Office of Inspector General

Office of Material Loss Reviews
Report No. MLR-10-017

Material Loss Review of First Piedmont Bank, Winder, Georgia

February 2010

Office of Inspector General

Executive Summary

Material Loss Review of First Piedmont Bank, Winder, Georgia

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Why We Did The Audit

The FDIC Office of Inspector General (OIG) contracted with KPMG LLP (KPMG) to conduct a material loss review of First Piedmont Bank (FPB), Winder, Georgia.

On July 17, 2009, the Georgia Department of Banking and Finance (DBF) closed FPB and named the FDIC as receiver. On August 12, 2009, the FDIC notified the OIG that FPB's total assets at closing were $115.1 million and the estimated loss to the Deposit Insurance Fund (DIF) was $29.4 million. As of December 31, 2009, the estimated loss had increased to $32.2 million. The OIG was required by section 38(k) of the Federal Deposit Insurance (FDI) Act to conduct a material loss review of the failure of FPB, and retained KPMG for this purpose.

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

Background

FPB was chartered as a state nonmember bank on April 15, 1998. The bank's operations were centered in the northeastern quadrant of the Atlanta metropolitan area, with three offices in the Georgia counties of Barrow and Walton. FPB had no holding company, subsidiaries, or affiliates.

FPB's assets were concentrated in residential and commercial acquisition, development and construction (ADC) loans. The majority of the bank's ADC exposure consisted of residential developments. Funding sources consisted primarily of time deposits, and FPB had less than a 6-percent share of the deposit market in the combined two-county area.

Audit Results

Causes of Failure and Material Loss

FPB's failure can be attributed to a high ADC loan concentration, weaknesses in loan underwriting and credit administration practices, and poor management and Board of Directors (Board) oversight. In the final FDIC Report of Examination, dated November 4, 2008, examiners noted that management's policies, procedures and risk mitigation efforts did not effectively address the changing market conditions and that management had failed to adequately address concerns and risks that examiners identified at the prior examination. The examination report further indicated that ineffective limits on the ADC loan concentration, coupled with underwriting weaknesses, unnecessarily exposed the bank to unacceptable levels of risk associated with market fluctuations in the regional Atlanta housing industry, which had experienced a sharp downturn. The extent of problem loans in the ADC portfolio led to the deterioration of the bank's asset quality and increased Other Real Estate (ORE) levels which, in conjunction with other operating losses, eliminated earnings, eroded capital, and threatened the viability of FPB.

The FDIC's Supervision of FPB

Through its supervisory efforts, the FDIC identified risks in FPB's operations and brought these risks to the attention of the institution's Board and management through regular discussions and correspondence, examination reports, a visitation, and informal and formal supervisory actions. Key areas of risk identified by examiners included ADC loan concentrations, loan underwriting, and credit administration functions. As reflected in the bank's safety and soundness examination ratings, FPB was considered to be fundamentally sound until the December 2007 examination.

The Board's decision to pursue rapid asset growth in ADC lending created a strategic risk that FPB had a responsibility to properly monitor and control. Onsite examinations and offsite reviews identified the increasing ADC concentration and appropriately identified weaknesses; however, the ultimate impact of management's inability to manage and monitor its ADC loan concentration was not fully exposed until the local real estate market slowed. Further, the inherent risks represented by the ADC lending concentration and the consequent vulnerability of the bank to an economic downturn, particularly in the local real estate market, were not reflected in the financial ratios and other metrics used by the examiners. Therefore, taking into consideration that institutions with high ADC loan concentrations are especially vulnerable to economic downturns, earlier and greater supervisory attention to the risks associated with FPB's aggressive growth may have been prudent.

Based on the supervisory actions taken, the FDIC properly implemented applicable PCA provisions of section 38. However, capital levels turned out to be a lagging indicator of the institution's financial well-being. Other factors, including earnings, asset quality, and management, identified and addressed in earlier examinations, were better indicators that the bank's viability was in question.

Management Response

After we issued our draft report, we met with management officials to further discuss our results. Management provided additional information for our consideration, and we revised our report to reflect this information, as appropriate. On February 12, 2010, the Director, Division of Supervision and Consumer Protection (DSC), provided a written response to the draft report. That response is provided in its entirety on page II-2 of this report.

DSC reiterated the OIG's conclusions regarding the causes of FPB's failure and the FDIC's supervision of the bank. DSC stated that it issued *Interagency Guidance on CRE Monitoring* in 2006 and a Financial Institution Letter to banks on *Managing Commercial Real Estate Concentrations in a Challenging Environment* in 2008 that re-emphasized the importance of robust credit risk-management practices for institutions with concentrated CRE exposures and set forth broad supervisory expectations.

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

Office of Material Loss Reviews
Office of Inspector General

DATE: February 12, 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 Piedmont Bank, Winder, Georgia*
(Report No. MLR-10-017)

The subject final report is provided for your information and use. Please refer to the Executive Summary, included in the report, for the overall audit results. The report did not contain recommendations, thus a response was not required. However, the Division of Supervision and Consumer Protection provided a written response on February 12, 2010. We incorporated the information into Part II of the final report.

If you have questions concerning the report, please contact me at (703) 562-6352 or Mike Lombardi, Audit Manager, at (703) 562-6328. We appreciate the courtesies extended to the audit staff.

Attachment

cc: Doreen R. Eberley, Acting Regional Director, DSC
Christopher E. Drown, Chief, Office of Internal Control and Review, DSC
James H. Angel, Jr., Director, OERM

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Part I

Report by KPMG LLP

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Prepared for the
Federal Deposit Insurance Corporation
Office of Inspector General

KPMG LLP
2001 M Street, NW
Washington, DC

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KPMG LLP

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February 12, 2010

EXECUTIVE SUMARY

Stephen M. Beard
Assistant Inspector General for Material Loss Reviews
Federal Deposit Insurance Corporation
3501 North Fairfax Drive
Arlington, VA 22226

RE: Transmittal of Results for the Material Loss Review Report for First Piedmont Bank, Winder, Georgia

Dear Mr. Beard:

This letter is to acknowledge delivery of our performance audit report on the results of the Material Loss Review for First Piedmont Bank (FPB), Winder, Georgia, in accordance with Task Assignment Number 09-10, dated August 22, 2009. The objectives of this performance audit were to (1) determine the causes of FPB's failure and the resulting material loss to the Deposit Insurance Fund (DIF) and (2) evaluate the FDIC's supervision of FPB, including the FDIC's implementation of the Prompt Corrective Action (PCA) provisions of section 38.

Causes of Failure

FPB's failure can be attributed to high Acquisition, Development and Construction (ADC) loan concentrations, weaknesses in loan underwriting and credit administration practices, and poor management and Board of Directors (Board) oversight. The Board's decision to pursue rapid asset growth in ADC lending created a strategic risk that FPB had a responsibility to properly monitor and control. However, ineffective limits on the ADC concentration, coupled with underwriting weaknesses and a failure to adequately address examiners' concerns, exposed the bank to unacceptable levels of risk associated with market fluctuations in the regional Atlanta housing industry, which started experiencing a downturn in 2007. The level of problem loans in the ADC-concentrated loan portfolio was responsible for the deterioration of the bank's asset quality, which by 2008 eliminated earnings and rapidly eroded capital.

