Audit Report

OIG-09-042

SAFETY AND SOUNDNESS: Material Loss Review of National Bank of Commerce

August 6, 2009

Office of Inspector General

Department of the Treasury

Contents

Abbreviations

CFP	contingency funding plan
CPP	Capital Purchase Program
CRP	capital restoration plan
EESA	Emergency Economic Stabilization Act of 2008
FDIC	Federal Deposit Insurance Corporation
GSE	Government-Sponsored Enterprises

IT	information technology
MRA	matters requiring attention
NBC	National Bank of Commerce
OIG	Department of the Treasury Office of Inspector General
OCC	Office of the Comptroller of the Currency
PCA	Prompt Corrective Action
ROE	report of examination
TARP	Troubled Asset Relief Program

August 6, 2009

John C. Dugan
Comptroller of the Currency

This report presents the results of our review of the failure of National Bank of Commerce (NBC), of Berkeley, Illinois, and of the Office of the Comptroller of the Currency's (OCC) supervision of the institution. Our review is mandated under section 38(k) of the Federal Deposit Insurance Act, as amended. OCC closed NBC and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on January 16, 2009. As of June 30, 2009, FDIC estimated that the loss to the Deposit Insurance Fund would be $92.5 million because of NBC's failure.

Section 38(k) requires that we determine why the failure of NBC resulted in a material loss to the insurance fund; review OCC's supervision of NBC, including implementation of the Prompt Corrective Action (PCA) provisions of section 38; and make recommendations for preventing such a loss in the future. Accordingly, we reviewed the supervisory files and interviewed key officials. We conducted fieldwork from February 2009 through June 2009 at OCC's headquarters in Washington, D.C. and field office in Chicago, Illinois, and at FDIC's Division of Resolutions and Receiverships in Dallas, Texas.

Appendix 1 contains a more detailed description of our objectives, scope, and methodology. Appendix 2 contains background information on NBC's history and OCC's supervision processes. Appendix 3 provides a glossary of terms used in this report. The terms are underlined and hyperlinked to the glossary where first used in the report. Appendix 4 contains a chronology of significant events related to NBC's history and OCC's supervision of the institution. Appendix 5 provides bank examination results and information on enforcement actions.

Results in Brief

The primary cause of NBC's failure was its significant losses from preferred stock holdings in Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac), (also referred to as Government-Sponsored Enterprises (GSE) securities in this report). These losses depleted NBC's capital and strained its liquidity. In the end, after several attempts, NBC was unable to raise capital or obtain financial assistance to prevent its closure.

OCC conducted timely and regular examinations of NBC and provided oversight through off-site monitoring. The scope of the examinations appeared comprehensive as indicated by the reports of examinations (ROE), although workpaper evidence supporting the examination procedures performed was somewhat limited. OCC used its authority under PCA in an appropriate and timely manner. Also, OCC's Special Supervision Division took appropriate actions after oversight of NBC was transferred to it.

All things considered, we believe that NBC acted in good faith when it invested in the GSE securities. Additionally, we have no reason to fault OCC's supervision of the institution as it relates to NBC's investment practices. Current law and regulatory standards permit banks to purchase GSE securities without limitation.[1]

What happened to Fannie Mae and Freddie Mac during the current economic crisis, including the rapid decline in the value of their securities, was unprecedented. Retrospectively, the lesson to be taken from the NBC material loss is that banks and regulators need to be cognizant that securities that are not backed by the full faith and credit of the U.S. government do entail risk, and high concentrations of such holdings elevate that risk. That risk was clearly underscored by NBC's failure.

We are recommending that OCC (1) conduct a review of investments held by national banks for any potential high risk

[1] 12 U.S.C. 24 (Seventh). OCC issued implementing guidance in 12 C.F.R. Part 1, *Investment Securities*. Banks that are well capitalized may also purchase other securities, such as municipal bonds, in unlimited amounts.

concentrations and take appropriate supervisory action, and (2) reassess examination guidance regarding investment securities, including GSE securities.

In a written response, OCC stated that its ongoing supervisory activity will identify and address other concentrations in high-risk securities. OCC also stated that it will issue a Supervisory Memorandum containing supplemental examiner guidance on investment securities risk management practices by September 1, 2009. The actions taken and planned by OCC are responsive to our recommendations. The response is provided as appendix 7.

Causes of National Bank of Commerce's Failure

Significant Losses Incurred Due to Devaluation of Investments in GSE Securities

Starting in May 2003 through November 2007, NBC made a number of purchases of GSE securities for investment purposes. The book value of these investments totaled $98.2 million as of June 30, 2008. After the Federal Housing Finance Agency placed Fannie Mae and Freddie Mac into conservatorship on September 7, 2008, the market value of the GSE preferred stock owned by the bank declined significantly, to approximately $4.5 million as of September 30, 2008.[2] The loss in market value of its holdings in these securities was the primary cause of NBC's failure.

Table 1 shows NBC's total purchases in GSE securities for calendar years 2003 through 2007.

[2] Fannie Mae and Freddie Mac were created to provide stability in the secondary mortgage market and promote access to mortgage credit throughout the United States. By purchasing some mortgages and guaranteeing others, Fannie Mae and Freddie Mac help bring the liquidity of global capital markets to local banks and other financial institutions. These two GSEs operate solely in the mortgage market and were therefore very much exposed to fluctuations in the housing market. When placed in conservatorship on September 7, 2008, the Federal Housing Finance Agency suspended dividends on the GSEs' stock. The common and preferred stock shares, however, remained outstanding. At the same time, Treasury entered into Senior Preferred Stock Purchase Agreements with the GSEs to ensure each maintained a positive net worth. In exchange, Treasury received senior preferred stock in the GSEs as well as warrants for the purchase of common stock of the GSEs. The warrants represent 79.9 percent of each GSE's common stock on a fully-diluted basis.

