



Audit Report



OIG-10-042

SAFETY AND SOUNDNESS: Material Loss Review of BankUnited, FSB

June 22, 2010

Office of Inspector General

Department of the Treasury

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Abbreviations

ALLL	allowance for loan and lease losses
BFC	BankUnited Financial Corporation
BSA	Bank Secrecy Act

C&D	cease and desist order
CEO	chief executive officer
Fannie Mae	Federal National Mortgage Association
FDIC	Federal Deposit Insurance Corporation
FICO	Fair Isaac Corporation
FHLB	Federal Home Loan Bank
IT	information technology
MOU	memorandum of understanding
MRBA	matter requiring board attention
option ARM	option adjustable rate mortgage
OIG	Treasury Office of Inspector General
OTS	Office of Thrift Supervision
PCA	prompt corrective action
RCBAP	residential condominium building association policy
REO	real estate owned
ROE	report of examination
SAR	suspicious activity report
TFR	thrift financial report

*The Department of the Treasury
Office of Inspector General*

June 22, 2010

John E. Bowman, Acting Director
Office of Thrift Supervision

This report presents the results of our material loss review of the failure of BankUnited, FSB (BankUnited), of Coral Gables, Florida, and of the Office of Thrift Supervision's (OTS) supervision of the institution. OTS closed BankUnited and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on May 21, 2009. Section 38(k) of the Federal Deposit Insurance Act mandated this review because of the magnitude of BankUnited's estimated loss to the Deposit Insurance Fund.¹ As of March 8, 2010, FDIC estimated that the loss would be \$4.9 billion. FDIC also estimated that BankUnited's failure resulted in a loss of \$25.7 million to its Transaction Account Guarantee Program.

Our objectives were to determine the causes of BankUnited's failure; assess OTS's supervision of BankUnited, including implementation of the prompt corrective action (PCA) provisions of section 38; and make recommendations for preventing such a loss in the future. To accomplish these objectives, we reviewed the supervisory files and interviewed officials at OTS and FDIC. We conducted our fieldwork from July 2009 through November 2009. Appendix 1 contains a more detailed description of our objectives, scope, and methodology.

We also include several other appendices to this report. Appendix 2 contains background information on BankUnited's history and OTS's supervision processes. Appendix 3 is a glossary of terms used in this report. These terms are underlined in the body of the report and, in the electronic version of the report on our web site, hyperlinked to the glossary. Appendix 4 contains a chronology of significant events related to BankUnited's history and OTS's supervision of the

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

institution. Appendix 5 summarizes results of OTS examinations of BankUnited from August 2003 until its closure in May 2009, including enforcement actions taken against BankUnited by OTS. Appendix 6 contains Treasury Office of Inspector General (OIG) recommendations from material loss reviews of failed OTS-regulated institutions completed since April 2008.

Results in Brief

The primary cause of BankUnited's failure was a high-risk growth strategy with excessive concentration in option adjustable-rate mortgages (option ARM) without implementing adequate controls to manage the associated risks. Option ARMs are high-risk loans that feature, among other things, the possibility of negative amortization and payment shock as rates reset. Deficient underwriting and credit administration, combined with the rapid decline in the real estate market, resulted in the deterioration of the thrift's asset quality, including a substantial volume of problem loans and significant loan losses. In turn, these loan losses significantly diminished earnings and resulted in negative capital, and ultimately, the failure of BankUnited.

Regarding supervision, OTS did not impose limits or restrict BankUnited's concentration and growth in high-risk option ARMs. In addition, OTS did not adequately assess BankUnited's underwriting practices, partly due to using inappropriate risk indicators to measure the performance of the loan portfolio and relying on the thrift's mitigating controls that proved inadequate. Furthermore, OTS did not identify or address the thrift's inaccurate risk-weighting of its loan assets. Inaccurate risk-weighting can have the effect of misstating capital ratios as it did in the case of BankUnited. We also found that OTS improperly directed the thrift to backdate a capital infusion from its holding company. As BankUnited reported falling capital levels, we concluded that OTS used its authority under PCA in a timely manner but those actions did not prevent BankUnited's failure or a material loss to the insurance fund.

During our material loss review, OTS completed an internal failed thrift review of BankUnited which concluded, similar to our material loss review, that BankUnited's deficient underwriting increased the credit risk of its option ARM portfolio and contributed to its failure. The internal review also found that there were objectionable practices occurring at BankUnited in 2004, 2005, and 2006 that were not timely addressed by

supervisory staff. The review recommended OTS emphasize to supervisory staff the importance of timely identification of unsafe and unsound practices in general, as well as a cautious supervisory approach when evaluating the risks of new products.

We have reported on excessive concentrations in option ARMs and a lack of strong supervisory response in a number of our 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 too soon to tell 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.

As a final note, we referred the matters involving BankUnited's financial reporting to the Treasury Inspector General Office of Investigations.

Recommendations

We are recommending that the OTS (1) implement the recommendations from its internal failed thrift review of BankUnited and (2) caution examiners to pay particular attention to the risk-weighting of option ARMs and, going forward, ensure that decisions by thrifts to risk-weight these loans at anything other than 100 percent are adequately justified. In this regard, OTS should issue clarifying guidance to thrifts and examiners as to those option ARMs that qualify for risk-weighting other than 100 percent. Due to the significant impact the clarifying guidance may have on thrift financial reporting, the clarifying guidance should be issued in an expeditious manner.

Management Response

OTS concurred with the recommendations. As actions taken, it cited previously issued guidance to thrifts and examiners on concentrations and guidance to examiners on identifying risks with new products and other new activities. OTS is currently drafting clarifying guidance for issuance to the industry and examiners on the risk-weighting of option ARMs and plans to issue the guidance by July 31, 2010. OTS's response is provided as appendix 7.

OIG Comment

Overall, we consider OTS's actions, taken and planned, to be responsive to our recommendations. However, it is too early to determine the effectiveness of the recent issuances. We also plan to assess the clarifying guidance for risk-weighting option ARMs in future work.

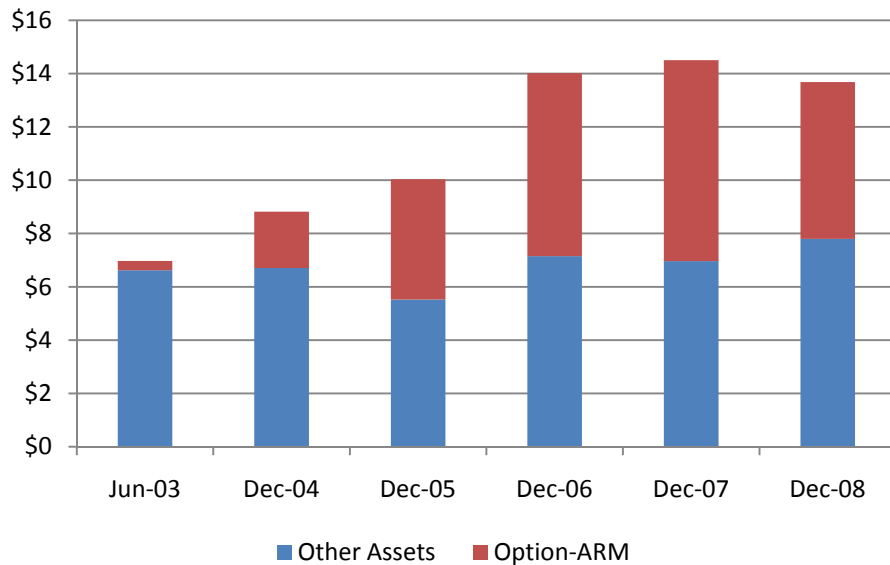
Causes of BankUnited's Failure

BankUnited's board and management embarked on a high-risk growth strategy with excessive concentration in option ARMs without implementing adequate controls to manage the associated risks. Deficient underwriting and credit administration, combined with the rapid decline in the real estate market, resulted in the deterioration of the thrift's asset quality, including a substantial volume of problem loans and significant loan losses. In turn, these loan losses significantly diminished earnings and resulted in negative capital, and ultimately, the failure of BankUnited.

High Concentration in Option ARMs

BankUnited historically focused on single-family residential loans which made up the thrift's largest loan category throughout its existence. Beginning in 2004, BankUnited started to substantially grow its loan portfolio by principally originating and holding single-family residential option ARMs. As figure 1 shows, option ARMs totaled \$348.5 million in 2003 and by 2004 had increased to \$2.1 billion. By December 31, 2007, these loans increased to \$7.5 billion, making up 52 percent of BankUnited's total assets.

Figure 1: BankUnited’s Option ARM and Asset Growth, 2003–2008 (in billions)



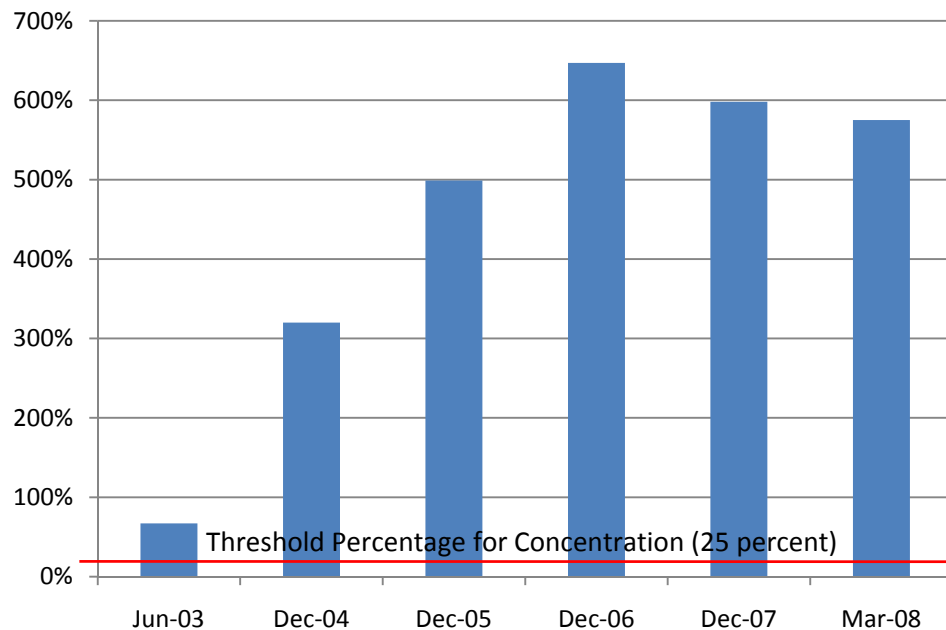
Source: OTS internal failed thrift review report for BankUnited (Oct. 2, 2009).

Concentrations pose additional risk to an institution because negative events affecting overly concentrated groups have greater detrimental impact. OTS defines a concentration as a group of similar types of assets or liabilities that, when aggregated, exceed 25 percent of a thrift’s risk-based capital.²

In the case of BankUnited, as shown in figure 2, the percentage of the thrift’s risk-based capital concentrated in option ARM loans rose from 67 percent as of June 30, 2003, to as much as 640 percent at December 31, 2006, and then to 575 percent as of March 31, 2008.

² OTS New Directions 06-14, Concentrations of Risk

Figure 2: Option ARM Loan Exposure as a Percentage of Risk-Based Capital



Source: BankUnited thrift financial reports (TFR) and OTS internal failed thrift review report (Oct. 2, 2009).

High concentration risks are compounded when they consist of nontraditional mortgage products, such as option ARMs. These loans are riskier because they give borrowers the option of making a minimum monthly payment that does not even cover the interest charges accrued, let alone the principal amount. For borrowers who pay the optional minimum payment, the result is negative amortization.

BankUnited's negatively amortizing loans generated large amounts of capitalized interest, which was recorded on the thrifts' books as accrued (uncollected) interest income. This accrued interest ultimately totaled over 30 percent of BankUnited's capital. As shown in table 1, the percentage of option ARM loans with negative amortization increased from 53 percent as of December 31, 2005, to 92 percent as of June 30, 2008. In other words, over 90 percent of BankUnited's borrowers elected to make payments that were less than the monthly interest accruing on their loans.

Table 1: Option ARMs With Negative Amortization

	12/31/05	12/31/06	12/31/07	6/30/08
Total outstanding balance of negatively amortizing option ARMs	\$2.4 billion	\$5.6 billion	\$6.9 billion	\$6.5 billion
Percentage of negatively amortizing option ARMs to total option ARMs	53%	81%	92%	92%
Total negative amortization during year	\$21 million	\$130 million	\$317 million	\$376 million

Source: OTS internal failed thrift review report for BankUnited (Oct. 2, 2009).

