximately $4.1 billion as of March 31, 2009.

Silverton's main office was in Atlanta, Georgia. The bank had no branches but had offices for loan production or business development in Alabama, California, Colorado, Florida, Georgia, Illinois, Maryland, Mississippi, North Carolina, Ohio, Tennessee, Virginia, and Washington. Silverton did not accept deposits directly from the general public. It provided correspondent banking services to approximately 1,000 community banks, including payment and check clearing services and other services related to lending, cash management, investment, investment banking, and consulting. Silverton's lending services included loan participations, loans to directors and executive officers of client/owner banks, organizational lines of credit for de novo banks, direct loans to financial institutions, and direct loans to individuals to purchase holding company stock of financial institutions. Silverton offered consulting services to approximately 1,500 community banks in 39 states.

Silverton wholly owned Specialty Finance Group, LLC, an operating subsidiary that made direct commercial loans to the hospitality industry. Silverton owned 25 percent of Medici, LLC, a limited liability company that holds bank premises, and 15 percent of Salem Capital partners, LP, a partnership that operates a small business investment company.

Appendix 4 contains a chronology of significant events regarding Silverton.

Types of Examinations Conducted by OCC

OCC conducts various types of examinations, including full-scope on-site examinations. A full-scope examination is a combined examination of the institution's safety and soundness, compliance with regulations, and information technology (IT) systems.

The safety and soundness portion of the examination includes a review and evaluation of the six CAMELS components: Capital adequacy, Asset quality, Management administration, Earnings, Liquidity, and Sensitivity to market risk. OCC assigns the bank a rating for each component and a composite rating based on its assessment of the overall condition of the bank and its level of supervisory concern. The IT portion of the examination evaluates the overall performance of IT within the institution and the institution's ability to identify, measure, monitor, and control technology-related risks. The compliance portion of the examination includes an assessment of how well the bank manages compliance with various consumer protection laws and related regulations, such as the Truth in Lending Act, the Truth in Savings Act, and the Bank Secrecy Act. A targeted examination is any examination that does not fulfill all the statutory requirements of a full-scope examination.

OCC must schedule full-scope, on-site examinations of insured banks once during either a 12-month or 18-month cycle. OCC is to conduct examinations on a 12-month cycle until a bank's management has demonstrated its ability to operate the institution in a safe and sound manner and satisfied all conditions imposed at the time of approval of its charter. Once a bank meets these criteria, OCC may use an 18-month examination cycle if the bank

- has total assets of less than $500 million;

- is well-capitalized;
- at its most recent examination received a:
    - Management component rating of 1 or 2, and
    - Composite rating of 1 or 2; and
- is not currently subject to a formal enforcement proceeding or order by the Federal Deposit Insurance Corporation , OCC, or the Federal Reserve Board; and
- has not undergone a change in control during the 12-month period since completion of the last full-scope, on-site examination.

Enforcement Actions Available to OCC

OCC examinations of banks result in the issuance of reports of examinations (ROE) that identify any areas of concern. OCC uses informal and formal enforcement actions to address violations of laws and regulations and to address unsafe and unsound practices.

<u>Informal Enforcement Actions</u>

OCC may use informal enforcement actions when a bank's overall condition is sound, but it is necessary to obtain written commitments from a bank's board of directors or management to ensure that it will correct problems and weaknesses. Informal enforcement actions provide a bank with more explicit guidance and direction than a ROE normally contains but are generally not legally binding. Informal enforcement actions include commitment letters and memoranda of understanding. Also included are safety and soundness plans authorized by 12 C.F.R. Part 30. Informal enforcement actions are not disclosed to the public.

<u>Formal Enforcement Actions</u>

Formal enforcement actions are authorized by statute, generally more severe than informal actions, and disclosed to the public. 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 influence bank management and board members to correct identified problems and concerns in the bank's operations. Because formal actions are enforceable, OCC can assess civil money penalties against banks and individuals for noncompliance with a formal agreement or final order. OCC can also request a federal court to require the bank to comply with an order. Formal enforcement actions include consent orders, cease and desist orders, formal written agreements, and prompt corrective action directives.

