Office of Inspector General

August 2009
Report No. AUD-09-016

Material Loss Review of The Community Bank, Loganville, Georgia

AUDIT REPORT

Office of Audits

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Federal Deposit Insurance Corporation

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Why We Did The Audit

On November 21, 2008, the Georgia Department of Banking and Finance (DBF), closed The Community Bank (Community) and named the FDIC as receiver. On December 15, 2008, the FDIC notified the OIG that Community's total assets at closing were $653.1 million, with a material loss to the Deposit Insurance Fund (DIF) estimated at $218.3 million. As required by section 38(k) of the Federal Deposit Insurance (FDI) Act, the Office of Inspector General (OIG) conducted a material loss review of the failure of Community.

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 of the FDI Act.

Background

Community was a state-chartered nonmember bank insured by the FDIC on October 5, 1946. Community was headquartered in Loganville, Georgia, and had three other branches in surrounding counties. Community was wholly owned by Triangle Financial Group, Inc., a one-bank holding company. The bank provided traditional banking services within its marketplace.

Community's loan portfolio largely consisted of commercial real estate loans (CRE), with a significant concentration in land acquisition, development, and construction (ADC) loans, many of which were funded with brokered deposits and other potentially volatile sources of funding. Community's loan portfolio grew over 135 percent between December 2003 and September 2008, with total loans peaking at over $500 million as of September 2008. Throughout this almost 5-year period, Community's ADC loans averaged over 70 percent of its loan portfolio.

Audit Results

Causes of Failure and Material Loss – Community's management implemented a business strategy centered on asset growth, primarily through concentrations in ADC loans in its market area, and funded through wholesale funding sources, including brokered deposits. Community's asset and funding strategies resulted in an increased risk profile for the bank. However, Community management did not establish and implement sound risk management practices and controls to mitigate this risk. For example, examinations identified weaknesses in loan underwriting and credit administration, recognition of problem assets, the methodology for computing the allowance for loan and lease losses (ALLL), and liquidity planning. As a result, Community was unprepared and unable to effectively manage the risk to its operations in a declining economic environment. Deterioration in Community's loan portfolio eroded earnings and capital and, in turn, the availability of wholesale funding sources. Ultimately, the bank became significantly undercapitalized and was unable to satisfy its liquidity requirements, leading to its failure.

Assessment of FDIC Supervision and PCA Implementation – Beginning February 2002 through September 2008, the FDIC and DBF provided supervisory oversight of Community, including through six risk management examinations, two visitations, and offsite monitoring. Community received composite ratings of 2 from 2002-2006 with the exception of the 2003 examination when it was downgraded to a 3, indicating increasing risk. At the November 2007 examination, the composite rating was downgraded to 4, indicating unsafe and unsound practices or conditions and a distinct possibility of failure if such conditions and practices were not satisfactorily addressed and resolved. As a result of the September 2008 targeted visitation, the composite and all component ratings were downgraded to a 5, indicating extremely unsafe and unsound practices or conditions, critically deficient performance, inadequate risk management practices, and great supervisory concern.

In addition to providing composite and component ratings for each Report of Examination (ROE), the FDIC took other supervisory actions, including making recommendations for improvement in each ROE; working with the DBF to convince Community's management to agree to adopt a Bank Board Resolution after the 2003 examination to address underwriting and administration deficiencies; and, in conjunction with the DBF, issuing a Cease and Desist Order on July 1, 2008 to address examiner concerns, which included ineffective supervision of asset quality by Community's board and management, asset quality that negatively affected capital and liquidity, an ineffective loan review process, and an inadequate ALLL.

With respect to PCA, the FDIC issued a letter to Community in May 2008, stating that, based on the bank's March 31, 2008 financial information, the bank was being downgraded to the PCA category of Adequately Capitalized and, therefore, could no longer accept, renew, or roll over any brokered deposits unless it obtained a waiver from the FDIC. On November 17, 2008, the FDIC used its authority under the PCA provisions of the FDI Act to issue a PCA Directive when Community became Significantly Undercapitalized, and DBF closed the bank 4 days later.

We concluded that the FDIC could have exercised greater supervisory concern as part of the 2006 examination regarding calculation of the ALLL and controls over ADC loan concentrations and helped ensure earlier supervisory action as a result of the 2007 examination to address the critical problems that led to the bank's failure.

The FDIC OIG plans to issue a series of summary reports on material loss reviews and will make appropriate recommendations related to the failure of Community and other FDIC-supervised banks at that time.

Management Response

On July 29, 2009, the Division of Supervision and Consumer Protection (DSC) provided a written response to the draft report. DSC did not comment on the OIG's conclusions regarding the causes of failure and material loss or on the OIG's assessment of the FDIC's supervision. However, DSC stated that the FDIC should take immediate supervisory action when an institution rated 3, 4, or 5 fails to implement a plan to stabilize or reduce its risk exposure and limit growth. DSC indicated that on March 3, 2009, it issued related guidance entitled, *The Use of Volatile or Special Funding Sources by Financial Institutions That are in a Weakened Condition*, to all FDIC-supervised institutions.

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

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

Office of Audits
Office of Inspector General

DATE: August 3, 2009

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

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

SUBJECT: *Material Loss Review of The Community Bank, Loganville, Georgia* (Report No. AUD-09-016)

As required by section 38(k) of the Federal Deposit Insurance Act (FDI Act), the Office of Inspector General (OIG) conducted a material loss[1] review of the failure of The Community Bank (Community), Loganville, Georgia. On November 21, 2008, the Georgia Department of Banking and Finance (DBF) closed the institution and named the FDIC as receiver. On December 15, 2008, the FDIC notified the OIG that Community's total assets at closing were $653.1 million and the material loss to the Deposit Insurance Fund (DIF) was $218.3 million. As of July 17, 2009, the estimated loss to the DIF increased to $247 million.

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

The audit objectives were to: (1) determine the causes of the financial institution's failure and resulting material loss to the DIF and (2) evaluate the FDIC's supervision[2] of the institution, including implementation of the PCA provisions of section 38 of the FDI Act. Appendix 1 contains details on our objectives, scope, and methodology. Appendix 2 contains a glossary of terms, and Appendix 4 contains a list of acronyms used in the report.

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

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

This report presents the FDIC OIG's analysis of Community's failure and the FDIC's efforts to ensure Community's management operated the bank in a safe and sound manner. The FDIC OIG plans to issue a series of summary reports on our observations on the major causes, trends, and common characteristics of financial institution failures resulting in a material loss to the DIF. Recommendations in the summary reports will address the FDIC's supervision of the institutions, including implementation of the PCA provisions of section 38.

BACKGROUND

Community was a state-chartered nonmember bank, established on October 5, 1946 by the DBF and insured by the FDIC on the same day. Community, which was headquartered in Loganville, Georgia:

- had three branches in Georgia;
- was a wholly-owned subsidiary of Triangle Financial Group, Inc., a one-bank holding company;
- provided traditional banking activities within its marketplace;
- specialized in commercial lending, with concentrations in commercial real estate (CRE) and acquisition, development, and construction (ADC) loans; and
- used brokered deposits, Internet deposits, Federal Home Loan Bank (FHLB) borrowings, and loan participations to fund asset growth.

