Audit Report

OIG-11-075

SAFETY AND SOUNDNESS: Material Loss Review of First Security National Bank

June 10, 2011

Office of Inspector General

Department of the Treasury

Contents

This page intentionally left blank.

OFFICE OF
INSPECTOR GENERAL

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

June 10, 2011

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

FROM: Susan Barron /s/
Director, Banking Audits

SUBJECT: Material Loss Review of First Security National Bank

INTRODUCTION

The Office of the Comptroller of the Currency (OCC) closed First Security National Bank (First Security), Norcross, Georgia, and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on December 04, 2009. As of March 31, 2011, FDIC estimated that First Security's loss to the Deposit Insurance Fund was $35.4 million.

Under section 38(k) of the Federal Deposit Insurance Act, we are responsible for conducting a material loss review of the failure of First Security.[1] To help fulfill this responsibility, we contracted with Crowe Horwath LLP, an independent certified public accounting firm. Crowe Horwath's report dated May 18, 2011, is provided as Section I.

RESULTS OF MATERIAL LOSS REVIEW

We concur with Crowe Horwath's reported conclusions regarding First Security's causes of failure and OCC's supervision of First Security:

- First Security failed primarily because of (1) loan losses resulting from the bank's concentration in residential acquisition, development and construction (ADC) and land loans; and (2) the significant decline in the Atlanta real estate market. The bank's Board of Directors and management

[1] At the time of the failure of First Security, section 38(k) defined a loss as material if it exceeded the greater of $25 million or 2 percent of the institution's total assets. Effective July 21, 2010, section 38(k defines a loss as material if it exceeds $200 million for calendar years 2010 and 2011, $150 million for calendar years 2012 and 2013, and $50 million for calendar years 2014 and thereafter (with a provision that the threshold be raised temporarily to $75 million under certain conditions).

made a strategic decision to increase its concentration in ADC lending beginning in 2006. First Security's strategy of substantially increasing ADC loans without managing commensurate risk left the bank vulnerable to diminishing asset quality and future losses tied to fluctuations in the real estate market. Starting in mid- to late 2007, metro Atlanta began to experience a severe decline in the residential real estate market and First Security experienced deterioration in loan quality. Also, First Security was heavily reliant on alternative funding sources, specifically brokered deposits. As the condition of the bank deteriorated, First Security faced restrictions on its acceptance of brokered deposits. First Security was unable to maintain adequate capital levels to sustain its losses, which ultimately resulted in the bank's failure.

- OCC's supervision of First Security did not prevent a material loss to the Deposit Insurance Fund. However, OCC's supervision of First Security was adequate and the appropriate issues were identified by OCC; these issues were identified in a timely manner, and appropriate supervisory actions were taken. As a result, the material loss review of this failure did not identify any recommendations for OCC.

Details of Crowe Horwath's conclusions are in their report.

OBJECTIVES, SCOPE, AND METHODOLOGY

Under section 38 (k), we are responsible to prepare a report to OCC that (1) ascertains why First Security's problems resulted in a material loss to the Deposit Insurance Fund; (2) reviews OCC's supervision of the institution, including its implementation of the prompt corrective action provisions of section 38(k); and (3) makes recommendations for preventing any such loss in the future.

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

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

This page intentionally left blank.

Section I

Crowe Horwath LLP's Report on the Material Loss Review of First Security National Bank

This page intentionally left blank.

First Security National Bank
Material Loss Review
Safety and Soundness Performance Audit
June 10, 2011

Contents

Appendices

Abbreviations

ADC	Acquisition, Development and Construction
ALLL	Allowance for Loan and Lease Losses
Board	Board of Directors
CRE	Commercial Real Estate
FDIC	Federal Deposit Insurance Corporation
MRA	Matter Requiring Attention
OCC	Office of the Comptroller of the Currency
OIG	Office of Inspector General
OREO	Other Real Estate Owned
PCA	Prompt Corrective Action
ROE	Report of Examination
TARP	Troubled Asset Relief Program

Inspector General
Department of the Treasury

RE: Transmittal of Results for the Material Loss Review Report for First Security National Bank, Norcross, Georgia.