OCC Enforcement Guidelines

Factors used in determining whether to use informal action or formal action include the following:

- 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 Policies and Procedures Manual 5310-3 (Rev).

Brokered deposits	Any deposit that is obtained, directly or indirectly, from a deposit broker. Under 12 U.S.C. 1831f and 12 C.F.R. 337.6, the use of brokered deposits is limited to well-capitalized insured depository institutions and, with a waiver from the Federal Deposit Insurance Corporation, to adequately capitalized institutions. Undercapitalized institutions are not permitted to accept brokered deposits.
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. The Office of the Comptroller of the Currency uses the CAMELS rating system to evaluate a bank's overall condition and performance by assessing each of the six rating components and assigning numerical values. The Office of the Comptroller of the Currency then assigns each bank a composite rating based on its assessment of the overall condition and level of supervisory concern.
Capital Purchase Program	The Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-342, 122 Stat. 3267, section 101(a) authorized Treasury to establish the Troubled Asset Relief Program to, among other things, purchase troubled assets from financial institutions. Under this authority, Treasury created a voluntary program--the Capital Purchase Program in which the United States government, through the Department of the Treasury, invests in preferred equity securities issued by qualified financial institutions.

Capital restoration plan	Under the prompt corrective action requirements of the Federal Deposit Insurance Act, as amended, a capital restoration plan is to be submitted to the appropriate federal banking agency by any 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.
Classified asset	An asset rated as substandard, doubtful, or loss. Substandard assets are inadequately protected by the current worth and paying capacity of the obligor or of the collateral pledged, if any. A doubtful asset has all the weaknesses of a substandard asset with the added characteristic that the weaknesses make collection or liquidation in full questionable and improbable. A loss asset is considered uncollectible and of such little value that continuation as a bankable asset is not warranted.
Community Reinvestment Act	Enacted by Congress in 1977, the act encourages banks to help meet the credit needs of their communities for housing and other purposes, particularly in neighborhoods with low or moderate incomes, while maintaining safe and sound operations.
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 to a cease and desist order that 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.
Curtailment	A required reduction (payment) of an outstanding principle by a borrower.
Full-scope examination	Examination activities performed during the supervisory cycle that (1) are sufficient in scope to assign or confirm an institution's CAMELS composite and component ratings; (2) satisfy core assessment requirements; (3) result in conclusions about an institution's risk profile; (4) include onsite supervisory activities; and (5) generally conclude with the issuance of a report of examination.
Interest reserve	An account established by the lender to periodically advance funding to pay interest charges on the outstanding balance of a loan.
Loan participation	The sharing of a loan by a group of banks that join together to make a loan too large for any one of the banks to handle. Loan participation is a convenient way for smaller banks to book loans that would otherwise exceed their legal lending limits (see loan-to-value for limits).
Loan-to-value	A ratio for a single loan and property calculated by dividing the total loan amount at origination by the market value of the property securing the credit plus any readily marketable collateral or other acceptable collateral. In accordance with Interagency Guidelines for Real Estate Lending Policies, institutions' internal loan-to-value limits should not exceed the legal lending limit: (1) 65 percent for raw land; (2) 75 percent for land development; (3) 80 percent for commercial, multifamily, and other nonresidential loans; and (4) 85 percent for one-family to four-family residential loans The guidelines do not specify a limit for owner-occupied one-family to four-family properties and

home equity loans. However, when the loan-to-value ratio on such a loan equals or exceeds 90 percent at the time of origination, the guidelines state that the bank should require mortgage insurance or readily marketable collateral.

Matters requiring attention — A bank practice noted during an examination of a bank that deviates from sound governance, internal controls, and risk management principles. The matters, if not addressed, may adversely impact the bank's earnings, capital, risk profile, or reputation, or may result in substantive noncompliance with laws and regulations, internal policies or processes, Office of the Comptroller of the Currency supervisory guidance, or conditions imposed in writing or other requests by a bank. Although matters requiring attention are not formal enforcement actions, the Office of the Comptroller of the Currency requires that banks address them. A bank's failure to do so may result in a formal enforcement action.

Multi-variable stress testing — An integrated, enterprise wide stress testing program in which the impact of the various risks such as credit, market, and operational on applicable loans are assessed and used in strategic decision making processes.

