Office of Inspector General

Office of Material Loss Reviews
Report No. MLR-10-038

Material Loss Review of Benchmark Bank, Aurora, Illinois

June 2010

Office of Inspector General

Executive Summary

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Why We Did The Audit

On December 4, 2009, the Illinois Department of Financial and Professional Regulation (IDFPR) closed Benchmark Bank (Benchmark), Aurora, Illinois, and named the FDIC as receiver. On December 16, 2009, the FDIC notified the Office of Inspector General (OIG) that Benchmark's total assets at closing were $193 million and that the estimated loss to the Deposit Insurance Fund (DIF) was $63 million. As of April 30, 2010, the estimated loss to the DIF had increased to $72 million. As required by section 38(k) of the Federal Deposit Insurance (FDI) Act, the OIG conducted a material loss review of the failure.

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

Background

Benchmark was established in 1898 as Verona Exchange Bank, Verona, Illinois and became an insured state nonmember bank on January 1, 1934. The bank assumed its current name on July 6, 2000 and moved its headquarters to Aurora, Illinois. The bank was wholly-owned by Benchmark Bancorp, Aurora, Illinois, a one-bank holding company. The stock of the holding company was widely held. In addition to its main location, Benchmark operated four branches in St. Charles, Verona, Seneca, and Ransom, Illinois.

In 2000, Benchmark had nine members on its Board, eight of whom were newly elected. At that time, the Board shifted the bank's business strategy to emphasize commercial real estate (CRE), with a particular focus on residential acquisition, development, and construction (ADC) lending. Benchmark relied increasingly on Internet certificates of deposit (CDs), brokered deposits, and Federal Home Loan Bank borrowings to fund its loan growth. Benchmark had significant turnover in its senior management; most importantly, the bank had six changes in those individuals serving as president from 2004 to 2009 with three individuals serving as president in 2006.

Audit Results

Causes of Failure and Material Loss

Benchmark failed because its Board and management pursued a strategy focused on CRE and residential ADC lending and did not adequately manage the risks associated with the resulting CRE and ADC concentrations. Management increasingly relied on non-core funding to fund the CRE and ADC loan growth, especially brokered deposits and higher-cost Internet CDs. The risk management deficiencies, in conjunction with the decline in the Chicago area real estate market in 2007, led to significant losses in the loan portfolio, which depleted earnings and eroded capital. The Board was unsuccessful in its attempts to raise adequate capital to sustain the bank's operations, and the IDFPR closed Benchmark on December 4, 2009 due to lack of capital.

During the 2004-2009 timeframe, Benchmark was cited for various violations of law and contraventions of supervisory policy. A senior bank official, also a member of the Board, played a key role in the day-to-day operations of the bank, including the origination of Board-approved, high-dollar CRE and ADC loans, many of which were later adversely classified.

The FDIC's Supervision of Benchmark

The FDIC and the IDFPR conducted onsite risk management examinations of Benchmark consistent with requirements. In addition, the FDIC monitored the bank's condition through the use of various offsite monitoring mechanisms. Beginning as early as 2004, examiners consistently reported that Benchmark had a concentration in CRE and ADC lending. Examiners also included comments in examination reports regarding the importance of risk diversification. However, examiners did not formally recommend that bank management reduce concentrations or increase capital commensurate with the risks of the concentrations. Further, examiners noted that the bank continued to increase its reliance on volatile deposits for its funding base. From 2004 to 2007, examiners also identified concerns with the bank's credit administration and/or loan underwriting practices, but considered Benchmark's overall financial condition to be satisfactory. The financial impact of the weak practices and declining market became apparent at the 2008 examination, as evidenced by the dramatic increase in adversely classified assets.

Although the IDFPR and the FDIC downgraded Benchmark's ratings in 2008 and 2009 and pursued enforcement actions to correct identified problems, these supervisory actions, and Benchmark's efforts to address them, were not successful in preventing the bank's failure. The supervisory approach to Benchmark was consistent with prevailing practices at the time for a bank with Benchmark's risk profile. A lesson learned, however, is that earlier and more formal supervisory actions to mitigate the risk associated with CRE and ADC concentrations, increased reliance on non-core funding to support growth, and weak credit administration and loan underwriting practices, may have been warranted. Such actions could have included lowering key supervisory ratings in the 2004, 2007, and 2008 examinations; recommending formally that the Board diversify the bank's loan portfolio, or increase its capital levels commensurate with the concentration risks, and submit progress reports on the bank's diversification efforts to the FDIC and the IDFPR; and conducting visitations and/or increased offsite monitoring between regularly scheduled examinations.

With respect to issues discussed in this report, the FDIC recently implemented procedures to better ensure that examiner concerns and recommendations are appropriately tracked and addressed. The FDIC also implemented new procedures to expedite the issuance of formal Cease and Desist orders under certain circumstances. In regard to PCA, the FDIC properly implemented applicable provisions, including notifying Benchmark of its capital position and associated requirements in a timely manner and monitoring the bank's compliance with those requirements.

Management Response

In its response, DSC reiterated the OIG's conclusions regarding the causes of s failure and cited several supervisory activities, discussed in the report, that were undertaken to address risks at the institution prior to its failure. With regard to our assessment of the FDIC's supervision, DSC stated that strong supervisory attention is necessary for institutions with high CRE and ADC concentrations. In addition, DSC stated that its updated guidance re-emphasizes the importance of robust credit risk-management practices for institutions with concentrated CRE exposures and setting forth broad supervisory expectations. DSC also stated that examination procedures have been implemented to ensure that material issues and recommendations needing immediate consideration by the institution's Board are appropriately tracked and addressed.