Furthermore, BankUnited's option ARMs automatically recast and result in higher payments after 5 years or when the balance of the loan increases, because of negative amortization, to more than 115 percent of the initial value of the loan.³ In this regard, BankUnited had \$1.3 billion in option ARM loans that were scheduled to recast to a fully amortizing payment in 2009.

In summary, BankUnited continued to increase its concentrations in its option ARM portfolio by originating such loans at or near the market peak in 2006. When the real estate market began to deteriorate in 2007, the concentrated option ARM portfolio, especially the loans acquired at or near the peak of the market, suffered significant credit deterioration, leading to BankUnited's failure.

Ineffective Controls Over High Option ARM Loan Concentration

Deficient Underwriting

The rapid growth in BankUnited's option ARM loan portfolio began in 2004. BankUnited's underwriting guidelines provided flexibility in determining whether, or how, loan applicants' employment, income and assets were documented or verified. The following procedures were used by the thrift.

- No Doc: income, employment and assets are not verified

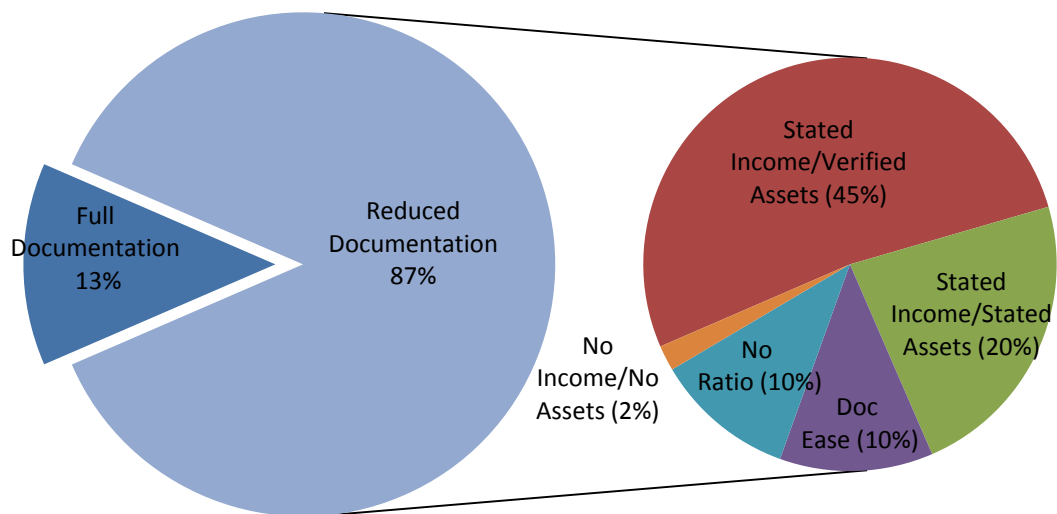
³ Recast is the recalculation of the remaining amortization schedule of a loan. The recalculation occurs when certain triggers contained in the terms of the loan are reached. This might lead to a substantial increase in the loan's scheduled periodic payments.

- No income/no assets: income and assets are not verified; employment is verbally verified
- No ratio: no information about income is obtained; employment is verbally verified, assets are verified
- Stated income: income documentation is waived, employment is verbally verified and assets are verified
- DocEase: no information collected or verification performed on employment, income, and assets

At the time BankUnited began offering reduced documentation loan products, the loan products had not been tested in stressful economic conditions. To compound the risk associated with the products, in 2006 BankUnited further lowered its underwriting standards to compete with other lenders and to increase its option ARM portfolio. Among other things, BankUnited lowered its credit score requirements and eased other qualifying criteria for some of its loan programs including no documentation requirements.

As shown in figure 3, nearly 88 percent of BankUnited’s option ARMs as of March 31, 2008, had been underwritten using lowered underwriting standards.

Figure 3: Option ARM Portfolio Distribution, by Documentation Type



Source: OTS January 2008 examination report.

Option ARM portfolio credit risk is also impacted by the amount of borrowers' equity in the pledged collateral. In this regard, BankUnited generally required either (1) loan-to-value (LTV) ratios of either 80 percent or less or (2) private mortgage insurance when the LTV ratio was over 80 percent. BankUnited did not originate simultaneous ("piggyback") mortgages. Normally, these factors would mitigate credit risk. However, according to OTS information, the thrift was aware that some of its borrowers had obtained piggyback loans from other lenders thereby decreasing their equity in the pledged collateral and increasing the credit risk to the thrift.

When the market started to deteriorate in 2007, BankUnited began tightening underwriting. By then, however, it was too late for BankUnited to reduce or mitigate the risk already present in its option ARM portfolio, and due to a frozen secondary market it was unable to sell option ARM loans⁴. BankUnited stopped making stated income loans in February 2008 and option ARM loans in May 2008, but its concentration in high-risk option ARMs and lax underwriting had already undermined the asset quality and condition of the thrift.

Inadequate Board Supervision of Option ARM Lending and Growth

When BankUnited began in 2004 to rapidly increase its option ARM portfolio, its board had not established underwriting policies, monitoring practices, limits, or risk controls commensurate with the risks posed by such growth. There was no evidence in the board minutes of any strategic discussions among the thrift's board regarding risk tolerances, portfolio diversification, economic risk, growth risk, or limits of any kind.

Inadequate Controls Over Third-Party Mortgage Brokers

BankUnited marketed its option ARM loan products through a network of third-party mortgage brokers (more than 4,000 in 2006, when the thrift's production of these loans was at its peak). According to OTS examination documentation, BankUnited evaluated the brokers' performance primarily in terms of productivity or volume. Other

⁴ BankUnited principally originated loans to hold in its own loan portfolio; however, it did sell some loans on the secondary market.

criteria, such as credit quality and adherence to loan policy with respect to the loans they placed, were secondary. BankUnited also granted mortgage brokers wide discretion in setting the margins for the option ARMs.⁵ Loans with higher margins resulted in greater broker compensation. The brokers therefore had a financial incentive to place borrowers in large loans with high margins, with only secondary regard if any for credit quality. These factors, coupled with the already reduced underwriting standards, led to the very poor asset quality of the option ARMs.

Decline in BankUnited's Real Estate Markets

By 2007, there were clear indications that the economy as a whole and, in particular, the real estate market were in decline. Before 2007, the banking industry had experienced strong financial performance and success, which had led to some industry complacency regarding risk management practices. Many bank portfolios became heavily concentrated in real estate because it was profitable and in demand.

BankUnited's concentration in option ARM loans was primarily in Florida, constituting approximately 55 percent of its loan portfolio. To a lesser but still significant extent, BankUnited's loan portfolio was also concentrated in California, Illinois, and Arizona. In 2007, in concert with deteriorating housing markets throughout the United States, BankUnited's lending areas began to experience a severe real estate downturn. Behind only Nevada, Florida suffered the largest decline in real estate values nationwide. Nonperforming real estate loans in BankUnited's primary lending areas significantly increased. By June 30, 2008, 51 percent of BankUnited's nonperforming option ARMs were located in Florida. The increase in BankUnited's nonperforming real estate loans in all categories, totaling \$1.8 billion as of March 31, 2009, resulted in increases in its allowance for loan and lease losses (ALLL) and large losses that significantly diminished the thrift's earnings and capital to unacceptable levels.

In summary, BankUnited failed to implement adequate controls and manage the risks associated with its high-risk growth and concentration in option ARMs. When conditions worsened and the

⁵ A margin for an adjustable rate loan is the amount the lender adds to the index rate that serves as the basis for the loan. The interest rate the borrower pays consists of the index rate, which typically changes over time, plus whatever margin the lender charges, which is usually fixed over the life of the loan.

thrift incurred substantial losses, BankUnited was unable to sustain its capital at acceptable levels and became critically undercapitalized for PCA purposes. Deeming the thrift in unsafe and unsound condition, OTS closed BankUnited on May 21, 2009, and appointed FDIC as receiver.

OTS's Supervision of BankUnited

Despite the significant increase of the option ARM portfolio, OTS did not impose limits or restrict BankUnited's concentration and growth in these loans. In addition, OTS did not adequately assess the underwriting practices of these loans, partly due to its using inappropriate risk indicators to measure the performance of the loan portfolio and relying on inadequate or nonexistent thrift mitigating controls. Furthermore, OTS did not identify or address deficiencies in the thrift's risk-weighting of loan assets. As reported previously by our office, OTS had improperly directed BankUnited to backdate a capital infusion from its holding company.

As BankUnited reported falling capital levels, we concluded that OTS used its authority under PCA in a timely manner but those actions did not prevent BankUnited's failure or a material loss to the insurance fund.

During our material loss review, OTS completed an internal failed thrift review. Consistent with our findings, the review concluded that BankUnited's failure was caused by losses in its higher risk and geographically concentrated option ARM portfolio and unsafe and unsound practices that elevated the risk profile of these loans. The review found that OTS provided regular oversight of BankUnited, but identified instances where OTS supervision could have been more stringent.

Summary of OTS's BankUnited Supervisory Actions

Table 1 summarizes the results of OTS's safety and soundness and limited examinations of BankUnited from 2003 until its closure in May 2009.⁶ Appendix 5 provides details of the matters requiring board attention (MRBA) and other corrective actions and recommendations reported in the reports of examinations (ROE). Generally, MRBAs

⁶ OTS conducted its examinations and performed offsite monitoring of BankUnited in accordance with the timeframes prescribed in the OTS Examination Handbook.

represent the most significant items reported in ROEs requiring corrective action.

Table 1. Summary of OTS's Examinations of and Enforcement Actions Against BankUnited

Date started/date completed	Total assets (in \$ billions) at time of examination ^a	Examination Results			
		CAMELS rating	No. of MRBAs	No. of recommendations/corrective actions	Informal/formal enforcement actions
8/25/2003 12/11/2003 Full scope examination	\$6.9	2/222222	5	18	None
1/31/2005 6/06/2005 Full scope examination	\$8.8	2/212222	0	7	None
1/20/2006 5/19/2006 Limited examination	N/A	2/212222	None	None	None
7/31/2006 12/27/2006 Full scope examination	\$12.9	2/212222	None	14	None
5/21/2007 7/25/2007 Limited examination	N/A	2/222222	None	2	None
11/5/2007 12/13/2007 Limited IT examination	N/A	N/A	None	4	None
6/30/2008 6/30/2008 Notice of rating downgrade	N/A	3/343432	OTS, BankUnited, and its holding company entered into memoranda of understanding (MOU), which are informal enforcement actions, on July 24, 2008.		
1/31/2008 7/11/2008 Full scope examination	\$14.3	4/443442	14	18	None
8/11/2008 9/3/2008 Limited examination	N/A	4/443442	OTS reclassified BankUnited from well-capitalized to adequately capitalized.		

Table 1. Summary of OTS's Examinations of and Enforcement Actions Against BankUnited

Date started/date completed	Total assets (in \$ billions) at time of examination ^a	Examination Results			
		CAMELS rating	No. of MRBAs	No. of recommendations/corrective actions	Informal/formal enforcement actions
9/4/2008 12/18/2008 Notice of rating downgrades	N/A	5/554554	OTS issued <u>cease and desist (C&D) orders</u> , which are formal enforcement actions, to Bank United and its holding company on September 19, 2008. OTS issued a PCA directive to BankUnited on April 19, 2009.		

Source: OTS ROEs and enforcement actions.

OTS Did Not Impose Limits on BankUnited's Significant Growth and High Risk Concentration of Option ARM Loans

BankUnited's option ARM portfolio grew from 5 percent of total assets in 2003 to 52 percent by December 31, 2007. As shown earlier in figure 2, the concentration of option ARMs as a percentage of the thrift's risk-based capital rose from 67 percent as of June 30, 2003, to 575 percent as of March 31, 2008.

In the 2005 and 2006 ROEs, OTS examiners identified BankUnited's significant growth in its option ARM loan portfolio as asset and geographic risk concentrations. However, despite the significant increase of the portfolio, OTS did not include any MRBAs or corrective actions in the 2005 through 2008 ROEs to impose limits or restrict the thrift's concentration and growth in these loans. In addition, as discussed further below, examiners had identified as risk indicators in the 2006 examination that 70 percent of the thrift's option ARM loans were negatively amortizing, deferred interest represented a growing percentage of income, and 84 percent of the thrift's option ARMs were underwritten with less than full documentation.