Prompt corrective action — A framework of supervisory actions, set forth in 12 U.S.C. §1831o, for insured depository institutions that are not adequately capitalized. It was intended to ensure that action is taken when an institution becomes financially troubled in order to prevent a failure or minimize resulting losses. These actions become increasingly severe as 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] To be well-capitalized, a bank also cannot be subject to a higher capital requirement imposed by OCC.

Risk-based capital	The sum of Tier 1 plus Tier 2 capital.
Special Supervision Division	The Special Supervision Division of the Midsize/Community Bank Supervision Department supervises critical problem banks through rehabilitation or other resolution processes such as orderly failure management or the sale, merger, or liquidation of such institutions. It is located at the Office of the Comptroller of the Currency's headquarters in Washington, D.C.
Subordinated debt	Debt that is either unsecured or has a lower priority than that of another debt claim on the same asset or property, also called junior debt.
Tangible equity ratio	Tier 1 capital plus cumulative preferred stock and related surplus less intangibles except qualifying purchased mortgage servicing rights divided by total assets less intangibles except qualifying purchased mortgage servicing rights.
Transaction Account Guarantee Program	A component of the Federal Deposit Insurance Corporation's Temporary Liquidity Guarantee Program. The Temporary Liquidity Guarantee Program was established in October 2008 as part of a coordinated effort by the Federal Deposit Insurance Corporation, the Department of the Treasury, and the Federal

	Reserve to address unprecedented disruptions in credit markets and the resultant inability of financial institutions to fund themselves and make loans to creditworthy borrowers. The Temporary Liquidity Guarantee Program has two distinct components: (1) the Debt Guarantee Program and (2) the Transaction Account Guarantee Program. The Federal Deposit Insurance Corporation guarantees certain senior unsecured debt issued by participating entities under the Debt Guarantee Program and all funds held in qualifying noninterest-bearing transaction accounts at participating insured depositary institutions under the Transaction Account Guarantee Program. Originally scheduled to expire on December 31, 2009, the Transaction Account Guarantee Program was extended in August 2009 until June 30, 2010. Participating insured depositary institutions pay an assessment fee for the additional guarantee.
Tier 1 capital	Common shareholder's equity (common stock, surplus, and retained earnings), noncumulative perpetual preferred stock, and minority interests in the equity accounts of consolidated subsidiaries.
Tier 2 capital	Consists of subordinated debt, intermediate-term preferred stock, cumulative and long-term preferred stock, and a portion of a bank's allowance for loan and lease losses.
Troubled Asset Relief Program (TARP)	A program established under the Emergency Economic Stabilization Act of 2008 with the specific goal of stabilizing the United States financial system and preventing a systemic collapse. The act gives the program the authority to purchase and make fund commitments to purchase troubled assets from any financial institution.

The following chronology describes significant events in the history of Silverton Bank, N.A. (Silverton), including examinations conducted and enforcement actions taken by the Office of the Comptroller of the Currency (OCC).

2/3/1986	The bank is chartered as a commercial bank with the State of Georgia. Its authority is limited by articles of incorporation to providing banking services to depository financial institutions. The bank's original name is Georgia Bankers Bank.
5/24/1994	The bank changes its name to The Bankers Bank.
4/2/2007	OCC receives The Bankers Bank's application to convert from a state-chartered institution to a national banking association.
5/14/2007	OCC begins a preconversion examination, which results in CAMELS composite and component ratings of 2/222222.
6/5/2007	In internal memorandum, examiners express concerns as reflected in MRAs in credit risk management processes, strategic planning and capital planning but conclude there is no 'deal breaker."
6/18/2007	OCC officials meet with Silverton management to discuss OCC concerns. OCC perspective is management understood concerns and was committed to correction.
6/26/2007	OCC officials hold second meeting with Silverton management, at which the bank president states that OCC can be assured remediation efforts will exceed OCC expectations.
7/20/2007	OCC notifies The Bankers Bank management in a letter that the overall findings from the preconversion examination are favorable. However, the letter discusses several significant supervisory issues identified by OCC examiners, resulting in three matters requiring attention (MRA) regarding credit risk management processes, strategic planning, and capital planning. OCC asks that bank management respond, in writing, outlining specific commitments to address these MRAs. OCC informs bank management that it will recommend that the bank's application be approved with the

