Audit Report

OIG-10-040

SAFETY AND SOUNDNESS: Material Loss Review of Peoples Community Bank

May 27, 2010

Office of Inspector General

Department of the Treasury

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OFFICE OF
INSPECTOR GENERAL

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

May 27, 2010

MEMORANDUM FOR **JOHN E. BOWMAN**
ACTING DIRECTOR

FROM: Susan Barron /s/
Director, Banking Audits

SUBJECT: Material Loss Review of Peoples Community Bank

INTRODUCTION

The Office of Thrift Supervision (OTS) closed Peoples Community Bank (PCB), West Chester, Ohio, and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on July 31, 2009. As of April 16, 2010, FDIC estimated that PCB's loss to the Deposit Insurance Fund was $136 million.

Under section 38(k) of the Federal Deposit Insurance Act, we are responsible for conducting a material loss review of the failure of PCB. To help fulfill this responsibility, we contracted with Mayer Hoffman McCann P.C. (MHM), an independent certified public accounting firm. MHM's report dated May 26, 2010, is provided as Section I.

RESULTS OF MATERIAL LOSS REVIEW

We concur with MHM's report that indicated:

- PCB failed primarily because of large concentrations in higher risk commercial real estate loans that resulted in large loan losses that led to the thrift having insufficient capital. While pursuing aggressive growth, PCB's board and management did not establish adequate risk management systems to properly monitor and manage elevated risks in its loan portfolio. As a result, when the real estate market began deteriorating in 2006, PCB was exposed to rapid asset quality deterioration and corresponding losses that ultimately led to the thrift's demise.

- OTS's supervisory actions complied with its guidance available at the time. However, the aggregate limit for higher risk loans in place from 2004 through 2006 was at a level that was too high to effectively reduce PCB's risk profile to a manageable level. There was little examination guidance available during this time frame to assist the examiners in their evaluation of the effectiveness of the limits set by PCB, which were proven to be excessive. As a result, OTS's supervision of PCB did not prevent a material loss to the Deposit Insurance Fund. An OTS internal failed bank review concluded that (1) supervision of the thrift could have been improved in the area of concentration limitations; (2) although underwriting, administration, and monitoring systems did improve between 2000 and 2004, the thrift continued to originate aggressively underwritten loans that placed a heavy reliance on continued strong collateral valuations in a concentrated segment of the market; and (3) the timing and nature of enforcement actions were generally considered to be effective. The material loss review affirmed OTS's first two findings.

Details of MHM's conclusions are in their report.

We also concur with MHM's recommendations in the report that:

- OTS ensure that action is taken on the lessons learned and that the recommendations made from OTS's internal review as documented in the Internal Failed Bank Review for PCB that was issued December 30, 2009, are implemented; and

- OTS work with its regulatory partners to determine whether to propose legislation and/or change regulatory guidance to establish limits or other controls for concentrations that pose an unacceptable safety and soundness risk and determine an appropriate range of examiner responses to high risk concentrations.

As a final note, we referred possible fraudulent activities involving two PCB loan transactions to the Treasury Inspector General Office of Investigations.

Please be advised that in accordance with Treasury Directive 40-03, "Treasury Audit Resolution, Follow-up, and Closure," OTS is responsible for taking corrective action on these recommendations. OTS should also record the recommendations and related actions in the Department of the Treasury's Joint Audit Management Enterprise System.

We are providing, as Section II, a listing of recommendations made as a result of completed material loss reviews of OTS-regulated institutions during the current economic crisis. Section III identifies the recipients of this report.

OBJECTIVES, SCOPE, AND METHODOLOGY

Under section 38 (k), we are responsible to prepare a report to OTS that (1) ascertains why PCB's problems resulted in a material loss to the Deposit Insurance Fund; (2) reviews OTS's supervision of the institution, including its implementation of the prompt corrective action provisions of section 38(k); and (3) 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.

To help fulfill this responsibility, we contracted with MHM to perform a material loss review in accordance with generally accepted government auditing standards. We evaluated the nature, extent, and timing of the work; monitored progress throughout the audit; reviewed the documentation of MHM; met with partners and staff members; evaluated the key judgments; met with OTS officials; performed independent tests of OTS supervisory records; and performed other procedures we deemed appropriate in the circumstances. We conducted our work in accordance with generally accepted government auditing standards.

Should you wish to discuss the report, you may contact me at (202) 927-5776.

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Section I

Mayer Hoffman McCann P.C.'s Report on the Material Loss Review of Peoples Community Bank

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Peoples Community Bank
Material Loss Review
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Abbreviations

ADC	Acquisition, Development, and Construction
ALLL	Allowance for Loan and Lease Losses
C&D	Cease and Desist Order
CEO	Chief Executive Officer
CRE	Commercial Real Estate
FDIC	Federal Deposit Insurance Corporation
LTV	Loan-To-Value
MOU	Memorandum of Understanding
MRBA	Matters Requiring Board Attention
OIG	Office of Inspector General
OTS	Office of Thrift Supervision
PCA	Prompt Corrective Action
PCB	Peoples Community Bank
ROE	Report of Examination
TFR	Thrift Financial Report

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Inspector General
Department of the Treasury

RE: Transmittal of Results for the Material Loss Review Report for Peoples Community Bank, West Chester, Ohio.

This letter is to acknowledge delivery of our performance audit report of the Material Loss Review for Peoples Community Bank (PCB). The objectives of this performance audit were to: (1) determine the causes of PCB's failure and resulting material loss to the Deposit Insurance Fund and (2) evaluate the Office of Thrift Supervision's supervision of PCB, including the implementation of the Prompt Corrective Action (PCA) provisions of section 38.

The performance audit results are in the accompanying performance audit report. The information included in this report was obtained during our fieldwork, which occurred during the period from October 8, 2009 through December 23, 2009.

We conducted our 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

We also included several appendices to this report. Appendix 1 contains a more detailed description of our material loss review objectives, scope, and methodology. Appendix 2 contains background information on PCB's history and OTS's supervision process. Appendix 3 provides a glossary of terms used in this report. The terms defined in the glossary are underlined the first time they are used in the report. Appendix 4 contains a chronology of significant events related to PCB's history and OTS's supervision. Appendix 5 shows examinations of PCB by OTS from 2003 through 2009. Appendix 6 provides OTS's comments regarding the report's recommendations.

Leawood, Kansas
May 26, 2010

Mayer Hoffman McCann P.C.

Results in Brief

Peoples Community Bank (PCB or thrift) failed primarily because of large concentrations in higher risk commercial real estate (CRE) loans, such as one-to-four family non-owner occupied, construction and land development, unsecured lines of credit, and high loan-to-value (LTV) loans that resulted in large loan losses that led to the thrift having insufficient capital. PCB pursued an aggressive growth strategy, with a focus on higher risk loans. As a result of acquiring three thrifts and one bank as well as growth from existing operations, PCB grew from $416 million in total assets in 2001 to over $1 billion in total assets in 2005. While pursuing aggressive growth, PCB's board and management did not establish adequate risk management systems to properly monitor and manage elevated risks in its loan portfolio. As a result, when the real estate market began deteriorating in 2006, PCB was exposed to rapid asset quality deterioration and corresponding losses that ultimately led to the thrift's demise.

The Office of Thrift Supervision (OTS) recognized risks associated with the thrift's higher risk lending strategy early. Examiners noted in the April 2003, June 2004, and May 2005 examinations the higher risk loan portfolio and concentration risks and directed PCB to establish an aggregate limit for higher risk loans. During the July 2006 examination, OTS recommended certain corrective actions through Matters Requiring Board Attention (MRBA) to address concerns with PCB's deterioration in asset quality resulting from its high exposure to a declining real estate economy. As a result of rapid deterioration of asset quality during 2006, OTS downgraded PCB in November 2006 from a composite CAMELS rating of 2 to 3. OTS initiated enforcement actions on March 31, 2007, when it issued a Memorandum of Understanding (MOU) followed by a cease and desist (C&D) order on April 2, 2008. We concluded that OTS was monitoring concentrations in higher risk loans consistent with existing examination guidance and issuing corrective actions as asset quality deteriorated. However, the aggregate limit for higher risk loans in place from 2004 through 2006 was at a level that was too high to effectively reduce PCB's risk profile to a manageable level. There was little examination guidance available during this time frame to assist the examiners in their evaluation of the effectiveness of the limits set by PCB, which were proven to be excessive. As a result, OTS's supervision of PCB did not prevent a material loss to the Deposit Insurance Fund.

In 2008, once PCB's capital level dropped below well-capitalized,[1] OTS appropriately used its authority under prompt corrective action (PCA). Specifically, on November 12, 2008, OTS sent a PCA notice to the board informing it that its capital level had declined to adequately capitalized. In 2009, once PCB's capital level dropped to significantly undercapitalized, a second PCA notice was sent to the board on April 14, 2009 requiring the submission of a capital restoration plan by April 30, 2009.

