Office of Inspector General

Office of Material Loss Reviews
Report No. MLR-10-043

Material Loss Review of United Commercial Bank, San Francisco, California

July 2010

Office of
Inspector General

Executive Summary

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Why We Did The Audit

On November 6, 2009, the California Department of Financial Institutions (CDFI) closed United Commercial Bank (UCB), San Francisco, California, and named the FDIC as receiver. On January 20, 2010, the FDIC notified the Office of the Inspector General (OIG) that UCB's total assets at closing were $10.9 billion and the estimated loss to the Deposit Insurance Fund (DIF) was $1.4 billion. As of June 25, 2010, the estimated loss to the DIF had increased to $1.5 billion.

As required by section 38(k) of the Federal Deposit Insurance (FDI) Act, the OIG conducted a material loss review of this failure. The primary objectives of this review were to (1) determine the causes of UCB's failure and the resulting material loss to the DIF and (2) evaluate the FDIC's supervision of UCB, including the FDIC's implementation of the *Prompt Corrective Action* (PCA) provisions of section 38 of the FDI Act. In November 2008, UCB's holding company, United Commercial Bank Holdings, Inc. (UCBH), received $298.7 million through the United States Department of the Treasury's (Treasury) Troubled Asset Relief Program's (TARP) Capital Purchase Program (CPP), which resulted in a loss to the Treasury when UCB failed. As a result, we added a third objective to this review, which was to determine whether the FDIC followed applicable procedures in recommending UCBH for CPP funding and in monitoring UCB's compliance with the CPP securities purchase agreement with the Treasury.

Background

UCB was a state, nonmember commercial bank, and the only significant subsidiary of UCBH, a one-bank holding company, which operated essentially as a shell company. UCB's assets comprised 99.5 percent of UCBH's assets.

UCB was founded as United Federal Savings and Loan Association in 1974 to serve the financial needs of San Francisco's Chinese community. As the Chinese-American population grew and expanded throughout California, the institution became United Savings Bank, Federal Savings Bank, enabling it to provide statewide banking services. In 1998, to reflect its rapidly growing focus on commercial banking activities, the institution converted its charter from a savings and loan regulated by the Office of Thrift Supervision to a commercial bank regulated by the FDIC, and was renamed UCB.

The bank was headquartered in San Francisco and provided a full range of commercial and consumer banking products to small- and medium-sized businesses, professionals, and other individuals. Beginning in the late 1990s, UCB expanded beyond its core market of California through mergers and acquisitions, both domestically and abroad.

Audit Results

Causes of Failure and Material Loss

The primary reason for UCB's failure was inadequate oversight by the Board of Directors (Board) and management. In particular, UCB's Board and management failed to control the risks associated with the institution's rapid expansion, which began in 2002. Further, management controls were insufficient to prevent the occurrence of inaccuracies, omissions, and misrepresentations that affected key UCB financial

data. In this regard, examiners informed UCB's external auditor of asset quality issues identified in the FDIC's April 2009 targeted review, which in part led to an investigation commissioned by UCBH's audit committee in May 2009. The investigation found that various UCB officials misrepresented or omitted relevant loan performance data, altered documents to improve the perception of loan quality, and made other misrepresentations that impacted UCBH's financial statements. UCBH reported that its 2008 financial statements were materially inaccurate and required revision. The investigation and UCBH's inaccurate financial statements made it harder for UCB to raise the capital the bank needed in 2009 to absorb substantial provisions and losses associated with its loan portfolio.

Also contributing to the failure were UCB's high concentrations in acquisition, development, and construction (ADC) and commercial real estate (CRE) loans and heavy reliance on non-core funding sources to support its expansion efforts, all of which increased the bank's risk profile. UCB management was reluctant to downgrade troubled loans in a timely manner, in an effort to mask deteriorating financial conditions. As the real estate market declined, UCB experienced increasing levels of adversely classified assets and associated losses, which required significant increases to its allowance for loan and lease losses. Losses and provisions associated with ADC and CRE concentrations eroded the bank's earnings and capital and led to deficient liquidity. Absent an adequate capital infusion and improvement to the bank's liquidity position, the CDFI closed UCB on November 6, 2009 because it was no longer viable.

The FDIC's Supervision of UCB

The FDIC conducted timely and regular examinations of UCB and monitored its condition through offsite monitoring mechanisms. The examinations included onsite reviews of UCB's Hong Kong branch and a bank that it owned in China in 2008 and 2009, respectively. San Francisco Regional Office officials told us that misrepresentations and financial reporting matters that were identified in the investigation masked the bank's true financial condition and frustrated examination efforts in late 2008 and into 2009. Through its supervisory efforts, the FDIC identified key risks in UCB's operations and brought these risks to the attention of the institution's Board and management in examination reports and other correspondence. The FDIC also instituted a Bank Board Resolution in 2008 to address UCB's non-compliance with the Bank Secrecy Act and a Cease and Desist Order in 2009 requiring UCB to develop an adequate capital restoration plan. Finally, the FDIC implemented applicable PCA provisions of section 38 of the FDI Act in a timely manner.

Notwithstanding these supervisory efforts:

- Given UCB Board and management weaknesses reported during 2007 through 2009, a lower Management component rating may have been justified earlier than April 2009;
- While the Division of Supervision and Consumer Protection (DSC) downgraded UCB's Asset Quality component rating in consecutive examinations and targeted reviews during 2008 and 2009, given the bank's rapidly deteriorating financial condition, an informal supervisory action based on the December 2008 visitation may have been warranted; and
- Although DSC noted that it closely monitored UCB in 2008, had DSC transitioned UCB to a targeted review schedule during that year, the FDIC may have had additional information upon which to base its October 2008 CPP funding recommendation.

We also determined that while the FDIC monitored UCB through the FDIC's Large Insured Depository Institution (LIDI) program, as required, the FDIC's quarterly LIDI ratings were lower than UCB examination ratings during 2008, reflecting the more forward-looking orientation of the LIDI program.

Capital Purchase Program

On November 14, 2008, UCBH received $298.7 million in TARP CPP funds and subsequently down-streamed the money to UCB. Treasury lost this investment when UCB was closed on November 6, 2009. UCB was the first depository institution to lose CPP funds. Nevertheless, we determined that (1) the FDIC followed applicable procedures in recommending UCBH for CPP funding and (2) examiners evaluated UCB's compliance with the CPP Securities Purchase Agreement in accordance with DSC guidance. The FDIC was not aware of UCB's serious financial reporting matters when it assessed UCB's TARP application in October 2008; these matters became apparent in 2009, after the investigation by UCBH's audit committee.

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 July 20, 2010, the Director, DSC, provided a written response to the draft report. That response is provided in its entirety as Appendix 5 of this report.

DSC reiterated the OIG's conclusions regarding the causes of UCB's failure. With regard to our assessment of the FDIC's supervision of UCB, DSC stated that from 2005 through 2009, the FDIC and the CDFI jointly and separately completed several examinations, visitations, reviews, and other oversight activities of UCB. Through these activities, examiners identified key risks and brought them to the attention of UCB's Board and management in examination reports and other correspondence. DSC pointed out that in December 2008, the FDIC and the CDFI downgraded UCB's Asset Quality and Earnings component ratings to "3" and identified further deterioration during an April 2009 joint targeted review. DSC also stated that UCBH's external auditor found that UCB's management had begun to conceal serious financial reporting issues around October 2008.

