Office of Inspector General

Office of Material Loss Reviews
Report No. MLR-10-030

Material Loss Review of Georgian Bank, Atlanta, Georgia

April 2010

Office of Inspector General

Executive Summary

Material Loss Review of Georgian Bank, Atlanta, Georgia

Report No. MLR-10-030
April 2010

Why We Did The Audit

On September 25, 2009, the Georgia Department of Banking and Finance (DBF) closed Georgian Bank (Georgian), Atlanta, Georgia, and named the FDIC as receiver. On October 9, 2009, the FDIC notified the OIG that Georgian's total assets at closing were $2.1 billion and the estimated material loss to the Deposit Insurance Fund (DIF) was $807.7 million. As of April 1, 2010, the estimated loss to the DIF had decreased to $798.4 million. As required by section 38(k) of the Federal Deposit Insurance (FDI) Act, the OIG conducted a material loss review.

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

Background

Georgian was headquartered in Atlanta, Georgia and chartered as a state nonmember bank in November 2001. Georgian was wholly-owned by Georgian Bancorporation, Inc. (Bancorp), a single-bank holding company. In addition to its main office, the bank operated four branch offices. In mid-2003, Georgian notified the FDIC and the DBF of its plan to raise additional capital and change its business focus. Growth was supported by Bancorp capital injections of $49 million, $31.9 million, and $36.7 million in 2003, 2005, and 2006, respectively.

Audit Results

Causes of Failure and Material Loss

Georgian failed because its Board and management, led by a senior bank official, pursued an aggressive growth strategy focused on acquisition, development, and construction (ADC) lending that coincided with declining economic conditions in the Atlanta metropolitan area. Although the growth strategy was initially successful, the resulting increasing level of concentrations and corresponding lack of diversification in the loan portfolio left the bank vulnerable to the significant downturn in the Atlanta metropolitan residential real estate market. Concurrently, Georgian's loan underwriting and administration practices became increasingly lax and its financial condition began to decline. Georgian's reliance on brokered deposits to fund its growth and its relationship with a single large depositor also factored significantly in the bank's failure. By 2009, the bank's assets were critically deficient, earnings were poor, capital was weak, and prospects for raising additional capital were unfavorable. As its capital eroded, Georgian's largest depositor signaled its intent to withdraw its deposits, which severely strained the bank's liquidity position and ultimately led to its closure.

The FDIC's Supervision of Georgian

The FDIC and the DBF conducted timely and regular examinations of Georgian and monitored its condition through the use of offsite monitoring mechanisms. Examiners consistently identified and reported on Georgian's ADC concentrations and reliance on non-core funding. However, the bank's asset quality, liquidity, and overall financial condition were considered satisfactory until the 2008 examination.

In 2008, asset quality was showing signs of deterioration due to the severe economic downturn, and offsite analysis prompted an FDIC visitation in November 2008.

In hindsight, more supervisory emphasis on Georgian's risk management practices prior to the visitation in November 2008 would have been prudent. Doing so might have been beneficial in raising bank management's awareness of the broad supervisory expectations with regard to managing risk associated with commercial real estate (CRE) and ADC concentrations, which ultimately Georgian failed to meet. Further, examiners could have recognized earlier and emphasized Georgian's lack of a viable contingency funding plan, in light of the bank's reliance on non-core funding and a single large depositor. Once problems were identified, the FDIC and the DBF pursued supervisory actions. However, by the time those actions became effective, the financial condition of the bank had become critically deficient.

With respect to PCA, based on the supervisory actions taken, the FDIC properly implemented applicable PCA provisions of section 38 in a timely manner. Georgian was unsuccessful in raising needed capital and the bank was subsequently closed on September 25, 2009.

Management Response

After we issued our draft report, management provided additional information for our consideration, and we revised our report to reflect this information, as appropriate. On April 7, 2010, the Director, Division of Supervision and Consumer Protection (DSC), provided a written response to the draft report. DSC reiterated the OIG's conclusions regarding the causes of Georgian's failure. With regard to our assessment of the FDIC's supervision of Georgian, DSC's response stated that examiners consistently noted Georgian's ADC concentrations and reliance on non-core funding and made numerous recommendations to improve risk management practices and procedures to identify and report concentrations to the Board. In response to the FDIC's November 2008 visitation, which revealed significant deterioration in Georgian's overall condition, the Board adopted a resolution agreeing to address identified weaknesses. However, Georgian's management and Board were unable to sufficiently address its problems, and the FDIC and the DBF took action through a formal enforcement order. DSC's response acknowledged, as discussed in our report, that greater emphasis on the correction of Georgian's risk management practices prior to the November 2008 visitation could have influenced its Board and reduced resulting losses. Further, DSC's response identified updated guidance it has issued, also discussed in our report, to enhance supervision of institutions, such as Georgian, with concentrations in CRE/ADC lending and reliance on volatile non-core funding.

Contents

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

Office of Material Loss Reviews
Office of Inspector General

DATE: April 9, 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 Georgian Bank, Atlanta, Georgia* (Report No. MLR-10-030)

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 Georgian Bank (Georgian), Atlanta, Georgia. The Georgia Department of Banking and Finance (DBF) closed the institution on September 25, 2009, and named the FDIC as receiver. On October 9, 2009, the FDIC notified the OIG that Georgian's total assets at closing were approximately $2.1 billion and that the estimated loss to the Deposit Insurance Fund (DIF) was $807.7 million. As of April 1, 2010, the estimated loss to the DIF had decreased to $798.4 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 Georgian's failure and the resulting material loss to the DIF and (2) evaluate the FDIC's supervision[2] of Georgian, including the FDIC's implementation of the PCA provisions of section 38 of the FDI Act. This report presents our analysis of Georgian'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

[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.

institution failures are identified in our material loss reviews, we will 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. 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 contains the Corporation's comments on this report.

Background

Georgian was headquartered in Atlanta, Georgia and chartered as a state nonmember bank in November 2001.[3] Georgian was wholly-owned by Georgian Bancorporation, Inc. (Bancorp), a single-bank holding company. In addition to its main office, the bank operated four branch offices. In mid-2003, Georgian notified the FDIC and the DBF of its plan to raise additional capital and change its business focus. Growth was supported by Bancorp capital injections of $49 million, $31.9 million, and $36.7 million in 2003, 2005, and 2006, respectively. Table 1 provides details on Georgian's financial condition as of June 30, 2009 and for the 5 preceding calendar years.