Evaluation of Supervision

Through its supervisory efforts, the FDIC identified key risks in FPB's management practices and operations and brought these risks to the attention of the institution's Board and management team through regular discussions and correspondence, examination reports, a visitation, and informal and formal supervisory actions. Regulators conducted one visitation in June 2008, and 10 on-site examinations beginning in 1998.

From 1998 through 2006, FPB's Risk Management composite rating fluctuated between a "1" and a "2", and the institution's safety and soundness was regarded as satisfactory by examiners. However, the ultimate impact of management's inability to manage and monitor its ADC concentration was not fully exposed until the local real estate market slowed. Taking into consideration that institutions with high ADC concentrations are especially vulnerable to economic downturns, earlier and greater supervisory attention to FPB's lending practices and the risks associated with the bank's growth strategy may have been prudent.

Prompt Corrective Action

The FDIC followed PCA guidance, but this had little or no impact on minimizing the loss to the DIF. Capital levels turned out to be a lagging indicator of the institution's financial condition. When FPB entered into a Memorandum of Understanding that required increased capital to mitigate loan losses, the bank was still considered *Well Capitalized* for PCA purposes. By the time a PCA Capital Directive was issued, FPB was at serious risk of failure.

We conducted our performance audit in accordance with Generally Accepted Government Auditing Standards (GAGAS). Those standards require that we plan and perform the performance 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.

The information included in this draft report was obtained during our fieldwork, which occurred during the period from September 22, 2009 through January 8, 2010.

Very truly yours,

KPMG LLP

Background

On July 17, 2009, the Georgia Department of Banking and Finance (DBF) closed First Piedmont Bank (FPB) and named the FDIC as receiver. On August 12, 2009, the FDIC notified the Office of Inspector General (OIG) that FPB's total assets at closing were $115.1 million and the estimated loss to the Deposit Insurance Fund (DIF) was $29.4 million. The OIG was required by section 38(k) of the Federal Deposit Insurance (FDI) Act to conduct a material loss review of the failure of FPB, and retained KPMG for this purpose.[1]

FPB was chartered as a state nonmember bank on April 15, 1998. FPB's operations were centered in the northeastern quadrant of the Atlanta metropolitan area. Its main office was located in Winder, Barrow County, Georgia. As of June 30, 2008, the bank operated three offices in the Georgia counties of Barrow and Walton. Approximately 90 percent of the institution's total deposits were concentrated in the main office. All offices operated in competitive deposit markets and FPB had less than a 6 percent share of the deposit market in the combined two-county area. FPB had no holding company, subsidiaries, or affiliates.

FPB's assets were concentrated in residential and commercial Acquisition, Development and Construction (ADC) loans. The majority of the bank's ADC exposure consisted of residential developments. The institution's loan portfolio did not contain any subprime loans or non-traditional mortgage products. Funding sources consisted primarily of time deposits.

Table 1 provides details on FPB's financial condition as of December 2008, and for the three preceding calendar years.

Table 1: Financial Information for FPB

	Dec-08	Dec-07	Dec-06	Dec-05
Total Assets ($000s)	$122,806	$129,427	$113,875	$87,814
Total Loans ($000s)	$83,618	$105,016	$91,975	$72,514
Total Deposits ($000s)	$114,203	$114,777	$97,290	$74,832
Net Income (Loss) ($000s)	($6,228)	$44	$1,387	$1,143

Source: Uniform Bank Performance Report (UBPR) for FPB, December 31, 2008.

[1] In conducting this performance audit and preparing this report, KPMG relied primarily on information provided by the FDIC OIG and Division of Supervision and Consumer Protection (DSC). Appendix 1, Objectives, Scope, and Methodology, describes in greater detail the procedures used by KPMG.

Causes of Failure and Material Loss

FPB's failure can be attributed to a high ADC loan concentration, weaknesses in loan underwriting and credit administration practices, and poor management and Board of Directors (Board) oversight. In the final FDIC Report of Examination (ROE), dated November 4, 2008, examiners noted that management's policies, procedures and risk mitigation efforts did not effectively address the changing market conditions and that management had failed to adequately address concerns and risks identified by examiners at the prior examination. The examination report further indicated that ineffective limits on the ADC concentrations, coupled with underwriting weaknesses, unnecessarily exposed the bank to unacceptable levels of risk associated with market fluctuations in the regional Atlanta housing industry, which had experienced a sharp downturn. The level of problem loans in the ADC portfolio was responsible for the deterioration of the bank's asset quality and increased Other Real Estate (ORE) levels which, in conjunction with other operating losses, had eliminated earnings, eroded capital, and threatened the viability of FPB.

Concentration in ADC Lending

Early in FPB's history, asset concentration centered in ADC lending was identified by examiners. In the October 1998 and November 1999 examinations, the bank's ADC concentration as a percent of Tier 1 Capital plus the Allowance for Loan and Lease Losses (ALLL) was 73 percent and 152 percent, respectively. In the years that followed, FPB continued to maintain a concentration in real estate development loans that were primarily residential. As of March 31, 2001, these loans as a percent of Tier 1 Capital plus the ALLL represented 149 percent of funded commitments and 216 percent of total commitments.[2] The April 2001 examination indicated that speculative construction loans continued to comprise a major portion (44 percent) of the ADC portfolio. The report stated that management should consider more conservative limitations on ADC loans as well as limitations by types of loans, such as commercial or residential development, commercial or residential construction, and commercial or residential speculative construction.

By the July 2003 examination, the bank's ADC concentration represented 239 percent of Tier 1 Capital plus the ALLL. Figure 1 summarizes FPB's ADC concentrations in comparison to its peer group[3] from 2004 to 2008. As illustrated, FPB's volume of ADC loans as a percentage of total capital increased each year from 2005 to 2008, and each year was at least three times the percentage of its peer group.

