Office of Inspector General

Office of Material Loss Reviews
Report No. MLR-10-023

Material Loss Review of First Coweta Bank, Newnan, Georgia

March 2010

Office of Inspector General

Executive Summary

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Why We Did The Audit

On August 21, 2009 the Georgia Department of Banking and Finance (DBF) closed First Coweta Bank (First Coweta) and named the FDIC as receiver. On September 10, 2009, the FDIC notified the Office of Inspector General (OIG) that First Coweta's total assets at closing were $164 million and that the estimated loss to the Deposit Insurance Fund (DIF) was $47.7 million. As of March 1, 2010, the estimated loss to the DIF had increased to $50.1 million. As required by section 38(k) of the Federal Deposit Insurance (FDI) Act, the OIG conducted a material loss review.

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

Background

First Coweta was a state-chartered nonmember bank established by the DBF on July 12, 2004, and insured by the FDIC the same day. The full-service community bank was headquartered in Newnan, Georgia and specialized in commercial real estate (CRE), including residential acquisition, development, and construction (ADC) loans. First Coweta was located in the southwest quadrant of the Atlanta metropolitan area which, at that time, was seen as a good area for residential and commercial development. In addition to its main office, the bank had three branch offices, one in Newnan, and two in adjoining counties. The bank had no holding company or affiliates. The bank's stock was widely held, with directors collectively controlling 22 percent.

Audit Results

Causes of Failure and Material Loss

First Coweta failed because its Board and management pursued a strategy focused on ADC lending and failed to adequately manage the risks associated with the resulting ADC concentrations. Supervisory guidance emphasizes that strong risk management practices and appropriate levels of capital are essential elements of a sound CRE lending program, particularly when the institution has a concentration. The bank focused on residential ADC lending in and around Atlanta with its growth funded, in part, by higher-priced certificates of deposit, including brokered deposits. The precipitous economic decline in the Atlanta metropolitan real estate market that began in 2007 led to loan losses that quickly eroded the bank's capital. Weaknesses in First Coweta's loan underwriting and credit administration practices contributed to the rapid decline in bank's financial condition. The bank hired a new chief loan officer in 2008 but this action and other Board efforts to rehabilitate the bank in late 2008 and during 2009 came too late and its condition continued to deteriorate in 2009. DBF closed First Coweta because of its core unprofitability, inability to raise sufficient capital to support its operations, and strained liquidity position.

The FDIC's Supervision of First Coweta

Our review focused on FDIC and DBF supervisory oversight of First Coweta between 2005 and 2009. The first three examinations, conducted during First Coweta's de novo period, identified ADC concentrations and the need for the bank to enhance various underwriting and credit administration practices. During its de novo period, examiners generally concluded that First Coweta's overall financial condition was sound and management's performance and oversight was satisfactory. The FDIC's offsite monitoring program was used to monitor the bank's condition between the 2007 and 2008 examinations and prompted a joint visitation in late 2008 and the acceleration of the DBF's on-site examination. In 2008, examiners found the overall condition of the bank had significantly deteriorated because of a slowing economy and poor Board and management oversight. Formal supervisory action was taken in 2009; however, by the time that action became effective, the financial condition of the bank had become critically deficient.

Although the FDIC and the DBF closely monitored First Coweta, in retrospect, it may have been prudent for the FDIC to downgrade the management component and/or pursue supervisory action in 2007 considering the following risks that were apparent at the institution:

- significant growth during the de novo period;
- lack of adherence to business plan projections;
- high concentrations of ADC loans;
- noted weaknesses in underwriting and credit administration practices, including contraventions and violations of regulatory guidance; and
- reliance on non-core funding.

Such an approach may have (1) been more effective in bringing about necessary risk mitigation by requiring more formal Board and management commitments to corrective actions and (2) resulted in increased supervisory oversight at a critical point in time. We recognize that rating determinations are a matter of judgment. Further, while it was possible for examiners to downgrade the management component, it may have been difficult for them to support a lower rating in 2007 based on weak practices because the bank's earnings and capital were considered to be satisfactory at that time.

In recognition of the risk factors present in First Coweta and in similarly troubled or failed institutions, the FDIC established broad supervisory expectations in 2006 and again in 2008 with regard to managing risk associated with CRE and ADC concentrations. In 2008 and 2009, the FDIC issued guidance related to liquidity management and use of volatile or special funding sources by financial institutions that are in a weakened condition, respectively. Additionally, in 2009, the FDIC extended the de novo period in recognition that unseasoned institutions may warrant stronger supervisory attention. The FDIC also recently established procedures to better communicate and follow up on risks and deficiencies identified during examinations.

With respect to PCA, based on the supervisory actions taken, the FDIC properly implemented applicable PCA provisions of section 38 in a timely manner. First Coweta was unsuccessful in raising needed capital and the bank was subsequently closed on August 21, 2009.

Management Response

After we issued our draft report, management provided additional information for our consideration, and we revised our report to reflect this information as appropriate. On March 5, 2010, the Director, Division of Supervision and Consumer Protection (DSC), provided a written response to the draft report. DSC reiterated the OIG's conclusions regarding the cause of First Coweta's failure. With regard to our assessment of the FDIC's supervision of First Coweta, DSC cited supervisory action taken in 2007 and 2008, discussed in our report, to address the bank's heightened risk profile and deteriorating financial condition due to its high concentrations in ADC lending. Further, DSC's response recognizes that strong supervisory attention is necessary for institutions, like First Coweta, with high ADC/CRE concentrations and volatile funding sources and, as also discussed in our report, has issued updated guidance reminding examiners to take appropriate action when those risks are imprudently managed.