Table 1. Total Purchases in GSE Securities for Calendar Years 2003-2007

Year purchased	Amount purchased (millions)
2003	$11.0
2004	5.4
2006	8.3
2007	73.5
Total	98.2

Source: OCC's Chicago Field Office based on NBC's Inventory Reports

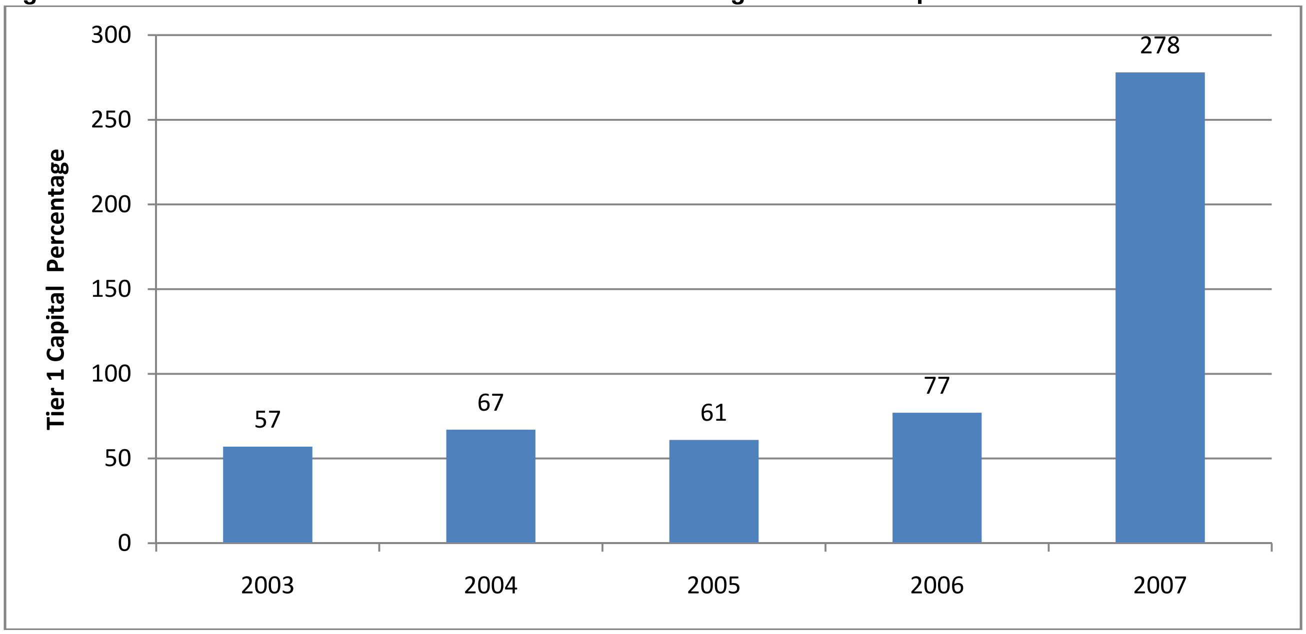
As of September 30, 2008, the bank recognized $93.7 million in other-than-temporary impairment charges associated with the decline in value of its GSE securities holdings. Of this impairment charge, approximately $57.4 million was recorded as a loss on the bank's income statement and approximately $36.3 million was recorded as a deferred tax asset on the bank's balance sheet.

The devaluation of NBC's Fannie Mae and Freddie Mac stock holdings essentially eliminated the bank's regulatory capital and strained its sources of liquidity. As of June 30, 2008, the bank had $32.4 million in Tier 1 capital and was well capitalized for PCA purposes. Three months later, the bank's Tier 1 capital fell to *negative* $39 million. At that time, the bank's total risk-based capital was *negative* 15.59 percent. A bank with a total risk-based capital ratio below 8 percent is considered to be undercapitalized. Also, as of September 30, 2008, the bank's tangible equity ratio was *negative* 10.26 percent, well below the 2 percent threshold that defines a bank to be critically undercapitalized for PCA purposes. Therefore, the bank was critically undercapitalized.

NBC's Investments Were Concentrated in GSE Securities

NBC's holdings in GSE securities represented 74 percent of its total investments and constituted approximately 278 percent of the bank's Tier 1 capital as of September 30, 2007. Figure 1 shows NBC's investments in GSE securities compared to its Tier 1 Capital.

Figure1. NBC's Investment in GSE Securities as a Percentage of Tier 1 Capital



Source: OIG analysis of NBC's Reports of Condition and Income (call reports)

While NBC had a high concentration in GSEs at the time, statute and regulatory standards allow banks to purchase investment securities issued by Fannie Mae and Freddie Mac without limitation. Based on the standards, NBC acted in good faith in investing in the GSEs. NBC's investment policy, *Portfolio Diversifications/Concentration of Risk*, adopted by the board of directors in March 2007, stated that "while the various federal agency securities not all bear the explicit guarantee of the U.S. Treasury, it is implicitly deemed unthinkable that the U.S. government would allow any of its agencies to default on outstanding debt."[3] For this reason, the policy stated that the bank would treat the Fannie Mae and Freddie Mac securities the same as U.S. Treasury securities and therefore, did not require a limitation.

In the end, however, the concentration of its holdings in GSE securities exposed NBC to greater risk and eventually was the contributing factor to its failure. In retrospect, banks and regulators need to be cognizant that securities that are not backed by the full faith and credit of the U.S. government do entail risk, and high concentrations of such holdings elevate that risk.

[3] National Bank of Commerce, *Investment Policy* (March 2007).

NBC Was Unable to Prevent Its Failure

During a targeted examination in October 2008, OCC examiners estimated that NBC would need approximately $55 million to be adequately capitalized. Examiners observed that the bank's ability to pay obligations, including depositors' demands, could affect the bank's viability. In a PCA notice dated November 3, 2008, OCC informed the bank that it was critically undercapitalized. Under PCA, the bank was prohibited from, among other things, (1) entering into any material transaction other than in the usual course of business, (2) extending credit for any highly leveraged transactions, (3) amending the bank's charter or bylaws, (4) making any change in accounting methods, (5) paying excessive compensation or bonuses, (6) paying interest rates that significantly exceed the prevailing rates of interest, and (7) making any principal or interest payments on subordinated debt. OCC further informed the bank that it was also prohibited from accepting, renewing, or rolling over brokered deposits and restricted the effective yield offered on insured deposits.

To further exacerbate NBC's already tenable situation, it also did not have any available lines of credit. A $12 million unsecured line of credit with another bank and a secured $30 million line of credit at the Federal Home Loan Bank had been closed by both institutions in September 2008. At that time, NBC owed $10 million to the Federal Home Loan Bank on the closed line. NBC did seek a new $15 million line of credit from a state-chartered financial institution, but was unsuccessful.

