Audit Report

OIG-09-043

SAFETY AND SOUNDNESS: Material Loss Review of Ocala National Bank

August 26, 2009

Office of Inspector General

Department of the Treasury

Contents

Abbreviations

ALLL	allowance for loan and lease losses
CEO	chief executive officer
DRR	Division of Resolutions and Receiverships

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

August 26, 2009

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Comptroller of the Currency

This report presents the results of our review of the failure of Ocala National Bank of Ocala, Florida, 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 Ocala National Bank and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on January 30, 2009. As of August 7, 2009, FDIC estimated that the loss to the Deposit Insurance Fund was $99.6 million.

Our objectives were to determine the cause of Ocala National Bank's failure and assess OCC's supervision of the bank, including implementation of the Prompt Corrective Action (PCA) provisions of section 38(k). We conducted our fieldwork from March 2009 through July 2009 at OCC's headquarters in Washington, D.C., its Southern District office in Dallas, Texas, and its field office in Jacksonville, Florida. We also performed work at FDIC's Division of Resolutions and Receiverships (DRR) in Dallas, Texas. We reviewed the supervisory files and interviewed key officials involved in the regulatory matters. Appendix 1 contains a more detailed description of our objectives, scope, and methodology.

We also include several other appendices in this report. Appendix 2 contains background information on Ocala National Bank and OCC's supervision and enforcement processes. Appendix 3 provides a glossary of terms used in this report. Appendix 4 contains a chronology of significant events related to the bank's history and OCC's supervision of the institution. Appendix 5 provides bank examination results and information on enforcement actions.

Results in Brief

Ocala National Bank failed because of significant losses within its construction and land development loan portfolio. The bank grew rapidly from 2004 to 2006, largely due to the increased number and high concentration of these loans, but its management did not adequately control concentration risk or ensure that credit underwriting and administrative controls were adequate. These deficiencies were exacerbated by the decline in the real estate market and the secondary loan market.

OCC's supervision of Ocala National Bank did not prevent a material loss to the Deposit Insurance Fund. OCC identified problems early at the bank, but the actions taken by the bank were not sufficient. OCC identified areas needing correction, but its supervisory approach in 2005 through 2007 was primarily to rely on examiner recommendations and Matters Requiring Attention (MRA) in the ROEs. From 2005 through 2006, OCC also continued to assign the bank a CAMELS composite rating of 2, the same rating assigned in 2004 when relatively few problems were noted. This proved to be an ineffective strategy, as these problems persisted and grew worse until the bank ultimately failed in 2009.

In February 2008, OCC entered into a consent order with the bank. OCC was reluctant to take more forceful action earlier because prior to 2007 the bank was profitable and asset quality problems were not yet readily apparent. While we understand the judgment involved, in retrospect we believe a more forceful approach should have been used sooner given the bank's circumstances. Starting in 2004, the bank owner's son became chief executive officer (CEO). At the time, he had banking experience, but not in running a bank. Under his direction, the bank began aggressively growing by way of high-risk products. OCC's response was to require bank management to voluntarily rein in this high-risk growth strategy; it did not. OCC's enforcement action policy states that problems or weaknesses should be dealt with early, before they develop into more serious supervisory issues or adversely affect a bank's performance and viability.

We also identified two other matters that negatively affected Ocala National Bank, but financially benefited the owner and board members. First, in 2007, while the bank was incurring a net operating loss of $2.3 million, it paid dividends of $3.9 million to the bank's holding company, some of which may have been unallowed. The owner and his family were the majority shareholders of the holding company. Second, the bank made payments totaling approximately $1 million to a company partly owned by the bank owner's son and several bank board members to repurchase the company's portion of loans, some of which were nonperforming, while the bank's financial condition was deteriorating. We believe that OCC should have more aggressively examined both of these matters. We also noted that OCC guidance does not require examiners to expand procedures to include a more detailed review of dividends or payments made to related organizations for troubled or high-risk banks.[1]

OCC acted forcefully against the bank in early 2008 when it appropriately used its authority under the PCA provisions of the Federal Deposit Insurance Act, as amended. Specifically, OCC's February 2008 consent order reclassified Ocala National Bank's capital level to adequately capitalized, which prohibited the bank from accepting or renewing brokered deposits without a waiver from FDIC. The bank did request such a waiver from FDIC and in May 2008, FDIC granted the bank permission to accept, renew, and roll over brokered deposits until August 2008.

We recommend that OCC (1) caution examiners and supervisors that decisions to assign the same CAMELS component and composite ratings as in prior exams and refrain from taking enforcement action when conditions at a bank have deteriorated need to be well justified and documented in the examination workpapers, and (2) remind examiners that it is prudent to expand

[1] A related organization is an entity related to a national bank, typically by common ownership or control. Generally, related organizations are affiliates or subsidiaries. They can include bank holding companies, operating subsidiaries, financial subsidiaries, statutory subsidiaries, chain banking organizations, community development corporations, and related interests of principal shareholders.

examination procedures for troubled or high-risk banks to review the appropriateness of (a) dividends and (b) payments to related organizations, particularly when the dividends or payments may benefit bank management and board members. In this regard, OCC should reassess its examination guidance concerning review of dividends and related organizations.

In a written response, OCC agreed that there were shortcomings in its supervision and that it is appropriate to reinforce certain principles to its examining staff. OCC stated that senior management used a national examiner conference call to illustrate for examiners, through the experience of earlier bank failures, the importance of being assertive in identifying and following through on identified weaknesses in a timely manner. OCC will continue this message through examiner briefings, future examiner conference calls, and as other opportunities arise. OCC also stated that heightened scrutiny of certain dividends and payments to related organizations is appropriate. OCC will reinforce this message to examiners during one of its regular national conference calls. The actions taken and planned by OCC are responsive to our recommendations.

Causes of Ocala National Bank's Failure

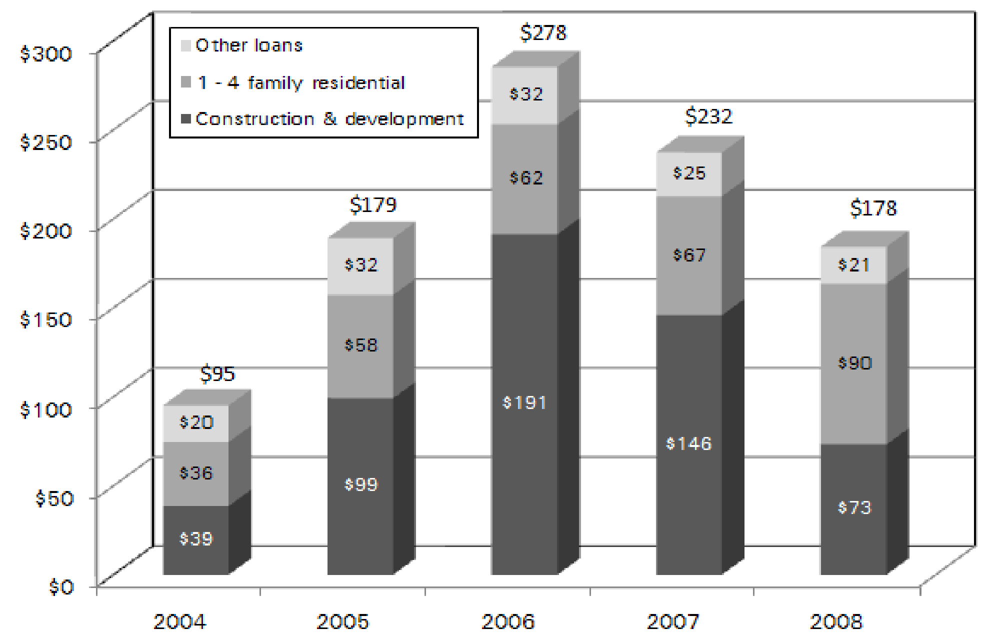
Significant losses within its construction and land development loan portfolio were the primary cause of Ocala National Bank's failure. Beginning in 2004, the bank's board and management embarked on a strategy of aggressive growth through the origination of construction and land development loans for residential real estate. These loans as a percentage of Ocala's capital greatly exceeded that of similar sized banks. Furthermore, these loans were being made for properties located in an area of Florida that was affected by the significant decline in real estate values. Bank management did not adequately control the risk posed by the loan concentration or ensure that controls over the bank's credit underwriting and administrative practices were adequate.

Aggressive Growth and High Concentration in Construction and Land Development Loans

Ocala National Bank grew rapidly from 2004 to 2006 by originating construction and land development loans for residential real estate in Ocala, Florida. When the homes were completed, the bank converted the construction and land development loans to residential mortgage loans, which it then sold to investors in the secondary market.

From 2004 through 2006, the bank increased its construction loans by approximately 400 percent (from $39 million to $191 million). Growth rates then declined in 2007 and 2008 because of the real estate market downturn. Figure 1 illustrates the size and composition of Ocala National Bank's loan portfolio from year-end 2004 through 2008.