OTS stated in its October 2009 internal failed thrift report that these indicators could have supported the establishment of growth and concentration risk limits. OTS's internal report further stated that both the 2005 and 2006 examinations would have been appropriate times for OTS supervisory staff to intervene and require option ARM loan concentration and growth limits.

OTS's examiners for BankUnited told us it would have been difficult to limit concentrations due to the thrift's mitigating risk controls and the lack of existing guidance. As mitigating risk controls, the examiners noted in ROEs that BankUnited (1) required mortgage insurance on loans with an LTV ratio over 80 percent; (2) did not make loans to borrowers with a credit score less than 620; (3) did not make second mortgages; (4) limited lending to the high rise condominium market in Miami, Florida; and (5) required a reasonability of income test by its underwriters on stated income loans. Examiners also identified the low historical loss rates associated with the thrift's option ARM portfolio at the time as a basis for not elevating concern over risky lending practices and high credit concentrations. Furthermore, examiners noted existing regulatory guidance set only general limitations for loan concentrations, and did not provide regulatory guidance for concentrations in nontraditional mortgage products such as option ARMs. We reviewed the existing guidance and found that to be the case.

We have reported on excessive concentrations in option ARMs and a lack of strong supervisory response in a number of our 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 existing concentration policies in light of the current economic environment. The guidance informs thrifts that OTS examiners will scrutinize higher 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 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

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

address excessive concentrations.⁸ This is an area we believe requires continued OTS management action.

OTS Did Not Adequately Assess BankUnited's Underwriting Practices

OTS has long maintained that "no documentation" residential real estate lending is an unsafe and unsound practice. According to OTS guidance, a prudently underwritten loan is one that has been made in a safe and sound manner to ensure the borrower has the ability and willingness to repay the loan in a timely manner. Furthermore, the 2006 *Interagency Guidance on Nontraditional Mortgage Product Risks* (2006 interagency guidance) states that loans to individuals who do not demonstrate the capacity to repay, from sources other than the collateral pledged, are generally considered unsafe and unsound.⁹

Throughout OTS's supervision of BankUnited the examiners considered the thrift's underwriting standards to be prudent even though "reduced documentation" lending was a significant part of BankUnited's business. In the 2005 and 2006 ROEs, OTS examiners reported that the thrift's option ARM loans were underwritten to strict standards to mitigate risk, and described the underwriting as both prudent and satisfactory. Also in the 2006 ROE the examiners noted that BankUnited's option ARM portfolio had an average LTV ratio after mortgage insurance of 73 percent and an average credit score of 710. Examiners further wrote that as the level of documentation decreased, required credit scores were higher, LTV ratios lower, loan balances smaller, and the occurrence of cash out, investor loans, second homes, and other higher-risk loans diminished greatly.

While on the surface these factors were positive, we believe OTS inadequately assessed the thrift's underwriting practices partly due to using inappropriate risk indicators to measure the performance of the option ARM portfolio and relying on inadequate mitigating controls. The examiners failed to consider that option ARM loans negatively amortize when borrowers pay only the minimum payment, which was the case with the majority of BankUnited's borrowers. How the examiners came to their conclusions about the thrift's underwriting was further flawed

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 OTS No. 2006-35

considering that no doc lending practices, which comprised nearly 11 percent of the option ARM portfolio, did not conform with existing OTS guidance which deemed the types of loan products being offered as unsafe and unsound.¹⁰ Additionally, until October 2007 BankUnited did not have any formal guidelines to document its reasonableness tests of borrowers' reported income for stated income loans. This was a significant deficiency in that more than 65 percent of BankUnited's option ARMs were made based on (1) stated income or (2) stated income and stated assets. Therefore, approximately 75 percent of BankUnited's option ARMs originated between 2006 and 2007 were not prudently underwritten in a safe and sound manner based on existing OTS guidance.

It should be noted that by 2008, OTS started to report underwriting weaknesses. In the 2008 ROE, the examiners noted that BankUnited's internal audit reports, quality assurance reports, and the examiner's loan review sample had disclosed weaknesses in assessing borrower capacity and willingness to pay.

OTS Did Not Detect BankUnited's Improper Risk-Weighting of Its Option ARM Portfolio in a Timely Manner

An insured financial institution's capital category for PCA purposes is determined, in part, by calculation of the total risk-based capital ratio.¹¹ To calculate the ratio, assets are risk-weighted through assignment to one of four standard risk-weight categories, depending upon the nature of the assets, obligors, and collateral.¹² As an asset's level of risk increases, the risk-weight assigned to the asset increases causing the total risk-based capital ratio to decrease. Therefore, higher volumes of riskier assets create the need for an institution to maintain larger amounts of capital. A thrift's total risk-based capital ratio must exceed 10 percent to meet the regulatory threshold for a well-capitalized designation unless the regulator has imposed a higher capital level under its PCA authority.

¹⁰ BankUnited's DocEase program required no employment, income, or asset information from the borrower. At March 31, 2008, 10.6 percent of the option ARM portfolio consisted of DocEase loans.

¹¹ There are five established capital classifications for insured financial institutions: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. PCA restricts the activities of institutions that are not well-capitalized. For example, the unlimited use of brokered deposits is reserved to well-capitalized insured depository institutions. Adequately capitalized or lower institutions are required to obtain a waiver from FDIC in order to accept brokered deposits.

¹² There are four standard risk-weight categories: 0 percent, 20 percent, 50 percent, and 100 percent.

According to OTS guidance, thrifts must assign at least a 50 percent risk-weight to qualifying single family mortgages that are (1) prudently underwritten; (2) performing and not more than 90 days past due;¹³ and (3) have a current LTV ratio of 90 percent or less, calculated using the value at origination. Should a mortgage fail to meet any of the criteria, it must be categorized as a non-qualifying mortgage and assigned a 100 percent risk-weight.

Inaccurate risk-weighting can have the effect of misstating capital ratios as it did in the case of BankUnited. Based on its risk-weighting of assets, BankUnited reported its condition as well-capitalized through the quarter ending June 30, 2008. BankUnited risk-weighted all performing option ARM loans at 50 percent. However, it is our opinion that most of BankUnited's option ARM loans did not meet the prudently underwriting criterion for this risk-weight. In this regard, approximately 75 percent of BankUnited's option ARM portfolio originated between 2006 and 2007 had no documentation or reduced documentation features. Accordingly, we concluded that this portion of the performing option ARM portfolio did not qualify for the 50 percent risk-weighting and instead should have been risk-weighted at 100 percent. During its 2008 examination, OTS examiners failed to detect that BankUnited was not properly risk-weighting its option ARMs. Subsequent to the examination, a September 2008 internal OTS email indicates that OTS officials also had concerns with BankUnited's risk-weighting of reduced documentation option ARM loans at 50 percent instead of at 100 percent.

OTS Directed BankUnited to Backdate a Capital Contribution

In June 2009, we reported on the circumstances surrounding inappropriately backdated capital contributions by six thrifts.¹⁴ One of those thrifts was BankUnited. In the case of BankUnited, on August 4, 2008, OTS regional officials had requested BankUnited's holding company to infuse \$80 million in capital to the thrift in order to improve BankUnited's regulatory capital ratio. OTS officials also, inappropriately, instructed the thrift to revise its TFR, dated as of June 30, 2008, to reflect the backdated capital infusion. The contribution was in fact made in August 2008 and the TFR was amended to reflect the contribution as of June 30, 2008. The OTS

¹³ BankUnited properly risk-weighted numerous loans once they became 90 days past due.

¹⁴ *OIG, Safety and Soundness: OTS Involvement With Backdated Capital Contributions by Thrifts*, OIG-09-037 (May 21, 2009).

regional officials' instructions to BankUnited were made at the direction of the OTS Senior Deputy Director at the time, that individual is no longer with OTS.

An unusual factor in this case was that even without the backdated capital contribution, BankUnited appeared to have met the regulatory minimum requirement of well-capitalized as of June 30, 2008, based on its TFR information. Including the \$80 million backdated capital contribution, the TFR reported total risk-based capital ratio at 13.9 percent. However, the capital ratio of 13.9 percent is based on BankUnited's performing option ARM portfolio being risk-weighted at 50 percent. As discussed in the previous subsection, we concluded that most of these loans should have been risk-weighted at 100 percent because of their no documentation or reduced documentation features. Had these loans been risk-weighted at 100 percent and excluding the August 2008 backdated capital contribution of \$80 million, we calculated that BankUnited's actual risk-based capital ratio as of June 30, 2008, was 9.8 percent. That means that the thrift was only adequately capitalized, not well-capitalized, at June 30, 2008. By reporting its financial condition the way it did, BankUnited delayed PCA.¹⁵

We referred these matters involving BankUnited's financial reporting to the Treasury Inspector General Office of Investigations.

As Conditions Swiftly Deteriorated at BankUnited, OTS's Use of PCA and Enforcement Authorities Was Reasonable

Notwithstanding our criticisms of the improper backdating of the capital contribution and BankUnited's improper risk-weighting of its option ARMs, we concluded that OTS acted in a reasonable and appropriate manner in its supervisory response to the deteriorating conditions at BankUnited starting in late June 2008. Following is a description of the key actions OTS took.

- In a letter dated June 30, 2008, OTS notified BankUnited's board that OTS had downgraded the thrift's composite rating and component ratings for capital, asset quality, management, earnings, and liquidity. The resulting ratings were 3/343432.

¹⁵ Under PCA, an adequately capitalized institution is prohibited from accepting or renewing brokered deposits unless a waiver is obtained from FDIC.

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- On July 24, 2008, OTS executed an MOU with BankUnited that required the thrift to, among other things, (1) terminate negative amortization and reduced documentation lending programs; (2) submit a loan reduction plan and business plan within 60 days; (3) achieve and maintain core and risk-based capital ratios of 8 and 15 percent, respectively; and (4) ensure that its loss reserves are no less than \$280 million at September 30, 2008.

The terms of the MOU addressed the major issues of the thrift and were consistent with the type of informal enforcement action OTS may take under its examination guidance when a thrift is downgraded to a composite rating of 3.

- In a separate letter dated July 24, 2008, OTS notified BankUnited's board of OTS's intent to reclassify the thrift's PCA capital category from well-capitalized to adequately capitalized pursuant to OTS's authority under PCA. OTS stated in the letter that it had determined that the thrift was in an unsafe and unsound condition due to the deterioration in its portfolio of nontraditional mortgage loans, the concentration of risk associated with the portfolio, and the resultant need for significant additional capital. BankUnited was given until August 15, 2008, to provide a written response stating why the reclassification should not be done. The thrift did provide a written response by that date and a supplemental response on August 20, 2008.
- In a letter dated August 8, 2008, OTS transmitted its 2008 ROE to BankUnited's board. In the ROE, OTS downgraded the CAMELS composite rating to 4 and the component ratings for capital, asset quality, earnings and liquidity to 4. As a result of the downgraded composite rating of 4, the letter also designated the thrift to be in troubled condition as defined by 12 C.F.R. § 563.555.
- In a letter dated September 5, 2008, OTS formally downgraded BankUnited to adequately capitalized under PCA. The letter stated that based on a review of BankUnited's written submissions and other documentation, OTS confirmed that BankUnited was in an unsafe and unsound condition for the reasons described in the July 24th letter.

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- On September 19, 2008, OTS issued C&D orders to BankUnited and its holding company. Among other things the C&D order required the thrift to meet and maintain tier 1 capital levels at 7 percent and total risk-based capital at 14 percent.
 - On February 10, 2009, OTS sent a PCA directive to BankUnited's board regarding the bank's critically undercapitalized status and required the submission of a capital restoration plan. This action was taken in response to a December 2008 field visit and downgrade of the CAMELS composite rating to 5.
 - BankUnited submitted a capital restoration plan on February 25, 2009, which was based on an injection of \$1 billion in new capital by March 31, 2009, but was made contingent upon Open Bank Assistance in the form of a loss sharing arrangement with FDIC or another government agency. OTS determined that Open Bank Assistance was not available in BankUnited's case because it was not believed that BankUnited's failure presented a systemic risk, and the plan submitted by BankUnited was not based on realistic assumptions and would not succeed in restoring the thrift's capital.
 - On April 10, 2009, OTS sent BankUnited a notice of intent to issue a PCA directive and its denial of the thrift's capital restoration plan. OTS finalized that directive 4 days later, which included the consent of BankUnited's board to the appointment of a conservator or receiver. (OTS closed the thrift on May 21, 2009.)