Finally, DSC stated that it has issued guidance from 2006 through 2009 that re-emphasizes the importance of monitoring institutions that have concentrated ADC and CRE exposures and rely on volatile non-core funding sources.

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

Office of Material Loss Reviews
Office of Inspector General

DATE: July 20, 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 United Commercial Bank, San Francisco, California* (Report No. MLR-10-043)

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 United Commercial Bank (UCB), San Francisco, California. On November 6, 2009, the California Department of Financial Institutions (CDFI) closed UCB and appointed the FDIC as the receiver. On January 20, 2010, the FDIC notified the OIG that UCB's total assets at closing were $10.9 billion and the estimated loss to the Deposit Insurance Fund (DIF) was $1.4 billion. As of June 25, 2010, the estimated loss to the DIF had increased to $1.5 billion.

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 primary objectives of this material loss review were to (1) determine the causes of UCB's failure and the resulting material loss to the DIF and (2) evaluate the FDIC's supervision of UCB, including the FDIC's implementation of the PCA provisions of section 38 of the FDI Act. In November 2008, UCB's holding company, United Commercial Bank Holdings, Inc. (UCBH), received $298.7 million through the United States Department of the Treasury's (Treasury) Troubled Asset Relief Program's (TARP) Capital Purchase Program (CPP), and down-streamed the funds to UCB.[1] The Treasury lost this investment when UCB failed. As a result, we added a third objective to this review, which was to determine whether the FDIC followed applicable procedures in recommending UCBH for CPP funding and in monitoring UCB's compliance with the

[1] UCB and UCBH were separate entities. For technical accuracy, certain parts of this report refer to UCB and other parts refer to UCBH.

CPP Securities Purchase Agreement with the Treasury.[2] We coordinated with the Special Inspector General for the Troubled Asset Relief Program in completing this objective.

The report does not contain formal recommendations. Instead, as major causes, trends, and common characteristics of institution failures are identified in our material loss reviews, we will communicate those to FDIC management for its consideration. As resources allow, we may also conduct more in-depth reviews of specific aspects of the FDIC's supervision program and make recommendations as warranted.[3]

Appendix 1 contains details on our objectives, scope, and methodology. We also include several other appendices to this report. Appendix 2 contains a glossary of key terms; including material loss, the FDIC's supervision program, and the Uniform Financial Institutions Rating System, otherwise known as the CAMELS ratings. Appendix 3 contains a list of acronyms; Appendix 4 contains an organizational chart; and Appendix 5 contains the Corporation's comments on this report.

Background

UCB History

UCB was a state, nonmember commercial bank, and the only significant subsidiary of UCBH, a one-bank holding company, which operated essentially as a shell company. UCB's assets comprised 99.5 percent of UCBH's assets. (See the organizational chart in Appendix 4.)

UCB was founded as United Federal Savings and Loan Association in 1974 to serve the financial needs of San Francisco's Chinese community. As the Chinese-American population grew and expanded throughout California, the institution became United Savings Bank, Federal Savings Bank, enabling it to provide statewide banking services. In 1998, to reflect its rapidly growing focus on commercial banking activities, the institution converted its charter from a savings and loan regulated by the Office of Thrift Supervision (OTS) to a commercial bank regulated by the FDIC, and was renamed UCB.

The bank was headquartered in San Francisco and provided a full range of commercial and consumer banking products to small- and medium-sized businesses, professionals, and other individuals. Beginning in the late 1990s, UCB expanded beyond its core market of California through mergers and acquisitions, both domestically and abroad. UCBH issued trust preferred securities[4] or its own common stock to fund a number of the bank's acquisitions.

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[2] The CPP Securities Purchase Agreement describes the terms of a financial institution's agreement to issue shares and fulfill other requirements in exchange for the Treasury's investment.

[3] A further discussion of OIG-related coverage of financial institution failures can be found in the *Objectives, Scope, and Methodology* section of our report.

[4] Trust preferred securities are securities issued by a wholly-owned trust subsidiary of a bank holding company to raise capital.

UCBH was incorporated in 1998 in Delaware and was regulated by the Federal Reserve Bank of San Francisco (FRBSF). UCBH and its subsidiaries operated 71 branches or offices in California, New York, Georgia, New England, the Pacific Northwest, and Texas; and had branches and representative offices in Hong Kong, China, and Taiwan. UCBH became a publicly-traded company on November 5, 1998, when it began trading on the NASDAQ stock exchange.

Table 1 summarizes UCB's financial information from 2004 through September 2009.

Table 1: Selected Financial Information for UCB

Financial Measure	Dec-04	Dec-05	Dec-06	Dec-07	Dec-08	Sept-09
Total Assets ($000s)	6,311,706	7,953,849	10,324,737	11,780,002	13,476,095	10,895,336
Total Loans ($000s)	4,381,749	6,070,282	6,778,521	8,009,287	8,670,687	7,703,981
Total Deposits ($000s)	5,222,762	6,275,530	7,214,319	7,800,631	9,057,304	7,653,666
Net Income ($000s)	93,818	109,590	109,990	116,498	(54,253)	(1,085,667)
Brokered Deposits/Total Deposits	0.00%	2.50%	2.91%	2.10%	13.39%	13.56%
Federal Home Loan Bank (FHLB) Advances / Total Liabilities	6.31%	10.90%	15.39%	15.04%	14.60%	16.65%
Return on Average Assets	1.58%	1.57%	1.34%	1.11%	(0.42%)	(11.12%)
Net Interest Margin	3.84%	3.78%	3.54%	3.54%	2.94%	2.44%
Noncurrent Loans/Gross Loans	0.41%	0.40%	0.26%	1.08%	6.11%	14.06%

Source: Uniform Bank Performance Reports (UBPR).

Mergers and Acquisitions

UCB's primary merger and acquisition activities occurred from 2002 through 2007, as shown in Table 2 on the following page. UCB's strategic plan included growing its assets to more than $10 billion, in part, to meet foreign criteria to purchase a bank in the People's Republic of China. UCB achieved this goal when its assets exceeded $10 billion in the fourth quarter of 2006. In December 2007, UCB became the first state nonmember bank in the United States to wholly own a bank in the People's Republic of China when it purchased Business Development Bank Limited, since renamed United Commercial Bank (China) Limited (UCBC). UCBC operated as a wholly-owned subsidiary of UCB and, as of September 2009, had total assets of $565 million and total deposits of $132 million.