Figure 1. Growth and Composition of Ocala National Bank's Loan Portfolio ($ millions)

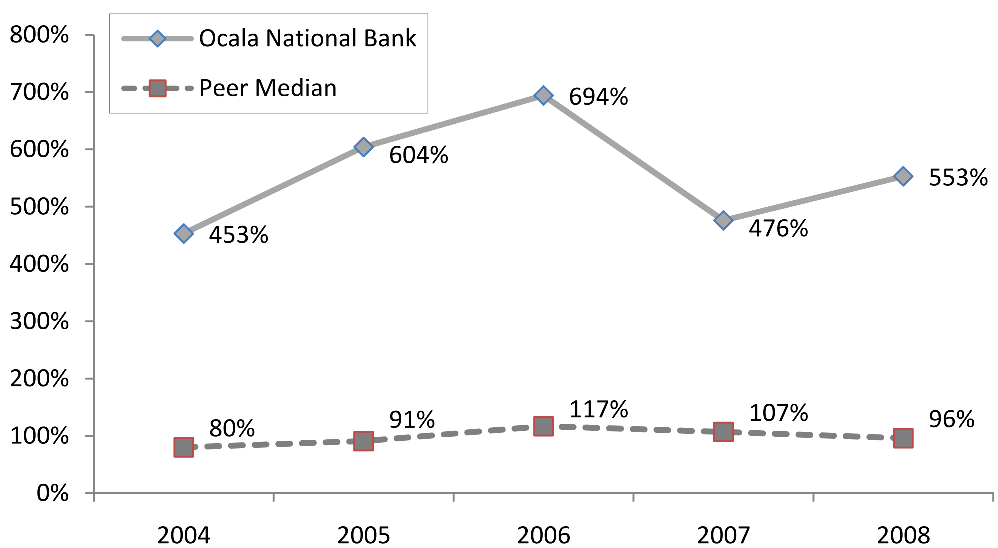


Source: OIG analysis of Ocala National Bank's Uniform Bank Performance Reports.

To finance its rapid growth from 2004 to 2006, the bank relied on volatile wholesale funding, including brokered deposits and loans from the Federal Home Loan Bank. In September 2005, wholesale funding totaled about 21 percent of the bank's total liabilities. In September of 2006 and 2007, brokered deposits represented approximately 22 percent and 16 percent, respectively, of its total deposits. The bank's heavy reliance on brokered deposits increased its vulnerability to an economic downturn. In 2008, the bank could no longer readily rely on wholesale funding, including brokered deposits, because of its asset deterioration and restrictions on the use of brokered deposits. As a result, liquidity became stressed.

As shown in figure 2, from 2004 through 2008, Ocala National Bank's construction and land development loans as a percentage of its total capital greatly exceeded that of its peer banks.

Figure 2. Construction and Land Development Loans as a Percentage of Total Capital



Source: OIG analysis of Ocala National Bank's Uniform Bank Performance Reports.

Ocala National Bank's high concentration of construction and land development loans peaked in 2006 (reaching nearly 700 percent of total capital on June 30, 2006, the highest concentration in the nation that year) and remained high when real estate prices dropped in 2007. In the interagency guidance Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices, effective December 12, 2006, a bank is potentially exposed to commercial credit risk if (1) loans for construction, land development and other land exceed 100 percent of total capital, or (2) total commercial real estate loans represent over 300 percent of total capital and the balance of the portfolio has increased more than 50 percent in the prior 36 months.[2] The bank's considerable concentration in construction and land development loans made it highly susceptible to declining real estate values and to changes in secondary market underwriting standards.

As a percentage of tier 1 capital plus allowance for loan and lease losses (ALLL), the bank's classified assets were relatively low in 2005 (4.1 percent in September 2005) and 2006 (8.2 percent in June 2006). As the Ocala real estate market declined in 2007 and 2008, however, the bank had to manage an increasing volume of problem loans. In November 2008, the bank had $56.3 million of classified assets, which represented 733 percent of its capital. By year-end 2008, the bank's past due loans totaled $46.8 million, representing 25 percent of its loan portfolio. This severe decline in the quality of the bank's loans led to net operating losses of $2.3 million and $31.6 million in 2007 and 2008, respectively.

In July 2007, OCC examiners found that many of Ocala National Bank's borrowers who had used loan proceeds to speculate in the real estate market defaulted. The bank was forced to foreclose on those properties and write down the property values. The foreclosures resulted in a sizeable amount of nonperforming assets held as other real estate owned (OREO). As real estate values continued to decline, the bank was required to further substantially write down the values of OREO and reduce the amounts the bank could recover from selling OREO.

With the decline in the real estate values, investors in the secondary loan market refused the bank's loans they had previously committed to purchase. Stricter underwriting requirements of the secondary market made it necessary for the bank to tighten its underwriting standards on loans—for example, by reducing the loan-to-value ratio. The bank, however, could not sell a large number of loans already in process because, with the

[2] Under OCC's previous guidance, a concentration of credit consisted of direct, indirect, or contingent obligations exceeding 25 percent of the bank's capital structure, which is composed of tier 1 capital plus the allowance for loan and lease losses.

tighter standards, the loans did not meet this new underwriting requirement. As of September 30, 2007, Ocala National Bank held $139 million of construction and land development loans in its portfolio, but because they did not conform to purchasers' stricter underwriting standards, the bank could not sell approximately 80 percent ($111 million) of them.

By December 2008, the asset write-downs, combined with large ALLL provisions and ongoing operating losses, depleted all of Ocala National Bank's capital. Its tangible equity capital at that time was negative $6.3 million.

Unsound Credit Risk Management, Underwriting, and Administration

Ocala National Bank's board and management pursued aggressive growth without establishing adequate credit risk management, underwriting, and administration controls. The bank approved loans that conformed to secondary market underwriting standards at the time, which required little borrower equity and no income verification. Many of the bank's borrowers speculated in the real estate market by using the loan proceeds to fund construction of residential real estate to be sold later for profit, often obtaining multiple loans for this purpose. The bank's underwriting did not fully assess the capability of borrowers to repay these loans. By October 2007, loans held by borrowers with two or more loans accounted for 42 percent of classified assets.

From 2005 through 2008, OCC examiners repeatedly communicated to Ocala National Bank's management their concerns about poor credit underwriting and administration practices.

- In OCC's 2005 ROE, examiners criticized bank management for making loans that exceeded the supervisory loan-to-value limits.[3] Examiners found bank financed construction loans with

[3] Interagency Guidelines for Real Estate Lending Policies establish supervisory loan-to-value limits that institutions should not exceed: (1) 65 percent for raw land; (2) 75 percent for land development; (3) 80 percent for commercial, multifamily, and other nonresidential loans; and (4) 85 percent for one- to four-family family residential loans. The guidelines state that institutions must establish review and approval procedures for loans with loan-to-value percentages in excess of supervisory limits.

loan-to-value ratios of 100 percent of the future retail price of the homes being constructed.

- In the 2005 and 2007 ROEs, examiners criticized bank management for failing to fully capture and assess the financial condition of borrowers.

- In the 2005, 2006, and 2007 ROEs, examiners criticized bank management for failing to obtain real estate appraisals or evaluations (evaluations are less comprehensive than appraisals and are allowed for certain types of transactions where an appraisal is not required) that met minimum regulatory standards. Examiners found instances in which appraisals or evaluations were not always performed or were not performed timely or completely. Examiners also found inadequate support for values or assumptions on appraisals. For example, in 2007, examiners found a loan that had been approved in 2006 for $862,000 for which the appraisal included sales data of properties that were not of the same lot size or within the same geographical area. In addition, the appraiser had not inspected the property. The property was appraised for $1.2 million but valued at $680,160 in 2007. OCC examiners downgraded the loan to a classified asset in 2007.

- In the 2007 ROE, examiners criticized bank management for failing to recognize most of its problem loans in the commercial real estate loan portfolio during 2007. Examiners identified $6 million of problem loans that the bank should have classified as such. Failure to recognize problem loans impaired managements' ability to take timely action to address loan quality problems and to accurately evaluate the ALLL.

- In the 2007 and 2008 ROEs, examiners criticized the lending staff's lack of experience in commercial real estate lending and emphasized the need for the bank to retain a loan officer with the requisite experience.

Ineffective Board and Management

From 2005 through 2008, Ocala National Bank's board and management, heavily influenced by the owner and his family, repeatedly failed to ensure that adequate policies and procedures were in place to manage significant lending risks. In January 2009, when the board was chaired by the owner and his sons were executives of the bank, one the CEO and the other the chief operating officer, OCC concluded that the board and management were critically deficient, having failed to

- establish safe and sound real estate lending practices,
- establish adequate loan underwriting procedures,
- establish adequate credit administration practices,
- implement effective concentration risk management controls,
- properly control loan growth, and
- prevent excessive concentrations related to real estate loans.

OCC examiners attributed the bank's poor lending practices to management's desire for significant growth and earnings with little regard for the controls needed to support such growth.

Ocala National Bank had a lengthy history of problems. In 1997 and 1998, OCC took enforcement action, entering into formal agreements with the bank concerning its ineffective management, uncontrolled loan growth, and poor credit administration practices.[4] In response, the bank hired an experienced CEO to run the bank. OCC viewed the new CEO as competent and believed the bank was stable with proper systems and controls in place. However, the CEO relinquished his position to the owner's son in 2004, and the bank embarked on a path of aggressive high-risk loan growth with poor underwriting controls. OCC did not express concern about the management change. OCC thought management had become more experienced and that the examiners could monitor the bank's management through its examinations.