In an attempt to regain adequately capitalized status, NBC made multiple requests for federal financial assistance. Our review of OCC documents identified the following requests:

- NBC requested Emergency Economic Stabilization Act of 2008 (EESA) assistance, first on October 6, 2008, and again on October 17, 2008. Specifically, NBC asked Treasury to buy its Fannie Mae and Freddie Mac stock for $44.5 million and requested any and all applicable assistance available. Treasury's Troubled Asset Relief Program's (TARP) Capital Purchase Program (CPP) Investment Committee denied NBC's request.

- On October 24, 2008, NBC's holding company, Commerce Bancorp Inc., requested from the Federal Reserve Bank $8.7 million in assistance from the TARP CPP. The Federal Reserve Bank considered this request to be part of the earlier requests for a federal purchase of the bank's Fannie Mae and Freddie Mac GSE securities. On January 9, 2009, Treasury determined that the bank was not qualified for CPP assistance.
- On November 18, 2008, NBC requested financial assistance from FDIC, asserting that the financial assistance NBC requested would be less than the cost of NBC's potential receivership. FDIC denied NBC's request for assistance.
- On November 21, 2008, the bank requested a capital infusion of $42.8 million from Treasury, pursuant to EESA. Treasury denied the bank's request.
- On January 7, 2009, the bank sought financial assistance from FDIC. FDIC denied the bank's request because its proposal provided that FDIC's assistance would be used inappropriately to benefit preexisting shareholders.

In short, NBC was unable to raise the capital necessary to restore itself to adequately capitalized and did not submit an acceptable capital restoration plan (CRP).[4] Therefore, OCC closed the bank on January 16, 2009.

OCC's Supervision of National Bank of Commerce

OCC conducted timely and regular examinations of NBC and provided oversight through off-site monitoring. The scope of OCC's examinations appeared comprehensive, although workpaper evidence supporting the examination procedures performed was somewhat limited. We conclude, however, that OCC's supervision of NBC was appropriate. OCC transferred supervision of NBC to its Special Supervision Division in September 2008. OCC also used its authority under PCA appropriately when it reclassified NBC's capital level, restricted the bank's activities, and instructed the bank to submit an acceptable capital restoration plan.

[4] On December 16, 2008, OCC did not accept the capital restoration plan submitted by NBC because the plan was dependent on government assistance to restore capital. NBC's applications for government assistance submitted during October and November 2008 were denied.

Table 2 summarizes the results of OCC's full-scope on-site examinations, a targeted examination, and an enforcement action. Appendix 5 details matters requiring attention (MRA), other recommendations, and suggestions made by OCC as part of its examinations of NBC.

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

		Examination Results			
Date started[a]	**Assets (millions)**[b]	**CAMELS rating**	**Number of MRAs**	**Number of recommendations or suggestions**	**Enforcement actions**
4/4/2005	$389	2/212322	0	10	None
8/14/2006	$398	2/212222	0	6	None
12/18/2007	$423	2/222222	3	0	None
10/14/2008[c]	$459	5/554554	0	0	PCA Notice of Critically Undercapitalized issued 11/3/2008

Source: OCC ROEs and PCA notice.
[a] From 2005 to 2007, NBC was on an 18-month examination cycle. An examination cycle begins with the transmittal of the ROE. See appendix 2, Types of Examinations Conducted by OCC, for additional information about OCC examinations.
[b] Asset amounts are as of 12/31 except for the last examination which is as of 9/30/08.
[c] The October 14, 2008, targeted examination was directed by the Special Supervision Division.

OCC's Supervision of NBC Was Appropriate

During our review, we asked examiners why they did not express supervisory concern over NBC's increasing investments in GSE securities. Current law and regulatory standards established in 12 U.S.C. § 24 (Seventh) and OCC's 12 C.F.R §1.3 were the main reasons cited by the examiners for not challenging NBC's investment practices.

One examiner stated that he would hesitate to tell a bank not to purchase GSE securities or raise a concentration concern because of the implied backing by the U.S. government. Two examiners told us that, in hindsight, it would have been a good idea to either mention the concentrations to management or require the bank to monitor its investment portfolio more closely. We accept that at the time NBC made the purchases of the GSE securities, there would have been little basis to criticize the bank given the regulatory standards and perception of minimal risk associated with these holdings. Therefore, we do not fault OCC for not taking issue with NBC's investment practices.

While the circumstances surrounding the collapse of Fannie Mae and Freddie Mac were unprecedented, the circumstances underscore that high concentrations in supposedly safe investments that are not explicitly backed by the full faith and credit of the U.S. government do nevertheless pose risk that must be managed. Accordingly, we believe that going forward OCC should reassess examination guidance regarding investments in GSE securities.

OCC officials told us they are working to revise their guidance to the industry regarding GSEs. Furthermore, they told us that they will also be revising the investment securities handbook.

OCC Transferred Supervision of NBC to Its Special Supervision Division and Appropriately Used PCA

On September 11, 2008, shortly after Fannie Mae and Freddie Mac were placed into conservatorship, OCC's Central District Deputy Comptroller and the Director of Special Supervision mutually agreed that the bank be transferred to OCC's Special Supervision Division. OCC decided this because of NBC's investment concentration in Fannie Mae and Freddie Mac preferred stock, and the anticipated impact of the stocks' decline in value on the bank's capital.

OCC's *Examiner's Guide to Problem Bank Identification, Rehabilitation, and Resolution* provides guidance for banks supervised by the Special Supervision Division. According to the guide, the Special Supervision Division supervises the resolution of critical problem banks through rehabilitation or through other resolution processes. Ideally, the Special Supervision Division assumes supervisory responsibility of a deteriorating problem bank prior to its becoming a composite 5 CAMELS-rated entity.

The Special Supervision Division directed the overall supervision of NBC from September 2008 until its closure on January 16, 2009. During the week of October 14, 2008, the Special Supervision Division led a targeted examination of NBC with assigned field examiners working under the direction of a Special Supervision

Division analyst. During the review, examiners concluded that the bank's loans did not pose a risk to the bank's viability; however, because of the significant decline in the value of its investments in GSE securities and related concerns over the bank's liquidity, NBC's viability could be at risk.[5] In addition to formally notifying the bank on November 3, 2008, that it was critically undercapitalized, the Director of the Special Supervision Division told the bank that its composite CAMELS rating had been downgraded to 5 and instructed the bank to submit an acceptable capital restoration plan.