	requirement that total risk-based capital be maintained at not less than 11 percent.[18]
7/26/2007	The Bankers Bank management responds to OCC's July 20, 2007, letter, committing to address supervisory concerns and outlining steps to address the three MRAs.
8/7/2007	OCC approves The Bankers Bank's application to convert to a national banking association. Conversion is conditioned on the bank's maintaining a total risk-based capital ratio of not less than 11 percent and taking the steps necessary to adopt the commitments set forth in its July 26, 2007, letter.
8/17/2007	The bank's conversion, under the name The Bankers Bank, N.A., from a state charter to a national bank charter is effective. Based on the preconversion examination, examiners assign the bank CAMELS composite and component ratings of 2/222222.
1/1/2008	The bank changes its name to Silverton Bank, N.A.
1/20/2008	The OCC examiner-in-charge reviews problem loans, assesses lending area risk, and begins developing an OCC supervisory strategy for Silverton.
4/24/2008	OCC's April 2008 targeted examination results in CAMELS composite and component ratings of 2/232222. OCC notifies Silverton in a letter that the bank's asset quality has significantly deteriorated since the preconversion examination.
6/2/2008	OCC begins a full-scope safety and soundness examination using March 31, 2008, financial information, which is later updated with December 31, 2008, financial information. The examination results in CAMELS composite and component ratings of 4/444442.
8/2008	OCC conducts a meeting with Silverton's executive management and credit management outlining asset quality concerns. In

[18] The 11 percent requirement is consistent with conditions established in a 2006 joint examination of the bank by the Federal Reserve Bank of Atlanta and the Georgia Department of Banking and Finance. Following that examination, The Banker's Bank was required to maintain Tier 1 leverage of not less than 6 percent and a total risk-based capital ratio of not less than 11 percent.

	response to OCC's urging, Silverton's board contracts for a comprehensive independent loan review.
9/9/2008	Silverton's chief credit officer is terminated by bank management and a new one is appointed.
10/20/2008	OCC is advised by the contractor that the results from the contracted loan review that began in September 2008 are consistent with OCC examination findings.
10/24/2008	Silverton Financial Services, Inc., Silverton's holding company, files an application for $77.3 million capital under the Troubled Asset Relief Program (TARP) Capital Purchase Program.
11/24/2008	OCC's supervisory office orally advises Silverton's management of its decision not to recommend approval of the bank's TARP application.
12/10/2008	OCC's District Supervisory Review Committee meets to finalize Silverton's ratings for the June 2, 2008, examination. OCC's Atlanta field office recommends CAMELS composite and component ratings of 3/343432 and the issuance of a formal agreement; while OCC's Southern District Office recommends ratings of 4/444442 and a consent order. Silverton's ratings are ultimately downgraded in accordance with the ratings recommended by OCC Southern District, and the proposed formal agreement is changed to a consent order.
12/29/2008	OCC informs Silverton that it is deemed to be in troubled condition and transfers supervision of the bank to OCC's Special Supervision Division in Washington, DC.
12/31/2008	Silverton's assets are approximately $3.2 billion. A decline in the bank's asset quality causes its total risk-based capital to fall below 11 percent, to 10.85 percent.
12/31/2008	OCC directs Silverton to reverse a $3.5 million dividend to Silverton Financial Services, Inc. Silverton subsequently reversed the dividend.

