Audit Report

OIG-09-047

SAFETY AND SOUNDNESS: Material Loss Review of Suburban Federal Savings Bank

September 11, 2009

Office of Inspector General

Department of the Treasury

Contents

Abbreviations

ADC	acquisition, development, and construction
C&D order	cease and desist order
CEO	chief executive officer
CFO	chief financial officer
CLO/SVP	chief loan officer/senior vice president

Contents

CMP	civil money penalty
FDIC	Federal Deposit Insurance Corporation
MRBA	matters requiring board attention
OIG	Office of Inspector General
OTS	Office of Thrift Supervision
PCA	Prompt Corrective Action
ROE	report of examination
Suburban	Suburban Federal Savings Bank
TARP	Troubled Asset Relief Program
TCL	Troubled Condition and Directive Letter
TFR	Thrift Financial Report

September 11, 2009

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Office of Thrift Supervision

This report presents the results of our review of the failure of Suburban Federal Savings Bank (Suburban), Crofton, Maryland, and of the Office of Thrift Supervision's (OTS) supervision of the institution. Our review was mandated under section 38(k) of the Federal Deposit Insurance Act (FDIA), as amended. OTS closed Suburban on January 30, 2009 and named the Federal Deposit Insurance Corporation (FDIC) as receiver. As of August 14, 2009, FDIC estimated that Suburban's failure would cost the Deposit Insurance Fund $126 million.

Our objectives were to determine the cause of Suburban's failure and assess OTS's supervision of the bank, including implementation of the Prompt Corrective Action (PCA) provisions in section 38(k). We conducted our fieldwork from March 2009 through July 2009 at OTS's headquarters in Washington, DC, regional office in Atlanta, Georgia, and field office in Braintree, Massachusetts. We reviewed the supervisory files and interviewed key officials involved in the regulatory, supervisory, and enforcement matters. We also interviewed officials within FDIC's Division of Supervision and Consumer Protection and Division of Resolutions and Receiverships. Appendix 1 contains a more detailed description of our material loss review objectives, scope, and methodology.

We also include several other appendices to this report. Appendix 2 contains background information on Suburban and OTS's thrift supervision processes. Appendix 3 is a glossary of terms used in this report. Appendix 4 provides a chronology of significant events related to Suburban and its supervision by OTS. Appendix 5 shows examinations of Suburban by OTS and enforcement actions taken by OTS against Suburban from 2003 through 2008. Appendix 6 shows Office Inspector General (OIG) recommendations from material loss reviews of failed OTS-regulated institutions completed since April 2008.

Results in Brief

Suburban failed primarily because of significant loan delinquencies and losses in speculative and high-risk acquisition, development, and construction (ADC) loans. Suburban pursued an aggressive growth strategy in ADC loans from 2003, when it transitioned from traditional mortgage lending into mortgage banking, until 2007. During this period, Suburban's ADC loan assets more than doubled. While pursuing this growth, Suburban's board and management did not establish adequate internal controls over its operations and accounting systems, resulting in the failure to recognize, properly report, or correct the thrift's deteriorating financial position. As a result, when the real estate market it served took a downturn in 2007, Suburban was particularly vulnerable and the losses ultimately led to its demise.

OTS's supervision did not adequately address Suburban's problems early enough to prevent a material loss to the Deposit Insurance Fund. OTS conducted timely and regular examinations of Suburban and provided oversight through its off-site monitoring during the period reviewed from 2003 through 2008. The examinations and oversight identified the thrift's problems, including concerns with Suburban's aggressive growth strategy in highly concentrated, speculative ADC loans and weaknesses in its internal controls. However, Suburban did not sufficiently correct problems and OTS did not adequately monitor the thrift's actions through field visits to ensure that corrections were made.

OTS repeatedly recommended corrective actions through matters requiring board attention (MRBA). In July 2007, OTS took informal enforcement action with a Troubled Condition and Directive Letter (TCL). In March 2008, OTS took formal enforcement action when it issued a cease and desist (C&D) order. By then it was too late to prevent the thrift from failing. In 2007, OTS also considered but did not assess civil money penalties (CMP), deciding instead to pursue them only if the thrift did not comply with the TCL and C&D order.

We concluded that as Suburban's capital level fell below prescribed regulatory thresholds, OTS appropriately and timely initiated required actions in accordance with the PCA provisions of FDIA. Suburban fell below a well-capitalized level twice, in 2004 and in 2008. OTS did not take PCA in 2004 because Suburban merged with another financial institution that improved Suburban's capital position. In November 2008, OTS took PCA that required Suburban to file a Capital Restoration Plan and abide by various restrictions. The thrift's plan determined that the only solution to its undercapitalized state was to find a merger partner. When this effort failed, OTS took timely action to appoint FDIC as receiver.

It should be noted that OTS did conduct an internal failed bank review of Suburban in accordance with OTS policy. OTS's internal review found that Suburban's failure primarily resulted from ineffective management and board oversight in a period of aggressive, high-risk growth extending from 2003 to 2007. OTS's review concluded that it (1) did not take timely enforcement action, (2) failed to conduct adequate follow up with Suburban to ensure MRBAs were resolved in a timely manner, and (3) did not effectively control asset concentration by requiring concentration limits as a percentage of capital. Our material loss review affirmed OTS's internal findings and the need for earlier corrective action.

We are recommending that OTS ensure that (1) recommendations from OTS's internal assessment of Suburban's failure are implemented and that the lessons learned from the assessment are taken into account going forward; (2) regional offices more closely monitor and scrutinize Thrift Financial Reports (TFR), and consider appropriate enforcement action, including CMPs, when chronic errors are found; and (3) examiners conduct timely and appropriately scoped field visits to thrifts with repeat problems and elevate the supervisory response, to include enforcement action when necessary, should the field visits find corrective action had not been taken.

In a written response, OTS concurred with our recommendations and committed to take necessary action to address them. OTS issued new internal guidelines in May 2009 for Enforcement Review Committee meetings to ensure consistent implementation and resolution of enforcement actions. OTS also issued guidance through a memorandum to thrift Chief Executive Officers in July 2009 on asset and liability concentrations and related risk management practices. OTS will need to identify and record its other planned actions and expected completion dates in the Department of the Treasury Joint Audit Management Enterprise System.

Causes of Suburban's Failure

Suburban failed primarily because of significant loan delinquencies and losses in speculative and high-risk ADC loans. Suburban pursued an aggressive growth business strategy and expanded into high-risk ADC and nontraditional lending. While pursuing this strategy, Suburban's management and board did not establish adequate internal controls, resulting in a failure to recognize, properly report, or correct the thrift's deteriorating financial position until it was too late.

Suburban Pursued an Aggressive Growth, High-Risk Strategy

From 2003 through 2007, Suburban pursued an aggressive growth strategy. Asset growth was largely in ADC loan originations, which more than doubled from $65 million in 2003 to its highest point of $158 million in 2007. In July 2007, OTS imposed constraints through the TCL that halted Suburban's ADC lending.

Prior to 2003, Suburban was a family-run community thrift focused on residential mortgage lending and deposit services. In 2003, the third generation of family took control of the thrift and pursued aggressive growth. The new Chief Executive Officer (CEO)/president of the thrift (the founder's grandson) sought to increase the thrift's asset size and convert Suburban from a mutual bank into a publicly traded company. To achieve this, the thrift hired loan officers, acquired a loan production office, merged with another bank to add branches and capital, and added riskier loan products to increase profitability. These riskier loan products were not adequately underwritten, monitored, and controlled, and subsequently resulted in high delinquency rates.

Additional Loan Officers

In November 2001, Suburban hired a loan officer for the thrift's residential construction to permanent, residential ADC, and land loan programs. In January 2003, the thrift hired a chief loan officer/senior vice president (CLO/SVP) to supervise and lead the expansion of lending and mortgage banking operations. The CLO/SVP subsequently hired a group of loan officers, whose compensation was based on the quantity of loans they originated. In March 2003, the CLO/SVP facilitated a contractual arrangement between Suburban and an independent loan production office in Timonium, Maryland, referred to by OTS and Suburban as Timonium.

Suburban projected that Timonium would generate a substantial volume of new mortgage loans, primarily for sale in the secondary market. However, in April 2004 OTS criticized loans being approved by Timonium (agency office) personnel, rather than Suburban headquarters' personnel. In a field visit report, OTS said that Suburban clearly violated the intent of 12 CFR Section 545.96,[1] in relation to the establishment and operation of an "agency office," and had circumvented the requirement that OTS review and approve the operation. Suburban had Timonium loan officers drive to Suburban headquarters to approve the loans on Suburban's premises to give the appearance that loans were being approved by Suburban headquarters personnel. OTS called it a "charade" and required it to be stopped. Timonium ceased this practice but continued to produce loans for Suburban.

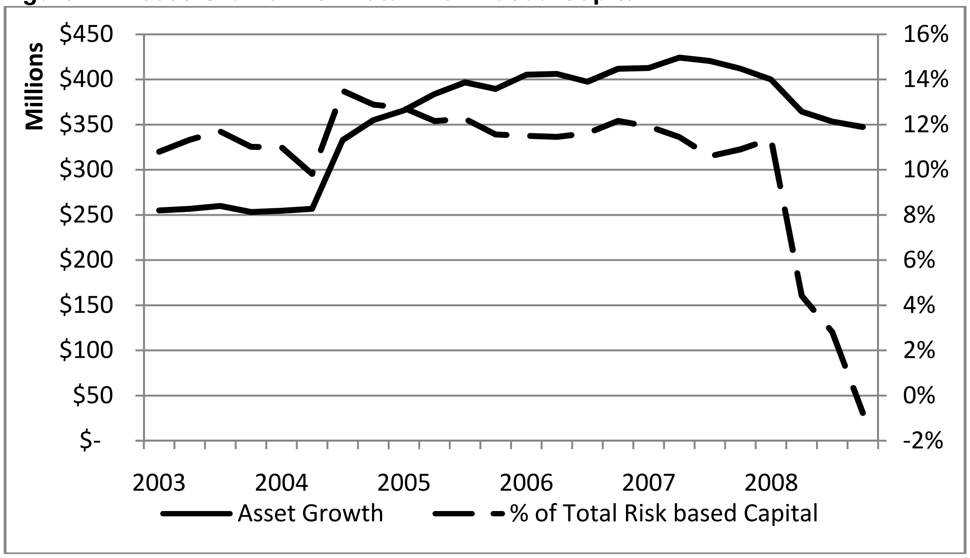
Merger With Westview Savings Bank

On June 30, 2004, Suburban's capital level fell to 9.82 percent, or adequately capitalized, below the 10 percent well-capitalized standard. This drop resulted from a combination of factors—asset growth outpacing capital growth (see figure 1), and a shift to higher risk-weighted assets such as ADC loans; and corrections of errors in the calculation of the thrift's risk- based capital ratio. (Accounting errors are discussed later in the report.) In October 2004, Suburban merged with Westview Savings Bank (Westview), based in Baltimore, Maryland. The merger added two branches,

[1] In 2003, 12 CFR Section 545.96 allowed a federal savings association, with board authorization, to establish agencies that service and originate loans and contracts. Final loan and contract approval authority, however, had to remain with the thrift. Such agency relationships did not require OTS approval. In November 2004, the regulations were modified to allow the approval of loans at the agency office.

increased assets by $65 million, and increased capital by $10.6 million, enabling Suburban to regain its well-capitalized status.[2]

Figure 1. Asset Growth vs. Total Risk-Based Capital



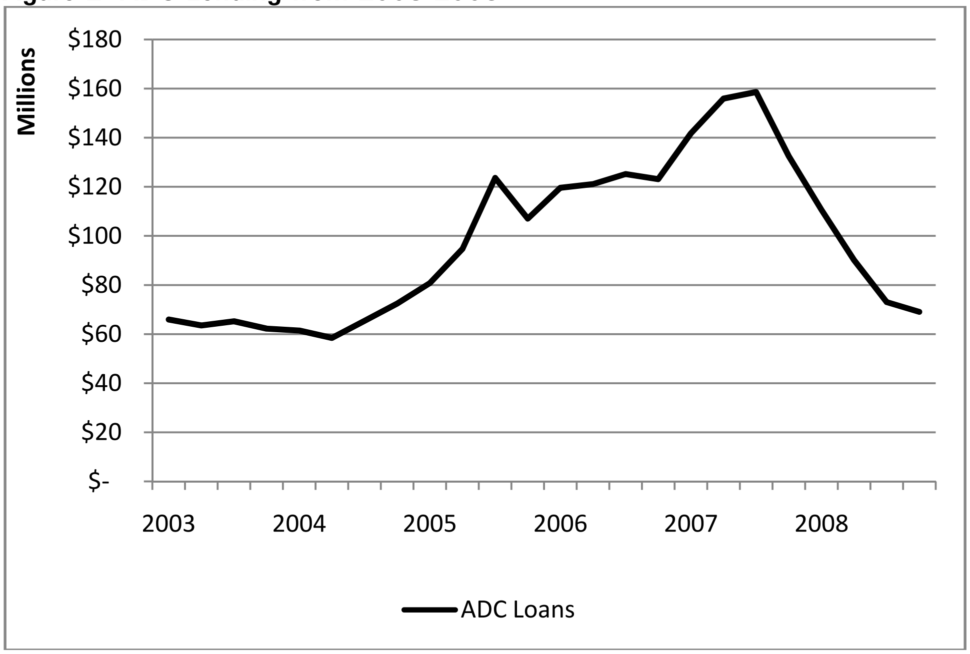
Source: OIG analysis of FDIC statistics on depository institutions
Note: The sharp increase in total risk based capital in 2004 resulted from Suburban's merger with Westview.