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

Office of Material Loss Reviews
Office of Inspector General

DATE: June 15, 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 Benchmark Bank, Aurora, Illinois* (Report No. MLR-10-038)

As required by section 38(k) of the Federal Deposit Insurance (FDI) Act, the Office of Inspector General (OIG) conducted a material loss[1] review of the failure of Benchmark Bank (Benchmark), Aurora, Illinois. The Illinois Department of Financial and Professional Regulation (IDFPR) closed the institution on December 4, 2009, and named the FDIC as receiver. On December 16, 2009, the FDIC notified the OIG that Benchmark's total assets at closing were $193 million and that the estimated loss to the Deposit Insurance Fund (DIF) was $63 million. As of April 30, 2010, the estimated loss to the DIF had increased to $72 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 Benchmark's failure and the resulting material loss to the DIF and (2) evaluate the FDIC's supervision[2] of Benchmark, including the FDIC's implementation of the PCA provisions of section 38 of the FDI Act. This report presents our analysis of Benchmark's failure and the FDIC's efforts to ensure that the Board of Directors (Board) and management operated the institution in a safe and sound manner. The report does not contain formal recommendations. Instead, as major causes, trends, and common characteristics of institution failures are identified in our material loss reviews, we will

[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.

communicate those to FDIC 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.[3] Appendix 1 contains details on our objectives, scope, and methodology; Appendix 2 contains a glossary of terms; and Appendix 3 contains a list of acronyms. Appendix 4 presents the Corporation's comments on our report.

Background

Benchmark was established in 1898 as Verona Exchange Bank and became an insured state nonmember bank on January 1, 1934. The bank assumed its current name on July 6, 2000 and moved its headquarters to Aurora, Illinois. The bank was wholly-owned by Benchmark Bancorp, Aurora, Illinois, a one-bank holding company. The stock of the holding company was widely held. In addition to its main location, Benchmark operated four branches in St. Charles, Verona, Seneca, and Ransom, Illinois.

In 2000, Benchmark had nine members on its Board, eight of whom were newly elected. At this time, the Board shifted the bank's business strategy to emphasize commercial real estate (CRE), with a particular focus on residential acquisition, development, and construction (ADC) lending. Benchmark relied increasingly on Internet certificates of deposit (CDs), brokered deposits, and Federal Home Loan Bank borrowings to fund its loan growth. Benchmark had significant turnover in its senior management; most importantly, the bank had six changes in those individuals serving as president from 2004 to 2009 with three individuals serving as president in 2006.[4]

Table 1 provides details on Benchmark's financial condition as of September 30, 2009 and for the 5 preceding calendar years.

Table 1: Financial Condition of Benchmark, 2004 to 2009

Financial Measure ($000s)	Sep-09	Dec-08	Dec-07	Dec-06	Dec-05	Dec-04
Total Assets	173,062	216,318	221,145	187,521	153,106	160,188
Total Loans	128,241	160,124	171,120	141,743	112,971	124,549
Total Deposits	182,760	198,366	195,019	166,180	133,712	135,634
Brokered Deposits	18,247	26,238	15,909	8,806	462	0
Net Income (Loss)	-35,521	-7,372	917	867	1,624	1,730

Source: Uniform Bank Performance Reports (UBPR) for Benchmark.

[3] For example, in May 2010, the FDIC OIG's Office of Evaluations initiated a review of the role and federal regulators' use of the Prompt Regulatory Action provisions of the FDI Act (section 38, *PCA* and section 39, *Safety and Soundness Standards*) in the banking crisis.

[4] One individual held the president position for part of 2006 and 2007, left, and returned to the position in 2009.

Benchmark Bancorp provided capital to support the bank's growth, including a capital injection of $2 million in 2004. However, as capital ratios continued to decline because of large loan losses, Benchmark Bancorp was not able to provide additional support to the bank.

Causes of Failure and Material Loss

Benchmark failed because its Board and management pursued a strategy focused on CRE and ADC lending and did not adequately manage the risks associated with the resulting CRE and ADC concentrations. Management increasingly relied on non-core funding to fund the CRE and ADC loan growth, especially brokered deposits and higher-cost Internet CDs. The risk management deficiencies, in conjunction with the decline in the Chicago area real estate market in 2007, led to significant losses in the loan portfolio, which depleted earnings and eroded capital. The Board was unsuccessful in its attempts to raise adequate capital to sustain the bank's operations, and the IDFPR closed Benchmark on December 4, 2009 due to lack of capital.

A senior bank official, also a member of the Board, played a key role in the day-to-day operations of the bank, including the origination of Board-approved, high-dollar CRE and ADC loans, many of which were later adversely classified.

Board and Management Oversight

Benchmark's Board pursued growth and focused on CRE and ADC loans without establishing effective risk management practices commensurate with the risk level of the resulting concentrations. For example, from 2004 to 2009, Benchmark was cited in examination reports for deficient credit administration and/or loan underwriting practices, particularly regarding its loan policy.[4] Also indicative of the inadequate oversight was the extent to which the bank was cited for apparent violations and contraventions of policy. Specifically, from 2004 to 2009, Benchmark was cited for various violations of laws and contraventions of statements of policy related to lending limits, appraisals, and real estate lending standards. Further, the Board's and management's failure to pay close attention to controls negatively impacted the bank's ability to conduct insider activities in a safe and sound manner. In that regard, the bank was cited at five consecutive examinations for Regulation O violations pertaining to the extension of credit to directors, officers, or principal shareholders of an institution.[5]

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[4] The 2009 examination report was not issued in final prior to Benchmark's closing.