OTS conducted an internal failed bank review of PCB in accordance with OTS policy. The internal review found that PCB's failure primarily resulted from high levels of problem assets that steadily eroded capital. OTS's review concluded that (1) supervision of the thrift could have been improved in the area of concentration limitations; (2) although underwriting, administration, and monitoring systems did improve between 2000 and 2004, the thrift continued to originate aggressively underwritten loans that placed a heavy reliance on continued strong collateral valuations in a concentrated segment of the market; and (3) the timing and nature of enforcement actions were generally considered to be effective. Our material loss review affirmed OTS's first two findings. We also agree that the OTS's supervisory actions complied with its guidance available at the time, however; its supervision did not prevent the thrift's failure.

The Treasury OIG has reported on excessive concentrations in higher risk real estate loans and a lack of strong supervisory responses in a number of their material loss reviews during the current crisis. OTS issued guidance to thrifts in July 2009 regarding asset and liability concentrations and related risk management practices. The guidance reemphasizes important risk management practices and encourages financial institutions to revisit existing concentration policies in light of the current economic environment. While we believe the guidance is better than what had been available to thrifts previously, it is

[1] 12 U.S.C. § 1831o establishes a tiered framework that classifies institutions' capital levels. An Institution's Total Risk-Based Capital Ratio must be higher than 10 percent to be considered well-capitalized. PCB reported a Total Risk-Based Capital ratio of 8.71 percent on November 7, 2008 when it amended its TFR report. Refer to Table 1 for a history of PCB's regulatory capital levels.

too soon to tell at this point whether the guidance will be effective at controlling risky concentrations going forward. Furthermore, there has been no recent update to examiner procedures that would identify a trigger point where concentrations are excessive from a safety and soundness perspective nor provide examiners a range of responses to address excessive concentrations. This is an area we believe requires continued OTS management action.

We are recommending: 1) OTS ensure that action is taken on the lessons learned and that the recommendations made from OTS's internal review as documented in the Internal Failed Bank Review for PCB's that was issued December 30, 2009 are implemented; and 2) OTS work with its regulatory partners to determine whether to propose legislation and/or change regulatory guidance to establish limits or other controls for concentrations that pose an unacceptable safety and soundness risk and determine an appropriate range of examiner response to high risk concentrations.

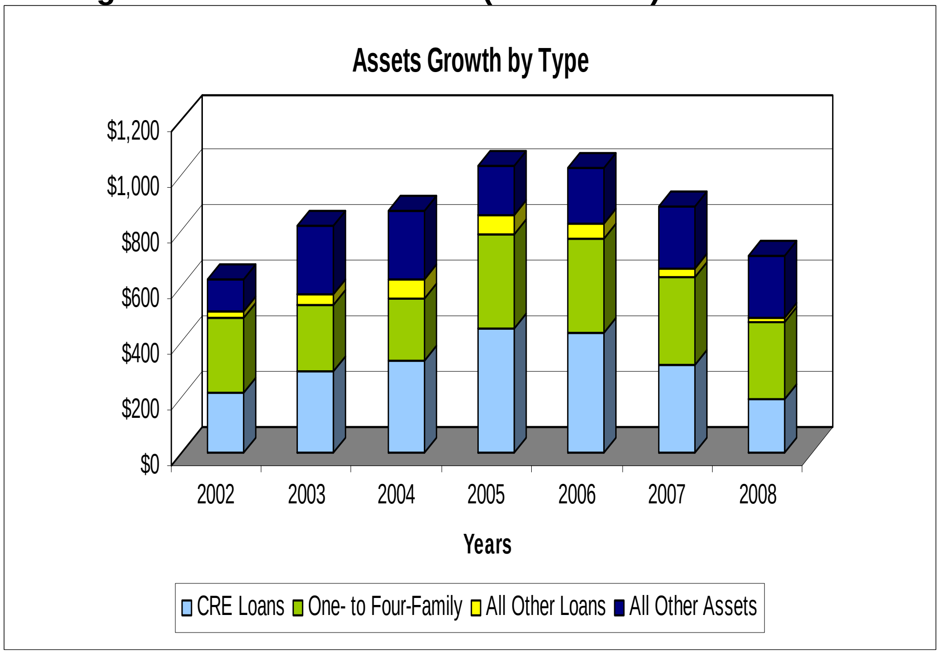
Causes of PCB's Failure

While pursuing aggressive growth, PCB's board and management did not establish adequate risk management systems to properly monitor and manage elevated risks in its loan portfolio. Policies in place for LTV and minimum debt service coverage ratios were often ignored as PCB's management routinely approved loans as exceptions to PCB's lending standards.

Aggressive Growth

PCB had an aggressive growth strategy that focused on two drivers. The first driver was PCB's acquisitions during 2003 through 2006 of $340 million of assets through the purchase of three thrifts and one bank branch in the southern Ohio and southeast Indiana markets. The second driver was PCB's focus on growing its existing asset base by generating higher risk loans such as one-to-four family non-owner occupied mortgage loans, construction and land development loans, and unsecured commercial and consumer lines of credit. As illustrated in Figure 1, much of the thrift's growth occurred in 2005 through the first half of 2006 through the acquisition of two thrifts.

Figure 1. Growth in Assets (in millions)



Source: Analysis from the Federal Deposit Insurance Corporation (FDIC) Statistics on Depository Institutions

Starting in mid-2006, PCB management, responding to examination concerns raised by OTS as well as declining economic conditions, altered its growth strategy and sought to decrease its asset base in order to preserve capital and reduce its real-estate concentrations. The thrift's efforts to shrink its balance sheet by selling existing loans and slowing the origination of riskier loans were ultimately insufficient to prevent its failure.

PCB's CRE Concentrations Were High Risk

In December 2006, OTS issued "Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices,"[2] to clarify to its examiners that institutions actively engaged in CRE lending should (1) assess their concentration risk and (2) implement appropriate risk management policies to identify, monitor, manage, and control their concentration risks. The 2006 CRE guidance set forth two benchmarks for identifying institutions with CRE

[2] In December 2006, OTS issued guidance entitled, "Concentrations in Commercial Real Estate Lending, Sound Management Practices," which set forth benchmarks for identifying CRE loan concentrations. One of the benchmarks was defined as commercial real estate loans that represent 300 percent or more of total capital.

loan concentrations that may warrant greater supervisory scrutiny. Such institutions are those for which:

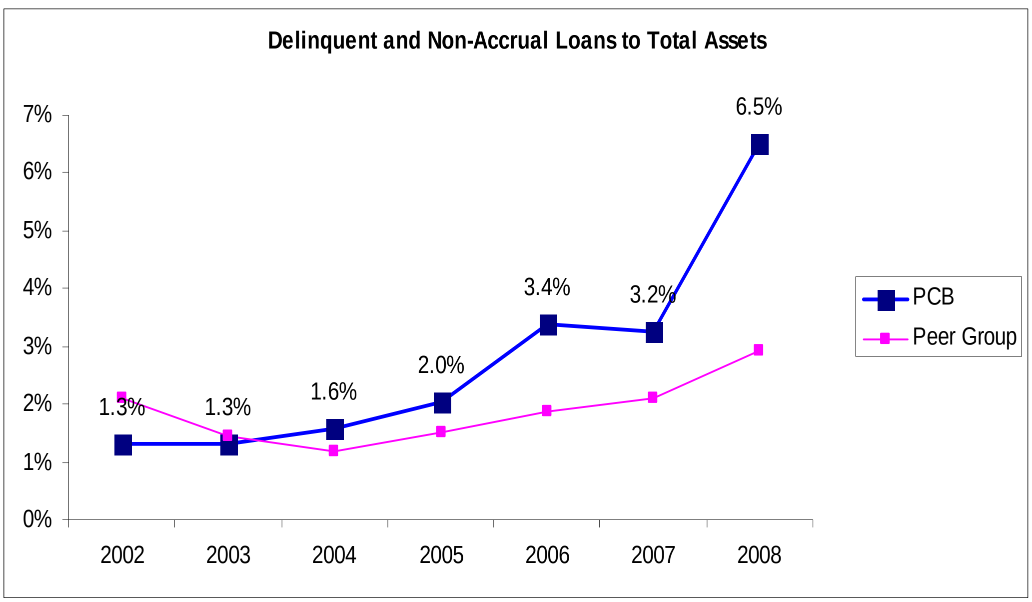
- Loans for construction, land development, and other land exceed 100 percent of total capital; or

- Total CRE loans exceed 300 percent of total capital.

PCB primarily achieved loan growth through originations of real-estate loans in the Cincinnati area, including construction and land development loans and one-to-four family residences that were not occupied (non-owner occupied). The growth in real estate loans lead to significant levels of CRE concentration risk. At June 30, 2006, the thrift's concentration of construction and land development loans was 217 percent of capital while its total CRE loan portfolio (construction, land development, and other real estate loans secured by multifamily and non-owner occupied property) was 457 percent of capital.

As shown in figure 2, the thrift experienced high levels of non-performing loans compared to its peers[3].

Figure 2. PCB's Delinquent and Non-Accrual Loans to Total Assets



Source: FDIC Statistics on Depository Institutions

[3] For purposes of Figure 2, Peer Group consists of similar sized institutions located in the Chicago FDIC supervisory region with assets ranging from $400 million to $1 billion.