Table 1: Financial Information for Georgian, 2004 to 2009

Financial Measure ($000s)	Jun-2009	Dec-2008	Dec-2007	Dec-2006	Dec-2005	Dec-2004
Total Assets	2,230,230	2,242,028	2,039,632	1,619,353	1,153,552	736,929
Total Loans	1,772,280	1,867,065	1,700,136	1,327,639	930,343	611,377
Total Deposits	1,960,123	1,921,602	1,696,790	1,366,538	1,019,678	648,387
Total Brokered Deposits	714,150	960,082	575,614	455,545	288,579	180,902
Net Income (Loss)	(45,016)	4,062	20,978	16,657	9,771	2,665

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

Causes of Failure and Material Loss

Georgian failed because its Board and management, led by a senior bank official, pursued an aggressive growth strategy focused on acquisition, development, and construction (ADC) lending that coincided with declining economic conditions in the Atlanta metropolitan area. Although the growth strategy was initially successful, the resulting increasing level of concentrations and corresponding lack of diversification in the loan portfolio left the bank vulnerable to the significant downturn in the Atlanta metropolitan residential real estate market. Concurrently, Georgian's loan underwriting and administration practices became increasingly lax and its financial condition began to decline. Georgian's reliance on brokered deposits to fund its growth and its relationship

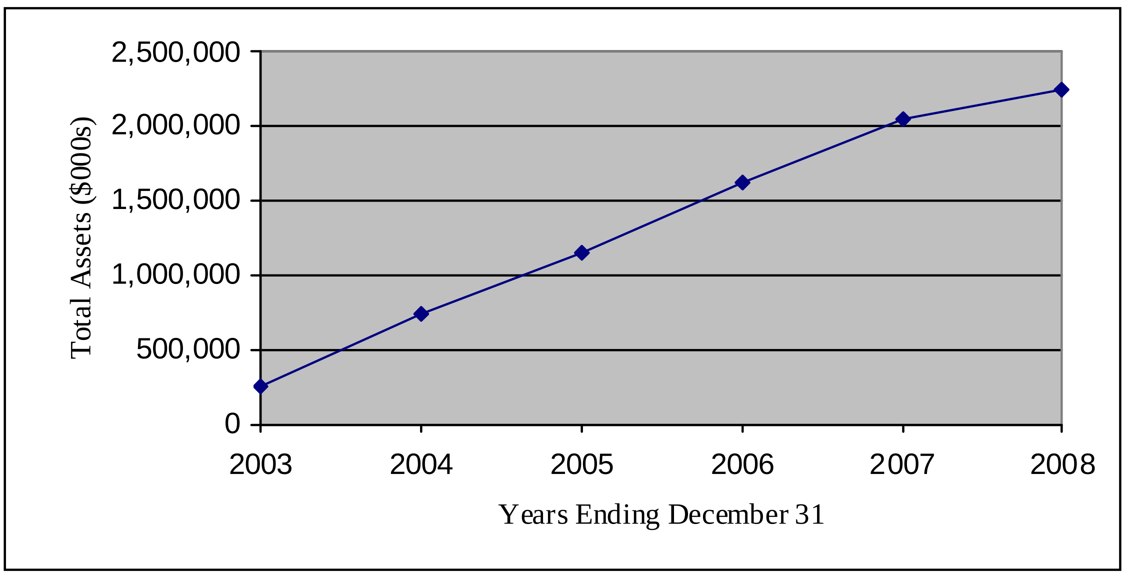
[3] Until 2009, the FDIC defined a de novo institution as one within its first 3 years of operation. Georgian's de novo period ended November 2004. It was subsequently considered a young institution (defined as institutions in their 4th through 9th years of operation). On August 28, 2009, the FDIC extended the de novo period from 3 to 7 years in Financial Institution Letter (FIL) 50-2009, entitled, *Enhanced Supervisory Procedures for Newly Insured FDIC-Supervised Depository Institutions*.

with a single large depositor also factored significantly in the bank's failure. By 2009, the bank's assets were critically deficient, earnings were poor, capital was weak, and prospects for raising additional capital were unfavorable. As its capital eroded, Georgian's largest depositor signaled its intent to withdraw its deposits, which severely strained the bank's liquidity position and ultimately led to its closure.

Aggressive Growth Strategy

Pursuant to the FDIC's order approving deposit insurance, during its de novo period, Georgian was required to notify the FDIC and the DBF of any proposed material change to its business plan 60 days before implementing the change. On July 28, 2003, Georgian submitted a proposed change in its business plan that represented a shift from the bank's original focus on providing community banking services in its local market area to serving the middle market business and investment community in a broader geographic area. According to financial projections, Georgian planned to focus on real estate lending, primarily ADC and commercial real estate (CRE). Further, the bank's revised business plan reflected an aggressive growth strategy, with assets increasing from $71 million to $1.4 billion in 5 years. As discussed later in this report, the FDIC and the DBF approved this change. The bank's assets grew from $249 million at year-end 2003 to $2.2 billion at year-end 2008, exceeding Georgian's initial business projections. Figure 1 illustrates Georgian's asset growth between 2003 and 2008.

Figure 1: Georgian's Asset Growth, 2003 to 2008



Source: UBPRs for Georgian.

Dominant Official

The bank added several new directors and officers to its management team in 2003 to guide its expansion and implement its new strategic direction. The change in strategic direction was predominately led by one senior banking official, a veteran banker in Atlanta who joined Georgian in 2003. According to examiners, this official dominated decision-making and had a strong influence over other board members and bank employees. For example, in conjunction with the 2005 examination, a director expressed concerns that this individual did not allow the Board to openly discuss bank business at the Board meetings. Additionally, this director asserted that issues were not allowed proper debate during the meetings and the Board was not given sufficient time or information for deliberation. In response to those allegations, examiners reviewed Board minutes and concluded that the Board discussion did not appear to be dominated by this individual. Nonetheless, examiners also noted that this individual ran all aspects of the bank and that management often mentioned this individual as the reason why things were done a certain way. Notwithstanding these observations, examiners indicated in the 2007 examination report that Board and management oversight was strong and that this official was supported by a capable management team. However, the 2009 examination report noted that this individual was slow to recognize the severity of the economic downturn and address the significant problems facing the bank. On July 1, 2009, the bank notified the FDIC that this official had been replaced.

Loan Concentrations

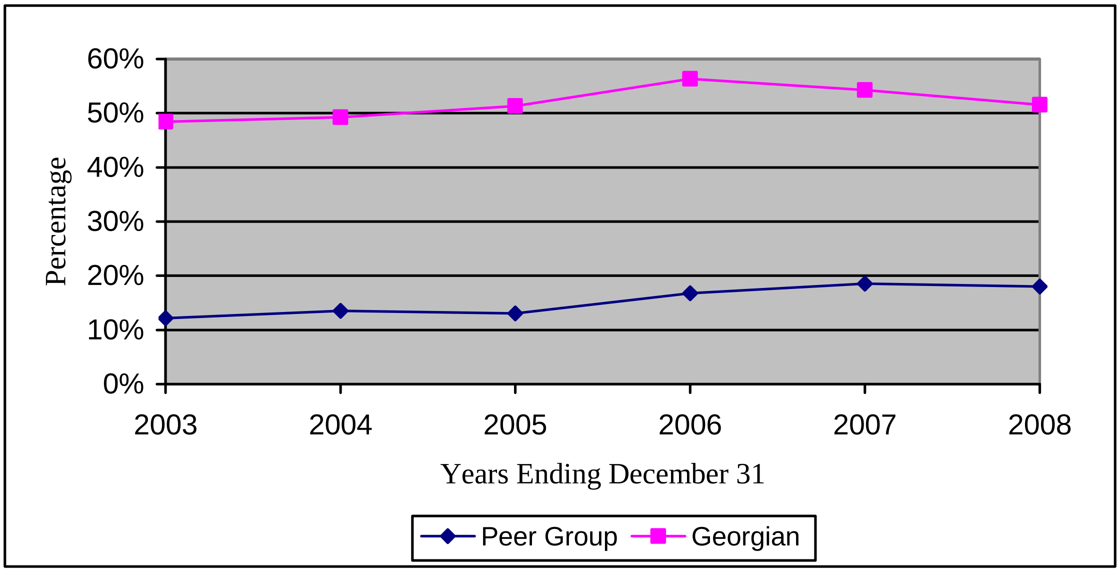
Georgian's growth strategy resulted in concentrations in higher-risk ADC loans as well as substantial lending to individual borrowers tied to the real estate construction industry.