Table 2: UCB's Merger and Acquisition History

Name of Financial Institution	Type of Institution	Assets of Institution ($000s)	Date of Merger or Acquisition
USB Holdings	Thrift	$1,561,594	4/21/1998
Bank of Canton of California	Bank	$1,389,977	10/29/2002
BNB Financial Services Corporation (UCB acquired 1 branch)	Bank	$12,732	12/16/2002
UCB Hong Kong branch	Bank	$1,400,000	7/09/2003
First Continental Bank	Bank	$334,215	7/11/2003
Pacifica Bancorp, Inc.	Bank	$164,336	10/31/2005
Asian American Bank & Trust Company	Bank	$129,931	11/28/2005
Summit Bank Corporation	Bank	$656,702	12/29/2006
Chinese American Bank Holding, LLC	Bank	$321,597	5/23/2007
Business Development Bank Limited (now called UCBC)	Bank	$338,700	12/10/2007

Source: SNL Financial and UCB's Form 10-K filed with the Securities and Exchange Commission (SEC) for the fiscal year ended December 31, 2008. SNL Financial collects, standardizes, and disseminates merger and acquisition, corporate, financial, and market data for banks, financial services, and other agencies and industries.

TARP

In October 2008, Congress passed and the President signed the Emergency Economic Stabilization Act of 2008 (EESA), which authorized the TARP and provided authority for the federal government to purchase up to $700 billion of troubled assets to provide stability to the economy and the nation's financial system. One TARP program, the CPP, allowed the Treasury to purchase up to $250 billion of preferred stock in qualifying financial institutions. Through the CPP, institutions submitted applications to the FDIC or other appropriate federal banking agency,[5] which made recommendations to the Treasury on whether to approve or deny CPP requests. In turn, the Treasury determined the final eligibility and allocations for interested parties. The deadline to fund institutions through the CPP ended on December 31, 2009.

On November 14, 2008, UCBH received $298.7 million in TARP CPP funds and subsequently down-streamed the money to UCB. Treasury lost this investment when UCB was closed on November 6, 2009. UCB was the first depository institution to lose TARP funds. We discuss the specific criteria for approving these funds, the FDIC's role in recommending UCBH for CPP funding, and the FDIC's monitoring of UCB's compliance with CPP provisions later in this report.

[5] The banking agencies are the FDIC, the Board of Governors of the Federal Reserve System (FRB), the Office of the Comptroller of the Currency (OCC), and the OTS.

Causes of Failure and Material Loss

The primary reason for UCB's failure was inadequate oversight by the Board of Directors (Board) and management. In particular, UCB's Board and management failed to control the risks associated with the institution's rapid expansion, which began in 2002. Further, management controls were insufficient to prevent the occurrence of inaccuracies, omissions, and misrepresentations that affected key UCB financial data. In this regard, examiners informed UCB's external auditor of asset quality issues identified in the FDIC's April 2009 targeted review, which in part led to an investigation commissioned by UCBH's audit committee. The investigation found that various UCB officials misrepresented or omitted relevant loan performance data, altered documents to improve the perception of loan quality, and made other misrepresentations that impacted UCBH's financial statements. UCBH reported that its 2008 financial statements were materially inaccurate and required revision. The investigation and UCBH's inaccurate financial statements made it harder for UCB to raise the capital the bank needed in 2009 to absorb substantial provisions and losses associated with its loan portfolio.

Also contributing to the failure were UCB's high concentrations in acquisition, development, and construction (ADC) and commercial real estate (CRE) loans and heavy reliance on non-core funding sources to support its expansion efforts, all of which increased the bank's risk profile. UCB management was reluctant to downgrade troubled loans in a timely manner, in an effort to mask deteriorating financial conditions. As the real estate market declined, UCB experienced increasing levels of adversely classified assets and associated losses, which required significant increases to its allowance for loan and lease losses (ALLL). Losses and provisions associated with ADC and CRE concentrations eroded the bank's earnings and capital and led to deficient liquidity. Absent an adequate capital infusion and improvement to the bank's liquidity position, the CDFI closed UCB on November 6, 2009 because it was no longer viable.

Board and Management Oversight

According to examination reports from 2002 through 2008, UCB's Board and management performed satisfactorily and were generally responsive to examination findings and recommendations, as indicated by Management component ratings of "1" or "2" during that timeframe. Beginning in 2007, however, examination reports began to note more significant weaknesses in oversight by UCB's Board and management. The reports also indicated that the Board and management were dominated by one individual who held the titles of President, Chief Executive Officer (CEO), and Chairman of the Board and was responsible for certain practices that ultimately contributed to the bank's failure. Examination reports and related documentation in these latter years noted that UCB: (1) had a weak Board of Directors and needed increased Board oversight; (2) management did not provide UCB's internal loan review unit, the Independent Asset Review Division (IARD), with the necessary support to fulfill its mandate; (3) needed to improve its risk management and infrastructure by using better technology and increasing staffing to accommodate UCB's rapid growth; (4) was unable to effectively integrate its foreign operations with its domestic operations; and (5) had high CRE loan

concentrations and increases in problem loans. These issues are discussed more fully in *The FDIC's Supervision of UCB* section of this report.

Investigation of UCB

UCBH changed its external auditor from PricewaterhouseCoopers LLC (PwC) to KPMG, to opine on its 2008 financial statements.[6] KPMG provided UCBH with an unqualified opinion on its 2008 financial statements, dated March 16, 2009.[7] However, shortly after issuing its opinion letter and during its 2009 first quarter review of UCBH's financial information, KPMG became suspicious that UCB officials and/or employees had engaged in illegal acts to conceal the bank's true financial condition. San Francisco Regional Office (SFRO) officials stated that FDIC and CDFI examiners met with KPMG representatives on May 8, 2009, and informed KPMG that the April 2009 targeted review identified deterioration in UCB's asset quality and overall financial condition and prompted UCB to write-down a large number of loans reviewed by examiners. Five days later, on May 13, 2009, KPMG alerted UCBH's audit committee that illegal acts may have occurred at UCB and issued a related letter to the committee on May 15, 2009, pursuant to section 10A of the Securities Exchange Act of 1934.[8] KPMG indicated that UCB's potential illegal acts were related to an over-valuation of impaired and real estate owned (REO) loans, which resulted in a potential understatement of UCB's ALLL.

KPMG's notification prompted UCBH's audit committee to initiate an internal investigation that began in May 2009 and was completed in September 2009. According to SFRO officials, KPMG stated that the scope of the investigation needed to take into account the issues noted in the April 2009 targeted review, some of which were in fact identified in the investigative report resulting from the audit committee's investigation. The investigation's findings, which were provided to UCBH's Board and publicly disclosed, identified serious financial reporting matters, as follows:

- ***Modification of loan terms to delay negative consequences***. The investigation found instances where bank employees modified loan terms in an effort to delay the negative consequences of a weakened borrower. The modifications were

[6] PwC was UCBH's external auditor from 1999 through 2007. UCBH received an unqualified opinion from PwC in each of these years. Upon terminating the engagement, PwC represented that it was not aware of any disagreement with UCBH concerning the scope of its audit or the conformity of UCBH's reported financial statements to generally accepted accounting principles.

[7] This report also noted that KPMG identified a material weakness in UCBH's internal controls related to its financial reporting. The material weakness resulted in a material misstatement of UCB's ALLL and its provision for loan loss reserves.