<u>Growth in Riskier ADC and Nontraditional Mortgage Lending</u>

Suburban pursued higher-risk ADC lending. As shown in figure 2, ADC lending grew significantly from $65 million in 2003 to $158 million by September 30, 2007.

[2] Mutual banks raise capital almost exclusively through retained earnings or by merging with another bank with more capital.

Figure 2. ADC Lending from 2003-2008



Source: OIG analysis of FDIC statistics on depository institutions

Suburban's ADC portfolio contained multiple land lot loans (loans for vacant lots on which to build) and speculatively built houses. By 2008, Suburban management identified 97 percent of its ADC lending portfolio as speculative. OTS stated in its 2007 report of examination (ROE) for Suburban that the thrift's ADC portfolio risk had increased because many of its ADC borrowers lacked financial strength, had interest reserves, or were dependent on inventory sales to maintain adequate cash flow.

In 2003, Suburban expanded into nontraditional mortgages, such as no income/no asset verification and stated income loans. Under the direction of the thrift's new CLO/SVP, the thrift loosened underwriting standards. In 2006, nearly 73 percent of the thrift's $231 million residential loan portfolio was originated with less than full documentation, including no income or asset verification loans. The thrift also began granting residential loans to borrowers who had lower FICO scores and higher loan-to-value ratios.

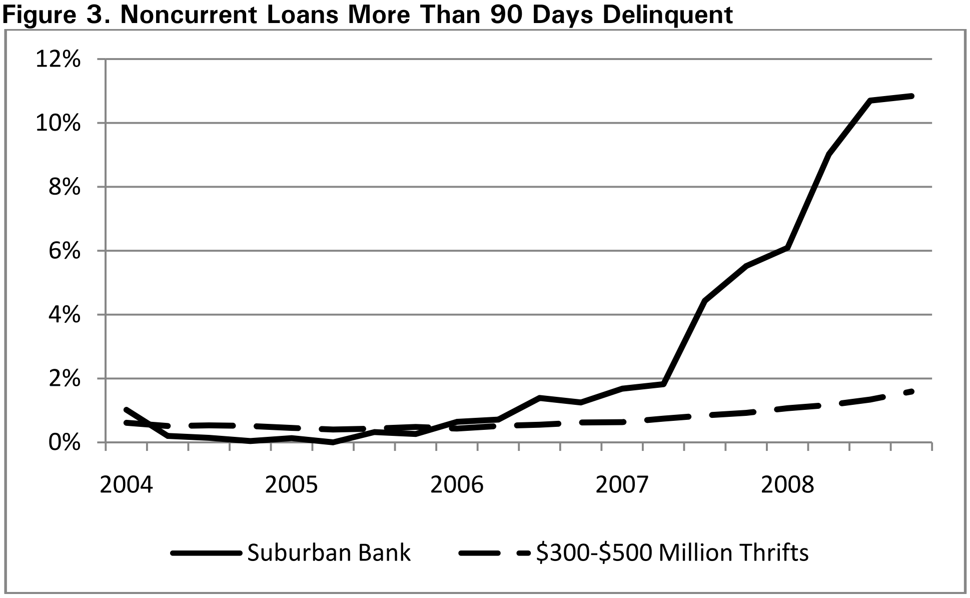
To reduce loan risk exposure, Suburban's CLO/SVP sold nontraditional residential mortgages and a portion of the performing ADC loans through the thrift's mortgage banking operation. When demand for these loans fell in 2007, Suburban decided not to sell some of the loans. The decision required Suburban, to reclassify the loans from held-for-sale to the loan portfolio in accordance with generally accepted accounting principles (GAAP). The significance of this accounting change was that Suburban had to write-down the value of the loans transferred to the loan portfolio to their estimated market value. Suburban reclassified $21.3 million in ADC loans resulting in a $3.0 million loss and $18.2 million in second mortgages that resulted in a $206 thousand loss.

To assess the quality of its loan portfolio, Suburban hired an outside contractor in mid-2008. The contractor identified underwriting and loan application process weaknesses in the thrift's residential mortgage loans, land lot loans, and construction to permanent loans. In one case, a borrower had no assets (not even a checking or savings account) and used the cash disbursed from the loan to satisfy the cash reserves required to qualify for the loan. In another case, a borrower used multiple aliases to endorse her loan documents. Both of these loans went into default without the borrower making a single payment.

High Delinquencies in Loan Portfolios

As shown in figure 3, the delinquency rates in Suburban's loan portfolio grew from under 2 percent in 2006 to 11 percent in 2008, when the institution was closed. By comparison, while the same measure had risen slightly for other institutions in Suburban's peer group, overall, it was still under 2 percent at the end of 2008.

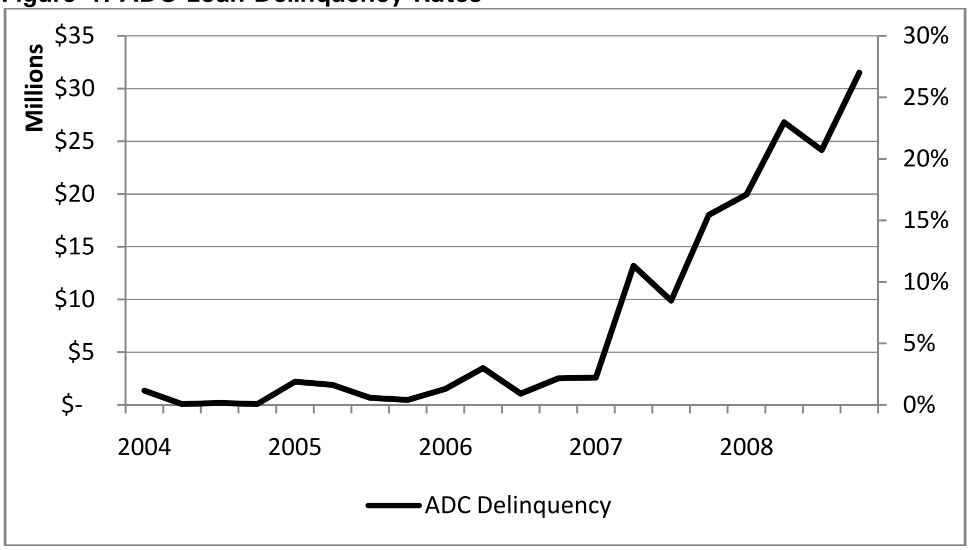
Figure 3. Noncurrent Loans More Than 90 Days Delinquent



Source: OIG analysis of FDIC statistics on depository institutions

Even more striking was the sharp rise in delinquencies in the thrift's ADC portfolio. As shown in figure 4, by late 2008, over $30 million, of Suburban's ADC loans, were delinquent.

Figure 4. ADC Loan Delinquency Rates



Source: OIG analysis of Suburban internal data.

The rate of delinquency was also high in the thrift's residential mortgage portfolio. As of September 30, 2008, nearly $41 million of these loans, or 18 percent, were delinquent.

Suburban's Management and Board Did Not Establish Adequate Internal Controls

Suburban's management and board did not establish adequate internal controls over operations and accounting. The thrift lacked appropriate internal review, did not properly identify criticized assets, and had chronic accounting deficiencies that were not corrected. These accounting deficiencies prevented accurate and timely account reconciliation and led to the need for numerous amendments of Suburban's TFRs. These areas were the subject of OTS's MRBAs for over 5 years, but the thrift did not implement adequate corrections.

Lack of Appropriate Internal Review

Suburban had an inadequate internal asset review function and lacked an internal audit function. From 2003 through 2008, OTS repeatedly directed Suburban's board to implement a comprehensive internal asset review function to better monitor the credit quality of its portfolio and compliance with lending policies. In this regard, OTS directed Suburban to ensure that the review function monitored the ADC loan portfolio. However, the thrift failed to adequately implement the function as directed by OTS.

Failure to Properly Identify Criticized Assets

Suburban did not properly identify its criticized assets, which grew from $1.0 million (0.3 percent of total assets) in September 2005 to $64.3 million (almost 18 percent of total assets) in June 2008. The majority of these criticized assets were ADC loans. Table 1 shows the criticized assets identified by Suburban and the additional criticized assets identified by OTS in the 2007 and 2008 ROEs.

Table 1. Criticized Assets

	Identified by Suburban	Additional Identified by OTS	Total
2007 ROE	$13.9	$9.8	$23.7
2008 ROE	$49.1	$15.2	$64.3

Source: OTS ROEs

In January 2008, a review of the bank's loan portfolio performed by a third party engaged by Suburban reported similar deficiencies. Suburban's management and board did not adopt the third party's recommended loan downgrades that resulted from Suburban's inadequate internal asset review. Suburban's asset review failed to identify all criticized assets.

OTS and Suburban's independent auditor also reported that the thrift needed to establish an internal audit function to ensure that the thrift established adequate policies and procedures and internal controls. In fact, the thrift's independent auditor reported the deficiency as a material weakness in connection with the audit of Suburban's June 30, 2007 financial statement.[3] In February 2007, after Suburban had been non-responsive with respect to this issue for several years, OTS directed in an MRBA that Suburban establish a comprehensive internal audit function. In response, Suburban hired a contractor to fulfill the internal audit function. OTS's 2008 examination found, however, that internal audit excluded from its audit program Suburban's troubled accounting

[3] Suburban's fiscal year for financial reporting was July 1 to June 30.

and finance function, an action which violated the provisions of the TCL.

Failure to Correct Chronic Accounting Deficiencies

From 2003 through 2008, OTS expressed an escalating level of concern regarding the accuracy of Suburban's books and records and quarterly TFR filings. Several times, OTS examiners noted significant uncertainty about the accuracy of reported earnings and the true financial position of the thrift. From 2004 and thereafter, Suburban's independent auditors also identified material weaknesses in the thrift's accounting practices.

OTS examiners repeatedly identified deficiencies in Suburban's accounting function. . Examples of what OTS examiners found include the following – Suburban did not:

- reconcile general ledger accounts (including a Federal Reserve Bank cash account and a Federal Home Loan Bank overnight account),
- report accurate financial information on a consistent basis, which resulted in numerous amendments to the TFRs,
- maintain control over the mortgage banking operation, which was run solely by the CLO/SVP and operated without effective accounting supervision or formal accounting policies or procedures, and
- determine the accuracy of the mortgage banking data provided to the accounting staff by the CLO/SVP.

