Office of Inspector General

September 2009
Report No. AUD-09-024

Material Loss Review of FirstBank Financial Services, McDonough, Georgia

AUDIT REPORT

Office of Audits

Office of Audits

OIG

Federal Deposit Insurance Corporation

Why We Did The Audit

On February 6, 2009, the Georgia Department of Banking and Finance (GDBF) closed FirstBank Financial Services (FirstBank) and named the FDIC as receiver. On March 4, 2009, the FDIC notified the Office of Inspector General (OIG) that FirstBank's total assets at closing were $325 million and the material loss to the Deposit Insurance Fund (DIF) was $112 million. As required by section 38(k) of the Federal Deposit Insurance (FDI) Act, the OIG conducted a material loss review of the failure of FirstBank.

The audit objectives were to (1) determine the causes of the financial institution's failure and resulting material loss to the DIF and (2) evaluate the FDIC's supervision of the institution, including implementation of the Prompt Corrective Action (PCA) provisions of section 38.

Background

FirstBank was a state-chartered nonmember financial institution, established by the GDBF and insured by the FDIC effective January 28, 2002. FirstBank, which was headquartered in McDonough, Georgia, had two branches in Henry County, Georgia, and one branch in Clayton County, Georgia. FirstBank was wholly owned by FirstBank Financial Services, Incorporated, a one-bank holding company, which was also located in McDonough, Georgia.

As a de novo bank for its first 3 years in operation, FirstBank was subject to additional supervisory oversight and regulatory controls. In addition, FirstBank provided commercial banking activities within its marketplace, specializing in commercial lending, with a concentration in commercial real estate (CRE), including residential acquisition, development, and construction (ADC) loans funded by wholesale sources.

FDIC guidance issued to financial institutions describes a risk management framework to effectively identify, measure, monitor, and control CRE concentration risk. That framework includes effective oversight by bank management, including the board of directors (BOD) and senior executives, and sound loan underwriting, administration, and portfolio management practices.

To view the full report, go to www.fdicig.gov/2009reports.asp

Report No. AUD-09-024 **September 2009**

Material Loss Review of FirstBank Financial Services, McDonough, Georgia

Audit Results

Causes of Failure and Material Loss - FirstBank failed due to bank management's pursuit of rapid growth in CRE/ADC lending concentrated in the Atlanta, Georgia, market. FirstBank funded the CRE/ADC lending primarily with more volatile wholesale funding, including brokered deposits and Federal Home Loan Bank (FHLB) advances, which deviated from the bank's approved business plan. This business strategy, coupled with weak risk management controls, left the bank unprepared to handle the effect of the significant downturn in the bank's market.

FirstBank's BOD and management did not ensure that loan underwriting and credit administration practices were adequate and failed to recognize problem loans in a timely manner. As the market declined, FirstBank experienced increasing levels of adversely classified assets and associated losses and significant increases in the allowance for loan and lease losses. Further, FirstBank did not have a definitive plan to reduce the bank's reliance on wholesale funding sources and had not developed a comprehensive contingency liquidity plan. As losses in the loan portfolio increased, the bank's earnings and capital eroded, and liquidity became strained, ultimately leading to the failure of the bank and an initial estimated loss to the DIF of $112 million.

Assessment of FDIC Supervision and Implementation of PCA - The FDIC provided ongoing supervision of FirstBank and identified key concerns for attention by bank management, including the problems that led to the bank's failure. In 2008, the FDIC and GDBF pursued enforcement actions based on the bank's significant financial decline noted at the December 2007 examination and March 2008 visitation. FirstBank adopted a bank board resolution (BBR) in June 2008, and the FDIC and GDBF issued a Cease and Desist Order in October 2008. The FDIC notified the bank of its PCA status in a timely manner, including when FirstBank fell to a significantly undercapitalized level as of November 30, 2008.

However, the FDIC could have provided additional and timelier supervisory attention for FirstBank. The examinations of FirstBank could have more fully considered the risks associated with the rapid growth of the de novo institution with concentrations in CRE/ADC lending, funded with wholesale funding sources, and weak risk management controls. Although the bank's financial condition deteriorated significantly between the May 2006 and December 2007 examinations, the risk and deficiencies associated with the ADC concentration had been present throughout the bank's existence. Supervisory action was not taken until 2008 when there were significant and quantifiable losses in the bank's loan portfolio. Consideration of the associated risk that the FDIC and GDBF examinations identified could have resulted in elevated supervisory concern and action to address FirstBank's problems earlier.

This report presents the FDIC OIG's analysis of FirstBank's failure and the FDIC's efforts to ensure FirstBank's management operated the bank in a safe and sound manner. We are not making recommendations. Instead, as major causes, trends, and common characteristics of financial institution failures are identified in our reviews, we will communicate those to management for its consideration. As resources allow, we may also conduct more in-depth reviews of specific aspects of the FDIC's supervision program and make recommendations, as warranted.

Management Response

The Director, Division of Supervision and Consumer Protection (DSC), provided a written response to the draft report. DSC reiterated our findings that FirstBank failed primarily due to management's pursuit of rapid growth in CRE and ADC loans, which were concentrated in suburban Atlanta, Georgia, and funded with higher-cost, volatile wholesale sources. DSC stated that this business strategy, coupled with the economic downturn that accelerated in 2007, resulted in loan losses depleting capital and earnings and impairing liquidity to the magnitude of which the institution was unable to recover and ultimately failed. DSC acknowledged that FirstBank's practice of highly concentrated ADC lending warranted earlier intervention before the bank's financial condition deteriorated and stated that it has issued additional guidance to address CRE/ADC concentrations and volatile non-core funding.

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Federal Deposit Insurance Corporation
3501 Fairfax Drive, Arlington, VA 22226

Office of Audits
Office of Inspector General

DATE: September 3, 2009

MEMORANDUM TO: Sandra L. Thompson, Director
Division of Supervision and Consumer Protection

/Signed/
FROM: Russell A. Rau
Assistant Inspector General for Audits

SUBJECT: *Material Loss Review of FirstBank Financial Services, McDonough, Georgia* (Report No. AUD-09-024)

As required by Section 38(k) of the Federal Deposit Insurance Act (FDI Act), the Office of Inspector General (OIG) conducted a material loss[1] review of the failure of FirstBank Financial Services (FirstBank), McDonough, Georgia. On February 6, 2009, the Georgia Department of Banking and Finance (GDBF) closed the institution and named the FDIC as receiver. On March 4, 2009, the FDIC notified the OIG that FirstBank's total assets at closing were $325 million and the material loss to the Deposit Insurance Fund (DIF) was $112 million.

When the DIF incurs a material loss with respect to an insured depository institution for which the FDIC is appointed receiver, the FDI Act states that the Inspector General of the appropriate federal banking agency shall make a written report to that agency which reviews the agency's supervision of the institution, including the agency's implementation of FDI Act section 38, *Prompt Corrective Action* (PCA); ascertains why the institution's problems resulted in a material loss to the DIF; and makes recommendations to prevent future losses.

The audit objectives were to: (1) determine the causes of the financial institution's failure and resulting material loss to the DIF and (2) evaluate the FDIC's supervision[2] of the institution, including implementation of the PCA provisions of section 38 of the FDI Act. Appendix 1 contains details on our objectives, scope, and methodology; Appendix 2 contains a glossary of terms; Appendix 3 contains a chronology of significant events; and Appendix 5 contains a list of acronyms used in the report.

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[1] As defined by section 38(k)(2)(B) of the FDI Act, a loss is material if it exceeds the greater of $25 million or 2 percent of an institution's total assets at the time the FDIC was appointed receiver.

[2] The FDIC's supervision program promotes the safety and soundness of FDIC-supervised institutions, protects consumers' rights, and promotes community investment initiatives by FDIC-supervised insured depository institutions. The FDIC's Division of Supervision and Consumer Protection (DSC) (1) performs examinations of FDIC-supervised institutions to assess their overall financial condition, management policies and practices, including internal control systems; and compliance with applicable laws and regulations; and (2) issues related guidance to institutions and examiners.

This report presents the FDIC OIG's analysis of FirstBank's failure and the FDIC's efforts to ensure FirstBank's management operated the bank in a safe and sound manner. We are not making recommendations. Instead, as major causes, trends, and common characteristics of financial institution failures are identified in our reviews, we will communicate those to management for its consideration. As resources allow, we may also conduct more in-depth reviews of specific aspects of the FDIC's supervision program and make recommendations, as warranted.

BACKGROUND

FirstBank was a state-chartered nonmember financial institution, established by the GDBF and insured by the FDIC effective January 28, 2002. The bank was originally chartered under the name of First Bank of Henry County but officially changed its name to FirstBank Financial Services on January 1, 2007. FirstBank, which was headquartered in McDonough, Georgia, had two branches in Henry County, Georgia, and one branch in Clayton County, Georgia. FirstBank was wholly owned by FirstBank Financial Services, Incorporated,[3] a one-bank holding company, which was also located in McDonough, Georgia. FirstBank provided commercial banking activities within its marketplace, specializing in commercial lending, with a concentration in commercial real estate (CRE), including residential acquisition, development, and construction (ADC) loans funded by wholesale sources, including brokered deposits and Federal Home Loan Bank (FHLB) advances.

As a de novo bank[4] for its first 3 years in operation, FirstBank was subject to additional supervisory oversight and regulatory controls, such as adherence to conditions[5] established by the GDBF, which granted FirstBank's charter, and by the FDIC, which approved the bank's application for deposit insurance. Those conditions included, but were not limited to, operating within the parameters of the bank's business plan and obtaining annual financial statement audits. In addition, as a de novo bank, FirstBank was subject to examinations during the first 3 years conducted on a 12-month schedule. The FDIC has recognized that de novo institutions can pose additional risk to the DIF and may exhibit certain risk factors, including rapid asset growth and CRE/ADC concentrations funded by wholesale sources, which require elevated supervisory concern.