The thrift's ratio of delinquent and non-accrual loans to total assets exceeded its peer group – a further indication that PCB's concentration in higher-risk loans was adversely affecting its levels of non-performing loans.

Ineffective Controls Over CRE Concentrations

The 2006 CRE guidance describes risk management practices an institution is expected to have in place to pursue CRE lending in a safe and sound manner. When concentrations in CRE 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. 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

PCB's board and management failed to implement the risk management processes necessary to control the thrift's growth and concentration levels and to maintain adequate capital levels. Examiners expressed concerns with asset quality in the July 2006 report of examination (ROE) and directed PCB through MRBAs to address the following:

- Adopt a board resolution establishing an action plan for reduction of adversely classified assets,

- Evaluate the adequacy of the board established loan portfolio diversification limits,

- Strengthen the underwriting standards that contribute to the concentration of regulatory LTV exceptions that magnify the concentration risk of Acquisition, Development and Construction (ADC) loans,

- Develop appropriate reports for monitoring the key risks in the loan portfolio, and
- Evaluate the adequacy of the internally established minimum Total Risk-Based Capital ratio and the adequacy of the components of total capital.

During our review of the 2005 and 2006 board minutes, we noted the following instances where the board elected to allow exceptions to its own lending policies, including:

1) approved ADC loans with no personal guarantees,
2) approved ADC loans with 100 percent LTV,
3) approved loans that exceeded the thrift's LTV limit, and
4) approved loans to borrowers to finance construction of speculative residential homes when the borrowers' existing inventory of speculative homes already exceeded the thrift's policy limits.

Inadequate Capital Levels

PCB incurred net operating losses from 2006 through 2009. Prior to 2006, the thrift was marginally profitable with less return on assets when compared to peers. However, declining asset quality caused capital to steadily decrease. Over time, the operating losses eroded PCB's capital until eventually the thrift became critically undercapitalized. The following table shows PCB's capital ratios and the dates of significant regulatory actions by OTS from December 2003 to June 2009.

Table 1. PCB's Capital Levels

Date of Report	Percent: Total Risk-Based Capital Ratio	Tier 1 Risk-Based Capital Ratio	Tier 1 Leverage Capital Ratio	Regulatory Capital Category[1]
12/31/2003	11.60	10.30	6.80	Well capitalized
12/31/2004	13.40	12.10	8.60	Well capitalized
12/31/2005	12.00	10.80	8.20	Well capitalized
12/31/2006	12.59	11.32	8.50	Well capitalized
12/31/2007	11.30	10.00	7.01	Well capitalized
3/4/2008	OTS sent notice of Troubled Condition			
3/31/2008	11.55	10.24	7.09	Well capitalized
4/2/2008	OTS issued a C&D order			
6/30/2008	12.28	10.97	7.94	Well capitalized
9/30/2008 (as amended 11/7/2008)[2]	8.71	7.41	5.09	Adequately capitalized
11/12/2008	OTS issued a PCA notice			
12/31/2008 (as amended 4/9/2009)[3]	4.81	3.50	2.23	Significantly Undercapitalized
3/31/2009	4.15	2.82	1.81	Critically Undercapitalized
4/14/2009	OTS issued a PCA notice			
4/29/2009	OTS issued an amended C&D order			
6/30/2009	1.11%	0.55%	0.37%	Critically Undercapitalized

Source of information: Thrift Financial Report (TFR) reports obtained from FFIEC website

[1] *Thrifts must maintain a minimum Total Risk-Based Capital ratio of 10 percent, Tier 1 Risk-Based Capital Ratio of 6 percent, and Tier 1 Leverage Capital Ratio of 5 percent to be considered well-capitalized. A November 2005 board resolution, however, committed PCB to maintain a 12 percent Total Risk-Based Capital Ratio and 8 percent Tier 1 Risk-Based Capital Ratio.*
[2] *TFR amended after PCB's independent auditor recommended that held-for-sale criticized loan portfolio must be fair valued, resulting in $21.6 million adjustment.*
[3] *TFR amended as a result of independent audit adjustment to loan loss provision of $21.3 million.*

Given the thrift's high levels of higher risk lending, OTS commented in its 2005 examination that PCB should maintain capital levels in excess of the statutory levels to be considered well-capitalized. The board responded in November 2005 when it adopted a resolution committing the thrift to maintaining Tier 1 Risk-Based Capital levels of 8 percent and total Risk-Based Capital levels of 12 percent. As shown in Table 1 above, by December 31, 2007, the thrift was unable to maintain the capital levels required by the resolution as total Risk-Based Capital was 11.3 percent ($68,335,000), below the required 12 percent ($72,152,000). Net operating losses attributed primarily to the provision for loan losses charged to earnings was the primary reason the thrift was unable to maintain the required capital levels.

Effect of Real Estate Downturn

PCB had a significant geographic concentration of real estate loans in Ohio and Indiana which accounted for approximately 75 percent and 14 percent respectively of the thrift's total loans outstanding at December 31, 2008. The metropolitan areas of Cincinnati, Westchester, and Lebanon accounted for the majority of PCB's loans in Ohio.

PCB significantly increased its CRE lending in the Cincinnati market just as the region began experiencing an economic downturn. The unemployment rate for metropolitan Cincinnati had been lower than the national average from 1999 through 2005. However, by October 2006, the loss of manufacturing jobs in the region increased the metropolitan's unemployment rate to 4.7 percent while the national average rate was 4.4 percent.[4] Since then, Cincinnati's unemployment rate has continued to increase with the national average. In July 2009, when the thrift was closed, Cincinnati's metropolitan unemployment rate was 10.4 percent, while the U.S. average was 9.7 percent.[5] The region's growing unemployment rate accentuated the real-estate market decline, stressing the thrift's loan portfolio which caused an increase in criticized and non-performing loans. The deterioration in loan quality led to increases in the allowance for loan and lease loss (ALLL), and impairment of other real estate owned which stressed net income and eroded capital.

OTS's Supervision of PCB

We concluded that OTS was generally following existing examination guidance in its supervision of PCB. At OTS's direction PCB did establish aggregate limits on total higher risk assets to manage concentrations in CRE and other

[4] Cleveland District Federal Reserve Board December 2006, "Economy in Perspective"
[5] As reported by Cincinnati Regional Chamber of Commerce

higher risk loans. However, those limits were very high and ineffective at reducing PCB's risk profile to a manageable level.

Supervisory History

Table 2 summarizes the results of OTS's safety and soundness examinations from ROEs starting with the 2003 examination cycle.[6] Appendix 5 provides the details of the MRBAs.

Table 2. Summary of OTS Examinations

Date Started	Scope	CAMELS Rating	Number of MRBAs	Number of Corrective Actions	Enforcement Actions
4/07/2003	Full Scope	2/223221	12	15	None
6/15/2004	Full Scope	2/222221	3	4	None
5/16/2005	Full Scope	2/222221	8	15	None[1]
7/17/2006	Full Scope	2/232222	8	15	None
11/17/2006	Off-Site Downgrade	3/332322	N/A	N/A	MOU Effective 4/21/2007
9/10/2007	Full Scope	3/343421	6	N/A	None
4/07/2008	Off-Site Downgrade	4/343421	N/A	N/A	None
2/09/2009	Full Scope	5/554544	6	8	Amended C&D effective 4/29/2009

Source: OTS ROEs
[1] As noted earlier, PCB's board adopted a resolution on November 10, 2005, to maintain Core Capital levels of 8 percent and Risk-Based Capital levels of 12 percent

Table 3 shows a summary of the types of comments requiring management's attention from each examination during the period reviewed.

[6] OTS conducted its examinations and performed off-site monitoring of PCB in accordance with the timeframes prescribed in OTS Examination Handbook.

Table 3. Summary of MRBAs by Topic

Section	Comment	2003	2004	2005	2006	2007	2009	Grand Total
Asset Quality	ALLL				1	1	1	3
	Classified Assets	3			1		1	5
	Concentrations				1	2		3
	Internal Asset Review	1		1	1	1	1	5
	Stock Loans			1				1
	Underwriting	3			1			4
Capital	Business Plan		1	1				2
	Capital Adequacy	1			1			2
Compliance	Compliance			1			1	2
Earnings	Concentrations				1			1
Liquidity	Business Plan			1				1
	Liquidity	1		3				4
Management	Business Plan					1	2	3
	Compliance	1						1
	Concentrations					1		1
	Disaster Recovery Plan	1	1					2
	Management		1					1
	Underwriting	1						1
Sensitivity to Market Risks	Sensitivity to Market Risks				1			1
Grand Total		**12**	**3**	**8**	**8**	**6**	**6**	**43**

Source: OTS ROEs

OTS recognized the significance of the economic downturn on PCB late in 2006 when it downgraded the CAMELS composite rating in November 2006 to 3. During the 2006 examination, OTS observed significant weaknesses with the thrift's asset quality, management, and earnings. In the ROE, examiners expressed concerns regarding high risk loan concentrations, internal loan review effectiveness, ALLL adequacy and methodology, earning performance, and liquidity monitoring.