In its 2005 ROE, OTS characterized the lack of accurate and timely reconciliation of general ledger accounts as "unsafe and unsound." The 2005 ROE also noted that the accounting staff lacked expertise in the requirements of GAAP with respect to the hedging in the mortgage pipeline risk. Similarly, the 2007 ROE stated the deficiencies "clearly indicated an unsafe and unsound operating environment and a near complete breakdown in the thrift's internal controls."

OTS's Supervision of Suburban

OTS's supervision of Suburban did not prevent a material loss to the Deposit Insurance Fund. OTS conducted timely safety and soundness examinations of the thrift and provided oversight through its off-site monitoring from 2003 through the date of the thrift's closure.[4] OTS identified problems early at the thrift, including concerns about Suburban's aggressive growth strategy in speculative ADC loans and its deficiencies in internal controls that resulted in accounting and recordkeeping errors. OTS relied primarily on examiner recommendations and MRBAs in the ROEs to correct problems but conducted few field visits to monitor corrective actions. This proved to be an ineffective supervisory strategy, and problems persisted until the thrift failed in 2009.

OTS delayed taking informal enforcement action to address problems at Suburban until 2007. At the time, it issued a TCL to the thrift. At the same time, OTS initiated formal enforcement action, a C&D order. However, OTS delayed issuing it until March 2008, waiting for Suburban's board to consent to the action.

Table 2 summarizes the results of OTS's safety and soundness examinations and provides the dates of enforcement actions. Appendix 5 provides details of MRBAs and corrective actions.

[4] OTS measures the 12-month and 18-month cycles from the "mail date" of the last examination to the "start date" of the next examination. The "mail date" is the date OTS transmits the ROE to the association. Suburban was on a 12-month cycle.

Table 2. Summary of OTS's Examinations of and Enforcement Actions Against Suburban

		Safety and Soundness Examination Results			
Date started/ Date mailed	Assets (in millions)	CAMELS rating	Number of matters requiring board attention	Number of corrective actions	Enforcement actions
4/28/2003 7/11/2003	$237	3/233222	9	8	None
3/29/2004 5/11/2004	$253	N/A	Field visit to review the operations of the Timonium office acquired by Suburban		
8/16/2004 11/3/2004	$263	2/232222	1	6	None
9/29/2004 9/30/2004	$263	2/232222	Limited off-site examination to establish the CAMELS rating to be in effect for the next FDIC assessment cycle		
11/21/2005 2/23/2006	$397	2/223222	8	0	None
3/13/2006 5/3/2006	$389	N/A	Limited examination to assess Suburban's nontraditional first mortgage loan portfolio		
2/20/2007 7/20/2007	$411	3/234222	7	10	• On July 23, 2007, OTS issued a TCL • OTS and Suburban enter into a consent order March 21, 2008
6/28/2007 6/28/2007	$413	3/234222	Limited off-site examination to establish the CAMELS rating to be in effect for the next FDIC assessment cycle		
8/13/2007 9/20/2007	$424	N/A	Limited examination to obtain additional facts concerning Suburban management's stated improvements since the preceding examination		
7/21/2008 1/16/2009	$400	5/555544	22	37	• January 21, 2009, OTS initiates PCA directive
10/6/2008 10/6/2008	$381	4/444433	Limited off-site examination to change the examination ratings to more accurately reflect Suburban's current condition		
11/7/2008 11/7/2008	$354	5/555534	Limited off-site examination to change the examination ratings to more accurately Suburban's current condition		

Source: OIG analysis of OTS data

OTS Did Not Impose Limits on Suburban's High Concentration of ADC Loans Until 2007

Although OTS examiners reported growth in Suburban's speculative ADC loans beginning in 2003 and again in 2005, OTS did not report the need for concentration limits until 2007. By then, the thrift had a high concentration of these loans in its portfolio. In the 2007 ROE, OTS reported that Suburban's balance of ADC loans represented just over 30 percent of total assets and 393 percent of total risk-based capital.

In 2007, OTS directed Suburban management, through an MRBA, to comprehensively review its ADC loan portfolio. In July 2007, OTS issued a TCL to Suburban that prohibited it from granting any more ADC loans. At the time, examiners were particularly concerned with the slowdown in the housing market and the inability of borrowers to independently carry such debt.

OTS examiners for Suburban told us that it was difficult to limit concentrations due to the lack of guidance. Regulatory guidance available at the time set only general limitations for loan concentrations; it did not set specific numeric thresholds, such as percentage of capital. This made it difficult for examiners to assess whether institutional limitations were appropriate. Examiners told us that regulatory guidelines for loan concentrations were needed.

To address the need for more guidance on concentration limits, in July 2009 OTS issued guidance to thrifts on asset and liability concentrations and related risk management practices. The guidance re-emphasized to financial institutions important risk management practices and encouraged institutions to revisit their existing concentration policies in light of the current economic environment. Under the guidance, OTS examiners are to review and scrutinize higher risk concentrations and pursue appropriate corrective or enforcement action when an institution does not maintain appropriate concentration limits or takes excessive risks. Specifically, OTS will monitor any institution with a concentration that exceeds 100 percent of core capital plus the Allowance for Loan and Lease Losses (ALLL).

OTS Identified Repeat Internal Control Deficiencies But Did Not Ensure That They Were Corrected

From 2003 through 2008, OTS repeatedly identified internal control deficiencies at Suburban, mostly in the accounting and recordkeeping systems, and reported them in the ROEs. OTS examiners found accounts out of balance, ineffective accounting supervision and financial controls, significant uncertainty with the thrift's reported financial information, and inaccurate TFRs, which were often amended by the thrift. OTS relied on MRBAs in the ROEs to correct these deficiencies, though it considered but ruled out CMPs against the thrift's board and management in 2007. This was an ineffective strategy. Suburban's response to the MRBAs was insufficient to correct problems. Although Suburban employed three Chief Financial Officers (CFO) between 2003 and 2006 and re-organized the accounting department several times, the thrift's actions did not eliminate the internal control deficiencies.

OTS's 2003 examination found multiple accounting deficiencies, including Suburban's failure to charge off delinquent loans, failure to charge off unreconciled suspense account items as directed by examiners in the previous examination, and repeat loan to one borrower (LTOB) recordkeeping problems.

OTS's August 2004 examination continued to note that accounts were not being reconciled in a timely manner. The examiners held discussions with Suburban's Treasurer who promised corrective actions, but did not include MRBAs or corrective actions in the examination report.

OTS's 2005 examination found multiple general ledger accounts out of balance. Suburban's management attempted to quantify the amount of items that needed to be reconciled, but at the close of the examination was unsuccessful. Examiners found these continuing issues to be of significant regulatory concern and reflective of an unsafe and unsound internal control environment. Examiners also found during the 2005 examination a lack of effective accounting supervision and financial controls over the mortgage banking operation.

Examiners remained concerned about the thrift's accounting function and internal controls through the 2007 examination. OTS reported significant uncertainty about the reliability of reported financial information. OTS also reported that completion of the thrift's fiscal year 2006 independent audit had been delayed because of internal control environment deficiencies. Furthermore, OTS reported that in response to concerns cited in Suburban's fiscal years 2004 and 2005 independent audits, Suburban engaged a consulting firm in March 2006 to help management reconcile out-of-balance accounts, restructure the accounting department, and establish an adequate system of internal controls. Part of the restructuring included hiring a new CFO in June 2006.

OTS's 2008 ROE stated that Suburban's CEO/president, CFO/SVP, and board had not managed and directed the thrift in a satisfactory manner, resulting in the thrift's poor financial condition and impending insolvency. Accounting and financial reporting difficulties continued at the thrift, resulting in inaccurate financial reporting, numerous audit adjustments, and another prolonged independent audit for fiscal year 2008. The CFO had not managed the accounting department effectively and the CEO/president and board had not initiated appropriate steps to address this serious problem, reflecting an inability to resolve the unsafe and unsound condition.

The 2008 ROE also stated that Suburban had engaged a consulting firm to perform a comprehensive internal audit of the thrift in response to OTS's 2007 ROE, which had reported that the thrift needed an internal audit function. Suburban's Audit Committee restricted the thrift's internal audit department and directed the consulting firm to not review finance and accounting because of the problems in that area. The consulting firm was instead directed to provide assistance in a limited area and found the records were not auditable because they were in such disarray and in its words a "total mess." This confirmed OTS's findings, as the thrift's finance and accounting practices had been the subject of MRBAs from previous examinations.

Additionally, Suburban amended its TFR filings nine times from September 2007 through June 2008, to correct multiple reporting errors. The most significant amendment was in October of 2008, when OTS required thrift management to increase the reported net loss in its TFR from $5.5 million to $22.7 million for the 6-month period ending June 30, 2008. This adjustment sharply decreased core and risk-based capital ratios from 6.7 percent to 2.3 percent and from 10.9 percent to 4.4 percent, respectively.

Table 3 shows the total number of amendments and line changes to Suburban's TFRs.

Table 3. TFR Amendments by Suburban

TFR cycle	Total amendments made	Line item changes
September 2007	2	>100
December 2007	2	>50
March 2008	2	>100
June 2008	3	>15

Source: OTS's 2008 ROE for Suburban

In 2007, OTS's Southeast Region considered, but ultimately decided against, using its statutory authority to assess a CMP against Suburban's board and management for the serious and significant deficiencies found including the failure to file accurate TFRs. [5] If it had decided to go forward with a CMP, the cost to Suburban could be as high as $1.1 million, or 1 percent of total assets. According to OTS's Southeast regional counsel, a CMP is an option to get cooperation from the board and show how serious OTS is. OTS's Southeast regional counsel opposed a CMP against Suburban because she considered CMPs as more of a punitive measure used to correct attitude problems. OTS's Southeast regional officials opposed assessing a CMP against Suburban in 2007. The officials considered a CMP to be an option after using other enforcement actions. We find it hard to believe that OTS would not have wanted to assess a CMP against Suburban for its misleading TFR financial reporting, especially in light of the thrift's long-term pattern of significant accounting and financial reporting deficiencies, as well as its ignoring OTS's directives in ROEs to correct these deficiencies.

OTS Relied on MRBAs to Correct Suburban's Problems But Did Not Perform Many Field Visits to Monitor Corrective Actions

In addition to annual comprehensive examinations, OTS may conduct interim, limited examinations, referred to as field visits, to determine if management has taken action to correct items of concern noted during the annual examinations. The OTS Examination Handbook states that field visits (limited examinations) may be conducted to ensure a thrift is taking needed corrective actions in a timely manner. According to OTS officials, field visits are risk focused and intended to cover the areas of significant risk. Despite the many MRBAs issued to Suburban in the ROEs for 2003 to 2008, OTS conducted only three field visits, in 2004, 2006, and 2007.

In 2003, OTS's Southeast regional official determined that a field visit to Suburban should be conducted to assess actions taken to correct deficiencies reported in the 2003 examination and to review the thrift's Timonium mortgage banking operation. The field visit conducted in 2004 was limited to just a review of Timonium. OTS accepted without verification written responses from Suburban with respect to other corrective actions, such as improving the underwriting and implementing a formal internal asset review function.

[5] The Financial Institutions Regulatory and Interest Rate Control Act of 1978

In 2005, OTS conducted a full-scope examination of Suburban and found that lack of timely reconciliation of accounts was of significant regulatory concern and reflective of an unsafe and unsound internal control environment. OTS identified eight MRBAs related to internal control deficiencies. A field visit in 2006 covered Suburban's nontraditional mortgages but did not cover action(s) taken with respect to the eight MRBAs. No follow-up was done on the MRBAs until 2007.

OTS found a significant increase in criticized assets that were reported incorrectly in Suburban's TFRs and weaknesses with the thrift's monitoring and identification of problem loans.

OTS Took Enforcement Action in 2007 and 2008

In 2007, OTS took informal enforcement action, issuing a TCL to Suburban. In 2008, OTS took formal enforcement action against Suburban through a C&D order. The actions came too late to prevent the thrift's failure. According to OTS, it did not take enforcement action sooner in order to provide the thrift an opportunity to correct its problems.