Contents

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

Office of Material Loss Review
Office of Inspector General

DATE: March 10, 2010

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

/Signed/

FROM: Stephen M. Beard
Assistant Inspector General for Material Loss Reviews

SUBJECT: *Material Loss Review of First Coweta Bank, Newnan, Georgia* (Report No. MLR-10-023)

As required by section 38(k) of the Federal Deposit Insurance (FDI) Act, the FDIC Office of Inspector General (OIG) conducted a material loss[1] review of the failure of First Coweta Bank (First Coweta), Newnan, Georgia. The Georgia Department of Banking and Finance (DBF) closed First Coweta on August 21, 2009 and named the FDIC as receiver. On September 10, 2009, the FDIC notified the OIG that First Coweta's total assets at closing were $164 million and that the estimated loss to the Deposit Insurance Fund (DIF) was $47.7 million. As of March 1, 2010, the estimated loss to the DIF had increased to $50.1 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. The report is to consist of a review of the agency's supervision of the institution, including the agency's implementation of FDI Act section 38, *Prompt Corrective Action* (PCA); a determination as to why the institution's problems resulted in a material loss to the DIF; and recommendations to prevent future losses.

The objectives of this material loss review were to (1) determine the causes of First Coweta's failure and the resulting material loss to the DIF and (2) evaluate the FDIC's supervision[2] of First Coweta, including the FDIC's implementation of the PCA provisions of section 38 of the FDI Act. This report presents our analysis of First Coweta's failure and the FDIC's efforts to ensure that First Coweta's Board of Directors (Board) and management operated the institution in a safe and sound manner.

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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.

The report does not contain formal recommendations. Instead, as major causes, trends, and common characteristics of financial institution failures are identified in our material loss 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 DSC's supervision program and make recommendations, as warranted. Appendix 1 contains details on our objectives, scope, and methodology. Appendix 2 contains a glossary of key terms and Appendix 3 contains a list of acronyms. Appendix 4 contains the Corporation's comments on this report.

Background

First Coweta was a state-chartered nonmember bank established by the DBF on July 12, 2004,[3] and insured by the FDIC the same day. The full-service community bank was headquartered in Newnan, Georgia and specialized in commercial real estate (CRE), including residential acquisition, development, and construction (ADC) loans. First Coweta was located in the southwest quadrant of the Atlanta metropolitan area which, at that time, was seen as a good area for residential and commercial development. In addition to its main office, the bank had three branch offices, one in Newnan, and two in adjoining counties. The bank had no holding company or affiliates. The bank's stock was widely held, with directors collectively controlling 22 percent. Table 1 provides details on First Coweta's financial condition as of June 30, 2009 and for the 4 preceding calendar years.

Table 1: Financial Information for First Coweta, 2005 to 2009

Financial Measure	Jun-2009	Dec-2008	Dec-2007	Dec-2006	Dec-2005
Total Assets ($000s)	163,755	166,123	179,439	120,943	84,509
Total Loans ($000s)	116,018	129,848	148,842	97,885	63,969
Total Deposits ($000s)	154,903	153,169	151,433	101,442	71,288
Brokered Deposits ($000s)	16,769	28,726	29,656	20,981	9,249
FHLB Borrowings ($000s)	5,000	5,000	12,000	5,000	0
Net Income ($000s)	(4,007)	(7,956)	671	713	339

Source: Uniform Bank Performance Reports (UBPR) for First Coweta.

Causes of Failure and Material Loss

First Coweta failed because its Board and management pursued a strategy focused on ADC lending and failed to adequately manage the risks associated with the resulting ADC concentrations. Supervisory guidance emphasizes that strong risk management practices and appropriate levels of capital are essential elements of a sound CRE lending program, particularly when the institution has a concentration. The bank focused on residential

[3] Until 2009, the FDIC defined a de novo institution as one within its first 3 years of operation. First Coweta's de novo period ended July 2007. It was subsequently considered a young institution (defined as institutions in their 4th through 9th year of operation). On August 28, 2009, the FDIC extended the de novo period from 3 to 7 years in Financial Institution Letter (FIL) 50-2009, entitled, *Enhanced Supervisory Procedures for Newly Insured FDIC-Supervised Depository Institutions*.

ADC lending in and around Atlanta with its growth funded, in part, by higher-priced certificates of deposit, including brokered deposits. The precipitous economic decline in the Atlanta metropolitan real estate market that began in 2007 led to loan losses that quickly eroded the bank's capital. Weaknesses in First Coweta's loan underwriting and credit administration practices contributed to the rapid decline in the bank's financial condition. The bank hired a new chief loan officer in 2008, but this action and other Board efforts to rehabilitate the bank in late 2008 and during 2009 came too late and its condition continued to deteriorate in 2009. DBF closed First Coweta because of its core unprofitability, inability to raise sufficient capital to support its operations, and strained liquidity position.

Concentrations in ADC Loans

First Coweta grew its assets from $85 million to $179 million from year-end 2005 to year-end 2007. First Coweta's growth, centered in ADC loans, comprised almost 40 percent of the bank's average gross loans between 2005 and 2009. In addition, ADC loans, as a percentage of total capital, increased from 191 percent as of December 31, 2005 to approximately 559 percent as of December 31, 2008,[4] nearly 4 times greater than the bank's peer group.[5] Table 2 summarizes First Coweta's ADC concentrations in comparison to its peer group.

Table 2: First Coweta's ADC Concentrations Compared to Peer Group

	ADC Loans as a Percentage of Total Capital		ADC Loans as a Percentage of Average Gross Loans	
Period Ending	First Coweta	Peer Group	First Coweta	Peer Group
December 31, 2005	191.26	73.28	39.04	16.95
December 31, 2006	264.62	119.88	40.31	20.75
December 31, 2007	360.93	139.80	39.34	21.67
December 31, 2008	558.80	141.06	40.92	20.01
June 30, 2009	922.13	84.98	40.15	12.32

Source: UBPRs for First Coweta.

Federal banking regulatory agencies issued guidance in December 2006, entitled, *Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices* (Joint Guidance), to reinforce existing regulations and guidelines for real estate lending and safety and soundness.[6] The Joint Guidance focuses on those CRE loans for which cash flow from real estate is the primary source of repayment (i.e., ADC lending). The Joint Guidance states that the agencies had observed an increasing trend in the number of institutions with concentrations in CRE loans and noted that rising CRE concentrations

[4] The increase in risk exposure from ADC loans in 2008 was due primarily to the decline in the bank's capital level.