On November 14, 2008, NBC submitted a capital restoration plan that relied on financial assistance of approximately $42.8 million from Treasury or the FDIC, along with a commitment from the bank's board to raise $10 million following the receipt of federal assistance to restore the bank's capital to adequately capitalized. OCC deemed NBC's capital restoration plan unacceptable on December 16, 2008, due to its dependence on receiving government assistance to restore capital and because it was based on events that had not occurred, were unlikely to occur, and were not within the bank's control.

When the bank had no viable plan to restore capital, on January 15, 2009, the Deputy Comptroller and Director of the Special Supervision Division recommended that OCC appoint the FDIC as receiver of NBC. We conclude that the Special Supervision Division took appropriate and timely supervisory actions. We also conclude that OCC used its authority under PCA in an appropriate and timely manner.

Without reasonable prospect of NBC becoming adequately capitalized, OCC continued preparing for the closure and appointment of a receiver for the bank. OCC closed NBC on January 16, 2009, and appointed FDIC receiver 78 days after NBC was deemed critically undercapitalized.[6]

[5] Our review of the examination workpapers did not reveal any unsafe or unsound conditions with the bank's loan portfolio and lending practices.
[6] In accordance with 12 U.S.C. §1831(h)(3)(A), OCC must appoint a receiver within 90 days after any national bank becomes critically undercapitalized.

Other Matters

Recently Issued OCC Guidance on Investment Securities

OCC did not conduct a lessons-learned review of the NBC failure. According to OCC management, the issue with the bank's investment in GSE securities that led to its failure was straightforward and an internal review would not have revealed additional information important to communicate to examiners.

OCC issued a bulletin in May 2009 regarding investment securities and risk management.[7] The new bulletin highlights lessons-learned from the current market disruption and re-emphasizes the key principles discussed in the following OCC guidance: OCC 98-20, *Supervisory Policy Statement on Investment Securities and End-User Derivatives Activities*, OCC 2002-19, *Unsafe and Unsound Investment Portfolio Practices*. Also, the bulletin reminds bank management of the important liquidity objectives of a bank's investment portfolio and the supervisory risk management expectations associated with investment portfolio holdings of structured investment securities.

OCC cited the following lessons learned in the bulletin:

- Undue Reliance on Credit Ratings--Bank management should be very careful when using credit ratings in making investment portfolio decisions and should be particularly diligent when purchasing structured securities. Bank managers should understand the basis for the rating and should supplement credit ratings with the bank's own internal analysis. The more complex a security's structure, the more due diligence should be done, even for the highly rated securities.

- Limited Investment Portfolio Liquidity--Banks have traditionally owned investment securities to support liquidity needs, to achieve asset/liability objectives, to provide collateral and diversify bank earnings. The bulletin notes that in recent years, the investment portfolio earning's objectives

[7] OCC Bulletin 2009-15, *Investment Securities,* (May 22, 2009).

at many national banks took priority over liquidity objectives, often resulting in bank management purchasing structured investment securities that offered a high yield as well as a high credit rating. While portfolio yield is an important consideration, the bulletin cautions that yield generation should not be the primary motivation when making investment decisions. Bank management should ensure that earnings pressures do not override liquidity needs when making decisions about the composition of the investment portfolio.

- Inadequate Valuation of Structured Products--OCC expects national banks to maintain robust governance processes to ensure compliance with regulatory reporting requirements and fair value accounting guidelines. If a bank is holding or purchasing structured investment securities, bank management should ensure that its valuation process allows for a thorough assessment of projected cash flows and that the probability of default and loss, given default assumptions, is reasonable. National banks should fully understand and effectively manage the risk inherent in their investment activities. Failure to maintain an adequate investment portfolio risk management process, which includes understanding key portfolio risks, is considered an unsafe and unsound practice.

While the new bulletin does not address investments in GSE securities directly, we believe it provides useful and appropriate guidance to banks in managing investment activities.

Examination Workpapers

During our review of the OCC examiners' workpapers for NBC, we found documentation was lacking to support some of the examination steps, objectives, and sub-objectives for the 2005 and 2007 examinations. We included a similar finding in our February 2009 material loss review of the failed First National Bank of Nevada and First Heritage Bank, National Association.[8] OCC

[8] OIG, *Safety and Soundness: Material Loss Review of First National Bank of Nevada and First Heritage Bank, National Association,* OIG-09-033 (Feb. 27, 2009).

concurred with our recommendation in that report to re-emphasize to examiners OCC's policy on the preparation of supervision workpapers. This is an area that warrants continued attention by OCC management.

Recommendations

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

As a result of our material loss review of NBC, we recommend that the Comptroller of the Currency do the following:

1. Conduct a review of investments by national banks for any potential high risk concentrations and take appropriate supervisory action.

   Management Response

   During the months leading up to the government intervention at Fannie Mae and Freddie Mac, OCC proactively used call report financial data to identify banks with concentrations in GSEs. Banks with high exposure relative to their capital were identified and supervisory offices were provided with the information to investigate further and take appropriate supervisory action. This process is embedded in ongoing supervisory activities and will be used on an ongoing basis to identify and address other concentrations in high-risk securities.

   OIG Comment

   OCC has taken steps to address the intent of our recommendation.

2. Reassess examination guidance regarding investment securities, including GSE securities.

Management Response

OCC plans to issue a Supervisory Memorandum containing supplemental examiner guidance on investment securities risk management practices to all OCC examining staff no later than September 1, 2009.

OIG Comment

To the extent that the planned supplemental guidance also addresses GSE securities, OCC's planned action meets the intent of our recommendation.

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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) 927-6512 or Delores V. Dabney, Audit Manager, at (202) 927-5941. Major contributors to this report are listed in appendix 8.

/s/

Michael J. Maloney
Audit Director

We conducted a material loss review of National Bank of Commerce (NBC) of Berkeley, Illinois, in response to our mandate under section 38(k) of the Federal Deposit Insurance Act, as amended.[9] This section provides that if the deposit insurance fund incurs a material loss with respect to an insured depository institution, the inspector general for the appropriate federal banking agency is to prepare a report to the agency, that

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

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

We initiated a material loss review of NBC based on the loss estimate by the Federal Deposit Insurance Corporation (FDIC). As of June 30, 2009, FDIC estimated that the loss to the Deposit Insurance Fund would be $92.5 million because of NBC's failure.