OCC's Supervision of Ocala National Bank

OCC's supervisory approach to correcting Ocala National Bank's problems did not prevent a material loss to the Deposit Insurance Fund. OCC identified problems early at the bank, but the bank did

[4] The formal agreement issued in 1997 was replaced with a revised formal agreement in 1998. The revised agreement was more stringent because of the bank's noncompliance with the original formal agreement.

not take sufficient corrective actions to prevent a material loss. OCC conducted timely examinations of the bank and provided oversight through its off-site monitoring. OCC identified areas needing correction, but its supervisory approach in 2005 through 2007 was primarily to rely on examiner recommendations and MRAs in the ROEs. From 2005 through 2006, OCC also continued to assign the bank a CAMELS composite rating of 2, the same rating it assigned in 2004 when relatively few problems were noted. This proved to be an ineffective strategy as these problems persisted and grew worse in 2008 until the bank failed in 2009.

Because the bank was profitable, OCC was reluctant to take more forceful action, until it entered into a consent order with the bank in February 2008. While we recognize the judgment involved, in retrospect we believe that a more forceful approach towards Ocala National Bank was necessary considering the circumstances. Starting in 2004, the owner's son became CEO when the previous CEO, who had corrected many of the bank's prior problems, resigned. At the time, the owner's son, who had banking experience but not as a CEO, began aggressively growing the bank in high-risk products. OCC's supervisory approach cautioned bank management to rein in this high-risk growth strategy, which it did not.

In addition, we identified two other matters that negatively affected the bank that we believe OCC should have examined more aggressively. Both matters financially benefited shareholders while the bank's financial condition was deteriorating. The first matter involved the payment of $3.9 million in dividends by the bank to its holding company in 2007, some of which may have been unallowed. At the time, the bank was losing money. The second matter involved a questionable payment of approximately $1 million in 2008 to repurchase loans from a company owned by the owner's son and other shareholders.

We also found that OCC appropriately used its authority under PCA when it imposed PCA-required restrictions on the bank through a February 2008 consent order. At that time, OCC reclassified Ocala National Bank's capital level to adequately capitalized. This reclassification restricted the bank from accepting or renewing brokered deposits without an FDIC waiver. The bank requested the waiver and in May 2008 FDIC granted the bank permission to accept, renew, and roll over brokered deposits until August 2008.

Table 2 summarizes the results of OCC's annual safety and soundness examinations and enforcement actions. Appendix 5 provides details of MRAs, corrective actions, and other issues noted during the examination.

Table 2: Summary of OCC's Ocala National Bank Examinations and Enforcement Actions

		Examination Results			
Date started	**Assets ($Millions)[a]**	**CAMELS rating**	**Number of MRAs**	**Number of Corrective actions**	**Enforcement actions**
03/29/2004	$110	2/222122	0	5	None
11/28/2005	$220	2/222122	2	10	None
10/02/2006	$317	2/222122	3	12	None
07/25/2007	$269	2/232222	N/A	N/A[b]	None
11/13/2007	$269	4/444432	6	8	Consent order executed 2/14/2008
06/12/2008	$219	4/454532	N/A	N/A[b]	None
11/17/2008	$219	5/555552	0	5	None

Source: OCC ROEs and Reports of Condition and Income (Call Reports).
Note: The 2008 ROE did not include any MRAs because OCC was already preparing to close the institution.
[a] Amounts are as of December 31 of each year.
[b] The review scope was limited to follow-up on prior recommendations.

Earlier and Stronger Supervisory Response to the Bank's Concentration in Construction and Land Development Loans Was Warranted

OCC's enforcement action policy states that enforcement action should deal with a bank's problems at an early stage, before they develop into more serious supervisory issues or adversely affect a bank's performance and viability.[5] We believe that OCC did not fully adhere to this policy in addressing the deficient conditions at Ocala National Bank. In 2005 and 2006, OCC identified problems with Ocala National Bank's rapid growth, high concentration in construction and land development loans, and weak credit risk management practices, but took no forceful action to achieve

[5] *Bank Supervision Operations—Enforcement Action Policy* (PPM 5310-3).

corrections. Despite OCC's repeated recommendations that the bank establish concentration limits and improve its credit risk management, OCC stopped short of taking enforcement action and continued to assign the bank a CAMELS composite rating of 2. In 2007, when the examiners found that the bank had incurred significant loan losses, OCC downgraded the bank's CAMELS composite rating to 4 and initiated formal enforcement action resulting in the February 2008 consent order. Ultimately, the formal enforcement action was unsuccessful in preventing the bank's failure, as problems had become too large and severe to resolve.

OCC's 2005 and 2006 Examinations Identified Significant Problems

At the end of 2004, Ocala National Bank had 452 percent of its capital concentrated in construction and land development loans. OCC's 2005 ROE for the bank reported that construction and land development loans made-up 93 percent of the bank's total loan portfolio. This significant concentration made the bank more susceptible to a decline in real estate values and to changes to underwriting standards set by the secondary market. OCC warned the bank that a downturn in the real estate market could significantly affect the bank and recommended that the bank's board establish concentration tolerances. Instead, the bank continued to increase its concentration in these loans in 2006; by year-end, the concentration had increased to 694 percent of the bank's capital.

In the 2005 ROE, OCC examiners also concluded that Ocala National Bank's board and management were less than fully effective because of the bank's rapid growth. Bank management did not ensure that its systems and processes, especially in the high-priority areas of credit administration, funding and liquidity, and asset and liability management, kept pace with its growth. OCC recommended that the board and management establish strong formal planning to manage the bank's growth, with appropriate plans for capital, funding, and credit.

In addition, OCC examiners criticized the bank in the 2005 ROE for its heavy reliance on wholesale funding and warned of the liquidity risk posed by wholesale funding sources. To finance its rapid loan growth in 2005, Ocala National Bank relied on volatile wholesale funding from brokered deposits and loans from the Federal Home Loan Bank. Wholesale funding made up approximately 21 percent of the bank's total liabilities. OCC issued an MRA that directed the bank to enhance its funding and liquidity risk management systems and recommended that it consider establishing additional liquidity risk tolerances, such as limits on brokered funds and guidelines on wholesale funding.

OCC examiners also identified several issues with Ocala National Bank's credit risk management and credit administration practices in 2005. Examiners found deficient practices in most areas of the lending function that were caused by unprecedented growth without the necessary infrastructure and leadership to manage the growth. OCC issued an MRA that directed the bank to strengthen its credit administration by correcting the bank's deficient practices. These deficient practices included:

- liberal underwriting standards and instances in which the bank did not identify loans that failed to meet supervisory loan-to-value requirements,
- loans for construction of investment homes with loan-to-value ratios of 100 percent based on the future sales price, and
- instances in which the bank failed to obtain appraisals or evaluations on underlying real estate.

Despite these concerns, OCC assigned Ocala National Bank a CAMELS composite rating of 2, the same rating assigned in 2004 when relatively few problems were noted.

In 2006, the bank continued to increase its reliance on wholesale funding to support its rapid growth. In light of this reliance, OCC recommended in its 2006 ROE that the bank prepare an adequate contingency funding plan. In the 2006 ROE, OCC examiners again criticized the bank's credit underwriting and administration practices and, through an MRA, directed the board to improve the bank's loan analyses, documentation of real estate evaluations, identification and reporting of loan policy exceptions, and acquisition of real estate market data and analysis. In addition, the examiners criticized the board and management for failing to address appraisal regulation violations found in the 2005 examination and for the high level of borrower financial statement exceptions where loans were approved that did not meet the bank's underwriting standards. Despite what appeared to be further deterioration in these areas based on the examiners' findings, OCC concluded in the ROE that the bank had improved credit underwriting and administration practices and deemed board and management supervision to be satisfactory.

Ocala National Bank's significant loan growth and high concentration of construction and land development loans continued during 2006. In the 2006 ROE, examiners once again criticized the high concentration, this time as an MRA. The MRA directed the board to establish detailed risk limits by industry and loan type—the same recommendation as in 2005. Nevertheless, OCC now concluded that management had the knowledge and expertise to manage the concentration risk and deemed board and management supervision to be satisfactory. In 2006, OCC again assigned the bank a CAMELS composite rating of 2.

In 2007, OCC took a stronger stance toward Ocala National Bank for its high concentrations and ineffective concentration risk management. In the 2007 ROE, examiners now concluded that the bank operated in an unsafe and unsound manner because of the high concentration and ineffective concentration risk management and that the bank's board and management were deficient. OCC downgraded the bank's CAMELS composite rating to 4.

OCC Allowed the Bank's Continued Growth and Unsound Lending

In 2005, OCC examiners warned Ocala National Bank that a downturn in the real estate market could significantly affect the bank. In 2006, examiners expressed concern to the bank that the Ocala, Florida, real estate market was weakening. However, the bank continued to rapidly increase its loan portfolio, increasing the concentration that OCC considered to be unsound. According to the OCC Comptroller's Handbook, a loan is generally considered unsound if the following conditions exist:

- Its liquidation depends on the sale of the underlying real estate.

- The amount of the loan is large relative to the fair value of the property.
- The ability of the obligor to pay is questionable.[6]

OCC's Southern District office placed Ocala National Bank on the district's watch list in September 2006.[7] OCC's strategy was to caution bank management to slow the bank's growth and address the credit administration issues identified in the 2006 examination and 2007 quarterly review. OCC did not downgrade the bank's CAMELS composite rating or initiate formal enforcement action until the 2007 examination, when it learned that the bank's classified assets exceeded 127 percent of tier 1 capital plus ALLL. We believe that OCC should have taken stronger action earlier to address the bank's unsound real estate lending practices.