ADC Lending

ADC loans comprised at least 48 percent of the bank's average gross loans between 2003 and 2008. Further, as illustrated in Figure 2, the percentage of Georgian's ADC loans to average gross loans was consistently and significantly above the average for its peer group.[4]

[4] Institutions are assigned to 1 to 15 peer groups based on asset size, number of branches, and whether the institution is located in a metropolitan or non-metropolitan area. De novo institutions are compared to other banks that opened in the same period for 5 years. Accordingly, Georgian's peer group included institutions established in 2001 with assets less than $750 million. Subsequent to its de novo period, Georgian's peer group included institutions with assets between $1 billion and $3 billion.

Figure 2: Georgian's ADC Loans as a Percentage of Average Gross Loans Compared to Peer Group, 2003 to 2008



Source: UBPRs for Georgian.

Federal banking regulatory agencies issued guidance in December 2006, entitled, *Commercial Real Estate Lending, Sound Risk Management Practices* (Joint Guidance), to reinforce existing regulations and guidelines for real estate lending and safety and soundness.[5] The Joint Guidance focuses on those CRE loans for which cash flow from the real estate is the primary source of repayment (i.e., ADC lending). The Joint Guidance states that the agencies had observed an increasing trend in the number of institutions with concentrations in CRE loans and notes that rising CRE concentrations could expose institutions to unanticipated earnings and capital volatility in the event of adverse changes in the general CRE market. Indeed, as noted in Georgian's 2009 examination report, the bank's risk profile increased significantly as the economy declined and residential construction suffered a severe downturn.

The Joint Guidance does not establish specific CRE lending limits; rather, it promotes sound risk management practices and appropriate levels of capital that will enable institutions to pursue CRE lending in a safe and sound manner. Specifically, it states that an institution that has experienced rapid growth in CRE lending, has notable exposure to a specific type of CRE, or is approaching the following supervisory criteria may be identified for further supervisory analysis of the level and nature of its CRE concentration risk: (1) total ADC loans that represent 100 percent or more of the institution's total capital; or (2) total CRE loans that represent 300 percent or more of an institution's total capital, where the outstanding balance of the institution's CRE loan portfolio has increased by 50 percent or more during the prior 36 months. Table 2 summarizes Georgian's ADC concentrations in comparison to its peer group.

---

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

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

Period Ending	ADC Loans as a Percentage of Total Capital: Georgian	Peer Group
December 31, 2003	174.52	72.43
December 31, 2004	417.81	100.03
December 31, 2005	441.20	106.69
December 31, 2006	441.07	135.57
December 31, 2007	436.11	146.50
December 31, 2008	471.82	139.03
June 30, 2009	559.33	116.88

Source: UBPRs for Georgian.

According to the 2008 examination report, management recognized the need to diversify its loan portfolio sometime in 2006 and began promoting the bank's then-current commercial and industrial products. Although this effort reduced its ADC portfolio, the bank's concentration levels remained high.

Individual Borrower Lending

In addition to its ADC concentration, examination reports for Georgian between 2004 and 2009 identified concentrations of 25 percent or more of Tier 1 Capital to individual borrowers. Most of these individual relationships were heavily tied to the real estate construction industry and depended on the sale of homes and/or lots as the primary source of repayment. Consequently, as the real estate market declined, the guarantor's liquidity to service the debt became doubtful because the primary source of repayment was significantly diminished. The 2009 examination report identified five such individual borrower concentrations and, as discussed later in this report, these borrower relationships were cited to be in apparent violation of the Georgia state legal lending limit. Under the banking provisions of the Official Code of Georgia, these loans, previously considered independent, were required to be combined for lending limit purposes based on the determination by examiners that the five borrowers involved could provide no evidence of a separate source of repayment and lacked the ability to service the obligation from the operations of the separate companies. The change in status for legal lending purposes was primarily driven by the deterioration in economic conditions. Additionally, the 2009 examination report noted that 16 borrowers represented 34 percent of total loans, or 347 percent of Tier 1 Capital. Most, if not all, of those relationships were in the residential construction industry and 10 of the relationships were classified as substandard.

Risk Management Practices

An institution's Board is responsible for establishing appropriate risk limits, monitoring exposure, and evaluating the effectiveness of the institution's efforts to manage and control risk. The Joint Guidance reiterates that concentrations in CRE lending, coupled with weak loan underwriting and depressed CRE markets, contributed to significant credit losses in the past.

According to the Joint Guidance:

- strong risk management practices are an important element of a sound CRE lending program, particularly when an institution has a concentration in CRE loans;
- financial institutions with CRE concentrations should ensure that risk management practices appropriate to the size of the portfolio, as well as the level and nature of concentrations, and the associated risk to the institution are implemented; and
- financial institutions should establish a risk management framework that effectively identifies, monitors, and controls CRE concentration risk.

In addition, FIL-22-2008, *Managing Commercial Real Estate Concentrations in a Challenging Environment*, issued March 17, 2008, provides key risk management processes for institutions with CRE concentrations, including maintaining prudent, time-tested lending policies with a strong credit review and risk rating system to identify deteriorating credit trends early and maintaining updated financial and analytical information for borrowers. For example, institutions should emphasize global financial analysis of obligors, which involves analyzing borrowers' complete financial resources and obligations. The guidance further states that inappropriately adding extra interest reserves on loans where the underlying real estate project is not performing as expected can erode collateral protection and mask loans that would otherwise be reported as delinquent.

Georgian's management and Board did not establish effective risk management practices sufficient to limit the bank's exposure to ADC concentrations, allowing the growth of the bank without implementing appropriate risk limits and requiring satisfactory monitoring.

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

In 2008, examiners noted various loan administration and credit underwriting issues and indicated that Georgian's management needed to:

- develop a relationship report to aid in measuring, monitoring, and controlling the increased risk presented by relationships where repayment of multiple loans was dependent on one borrower,
- improve external loan review methodology to ensure that complete loan relationships were reviewed, and
- track and monitor the aggregate volume of interest reserve balances and monitor the financial condition of its borrowers to ensure borrowers' capacity for repayment remained viable.

Further, in the February 2009 examination, examiners outlined a number of loan underwriting and credit administration concerns, including:

- lax limitations and guidelines on ADC lending,
- liberal loan underwriting terms,
- lack of global cash flow analyses,
- inadequate pricing of risk,
- improper utilization of interest reserves,
- inadequate recognition of collateral-dependent loans, monitoring of individual concentrations, and review of appraisals.

Examiners also stated that management had not consistently applied guidelines and recommendations made in the Joint Guidance. For example, management did not develop an adequate action plan to reduce problem assets. Instead, management placed a large volume of loans on a deferred payment structure (principal and interest at maturity), which overstated interest income and understated past-due loans. In many cases, matured ADC loans were renewed to 1-year, single payment loans in the hope that the residential real estate market and the economy in general would recover in the coming year. The bank renewed many of these loans in 2008 without formally evaluating the change in market conditions, as required under FDIC Rules and Regulations, Part 323, *Real Estate Appraisals*. Further, management did not have an adequate exit strategy in place to combat a significant downturn in the real estate construction industry.