[3] On February 1, 2005, FirstBank Financial Services, Incorporated, became a bank holding company pursuant to section 3(a)(l) of the Bank Holding Company Act, based on the December 29, 2004 approval provided by the Federal Reserve Bank of Atlanta (Federal Reserve). The Federal Reserve conducted a visitation of the holding company on April 3, 2006.

[4] At the time FirstBank was chartered and received deposit insurance, the designation of a "de novo" institution indicated newly established banks that were in their first 3 years of operation.

[5] Along with the submission of initial applications for deposit insurance, proposed financial institutions are expected to submit business plans that include information on a bank's business strategy and financial data for a 3-year period. The FDIC can impose standard conditions and may include nonstandard conditions, as deemed appropriate, in the Final Order for Deposit Insurance.

Details on FirstBank's financial condition, as of December 31, 2008, and for the 4 preceding calendar years follow in Table 1.

Table 1: Financial Condition of FirstBank

	31-Dec-08	31-Dec-07	31-Dec-06	31-Dec-05	31-Dec-04
Total Assets ($000s)	$317,237	$345,161	$276,821	$222,465	$176,823
Total Deposits ($000)	$279,308	$278,004	$224,313	$174,336	$131,363
Total Loans ($000s)	$218,962	$256,866	$210,397	$168,674	$133,781
Net Loan and Leases Growth Rate	(20.23)%	20.06%	24.74%	26.04%	107.29%
Net Income (Loss) ($000)	($25,172)	($891)	$2,677	$2,574	$1,804
Tier 1 Leverage Capital Ratio	2.31	8.99	10.26	11.79	13.96
Loan Mix (% of Loans)					
All Loans Secured by Real Estate	91.19%	90.81%	88.41%	88.57%	88.78%
Construction and Development	67.81%	72.89%	66.94%	61.05%	47.00%
CRE - Nonfarm/nonresidential	12.87%	13.34%	17.52%	22.65%	39.15%
1-4 Family Residential – excluding Home Equity Lines of Credit	9.70%	3.69%	2.71%	3.77%	1.84%
Home Equity Lines of Credit	.74%	.85%	1.14%	1.02%	.79%
Commercial and Industrial Loans	8.01%	8.22%	10.37%	10.38%	9.71%
Funding					
Total Core Deposits ($000)	$247,860	$239,700	$97,081	$63,829	$46,288
Federal Home Loan Bank Advances ($000)	$28,000	$34,000	$22,000	$22,000	$22,000
Brokered Deposits ($000)	$150,184	$127,150	$85,786	$79,873	$62,876
Net Non-Core Dependence Ratio	69.02%	59.90%	54.41%	59.61%	60.33%
Loans/Deposits	71.32%	89.83%	92.73%	95.65%	100.72%
Core Deposits/Average Assets	78.13%	69.45%	35.07%	28.69%	26.18%
FHLB/Average Assets	9.49%	8.86%	8.81%	12.12%	11.73%
Brokered/Average Assets	46.02%	33.62%	33.24%	36.01%	28.13%
Large Time/Average Assets	9.82%	19.13%	48.22%	49.15%	41.38%
Examination Information	**12/10/2007[b]**	**05/30/2006**	**09/28/2004**	**10/06/2003**	**12/02/2002**
Examination Conducted By	FDIC	GDBF	FDIC	GDBF	FDIC
Composite/Component Ratings[a]	4/444443	2/212122	2/112122	2/222222	2/222322
Adverse Classifications Ratio	149.85%	1.17%	.29%	20.57%	0%

Source: Uniform Bank Performance Reports (UBPR) and Reports of Examination (ROE) for FirstBank.
[a] Financial institution regulators and examiners use the Uniform Financial Institutions Rating System (UFIRS) to evaluate a bank's performance in six components represented by the CAMELS acronym: **C**apital adequacy, **A**sset quality, **M**anagement practices, **E**arnings performance, **L**iquidity position, and **S**ensitivity to market risk. Each component, and an overall composite score, is assigned a rating of 1 through 5, with 1 having the least regulatory concern and 5 having the greatest concern.
[b] On March 25, 2008, the FDIC conducted a visitation to assess changes that had occurred in FirstBank's financial condition since the December 10, 2007 full-scope examination.

Downturn in the Local Economy

Some community banks in the Atlanta, Georgia, metropolitan area, which includes FirstBank's local marketplace—Henry and Clayton counties—developed significant concentrations in construction and CRE/ADC lending as the housing market boomed. According to Moody's Economy.com (Moody's), high population and income growth and a relatively balanced real estate market encouraged too many lenders to enter residential and commercial development, and investors overestimated the resilience of the local economy.

However, the economy in Georgia, in general, and in the Atlanta metropolitan area, in particular, slowed beginning in 2006, became more pronounced in 2007, and continued to slow throughout 2008. As indicated in Table 2, according to Moody's, various economic indicators started to show a decline, beginning in 2006, with personal income growth and single-family construction permits declining. In 2007, single-family construction permits continued to decline along with the number of mortgage originations, and the number of personal bankruptcies increased. According to Moody's, the economy in the Atlanta metropolitan area crashed under the weight of the steep national downturn and led the nation in the number of bank failures.

Table 2: Indicators of an Economic Downturn in Georgia

Year	Total Employment	Personal Income Growth Rate	Single-Family Construction Permits	Mortgage Originations	Personal Bankruptcies
Georgia					
2005	4,002	7.3%	94,467	$78,326	79,273
2006	4,089	5.9%	86,106	$80,872	39,142
2007	4,146	6.0%	55,210	$73,938	48,636
2008	4,103	3.0%	24,317	$53,950	59,287
Atlanta Metropolitan Area					
2005	2,336	8.0%	61,558	$57,512	43,800
2006	2,402	6.2%	53,927	$57,536	21,203
2007	2,453	6.0%	31,089	$50,147	27,525
2008	2,426	2.6%	12,056	$34,077	31,714

Source: Moody's Economy.com, *Précis STATE® and METRO*, March 2009.

The FDIC's December 2007 examination of FirstBank:

- identified significant deterioration in the bank's financial condition, as evidenced by a substantial volume of adversely classified assets;

- concluded that FirstBank's board of directors (BOD) and management had not adequately administered the bank's ADC loan portfolio; and

- concluded that FirstBank's BOD (1) had not recognized that the local real estate market had begun to show signs of a slowdown in early to mid-2007, (2) had been slow to respond to changing real estate market conditions, and (3) had failed to direct the bank into a more conservative position.

Based on the results of the December 2007 examination, FirstBank was not able to effectively respond to the rapid decline in the local real estate market, which resulted in an excessive volume of past-due and nonaccrual loans. According to the FDIC's March 2008 visitation, which followed up on the significant deterioration in FirstBank's financial condition identified in the December 2007 examination, and despite the significant economic downturn in the bank's local market, beginning in 2006 and continuing into 2007, bank management planned to follow its business strategy that focused on ADC lending and reliance on wholesale funding sources.

CAUSES OF FAILURE AND MATERIAL LOSS

FirstBank failed due to bank management's pursuit of rapid growth in CRE/ADC lending concentrated in the Atlanta, Georgia, market. FirstBank funded the CRE/ADC lending primarily with more volatile wholesale funding, including brokered deposits and FHLB advances, which deviated from the bank's FDIC-approved business plan. This growth strategy, coupled with weak risk management controls, left the bank unprepared to handle the effect of the significant downturn in the bank's market.

FirstBank's BOD and management did not ensure that loan underwriting and credit administration practices were adequate and failed to recognize problem loans in a timely manner. As the market declined, FirstBank experienced increasing levels of adversely classified assets and associated losses and significant increases in the allowance for loan and lease losses (ALLL). Further, FirstBank did not have a definitive plan to reduce the bank's reliance on wholesale funding sources and had not developed a comprehensive contingency liquidity plan (CLP). As losses in the loan portfolio increased, the bank's earnings and capital eroded, and liquidity became strained, ultimately leading to the failure of the bank and an initial estimated loss to the DIF of $112 million.

Rapid Asset Growth and Concentration in ADC Loans

According to DSC, the ultimate goal of FirstBank's BOD and management was to increase the bank's total assets to $500 million by the end of calendar year 2010. To achieve that goal, bank management pursued an aggressive asset growth plan without sufficient consideration for the risk to the bank and the DIF (see Table 3 on the next page).

Although newly chartered banks are expected to prudently increase their level of assets as they attempt to establish a presence in the bank's marketplace, FirstBank's strategy of aggressive growth and concentration in ADC loans and use of wholesale funding sources significantly increased the risk to the institution. The FDIC and GDBF examiners first noticed FirstBank's ADC concentration in the July 2002 examination, conducted 6 months after the bank opened, and the concentration steadily and consistently increased as indicated in Table 4, on the next page.

The bank's highest annual rates of growth occurred during the bank's first 3 years of existence—the de novo period—and the bank had a cumulative growth rate of 369 percent for that period (see Table 3).[6] As of December 31, 2007, FirstBank's loan growth rate was 20 percent for the year and almost twice as much as its peer group. Additionally, for the same period, FirstBank's ADC loans represented about 73 percent of its entire loan portfolio, while the peer group's ADC loans represented a little over 16 percent of total loans.

[6] The de novo period for FirstBank ended January 28, 2005. The cumulative growth of 369 percent is based on January 28, 2002 through December 31, 2004—about 1 month short of the end of the bank's third year of existence.

Table 3: FirstBank's Asset Growth

Year Ending	FirstBank's Total Assets (Dollars in Thousands)	Annual Asset Growth		FirstBank's Cumulative Asset Growth Rate
		FirstBank	Peer Group	
Dec-02	$37,685	Not Applicable	Not Applicable	Not Applicable
Dec-03	$87,482	132%	113%	132%
Dec-04	$176,823	102%	52%	369%
Dec-05	$222,465	26%	34%	490%
Dec-06	$276,821	24%	23%	635%
Dec-07	$345,161	25%	8%	816%
Dec-08	$317,237	(8%)	9%	742%

Source: UBPRs for FirstBank.

