



# Audit Report



OIG-11-015

SAFETY AND SOUNDNESS: Failed Bank Review of Bay National Bank

November 05, 2010

## Office of Inspector General

Department of the Treasury





DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

OFFICE OF  
INSPECTOR GENERAL

November 05, 2010

OIG-11-015

MEMORANDUM FOR JOHN WALSH  
ACTING COMPTROLLER OF THE CURRENCY  
OFFICE OF THE COMPTROLLER OF THE CURRENCY

FROM: Kieu T. Rubb /s/  
Director, Procurement and Manufacturing Audits

SUBJECT: Failed Bank Review of Bay National Bank

This memorandum presents the results of our review of the failure of Bay National Bank (Bay). Bay opened in May 2000 and had a main office in Lutherville, Maryland, and one branch office in Salisbury, Maryland. The bank was a wholly owned subsidiary of Bay National Corporation, a bank holding company located in Lutherville, Maryland. The Office of the Comptroller of Currency (OCC) closed Bay and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on July 9, 2010. At March 31, 2010, the bank had \$282.2 million in total assets. FDIC estimated that the loss to the Deposit Insurance Fund is \$17.4 million.

Because the loss to the Deposit Insurance Fund is less than \$200 million, as set forth by section 38(k) of the Federal Deposit Insurance Act (FDIA), we conducted a review of the failure of Bay that was limited to (1) ascertaining the grounds identified by OCC for appointing the FDIC as receiver and (2) determining whether any unusual circumstances exist that might warrant a more in-depth review of the loss. In performing our review we (1) examined documentation related to the appointment of FDIC as receiver, (2) reviewed OCC reports of examination, and (3) interviewed OCC personnel.

We conducted this performance audit during August and September 2010 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.

## **Causes of Bay's Failure**

The primary causes of Bay's failure were its aggressive growth strategy, excessive concentrations in higher-risk construction and development loans, and insufficient capital relative to the risk level of its loans. These conditions were exacerbated by the downturn in residential real estate values in Maryland, Bay's market. In addition, risk management activities at Bay were inadequate. For example, liberal underwriting standards allowed originations of loans without proper analysis of the borrowers' stated income or their ability to sustain a project should it be delayed. Bay's asset quality began deteriorating in late 2007, resulting in significant increases in its problem assets and loan losses. In turn, these loan losses significantly diminished earnings and capital and, ultimately, led to Bay's failure.

## **Conclusion**

Based on our review of the causes of Bay's failure and the grounds identified by OCC for appointing FDIC as receiver, we determined that there were no unusual circumstances surrounding the bank's failure or the supervision exercised by OCC. Accordingly, we have determined that a more in-depth review of the bank's failure by our office is not warranted.

We provided a draft of this memorandum to OCC management for comment. In its response, OCC stated it agreed with the primary causes of Bay's failure summarized in this memorandum and had no concerns with our determination that a more in-depth review of the bank's failure by our office is not warranted. The response is provided as Attachment 1. A list of the recipients of this memorandum is provided as Attachment 2.

We appreciate the courtesies and cooperation provided to our staff during the audit. If you have any questions, you may contact me at (202) 927-5904 or Katherine Johnson, Audit Manager, at (202) 927-8783.

Attachments



## MEMORANDUM

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Comptroller of the Currency  
Administrator of National Banks

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Washington, DC 20219

To: Kieu T. Rubb, Director, Procurement and Manufacturing Audits

From: John Walsh, Acting Comptroller /s/

Date: October 25, 2010

Subject: Response to Failed Bank Review of Bay National Bank

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We have received and reviewed your draft report titled "Failed Bank Review of Bay National Bank (Bay)." Because the loss to the Deposit Insurance Fund is less than \$200 million, as set forth by section 38(k) of the Federal Deposit Insurance Act, you conducted a review of the failure of Bay that was limited to: (1) ascertaining the grounds identified by the OCC for appointing the FDIC as receiver; and, (2) determining whether any unusual circumstances exist that might warrant a more in-depth review of the loss. In performing your review you: (1) examined documentation related to the appointment of FDIC as receiver; (2) reviewed OCC reports of examination; and, (3) interviewed OCC personnel.

You conducted this performance audit during August and September 2010 in accordance with generally accepted government auditing standards. Those standards require that you plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for your findings and conclusions based on your audit objectives. You believe that the evidence obtained provides a reasonable basis for your findings and conclusions based on your audit objectives.

You concluded that the primary causes of Bay's failure were its aggressive growth strategy, excessive concentrations in higher-risk construction and development loans, and insufficient capital relative to the risk level of its loans. We agree.

You determined that there were no unusual circumstances surrounding the bank's failure or the supervision exercised by OCC. As a result, you determined that a more in-depth review of the bank's failure by the OIG is not warranted. We have no concerns with your determination.

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

**Department of the Treasury**

Deputy Secretary  
Office of Strategic Planning and Evaluations  
Office of Accounting and Internal Control

**Office of the Comptroller of the Currency**

Acting Comptroller of the Currency  
Liaison Officer

**Office of Management and Budget**

OIG Budget Examiner