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

The performance audit results are in the accompanying performance audit report. The information included in this report was obtained during our fieldwork which occurred during the period from March 2010 through May 2010.

We conducted our performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We also included several appendices to this report. Appendix 1 contains a more detailed description of our material loss review objectives, scope and methodology. Appendix 2 contains background information on First Security and OCC's supervision processes. Appendix 3 is a glossary of terms used in this report. These terms are underlined where first used in the body of the report.

Crowe Horwath LLP

Fort Lauderdale, Florida
May 18, 2011

Results in Brief

First Security failed primarily because of (1) loan losses resulting from the bank's concentration in residential acquisition, development and construction (ADC) and land loans; and (2) the significant decline in the Atlanta real estate market. The bank's Board of Directors (Board) and management made a strategic decision to increase its concentration in ADC lending beginning in 2006. First Security's strategy of substantially increasing ADC loans without managing commensurate risk left the bank vulnerable to diminishing asset quality and future losses tied to fluctuations in the real estate market. Starting in mid- to late 2007, metro Atlanta began to experience a severe decline in the residential real estate market and First Security experienced deterioration in loan quality. Also, First Security was heavily reliant on alternative funding sources, specifically brokered deposits. As the condition of the bank deteriorated, First Security faced restrictions on its acceptance of brokered deposits. First Security was unable to maintain adequate capital levels to sustain its losses, which ultimately resulted in the bank's failure.

OCC's supervision of First Security did not prevent a material loss to the Deposit Insurance Fund. However, our audit found that OCC's supervision of First Security was adequate and that the appropriate issues were identified by OCC; these issues were identified in a timely manner, and appropriate supervisory actions were taken. As a result, our material loss review of this failure did not identify any recommendations for OCC.

Causes of First Security National Bank's Failure

First Security failed because of significant loan delinquencies and losses incurred on ADC and land loans. First Security's Board and management made a strategic decision to increase its existing concentration of ADC and land loans, a form of commercial real estate (CRE) lending, in the Atlanta area beginning in 2006. The Board and management failed to establish specific concentration limits for CRE loans. These loans were concentrated in the greater Atlanta area, which subsequently experienced severe real estate market declines. First Security was heavily reliant on alternative funding sources, specifically brokered deposits. Losses resulting from these higher-risk loans created a capital deficiency that prompted the OCC to close the bank in late 2009.

Concentrations of Residential ADC and Land Loans

OCC defines a concentration as a group of similar types of assets or liabilities that, when aggregated, exceeds 25 percent of a bank's risk-based capital (core capital plus allowance for loan and lease losses (ALLL)).[1] Concentrations pose risk to an institution because negative events affecting overly concentrated groups of assets can have a highly detrimental impact on the institution. First Security maintained high concentrations in ADC and land loans in its portfolio.

First Security's Board and management's business plan resulted in the heavy concentration of residential ADC and land loans. At one point during 2006, ADC and land loans reached more than 600 percent of capital. Although the concentration was reduced in 2008 as a result of repayments and increases in foreclosure activity, which shifted loans to the Other Real Estate Owned (OREO) category, it remained significant at 323 percent of capital.

OCC examiners identified concentration issues as early as 2001, noting enhancements were needed in concentration reporting and identification. During examinations conducted during 2003 and 2004, OCC examiners recommended that First Security improve its concentration risk management, credit administration, and ALLL methodology. Subsequently, in its 2006 report of examination (ROE), examiners recommended that the Board establish more specific internal concentration of credit limits for significant exposures and that concentration reports show the existing level of each concentration compared to the Board limits. However, no specific reductions in the concentration were required as a result of the ROE as OCC felt that concentration management had improved, the opening of new branches would help facilitate diversifying the bank's loan portfolio, and capital levels remained strong relative to the bank's overall risk profile.