Selected details on Community's financial condition, as of September 2008, and for the 5 preceding calendar years follow in Table 1.

Table 1: Financial Condition of Community

	Sept-08	**Dec-07**	**Dec-06**	**Dec-05**	**Dec-04**	**Dec-03**
Total Assets ($000s)	$634,901	$601,715	$476,117	$391,315	$310,444	$251,126
Total Deposits ($000s)	$603,733	$539,246	$418,438	$343,399	$265,585	$212,645
Total Loans ($000s)	$505,755	$491,161	$410,420	$343,769	$276,053	$215,471
Loan Growth Rate	-3.24%	18.83%	19.48%	24.55%	28.13%	33.67%
Net income (Loss) ($000s)	(26,757)	2,962	10,027	8,424	6,770	4,687
Loan Mix (% of Loans):						
All Loans Secured by Real Estate	**98%**	**98%**	**97%**	**97%**	**96%**	**94%**
ADC	79.85%	78.44%	76.19%	75.05%	73.07%	68.63%
CRE - Nonfarm/nonresidential	9.35%	9.79%	11.64%	12.32%	10.82%	11.18%
Multifamily Residential Real Estate	1.89%	2.65%	1.49%	.24%	.68%	.93%
1-4 Family Residential Real Estate	6.83%	6.92%	8.15%	9.68%	11.23%	13.56%
Home Equity Loans	1.71%	1.84%	1.61%	.55%	.20%	.70%

	Sept-08	Dec-07	Dec-06	Dec-05	Dec-04	Dec-03
Other Real Estate Loans	11.24%	12.44%	13.13%	12.56%	11.54%	12.23%
Commercial and Industrial Loans	**1.68%**	**1.74%**	**1.89%**	**1.94%**	**2.95%**	**3.61%**
Funding:						
Total Core Deposits ($000)	$244,073	$208,736	$181,426	$145,434	$165,347	$165,305
Total FHLB Borrowings ($000)	0	$1,500	$1,500	$1,500	$7,000	$7,000
Total Brokered Deposits ($000)	$295,013	$265,545	$193,537	$161,386	$107,717	$50,860
Examination Information	**9/29/2008**	**11/6/2007**	**5/22/2006**	**4/18/2005**	**1/12/2004**	**6/18/2003**
Component/Composite Ratings[a]	555555/5	344434/4	122121/2	132121/2	232121/2	233222/3
Adverse Classifications Ratio	[b]	136%	37%	56%	61%	51%

Source: Uniform Bank Performance Report (UBPR) data, Reports of Examination (ROE) and Visitation Report.

[a] Financial institution regulators and examiners use the Uniform Financial Institutions Rating System (UFIRS) to evaluate a bank's performance in six components represented by the CAMELS acronym: **C**apital adequacy, **A**sset quality, **M**anagement practices, **E**arnings performance, **L**iquidity position, and **S**ensitivity to market risk. Each component, and an overall composite score, is assigned a rating of 1 through 5, with 1 having the least regulatory concern and 5 having the greatest concern.

[b] The targeted visitation report prepared by the DBF did not include the adverse classifications ratio.

CAUSES OF FAILURE AND MATERIAL LOSS

The failure of Community Bank and resulting material loss to the DIF occurred because of the bank's rapid growth concentrated in local market ADC loans and funded with wholesale funding sources, including brokered deposits. The bank's management did not establish and implement sound risk management practices and controls to mitigate risks in the loan portfolio. Weaknesses in loan underwriting and credit administration, delayed recognition of problem assets, and an untested methodology for computing the allowance for loan and lease losses (ALLL) left Community unprepared and unable to effectively manage the risk to its operations in a declining economic environment. Resulting deterioration in the loan portfolio eroded Community's earnings and capital, which affected Community's ability to secure wholesale funding. Ultimately, the bank became Significantly Undercapitalized and was unable to satisfy its liquidity requirements, leading to its failure. The resulting loss to the DIF at closing was estimated at $218.3 million, or 33 percent of Community's estimated assets.

Losses in Community's ADC loan portfolio were the primary cause of the bank's failure. Community's loan portfolio grew over 135 percent between December 2003 and September 2008, with total loans peaking at over $500 million as of September 2008. Throughout this almost 5-year period, Community's ADC loans averaged over 70 percent of its loan portfolio. Community's growth in ADC lending was funded by brokered deposits and other wholesale funding. The bank had a non-core funding dependence well in excess of its peer institutions. Community's use of brokered deposits grew 480 percent from December 2003 through its closing. As of September 2008, brokered deposits totaled $295 million, exceeding Community's total core deposits of $244 million. Losses in the ADC loan portfolio affected Community's ability to secure necessary funding to continue operations.

The value of Community's loan portfolio deteriorated significantly as the Atlanta real estate market and overall economy slowed. Such deterioration became particularly evident as adversely classified loans increased from about $18 million in 2006 to about $62 million in 2007, as shown in Table 2, which follows.

Table 2: Community's Adverse Loan Classifications

	Asset Quality (Dollars in Thousands)			
	Adverse Loan Classifications			
Examination Date	**Substandard**	**Doubtful**	**Loss**	**Total Adversely Classified Items**
February 2002	$2,223	0	$55	$2,278
June 2003	$8,160	$105	$85	$8,350
January 2004	$19,560	0	$80	$19,640
April 2005	$21,312	0	$10	$21,322
May 2006	$17,480	0	$28	$17,508
November 2007	$61,803	0	$341	$62,144
September 2008*	$43,508	N/A	N/A	N/A

Source: FDIC and DBF ROEs for Community.
* DBF/FDIC targeted visitation.
N/A - Information was not included in the visitation report.

ADC Loan Concentrations

ADC concentrations in Community's loan portfolio, which peaked at 80 percent of average assets in 2008, magnified the effect of loan losses because it put the bank at risk in the event of an economic downturn impacting the construction market in which it was lending. During the period 2002 through 2007, FDIC and DBF ROEs reported Community's ADC concentrations to be above 300 percent of Tier 1 Capital, reaching over 1,100 percent of Tier 1 Capital at the June 2003 examination and over 1,300 percent at the September 2008 targeted visitation. UBPR data showed that Community's ADC concentrations were also high in comparison to Community's peer group. Specifically, as shown in Table 3, within its peer group, Community was consistently in the 99th percentile of ADC loans as a percentage of average loans.

Table 3: ADC Loans as a Percentage of Average Loans – Compared to Peer

Period Ended	**ADC Loans** (%)	**Percentile Ranking** (%)
Sept-08	80	99
Dec-07	78	99
Dec-06	76	99
Dec-05	75	99
Dec-04	73	99

Period Ended	**ADC Loans** (%)	**Percentile Ranking** (%)
Dec-03	69	99
Dec-02	70	99

Source: UBPRs for Community.