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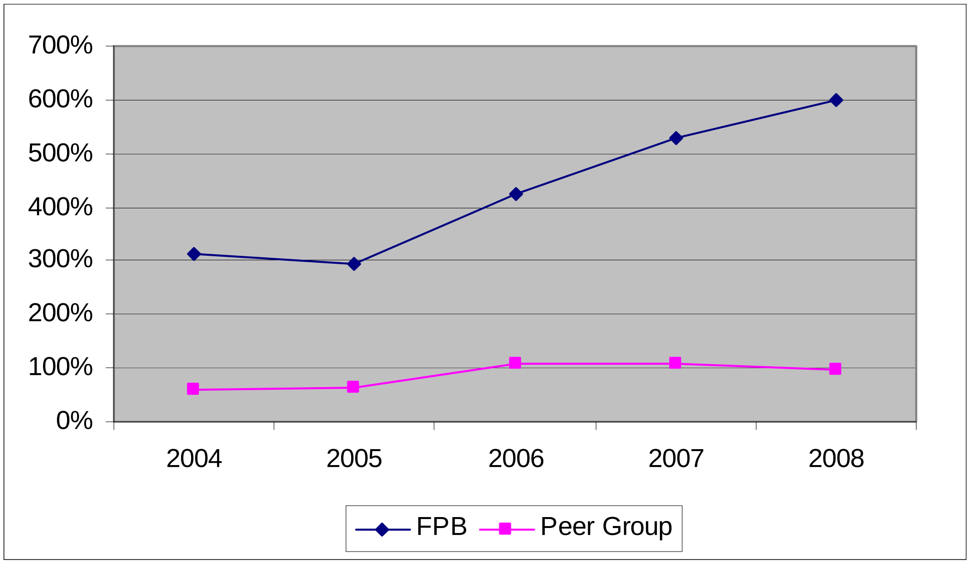
[2] Report of Examination, April 16, 2001.
[3] The peer group for FPB is made up of all insured commercial banks having assets between $100 million and $300 million in a metropolitan area that has three or more full service offices.

Figure 1: ADC Loans as a Percentage of Total Capital Compared to Peer Group



Source: UBPR for FPB, December 31, 2008.

The January 2005 State examination noted that the total funded balance of loans extended for ADC lending represented 357 percent of Tier 1 Capital plus the ALLL as of November 30, 2004. Total committed ADC loans equaled 507 percent of Tier 1 Capital plus the ALLL. The July 2006 examination reported that the ADC loan concentration was monitored adequately, and that it represented approximately 396 percent of Tier 1 Capital plus the ALLL as of June 30, 2006. Overall demand for real estate was high in the Atlanta housing market at that time, and ADC lending in the region grew accordingly.[4] As discussed in Financial Institution Letter (FIL) 104-2006 issued December 12, 2006, titled, *Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices* (Interagency Guidelines), rising Commercial Real Estate (CRE) concentrations could expose institutions to unanticipated earnings and capital volatility in the event of adverse changes in the general CRE market. The December 2006 guidance states that institutions potentially exposed to significant CRE concentration risk include those with ADC representing 100 percent or more of total capital. Due to the risks associated with CRE and ADC lending, regulators consider institutions with significant CRE and ADC concentrations to be of greater supervisory concern.

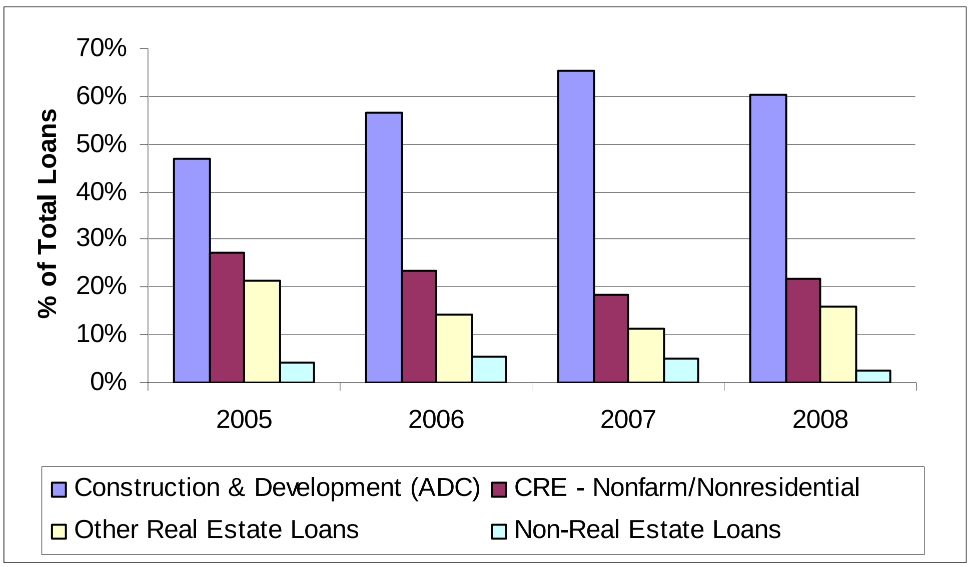
Until 2007, there was a high demand for ADC lending in the Atlanta area as a result of the growing population and robust economy.[5] However, by mid-2007, the Atlanta real estate market was beginning to show signs of deterioration. These conditions were exacerbated by the collapse of the national subprime markets.[6] CRE portfolios for residential construction and development in the Atlanta area experienced an increase in past due rates from 0.78 percent at the end of 2006 to 3.31 percent by December 31, 2007.[7] The December 2007 State examination noted that the bank's concentration in

[4] Atlanta Business Chronicle, "Banks at Risk", April 6, 2006.
[5] Interview with officials of the DBF.
[6] Supervisory History Memorandum, January 2009.
[7] Atlanta Regional Risk Committee Summary Report, March 21, 2008.

ADC lending had increased to 773 percent as of November 2007. While the concentration level in ADC lending was within the Board's policy limits of 800 percent of capital for total committed balances, the level was considered excessive as measured against reasonable industry standards, particularly the December 2006 Interagency Guidelines. The examination concluded that the Board and management had pursued an industry concentration in ADC lending without fully mitigating the risk.

At the end of 2007, approximately 95 percent of FPB's loan portfolio was in real estate. The loan portfolio included significant concentrations of ADC and CRE loans. Figure 2 summarizes FPB's distribution of total loans as of December 2008, and for the three preceding calendar years.

Figure 2: Summary of FPB's Loan Mix



Source: UBPR for FPB, December 31, 2008.

The December 2007 State examination indicated that the bank's asset quality was deficient. The downturn in the residential real estate market resulted in FPB's classified assets reaching critical levels at 153 percent of Tier 1 Capital plus the ALLL. A June 2008 visitation revealed that management had not taken the actions promised at the previous State examination to address asset quality concerns. The economy continued to deteriorate in 2008 given the significant excess of undeveloped home lots in the metropolitan Atlanta area and sluggish home sales. As a result, real estate development loans soured as builders were unable to repay them.[8]

As of September 30, 2008, funded ADC loans represented 582 percent of Tier 1 Capital plus the ALLL. Total commitments represented 740 percent of Tier 1 Capital plus the ALLL. The November 2008 examination determined that asset quality was critically deficient and that problems were centered in ADC loans. The ROE indicated that ineffective limits on the ADC concentration, coupled with underwriting weaknesses,

[8] Atlanta Business Chronicle, "Housing skips spring thaw", June 12, 2008.

exposed the bank to high levels of risk associated with market fluctuations in the local housing industry. The level of problem loans in the ADC portfolio was responsible for the deterioration of the bank's asset quality and increased ORE levels which, in conjunction with other operating losses, eroded capital and therefore jeopardized FPB's viability.