To accomplish our review, we conducted fieldwork at the Office of the Comptroller of the Currency's (OCC) headquarters in Washington, D.C. and its field office in Chicago, Illinois. We interviewed headquarters, field, and district office personnel. We performed work at FDIC's Division of Resolutions and Receiverships in Dallas, Texas, and interviewed personnel involved in NBC's closing and receivership. We also interviewed FDIC's Division of Supervision and Consumer Protection personnel. We conducted fieldwork from February 2009 through June 2009.

To assess the adequacy of OCC's supervision of NBC, we determined (1) when OCC first identified NBC's safety and

[9] 12 U.S.C. § 1831o(k).

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

- We determined that the time period covered by our audit would be from April 2005 through NBC's failure on January 16, 2009. This period included three safety and soundness examinations prior to OCC identifying NBC as a critically undercapitalized institution and assigning it a composite CAMELS rating of 5.

- We reviewed OCC's supervisory files and records for NBC from 2005 through 2008. We analyzed examination reports, supporting workpapers, and related supervisory 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 OCC used to compel bank 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 NBC with OCC officials, examiners, and an attorney to obtain their perspective on the bank's condition and the scope of the examinations. We also interviewed FDIC officials responsible for monitoring NBC for federal deposit insurance purposes.

- We interviewed FDIC's Division of Resolutions and Receiverships personnel involved in the receivership process, which was conducted before and after NBC's closure and appointment of a receiver.

- We assessed OCC's actions based on its internal guidance and requirements of the Federal Deposit Insurance Act, at 12 U.S.C. § 1811 et seq.

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.

National Bank of Commerce History

The National Bank of Commerce (NBC) was a federally chartered national bank, the deposits of which were insured by the Federal Deposit Insurance Corporation (FDIC). NBC was a wholly owned subsidiary of Commerce Bancorp, Inc., a one bank holding company. Five individuals and the estate of another individual owned approximately 42 percent of the holding company.

NBC opened for business in Illinois and became subject to Office of the Comptroller of the Currency (OCC) supervision on September 1, 1984. Its predecessor had incorporated in 1966 as a state-chartered bank. NBC's main office was in Berkeley, Illinois, with a branch office in Addison, Illinois. NBC provided deposit accounts, cash management products, merchant processing, and personal and business loans.

Appendix 4 contains a chronology of significant events regarding NBC.

Types of Examinations Conducted by OCC

OCC conducts various types of examinations including full-scope on-site examinations. A full-scope examination is a combined examination of the institution's safety and soundness, compliance with various regulations, and information technology (IT) systems. The safety and soundness portion of the examination includes a review and evaluation of capital adequacy, asset quality, management administration, earnings, liquidity, and sensitivity to the market. The IT portion of the full-scope examination evaluates the overall performance of IT within the institution and the institution's ability to identify, measure, monitor, and control technology-related risks. The compliance portion of the examination includes an assessment of how well the bank manages compliance with various consumer protection regulations, such as Truth in Lending, Truth in Savings, and the Bank Secrecy Act. A targeted examination is any examination that does not fulfill all the statutory requirements of a full-scope examination.

OCC must schedule full-scope, on-site examinations of insured banks once during either a 12-month or 18-month cycle. The 12-

month cycle should continue until the bank's management has demonstrated its ability to operate the institution in a safe and sound manner and satisfied all conditions imposed at the time of approval. OCC may extend the 12-month requirement to 18 months if the bank:

- has total assets of less than $500 million;
- is well capitalized;
- at its most recent examination received a management component rating of 1 or 2;
- is not currently subject to a formal enforcement proceeding order by the FDIC, OCC, or Federal Reserve System; and
- has not undergone a change in control during the preceding 12-month period since completion of the last full-scope, on-site examination.

During a full-scope examination, examiners conduct an on-site examination and rate all CAMELS components. OCC then assigns the bank a composite rating based on its assessment of the overall condition and level of supervisory concern.

Enforcement Actions Available to OCC

OCC performs various examinations of banks resulting in the issuance of reports of examinations (ROE) 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

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

Formal Enforcement Actions

Formal enforcement actions are authorized by statute, generally more severe than informal actions, and disclosed to the public. Formal enforcement actions are enforceable under the Federal Deposit Insurance Act. They are appropriate when a bank has significant problems, especially when there is a threat of harm to the bank, depositors, or the public. OCC is to use formal enforcement actions when informal actions are considered inadequate, ineffective, or otherwise unlikely to influence bank management and board members to correct identified problems and concerns in the bank's operations. Because formal actions are enforceable, OCC can assess civil money penalties against banks and individuals for noncompliance with a formal agreement or final order. OCC can also request a federal court to require the bank to comply with an order. Formal enforcement actions include consent orders, cease and desist orders, formal written agreements, and Prompt Corrective Action directives.

OCC Enforcement Guidelines

Determining whether to use informal action or formal action include the following:

- the overall condition of the bank;
- the nature, extent, and severity of the bank's problems and weaknesses;
- the commitment and ability of bank management to correct the identified deficiencies; and
- the existence of previously identified but unaddressed problems or weaknesses.[10]

[10] OCC Policies and Procedures Manual 5310-3 (Rev).

Brokered Deposits	Any deposit that is obtained, directly or indirectly, from a deposit broker. Under 12 U.S.C. 1831f and 12 C.F.R. 337.6, the use of brokered deposits is limited to well-capitalized insured depository institutions and, with a waiver from the Federal Deposit Insurance Corporation, to adequately capitalized institutions. Undercapitalized institutions are not permitted to accept brokered deposits.
Call report	A quarterly report of income and financial condition that banks file with their regulatory agency. The contents of call reports include consolidated detailed financial information on assets, liabilities, capital, and loans to executive officers, as well as income, expenses, and changes in capital accounts.
CAMELS	An acronym for performance rating components for financial institutions: Capital Adequacy, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to market risk. Numerical values range from 1 to 5 with 1 being the best rating and 5 being the worst. The Office of the Comptroller of the Currency (OCC) uses the CAMELS rating system to evaluate a bank's overall condition and performance by assessing each of the six rating components and assigning numerical values. OCC then assigns each bank a composite rating based on its assessment of the overall condition and level of supervisory concern.
Capital Purchase Program	The Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-342, 122 Stat. 3267, section 101(a) authorized Treasury to establish the Troubled Asset Relief Program (TARP) to, among other things, purchase troubled assets from financial institutions. Under this authority, Treasury created a voluntary program--the Capital Purchase Program in which the U.S. government, through the Department of the Treasury, invests in preferred equity securities issued by qualified financial institutions.
Capital restoration plan	Under the Prompt Corrective Action requirements of the Federal Deposit Insurance Act, as amended, a