[5] Part 215 of the Federal Reserve Board's Regulation O was issued pursuant to Sections 22(g) and 22(h) of the Federal Reserve Act. It requires that extensions of credit to executive officers, directors, principal shareholders or their related interests be made on substantially the same terms and follow credit underwriting procedures that are not less stringent than those prevailing at the time for comparable transactions with persons not covered by the regulation. Aggregate lending limits and prior approval requirements are also imposed by Regulation O. Section 337.3 of the FDIC Rules and Regulations makes Regulation O applicable to state nonmember banks and sets forth requirements for approval of extensions of credit to insiders.

A senior bank official and Board member played a key role in the day-to-day operations of the bank, including the origination of high-dollar, Board-approved CRE and ADC loans, many of which were later adversely classified. Further, our review of the bank's Director Loan Committee meeting minutes from 2005 to 2009 indicated that this senior official received the Board's approval for numerous high-dollar, unsecured loans, some of which ranged from $1 million to over $2 million. The same senior official originated numerous secured and unsecured loans to Board members. Although the FDIC did not issue a final examination report for the 2009 examination, in a memorandum documenting the results of that examination, examiners noted: (1) the same senior official was involved in a number of "Questionable Insider Transactions" and (2) two of the bank's former Board members had loans totaling over $2 million classified as substandard and $1 million classified as loss.

Concentrations in CRE and ADC Loans

Benchmark's growth strategy led to concentrations in CRE and ADC lending, which ultimately caused the bank's failure. Benchmark experienced significant asset growth—increasing from over $19 million at year end 1999 to over $216 million in 2008. To fund the growth, Benchmark became increasingly reliant on non-core funding sources. For example, brokered deposits went from zero in 2004 to over $26 million in 2008.

The FDIC, the Office of the Comptroller of the Currency, and the Board of Governors of the Federal Reserve System, issued joint guidance in December 2006, entitled, *Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices* (Joint Guidance). Although the Joint Guidance does not establish specific CRE lending limits, it defines criteria to identify institutions potentially exposed to significant CRE concentration risk. According to the guidance, an institution that has experienced rapid growth in CRE lending, has notable exposure to a specific type of CRE, or is approaching or exceeds the following supervisory criteria may be identified for further supervisory analysis of the level and nature of its CRE concentration risk.

- Total reported loans for construction, land and development, and other land (i.e., ADC) representing 100 percent or more of total capital; or
- Total CRE loans representing 300 percent or more of total capital, where the outstanding balance of CRE has increased by 50 percent or more during the prior 36 months.

As shown in Table 2, Benchmark's concentrations in ADC loans consistently exceeded the criteria for identifying institutions that may warrant further supervisory analysis, once the Joint Guidance took effect in December 2006. In addition, ADC loans as a percent of the bank's total capital and total loans were significantly above Benchmark's peer group averages from 2006 to 2008. Benchmark's ADC loan portfolio increased from approximately $37 million at December 31, 2004 to nearly $66 million at December 31, 2007. We did note, however, that Benchmark management was reducing its ADC loan portfolio in latter years, to about $60 million at December 31, 2008 and approximately $36 million at September 30, 2009.

Table 2: Benchmark's ADC Concentrations Compared to Peer Group

Period Ended	ADC Loans as a Percent of Total Capital			ADC Loans as a Percent of Total Loans		
	Benchmark	Peer Group	Benchmark Percentile	Benchmark	Peer Group	Benchmark Percentile
Dec 2004	227	81	Not Available	30	11	N/A
Dec 2005	166	91	Not Available	26	13	N/A
Dec 2006	290	101	94	38	14	94
Dec 2007	327	107	95	39	15	94
Dec 2008	423	97	98	37	13	96
Sep 2009	-149*	79	N/A	28	11	95

Source: UBPR data for Benchmark.
*Percentage is negative because of negative capital.

Benchmark's CRE concentrations also exceeded the levels for institutions that may be identified for further supervisory analysis, as shown in Table 3. In addition, CRE loans as a percent of the bank's total capital ranked above the bank's peer group in 2007 and 2008 and total loans ranked above the bank's peer group averages from 2007 to 2009 – years in which the guidance was in effect. Benchmark's CRE loan portfolio peaked at $94.8 million as of December 31, 2007 and declined to $72.4 million as of September 30, 2009.

Table 3: Benchmark's CRE Concentrations Compared to Peer Group*

Period Ended	CRE Loans as a Percent of Total Capital			CRE Loans as a Percent of Total Loans		
	Benchmark	Peer Group	Benchmark Percentile	Benchmark	Peer Group	Benchmark Percentile
Dec 2004	376	323	Not Available	49	45	N/A
Dec 2005	304	332	Not Available	48	47	N/A
Dec 2006	424	335	68	56	48	63
Dec 2007	420	218	89	55	48	62
Dec 2008	580	215	98	57	47	68
Sep 2009	-246**	202	N/A	56	47	69

Source: UBPR data for Benchmark.
* For 2004-2006 the percentages for Benchmark and peers include owner-occupied CRE; for 2007-2009 the percentages for Benchmark and peer exclude owner-occupied CRE loans.
**Percentage is negative because of negative capital.

Inadequate risk management practices, coupled with the decline in the Chicago area real estate market in 2007, caused Benchmark's CRE and ADC loan portfolios to deteriorate. Specifically, at the 2004 examination, adversely classified assets increased from 8.51 percent of Tier 1 Capital plus the allowance for loan and lease losses (ALLL) to over 500 percent at the 2009 examination. The past due and nonaccrual loans also increased from 1.21 percent as a percentage of gross loans at the 2004 examination to over 33 percent at the 2009 examination.

Recognition of significant loan losses subsequently depleted earnings and eroded capital. The Board was unsuccessful in its attempts to raise the needed capital to sustain the

bank's operations, and the IDFPR closed Benchmark on December 4, 2009 due to lack of capital.