Loan Underwriting and Credit Administration

During the January 2005 State examination, examiners noted that classifications increased since the previous examination in 2003 but remained manageable at 23 percent of capital. The examination report indicated that management appeared to be appropriately monitoring the bank's credit risk and that the identification of problem loans appeared to be timely and accurate. The July 2006 examination noted that all adverse classifications identified at the prior State examination were successfully eliminated from the bank's general ledger. No adversely classified assets were evident at this examination.

In the December 2007 State ROE, examiners stated, "While the current condition of the real estate market has had an impact on borrowers' rapid financial demise, several weaknesses in credit underwriting and administration were also evident during the examination." The examination noted that many of the loan write-ups exhibited weaknesses such as outdated financial information, no global cash flow analysis, and the lack of documentation in the file to document financial capacity. The examination report indicated that the volume of adversely classified assets reflected an increase from the previous examination. Adversely classified assets totaled $21 million and represented 152.5 percent of the bank's Tier 1 Capital plus the ALLL.

The 2007 examination also reported that as of December 31, 2007, management had identified an additional $704,000 in losses in the ADC segment of their portfolio, which resulted in the ALLL being deficient by $1 million. The ROE indicated that at the time of the examination, management was in the process of developing a methodology that conformed to Financial Accounting Standard (FAS) 114 and FAS 5.[9] After the examiners performed their on-site review and prior to the completion of their examination, management was able to construct and provide an adequate ALLL methodology. Management made adjustments to the ALLL based on the new methodology that resulted in an additional $1 million provision. This increased provision had a significant impact on the bank's earnings.

The June 2008 FDIC on-site visitation revealed that despite continued asset quality deterioration, management had only provided $75,000 to the ALLL. Management conceded during the visitation that the ALLL was underfunded; however, the extent of

[9] Accounting Standard Codification (ASC) Subtopics 450-20 (formerly Statement of Financial Accounting Standard No. 5) and ASC 310-10-35 (formerly Statement of Financial Accounting Standard No. 114) provide accounting guidance for loss contingencies on a pool basis and the impairment of loans on an individual basis, respectively.

the underfunding was unknown due to management's failure to assess the overall quality of the loan portfolio since the last State examination in December 2007. Operating losses totaled $441,000 through June 17, 2008, and additional losses were deemed likely given asset deterioration and an underfunded ALLL.

The November 2008 examination noted that capital was critically deficient and no longer supported the risk profile of the bank. Loan losses, increasing ALLL provision expenses, and continuing operating losses had exceeded earnings and were eroding capital. The amount needed to restore capital to an adequate level appeared beyond the ability of the Board and major stock holders.[10] The examination noted that management had failed to correct many of the 2007 examination deficiencies in regard to loan underwriting and credit administration. These deficiencies included the lack of meaningful global cash flow analyses on borrowers and limited financial analysis noted in the credit memorandums. The 2008 examination report indicated that adversely classified assets totaled 391 percent of Tier 1 Capital plus the ALLL. More than 80 percent of the classifications were within the ADC portfolio.

Board and Management Oversight

FDIC examination results indicate that FPB's Board and management failed to adequately identify, measure, monitor and control emerging risks related to the ADC loan concentration and effectively deal with the changing economic environment after 2007. In addition, management failed to address examiners' concerns from the December 2007 examination.

<u>Identifying, Measuring, Monitoring and Controlling Risks</u>

The July 2006, FDIC ROE described management and Board oversight as sound, based upon the strong financial condition of the bank. Further, examiners pointed out that the strong asset quality was indicative of management's conservative investment and lending philosophies. However, by December 2007, State examiners deemed management as less than satisfactory, noting that the Board and management had pursued an industry concentration in ADC lending without fully mitigating the risk. Examiners warned that if the decline in the real estate market continued, additional deterioration in the bank's asset quality was likely given the bank's asset concentration.

The November 2008 FDIC ROE noted that asset quality problems centered in the ADC portfolio had resulted in material losses that threatened the viability of the institution. Examiners indicated that the Board and management had failed to adequately identify, measure, monitor, and control the growing risks in the bank. Further, examiners noted that management's policies, procedures, and risk mitigation efforts were ineffective in coping with adverse changes in the real estate market. As a consequence, FPB's financial condition had deteriorated significantly. Examiners mentioned that the Board and

[10] Report of Examination, November 4, 2008.

management needed to review risk identification, limits and mitigation strategies for ADC concentrations.

Implementation of Examiner Recommendations

When the local real estate market reversed trends in 2007, management's inability to run the bank successfully under more adverse economic conditions became evident. In the December 2007 examination, it was noted that the level of classified assets would require a significant amount of monetary and staff resources as management worked to mitigate losses. In addition, the ROE indicated that management should review policies and procedures in regard to ADC lending and determine if any mitigating factors could be taken to reduce the risks associated with this portfolio. Six months later, the June 19, 2008 on-site visitation revealed that management had not taken the action steps to resolve concerns from the December 2007 State examination. Management did not commit sufficient time or resources to address noted issues, in particular, the hiring of personnel to work on resolving problem credits. Management also conceded during the visit that the ALLL was underfunded and that the extent of the underfunding was unknown. The November 2008 examination again indicated that management had not taken the necessary actions to improve the bank's financial condition based on the findings from the December 2007 examination. During this examination, it was noted that management's resources were severely stretched by the volume and severity of issues facing the institution.

The FDIC's Supervision of FPB

Through its supervisory efforts, the FDIC identified risks in FPB's operations and brought these risks to the attention of the institution's Board and management through regular discussions and correspondence, examination reports, a visitation, and informal and formal supervisory actions. Key areas of risk identified by examiners included ADC loan concentrations, loan underwriting, and credit administration functions. As reflected in the bank's CAMELS[11] ratings, FPB was considered to be fundamentally sound until the December 2007 examination. The Board's decision to pursue rapid asset growth in ADC lending created a strategic risk that FPB had a responsibility to properly monitor and control. On-site examinations and offsite reviews identified the increasing ADC concentration and appropriately identified weaknesses; however, the ultimate impact of management's inability to manage and monitor its ADC concentration was not fully exposed until the local real estate market slowed. Further, the inherent risks represented by the ADC lending concentrations and the consequent vulnerability of the bank to an economic downturn, particularly in the local real estate market, were not reflected in the financial ratios and other metrics utilized by the examiners. Therefore, taking into

[11] 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: Capital adequacy, Asset quality, Management practices, Earnings performance, Liquidity position, and Sensitivity 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.

consideration that institutions with high ADC concentrations are especially vulnerable to economic downturns, earlier and greater supervisory attention to the risks associated with FPB's aggressive growth may have been prudent.

Supervisory History

Between 1998 and 2008, the FDIC and DBF conducted one visitation and 10 safety and soundness examinations of FPB. From 1998 through 2006, FPB's Risk Management composite rating fluctuated between a "1" and a "2". As discussed below, based on the December 2007 DBF examination, FPB was subject to a Memorandum of Understanding (MOU) which was signed on April 29, 2008. In addition, a PCA Capital Directive was issued on February 12, 2009. Table 2 summarizes FPB's examination history during its last 7 years.