Community's concentrations in ADC lending was a long-standing condition. Each ROE from 2002 through 2006 mentioned ADC concentrations or specifically suggested that bank management diversify its loan portfolio. For example:

- The February 2002 ROE states, "While the level of adversely classified assets remains low, management has significant concentrations of credit in residential acquisition, development and construction lending (749 percent of tier one capital) . . . ."

- The January 2004 ROE states, "Concentrations in the Acquisition, Development, and Construction (ADC) industry continue and represent 383 percent of Tier One Capital and management closely monitors the ADC portfolio . . . ."

- The May 2006 ROE states, "The bank has an industry concentration of credit in acquisition, development, and construction (ADC) loans . . . The ADC concentration totals 731 percent of Tier 1 Capital, management is encouraged to diversify its loan portfolio to the extent possible and continue to closely monitor these concentrations. . . ."

However, according to FDIC and DBF officials, Community's response to requests to diversify its loan portfolio was that the bank's earnings were good and loan losses were low. Therefore, Community's management did not implement timely actions to address its ADC concentration risk.

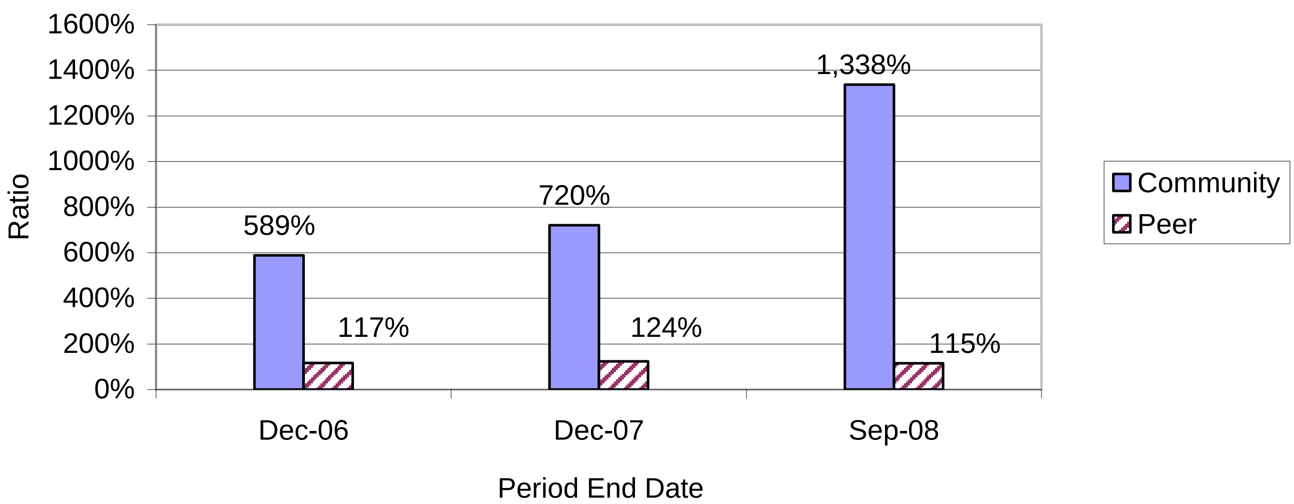
Additionally, on December 12, 2006, the FDIC, the Office of the Comptroller of the Currency, and the Board of Governors of the Federal Reserve System jointly issued guidance regarding concentrations in CRE entitled, *Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices*. The guidance acknowledges that a concentration in CRE loans, coupled with weak loan underwriting and depressed CRE markets, may contribute to significant loan losses.[3] The guidance reminds banks that their ". . . risk management practices and capital levels should be commensurate with the level and nature of their CRE concentration risk." With respect to supervisory oversight, the guidance also states the following:

[3] Additionally, the FDIC issued Financial Institution Letter (FIL) 22-2008 on March 17, 2008, entitled, *Managing Commercial Real Estate Concentrations In a Challenging Environment*, which re-emphasized the importance of strong capital, ALLL, and loan risk management practices for state nonmember institutions with significant CRE and construction and development loan concentrations.

> As part of their ongoing supervisory monitoring processes, the Agencies will use certain criteria to identify institutions that are potentially exposed to significant CRE concentration risk. An institution that has experienced rapid growth in CRE lending, has notable exposure to a specific type of CRE, or is approaching or exceeds the following supervisory criteria may be identified for further supervisory analysis of the level and nature of its CRE concentration risk:
>
> (1) Total reported loans for construction, land development, and other land represent 100 percent or more of the institution's total capital; or
>
> (2) Total commercial real estate loans as defined in this Guidance represent 300 percent or more of the institution's total capital, and the outstanding balance of the institution's commercial real estate loan portfolio has increased by 50 percent of more during the prior 36 months.
>
> The Agencies will use this criteria as a preliminary step to identify institutions that may have CRE concentrations.

As noted in Figure 1, which follows, Community's ADC loan concentrations continued to grow after the guidance was issued – increasing from 589 percent to 1,338 percent of total capital between December 2006 and September 2008. Based on the above guidance, these concentrations may have warranted additional management attention. Although the percentage of ADC loans to total capital as of September 2008 may have been somewhat skewed due to the bank's extensive losses and reduced capital level, the bank was consistently in the 99th percentile of its peer group for this measure for a number of years.

Figure 1: ADC Loans as a Percentage of Total Capital



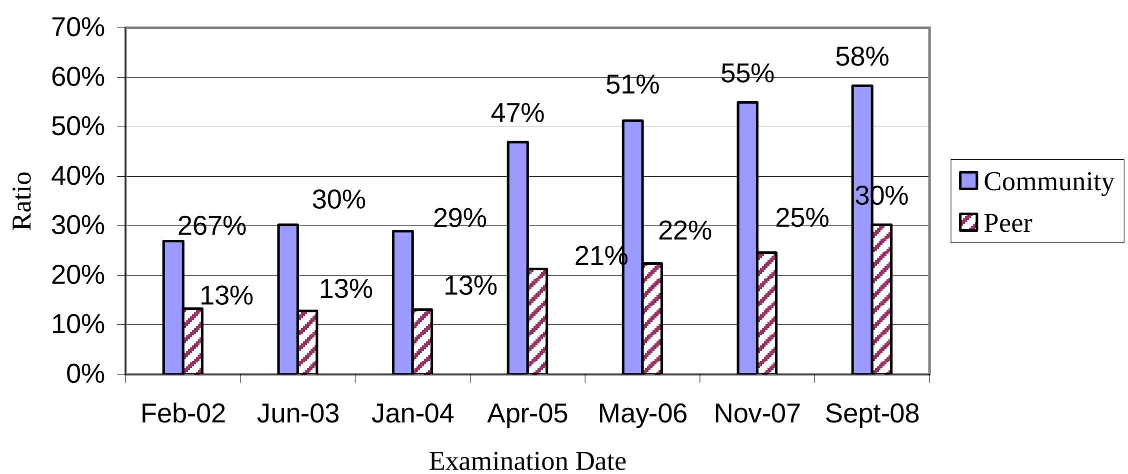
Source: OIG review of UBPR reports.