OCC provides guidance to examiners as to when institutions' CRE loan assets reach concentration levels representing concentration risk requiring further analysis.[2] Such institutions are those for which:

- total reported loans for construction, land development, and other land represent 100 percent or more of the institution's total capital; or

---

[1] OCC Comptroller's Handbook, Concentration of Credits (March 1990)

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

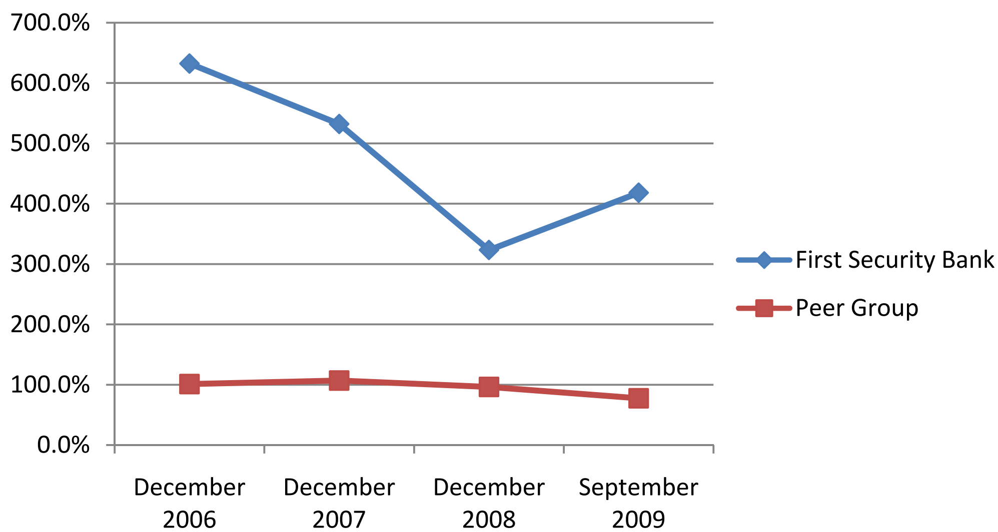
- total CRE loans represent 300 percent or more of the institution's total capital, and the outstanding balance of the institution's CRE loan portfolio has increased by 50 percent or more during the prior 36 months.

Although OCC guidance does not provide quantifiable limits on banks' CRE lending, it does describe risk management practices an institution is expected to have in place to pursue CRE lending in a safe and sound manner. According to the guidance, institutions should address the following key elements in establishing a risk management framework that effectively identifies, monitors, and controls CRE concentration risk:

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

However, by the time the guidelines were established in December, 2006, First Security's residential ADC and land lending had reached 562 percent of capital. Figure 1 illustrates First Security's ADC and land loans as a percentage of total capital compared to its peer group.

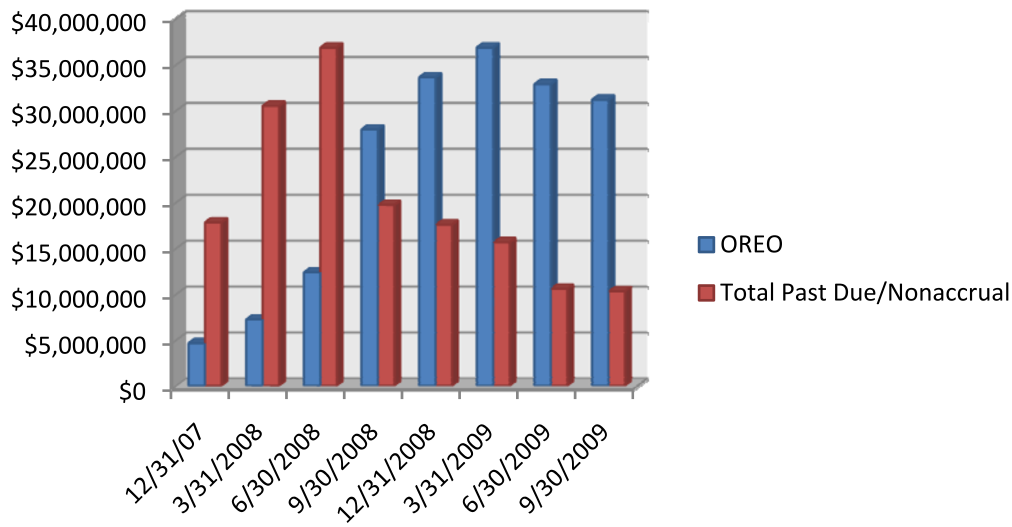
Figure 1. First Security's ADC and Land Loans as a Percentage of Total Capital Compared to Its Peer Group



Source: Uniform Bank Performance Reports

Beginning in 2007, First Security began to experience a decline in asset quality related to the concentration in residential ADC and land loans. As a result of deteriorating asset quality, First Security experienced significant increases in its level of past due and non-accrual loans and then increases in its OREO as the past due and non-accrual loans went into foreclosure. Figure 2 highlights the increase in past due and non-accrual loans from the end of 2007 to the middle of 2008 and the subsequent increases in OREO.