The FDIC's Supervision of Benchmark

The FDIC and the IDFPR conducted onsite examinations of Benchmark consistent with requirements.[6] In addition, the FDIC monitored the bank's condition through the use of various offsite monitoring mechanisms. Beginning as early as 2004, examiners consistently reported that Benchmark had CRE and ADC concentrations. Examiners also included comments in examination reports regarding the importance of risk diversification. However, examiners did not formally recommend that bank management reduce concentrations or increase capital commensurate with the risk associated with such concentrations.[7] Further, examiners noted that the bank continued to increase its reliance on volatile deposits for its funding base. In addition, from 2004 to 2007, examiners identified concerns with the bank's credit administration and/or loan underwriting practices, but considered the bank's overall financial condition satisfactory. The financial impact of the weak practices and declining market became apparent at the 2008 examination, as evidenced by the dramatic increase in adversely classified assets.

Although the IDFPR and the FDIC downgraded Benchmark's ratings in 2008 and 2009 and pursued enforcement actions to correct identified problems, these supervisory actions, and Benchmark's efforts to address them, were not successful in preventing the bank's failure. The supervisory approach to Benchmark was consistent with prevailing practices at the time for a bank with Benchmark's risk profile. A lesson learned, however, is that earlier and more formal supervisory action to mitigate the risk associated with CRE and ADC concentrations, increased reliance on non-core funding to support growth, and weak credit administration and loan underwriting practices may have been warranted. Such actions could have included (1) lowering key supervisory ratings[8] in the 2004, 2007, and 2008 examinations; (2) recommending formally that the Board diversify the bank's loan portfolio or increase its capital levels commensurate with the concentration risks and submit progress reports on the bank's diversification efforts to the FDIC and the IDFPR; and (3) conducting visitations and/or increased offsite monitoring between regularly scheduled examinations.

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[6] Section 337.12 of the FDIC Rules and Regulations, which implements section 10(d) of the FDI Act, requires annual full-scope, onsite 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. Benchmark met the conditions for the 18-month examination cycle.

[7] A formal recommendation requires a response from bank management and follow-up by examiners.

[8] 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.

With respect to issues discussed in this report, the FDIC recently implemented procedures to better ensure that examiner concerns and recommendations are appropriately tracked and addressed. The FDIC also implemented new procedures to expedite the issuance of formal Cease and Desist (C&D) orders under certain circumstances.

Supervisory History

From 2004 to 2009, the FDIC and the IDFPR conducted five examinations of Benchmark, alternating these examinations with the exception of the 2004 and 2009 examinations. In addition, prior to the final joint examination, the FDIC conducted a visitation in June 2009. The FDIC and the IDFPR also pursued enforcement actions, including a Bank Board Resolution (BBR) and a C&D. Table 4 summarizes key supervisory information for these examinations and one visitation.

Table 4: Onsite Examinations and Visitations of Benchmark, 2004 to 2009

Examination Start Date	Agency	Supervisory Ratings (UFIRS)	Contraventions and/or Violations*	Supervisory Action
1/12/04	Joint	222322/2	✓	None
07/25/05	IDFPR	112222/2	✓	None
01/29/07	FDIC	222222/2	✓	None
07/7/08	IDFPR	233322/3	✓	BBR***
06/15/09	FDIC Visitation	554545/5	Not Applicable**	Lowered composite rating and initiated the C&D process.***
08/10/09	Joint	555555/5	✓	C&D process continued.***

Source: The FDIC's Virtual Supervisory Information on the Net and Reports of Examination (ROEs) for Benchmark.
*Discussed earlier in the Cause of Failure Section.
**The scope of the visitation did not include reviewing the bank's compliance with laws and regulations.
***Informal enforcement actions often take the form of Bank Board Resolutions (BBR) or Memorandum of Understanding (MOU). Formal enforcement actions often take the form of C&D orders, but under severe circumstances can also take the form of insurance termination proceedings. The C&D became effective on October 25, 2009.

The FDIC's offsite monitoring procedures generally consisted of contacting the institution's management from time to time to discuss current and emerging business issues and using automated tools[9] to help identify potential supervisory concerns. The FDIC conducted offsite monitoring of Benchmark in 2008.

At the 2008 examination, examiners determined that the significant increase in adversely classified assets was excessively high and contained an unacceptable and objectionable

[9] The FDIC uses various offsite monitoring tools to help assess the financial condition of institutions. Two such tools are the Statistical CAMELS Offsite Rating (SCOR) system and the Growth Monitoring System (GMS). Both tools use statistical techniques and Call Report data to identify potential risks, such as institutions likely to receive a supervisory downgrade at the next examination or institutions experiencing rapid growth and/or a funding structure highly dependent on non-core funding sources.

degree of risk; accordingly, examiners downgraded the asset quality and management components and overall composite ratings each to a "3." As a result, the Board agreed to adopt a BBR on December 16, 2008, to address the concerns identified during the examination. Subsequently, Benchmark was flagged for offsite review in September and December 2008 because of the bank's asset quality deterioration and high probability of a composite downgrade. Although the bank's risk was considered medium and increasing, the FDIC did not contact bank management.

Based on the further decline in the bank's condition at the June 2009 FDIC visitation, the FDIC downgraded all CAMELS components to a "4" or a "5" and began pursuing a C&D for unsafe and unsound banking practices. While still pursuing the C&D, the FDIC and the IDFPR conducted a joint examination in August 2009 and found further deterioration in the bank's condition and assigned a "5" rating to all CAMELS components. Notwithstanding the C&D, which became effective on October 25, 2009, Benchmark failed less than 2 months later on December 4, 2009.