[8] If during the course of an audit, an auditor becomes aware of potential illegal acts, Section 10A of the Securities Exchange Act of 1934 requires the auditor to determine the likelihood that an illegal act occurred and if so, unless the matter is inconsequential, the auditor is required to provide assurance that the institution's audit committee is adequately informed about the matter. Pursuant to Section 10A, the auditor may require the bank's audit committee to conduct an internal investigation to determine whether a violation of law occurred that will have a material effect on the institution's financial statements, what remediation is required to correct the violation, and whether the institution's Board and management took adequate steps to achieve remediation.

numerous and included extending terms, lowering interest rates, and improperly using the interest reserve account.

- ***Intentional delays in recognizing risk rating downgrades or specific reserves.*** The investigation found instances where bank employees acted to delay the recognition of a risk rating downgrade, or to minimize the loan loss allowance or write-down of REO loans.

- ***Misrepresentation or omission of relevant information.*** The investigation found numerous instances where relevant information was intentionally withheld from KPMG, misrepresented to KPMG, or both. It also found instances where information was withheld from or misrepresented to the bank's Finance Department.

- ***Inappropriate alteration of documents.*** The investigation found instances where bank employees altered documents in an effort to improve the perception of credit quality. In some cases, the alterations either removed or ameliorated negative facts that were material to the evaluation of a credit. Other cases included backdating documents to make them appear more reliable.

SFRO officials informed us that KPMG estimated these activities started around October 2008. The investigative report concluded that these activities were driven by an apparent desire of UCB senior executives to mask deteriorating financial conditions by deliberately delaying risk rating downgrades and minimizing the bank's overall loan loss allowance. The investigative report raised serious concerns regarding the actions of a number of UCB management officials. As a result, UCB's CEO and Chief Operating Officer resigned, while others were terminated. The report also contained recommendations, which were adopted by UCBH's Board. For example, UCBH's Board and management agreed to provide bank employees with additional job training, and to reprimand, reassign, and in some instances, terminate or demote certain UCB employees.[9]

As a result of the investigation, UCBH's stock price collapsed and several law firms initiated shareholder class action lawsuits accusing UCBH of falsifying its financial statements and violating federal securities laws.

Restatement of UCBH's 2008 Financial Statements

On May 18, 2009, UCBH and its audit committee agreed that (1) UCBH's consolidated financial statements, as of and for the year ended December 31, 2008, needed to be restated and (2) the bank's earnings release for the first quarter of 2009 should not be relied upon.

UCBH identified corrections that may have increased its pre-tax losses by approximately $45 million to $55 million for the year ended December 31, 2008, but this analysis was

[9] UCBH press release dated September 8, 2009.

preliminary and was never finalized as a result of the bank's closure. The restatement, if completed, would have resulted in material adjustments to UCB's loan loss provision and related ALLL, charge-offs, non-performing loan levels, and other REO expenses for the quarter and year ended December 31, 2008, which flowed through to UCBH's financial statements. Additionally, the re-examination resulted in the need to increase UCB's first quarter 2009 ALLL.

UCBH's failure to restate its 2008 financial statements also delayed and eventually precluded it from filing its first quarter 2009 filing with the SEC. As a result, UCBH violated the NASDAQ Marketplace Listing Criteria Rule 5250(c)(1) "Obligation to File Periodic Financial Reports" and its stock ceased trading on the NASDAQ stock exchange on November 18, 2009. The investigation's findings and UCBH's failure to restate its financial statements significantly hampered UCB's ability to raise capital, which eventually led to the bank's closing.

ADC and CRE Loan Concentrations

Guidance issued by the FDIC, the OCC, and the FRB entitled, *Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices* (Joint Guidance),[10] recognizes that there are substantial risks posed by institutions with high ADC and CRE concentrations. Such risks include unanticipated earnings and capital volatility during a downturn in the real estate market. The Joint Guidance defines institutions with significant ADC and CRE concentrations as those reporting:

- ADC loans representing 100 percent or more of total capital; or
- CRE loans representing 300 percent or more of total capital, where the outstanding CRE balance increased by 50 percent or more during the prior 36 months.

According to the Joint Guidance, institutions with such concentrations should employ heightened risk management practices. In April 2010, the FDIC issued additional guidance applicable to monitoring CRE concentrations. This guidance identifies areas examiners should consider when reviewing a bank's overall risk exposure to CRE loans, and notes the prudency of monitoring an institution's exposure to CRE loans.[11]

As shown in Table 3, UCB's ADC concentrations exceeded the 100-percent threshold established in the Joint Guidance from 2006 through 2009. UCB's CRE concentrations also significantly and consistently exceeded the 300-percent criteria since at least 2002.[12]

[10] This guidance, dated December 12, 2006, was developed to reinforce sound risk management practices for institutions with high and increasing levels of ADC and CRE loans.
[11] Division of Supervision and Consumer Protection (DSC) memorandum, Transmittal No. 2010-007, entitled: *Clarification of Calculation in Guidance on Commercial Real Estate*, April 1, 2010.
[12] UCB's CRE concentrations as a percentage of Total Risk-based Capital were 661.43 percent, 669.56 percent, and 586.05 percent as of December 31, 2002, 2003, and 2004, respectively. We did not review CRE concentrations prior to 2002.