OTS's 2003 examination found a number of areas of supervisory concern in asset quality and management, which resulted in assignment of a CAMELS composite rating of 3 to Suburban. The examination found less than satisfactory performance of management and the board, as well as repeat internal control deficiencies from the previous examination. OTS guidance in effect at the time provided for some type of enforcement action to be taken if an institution receives a CAMELS composite rating of 3. Whether the action taken was informal or formal depended on the cooperation, integrity, and commitment of management to address problems identified.[6] OTS regional officials decided against taking enforcement action at the time because a field visit was planned in 6 months and they wanted to allow Suburban an opportunity to correct the deficiencies. The officials also cited a reluctance to take enforcement action because it was believed that such action would threaten the thrift's planned conversion from mutual to stock ownership. OTS further believed that Suburban's desire to avoid formal supervisory action may result in management taking timely corrective action. Given the number, seriousness, and repetitiveness of the deficiencies identified in the 2003

[6] OTS Regulatory Handbook 370.3, June 2003

examination, we believe that OTS erred in not taking strong action following the 2003 examination.

In 2005, OTS continued to identify significant weaknesses in Suburban's management and earning components. Many of these were repeat conditions from prior examinations. According to the OTS Regulatory Handbook, conditions that remain uncorrected presume that an enforcement action should be taken to ensure corrections are made. The 2005 ROE noted concerns about the thrift's internal control environment, accuracy of accounting records, and reliability of reported financial results. The examiners wrote that continuing issues with the timely reconciliation of accounts were of significant regulatory concern and made it questionable whether the reported earnings were a reasonable reflection of actual performance. Despite these concerns, OTS rated Suburban a CAMELS composite 2 in the ROE transmitted on February 23, 2006.[7]

In 2007, examiners found that conditions at Suburban had deteriorated further, and OTS downgraded Suburban's CAMELS composite rating to 3. OTS regional officials met in July 2007 to discuss the findings of the February 2007 ROE and the appropriate supervisory response. Based on serious concerns about Suburban's asset quality, the Southeast Region decided to issue a TCL as well as issue a C&D and possible CMP against the individual board members.

The 2007 TCL directed Suburban to not (1) originate any new ADC Loans; (2) renew any non-performing ADC loans; (3) enter into third party contracts; and (4) engage in any new business activity, lending program, or business line.

Beginning in July 2007, OTS engaged in a lengthy negotiation process to obtain consent by Suburban's board to a C&D order. OTS generally attempts to obtain consent to an enforcement action from an association's board of directors. Although rare, OTS may not seek consent where an immediate cessation to an activity is necessary to halt harm to an association. According to OTS's Southeast regional counsel, the board resisted consenting to a C&D

[7] The ROE also included an incorrect CAMELS component rating for Earnings of 2. OTS's Southeast Assistant Regional Director had sent an e-mail dated February 16, 2006 to the field manager, stating that he had determined the component rating should be changed to 3. Because of an apparent administrative oversight, the ROE was mailed with the incorrect component rating.

because of employment contract issues and Suburban's loan officer compensation, which included incentives related to loan production.

According to OTS officials , OTS generally attempts to obtain consent to a C&D in order to ensure the board of directors recognizes the extent of the problem and to avoid protracted legal proceedings. In the case of Suburban, OTS reached resolution with the board and OTS issued a C&D on March 21, 2008, nearly 9 months later. We believe that given Suburban's pattern of ineffective action or non-response to OTS's supervision over the years, this is one of those rare circumstances when the lengthy consent process should not have been allowed, and OTS should have issued a C&D in a more timely manner.

OTS's Lessons-Learned Review

In accordance with OTS policy, an internal review of Suburban's failure was performed.[8] The review, completed in April 2009, found that Suburban's failure resulted primarily from ineffective management and a lack of board of director oversight in a period of aggressive, high-risk growth extending from 2003 to 2007. A critical failure of management and the board was not imposing constraints on the growth of the high-risk loan portfolio, either in terms of total assets or the capital base necessary to support the expansion.

The review identified several lessons learned in its report:

- Timely enforcement actions should be taken to address deficiencies identified when an institution receives a CAMELS composite rating of 3.
- Concentration limits should be established as a percentage of capital for thrifts with excessive asset concentrations.

The OTS report made the following recommendations:

[8] OTS policy requires that an internal assessment be conducted when a thrift fails. That assessment, referred to as an internal failed bank review, is performed by staff independent of the region responsible for supervisory oversight of the failed thrift. The report is reviewed and signed by OTS's deputy director of examinations, supervision, and consumer protection. OTS's Northeast Region initiated an internal review of Suburban following its failure in January 2009. The scope of the review focused primarily on OTS's supervision from January 2000 to January 2009.

Enforcement Action

- OTS should take timely enforcement action to address deficiencies identified when an institution receives a CAMELS composite rating of 3.
- When board-directed corrective action has not been implemented within two consecutive examinations, an enforcement action should be considered.

Material Internal Control Weaknesses

- When OTS identifies material internal control weaknesses inclusive of substantive books and records concerns, the agency should pursue informal enforcement action, at a minimum. If the thrift does not implement effective measures to correct the identified weaknesses within a reasonable period of time, the agency should consider formal enforcement action.

Enforcement Review Committee Meetings

- OTS should amend internal policy guidance to require participation of appropriate field staff (including the Field Manager or examiner-in-charge) in Supervisory Action Committee meetings.[9]

Oversight and Control of Asset and Liability Concentrations

- OTS should clearly communicate to the industry and examination staff its expectation that concentration measurements and limits be established for both individual and aggregate high-risk asset and liability positions. In addition, OTS should emphasize establishing a sound risk management framework to identify, measure, and control the level of risk commensurate with the size and complexity of the institution.

In response to the recommendations, OTS issued new internal guidelines on May 1, 2009, for Enforcement Review Committee meetings to ensure consistent, fair, and appropriate implementation of, and resolution of, enforcement actions. Also, in July 2009, OTS released a CEO memorandum on asset and liability concentrations and related risk management practices, initially in response to a

[9] Supervisory Action Committee is comprised of OTS Southeast Region management who determine whether enforcement action should be taken against a thrift.

separate lessons learned of another thrift failure, but also applicable to Suburban.

Our material loss review affirms the findings of OTS's internal review.

OTS Appropriately Used Prompt Corrective Action

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

Suburban fell below the well-capitalized regulatory standard twice between 2004 and 2008. During the 2004 examination, Suburban was required to file an amended TFR causing its total risk-based capital ratio to fall below the 10 percent well-capitalized regulatory standard to 9.82 percent. Suburban's transition from a PCA category of well-capitalized to adequately capitalized represented a condition that under PCA would require OTS to issue a PCA notice and impose restrictions on the thrift. OTS did not take PCA after the 2004 examination because Suburban merged with Westview Savings Bank shortly afterward. The merger resulted in an infusion of capital that increased Suburban's total risk-based capital ratio from 9.82 percent to 13.50 percent. We concluded that OTS acted appropriately in this circumstance.

Suburban again fell below well-capitalized when OTS notified Suburban of its critically undercapitalized status on November 7, 2008. OTS's PCA notice required Suburban to file a Capital Restoration Plan (CRP) with OTS no later than November 21, 2008, and abide by various PCA restrictions applicable to critically undercapitalized institutions. Suburban filed a CRP that provided for it to (1) continue to seek an acquirer through a merger with a mutual or through a voluntary supervisory conversion, (2) maintain effective underwriting practices, and (3) continue to enhance risk management practices to address credit problems.

The CRP indicated four entities were interested in acquiring the thrift. OTS conducted a meeting with one potential investor shortly after the plan was filed. The investor executed a letter of intent with Suburban on December 31, 2008, but the proposal raised supervisory issues that made prompt resolution unlikely. On January 12, 2009, OTS notified Suburban of conditional approval of the CRP as well as OTS's intention to issue a PCA directive. On January 21, 2009, OTS issued the PCA directive which required Suburban to comply with its CRP, find a merger partner, and achieve an adequately capitalized status. Acting on behalf of the board and management of the thrift, on January 23, 2009, Suburban's CEO/president executed a stock purchase agreement with the potential investor. However, the stock purchase agreement was conditioned on the Department of the Treasury's approval of the proposed successor thrift for Troubled Asset Relief Program (TARP) funds. The investor's attorney also sent letters to the OTS Director requesting a 30-day delay, to March 1, 2009, for appointing FDIC as receiver. OTS informed the investor that the proposed transaction was not feasible as the proposal did not include sufficient capital to address Suburban's problems. Suburban was informed on January 27, 2009 that OTS would not delay the planned receivership and on January 30, 2009, OTS appointed FDIC as receiver. We concluded that OTS acted appropriately in this circumstance.

Recommendations

Our material loss review of Suburban is the sixth such review we have performed of failed OTS-regulated financial institutions during the current financial crisis. Appendix 6 lists the prior completed material loss reviews and our associated recommendations. OTS management agreed with the prior recommendations and has taken or is taking corrective actions to address them. In particular, prior recommendations have addressed the need to more closely review and monitor thrifts with excessive high-risk concentrations, which Suburban had with its ADC loans.

We recommend that the Director of OTS ensure that:

1. The recommendations from OTS's internal assessment of the Suburban failure are implemented and that the lessons learned from the assessments are taken into account going forward.

2. Regional offices more closely monitor and scrutinize the TFR amendments made by institutions for accuracy and consider appropriate action where chronic errors are found, including enforcement action and assessment of CMPs.

3. Regional offices ensure examiners conduct timely and adequately scoped field visits to determine whether thrifts with repeat problems have taken appropriate corrective action. In the event that the field visits find that corrective action has not been taken, examiners should be instructed to elevate the supervisory response, including the taking of enforcement action when necessary.

Management Response

OTS concurred with our recommendations, and will take necessary action to address them. OTS noted that it has already addressed recommendations from its internal failed bank review. OTS issued new internal guidelines in May 2009 for Enforcement Review Committee meetings to ensure consistent implementation and resolution of enforcement actions, and issued a CEO memorandum in July 2009 on asset and liability concentrations and related risk management practices.

OIG Comment

OTS will need to identify its planned actions and establish completion dates for these actions in the Department of the Treasury, Joint Audit Management Enterprise System.

* * * * *

We would like to extend our appreciation to OTS for the cooperation and courtesies extended to our staff during the audit. If you have any questions, please contact me at (617) 223-8640 or Sharon Torosian, Audit Manager, at (617) 223-8642. Major contributors to this report are listed in appendix 8.

/s/
Donald P. Benson
Audit Director

Our objectives were to determine the cause of Suburban Federal Saving Bank's (Suburban) failure and assess the bank's supervision by the Office of Thrift Supervision (OTS). We conducted this material loss review of Suburban Federal Savings Bank, Crofton, Maryland, 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 Suburban based on the loss estimate by the Federal Deposit Insurance Corporation (FDIC). As of August 14 2009, FDIC estimated that Suburban's failure would cost the Deposit Insurance Fund $126 million.

To accomplish our review, we conducted fieldwork at the OTS's headquarters in Washington, D.C.; regional office in Atlanta, Georgia; and field office in Braintree, Massachusetts. We interviewed officials with FDIC's Division of Supervision and Consumer Protection at its regional office in New York, New York, and at its field office in Baltimore, Maryland. We also interviewed officials with FDIC's Division of Resolutions and Receiverships in

[10] 12 U.S.C. § 1831o(k).

Dallas, Texas. While in Dallas, we reviewed selected Suburban records in FDIC's possession.

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

- We reviewed OTS supervisory files and records for Suburban from 2003 through 2009. We choose 2003 as the starting point for our detailed review once we ascertained that this was the year Suburban embarked on a strategy of aggressive growth. We analyzed examination reports, supporting workpapers, and related supervisory and enforcement correspondence. We performed these analyses to gain an understanding of the problems identified, the approach and methodology OTS used to assess the thrift's condition, and the regulatory action used by OTS to compel thrift management to address any deficient conditions. In assessing OTS's supervisory actions with respect to Suburban, we considered internal OTS guidance and authorities provided by the Federal Deposit Insurance Corporation Improvement Act, 12 U.S.C. § 1820(d).