[5] Institutions are assigned to 1 of 15 peer groups based on asset size, number of branches, and whether the institution is located in a metropolitan or non-metropolitan area. De novo institutions are compared to other banks that opened in the same period for 5 years. Accordingly, First Coweta's peer group included institutions with assets less than $750 million established in 2004. Subsequent to that period, First Coweta's peer group included institutions with assets between $100 million and $300 million in a metropolitan area with three or more full-service offices.

[6] The guidance was issued jointly by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the FDIC (collectively referred to as the agencies in the guidance).

could expose institutions to unanticipated earnings and capital volatility in the event of adverse changes in the general CRE market. Indeed, as noted in First Coweta's August 2007 examination report, the softening of the 1-4 family residential real estate market in 2007 resulted in an upward trend in classified credits, and First Coweta's ADC concentrations left the bank vulnerable to deteriorating economic conditions in 2008 and 2009.

Risk Management Practices

An institution's Board is responsible for establishing appropriate risk limits, monitoring exposure, and evaluating the effectiveness of the institution's efforts to manage and control risk. The Joint Guidance reiterates that concentrations in CRE lending, coupled with weak loan underwriting and depressed CRE markets, contributed to significant credit losses in the past. Earlier guidance on ADC lending[7] emphasized that management's ability to identify, measure, monitor, and control portfolio risk through effective underwriting policies, systems, and internal controls was crucial to a sound ADC lending program. First Coweta's Board did not ensure that management established effective risk management practices sufficient to limit the bank's exposure to ADC concentrations, allowing the bank to grow significantly without risk limits and monitoring practices commensurate with the increased risk associated with those concentrations.

<u>Loan Underwriting and Credit Administration</u>

According to the FDIC's *Risk Management Manual of Examination Policies,* the degree of risk in a real estate loan depends primarily on the loan amount in relation to collateral value, the interest rate, and most importantly, the borrower's ability to repay in an orderly fashion. Placing undue reliance upon a property's appraised value in lieu of an adequate initial assessment of a debtor's repayment ability is a potentially dangerous mistake. In that regard, First Coweta did not implement sound loan underwriting and credit administration practices, as illustrated by the following weaknesses reported by examiners:

- Management did not conduct a proper review and analysis of appraisals at loan inception. Further, management did not satisfactorily review appraisals as economic conditions changed, nor adjust them for current conditions, such as a decline in sales prices and an increase in absorption period.

- Management did not perform appropriate due diligence when purchasing loan participations. According to examiners, the level of analysis for participations should be as stringent as that done for loans originated by the bank's loan officers. First Coweta purchased a significant volume of loans from a financial services firm in Georgia. Loans purchased from this firm totaled approximately 8 percent of total loans and 97 percent of Tier 1 Capital. The bank failed, however, to perform any

[7] FIL-110-98, entitled, *Internal and Regulatory Guidelines for Managing Risks Associated with Acquisition, Development, and Construction Lending,* dated October 8, 1998.

independent review of these loans and relied upon the firm's underwriting and credit administration, which was found to be poor.

- Preparation of cash flow and debt servicing analysis was not consistently performed. Specifically, global cash flow analyses, which involve analyzing borrowers' complete financial resources and obligations, were not always performed and documented. Credit memorandums[8] did not focus on the borrower's and/or company's financial status but on getting credit approval. FIL-22-2008, entitled, *Managing Commercial Real Estate Concentrations in a Challenging Environment*, issued March 17, 2008, provides key risk management processes for institutions with CRE concentrations, one of which is to maintain updated financial and analytical information for borrowers, and states that global financial analyses of obligors should be emphasized.

- There were numerous documentation exceptions related to credit administration, such as the absence of current financial statements, tax returns, and credit memorandums. In general, First Coweta failed to inspect and document the current status of ADC loans on a timely basis.

Further, although the bank monitored concentrations by type and location, examiners recommended in 2008 that a portfolio-level stress test or sensitivity analysis to quantify the impact of the changed economic conditions be performed.

An external loan review of the bank conducted in 2008 identified underwriting and credit administration weaknesses similar to those identified by examiners and attributed past credit underwriting weaknesses to the fact that asset growth took priority over asset quality. Additionally, the 2008 external loan review report stated that First Coweta's inadequate evaluation of borrower repayment capability was disguised with inflating real estate values and turnover in the real estate sales market. However, when the real estate market slowed, the borrower's ability to repay became challenged because the borrower's liquidity and outside income sources were not capable of supporting stagnant speculative projects. The external loan review also identified evidence of apparent loan fraud concerning one loan relationship.

The loan officers responsible for the majority of the poor quality loans were no longer working at the bank by the end of 2008 and the bank hired a new chief lending officer. Notwithstanding those changes in bank personnel, the December 2008 examination report stated that Board and management supervision was deficient and a significant contributor to the bank's poor financial condition. Further, the report stated that the poor condition of the bank preempted substantial improvement and, despite positive actions taken by the new management team, it could not effectively correct the bank's problems.

[8] In general, a credit memorandum describes the terms and conditions of the loan request and should serve as a basis for the loan approval.

Loan Policy

The DBF's 2006 examination report recommended that the bank's loan policy include credit memorandum guidelines. During the DBF's 2008 examination, as First Coweta was revising its loan policy, examiners noted additional areas that the policy needed to address, including:

- providing detailed definitions of the loan grades used by the bank;
- referencing the Allowance for Loan and Lease Losses (ALLL) methodology, including how it will be assessed, how often it will be calculated, and the frequency of the Board review; and
- outlining a process for external loan reviews.

Contraventions and Violations of Regulatory Requirements

First Coweta was also cited for being in contravention to, or in violation of, regulatory requirements—an indication of weak risk management practices. Specifically, the 2005 examination report identified two loans and the 2007 examination report identified seven loans that exceeded supervisory loan-to-value (LTV) limits that were not reported to the Board in contravention of Appendix A (*Interagency Guidelines for Real Estate Lending Policies)* to Part 365, *Real Estate Lending Standards*, of the FDIC Rules and Regulations. Appendix A states that institutions should establish their own internal LTV limits for real estate loans which should not exceed established supervisory limits. The guidelines also state, in part, that it may be appropriate in individual cases to originate or purchase loans with LTV in excess of the supervisory limits but that such loans should be identified in the institution's records and the aggregate amount reported to the Board at least quarterly.