Use of Wholesale Funding

Another factor that contributed to Community's failure and the material loss to the DIF was Community's increasing dependence on higher-cost and more volatile wholesale (non-core) sources of funding, such as brokered deposits and Internet certificates of deposits (CD), to fund asset growth and manage its liquidity position. Non-core sources of funding add risk to an institution because they often become unavailable when institutions need them most, during a period of tightened liquidity. Liquidity represents the ability to fund assets and meet obligations as they become due. A key metric of the risks related to a bank's liquidity management is the net non-core dependency ratio. This ratio indicates the degree to which the bank relies on non-core/potentially volatile liabilities to fund long-term earning assets. Generally, a lower ratio indicates less risk exposure for a bank, whereas a higher ratio reflects a reliance on funding sources that may not be available in times of financial stress or adverse changes in market conditions.

As noted in Figure 2, which follows, from 2002 through 2008, Community's reliance on non-core/volatile liabilities significantly exceeded its peer group average, with the variance becoming considerably greater in recent years. Brokered deposits grew by about $72 million from December 2006 to December 2007 alone, reaching a total of about $266 million. Further, the bank's March 31, 2008 Call Report indicated that 3 months later, brokered deposits increased to about $289 million, representing about 51 percent of total deposits.

Figure 2: Net Non-Core Funding Dependence - Compared to Peer



Source: OIG review of UBPR Reports.

Examiners were concerned about Community's liquidity position, noting in the November 2007 ROE that the bank's liquidity was strained and that the bank was relying on non-core funding, with brokered deposits accounting for 49 percent of total deposits. Community was notified by the FDIC in May 2008 that as a result of its weakened capital condition, the bank could no longer accept, renew, or roll over any brokered deposits without a waiver from the FDIC. The bank was not able to attract sufficient core deposits to reduce its non-core funding dependency and was unable to obtain alternative sources of funding, which contributed to the bank's failure. Community received a waiver through September 30, 2008 to continue to accept brokered deposits, but a second waiver application was not approved.

Weak Risk Management Practices

In addition to rapid growth in ADC lending and substantial use of wholesale funding to support loan growth and manage liquidity needs, Community also exhibited several weak risk management practices, as described below, that contributed to its failure. As a result, Community did not take adequate corrective action in response to repeat examination findings related to loan concentrations, loan underwriting and credit administration, and properly classifying assets.

Dominant Bank Official. According to examiners, one individual, who was the president, Chief Executive Officer (CEO), and chairman of Community's board of directors (BOD), dominated the daily operations of the bank and hired family members for senior lending positions even though they had no prior banking/lending experience. Further, FDIC and DBF officials stated that the CEO showed contempt for the regulatory process and would not implement any examiner suggestions or recommendations unless the actions were required by regulation.

Loan Underwriting and Credit Administration. Community exhibited weaknesses in its loan underwriting and credit administration activities. For example, in the June 2003 ROE, examiners noted that senior management in Community failed to adequately supervise and monitor the loan administration area and activities of loan officers and other loan personnel. According to that ROE, financial information in some loan files was unsigned or did not accurately reflect a borrower's net worth, which is used for determining the borrower's ability to repay a loan. Further, in some loan files, there was no meaningful evidence of the bank's analysis of financial statements received; in particular, cash flow and/or debt service analyses. The 2003 and other examinations also identified that Community did not always follow sound loan underwriting standards, including those related to (1) legal lending limits[4] to individuals and (2) real estate loan-to-value limits. In our opinion, these weaknesses may have contributed to the decline in asset quality and losses in Community's loan portfolio.

- **Legal Lending Limit:** Community did not follow a state legal lending limit designed to help banks avoid concentrations of lending to individual borrowers. Specifically, at each examination conducted in 2002 through 2004 and again in 2007 and 2008, examiners cited Community for violation of subsection 7-1-285(b) of the Financial Institutions Code of Georgia, which states, in part,

[4] Senior DSC officials stated that there are no federal legal lending limits and, as a part of each FDIC examination, examiners check each bank's compliance with state legal lending limits.

> . . . bank shall not directly or indirectly make loans to any one person or corporation that in the aggregate, exceed 15 percent of the statutory capital base of the bank unless the entire amount of such loans is secured by good collateral or other ample security and does not exceed 25 percent of the statutory capital base.

The November 2007 ROE states that violations of the secured lending limit were particularly egregious, as evidenced by loan approval forms for individual extensions of credit that were clearly in excess of secured lending limits. These concentrations of credit to individual borrowers increased Community's risk profile as evidenced by the results of our review of the same large borrowing relationships reviewed by examiners during the September 2008 targeted visitation. The visitation identified a $25 million shortfall in the ALLL, of which about $20 million related to six individual concentrations of credit.[5]

- **Real Estate Loan-to-Value Limits:** Community also made loans that exceeded the regulatory real estate loan-to-value limits. Specifically, the May 2006 ROE cited Community for being in contravention of a statement of policy with regard to Appendix A to Part 365 of the FDIC Rules and Regulations, which establishes loan-to-value limit guidelines for various types of real estate to be set forth in a bank's lending policies. Appendix A states, in part, that it may be appropriate in individual cases to originate or purchase loans with loan-to-value ratios in excess of the supervisory limits, based on the support provided by other credit factors. Appendix A also stipulates that the aggregate amount of all loans in excess of the supervisory loan-to-value limits should not exceed 100 percent of total capital and that exceptions should be reported to the institution's BOD at least quarterly. Failure to report all exceptions can increase the amount of loss to an institution when a borrower defaults and collateral is the only source of repayment.

  Specifically, the ROE identified seven loan relationships that Community failed to report as exceptions to Appendix A to Part 365. The seven loans had a total balance of $11.1 million, which, according to the ROE, brought the aggregate balance of loans, with exceptions, to $35.3 million, equaling 74 percent of total capital. Although this percentage is below the supervisory criteria, the deficiencies in identifying and reporting exceptions were a supervisory concern.

Recognition of Problem Assets. Community's management did not recognize problem assets in a timely manner. The May 2006 and November 2007 ROEs noted that Community's grading system for non-consumer loans was based on a 2005 interagency proposal of classifications of commercial credit exposures; however, the proposal was ultimately not adopted by the regulatory agencies. At the beginning of the November 2007 examination, the bank rated loans of about $35.1 million as marginal, $5.2 million as weak, and $7.0 million as default. According to the November 2007 ROE, when Community management updated its loan grading system, about $74.0 million in loans

[5] The bank had been previously cited for violations of the legal lending limit in one or more ROEs from 2002 through 2007 in relation to these six individual concentrations.

was rated weak or default – a significant increase over the previous classifications. Earlier recognition of problem assets by Community's management may have led to earlier corrective action by the bank.