The PCA and other enforcement actions taken by OTS ultimately were unsuccessful to prevent the thrift's failure or a material loss to the Deposit Insurance Fund.

OTS Lessons Learned Review

OTS policy requires that an internal assessment be conducted when a thrift fails. That assessment, referred to as an internal failed bank review, is performed by staff independent of the region responsible for supervisory oversight of the failed thrift. The report is reviewed and signed by OTS's deputy director of examinations, supervision, and consumer protection. OTS's Western Region initiated an internal review of BankUnited following its failure in May 2009. The scope of the review focused primarily on OTS's supervision from August 2003 to May 2009.

OTS's review determined that BankUnited's failure was caused by losses in its higher risk and geographically concentrated option ARM portfolio. These nontraditional mortgage products were primarily underwritten with unverified borrower stated income and to a lesser degree, unverified stated assets. The internal review also stated that the following unsafe and unsound practices elevated the risk profile of the option ARM portfolio:

- inadequate board of director supervision over option ARM lending and growth,
- weak underwriting standards combined with stated-income and reduced documentation,
- loosening of option ARM credit standards and inadequate internal controls over third party mortgage brokers, and
- option ARM product concentration and geographic concentrations.

Regarding supervision, the review found that OTS provided regular oversight of BankUnited, but identified instances where OTS supervision could have been more stringent. Specifically, the 2005 and 2006 examinations were identified as opportunities for OTS supervisory staff to intervene and require option ARM concentration and growth limits. Even though option ARMs were performing well at this time, the review asserted that growth and concentration limits would have been prudent for this type of product, noting that the performance of which was untested in stressful economic conditions.

OTS examiners cited the following alternative risk indicators as evidence of potential option ARM risk in the 2006 examination: 70 percent of option ARMs were negatively amortizing; deferred interest represented a growing percentage of income, 87 percent of option ARMs were underwritten with less than full documentation, BankUnited's option ARM monitoring procedures needed improvement, and BankUnited was not fully complying with the 2006 interagency guidance. The 2006 examination was also identified as an appropriate time to bring the growing option ARM credit risks, weaknesses in option ARM monitoring procedures, and BankUnited's noncompliance with the 2006 interagency guidance to the board's attention for corrective action.

The OTS report made the following recommendations:

- OTS should consider as an unsafe and unsound practice, the use of reduced documentation underwriting, including stated income and stated asset underwriting, unless mitigating risk controls are in place.¹⁶
- OTS should emphasize to supervisory staff the importance of timely identification of unsafe and unsound practices in general, and a cautious supervisory approach when evaluating the risks of new products.

The report did not include a recommendation regarding concentration issues noting that these matters were substantially the same issues noted in recent 2009 failed bank reviews and other OIG audit reports, and had been addressed with the July 9, 2009 release of Chief Executive Officer (CEO) Letter No. 311, Risk Management: Asset and Liability Concentrations.

Our material loss review affirms the findings and recommendations of OTS's internal review. It should be noted, however, that OTS's internal review did not identify the problem with BankUnited's risk-weighting of option ARMs and that the 2008 examination did not detect this deficiency.

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 such as those that led to BankUnited'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.

¹⁶ Current OTS guidance states that no documentation lending is unsafe and unsound. With respect to reduced documentation loans, the guidance requires examiners to scrutinize such loans. What is new with the OTS lessons-learned recommendation is that absent mitigating controls, reduced documentation loans would now be considered unsafe and unsound.

Recommendations

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

The most recent prior material loss review, of Peoples Community Bank completed by a contractor under our supervision, included a recommendation that 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. Our material loss review of BankUnited reaffirms the need for OTS to take action on this recommendation.

As new recommendations from our material loss review of BankUnited, we recommend that the Director of OTS do the following:

1. ensure that recommendations from OTS's internal failed thrift review of BankUnited's failure are implemented.

Management Response

OTS concurred with the recommendation. OTS cited, as actions taken (1) the issuance of CEO Letter No. 311 to address concentrations and (2) the issuance of a new section to the OTS Examination Handbook on September 16, 2009 (Section 760, Other Activities). The purpose for issuing Section 760 was to address the internal failed bank review recommendation that supervisory staff be advised of the importance of timely identification of unsafe and unsound practices and the need for a cautious approach when evaluating new product risk. OTS expects to complete action by July 31, 2010, on the internal review recommendation that reduced documentation loan underwriting be considered as unsafe and unsound unless appropriate mitigating controls are in place.

OIG Comment

We consider OTS's actions taken and planned to be responsive to our recommendation. As noted in our report, we believe the guidance provided in CEO Letter No. 311 is better than what had been available to thrifts previously. However, as we also noted, it is too soon to tell whether the guidance will be effective at controlling risky concentrations going forward. We agree that the new Section 760 provides additional guidance to examiners on evaluating risks associated with new products and other new activities and on the need to exercise caution with respect to new activities. If implemented as described, the new section should result in earlier identification of potentially unsafe and unsound practices for supervisory action.

2. caution examiners to pay particular attention to the risk-weighting of option ARMs and, going forward, ensure that decisions by thrifts to risk-weight these loans at anything other than 100 percent are adequately justified. In this regard, OTS should issue clarifying guidance to thrifts and examiners as to those option ARMs that qualify for risk-weighting other than 100 percent. Due to the significant impact the clarifying guidance may have on thrift financial reporting, the clarifying guidance should be issued in an expeditious manner.

Management Response

OTS concurred with the recommendation and is currently drafting clarifying guidance for issuance to the industry and examiners by July 31, 2010.

OIG Comment

We consider OTS's planned action to be responsive to our recommendation. We plan to assess the clarifying guidance in future work.

* * * * *

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

/s/
Susan Barron
Audit Director

We conducted this material loss review of BankUnited, FSB (BankUnited), of Coral Gables, Florida, in response to our mandate under section 38(k) of the Federal Deposit Insurance Act.¹⁷ This section provides that if the Deposit Insurance Fund incurs a material loss with respect to an insured depository institution, the inspector general for the appropriate federal banking agency is to prepare a report to the agency that

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

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

We initiated a material loss review of BankUnited based on the loss estimate by the Federal Deposit Insurance Corporation (FDIC). As of March 8, 2010, FDIC estimated that the loss to the Deposit Insurance Fund from BankUnited's failure would be \$4.9 billion.

Our objectives were to determine the causes of BankUnited's failure; assess the Office of Thrift Supervision's (OTS) supervision of BankUnited, including implementation of the PCA provisions of section 38; and make recommendations for preventing such a loss in the future. To accomplish our review, we conducted fieldwork at OTS's headquarters in Washington, D.C.; OTS's southeast region office in Atlanta, Georgia; and BankUnited's operations center in Miami Lakes, Florida. We also met with officials of FDIC's Division of Supervision and Consumer Protection in Atlanta, Georgia. We conducted our fieldwork from July 2009 through November 2009.

¹⁷12 U.S.C. § 1831o(k).

To assess the adequacy of OTS's supervision of BankUnited, we determined (1) when OTS first identified BankUnited's safety and soundness problems, (2) the gravity of the problems, and (3) the supervisory response OTS took to get the thrift to correct the problems. We also assessed whether OTS (1) might have discovered problems earlier; (2) identified and reported all the problems; and (3) issued comprehensive, timely, and effective enforcement actions that dealt with any unsafe or unsound activities. Specifically, we performed the following work:

- We determined that the time period relating to OTS's supervision of BankUnited covered by our audit would be from August 2003 through BankUnited's failure on May 21, 2009. This period included four full-scope safety and soundness examinations prior to OTS's August 2008 designation of BankUnited as a troubled institution and four limited-scope examinations.
- We reviewed OTS's supervisory files and records for BankUnited from 2003 through May 2009. We analyzed examination reports, supporting workpapers, and related supervisory and enforcement correspondence. We performed these analyses to gain an understanding of the problems identified, the approach and methodology OTS used to assess the thrift's condition, and the regulatory action OTS used to compel thrift management to address deficient conditions. We did not conduct an independent or separate detailed review of the external auditor's work or associated workpapers other than those incidentally available through the supervisory files.
- We interviewed and discussed various aspects of the supervision of BankUnited 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 BankUnited for federal deposit insurance purposes.
- We reviewed BankUnited documents that had been taken by FDIC and inventoried by FDIC Division of Resolutions and Receiverships personnel.

- We assessed OTS's actions based on its internal guidance and requirements of the Federal Deposit Insurance Act.¹⁸

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.

¹⁸ 12 U.S.C. § 1811 et seq.

History of BankUnited

BankUnited, FSB (BankUnited) began operations as a state-chartered institution in October 1984 under the name United Savings Association. In 1993, it converted to a federal stock charter and changed its name to BankUnited, FSB. BankUnited was the largest financial institution headquartered in Florida, operating Florida branches, numerous loan production offices around the country, and a wholesale network for originating loans through mortgage brokers. BankUnited became a wholly owned subsidiary of BankUnited Financial Corporation (BFC) in 1995. BFC was a holding company that operated primarily as a financing vehicle for the thrift. Beginning with its formation in 1995, BFC raised capital for BankUnited by issuing debt, primary trust preferred securities, and equity securities. BankUnited's assets were approximately \$13.1 billion as of March 31, 2009.

BankUnited was historically a residential mortgage lender and was consistently profitable. It had low loan delinquencies, good asset quality, and strong capital levels until 2008. Beginning in 2004, BankUnited embarked on a strategy to increase its option adjustable rate mortgage option ARM) portfolio. In 2003, option ARM loans were only 5 percent of BankUnited's total assets. By 2004, option ARM loans had risen to 24 percent of the thrift's total assets and by June 30, 2008, they had grown to 65 percent of total assets.

The decline in housing prices in BankUnited's Florida market area in 2007 contributed to rising delinquencies in its large portfolio of option ARMs. Further, these loans were originated during the peak of the real estate market and were underwritten mostly using alternative documentation standards. Ultimately, the combination of an excessive concentration in risky option ARM loans and rapidly deteriorating economic conditions overwhelmed BankUnited's capacity to absorb the losses on its option ARM portfolio. OTS closed the thrift on May 21, 2009.

Appendix 4 contains a chronology of significant events regarding BankUnited.

Types of Examinations Conducted by OTS

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

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.¹⁹ BankUnited was on a 12-month cycle. 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 (ROE) identifying areas of concern. OTS uses informal and formal enforcement actions to address violations of laws and regulations and to address unsafe and unsound practices.

Informal Enforcement Actions

When a thrift's overall condition is sound but it is necessary to obtain written commitments from 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 actions for problems in well- or adequately capitalized thrifts and for thrifts with a composite rating of 1, 2, or 3.

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

¹⁹ The 18-month examination cycle applies to insured thrifts with total assets of \$500 million or less that (1) received a CAMELS composite rating of 1 or 2 and a compliance component rating of 1 or 2 for their most recent examination, (2) received a CAMELS management component rating of 1 or 2 for their most recent examination, (3) are well-capitalized, (4) are not currently subject to a formal enforcement proceeding or order by OTS or FDIC, and (5) have not undergone a change in control during the 12-month period since completion of their last full scope examination.

The effectiveness of informal 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 action 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 may occur again;
- the thrift's record for taking corrective action in the past;
- the capability, cooperation, integrity, and commitment of the thrift's management, board of directors, and ownership to correct identified problems;
- the effect of the illegal, unsafe, or unsound conduct on other financial institutions, depositors, or the public;
- the examination rating of the thrift;
- whether the thrift's condition is improving or deteriorating; and
- the presence of unique circumstances.