Further, Appendix A stipulates that the aggregate amount of all loans in excess of the supervisory LTV limits should not exceed 100 percent of total capital and that all loans for commercial, agricultural, multi-family, or other non-1-4 family residential properties should not exceed 30 percent of total capital. In contravention of the guidelines, as of September 30, 2008, First Coweta's total loans in excess of supervisory limits equaled almost 101 percent of total capital and total non-1-to-4 family loans in excess of supervisory limits represented approximately 88 percent of total capital. In addition, the 2008 examination report cited First Coweta for being in contravention of the *Interagency Policy Statement on the Allowance for Loan and Lease Losses,* as discussed in the next section of this report.

Finally, in the 2008 examination report, First Coweta was also cited for three apparent violations of Part 323 of FDIC Rules and Regulations (*Appraisals*) related to (1) independence requirements of the appraiser, (2) the sufficiency of the support for one appraised value, and (3) the failure to include discounted cash flows in the appraisal of a commercial property.

Allowance for Loan and Lease Losses

According to guidance related to the *Interagency Policy Statement on the Allowance for Loan and Lease Losses*, the ALLL represents one of the most significant estimates in an institution's financial statements and regulatory reports. As a result, each institution has a responsibility for developing, maintaining, and documenting a comprehensive, systematic, and consistently applied process for determining the amounts of the ALLL. DBF's practice is to expect institutions in the de novo period to maintain an allowance of at least 1 percent of total loans outstanding and First Coweta did so using traditional allocation factors for problem loans. According to DBF examination guidance, the standard allowance is viewed as a regulatory floor and institutions are expected to develop a satisfactory ALLL methodology compliant with accounting standards[9] for the long-term needs of the bank. Accordingly, in order to comply with accounting standards, First Coweta was required by December 31, 2007 to maintain the ALLL at a level appropriate to cover estimated credit losses on individually evaluated loans deemed impaired, as well as estimated credit losses inherent in the remainder of the portfolio. The 2007 examination report outlined steps First Coweta needed to comply with the accounting standards and emphasized to management the importance of accurate internal loan ratings. The 2008 examination report, however, cited First Coweta for being in contravention of the *Interagency Policy Statement on the Allowance for Loan and Lease Losses* because of the bank's noncompliance with the accounting standards. Subsequent to the 2008 examination, management provided examiners with an amended ALLL methodology that was determined to appropriately reflect the risks in the loan portfolio and address the contravention cited in the 2008 examination report.

Reliance on Non-Core Funding

First Coweta used brokered deposits, Internet certificates of deposit, and Federal Home Loan Bank (FHLB) funds to supplement loan growth. As shown in the figure on the next page, First Coweta's net non-core funding dependence ratio[10] was consistently higher than its peer group from 2005 through 2008 but trended lower after December 2007. Generally, the lower the ratio, the less risk exposure there is for the bank, whereas higher ratios reflect a reliance on funding sources that may not be available in times of financial stress or adverse changes in market conditions. Further, First Coweta's net non-core ratios consistently exceeded the bank's policy parameters. The 2008 examination also noted that First Coweta needed to develop a better tool to monitor its liquidity position and more accurately forecast funding needs and recommended that management evaluate its liquidity action plan.

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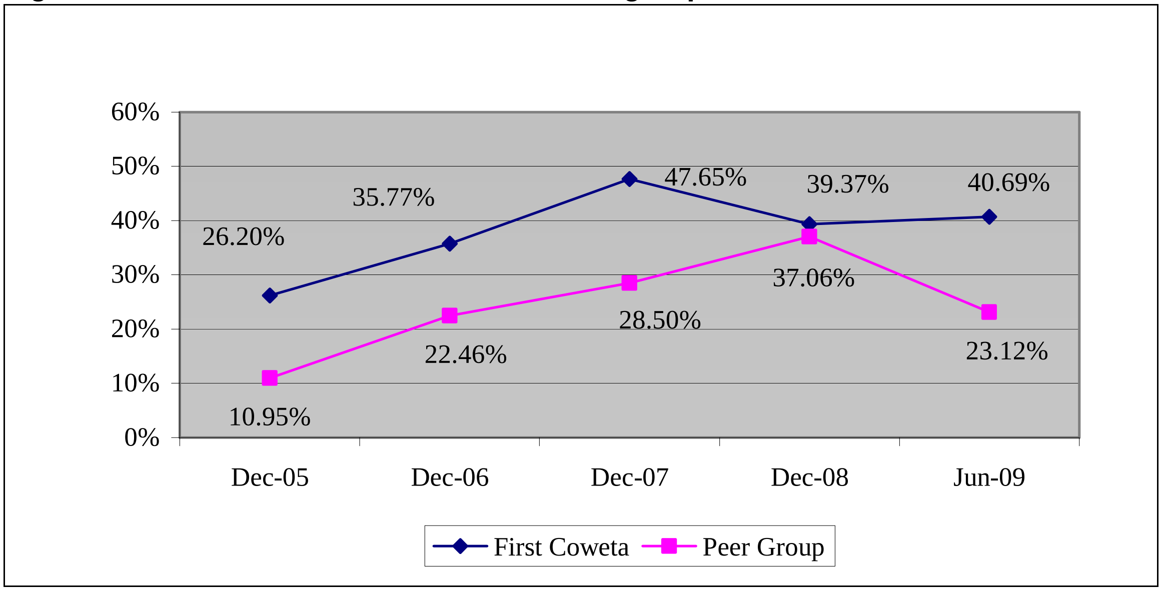
[9] Statement of Financial Accounting Standards (FAS) No. 5, *Accounting for Contingencies* and FAS No. 114, *Accounting by Creditors for Impairment of a Loan*.

[10] The net non-core funding dependence ratio is defined as non-core liabilities less short-term investments divided by long-term assets. Non-core liabilities include time deposits of $100,000 or more, brokered deposits, federal funds purchased, and other borrowed money.

Figure: First Coweta's Net Non-Core Funding Dependence Ratio



Source: UPBRs for First Coweta.