The 2006 ROE noted that previously classified loans remained in the bank but under different borrowers' names, including the limited liability corporations created by Community's holding company. Further, the 2007 ROE noted that the bank had taken in over $30 million in bank-owned real estate since the prior examination and that over 95 percent of the reduction in the bank's owned real estate since the 2006 examination had been sold to existing customers, with financing provided by the bank, often with significant concessions in terms of loan fees, interest rates, down payments, and frequency of interest payments. Some of the borrowers may not have qualified for credit under other circumstances, which could have resulted in repeat property foreclosures. In our opinion, these practices could have created the appearance that loan losses at the bank were low. Moreover, selling properties to borrowers who may not be creditworthy may have further delayed Community's recognition of problem assets.

Allowance for Loan and Lease Losses. Community's methodology for determining its ALLL did not follow interagency policy. Specifically, on December 13, 2006, the FDIC issued FIL-105-2006, which distributed the *Interagency Policy Statement on the Allowance for Loan and Lease Losses* (Policy Statement). The Policy Statement indicated that each institution must analyze the collectibility of its loans and maintain an ALLL at a level that is appropriate and determined to be in accordance with Generally Accepted Accounting Principles (GAAP).[6] An appropriate ALLL covers estimated loan losses on individually evaluated loans that are determined to be impaired as well as estimated loan losses inherent in the remainder of the loan and lease portfolio.

In the 2003, 2006, and 2007 ROEs, examiners recommended either an increase in Community's ALLL or improvements in the ALLL methodology. Specifically:

- The 2003 ROE states that the ALLL was deficient by approximately $1.3 million based on the adversely classified and criticized loans identified in the examination and the bank's methodology for determining ALLL adequacy. The examiners told management to ensure that the bank's ALLL was sufficient by the next Consolidated Report of Condition and Income (Call Report) date.

- The 2006 ROE states that management should consider adverse classifications identified by the external loan review and regulatory examinations to help determine ALLL adequacy in future calculations, in accordance with bank policy.

[6] The Policy Statement reiterates key concepts and requirements pertaining to the ALLL included in the GAAP and existing regulatory guidance. In addition, the policy describes the nature and purpose of the ALLL; the responsibilities of BODs, management, and examiners; factors to be considered in the estimation of the ALLL; and the objectives and elements of an effective loan review system, including a sound loan grading system.

- During the course of the 2007 examination, the DBF required bank management to conduct an ALLL analysis to conform to the guidance in FIL-105-2006. As a result, the bank had to increase the ALLL by $3.2 million.

Further, a July 2008 Cease and Desist Order (C&D) required the bank to review the adequacy of the ALLL and establish a comprehensive policy for determining the adequacy of the allowance. However, the September 2008 targeted visitation to review large borrowing relationships identified a shortfall in the ALLL of at least $25 million, which reduced capital and led to the bank being deemed Significantly Undercapitalized for PCA purposes.

Contingency Liquidity Planning. Community did not implement sound liquidity risk management controls that included a comprehensive contingency liquidity plan (CLP).[7] As a result, when Community's liquidity position became severely critical in 2008, bank management was ineffective in obtaining sufficient liquidity for the institution. Examiners noted in the 2002-2007 ROEs and the 2004 and 2008 visitation reports that management kept liquidity levels low.

According to the FDIC's *Risk Management Manual of Examination Policies* (Examination Manual), CLPs should be in force and include strategies for handling liquidity crises and procedures for addressing cash-flow shortfalls in emergency situations. The manual also states that financial institutions should have an adequate CLP in place to manage and monitor liquidity risk, ensure that an appropriate amount of liquid assets is maintained, measure and project funding requirements during various scenarios, and manage access to funding sources.

By the 2007 examination, Community continued to increase its reliance on brokered deposits for funding and experienced a significant decline in asset quality, two early warning indicators that should have prompted Community's management that there was a need for a comprehensive CLP. Bank management reviewed and revised its liquidity policy in response to the July 2008 C&D. However, bank management was not able to fully implement the revised policy, because bank management was unsuccessful in identifying capital investors. During the September 2008 visitation, examiners concluded that the bank understated the initial $26 million in additional capital needed to maintain operations, given the required increase of at least $25 million for the ALLL and the unidentified losses that remained in the loan portfolio.

Prior to Community's failure, the FDIC issued additional guidance related to liquidity risk and the CLP. The FDIC's *Liquidity Risk Management* guidance, dated August 26, 2008, urged financial institution BODs to establish a formal CLP that identifies quantitative liquidity risk guidelines. The guidance also states that CLPs should identify the institution's liquidity risk profile and the types of stress events, including, but not limited to, deterioration in asset quality; becoming less than Well Capitalized; the need to fund unplanned asset growth; loss of access to market funding sources; and the impact of

[7] The FDIC uses the terms CLP, liquidity contingency plan, and contingency funding plan interchangeably. For purposes of this report, we use CLP.

negative press coverage. The guidance also reiterates the need to address in the CLP many of the elements that Community's CLP did not include such as: (1) an adequate system of internal controls that ensures an independent review, (2) a method of computing the bank's cost of funds, (3) establishing a process for measuring and monitoring liquidity, and (4) tax planning.

The 2007 ROE noted increased concerns about Community's liquidity position. Community's liquidity was downgraded to a 3 rating, which is considered marginally adequate, and the ROE states that management relied heavily on brokered deposits for funding. The ROE also states that Community attempted to attract core deposits in the fourth quarter of 2007, but that effort met with limited success. Further, bank management allowed one line of credit to lapse, while another bank reduced Community's federal funds line of credit from $10 million to $2.5 million, thereby negatively affecting Community's liquidity management options. In an attempt to address liquidity issues, the bank submitted a brokered deposit waiver request to the FDIC and was approved to accept brokered deposits and to renew such deposits maturing between July 1, 2008 and September 30, 2008.

In September 2008, the DBF and FDIC conducted a joint visitation at Community. The visitation concluded that the bank would become insolvent because it was unable to meet liquidity demands based on asset quality problems, even though Community took initial steps to increase its liquidity levels and was continuing to obtain deposits through Internet deposit listing services. Ultimately, the FDIC did not approve Community's second brokered deposit waiver request based on the results of the visitation. The examination results and supervisory activities involving Community's liquidity needs highlight the importance of contingency liquidity planning.

ASSESSMENT OF FDIC SUPERVISION

Over the life of Community, the FDIC and DBF provided supervisory oversight in many ways, including risk management examinations, visitations, and offsite monitoring. Overall, the FDIC drew bank management attention to critical matters that contributed to the failure; however, the FDIC could have exercised greater supervisory concern regarding ADC loan concentrations in the 2006 examination and taken supervisory action prior to the completion of the 2007 examination to help prevent the bank's failure and/or potentially reduced the loss to the DIF.