	capital restoration plan is to be submitted to the appropriate federal banking agency by any undercapitalized insured depository institution. A capital restoration plan specifies the steps the insured depository institution is to take to become adequately capitalized, the levels of capital to be attained during each year in which the plan is in effect, how the institution is to comply with the restrictions or requirements then in effect, the types and levels of activities in which the institution is to engage, and any other information that the federal banking agency may require.
Deferred tax asset	The deferred tax consequences attributable to deductible temporary differences and carryforwards. A deferred tax asset is measured using the applicable enacted tax rate and provisions of the enacted tax law. A deferred tax asset is reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.
Deferred tax consequences	The future effects on income taxes as measured by the applicable enacted tax rate and provisions of the enacted tax law resulting from temporary differences and carryforwards at the end of the current year.
Government-Sponsored Enterprises	Financial services corporations created by the U.S. to enhance the flow of credit to the agriculture and home finance sectors of the economy. Fannie Mae, Freddie Mac, Government National Mortgage Association, Federal Farm Credit Banks, Agriculture Credit Bank, Federal Agriculture Mortgage Corporation, and twelve federal Home Loan Banks are collectively referred to as government-sponsored enterprises.
Impairment	Decline in fair value below the amortized cost basis.
Matters requiring attention	A bank practice noted during an OCC examination of a bank that deviates from sound governance, internal controls, and risk management principles. The matters, if not addressed, may adversely impact the

	bank's earnings, capital, risk profile, or reputation, or may result in substantive noncompliance with laws and regulations, internal policies or processes, OCC supervisory guidance, or conditions imposed in writing or other requests by a bank. Although matters requiring board attention are not formal enforcement actions, OCC requires that banks address them. A bank's failure to do so may result in a formal enforcement action.
Merchant processing	The settlement of electronic payment transactions for merchants. Merchant processing activities involve gathering sales information from the merchant, obtaining authorization for the transaction, collecting funds from the card-issuing bank, and reimbursing the merchant.
Other-than-temporary Impairment Charges	When it is determined that the impairment is other than temporary, then an impairment loss must be recognized in earnings equal to the entire difference between the investment's cost and its fair value at the balance sheet date of the reporting period for which the assessment is made. In periods subsequent to the recognition of an other-than-temporary impairment loss for debt securities, an investor must account for the other-than-temporarily impaired debt security as if the debt security had been purchased on the measurement date of the other-than-temporary impairment. That is, the discount or reduced premium recorded for the debt security, based on the new cost basis, would be amortized over the remaining life of the debt security in a prospective manner based on the amount and timing of future estimated cash flows.
Permanent Capital	The sum of a bank's capital stock and capital surplus accounts. OCC must certify the increases in a bank's permanent capital before the bank can issue additional capital or reflect the capital change on its financial statements.
Prompt Corrective Action	A framework of supervisory actions, set forth in 12 U.S.C. §1831o, for insured depository institutions

that are not adequately capitalized. It was intended to ensure that action is taken when an institution becomes financially troubled in order to prevent a failure or minimize resulting losses. These actions become increasingly severe as a bank falls into lower capital categories. The capital categories are well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. The Prompt Corrective Action minimum requirements are as follows:

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

[a] To be well capitalized, a bank also cannot be subject to a higher capital requirement imposed by OCC.

Risk-based capital — The sum of Tier 1 plus Tier 2 capital.

Structured Investment Securities — The term "structured" used in reference to securities is a common term used in the industry to refer to many of the products that are part of the securitization market. In an asset-backed security the cash flows from the underlying assets (collateral) can be allocated to investors in different ways. Cash flows (payment streams) can be "passed-through" directly to the investors or carved up according to specific rules and investor demand and thereby creating "structured" securities. These various structures meet the needs of different investor types by allowing them to invest in a product that meets their risk appetite and collateral and earnings requirements. These

	securities include private label mortgage-backed securities, resecuritizations, and trust-preferred securities.
Subordinated debt	Debt that is either unsecured or has a lower priority than that of another debt claim on the same asset or property, also called junior debt.
Tangible equity ratio	Tier 1 capital plus cumulative preferred stock and related surplus less intangibles except qualifying purchased mortgage servicing rights divided by total assets less intangibles except qualifying purchased mortgage servicing rights.
Tier 1 capital	Common shareholder's equity (common stock, surplus, and retained earnings), noncumulative perpetual preferred stock, and minority interests in the equity accounts of consolidated subsidiaries.
Tier 2 capital	Consists of subordinated debt, intermediate-term preferred stock, cumulative and long-term preferred stock, and a portion of a bank's allowance for loan and lease losses.
Troubled Asset Relief Program (TARP)	A program established under the Emergency Economic Stabilization Act of 2008 (EESA) with the specific goal of stabilizing the United States financial system and preventing a systemic collapse. EESA gives TARP the authority to purchase and make fund commitments to purchase troubled assets from any financial institution.

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

7/26/1966	NBC is established under its original name, Bank of Commerce, as an Illinois state bank.
7/13/1967	Bank of Commerce becomes insured by the Federal Deposit Insurance Corporation (FDIC).
9/1/1984	Bank of Commerce converts to a national bank charter and changes to its current name.
2/3/1993	Commerce Bancorp, Inc., acquires NBC for $33,904,000.
3/7/1994-7/1/2002	NBC receives composite CAMELS ratings of 2 for eight examination cycles.
5/22/2003 10/2/2003	NBC purchased Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac) preferred stock on various dates during the period for a total of $11,021,159.
5/27/2003-5/05/2004	NBC receives composite ratings of 2 for two examinations.
6/1/2004-9/29/2004	NBC purchases Fannie Mae and Freddie Mac preferred stock on various dates during the period for a total of $5,371,926.
8/2004	NBC opens a full-service branch in Addison, Illinois.
4/4/2005-8/14/2006	NBC receives composite ratings of 2 for two examinations.
4/18/2006-5/17/2006	NBC purchases Fannie Mae and Freddie Mac preferred stock on various dates during the period for a total of $8,264,217.
1/17/2007-11/21/2007	NBC purchases Fannie Mae and Freddie Mac preferred stock on various dates during the period for a total of $73,497,160.