Allowance for Loan and Lease Losses

On December 13, 2006, the federal financial institutions regulatory agencies issued an *Interagency Policy Statement on the Allowance for Loan and Lease Losses* (ALLL Policy Statement) that reiterated key concepts and requirements related to generally accepted accounting principles (GAAP)[6] and existing supervisory guidance. Specifically, the ALLL Policy Statement describes the nature and purpose of the ALLL; the responsibilities of boards of directors, 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 credit grading system. The ALLL Policy Statement notes that determining the appropriate level for the ALLL is inevitably imprecise and requires a high degree of management judgment. An institution's process for determining the ALLL should be based on a comprehensive, well-documented, and consistently applied analysis of its loan portfolio that considers all significant factors that affect collectability. That analysis should include an assessment of changes in economic conditions and collateral values and their direct impact on credit quality. If declining credit quality trends relevant to the types of loans in an institution's portfolio are evident, the ALLL level as a percentage of the portfolio should generally increase, barring unusual charge-off activity.

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

The February 2009 examination cited Georgian for being in contravention of the ALLL Policy Statement. According to the examination report, management had not fully incorporated requirements of financial accounting standards, as required by the policy statement, into the ALLL methodology and did not maintain supporting documentation to justify the adequacy of the ALLL. Specifically, examiners found that:

- current market conditions were not reflected in certain reserve percentages,
- management had not been proactive in identifying problem credits, and
- new appraisals or evaluations had not been obtained to facilitate accurate impairment analysis or for measuring fair value of collateral-dependent loans.

Ultimately, based on 2009 examination findings and measuring collateral-dependent loans at fair value, examiners recommended that management charge off almost $23 million as a loss.

Contraventions and Violations of Regulatory Requirements

Georgian was also cited for being in contravention or in violation of regulatory requirements—an indication of weak risk management practices. Specifically, the 2004, 2005, 2008, and 2009 examination reports noted apparent legal lending violations of Section 7-1-285 of the Official Code of Georgia, which sets limits on loans and obligations an institution may extend to any one person or corporation. In 2004, the bank recognized that a loan to a certain borrower would trigger the legal lending limit and took steps to sell a participation in the loan to another institution. However, the apparent violation was cited because the participation agreement was not executed in a timely manner. The 2005 examination report cited the bank for an apparent violation because the bank extended a loan in excess of the limit and there was no evidence of advanced approval by the Board or a committee authorized to act for the Board as required by Georgia law. The 2008 examination cited the bank for apparent violation related to one borrower who exceeded the unsecured lending limits based on the bank's financial position as of September 30, 2007.

Furthermore, Rule 80-1-5-.01 (13) of Georgia's Rules and Regulations[7] states, in part, that the liabilities of separate persons, corporations, and entities shall be combined for lending limit purposes when there is (1) no evidence of a separate source of repayment, or (2) an apparent lack of ability to service the obligation from the operations of the separate person or corporation without relying on a related source of repayment, or (3) where the separate entities make common use of or are dependent upon funds of the group. As discussed earlier in this report, the 2009 examination cited an apparent violation of this rule because loans that were previously considered independent were combined based on the determination by examiners that the five borrowers involved could provide no evidence of a separate source of repayment and lacked the ability to service the obligation from the operations of the separate companies.

[7] Effective September 6, 2009, pertinent sections of the Rules and Regulations of Georgia were amended. Rule 80-1-5.11 now sets forth provisions regarding the combination of debt for legal lending limit purposes.

The 2009 examination report also cited Georgian for the following violations:

- Failure to comply with Part 364 of the FDIC Rules and Regulations, *Standards for Safety and Soundness*: The findings of the examination reflected the bank's failure to comply with Appendix A - Section II - *Operational and Managerial Standards*. Included in these findings were noncompliance with standards for internal controls and information systems, loan documentation, credit underwriting, asset growth, and asset quality.

- Multiple apparent violations of Part 323 of FDIC Rules and Regulations, *Appraisals,* related to (1) loans renewed with no extension of new funds without a formal evaluation given the change in market conditions, (2) failure to obtain an appraisal, and (3) failure to conform to generally accepted appraisal standards.

- Failure to implement recommendations set forth in the Joint Guidance regarding, among other things, risk assessments, contingency plans, market analysis, credit underwriting, and stress testing.

In addition, the 2009 examination report cited Georgian for being in contravention of the *Interagency Policy Statement on the Allowance for Loan and Lease Losses,* as discussed in the previous section of this report.

Funding Strategy

Georgian's reliance on brokered deposits to fund its growth and a relationship with a single large depositor also contributed to the bank's failure.

Non-Core Funding Dependence

Georgian maintained a significant dependence on non-core funding sources, including brokered deposits, to fund its growth. Brokered deposits increased from 5 percent of total deposits on December 31, 2002, to 50 percent of total deposits on December 31, 2008. Table 3 summarizes Georgian's funding sources from 2004 to 2009.

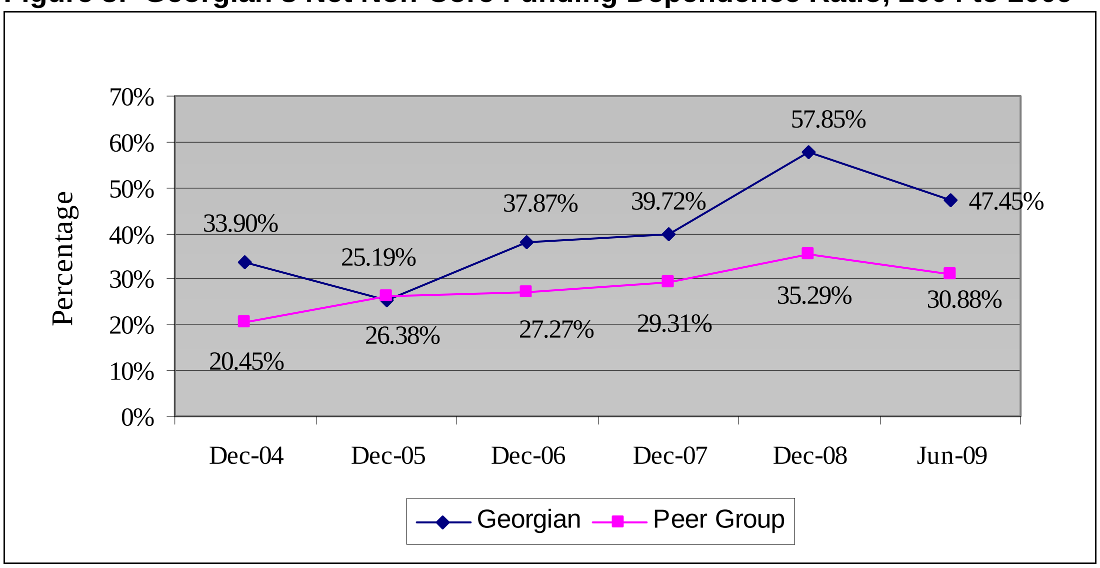
Table 3: Georgian's Core and Non-Core Funding Sources, 2004 to 2009

Period Ending	Core Deposits	Brokered Deposits	Time Deposits of $100M or More	Federal Home Loan Bank (FHLB) Borrowings
		($000s)		
Dec-04	424,641	180,902	223,746	17,000
Dec-05	702,391	288,579	317,287	17,000
Dec-06	801,584	455,545	564,953	57,000
Dec-07	978,185	575,614	718,607	82,000
Dec-08	1,801,539	960,082	120,063	82,000
Jun-09	1,708,145	714,150	251,978	82,000

Source: UBPRs for Georgian.