Table 2: FPB's Examination History from 2003 to 2008

Examination Start Date	On-Site Supervisory Effort	Supervisory Ratings (UFIRS)	Informal or Formal Action* Taken
7/14/2003	FDIC	122222/2	None
1/4/2005	DBF	122222/2	None
7/10/2006	FDIC	111122/1	None
12/10/2007	DBF	343322/3	MOU 4/29/08
6/19/2008	FDIC Visitation	No Ratings	None
11/4/2008	FDIC	554544/5	Capital Directive 2/12/2009 Institution Closed 7/17/2009

Source: Reports of Examinations: July 14, 2003, January 4, 2005, July 10, 2006, December 10, 2007, and November 4, 2008, FDIC Visitation, June 19, 2008; Supervisory History; Capital Directive, February 12, 2009.
*Informal supervisory actions often take the form of Bank Board Resolutions or MOU. Formal enforcement actions often take the form of Prompt Corrective Actions or Cease and Desist Orders (C&D), but under severe circumstances can also take the form of insurance termination proceedings.

As shown in Table 2, one visitation was conducted at FPB in June 2008 in addition to the required risk management examinations. The purpose of the visitation was to follow up on concerns related to the previous (2007) examination and the bank's progress in addressing the April 2008 MOU provisions.

The FDIC and DBF pursued one informal action and one PCA action to address concerns identified by the examiners. A brief description of these actions follows.

- **MOU.** In response to the December 2007 DBF examination, FPB entered into an MOU effective April 29, 2008. The MOU addressed ALLL levels, loan portfolio review, loan underwriting and credit administration weaknesses, the bank's ADC policy, and capital ratios among other matters.
- **PCA Capital Directive.** FPB became *Undercapitalized* for PCA purposes when it filed its year end 2008 Consolidated Report of Condition and Income (Call

Report). In response, the FDIC issued a PCA Capital Directive. The Directive mandated that management develop a Capital Restoration Plan (CRP) and increase the bank's Tier 1 Leverage and Total Risk-Based Capital (RBC) ratios to 8 percent and 10 percent, respectively, within 90 days.

Supervisory Response to Key Risks

Through its supervisory efforts, the FDIC identified risks in FPB's operations and brought these risks to the attention of the institution's Board and management. However, in 2006, just prior to the real estate downturn in the Atlanta metropolitan region, the FDIC could have placed greater focus on (1) the ADC loan concentration and the capability of bank management and (2) the adequacy of its risk management practices to withstand a potential downturn in the local real estate market. In addition, greater scrutiny could have been placed on loan underwriting and credit administration practices, given that these were identified as issues in prior examinations (2001 and 2003) and the competitive environment in which the bank was operating at the time. After the July 2006 examination, the bank entered a period of rapid asset growth which, coupled with the changing economic environment, highlighted management weaknesses noted in the December 2007 examination. In fact, according to examiners, most of the loans that led to the bank failure were extended between the 2006 and 2007 examinations. By the end of 2007, it was clear that management was unprepared for the reversal in the real estate market that resulted in the deterioration of the loan portfolio and the depletion of the bank's capital base.

To its credit, the FDIC, as a result of the State examination in December 2007, worked with the bank to put an MOU in place and instituted an on-site visitation program to follow up on actions taken to address the MOU provisions.

Supervisory Response to ADC Concentration, Loan Underwriting, and Credit Administration

Examiners identified problems with FPB's loan concentration, and loan underwriting and credit administration practices at various points in time during the life of the institution. Table 3 summarizes the supervisory responses to the ADC concentration, loan underwriting, and credit administration risks.

Table 3: Supervisory Responses to Key Risks for FPB

Examination Date	Asset Quality Component Rating	ADC Concentration as a Percentage of Tier 1 Capital plus the ALLL	Examiner Comment
4/16/2001	2	149 percent	Examiners noted that the bank should continue to closely monitor and manage the concentration as a percent of capital and total loans. Examiners also noted that the volume of loans with credit data and

Examination Date	Asset Quality Component Rating	ADC Concentration as a Percentage of Tier 1 Capital plus the ALLL	Examiner Comment
			collateral documentation exceptions was high. The dominant exception was inadequate financial and cash flow documentation.
5/10/2002	2	206 percent	Examiners did not cite any issues relating to credit underwriting or administration, and there were no material criticisms of the ADC concentration.
7/14/2003	2	239 percent	The examination noted an increase in classifications to 18 percent of capital; however, the overall level remained manageable. The examination did criticize underwriting and administration practices, primarily the analysis of financial information and preparation of credit memos.
1/4/2005	2	357 percent	The examination noted that the Board received detailed monthly reports addressing all relevant risk factors related to this type of lending. The examination report contained no criticisms of ADC concentration risk management practices. The examination cited no concerns with credit underwriting and administration practices.
7/10/2006	1	396 percent	During this examination, the ADC concentration was deemed to be adequately monitored and managed. Credit underwriting and loan administration practices were considered strong.
12/10/2007	4	773 percent	Examiners noted that while a concentration in ADC lending at 773 percent was within the bank's policy limits of 800 percent for total committed ADC lending, the level was considered excessive given the December 12, 2006, Interagency Guidelines. Credit underwriting and administration weaknesses were noted in several credits.

Source: Reports of Examination for FPB.

The State's 2005 and the FDIC's 2006 examinations identified ADC concentrations of 357 percent and 396 percent of Tier 1 Capital plus the ALLL, respectively. However, these examination reports did not contain any criticisms of the ADC concentration risk management practices. Examiners concluded that management had a reasonable level of expertise in ADC lending, had adequately underwritten loans, and was now regularly monitoring this concentration. The Asset Quality rating was upgraded from a "2" to a "1" during the 2006 examination.

Examiners indicated that the Asset Quality rating of "1" at the 2006 examination was based on the perceived risk in the loan portfolio, financial condition of the bank, and strong economy and residential real estate market.[12] That said, examiners also noted that the rating was based largely on the fact that loans were being "paid-as-agreed" and there were no classified assets. Examiners also indicated that, at the time of the 2006 examination, high concentrations of ADC lending were commonplace in the Atlanta metropolitan region.[13] However, when compared to its peer group, FPB's asset concentration levels were substantially higher (see Figure 1). Further, although the Interagency Guidelines were issued after the July 2006 examination, ADC concentrations were already high at 396 percent of Tier 1 Capital plus the ALLL – nearly 4 times the level at which greater scrutiny is warranted.

In retrospect, FPB's continued rapid growth and high ADC concentration in a changing local economic environment presented greater risk than what was apparent at the time of the 2006 examination. FDIC examiners could have taken a stronger posture requiring that the bank reduce and/or better mitigate the risk associated with its concentration levels. The bank had been operating in a benign economic environment since its inception, which resulted in a satisfactory financial condition. However, as it turned out, FPB's management was not prepared to face a downturn in the local real estate market due to inadequate risk management practices.