Figure 2. Summary of Past Due/Non-accrual and OREO by Quarter from December 31, 2007 through September 30, 2009



Source: Federal Deposit Insurance Corporation (FDIC) call reports

The increase of past due and non-accrual loans resulted in significant loan losses. Bad debt expense totaled $1,549,000 in 2007, $3,076,000 in 2008 and $4,788,000 in the 9 months ended September 30, 2009. These loan losses significantly diminished earnings and resulted in inadequate capital, and ultimately, the failure of First Security.

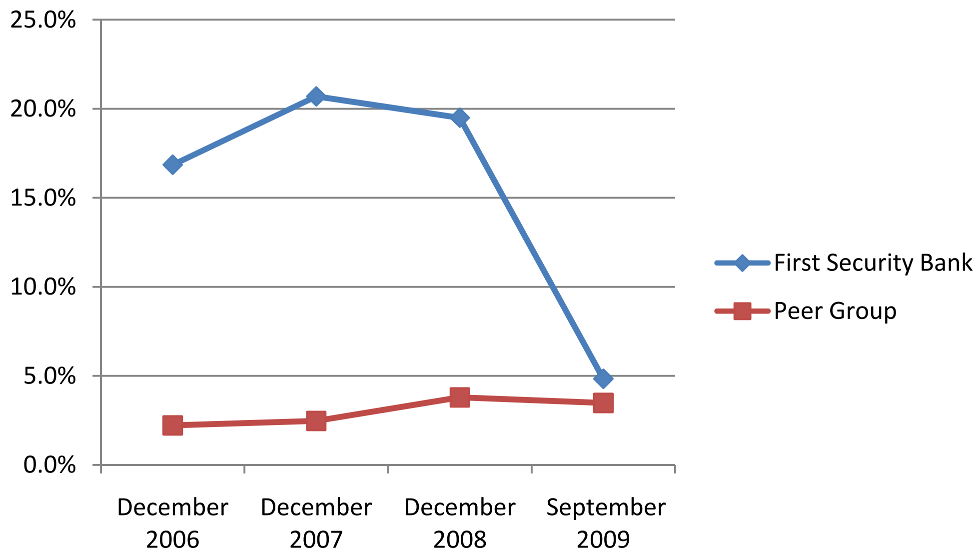
Significant Downturn in the Atlanta and National Real Estate Markets

First Security's loans were concentrated within its marketplace in the Atlanta metropolitan area. The Atlanta residential real estate market peaked and began to depreciate in value beginning in 2007. As the residential real estate values depreciated significantly, the bank's concentration in residential ADC and land lending could not be overcome by management. The residential real estate values depreciated to a level well beyond that anticipated by management or the Board. The bank did not have sufficient capital to absorb the losses that resulted from the bank's increase in troubled loans resulting from the downturn in the Atlanta real estate market.

Extensive Reliance on Non-Core Funding

First Security relied on alternative funding sources extensively. During 2007, 22 percent of its deposits were derived from non-core funding sources, specifically brokered deposits. The bank relied on non-core funding to expand its residential ADC portfolio. As shown in Figure 3, First Security relied extensively more on brokered deposits as a percentage of total deposits than its peers.

Figure 3: First Security's Brokered Deposits as a Percentage of Total Deposits Compared to Its Peer Group



Source: Uniform Bank Performance Reports

OCC included in its ROE dated October 16, 2008 a matter requiring attention (MRA) directing the Board to finalize a plan to protect existing capital. The examiners concluded that liquidity was a growing concern as access to funds was becoming more difficult given First Security's financial condition. Another MRA directed management to ensure the availability of sufficient liquidity to meet planned and unplanned demands for funds, increase monitoring efforts, and analyze the likely timing and cause of liquidity depletion.