1/2009	OCC successfully requests the return of $3 million in bonuses paid by the bank to Silverton's senior executive officers and the holding company.
2/2/2009	OCC begins a targeted examination of Silverton's liquidity, and asset quality with particular focus on loans secured by bank and/or bank holding company stock, and trust preferred securities. The examination is completed on March 24, 2009, and results in CAMELS composite and component ratings of 5/555552.
2/26/2009	OCC issues a consent order with 13 articles, 10 of which require action by Silverton within specified time limits. The consent order primarily requires the board to address deficiencies identified in the 2008 examination with respect to management, capital, asset quality, earnings, and liquidity. The consent order also changes Silverton's regulatory capital designation from well-capitalized to adequately capitalized.
3/24/2009	OCC notifies Silverton of the results of the 2009 targeted review in a letter. OCC concludes that Silverton's overall condition has deteriorated substantially since the 2008 examination and is now critically deficient. The letter states that Silverton is in an extremely unsafe or unsound condition, its overall risk profile is high and increasing, and immediate outside financial or other assistance is needed for Silverton to be viable.
4/2/2009	Silverton submits the mandated code of ethics in accordance with OCC's February 26, 2009, consent order.[19]
4/3/2009	OCC informs Silverton that its tangible equity ratio of 1.19 percent as of March 31, 2009, causes the bank to be deemed critically undercapitalized for prompt corrective action purposes and directs Silverton to submit an acceptable capital restoration plan by April 12, 2009. The deadline for the plan is later extended to April 16, 2009. The letter also informs Silverton of restrictions applicable to institutions in the critically undercapitalized category.[20]

[19] OCC was evaluating Silverton's submission and had not rendered an opinion prior to the closing of Silverton.
[20] Pursuant to 12 U.S.C. § 1831o and 12 C.F.R. § 6.6 and 337.6, restrictions prescribed for critically undercapitalized institutions include prohibition of the following without FDIC's prior written approval:

4/7/2009	Silverton's president and chief executive officer and its chief operating officer resign. A board member is appointed interim president and chief executive officer of Silverton and Silverton Financial Services, Inc.
4/18/2009	OCC receives a capital plan from Silverton intended to serve as a capital restoration plan for prompt corrective action purposes and also designed to meet capital plan requirements set forth in the February 26, 2009, consent order. This plan requires Silverton to (1) eliminate shareholder dividend payments and suspend dividends paid to the holding company; (2) decrease the balance sheet by approximately $175 million to $3 billion by the end of 2009; (3) eliminate the holding company by filing bankruptcy (4) raise capital, most likely through a convertible preferred stock offering; and (5) fund the capital infusion with an Federal Deposit Insurance Corporation (FDIC)-backed open bank structure.[21],
4/23/2009	OCC informs Silverton by letter that the capital plan is unacceptable for prompt corrective action purposes and does not satisfy the consent order requirements. With respect to prompt corrective action, OCC stated that the plan was based on events that had not occurred, was primarily based on events not within Silverton's control, did not ensure that the events outside of Silverton's control would occur or be successful, was not based on realistic assumptions, did not contain sufficient information and analysis, and did not contain a guarantee and pledge of assets by the holding company. With respect to the consent order requirements, the plan did not contain the specificity, support, and analysis required by the consent order.

entering into material transactions not in the usual course of business; extending credit for any highly leveraged transactions as defined in 12 C.F.R. Part 325; amending the bank's charter or bylaws; making any material change in accounting methods; engaging in any covered transaction as defined in 12 U.S.C. § 371c(b); paying excessive compensation or bonuses; paying interest on new or renewed liabilities at a rate that would increase the bank's weighted average cost of funds to a level significantly exceeding prevailing rates of interest; making principal or interest payments on subordinated debt; accepting, renewing, or rolling over brokered deposits; and restricting the effective yield the bank offers on deposits.

[21] Open back securities are part of a government assistance program to help prevent a bank from failing and entails the bank taking the first $120 million of losses, 20 percent of the next $400 million of losses, and 5 percent of all losses thereafter.

5/1/2009	OCC closes Silverton and appoints FDIC as receiver. FDIC creates a bridge bank, Silverton Bridge Bank, N.A., to take over operations of the bank. At closing, Silverton has approximately $4.1 billion in assets and $3.3 billion in deposits. FDIC estimates that the cost to the Deposit Insurance Fund will be $1.3 billion.

This appendix summarizes the Office of the Comptroller of the Currency's (OCC) preconversion, safety and soundness, and targeted examinations of Silverton Bank, N.A. (Silverton), from May 2007 through February 2009, and provides information on the significant results of those examinations. We list the matters requiring attention contained in the reports of examination. Generally, matters requiring attention represent the most significant items requiring corrective action. The reports included no other recommendations or suggestions.