Historical Snapshot of Supervision

The FDIC and DBF performed regular examinations of Community, conducting six examinations and two visitations from February 2002 through September 2008. Community received composite CAMELS ratings of 2 from the 2002-2006 examinations, with the exception of the 2003 examination when it was downgraded to 3, indicating increasing risk. At the November 2007 examination, the composite rating was downgraded to 4, indicating unsafe and unsound practices or conditions and a distinct possibility of failure if such conditions and practices were not satisfactorily addressed and resolved. As a result of the September 2008 targeted visitation, the composite and component ratings were downgraded to a 5, indicating extremely unsafe and unsound practices or conditions, critically deficient performance, inadequate risk management practices, and great supervisory concern.

At each FDIC examination, the FDIC made recommendations for improvements, including: revising or amending the bank's loan policy, correcting internal control deficiencies, and revising the funds management policy. In addition, the FDIC made suggestions to improve the bank's operations which included: diversifying the loan portfolio, continuing to closely monitor the ADC concentrations; and reconciling the bank's internal loan grading system to the one used by regulators.

As a result of the 2003 examination, Community's management agreed to adopt a Bank Board Resolution (BBR), which included: implementing procedures to correct loan underwriting and administration deficiencies, reducing assets classified substandard and doubtful, and correcting all violations of laws and regulations.

According to the FDIC, on March 3, 2008, DSC issued its offsite review list (ORL) based on the Bank's December 31, 2007 Call Report data. An FDIC Case Manager reviewed the Call Report data and noted, in an *Offsite Review* report, dated March 31, 2008, that the ORL flagged Community as having a 100-percent probability of downgrade to a composite 5 rating and that:

> The State Authority commenced an examination of the subject institution on November 6, 2007, with preliminary ratings of 2-4-4-3-3-3/4 assigned . . . The State report remains outstanding pending determination of an appropriate ALLL level. The state has yet to determine the form of any administrative action that will be pursued in this matter.

On May 23, 2008, the FDIC notified Community that, based on its March 31, 2008 Call Report, the bank had fallen from the Well Capitalized PCA category to the Adequately Capitalized category and, therefore, the bank could no longer accept, renew, or roll over any brokered deposits unless it obtained a waiver from the FDIC as stated in the PCA-related provisions in Part 325 of the FDIC Rules and Regulations. The bank submitted a waiver application and was approved to accept brokered deposits and to renew such deposits maturing between July 1, 2008 and September 30, 2008. The waiver stated:

> Given the bank's reliance on wholesale funding and the volume of brokered deposits maturing during the next 90 day period, approval of this waiver will be critical to the bank's survival over that period…. The goal of the waiver is to allow for an orderly reduction while the bank continues to address this and other significant problems.

According to the FDIC, bank management reduced the dollar volume of brokered deposits per a reduction schedule submitted with its brokered deposit waiver application; however, the bank's total brokered deposits and non-core funding dependence increased, and peaked in September 2008. Community filed a second brokered deposit waiver application in September 2008 to cover brokered deposits maturing during the fourth quarter of 2008. The FDIC held the request, pending the preliminary findings of the September joint DBF/FDIC visitation and, based on the results of the visitation, did not approve the waiver application.

In June 2008, the DBF issued the ROE documenting the results of its November 2007 examination. In the ROE, the DBF downgraded the bank to a composite 4 because the bank's condition had significantly deteriorated due to management's continued reliance on rising real estate values as collateral to protect the bank from losses rather than the borrower's ability to pay, coupled with management's failure to diversify the bank's loan portfolio. The DBF concluded that the bank was exposed to substantial losses with the dramatic decline in the local housing market. The ROE also stated that Community's BOD had not adequately identified, measured, monitored, and controlled the risks of the bank as evidenced by: (1) the excessive number of violations of law and contraventions of statements of policy, (2) the escalating level of nonperforming assets, (3) the high dependence on non-core funding, (4) insufficient earnings to sustain bank operations, (5) significant degree of interest rate risk, and (6) a deficient capital level. The level of adversely classified items had increased approximately 470 percent from the prior examination. Also, examiners stated that management was still unreceptive to suggestions to diversify the loan portfolio in light of the high concentration levels.

As a result of the November 2007 examination, the DBF, in consultation with the FDIC, issued a C&D on July 1, 2008 to address examiner concerns. Those concerns included, but were not limited to, ineffective supervision of asset quality by Community's BOD and management, asset quality negatively impacting capital and liquidity, an ineffective loan review process, and an inadequate ALLL. The C&D required Community management to, among other things:

- Develop a written analysis and assessment of the bank's management and staffing needs, including hiring an experienced lending officer and credit analyst.
- Develop and adopt a plan to meet the minimum capital requirements.
- Develop goals and strategies for improving and sustaining the earnings of the bank.
- Properly recognize adversely classified assets.
- Establish a plan to reduce the level of concentrations in the loan portfolio.

- Extend no additional credit to any borrower who had a loan or other extension of credit from the bank that had been charged off or was classified, in whole or in part; was classified as loss or substandard; or was uncollected.

- Review the adequacy of the ALLL and establish a comprehensive policy for determining the adequacy of the allowance.

- Submit a revised loan policy to supervisory authorities for review that includes a requirement for written documentation of the borrower's ability to repay each extension of credit and guidelines for obtaining and reviewing required collateral documentation.

As part of the July 2008 C&D, the FDIC and DBF also required Community to report its liquidity position on a weekly basis.

By the time of the FDIC/DBF targeted visitation in September 2008, the bank had further deteriorated due to management's inability to recognize and address the asset quality problems and acquire necessary capital to sustain the bank's operations. The visitation concluded that substandard loans totaled $43.5 million, while the level of noncurrent loans totaled $164.3 million. Noncurrent loans and bank-owned real estate (which totaled $54.9 million) represented 319 percent of Tier 1 Capital and the ALLL as of September 30, 2008. The ratio of past-due and nonaccrual loans to total loans was calculated at 40 percent during the visitation, with a noncurrent loans-to-total-loans ratio of 33 percent. Based on this information, examiners determined that the ALLL was underfunded by at least $25 million and that the deterioration in asset quality threatened the viability of the bank. As a result, examiners downgraded Community's asset quality rating to a 5.

On November 17, 2008, the FDIC notified Community that the bank was considered Significantly Undercapitalized under the PCA provisions of section 325 of the FDIC Rules and Regulations and required the bank to file a written capital restoration plan within 45 days. The bank failed 4 days later on November 21, 2008.

OIG Assessment of FDIC Supervision

Based on our review, we concluded that the FDIC provided regular supervision of Community Bank, identified key concerns for attention by bank management, including the problems that led to the bank's failure, and, together with the DBF, pursued enforcement action as the bank's financial condition deteriorated prior to failure. However, the FDIC could have taken additional supervisory action to ensure the bank followed examiner recommendations as part of the 2006 examination regarding calculation of the ALLL and ADC loan concentrations. Such supervisory action may have helped to ensure earlier action to address the critical problems that led to the bank's failure. Further, in hindsight, more timely supervisory action may have been warranted based on the results of the ongoing 2007 examination.