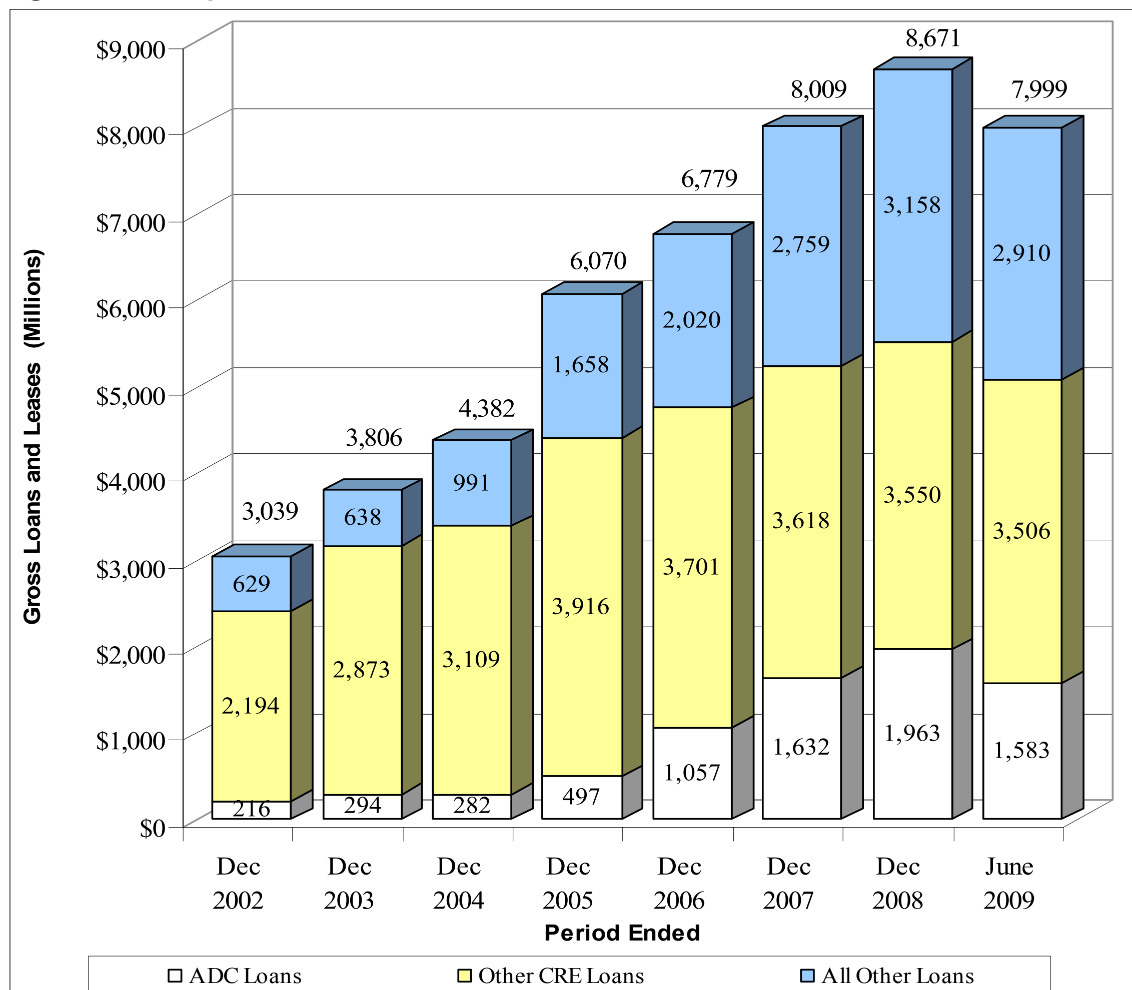
Table 3: UCB's ADC and CRE Concentrations as a Percentage of Total Risk-based Capital

Loan Type	Dec 2005	Dec 2006	Dec 2007	Dec 2008	June 2009
ADC	71.68%	126.22%	161.65%	138.51%	210.98% *
CRE	636.92%	568.00%	519.99%	389.05%	678.38% *

Source: UBPRs for UCB.
* The increases in the concentration levels in 2009 resulted from increasing losses and declining capital levels, rather than asset growth.

UCB's significant ADC and CRE concentrations made it more vulnerable to, and were significantly impacted by, the decline in the commercial real estate sector. Figure 1 presents the composition of UCB's loan portfolio.

Figure 1: Composition of UCB's Loan Portfolio, 2002 to 2009



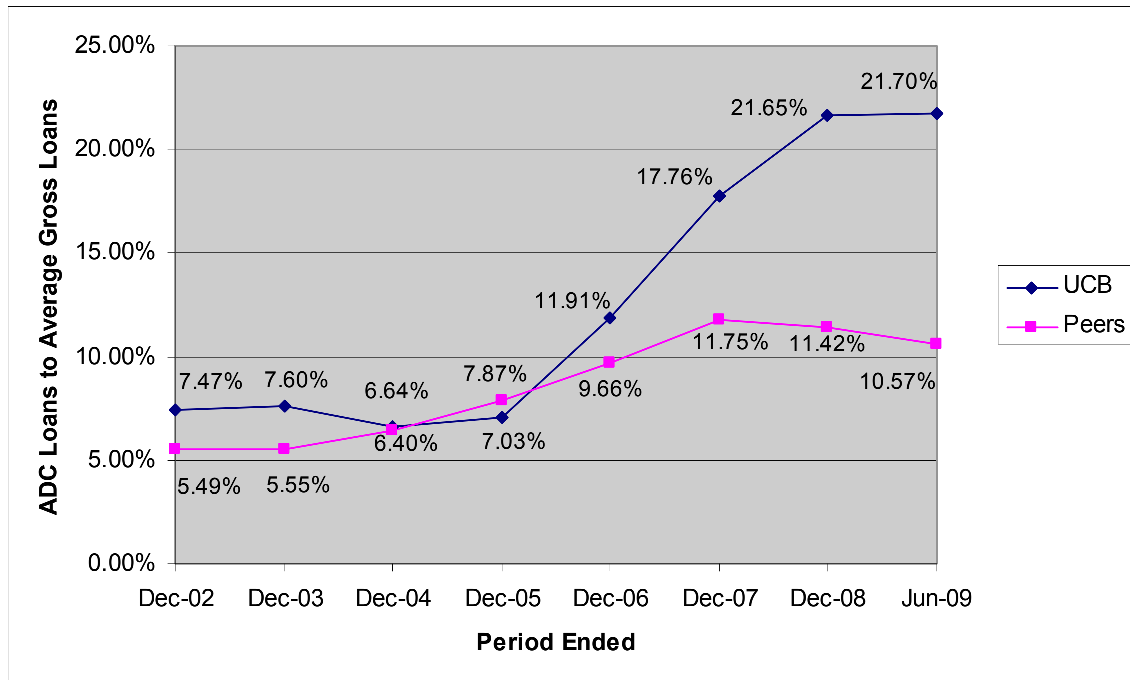
Source: Consolidated Reports of Condition and Income (Call Reports) for UCB.

As of June 2009, UCB's ADC and CRE concentrations represented 22 percent and 64 percent of its average gross loans, respectively, as shown in Figures 2 and 3. These percentages placed UCB in the 83rd percentile of its peer group for ADC loans and the

85th percentile for all other CRE loans, as of June 2009. UCB's peer group was comprised of 189 commercial banks, each with assets greater than $3 billion.[13]

UCB was particularly competitive with certain banks in its peer group that served similar markets and had similar ADC and CRE concentrations. Former FDIC and UCB staff interviewed indicated that UCB overpaid for certain acquisitions as a result of this competition and approved numerous exceptions to its loan policies in order to originate more loans.