Date Started/Type of Exam	CAMELS rating	Assets (billions)	Significant safety and soundness matters requiring attention and recommendations cited in reports of examination and workpapers	Enforcement actions
5/14/2007 **Preconversion examination**	2/222222	$2.1	**Matters requiring attention** • Develop a comprehensive plan to develop strong credit risk management processes. Due to the bank's high level of commercial real estate (CRE) lending, this should include compliance with OCC Bulletin 2006-46, Interagency Guidance on CRE Concentration Risk Management. This should address at a minimum, the following issues: a. The board should ensure that an appropriate level of oversight is provided as part of a strong credit risk management process. b. Management of the loan portfolio should be improved, including the policy, reports, market analysis, and credit risk review function. • Revisit the strategic planning process to ensure that growth and expansion plans are appropriate. The strategic plan should be re-evaluated in light of the bank's increasing risk profile and risk management systems, which do not support these plans. Goals and objectives outlined in the strategic plan are too broad and not supported by more specific departmental level business plans. • Develop a more comprehensive capital plan to meet the guidelines outlined in the bank's capital and dividend policy, including a thorough analysis of the impact of growth plans and qualitative risk factors on capital adequacy.	None

Date Started/Type of Exam	CAMELS rating	Assets (billions)	Significant safety and soundness matters requiring attention and recommendations cited in reports of examination and workpapers	Enforcement actions
4/24/2008 **Targeted examination of bank and holding company stock loans**	2/232222	$2.7	<u>**Matters requiring attention**</u> • The letter issued to the bank did not discuss the status of prior MRAs nor were new MRAs identified.	None
6/2/2008 **Safety and soundness full-scope examination**	4/444442	$3.1	<u>**Matters requiring attention**</u> **Reduce Problem Asset Levels (Repeat from preconversion examination):** To reduce credit risk: • Assure that adequate staff with needed expertise is in place to manage problem loans. • Reduce special mention and classified loan levels. • Reduce past due and nonperforming asset levels. • Reduce loan concentrations, especially in the riskier loan sectors. • Remain proactive in identifying troubled credit relationships. • Continue to ensure that the allowance remains at an adequate level. **Capital Plan and Budgeting—Capital (Repeat from preconversion examination):** **)** • Given the recent and material increase in the bank's	None (Note: Consent order was recommended by the Southern District Supervisory Review Committee in December 2008 and the consent order was issued February 26, 2009[22]

[22] The consent order required that Silverton comply with the following: (1) within 45 days, the board shall forward to the director for his review a written strategic plan for the bank, covering at least a 3-year period. (2) within 150 days, the bank shall achieve and maintain, at a minimum, the following capital ratios: -Tier 1 capital at least equal to 11 percent of risk-weighted assets: and Tier 1 capital at least equal to 8 percent of adjusted total assets. (3) the board shall ensure that the bank has capable management in place on a full-time basis in all executive officer positions with qualifications and experience commensurate with his or her duties necessary to carry out the board's policies. (4) within 30 days, the board shall revise and maintain a comprehensive liquidity risk management program which assesses, on an ongoing basis, the bank's current and projected funding needs, and ensures that sufficient funds or access to funds exist to meet those needs. (5) within 30 days, the board shall adopt and the bank shall implement and thereafter ensure adherence to a written concentration management program. (6) within 60 days, the board shall adopt and the bank shall implement and thereafter ensure adherence to a written credit policy to improve the bank's loan portfolio management. (7) and the board shall require the bank to revise and maintain a program for the maintenance of an adequate ALLL.

Date Started/Type of Exam	CAMELS rating	Assets (billions)	Significant safety and soundness matters requiring attention and recommendations cited in reports of examination and workpapers	Enforcement actions
			risk profile, management and the board should aggressively identify all options to increase capital, such as shrinking the bank, reducing operating expenses where possible, and selling assets. Given the seriousness of the bank's asset quality problems and pessimistic projections for real estate market recovery, obtaining as much capital as possible is critical to the bank's long-term viability. **Concentration Management—Loans (Repeat from preconversion examination):** • Develop a concentration policy in keeping with OCC guidance. • Establish appropriate concentration limits to reduce the risk from concentrations. **Strategic Planning—Management (Repeat from preconversion examination):** • The board needs to revise the bank's strategic plan, specifically as it relates to near-term and prospective growth and target markets. Uncontrolled growth and expansion into new markets over the last several years have strained capital and liquidity. The revised strategic plan should be developed in concert with the capital plan and budget. **Review Staffing Needs—Staffing (Repeat from preconversion examination):** • It is critical that the board and management realistically assess their current and prospective staffing needs, accounting for the possibility that problem loan levels may increase in the near term, and fill those positions as soon as possible.	