The *FDIC Risk Management Manual of Examination Policies* states that the non-core funding dependence ratio is a key measure of the degree to which the bank relies on potentially volatile liabilities, such as, but not limited to, certificates of deposit over $100,000 and brokered deposits to fund long-term earning assets. Generally, the lower the ratio, the less risk exposure there is for the bank, whereas higher ratios reflect reliance on funding sources that may not be available in times of financial stress or adverse changes in market conditions. Figure 3 illustrates Georgian's net non-core funding dependence ratio compared to its peer group, from 2004 to 2009.

Figure 3: Georgian's Net Non-Core Funding Dependence Ratio, 2004 to 2009



Source: UBPRs for Georgian.

<u>Relationship with a Large Depositor</u>

Georgian was also reliant on a single large depositor, a privately-held trust company with assets of $60 billion under its administration. According to examiners, the deposit relationship began in 2003 and appears to have been brought to the bank by the senior banking official discussed previously in this report. By 2009, this relationship represented approximately $212 million in deposits. When the bank's capital levels fell to *Adequately Capitalized,* the depositor signaled its intent to withdraw its deposits by October 2009 and this resulted in a strained liquidity position for the bank.

The FDIC's Supervision of Georgian

The FDIC and the DBF conducted timely and regular examinations of Georgian and monitored its condition through the use of offsite monitoring mechanisms. Examiners consistently identified and reported on Georgian's ADC concentrations and reliance on non-core funding. However, the bank's asset quality, liquidity, and overall financial condition were considered satisfactory until the 2008 examination. In 2008, asset quality was showing signs of deterioration due to the severe economic downturn, and offsite analysis prompted an FDIC visitation in December 2008. In hindsight, more supervisory emphasis on Georgian's risk management practices prior to the visitation in December 2008 would have been prudent. Doing so might have been beneficial in raising bank management's awareness of the broad supervisory expectations with regard to managing risk associated with CRE and ADC concentrations, which ultimately Georgian failed to meet. Further, examiners could have earlier recognized and emphasized Georgian's lack of a viable contingency funding plan, in light of the bank's reliance on non-core funding and a single large depositor. Once problems were identified, the FDIC and the DBF pursued supervisory actions. However, by the time those actions became effective, the financial condition of the bank had become critically deficient.

In addition to specific supervisory action taken with respect to Georgian, the FDIC either on its own, or jointly with the other federal banking agencies, has issued guidance relevant to the causes of the institution's failure. For example, guidance was issued in 2008, 2009, and more recently in March 2010, on liquidity management and the use of volatile or special funding sources by financial institutions that are in a weakened condition. Additionally, in 2009, the FDIC issued guidance extending the de novo period in recognition that unseasoned institutions may warrant stronger supervisory attention. Further, the FDIC recently established procedures to better communicate and follow up on risks and deficiencies identified during examinations.

Supervisory History

Georgian was examined nine times between 2001 and 2009 and received a composite "2" CAMELS rating[8] at the first seven examinations. Our review focused on the FDIC's supervision of Georgian between 2004 and its failure in 2009. During that period, the FDIC and the DBF conducted five safety and soundness examinations and the FDIC completed one visitation in 2008. In the 2007 examination, the FDIC used Maximum

---

[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.

Efficiency, Risk-focused, Institution Targeted (MERIT)[9] examination procedures. Table 4 summarizes the examination and visitation history for Georgian, from 2004 to 2009.

Table 4: Examinations and Visitation of Georgian, 2004 to 2009

Start Date	As of Date	Agency	Supervisory Rating	Supervisory Action
11/15/2004	09/30/2004	FDIC	212332/2	
11/28/2005	09/30/2005	DBF	212222/2	
01/09/2007	09/30/2006	FDIC	211222/2	
01/14/2008	09/30/2007	DBF	232222/2	
11/24/2008	N/A	FDIC (Visitation)	343332*/3	Bank Board Resolution (BBR)
02/02/2009	12/31/2008	Joint	554555/5	Cease and Desist (C&D) Order

Source: Reports of Examination (ROE) and Visitation Report for Georgian.
*Sensitivity to market risk was not reviewed at the visitation but this rating was included in the visitation memorandum.

In addition to the on-site examinations, Georgian was flagged for offsite review once in 2005 and twice in 2008. The second quarter 2008 offsite review, completed in October 2008, noted that although Georgian maintained a significant exposure to ADC lending, its overall performance was showing no signs of deterioration, unlike other institutions with similar exposure. Nonetheless, the FDIC scheduled a targeted visitation during the fourth quarter of 2008 that focused on underwriting practices that were potentially masking loan portfolio problems, liquidity levels, and contingency plans.

Specifically, the November 2008 visitation focused on a review of the bank's 10 largest commercial loans and the accompanying ALLL methodology. A limited review of the bank's capital adequacy, earnings, and liquidity was also conducted. The visitation identified significant deterioration in Georgian's overall performance and, on December 16, 2008, the bank's Board adopted a BBR in response to the visitation's findings. The BBR included provisions that addressed the ALLL, the establishment of a compliance committee, a review of the loan policy, a plan to reduce concentrations of credit, the adoption of a capital plan, a prohibition on additional brokered deposits, the preparation of a strategic business plan, and a review and amendment of the bank's interest rate risk policy.

The February 2009 full-scope joint examination determined that Georgian's overall condition was poor and had deteriorated significantly since the prior regulatory examination and resulted in a composite "5" CAMELS rating. The FDIC and the DBF pursued the implementation of a formal enforcement action, a C&D, to address the issues noted at the examination. The bank stipulated to the C&D on August 24, 2009.

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

The C&D required the bank to, among other things:

- increase Board participation in the affairs of the bank;
- retain qualified management;
- achieve and maintain its Tier 1 Capital at not less than 8 percent and its Total Risk-based Capital ratio of at least 10 percent;
- eliminate from its book by charge-off or collection assets or portions of assets classified as losses and 50 percent of doubtful loans;
- not extend, directly or indirectly, any additional credit to, or for the benefit of, any borrower who has a loan or other extension of credit from the bank that has been charged off or classified;
- review, revise, and implement its written lending policy;
- reduce concentrations of credit;
- review the ALLL policy and methodology;
- eliminate/correct all violations of law and contraventions of statement of policy;
- review liquidity and funds management and develop or revise, adopt, and implement a written contingency liquidity plan;
- formulate a written plan to reduce classified items;
- revise its internal loan review grading system;
- not pay cash dividends without prior written consent;
- not accept, renew, or roll over any brokered deposits and submit a written plan for reducing its reliance on brokered deposits;
- review its interest rate policy; and
- limit asset growth to 10 percent per annum.

Supervisory Concern Related to Aggressive Growth Strategy

Prior to the end of Georgian's de novo period in November 2004, as discussed earlier in this report, Georgian was required to notify the FDIC and the DBF of any proposed material change to its business plan. Consistent with that requirement, Georgian notified both the FDIC and the DBF, and they approved Georgian's 2003 proposal to raise additional capital and change its business focus. At that time, officials viewed Georgian's plan as reasonable based on the fact that a management team with a proven track record at other institutions with similar strategies would be implementing the plan. Although the FDIC approved the plan, it also recommended closely monitoring the bank's progress in implementing the strategy. In the 2004 examination, examiners compared Georgian's business plan projections to its actual performance. Table 5 provides a summary of key comparisons made as of September 30, 2004.