Ultimately, these supervisory actions, and Benchmark's efforts to address them, were not successful in preventing the bank's failure. Earlier and more formal supervisory action may have been prudent to mitigate the risk associated with the CRE and ADC concentrations, inadequate credit administration and loan underwriting practices, and increased reliance on non-core funding to support growth.

Supervisory Response to Key Risks

Historically, Benchmark was considered a well-performing institution and consistently received composite "2" supervisory ratings from 2004 to 2007. Examiners identified key risks and made recommendations to Benchmark's management to address certain ones at each examination. However, regulators did not require management to submit formal responses to the recommendations. As a result, examiners did not follow up to determine what actions the bank took to address the problems until the next regularly scheduled examination. In retrospect, more aggressive supervisory action at earlier examinations and additional offsite monitoring may have been prudent given the risks in Benchmark's loan portfolio, reliance on non-core funding, and managerial weaknesses.

January 2004 Examination

Examiners concluded that the bank's overall condition was satisfactory and assigned the bank a composite "2" rating, which indicated that only moderate weaknesses were present and well within the Board's and management's capabilities and willingness to correct. Given the concerns noted at the examination, however, the assigned management and capital component ratings of "2" did not reflect the increasing risks in the bank's loan portfolio or overall risk management practices that warranted greater

concern. Specifically:

- Earnings remained weak.[10]
- ADC concentrations represented 331 percent of Tier 1 Capital.
- Benchmark continued to rely on Internet CDs to support its growth.
- Enhancements were needed to the appraisal review and credit analysis processes.
- Previously noted concerns with the bank's audit program were not corrected and remained concerns.
- Lending violations were noted.

In addition, Benchmark remained *Adequately Capitalized* in 2004 for the third consecutive year. According to the UFIRS capital definition, the types and quantity of risk inherent in an institution's activities will determine the extent to which it may be necessary to maintain capital at levels above the required regulatory minimums to properly reflect the potentially adverse consequences that these risks may have on the institution's capital. Given the ADC concentrations and other risks at Benchmark at the time, an *Adequately Capitalized* capital position may not have been sufficient to withstand difficult market conditions.

Had the FDIC taken a more aggressive approach to the risks present at Benchmark and established a stronger supervisory tenor at this examination, some of these issues may not have been repeated at later examinations or their negative impact on the bank may have been reduced when the economy declined.

July 2005 Examination

Examiners reported that the bank's overall condition was satisfactory and noted improvements in the bank's earnings. The holding company's capital injection of $2 million in March 2004 had elevated the bank's capital position to *Well Capitalized*. Nevertheless, examiners again identified a continued concentration in CRE and ADC loans and included comments in the examination report regarding the importance of risk diversification. Examiners did make recommendations to improve the loan policy and cited a lending violation.

January 2007 Examination

Examiners reported that the bank's financial condition remained satisfactory and assigned it a composite rating of "2" and component ratings of "2" for asset quality and management. According to UFIRS definitions, a composite "2" rating means that an institution is fundamentally sound; a component "2" for asset quality indicates satisfactory asset quality and credit administration practices; and a component 2 for management indicates that management's and the Board's performance and risk management practices are also satisfactory.

[10] Benchmark's earnings component was rated either a "3" or a "4" from 1999 to 2004.

Given its increasing CRE and ADC concentrations, repeat findings related to credit administration practices (asset quality), continued violations of laws and regulations and contraventions of FDIC policy (management), and the above definitions, the composite, asset quality, and management ratings did not appear to reflect the increasing risks in the bank's loan portfolio. Such risks included:

- **Rapid Growth.** Since the 2005 examination, the bank's asset growth had gone from a negative 4.42 percent at year-end 2005 to approximately 12 percent at the end of the third quarter 2006, with increasing dependence on non-core funding. In that regard, brokered deposits increased from $462,000 at year-end 2005 to $8.7 million at the quarter ending September 30, 2006.[11]
- **Increasing CRE and ADC Loan Concentrations.** Since the 2005 examination, CRE concentration growth had changed from a negative 13 percent at year-end 2005 to a positive 14 percent at the quarter ending September 30, 2006. During the same period of time, ADC concentration growth had changed from a negative 22 percent to a positive 48 percent.
- **Capital Ratios.** Since the 2005 examination, the bank's capital ratios had changed from an overall upward trend at year-end 2005 to an overall declining trend at the quarter ending September 30, 2006.
- **Loan Policy.** The bank's loan policy needed significant enhancements commensurate with the bank's lending practices. Examiners made recommendations related to repayment analysis, unsecured lending guidelines, loan-to-value limits and monitoring, file documentation, appraisal guidelines, and collateral inspections.
- **ALLL.** Enhancements were needed in the ALLL to ensure compliance with Generally Accepted Accounting Principles (GAAP),[12] Financial Accounting Standard No. 5 *Accounting for Contingencies*, and No. 114 *Accounting by Creditors for Impairment of a Loan*.

Although the December 2006 CRE guidance had just been issued prior to this examination, examiners did not formally recommend that bank management diversify its loan portfolio and/or increase capital levels to mitigate the CRE and ADC concentration risks. Further, the FDIC did not require a response from Benchmark's Board in its transmittal letter of the January 2007 examination results to the bank. In retrospect, a stronger supervisory approach regarding examiner concerns, including (1) downgrading the bank's asset quality, management, and/or composite ratings; (2) requiring the bank to submit a response to the concerns identified; and (3) following up on examiner recommendations between examinations may have instilled more urgency in bank management to address operational deficiencies and the risks inherent in the loan portfolio.