OTS imposed one informal action and two formal actions between 2007 and the thrift's failure. A discussion of these actions follows:

- OTS entered into a MOU on March 21, 2007, in response to the findings of the 2006 examination and directed management to halt its growth, curtail non-homogenous lending, reduce the thrift's risk profile, increase the ALLL, and address all MRBAs identified in the examination.
- OTS imposed a C&D order against PCB on April 2, 2008. The C&D order resulted from the onset of adverse market conditions that were negatively impacting PCB's higher risk lending. The C&D order required an updated asset reduction plan; a revised

business plan; a third party loan review with a lower asset base from the current independent review; and the submission of quarterly variance reports to OTS. The C&D order further restricted dividend payments, required prior notice of changes in directors and the senior executive officer, employment contracts, and other compensation arrangements, and restricted payment of a golden parachute or prohibited indemnification.

- OTS amended the C&D order with PCB on April 29, 2009, in response to the significant decline in capital reported by PCB in an amended TFR for the quarter ended December 31, 2008 filed on April 9, 2009. In that TFR, PCB reported that it was significantly undercapitalized. The thrift was now required to meet and maintain a Tier 1 Risk-Based Capital Ratio of at least 8 percent and a Total Risk-Based Capital Ratio of 12 percent by July 14, 2009.

Aggregate Limit for Higher Risk Loans Proved to be Ineffective

As part of their examinations, OTS monitored PCB's high concentration levels in CRE and other higher risk loans. In its April 2003 examination, OTS noted that PCB's internal limits for individual loan categories appeared reasonable; however, the board had not established an overall aggregate limit for higher risk loans. In a MBRA to the thrift, OTS stated such a limitation should consider the aggregate levels of higher risk loans relative to total assets as well as capital levels.

In response, PCB's board established an aggregate limit for higher risk loans in May 2004 of 800 percent of Risk-Based Capital plus excess ALLL and 75 percent of total assets. Higher risk loans included in the calculation consisted of:

- One-to-Four Family Non-Owner Occupied Real Estate
- Multifamily Real Estate
- Lots and Land – CRE
- Land Development
- Commercial Loans
- Stock Loans
- Consumer Loans
- Unsecured Line of Credits

In the June 2004 examination, the examiners commented on the previous examination recommendation and confirmed that the systems and procedures for managing the higher risk loan types were greatly improved and expanded compared to the findings reported in the April 2003 examination. In the May 2005 examination, examiners noted that PCB was in compliance with its aggregate limitation on total higher risk assets, but made no other comment on the adequacy of the limits.

The aggregate limit for higher risk loans set by the board did not meaningfully reduce PCB's overall risk exposure. At March 31, 2005, the thrift was in compliance with its internal limits, however; higher risk loans constituted 701.7 percent of Risk-Based Capital plus excess ALLL – more than twice the amount that 2006 guidance would eventually identify as possible CRE concentration risk. The board's internal limits proved to be ineffective beginning in 2006 when local real estate collateral values started to decline, reducing the thrift's asset quality to unmanageable levels.

In interviews with the examiners, we asked whether they had assessed the adequacy of the aggregate limit for higher risk loans set by PCB. The examiners responded that PCB likely established the initial aggregate limit for higher risk loans based on the levels in their portfolio at the time, but that OTS was comfortable with the initial limits set by PCB based on the low levels of classified assets and overall economic conditions at the time. The examiners stated that they were performing quarterly monitoring of PCB with the understanding that the aggregate limits should change with deterioration in asset quality or economic conditions. OTS began placing more restrictions on asset concentrations beginning in 2006 once classified assets began increasing. Specifically, in the July 2006 examination, an MRBA directed PCB to evaluate the adequacy of the board-established aggregate limit on higher risk loans to reduce these limits in light of the fact that further growth in the concentration of higher risk assets was inappropriate given the high level of problem assets. PCB management responded by decreasing its asset base in order to preserve capital and reduce its real-estate concentrations by selling existing loans and slowing the origination of riskier loans.

Prior to the 2006 CRE Guidance, there was only limited examination guidance available on CRE Concentrations. OTS Examination Handbook Section 201, "Overview, Lending Operations and Portfolio Risk Management (Examination Handbook), June 2005," discusses concentrations of credit. Section 201 indicates that the board of directors should establish limits on and monitor the thrift's concentrations.

We concluded that OTS monitored concentrations in higher risk loans consistent with existing examination guidance and increased its corrective actions as asset quality deteriorated in 2006 and additional guidance was issued with the 2006 CRE Guidance. The Examination Handbook that examiners relied on prior to the 2006 guidance did not identify specific levels of concentrations that may warrant greater supervisory scrutiny, accordingly, evaluation of the aggregate limit for higher risk assets set by PCB was based primarily on examiner judgment. The 2006 CRE Guidance helps support that the level of concentrations carried by PCB were high risk, however, the Guidance does not establish specific CRE lending limits beyond the statutory limit. It notes that all thrifts actively engaged in CRE lending are responsible for assessing and managing their CRE concentration risk.

We concluded that the aggregate limit for higher risk loans in place from 2004 through 2006 was at a level that was too high to effectively reduce PCB's risk profile to a manageable level. Had additional examination guidance been available from 2004 through 2006, the examiners may have taken stronger action in supervising PCB and addressing the high levels of concentrations.

The Treasury OIG has reported on excessive concentrations in higher risk real estate loans and a lack of strong supervisory responses in a number of their material loss reviews during the current crisis. To address the need for more guidance on concentration limits, OTS issued guidance to thrifts in July 2009 regarding asset and liability concentrations and related risk management practices.[7] The guidance reemphasizes important risk management practices and encourages financial institutions to revisit

[7] Chief Executive Officer (CEO) Letter No. 311, Risk Management: Asset and Liability Concentrations (July 9, 2009)

existing concentration policies in light of the current economic environment. The guidance informs thrifts that OTS examiners will scrutinize high risk concentrations and pursue appropriate corrective or enforcement action when an institution does not maintain appropriate concentration limits or takes excessive risks. The guidance states that OTS will monitor institutions with a concentration exceeding 100 percent of core capital plus ALLL. While we believe the guidance is better than what had been available to thrifts previously, it is too soon to tell at this point whether the guidance will be effective at controlling risky concentrations going forward. Furthermore, there has been no recent update to examiner procedures that would identify a trigger point where concentrations are excessive from a safety and soundness perspective nor provide examiners a range of responses to address excessive concentrations.[8] This is an area we believe requires continued OTS management action.

PCA Was Taken by OTS as PCB's Capital Levels Fell

The purpose of PCA is to resolve the problems of insured depository institutions with the least possible long-term loss to the Deposit Insurance Fund.[9] PCA provides federal banking agencies with the authority to take certain actions when an institution's capital drops to certain levels. PCA also gives regulators flexibility to discipline institutions based on criteria other than capital to help reduce deposit insurance losses caused by unsafe and unsound practices. For example, OTS's Enforcement Action Policy allows for the imposing of more severe limitations than a thrift's PCA capital category would otherwise permit or require if it is determined that the thrift is operating in an unsafe or unsound condition or engaging in unsafe or unsound practices.

We concluded that OTS appropriately used its authority under PCA and took the appropriate steps timely as the thrift's capital levels fell.

- On March 4, 2008, OTS sent a Troubled Condition letter to the thrift after it was unable to meet and

[8] The last update to the OTS Examination Handbook pertaining to this subject was in June 2005. That update required examiners to identify asset concentrations over 25 percent of total risk-based capital or 2 percent of assets in ROEs.
[9] 12 U.S.C. Sec. 1831o and 12 C.F.R. Sec. 6

maintain minimum capital levels pursuant to its board resolution.

- On November 12, 2008, OTS issued a PCA notice to PCB's board informing it that based on its amended September 30, 2008 TFR filed in November 2008, PCB's Tier 1 Risk-Based Capital ratio had dropped to 5.09 percent and total risk-based capital had declined to 8.71 percent. As such the thrift was considered adequately capitalized. PCB's independent auditors informed the thrift that because of its on-going negotiations to sell a portion of its loan portfolio, it would need to move the loans to held-for-sale status and mark them to market. This prompted PCB to amend its TFR to report additional losses caused by mark-to-market accounting for its held-for-sale loan portfolio. [10]
- On April 14, 2009, OTS sent a PCA notice to PCB's board regarding the thrift's significantly undercapitalized status based on its amended December 31, 2008 TFR. The TFR was amended after PCB's independent auditors proposed an audit adjustment to increase the allowance for loan losses. The PCA notice required the submission of a capital restoration plan by April 30, 2009. The capital restoration plan was submitted as required on April 30, 2009. The plan was based solely on the strategy to sell numerous branches. OTS deemed the plan incomplete and not viable and denied the capital restoration plan.

OTS's Internal Failed Bank Review Identified Key Lessons Learned

OTS policy is to conduct an internal failed bank review. The purpose of the review is to examine causes of the thrift's failure, identify lessons learned for OTS staff, and provide recommendations where OTS internal guidance could be strengthened based upon the review. While these reviews are not independent, we believe they are useful in providing OTS senior management additional insight into failures and

[10] Generally accepted accounting principles require held for sale loan portfolios to be carried at the lower of cost or fair value. In order to reduce its exposure to CRE, the thrift was marketing loans that had experienced credit and/or market deficiencies, therefore; it was offering the portfolio at less than par.

needed supervisory improvement outside of and before the completion of statutorily required material loss reviews.