Allowance for loan and lease losses	An estimate of uncollectible amounts that is used to reduce the book value of loans and leases to the amount that is expected to be collected. It is established in recognition that some loans in the institution's overall loan and lease portfolio will not be repaid.
Brokered deposit	Any deposit that is obtained, directly or indirectly, from a deposit broker. The bank or thrift solicits deposits by offering rates of interest that are significantly higher than the rates offered by other insured depository institutions in its normal market area. Use of brokered deposits is limited to well-capitalized insured depository institutions and, with a waiver from the Federal Deposit Insurance Corporation, to adequately capitalized institutions. Undercapitalized institutions are not permitted to accept brokered deposits. (See 12 U.S.C. § 1831(f) and 12 C.F.R. 337.6.)
CAMELS	An acronym for performance rating components for financial institutions: <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.
Capital restoration plan	A plan submitted to the appropriate federal banking agency by an undercapitalized insured depository institution. A capital restoration plan specifies the steps the insured depository institution is to take to become adequately capitalized, the levels of capital to be attained during each year in which the plan is in effect, how the institution is to comply with the restrictions or requirements then in effect, the types and levels of activities in which the institution is to engage, and any other information that the federal banking agency may require.
Cease and desist order	A type of formal enforcement action. A cease and desist order issued by the Office of Thrift Supervision normally requires the thrift to correct a violation of a law or regulation, or an unsafe or unsound practice.

	<p>The Office of Thrift Supervision may issue a cease and desist order in response to violations of federal banking, securities, or other laws by thrifts or individuals or if it believes that an unsafe and unsound practice or violation is about to occur.</p>
Concentration	<p>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 may include direct, indirect, and contingent obligations or large purchases of loans from a single counterparty.</p>
Concentration risk	<p>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.</p>
Division of Resolutions and Receiverships	<p>A division within the Federal Deposit Insurance Corporation that is charged with resolving failing and failed financial institutions, including ensuring that depositors have prompt access to their insured funds.</p>
Federal Home Loan Bank System	<p>A system of 12 regional cooperative banks created by Congress from which member institutions borrow funds to finance housing, economic development, infrastructure, and jobs. The system provides liquidity to member institutions that hold mortgages in their portfolios and facilitates the financing of mortgages by making low-cost loans, called advances, to members. Advances with a wide variety of terms to maturity, from overnight to long-term, are available to members and are collateralized. Advances are designed to prevent any possible loss to Federal Home Loan Banks, which also have a super lien (a lien senior or superior to all current and future liens on a property or asset) when institutions fail. To protect their position, Federal Home Loan Banks have a claim on any of the additional eligible collateral in a failed institution. In addition, the Federal Deposit Insurance Corporation has a regulation that reaffirms the priority of Federal</p>

	Home Loan Banks, which can demand prepayment of advances when institutions fail.
Field visit	A visit conducted to review specific areas of concern that the Office of Thrift Supervision has about an institution.
Formal agreement	A type of formal enforcement action authorized by statute. Formal agreements are generally more severe than informal actions and are disclosed to the public. Formal actions are also enforceable through the assessment of civil money penalties.
Full scope examination	Examination activities performed during the supervisory cycle that (1) are sufficient in scope to assign or confirm an institution's CAMELS composite and component ratings; (2) satisfy core assessment requirements; (3) result in conclusions about an institution's risk profile; (4) include onsite supervisory activities; and (5) generally conclude with the issuance of a report of examination.
Generally accepted accounting principles	A widely accepted set of rules, standards, and procedures for reporting financial information established by the Financial Accounting Standards Board.
Loan production offices	Banking offices that take loan applications and arrange financing for corporations and small businesses but that do not accept deposits. Loan applications taken by loan production offices are subject to approval by the lending institution.
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.

Matter requiring board attention

A practice noted during an Office of 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.

Mortgage Broker

Mortgage broker An intermediary that brings mortgage borrowers and mortgage lenders together but does not use its own funds to originate mortgages.

Negative amortization

occurs when the monthly payments on a loan do not cover all the interest owed. The interest not paid is added to the principal loan balance and is referred to as capitalized interest. With negative amortization, borrowers may owe more than they did at the beginning of the loan even after they have made many payments. Additionally, the borrower's equity in the property will decrease over time unless the property value increases at a higher rate than negative amortization.

Open Bank Assistance A type of resolution method where the Federal Deposit Insurance Corporation provides financial assistance to an operating insured bank or thrift to keep it from failing.

Prompt corrective action A framework of supervisory actions for insured institutions that are not adequately capitalized. It was intended to ensure that action is taken when an institution becomes financially troubled in order to prevent a failure or minimize resulting losses. These actions become increasingly severe as an institution falls into lower capital categories. The capital categories are well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. (See 12 U.S.C. § 1831o.)

The prompt corrective action minimum requirements are as follows:

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

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

Recourse With respect to financial assets such as loans, the legal ability of the purchaser an asset to make a claim against the seller of the asset if the asset fails to pay. For example, a loan sold with a recourse provision would allow the loan’s purchaser to make a claim against the loan’s seller in the event of debtor default.

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

Stated income loan	A specialized mortgage loan for which the lender verifies employment and assets, but not income. Instead, income is simply stated on the loan application.
Stress testing	Analysis that estimates the effect of economic or other changes on key performance measures, such as losses, delinquencies, and profitability. Key variables used in stress testing may include interest rates, Fair Isaac Corporation score distributions, asset values, growth rates, and unemployment rates.
Supervisory directive	An informal enforcement action by the Office of Thrift Supervision that directs a thrift to cease an activity or take an affirmative action to remedy or prevent an unsafe or unsound practice.
Tangible equity	Total assets minus intangible assets minus total liabilities.
Tier 1 capital	Common shareholder's equity (common stock, surplus, and retained earnings), noncumulative perpetual preferred stock, and minority interests in the equity accounts of consolidated subsidiaries.
Tier 2 capital	Subordinated debt, intermediate-term preferred stock, cumulative and long-term preferred stock, and a portion of the allowance for loan and lease losses.
Thrift financial report	A financial report that thrifts are required to file quarterly with 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 <u>generally accepted accounting principles</u> . The thrift financial report is similar to the call report required of commercial banks.

Transaction Account
Guarantee Program

A component of the Federal Deposit Insurance Corporation's Temporary Liquidity Guarantee Program. The Temporary Liquidity Guarantee Program was established in October 2008 as part of a coordinated effort by the Federal Deposit Insurance Corporation, the Department of the Treasury, and the Federal Reserve to address unprecedented disruptions in credit markets and the resultant inability of financial institutions to fund themselves and make loans to creditworthy borrowers. The Temporary Liquidity Guarantee Program has two distinct components: (1) the Debt Guarantee Program and (2) the Transaction Account Guarantee Program. The Federal Deposit Insurance Corporation guarantees certain senior unsecured debt issued by participating entities under the Debt Guarantee Program and all funds held in qualifying noninterest-bearing transaction accounts at participating insured depository institutions under the Transaction Account Guarantee Program. Originally scheduled to expire on December 31, 2009, the Transaction Account Guarantee Program was extended in August 2009 until June 30, 2010. Participating insured depository institutions pay an assessment fee for the additional guarantee.

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) It is subject to a capital directive, a cease and desist 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 it 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

The following chronology describes significant events in the history of BankUnited, FSB (BankUnited), including examinations conducted and enforcement actions taken by the Office of Thrift Supervision (OTS).

- 10/3/1984 The thrift is established as a state chartered de novo institution under the name United Savings Association.
- 10/1/1989 United Savings Association changes its name to Bank United Savings Bank and becomes a mutual savings bank, a type of bank that does not issue capital stock, is owned by its depositors, and managed by a board of trustees. The bank distributes profits to the depositors in proportion to the business they do with the bank.
- 2/2/1990 Bank United Savings Bank changes its name to Bank United, A Savings Bank, and changes its organization type to stock savings and loan, which allows the institution to raise capital by issuing stock and primarily uses the savings of its stockholders to fund mortgage, single family construction, and personal loans.
- 3/5/1993 Bank United, A Savings Bank, changes its name to BankUnited, FSB, and changes its organization type to stock savings bank, a type of institution that issues stock and distributes its profits to its stockholders who possess the right to elect directors to the board.
- 1/31/1995 BankUnited becomes a wholly owned subsidiary of BankUnited Financial Corporation (BFC).
- 8/25/2003 OTS begins a full scope examination that is completed on December 11, 2003, resulting in CAMELS composite and component ratings of 2/222222. BankUnited meets the regulatory standard for a well-capitalized designation.
- 2004 BankUnited begins increasing its emphasis on option adjustable rate mortgage (option ARM) loans originated for portfolio (held for investment).
- 1/31/2005 OTS begins a full scope examination that is completed on June 6, 2005, resulting in CAMELS composite and component ratings of 2/212222. BankUnited meets the regulatory standard for a well-capitalized designation.

Appendix 4
Chronology of Significant Events

- 3/31/2005 Option ARMs total \$2.7 billion, or 29 percent, of total assets, compared with only 5 percent at June 30, 2003. Twenty-eight percent of the option ARM loans are negatively amortizing.
- 1/20/2006 OTS begins a limited examination that is completed on May 19, 2006. The examination includes a review of both the underwriting of BankUnited's option ARM loans and the disclosures provided to option ARM borrowers. No exceptions were noted concerning the underwriting or consumer disclosures.
- 6/30/2006 Option ARMs in a negative amortization position total approximately 70 percent.
- 7/31/2006 OTS begins a full scope examination that is completed on December 27, 2006, resulting in CAMELS composite and component ratings of 2/212222. BankUnited meets the regulatory standard for a well-capitalized designation.
- 9/30/2006 Option ARMs total \$6.7 billion, or 49 percent of BankUnited's total assets.
- 5/21/2007 OTS begins a limited examination to assess management's efforts to achieve compliance with current interagency guidance on nontraditional mortgage product risks and other corrective actions noted in the last examination related to nontraditional mortgage products. A review of asset quality ratios and trends demonstrates deterioration since the last examination, completed in December 2006, and the adverse trend does not appear to be subsiding. As a result, OTS downgrades BankUnited's CAMELS asset quality rating from 1 to 2.
- 12/10/2007 OTS begins a limited examination that is completed December 14, 2007. The purpose of the examination is to assess BankUnited's compliance with outstanding issues related to the interagency guidance on nontraditional mortgage product risks that were found during the May 21, 2007, limited examination. OTS notes that the level of problem residential loans continues to increase rapidly and gives no indication that it will begin to subside. Based on current projections, BankUnited's nonaccrual loans and real estate owned are expected to be about \$865 million (or about 65 percent of total capital) by September 30, 2008.

- 12/31/2007 Ninety-one percent, or \$6.9 billion, of BankUnited's option ARMs are negatively amortizing.
- 1/31/2008 OTS, joined by the Federal Deposit Insurance Corporation, begins a full scope examination that is completed on July 11, 2008, resulting in CAMELS composite and component ratings of 4/443442. BankUnited meets the regulatory standard for a well-capitalized designation.
- 3/31/2008 Option ARMs total \$7.3 billion, or 51 percent of BankUnited's total assets.
- 5/2008 BankUnited discontinues production of option ARMs.
- 6/30/2008 OTS downgrades BankUnited's CAMELS composite and component ratings for asset quality, earnings, capital, and liquidity, resulting in ratings of 3/343432 (downgraded further to 4/443442 on July 11, 2008). BFC is also assigned a composite CAMELS rating of 3 to reflect OTS's concerns about the holding company's ability to continue to service the significant debt it has accumulated and to successfully access capital markets in light of BankUnited's significant asset quality issues.
- 7/24/2008 OTS issues a memorandum of understanding (MOU) to BFC that requires the holding company to raise a minimum of \$400 million and to adopt a capital augmentation plan.
- 7/24/2008 OTS issues an MOU to BankUnited that requires the thrift to (1) terminate negative amortization and reduced documentation lending programs; (2) submit a loan reduction plan and business plan within 60 days; (3) achieve and maintain core and risk-based capital ratios of 8 and 15 percent, respectively; and (4) ensure that its loss reserves are no less than \$280 million at September 30, 2008.
- 7/24/2008 OTS notifies BankUnited of its intent to reclassify the thrift's prompt corrective action (PCA) capital category from well-capitalized to adequately capitalized. OTS determines that the thrift is in an unsafe and unsound condition due to the deterioration in its portfolio of nontraditional mortgage loans, the concentration of risk associated with the portfolio, and the resultant need for significant additional capital.
- 8/4/2008 OTS headquarters officials, including the senior deputy director and the deputy director for examinations, supervision, and consumer protection,

participate in a conference call with OTS southeast region officials to discuss BankUnited's CAMELS ratings for a recently concluded examination of the thrift and the appropriate supervisory and enforcement response. Among the items discussed is the willingness of thrift management to infuse capital from the holding company into the thrift to offset a loss for the quarter ending June 30, 2008. The senior deputy director directs OTS regional management to request the holding company to infuse as close to a certain amount of funds as possible. The senior deputy director advises that for regulatory purposes the infusion should be recognized as of June 30, 2008, and the thrift financial report (TFR) amended accordingly.