According to OCC officials, OCC did not elevate its concerns about the bank's use of liberal underwriting standards before 2007 because examiners believed that the associated risk was mitigated by the sale of these loans to secondary market investors. However, this belief proved to be a mistake. In 2007, secondary market investors tightened their underwriting standards and refused to honor prior commitments to purchase loans that Ocala National Bank was already processing. As a result, the bank was left holding loans that it originally intended to sell to the secondary market. When borrowers began to default on those loans, the bank had to foreclose on them, hold the underlying properties as OREO, and sell those properties at a loss.

OCC Took Enforcement Action in February 2008

OCC warned Ocala National Bank about its high concentration in construction and land development loans and its other deficient practices in 2005 and 2006, but it was not until 2007 that OCC began to take a forceful action against the bank regarding these issues.

[6] OCC, Comptroller's Handbook, "Real Estate Loans" (Section 213).
[7] Each OCC district maintains a watch list of banks that deserve close attention. The weaknesses of watch list banks are not pervasive enough for them to be designated as problem banks, and watch list banks are not adversely rated (i.e., their CAMELS composite rating is 1 or 2). The narrative section of the watch list discusses problems, supervisory strategy, current status, and any necessary additional background information.

By July 2007, Ocala National Bank's level of classified loans had increased dramatically to 55 percent of tier 1 capital plus ALLL, up from 5.1 percent in 2006. Because of the deterioration of the real estate market, OCC examiners projected that the level of classified assets could rise to as high as 160 percent of tier 1 assets plus ALLL by the fourth quarter of 2007. As a result, OCC downgraded Ocala National Bank's CAMELS asset quality component rating to 3 from 2 and the earnings component to 2 from 1. Despite the significant asset quality issues, however, OCC assigned the bank a CAMELS composite rating of 2—which was the same rating assigned in 2004, 2005, and 2006, when examiners noted relatively few problems. The examiners concluded in the examination report that while asset quality was unsatisfactory, the bank was still in satisfactory condition. OCC took neither informal nor formal enforcement action against the bank at that time.

Later, in November 2007, OCC performed a full-scope examination of the bank. Based on the results, OCC examiners concluded that Ocala National Bank operated in an unsafe and unsound manner because of its inadequate real estate lending practices, including its uncontrolled growth, high concentration, poor underwriting, and ineffective concentration risk management. Management had allowed the bank to become too concentrated in certain sectors of the residential real estate market, particularly single-family home construction. OCC downgraded the bank's CAMELS composite rating to 4 from 2 and informed the bank that immediate attention was required to ensure that satisfactory policies and procedures were in place. OCC also started to take formal enforcement action against the bank.

On February 14, 2008, OCC entered into a consent order with Ocala National Bank.[8] The consent order required that the bank address deficiencies in management, capital, asset quality, earnings, and liquidity within specified timeframes.

[8] On January 16, 2008, OCC's Southern District approved the use of a consent order for Ocala National Bank. OCC's Jacksonville field office provided a consent order to Ocala National Bank for review on January 23, 2008.

The bank did not comply with many of the consent order's requirements. The bank's problems were too large and too severe to resolve without substantial additional capital. By November 30, 2008, classified assets totaled 733 percent of the bank's tier 1 capital plus ALLL ($56.3 million). At that time, the bank had depleted all of its capital because of the continued write-downs of asset values, large ALLL provisions, and ongoing operating losses. The bank's equity was also a negative $6.3 million. The bank was unable to achieve the minimum capital ratios established by the consent order. It attempted to obtain capital through the sale of a branch and later through the sale of the entire bank, but neither sale materialized.

On October 9, 2008, OCC's Southern District transferred supervision of Ocala National Bank to the OCC's Special Supervision Division in Washington D.C. OCC at the time also downgraded Ocala National Bank's CAMELS composite rating to 5. The role of the Special Supervision Division is to supervise problem banks through rehabilitation or through other resolution processes such as the sale, merger, or liquidation of such institutions. By the time of the transfer, the bank's financial condition had deteriorated rapidly and little could be done to rehabilitate the bank.

The OCC Assistant Deputy Comptroller responsible for the supervision of Ocala National Bank told us that he believed there was nothing OCC examiners should have done differently, based on the facts as they knew them at the time. He said that there was no legal basis for formal enforcement action before 2007 because the bank was in good financial condition. However, OCC's enforcement action policy states that there is a presumption in favor of formal enforcement action when a bank faces serious problems or weakness, even if the problems have not yet resulted in a change of rating or have not been reflected in the bank's financial performance or condition. When asked why OCC did not at least take an informal enforcement action against the bank, the OCC official told us that an informal enforcement action had the same level of severity as MRAs that were already presented in the ROEs. Yet, the MRAs OCC presented never fully resolved the bank's significant problems. According to OCC enforcement action policy, an informal enforcement action typically provides more explicit direction than an MRA does; in addition, an informal enforcement action can be promptly followed up with a formal action if there is noncompliance with the informal action.

We also asked why OCC did not take more aggressive action to limit Ocala National Bank's concentration in construction and land development loans. The examiner-in-charge stated that OCC's interagency guidance on commercial real estate concentration required banks to implement proper risk management controls and the bank had made continuous improvements to its risk management.[9] The examination reports we reviewed, however, did not show that the bank fully developed sound concentration risk management practices. The OCC Assistant Deputy Comptroller told us that the interagency guidance on commercial real estate concentration did not establish concentration limits. Had there been regulatory concentration limits, concentration limits would have been enforceable, according to the official. OCC's Deputy Comptroller of Special Supervision, who did not know the details of the examinations, commented on OCC's general use of enforcement actions. The OCC official told us that OCC examiners could address concerns about high concentration earlier by taking enforcement action or requiring the bank to obtain more capital by establishing higher individual minimum capital ratios.

When asked why OCC waited until February 2008 to take enforcement action, especially after the results of the July 2007 review, the examiner-in-charge told us that he felt that OCC did take appropriate action against Ocala National Bank in 2007. He explained that the original purpose of the July 2007 review had been to observe the bank's progress in addressing the 2006 MRAs but that the review found a significant increase in classified assets. The examiner-in-charge stated that OCC took action by moving up its full-scope examination schedule and downgrading the bank's CAMELS asset quality and earnings ratings. The examiner-in-charge explained that regardless of whether enforcement action had been taken in July 2007, the damaging loans were already on the bank's books and the results would likely have been the same.

[9] *Concentrations in Commercial Real Estate Lending, "Sound Risk Management Practices,"* OCC 2006-46.

We believe that a sufficient basis existed for OCC to have used its authorities to take enforcement action against the bank as early as 2005. OCC was aware that in 2004 Ocala National Bank's CEO resigned and the owner's son took over as CEO. As soon as the owner's son took over management of the bank, the bank began aggressively growing in high-risk products. OCC did issue MRAs to obtain corrective action, but this approach cautioned bank management to rein in its high-risk growth strategy, which it did not. We understand that there is judgment involved in deciding when stronger action should be taken—to give a bank a chance to respond to the examiners recommendation—but in retrospect a more forceful approach was needed to control the bank's increasingly risky growth strategy.

Owner, Family, and Board Members Benefited Financially While Bank's Financial Condition Deteriorated

When Ocala National Bank's financial condition was rapidly deteriorating, there were two matters involving the bank that further exacerbated the bank's poor financial condition and, at the same time, financially benefited its owners and board members.

<u>Unallowed Dividend Payments Benefited Owners and Board Members</u>

In 2007, Ocala National Bank paid $3.9 million in dividends to its holding company, including dividends that ended up distributed to the owner, members of his family, and board members. (We could not determine the precise amount that was paid to the owner and family members.) That same year, the bank incurred a net operating loss of $2.3 million.

According to 12 U.S.C. §60, a bank cannot declare cash dividends if dividends exceed its year-to-date net income plus retained net income of the preceding 2 years. Accordingly, we believe that some of the $3.9 million in dividends paid in 2007 may have been unallowable.

When asked why the dividends were not challenged, the examiner-in-charge told us that the bank was not under a consent order in 2007 and was within the dividend limits of 12 U.S.C. §60 because the bank had positive net income in 2006. The OCC examiners, however, did not review the dividend disbursements to determine if they were legally allowable.

Cash Payment to the Owner's Son Benefited His Company

In 2008, Ocala National Bank paid a company owned by the owner's son and other shareholders approximately $1 million. This amount represented repayment for the company's loan participations, some of which were in default. The company was formed in 2006 as an independent limited liability corporation. Five of the nine Ocala National Bank board members, who were involved in approving this payment, also shared ownership of the company and therefore stood to personally benefit from the bank's repurchase of the loan participations.

During our review of the bank's records, we found that its CEO created this company to reduce Ocala National Bank's loan-to-value position on construction loans by providing secondary financing to borrowers lacking a down payment. This was accomplished through the company's participation in the loans with Ocala National Bank. The amount Ocala National Bank funded was 85 percent of the underlying property's estimated value, while the company financed the other 15 percent. After construction, the loans were sold to secondary market investors and the company was repaid the 15 percent plus profit. The company absorbed the first 15 percent of any loss, while Ocala National Bank took any remaining loss. This arrangement reduced Ocala National Bank's exposure to losses resulting from borrower defaults.