Date Started/Type of Exam	CAMELS rating	Assets (billions)	Significant safety and soundness matters requiring attention and recommendations cited in reports of examination and workpapers	Enforcement actions
2/2/2009 **Targeted examination of asset quality, credit risk management, allowance for loan and lease loss adequacy, and financial performance**	5/555552	$3.1	• **Matters requiring attention** None, however, OCC was in the process of issuing a consent order.	

Source: OCC reports of examination and examination workpapers

We have completed seven mandated material loss reviews of failed banks since November 2008. This appendix provides our recommendations to the Office of the Comptroller of the Currency (OCC) resulting from these reviews. With one exception as footnoted in this appendix, OCC management concurred with the recommendations and has taken or planned corrective actions that are responsive to the recommendations. In certain instances, the recommendations address matters that require ongoing OCC management and examiner attention.

Report Title	Recommendations to the Comptroller
Safety and Soundness: Material Loss Review of ANB Financial, National Association, 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 a loss to the Deposit Insurance Fund of $214 million.	Re-emphasize to examiners that examiners must closely investigate an institution's circumstances and alter its supervisory plan if certain conditions exist as specified in OCC's Examiner's Guide to Problem Bank Identification, Rehabilitation, and Resolution. Re-emphasize to examiners that formal 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 reasons 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 wholesale funding with 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, National Association, OIG-09-033 (Feb. 27, 2009) OCC closed First National Bank of Nevada and First Heritage Bank and appointed FDIC as receiver on July 25, 2008. As of December 31, 2008, FDIC estimated losses to the Deposit Insurance Fund of $706 million for First National Bank of Nevada and $33 million for First Heritage Bank.	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 (i.e, workpapers are to be clear, concise, and readily understood by other examiners and reviewers).

Safety and Soundness: Material Loss Review of the National Bank of Commerce, OIG-09-042 (Aug. 6, 2009) OCC closed National Bank of Commerce and appointed FDIC as receiver on January 16, 2009. As of June 30, 2009, FDIC estimated a loss to the Deposit Insurance Fund of $92.5 million from this failure.	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 a loss to the Deposit Insurance Fund of $99.6 million.	Caution examiners and their supervisors that when a bank's condition has deteriorated, it is incumbent on examiners to properly support and document in examination work papers the CAMELS component and composite ratings assigned, including those that may not have changed from prior examinations, as well as support a decision not to take an 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. In this regard, OCC should reassess, and revise as appropriate, its examination guidance for when expanded reviews of dividends and related organizations should be performed.
Safety and Soundness: Material Loss Review of TeamBank, National Association, OIG-10-01 (Oct. 7, 2009) OCC closed TeamBank National Association and appointed FDIC as receiver on March 20, 2009. As of September 18, 2009, FDIC estimated a loss to the Deposit Insurance Fund of $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.
Safety and Soundness: Material Loss Review of	Review OCC processes to ensure that more

Omni, National Bank, OIG-10-017 (Dec. 9, 2009) OCC closed Omni, National Bank and appointed FDIC as receiver on March 27, 2009. As of October 31, 2009, FDIC estimated a loss to the Deposit Insurance Fund of $288.2 million.	timely enforcement action is taken once the need for such action is identified.[23] 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. Implement a policy for EIC rotation for midsize and community.

[23] OCC did not agree with this recommendation. In its response to our report, OCC asserted that current policies are sufficient to ensure that timely enforcement action is taken. We accepted its position with respect to its current processes and consider the recommendation closed.