- 8/8/2008 OTS notifies the BankUnited that it is in troubled condition, based on the findings of its full -scope examination completed on July 11, 2008.
- 8/11/2008 OTS begins a limited examination of BankUnited that is completed on September 3, 2008, resulting in CAMELS composite and component ratings of 4/443442. Although BankUnited meets the regulatory standard for a well-capitalized designation, OTS concludes that the thrift's capital levels are insufficient to support its current risks.
- 8/11/2008 BFC files Form 8-K with the Securities and Exchange Commission (the "current report" companies must file to announce major events that shareholders should know about). The 8-K includes a press release and a presentation, dated August 8, 2008, of BFC's financial results for the quarter ended June 30, 2008. The 8-K announces that BFC strengthened BankUnited's capital "through an \$80 million capital contribution." BankUnited's resulting core and risk-based capital ratios are 7.6 percent and 13.8 percent, respectively.
- 8/12/2008 BFC files a notification of late filing of its 10-Q (a filing that contains an entity's unaudited financial statements) with the Securities and Exchange Commission for the quarter ended June 30, 2008. According to the notification, the late filing results from continuing adverse market conditions that have increased the complexity of accounting and disclosure issues.
- 8/25/2008 BFC files the 10-Q for the quarter ended June 30, 2008, disclosing that the company has agreed with its regulators to take a number of actions, including raising \$400 million of new capital, and that OTS may downgrade the thrift's capital category and impose additional restrictions.

The 10-Q states that effective June 30, 2008, for regulatory capital purposes, BFC contributed \$80 million in additional capital to BankUnited. Ultimately, BankUnited was never successful in raising new capital prior to the thrift's closing in May 2009.

- 9/4/2008 OTS begins a limited examination of BankUnited that is completed on December 18, 2008, resulting in CAMELS composite and component ratings of 5/54554.
- 9/5/2008 OTS downgrades BankUnited to adequately capitalized for PCA purposes. OTS bases the reclassification on examination findings and projected growth in BankUnited's nonperforming assets and projected losses in its option ARM portfolio.
- 9/19/2008 OTS issues cease and desist (C&D) orders to BankUnited and BFC that replace the July 24, 2008, MOUs.

The C&D order to BankUnited requires the thrift to (1) meet and maintain minimum levels of Tier 1 capital of 7 percent and total risk-based capital of 14 percent (regulatory minimum requirements are 6 percent and 10 percent, respectively); (2) cease production of new loans that may result in negative amortization and loans underwritten using reduced documentation standards; (3) adopt and submit for OTS review a loan reduction plan to reduce the level of option ARM loans; (4) adopt and submit for OTS review a comprehensive business plan extending through the fiscal year ending September 30, 2011; (5) adopt and submit for OTS review a revised allowance for loan and lease losses methodology; (6) restrict growth, dividend payments, management changes, severance and indemnification payments, and changes in employment contracts and compensation arrangements; (7) prepare a quarterly liquidity report for the board's review; and (8) appoint a committee of nonemployee directors to monitor and coordinate compliance with all provisions of the C&D order on a quarterly basis.

The C&D order to BFC requires the holding company to (1) adopt and implement the capital augmentation plan and the alternative capital strategy submitted in conformance with the requirements of the BFC MOU dated July 24, 2008; (2) restrict dividend payments; (3) comply with prior notification requirements for changes in directors or senior executive officers, employment contracts, and any other compensation arrangements; (4) restrict golden parachute payments or prohibited

indemnification payments unless compliance with specified regulatory requirements is achieved; (5) comply with prior notification with respect to new or renewed debt.

- 10/20/2008 The individual holding the positions of chairman, chief executive officer, and director of BankUnited and BFC resigns. The individual holding the positions of president and chief operating officer of BankUnited and BFC is appointed chief executive officer of the thrift and BFC.
- 11/2008 The Federal Home Loan Bank (FHLB) (1) denies BankUnited's request for a \$50 million advance, (2) indicates that it will no longer lend to the thrift, (3) expects the thrift to pay down all maturing advances to eliminate any collateral shortfall, and (4) informs thrift management that its credit score will be downgraded from a 9 to a 10. Ten represents the lowest credit rating on FHLB's credit risk rating scale of 1 to 10.
- 12/16/2008 BFC files a notification of late filing of its 10-K (an annual filing that provides a comprehensive overview of a company's business and financial condition and includes audited financial statements) with the Securities and Exchange Commission for the fiscal year ended September 30, 2008. According to the notification, the late filing is caused by continuing adverse market conditions and the complexity of accounting and disclosure issues—factors that have resulted in the need for additional review and analysis of the business, including regulatory issues, liquidity, and capital. BankUnited expects to file the 10-K in January 2009.
- 12/18/2008 OTS issues a report of examination for a field visit to BankUnited, resulting in CAMELS composite and component ratings of 5/554554. OTS also assigns BFC a composite rating of 5.
- 1/26/2009 BankUnited amends its TFR for the quarter ended September 30, 2008, to include a larger loan loss provision. Based on the amendment, the thrift meets the definition of undercapitalized under PCA.
- 1/30/2009 The thrift files its TFR for the quarter ended December 31, 2008, and meets the definition of critically undercapitalized under PCA.
- 2/10/2009 BFC files a notification of late filing with the Securities and Exchange Commission for its 10-Q for the quarter ended December 31, 2008. The notification states that BFC expects to need about 2 more months to file

the 10-K and the 10-Q because of the need for additional review and analysis of the business resulting from continuing adverse market conditions and the complexity of accounting and disclosure issues.

- 2/10/2009 OTS sends a PCA notice to BankUnited's board regarding the thrift's critically undercapitalized status and requires that the thrift submit a capital restoration plan.
- 2/25/2009 BankUnited submits a capital restoration plan to OTS. The capital restoration plan submitted by BankUnited includes the an injection of \$1 billion in equity capital at March 31, 2009 and is contingent upon Open Bank Assistance in the form of a loss sharing arrangement with the FDIC or other government agency and development of an appropriate deal structure.
- 3/12/2009 BankUnited provides notification to the Federal National Mortgage Association (Fannie Mae) that it will voluntarily terminate the mortgage selling and servicing contract between the thrift and Fannie Mae effective April 1, 2009. The voluntary termination will require the thrift to write off its recorded Fannie Mae servicing asset, which totaled \$15.8 million at February 28, 2009.
- 4/10/2009 OTS sends BankUnited a notice of intent to issue a PCA directive and a denial of the thrift's capital restoration plan. OTS rejects the plan because it relies on a government-assisted open bank transaction.
- 4/14/2009 OTS issues the PCA directive, which includes the consent of BankUnited's board to the appointment of a conservator or receiver.
- 5/12/2009 BFC files a notification of late filing of its 10-Q for quarter ended March 31, 2009, with the Securities and Exchange Commission. The notification states that management is working diligently to complete all late filings by June 15, 2009, but that no assurances can be given about BFC's ability to file by this date.
- 5/21/2009 OTS closes BankUnited, and the Federal Deposit Insurance Corporation is appointed as receiver.

This appendix lists the Office of Thrift Supervision’s (OTS) full-scope safety and soundness and limited examinations of BankUnited, FSB (BankUnited), from August 2003 until the thrift’s failure in May 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 the examiners. This appendix also lists the informal and formal enforcement actions taken against BankUnited by OTS.

Date examination started/ended	CAMELS rating	Assets (in billions)	Significant safety and soundness matters requiring board attention and other corrective actions and recommendations cited in reports of examinations and limited examination reports	Informal/formal enforcement action
8/25/2003 12/11/2003 (Full scope examination)	2/222222	\$6.9	<p data-bbox="768 856 1230 888"><u>Matters requiring board attention</u></p> <ul data-bbox="768 898 1230 1883" style="list-style-type: none"> <li data-bbox="768 898 1230 1329">• Identify and cure all flood insurance shortages on existing loans in every department. The review should encompass loans requiring flood insurance covered by a dwelling policy form, as well as loans insured through a residential condominium building association policy (RCBAP) form. This review should be thoroughly documented, including specifically addressing the loans with flood insurance shortages and the action taken. <li data-bbox="768 1339 1230 1812">• Revise policies and procedures in the residential and consumer lending departments to accurately describe the methodology for determining the amount of flood insurance required by federal regulations. If the bank uses evaluation reports in addition to appraisal reports to determine insured value for flood insurance purposes, the procedures should specifically describe all applicable methodologies for calculating coverage and be consistent with regulatory requirements. <li data-bbox="768 1822 1230 1883">• Revise procedures to describe the methodology for analyzing 	None

Appendix 5
OTS Examinations and Enforcement Actions

Date examination started/ended	CAMELS rating	Assets (in billions)	Significant safety and soundness matters requiring board attention and other corrective actions and recommendations cited in reports of examinations and limited examination reports	Informal/formal enforcement action
			<p>condominium unit loans insured through a RCBAP form to ensure that flood insurance is adequate to meet federal regulatory requirements. These procedures should reflect the review at loan origination and renewal and the review of updated RCBAP master policies.</p> <ul style="list-style-type: none"> • Revise the adjustable rate mortgage (ARM) program, disclosures, notes, and other consumer documents to reflect the actual loan servicing practices in the consumer department. This would include, but not be limited to, defining, using, and selecting the index values for subsequent rate adjustments as specified in the note and matching ARM program disclosure. • Obtain documentation from legal counsel opining that BankUnited is legally permitted, without the agreement of the affected borrowers, to revise its notes and look-back period for loans with look-back periods that are inconsistent with the note and ARM program disclosures. <p><u>Other corrective actions</u></p> <ul style="list-style-type: none"> • Perform and document a periodic country risk analysis for the nations representing the highest risk and adjust the maximum portfolio limits by country, if appropriate, based on this analysis. • Ensure that the following internal audit areas are addressed: (1) weaknesses cited in audit follow-ups; (2) an assessment of department effectiveness; and (3) contingency planning. 	

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Date examination started/ended	CAMELS rating	Assets (in billions)	Significant safety and soundness matters requiring board attention and other corrective actions and recommendations cited in reports of examinations and limited examination reports	Informal/formal enforcement action
			<ul style="list-style-type: none"> • Strengthen the compliance audit area and provide for sufficient departmental resources to address corrective actions in this area without materially disrupting future performance. • Develop a policy and procedures manual for the operation of mortgage servicing assets as recommended by internal audit. The manual should address pricing, revaluation, accounting and risk assessment, along with methods used to manage the servicing asset. Review the requirements of the Interagency Advisory on <u>Mortgage Banking</u> and ensure that the new policy and procedures comply. The board should approve the new policy no later than 120 days following the receipt of this report. • Revise the liquidity management policy to more fully address the guidance outlined in Thrift Bulletin 77. The policy should establish quantitative guidelines and limits to ensure adequate liquidity, including limits on the use of wholesale funds. The board of directors should review and approve the revised policy no later than 90 days after the receipt of this report, and management should institute reports to periodically monitor compliance with the approved limits. • (directed to the board) If interest rate risk policy limits are exceeded going forward, address the exception and approve remedial strategies to bring the institution into compliance. 	