- We interviewed and discussed various aspects of the supervision of Suburban with OTS management officials and examiners to obtain their perspective on the thrift's condition and the scope of the examinations.

- We interviewed FDIC officials who monitored Suburban for federal deposit insurance purposes up to its failure, implemented the receivership process once OTS appointed FDIC as receiver, and ran the thrift's operations under FDIC's conservatorship.

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

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.

Suburban, FSB, History

Founded in 1954 by a local developer, Suburban Federal Savings Bank (Suburban) of Crofton, Maryland, was a mutual chartered thrift focused primarily on traditional single-family mortgage lending. Leadership was kept within the founder's family. In 1972, the thrift had $12 million in assets; that year, the founder's son became a thrift employee and expanded the thrift to five branches.

In the 1980's, Suburban became a third generation family business when the founder's grandson became a thrift employee. The grandson gradually took on more prominent roles within the thrift. Finally by December 2003, he became chief executive officer (CEO). Under his direction, Suburban began a lending program that included reduced documentation and interest-only loans and the thrift initiated a mortgage banking operation. Suburban also expanded its acquisition, development and construction loan (ADC) and land lot loan programs.

In 2003, Suburban hired a chief loan officer/senior vice president (CLO/SVP) to oversee the thrift's entire lending operation. The CLO/SVP also developed the thrift's mortgage banking operation, primarily through the acquisition of the Timonium mortgage production office.

In 2003, OTS expressed concerns about the financial impact from the combined level of compensation and benefits being provided to the founder's son and grandson. Because of this concern, OTS directed Suburban's board in the 2003 report of examination (ROE) to review all forms of compensation for compliance with existing interagency guidelines.[11] The following year, OTS stated in its ROE that the 2004 examination found that the compensation package for these individuals remained generous; however, the ROE noted that the board determined that Suburban was in compliance with the interagency guidelines.

[11] Appendix A to 12 C.F.R. Part 570, Interagency Guidelines Establishing Standards For Safety and Soundness, states that excessive compensation is prohibited as an unsafe and unsound practice if it could lead to material financial loss to an institution. Compensation is considered excessive when it is unreasonable and disproportionate to the services performed considering such factors as compensation practices at comparable institutions, and the financial condition of the institution.

In September 2004, Suburban merged with Westview Savings bank, a $70 million institution with two branches and a strong capital position. After the merger the thrift remained a mutual savings bank. Just prior to the merger, Suburban's capital level dropped from well-capitalized to adequately capitalized. The merger brought Suburban's capital level back to well-capitalized, allowing Suburban to continue underwriting ADC loans.

As part of Suburban's new business strategy, the thrift made plans in 2003 to convert from a mutual to a stock institution. However, the initial public offering was repeatedly postponed due to accounting and recordkeeping difficulties, and was cancelled when Office of Thrift Supervision (OTS) issued a notification of troubled condition status to Suburban in July 2007.

On July 20, 2007, OTS completed a safety and soundness examination and assigned the thrift a CAMELS composite rating of 3. The examination found significant asset deterioration, repeat internal control and accounting issues. As a result, OTS issued Suburban a Troubled Condition and Directive Letter on July 23, 2007, that, among other things, prohibited the thrift from underwriting new ADC loans. On March 21, 2008, OTS issued the thrift a cease and desist order order which, in addition to the directives in the letter, contained supplemental directives.

On November 5, 2008, Suburban reported that it was critically undercapitalized in its September 30, 2008 Thrift Financial Report. OTS officially notified Suburban of its critically undercapitalized status and required the board to file a Capital Restoration Plan with OTS. As part of the plan, Suburban solicited potential buyers but was unable to sell the thrift before the receivership action scheduled for January 30, 2009. A request by a potential investor to delay the planned receivership action was denied by OTS.

On January 30, 2009, OTS closed Suburban and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver. FDIC subsequently sold the thrift in a whole bank transaction to Essex bank of Tappahannock, Virginia. At the time of closing, Suburban had total assets of $353 million and total deposits of $302 million.

Appendix 4 contains a chronology of significant events regarding Suburban.

Types of Examinations Conducted by OTS

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

OTS must conduct full-scope, onsite examinations of insured thrifts with assets over $250 million, as in the case of Suburban, once a year. OTS is permitted to conduct examinations of thrifts with assets less than $250 million on an 18-month cycle if certain criteria are met. Limited examinations are also conducted under certain circumstances to ensure the thrift's compliance with certain conditions.

During a full-scope examination, examiners rate all CAMELS components. OTS then assigns each thrift a composite rating based on its assessment of the overall condition and level of supervisory concern.

Enforcement Actions Available to OTS

OTS performs various examinations of thrifts that result in the issuance of reports of examinations (ROE) identifying areas of concern. OTS uses informal and formal enforcement actions to address violations of laws and regulations and to address unsafe and unsound practices.

Informal Enforcement Actions

When a thrift's overall condition is sound, but it is necessary to obtain written commitments from a thrift's board or management to ensure that it will correct identified problems and weaknesses, OTS may use informal enforcement actions. OTS commonly uses informal actions for problems in

- well or adequately capitalized thrifts,
- thrifts with a 3-rating with strong management, and
- thrifts with a CAMELS composite rating of 1 or 2.

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

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

Informal enforcement actions include supervisory directives and board resolutions.

Formal Enforcement Actions

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

OTS can assess civil money penalties against thrifts and individuals for noncompliance with a formal agreement or final orders. OTS can also request a federal court to require the thrift to comply with an order. Unlike informal actions, formal enforcement actions are public.

Formal enforcement actions include cease and desist orders, civil money penalties, and Prompt Corrective Action directives.

OTS Enforcement Guidelines

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

- the extent of actual or potential damage, harm, or loss to the thrift because of the action or inaction;

- whether the thrift has repeated the illegal action or unsafe or unsound practice;
- the likelihood that the conduct may occur again;
- the thrift's record for taking corrective action in the past;
- the capability, cooperation, integrity, and commitment of the thrift's management, board, and ownership to correct identified problems;
- the effect of the illegal, unsafe, or unsound conduct on other financial institutions, depositors, or the public;
- the examination rating of the thrift;
- whether the thrift's condition is improving or deteriorating;
- the presence of unique circumstances;
- the extent to which the thrift's actions were preventable; and
- the supervisory goal OTS wants to achieve.

80/20 loans	A loan type that requires no borrower down payment or mortgage insurance, for this fully financed loan, which is written as two separate loans of 80 percent and 20 percent.
Acquisition, development and construction	A loan made for the purpose of acquiring raw land, the development of that raw land into individual building lots, and the construction of houses on those individual developed building lots. One loan is made for the purpose of taking a project all the way from the raw land to the completed house, ready for sale. The loans are almost always made in connection with what in the end will be residential property.
Allowance for loan and lease losses	A valuation reserve established and maintained by charges against the financial institution'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.
CAMELS	An acronym for the performance rating components: Capital adequacy, Asset quality, Management administration, Earnings, Liquidity, and Sensitivity to market risk. Numerical values range from 1 to 5, with 1 being the highest rating and 5 representing the worst-rated banks.
Capital restoration plan	A capital restoration plan (CRP) is submitted to the appropriate federal banking agency by any undercapitalized insured depository institution. A CRP specifies the steps the insured depository institution will take to become adequately capitalized, the levels of capital to be attained during each year in which the plan will be 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.
Cease and desist order	A type of OTS formal enforcement action. A C&D order normally requires the thrift to correct a violation of law or regulation, or an unsafe or unsound practice. OTS may issue a C&D order in response to violations of federal banking, securities, or other laws by thrifts or individuals, or if it believes that an unsafe and unsound practice or violation is about to occur.
Civil money penalties	Money penalties assessed for the violation of any law or regulation. A Tier 1 penalty of up to $5,500 per day may be assessed for most violations. A Tier 2 penalty increases to $27,500 per day if a party, for example, commits a violation or recklessly engages in an unsafe or unsound practice and causes more than minimal loss to the institution. If the party knowingly commits a violation or an unsafe or unsound practice that causes substantial loss to the institution, a Tier 3 penalty of the lessor of $1,100,000 or 1 percent of total institution assets may be assessed. These penalties are assessed not only to punish the violator according to the degree of culpability and severity of the violation, but also to deter future violations.
Concentration	As defined by OTS, a group of similar types of assets or liabilities that, when aggregated, exceed 25 percent of a thrift’s core capital plus allowance for loan and lease losses. Concentrations may include direct, indirect, and contingent obligations or large purchases of loans from a single counterparty. Some higher-risk asset or liability types (e.g., residual assets) may warrant monitoring as concentrations even if they do not exceed 25 percent of core capital plus allowance for loan lease losses.
Construction permanent	Construction to Permanent loans finance the building of a new property. This type of financing carries a regular amortization schedule, and does not require any refinancing after completion of the building work.

Criticized assets	Loans and other assets that are at risk to some degree, in the opinion of bank examiners. Criticized assets are further classified as substandard, doubtful, loss, or special mention. Substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or by the collateral pledged, if any. Doubtful assets have all of the weaknesses inherent in an asset classified substandard with the weaknesses that make collection or liquidation in full highly questionable and improbable. Loss, is considered uncollectible and of such little value that its continuance on the books is not warranted. Special mention has potential weaknesses that deserve management's close attention and if left uncorrected, these weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position sometime in the future.
Disclaimer	An auditor conclusion that the financial statements of a company are not fairly presented, and the auditor is unable to form an opinion as to whether the financial statements are fairly presented.
FICO scores	Credit scores provided to lenders by credit reporting agencies to reflect information that each credit bureau keeps on file about the borrower and are produced from software developed by Fair Isaac and Company. The credit scores take into consideration borrower information such as (1) timeliness of payments; (2) the length of time credit has been established; (3) the amount of credit used versus the amount of credit available; (4) the length of time at present residence; and (5) negative credit information such as bankruptcies, charge-offs, and collections. The higher the credit score is, the lower the risk to the lender.

Generally accepted accounting principles	A widely accepted set of rules, conventions, standards, and procedures for reporting financial information, as established by the Financial Accounting Standards Board.
Hedging	A strategy designed to reduce investment risk. A hedge can help lock in existing profits. Its purpose is to reduce the volatility of a portfolio by reducing the risk of loss.
Initial public offering	Also called IPO. The first price for which a company offers to sell its stock when it moves from private ownership to public trade. More generally, it refers to the actual first sale of stock to the public. Small companies looking for a new source of financing offer most IPOs, but large companies who wish to be publicly traded can offer them as well. An IPO is generally a risky investment, because one does not know how much demand will exist for the stock after its initial offering; the risk comes from the uncertainty of the stock's resale value.
Interest reserve	A special savings account funded from the proceeds of the construction loan. Generally, it is used to pay off interest costs accrued from a large construction project. The amount of money that needs to be set aside is calculated based on several formulas. For example, one method is to take the total loan value multiplied by the interest percentage multiplied by the length of time it will take to complete the project, which is multiplied by the percentage of time the loan will be outstanding.
Internal asset review	A system implemented to monitor the credit quality of an institution's portfolio and compliance with or conformity to policies. The internal asset review (IAR) process should be separate and independent of the lending function. The IAR program must include frequent sampling of all asset types and result in the internal identification of all major portfolio problems and an accurate assessment of overall asset quality.