In April 2008, the president of the company, who was also Ocala National Bank's CEO, issued a demand letter to Ocala National Bank for repayment of all loan participations in which the company was involved. It threatened legal action if its demand was not met. The loan participations at issue could not be sold to investors and most were nonperforming. Ocala National Bank's chairman and legal counsel reviewed the participation agreements and determined that it was unclear as to what the bank was obligated to repay. Nevertheless, in July 2008, the board voted to take back all loan participations involving the company and assume full risk for losses associated with the nonperforming loans. Ocala National

Bank repaid the company approximately $1 million for the loan participations.

OCC examiners did not investigate the repayment of loan participations to the company. OCC field and district office representatives told us that they had very limited knowledge regarding the arrangement. The consent order required the bank to inform OCC of any material transactions, but OCC was not notified of the loan repurchase at the time it occurred.

The OCC Comptroller's Handbook provides guidance and examination procedures to assess the adequacy of dividends, related organizations, and insider activities. Examiners are required to follow core assessment standards that are minimum procedures needed to conclude on the bank's risk profile and CAMELS ratings. The guidance states that after considering the bank's risk profile and any outstanding supervisory issues, examiners could expand procedures to include a more detailed review of dividends, related organizations, and insider activities. Regarding Ocala National Bank, we believe that examiners should have been more concerned about the bank's high risk profile and troubled bank status and should therefore have applied the expanded procedures to include a detailed review of the adequacy of dividends and related organizations.

OCC Appropriately Used Prompt Corrective Action

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

Although we believe that OCC should have acted much more forcefully and sooner to address unsafe and unsound practices at Ocala National Bank, we conclude that OCC did appropriately use its authority under PCA. As the bank's capital levels deteriorated, OCC acted timely to impose PCA restrictions on the institution. As authorized by PCA, OCC's February 2008 consent order with the bank, among other things, reclassified the bank's capital category to adequately capitalized even though the bank's capital level met the regulatory definition of well-capitalized. Because of the adequately capitalized designation, the bank was prohibited from accepting or renewing brokered deposits without a waiver from FDIC. The bank requested the waiver. On May 5, 2008, FDIC granted the bank permission to accept, renew, and roll over $5 million in brokered deposits until August 15, 2008. With respect to the waiver, we found that Ocala National Bank did comply with FDIC's requirement that the bank reduce its brokered deposit balance.

On November 4, 2008, OCC notified the bank that it had fallen into the undercapitalized PCA category based on the bank's September 30, 2008, call report. The PCA notice required that the bank abide by the mandatory PCA restrictions, which included restrictions on capital distributions and management fees.

In accordance with PCA, OCC directed Ocala National Bank to submit a capital restoration plan by November 30, 2008. The bank, however, never submitted a capital restoration plan to OCC. On December 30, 2008, OCC notified the bank that it was critically undercapitalized. Its condition had become increasingly dire as its losses mounted. The bank had incurred losses that depleted all of its capital, resulting in tangible equity capital of negative $10 million by year-end 2008. PCA mandates that a critically undercapitalized bank be put into receivership or, with the concurrence of FDIC, conservatorship within 90 days after it becomes critically undercapitalized. OCC appointed FDIC as receiver for Ocala National Bank on January 30, 2009.

OCC Southern District's Internal Quality Assurance Review Found that Supervision Was Satisfactory and Effective

In February 2009, OCC's Southern District performed an internal district quality assurance review on the 2007 examination of Ocala National Bank. The review, performed by a different field office within OCC's Southern District, concluded that the district's supervision of Ocala National Bank was satisfactory and effective, that the examination identified the continuing deterioration of the bank, and that the ROE appropriately discussed the bank's significant weaknesses. The quality assurance review also noted that the Jacksonville field office had identified weaknesses over the past several examination cycles and that the ratings were downgraded in a timely manner.

We disagree with the quality assurance review's conclusion that OCC supervision of Ocala National Bank was satisfactory and effective and that ratings were downgraded in a timely manner. As stated previously, we found that from 2005 through 2007, OCC examiners repeatedly communicated to bank management concerns about rapid loan growth, high concentration in construction and land development loans, and poor credit underwriting and administration. Despite these concerns, however, OCC did not take strong action to force the bank to correct the problems until 2008. In addition, we believe that OCC was not timely in its downgrading of Ocala National Bank's CAMELS composite and component ratings.

According to OCC headquarters officials, an internal lessons-learned review of the failure of Ocala National Bank was in process. The purpose of that review is to assess both the causes of the failure and OCC's supervision of the bank. At the time of our audit, OCC had not yet completed the review.

Recommendations

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

Based on our material loss review of Ocala National Bank, we recommend that the Comptroller of Currency do the following:

1. Caution examiners and their supervisors that when a bank's condition has deteriorated, it is incumbent on examiners to

properly support and document in examination work papers the CAMELS component and composite ratings assigned, including those that may not have changed from prior examinations, as well as support a decision not to take an enforcement action.

Management Response

OCC agreed it is critical for examiners to always properly support and document CAMELS and component ratings, as well as any decision to take or not take an enforcement action. OCC senior management used the "lessons learned" in earlier bank failures to illustrate the importance of being assertive in identifying and following through on identified weaknesses in a timely manner. OCC management also reiterated that compliance with OCC's policy on workpaper documentation is particularly important in problem bank situations. OCC plans to continue to emphasize this message through district management meetings, future examiner conference calls, and as other opportunities arise.

2. Remind examiners that it is prudent to expand examination procedures for troubled or high-risk banks to review the appropriateness of (a) dividends and (b) payments to related organizations, particularly when the dividends or payments may benefit bank management and board members. In this regard, OCC should reassess, and revise as appropriate, its examination guidance for when expanded reviews of dividends and related organizations should be performed.

   Management Response

   OCC responded that heightened scrutiny of certain dividends and payments to related organizations is appropriate. OCC believes its existing guidance is sufficient to compel examiners to perform expanded reviews of dividends and payments to related organizations when appropriate. OCC plans to use one of its regular national conference calls to reinforce to examining staff that it is prudent to expand examination procedures for dividends and related organizations when warranted, particularly when payments may benefit bank management or board members.

OIG Comment

OCC's actions, both taken and planned, meet the intent of our recommendations.

* * * * * *

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 (617) 223-8640 or Mark Ossinger, Audit Manager, at (617) 223-8643. Major contributors to this report are listed in Appendix 7.

/s/
Donald P. Benson
Audit Director

Our objectives were to determine the cause of Ocala National Bank's failure and assess the bank's supervision by the Office of the Comptroller of the Currency (OCC). We conducted this material loss review of Ocala National Bank, of Ocala, Florida, in response to our mandate under section 38(k) of the Federal Deposit Insurance Act, as amended.[10] 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, which shall

- ascertain why the institution's problems resulted in a material loss to the insurance fund;
- review the agency's supervision of the institution, including implementation of the Prompt Corrective Action provisions of section 38; and
- make 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 Ocala National Bank based on the loss estimate by the Federal Deposit Insurance Corporation (FDIC). As of August 7, 2009, FDIC estimated that Ocala National Bank's failure would cost the Deposit Insurance Fund $99.6 million.

To assess the adequacy of OCC's supervision of Ocala National Bank, we determined (1) when OCC first identified Ocala National Bank safety and 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 determined whether OCC (1) might have discovered problems earlier; (2) identified and reported all the problems; and (3) issued comprehensive, timely,

[10] 12 U.S.C. § 1831o(k).

and effective enforcement actions that dealt with any unsafe or unsound activities. We performed the following work:

- We determined that the time period covered by our audit would be March 29, 2004, through Ocala National Bank's failure on January 30, 2009. This period included three safety and soundness examinations prior to OCC's identifying Ocala National Bank as a troubled institution and assigning it a CAMELS composite rating of 4. We reviewed OCC supervisory files and records for Ocala National Bank from 2004 through 2008. 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 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 Ocala National Bank with OCC officials, examiners, and attorneys to obtain their perspective on the bank's condition and the scope of the examinations.

- We interviewed personnel with FDIC's Division of Resolutions and Receiverships who were involved in the receivership process, which was conducted after Ocala National Bank's closure and the appointment of FDIC as receiver.

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

We conducted our fieldwork from March 2009 through July 2009. 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.

Ocala National Bank History and Corporate Structure

Ocala National Bank, Ocala, Florida, was chartered by OCC in 1986. The bank had its main office and three branches in Marion County, Florida. ONB Financial Services, Inc., a one-bank holding company, wholly owned the bank. As of April 2008, the chairman and his two sons together owned 92.27 percent of the holding company. The bank's directors owned the remaining shares. The bank was not publically traded. At the time of its failure on January 30, 2009, Ocala National Bank had approximately $224 million in assets.

Appendix 4 contains a chronology of significant events regarding Ocala National Bank.

Types of Examinations Conducted by OCC

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

OCC must schedule full-scope, onsite examinations of insured banks once during either a 12-month cycle or an 18-month cycle. All de novo banks are subject to the 12-month examination cycle. The 12-month cycle should continue until the bank has had two full-scope, on-site examinations and achieves stability with regard to earnings, core business operations, and management.

An 18-month examination interval applies to insured banks with total assets of $250 million or less that

- for the most recent examination received a CAMELS composite rating of 1 or 2 and a compliance rating of 1 or 2;
- for the most recent examination received a CAMELS Management component rating of 1 or 2;
- are well-capitalized;
- are not currently subject to a formal enforcement proceeding or order by OCC or FDIC; and
- have not undergone a change in control during the 12-month period since completion of the last full-scope, onsite examination.