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Date examination started/ended	CAMELS rating	Assets (in billions)	Significant safety and soundness matters requiring board attention and other corrective actions and recommendations cited in reports of examinations and limited examination reports	Informal/formal enforcement action
			<ul style="list-style-type: none"> • Report to the board the results of the in-house interest rate risk model as soon as possible after the end of the quarter. • Force-place flood insurance in a timely manner and in accordance with regulatory requirements. • Accurately describe index values used for rate adjustments in ARM program disclosures. Index values used for rate adjustments must be readily available to and verifiable by the borrower and beyond the control of the bank. • If management decides to add margins to the residential department ARM loans with improperly omitted margins, seek legal guidance to ensure that contract law and Truth in Lending laws and regulations are followed. If pursued, this course of action, including a legal opinion, should be documented for future OTS review. • Officially appoint the Community Reinvestment Act officer. • Continue to monitor application rates by race and present this analysis at least annually, along with a comparison with benchmarks, to the board. • Continue to monitor the geographic distribution of residential loans, as well as loans to borrowers of different incomes, and compare the results to the same benchmarks used by federal banking regulators. The board should be apprised at least annually of lending results to low- and moderate-income borrowers and 	

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Date examination started/ended	CAMELS rating	Assets (in billions)	Significant safety and soundness matters requiring board attention and other corrective actions and recommendations cited in reports of examinations and limited examination reports	Informal/formal enforcement action
1/31/2005 6/06/2005	2/212222	\$8.8	<p>in low- and moderate-income geographies in the assessment area.</p> <p><u>Matters requiring board attention</u></p> <ul style="list-style-type: none"> • None 	None
(Full scope examination)			<p><u>Other corrective actions</u></p> <ul style="list-style-type: none"> • Ensure that, as appropriate, a discounted value rather than a gross retail value is used to calculate loan-to-value ratios. • Develop a more comprehensive liquidity policy commensurate with the bank's practices, size, and complexity of operations. The policy should incorporate the bank's liquidity procedure and guidelines as well as the contingency plan. The policy should also include the following: (1) a description of the various forecasting methods utilized for cash flow projections; (2) definitions of the procedures necessary for approvals of exceptions to policies, limits, and authorizations; (3) a detailed contingency plan for handling unanticipated stressful scenarios. • Ensure that the revised liquidity plan is reviewed and approved by the board. • Review the accounts associated with all federal grand jury and law enforcement subpoenas received since January 1, 2003. This review is to be conducted to identify potential money laundering, suspicious activity, or other violations of Bank Secrecy Act (BSA) regulations and should be completed by September 30, 2005. 	

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Date examination started/ended	CAMELS rating	Assets (in billions)	Significant safety and soundness matters requiring board attention and other corrective actions and recommendations cited in reports of examinations and limited examination reports	Informal/formal enforcement action
			<ul style="list-style-type: none"> • Perform a retroactive review of wire transfers since January 1, 2004, to identify suspicious activity involving money laundering or potential BSA violations. Suspicious activity reports (SAR) should be filed as necessary. This review should be completed by September 30, 2005. • Conduct a retroactive review of significant and/or unusual cash transactions going back to January 1, 2004, to identify suspicious activity involving money laundering or potential BSA violations. SARs should be filed as necessary. This review should be completed by December 31, 2005. • Review the customer profiles for all existing high-risk accounts to ensure that the profiles are accurate and complete. Special emphasis should be placed on accounts with international wire transfer activity and/or significant cash transactions. This review should be completed by December 31, 2005. 	
1/20/2006 5/19/2006 (Limited examination)	2/212222	N/A	In this limited examination, OTS reviewed the underwriting of and disclosures provided to recent option adjustable rate mortgage (option ARM) borrowers for residential properties. OTS noted no exceptions in its review.	None
7/31/2006 12/27/2006 (Full scope examination)	2/212222	\$12.9	<u>Matters requiring board attention</u> <ul style="list-style-type: none"> • None <u>Other corrective actions</u> <ul style="list-style-type: none"> • Develop and begin using a standardized format when presenting option ARM information to senior management and the board. On at 	None

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OTS Examinations and Enforcement Actions

Date examination started/ended	CAMELS rating	Assets (in billions)	Significant safety and soundness matters requiring board attention and other corrective actions and recommendations cited in reports of examinations and limited examination reports	Informal/formal enforcement action
			<p>least a quarterly basis, the standard reviews should include a written analysis of the more material changes and trends in portfolio characteristics, loan originations, loan sales, delinquencies, prepayments, budget projections, program changes, and so on. There also needs to be a more robust form of vintage analysis (by year of origination) to track and analyze the portfolio characteristics and performance in all areas. As part of the vintage analysis, the percentage of customers utilizing the negative amortization option and the percentage of the portfolio in a negative amortization position should be identified at least quarterly.</p> <ul style="list-style-type: none"> • Ensure that the following areas of the interagency guidance on nontraditional mortgage product (NMP) risks are implemented no later than March 31, 2007: <ol style="list-style-type: none"> (1) methodology for <u>stress testing</u> the option ARM portfolio; (2) revised allowance for loan and lease losses (ALLL) methodology and policy to account for specific levels of risk identifiable in the option ARM portfolio; (3) consideration in the repayment analysis, when applicable, any balance increase that may accrue from the loan's negative amortization feature; (4) explanation of what factors other than credit score are considered when assessing the borrower's repayment capacity on the DocEase loan program; and (5) development and adoption of written policies that specify 	

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OTS Examinations and Enforcement Actions

Date examination started/ended	CAMELS rating	Assets (in billions)	Significant safety and soundness matters requiring board attention and other corrective actions and recommendations cited in reports of examinations and limited examination reports	Informal/formal enforcement action
			<p>production and portfolio limits. Some items to consider within the portfolio limits are geographic concentrations, option ARM types (e.g., stated income/stated assets, no income/no asset verification), and (c) Fair Isaac Corporation (FICO) scores.</p> <ul style="list-style-type: none"> • Assign one person responsibility for coordinating the review of compliance with transactions with affiliates regulations. This review should be completed on a regular schedule every year or when considering new material affiliated transactions. • Provide assurances by the audit committee that management's analysis of compliance with transactions with affiliates regulations has considered not only whether a transaction is at market terms, but also whether the particular arrangement is reasonable and makes business sense from the bank's perspective. • Establish a timeline for upgrading the interest rate risk function with sufficient staffing and modeling tools to more fully address all the requirements of Thrift Bulletin 13a for complex institutions. • Establish a back-testing regime for the option ARMs. This should include back testing estimates, comparing effective duration estimates to large dealer estimates and including default estimates if appropriate. • Look critically at the staffing and turnover in the BSA department since the preceding examination. This 	

Appendix 5
OTS Examinations and Enforcement Actions

Date examination started/ended	CAMELS rating	Assets (in billions)	Significant safety and soundness matters requiring board attention and other corrective actions and recommendations cited in reports of examinations and limited examination reports	Informal/formal enforcement action
			<p>review should be documented in the board minutes.</p> <ul style="list-style-type: none"> • Consider developing an electronic spreadsheet on wire transfers that would include at least the names, addresses, and phone numbers of senders and beneficiaries and the names of banks sending or receiving the wires. The BSA department should then sort and analyze this information periodically to determine if there are any unusual patterns that might require further inquiry, up to potentially filing a SAR. • Review the accounts associated with all federal grand jury and law enforcement subpoenas in a timelier manner. Include timeframe requirements for completing these reviews in the BSA policies and present the status of these reviews, including some form of aging report, at each BSA committee meeting. • Establish parameters for clearing exceptions highlighted by the ASSIST system and include an aging report for uncleared exceptions that is provided to the BSA committee. • Expand the periodic statistical analysis of Home Mortgage Disclosure Act lending activity to help detect unrecognized disparities. • Enhance the fair lending transactional reviews by targeting areas of risk and incorporate the guidance provided in the Federal Financial Institutions Examination Council Fair Lending Examination Procedures. • Monitor broker compensation to help detect disparities in loan pricing on 	

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OTS Examinations and Enforcement Actions

Date examination started/ended	CAMELS rating	Assets (in billions)	Significant safety and soundness matters requiring board attention and other corrective actions and recommendations cited in reports of examinations and limited examination reports	Informal/formal enforcement action
5/21/2007 7/25/2007 (Limited examination)	2/222222	N/A	<p>prohibited bases.</p> <ul style="list-style-type: none"> Conduct a risk assessment of BankUnited’s activity in alternative mortgage products and adopt best practices for consumer protection to the extent that management has not already done so. <p>The limited examination assessed management’s efforts to achieve compliance with current interagency guidance on nontraditional mortgage product risks and other corrective actions noted at the last examination related to nontraditional mortgage products. There was also a review of asset quality ratios and trends to assess the appropriateness of the current asset quality component rating. Based on OTS’s findings, BankUnited’s asset quality rating was downgraded from 1 to 2.</p> <p><u>Recommendations</u></p> <ul style="list-style-type: none"> Consider recommending that the board revise the current limits (includes the following loan types: stated income verified assets, other low doc types, second homes, investor properties, credit score 660-699, credit score 621-659, and total debt ratio 48 percent or above) to include limits on combinations of credit attributes (layered risks) similar to the product matrix, or limits that are based not only on outstanding balances but also on periodic origination levels. Ensure that the ALLL calculation methodology and policy are consistent with the interagency guidance. A segregation of 	None

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OTS Examinations and Enforcement Actions

Date examination started/ended	CAMELS rating	Assets (in billions)	Significant safety and soundness matters requiring board attention and other corrective actions and recommendations cited in reports of examinations and limited examination reports	Informal/formal enforcement action
12/10/2007 12/14/2007	N/A	N/A	nontraditional mortgage products into pools with similar characteristics must be incorporated into the analysis to achieve an appropriate methodology.	None
(Limited examination)			The limited examination assessed compliance with outstanding issues noted during OTS's May 2007 field visit, where were related to the interagency guidance on nontraditional mortgage products risks. OTS also conducted a limited review of asset quality trends, with particular emphasis on the performance of the nontraditional residential loan portfolio. The limited examination concluded that management took appropriate steps to address the unresolved issues from the May 2007 field visit related to nontraditional mortgage products. OTS also noted that the level of problem residential loans continued to increase rapidly, with no indication that the trend would begin to subside.	
1/31/2008 7/11/2008	4/443442	\$14.3	<p data-bbox="764 1331 1175 1362"><u>Matters requiring board attention</u></p> <ul data-bbox="764 1367 1268 1873" style="list-style-type: none"> <li data-bbox="764 1367 1268 1772">• Assess the overall capital level as compared to the risk profile of BankUnited, including the status of any capital-raising efforts by the holding company, given the increasing levels of delinquent option ARMs and the average losses on the sales of real estate owned (REO). The board's review of these matters at each regular board meeting must be fully detailed in the board meeting minutes. <li data-bbox="764 1776 1268 1873">• Reevaluate the appropriateness of the level of the ALLL and the methodology used to ensure that 	None

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OTS Examinations and Enforcement Actions

Date examination started/ended	CAMELS rating	Assets (in billions)	Significant safety and soundness matters requiring board attention and other corrective actions and recommendations cited in reports of examinations and limited examination reports	Informal/formal enforcement action
			<p>sufficient loss reserves have been established.</p> <ul style="list-style-type: none"> • Validate the ALLL methodology periodically. This validation process should include procedures for a review, by a party independent of the institution's credit approval and ALLL estimation processes, of the ALLL methodology and its application in order to confirm its effectiveness. A specific timeframe for validating the ALLL should be established. • Document fully why the loss reserve calculated for loans that are nonaccrual but are less than 180 days delinquent is not used for loans that are more than 180 days delinquent, particularly when there are substantial differences between the two loss reserves. Management should consider using the loss rate determined for the loans that are nonaccrual but are less than 180 days delinquent. • Adjust the cure rate calculation, since it appears to greatly overestimate the cure rate, which is presently at 28 percent. Consider obtaining data on the loans more than 180 days delinquent and on loans that are nonaccrual but not more than 180 days delinquent and determining what the actual historical cure rate has been on these two types of delinquencies. These historical cure rates can then be compared with the cure rate being used in the ALLL methodology. • Use the calculated loss rate against the additional loans that are projected 	

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OTS Examinations and Enforcement Actions

Date examination started/ended	CAMELS rating	Assets (in billions)	Significant safety and soundness matters requiring board attention and other corrective actions and recommendations cited in reports of examinations and limited examination reports	Informal/formal enforcement action
			<p>to be on nonaccrual or worse at least 6 months in the future when calculating the loss reserves on residential loans.</p> <ul style="list-style-type: none"> • Perform a formal comparison of in-house evaluations to the actual appraisals subsequently obtained for properties that go into REO to assess the reliability of the in-house evaluations; adjust for material variance if required. • Document and fully address items in the section on the ALLL in the asset quality section of this report. • Prepare a detailed, written plan with reasonable and appropriate timeframes and reporting requirements to prudently and diligently reduce the level of negatively amortizing loans. • Classify loans modified with letter agreements as substandard. • Review the modified loan portfolio from July 1, 2007, forward and, in conjunction with advice and review by the independent auditors, make a written determination whether these modifications should be accounted for and reported as troubled debt restructurings. • Review the loss mitigation department's work to ensure that all potential significant suspicious activity has been fully identified and file any necessary SARs. This review should be documented and presented to senior management. • Analyze the depth, structure, and functions of the accounting and finance areas. This review should 	