Letter of intent	A letter from one company to another acknowledging a willingness and ability to do business. It is most often issued to acknowledge a merger between companies or an acquisition that is it being seriously considered. It is not a contract and cannot be enforced.
Loan to one borrower	In accordance with 12 CFR section 560.93, regulations that impose lending limitations on thrifts to avoid the risk of concentrating too great of a portion of their assets in any single borrower who are related in a common enterprise. It limits the aggregate dollar amount of an association's loans to each borrower, but does not limit the number of loans to any one borrower within that aggregate dollar limitation.
Loan to value ratio	A ratio for a single loan and property calculated by dividing the total loan amount at origination by the market value of the property securing the credit, plus any readily marketable collateral or other acceptable collateral. In accordance with Interagency Guidelines for Real Estate Lending Policies (appendix to 12 C.F.R. § 560.101), institutions' internal loan-to-value limits should not exceed (1) 65 percent for raw land; (2) 75 percent for land development; and (3) 80 percent for commercial, multifamily, and other nonresidential 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 thrift should require mortgage insurance or readily marketable collateral.
Material weakness	When one or more of company's internal controls, put in place to prevent significant financial statement irregularities, is considered to be ineffective. If a deficiency in an internal control is thought to be a material weakness, this means that it could lead to a

	material misstatement in a company's financial statements.
Matter requiring board attention	A thrift practice noted during an OTS examination that deviates from sound governance, internal control, and risk management principles, and which may adversely impact the bank's earnings or capital, risk profile, or reputation, if not addressed; or result in substantive noncompliance with laws and regulations, internal policies or processes, OTS supervisory guidance, or conditions imposed in writing in connection with the approval of any application or other request by the institution. A matter requiring board attention (MRBA) is not a formal enforcement action. Nevertheless, OTS requires that thrifts address the matter and failure to do so may result in a formal enforcement action.
Mortgage banking	The term refers to the origination, sale and servicing of mortgages. A mortgage banker takes an application from the borrower and issues a loan to the borrower. The mortgage banker then sells the loan to an investor and may retain or sell the servicing of the loan that includes collecting monthly payments, forwarding the proceeds to the investors who purchased the loan, and acting as the investor's representative for other issues and problems with the loan.
Mutual bank	An institution that is owned by, and operated for the benefit of, its depositors.
Nontraditional mortgages	Mortgages that include "interest-only" and "payment option" adjustable-rates. These products allow borrowers to exchange lower payments during an initial period for higher payments during a later amortization period.
Pipeline	Loans inventoried in an institution's held for sale portfolio to be sold to investors.

Prompt corrective action

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

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

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

Risk-based capital

A thrift's risk-based capital is the sum of its Tier 1 capital plus Tier 2 capital (to the extent that Tier 2 capital does not exceed 100 percent of Tier 1 capital). This amount is then reduced by (1) reciprocal holdings of the capital instruments of another depository institution, (2) equity investments, and (3) low-level recourse exposures and residual interests that the thrift chooses to deduct using the simplified/direct deduction method, excluding the credit-enhancing interest-only strips already deducted from Tier 1 capital.

Risk-weighted asset	An asset rated by risk to establish the minimum amount of capital that is required within institutions. To weight assets by risk, an institution must assess the risk associated with the loans in its portfolio. Institutions whose portfolios hold more risk require more capital.
Secondary market	Financial market where previously issued securities (such as bonds, notes, shares) and financial instruments (such as bills of exchange and certificates of deposit) are bought and sold. All commodity and stock exchanges, and over-the-counter markets, serve as secondary markets which (by providing an avenue for resale) help in reducing the risk of investment and in maintaining liquidity in the financial system.
Standard unqualified opinion	The auditor issues an opinion on the financial statements of a company that these statements give a true and fair view of the state of affairs of a company.
Stated income	A stated income mortgage loan is a specialized mortgage loan where the mortgage lender verifies employment and assets, but not income. Instead, an income is simply stated on the loan application (the stated income on the application has to be realistic for the employment type).
Suspense account	Temporary account (one not included in financial statements) created to record (1) disbursements or receipts associated with yet-unconcluded transactions until their conclusion, or (2) discrepancies between totals of other accounts until their rectification or correct classification.
Thrift Financial Report	A financial report that thrifts are required to file quarterly with OTS. The report includes detailed information about the institution's operations and financial condition, and must be prepared in accordance with generally accepted accounting principles. The thrift financial report for thrifts is similar to the call report required of commercial banks.

Troubled Asset Relief Program	A program authorized by the Emergency Economic Stabilization Act of 2008 that provides Treasury with broad, flexible authorities to buy up to $700 billion in "troubled assets" and allows Treasury to purchase and insure mortgages and securities based on mortgages. Also, in consultation with the Chairman of the Board of Governors of the Federal Reserve System Treasury may purchase any other financial instrument deemed necessary to stabilize financial markets.
Troubled Condition and Directive Letter	An informal enforcement action issued to an institution that it has one or more of the following conditions that put it into a troubled condition: (1) self-dealings or other conflicts of interest, (2) unsafe and unsound practices, (3) management incompetence, (4) lack of director participation, or (5) disregard for the regulatory process. The institution's board is ultimately responsible for prevention or correction of these problems. If the board is unable or unwilling to correct serious problems, OTS must act immediately to protect the association and ensure its safety and soundness.
Unqualified opinion	This opinion on the financial statements of a company can include an explanatory paragraph stating that a complete audit took place with satisfactory results and the financial statements are fairly presented, but the auditor believes that it is important or is required to provide additional information regarding the financial statements.

The following chronology describes significant events in the history of Suburban Federal Savings Bank (Suburban), including examinations conducted and enforcement actions taken by the Office of Thrift Supervision (OTS). Appendix 5 contains additional information on the results of examinations, including any significant safety and soundness matters requiring attention, and recommended actions.

Date	Event
1/1/1954	Suburban bank is established under the name Suburban Federal Savings and Loan Association of Lanham.
1972	The founder son became an employee of the thrift.
2/24/1988	Suburban changed its name to Suburban Federal Savings Bank and type to a mutual savings bank.
11/2001	A new loan officer is hired to oversee the expansion of the acquisition, development and construction (ADC) portfolio.
2/11/2002	Suburban moved thrift headquarters from Landover Hills, Maryland, to Crofton, Maryland.
1/2003	A new chief lending officer (CLO) is hired and eventually given responsibility for overseeing the expansion of the thrift's higher risk lending activities.
4/28/2003	OTS started a comprehensive examination that resulted in an overall CAMELS composite rating of 3. Examiners identified substantive books and records deficiencies, significant concerns in asset quality, and corrective actions that were not fully addressed by management and the board from the prior examination. The examination was completed on 6/11/2003 and mailed on 7/11/2003.
7/30/2003	OTS's Southeast Regional Office holds a Supervisory Action Committee (SAC) meeting to consider whether enforcement action should be pursued based on the findings of the April 28, 2003 examination. The SAC made the decision to not pursue formal action based on it being the thrift's first 3 rating and none of the Section E factors[12] were present.
8/13/2003	Southeast Region staff scheduled a meeting with Suburban's management and board of Suburban to meet on August 18, 2003 to review the findings of the April 28, 2003 ROE.
9/29/2003	Internal audit report was issued for fiscal year June 30, 2003. The auditors gave a standard unqualified opinion and no matters were considered to be a material weakness.
11/1/2003	Suburban acquired a mortgage production office located in Timonium, Maryland. The private owner of the office became an employee (mortgage

[12] Section 370 of the OTS Examination Handbook states that there is a presumption that savings associations with a composite rating of 3 for the latest safety and soundness, compliance, trust, or information technology examination warrant formal enforcement action under the following circumstances; management is weak, there is uncertainty as to whether management and the board have the ability or willingness to take appropriate corrective measures, conditions are rapidly deteriorating, and a 3-rating continues for two consecutive examinations following the thrift entering into the informal enforcement action, unless the thrift complies with the informal enforcement action and no new grounds exist for taking a formal action.

Date	Event
	banking officer) of the thrift and with the thrift's chief loan officer (CLO), managed the operation.
12/15/2003	The founder's son passed the title of chief executive officer (CEO) to his son, the third generation of family to run Suburban bank.
3/29/2004	OTS conducted a field visit to review the operations of the Timonium mortgage production office. The examination was completed on 4/12/2004 and mailed 5/11/2004.
6/30/2004	Suburban's Prompt Corrective Action (PCA) category was downgraded to adequately capitalized from well capitalized.
8/16/2004	OTS started a comprehensive examination that resulted in an overall CAMELS composite rating of 2. OTS noted ongoing concerns with asset quality and concerns with respect to internal controls and accounting errors. The examination was completed on 10/4/2004 and mailed 11/3/2004.
9/30/2004	Suburban merged with Westview Federal Savings Bank located in Baltimore, Maryland, adding two branches, increasing its asset base by $65.0 million and capital by $10.6 million. Through this merger, Suburban regained a well capitalized status.
11/22/2004	Internal audit report was issued for fiscal year June 30, 2004. The auditors gave an unqualified opinion with an explanatory paragraph and three matters involving the internal control structure and its operation were considered to be a material weakness.
8/19/2005	Suburban posted a "Notice of Adoption of a Plan of Conversion" in the Washington Times to announce its intent to convert from a federal mutual savings bank to a federal stock savings bank.
11/21/2005	OTS started a comprehensive examination that resulted in an overall CAMELS composite rating of 2. OTS noted concerns with respect to Suburban's accounting and financial reporting errors and internal controls. The examination is completed on 1/24/2006 and mailed on 2/23/2006.
3/7/2006	Internal audit report was issued for fiscal year June 30, 2005. In the auditors opinion, no matters involving internal control and its operation were considered to be a material weakness.
1/25/2007	Suburban's attorney notified OTS that the thrift would file a stock conversion application in March 2007. An application, however, was never filed.
2/20/2007	OTS started a comprehensive examination that resulted in an overall CAMELS composite rating of 3. OTS noted concerns with the high level of classified and criticized assets, a concentration of higher risk assets (residential construction permanent, ADC, land, and nontraditional mortgage loans); inaccurate reporting of earnings, material internal control weaknesses, and material accounting errors. The examination was completed on 6/20/2007 and mailed on 7/20/2007.
5/8/2007	Suburban's attorney notified OTS that the thrift would file a stock conversion application in August or September of 2007. An application, however, was not filed.
5/18/2007	Internal audit report was issued for fiscal year June 30, 2006. The auditors gave an unqualified opinion with explanatory paragraph, two matters in internal control were considered significant deficiencies and

Date	Event
	three matters pertaining to the control environment were considered to be a material weakness.
7/5/2007	The OTS Southeast regional office held a SAC meeting to determine whether enforcement action was warranted based on the findings of the February 20, 2007, examination. The SAC determined that the following enforcement actions should be taken: (1) issuance of a Troubled Condition and Directive Letter (TLC) contemporaneous to the transmission of the Report of Examination (ROE) to the thrift; and (2) issuance of a cease and desist order.
7/23/2007	OTS issued a TCL that prohibited Suburban from engaging in new lending or business activities, entering into new third party contracts, making new ADC loans, and renewing existing ADC loans unless the loans were performing as agreed.
7/26/2007	OTS's Southeast regional director and staff met with Suburban the CEO/president and a select group of directors to discuss the February 2007 examination findings.
8/13/2007	OTS started a field visit to follow-up on the asset quality concerns noted in the February 20, 2007 ROE. The review found that asset quality had deteriorated further. The examination was completed on 8/22/2007 and mailed on 9/20/2007.
12/10/2007	Internal audit report was issued for fiscal year June 30, 2007. The auditors gave a standard unqualified opinion with two matters in internal control were considered significant deficiencies and four matters in internal control were considered to be a material weakness.
1/31/2008	The founder's son retired as chairman of the board and director of Suburban.
3/21/2008	The Cease & Desist order is signed into effect. The order required; • restrictions on origination of new ADC loans, • revised lending policies, • identification of all nontraditional loans for continuing review, • new review and monitoring guidelines for residential loan portfolios, • new internal asset review and classification programs, • revised internal controls and internal audit programs, • a new business plan, • a revised compliance program, • board review and oversight of management performance and responsibilities, and • establishment of a board compliance committee to ensure compliance with the order.
7/21/2008	OTS started a comprehensive examination at Suburban that resulted in an overall CAMELS composite rating of 5. OTS noted concerns in nearly all phases of the examination, including numerous records and financial report concerns, questionable and unsound management decisions, a dramatic decline in the quality of loans and related significant loan losses, rapidly increasing operating losses, and a resultant sharp decline in the capital position. The examination was completed on 1/15/2009 and mailed on 1/16/2009.
9/6/2008	OTS started a limited comprehensive examination to downgrade the thrift