In addition, after the bank's application for deposit insurance was approved, the bank changed its overall strategy related to ADC lending. According to the DSC's *Report of Investigation*,[7] dated June 28, 2000, and the FDIC's review of FirstBank's business plan, the bank planned to offer small-scale ADC residential lending. Contrary to the bank's initial plans, which served as the basis for the FDIC-approved deposit insurance, FirstBank's BOD and management changed their business strategy to significantly concentrate the bank's loan portfolio in ADC lending. In December 2002, FirstBank's concentrations had increased significantly and remained high throughout the bank's existence as shown in Table 4.

Table 4: FirstBank's CRE and ADC Concentration Levels

	Examination/Visitation Date (Percent of Total Capital)							
	July 2002*	Dec 2002	Oct 2003	Sept 2004	May 2006	Dec 2007	Mar 2008*	Nov 2008*
CRE Concentration	69.80	308.81	594.35	402.58	519.54	645.07	624.83	672.65
ADC Concentration	47.91	153.81	353.93	180.90	402.87	558.41	532.33	546.44

Source: UBPRs and Reports of Condition and Income (Call Report) for FirstBank.
* FDIC visitation.

On December 12, 2006, the federal banking agencies issued joint guidance in Financial Institution Letter 104-2006 (FIL-104-2006) on CRE lending entitled, *Guidance on Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices*. The guidance concluded that concentrations in CRE lending may expose institutions to unanticipated earnings and capital volatility in the event of adverse changes in the general CRE market. The guidance also addressed sound risk management practices for concentrations in CRE lending, provided supervisory criteria for identifying institutions with potentially significant CRE loan concentrations that may warrant greater supervisory scrutiny, and stated that the guidance was not intended to limit banks' CRE lending. Further, the guidance acknowledged that a concentration in CRE loans, coupled with weak

[7] The *Report of Investigation* contains conclusions and recommendations that present an overview of the application for insurance and an analysis of findings and concludes with the investigating examiner's recommendation on whether the FDIC should grant federal deposit insurance to the proposed financial institution.

loan underwriting and depressed CRE markets, had contributed to significant loan losses in the past.

Although the guidance does not specifically limit a bank's CRE lending, the guidance provides the following supervisory criteria for identifying financial institutions that may have potentially significant CRE loan concentrations warranting greater supervisory scrutiny.

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

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

Since December 2002, FirstBank's level of CRE/ADC concentrations had been high. Further, FirstBank's December 2007 CRE concentration level of 645 percent was more than twice the 2006 supervisory criteria of 300 percent, and the concentration level of 558 percent ADC was more than five times the 2006 supervisory criteria for ADC lending.

Deficient Underwriting and Credit Administration

The December 2007 examination reported that FirstBank's overall credit practices were increasingly ineffective, with underwriting standards and loan monitoring practices insufficiently and inconsistently applied. Deficiencies in FirstBank's loan underwriting and credit administration practices had been noted at each of its six examinations, with varying degrees of examiner concern. Examples of those deficiencies, starting with the 2004 examination, are described below.

September 2004. The examination noted the following deficiencies that related to credit administration and the bank's Loan Policy:

- a high volume of loan documentation exceptions;
- lending officers needed to better document loan files with regard to discussions with borrowers and the status of specific projects;
- appraisal reviews were not consistently conducted; and
- management needed to develop a system to identify exceptions to regulatory real estate lending standards and ensure that exceptions were reported to the BOD at least quarterly.

May 2006. Although bank management had taken steps to improve loan administration, the examination noted loan exceptions in 23 percent of the loans reviewed. The examiners reported that the bank's credit grading system appeared appropriate and that management had revised the Loan Policy to address prior examiner recommendations. However, continued improvement was needed in obtaining and analyzing financial information as well as completing credit memoranda and obtaining current financial data on borrowers.

December 2007. Examiners concluded that the BOD and management had not effectively identified, monitored, and controlled the risks inherent in the bank.

- Risk management policies and practices, as well as management's compliance with existing policies, needed improvement. Numerous weaknesses in credit underwriting and administration were identified, including (1) missing and/or inadequate loan officer credit memorandums, (2) no annual credit reviews on larger credit relationships, and (3) frequent loan renewals without principal reductions.
- An excessive level of technical exceptions was identified (FirstBank's 2007 independent loan review noted an increase in loan documentation exceptions to 88 percent—up from 81 percent as identified in 2006).
- The frequency of external loan reviews was inadequate.
- The internal loan grading system needed improvement.
- Deficiencies in management reports and risk monitoring systems relating to concentrations of credit, loan-to-value exceptions, and interest reserves were identified.
- Inadequate risk management policies and practices led to numerous credit administration and underwriting deficiencies. Consequently, apparent violations of Part 365.2 of the FDIC Rules and Regulations,[8] a contravention of Appendix A to Part 365—*Interagency Guidelines for Real Estate Lending Policies*, and a contravention of the interagency guidelines, *Concentrations in CRE Lending, Sound Risk Management Practices,* were cited.

Additionally, examiners noted that FirstBank used interest reserves for some ADC loans. However, examiners reported that FirstBank did not have a process for properly establishing, measuring, monitoring, and controlling the use of interest reserves. The FDIC has determined that interest reserves can mask problems with a borrower's willingness and ability to repay debt consistent with loan obligations.

Untimely Recognition of Problem Assets and Inadequate ALLL

As reported by examiners and FirstBank's external auditors and identified by independent loan reviews, FirstBank's controls over the recognition of problem assets, including the bank's loan grading system, and the ALLL needed improvement. Accurate and timely credit grading is a primary component of an effective loan review system. Prompt recognition of problem loans (1) is necessary so that timely action can be taken to minimize losses and (2) provides essential information for determining the adequacy of the ALLL. Accordingly, the lack of timely recognition of problem assets affected the adequacy of the bank's ALLL and overstated the bank's capital and earnings.

[8] Section 365.2 of the FDIC's Rules and Regulations is entitled, *Real Estate Lending Standards*.

Problems with FirstBank's loan grading system were first identified during the October 2003 examination, in which examiners identified and classified loans that had not been appropriately graded on the bank's watch list. In addition, FirstBank's external auditors noted significant deficiencies in FirstBank's timely recognition of problem loans, including its loan grading system, from 2005 through 2007, that could have impacted the loan losses and the ALLL. Specifically:

- FirstBank's external auditors reported in their *Report to the Audit Committee*, dated March 22, 2006, that FirstBank's high percentage of loan documentation exceptions in the loan files was a significant deficiency and that failure to obtain required loan documentation could impact the collectability of loans and the adequacy of the ALLL.

- In their December 31, 2006 audit management letter, FirstBank's external auditors highlighted an internal control deficiency that, in several instances, FirstBank had incorrectly graded loans on its internal management reports.

- The external auditors' *Report to the Audit Committee*, dated March 21, 2007 (1) stated that based on a sample of loans, FirstBank did not adequately obtain and track required loan documentation and (2) emphasized the lack of current financial information on borrowers. The report concluded that failure to obtain such documentation could impact the collectability of the loans and the adequacy of the ALLL.

- At the bank's Audit Committee meeting on November 7, 2007, FirstBank's external auditors expressed a strong concern regarding the accuracy of the ALLL, as of September 30, 2007, and stressed the importance of properly grading loans in a timely manner.

- In the *Report to the Audit Committee*, dated April 9, 2008, the independent auditors cited a significant deficiency in FirstBank's internal control over financial reporting. The auditors concluded that problem loans should be brought to the attention of senior management in a timely manner. Further, the report stated that loan officers should be encouraged to monitor their portfolios and place loans on non-accrual status as soon as they become aware of credit weaknesses.

The FDIC's December 2007 examination found that FirstBank's internal loan grading was ineffective and not properly applied according to the bank's Loan Policy definitions. Actual risk ratings assigned to loan relationships were not commensurate with the degree of underlying risk. More loans were adversely classified by the independent-third-party loan review and examiners than by FirstBank. Additionally, examiners concluded that FirstBank's asset quality had deteriorated significantly because the real estate market and economy declined, and it became apparent that the likelihood of collecting on a significant portion of the bank's loan portfolio was low. As indicated in Table 5, which follows, loan classifications increased from $327,000 in the May 2006 examination to over $50 million in the December 2007 examination.

Table 5: FirstBank's Adversely Classified Assets

Examination Date	Substandard	Doubtful	Loss	Total Adversely Classified Assets
	(Dollars in Thousands)			
July 2002	0	0	0	0
Dec 2002	0	0	0	0
Oct 2003	$1,343	$18	$14	$1,375
Sept 2004	$ 64	0	$3	$67
May 2006	$327	0	0	$327
Dec 2007	$44,822	$4,255	$964	$50,041

Source: ROEs for FirstBank.

In November 2007, FirstBank revised its ALLL methodology to conform to the December 2006 regulatory guidelines.[9] FirstBank originally calculated the ALLL at $4.4 million. As a result of the additional downgrades and increase in adversely classified assets at the December 2007 examination, and further deterioration through the first quarter of 2008, FirstBank increased the ALLL an additional $1.9 million retroactive to December 31, 2007. Also as a result of the December 2007 examination, FirstBank was required to restate earnings for the year ended December 31, 2007, changing the bank's net income from $867,000 to a net loss of $296,000.

As indicated in Table 6, the funding for the provision for loan and lease losses (PLLL) and ALLL between May 2006 and December 2007 almost doubled—from just below $2 million to about $3.7 million.

Table 6: FirstBank's PLLL and ALLL

Examination Date	PLLL	ALLL	ALLL/ Total Loans & Leases
	(Dollars in Thousands)		
July 2002	$55	$55	1.01%
Dec 2002	$226	$226	1.00%
Oct 2003	$206	$511	1.08%
Sept 2004	$450	$1,169	1.11%
May 2006	$45	$1,958	1.16%
Dec 2007	$1,327	$3,672	1.47%

Source: UBPRs, Call Reports, and ROEs for FirstBank.