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OTS Examinations and Enforcement Actions

Date examination started/ended	CAMELS rating	Assets (in billions)	Significant safety and soundness matters requiring board attention and other corrective actions and recommendations cited in reports of examinations and limited examination reports	Informal/formal enforcement action
			<p>include day-to-day management of these areas, the high-level needs of the bank and holding company with respect to these areas, and consideration for planning for the increasing complexity in these areas as nonperforming assets increase.</p> <ul style="list-style-type: none"> • Prepare a comprehensive business plan covering the last 6 months of calendar year 2008 and all of calendar years 2009 and 2010. Include a detailed description of BankUnited’s plans to improve earnings, preserve and enhance capital, and strengthen liquidity. Include quarterly financial projections and identify all relevant assumptions. • Review the overall liquidity position and prepare a written report that considers new strategies and means for improving and strengthening the overall liquidity position. • Review and monitor the bank’s credit availability and outstanding borrowings, and consider alternative plans should collateral requirements increase and/or credit availability decrease. 	
			<p><u>Other corrective actions</u></p> <ul style="list-style-type: none"> • Ensure that corrections are made to Schedule Compliance Capital Ratios no later than the filing of the June 30, 2008, thrift financial report (TFR). • Address the issue of improving the timeliness of the final ALLL analysis. • Enhance the reporting/analysis area related to measuring multiple layered risks (i.e., loan-to-value/FICO/ 	

Appendix 5
OTS Examinations and Enforcement Actions

Date examination started/ended	CAMELS rating	Assets (in billions)	Significant safety and soundness matters requiring board attention and other corrective actions and recommendations cited in reports of examinations and limited examination reports	Informal/formal enforcement action
			<p>mortgage insurance) and performing migration analysis on the portfolio by refreshing credit scores and collateral valuations (asset valuation models or applying home pricing index adjustments).</p> <ul style="list-style-type: none"> • Include a more detailed assessment of recast dates and stress testing recast projections in option ARM reporting. Separately report the interest-only loans, using the style of analytical reports prepared by another bank area. Items to include are payment shock and recast dates, as well as portfolio characteristics and payment analysis. • Develop and implement enhanced operating procedures for short sales, letter agreements, and other key areas within the specialty assets/default administration department. • Develop and implement operating procedures for the loan retention program. • Formalize the customer outreach programs that are in the process of being implemented to address the recast risk. • Review loss mitigation strategies to ensure that loans are accounted for properly, with particular emphasis on troubled debt restructuring accounting, fair value calculations, recorded investment, writing off broker premiums, and nonaccrual issues. • Incorporate a procedure to ensure that loans in active foreclosure receive periodic valuation updates. 	

Appendix 5
OTS Examinations and Enforcement Actions

Date examination started/ended	CAMELS rating	Assets (in billions)	Significant safety and soundness matters requiring board attention and other corrective actions and recommendations cited in reports of examinations and limited examination reports	Informal/formal enforcement action
			<p>These updates should be used to establish fair value for the appropriate accounting methodologies.</p> <ul style="list-style-type: none"> • Ensure that before transferring loan balances to REO that unpaid escrow and corporate advances are expensed and not capitalized. • Enhance reports on unpaid mortgage insurance claims to include the likelihood of collecting claims, curtailment, denial ratios, and overall exposure (e.g., REO, active foreclosure, short sales). • Initiate ongoing BSA/SAR training for the loss mitigation department. • Have an independent group sample Loss Mitigation Department activity after BSA training has been provided to ensure that appropriate identification, documentation, and investigation of suspicious activity are being conducted. • Have the compliance department review the notes and borrower disclosures for modified loans and ensure that they are consistent and sufficiently clear so that borrowers understand when their loans will recast. The results of this review should be provided to the board. • Monitor short sale and deficiency note statistics by race and ethnicity to ensure that protected groups do not receive disparate treatment. Should the statistical review indicate a potential disparity on a prohibited basis, a transactional review should be conducted to determine if the bank is following its written nondiscriminatory guidelines for 	

Appendix 5
OTS Examinations and Enforcement Actions

Date examination started/ended	CAMELS rating	Assets (in billions)	Significant safety and soundness matters requiring board attention and other corrective actions and recommendations cited in reports of examinations and limited examination reports	Informal/formal enforcement action
6/30/2008 6/30/2008 (Notice of rating downgrades)	3/343432	N/A	<p>eligibility and treatment under these programs.</p> <ul style="list-style-type: none"> • Review the various options available for a more advanced and efficient anti-money laundering monitoring system, such as a rules-based system, and establish implementation goals for the system. These goals should be completed within 90 days of receipt of this report. • Consider the options available for a more advanced or automated anti-money laundering monitoring system for wire transfers. Document this analysis within 90 days of receipt of this report. • Consider options to upgrade the bank's customer risk-rating process. Select an option and prepare a timetable for its implementation within 90 days of receipt of this report. 	Memoranda of understanding (informal) issued on 7/24/2008 to BankUnited and BFC
8/11/2008 9/03/2008	4/443442	N/A	OTS reviewed BankUnited's written submissions, information regarding changes in the thrift's condition since	None

Appendix 5
OTS Examinations and Enforcement Actions

Date examination started/ended	CAMELS rating	Assets (in billions)	Significant safety and soundness matters requiring board attention and other corrective actions and recommendations cited in reports of examinations and limited examination reports	Informal/formal enforcement action
(Limited examination)			July 24, 2008, and other information. As a result of this review and analysis, OTS confirmed that BankUnited was in an unsafe and unsound condition for the reasons outlined in the July 24, 2008, letter and this report of examination. Therefore, effective September 5, 2008 OTS reclassified BankUnited's capital category from well-capitalized to adequately capitalized, pursuant to 12 C.F.R. § 565.4(c).	
9/04/2008 12/18/2008	5/554554	N/A	OTS revised BankUnited's CAMELS ratings because of continuing and significant deterioration in the thrift's asset quality and earnings, and the resultant impact on its capital position. BankUnited's composite CAMELS rating is adjusted to 5. Component ratings for asset quality, earnings, liquidity, and capital are downgraded to 5, and the ratings for management and sensitivity are downgraded to 4.	Cease and desist orders issued on 9/19/2008 to BankUnited and BFC Prompt corrective action directive executed on 4/14/2009 between OTS and BankUnited

Source: OIG analysis of OTS reports of examination and enforcement actions.

Our material loss review of BankUnited is the tenth such review performed since September 2007 of a failed institution regulated by the Office of Thrift Supervision (OTS). This appendix provides recommendations made to 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
<p><i>Safety and Soundness: Material Loss Review of NetBank, FSB, OIG-08-032 (Apr. 23, 2008)</i></p> <p>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.</p>	<p>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.</p> <p>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.</p> <p>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.</p>
<p><i>Safety and Soundness: Material Loss Review of IndyMac Bank, FSB, OIG-09-032 (Feb. 26, 2009)</i></p> <p>OTS closed IndyMac on July 11, 2008, and named FDIC as conservator. As of May 8, 2009, FDIC estimated that IndyMac’s failure would cost the Deposit Insurance Fund \$10.7 billion.</p>	<p>Ensure that action is taken on the lessons learned and recommendations from the OTS internal review of the IndyMac failure.</p> <p>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</p>

Appendix 6
Prior OIG Material Loss Review Recommendations

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.

Safety and Soundness: Material Loss Review of Ameribank, Inc., OIG-09-036 (Apr. 7, 2009)

Remind examiners of the risks associated with rapid growth in high-risk concentrations.

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 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)

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:

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.

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

Appendix 6
Prior OIG Material Loss Review Recommendations

	internal risk management system that includes stress testing, regular periodic monitoring, and other risk management tools for higher-risk concentrations.
<p><i>Safety and Soundness: Material Loss Review of Downey Savings and Loan, FA, OIG-09-039 (June 15, 2009)</i></p> <p>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.</p>	<p>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:</p> <p>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.</p> <p>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</p> <p>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.</p> <p>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.</p>
<p><i>Safety and Soundness: Material Loss Review of Suburban Federal Savings Bank, OIG-09-047 (Sept. 11, 2009)</i></p> <p>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.</p>	<p>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.</p> <p>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.</p> <p>Have regional offices ensure that examiners</p>

Appendix 6
Prior OIG Material Loss Review Recommendations

	<p>conduct timely and adequately scoped <u>field visits</u> 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 action when necessary.</p>
<p><i>Safety and Soundness: Material Loss Review of American Sterling Bank, OIG-10-011 (Nov. 25, 2009)</i></p> <p>OTS closed American Sterling and appointed FDIC as receiver on April 17, 2009. As of October 31, 2009, FDIC estimated that American Sterling's failure would cost the Deposit Insurance Fund \$41.9 million. FDIC also estimated a loss to the Transaction Account Guarantee Program of \$0.2 million.</p>	<p>Ensure that action is taken on its internal failed bank review of American Sterling Bank.</p> <p>Remind supervisory and examination staff of the importance of requiring thrifts to hold capital to mitigate their <u>recourse</u> exposure on sold loans.</p> <p>Remind supervisory and examination staff to scrutinize capital contributions made to thrifts especially noncash capital contributions.</p> <p>Ensure examiners take forceful action to mitigate losses whenever a thrift's line of business incurs losses that threaten the viability of the institution.</p>
<p><i>Safety and Soundness: Material Loss Review of First Bank of Idaho, OIG-10-036 (February 16, 2010)</i></p> <p>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. FDIC also estimated a loss to the Transaction Account Guarantee Program of \$4.7 million.</p>	<p>Ensure that examination staff sufficiently considers a thrift's risk profile when deciding whether to allow a thrift to lower its internal capital targets and when determining the thrift's CAMELS ratings.</p>
<p><i>Safety and Soundness: Material Loss Review of Peoples Community Bank, OIG-10-040 (May 27, 2010) (Review performed by Mayer Hoffman McCann P.C., an independent certified public accounting firm, under the supervision of the Treasury Office of Inspector General)</i></p> <p>OTS closed Peoples Community Bank and appointed FDIC as receiver on July 31, 2009. As of April 16, 2010, FDIC estimated that First Bank of Idaho's failure would cost the Deposit Insurance Fund \$136 million.</p>	<p>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;</p> <p>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.</p>

Appendix 7
Management Response



Office of Thrift Supervision
Department of the Treasury

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John E. Bowman
Acting Director

June 9, 2010

MEMORANDUM FOR: Susan Barron,
Director, Banking Audits
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
BankUnited, FSB

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

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

1. The OTS Director ensure that the recommendations from the OTS internal failed thrift review of BankUnited's failure are implemented.
2. OTS caution examiners to pay particular attention to the risk-weighting of option ARM loans and, going forward, ensure that decisions by thrifts to risk-weight these loans at anything other than 100 percent are adequately justified. Further, OTS should issue clarifying guidance to thrifts and examiners regarding option ARMs that qualify for risk-weighting other than 100 percent.

In addition, the report reaffirms an earlier recommendation that OTS work with its regulatory partners to determine whether to propose legislation and/or change regulatory guidance on concentrations posing unacceptable risk.

OTS concurs with these recommendations and has initiated, or will take, actions to address them. For OTS supervisory purposes, CEO Letter # 311 of July 9, 2009, addressed the internal failed bank review in connection with concentrations. The internal review also recommended that supervisory staff be advised of the importance of timely identification of unsafe and unsound practices and the need for a cautious approach when evaluating new product risks. That

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Management Response

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recommendation was fulfilled by the issuance of new OTS Examination Handbook Section 760 on September 16, 2009. Finally, the internal review also recommended that OTS generally consider as unsafe and unsound the use of reduced documentation loan underwriting unless appropriate mitigating controls are in place. OTS expects this recommendation to be completed by July 31, 2010.

With regard to the second recommendation on risk-weighting of option ARM loans, the staff is currently drafting clarifying guidance for issuance to the industry and examiners. This guidance will be issued by July 31, 2010.

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

Appendix 8
Major Contributors to This Report

Susan Barron, Audit Director
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OIG Budget Examiner

United States Senate

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

Chairman and Ranking Member
Committee on Finance

U.S. House of Representatives

Chairman and Ranking Member
Committee on Financial Services

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Chairman
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