Table 5: Georgian's Business Plan Compared to Actual Performance in 2004

Category	Business Plan	Actual Performance	Variance	Explanation for Variance
Net Income ($000s)	$1,811	$1,331	(27%)	The variance was attributed to higher interest expense that was linked to (1) a higher volume of deposits and (2) the bank paying higher than market rates on deposits.
Total Deposits ($000s)	$274,041	$547,913	99.93%	Deposit growth was significantly above projections and was attributed to the bank's ability to obtain higher volume deposits, especially from Internet and brokered deposits. The bank offered above average rates on Certificates of Deposit (CD).
Total Loans ($000s)	$304,656	$546,551	79%	The volume of real estate and commercial lending was greater than projected as a result of higher demand in Georgian's market.

Source: 2004 ROE for Georgian.

Subsequent to this comparison, the 2005 examination report did not explicitly comment on the bank's growth strategy, other than to note that holding company capital injections continued to support the bank's asset growth of 70.65 percent for the first 3 quarters of 2005 and also resulted in an increase to the Tier 1 Leverage Capital Ratio. In 2006, examiners noted that the Tier 1 Leverage Capital Ratio declined despite additional capital injections due to continued strong asset growth. The 2007 examination report noted additional capital infusions and also that management expected asset growth to reach $400 million, resulting in total assets of $2 billion. Examiners stated asset quality was strong and viewed management and the Board as capable and providing strong oversight.

In 2009, the FDIC recognized that unseasoned institutions may warrant stronger supervisory attention. Specifically, in FIL-50-2009, the FDIC stated that recent experience had demonstrated that newly-insured institutions posed an elevated risk to the DIF. The FDIC had found that a number of newly-insured institutions, like Georgian, had pursued changes in business plans during the first few years of operation that had led to increased risk and financial problems because accompanying controls and risk management practices were inadequate. Accordingly, to address the heightened risks presented by newly-insured depository institutions, the FDIC extended the supervisory procedures for the de novo period from 3 to 7 years, and now requires the institutions to remain on a 12-month examination cycle and to obtain prior FDIC approval of any material change in an institution's business plan during the de novo period. In Georgian's case, the FDIC and the DBF approved the change in the business plan and kept the bank on a 12-month examination cycle but, going forward, acknowledged they would likely focus more supervisory attention on the growth rate and risk management practices.

Supervisory Concern Related to ADC Concentrations and Risk Management

Examiners consistently identified Georgian's ADC concentrations and made a number of recommendations related to risk management practices between 2004 and 2008. Nevertheless, during that period, examiners generally found risk management processes to be adequate in relation to economic conditions and asset concentrations.

November 2004 and November 2005 Examinations

In November 2004, examiners noted significant increases in ADC concentrations and recommended that limits be established for speculative loans. They also noted individual concentrations and recommended that procedures be improved to identify, monitor, and report the concentrations to the Board. In 2005, examiners again identified concentrations and made recommendations to ensure that the bank's Board (1) reviewed quarterly reports listing the major lines of credit, including individual concentrations and their relationship to Tier 1 Capital and (2) received a summary report outlining the bank's ADC concentration, including a calculation of funded and unfunded concentrations as a percentage of Tier 1 Capital.

January 2007 Examination

The FDIC 2007 examination identified significant concentrations that were deemed to be adequately monitored and controlled. Examiners commented that strong asset quality was indicative of management's conservative investment and lending philosophies, as well as management's approach to identifying and servicing problem credits. In addition, examiners noted that the Board had established adequate policies and oversight to provide management satisfactory guidance, but recommended that global cash flow analyses be implemented for borrowers with multiple relationships.

Although the asset quality and management components were each assigned "1" ratings, there were signs of increasing risks in that total loans had increased from $941 million at the 2005 examination, to $1.3 billion at the 2007 examination. In addition, the adversely classified items coverage ratio increased from 2.97 percent at the prior examination, to 6.97 percent at the 2007 examination, and the net non-core funding dependence had increased from 25 percent to 38 percent during that timeframe. Finally, loan penetration[10] was reduced from previous examinations because examiners used MERIT procedures. Specifically, loan penetration was 38 percent in 2004, 31 percent in 2005, and 20 percent in 2007. FDIC officials stated that the use of MERIT procedures was not a factor in their classification of Georgian's loan portfolio in 2007. Under MERIT, examiners had the option of expanding the sample had issues been uncovered.

[10] Loan penetration is calculated by dividing the total volume of nonhomogenous loans reviewed by the total dollar volume of nonhomongenous loans. Nonhomogenous loans are broadly defined as loans that are commercial or agricultural in nature and which generally require individual loan review.

January 2008 Examination

Although the overall condition of Georgian was determined to be satisfactory, the asset quality component rating was deemed less than satisfactory and reduced from a "1" to a "3", and the management component rating was downgraded to a "2". However, the DBF examination did not result in either a formal or informal supervisory action. Concentrations were noted, and DBF examiners commented that the exposure had resulted in a decline in asset quality but was mitigated by management's reduction in ADC lending since the last examination. Examiners stated that the decline in asset quality was primarily driven by deterioration in the real estate market, in which the bank had significant exposure through concentrations of credit. Examiners credited management with pursuing a strategy of portfolio diversification and reducing the concentration in ADC lending; however, they also noted that exposure remained at a level that could be problematic if market conditions continued to decline. Other risks identified included a substantial increase in the adversely classified items coverage ratio since the prior examination from 6.97 percent to 50.13 percent. Recommendations were related to improvements to the loan policy and loan administration.

To ensure that examiner follow-up is conducted, the FDIC issued guidance in January 2010 that defines a standard approach for communicating matters requiring bank Board attention (e.g., examiner concerns and recommendations) in examination reports. The guidance states that examination staff should request a response from the institution regarding the action that it will take to mitigate the risks identified during the examination and correct noted deficiencies. This approach provides examiners with another tool to hold the Board and management accountable for improved performance and should also facilitate effective supervisory follow-up. The DBF outlined the recommendations clearly in the examination report and also requested that the Board provide a response to the FDIC and the DBF within 30 days. The process the DBF followed is consistent with the recently issued supervisory guidance.

November 2008 Visitation

Examiners determined that the bank's risk profile had significantly increased due to its material concentration in ADC lending. Adversely classified loans, other real estate owned, and non-accrual loans greater than 90-days past due represented 145 percent of capital and reserves. Several inappropriate loan underwriting practices were also revealed. Examiners recommended that the bank's asset quality rating be downgraded to a "4" and the composite rating downgraded to a "3". Examiners concluded that management needed to reduce the bank's concentration in ADC lending and increase capital to a level commensurate with the bank's risk profile and, as previously discussed in this report, management adopted a BBR to correct deficiencies noted at the visitation.

February 2009 Examination

Georgian's financial condition was considered unsatisfactory and its composite rating was downgraded to a "5" rating. Further, the examination report noted that a majority of the provisions in the BBR had not yet been implemented. Overall, the FDIC and the

DBF deemed the bank's risk management practices to be unacceptable relative to the institution's size, complexity, and risk profile.

As discussed previously, Georgian stipulated to a C&D that became effective on August 31, 2009, but the order came too late to have any meaningful impact on the bank's viability. The bank closed on September 25, 2009 due to liquidity concerns. In hindsight, earlier and stronger supervisory action (i.e., prior to the November 2008 visitation) to address Georgian's high-risk profile and risk management weaknesses associated with the ADC concentration may have been prudent. Such action may have persuaded the bank's Board and management to take more timely and meaningful action to address the bank's increasing risk profile.