OTS issued its Internal Failed Bank Review report for PCB on December 30, 2009. The review found that the immediate cause of PCB's failure was caused by high levels of problem assets that steadily eroded capital. From their review, OTS identified the following key lessons learned.

1. The primary areas where the supervision of this thrift could have been improved were focused in the area of concentration limitations. Examiners and regional management viewed the thrift's concentrations as risk factors, but the limitations established by the thrift did not meaningfully restrict the level of risk exposure.

2. Although underwriting, administration, and monitoring systems did improve between 2000 and 2004, the thrift continued to originate aggressively underwritten loans that placed a heavy reliance on continued strong collateral valuations in a concentrated segment of the market. Effective and timely implementation of enhanced risk management systems at this institution should have identified the level of reliance on collateral valuations, and helped shape the thrift's strategic direction to control that risk. The extent of the thrift's use of stress testing was limited to an underwriting exercise that gauged the effect of a 200 basis point increase in interest rates on the borrower's debt service coverage ratios.

3. The timing and nature of enforcement actions were generally considered to be effective, though they did not prevent the failure.

From their review, OTS made the following recommendations.

1. Excessive concentrations of risk were a major contributor to the thrift's failure. Many of the thrift's loan portfolios exposed the thrift to falling home prices, and the aggregated risk of these concentrations ultimately led the thrift to failure. As recommended in other Failed Bank Reviews, OTS examination and supervisory staff should consider higher capital requirements as well as absolute limitations of higher-risk lending concentrations. Such

concentrations must also be considered in aggregate, as many concentrations will behave in similar ways in a stressed market. This recommendation has been made in numerous previous Failed Bank Reviews, and is appropriately addressed within Chief Executive Officer (CEO) Letter #311, issued on July 9, 2009.

2. Revise Examination Handbook Section 209 to provide prescriptive guidance to examiners for sampling and policy review when a high level of policy exceptions are identified through institution's tracking reports or examiner loan reviews. In these cases, guidance should not allow reliance on the institution's loan review function to supplement examination sample coverage, and the policy review should consider that policies do not reflect institution practice.

3. CEO Letter No. 311 should be expanded to clearly convey expectations for the approach for completed stress test analysis, including assessing the impact of multiple simultaneous stresses and consideration of possible correlations between risks.

Based on our review of the examination records and reports and interviews with OTS staff, we affirm OTS's internal findings regarding improved supervision of concentration limits and enhanced risk management systems. We also agree that the OTS's supervisory actions complied with its guidance available at the time; however; its supervision did not prevent the thrift's failure. Excessive concentrations of risk was clearly a major cause of failure and examiners did not have clear guidance on what levels of concentrations posed excessive risk. In addition, we agree that CEO Letter No. 311 re-emphasizes important risk management practices with respect to concentration issues, and that additional guidance on stress testing would be useful. We also agree that Handbook Section 209 provide prescriptive guidance to examiners regarding sampling and policy review when high levels of policy exceptions are identified. We are also recommending that additional guidance be considered, including guidance on when to impose absolute limits to prevent excessive concentration.

As stated earlier, while we recognize that additional guidance has been issued to thrifts on concentration issues as in the CEO letter mentioned above, it is too soon to tell whether that guidance is effective. The success of this guidance to prevent or mitigate conditions that led to PCB's failure and loss to the Deposit Insurance Fund is dependent on its consistent and faithful implementation by thrifts and assertive regulatory intervention when unsound and unsafe practices are found in both good and bad times. This is a point that cannot be emphasized enough. Additionally, the CEO Letter and existing examiner guidance does not address at what levels concentrations are unsafe and unsound.

Recommendations

As a result of our material loss review of PCB, we recommend that OTS do the following:

1. Ensure that action is taken on the lessons learned and that the recommendations made from OTS's internal review as documented in the Internal Failed Bank Review for PCB's that was issued December 30, 2009 are implemented.

   Management Response
   OTS concurred with the above recommendation and ensured that recommended actions from the Internal Failed Bank Review of thrift are implemented in a timely manner. OTS had already taken action on one of the Internal Failed Bank Review's recommendations by issuing CEO Letter No. 311 "Risk Management: Asset and Liability Concentrations" in July 2009, to address asset and liability concentrations and related risk management practices.

   Mayer Hoffman McCann P.C. Comment
   The implementation of the recommendation is the responsibility of OTS management.

2. Work with its regulatory partners to determine whether to propose legislation and/or change regulatory guidance to establish limits or other controls for concentrations that pose an unacceptable safety and soundness risk and determine an appropriate range of examiner response to high risk concentrations.

Management Response

OTS responded that it works with other regulators and the Federal Financial Institutions Examination Council to develop guidance on a variety of subjects where common issues and/or concerns exist. OTS ensured that it would continue to review the situation and interface with regulatory partners to determine whether to propose legislation or change regulatory guidance for concentrations that pose an unacceptable level of risk.

Mayer Hoffman McCann P.C. Comment

The implementation of the recommendation is the responsibility of OTS management.

Our objectives were to determine the causes of Peoples Community Bank's (PCB) failure and assess the thrift's supervision by the Office of Thrift Supervision (OTS). We conducted this material loss review of PCB under contract with the Department of the Treasury Office of Inspector General (OIG) in response to its mandate under section 38(k) of the Federal Deposit Insurance Act.[11] 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 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.

The OIG contracted with our firm to conduct this material loss review of PCB based on the loss estimate by the Federal Deposit Insurance Corporation (FDIC). As of April 16, 2010, FDIC estimated that the loss to the Deposit Insurance Fund from PCB's failure would be $136 million.

To accomplish our review, we conducted fieldwork at OTS's headquarters in Washington, D.C.; it's Central Regional Office in Chicago; and PCB former headquarters in West Chester, Ohio. We also interviewed officials and examiners at FDIC's Division of Supervision and Consumer Protection in Chicago, contract personnel at FDIC's Division of Resolutions and Receivership, and conducted telephone interviews of OTS personnel who worked on the PCB examinations and work from OTS's field office in Cincinnati, Ohio. We conducted our fieldwork from October 2009 through January 2010.

To assess the adequacy of OTS's supervision of PCB, we determined (1) when OTS first identified PCB's safety and soundness problems, (2) the gravity of the problems, and (3) the supervisory response OTS

[11] 12 U.S.C. § 1831o(k).

took to get the thrift to correct the problems. We also assessed whether OTS (1) might have discovered problems earlier; (2) identified and reported all the problems; and (3) issued comprehensive, timely, and effective enforcement actions that dealt with any unsafe or unsound activities. Specifically, we performed the following work:

- We determined that the time period relating to OTS's supervision of PCB covered by our audit would be from January 1, 2003 through PCB's failure on July 31, 2009. This period included six full-scope safety and soundness examinations prior to the OTS's April 2009 amended C&D.

- We reviewed OTS's supervisory files and records for PCB from 2003 through 2009. We analyzed examination reports, supporting workpapers, and related supervisory and enforcement correspondence. We performed these analyses to gain an understanding of the problems identified, the approach and methodology OTS used to assess the thrift's condition, and the regulatory actions OTS used to compel thrift management to address deficient conditions. We did not conduct an independent or separate detailed review of the external auditors' work or associated workpapers other than those incidentally available through the supervisory files.

- We interviewed and discussed various aspects of the supervision of PCB with OTS officials and examiners to obtain their perspectives on the thrift's condition and the scope of the examinations.

- We interviewed FDIC officials who were responsible for monitoring PCB for federal deposit insurance purposes.

- We assessed OTS's actions based on its internal guidance and requirements of the Federal Deposit Insurance Act.[12]

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.

[12] 12 U.S.C. § 1811 et seq.

History of Peoples Community Bank

Peoples Community Bancorp, Inc. was a registered savings and loan holding company which owned all the outstanding common shares of Peoples Community Bank (PCB), a federally chartered savings thrift founded in 1889. Peoples Community Bancorp, Inc. was formed in December 1999 in connection with a mutual-to-stock conversion of PCB and became a public company in 2000. From September 2001 to December 2006, PCB grew total assets from $416 million to over a billion dollars through acquisition and internal growth. The primary acquisitions were: two branches of Americana Bank and Trust, New Castle, Indiana (2003); American State Bank, Lawrenceburg, Indiana (2005); Peoples Federal Savings Bank, Aurora, Indiana (2005); and The Mercantile Savings Bank, Cincinnati (2006). At its largest, the thrift operated 19 full-service branches in Ohio and Indiana.

The primary driver of PCB's growth was the escalation in higher risk lending including one to four family non-owner occupied, land development, construction, unsecured lines of credit, and high Loan To Value real estate loans mostly in the greater Cincinnati area.

Appendix 4 contains a chronology of significant events regarding PCB.

Types of Examinations Conducted by OTS

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

OTS must conduct full-scope examinations of insured thrifts either once every 12 months or once every 18 months, depending on the size of the thrift and other factors.[13] During a full-scope examination, examiners conduct an onsite examination and rate all CAMELS components. OTS then assigns the thrift a CAMELS composite rating based on its assessment of the thrift's overall condition and OTS's level of supervisory concern.