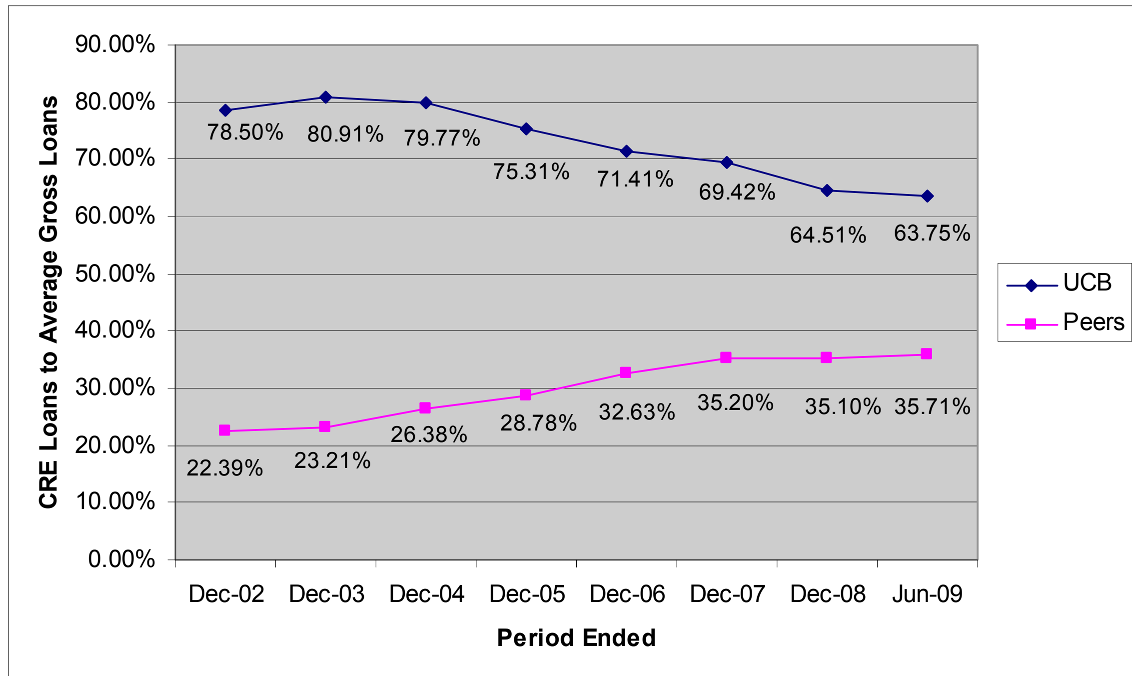
Figure 2: UCB's ADC Loans as a Percentage of Average Gross Loans Compared to Peers



Source: UBPRs for UCB.

[13] This classification is based on the UBPR, which categorizes commercial banks into one of 15 peer groups based on asset size, number of branches, and whether the bank is located in a metropolitan or non-metropolitan area.

Figure 3: UCB's CRE Loans as a Percentage of Average Gross Loans Compared to Peers



Source: UBPRs for UCB.

Reliance on Non-Core Funding Sources

UCB increasingly relied on non-core funding sources to support increased ADC and CRE lending, as shown in Table 4. The February 2008 examination noted that UCB was overly dependent on non-core funding sources, which could strain liquidity in the future.

Table 4: UCB's Non-Core Funding Sources

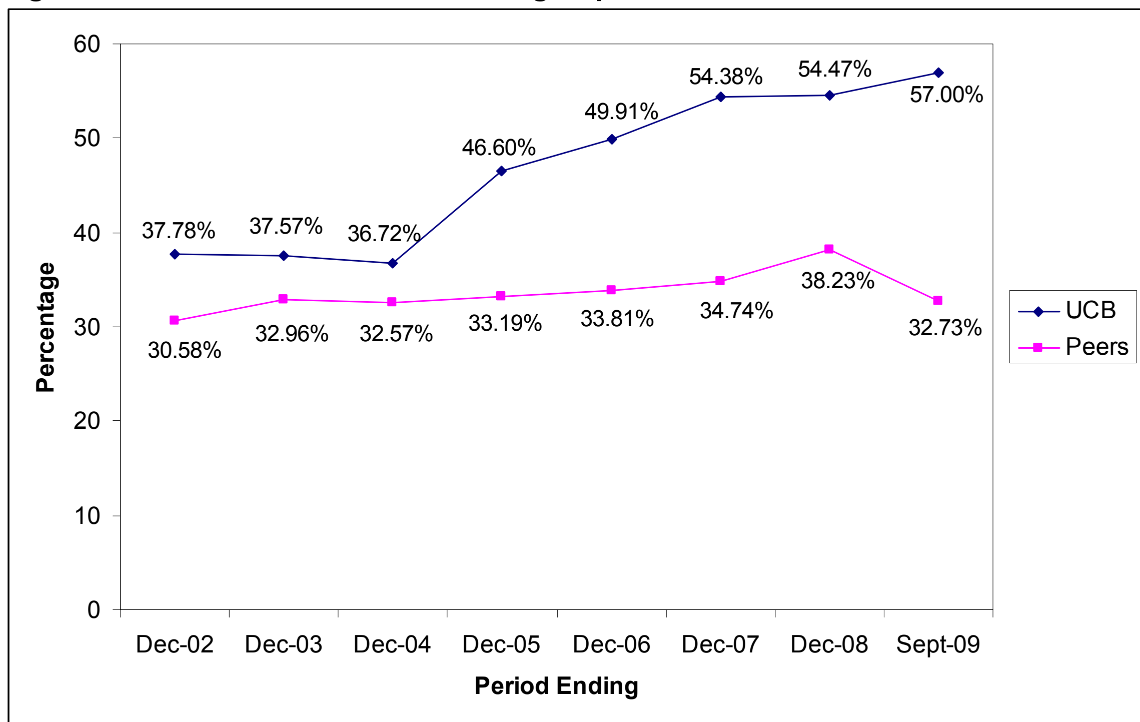
	Period Ended					
Funding Sources ($000s)	**Dec-04**	**Dec-05**	**Dec-06**	**Dec-07**	**Dec-08**	**Sept-09**
Total Deposits	5,222,762	6,275,530	7,214,319	7,800,631	9,057,304	7,653,666
Time Deposits ($100,000 or more)	1,610,270	1,965,157	2,104,229	2,247,531	2,038,587	1,746,499
Federal Funds Purchases and Resale	0	0	401,600	728,000	700,000	773,434
FHLB Advances	360,952	788,031	1,434,718	1,566,183	1,716,757	1,741,565
Brokered Deposits	0	156,744	210,063	163,505	1,213,034	1,037,608

Source: UBPRs for UCB.

The net non-core funding dependence ratio shows the degree to which a bank relies on potentially volatile liabilities to fund long-term earning assets. Generally, the lower the

dependence ratio, the less risk exposure there is for the bank. As shown in Figure 4, UCB's net non-core funding ratio was consistently above its peers since at least 2002.[14]

Figure 4: UCB's Net Non-Core Funding Dependence Ratio



Source: UBPRs for UCB.

<u>Allowance for Loan and Lease Losses and Adversely Classified Items</u>

The *Interagency Policy Statement on the Allowance for Loan and Lease Losses* requires institutions to maintain an appropriate ALLL level, discusses items that need to be addressed in written policies and procedures, and describes methodologies that institutions should use to determine an appropriate ALLL level.

From 2002 through 2007, UCB had low levels of adversely classified items, and examiners did not identify a need for the bank to increase its ALLL. The February 2008 examination noted increases in adverse classifications and deterioration in the bank's asset quality. As a result, UCB downgraded a significant number of construction loans. The December 2008 visitation identified further deterioration in UCB's asset quality, with increased problem assets centered around UCB's ADC loan portfolio.

By the April 2009 targeted review, examiners identified sharp increases in adversely classified assets and due to deteriorating market conditions and inaccurate loan grades, UCB downgraded a significant number of loans in its construction, commercial, and commercial real estate portfolios. Although the August 2009 targeted review draft report[15] noted some improvements in UCB's loan grading system, examiners found the

[14] We did not examine this ratio prior to 2002.
[15] The SFRO did not finalize this report because UCB was closed before a final report could be issued.

system to be inadequate and asset quality to be critically deficient. UCB again downgraded additional loans as a result of examiners' findings and the draft review noted that several deficient lending practices heavily contributed to UCB's excessive level of adversely classified assets.