Date	Event
	based on the findings of the in-progress July 21, 2008, comprehensive examination. OTS assigned an overall CAMELS composite rating of 4.
9/16/2008	OTS's Southeast regional director and staff held a conference call with Suburban's board and counsel to discuss the possibility of a voluntary supervisory conversion or merger of the institution.
10/7/2008	OTS's Southeast regional director and staff held a conference call with Suburban's counsel to discuss the progress in finding a merger partner. Suburban informed OTS that it had engaged an investment banker to find potential acquirers.
10/20/2008	During this week, OTS examiners directed the thrift to amend the TFR for the period ending June 30, 2008. The adjustment moved the core and risk-based capital ratios at June 30, 2008, from 6.7 percent and 10.9 percent to 2.3 percent and 4.4 percent, respectively changing the thrift's PCA category from well capitalized to significantly undercapitalized.
10/24/2008	OTS's Southeast regional director and staff held a conference call with Suburban management who informed OTS that no serious merger or acquisition candidates have been identified.
11/5/2008	Suburban filed its TFR for the quarter ended September 30, 2008. The TFR indicated that Suburban was critically undercapitalized.
11/7/2008	OTS started a limited comprehensive examination to downgrade the thrift based on additional findings of the in-progress July 20, 2008, comprehensive examination. OTS assigned an overall CAMELS composite rating of 5. The examination was completed on 11/7/2008 and mailed 11/7/2008.
11/7/2008	OTS issued a critically undercapitalized notice to Suburban which required the thrift to file a capital restoration plan by November 21, 2008. The notice also placed additional restrictions on the thrift's activities including capital distributions, increasing asset size, acquisitions, brokered deposits and compensation.
11/14/2008	A foreign-owned insurance corporation filed an application with OTS to become a savings and loan holding company. It announced a plan to acquire Suburban contingent upon receiving Treasury Asset Relief Program (TARP) funds.
11/26/2008	Internal audit report was issued for fiscal year June 30, 2008. The auditors gave a disclaimer, and noted seven matters were considered significant deficiencies and three matters in internal control were considered to be a material weakness.
12/12/2008	The foreign-owned insurance corporation withdrew its application once it determined that it was not eligible to participate in the TARP program.
12/17/2008	OTS's Southeast regional director and staff met with management of a potential acquirer to discuss acquiring the thrift through a voluntary supervisory conversion.
12/17/2008	OTS Southeast Region recommended to OTS headquarters that Suburban be referred to the Department of Justice (DOJ) because of a pattern or practice of violating the Equal Credit Opportunity Act. OTS follows through with the recommendation and on January 30, 2009 notifies Suburban of its referral to the DOJ.
12/31/2008	A potential acquirer issued a nonbinding letter of intent to acquire

Date	Event
	Suburban. The letter gave the potential acquirer a right of first refusal to purchase Suburban and indicates that it will continue with due diligence.
1/12/2009	Suburban filed an application for voluntary supervisory conversion with OTS. The application, however, was substantially incomplete in that the application package did not include a signed definitive agreement with the acquirer.
1/16/2009	OTS transmitted the July 20, 2008, ROE that assigns an overall CAMELS composite rating of 5. The ROE notes severe losses, high levels of criticized assets, and material accounting and internal controls weaknesses.
1/16/2009	OTS's Southeast regional director and staff met with management of the potential acquirer, who indicated that it wanted open bank assistance [13]and would be discussing this with the Federal Deposit Insurance Corporation (FDIC).
1/20/2009	The potential acquirer's attorney provided OTS's Southeast Region with a draft copy of a stock purchase agreement with Suburban. The agreement, however, was contingent on obtaining TARP funds.
1/21/2009	OTS informed the potential acquirer that it will not process the application with the TARP funds contingency. The potential acquirer indicates it would withdraw its application.
1/21/2009	OTS issued a Prompt Corrective Action directive requiring Suburban to comply with the terms of its Capital Restoration Plan, find a merger partner, and achieve well capitalized status.
1/23/2009	Suburban executed a stock purchase agreement provided by the potential acquirer that includes a TARP approval requirement.
1/26/009	OTS informed the potential acquirer's attorneys that the proposed transaction is not feasible due to the contingency clause and other concerns.
1/27/2009	Suburban's CEO/president sent a letter to the thrift's congressman requesting assistance in obtaining a 60-day extension on the closing of the thrift. The request was forwarded to OTS who then responded on March 12, 2009 informing the congressman of the thrift's condition leading up to the closure.
1/27/2009	OTS informed Suburban's CEO/president and board that the agency would not take action to delay the planned receivership.
1/30/2009	OTS appointed FDIC receiver of Suburban and is subsequently merged with Bank of Essex in Tappahannock, Virginia.

Source: OIG analysis of OTS, FDIC, and Suburban Federal Savings Bank data.

[13] The third basic resolution method for failing financial institutions is an open bank assistance transaction. In an open bank assistance transaction, the Federal Deposit Insurance Corporation (FDIC) provides financial assistance to an operating insured bank or thrift to keep it from failing. The FDIC can make cash contributions to, make loans to, purchase the assets of, or place deposits in the troubled bank or thrift.

This appendix lists Office of Thrift Supervision (OTS) safety and soundness examinations of Suburban beginning April 2003 until the thrift's failure in January 2009 and provides information on the significant results of those examinations. Generally, matters requiring board attention represent the most significant items requiring corrective action found by the examiners.

Date examination started	CAMELS rating	Assets ($Millions)	Significant safety and soundness corrective actions and other issues cited in reports of examination (ROE)	Enforcement action
4/28/2003	3/233222	$237	**Matters requiring board attention** • Charge-off all education loans that are 120 days or more delinquent. • Take steps to improve the underwriting and administration of all non-homogeneous loans, and participation loans in particular. Prior to executing additional participation agreements, management should ensure that each loan has been fully underwritten in accordance with regulatory guidelines. Management should also obtain appropriate support prior to each disbursement for participation loans. • Recalculate the required level of the allowance for loan and lease losses (ALLL) using interagency guidelines and immediately book the indicated shortage. • Implement a formal internal asset review function consistent with regulatory guidelines. • Take steps to improve its loan to one borrower (LTOB) record keeping system. • Review and address all corrective actions in this examination report and submit a report to the OTS regional office detailing planned corrective actions. Follow-up reports should be submitted as necessary once corrective actions have been fully implemented. All corrective actions taken should be reviewed by the board and documented in the board meeting minutes. • Take steps to ensure that future loans to insiders are in full compliance with Regulation O requirements.	None

Date examination started	CAMELS rating	Assets ($Millions)	Significant safety and soundness corrective actions and other issues cited in reports of examination (ROE)	Enforcement action
			• Review all forms of compensation made available to the Chief Executive Officer (CEO) and president. The review should be made to determine the appropriateness of the levels of such compensation and to determine compliance with Appendix A to 12 C.F.R. Part 570 – Interagency Guidelines Establishing Standards for Safety and Soundness. Such review should be made on an annual basis and recorded in the board's meeting minutes. The process should entail not only a simple review of compensation, but should also include fully detailed and documented comparisons of remuneration to both industry standards and institutions that operate similar lines of business at similar levels of activity. These reviews and comparisons must fully justify compensation levels that are appropriate in light of both management and institution performance. • Adopt a liquidity management policy consistent with the guidance contained in Thrift Bulletin 77. •	
8/16/2004	2/232222	$263	**Matters requiring board attention** • Make the transfer of mortgages from the held for sale portfolio to the long-term investment classification in accordance with Generally Accepted Accounting Principles (GAAP) at the lower of cost or market value. **Other corrective actions to be taken by Suburban** • Modify the inspection policies and procedures for land development and construction loans to provide for adequate documentation of inspections, and to ensure that adequate controls exist with regard to the inspection process. • Revise appraisal practices to ensure that values are adequately supported, and based on discounted value	None

Date examination started	CAMELS rating	Assets ($Millions)	Significant safety and soundness corrective actions and other issues cited in reports of examination (ROE)	Enforcement action
			estimates, where applicable. • Continue its efforts to improve monitoring procedures on participation loans. • Strengthen the internal review function with particular attention given to the guidelines discussed in OTS CEO Memorandum 140. • Reassess the adequacy of the ALLL based on September 30, 2004 data, including the additional criticized assets identified during the current examination. •	
11/21/2005	**2/223222**	**$397**	**Matters requiring Suburban board attention** • Immediately establish policies and procedures to ensure the timely reconciliation of all balance sheet accounts. The policy should note, at a minimum, that no unreconciled items be carried longer than 90 days. • Write-off any stale dated reconciling items in all balance sheet accounts. These reconciling items should be immediately recognized in earnings/capital. Since the amounts of reconciling items were unknown at the end of the examination, management should notify the Atlanta regional office of the total amount of these reconciling items. • The Audit Committee should closely monitor and evaluate the effectiveness of policies and procedures established to ensure the timely reconciliation of accounts. • Strengthen the accounting, supervision, and financial controls over the mortgage banking department. • Establish written policies and procedures for the manner in which the mortgage banking department's transactions are recorded and independently verified. • Approve an appropriate written Hedging Policy that follows the guidance of Thrift Activities Handbook	None

Date examination started	CAMELS rating	Assets ($Millions)	Significant safety and soundness corrective actions and other issues cited in reports of examination (ROE)	Enforcement action
			Section 660: Derivative Instruments and Hedging. • Ensure that appropriate segregation of duties and internal controls are developed to properly supervise the thrift's hedging positions. • In conjunction with the thrift's independent audit firm, management and the board should ensure appropriate application of SFAS 133 and other accounting guidance before relevant transactions are booked. **Other Corrective actions to be taken by Suburban** • None Identified	
2/20/2007	**3/234222**	**$411**	**Matters requiring Suburban board attention** • Take immediate steps to establish a comprehensive internal audit function. The audit function should address all areas of the thrift's operations in order to provide a means for the board to assess the adequacy of policies, procedures and controls, and to ensure accurate books and records, as well as compliance with safety and soundness standards. • Undertake all possible actions to reduce the level of problem assets at the thrift. • Implement a comprehensive asset review process for the acquisition, development, and construction (ADC) loan portfolio, which includes review and analysis of project and borrower/guarantor financial performance, and loan performance. Provide the findings of this review to the Asset Review Committee for use in determining the classification and designation of troubled assets, and provide the same findings to the board on a monthly basis. • Adopt specific guidelines detailing appropriate and acceptable exposure levels for each of the thrift's higher-risk residential loan portfolio categories. • Increase the ALLL to $2,223,000,	Troubled Condition and Directive Letter issued 7/23/2007 Cease and Desist Order issued 3/21/2008

Date examination started	CAMELS rating	Assets ($Millions)	Significant safety and soundness corrective actions and other issues cited in reports of examination (ROE)	Enforcement action
			based on the examiner's ALLL calculations as of December 31, 2006. In addition, management must immediately incorporate the December 2006 ALLL interagency guidance into its ALLL process. • Review the entire loan portfolio to ensure that all high loan-to-value (LTV) loans are identified, that all high LTV loans are included on the high LTV schedule, and that high LTV loans are properly reported to the board, as required by 12 C.F.R. § 560.101. • Develop a consolidated and comprehensive LTOB report, to include all borrowers, principals, and guarantors, so that regulatory compliance can be properly monitored. **Other corrective actions to be taken** • Formalize cash flow management practices in order to fully comply with the guidance included in Thrift Bulletin 77. • Present a summary of the thrift's interest rate risk (IRR) position to the board on at least a quarterly basis. • Review and present to the board for approval, revised board limits for allowable levels of IRR.	
7/21/2008	5/555544	$400	Matters requiring Suburban board attention • Continue its efforts to identify viable acquisition candidates in accordance with the board-approved Capital Restoration Plan. • Develop a monitoring system for second mortgage loans, including a process for monitoring the performance of the first mortgage on these properties. • Require that a report on the performance of the second mortgage loan portfolio be presented to it on at least a quarterly basis. • Ensure that high LTV loans of all types are properly identified and included in the quarterly report of such loans submitted to it.	Prompt Correct Action Directive issued 1/21/2009