During a full-scope examination, examiners conduct an onsite examination and rate all CAMELS components. The six components are **C**apital Adequacy, **A**sset Quality, **M**anagement, **E**arnings, **L**iquidity, and **S**ensitivity to Market Risk (CAMELS). OCC then assigns each bank a composite rating based on its assessment of the overall condition and level of supervisory concern. The rating scale ranges from 1 to 5, with a rating of 1 indicating the strongest performance and risk management practices relative to the bank's size, complexity, and risk profile and the level of least supervisory concern. A 5 rating indicates the most critically deficient level of performance; inadequate risk management practices relative to the bank's size, complexity, and risk profile; and the greatest supervisory concern. Generally, component ratings reflect examination findings and an examiner's assessment of the bank's performance in the six key performance groups that are common to all banks.

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.

<u>Informal Enforcement Actions</u>

When a bank's overall condition is sound but it is necessary to obtain written commitments from its board of directors or management to ensure that they correct identified problems and weaknesses, OCC may use informal enforcement actions. Informal enforcement actions provide a bank with more explicit guidance and direction than an ROE normally contains but are generally not legally binding. OCC commonly uses informal actions for problems in

- well- or adequately capitalized banks and in
- banks with a composite rating of 1, 2, or 3.

Informal actions notify the 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 commitment letters, memoranda of understanding, and Part 30 safety and soundness plans. Commitment Letter and memoranda of understanding contain specific bank commitments to take corrective actions in response to problems or concerns identified by OCC in its supervision of a bank. A Part 30 informal enforcement action requires a bank to submit a compliance plan for OCC approval that outlines the steps it will take and timeframes to correct identified deficiencies. Unlike formal enforcement actions, informal actions are not disclosed to the public.

Formal Enforcement Actions

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. Because formal actions are enforceable, OCC can assess civil money penalties against banks and individuals for noncompliance with formal agreements or final orders. OCC can also request a federal court to require a 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

Consideration for determining whether to use informal action or formal action include

- 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.[11]

[11] Bank Supervision Operations—Enforcement Action Policy (PPM 5310-3).

Allowance for loan and lease losses	A valuation reserve established and maintained by charges against a bank's operating income. As a valuation reserve, it is 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. These valuation allowances are established to absorb unidentified losses inherent in the institution's overall loan and lease portfolio.
Brokered deposits	Any deposit that is obtained, directly or indirectly, from a deposit broker. The 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. Under 12 U.S.C. § 1831(f) 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 FDIC, 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 a call report 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 administration, 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 rating.
Capital restoration plan	Under the Prompt Corrective Action (PCA) requirements of the Federal Deposit Insurance Act, as amended, a plan 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 will comply with the restrictions or requirements then in effect, the types and levels of activities in which the institution will engage, and any other information that the federal banking agency may require.
Classified assets	Assets rated as substandard, doubtful, and loss. Substandard assets are inadequately protected by the current worth and paying capacity of the obligor or of the collateral pledged, if any. A doubtful asset has all the weaknesses of a substandard asset with the added characteristic that the weaknesses make collection or liquidation in full questionable and improbable. A loss asset is considered uncollectible and of such little value that continuation as a bankable asset is not warranted.
Commercial real estate loans	Loans secured by raw land, land development, and construction. Commercial real estate includes one-to four-family residential construction, multifamily property, and nonfarm nonresidential property where the primary or a significant source of repayment is from rental income associated with the property (i.e., loans for which 50 percent or more of the source of repayment comes from third-party, nonaffiliated, rental income) or the proceeds of the sale, refinancing, or permanent financing of the property.
Concentration risk	Risk in a loan portfolio that arises when a disproportionate number of an institution's loans are concentrated in one or a small number of financial sectors, geographical areas, or borrowers. If loans are more broadly distributed, weaknesses confined to one or a small number of sectors, areas, or borrowers would pose a smaller risk to the institution's financial health.
Consent order	The title given by OCC to an order to cease and

	desist, which is entered into and becomes final through the board of directors' execution of the bank of a stipulation and consent document on behalf of the bank. Its provisions are set out in article-by-article form and prescribe restrictions and corrective and remedial measures necessary to correct deficiencies or violations in the bank and return it to a safe and sound condition.
De novo	A newly chartered bank opened less than 3 years.
Division of Resolutions and Receiverships	A division within FDIC that is charged with resolving failing and failed financial institutions, which includes, among other important responsibilities, ensuring depositors' have prompt access to their insured funds.
District Supervision Review Committee	An OCC committee that ensures that OCC bank supervision and enforcement policies are applied effectively and consistently. The committee advises the deputy comptrollers on bank supervision and enforcement cases by providing recommendations on supervisory strategies and enforcement actions.
Federal Home Loan Bank	A government-sponsored enterprise chartered by Congress in 1932 whose purpose is to support residential mortgage lending and community investment at the local level by providing primary direct loans to its more than 8,000 member financial institutions (primarily banks and thrift institutions). Each member institution is a shareholder in 1 or more of 12 regional Federal Home Loan Banks, which are privately capitalized, separate corporate entities. The system's Office of Finance is its centralized debt issuance facility. The funds obtained through debt issuance are used to support Federal Home Loan Bank activities.
Formal agreement	A type of formal enforcement action authorized by statute. Formal agreements are generally more severe than informal actions and are disclosed to the public. Formal actions are also enforceable through the

	assessment of civil money penalties.
Individual minimum capital ratio	Established under OCC authority, a minimum level of capital for a banking institution that OCC considers to be necessary or appropriate in light of the particular circumstances of the institution.
Loan-to-value	A ratio for a single loan and property calculated by dividing the total loan amount at origination by the market value of the property securing the credit plus any readily marketable collateral or other acceptable collateral. In accordance with Interagency Guidelines for Real Estate Lending Policies, institutions' internal loan-to-value limits should not exceed the legal lending limit: (1) 65 percent for raw land; (2) 75 percent for land development; (3) 80 percent for commercial, multifamily, and other nonresidential loans; and (4) 85 percent for one-to-four-family residential loans. The guidelines do not specify a limit for owner-occupied one-to-four-family properties and home equity loans. However, when the loan-to-value ratio on such a loan equals or exceeds 90 percent at the time of origination, the guidelines state that the bank should require mortgage insurance or readily marketable collateral.
Loan participation	The sharing of a loan by a group of banks that join together to make a loan too large for any one of the banks to handle. Loan participation is a convenient way for smaller banks to book loans that would otherwise exceed their legal lending limits (see loan-to-value for limits).
Matter requiring attention	A practice noted during an OCC examination of the bank that deviates from sound governance, internal control, and risk management principles. The matter, if not addressed, may adversely affect the bank's earnings or 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

	in connection with the approval of any application or other request by a bank. Matters requiring attention are not enforcement actions, but failure by a bank's board and management to address a matter requiring attention could lead to an enforcement action.
Nonperforming loans	Loans that are not earning income and for which (1) payment of principal and interest is no longer anticipated, (2) principal or interest is 90 days or more delinquent, or (3) the maturity date has passed and payment in full has not been made.
Other real estate owned	Real properties that a bank has acquired that do not constitute its banking facilities. Such properties include real estate acquired in full or partial satisfaction of a debt previously contracted and are subject to specific holding periods, disposition requirements, and appraisal requirements.
Prompt Corrective Action	A framework of supervisory actions, set forth in 12 U.S.C. § 1831o, for insured banks 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.				

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

Safety and soundness examination — The part of an examination that includes a review and evaluation of each of the CAMELS component ratings (see explanation of CAMELS, above).

Tangible equity — The amount of tier 1 capital plus outstanding cumulative perpetual preferred stock minus all intangible assets except mortgage servicing assets to the extent permitted in tier 1 capital.

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.

Uniform Bank Performance Reports (UBPR) — An analytical tool created by the Federal Financial Institutions Examinations Council to help supervise and examine financial institutions. A UBPR is produced quarterly for each commercial bank that is supervised by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, or the Office of the Comptroller of the Currency. The performance and composition data contained in the report are presented in the form of ratios, percentages, and dollar amounts computed mainly from call reports submitted by the bank. The UBPR also provides comparisons of an individual bank's performance and balance sheet structure with similarly sized banks.

The following chronology describes significant events in the history of Ocala National Bank, including examinations conducted and enforcement actions taken by the Office of the Comptroller of the Currency (OCC). Appendix 5 contains additional information on the results of examinations, including any significant safety and soundness matters requiring attention, and recommended actions.