FPB's management continued to aggressively grow the bank's assets after the 2006 examination and into 2007. Such growth, coupled with the rapidly deteriorating economic conditions, amplified weaknesses in management's inability to appropriately cope with the bank's risks. Specifically, at the time of the 2007 examination, FPB's ADC concentration had climbed to 773 percent of Tier 1 Capital plus the ALLL and asset quality was considered deficient. Although the ADC concentration of 773 percent was within the bank's policy limits, the level was considered excessive by examiners given the asset quality deterioration in the bank's ADC portfolio.[14] In addition, examiners commented that FPB pursued an industry concentration in ADC lending without fully mitigating the risk. The downturn in the residential real estate market resulted in FPB's problem assets reaching a critical level. To illustrate this point, examiners noted that the level of past due loans had climbed from 0.05 percent to a high of 4.05 percent from the 2006 examination to the 2007 examination. Examiners also identified numerous weaknesses in credit underwriting and administration, including:

- Outdated financial information;
- No global cash flow analysis; and
- Lack of documentation in the file to evidence financial capacity of borrowers.

[12] Auditor comments based on interview with DSC Atlanta Assistant Regional Director, Report of Examination, December 10, 2007, Report of Examination, July 10, 2006, pages 1-2.
[13] Interview with Examiner-in-Charge for the July 10, 2006 Examination.
[14] Report of Examination, December 10, 2007.

As a result of examination findings in 2007, the Asset Quality component rating was significantly downgraded from a "1" to a "4".[15] The DBF and FDIC executed an MOU on April 29, 2008 with FPB based on the findings of the 2007 examination. Specifically, the MOU included two provisions in reference to loan concentration issues:

- Within 90 days, the bank was to conduct a review of the composition of its loan portfolio, including industry concentrations. The limits set within the loan policy were to be reviewed to determine whether or not the limits were appropriate given the current risk environment.
- Within 60 days, the bank was to have revised, adopted, and implemented a written lending policy to provide effective guidance, monitoring, and control over the bank's ADC lending function. Also, the policy was to have provided for a planned reduction in the volume of funded and unfunded ADC loans as a percentage of Tier 1 Capital.

In the December 2007 State ROE, examiners referred bank management to the December 2006 Interagency Guidelines to assist them with formulating a sound risk management plan. Although the guidance does not specifically limit a bank's ADC lending, the guidance does provide the following supervisory criteria for identifying institutions with potentially significant CRE loan concentrations that may warrant greater supervisory scrutiny:

- Total reported loans for construction, land development and other land (i.e., ADC) representing 100 percent or more of total capital, or;
- Institutions reporting 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.

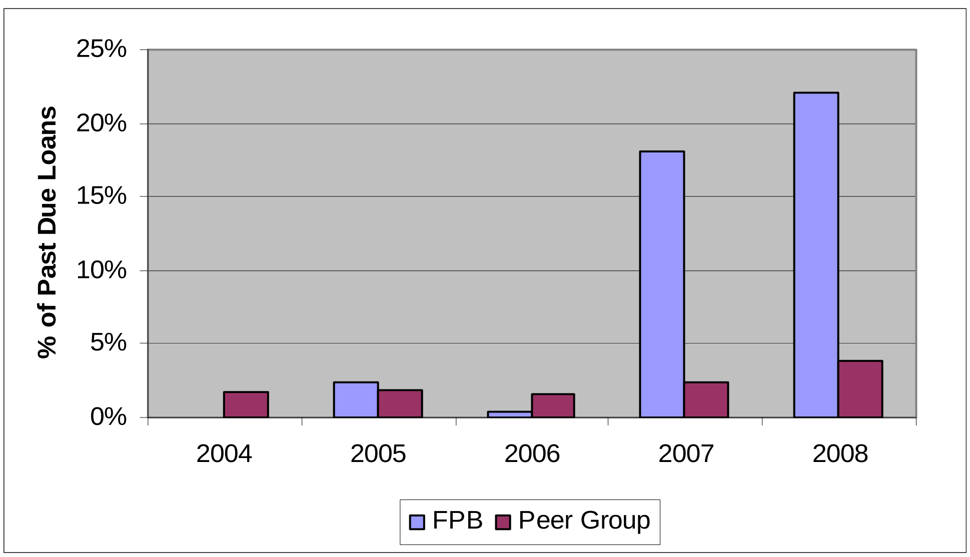
During the examination performed in November 2008, examiners indicated that the bank was compliant with the MOU provision that recommended that the bank revise, adopt and implement effective written guidance to monitor and control its ADC lending function. Still, examiners also concluded that risk management policies and practices in relation to economic conditions and asset concentrations were not adequate. Management and the Board needed to review risk identification, limits and mitigation strategies for the ADC concentration. As a result, it appears that stronger supervisory actions than those established by the MOU may have been warranted to compel the Board and management to take even more aggressive steps to mitigate loan concentration risks. This is particularly relevant considering that market conditions in the Atlanta region and nationally were deteriorating rapidly and that FPB had a limited window of opportunity to address weaknesses found during the 2007 examination.[16]

[15] The Management and the Risk Management Composite ratings were also downgraded from a "1" to a "3".
[16] Auditor comment based on Report of Examination, December 10, 2007 and Report of Examination, November 4, 2008.

At the November 2008 examination, the FDIC noted that FPB's asset quality problems were centered in the ADC loan portfolio. Figure 3 illustrates FPB's total past due loans compared to its peer group and indicates a surge in delinquencies starting in 2007. Adversely classified assets totaled 391 percent of Tier 1 Capital plus the ALLL and included loan classifications totaling $2.7 million and ORE totaling $15.6 million (after losses). In addition, loan administration and underwriting deficiencies were noted again at this examination. Examiners indicated that FPB's Board and management were responsible for failing to adequately identify, measure, monitor, and control growing risks and for not taking the necessary timely actions to improve the bank's financial condition. Examiners cited that ineffective limits on the ADC concentration, coupled with underwriting weaknesses, unnecessarily exposed the bank to unacceptable levels of risk and associated market risk in the local housing industry. Further, FPB failed to fully comply with five of the thirteen provisions of the MOU.

The bank's Asset Quality component rating was downgraded from a "4" to a "5", and similarly, the Management component rating was downgraded from a "3" to a "4", and the Risk Management composite rating downgraded from a "3" to a "5". FDIC examiners proposed instituting a C&D after the examination and concluded that the bank needed to address unsafe and unsound practices.

Figure 3: FPB's Percentage of Past Due* Loans Compared to Peer Group



Source: UBPR for FPB, December 31, 2008.
* Includes: Non-Accrual Loans

The FDIC and DBF decided not to pursue a C&D for the following reasons:

- FPB was originally expected to fail in May and examiners considered it highly unlikely the bank would have had time to address the requirements of a C&D before it failed.
- As discussed later in this report, subsequent to the 2008 examination, the bank became *Undercapitalized* for PCA purposes and the FDIC issued a PCA Capital

Directive on February 12, 2009. The directive addressed the most immediate concern of both the FDIC and DBF, which was capital.
- The MOU already addressed most issues that would be addressed in a C&D.