The FDIC's Supervision of First Coweta

Our review focused on FDIC and DBF supervisory oversight of First Coweta between 2005 and 2009. The first three examinations, conducted during First Coweta's de novo period, identified ADC concentrations and the need for the bank to enhance various underwriting and credit administration practices. During its de novo period, examiners generally concluded that First Coweta's overall financial condition was sound and management's performance and oversight was satisfactory. The FDIC's offsite monitoring program was used to monitor the bank's condition between the 2007 and 2008 examinations and prompted a joint visitation in late 2008 and the acceleration of the DBF's on-site examination. In 2008, examiners found the overall condition of the bank had significantly deteriorated because of a slowing economy and poor Board and management oversight. Formal supervisory action was taken in 2009; however, by the time that action became effective, the financial condition of the bank had become critically deficient.

Although the FDIC and the DBF closely monitored First Coweta, in retrospect, it may have been prudent for the FDIC to downgrade the management component and/or pursue supervisory action in 2007 considering the following risks that were apparent at the institution:

- significant growth during the de novo period;
- lack of adherence to business plan projections;
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Such an approach may have (1) been more effective in bringing about necessary risk mitigation by requiring more formal Board and management commitments to corrective actions and (2) resulted in increased supervisory oversight at a critical point in time. We recognize that rating determinations are a matter of judgment. Further, while it was possible for examiners to downgrade the management component, it may have been difficult for them to support a lower rating in 2007 based on weak practices because the bank's earnings and capital were considered to be satisfactory at that time.

In recognition of the risk factors present in First Coweta and in similarly troubled or failed institutions, the FDIC established broad supervisory expectations in 2006 and again in 2008 with regard to managing risk associated with CRE and ADC concentrations. In 2008 and 2009, the FDIC issued guidance related to liquidity management and use of volatile or special funding sources by financial institutions that are in a weakened condition, respectively. Additionally, in 2009, the FDIC extended the de novo period in recognition that unseasoned institutions may warrant stronger supervisory attention. The FDIC also recently established procedures to better communicate and follow up on risks and deficiencies identified during examinations.

Supervisory History

Between 2005 and 2009, the FDIC and the DBF conducted five on-site examinations of First Coweta as required[11] and monitored First Coweta's condition using various offsite monitoring tools. The FDIC conducted a visitation in January 2005[12] and a joint visitation was completed in 2008. Table 3 summarizes First Coweta's supervisory history from 2005 to 2008, including the supervisory actions taken.

[11] Section 337.12 of the FDIC Rules and Regulations, which implements section 10(d) of the FDI Act, requires annual full-scope, on-site examinations of every state nonmember bank at least once every 12-month period and allows for 18-month intervals for certain small institutions (total assets of less than $500 million) if certain conditions are satisfied. After its de novo period ended, First Coweta met the conditions for the 18-month examination cycle.

[12] In accordance with the FDIC's *Risk Management Manual of Examination Procedures,* a limited-scope examination (i.e., visitation) was conducted within the first 6 months of operation.

Table 3: Examinations and Visitations of First Coweta, 2005 to 2008

Start Date	As of Date	Agency	Supervisory Rating*	Supervisory Action
01/14/05	09/30/04	State	112323/2	N/A
1/18/05 Visitation	N/A	FDIC	N/A	N/A
07/19/05	03/31/05	FDIC	112222/2	N/A
08/28/06	06/30/06	State	122222/2	N/A
08/13/07	06/30/07	FDIC	232222/2	N/A
12/01/08 Joint Visitation	09/30/08	FDIC/State	454543/4	Visitation focused on largest ADC relationships.
12/01/08	09/30/08	State	554554/5	Issued Cease and Desist (C&D) order.

Source: Reports of Examination (ROE) and Joint Visitation Reports for First Coweta.
*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.

First Coweta consistently received composite "2" CAMELS ratings in its de novo period. Although the bank's de novo status ended July 12, 2007, Maximum Efficiency, Risk-focused, Institution Targeted (MERIT)[13] examination procedures were not used in the 2007 examination. Following the August 2007 examination, the bank met the conditions that allow for an 18-month examination cycle. Consequently, the next examination was scheduled to commence in the first quarter of 2009.

First Coweta was flagged for offsite review in September 30, 2007 and each subsequent quarter through September 30, 2008 based on bank-filed Call Report data. As part of its offsite monitoring process, the FDIC contacted the DBF and institution management to coordinate the supervisory strategy and gain an understanding of steps being taken by bank management to address recommendations made during the 2007 examination. The first quarter 2008 offsite review noted an increased volume of nonperforming loans, declining earnings, and an overall deterioration in First Coweta's financial condition. These findings prompted the joint visitation conducted in December 2008 and the DBF to accelerate its on-site examination by 3 months. Table 4 summarizes the results of the FDIC's offsite monitoring of First Coweta.

[13] In 2002, DSC implemented MERIT guidelines to assist examiners in risk-focusing examination procedures in institutions with lower risk profiles. Under this program, the loan penetration ratio range was guided by the asset quality rating at the last examination. In March 2008, DSC eliminated MERIT examination procedures.

Table 4: First Coweta's Offsite Monitoring, September 2007 to September 2008

Call Report Date	Offsite Review Completion Date	Level of Risk	Risk Trend	Action Taken
09/30/2007	01/08/2008	Medium	Stable	Contacted bank management to discuss actions taken in response to examination report.
12/31/2007	04/01/2008	Medium	Stable	Continued monitoring.
03/31/2008	06/30/2008	Medium	Increasing	Continued to closely monitor.
06/30/2008	09/30/2008	Medium	Increasing	Contacted bank to discuss liquidity. Coordinated with the DBF and scheduled visitation.
09/30/2008	01/05/2009	High	Increasing	Joint visitation.

Source: DSC's Virtual Supervisory Information on the Net (ViSION).