In addition, on November 18, 2008, the Board entered into a consent order with OCC, which required, among other things, the bank to maintain a total risk-based capital ratio of 13 percent and a leverage ratio of 9 percent; develop and submit to OCC 3-year capital and strategic plans; and increase the bank's liquidity to a level sufficient to sustain operations. The consent order stated that the imposition of the higher capital levels meant that First Security could not be deemed to be well-capitalized for PCA purposes. As a result, First Security was restricted from accepting or renewing brokered deposits.[3] The restrictions on brokered deposits combined with depositor withdrawals further strained the liquidity of First Security.

First Security's financial condition continued to deteriorate, leading to the bank becoming undercapitalized as of March 31, 2009, and critically undercapitalized as of September 30, 2009. As a result, First Security was closed on December 4, 2009.

OCC's Supervision of First Security

OCC's supervision of First Security did not prevent a material loss to the Deposit Insurance Fund. However, based upon our audit work, we concluded that OCC's supervision of First Security was adequate. We have noted no actions that should have been taken by OCC that would have decreased the loss to the Deposit Insurance Fund in any significant manner. Our review of OCC's ROEs and related workpapers and interviews with OCC and FDIC officials indicate that OCC identified issues in a timely manner, and used appropriate enforcement actions. Ultimately, the bank's ADC lending concentration coupled with the rapid and significant decline in residential real estate values within the bank's market area caused severe losses that resulted in the bank's failure.

OCC identified First Security's concentration risk as early as 2001 and provided a number of comments in several ROEs related to enhancing the monitoring and management of concentration risk. In addition, a targeted examination was conducted related to CRE lending prior to the next scheduled full scope examination during 2008 which timely identified the increased credit risks and resulted in a consent order being issued in November 2008.

Concerns related to liquidity and funding risks were also identified timely. Among other things, OCC imposed minimum capital ratio requirements in the consent order. As a result, the bank became less than well-capitalized, which in turn, placed restrictions on the bank's use of brokered deposits. In turn, these restrictions prevented any further reliance on the use of brokered deposits and reduced the origination of additional loans, which ultimately, while this is somewhat speculative, we believe minimized the loss to the Deposit Insurance Fund.

---

[3] An institution that falls from well capitalized is prohibited from accepting or renewing brokered deposits under 12 CFR 337.6 and may be subject to other supervisory action.

Table 1 summarizes OCC's examinations of First Security and its related enforcement actions from 2006 through 2009. Generally, MRAs represent the most significant items reported.

Table 1. Summary of OCC's Examinations and Enforcement Actions for First Security

		Examination Results			
Date started	**Exam Type**	**CAMELS rating**	**Number of MRAs**	**Number of corrective actions**	**Enforcement actions**
4/24/2006	Full Scope	2/122121	None	None	None
10/24/2007	Full Scope	2/132121	3	12	None
6/10/2008	Targeted CRE	4/443532	6	-	Consent order
3/31/2009	Full Scope	5/555542	7	7	None (consent order still in place)

Source: OCC ROEs and enforcement actions

PCA Used Appropriately

The purpose of PCA is to resolve the problems of insured depository institutions at the least possible long-term loss to the Deposit Insurance Fund. According to PCA requirements, federal banking agencies are to take certain actions when an institution's capital drops to certain levels. Under PCA, regulators also have flexibility to discipline institutions based on criteria other than capital levels to help reduce deposit insurance losses caused by unsafe and unsound practices.

We concluded that OCC appropriately used its authority under PCA in accordance with PCA requirements as follows:

- First Security's capital levels fell to undercapitalized on March 31, 2009, based on the bank's call report. OCC issued a PCA notification letter dated May 1, 2009, informing First Security of its undercapitalized status and required a Capital Restoration Plan by May 15, 2009. First Security submitted a Capital Restoration Plan to OCC on May 15, 2009, in accordance with the PCA notification letter.

- On July 8, 2009 OCC rejected First Security's Capital Restoration Plan given that the execution of a definitive agreement and a confirmation of the availability of the funds had not occurred. OCC also notified the bank that it was subject to the restrictions applicable to significantly undercapitalized banks pursuant to PCA due to the failure of the bank to submit an acceptable capital restoration plan.