12/18/2007	OCC begins an examination that is completed on 3/19/2008, with composite and CAMELS ratings of 2/222222.
2/5/2008	NBC notifies OCC of an increase in permanent capital. The increase comes from a $6 million contribution from NBC's holding company.
9/7/2008	The Federal Housing Finance Agency places Fannie Mae and Freddie Mac into conservatorship.
9/11/2008	OCC District Office transfers NBC to the Special Supervision Division in light of NBC's significant concentration in Fannie Mae and Freddie Mac GSE securities and the pending impact on the bank's capital.
9/12/2008	NBC notifies OCC of an increase in permanent capital. The increase comes from a $6 million contribution from NBC's holding company.
9/30/2008	NBC concludes that its investments in GSE securities have a fair market value of approximately $4.5 million. NBC recognizes $93.7 million in other-than-temporary impairment charge associated with the GSE securities. Of this impairment charge, approximately $57.4 million was recorded as a loss on securities on the bank's income statement and approximately $36.3 million was recorded on the bank's balance sheet.
10/6/2008	NBC requests financial assistance from the Department of Treasury pursuant to the Emergency Economic Stabilization Act of 2008 (EESA) which authorized Treasury to establish the Troubled Asset Relief Program. NBC's counsel asks Treasury to purchase the bank's Fannie Mae and Freddie Mac GSE securities for approximately $44.5 million to restore the bank to adequately capitalized for PCA purposes.
10/14/2008	OCC examiners conduct a targeted examination of NBC's asset quality, liquidity, and capital that was completed on October 17, 2008, with composite and CAMELS ratings of 5/554554.
10/17/2008	NBC's counsel reiterates the Bank's request for financial assistance from Treasury in a letter to OCC, FDIC, and Treasury. The letter also requests that the bank delay filing the September 30, 2008, call report or as an alternative, asks for permission to file without recognizing losses sustained from ownership of its GSE securities.

10/22/2008	OCC's Director of Special Supervision Division informs the bank that OCC cannot permit the bank not to follow the statutory requirements for filing call reports and directs NBC to immediately develop a capital restoration plan (CRP) with the actions needed to restore the bank's capital.
10/24/2008	NBC submits a CRP. The bank's sole plan to reach the adequately capitalized category was to obtain $44.5 million from Treasury. Commerce Bancorp, Inc. submits a request to the Federal Reserve Bank of Chicago for $8.7 million in financial assistance through the Capital Purchase Program (CPP).
10/29/2008	Treasury's CPP Manager orally notifies OCC that Treasury did not grant NBC's request to purchase its Fannie Mae and Freddie Mac GSE securities for $44.5 million. Two Illinois Congressmen jointly request in a letter that Treasury provide financial assistance to NBC and coordinate with OCC and FDIC to forbear from taking any regulatory actions against the bank. According to personnel with the Department's Office of Legislative Affairs, Treasury did not respond to the request.
10/30/2008	NBC files its September 30, 2008, call report which discloses negative regulatory capital levels. OCC informs Treasury that it will notify NBC of Treasury's decision not to purchase NBC's GSE securities. NBC requests the United States District Court for the Northern District of Illinois to direct Treasury to consider its application under EESA in a timely manner and a temporary restraining order enjoining OCC from appointing a receiver or a conservator until Treasury acts on NBC's EESA application.
10/31/2008	The District Court denies the motion for a temporary restraining order.
11/3/2008	OCC notifies NBC that it is critically undercapitalized for PCA purposes, instructs NBC to submit an acceptable CRP by November 14, 2008, and notifies NBC that its composite CAMELS rating has been downgraded to a 5.

11/6/2008	OCC notifies NBC in a letter that Treasury decided not to grant assistance to restore NBC to an adequately capitalized status.
11/14/2008	NBC submits a CRP that relies on financial assistance of approximately $42.8 million from Treasury or the FDIC, along with a commitment from the bank's board to raise $10 million following the receipt of federal financial assistance, to restore the bank's capital to adequately capitalized for PCA purposes.
11/18/2008	NBC seeks financial assistance from FDIC, asserting that the financial assistance the bank requested will be less than the cost of its potential receivership.
11/20/2008	NBC responds to FDIC's questions and provides additional information regarding its request for financial assistance.
11/21/2008	NBC's counsel seeks a capital infusion of $42.8 million from Treasury pursuant to any available provision of EESA in a letter to OCC. NBC's letter to OCC notes that Treasury has decided not to purchase NBC's GSE securities.
11/24/2008	OCC forwards NBC's November 21, 2008, letter and asks Treasury again by email about the possibility of financial assistance of $42.8 million to the bank, given that FDIC estimated the cost of resolution in receivership to be $150 million.
12/16/2008	OCC notifies NBC that its CRP did not meet the criteria set forth in 12 U.S.C. §1831o(e)(2)(C) for accepting a plan.
12/22/2008	NBC responds to FDIC's questions and provides additional information regarding its request for financial assistance.
1/7/2009	NBC again seeks financial assistance from FDIC.
1/8/2009	OCC's Director of Special Supervision Division sends a letter to the Division of Bank Supervision and Regulations of the Board of Governors of the Federal Reserve System informing it that OCC has determined grounds to appoint FDIC as receiver.

1/9/2009	FDIC denies NBC's request for financial assistance because the bank's proposal provided that FDIC assistance would be used inappropriately to benefit preexisting shareholders. OCC forwards the November 24, 2008, email to Treasury and again seeks confirmation from Treasury that it will not be providing financial assistance to NBC. The Interim Assistant Secretary for Treasury's Financial Stability and Assistant Secretary of the Treasury for International Economics and Development respond in an email that NBC is not qualified for funds from CPP.
1/16/2009	OCC closes NBC and appoints FDIC as receiver.

This appendix summarizes the Office of the Comptroller of the Currency's safety and soundness and targeted examinations of the National Bank of Commerce that began in April 2005 through October 2008, and provides information on the significant results of those examinations. We list the following items contained in the report: matters requiring attention, recommendations, and suggestions. Generally, matters requiring attention represent the most significant items requiring corrective action and are more serious.