Sharp increases in adversely classified assets caused UCB's ALLL to be significantly underfunded in 2008 and 2009. As a condition for UCB's external auditor to issue an unqualified opinion on UCBH's 2008 financial statements, UCB increased its ALLL by $40 million as of December 31, 2008. As shown in Table 5, examiners recommended increases to the ALLL in 2008 and 2009.

Table 5: UCB's Adverse Classifications and ALLL

Examination Dates	Adverse Classifications	UCB's Funding for ALLL	Recommended Increase	Adversely Classified Items Coverage Ratio [a]
	($000s)			
1/10/2005	53,282	62,927	None	9.55%
1/30/2006	64,455	63,150	None	10.11%
3/05/2007	54,064	68,847	None	6.45%
2/27/2008	303,779	85,468	35,000	34.34%
12/01/2008 [b]	655,192	126,637	None	47.42%
4/06/2009 [c]	1,445,850	281,887	106,466	107.03%
8/03/2009 [c, d]	1,775,494	356,924	16,217	206.26%

Source: FDIC examination reports.
[a] This ratio is computed by dividing the dollar amount of adverse classifications by Tier 1 Capital plus ALLL and off-balance sheet reserves.
[b] Visitation [c] Targeted Review [d] A final report was not issued due to UCB's closure.

Insufficient Capital and Liquidity

UCB's asset quality continued to decline in 2009, which depleted earnings and eroded capital. As the real estate market declined, UCB experienced increasing levels of adversely classified assets and associated losses and significant increases in its ALLL. The August 2009 targeted review draft report noted loss provisions totaling $499 million, which contributed to a $288 million net loss for the second quarter of 2009. UCB became *Undercapitalized* for PCA purposes in June 2009 and *Significantly Undercapitalized* in September 2009.

UCB's efforts to raise sufficient capital in 2009 were significantly hampered due to the investigation's findings and UCBH's inability to file accurate financial statements, and were ultimately unsuccessful. The August 2009 targeted review draft report estimated that an $800 million to $1.1 billion capital injection, or more, was needed to return UCB to a *Well Capitalized* status.[16] The draft review found that UCBH was no longer able to provide support to UCB, as it had negligible cash, no access to equity markets, and was subject to significant shareholder lawsuits.

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[16] Examiners had a difficult time estimating UCB's actual capital needs at the time of the August 2009 targeted review, due to the ongoing need to restate UCB's 2008 financial statements.

On September 15, 2009, UCB submitted a written capital restoration plan to achieve a *Well Capitalized* status by December 31, 2009. The FDIC deemed the plan to be unacceptable and unrealistic and, in a PCA directive dated November 2, 2009, required UCB to submit a revised plan. UCB did not do so before it failed.

Liquidity

UCB's strained liquidity threatened its ability to meet depositor demands. The February 2008 examination stated that UCB's volatile liability dependence had steadily increased over the prior 3 years and that certain liquidity ratios exceeded UCB's own policy limits. Between September 9, 2009 and September 23, 2009, UCB experienced massive domestic depositor withdrawals, averaging $44 million per day. The withdrawals were precipitated by the investigation, UCB's deteriorating financial condition, the publicized resignations of UCB's President and Chief Operating Officer on September 4, 2009, and associated regulatory actions. Additionally, as of September 2009, most of the bank's $1.1 billion in brokered deposits were due to mature in a year and UCB's ability to replace those deposits or obtain alternative funding was uncertain.

Further, in September 2009, UCB's Hong Kong branch office was operating under standard liquidity restrictions imposed by the Hong Kong Monetary Authority. While the branch appeared to have an adequate long-term liquidity position, it lacked the short-term working capital necessary to process customer transactions. The lack of short-term working capital at the Hong Kong branch strained UCB's domestic operations because the branch relied on capital from UCB.

Absent an immediate improvement to the bank's liquidity position and an adequate capital infusion, the CDFI closed UCB since it was no longer viable.

The FDIC's Supervision of UCB

The FDIC conducted timely and regular examinations of UCB and monitored its condition through offsite monitoring mechanisms. The examinations included onsite reviews of UCB's Hong Kong branch and UCBC in 2008 and 2009, respectively. Through its supervisory efforts, the FDIC identified key risks in UCB's operations and brought these risks to the attention of the institution's Board and management in examination reports and other correspondence. As noted earlier, examiners told us that they informed KPMG of asset quality issues identified in the FDIC's April 2009 targeted review, which in part led to an investigation that uncovered serious financial reporting matters. The FDIC also instituted a Bank Board Resolution (BBR) in 2008 to address UCB's non-compliance with the Bank Secrecy Act (BSA) and a Cease and Desist Order in 2009 requiring UCB to develop an adequate capital restoration plan. Finally, the FDIC implemented applicable PCA provisions of section 38 of the FDI Act in a timely manner.

Notwithstanding these supervisory efforts:

- Given UCB Board and management weaknesses reported during 2007 through 2009, a lower Management component rating may have been justified earlier than April 2009;

- While DSC downgraded UCB's Asset Quality component rating in consecutive examinations and targeted reviews during 2008 and 2009, given the bank's rapidly deteriorating financial condition, an informal supervisory action based on the December 2008 visitation may have been warranted; and

- Although DSC noted that it closely monitored UCB in 2008, had DSC transitioned UCB to a targeted review schedule during that year, the FDIC may have had additional information upon which to base its October 2008 CPP funding recommendation.

We also determined that while the FDIC monitored UCB through the FDIC's Large Insured Depository Institution (LIDI) program, as required, the FDIC's quarterly LIDI ratings were lower than UCB examination ratings during 2008, reflecting the more forward-looking orientation of the LIDI program.

Supervisory History

The FDIC and the CDFI performed six examinations, three targeted reviews, and one visitation of UCB from 2002 until the bank was closed on November 6, 2009. Table 6 summarizes key information, including the implementation of formal and informal actions that resulted from this joint oversight.

Table 6: Onsite Examinations of UCB

Examination Start Date	Examination as of Date	Agency	Supervisory Ratings	Informal or Formal Action
6/24/2002	3/31/2002	FDIC	212221/2	None
12/01/2003	9/30/2003	FDIC/CDFI	212221/2	None
1/10/2005	9/30/2004	FDIC/CDFI	212121/2	None
1/30/2006	9/30/2005	FDIC/CDFI	211121/1	None
3/05/2007	12/31/2006	FDIC/CDFI	212122/2	None
2/27/2008	12/31/2007	FDIC/CDFI	222222/2	BBR to address BSA non-compliance, effective July 24, 2008; terminated June 30, 2009.
12/01/2008 [a]	9/30/2008	FDIC/CDFI	232322/2	None
4/06/2009 [b]	3/31/2009	FDIC/CDFI	344433/4	Interim downgrade to a composite "3," effective April 20, 2009. Cease and Desist Order issued on September 3, 2009.
6/16/2009 [b]	5/31/2009	FDIC/CDFI	344433/4	None.
8/03/2009 [b, c]	6/30/2009	FDIC/CDFI	555555/5	PCA Notification letter: August 11, 2009. Cease and Desist Order: September 3, 2009. PCA Directive: November 2, 2009.