Over a 1-year period from September 30, 2007 to September 30, 2008, the level of nonperforming assets increased from 44 percent to 240 percent of total capital, as management began reducing the use of interest reserves and other forms of interest

[9] *Interagency Policy Statement on the Allowance for Loan and Lease Losses* (FIL-105-2006), dated December 13, 2006 provides key concepts and requirements pertaining to the ALLL, including those in the Generally Accepted Accounting Principles and existing supervisory guidance, and describes the nature and purpose of the ALLL; the responsibilities of BODs, management, and examiners; factors to be considered in the estimation of the ALLL; and the objectives and elements of an effective loan review system, including a sound loan grading system.

capitalization to defer payments on non-viable construction projects. FirstBank's deficiencies related to the identification of impaired loans were also identified during the FDIC's November 2008 visitation when examiners determined that FirstBank management had not properly evaluated collateral values when assessing loan impairment and had determined loan impairment based on stale financial information.

As FirstBank's assets deteriorated, the need to substantially increase the ALLL became apparent. The increases in the ALLL ultimately led to the erosion of the bank's earnings and capital.

Ineffective BOD and Bank Management

The FDIC's December 2007 examination concluded that oversight provided by FirstBank's BOD and management was inadequate. Bank management had used a business strategy that consisted of a high volume of brokered deposits and FHLB advances to fund the bank's residential ADC loan concentration. The examiners also concluded that the BOD and management had not adequately underwritten or administered the ADC loan portfolio and had been slow to respond to changes in the real estate market conditions.

According to the DSC *Risk Management Manual of Examination Policies* (Examination Manual), the quality of management is probably the most important element of successful bank operations. The BOD is responsible for formulating sound policies and objectives and providing effective supervision of the bank's operations. Senior bank management is responsible for implementing policies and objectives during the day-to-day activities. However, FirstBank's BOD and management failed to effectively identify, measure, monitor, and control the risks associated with their decision to pursue a concentration in ADC lending. Contrary to the stated responsibilities, FirstBank's management failed to:

- ensure effective oversight of bank operations;
- make appropriate changes in the bank's overall strategy to reflect the downturn in the local economy;
- ensure that loan underwriting and credit administration were sound;
- develop adequate risk identification and monitoring systems commensurate with the overall risk presented by the significant ADC concentration and wholesale funding strategy; and
- ensure that loan policies were adequate and followed.

During the December 2007 examination, examiners concluded that deficiencies identified during that examination and the follow-up visitation were so extensive and systemic that they were cause for significant supervisory concern.

As previously mentioned, in December 2006, the federal banking agencies issued CRE lending guidance in the FIL-104-2006. According to the guidance, the framework to effectively identify, measure, monitor, and control CRE/ADC concentration risk includes effective BOD and management oversight, portfolio management, management information systems, market analysis, sound loan underwriting and credit administration, portfolio stress testing and market analysis, and credit risk review.

The December 2007 ROE concluded that FirstBank's management had failed to comply with the December 2006 CRE guidance because the BOD and management had failed to (1) implement adequate oversight and management information systems, (2) conduct adequate market analyses, and (3) establish strong CRE underwriting standards. Examiners also concluded that FirstBank had apparently violated Part 365 of the FDIC Rules and Regulations, which prescribes standards for real estate lending by insured state nonmember banks. In addition, examiners identified credit administration deficiencies during the examination that included the need to enhance reports such as concentration of credit reports, interest reserve reports, and loan-to-value exceptions reports.

Inadequate Planning to Address Overall Deterioration. During a March 2008 visitation, examiners identified significant deterioration in FirstBank's financial condition and concluded that FirstBank's management did not have an effective plan to address the bank's significant problems. Specifically, the FDIC determined that additional loan losses, reversals of accrued interest, and continued large provisions for the ALLL had been recognized during the first quarter of 2008 and stated that those issues were expected to continue through the remainder of the year. The visitation also concluded that liquidity remained problematic and that FirstBank's management did not have a plan to significantly decrease the bank's concentration of ADC loans and dependence on wholesale funding sources. Bank management had tentative plans to increase capital, and the holding company provided some financial support; however, capital was insufficient to address the institution's overall risk profile given the level of adversely classified loans and reliance on wholesale funding.

In spite of the deterioration in the bank's overall condition, bank management planned to continue with the business strategy that included a significant ADC concentration and the use of wholesale funding sources. The FDIC's March 2008 and November 2008 visitations resulted in the FDIC and GDBF taking supervisory actions (discussed later in this report) to address these deficiencies.

Inadequate Loan Policy

According to the Examination Manual, financial institutions should have loan policies that address the institution's goals for the loan portfolio mix and risk diversification, and cover the bank's plans for monitoring and taking appropriate action on any existing concentrations. At the December 2007 examination, the FDIC determined that FirstBank's Loan Policy did not include specific and comprehensive criteria with respect to ADC and residential lending—the bank's area of concentration. In addition, the bank either did not comply with or inconsistently applied other loan policies. Specifically, other than establishing the 40-percent limit of ADC loans to total loans, FirstBank did not have policy guidelines that addressed limits for different types of ADC loans. In addition, FirstBank had far exceeded the bank's limit on ADC loans to the total loans. FirstBank's Loan Policy, last revised in August 2004, included a maximum limit of 40 percent of ADC loans to total loans. For every quarter from December 2004 through March 2008, FirstBank exceeded its policy limits for ADC lending. As of September 30, 2007, the ratio of ADC loans to total loans was about 75 percent.

Heavy Reliance on Non-Core Funding

The FDIC's December 2007 examination concluded that FirstBank relied heavily on brokered deposits and FHLB borrowings to fund asset growth. Although FirstBank's initial business plan stated that the bank did not plan to raise deposits through deposit brokers, the bank's rapid growth in ADC loans was funded with substantial levels of such wholesale funding. As the bank's ADC concentrations increased, FirstBank's tolerance for risk in volatile funding also increased. Ultimately, the bank's liquidity position became strained because the bank's deteriorating financial condition resulted in regulatory restrictions on the institution's access to wholesale funding sources.

As early as December 2002, the examiners found that the volatile non-core funding dependence had been increasing as core funding became insufficient to support asset growth. As indicated in Table 7, which follows, except for the first two examinations conducted in 2002, FirstBank's net non-core dependence ratio substantially exceeded the bank's peer group, with dependence on non-core funding sources increasing from one examination to the next.

Table 7: FirstBank's Net Non-Core Dependence Ratio Compared to Peer

	Examination and Visitation Dates (%)						
	July 2002	**Dec 2002**	**Oct 2003**	**Sept 2004**	**May 2006**	**Dec 2007**	**Dec 2008***
FirstBank	(43.52)	.50	28.57	49.40	50.24	59.52	69.02
Peer	13.25	8.40	8.34	13.23	22.99	24.63	30.38

Source: UBPRs and ROEs for FirstBank.
***** Based on the UBPR reporting date rather than an examination or visitation date.

Beginning in 2003, FirstBank had consistently and increasingly used brokered deposits as one of its major funding sources for asset growth. The September 2004 examination reported that FirstBank's liquidity and funds management practices were satisfactory and noted that the bank had difficulty obtaining local deposits at a reasonable cost due to strong competition from area banks and higher-than-anticipated loan growth. Accordingly, the bank relied more heavily on brokered deposits. The September 2004 ROE noted that FirstBank was initiating efforts to raise local deposits, including opening additional branch offices. In fact, the May 2006 examination noted that FirstBank had increased core deposits by 34 percent between December 31, 2005 and March 31, 2006, and attributed the increase to the opening of a branch office. However, the increase in core deposits did not significantly affect the bank's net non-core dependence ratio.

FirstBank's dependence ratio was consistently higher than the bank's policy target. Examiners for the May 2006 examination reported that FirstBank's BOD increased the acceptable dependence ratio to a maximum of 50 percent in April 2006. Management expected its reliance on wholesale funding to continue but planned to reduce the level of brokered deposits while maintaining a high level of FHLB advances. The May 2006 examination also concluded that although the bank's dependence ratio had remained historically high, FirstBank management's close monitoring mitigated any undue risk that could be associated with the high-dependence ratio.

The December 2007 examination concluded that the competitive local market had contributed to the bank's inability to obtain low-cost retail deposits, and FirstBank's liquidity position was determined to be unsatisfactory and in need of immediate improvement due to the overreliance on brokered deposits. According to the FDIC, FirstBank's management chose this funding strategy based on the bank's cost analysis; however, the bank's cost of funds, as reflected in the December 31, 2007 UBPR, was 5.11 percent, which was significantly higher than the peer group average of 3.85 percent.

According to the FDIC's March 27, 2008 visitation, the institution's management did not have a definitive plan that would significantly decrease the institution's concentration of ADC loans and overdependence on brokered deposits and wholesale funding sources. The visitation report concluded that brokered deposits were still the major funding source for the bank. In response to the March 2008 visitation report, FirstBank officials acknowledged that obtaining local deposits would be a challenge for the bank and more expensive than wholesale deposits and further concluded that the bank would remain dependent on wholesale deposits. At the end of March 2008, FirstBank obtained $81 million in brokered deposits to meet the bank's liquidity needs, further placing the bank's use of such deposits outside of the bank's internal policy limits.

In June 2008, FirstBank was considered *Adequately Capitalized* for PCA purposes, and the bank's use of brokered deposits was restricted. On August 28, 2008, the FDIC received an application from FirstBank for a brokered deposit waiver[10] in the amount of $10 million, for a 120-day period, that would be used to retire maturing brokered deposits. According to the DSC *Supervisory History Memorandum*, dated October 2008, the bank's on-balance sheet liquidity totaled $17.5 million and represented 4.95 percent of total assets as of October 31, 2008. The bank had experienced $61 million in deposit runoff since March 31, 2008, and brokered deposits totaling $5.1 million and $10.3 million were to mature in November and December of 2008, respectively. Brokered deposits represented 48.3 percent of total assets. On November 17, 2008, the results of the FDIC's visitation determined that FirstBank's financial condition had continued to deteriorate, and the bank was considered to be *Significantly Undercapitalized* for PCA purposes. Accordingly, FirstBank withdrew the bank's brokered deposit waiver request.