Supervisory Concern Related to Funding Strategy

Examiners consistently noted Georgian's increasing reliance on potentially volatile funding sources in each of the examination reports we reviewed but generally found the bank's funds management to be satisfactory, except in 2004 and in the final visitation and examination. By that time, the deterioration of asset quality had begun to have an adverse impact on Georgian's overall funds management practices.

Specifically, in 2004, examiners found Georgian's liquidity position to be marginal because of management's heavy reliance on potentially volatile sources to fund rapid growth, and the liquidity component was rated a "3" as it had been in the prior examination. Examiners requested that management submit monthly financial statements, including liquidity and net non-core funding ratios, to the DBF. In 2005, examiners found the bank's liquidity position had improved and ranked the liquidity component a "2", indicating satisfactory liquidity levels and funds management practices. Further, this rating indicated that the institution had access to sufficient sources of funds on acceptable terms to meet present and anticipated liquidity needs and modest weaknesses may be evident in funds management practices.

Georgian's liquidity component rating remained a "2" in the 2007 and 2008 examinations, despite a significantly increased reliance on potentially volatile funding sources, because examiners concluded that Georgian's liquidity levels and monitoring practices were satisfactory. For example, the 2008 examination report stated that the bank's liquidity position was adequate, funds management procedures were considered satisfactory, and secondary sources of funds appeared to meet the current needs of the bank. However, by the November 2008 visitation, examiners deemed the bank's liquidity component to be unsatisfactory, and the 2009 examination report indicated that liquidity and funds management practices were deficient. The 2009 examination report noted that Georgian's strained financial condition might reduce the bank's ability to attract funds in the open market on reasonable terms and borrowing lines may be reduced.

Indeed, the poor asset quality identified during the 2009 examination necessitated a loan loss provision that reduced Georgian's capital position to *Adequately Capitalized*, which resulted in brokered deposit restrictions. Specifically, FDIC's Rules and Regulations Part

337, *Unsafe and Unsound Banking Practices,* which implements section 29 of the FDI Act, state that any *Well Capitalized* insured depository institution may solicit and accept, renew, or roll over any brokered deposit without restriction. However, *Adequately Capitalized* institutions must receive a waiver from the FDIC before they can accept, renew, or roll over any brokered deposit. As stated earlier, Georgian's largest deposit relationship was also affected when the bank fell below *Well Capitalized.*

In August 2008, the FDIC issued guidance, FIL-84-2008 entitled *Liquidity Risk Management*, that described the FDIC's expectations for insured institutions that have shifted from asset-based liquidity strategies (i.e., maintaining pools of highly liquid and marketable securities to meet unexpected funding needs) to liability-based or off-balance sheet strategies (i.e., funding partly through securitization, brokered/Internet deposits, or borrowings). Institutions that use wholesale funding, securitizations, brokered deposits, and other high-rate funding strategies should ensure that their contingency funding plans address relevant stress events. Contingency funding plans should incorporate events that could rapidly affect an institution's liquidity, including a sudden inability to securitize assets, tightening of collateral requirements or other restrictive terms associated with secured borrowings, or the loss of a large depositor or counterparty.

Although Georgian prepared a contingency funding plan in January 2009, it was developed too late to be effective in addressing the bank's liquidity crisis. In that regard, examiners could have earlier recognized and emphasized Georgian's lack of a viable contingency funding plan, in light of the bank's reliance on non-core funding and a single large depositor. Earlier development of such a plan at Georgian might have alerted management to the risks inherent in their funding strategy in time to better mitigate those risks.

Implementation of PCA

The purpose of PCA is to resolve problems of insured depository institutions at the least possible long-term cost to the DIF. PCA (section 38 of the FDI Act) establishes a system of restrictions and mandatory and discretionary supervisory actions that are to be triggered depending on an institution's capital levels. Part 325, *Capital Maintenance,* of the FDIC's Rules and Regulations implements PCA requirements by establishing a framework for taking prompt corrective action against insured state-chartered nonmember banks that are not *Adequately Capitalized*.

In addition to including provisions in the August 2009 C&D on minimum capital requirements, as discussed earlier in the report, the FDIC followed PCA guidance and appropriately notified the bank on June 30, 2009 that the bank was considered *Adequately Capitalized*. Although the FDIC followed PCA guidance, by the time Georgian's capital levels fell below the required thresholds necessary to implement PCA, the bank's condition had deteriorated to the point at which the institution could not raise additional capital. At no time was the bank *Undercapitalized* for purposes of PCA, which would have triggered additional restrictions and requirements under PCA.

Prior to falling below *Well Capitalized,* Georgian had submitted an application for the Troubled Asset Relief Program on October 29, 2008 for funding of $59 million. Georgian subsequently withdrew its application on February 18, 2009. The bank was unsuccessful in raising capital and was closed on September 25, 2009.

Corporation Comments

After we issued our draft report, management provided additional information for our consideration, and we revised our report to reflect this information, as appropriate. On April 7, 2010, the Director, DSC, provided a written response to the draft report. That response is provided in its entirety as Appendix 4 of this report. DSC reiterated the OIG's conclusions regarding the causes of Georgian's failure. With regard to our assessment of the FDIC's supervision of Georgian, DSC's response stated that examiners consistently noted Georgian's ADC concentrations and reliance on non-core funding and made numerous recommendations to improve risk management practices and procedures to identify and report concentrations to the Board. In response to the FDIC's November 2008 visitation, which revealed significant deterioration in Georgian's overall condition, the Board adopted a resolution agreeing to address identified weaknesses. However, Georgian's management and Board were unable to sufficiently address its problems, and the FDIC and the DBF took action through a formal enforcement order. DSC's response acknowledged, as discussed in our report, that greater emphasis on the correction of Georgian's risk management practices prior to the November 2008 visitation could have influenced its Board and reduced resulting losses. Further, DSC's response identified updated guidance it has issued, also discussed in our report, to enhance supervision of institutions, such as Georgian, with concentrations in CRE/ADC lending and reliance on volatile non-core funding.

Objectives, Scope, and Methodology

Objectives

We performed this audit in accordance with section 38(k) of the FDI Act, which provides, in general, that if a deposit insurance fund incurs a material loss with respect to an insured depository institution, the Inspector General of the appropriate federal banking agency shall prepare a report to that agency reviewing the agency's supervision, including implementation of PCA, 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 Georgian's failure and resulting material loss to the DIF and (2) evaluate the FDIC's supervision of Georgian, including implementation of the PCA provisions of section 38.

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

Scope and Methodology

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

- Analyzed examination reports prepared by FDIC and DBF examiners from 2004 to 2009.

- Reviewed the following:

  - Bank data contained in UBPRs and Call Reports.
  - Correspondence maintained at DSC's Atlanta Regional and Atlanta Field Offices.
  - Reports prepared by the Division of Resolutions and Receiverships (DRR) and DSC relating to the bank's closure.
  - Information obtained from DSC's Virtual Supervisory Information on the Net.
  - Pertinent DSC policies and procedures.

- Interviewed the following FDIC officials:

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

Objectives, Scope, and Methodology

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

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

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

Consistent with the audit objectives, we did not assess DSC's overall internal control or management control structure. We relied on information in DSC systems, reports, examination reports, and interviews of examiners to understand Georgian'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 examination reports, correspondence files, and testimonial evidence to corroborate data obtained from systems that were used to support our audit conclusions.