Supervisory Response to Board and Management Oversight

Conclusions and rating determinations made by examiners regarding Board and management oversight prior to 2007 appeared to have been based heavily on the financial performance of the bank. In the July 2006 FDIC examination, management was upgraded to a rating of "1" from a "2" in the prior examination, based on the strong financial condition of the bank. At this time, the ADC concentration stood at 396 percent of Tier 1 Capital plus the ALLL. In the same report, the Risk Management Assessment section indicated that the loan policy should be expanded to include guidelines addressing appraisal reviews, purchased and sold loans, and limitations on the maximum volume of loans relative to assets.

The *Risk Management Manual of Examination Policies* states that a rating of "1" for the Management component indicates that "All significant risks are consistently and effectively identified, measured, monitored and controlled". The level of loan concentrations and the exceptions found in the loan policy appear to be in contrast with the broad definition of a "1" rating. By the December 2007 State examination, when the Atlanta real estate market had already taken an adverse turn, several management weaknesses were identified and this component was downgraded to a less than satisfactory level of "3". In the November 2008 FDIC ROE, examiners noted that management's policies, procedures, and risk mitigating efforts did not appropriately address the market's deteriorating conditions. By this time, the viability of the bank was already in serious jeopardy.

In retrospect, stronger and earlier efforts to persuade the Board and management to improve risk management practices and diversify lending to reduce loan concentration levels could have established a more appropriate supervisory tone and prompted the Board and management to take more timely and adequate actions to address examiner concerns.

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 the requirements of PCA by establishing a framework of restrictions and mandatory supervisory actions that are triggered by an institution's capital levels. Based on the supervisory actions taken, the FDIC properly implemented applicable PCA provisions of section 38. However, capital levels turned out to be a lagging indicator of the institution's financial well-being. Other factors including earnings, asset quality, and management, identified and addressed in earlier examinations, were better indicators that the bank's viability was in question.

Table 4 illustrates that FPB was considered *Well Capitalized* for PCA purposes until the November 2008 FDIC examination when the institution's condition had already seriously deteriorated.

Table 4: Summary of Capitalization Categories for FPB

Examination as of Date	Capitalization Category	Informal or Formal Action Taken
3/31/2003	Well Capitalized	None
9/30/2004	Well Capitalized	None
3/31/2006	Well Capitalized	None
9/30/2007	Well Capitalized	MOU 4/29/2008
9/30/2008	Undercapitalized	Capital Directive 2/12/2009
*	Significantly Undercapitalized	Institution Closed 7/17/2009

Source: Reports of Examination for FPB.
* Based on FDIC PCA Notification, May 26, 2009.

By the December 2007 examination, examiners noted that the capital position was considered less than satisfactory and that if loans continued to deteriorate, the capital levels of the bank may not be sufficient to mitigate losses. Further, examiners pointed out that management should develop a capital plan in the event additional capital was required. In addition, management was expected to closely monitor the capital levels of the bank given the weak earnings and deficient asset quality at the time.[17] Nevertheless, for PCA purposes, the bank at that point still remained *Well Capitalized*.

Subsequent to the 2007 State examination, FPB entered into an MOU. One of the provisions of the MOU required the following:

- Tier 1 Leverage Capital Ratio of not less than 7 percent;
- Tier 1 Risk-Based Capital ratio of not less than 6 percent; and
- Total Risk-Based Capital ratio of not less than 10 percent.

By the following on-site examination in November 2008, it was noted that FPB's capital ratios had declined resulting in a PCA designation of *Undercapitalized*. Capital no longer supported the risk profile of the bank. Loan losses, increasing ALLL, and operating losses had eroded the bank's capital position. Examiners indicated that continued losses could further reduce the bank's designation to *Significantly Undercapitalized*. A minimum capital injection of at least $4 million was necessary to temporarily restore the bank to a PCA designation of *Well Capitalized*.

[17] Report of Examination, December 10, 2007.

On February 12, 2009 the FDIC issued a PCA Capital Directive. The Capital Directive mandated that FPB management develop a CRP and increase the bank's Tier 1 Leverage and Total Risk-Based Capital ratios to 8% and 10%, respectively, within 90 days. A May 2009 PCA Notification issued by the FDIC indicated that as a result of FPB's failure to implement the CRP, the bank was considered *Significantly Undercapitalized* for PCA purposes. The PCA Notification noted that based on the Call Report, FPB's key capital ratios as of March 31, 2009 were as follows: Tier 1 Leverage Ratio: 4.15 percent; Tier 1 Risk-Based Capital Ratio: 5.01 percent; and Total Risk-Based Capital Ratio: 6.26 percent. Although these capital ratios indicated an *Undercapitalized* PCA Capital Directive category, the bank was considered to be *Significantly Undercapitalized* based upon its inability to successfully implement its CRP dated March 25, 2009.

Under the Capital Directive from February 2009, FPB was already required to comply with provisions established in FDI Act section 38(f) applicable to *Significantly Undercapitalized* institutions, such as the requirement to increase capital levels. Consequently, no further provisions were established at the time the institution became *Significantly Undercapitalized*. Based on the information listed above, the supervisory actions taken by the FDIC adhered to applicable PCA provisions of section 38.

1. Objectives, Scope, and Methodology

Objectives

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

Our audit objectives were to (1) determine the causes of the financial institution's failure and resulting material loss to the DIF and (2) evaluate the FDIC's supervision of the institution, including implementation of the PCA provisions of section 38. We evaluated whether capital was an adequate indicator of safety and soundness and the FDIC's compliance with PCA guidelines.

We conducted this performance audit from September 2009 to January 2010 in accordance with Generally Accepted Government Auditing Standards (GAGAS). 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, as described in the Scope and Methodology section, 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 FPB from April 16, 2001, until its failure on July 17, 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 utilized the following techniques:

- Analyzed examination and visitation reports prepared by the FDIC and the DBF examiners from April 2001 to July 2009.

- Reviewed the following documentation:

   - Financial institution data and correspondence maintained at the DSC's Atlanta Regional Office and Atlanta Field Office, as provided to KPMG by DSC.

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

   - Pertinent DSC policies and procedures.

- Interviewed the relevant FDIC officials having supervisory responsibilities pertaining to FPB, which included DSC examination staff in the Atlanta Region.

- Interviewed appropriate officials from the DBF to discuss the historical perspective of the institution, its examinations, and other activities regarding the state's supervision of the bank.

- Researched various banking laws and regulations, including Atlanta state laws.