Contingency Liquidity Plan. The institution had an Asset/Liability Management (ALM) Policy in place since November 26, 2001. The ALM's last revision was dated December 21, 2006 and was approved by the BOD on February 21, 2008. The ALM

[10] Section 29 of the FDI Act prohibits an insured depository institution that is *Adequately Capitalized* from accepting funds obtained, directly or indirectly, by or through any deposit broker for deposit into one or more deposit accounts, but permits the FDIC to grant a waiver from the prohibition. Institutions that are considered to be *Undercapitalized* (including *Significantly Undercapitalized*), under PCA provisions, are subject to the prohibition but may not obtain a waiver.

included a section on a CLP, explaining FirstBank's policy and expectation to manage its funding sources and liquidity so that all funding needs were satisfied.

Our review of the December 21, 2006 CLP, contained in the ALM Policy, determined that it did not include various elements that DSC had suggested bank management include in a CLP. According to the Examination Manual, CLPs should:

- be in force and include strategies for handling a liquidity crisis and procedures for addressing cash flow shortfalls in emergency situations and

- be available to manage and monitor liquidity risk, ensure that an appropriate amount of liquid assets is maintained, measure and project funding requirements, and manage access to funding sources.

Although the FDIC has provided extensive guidance to financial institutions regarding the need for, and the suggested components of, a comprehensive CLP, FirstBank had not developed an adequate CLP that took into consideration the FDIC's guidance. When FirstBank's financial condition began to deteriorate, the bank's options for sources of funding were limited. The FDIC's December 2007 examination concluded that bank management needed to review and update the CLP, especially as it related to a potential liquidity crisis, and the institution needed to develop strategies to reduce the bank's dependence on non-core and potentially volatile liabilities.

ASSESSMENT OF SUPERVISION

Historical Snapshot of FDIC Supervision

DSC's Atlanta Regional Office and the GDBF provided supervision of FirstBank through onsite examinations, visitations, and off-site monitoring. The regulatory agencies conducted six examinations of FirstBank, and the FDIC conducted three visitations. The first visitation, conducted in July 2002, was concurrent with the GDBF's initial examination of FirstBank as a de novo bank. The second FDIC visitation was conducted in March 2008 after significant deterioration in the bank's financial condition had been identified during the December 2007 examination. There was also a visitation in November 2008. Each of the safety and soundness examinations for FirstBank identified the bank's rapid growth and ADC concentration and provided recommendations and suggestions to improve the bank's safety and soundness. The FDIC started daily monitoring of the bank's liquidity position in November 2008. These activities identified the problems that led to FirstBank's failure.

Table 8, which follows, provides a snapshot of FirstBank's CAMELS component and composite ratings.

Table 8: FirstBank's CAMELS Component and Composite Ratings

Examination Date	Supervisory Ratings
July 2002	112313/2
December 2002	222322/2
October 2003	222222/2
September 2004	112122/2
May 2006	212122/2
December 2007	444443/4
November 2008*	554554/5

Source: OIG Review of ROEs.
* Visitation that resulted in an interim downgrade in FirstBank's ratings.

FirstBank's composite ratings remained at 2 until the December 2007 examination, when the bank's composite rating was downgraded to 4, indicating serious financial or management deficiencies and increasing risk primarily resulting from the significant financial deterioration in the bank's ADC loans. The FDIC (1) conducted a visitation in March 2008 to review concerns raised in the December 2007 examination and (2) incorporated the results into the December 2007 ROE.[11] As a result of the FDIC's March 2008 visitation, the FDIC downgraded a number of the bank's ratings. The component rating was downgraded from a 3 to a 4 for capital, earnings, and management, and the composite rating was downgraded to a 4. Additionally, FDIC examiners recommended that an enforcement action should be implemented because the condition of the bank was continuing to deteriorate during the first quarter of 2008. The recommended downgrade in the management rating was attributed to the lack of a clear operating plan and the increasing risk profile of the bank, which included excessive levels of adversely classified items, inadequate capital, and deficient earnings. As a result of a visitation the FDIC conducted in November 2008 to assess the overall financial condition of the bank, FirstBank's composite rating was downgraded to a 5, indicating extremely unsafe and unsound practices or conditions, critically deficient performance, and inadequate risk management practices.

In addition to providing component and composite ratings for each examination, the FDIC made recommendations at various times to FirstBank related to the identification and monitoring of ADC loan concentrations, enhancements to loan underwriting and credit administration practices, liquidity sources and management, and compliance with internal policies and guidelines. However, the bank's corrective actions taken in response to the FDIC's recommendations did not resolve the underlying problems related to these issues.

Further, to address examiner concerns documented in the December 2007 ROE and discussed with the FDIC on May 7, 2008, including apparent violations of laws and regulations, inadequate risk management controls, and other safety and soundness issues, FirstBank adopted a Bank Board Resolution (BBR), which the bank's BOD transmitted to the FDIC on June 6, 2008. The BBR required FirstBank to, among other things:

[11] The FDIC's December 2007 examination started on December 10, 2007, was based on September 30, 2007 financial data, and incorporated the results of the FDIC's March 2008 visitation.

- perform a risk analysis with respect to credit concentrations and reduce the level of credit risk to the bank;
- establish limits on the nature and type of construction projects to be considered;
- maintain an appropriate ALLL;
- review and revise the bank's loan underwriting policies and procedures for ADC lending;
- reduce the amount of classified items;
- review the bank's liquidity and contingency plan and develop a plan to reduce reliance on brokered deposits; and
- review and amend, as necessary, the bank's capital plan.

On June 12, 2008, the FDIC notified FirstBank of its "troubled condition"[12] status and that the institution had been added to the FDIC's formal problem bank list.[13]

The FDIC and GDBF issued a C&D, dated October 20, 2008. Among other items, the C&D required FirstBank to:

- obtain an independent review of management,
- establish an effective loan review program,
- reduce classified assets,
- reduce concentrations of credit,
- develop a liquidity management program,
- eliminate reliance on brokered deposits, and
- maintain higher minimum capital levels and develop a capital plan.

In addition, in November 2008, the FDIC conducted a visitation to review the bank's troubled loan portfolio and the bank's capital adequacy, earnings, and liquidity.

CRE Review. To better understand and monitor the risks associated with CRE lending in Georgia, and particularly in the Atlanta metropolitan area, in 2003, the FDIC conducted an analysis of CRE lending practices and procedures in FDIC-supervised institutions. The 2003 pilot program targeted institutions with significant CRE holdings as reported in quarterly Call Reports as of December 31, 2002. The review included approximately 70 institutions, including FirstBank, which had reported a CRE concentration of 383 percent of capital at December 31, 2002. With only a few exceptions, the FDIC found that CRE risks and challenges were well understood and that the reviewed banks with

[12] Implementing section 32 of the FDI Act, FDIC Rules and Regulations section 303.101(c), indicates that "troubled condition" means in general that the FDIC-supervised institution is rated 4 or 5 subject to a Cease and Desist Order (C&D), or has been notified by the FDIC based on Call Report or other information. An institution in troubled condition is required to notify the FDIC of changes in the membership of its BOD or senior executive officer. The FDIC can disapprove the change.

[13] On June 23, 2008, the Federal Reserve Bank of Atlanta notified FirstBank's holding company that it also was considered to be in "troubled condition" and required the holding company to obtain written approval before the company took certain actions that might have affected the holding company's financial condition, including but not limited to: declaring and paying dividends, redeeming capital stock, and making any other payment that would result in a reduction of capital, except as related to normal and routine operating expenses.

significant CRE concentrations had implemented adequate policies and procedures to identify and manage risk associated with CRE loans. In addition, the FDIC identified a number of banks that were not in full compliance with the identification and BOD reporting requirements of Appendix A of Part 365 of the FDIC Rules and Regulations concerning real estate lending standards. The FDIC also noted deficiencies concerning the lack of consistent internal appraisal review procedures.

Regarding FirstBank, the FDIC concluded that the institution's CRE-related risk management practices were "fair," with respect to CRE lending, which indicated that the FDIC considered FirstBank to have (1) a higher concentration of CRE development loans; (2) Loan Policy risk limits and risk management controls for identifying, measuring, monitoring, and controlling risks that warranted improvement; and (3) a generally high volume of technical exceptions and past-due loans.

OIG Assessment of FDIC Supervision

Throughout the life of the bank, the FDIC and GDBF provided supervisory oversight of FirstBank by conducting onsite examinations, visitations, and off-site monitoring. Examiners identified concerns that related to FirstBank's concentrations in CRE/ADC lending; loan underwriting and credit administration deficiencies; and reliance on non-core deposits, including the bank's high net non-core dependence ratios. Examiners also made recommendations including, but not limited to, improving the bank's risk management policies and practices and actions needed to monitor risk. In addition, the examiners identified and cited apparent violations of laws and regulations.

Although the FDIC identified the significant issues that contributed to FirstBank's ultimate failure, the FDIC could have provided additional and timelier supervisory attention for FirstBank. The examinations of FirstBank could have more fully considered the risks associated with the rapid growth of the de novo institution with (1) concentrations in CRE/ADC lending funded with wholesale funding sources and (2) weak risk management controls. Further, although the FDIC's off-site monitoring identified the risk related to FirstBank between June 2006 and September 2007, the FDIC did not take action until the issuance of the December 2007 ROE, which incorporated the results of the March 2008 visitation. The bank's financial condition deteriorated significantly between the May 2006 and December 2007 examinations, as the economy slowed. However, the risk and deficiencies associated with the ADC concentration had been identified at the bank since the December 2002 ROE.