In 2008, examiners found that the overall condition of the bank had deteriorated significantly and assigned it a composite "4" CAMELS rating. The visitation report was transmitted to First Coweta on January 26, 2009, indicating that a C&D would be pursued. Among other things, the C&D, effective March 19, 2009, required the bank to:

- increase Board participation in the affairs of the bank;
- retain qualified management;
- develop a capital plan and adopt a plan to achieve and maintain its Tier 1 Capital at or above 8 percent of the bank's total assets and maintain minimum risk-based capital requirements for a *Well Capitalized* bank;
- charge off losses and 50 percent of doubtful loans;
- reduce concentrations of credit;
- reduce classified assets; and
- review liquidity and funds management and develop or revise, adopt, and implement a written liquidity contingency plan.

Despite efforts by the bank to address these issues, the condition of the bank continued to deteriorate.

Supervisory Concerns and Response Related to ADC Concentrations and Risk Management Practices

Each of the examination reports from 2005 through 2008 identified the bank's ADC concentrations and made recommendations to enhance monitoring of the concentrations as well as underwriting and credit administration practices. Further, First Coweta's growth exceeded business plan projections. For example, total assets in 2007 were approximately 85 percent higher than projections ($148 million versus $80 million). FDIC officials stated that de novo institutions often exceeded business plan projections but this was not considered a concern or a material deviation that required supervisory approval at the time.[14] DSC regional management indicated that growth of this magnitude would now be considered a material change.

As discussed earlier in the report, First Coweta's ADC concentrations consistently exceeded levels described in the 2006 Joint Guidance that may be identified for further supervisory analysis. In that regard, examiners made recommendations each year to enhance aspects of First Coweta's credit underwriting and credit administration practices. While asset quality and management were generally considered to be satisfactory in 2005 and 2006, the 2007 examination report found asset quality to be less than satisfactory due to the sharp increase in adverse classifications and weak monitoring practices. Specifically, credit administration deficiencies were found in approximately 15 percent of loans reviewed. Further, as stated earlier in this report, the softening of the 1-4 family residential real estate market had a negative effect on some of the classified assets. In addition, the 2007 examination report stated that management had not been proactive in immediately identifying problem credits, as evidenced by the increased level of adverse assets.

Despite the identified weaknesses, examiners found the overall performance of senior management and the Board to be satisfactory and rated the management component as a "2". A "2" rating indicates satisfactory management and board performance and risk management practices relative to the institution's size, complexity, and risk profile. Minor weaknesses may exist, but are not material to the safety and soundness of the institution and are being addressed. In retrospect, considering the institution's de novo status, significant ADC concentrations (424 percent of Tier 1 Capital as of June 2007), underwriting and credit administration weaknesses, and policy contravention citations, it may have been prudent for the FDIC to downgrade the management component to a "3" rating and/or pursue supervisory action in 2007. A "3" rating indicates that management and board performance need improvement or risk management practices are less than satisfactory given the nature of the institution's activities.

We recognize rating determinations are a matter of judgment. Further, while it was possible for examiners to downgrade the management component, it may have been difficult for them to support a "3" rating in 2007 based on weak practices because the bank's earnings and capital were considered to be satisfactory at that time. Going forward, however, downgrading the management component rating or taking supervisory action when there are weak risk management practices and risks, such as those at First Coweta, may better ensure that the Board and management are actively engaged in mitigating the risks.

Although a supervisory action was not taken in connection with the 2007 examination, the FDIC did perform offsite reviews to monitor actions taken by First Coweta to address the 2007 examination recommendations and improve its financial condition. Despite these efforts, the December 2008 joint visitation noted that management had not kept the Board

[14] In accordance with requirements in place at the time, FDIC and DBF officials reviewed and approved business plan changes related to First Coweta's use of Internet deposits and ability to perform remote deposit capture.

properly informed of the deteriorating conditions within the bank and the Board had not provided strong oversight of the lending function. In short, the Board and management failed to react to changing market conditions or curtail risks in the bank's ADC portfolio in a timely manner. Adversely classified loans at the visitation totaled $27.2 million classified as substandard and $1.9 million classified as loss, which equaled 201 percent of Tier 1 Capital and the ALLL. The depth and breadth of weaknesses noted in the visitations and concurrent DBF examination warranted the issuance of the March 2009 C&D discussed previously.

On January 26, 2010, the FDIC issued guidance that defines a standard approach for communicating matters requiring bank Board attention (e.g., examiner concerns and recommendations) in examination reports. The guidance also states that examination staff should request a response from the institution regarding the action that it will take to mitigate the risks identified during the examination and correct noted deficiencies. This approach provides examiners with another tool to hold the Board and management accountable for improved performance and should also facilitate and better ensure effective supervisory follow-up.

Supervisory Concerns and Response Related to ALLL

Examiner concerns related to First Coweta's ALLL methodology and level increased with the deterioration of the loan portfolio. According to the *Interagency Policy Statement on the Allowance for Loan and Lease Losses*, examiners should assess the credit quality of an institution's portfolio, the appropriateness of its ALLL methodology and documentation, and the appropriateness of the reported ALLL in the institution's regulatory reports. The 2005 examination report noted that the ALLL was adequate and that management should continue to monitor the reserve and make adjustments relative to loan growth and identified risk. The 2006 examination report noted that an additional provision expense was needed because of an adversely classified credit and to bring the ALLL to the level required by the bank policy. The 2007 examination report found that the ALLL methodology needed improvement. Moreover, the 2008 joint visitation and 2008 DBF examination indicated First Coweta's ALLL methodology did not comply with accounting standards and its ALLL reserve was inadequately funded and required an additional provision. Table 5 illustrates the significant growth in adversely classified assets as determined by the institution. Table 5 also illustrates the increase in ALLL examiners identified during the 2008 visitation/examination.

Table 5: First Coweta's Adversely Classified Assets and ALLL, 2005 to 2008

(Dollars in Thousands)						
	Examiner Adversely Classified Asset Amounts				ALLL Amounts	
Examination Date	Substandard	Doubtful	Loss	Total Adversely Classified Items	ALLL Computed by First Coweta Bank	Increase in ALLL Computed by Examiners
7/19/05	$0	$0	$0	$0	$340	$0
8/28/06	$0	$1,201	$0	$1,201	$919	$0
8/13/07	$8,767	$0	$39	$8,806	$1,463	$0
12/01/08	$43,437	$0	$2,307	$45,744	$3,197	$1,092*

Source: ROEs for First Coweta.
*Note: ALLL data for the 12/01/08 examination was based on 12/31/08 data.