KPMG relied primarily upon the materials provided by the FDIC OIG and DSC, including information and other data collected during interviews. KPMG did not perform specific audit procedures to ensure the information and data were complete and accurate. KPMG is, however, aware that Circular 12000.1, Cooperation with the Office of Inspector General, dated September 28, 2007, requires that all FDIC employees, contractors, and subcontractors cooperate with the OIG in order for the OIG to carry out its statutory mandate. To that end, all employees, contractors, and subcontractors must:

(1) Provide authorized representatives of the OIG immediate and unrestricted access to all Corporation, receivership, contractor, and subcontractor personnel, facilities, equipment, hard copy and electronic records, files, information systems, and other sources of information when requested during the course of their official duties.

(2) Provide authorized representatives of the OIG immediate and unrestricted access to any records or material available to any part of the FDIC.

Interviews were conducted to gain a better understanding of decisions made regarding the supervisory approach to the institution and to clarify information and conclusions contained in reports of examination and other relevant supervisory correspondence between the FDIC and the bank. KPMG relied on the information provided in the interviews without conducting additional specific audit procedures to test such information.

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 FPB'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 were used to support our audit conclusions.

The Government Performance and Results Act of 1993 (the Results Act) directs Executive Branch agencies to develop a customer-focused strategic plan, align agency programs and activities with concrete missions and goals, and prepare and report on annual performance plans. For this material loss review, we did not assess the strengths and weaknesses of DSC's annual performance plan in meeting the requirements of the Results Act because such an assessment is not part of the audit objectives. DSC's compliance with the Results Act is reviewed in OIG's 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 are discussed, where appropriate, in this report. Additionally, we assessed the risk of fraud and abuse related to our objectives in the course of evaluating audit evidence.

2. 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	Consolidated Reports of Condition and Income (also known as the Call Reports) are reports that are required to be filed by every national bank, state member bank, and insured nonmember bank pursuant to the Federal Deposit Insurance Act. These reports are used to calculate deposit insurance assessments and monitor the condition, performance, and risk profile of individual banks and the banking industry.
Capital Directive (Directive)	A capital directive is a final order issued by the FDIC to a State nonmember bank that fails to maintain capital at or above its minimum capital requirements
Cease and Desist Order (C&D)	A formal enforcement action issued by financial institution regulators to a bank or affiliated party to stop an unsafe or unsound practice or violation. 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.

Term	Definition
Memorandum of Understanding (MOU)	A Memorandum of Understanding is an informal agreement between the institution and the FDIC, which is signed by both parties. The State Authority may also be party to the agreement. MOUs are designed to address and correct identified weaknesses in an institution’s condition.
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 of the FDIC Rules and Regulations, 12 Code of Federal Regulations, section 325.101, et. seq. implements section 38, *Prompt Corrective Action*, of the FDI Act, 12 United States Code section 1831o, by establishing a framework for taking prompt corrective supervisory actions against insured nonmember banks that are less than adequately capitalized. The following terms are used to describe capital adequacy: Well Capitalized, Adequately Capitalized, Undercapitalized, Significantly Undercapitalized, and Critically Undercapitalized.
Uniform Bank Performance Report (UBPR)	The UBPR is an 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 Call Report data submitted by banks.

3. Acronyms

ADC	Acquisition, Development, and Construction
ALLL	Allowance for Loan and Lease Losses
ASC	Accounting Standard Codification
C&D	Cease and Desist Order
CAMELS	Capital, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk
CRE	Commercial Real Estate
CRP	Capital Restoration Plan
DBF	Georgia Department of Banking and Finance
DIF	Deposit Insurance Fund
DRR	Division of Resolutions and Receiverships
DSC	Division of Supervision and Consumer Protection
FAS	Financial Accounting Standard
FDI	Federal Deposit Insurance
FIL	Financial Institution Letter
FPB	First Piedmont Bank
GAGAS	Generally Accepted Government Auditing Standards
MOU	Memorandum of Understanding
OIG	Office of Inspector General
ORE	Other Real Estate
PCA	Prompt Corrective Action
RBC	Risk-Based Capital
ROE	Report of Examination
UBPR	Uniform Bank Performance Report
UFIRS	Uniform Financial Institutions Rating System

Part II

OIG Evaluation of Management Response

OIG Evaluation of Management Response

After we issued our draft report, we met with management officials to further discuss our results. Management provided additional information for our consideration, and we revised our report to reflect this information, as appropriate. On February 12, 2010, the Director, Division of Supervision and Consumer Protection (DSC), provided a written response to the draft report. That response is provided in its entirety on page II-2 of this report.

DSC reiterated the OIG's conclusions regarding the causes of FPB's failure and the FDIC's supervision of the bank. DSC stated that it issued *Interagency Guidance on CRE Monitoring* in 2006 and a Financial Institution Letter to banks on *Managing Commercial Real Estate Concentrations in a Challenging Environment* in 2008 that re-emphasized the importance of robust credit risk-management practices for institutions with concentrated CRE exposures and set forth broad supervisory expectations.

FDIC

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

TO: Stephen Beard

FROM: Sandra L. Thompson

SUBJECT: Draft Audit Report Entitled, Material Loss Review of First Piedmont Bank, Winder, GA (Assignment No. 2009-064)

Pursuant to Section 38(k) of the Federal Deposit Insurance act (FDI Act), the Federal Deposit Insurance Corporation's Office of Inspector General (OIG) conducted a material loss review of First Piedmont Bank (FPS) which failed on July 17, 2009. This memorandum is the response of the Division of Supervision and Consumer Protection (DSC) to the OIG's Draft Report (Report) received on January 22, 2010.

The Report concludes that FPB's failure was due to a high concentration in acquisition, development and construction (ADC) loans; weaknesses in loan underwriting and credit administration practices; and poor management and Board of Directors (Board) oversight. The Report notes that examiners identified the ADC lending concentration early in FPB's history. The Report also indicates that until 2007 there was a high demand for ADC lending in the Atlanta area as a result of the growing population and a robust economy, noting it was not until mid-2007 that the Atlanta real estate market began to show signs of deterioration.

The Report states that, through its supervisory efforts, FDIC identified risks in FPB's operations and brought these risks to the attention of FPB's Board and management. Key areas of risk identified by the examiners included ADC loan concentrations, loan underwriting, and credit administration. The institution's risk profile increased dramatically between the 2006 and 2007 examinations. Following the 2007 examination, the FDIC and Georgia Department of Banking and Finance (GDBF) collaborated to have FPB's Board and management adopt a Memorandum of Understanding (MOU), and DSC implemented an on-site visitation program to follow up on the actions FPB had taken to address the MOU provisions. However, FPB's Board and management failed to follow the requirements of the MOU and take appropriate corrective actions and the condition of the institution deteriorated.

DSC issued *Interagency Guidance on CRE Monitoring* in 2006 and a Financial Institution Letter to banks on *Managing Commercial Real Estate Concentrations in a Challenging Environment* in 2008 that re-emphasized the importance of robust credit risk-management practices for institutions with concentrated CRE exposures and set forth broad supervisory expectations.

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