Date examination started	CAMELS rating	Assets ($Millions)	Significant safety and soundness corrective actions and other issues cited in reports of examination (ROE)	Enforcement action
			• Ensure that management implements a quarterly asset review process for the ADC loan portfolio, which includes review and analysis of project and borrower/guarantor financial performance, and loan performance. • Ensure that management continues to seek ways to reduce concentrations of ADC loans, land loans, nontraditional residential loans, and second mortgage loans. • Require that management prepare a comprehensive review, response, and action plan to address the findings of any third party Internal Asset Review, and should require that this report be presented to the board of directors for discussion and approval. • Ensure that management avoid the purchase of foreclosed properties unless it is in the best interest of the bank, and in this regard, should ensure that such decisions are not based on real estate speculation. • Continue to seek ways to resolve the bank's high level of troubled assets in the most cost efficient manner possible. • Ensure that management objectively assesses all troubled assets, and ensure that these assets are properly classified and that all reserves for loss are properly established. • Be mindful of issues related to loan fraud, should ensure that the reasons for these incidents are investigated, and should develop methods and controls so that such occurrences are minimized and do not re-occur. • Ensure that the bank fully complies with all provisions of the July 2007 Troubled Condition and Directive Letter and the March 2008 Cease and Desist Order. • Reinstate the audit of finance and accounting into the Internal Audit Program. • Require that the Chief Financial Officer	

Date examination started	CAMELS rating	Assets ($Millions)	Significant safety and soundness corrective actions and other issues cited in reports of examination (ROE)	Enforcement action
			(CFO) identify all systems and personnel deficiencies that have caused the bank's continued accounting and financial reporting problems and should require that the EVP/CFO develop an action plan to resolve these problems. • Determine that CFO is unable to address and resolve these ongoing problems in the accounting department, the board should initiate steps to resolve these difficulties in a timely manner. • Review the Information Security Program on an annual basis, pursuant to 12 C.F.R Part 570, Appendix B. • Review and investigate the reasonableness of the benefits provided under the Employment Agreement with the CEO/president, and the costs associated with this plan. • Review and investigate the reasonableness of the Executive Salary Continuation Agreement with the CEO/president in light of management's performance and the cost to the institution. • Review and investigate the reasonableness of continuation of the bank owned life insurance (BOLI) contract. • Continue to seek ways to improve operating results, including focusing on ways to eliminate reliance on third parties and consultants. • Should ensure that available liquidity resources are carefully monitored and maintained to meet both present cash needs and those required for the near term maturity of Federal Home Loan Bank borrowings. • Ensure that IRR reports and net present value (NPV) exposure limits are presented and discussed at meetings of the board on a quarterly basis, pursuant to 12 C.F.R. Section 563.176 (d). <u>Other corrective actions to be taken by Suburban</u>	

Date examination started	CAMELS rating	Assets ($Millions)	Significant safety and soundness corrective actions and other issues cited in reports of examination (ROE)	Enforcement action
			• Make every effort to reduce the level of problem loans. • Seek to recognize loan impairment at an early stage in the problem loan cycle, and order updated appraisals when required, to ensure that SFAS 114 reserve calculations are as accurate as possible. • Utilize historical loss ratios as a starting point for Statement of Financial Accounting Standards (SFAS)5 allowances and should consider adjusting these ratios for changes in current trends, conditions, and other relevant factors that may affect repayment of the loans. • Classify all loans placed on nonaccrual status and review for possible impairment. Loans which display other collateral and/or borrower performance concerns should also be reviewed for classification. • When real estate owned (REO) is acquired, the acquisition price should be considered to be the indicator of value, unless management can fully document otherwise. • Carefully evaluate the property securing loan foreclosures to determine the proper management action at the time of the sale. This evaluation should include a current and supportable appraisal report, supported by a detailed inspection of the property, and a current assessment of the local market area. • Report all loans previously covered under the pool insurance program on future high LTV aggregate board reports. • Continue to reduce the level of high LTV loans to below the regulatory limit of 100 percent capital. • Not make any more high LTV loans until such time that the portfolio of high LTV loans is below the regulatory limit of 100 percent of capital.	

Date examination started	CAMELS rating	Assets ($Millions)	Significant safety and soundness corrective actions and other issues cited in reports of examination (ROE)	Enforcement action
			• Report the balance of both first and second mortgages on residential properties in which the combined LTV exceeds 90 percent and there are no appropriate credit enhancements. • Order new appraisals and calculate impairment when second mortgages become 60 days past due. • Continue to focus on reducing the level of nonperforming assets. • Make every effort to reduce the level of other operating expenses in order to offset the declining net interest margin. • Evaluate the purpose and need for the use of outside consultants in the effort to reduce excessive expenses. • Continue to closely monitor cash flow and liquidity, particularly to ensure that cash flow is sufficient to cover the upcoming borrowing maturity in May 2009. • Fully investigate all interest rate risk (IRR) reports provided by OTS so that interest rate risk can be effectively reported to the board in the most cost efficient manner. • Ensure that IRR reports and NPV exposure limits are presented and discussed at meetings of the board on a quarterly basis, pursuant to 12 C.F.R. Section 563.176 (d).	

Source: OIG analysis of OTS Reports of Examination.

We have completed five mandated material loss reviews of failed thrifts since April 2008, starting with the material loss review of NetBank, FSB. This appendix provides our recommendations to the Office of Thrift Supervision (OTS) resulting from these reviews. OTS management concurred with the recommendations and has taken or planned corrective actions that are responsive to the recommendations. In certain instances, the recommendations address matters that require ongoing OTS management and examiner attention.

Report Title	Recommendations to OTS Director
Safety and Soundness: Material Loss Review of NetBank, FSB, OIG-08-032 (Apr. 23, 2008) OTS closed NetBank and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on September 28, 2007. At that time, FDIC estimated that NetBank's failure would cost the Deposit Insurance Fund $108 million.	Ensure that the recommendations/lessons learned from OTS's internal assessments of the NetBank failure, as described on pages 21 and 28 of that report, are implemented. Re-emphasize to examiners that for 3-rated thrifts, formal enforcement action is presumed warranted when certain circumstances identified in the OTS Examination Handbook are met. Examiners are also directed to document in the examination files the reason for not taking formal enforcement action in those circumstances. Establish in policy a process to assess the causes of thrift failures and the supervision exercised over the institution and to take appropriate action to address any significant supervisory weaknesses or concerns identified.
Safety and Soundness: Material Loss Review of IndyMac Bank, FSB, OIG-09-032 (Feb. 26, 2009) OTS closed IndyMac on July 11, 2008, and named FDIC as conservator. As of My 8, 2009, FDIC estimated that IndyMac's failure would cost the Deposit Insurance Fund $10.7 billion.	Ensure that action is taken on the lessons learned and recommendations from the OTS internal review of the IndyMac failure. Caution examiners that assigning composite CAMELS ratings of 1 or 2 to thrifts with high-risk, aggressive growth business strategies need to be supported with compelling, verified mitigating factors. Such mitigating factors should consider things such as the institution's corporate governance, risk management controls, allowance for loan and lease losses methodologies, concentration limits, funding sources, underwriting standards, and capital levels and whether the mitigating factors are likely to be sustainable in the long-term. Another important factor that should be considered is the extent to which the thrift offers nontraditional loan products (regardless of whether loans are

	sold or retained) that have not been stress tested in difficult financial environments, and whether the thrift can adequately manage the risks associated with such products. OTS should re-examine and refine as appropriate its guidance in this area.
Safety and Soundness: Material Loss Review of Ameribank, Inc., OIG-09-036 (April 7, 2009) OTS closed Ameribank and appointed the FDIC as receiver on September 19, 2008. As of December 31, 2008, FDIC estimated that Ameribank's failure would cost the Deposit Insurance Fund $33.4 million.	Remind examiners of the risks associated with rapid growth in high-risk concentrations. Remind examiners to conduct more thorough loan sampling from the portfolio if they identify a rapid increase in concentration. Remind examiners of the examination guidance for thrift third-party relationships, with particular attention to the assessment of the risk the relationship may pose to the thrift's safety and soundness. Assess the need for guidance requiring risk assessment of construction rehabilitation account loans as an integral part of assessing a thrift's overall risk. Ensure that the recommendations and the lessons learned from OTS's internal assessment of the Ameribank failure are implemented.
Safety and Soundness: Material Loss Review of PFF Bank and Trust, OIG-09-038 (June 12, 2009) OTS closed PFF and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on November 21, 2008. As of May 8, 2009, FDIC estimated that PFF's failure would cost the Deposit Insurance Fund $729.6 million.	Ensure that the recommendations from OTS's internal assessment of the PFF failure are implemented and that the lessons learned from the assessment are taken into account going forward. In this regard, OTS should: • Direct examiners to closely review and monitor thrifts that refuse to establish appropriate limits of concentrations that pose significant risk and pursue corrective action when concentration limits are not reasonable. • Formally communicate the guidance in ND Bulletin 06-14 as to OTS's expectation that concentration measurements and limits be set as a percentage of capital, not just as a percentage of total assets or loans.

	• Formally communication the need for a sound internal risk management system that includes stress testing, regular periodic monitoring, and other risk management tools for higher –risk concentrations.
Safety and Soundness: Material Loss Review of Downey Savings and Loan, FA, OIG-09-039 (June 15, 2009) OTS closed Downy and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on November 21, 2008. As of May 8, 2009, FDIC estimated that PFF's failure would cost the Deposit Insurance Fund $1.4 billion.	Ensure that the recommendations from OTS's internal assessment of the Downey failure are implemented and that the lessons learned from the assessment are taken into account going forward. In this regard, OTS should • Direct examiners to closely review and monitor thrifts that refuse to establish appropriate limits of concentrations that pose significant risk and pursue corrective action when concentration limits are not reasonable. • Assess the need for more guidance for examiners on determining materiality of concentrations and determining appropriate examiner response to high-risk concentrations, including when to impose absolute limits to prevent excessive concentration • Formally communicate the need for a sound internal risk management system that includes stress testing, regular periodic monitoring, and other risk management tools for higher –risk concentrations. • Formally communicate the guidance in ND 06-14 as to OTS's expectation that concentration measurements and limits be set as a percentage of capital, not just as a percentage of assets or loans.

Office of Thrift Supervision
Department of the Treasury

John E. Bowman
Acting Director

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September 9, 2009

MEMORANDUM FOR: Donald P. Benson
Office of Inspector General
U.S. Department of the Treasury

FROM: John E. Bowman /s/
Acting Director

SUBJECT: Draft Audit Report on the Material Loss Review of Suburban Federal Savings Bank

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

The Inspector General report for Suburban recommends that the Director of OTS ensure:

1. The recommendations from OTS's internal assessment of the Suburban failure are implemented and that the lessons learned from the assessments are taken into account going forward.

2. Regional offices more closely monitor and scrutinize the TFR amendments made by institutions for accuracy and consider appropriate action where chronic errors are found, including enforcement action and assessment of CMPs.

3. Regional offices ensure examiners conduct timely and adequately scoped field visits to determine whether thrifts with repeat problems have taken appropriate corrective action. In the event that the field visits find that corrective action has not been taken, examiners should be instructed to elevate the supervisory response, including the taking of enforcement action when necessary.

OTS concurs with the recommendations and will take necessary action to address them. The agency has already taken actions pursuant to its internal failed bank review. These actions include issuing new internal guidelines in May 2009 for Enforcement Review Committee meetings to ensure consistent implementation and resolution of enforcement actions, and the agency also issued a CEO memorandum in July 2009 on asset and liability concentrations and related risk management practices.

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

Boston Audit Office

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The Department of the Treasury

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

Office of Thrift Supervision

Office of Thrift Supervision
Liaison Officer

Office of Management and Budget

OIG Budget Examiner

Federal Deposit Insurance Corporation

Chairman

United States Senate

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

Chairman and Ranking Member
Committee on Finance

U.S. House of Representatives

Chairman and Ranking Member
Committee on Financial Services

Comptroller General of the United States

Acting Comptroller General