Date started	CAMELS rating	Assets (millions)	Significant safety and soundness matters requiring attention, recommendations, and suggestions cited in Reports of Examination (ROE) and workpapers	Enforcement actions
4/4/2005	2/212322	$389	**Matters requiring attention** • None Identified. **Recommendations** • Require the Audit Committee to have a majority of outside directors. • Require the Audit Committee to review the risk assessment for adequacy. • Require the Audit Committee to ensure the items approved in the Outstanding Audit Findings tickler are corrected in a timely manner. • Conduct annual testing of Landmark Merchant Solution's disaster recovery and contingency plan. • Expand the monthly high risk business categories. • Expand monthly reports to include historic year-end data for comparison and analysis. • Improve earnings. **Suggestions** • Provide a brief narrative to the Quality Control Committee to summarize merchant processing activity. • Expand the audit scope to include detailed review of changes made in processing new merchants and risk management controls. • Obtain the most current high-risk merchant listing from the associations.	None
8/14/2006	2/212222	$398	**Matters requiring attention** • None identified. **Recommendations** • Enhance the Contingency Funding Plan (CFP) and bank's processes. • Review the CFP to ensure that they are aware of all possible sources of funds in case of liquidity crisis. The	None

Date started	CAMELS rating	Assets (millions)	Significant safety and soundness matters requiring attention, recommendations, and suggestions cited in Reports of Examination (ROE) and workpapers	Enforcement actions
			CFP should be tested, reviewed, and approved by the Board at least annually. • Review the Board of Directors-approved policy limits for the acceptable change in the investment portfolio. • Address the holding company's ability to draw on the line of credit from LaSalle or any bank. • Update the asset/liability policy to reflect new members. • Update the shareholder's list.	
12/18/2007	2/222222	$423	**Matters requiring attention** • Improve the Allowance for Loan and Lease Losses methodology to comply with Interagency Policy Statement and to address related financial accounting standards. • Appropriately document loan review reports to detail the analysis performed and support for the credit rating conclusion. • Revise the loan policy to specifically address the overdraft guidance as illustrated in the Interagency Joint Guidance on Overdraft Protection Program bulletin. **Recommendations** • None identified.	None
10/14/2008 Targeted Examination	5/554554	$459	**Matters requiring attention** • None identified. **Recommendations** • None identified.	Prompt Corrective Action Notice of Critically Undercapitalized issued 11/3/08 (See page 6)

Source: OCC ROEs, examination workpapers, and NBC's Call Reports.

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

Report Title	Recommendations to the Comptroller
Safety and Soundness: Material Loss Review of ANB Financial, National Association, OIG-09-013 (Nov. 25, 2008) OCC closed ANB Financial and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on May 9, 2008. At that time, FDIC estimated that ANB's failure would cost the Deposit Insurance Fund $214 million.	Re-emphasize to examiners that examiners must closely investigate an institution's circumstances and alter its supervisory plan if certain conditions exist as specified in OCC's Examiner's Guide to Problem Bank Identification, Rehabilitation, and Resolution. Re-emphasize to examiners that formal action is presumed warranted when certain circumstances specified in OCC's Enforcement Action Policy (PPM 5310-3) exist. Examiners should also be directed to document in the examination files the reasons for not taking formal enforcement action if those circumstances do exist. Reassess guidance and examination procedures in the Comptroller's Handbook related to bank use of wholesale funding with focus on heavy reliance on brokered deposits and other non-retail deposit funding sources for growth. Establish in policy a "lessons-learned" process to assess the causes of bank failures and the supervision exercised over the institution and to take appropriate action to address any significant weaknesses or concerns identified.
Safety and Soundness: Material Loss Review of First National Bank of Nevada and First Heritage Bank, National Association, OIG-09-033 (Feb. 27, 2009) OCC closed First National Bank of Nevada and First Heritage Bank and appointed FDIC as receiver on July 25, 2008. As of December 31, 2008, FDIC had recorded an estimated loss of $706 million for First National Bank of Nevada and $33 million for First Heritage Bank.	Re-emphasize to examiners the need to ensure that banks take swift corrective actions in response to examination findings. Re-emphasize to examiners OCC's policy on the preparation of supervision workpapers (i.e, workpapers are to be clear, concise, and readily understood by other examiners and reviewers).

MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

To: Michael J. Maloney, Audit Director

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

Date: August 3, 2009

Subject: Response to Material Loss Review of National Bank of Commerce

We have received and reviewed your draft report titled "Material Loss Review of National Bank of Commerce." Your overall objectives were to determine why National Bank of Commerce's (NBC's) problems resulted in a material loss to the FDIC insurance fund, review OCC's supervision of NBC, and make recommendations for preventing any such loss in the future.

You concluded that NBC failed due to significant losses from preferred stock holdings in the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), also referred to as Government-Sponsored Enterprises (GSEs). These losses depleted NBC's capital and strained its liquidity. After several attempts, NBC was unable to raise capital or obtain financial assistance to prevent its closure.

You also concluded that the OCC's supervision of NBC was appropriate given the unprecedented and rapid decline in the value of GSE securities that occurred during the recent market crisis. As your report also notes, banks and regulators need to be cognizant that securities not backed by the full faith and credit of the U. S. government do entail risk, and high concentrations of such holdings elevate that risk. The paragraphs below outline the steps that we have taken to address your recommendations.

Review of Investments by National Banks for Potential High Risk Concentrations

During the months leading up to the government intervention at Fannie Mae and Freddie Mac, OCC was proactive in utilizing call report financial data to identify banks with concentrations in GSEs. Banks with high exposure relative to their capital were identified and supervisory offices were provided with the information to investigate further and take appropriate supervisory action. This process is embedded in our ongoing supervisory activities and will be utilized on an ongoing basis to identify and address other concentrations in high-risk securities.

Examination Guidance Regarding Investment Securities

The OCC continuously assesses the need for examiner guidance on investments and other supervisory topics. This guidance is communicated through examiner handbooks, OCC Bulletins, Supervisory Memoranda to examiners, and ongoing dialogue between our Market Risk Division subject matter experts and supervision personnel. For example, as acknowledged in the OIG report, the OCC recently issued OCC Bulletin 2009-15, which highlights lessons learned from the recent market disruption, reiterates key investment risk management principles, and provides useful and appropriate guidance to banks in managing investment securities. In addition, a Supervisory Memorandum containing supplemental "Examiner Guidance on Investment Securities Risk Management Practices" will be issued to all OCC examining staff no later than September 1, 2009.

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

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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

Comptroller of the Currency
Liaison Officer

Office of Management and Budget

OIG Budget Examiner

Federal Deposit Insurance Corporation

Chairman
Inspector General

United States Senate

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

Chairman and Ranking Member
Committee on Finance

U.S. House of Representatives

Chairman and Ranking Member
Committee on Financial Services

U.S. Government Accountability Office

Acting Comptroller General of the United States