The FDIC did not take any informal action (i.e., BBR or Memorandum of Understanding) or formal action (C&D) until 2008 when there were significant and quantifiable losses in the bank's loan portfolio. Rather than issuing formal or informal actions, the DSC Atlanta Regional Office (ARO) officials stated that the region uses moral suasion as a means to convince bank officials to implement corrective actions to address examiner concerns when the bank has no or low levels of adversely classified assets, low loan loss rates, and high capital levels. The ARO officials also stated that it is a challenge to examiners to determine which action is appropriate when a financial institution has a high level of

CRE/ADC concentrations but no negative financial impact. However, given the risk that the CRE/ADC concentration funded with wholesale deposits presented to FirstBank, more timely consideration of the associated risk that the FDIC and GDBF examinations identified could have resulted in elevated supervisory concern and action to address FirstBank's problems earlier.

Identification of Risk. The FDIC identified risk-related deficiencies at FirstBank in 2003, and the subsequent examinations of FirstBank in 2004 and 2006 also identified continued high levels of CRE/ADC concentrations and risk management control deficiencies. ARO officials stated they had concluded that the deficiencies identified by the 2004 examination were correctable in the normal course of business and that additional supervisory action was not necessary. Therefore, the ARO did not take action to address the concentrations and control deficiencies until after the 2007 examination. Examiners identified the bank's concentrations in CRE/ADC lending as early as the July 2002 examination. Although the FDIC had concluded in 2003 that FirstBank had only "fair" CRE-related controls, that conclusion did not result in more timely supervisory action to address the related risks. The FDIC's 2004 examination concluded that the risk associated with the CRE/ADC concentrations was mitigated by the bank's experienced staff, sound underwriting practices, and the strong demand for residential and commercial development in the bank's market. That examination further concluded that the bank had not yet incurred any losses from those lending activities. The FDIC's 2004 examination also noted several deficiencies in FirstBank's credit administration and Loan Policy. The GDBF 2006 examination of FirstBank also reported the bank's ADC concentration, concluded that the lending did not present a risk to the bank, and noted that credit administration deficiencies were still present.

The bank's concentrations and the associated risk continued until the bank's last full-scope examination in December 2007 and the March 2008 visitation. Ultimately, the FDIC concluded that bank management had not effectively identified, monitored, and controlled the risks inherent to the bank, including the aggressive growth strategy in the ADC lending. Until the December 2007 examination, although FirstBank had exhibited significant ADC concentrations since December 2002 and had deficiencies related to CRE/ADC risk management controls, examiners had concluded that either the concentrations did not present an undue risk to the bank or that bank management was appropriately managing the risk. The examiners seemed to focus their overall assessment of asset quality more heavily on the bank's financial condition rather than its de novo status, risk presented by the BOD's and management's rapid growth strategy and plans for continued growth, high ADC concentration levels, and the absence of sound underwriting and credit administration practices.

The CRE concentration guidance issued in December 2006 reminded institutions and examiners that strong risk management practices and appropriate capital levels are significant to a sound CRE lending program. Further, financial institutions that (1) have rapid growth in CRE lending, (2) have notable exposure to a specific type of CRE, or (3) are approaching or exceed the supervisory criteria for CRE/ADC lending may be identified for further supervisory analysis of the level and nature of CRE concentration risk.

Off-site Monitoring. FirstBank was consistently flagged for off-site monitoring for at least 6 quarters, beginning June 2006 through March 2008. Concerns were related, but not limited to, the bank's rapid growth and increasing probability of downgrades in the bank's ratings. The FDIC's Off-site Review Program is designed to identify emerging supervisory concerns and potential problems so that supervisory strategies can be adjusted appropriately. Each of the off-site monitoring reports for FirstBank noted risk factors associated with the bank that included, but were not limited to:

- rapid asset growth,
- high concentration in CRE/ADC lending, and
- heavy use of non-core deposits to fund asset growth.

In addition, the FDIC's off-site monitoring activities in 2006 concluded that the bank's asset growth was significant and was outpacing the bank's capital, FirstBank's reliance on wholesale funding sources was higher than average, asset quality continued to be strong, and management had adequate plans in place to maintain a strong capital position.

According to DSC's *Relationship Manager Supervisory Plan* for FirstBank (the Plan), dated March 2007, although bank management was generally effective in managing risk, several exceptions in the loan administration practices and compliance with laws and regulations needed improvement. The Plan also stated that FirstBank had been flagged for off-site review due to rapid asset growth, which was centered in CRE loans—representing 88 percent of total loans. Also, in less than 5 years, FirstBank's assets had grown from $14 million as of March 31, 2002 to $277 million as of September 30, 2006.

Until September 2007, when examiners concluded that there was considerable risk in the bank's loan portfolio, FirstBank's level of past-due and adversely classified loans increased, and the bank's liquidity became strained, examiners had concluded that no follow-up was necessary beyond the regularly scheduled examination. Table 9, which follows, summarizes the off-site monitoring activity for FirstBank.

Table 9: FDIC's Off-site Monitoring Results

Issues Included in the FDIC's Off-site Review Documentation	Off-site Review Dates*					
	June 2006	Sept 2006	Dec 2006	Sept 2007	Dec 2007	Mar 2008
Rapid asset growth	✓	✓	✓	✓		✓
High CRE/ADC concentration	✓	✓	✓	✓	✓	✓
Growth funded by volatile deposits	✓	✓	✓			✓
High net non-core dependence ratio	✓	✓	✓			
Asset growth outpacing capital growth	✓	✓	✓			
Asset quality was deemed to be strong	✓	✓	✓			
Capital level of FirstBank was *Well Capitalized*	✓	✓	✓	✓		
Increasing/high probability of downgrades in CAMELS ratings			✓	✓	✓	
Considerable risk in loan portfolio				✓		
Increased adverse classifications/deterioration within the ADC portfolio				✓	✓	
Strained liquidity				✓		
No follow-up beyond the regular examination cycle was recommended	✓	✓	✓			
Continued monitoring of the bank's activities or follow-up visitation was warranted				✓	✓	
Supervisory and/or Enforcement action pursued						✓

Source: FDIC off-site reviews of FirstBank.

*FirstBank had been flagged for off-site review at December 2002 for a high probability of downgrades of management and earnings ratings, but no follow-up beyond the regular examination cycle was recommended.

According to the September 30, 2006 off-site monitoring results, asset growth rates had begun to subside, and bank management had funded asset growth through brokered deposits and FHLB borrowings, which led to a declining level of core deposits and a high non-core deposit dependence ratio of 59 percent. The FDIC concluded that although asset growth was significant and reliance on wholesale funding sources was above average, asset quality continued to be strong (i.e., no adversely classified assets), and the FDIC concluded that bank management had adequate plans in place to maintain a strong capital position.

Contrary to the risk factors identified during the off-site monitoring from June 2006 to September 2007 (as noted in Table 9), the FDIC did not accelerate FirstBank's examination schedule or conduct a visitation to follow up on identified risks. The FDIC continued to conclude until September 2007 that no follow-up beyond the regular examination cycle was warranted and did not take action to address identified risks until the December 2007 examination and March 2008 visitation—the results of which were incorporated into the December 2007 ROE. By the time the FDIC conducted the December 2007 examination—about 18 months after the June 2006 off-site monitoring reported the risk associated with FirstBank—and the March 2008 visitation, about 3 months later, FirstBank's overall financial condition had severely deteriorated.

Non-Core Funding. FirstBank's examinations consistently reported that the bank was heavily reliant on non-core/volatile funding sources to fund asset growth and that the level of such funding greatly exceeded the bank's peer group. However, it was not until the bank's December 2007 examination that the FDIC concluded that FirstBank's:

- liquidity was unsatisfactory and in need of immediate improvement due to an over-reliance on brokered deposits, increasing problem asset volume and negative earnings;

- internal liquidity ratio was barely over the bank's policy minimum, and the net non-core funding dependence ratio, as of September 2007, was in the highest 10th percentile relative to the bank's peer group;[14]

- CLP needed to be reviewed and updated; and

- strategies to reduce the level of reliance on non-core and potentially volatile liabilities needed to be developed.

Examiners concluded that the bank needed to operate in compliance with the BOD's approved liquidity guidelines, with noncompliance being the rare exception, rather than a frequent occurrence. The FDIC did not restrict the bank's use of non-core/volatile funding sources until after considering the results of the December 2007 examination and March 2008 visitation. In addition, examinations prior to December 2007 did not address whether the bank had a CLP or whether it was considered to be adequate or comprehensive. Consequently, when the bank's financial condition deteriorated, access to these funding sources was restricted.

Timeliness of Supervisory and Enforcement Action. The FDIC should have taken more timely supervisory and/or enforcement action regarding the risk that FirstBank's de novo status and CRE/ADC concentration presented to the bank and to the DIF. FirstBank's concentration in ADC loans was first identified in 2002 and again in the bank's 2004 and 2007 examinations and 2008 visitation. The concentration, coupled with inadequate risk management practices that had been identified and reported on in each examination and off-site monitoring, indicated increased risk to the bank.

The FDIC did not take informal or formal action until after the December 2007 examination, which determined that significant deterioration had occurred in the bank's financial condition. The supervisory actions consisted of a BBR and a C&D. The BBR was adopted by FirstBank on June 6, 2008, after the May 7, 2008 meeting with the FDIC regarding the December 2007 examination and March 2008 visitation results. Even though the C&D was recommended at the end of March 2008, it did not become effective until October 2008, nearly 7 months after it was first recommended and 4 months prior to the closing of FirstBank. ARO officials stated that the regional office did not start drafting the C&D until June 2008—after the examination report had been reviewed and processed. The C&D was comprehensive and covered the deficiencies identified at the bank; however, it was not timely in addressing the significant deterioration that resulted

[14] FirstBank's peer group includes all insured commercial banks having assets between $300 million and $1 billion.

from the bank's inadequate BOD and management oversight, the significant ADC concentration, and weak management controls, which were collectively amplified by the severe economic decline.