Date	Event
2/7/1986	Ocala National Bank is established.
1/2/1997	ONB Financial Services, Inc., is established as a bank holding company. Ocala National Bank is reorganized.
10/15/1997	Ocala National Bank is downgraded to a CAMELS composite rating of 4 from 2 in its previous full-scope exam conducted in 1996. The bank is placed under a formal agreement because of its uncontrolled loan growth led by former management and its resultant subsequent losses.
9/3/1998	Ocala National Bank is placed under a revised, more stringent formal agreement when OCC finds that the bank is noncompliant with 8 of the 9 substantive articles from the formal agreement in 1997. The bank's problems continue in the loan administration area.
9/15/1998	Ocala National Bank is found to be in violation of 12 U.S.C. § 375 and 375b and 12 C.F.R. § 215.4, in which the majority owners had participated in preferential transactions involving the sale of bank-owned property. OCC's Southern District decides to assess civil money penalties (CMP).
5/18/1999	CMP of $5,000 is assessed against the majority owner of Ocala National Bank and CMPs of $2,500 are assessed against each of the majority owner's two sons. The purpose of the CMPs is to penalize the owners for improper insider transactions and to deter future improper actions.
10/27/1999	OCC conducts a full-scope examination on Ocala National Bank and assigns a CAMELS composite rating of 3.
11/16/2000	OCC conducts a full-scope examination on Ocala National Bank and assigns a CAMELS composite rating of 3.
11/1/2001	OCC terminates the formal agreement against Ocala National Bank based on OCC's determination that the bank is operating with competent management, its financial condition is stable, and proper systems and controls are in place.
11/2/2001	OCC conducts a full-scope examination on Ocala National Bank and assigns a CAMELS composite rating of 2.
12/2/2002	OCC conducts a full-scope examination on Ocala National Bank and assigns a CAMELS composite rating of 2.
1/22/2004	The majority owner's son is named the President and Chief Executive Officer of Ocala National Bank.
3/22/2004 to 4/9/2004	OCC conducts a full-scope examination on Ocala National Bank and assigns a CAMELS composite rating of 2.
11/28/2005 to 12/8/2005	OCC conducts a full-scope examination on Ocala National Bank. OCC finds that the bank's credit administration is weak as well as many instances of superficial loan underwriting. OCC also found that credit risk management is deficient for the size and complexity of the portfolio and planned future

Date	Event
	growth. The bank's CAMELS composite rating remains a 2.
9/6/2006	OCC adds Ocala National Bank to its Southern District's *Watch List* after the bank informs OCC that it failed to keep its promise of curtailing growth and growing 35 percent.
9/7/2006 to 10/26/2006	OCC conducts a full-scope examination to evaluate the bank's overall condition and the board of directors and management's ability to effectively identify, measure, monitor, and control risk. The bank's CAMELS composite rating remains a 2.
7/23/2007	OCC finds the bank's asset quality has deteriorated. Total classified assets have risen in a year to 55 percent from 8 percent. OCC estimates that deterioration in the loan portfolio could increase total classified assets to 160 percent from 130 percent by the fourth quarter of 2007. OCC downgrades the bank's asset quality rating to 3 from 2 and earnings to 2 from 1.
11/13/2007 to 12/12/2007	OCC assesses the bank's overall condition, updates component and risk assessment ratings, gauges the extent of asset quality problems, evaluates problem loan management processes and skills, reassesses underwriting and risk selection, and evaluates general credit administration in a full-scope exam. OCC assigns the bank a CAMELS composite rating of 4 at the direction of the Southern District Supervisory Review Committee (DSRC) on January 16, 2008.
1/16/2008	DSRC meets to review the OCC Jacksonville field office's recommendation to downgrade Ocala National Bank to CAMELS composite rating to 3 from 2 along with a proposed formal agreement. Instead, the DSRC approves a CAMELS composite rating of 4 and the use of a consent order.
1/22/2008	Ocala National Bank is added to OCC's Problem Bank Report.
1/23/2008	OCC provided Ocala National Bank with the consent order.
2/14/2008	Ocala National Bank enters into a consent order with OCC. The bank is reclassified to adequately capitalized, although it capital ratios reflect the well-capitalized category for Prompt Corrective Action (PCA) purposes. One provision of the consent order requires the bank to achieve and maintain a Tier 1 risk-based ratio of 13 percent and a leverage ratio of 9 percent by June 30, 2008.
7/15/2008	Ocala National Bank is unable to meet the minimum capital ratio requirements set by the consent order. OCC extends the capital requirement due date to September 15, 2008.
8/6/2008	Ocala National Bank's classified assets increased to 202 percent in July 2008. OCC's Jacksonville field office proposes maintaining a CAMELS composite rating of 4 and downgrading asset quality to 5. DSRC concurs with the field office recommendation but also downgrades the earnings component to 5.
9/16/2008	OCC extends the capital requirement due date to November 30, 2008.
10/9/2008	DSRC concurs with the Jacksonville field office's recommendation to downgrade Ocala National Bank's CAMELS composite rating to 5 and to transfer supervision of the institution to OCC's Special Supervision Division in Washington DC.
10/15/2008	OCC downgrades Ocala National Bank's CAMELS composite rating to a 5.

Date	Event
11/4/2008	OCC notifies Ocala National Bank that the bank's PCA capital category is undercapitalized based on the bank's call report for the period ending September 30, 2008 (the call report was filed October 28, 2008). OCC requires the bank to submit a capital restoration plan by November 30, 2008. The bank, however, never submits a capital restoration plan to OCC.
11/28/2008	Ocala National Bank notifies OCC that it is unable to increase capital to the required levels by November 30, 2008.
12/30/2008	Ocala National Bank becomes critically undercapitalized for PCA purposes based on financial information as of November 30, 2008.
1/30/2009	Ocala National Bank is closed by OCC and FDIC is named Receiver. FDIC estimates the cost to its Deposit Insurance Fund will be $99.6 million

Source: OIG analysis of OCC, FDIC, and Ocala National Bank data.

This appendix summarizes the Office of the Comptroller of the Currency's (OCC) safety and soundness and targeted examinations of Ocala National Bank from March 2004 through November 2008 and provides information on the significant results of those examinations. We list the following items from the reports of examination (ROE): (1) matters requiring attention and (2) other issues/. Generally, matters requiring attention represent the most significant items requiring corrective action and are more serious.

Date examination started	CAMELS rating	Assets ($Millions)	Significant safety and soundness corrective actions and other issues cited in ROE	Enforcement action
3/29/2004	2/222122	$110	Matters requiring attention • None identified. Other issues/recommendations • Ensure loan officers provide more comprehensive loan presentations on larger credit requests. • Enhance allowance for loan and lease losses (ALLL). • Ensure comprehensive post-funding analyses are performed. • Develop methodology that identifies and tracks significant underwriting exceptions. • Ensure appraisal reviews are completed prior to loan funding. Reviews are to include o valid appraisal assumptions, and o independent reviewer.	None
11/28/2005	2/222122	$220	Matters requiring attention • Asset Quality – Immediately improve credit administration. Practices in credit granting and credit risk management to be addressed and/or improved including o liberal underwriting that included spec homes financed at 100 percent of the retail selling price, o incomplete and superficial underwriting analyses, o missing real estate appraisals and evaluations, o noncompliance with supervisory loan-to-value requirements, o incomplete annual loan reviews, o outdated loan policy (policy does	None

Date examination started	CAMELS rating	Assets ($Millions)	Significant safety and soundness corrective actions and other issues cited in ROE	Enforcement action
			not reflect current lending practices), o incomplete credit risk reports (reports do not identify volumes, trends, concentrations, exceptions and loan officer performance), and o incomplete ALLL methodology. • Liquidity Management – Upgrade funding analytics in order to have comprehensive cash flow forecasting analysis. <u>Other issues/recommendations</u> • Establish board approved tolerances for real estate lending in the Ocala market and manage exposures when tolerances are approached or when evidence of a downturn in real property values. • Reduce high credit and collateral loan exceptions. • Establish concentration tolerances, loan mix, and exceptions. • Contract out annual loan reviews. • Enhance existing strategic planning process to include detailed capital, funding, and credit plans. • Develop strong risk management systems. • Ensure monthly Asset and Liability Committee (ALCO) meetings are held. • Enhance the funds management policy to include additional liquidity risk tolerances such as limits on brokered funds and guidelines on wholesale funding. • Continue to add off-balance sheet funds providers as the bank grows. Seek additional backup funding lines as well as greater diversification among providers. • Address the following violations: o 12 C.F.R. §34.43(a) – Obtain appraisal prior to loan approval when required, o 12 C.F.R. §34.43(b) – Obtain	

Date examination started	CAMELS rating	Assets ($Millions)	Significant safety and soundness corrective actions and other issues cited in ROE	Enforcement action
			evaluation of real property prior to loan approval when appraisal is not required, o 12 C.F.R. §203.4(a) – Collect and record data as required by the Home Mortgage Disclosure Act, and o 12 C.F.R. §30, Appendix B (III) (B) – Implement standards for safeguarding customer information.	
10/02/2006	2/222122	$317	<u>Matters requiring attention</u> • Formalize strategic planning. • Improve or further refine credit administration because of continued significant loan growth, including the following: o Credit Granting Practices – Enhance pre-funding analysis and monitor market data and conditions. Ensure real estate evaluations are in writing, independent, and provide sufficient support for the value. o Credit Risk Management Practices – Provide more detailed risk limits including specific limits by industry and loan type. Implement a system to identify and report policy exceptions. o Construction Lending – Set limits on construction lines of credit. Ensure better documentation in the construction loan files. Provide management and the board better market analysis and data on construction lending. • Improve IT management to comply with several regulations and OCC guidance. <u>Other issues/recommendations</u> • Expand the bank's process to better identify and reduce the level of exceptions.	None