[11] FDIC examiners used September 30, 2006 financial data for the January 29, 2007 examination.

[12] The policy provides key concepts and requirements pertaining to the ALLL included in GAAP and existing supervisory guidance. It describes the nature and purpose of the ALLL; the responsibilities of Boards, 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.

As part of its efforts to monitor institutions with CRE and ADC concentrations, the FDIC contacted Benchmark's management in June 2007 because of the risk associated with the bank's ADC loan concentration exceeding 100 percent of total capital. At that time, the Chairman, Chief Executive Officer, and President stated that given the slowdown in the residential real estate market, the bank planned to lower its volume of ADC lending as part of its conservative and selective CRE loan philosophy. The FDIC did not take any further action. Benchmark's ADC loan portfolio subsequently increased from $55 million at June 30, 2007 to nearly $66 million at year-end 2007.

July 2008 Examination

At the July 2008 IDFPR examination, examiners reported that the overall condition of the bank was less than satisfactory and noted a dramatic increase in adversely classified assets, from approximately 10 percent at the 2007 examination to approximately 55 percent. They reported that Board oversight and management were inadequate and earnings were insufficient to support operations and augment capital. Examiners also cited management for two violations and one contravention of statement of policy related to lending limits. Further, examiners stated that the lack of oversight and compliance with policy limits related to CRE concentrations was a concern.

Although examiners considered capital to be marginally adequate, the capital component was assigned a "2" rating. At that time, examiners noted management's desire to maintain a *Well Capitalized* position in order to continue to use brokered deposits as a funding source without regulatory restrictions. As a consequence, the bank increased its use of brokered deposits to over $26 million by year-end 2008.

The IDPFR examiners downgraded the asset quality, management, and earnings components, and the composite rating each to a "3," given the serious decline in the bank's condition, and began pursuing a BBR. Benchmark's Board adopted the BBR on December 16, 2008. The BBR required Benchmark's Board to:

- Submit a written plan to lessen the bank's risk position for each classified asset.
- Refrain from lending or extending additional credit to any delinquent borrower.
- Require complete loan documentation, realistic repayment terms, and current financial information adequate to support the outstanding indebtedness of each borrower.
- Establish acceptable CRE limits and reduce any exposures that are above these limits.
- Correct violations and assure future compliance with the respective laws, rules, and regulations.
- Provide quarterly progress reports to the FDIC and the IDFPR.
- Maintain a Tier 1 Leverage Capital Ratio of 7.5 percent and a Total Risk-Based Capital Ratio of 10 percent.
- Limit growth of average total assets to no more than 2 percent during each calendar quarter.

Despite the BBR, the bank's risk profile continued to increase after the examination. For example, the bank had:

- increased CRE and ADC concentrations as a result of declining capital;
- increased reliance on brokered deposits;
- negative net income; and
- declining capital, resulting in the bank being *Undercapitalized* as of December 2008.

According to the FDIC's *Formal and Informal Action Procedures Manual*, an MOU is generally the preferred informal action for institutions that (1) receive a composite "3" rating and (2) have deficiencies noted during the examination and a need for a more structured program or specific terms to effect corrective action. While FDIC officials believed that an MOU would have been more appropriate, they ultimately deferred to the IDFPR's pursuit of the BBR because it was not the FDIC's examination. In addition, further downgrades in key component ratings and the overall composite rating may have been warranted at this examination given that examiners (1) deemed Board and management performance inadequate, (2) reported deficient asset quality and credit administration practices, and (3) identified repeat issues not being satisfactorily addressed or resolved by the Board and management—all characteristics of a "4" rating in management and asset quality, and the composite rating. Had there been further downgrades and a formal action in the form of a C&D, management would have been required to take immediate and decisive action to correct the bank's serious deficiencies and been put on notice that such action was necessary to avoid a potential failure.

June 2009 Visitation and August 2009 Examination

Based on the FDIC's review of Benchmark's March 31, 2009 Call Report data indicating that Benchmark was *Undercapitalized,*[13] the FDIC conducted a visitation in June 2009. Examiners found that the bank's financial condition had further deteriorated since the 2008 IDFPR examination, with asset quality deemed critically deficient. Adversely classified assets and nonaccrual loans represented 295 percent and 176 percent of Tier 1 Capital plus the ALLL, respectively. Further, examiners stated that the bank's capital position had eroded to a critically deficient level and management's performance was unacceptable; consequently, examiners downgraded all CAMELS components to a "4" or a "5," and the FDIC began pursuing a C&D.

The FDIC and the IDFPR conducted a joint examination in August 2009 while the C&D process was being initiated. The examination found further deterioration in Benchmark's condition, with adversely classified assets representing 512 percent of Tier 1 Capital plus the ALLL and nonaccrual loans representing 33 percent of gross loans and leases. In addition, capital and earnings were critically deficient and threatened the bank's viability.

[13] As a result of the independent auditor's review of Benchmark in early 2009, the bank had to resubmit its Call Report data for December 31, 2008 to correctly state 2008 earnings, which resulted in lowering the bank's capital category to *Undercapitalized*.

Management's performance, and the bank's liquidity and funds management practices were also deemed to be critically deficient. Accordingly, examiners downgraded all CAMELS components to a "5."

By the time the C&D was finalized and effective in October 2009, the bank's failure was likely, absent a large capital infusion. Benchmark's management was unable to raise the needed capital or find a buyer for the bank, and ultimately, the IDFPR closed the institution for lack of capital.