Conclusion

DSC's *2004 De novo Bank Study*,[15] reported that de novo institutions frequently exhibit factors that present significant risks, including, but not limited to (1) weak oversight by the BOD, (2) rapid asset growth, (3) departure from the business plan by exceeding projected asset growth, and (4) dependence on non-core sources to fund growth in high-risk loans. FirstBank's management implemented a high-risk growth strategy but failed to (1) follow the approved business plan and strategy as they related to ADC loans and funding sources, (2) ensure that sound risk management policies and practices were established and followed, and (3) ensure that the bank's dependence on wholesale funding sources was limited and that the bank developed and implemented a comprehensive CLP for effective liquidity management. The mismanagement and weaknesses that FirstBank exhibited in all of these areas contributed to the bank's failure.

IMPLEMENTATION OF PCA

The purpose of PCA is to resolve problems of insured depository institutions at the least possible long-term cost to the DIF. PCA establishes a system of restrictions and mandatory and discretionary supervisory actions that are to be triggered depending on an institution's capital levels. Part 325 of the FDIC's Rules and Regulations implements PCA requirements by establishing a framework for taking prompt corrective action against insured nonmember banks that are not adequately capitalized.

FirstBank had capital injections to support the bank's asset growth (see Table 10, which follows). Between 2003 and 2004, the bank received $14 million in capital. In 2007, the bank received $3 million in capital. In November 2008, FirstBank received $1 million during the first quarter and $1.25 million during the third quarter of the year.

[15] The DSC Atlanta Region led an interregional study of de novo financial institutions in fulfillment of a DSC 2004 business line objective. The purpose of the study was to review the timing of, and susceptibility to, problems of de novo financial institutions and to determine important factors in the application process that would aid in the efficient supervision of new banks. The study also provided information on "young" banks, which are banks in the fourth through ninth years of operation. The FDIC's Division of Insurance and Research and Legal Division also participated in the study.

Table 10: Capital Injections for FirstBank

Year	Amount of Capital Injection ($000)
2003	$2,000
2004	$12,000
2005	None
2006	None
2007	$3,000
2008	$2,250

Source: DSC's *Supervisory History Memorandum.*

Until 2007, the capital injections and the lack of significant adversely classified assets resulted in examiners concluding that the bank's capital was satisfactory. Although the bank had capital injections on various occasions, the FDIC's problem bank memorandum, dated November 12, 2008, concluded that the bank's continued asset deterioration more than offset the financial impact of the capital injection received in the first and third quarters of 2008.

Table 11 shows how FirstBank's capital ratios compared to the bank's peer group for three of the bank's six examinations and as of June 30, 2008, when FirstBank became *Adequately Capitalized* for PCA purposes. Table 11 reflects the change in capital between June 2004 and June 2008 and shows that FirstBank's capital ratios were either above or about the same as the bank's peer group until June 30, 2008.

Table 11: FirstBank's Capital Ratios Compared to Peer

Examination Dates	Financial Data as of Date	Tier 1 Leverage Capital		Tier 1 Risk-Based Capital		Total Risk-Based Capital	
		Bank	Peer	Bank	Peer	Bank	Peer
		(Percent)					
September 2004	June 30, 2004	16.41	12.97	18.38	17.11	19.36	18.16
May 2006	March 31, 2006	11.41	11.07	13.32	13.99	14.32	15.15
Dec 2007	September 30, 2007	9.14	9.15	10.61	11.77	11.87	12.87
N/A	June 30, 2008	5.94	8.93	8.42	11.46	9.69	12.59

Source: ROEs and UBPRs for FirstBank.

The FDIC and GDBF evaluated FirstBank's capital position and assigned a capital component rating of 1 or 2 for each of the five examinations conducted from July 2002 through May 2006, indicating a strong or satisfactory capital level relative to the bank's risk profile. However, the March 2008 FDIC visitation results, which were incorporated into the sixth and last examination of FirstBank—December 2007—concluded that FirstBank's risk profile was significantly greater than reflected in the PCA category of *Well Capitalized*. The visitation also noted that the bank's ADC concentration, in which most problem credits had been centered, was 568 percent of Tier 1 Capital at September 30, 2007. The risk profile was further compounded by the bank's heavy reliance on wholesale funding sources, which are potentially more volatile than more traditional deposits. Additionally, earnings were negative for 2007 and were projected to be negative in 2008. Given all these additional factors (identified in the March 2008 visitation), the bank's capital component rating was downgraded to a 4, indicating a deficient level of capital that could threaten the viability of the institution and require the bank to obtain financial support from shareholders or other external sources. As a result, the October 2008 C&D contained several capital-related provisions even though the bank's reported PCA capital ratios in 2008 had been in the *Well Capitalized* to *Adequately Capitalized* range. The capital-related provisions of the C&D required FirstBank to:

- maintain Tier 1 Leverage Capital at least equal to 8 percent of total assets;
- develop and adopt a capital maintenance plan; and
- restrict the payment of dividends without the prior written approval of the FDIC and GDBF.

In November 2008, as a result of off-site review and a visitation, the FDIC downgraded FirstBank's capital component rating to a 5. The downgrade resulted from the bank's materially deficient level of capital due to severe asset quality problems and operating losses that rapidly eroded the bank's capital position.[16] Visitation findings resulted in an additional $10.4 million provision to the ALLL, as well as a charge-off of $497,000 in accrued but uncollected interest. As a result, the bank's key capital ratios as of November 30, 2008 were as follows.

- Tier 1 Leverage Capital 2.90 percent
- Tier 1 Risk-Based Capital 4.12 percent
- Total Risk-Based Capital 5.44 percent

The capital ratios reflect a *Significantly Undercapitalized* category under PCA provisions in Part 325 of the FDIC's Rules and Regulations. On January 13, 2009, the FDIC presented the BOD with a PCA Notification of Capital Category letter that advised the bank of its *Significantly Undercapitalized* capital category. The notification letter required FirstBank to file a written capital restoration plan with the FDIC within 45 days. However, FirstBank was closed on February 6, 2009, less than a month after the notification.

PCA's focus is on capital, and capital can be a lagging indicator of an institution's financial health. FirstBank's capital designation for PCA purposes remained in the *Well Capitalized* range to *Adequately Capitalized* range long after its operations had begun to deteriorate because of problems related to management, asset quality, risk management controls, and net losses. In particular, the ALLL was significantly underfunded, which overstated capital and masked the deterioration of the loan portfolio. Further, by the time FirstBank's capital level fell below the required threshold necessary to implement PCA, the bank's condition had deteriorated to the point at which the institution could not raise additional needed capital or find other investors to assist in recapitalizing the bank.

[16] On November 13, 2008, FirstBank submitted an application for the Troubled Asset Relief Program's (TARP) Capital Purchase Program administered by the United States Department of the Treasury. FirstBank requested approval of $8.4 million in TARP funds and stated that the bank had been unsuccessful in raising additional capital. During the week of November 17, 2008, the FDIC discussed with FirstBank officials the continued significant deterioration of the bank. On November 21, 2008, FirstBank withdrew the TARP application.

In summary, examiners fulfilled the notification requirements of the PCA provisions of the FDI Act, but the notice was too late to correct the bank's capital problems.

CORPORATION COMMENTS

On September 1, 2009, the Director, DSC, provided a written response to the draft report. DSC's response is provided in its entirety as Appendix 4 of this report. In its response, DSC reiterated our findings that FirstBank failed primarily due to management's pursuit of rapid growth in CRE and ADC loans, which were concentrated in suburban Atlanta, Georgia, and funded with higher-cost, volatile wholesale sources. DSC stated that this business strategy, coupled with the economic downturn that accelerated in 2007, resulted in loan losses depleting capital and earnings and impairing liquidity to the magnitude of which the institution was unable to recover and ultimately failed.

DSC also noted that the FDIC, in conjunction with the GDBF, provided ongoing supervision of FirstBank and identified key concerns for attention by bank management, including problems that led to the bank's failure. Further, DSC stated that supervisory examinations and visitations in 2003, 2004, and 2006 discussed the risks associated with the elevated concentration in CRE/ADC lending and that the FDIC took formal enforcement action following the bank's December 2007 examination.

DSC acknowledged that FirstBank's practice of highly concentrated ADC lending warranted earlier intervention before the bank's financial condition deteriorated. DSC remarked that it has provided further guidance to enhance its supervision of institutions with concentrated CRE/ADC lending and volatile non-core funding.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

We performed this audit in accordance with section 38(k) of the FDI Act, which provides, in general, that if a deposit insurance fund incurs a material loss with respect to an insured depository institution, the Inspector General of the appropriate federal banking agency shall prepare a report to that agency reviewing the agency's supervision of the institution. The FDI Act requires that the report be completed within 6 months after it becomes apparent that a material loss has been incurred.

Our audit objectives were to (1) determine the causes of the financial institution's failure and resulting material loss to the DIF and (2) evaluate the FDIC's supervision of the institution, including implementation of the PCA provisions of section 38.

We conducted the audit from March 2009 to August 2009 in accordance with generally accepted government auditing standards. However, due to the limited scope and objectives established for material loss reviews, which are generally applied to just one financial institution, it may not have been feasible to address certain aspects of the standards, as described on the next page.

Scope and Methodology

The scope of this audit included an analysis of FirstBank's operations from January 28, 2002 until its failure on February 6, 2009. Our review also entailed an evaluation of the regulatory supervision of the institution over the same period.

To achieve the objectives, we performed the following procedures and techniques:

- Analyzed examination and visitation reports prepared by the FDIC and GDBF examiners from 2002 to 2008.

- Reviewed the following:
  - Bank data and correspondence maintained at DSC's ARO and the Tampa Field Office.

  - Reports prepared by the Division of Resolutions and Receiverships (DRR) and DSC relating to the bank's closure.