Date examination started	CAMELS rating	Assets ($Millions)	Significant safety and soundness corrective actions and other issues cited in ROE	Enforcement action
			• Enhance loan grading system and change the bank's definition of special mention to coincide with regulatory guidance. • Improve the ALLL methodology through o developing more support for the qualitative factors, o using a range of best and worst case scenarios including historical loss factors and qualitative factors, and o incorporating benchmarking to help validate the adequacy of ALLL. • Ensure quality assurance processes related to residential mortgage activity are more formalized and aligned with Fannie Mae's expectations to ensure ongoing investor compliance. • Continue refining forward-looking funding analysis. • Develop a more comprehensive contingency funding plan. • Continue to develop alternative diversified funding sources. • Report policy limit ratios through the asset-liability committee. • Consider revising the funding gap policy limit to a more realistic limit. • Consider incorporating additional liquidity ratios in the liquidity management process. • Improve interest risk rate management. • Violations cited included: o 12 C.F.R. §30, Appendix B (III)(B) – Implement standards for safeguarding customer information, and o 12 U.S.C. 2803 and 12 C.F.R. §203.4(a) – Collect and record data	

Date examination started	CAMELS rating	Assets ($Millions)	Significant safety and soundness corrective actions and other issues cited in ROE	Enforcement action
			as required by the Home Mortgage Disclosure Act.	
11/13/2007	4/444434	$269	Matters requiring attention • Strengthen credit risk identification and oversight: o Hire a lender with commercial real estate experience, and hire additional staff. ; o Improve the accuracy of problem loan identification and reduce the level of problem loans. o Improve underwriting and credit analysis. o Reduce concentration of home construction. • Make the necessary provisions to the ALLL to reflect the deterioration in asset quality. Establish ALLL policy and methodology that conforms to OCC guidance. • Strengthen the appraisal process by ensuring that the appraisers and appraisal reviewers have the necessary qualifications. Ensure that evaluations for real estate meet minimum interagency standards. • Improve loan portfolio management information reports. • When held for sale loans are transferred to the bank's permanent portfolio, write down loans where the market value is less than the bank's cost. • Reduce liquidity risk by increasing on-balance sheet liquidity, enhancing liquidity monitoring, and revising contingency funding plan. Other issues/recommendations • Improve asset diversification by increasing consumer lending, owner	Consent order issued on 2/14/2008 (formal action)

Date examination started	CAMELS rating	Assets ($Millions)	Significant safety and soundness corrective actions and other issues cited in ROE	Enforcement action
			occupied commercial real estate loans, and the investment portfolio. • Focus loan analyses more on the primary source of repayment such as cash flow from the project, the borrower, or the guarantor. Reviews also need to consider analysis of the borrower's other debt and projects. • Strengthen commercial real estate underwriting standards. • Convert problem loans and bank owned real estate properties into solid earning assets. • Ensure that the bank only books high quality loans to alleviate the need for additional large loan loss provisions. • Request an FDIC waiver for brokered deposits. • Enhance sensitivity to market risk. • Violations cited included: o 12 U.S.C. § 1828(o) – Appraisal required prior to real estate transaction, o 12 C.F.R. Part 34.44(b)) – Minimum appraisal standards must be met to support decision for real estate transaction, o 12 C.F.R. Part 34.43(b) – Evaluation of real property required prior to loan approval when appraisal is not required, and o 12 U.S.C. § 161(a) – Refile Reports of Condition and Income.	
11/17/2008	5/555552	$219	Matters requiring attention • No matters are identified. OCC was already preparing to close the bank. Other issues/recommendations • Adhere to the appropriate accounting	Consent order issued on 2/14/2008 still in place.

Date examination started	CAMELS rating	Assets ($Millions)	Significant safety and soundness corrective actions and other issues cited in ROE	Enforcement action
			procedures, policies, and internal controls to administer OREO, including periodic collateral valuations. • Overall credit administration continues to need improvement. • The following 2007 matters requiring attention need further action and are considered outstanding: o Reduce the level of problem assets and improve problem loan identification. o Reduce credit exposure, and strengthen underwriting and credit risk selection. o Improve appraisal ordering and review process to ensure compliance with appraisal regulations. o Ensure ALLL is adequate and the methodology complies with OCC guidance. • The commercial real estate (CRE) lending area require additional work: o Address CRE lending in the bank's strategic plan. o Establish CRE policy guidelines. o Obtain market analysis information to assess whether the CRE lending strategy and policy is appropriate. o Improve assessment of developers' overall credit worthiness. o Perform portfolio stress testing and sensitivity analysis on CRE loans. • Violations cited included: o 12 C.F.R. 337.6 (b)(3)(ii) and 12 U.S.C. § 1831f (e)(1) – Undercapitalized insured depository institution may not solicit deposits	

Date examination started	CAMELS rating	Assets ($Millions)	Significant safety and soundness corrective actions and other issues cited in ROE	Enforcement action
			by offering an effective yield that exceeds the allowable offering rate.	

Source: OIG analysis of OCC Reports of Examination.

We have completed three mandated material loss reviews of failed banks since the current economic crisis began in 2007. 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 of the Currency**
Safety and Soundness: Material Loss Review of ANB Financial, NA, 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 Financial'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 the supervisory plan if certain circumstances exist as specified in OCC's Examiner's Guide to Problem Bank Identification, Rehabilitation, and Resolution. Re-emphasize to examiners that formal enforcement 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 reason 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 a focus on heavy reliance on brokered deposits and other nonretail 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, NA, OIG-09-033 (Feb. 27, 2009) OCC closed FNB of Nevada and First Heritage Bank on July 25, 2008, and named FDIC as Receiver. As of December 31, 2008, FDIC estimated a loss to the Deposit Insurance Fund of $706 million for FNB Nevada and $33 million for First Heritage Bank.	Re-emphasize to examiners the need to ensure banks take swift corrective actions in response to examination findings. Reemphasize to examiners OCC's policy on the preparation of supervision workpapers (e.g., workpapers are to be clear, concise, and readily understood by other examiners and reviewers).

Report Title	Recommendations to the Comptroller of the Currency
Safety and Soundness: Material Loss Review of the First National Bank of Commerce, OIG-09-042 (Aug. 6, 2009) OCC closed the National Bank of Commerce and appointed FDIC as receiver on January 16, 2009. As of June 30, 2009, FDIC estimated that the bank's failure would cost the Deposit Insurance Fund $92.5 million.	Conduct a review of investments by national banks for any potential high risk concentrations and take appropriate supervisory action. Reassess examination guidance regarding investment securities, including [Government Sponsored Enterprise] securities.

MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

To: Donald P. Benson, Audit Director

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

Date: August 25, 2009

Subject: Response to Material Loss Review of Ocala National Bank, Ocala Florida

We have received and reviewed your draft report titled "Material Loss Review of Ocala National Bank." Your overall objectives were to determine the cause of the failure of Ocala National Bank (ONB), and assess the OCC's supervision of the bank, including implementation of the Prompt Corrective Action (PCA) provisions of section 38(k).

You concluded that ONB failed because of significant losses within its construction and land development loan portfolio. You also concluded that the OCC identified problems early, but the actions taken by the bank were not sufficient to prevent its failure. Your report also notes that the OCC acted forcefully against the bank in 2008 and appropriately used its authority under PCA. However, you also note that in retrospect, the OCC should have used a more forceful approach sooner, given ONB's circumstances.

You also concluded that, in the case of ONB, there were shortcomings in our execution of the supervisory process. We agree and will reinforce certain principles to our examining staff. The paragraphs below outline the steps that we have taken, or will take, to address your recommendations.

Support for CAMELS Ratings and Decisions Regarding Enforcement Action

We agree it is critical that examiners always properly support and document CAMELS and component ratings, as well as any decision to take, or not to take, an enforcement action. This is particularly important in situations where a bank's condition has deteriorated. We continue to reinforce to examiners the importance of timely recognition of problems, accurately reflecting an institution's condition in CAMELS ratings, and taking timely enforcement actions. During one of our national examiner conference calls, OCC senior management used the "lessons learned" in earlier bank failures to illustrate the importance of being assertive in identifying and following through on identified weaknesses in a timely manner. Further, we also reiterated that compliance with OCC's policy on workpaper documentation is particularly important in problem bank situations. We will continue to emphasize this message through district management meetings, future examiner conference calls, and as other opportunities arise.

Review of Dividends and Payments to Related Organizations

In the case of ONB, and in other high-risk and troubled institutions, heightened scrutiny of certain dividends and payments to related organizations is appropriate. As your report accurately states, the Comptroller's Handbook provides guidance and examination procedures for assessing the propriety of dividends and transactions with related organizations. The Comptroller's Handbook booklets for "Related Organizations" and "Capital Accounts and Dividends" include General Procedures that are used to set the scope and objectives of the examination. Assessments of the institution's quantity of risk and quality of risk management are integral to these procedures and guide examiners in determining the extent to which examinations should be expanded. Accordingly, existing guidance provided in the Comptroller's Handbook is sufficient to compel examiners to perform expanded reviews of dividends and related organizations when appropriate.

Nevertheless, OCC senior management will use one of its regular national conference calls to reinforce to our examining staff that it is prudent to expand examination procedures for dividends and related organizations when warranted, particularly when payments may benefit bank management or board members.

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 Mid-size and Community Bank Supervision, at 202-874-5020.

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OIG Budget Examiner

United States Senate

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

Chairman and Ranking Member
Committee on Finance

United States House of Representatives

Chairman and Ranking Member
Committee on Financial Services

Federal Deposit Insurance Corporation

Chairman

U.S. Government Accountability Office

Acting Comptroller General of the United States