O **MEMORANDUM**

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

To: Susan L. Barron, Audit Director

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

Date: January 19, 2010

Subject: Response to Material Loss Review of Silverton Bank, N.A., Atlanta, Georgia

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

You concluded that Silverton failed primarily due to its concentration in commercial real estate loans. The bank's deficient credit risk management processes, combined with a rapid decline in economic conditions, resulted in a substantial volume of problem loans, significant loan losses, diminished earnings, and depletion of capital. Your report reflects your view that the OCC should not have approved Silverton's conversion to a national charter until weaknesses identified at the preconversion examination had been addressed. You also concluded, however, that subsequent to the bank's conversion, the OCC could have done nothing significantly different to prevent Silverton's failure and the material loss to the Deposit Insurance Fund.

We acknowledge that stronger controls are required to ensure the clarity of our charter conversion processes and the completion of examination requirements for newly converted banks. We are taking the following specific measures to address the recommendations included in your report.

Enhancements to the Charter Conversion Process and Post Conversion Supervision of Newly Converted National Banks

We will address three of your recommendations through modification of our standard procedures for processing and deciding charter conversion applications. These procedures are included in the Conversions booklet of the *Comptroller's Licensing Manual* (Conversions booklet) and will be enhanced as follows:

- We acknowledge the positive effect timely assignment of an Examiner in Charge (EIC) has on the continuous supervision of a newly converted national bank. To ensure the responsible supervisory office immediately appoints an EIC when a charter conversion is effective, the *Conversion Handoff Package* prepared by licensing staff upon transfer of supervisory responsibility will be expanded to include specific language calling attention to this requirement.

- As your report accurately states, the *Bank Supervision Process* booklet of the Comptroller's Handbook clearly describes the examination requirements for new charters and converted banks. In addition, the Conversions booklet outlines the key policies and application process for conversions to national bank charters, including a section on Post Conversion Supervisory Activities which provides the following guidance for the timing and scope of examinations of newly converted national banks:

> All converted *insured* national depository institutions, including converted insured trust banks, must receive full-scope examinations as prescribed by 12 USC 1820(d). Generally, an *insured* converted national bank must receive a full-scope examination within 12 months from the date of its last full-scope examination conducted by a federal banking agency or its last examination by its state regulator, if the examination met Federal Financial Institutions Examination Council (FFIEC) guidelines. The time period may be extended to 18 months from its last examination if the bank meets the standard statutory criteria for such an extension. The timing of the first full-scope examination may be influenced by whether a conversion examination was performed, if increased risks, concerns, or weaknesses are disclosed or if the converted bank is pursuing a nontraditional strategy.

  The final sentence of this section is intended to address circumstances where examinations should be performed in *less* than the maximum 12 or 18 month time period. However, the statement that the "timing of the first full scope examination may be influenced by whether a conversion examination was performed" could be misunderstood to mean that a preconversion examination "restarts the clock" for the 12 or 18 month examination due date. The Conversions booklet will be revised to clarify this requirement.

- The Conversions booklet currently states that licensing staff reviews the results of any conversion examination and comments from the supervisory office, discusses and resolves any matters identified in the examination report with the supervisory office, and sends any response from the converting bank's management to the supervisory office. As was the case with Silverton, there are often significant issues – identified by the OCC or prior regulators –that a converting bank must address before its application can be approved. We will revise the Conversion booklet to include a more thorough description of the procedures that should be followed to determine that banks seeking conversion satisfactorily address significant deficiencies before approval.

With respect to your fourth recommendation to formalize the process for second level reviews of charter conversion applications, your report acknowledges that during the audit exit conference Senior Deputy Comptroller for Midsize and Community Bank Supervision Jennifer Kelly stated that the districts (including Midsize Banks) have been instructed to charge their respective Supervisory Review Committees (SRCs) with performing second level reviews of charter

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conversion proposals prior to recommending approval of the application. To formalize the process, Deputy Comptrollers will ensure that SRC charters are amended to include this responsibility.

Actions in Response to the Lessons Learned Review of the Silverton Failure

We are in the process of shifting responsibility for performing lessons learned reviews of bank failures to the OCC's Ombudsman. This change will ensure that these important evaluations are independent and timely. The Ombudsman will also work with bank supervision management to ensure that appropriate actions are taken in response to findings of the lessons learned reviews.

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.

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Office of Management and Budget

OIG Budget Examiner

Federal Deposit Insurance Corporation

Chairman
Inspector General

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

Government Accountability Office

Acting Comptroller General of the United States