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. Part 325 of the FDIC Rules and Regulations implements PCA requirements by establishing a framework for taking prompt corrective action against insured state-chartered nonmember banks that are not adequately capitalized. In addition to including provisions on minimum capital requirements in the C&D, the FDIC followed PCA guidance and appropriately notified the bank of its capital position and corresponding requirements, as follows:

- On March 1, 2004, the FDIC notified Benchmark that it was *Adequately Capitalized* based on the December 31, 2003 Call Report data and advised the bank of brokered deposit restrictions. The holding company injected $2 million in capital in March 2004, elevating the bank's capital position to *Well Capitalized*.

- On May 27, 2009, the FDIC notified Benchmark that it was *Undercapitalized* based on the March 31, 2009 Call Report data and the amended December 31, 2008 Call Report data, that were both filed on April 28, 2009 and advised the Board and management that the bank was subject to restrictions on asset growth, acquisitions, new activities, new branches, dividends, other capital distributions, and management fees. The FDIC also reminded the bank that, as of April 28, 2009, it had become subject to mandatory requirements of section 38, including the submission of a capital restoration plan that was due on July 11, 2009. Benchmark filed a capital plan on June 16, 2009. However, on August 12, 2009, the FDIC deemed Benchmark's PCA capital plan to be incomplete because it was too vague and requested more specific and timelier action regarding the time frame for acquiring new capital.

- On August 20, 2009, the FDIC notified Benchmark that it was *Significantly Undercapitalized* based on the June 30, 2009 Call Report data and advised the Board and management that on July 30, 2009, the bank had become subject to the mandatory requirements of section 38, including submission of a capital restoration plan and restrictions on asset growth, acquisitions, new activities, new branches, dividends, other capital distributions, and management fees. The FDIC required Benchmark's management to file a new written capital restoration plan by September 21, 2009; however, Benchmark did not do so.

- On September 25, 2009, the FDIC notified Benchmark that it was *Critically Undercapitalized* based on the results of the August 10, 2009 examination (which used June 30, 2009 financial information) and that, as of September 24, 2009, Benchmark was subject to the mandatory requirements of section 38, including submission of a capital restoration plan and restrictions on asset growth, acquisitions, new activities, new branches, payment of dividends, making other capital distributions, and paying management fees or senior executive compensation. The FDIC also informed the Board that the FDIC would be required to place Benchmark in receivership on December 23, 2009, unless it was determined that a different action would better carry out the purposes of section 38.

On October 29, 2008, Benchmark applied for funds under the Troubled Asset Relief Program (TARP).[14] Benchmark subsequently withdrew its application on April 9, 2009. On December 4, 2009, the IDFPR closed Benchmark due to its insolvency.

Supervisory Lessons Learned

According to the *DSC Risk Management Manual of Examination Policies* (Examination Manual), the quality of an institution's management, including its Board of Directors and executive officers, is perhaps the single most important element in the successful operation of a bank. The Board has overall responsibility and authority for formulating sound policies and objectives for the bank and for effectively supervising the institution's affairs. The Examination Manual further states that:

> …to effectively prevent serious problems in an institution, the conditions and circumstances that may lead to problems must be identified and corrected early. Corrective action should be taken immediately upon identifying excessive risk taking…when corrective action is not taken until conditions have deteriorated it is often too late to avoid failure. Moral suasion and informal agreements are normally sufficient where the unacceptable risk-taking is identified early, but formal action must be considered, even when an institution is rated 1 or 2, if circumstances warrant.

In hindsight, Benchmark's pursuit of growth centered in CRE and ADC lending may have warranted greater supervisory concern. As discussed earlier, the risks associated with the Board's growth and funding strategy and weak credit administration and loan underwriting practices became apparent at the 2008 and 2009 examinations as the economy declined. In that regard, earlier and stronger supervisory action at the 2004, 2007, and 2008 examinations may have been more effective in obtaining management's

[14]TARP was established under the Emergency Economic Stabilization Act of 2008. The Act established the Office of Financial Stability within the United States Department of the Treasury (Treasury). Under TARP, Treasury will purchase up to $250 billion of senior preferred shares from qualifying institutions as part of the Capital Purchase Program.

commitment and follow-through to address deficiencies identified by examiners and mitigate the associated risks. Such actions may have involved earlier component and composite rating downgrades, additional offsite monitoring, and an MOU or C&D instead of a BBR at the 2008 examination.

The FDIC has taken steps to increase supervisory attention to banks that have risk profiles similar to Benchmark. On January 26, 2010, the FDIC issued guidance to its examiners that defines procedures for better ensuring that examiner concerns and recommendations are appropriately tracked and addressed.[15] Specifically, the guidance defines a standard approach for communicating matters requiring 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 actions that it will take to mitigate the risks identified during the examination and correct noted deficiencies.

Finally, the FDIC recently completed a training initiative for its entire supervisory workforce that emphasizes the need to assess a bank's risk profile using forward-looking supervision. The training addressed the need for examiners to consider management practices as well as the financial institution's current financial performance or trends in assigning ratings as allowable under existing examination guidance.

Corporation Comments

We issued a draft of this report on May 17, 2010. DSC management subsequently provided us with additional information for our consideration. We made changes to our report based on this information, as appropriate. On June 14, 2010, the Director, DSC, provided a written response to the draft report dated June 11, 2010. The response is presented in its entirety as Appendix 4 of the report.

In its response, DSC reiterated the OIG's conclusions regarding the causes of s failure and cited several supervisory activities, discussed in the report, that were undertaken to address risks at the institution prior to its failure. With regard to our assessment of the FDIC's supervision, DSC stated that strong supervisory attention is necessary for institutions with high CRE and ADC concentrations. In addition, DSC stated that its updated guidance re-emphasizes the importance of robust credit risk-management practices for institutions with concentrated CRE exposures and setting forth broad supervisory expectations. DSC also stated that examination procedures have been implemented to ensure that material issues and recommendations needing immediate consideration by the institution's Board are appropriately tracked and addressed.