  - External audit records provided by Mauldin & Jenkins, FirstBank's external auditors located in Atlanta, Georgia.

  - Bank records maintained by DRR in Dallas regarding information that would provide insight into the bank's failure, various annual reports, and accompanying financial statements.

    - pertinent DSC policies and procedures.

- Interviewed the following FDIC officials:
    - DSC management in Washington, D.C., and the ARO.
    - FDIC examiners from the Atlanta Field Office and the Tampa Field Office who participated in examinations or reviews of examinations of FirstBank.
- Met with officials from the GDBF to discuss the historical perspective of the institution, its examinations, state banking laws, and other activities regarding the state's supervision of the bank.
- Researched various banking laws and regulations, including Georgia State laws.

We performed the audit field work at the ARO and Tampa Field Office in Atlanta, Georgia, and Tampa, Florida, respectively.

Internal Control, Reliance on Computer-processed Information, Performance Measurement, and Compliance With Laws and Regulations

Due to the limited nature of the audit objectives, we did not assess DSC's overall internal control or management control structure. We reviewed the examiner's assessment of FirstBank's management controls pertaining to its operations as discussed earlier in this report.

We obtained data from various systems but determined that information system controls were not significant to the audit objectives, and therefore, did not evaluate the effectiveness of information system controls. We relied on our analysis of information from various sources, including ROEs, correspondence files, and testimonial evidence to corroborate data obtained from systems that were used to support our audit conclusions.

The Government Performance and Results Act of 1993 (the Results Act) directs Executive Branch agencies to develop a customer-focused strategic plan, align agency programs and activities with concrete missions and goals, and prepare and report on annual performance plans. For this material loss review, we did not assess the strengths and weaknesses of DSC's annual performance plan in meeting the requirements of the Results Act because such an assessment is not part of the audit objectives. DSC's compliance with the Results Act is reviewed in program audits of DSC operations. Regarding compliance with laws and regulations, we performed tests to determine whether the FDIC had complied with provisions of PCA and limited tests to determine compliance with certain aspects of the FDI Act. The results of our tests were discussed, where appropriate, in the report. Additionally, we assessed the risk of fraud and abuse related to our objectives in the course of evaluating audit evidence.

GLOSSARY OF TERMS

Term	Definition
Adversely Classified Assets	Assets subject to criticism and/or comment in an examination report. Adversely classified assets are allocated on the basis of risk (lowest to highest) into three categories: Substandard, Doubtful, and Loss.
Allowance for Loan and Lease Losses (ALLL)	Federally insured depository institutions must maintain an ALLL that is adequate to absorb the estimated loan losses associated with the loan and lease portfolio (including all binding commitments to lend). To the extent not provided for in a separate liability account, the ALLL should also be sufficient to absorb estimated loan losses associated with off-balance sheet loan instruments such as standby letters of loan.
Cease and Desist Order (C&D)	A C&D is a formal enforcement action issued by a financial institution regulator to a bank or affiliated party to stop an unsafe or unsound practice or a violation of laws and regulations. A C&D may be terminated when the bank's condition has significantly improved and the action is no longer needed or the bank has materially complied with its terms.
Concentration	A concentration is a significantly large volume of economically related assets that an institution has advanced or committed to a certain industry, person, entity, or affiliated group. These assets may, in the aggregate, present a substantial risk to the safety and soundness of the institution.
Prompt Corrective Action (PCA)	The purpose of PCA is to resolve the problems of insured depository institutions at the least possible long-term cost to the DIF. Part 325, subpart B, of the FDIC Rules and Regulations, 12 Code of Federal Regulations, section 325.101, et. seq., implements section 38, *Prompt Corrective Action*, of the FDI Act, 12 United States Code section 1831o, by establishing a framework for taking prompt supervisory actions against insured nonmember banks that are less than adequately capitalized. The following terms are used to describe capital adequacy: (1) Well Capitalized, (2) Adequately Capitalized, (3) Undercapitalized, (4) Significantly Undercapitalized, and (5) Critically Undercapitalized. A PCA Directive is a formal enforcement action seeking corrective action of compliance with the PCA statute with respect to an institution that falls within any of the three categories of undercapitalized institutions.
Uniform Bank Performance Report (UBPR)	The UBPR is an individual analysis of financial institution financial data and ratios that includes extensive comparisons to peer group performance. The Federal Financial Institutions Examination Council produces the report quarterly, from banks' Call Report data, for use by banking supervisors, bankers, and the general public.

CHRONOLOGY OF SIGNIFICANT EVENTS

Date	Chronology of Significant Events
January 28, 2002	The institution was established as the First Bank of Henry County, and deposit insurance became effective.
July 15, 2002	The GDBF began the first examination of the institution. Ratings: 1-1-2-3-1-3/2
December 2, 2002	The FDIC began the second examination of the institution. Ratings: 2-2-2-3-2-2/2
October 6, 2003	The GDBF began the third examination of the institution. Ratings: 2-2-2-2-2-2/2
September 28, 2004	The FDIC began the fourth examination of the institution. Ratings: 1-1-2-1-2-2/2
February 1, 2005	The single-bank holding company, FirstBank Financial Services, Inc. was formed.
January 30, 2006	The institution opened the Stockbridge Branch Office.
May 30, 2006	The GDBF began the fifth examination of the institution. Ratings: 2-1-2-1-2-2/2
October 2, 2006	The institution opened the McDonough Branch Office.
January 1, 2007	The institution changed its name to FirstBank Financial Services.
July 30, 2007	FirstBank opened the Morrow Branch Office.
December 10, 2007	The FDIC began the sixth examination of FirstBank. The ROE for this examination was updated to include the results of the March 2008 visitation. Ratings: 4-4-4-4-4-3/4
June 6, 2008	FirstBank notified the FDIC of a BBR adopted to address weaknesses and deficiencies identified in the FDIC's December 2007 examination.
June 12, 2008	The FDIC notified FirstBank that it had been added to DSC's Problem Bank List.
June 23, 2008	The Federal Reserve Bank of Atlanta notified FirstBank's holding company of the bank's unsatisfactory condition.
June 30, 2008	FirstBank became *Adequately Capitalized* for PCA purposes.
August 28, 2008	The FDIC received FirstBank's brokered deposit waiver request. The bank withdrew the request on December 11, 2008.
October 23, 2008	The FDIC and GDBR jointly issued a C&D.
November 17, 2008	The FDIC conducted a visitation of the institution. Ratings: 5-5-4-5-5-4/5
November 30, 2008	FirstBank was *Significantly Undercapitalized* for PCA purposes.
January 13, 2009	The FDIC issued a PCA notification letter to FirstBank's BOD.
February 6, 2009	The GDBF closed the institution and named the FDIC as receiver.

CORPORATION COMMENTS

FDIC

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990

Division of Supervision and Consumer Protection

September 1, 2009

TO: Russell A. Rau
Assistant Inspector General for Audits

FROM: Sandra L. Thompson
Director

SUBJECT: Draft Audit Report Entitled, Material Loss Review of FirstBank Financial Services, McDonough, Georgia (Assignment No. 2009-022)

Pursuant to Section 38(k) of the Federal Deposit Insurance Act (FDI Act), the Federal Deposit Insurance Corporation's Office of Inspector General (OIG) conducted a Material Loss Review of FirstBank Financial Services (FirstBank), which failed on February 6, 2009. This memorandum is the response of the Division of Supervision and Consumer Protection (DSC) to the OIG's Draft Audit Report (Report) received on August 17, 2009.

The OIG found that FirstBank failed primarily due to management's pursuit of rapid growth in Commercial Real Estate (CRE) and Acquisition, Development, and Construction (ADC) loans. This growth was concentrated in suburban Atlanta, Georgia, and funded with higher cost, volatile wholesale sources. This business strategy, when coupled with the economic downturn that accelerated in 2007, resulted in loan losses depleting capital and earnings and impairing liquidity to the magnitude of which the institution was unable to recover and ultimately failed.

The Report concludes that the FDIC, in conjunction with the Georgia Department of Banking and Finance (GDBF), provided ongoing supervision of FirstBank and identified key concerns for attention by bank management, including problems that led to the bank's failure. Supervisory examinations and visitations in 2003, 2004, and 2006 discussed the risks associated with the elevated concentration in CRE/ADC lending. Although these examinations noted overall adequate oversight of concentrations and generally sound conditions, the combination of an economic downturn and the risk associated with FirstBank's lending and funding strategies led to formal enforcement action following the December 2007 examination. The OIG notes, and DSC acknowledges, that FirstBank's practice of highly concentrated ADC lending warranted earlier intervention, before its financial condition deteriorated. DSC has provided further guidance to enhance its supervision of institutions with concentrated CRE/ADC lending and volatile non-core funding.

Thank you for the opportunity to review and comment on the Report

ACRONYMS USED IN THE REPORT

Acronym	Definition
ADC	Acquisition, Development, and Construction
ALLL	Allowance for Loan and Lease Losses
ALM	Asset Liability Management
ARO	Atlanta Regional Office
BBR	Bank Board Resolution
BOD	Board of Directors
C&D	Cease and Desist Order
CAMELS	**C**apital, **A**sset Quality, **M**anagement, **E**arnings, **L**iquidity, and **S**ensitivity to Market Risk
CLP	Contingency Liquidity Plan
CRE	Commercial Real Estate
DIF	Deposit Insurance Fund
DRR	Division of Resolutions and Receiverships
DSC	Division of Supervision and Consumer Protection
FDI	Federal Deposit Insurance
FHLB	Federal Home Loan Bank
FIL	Financial Institution Letter
GDBF	Georgia Department of Banking and Finance
OIG	Office of Inspector General
PCA	Prompt Corrective Action
PLLL	Provision for Loan and Lease Losses
ROE	Report of Examination
TARP	Troubled Asset Relief Program
UBPR	Uniform Bank Performance Report
UFIRS	Uniform Financial Institutions Rating System