Greater Supervisory Concern Warranted at the 2006 Examination. Community did not take adequate corrective action in response to repeat examination findings related to loan concentrations, loan underwriting and credit administration, and properly classifying assets. Greater emphasis by the FDIC on management's response to supervisory concerns was warranted during the 2006 examination, particularly in relation to Community's calculation of the ALLL and high concentrations in ADC loans. The FDIC upgraded the bank's asset quality rating from a 3 to a 2 and gave the bank a composite 2 rating in the 2006 examination (the same as 2005) but expressed concerns with the bank's loan portfolio and, in a confidential section of the report, suggested that the next examination team review a larger sample of loans and that certain loans be reviewed more closely. Overall, the report concluded that asset quality reflected modest improvement and was marginally satisfactory, leading to the upgraded rating.

The 2006 examination indicated that adverse loan classifications had decreased but noted that the past-due ratio more than doubled shortly after March 31, 2006. The May 2006 ROE identified concerns related to adverse classifications but did not make recommendations in this regard. The ROE specifically noted Community management's attitude towards adversely classified items when examiners suggested that management consider adverse classifications from the bank's external loan review and regulatory examinations to help determine ALLL adequacy. The ROE indicated that management both disagreed with the regulatory definition of substandard and stated that bank management knew the quality of loans better than examiners. In addition, the ROE noted that the vice president/senior lending official asked "why the bank should care about the credit-worthiness of the borrower since the bank has the collateral (real estate)." It appears that these matters warranted greater concern and attention particularly given management's attitude toward corrective action.

Notably, the 2006 examination showed a level of ADC loan concentrations that had increased significantly from the April 2005 examination. The ADC loan concentration totaled 731 percent of Tier 1 Capital for funded loans and over 1,000 percent for committed amounts. Also, the 2006 examination noted seven individual concentrations that totaled 26 to 61 percent of Tier 1 Capital for committed amounts. The ROE indicates that these concentration levels were high; however, oversight was adequate. Examiners encouraged Community's management to diversify the loan portfolio to the extent possible and continue to closely monitor concentrations. In our opinion, greater concern regarding the ADC concentrations, including specific recommendations to address the need for diversification, was warranted. As noted in the 2007 examination report, uncertainties in the market could eliminate collateral margins and expose the bank to substantial losses.

More Timely Supervisory Action Warranted Based on the 2007 Examination. Once the deterioration in the bank's financial condition was noted during the November 2007 examination, more timely supervisory encouragement for corrective actions by bank management could have been initiated commensurate with the severe decline in asset quality, poor management oversight, and strain on liquidity. Specifically, a C&D addressing the bank's significant weaknesses identified during the November 2007 examination was not implemented until July 2008. (Selected provisions contained in the C&D were previously discussed in the "Historical Snapshot of Supervision" section of this report.) During the approximate 8-month period from November 2007 to July 2008, Community operated without a formal enforcement action, and its financial condition worsened.

The following synopsis of key milestones related to the DBF's November 2007 examination and the subsequent corrective action gives perspective to the period between the start of the 2007 examination and the issuance of the C&D:

- The DBF started its examination on November 6, 2007.

- The DBF completed it principal fieldwork in January 2008. However, based on concerns related to Community's ALLL calculation, the DBF required bank management to obtain new appraisals on impaired loans in order for the bank to re-compute its ALLL.

- Based on the revised loan information it received from the bank, the DBF completed its examination in late April 2008 and, after reviewing and processing the ROE, transmitted it to Community on June 3, 2008.

- The FDIC received the ROE on June 11, 2008.

- Community's BOD signed the C&D on June 20, 2008, and the C&D became effective 10 days later on July 1, 2008.

We recognize the difficulty faced by the FDIC with considering an enforcement action while the DBF's 2007 examination was in process. However, through offsite monitoring and communication with the DBF, the FDIC was aware of weaknesses regarding Community's operations and had concerns regarding the bank's concentrations prior to DBF's June 2008 issuance of the 2007 ROE. With respect to offsite monitoring, the FDIC identified Community as having increased probabilities of being downgraded in each of the three quarterly ORLs beginning with the June 30, 2007 Call Report data (with the March 3, 2008 ORL flagging Community as having a 100-percent probability of downgrade to a composite 5 rating). In fact, the offsite review report completed September 26, 2007 stated, "As of 6/30/07, the bank had a [construction and development] concentration of approximately 574% of [Tier 1 Capital] + ALLL and an overall [real estate] concentration of approximately 731% of [Tier 1 Capital] + ALLL." Also, while conducting its 2007 examination, the DBF had informed the FDIC of the preliminary results of its work. Therefore, in hindsight, FDIC action may have been warranted prior to the release of the 2007 ROE in June 2008. Such action could have reduced the loss to the DIF as a result of the bank's failure.

IMPLEMENTATION OF PROMPT CORRECTIVE ACTION

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

The FDIC and DBF evaluated Community's capital position and assigned capital component ratings; included capital-related provisions in formal actions, including a PCA Directive, in accordance with regulatory guidelines; and provided PCA notification letters. On May 23, 2008, the FDIC informed Community that, based on the March 31, 2008 Call Report, the bank reported Tier 1 Leverage Capital of 7.92 percent; Tier 1 Risk-Based Capital of 8.47 percent; and Total Risk-Based Capital of 9.72 percent, which placed the bank in the Adequately Capitalized category and, therefore, the bank could no longer accept, renew, or roll over any brokered deposits unless it obtained a waiver from the FDIC.

The July 2008 C&D included provisions related to capital and required Community to do the following:

- Within 120 days, attain a Tier 1 Capital ratio of no less than 8 percent. The level of capital was to be maintained in addition to a fully funded ALLL satisfactory to the DBF and FDIC, as determined at subsequent examinations or visitations.

- Within 90 days, develop and adopt a plan to meet the minimum risk-based capital requirements for a Well Capitalized bank.

- Within 60 days, develop and adopt a plan to meet the minimum capital requirements set forth in the C&D.

In response, Community submitted a plan on September 10, 2008, to meet the minimum capital requirements set forth in the C&D. The plan outlined potential solutions, which included: raising capital through institutional investors and local shareholders, selling of bank-owned real estate, raising additional capital, closing and/or selling branches and performing assets, and finding a strategic partner to acquire the bank.

The FDIC/DBF visitation on September 29, 2008 determined that capital should be downgraded to a 5 because the bank was Significantly Undercapitalized, bank management did not appear to be successful in obtaining the required capital infusion, and the loss exposure in the loan portfolio was not being properly recognized by management.

The Call Report for the bank as of September 30, 2008, reported the following ratios:

- Tier 1 Leverage Capital 3.71 percent
- Tier 1 Risk-Based Capital 4.06 percent
- Total Risk-Based Capital 5.39 percent

On November 17, 2008, the FDIC issued written notification to Community of its PCA capital category (Significantly Undercapitalized) based on the bank's September 30, 2008 Call Report. The notification required submission of a written capital plan. The DBF closed the bank 4 days later.