Supervisory Concerns and Response Related to Non-Core Funding

During 2006, examiners noted that the bank's non-core dependency levels exceeded the bank's policy limits and recommended that the Board prudently consider the level of acceptable dependency on non-core funding and take actions to reduce the ratio. The 2007 examination report concluded that management provided adequate monitoring and control of the bank's liquidity, but that liquidity levels were tight due to asset growth and a competitive deposit market. The report recommended that management continue to closely monitor the bank's liquidity position. During the third quarter of 2008, liquidity levels were reported to be unsatisfactory and management was asked to submit weekly liquidity monitoring reports to regulators. As of September 30, 2008, brokered deposits accounted for 27 percent of total deposits. The Board approved a Liquidity Action Plan on November 25, 2008 to assist management in managing and monitoring liquidity levels. The 2008 visitation report also noted that management was working to eliminate the use of brokered deposits.

FDIC's Rules and Regulations Part 337, *Unsafe and Unsound Banking Practices,* states that any *Well Capitalized* insured depository institution may solicit and accept, renew, or roll over any brokered deposit without restriction. However, *Adequately Capitalized* institutions must receive a waiver from the FDIC before they can accept, renew, or roll over any brokered deposit. First Coweta fell below a *Well Capitalized* position at the end of 2008 and was unable to recapitalize the bank. Further, the C&D issued in 2009 prohibited the bank from accepting, renewing, or rolling over brokered deposits without obtaining a waiver from the FDIC. After the issuance of the C&D, First Coweta did not request a waiver and made no further purchases of brokered deposits.

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, *Capital Maintenance,* of the FDIC's Rules and

Regulations implements PCA requirements by establishing a framework for taking prompt corrective action against insured state-charted nonmember banks that are not *Adequately Capitalized*. In addition to including provisions in the C&D on minimum capital requirements, as discussed earlier in the report, the FDIC followed PCA guidance and appropriately notified the bank of its capital position and corresponding requirements, as follows:

- On February 9, 2009, the FDIC notified First Coweta that it was *Adequately Capitalized*, based on the December 31, 2008 Call Report capital ratios.
- On May 11, 2009, the FDIC notified First Coweta that it was *Significantly Undercapitalized* and was required to submit a capital restoration plan. First Coweta submitted a contingency capital plan on April 24, 2009 in response to the C&D.
- On July 20, 2009, the FDIC notified First Coweta that it was *Critically Undercapitalized*.

PCA's focus is on capital, which can be a lagging indicator of an institution's financial health. Although the FDIC followed PCA guidance, by the time First Coweta's capital levels fell below the required thresholds necessary to implement PCA, the bank's condition had deteriorated to the point at which the institution could not raise additional capital. First Coweta had submitted an application for the Troubled Asset Relief Program (TARP) on November 14, 2008 for funding of $4.2 million, however, subsequently withdrew its application on December 8, 2008. The bank was unsuccessful in raising capital from its directors and marketing the bank to external investors and was closed on August 21, 2009.

Corporation Comments

After we issued our draft report, management provided additional information for our consideration, and we revised our report to reflect this information, as appropriate. On March 5, 2010, the Director, DSC, provided a written response to the draft report. That response is provided in its entirety as Appendix 4 of this report. DSC reiterated the OIG's conclusions regarding the causes of First Coweta's failure. With regard to our assessment of the FDIC's supervision of First Coweta, DSC cited supervisory action taken in 2007 and 2008, discussed in our report, to address the bank's heightened risk profile and deteriorating financial condition due to its high concentrations in ADC lending. Further, DSC's response recognizes that strong supervisory attention is necessary for institutions, like First Coweta, with high ADC/CRE concentrations and volatile funding sources and, as also discussed in our report, has issued updated guidance reminding examiners to take appropriate action when those risks are imprudently managed.

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.

The objectives of this material loss review were to (1) determine the causes of First Coweta's failure and the resulting material loss to the DIF and (2) evaluate the FDIC's supervision of First Coweta, including the FDIC's implementation of the PCA provisions of section 38 of the FDI Act.

We conducted the audit from October 2009 to March 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Scope and Methodology

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

- Analyzed examination reports prepared by the FDIC and the DBF from 2005 to 2008.

- Analyzed available examination work papers prepared by the FDIC from 2007 to 2008.

- Reviewed the following:

    - Bank data contained in UBPRs and Call Reports.
    - Correspondence maintained at DSC's Atlanta Regional and Atlanta Field Offices.
    - Reports prepared by the Division of Resolutions and Receiverships (DRR) and First Coweta records maintained by DRR.
    - DSC's ViSION Modules, including Supervisory Tracking & Reporting.
    - Reports from the bank's internal auditors as of October 2006 and June 2007 and external auditors for the years ended 2006 and 2008.
    - Pertinent DSC policies and procedures.

Objectives, Scope, and Methodology

- Interviewed the following FDIC officials:

  - DSC regional management in Atlanta, Georgia.
  - DSC examiners in the Atlanta Field Office.

- Interviewed DBF officials from Atlanta, Georgia, to discuss their perspective of the institution, its examinations, and other activities regarding the DBF's supervision of the bank.

We performed our audit field work at the OIG offices in Arlington, Virginia.

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

Consistent with our audit objectives, we did not assess DSC's overall internal control or management control structure. We relied on information in DSC's systems, reports, ROEs, and interviews of DSC and DBF examiners to obtain an understanding of First Coweta's management controls pertaining to the causes of failure and material loss as discussed in the body of this report. Although we obtained information from various FDIC systems, we determined that the controls pertaining to these systems were not significant to the audit objectives and, therefore, did not evaluate the effectiveness of information system controls. We relied on 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 was not part of the audit objectives. DSC's compliance with the Results Act is reviewed in OIG program audits of DSC operations.