- First Security became critically undercapitalized based on the filing of its September 30, 2009, call report. OCC issued a PCA notification letter dated November 16, 2009, informing First Security of its critically undercapitalized status and required another Capital Restoration Plan to be submitted as the previous plan was disapproved.

Despite OCC's timely identification of issues and appropriate use of enforcement actions, First Security's lending concentration coupled with the rapid and significant decline in the bank's market area caused severe losses. As a result, First Security was placed into receivership and closed by OCC on December 4, 2009.

Our objectives were to determine the causes of First Security National Bank's (First Security) failure and assess its supervision by the Office of the Comptroller of Currency (OCC). We conducted this material loss review of First Security under contract with the Department of the Treasury Office of Inspector General (OIG) in response to its mandate under section 38(k) of the Federal Deposit Insurance Act.[4] This section provides that if a deposit insurance fund incurs a material loss with respect to an insured depository institution, the inspector general for the appropriate federal banking agency is to prepare a report to the agency 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.

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

The OIG contracted with our firm to conduct this material loss review of First Security based on the loss estimate by the Federal Deposit Insurance Corporation (FDIC). As of March 31, 2011, the loss estimate was $35.4 million.

To accomplish our review, we conducted fieldwork off-site and at a FDIC regional office. We also interviewed personnel within the OCC Field Office; the OCC District Office; the OCC Special Supervision Division; the FDIC Regional Office; the FDIC Division of Resolutions and Receiverships; and the FDIC Division of Supervision and Consumer Protection. We conducted our fieldwork from March 2010 through May 2010.

To assess the adequacy of OCC's supervision of First Security, we determined (1) when OCC first identified the bank's safety and soundness problems, (2) the gravity of the problems, and (3) the

[4] P.L. 111-203, enacted on July 21, 2010, changed the definition of material loss in section 38(k) to any estimated loss in excess of $200 million for a loss occurring in 2010 and 2011, $150 million for a loss occurring in 2012 and 2013, and $50 million for a loss occurring in 2014 or after (with a provision for a temporary increase to $75 million if certain conditions are met).

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

- We determined that the period covered by our audit would be from OCC's examination starting on April 24, 2006, through the bank's failure on December 4, 2009.

- We reviewed OCC's supervisory files and records for First Security from 2006 through 2009. We analyzed examination reports, supporting workpapers, and related supervisory and enforcement correspondence. We performed these analyses to gain an understanding of the problems identified, the approach and methodology OCC used to assess the bank's condition, and the regulatory action used by OCC to compel bank management to address deficient conditions.

- We interviewed and discussed various aspects of the supervision of the bank with OCC officials and examiners to obtain their perspectives on the bank's condition and the scope of the examinations. We also interviewed FDIC officials who were responsible for monitoring First Security for federal deposit insurance purposes.

- We selectively reviewed First Security's documents that had been taken by FDIC and inventoried by FDIC Division of Resolutions and Receivership personnel. We identified from FDIC's inventory list those documents for our review that were most likely to shed light on the reasons for the bank's failure and OCC's supervision of the institution.

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

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.

First Security's National Bank History

First Security National Bank (First Security) was established as a federally-chartered commercial bank on June 25, 1985, and opened its first branch in Norcross, Georgia. First Security was a wholly owned subsidiary of First Security Corporation and operated four banking locations in the greater Atlanta area, including Cumming, Georgia; Canton, Georgia; and Atlanta, Georgia. The home office was in Norcross, Georgia.

First Security's business model focused on construction development and high-end residential construction. During strong real estate markets, this lending concentration resulted in reliable profits. However, beginning in early 2007, foreclosures overwhelmed Atlanta's real estate market and First Security's asset quality began to deteriorate rapidly. By June 2008, asset quality, capital levels, and earnings had deteriorated to such a degree that the Office of the Comptroller of the Currency (OCC) downgraded First Security's composite rating to a 4, and in November 2008 issued a consent order to the bank.