The Government Performance and Results Act of 1993 (the Results Act) directs Executive Branch agencies to develop a customer-focused strategic plan, align agency programs and activities with concrete missions and goals, and prepare and report on annual performance plans. For this material loss review, we did not assess the strengths and weaknesses of DSC's annual performance plan in meeting the requirements of the Results Act because such an assessment is not part of the audit objectives. DSC's compliance with the Results Act is reviewed in program audits of DSC operations.

Regarding compliance with laws and regulations, we performed tests to determine whether the FDIC had complied with provisions of PCA and limited tests to determine compliance with certain aspects of the FDI Act, and of the FDIC Rules and Regulations. The results of our tests were discussed, where appropriate, in the report. Additionally, we assessed the risk of fraud and abuse related to our objectives in the course of evaluating audit evidence.

Glossary of Terms

Term	Definition
Adversely Classified Assets	Assets subject to criticism and/or comment in an examination report. Adversely classified assets are allocated on the basis of risk (lowest to highest) into three categories: Substandard, Doubtful, and Loss.
Allowance for Loan and Lease Losses (ALLL)	Federally insured depository institutions must maintain an ALLL that is adequate to absorb the estimated loan losses associated with the loan and lease portfolio (including all binding commitments to lend). To the extent not provided for in a separate liability account, the ALLL should also be sufficient to absorb estimated loan losses associated with off-balance sheet loan instruments such as standby letters of credit.
Call Report	The report filed by a bank pursuant to 12 United States Code (U.S.C.) 1817(a)(1), which requires each insured State nonmember bank and each foreign bank having an insured branch which is not a Federal branch to make to the Corporation reports of condition in a form that shall contain such information as the Board of Directors may require. These reports are used to calculate deposit insurance assessments and monitor the condition, performance, and risk profile of individual banks and the banking industry.
Cease and Desist Order (C&D)	A C&D is a formal enforcement action issued by a financial institution regulator to a bank or affiliated party to stop an unsafe or unsound practice or a violation of laws and regulations. A C&D may be terminated when the bank's condition has significantly improved and the action is no longer needed or the bank has materially complied with its terms.
Concentration	A concentration is a significantly large volume of economically related assets that an institution has advanced or committed to a certain industry, person, entity, or affiliated group. These assets may, in the aggregate, present a substantial risk to the safety and soundness of the institution.
De novo Bank	Prior to the issuance of FIL-50-2009 on August 28, 2009, and for the purposes of FDIC-supervised institutions, this term referred to an institution within its first 3 years of operation. FIL-50-2009 changed the de novo period for newly-chartered FDIC-supervised institutions from 3 years to 7 years. This FIL does not apply to de novo bank subsidiaries of "eligible holding companies", i.e., those with $150 million in consolidated assets, that are 2 rated, and with at least 75 percent of consolidated depository institution assets comprised of eligible depository institutions. Under the new de novo period, institutions must undergo a limited-scope examination within the first 6 months of operation, and a full-scope examination within the first 12 months of operation. Subsequent to the first examination, and through the 7^{th} year of operation, institutions remain on a 12-month examination cycle. Extended examination intervals (i.e., 18-month intervals) do not apply during the de novo period.

Glossary of Terms

Federal Home Loan Bank (FHLB)	The Federal Home Loan Bank System provides liquidity to member institutions that hold mortgages in their portfolios and facilitates the financing of mortgages by making low-cost loans, called advances, to its members. Advances are available to members with a wide variety of terms to maturity, from overnight to long term, and are collateralized. Advances are designed to prevent any possible loss to FHLBs, which also have a super lien (a lien senior or superior to all current and future liens on a property or asset) when institutions fail. To protect their position, FHLBs have a claim on any of the additional eligible collateral in the failed bank. In addition, the FDIC has a regulation that reaffirms FHLB priority, and FHLBs can demand prepayment of advances when institutions fail.
Prompt Corrective Action (PCA)	The purpose of PCA is to resolve the problems of insured depository institutions at the least possible long-term cost to the DIF. Part 325, subpart B, of the FDIC Rules and Regulations, 12 Code of Federal Regulations (C.F.R.), section 325.101, et. seq., implements section 38, *Prompt Corrective Action*, of the FDI Act, 12 U.S.C. section 1831(o), by establishing a framework for taking prompt supervisory actions against insured nonmember banks that are less than adequately capitalized. The following terms are used to describe capital adequacy: (1) Well Capitalized, (2) Adequately Capitalized, (3) Undercapitalized, (4) Significantly Undercapitalized, and (5) Critically Undercapitalized.
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
DBF	Department of Banking and Finance
DIF	Deposit Insurance Fund
DRR	Division of Resolutions and Receiverships
DSC	Division of Supervision and Consumer Protection
FDI	Federal Deposit Insurance
FHLB	Federal Home Loan Bank
FIL	Financial Institution Letter
MERIT	Maximum Efficiency, Risk-focused, Institution Targeted
OIG	Office of Inspector General
PCA	Prompt Corrective Action
ROE	Report of Examination
UBPR	Uniform Bank Performance Report
UFIRS	Uniform Financial Institutions Rating System

Corporation Comments

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

April 7, 2010

TO: Stephen Beard
Assistant Inspector General for Material Loss Reviews

/Signed/
FROM: Sandra L. Thompson
Director

SUBJECT: Draft Audit Report Entitled, Material Loss Review of Georgian Bank, Atlanta, Georgia (Assignment 2010-008)

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 Georgian Bank, Atlanta, Georgia (Georgian) which failed on September 25, 2009. This memorandum is the response of the Division of Supervision and Consumer Protection (DSC) to the OIG's Draft Report (Report) received on March 23, 2010.

The Report concludes that Georgian Bank (Georgian) failed because the Board of Directors (Board) and management pursued an aggressive growth strategy concentrated in acquisition, development and construction (ADC) loans, noting that these loans accounted for at least 48 percent of Georgian's average gross loans between 2003 and 2009. The lack of a diversified loan portfolio made Georgian vulnerable to the downturn in the residential real estate market in the Atlanta metropolitan area in 2008. The Report also cites lax loan underwriting and administration, reliance on brokered deposits and potentially volatile sources to fund its growth, as additional contributors to Georgian's failure.

Georgian opened for business in 2001, and in mid-2003 shifted its business focus from a community-centered bank to a medium-size business bank. From 2001 to 2009, the FDIC and the Georgia Department of Banking and Finance (DBF) conducted 9 examinations. Examiners consistently noted Georgian's ADC concentrations and reliance on non-core funding and made numerous recommendations to improve risk management practices and procedures to identify, monitor and report concentrations to the Board. The November 2008 visitation revealed significant deterioration in Georgian's overall condition and as a result, the Board adopted a Resolution agreeing to address identified weaknesses. However, Georgian's management and Board were unable to sufficiently address its problems, and the FDIC and DBF took action through a formal enforcement order.

Greater emphasis on correction of Georgian's risk management practices prior to the November 2008 visitation could have influenced its Board and reduced the resulting losses. DSC has issued updated guidance requiring prompt follow-up on all institutions when recommendations are made to the Boards of Directors. Additionally, DSC issued a Financial Institution Letter in 2009 on *The Use of Volatile or Special Funding Sources by Financial Institutions That Are in a Weakened Condition* to enhance our supervision of institutions, such as Georgian, with concentrated commercial real estate/ADC lending and reliance on volatile non-core funding.

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