Regarding compliance with laws and regulations, we performed tests to determine whether the FDIC had complied with the 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 credit.
Call Report	The report filed by a bank pursuant to 12 United States Code (U.S.C.) 1817(a)(1), which requires each insured State nonmember bank and each foreign bank having an insured branch which is not a Federal branch to make to the Corporation reports of condition in a form that shall contain such information as the Board of Directors may require. These reports are used to calculate deposit insurance assessments and monitor the condition, performance, and risk profile of individual banks and the banking industry.
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.
De novo Bank	Prior to the issuance of FIL-50-2009 on August 28, 2009, and for the purposes of FDIC-supervised institutions, this term referred to an institution within its first 3 years of operation. FIL-50-2009 changed the de novo period for newly chartered FDIC-supervised institutions from 3 years to 7 years. Under the new de novo period, institutions must undergo a limited-scope examination within the first 6 months of operation, and a full-scope examination within the first 12 months of operation. Subsequent to the first examination, and through the 7th year of operation, institutions remain on a 12-month examination cycle. Extended examination intervals (i.e., 18-month intervals) do not apply during the de novo period.

Glossary of Terms

Federal Home Loan Bank (FHLB)	The Federal Home Loan Bank System provides liquidity to member institutions that hold mortgages in their portfolios and facilitates the financing of mortgages by making low-cost loans, called advances, to its members. Advances are available to members with a wide variety of terms to maturity, from overnight to long term, and are collateralized. Advances are designed to prevent any possible loss to FHLBs, which also have a super lien (a lien senior or superior to all current and future liens on a property or asset) when institutions fail. To protect their position, FHLBs have a claim on any of the additional eligible collateral in the failed bank. In addition, the FDIC has a regulation that reaffirms FHLB priority, and FHLBs can demand prepayment of advances when institutions fail.
Loan-to-Value	A ratio for a single loan and property calculated by dividing the total loan amount at origination by the market value of the property securing the credit plus any readily marketable collateral or other acceptable collateral.
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 (C.F.R.), section 325.101, et. seq., implements section 38, *Prompt Corrective Action*, of the FDI Act, 12 U.S.C. section 1831(o), 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.

Glossary of Terms

Tier 1 (Core) Capital	In general, this term is defined in Part 325 of the FDIC Rules and Regulations, 12 C.F.R. section 325.2(v), as **The sum of**: • Common stockholder's equity (common stock and related surplus, undivided profits, disclosed capital reserves, foreign currency translation adjustments, less net unrealized losses on available-for-sale securities with readily determinable market values); • Non-cumulative perpetual preferred stock; and • Minority interest in consolidated subsidiaries; **Minus:** • Certain intangible assets; • Identified losses; • Investments in securities subsidiaries subject to section 337.4; and • Deferred tax assets in excess of the limit set forth in section 325.5(g).
Troubled Asset Relief Program (TARP)	TARP is a program of the United States Department of the Treasury to purchase assets and equity from financial institutions to strengthen the financial sector.
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 report is produced by the Federal Financial Institutions Examination Council for the use of banking supervisors, bankers, and the general public and is produced quarterly from data reported in Reports of Condition and Income submitted by banks.

Acronyms

ADC	Acquisition, Development, and Construction
ALLL	Allowance for Loan and Lease Losses
C&D	Cease and Desist Order
CAMELS	**C**apital, **A**sset Quality, **M**anagement, **E**arnings, **L**iquidity, and **S**ensitivity to Market Risk
CRE	Commercial Real Estate
DBF	Department of Banking and Finance
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
LTV	Loan-to-Value
MERIT	Maximum Efficiency, Risk-focused, Institution Targeted
OIG	Office of Inspector General
PCA	Prompt Corrective Action
ROE	Report of Examination
TARP	Troubled Asset Relief Program
UBPR	Uniform Bank Performance Report
UFIRS	Uniform Financial Institutions Rating System
ViSION	Virtual Supervisory Information on the Net

FDIC
Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990 Division of Supervision and Consumer Protection

March 5, 2010

TO: Stephen Beard
Assistant Inspector General for Material Loss Reviews

/Signed/
FROM: Sandra L. Thompson
Director

SUBJECT: Draft Audit Report Entitled, Material Loss Review of First Coweta Bank, Newnan, Georgia (Assignment No. 2009-071)

Pursuant to Section 38(k) of the Federal Deposit Insurance Act, the Federal Deposit Insurance Corporation's Office of Inspector General (OIG) conducted a material loss review of First Coweta Bank, Newnan, Georgia (FCB) which failed on August 21, 2009. This memorandum is the response of the Division of Supervision and Consumer Protection (DSC) to the OIG's Draft Report (Report) received on February 24, 2010.

The Report concludes FCB failed due to the Board and management's aggressive pursuit of loan growth primarily funded with brokered deposits and large time deposits. FCB's management decision to concentrate the loan portfolio in acquisition, development, and construction (ADC) loans, its aggressive growth in residential ADC lending and participations, and its reliance on brokered and large deposits were the principal factors leading to FCB's deteriorating financial condition and failure. FCB's overall weak loan administration and the deterioration of the Atlanta metropolitan real estate market resulted in increased delinquencies and non-performing assets. FCB was unable to raise sufficient capital to absorb the loan losses, support its operations, and maintain liquidity.

As part of DSC's supervisory program from 2005 through August 2009, the FDIC and the Georgia Department of Banking and Finance (GDBF) jointly and separately conducted five full-scope examinations and two visitations. The FDIC also conducted offsite reviews and other offsite monitoring activities. At the August 2007 examination, examiners downgraded asset quality and noted a heightened risk due to high concentrations in ADC lending. FDIC immediately began offsite monitoring of the steps FCB management took to address recommendations contained in the 2007 report, including adding staff to address the credit administration and loan review issues. At the December 2008 GDBF examination and FDIC joint visitation, examiners found that FCB had further deteriorated to a level that raised significant regulatory concern and posed considerable risk, resulting in GDBF and FDIC implementing a formal enforcement action. FCB management was unable to correct the deficiencies, and FCB ultimately failed.

DSC recognizes that strong supervisory attention is necessary for institutions with high ADC/commercial real estate concentrations and volatile funding sources, such as FCB, and has issued updated guidance reminding examiners to take appropriate action when those risks are imprudently managed.

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