PCA's focus is on capital, and capital can be a lagging indicator of an institution's financial health as was the case with Community. Community remained in the Well Capitalized PCA category until March 31, 2008, even though the bank's financial condition had deteriorated significantly.

CORPORATION COMMENTS AND OIG EVALUATION

On July 29, 2009, the Director, DSC, provided a written response to the draft report. DSC's response is provided in its entirety as Appendix 3 of this report. In its response, DSC did not comment on the conclusions the OIG reached in the report regarding the causes of failure and material loss and the assessment of the FDIC's supervision.

DSC's response did reference a specific action taken as a result of the 2007 examination. DSC stated, "With respect to the 2007 examination and the timeliness of FDIC supervisory action, it is important to note that a Cease and Desist Order was issued within 60 days of the close of the examination, which was extended because the bank failed to provide for an adequate ALLL with updated appraisals in accordance with FAS [Financial Accounting Standard] 114." We acknowledge that the C&D was issued within 60 days of the close of the examination. Nevertheless, we reiterate that the date of issuance of the C&D was about 8 months after the examination began and that FDIC action prior to the issuance of the 2007 ROE (and release of the C&D) may have been warranted and could have reduced the loss to the DIF as a result of the bank's failure.

The response also states that DSC should take immediate supervisory action when an institution rated 3, 4, or 5 fails to implement a plan to stabilize or reduce its risk exposure and limit growth. DSC indicated that on March 3, 2009, DSC issued guidance to all FDIC-supervised institutions in FIL-13-2009 entitled, *The Use of Volatile or Special Funding Sources by Financial Institutions That are in a Weakened Condition*, which addresses such action. Specifically, this guidance states that, for an institution that is in a weakened financial condition, it is even more critical that management administer the institution in such a way to stabilize the risk profile and strengthen the financial condition. Institutions rated 3, 4, or 5 are expected to limit balance sheet growth and take actions to improve their risk profile while they work to remedy their problems. Institutions rated 3, 4, or 5 that engage in material growth strategies, especially those that are funded with volatile liabilities or temporarily expanded FDIC insurance or liability guarantees pose a significant risk to the DIF and will be subject to heightened supervisory review and enforcement.

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, on or after July 1, 1993, the Inspector General of the appropriate federal banking agency shall prepare a report to that agency reviewing the agency's supervision of the institution. The FDI Act requires that the report be completed within 6 months after it becomes apparent that a material loss has been incurred.

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

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

Scope and Methodology

The scope of this audit included an analysis of Community's operations from January 1, 2002 until its failure on November 21, 2008. Our review also entailed an evaluation of the regulatory supervision of the institution over the same period.

Our audit procedures did not include any observations of Community's operations. To achieve the objectives, we performed the following procedures and techniques:

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

- Reviewed the following:

    - Bank data and correspondence maintained at DSC's Atlanta Regional Office and Atlanta Field Office.

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

    - Community's audit work papers provided by David Giddens, Certified Public Accountant, in Eatonton, Georgia.

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

- Pertinent DSC policies and procedures.

- Interviewed the following FDIC officials:

  - DSC management in the FDIC's Atlanta Regional Office.

  - FDIC examiners from the DSC Atlanta Field Office who participated in examinations or reviews of examinations of Community.

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

We performed the audit field work at the FDIC's headquarters in Washington, D.C., and DSC regional and field offices in Atlanta, Georgia, and DRR offices in Dallas, Texas.

Our ability to evaluate the adequacy of DSC's supervisory efforts was limited by the lack of FDIC examination work papers prior to the 2006 FDIC examination. We were informed that prior examination work papers had been destroyed prior to the commencement of our review, in accordance with FDIC guidelines, and thus were no longer available. Regional Directors Memorandum 01-039, *Guidelines for Examination Workpapers and Discretionary Use of Examination Documentation Modules*, dated September 25, 2001, and the Examination Manual note that, with some exceptions, the retention of work papers beyond one examination for well-rated banks is generally discouraged. The OIG issued an audit memorandum, on May 1, 2009, to the Director, DSC, communicating matters related to workpaper retention.

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

Due to the limited nature of the audit objectives, we did not assess DSC's overall internal control or management control structure. We performed a limited review of Community's management controls pertaining to its operations as discussed in the body of this report.

For purposes of the audit, we did not rely on computer-processed data to support our significant findings or conclusions. Our review centered on interviews, ROEs, and correspondence and other evidence to support our audit.

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

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

GLOSSARY OF TERMS

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

CORPORATION COMMENTS

FDIC

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

Division of Supervision and Consumer Protection

July 29, 2009

MEMORANDUM TO: Russell A. Rau
Assistant Inspector General for Audits

FROM: Sandra L. Thompson
Director

SUBJECT: Draft Audit Report Entitled, Material Loss Review of The Community Bank, Loganville, Georgia
(Assignment No. 2009-012)

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 The Community Bank (Community Bank) which failed on November 21, 2008. This memorandum is the response of the Division of Supervision and Consumer Protection (DSC) to the OIG's Draft Report received July 14, 2009.

The OIG's Draft Report concludes that the FDIC and the Georgia Department of Banking and Finance (DBF) monitored and conducted timely and regular examinations of Community Bank and accurately diagnosed issues and prescribed corrective measures. With respect to the 2007 examination and the timeliness of FDIC supervisory action, it is important to note that a Cease and Desist Order was issued within 60 days of the close of the examination, which was extended because the bank failed to provide for an adequate ALLL with updated appraisals and in accordance with FAS 114.

We agree that in these instances the FDIC should take immediate supervisory action when an institution rated "3", "4", or "5" fails to implement a plan to stabilize or reduce their risk exposure and limit their growth. On March 3, 2009, DSC issued such guidance to all FDIC-supervised institutions in a Financial Institution Letter (FIL-13-2009).

Thank you for the opportunity to review and comment on the Draft Audit Report. We recognize the threat that institutions with high risk profiles, such as Community Bank, pose to the Deposit Insurance Fund; and we continue to look for and implement improvements to our supervisory program that focus on stabilizing an institution's risk profile and strengthening its financial condition.

ACRONYMS IN THE REPORT

Acronym	Definition
ADC	Acquisition, Development, and Construction
ALLL	Allowance for Loan and Lease Losses
BBR	Bank Board Resolution
BOD	Board of Directors
C&D	Cease & Desist Order
CAMELS	**C**apital, **A**sset Quality, **M**anagement, **E**arnings, **L**iquidity, and **S**ensitivity to Market Risk
CEO	Chief Executive Officer
CLP	Contingency Liquidity Plan
CRE	Commercial Real Estate
DBF	Georgia 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
GAAP	Generally Accepted Accounting Principles
OIG	Office of Inspector General
ORL	Offsite Review List
PCA	Prompt Corrective Action
ROE	Report of Examination
UBPR	Uniform Bank Performance Report
UFIRS	Uniform Financial Institutions Rating System