In December 2008, First Security engaged a consulting group to help find an investor or a merger/acquisition partner. Various commercial banks expressed interest in acquiring First Security pending the availability of financial funds, including approval of funds under Treasury's Troubled Asset Relief Program (TARP). However no definitive agreement was reached and First Security's application for TARP funds was also denied in December 2008. During this time, the bank's total available liquidity was $6-8 million, including a borrowing agreement with the Federal Reserve Bank of Atlanta. Agreements with other correspondent banks had been terminated.

On January 12, 2009, First Security submitted a plan to raise $5 million in capital by March 31, 2009, or merge with another financial institution. However, this deadline passed and the bank fell below well capitalized. On May 15, 2009, First Security submitted a new Capital Restoration Plan, which OCC rejected as impractical on July 8, 2009. In September 2009, the FDIC began preparations for receivership. On December 4, 2009, OCC closed the bank.

Types of Examinations Conducted by OCC

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

OCC conducts full-scope examinations of insured banks once every 12 or 18 months. During a full-scope examination, examiners conduct an onsite examination and rate all CAMELS components. OCC then assigns the bank a CAMELS composite rating based on its assessment of the overall condition and level of supervisory concern.

OCC uses the 12-month cycle until the bank's management has demonstrated its ability to operate the institution in a safe and sound manner and has satisfied all conditions imposed at the time of its charter approval. The 18-month examination interval applies to insured banks that have total assets of $500 million or less that: received a CAMELS composite rating of 1 or 2 and a Compliance rating of 1 or 2 for their most recent examination; received a CAMELS management component rating of 1 or 2 for their most recent examination; are well-capitalized; are not currently subject to a formal enforcement proceeding or order by OCC or the Federal Deposit Insurance Corporation; and have not undergone a change in control during the 12-month period since completion of the last full-scope examination.

Enforcement Actions Available to OCC

OCC performs various examinations of banks that result in the issuance of reports of examinations identifying areas of concern. OCC 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 bank's overall condition is sound, but it is necessary to obtain written commitments from a bank's board of directors or management to ensure that it will correct identified problems and weaknesses, OCC may use informal enforcement actions. OCC may use informal actions for problems in well- or adequately-capitalized banks and banks with a composite rating of 1, 2, or 3. However, in the case of a 3-rated bank, there is a presumption for use of a formal enforcement action for a bank with weak management or a less than satisfactory management rating, and where there is uncertainty as to whether management and the board have the ability and the willingness to take appropriate corrective measures.

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

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

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

Formal Enforcement Actions

If informal tools do not resolve a problem that has been identified, OCC is to use formal enforcement tools.

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

OCC can assess civil money penalties against banks and individuals for noncompliance with a formal agreement or final orders. OCC can also request a federal court to require the bank 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.

OCC Enforcement Guidelines

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

- the extent of actual or potential damage, harm, or loss to the bank because of the action or inaction;
- whether the bank has repeated the illegal action or unsafe or unsound practice;
- the likelihood that the conduct may occur again;

- the bank's record for taking corrective action in the past;
- the capability, cooperation, integrity, and commitment of the bank'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 bank;
- whether the bank's condition is improving or deteriorating; and
- the presence of unique circumstances.

OCC Assessments Paid by First Security

OCC funds its operations in part through semiannual assessments on national banks. OCC publishes annual fee schedules, which include general assessments to be paid by each institution based on the institution's total assets. If the institution is a problem bank (i.e., it has a CAMELS composite rating of 3, 4, or 5), OCC also applies a surcharge to the institution's assessment to cover additional supervisory costs. These surcharges are calculated by multiplying the sum of the general assessment by 50 percent for 3-rated institutions or by 100 percent for 4- and 5-rated institutions. Table 2 shows the assessments that First Security paid to OCC from July 2006 through 2009.

Table 2: Assessments Paid by First Security to OCC, 2006–2009

Billing Period	Exam Ratings	Amount Paid	% of Total Collection
7/1/2006–12/31/2006	2	$29,318	.009%
1/1/2007–6/30/2007	2	$32,398	.009%
7/1/2007–12/31/2007	2	$29,916	.009%
1/1/2008–6/30/2008	4	$28,260	.008%
7/1/2008–12/31/2008	4	$28,483	.008%
1/1/2009–6/30/2009	5	$55,940	.014%
7/1/2009–12/4/2009	5	$53,812	.014%

Number of OCC Staff Hours Spent Examining First Security

Table 3 shows the number of OCC staff hours spent examining First Security from 2006 to 2009.

