

Board of Governors of the Federal Reserve System

**REPORT ON THE REVIEW OF THE
SUPERVISION OF HAMILTON BANCORP,
INC.**



OFFICE OF INSPECTOR GENERAL

(A0201)

March 2003



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

OFFICE OF INSPECTOR GENERAL

March 31, 2003

The Honorable Susan S. Bies
Chairman, Committee on Supervisory and Regulatory Affairs
Board of Governors of the Federal Reserve System
Washington, DC 20551

Dear Governor Bies:

On January 11, 2002, the Office of the Comptroller of the Currency (OCC) closed Hamilton Bank, N. A. (Hamilton), and the Federal Deposit Insurance Corporation (FDIC) was appointed as Receiver. Hamilton was a wholly owned bank subsidiary of Hamilton Bancorp, Inc. (Bancorp), a noncomplex bank holding company supervised by the Board of Governors of the Federal Reserve System (Board). The Hamilton failure was expected to result in a loss to the Bank Insurance Fund (BIF) that would exceed the material loss threshold established under section 38(k) of the amended Federal Deposit Insurance Act (FDI Act). Since the OCC was Hamilton's primary regulator, the FDI Act required that the Office of Inspector General (OIG) of the Department of Treasury (Treasury) review OCC's supervision of Hamilton to 1) ascertain why the institution's problems resulted in a material loss to the insurance fund; and, 2) make recommendations for preventing any such loss in the future.

The Treasury OIG released its report, *Material Loss Review of Hamilton Bank, NA*, on December 17, 2002. According to the report, the root causes of Hamilton's failure can be attributed to

- aggressive growth and asset concentrations in foreign markets,
- increased credit risk due to weak underwriting,
- inadequate risk management systems and controls, and
- an ineffective board and non-responsive management.

The report also noted that OCC's supervisory and enforcement actions were generally adequate, but could have been invoked sooner.

The FDI Act does not mandate a review of the holding company of a failed depository institution. Nevertheless, the Inspectors General of the Board, Treasury, and FDIC entered into a Memorandum of Understanding, in August 1994, which states that the Board's OIG will perform a separate review of the holding company supervision, under the general audit authority of the Inspector General Act. Accordingly, we reviewed the actions taken by Bancorp to determine if they contributed to the failure of Hamilton and the anticipated material loss to the BIF. We also

assessed the Board's supervision of Bancorp. We coordinated our work with the Treasury OIG, and used information contained in their final report to corroborate our findings and conclusions.

To accomplish our objectives, we conducted fieldwork at the Board and the Federal Reserve Bank of Atlanta (FRB Atlanta). We reviewed relevant laws and regulations; interviewed supervisory officials and staff at the Board and FRB Atlanta; reviewed supervisory records of Bancorp, including inspection, financial, and surveillance reports; and reviewed correspondence and inspection workpapers. We also reviewed selected OCC reports of examination on Hamilton, and certain documents related to litigation by Hamilton against the OCC. Our review included Bancorp operations and financial data from 1998 through 2001 – the time period that spans the first unsatisfactory supervisory rating through the OCC's closure of Hamilton.

Overall, we believe that Bancorp did not contribute to either the failure of Hamilton or the anticipated material loss to the BIF. Specifically, Bancorp management had limited opportunities to engage in high-risk behavior because the holding company was noncomplex and conducted no substantial activities or operations. In addition, we did not find any intercompany transactions, such as management fees and dividends, that adversely affected Hamilton. Rather, when possible, Bancorp served as a source of financial strength through capital injections. No issues regarding the Federal Reserve's supervision of Bancorp were noted during the course of our review.

This letter completes our work on this matter. Please call me at extension 5003 if you have any questions or comments, or would like to discuss any aspect of our review.

Sincerely,



Barry R. Snyder
Inspector General

cc: Governor Mark W. Olson
Mr. Richard Spillenkothen
Mr. William Estes