Enforcement Actions Available to OTS

OTS performs various examinations of thrifts that result in the issuance of reports of examinations identifying areas of concern. OTS uses

[13] The 18-month examination cycle applies to insured thrifts with total assets of $500 million or less and meets certain other criteria of a well-managed and stable institution.

informal and formal enforcement actions to address violations of laws and regulations and to address unsafe and unsound practices.

Informal Enforcement Actions

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

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

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

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

Formal Enforcement Actions

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

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

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

OTS Enforcement Guidelines

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

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

Appendix 3
Glossary

Adversely classified asset	An asset rated as substandard, doubtful, or loss. Substandard assets are inadequately protected by the current worth and paying capacity of the obligor or of the collateral pledged, if any. A doubtful asset has all the weaknesses of a substandard asset with the added characteristic that the weaknesses make collection or liquidation in full questionable and improbable. A loss asset is considered uncollectible and of such little value that continuation as a bankable asset is not warranted.
Allowance for loan and lease losses	An estimate of uncollectible amounts that is used to reduce the book value of loans and leases to the amount that is expected to be collected. It is established in recognition that some loans in the institution's overall loan and lease portfolio will not be repaid.
Board resolution	A document designed to address one or more specific concerns identified by the Office of Thrift Supervision and adopted by a thrift's board of directors.
CAMELS	An acronym for performance rating components for financial institutions: <u>c</u>apital adequacy, <u>a</u>sset quality, <u>m</u>anagement, <u>e</u>arnings, <u>l</u>iquidity, and <u>s</u>ensitivity to market risk. Numerical values range from 1 to 5, with 1 being the best rating and 5 being the worst.
Cease and desist order	A cease and desist order issued by the Office of Thrift Supervision normally requires the thrift to correct a violation of a law or regulation, or an unsafe or unsound practice. The Office of Thrift Supervision issues a cease and desist order in response to violations of federal Banking, securities, or other laws by thrifts or individuals or if it believes that an unsafe and unsound practice or violation is about to occur.
Commercial real estate loan	A loan for real property where the primary or significant source of repayment is from rental income associated with the property or the proceeds of the sale, refinancing, or permanent financing of the property. Commercial real estate loans include construction and real estate development loans, land development loans, and commercial property loans (such as for office buildings and shopping centers).

Appendix 3
Glossary

Concentration	As defined by the Office of Thrift Supervision, a group of similar types of assets or liabilities that, when aggregated, exceed 25 percent of a thrift’s core capital plus allowance for loan and lease losses. Concentrations include direct, indirect, and contingent obligations or large purchases of loans from a single counterparty.
Concentration risk	Risk in a loan portfolio that arises when a disproportionate number of an institution’s loans are concentrated in one or a small number of financial sectors, geographical areas, or borrowers.
Full-scope examination	Examination activities performed during the supervisory cycle that (1) are sufficient in scope to assign or confirm an institution’s CAMELS composite and component ratings; (2) satisfy core assessment requirements; (3) result in conclusions about an institution’s risk profile; (4) include onsite supervisory activities; and (5) generally conclude with the issuance of a report of examination.
Generally accepted accounting principles	A widely accepted set of rules, standards, and procedures for reporting financial information established by the Financial Accounting Standards Board.
Loan-to-value ratio	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 institution should require mortgage insurance or readily marketable collateral.

Matters requiring board attention	A practice noted during an Office Thrift Supervision examination of a thrift that deviates from sound governance, internal control, and risk management principles. The matter, if not addressed, may adversely affect the thrift's earnings or capital, risk profile, or reputation or may result in substantive noncompliance with laws or regulations, internal policies or processes, supervisory guidance, or conditions imposed in writing in connection with the approval of any application or other request by the institution. Although matters requiring board attention are not formal enforcement actions, the Office of Thrift Supervision requires that thrifts address them. A thrift's failure to do so may result in a formal enforcement action.
Nonperforming loans	Loans that are not earning income and for which (1) payment of principal and interest is no longer anticipated, (2) principal or interest is 90 days or more delinquent, or (3) the maturity date has passed and payment in full has not been made.
Other real estate owned	Real properties that an institution has acquired that do not constitute its institution facilities. Such properties include real estate acquired in full or partial satisfaction of a debt previously contracted and are subject to specific holding periods, disposition requirements, and appraisal requirements.
Prompt corrective action	A framework of supervisory actions for insured institutions that are not adequately capitalized. It was intended to ensure that action is taken when an institution becomes financially troubled in order to prevent a failure or minimize resulting losses. These actions become increasingly severe as an institution falls into lower capital categories. The capital categories are well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. (See 12 U.S.C. § 1831o.) The prompt corrective action minimum requirements are as follows:

Appendix 3
Glossary

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 thrift also cannot be subject to a higher capital requirement imposed by the Office of Thrift Supervision.

Risk-based capital	The sum of Tier1 plus Tier 2 capital.
Special mention asset	An asset that has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.
Thrift financial report	A financial report that thrifts are required to file quarterly with the Office of Thrift Supervision. The report includes detailed information about the institution's operations and financial condition and must be prepared in accordance with generally accepted accounting principles. The thrift financial report is similar to the call report required of commercial banks.
Troubled condition	A condition in which a thrift meets any of the following criteria. (1) the Office of Thrift Supervision notifies it in writing that it has been assigned a composite CAMELS rating of 4 or 5. (2) The thrift is subject to a capital directive, a C&D order, a consent order, a formal written agreement, or a prompt corrective action directive relating to its safety and soundness or financial viability. (3) the Office of Thrift Supervision informs the thrift in writing of its troubled condition based on information available to the Office of Thrift Supervision . Such

information may include current financial statements and reports of examination.

Appendix 4
Chronology of Significant Events

Date	Event
March 14, 1889	Peoples Community Bank (PCB) is organized as Peoples Building, Loan and Savings Company, a state chartered mutual thrift.
April 7, 2003	The Office of Thrift Supervision (OTS) begins a safety and soundness examination of PCB, which is completed by May 21, 2003. OTS deems the thrift fundamentally sound, but issues several matters requiring board attention (MRBA) involving asset quality, capital and liquidity. The CAMELS composite and component ratings are 2/223221.
June 15, 2004	OTS begins a safety and soundness examination of PCB, which is completed by July 30, 2004. The CAMELS composite and component ratings are 2/222221.
May 16, 2005	OTS begins a safety and soundness examination of PCB, which is completed by July 18, 2005. OTS deems the thrift fundamentally sound, but issues several MRBAs involving asset quality, capital, and liquidity. The CAMELS composite and component ratings are 2/222221.
June 10, 2005	PCB acquires American State Bank in Lawrenceburg, Indiana.
December 15, 2005	PCB acquires Peoples Federal Savings Bank in Aurora, Illinois.
June 9, 2006	PCB acquires The Mercantile Savings Bank in Cincinnati, Ohio.
July 17, 2006	OTS begins a safety and soundness examination of PCB, which is completed by September 21, 2006. OTS deems the thrift fundamentally sound, but issues several MRBAs involving asset quality, capital, earnings, and sensitivity to market risk. The CAMELS composite and component ratings are 2/232222.
November 17, 2006	OTS downgraded the July 17, 2006 examination ratings from 2/232222 to 3/332322 based on the September 30, 2006 thrift financial report (TFR) report that revealed further asset quality deterioration.
March 21, 2007	Memorandum of Understanding signed between PCB and OTS becomes effective, addressing reduction of higher risk lending, limitations on certain lending activities, adoption of a no-growth strategy, and reduction of adversely classified assets to 20 percent of capital plus allowance for loan and lease losses (ALLL) by September 30, 2008.

September 10, 2007	OTS begins a safety and soundness examination of PCB, which is completed by December 14, 2007. OTS issues MRBAs involving asset quality and management. The CAMELS composite and component ratings are 3/343421.
March 4, 2008	OTS sends Notice of Troubled Condition report to PCB
April 2, 2008	Cease and Desist Order is executed requiring an updated classified asset reduction plan, a revised business plan, third party loan review with lower asset base than current independent review, quarterly variance reports, restriction on dividends, prior notice of changes in directors and senior officers, employment contracts and any other compensation agreements, restrictions on golden parachute payments, dividend payments, stock repurchases and debt issuance.
April 7, 2008	Based on review of the amended December 31, 2007 TFR that included the write off of the thrift's deferred tax asset[14] of $10.5 million and additional provision for ALLL of $24.5 million, OTS downgrades composite rating from 3/343421 to 4/343421. Based on its reported regulatory capital levels, the thrift is considered well capitalized.
April 14, 2008	The Federal Deposit Insurance Corporation (FDIC) requests to participate in future examinations and visits and suggests daily liquidity reporting using the FDIC's format. OTS grants FDIC requests for examination participation as well as daily liquidity reporting.
April 15, 2008	The annual financial audit report as of December 31, 2007 includes qualified independent auditors' opinion based on the company's ability to continue as a "going concern." Auditors' report notes that the holding company may not be able to meet its commitment to pay off a line of credit set to mature on June 30, 2008.
June 30, 2008	Holding company's $17.5 million line of credit secured by 100 percent of the PCB stock matures. Forbearance is extended until December 31, 2008 and later until January 31, 2009.