Table 3: Number of OCC Hours Spent on Examining First Security, 2005-2009

Examination Start Date	Type of Examination	Number of Examination Hours
4/24/2006	Full-scope	502
10/24/2007	Full-scope	680
6/10/2008	Targeted	592
3/31/2009	Full-scope	865

Source: OCC
*Hours are totaled for safety and soundness examinations, information technology examinations, and compliance examinations and do not include time spent performing off-site monitoring.

Allowance for loan and lease loss	An estimate of uncollectible amounts that is used to reduce the book value of loans and leases to the amount that is expected to be collected. It is established in recognition that some loans in the institution's overall loan and lease portfolio will not be repaid.
Board resolution	A document designed to address one or more specific concerns identified by the Office of the Comptroller of the Currency (OCC) and adopted by a bank's board of directors.
Brokered deposit	Any deposit that is obtained, directly or indirectly, from a deposit broker. The bank or bank solicits deposits by offering rates of interest that are significantly higher than the rates offered by other insured depository institutions in its normal market area. Use of brokered deposits is limited to well-capitalized insured depository institutions and, with a waiver from the Federal Deposit Insurance Corporation, 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	C - Capital adequacy A - Asset quality M - Management quality E - Earnings L - Liquidity S - Sensitivity to Market Risk Bank supervisory authorities assign each bank a rating on a scale of one (best) to five (worst) for each factor. If a bank has a composite rating less than two it is considered to be a high-quality institution, while banks with ratings greater than three are considered to be less-than-satisfactory establishments. The system helps the supervisory authority identify banks that are in need of attention.
Capital restoration plan	A plan submitted to the appropriate federal banking agency by an undercapitalized insured depository institution. A capital restoration plan specifies the steps the insured depository institution is to take to become

adequately capitalized, the levels of capital to be attained during each year in which the plan is in effect, how the institution is to comply with the restrictions or requirements then in effect, the types and levels of activities in which the institution is to engage, and any other information that the federal banking agency may require.

Commercial real estate loans Loans for real property where the primary or significant source of repayment is from rental income associated with the property or the proceeds of the sale, refinancing, or permanent financing of the property. Commercial real estate loans included construction and real estate development, land development, and commercial properties such as office buildings and shopping centers.

Compliance The part of a financial institution examination that includes an assessment of how well the institution manages compliance with consumer protection and public interest laws and regulations, including the Bank Secrecy Act.

Concentration As defined by OCC, a group of similar types of assets or liabilities that, when aggregated, exceed 25 percent of a bank'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.

Consent Order	The title given by the OCC to a cease and desist order that is entered into and becomes final through the board of directors' execution, on behalf of the bank, of a stipulation and consent document. Its provisions are set out in article-by-article form and prescribes restrictions and remedial measures necessary to correct deficiencies or violations in the bank in order to return it to a safe and sound condition.

MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

To: Michael Percy, Partner, Crowe Horwath LLP

From: John Walsh, Acting Comptroller of the Currency /s/

Date: May 17, 2011

Subject: Response to Material Loss Review of First Security National Bank

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

You concluded that First Security failed primarily because of loan losses resulting from the bank's concentration in residential acquisition, development, and construction and land loans; the significant downturn in the Atlanta real estate market; and its extensive reliance on non-core funding.

Your report states that OCC's supervision of First Security did not prevent a material loss to the Deposit Insurance Fund. However, you found that OCC's supervision was adequate and that the appropriate issues were identified by OCC in a timely manner and appropriate supervisory actions were taken. As a result, you did not identify any recommendations for OCC.

We agree with your conclusions.

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

Section II

Report Distribution

Department of the Treasury

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

Office of the Comptroller of the Currency

Acting Comptroller of the Currency
Liaison Officer

Office of Management and Budget

OIG Budget Examiner

United States Senate

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

Chairman and Ranking Member
Committee on Finance

U.S. House of Representatives

Chairman and Ranking Member
Committee on Financial Services

Federal Deposit Insurance Corporation

Chairman
Inspector General

U.S. Government Accountability Office

Comptroller General of the United States