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[15] DSC Regional Directors Memorandum entitled, *Matters Requiring Board Attention* (Transmittal No. 2010-003).

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 the 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 this performance audit from March 2010 to May 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

The scope of this audit included an analysis of Benchmark's operations from 2004 until its failure on December 4, 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 reports prepared by FDIC and IDFPR examiners from 2004 to 2009.
- Reviewed the following:
  - Bank data contained in UBPRs.
  - Correspondence files from DSC's Chicago Regional and Chicago Field Offices.
  - Select examination workpapers related to loans, investments, and Board and management activities.
  - Reports prepared by the Division of Resolutions and Receiverships and DSC relating to the bank's closure.

Objectives, Scope, and Methodology

    - Pertinent DSC policies and procedures and various banking laws and regulations.

- DSC's ViSION Modules, including Supervisory Tracking & Reporting.

- Reports from the bank's external auditor.

We also interviewed FDIC examiners who participated in the various examinations of Benchmark and an FDIC Regional Office official responsible for supervisory oversight.

We performed the audit 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 the audit objectives, we did not assess DSC's overall internal control or management control structure. We relied on information in DSC systems, reports, ROEs, and interviews of examiners to understand Benchmark's management controls pertaining to causes of failure and material loss as discussed in the body of this report.

We obtained data from various FDIC 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 was 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)	The ALLL is an estimate of uncollectible amounts that is used to reduce the book value of loans and leases to the amount that is expected to be collected. It is established in recognition that some loans in the institution's overall loan and lease portfolio will not be repaid. Boards of directors are responsible for ensuring that their institutions have controls in place to consistently determine the allowance in accordance with the institutions' stated policies and procedures, generally accepted accounting principles, and supervisory guidance.
Bank Board Resolution (BBR)	A Bank Board Resolution is an informal commitment adopted by a financial institution's Board of Directors (often at the request of the FDIC) directing the institution's personnel to take corrective action regarding specific noted deficiencies. A BBR may also be used as a tool to strengthen and monitor the institution's progress with regard to a particular component rating or activity.
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.
Memorandum of Understanding (MOU)	An informal corrective administrative action for institutions considered to be of supervisory concern but which have not deteriorated to the point where they warrant formal administrative action. As a general rule, this action is to be considered for all institutions rated a composite "3."

Glossary of Terms

Term	Definition
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 Deposit Insurance Fund. 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 1831(o), by establishing a framework for determining capital adequacy and taking supervisory actions against depository institutions that are in an unsafe or unsound condition. 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 or compliance with the PCA statute with respect to an institution that falls within any of the three categories of undercapitalized institutions.
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 financial subsidiaries subject to section 12 C.F.R. part 362; 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
BBR	Bank Board Resolution
C&D	Cease and Desist Order
CAMELS	**C**apital, **A**sset Quality, **M**anagement, **E**arnings, **L**iquidity, and **S**ensitivity to Market Risk
CD	Certificate of Deposit
CRE	Commercial Real Estate
DIF	Deposit Insurance Fund
DSC	Division of Supervision and Consumer Protection
FDI	Federal Deposit Insurance
FIL	Financial Institution Letter
GAAP	Generally Accepted Accounting Principles
GMS	Growth Monitoring System
IDFPR	Illinois Department of Financial and Professional Regulation
MOU	Memorandum of Understanding
OIG	Office of Inspector General
PCA	Prompt Corrective Action
ROE	Report of Examination
SCOR	Statistical CAMELS Offsite Rating
TARP	Troubled Asset Relief Program
UBPR	Uniform Bank Performance Report
UFIRS	Uniform Financial Institutions Rating System
ViSION	Virtual Supervisory Information on the Net

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

June 11, 2010

TO: Stephen Beard
Assistant Inspector General for Material Loss Reviews

/**Signed**/
FROM: Sandra L. Thompson
Director

SUBJECT: FDIC Response to the Draft Audit Report Entitled, Material Loss Review of Benchmark Bank, Aurora, Illinois (Assignment No. 2010-029)

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 Benchmark Bank (Benchmark), Aurora, Illinois, which failed on December 4, 2009. This memorandum is the response of the Division of Supervision and Consumer Protection (DSC) to the OIG's Draft Report (Report) received on May 17, 2010.

Benchmark failed because the Board of Directors and management pursued a growth strategy focused on commercial real estate (CRE) and acquisition, development, and construction (ADC) lending without establishing adequate risk management policies and practices. These weak risk management practices, in conjunction with the CRE/ADC concentrations, left Benchmark vulnerable to the sudden decline in the Chicago area real estate market. Significant losses in the loan portfolio ultimately depleted earnings and eroded capital.

The FDIC, in coordination with the Illinois Department of Financial and Professional Regulation (IDFPR), jointly and separately conducted five full-scope examinations, one visitation, and two offsite reviews from 2004 through 2009. The Report acknowledges that as early as 2004, examiners identified key risks including Benchmark's CRE/ADC concentrations as well as weak underwriting and credit administration practices. The IDFPR and the FDIC downgraded Benchmark's ratings in 2008 and 2009 and pursued informal and subsequent formal enforcement actions to correct identified problems.

DSC recognizes that strong supervisory attention is necessary for institutions with high CRE and ADC concentrations. DSC has updated guidance re-emphasizing the importance of robust credit risk management practices for institutions with concentrated CRE exposures and setting forth broad supervisory expectations. In addition, examination procedures have been implemented to ensure that material issues and recommendations needing immediate consideration by the institution's Board of Directors are appropriately tracked and addressed.

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