[14] Generally accepted accounting principles require thrifts to record deferred tax asset or liabilities for the tax effects of differences between the financial statements and tax basses of assets and liabilities. Realization of deferred tax asset is dependent upon taxable income expected to be generated within the carry forward period available under current tax law. The portion of any deferred tax asset that is not expected to be realized should be allowed for using a valuation allowance account

November 7, 2008	PCB amends its September 30, 2008 TFR to report a pre-tax loss of $21.6 million. As a result, the core capital ratio declined to 5.09 percent and Risk-Based Capital ratio to 8.71 percent. Prompt corrective action (PCA) category declines to adequately capitalized. OTS sends a PCA Notice on November 12, 2008. The PCA notice required the submission of a capital restoration plan by April 30, 2009.
February 9, 2009	OTS begins a safety and soundness examination of PCB, which is completed by May 28, 2009. OTS issues several MRBAs involving asset quality and management. The CAMELS composite and component ratings are 5/554544.
April 13, 2009	OTS notifies thrift via formal letter that it is Significantly Undercapitalized. The letter requires that PCB provide a Capital Restoration Plan no later than April 30, 2009 and that additional capital be in place so that the thrift is adequately capitalized by June 15, 2009.
April 29, 2009	Amended C&D order becomes effective. The amendment adds requirements that the thrift meet and maintain core capital ratio of 8 percent and Risk-Based Capital requirement of 12 percent by July 14, 2009. The amended C&D order also requires a contingency plan to merge or self-liquidate if thrift becomes critically undercapitalized.
April 30, 2009	PCB files March 31, 2009 TFR, which indicates that its capital had declined to the critically undercapitalized PCA category with a core capital ratio of 1.18 percent and a total Risk-Based Capital of 4.15 percent.
April 30, 2009	Capital Restoration Plan is submitted and is subsequently deemed incomplete and not viable by OTS because the plan would have resulted in the thrift selling its performing assets and leaving it with only two branches, volatile liabilities, and problem loans.
May 29, 2009	OTS issues PCA Capital Directive with the consent of the board and effective June 11, 2009 that provides for OTS to appoint a conservator, receiver or other legal custodian if the thrift becomes significantly undercapitalized or critically undercapitalized.
July 31, 2009	OTS appoints FDIC as receiver.

This appendix lists the Office of Thrift Supervision's (OTS) full-scope safety and soundness and limited examinations of Peoples Community Bank (PCB), from June 2003 until the thrift's failure in July 2009 and provides information on the significant results of those examinations. Generally, matters requiring board attention represent the most significant items requiring corrective action found by examiners. This appendix also lists the informal and formal enforcement actions taken against PCB by OTS.

Date examination started/Type of Exam	CAMELS Rating	Assets (in millions)	Significant safety and soundness matters requiring board attention cited in reports of examinations and limited examination reports	Enforcement or other actions
April 7, 2003 (Full-scope examination)	2/223221	$623.3	• Develop and implement effective strategies designed to reduce adversely classified assets to no more than 20 percent of tangible capital plus the allowance for loan and lease losses (ALLL) by December 31, 2003. • Develop a formal strategy for reducing risk in each classified asset relationship exceeding $500,000. • Enhance lending policy guidance to incorporate an aggregate limitation on higher risk lending. • Develop a formal Internal Asset Review process consistent with guidance contained in OTS chief executive officer Memorandum 140, Effective Internal Asset Review Systems. • Enhance the Institution's asset classification policy and procedures. • Formally identify and monitor high loan to value (LTV) loans and ensure compliance with applicable regulatory limitations on portfolio size. Also, improve procedures for the reporting and documentation of loans originated with little or no borrower "hard equity." • Incorporate improvements into the written loan underwriting standards and related procedures for significant borrowers with multiple credits, unsecured commercial lines of credit and lending to one- to four-family investors. • Ensure that appropriate resources are devoted correcting concerns identified with the IAR function and credit administration procedures. • Periodically test the Disaster Recovery Plan and provide for related test documentation. • Take steps to effect the recommendations to strengthen the anti-money laundering procedures as discussed in the Compliance Regulatory Findings section of this report. • Incorporate PCB elevated risk profile and associated need for increased capital protection into the financial planning processes. • Clarify formulas for calculating liquidity ratios and confirm that liquidity will be evaluated on a consistent, consolidated basis.	None

August 12, 2003 (Limited Examination – follow up on Matters Requiring Attention from 4/7/03 Examination)			Field Visit disclosed that PCB has made satisfactory progress in addressing most of the credit administration issues identified at the April 7, 2003 examination. The board and management still need to establish an aggregate limitation on high risk lending. The portfolio of <u>non-homogeneous loans</u> continued to grow during the quarter ended June 30, 2003 and represented 46.5 percent of total assets at that date.	None
6/15/2004 (Full-scope examination)	2/222221	$852	Provide OTS a revised business plan for review and approval by the Regional Director. • Inform OTS of the date by which independent testing of IT systems and controls will be completed. • Provide OTS confirmation that an engagement agreement has been consummated with a public accounting firm that will perform the September 30, 2004 independent audit.	None
May 16, 2005 (Full-scope examination)	2/222221	$910	• Develop specific limitations/triggers to control capital leveraging and incorporate these into the written business plan. • The internal loan review function is understaffed. At least one additional employee needs to be added to this function immediately. In addition, the board must ensure that the internal loan review function is adequately staffed, at all times, so that loan reviews are completed within the timeframes required by the board policy. • Secure documentation to show whether any stocks were margin stocks prior to the date of PCB's' legally binding commitment to extend credit. Identify any loans secured by margin stocks that exceeded the maximum allowable loan to value ratio of 50 percent and bring them into compliance at the first opportunity. • Projections in the business plan for liquidity levels that are below board established minimums. The projections must be revised and increased to show liquidity levels above the minimums required by the board policy. • Amend the Liquidity section of the Interest Rate Risk Policy Statement to clarify the types of borrowing capacity the board considers acceptable in its calculation of available liquidity. Borrowing at the Federal Reserve discount window cannot be considered for "available" liquidity. • The board should document the specific operational criteria that were used to determine the minimum "on hand" and "available" liquidity levels as established in the Interest Rate Risk Policy Statement. • "On hand" and "available" liquidity levels should be calculated daily. The monthly average of the daily balances should be calculated to determine that the "on hand" and "available" liquidity levels are being kept above board established minimums. • The board should require frequent self-assessments of compliance with Regulation E [15]until all corrective actions are fully implemented and no violations are identified for a sustained period of time. The self-assessments should also include testing to confirm that no preauthorized transfers from passbook accounts recur.	11/10/2005 Board agrees to maintain a Core Capital levels of 8 percent and a Risk-Based-Capital capital level of 12 percent

15 Regulation E provides a basic framework that establishes the rights, liabilities, and responsibilities of participants in electronic fund transfer systems.

July 17, 2006 (Full-scope examination)	2/232222	$1,100	• Adopt a board resolution establishing an action plan for the reduction of adversely classified assets to 20 percent or less of core capital plus general valuation allowances by December 31, 2007. • Evaluate the adequacy of the board established loan portfolio diversification limits. A reduction in these limits must be considered in light of the fact that further growth in the concentration of higher risk assets is inappropriate given the high level of problem assets. • Strengthen the underwriting standards that contribute to the concentration of regulatory loan-to-value exceptions and that magnify the concentration risk of acquisition, development, and construction loans. • Develop appropriate reports for monitoring the key risks of the loan portfolio, including, but not necessarily limited to, the risks identified with respect to unsecured lines of credit (ULOCs); debt-service-coverage and debt-to-income ratio exceptions; loan extension and renewal history; and, the mix of contract versus market and model construction loans. • Refine and update the Bank's ALLL methodology to comply with generally accepted accounting principles. • Evaluate the adequacy of the internally established minimum total (risk-based) capital ratio (now 12 percent) and the adequacy of the components of total capital, especially the ALLL. Further deterioration in asset quality should be met by the enhancement of risk buffers. The evaluation should be done at least every six months and made part of the board minutes • Review the business plans and projections as approved by OTS (present plan) and provide OTS revised projections, along with an explanation of any material changes from the present plan. Revised projections should incorporate the reduction in high risk loan concentration limits, as discussed on the preceding page in the second action requirement. Lastly, continue providing quarterly variance reports to OTS. • Ensure the prompt implementation and use of an internal IRR modeling process that reliably measures the Bank's net portfolio value (NPV) and interest rate sensitivity. A summary of major differences between the interest rate risk exposure results from the internal model and OTS NPV model should be included in quarterly reports to the board.	• 11/17/2006 downgraded CAMELs composite to 3 based on 9/30/2006 thrift financial report • 3/21/2007 Memorandum of Understanding signed
April 3, 2007 (Limited Scope – to review the large increase in assets listed for <u>special mention</u> at December 31, 2006)			• Based on limited review, Earnings score lowered to 4. All other ratings, including composite of 3, remained unchanged.	
July 3, 2007 (Limited Scope - level and trend of classified assets, sufficiency of ALLL, and sale of problem loans			• None	
September 10, 2007 (Full-scope examination)	3/343421	$903	• Provide an acceptable plan for significant asset quality risk reduction and restoration of profitability. The plan should cover a 3-year period. • Do not grant new loans/lines of credit for the purpose of land acquisition or development, speculative residential construction, commercial (including multi-	• CAMELS rating downgraded on April 7, 2008 because of write off of Deferred Tax Asset

			family) construction, or acquisition or retention of commercial property. • Continue the moratorium on non-owner occupied, one-to-four residential lending. • Reassess the risk in all loan portfolios and provide for an appropriate ALLL. The resulting ALLL should be at the higher end of the ranges as defined in the ALLL policy. • Provide OTS a loan review report prepared by a qualified third party acceptable to OTS. The loan review should include all loans or loan relationships that equal or exceed $2 million. • Continue to provide OTS with quarterly variance reports for the business plan and budget that demonstrate compliance with Memorandum of Understanding dated March 12, 2007, regarding reduction of classified assets. State the reasons for any adverse variances noted and the actions being contemplated to correct them.	creased capital levels. New rating was 4/343421 • 3/4/08 Troubled Institution letter issued due to decrease regulatory capital levels • 4/2/2008 cease and desist (C&D) Order executed imposing various operating restrictions • 11/12/08 Prompt Corrective Action Directive issue requiring submission of capital restoration plan.
September 19, 2009 (limited scope – to determine whether PCB was in compliance with amended C&D order issued April 2009)			• The examination concluded that the thrift was in compliance with the order.	
February 9, 2009 (Full-scope examination)	5/554544	$712	• Continue to develop strategies to reduce the level of adversely classified and nonperforming assets. • Ensure that an adequate ALLL is maintained and the ALLL methodology is properly implemented with current data. An appropriate ALLL level and methodology is required by the Order. • Improve the internal asset review process. Specifically, ensure that assets are classified in accordance with regulatory definitions for Special Mention and Substandard assets. • Continue efforts to resolve the thrift's troubled condition on an open thrift basis and keep OTS and the Federal Deposit Insurance Corporation apprised of related plans and progress. • The development and implementation of strategies to retain sufficient staff to operate the thrift in as safe and sound manner as possible should be a priority. • The board of directors must ensure the maintenance of an adequate Bank Secrecy Act/Anti Money Laundering program. Confirm that management has developed and implemented corrective procedures related to the deficiencies identified regarding the timely filing of Suspicious Activity Reports and Currency Transaction Reports. OTS will request the board to stipulate to an amended C&D Order covering compliance	• 6/8/09 Prompt Corrective Action Directive Issued • 4/29/09 Amended • C&D issued

Office of Thrift Supervision
Department of the Treasury

John E. Bowman
Acting Director

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May 12, 2010

MEMORANDUM FOR: Anthony M. Coble, CPA
Mayer Hoffman McCann P.C.
Contractor to Office of Inspector General
U.S. Department of the Treasury

FROM: John E. Bowman /s/
Acting Director

SUBJECT: Draft Audit Report on the Material Loss Review of Peoples Community Bank

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

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

1. "Ensure that action is taken on the lessons learned and that the recommendations made from OTS's internal review as documented in the Internal Failed Bank Review for PCB's that was issued December 30, 2009 are implemented."

   OTS concurs with the above recommendation and will ensure that recommended actions from the Internal Failed Bank Review of PCB are implemented in a timely manner. OTS has already taken action on one of the Internal Failed Bank Review's recommendations by issuing CEO Letter No. 311 "Risk Management: Asset and Liability Concentrations" in July 2009, to address asset and liability concentrations and related risk management practices.

2. "Work with its regulatory partners to determine whether to propose legislation and/or change regulatory guidance to establish limits or other controls for concentrations that pose an unacceptable safety and soundness risk and determine an appropriate range of examiner response to high risk concentrations."

   OTS works with other regulators and the Federal Financial Institutions Examination Council to develop guidance on a variety of subjects where common issues and/or concerns exist. OTS will continue to review the situation and interface with our

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regulatory partners to determine whether to propose legislation or change regulatory guidance for concentrations that pose an unacceptable level of risk.

cc: Robert Taylor, OIG
Susan Barron, OIG

Section II

Prior Office of Inspector General Material Loss Review Recommendations

The Treasury Office of Inspector General has completed eight mandated material loss reviews of failed thrifts since April 2008. This section provides our recommendations to the Office of Thrift Supervision (OTS) resulting from these reviews. OTS management concurred with the recommendations and has taken or planned corrective actions that are responsive to the recommendations. In certain instances, the recommendations address matters that require ongoing OTS management and examiner attention.

Report Title	Recommendations to OTS Director
Safety and Soundness: Material Loss Review of NetBank, FSB, OIG-08-032 (Apr. 23, 2008) OTS closed NetBank and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on September 28, 2007. At that time, FDIC estimated that NetBank's failure would cost the Deposit Insurance Fund $108 million.	Ensure that the recommendations/lessons learned from OTS's internal assessments of the NetBank failure, as described on pages 21 and 28 of that report, are implemented. Re-emphasize to examiners that for 3-rated thrifts, formal enforcement action is presumed warranted when certain circumstances identified in the OTS Examination Handbook are met. Examiners are also directed to document in the examination files the reason for not taking formal enforcement action in those circumstances. Establish in policy a process to assess the causes of thrift failures and the supervision exercised over the institution and to take appropriate action to address any significant supervisory weaknesses or concerns identified.
Safety and Soundness: Material Loss Review of IndyMac Bank, FSB, OIG-09-032 (Feb. 26, 2009) OTS closed IndyMac on July 11, 2008, and named FDIC as conservator. As of December 31, 2008, FDIC estimated that IndyMac's failure would cost the Deposit Insurance Fund $10.7 billion.	Ensure that action is taken on the lessons learned and recommendations from the OTS internal review of the IndyMac failure. Caution examiners that assigning composite CAMELS ratings of 1 or 2 to thrifts with high-risk, aggressive-growth business strategies needs to be supported with compelling, verified mitigating factors. Such mitigating factors should consider things such as the institution's corporate governance, risk management controls, allowance for loan and lease losses methodologies, concentration limits, funding sources, underwriting standards, and capital levels and whether the mitigating factors are likely to be sustainable in the long-term. Another important factor that should be considered is the extent to which the thrift offers nontraditional loan products (regardless of whether loans are sold or retained) that have not been stress-tested in difficult financial environments and whether the thrift can adequately manage the risks associated with such products. OTS should re-examine and refine as appropriate its guidance in this area.

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

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

Report Title	Recommendations to OTS Director
	action when necessary.
Safety and Soundness: Material Loss Review of American Sterling Bank, OIG-10-011 (November 24, 2009) OTS closed American Sterling Bank and appointed FDIC as receiver on April 17, 2009. As of October 31, 2009, FDIC estimated that American Sterling Bank's failure would cost the Deposit Insurance Fund $41.9 million.	Ensure that the recommendations from OTS's internal review of the American Sterling Bank's failure are implemented and that the lessons learned from the review are taken into account going forward. Remind supervisory and examination staff of the importance of requiring thrifts to hold capital, as required by federal banking regulations, to mitigate their recourse exposure on sold loans. Remind supervisory and examination staff to properly scrutinize capital contributions made to thrifts, especially noncash capital contributions. Ensure supervisory and examination staff take forceful action to mitigate losses whenever a thrift's line of business incurs losses that threaten the viability of this institution.
Safety and Soundness: Material Loss Review of First Bank of Idaho, OIG-10-036 (February 16, 2010) OTS closed First Bank of Idaho and appointed FDIC as receiver on April 24, 2009. As of December 31, 2009, FDIC estimated that First Bank of Idaho's failure would cost the Deposit Insurance Fund $174.6 million.	Ensure that recommendations from OTS's internal review of the First Bank of Idaho failure are implemented and that the conclusions from the review are taken into account going forward. The recommendations are (a) examiners should obtain the results of the most recent federal home loan bank and Federal Reserve Board onsite loan file reviews from bank management and assess and comment on the steps taken by management to address documentation exceptions provided to them, (b) OTS should revise preliminary examination response kit documents to request details about a thrift's high level of uninsured deposits, and (c) examiners should be reminded to closely review loans supported by interest reserves. In regards to the review of loans supported by interest reserves, OTS should ensure that examiners determine whether any extensions of the loan maturity date and use of interest reserves were appropriate. Ensure that examination staff sufficiently considers a thrift's risk profile when deciding whether to allow a thrift to lower its internal capital targets and when determining the thrift's CAMELS.

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Section III

Report Distribution

Department of the Treasury

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

Office of Thrift Supervision

Acting Director
Liaison Officer

Office of Management and Budget

OIG Budget Examiner

United States Senate

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Committee on Banking, Housing, and Urban Affairs

Chairman and Ranking Member
Committee on Finance

U.S. House of Representatives

Chairman and Ranking Member
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Federal Deposit Insurance Corporation

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Inspector General

U.S. Government Accountability Office

Acting Comptroller General of the United States