Source: OIG analysis of examination reports and information in the FDIC's Virtual Supervisory Information on the Net system for UCB, Orders, and Directives.
[a] Visitation [b] Targeted Review [c] A final report was not issued due to UCB's closure.

As discussed in the *Causes of Failure and Material Loss* section of this report, an investigative report found that UCB officials made intentional misrepresentations in an effort to mask the bank's true financial condition. SFRO officials told us that these activities hindered examiners' efforts to identify risks and assign accurate CAMELS ratings in late 2008 and into 2009. For example, UCB officials:

- presented examiners with inaccurate information on certain occasions regarding the loans they reviewed;

- did not provide examiners with a December 2008 IARD loan review report until approximately 3 months after it was prepared, and this report would have shed light on UCB's declining loan performance; and

- were not forthright with examiners when questioned about loan loss provision expenses for the fourth quarter of 2008.

Offsite Review Program

The Offsite Review Program is designed to identify emerging supervisory concerns and potential problems so that the FDIC's oversight strategy can be adjusted appropriately. Included in this program is an Offsite Review List (ORL), which consists of "1"- and "2"-rated institutions that have been identified with potential problems or pose the risk of being downgraded to a "3" rating or worse at the next examination. Institutions that appear on the ORL warrant additional FDIC oversight.

UCB appeared on the ORL three times as follows:

- June 2008: Prompted due to a potential downgrade resulting from an increase in UCB's non-performing assets and historical high levels of CRE concentrations. In response, the FDIC recommended ongoing monitoring of UCB and noted that UCB would be switched to a targeted review schedule.

- September 2008: Prompted due to a recommended downgrade in UCB's Asset Quality and Earnings component ratings, each from a "2" to a "3," as a result of UCB's increase in classified assets and decline in profitability. These component ratings were downgraded as a result of the December 2008 visitation.

- December 2008: Prompted due to the deterioration in UCB's construction loan portfolio and decline in earnings, which led the FDIC to consider a composite interim CAMELS downgrade to a "3." The FDIC subsequently downgraded UCB to a composite "3" rating and notified UCB in a letter dated April 20, 2009.

The FDIC also generally performed the following offsite monitoring activities on a quarterly basis throughout the period of our review:

- contacted management to discuss significant changes in the bank's risk profile and business activities;

- met with bank management to discuss quarterly financial results, correction of prior examination findings, and new activities; and

- reviewed Call Reports, UBPRs, SEC filings, press releases, and selected internally-prepared management reports, such as ALLL adequacy analyses.

Examiners notified FDIC regional management of significant changes in the bank's risk profile as a result of these activities.

Supervisory Actions

Table 7 further describes supervisory actions initiated by the FDIC, the FRBSF, and the CDFI in 2008 and 2009.

Table 7: FDIC, FRBSF, and CDFI Supervisory Actions Concerning UCB

Date	Action Taken
July 24, 2008	BBR imposed by the FDIC and the CDFI to address BSA issues identified at the February 2008 examination; terminated on June 30, 2009, after UCB fully complied with the BBR and improved its BSA compliance program.
April 20, 2009	FDIC letter notifying the bank of a downgrade to a composite "3" rating and designating the bank as "troubled." The letter also restricted UCB's issuance of debt under the Temporary Liquidity Guarantee Program.
May 28, 2009	Early notification (dear CEO) letter was delivered to the Board, which further restricted brokered deposits and the issuance of debt under the Temporary Liquidity Guarantee Program.
June 30, 2009	Joint letter from the FDIC and the CDFI to UCB summarizing the April 2009 targeted review results and announcing that a Cease and Desist Order would be issued. A letter from UCB to the FDIC dated July 29, 2009 acknowledged UCB's deterioration in its asset quality and concurred with examiners' April 2009 targeted review findings.
September 3, 2009	A joint FDIC/CDFI Cease and Desist Order was issued to address issues identified at the April 2009 targeted review. The Order required UCB to cease and desist from engaging in unsafe or unsound banking and required UCB, by December 31, 2009, to achieve and maintain adequate capital levels. The Order also required UCB to develop and adopt an adequate capital plan within 60 days of the date of the Order. UCB never developed an adequate plan.
September 9, 2009	FDIC letter notifying UCB of an interim rating downgrade to a composite "5."
September 9, 2009	Written agreement between UCBH and the FRBSF that required UCBH to develop a plan to raise capital within 60 days.
September 15, 2009	FRBSF letter to UCBH informing it of a composite rating downgrade.
September 17, 2009	SFRO letter to the bank restricting any additional transfers of assets to foreign operations without the FDIC's prior written consent.

Source: Correspondence between the FDIC and UCB and UCBH Form 8-K filings.

Supervisory Response to Board and Management Oversight

According to examination reports from 2002 through 2008, UCB's Board and management performed satisfactorily and were generally responsive to examination findings and recommendations, as indicated by Management component ratings of "1" or "2" during that timeframe. The Management component rating was first downgraded from a "2" at the April 2009 targeted review, at which time a "4" component rating was assigned.

DSC's *Risk Management Manual of Examination Policies* states that the quality of management is probably the single most important element in the successful operation of a bank. The capability and performance of the Board and management is rated based upon, but not limited to, an assessment of the following factors:

- The level and quality of oversight and support of all institution activities by the Board and management;

- The ability of the Board and management, in their respective roles, to plan for, and respond to, risks that may arise from changing business conditions or the initiation of new activities or products;

- The adequacies of, and conformance with, appropriate internal policies and controls addressing the operations and risks of significant activities;

- The accuracy, timeliness, and effectiveness of management information and risk monitoring systems appropriate for the institution's size, complexity, and risk profile;

- The adequacy of audits and internal controls to promote effective operations and reliable financial and regulatory reporting; safeguard assets; and ensure compliance with laws, regulations, and internal policies;

- Responsiveness to recommendations from auditors and supervisory authorities; and

- The extent that the Board and management are affected by, or susceptible to, dominant influence or concentration of authority.

A Management rating of "2" denotes satisfactory performance by management and the Board and satisfactory risk management practices. Based on our review of FDIC examination reports, particularly from 2007 forward, and discussions with FDIC and former UCB staff, we concluded that UCB's Board and management did not meet several of the factors described above. In particular, the February 2008 examination report led to a Matter Requiring Board Attention, requiring UCB's Board and management to:

- address apparent violations and program issues pertaining to its BSA and Anti-Money Laundering program;

- improve its liquidity monitoring;

- develop a Board-approved contingency funding plan;

- develop a comprehensive strategic plan to include the integration of UCB's Greater China strategy;

- assess its staffing, infrastructure needs, and management structure; and

- verify all unresolved high- and moderate-impact IT and general audit issues.

Examiners contemplated a "3" Management component rating, but after consultation with the SFRO, the FDIC provided a "2" rating because it was confident that UCB would remediate these issues and the bank's financial condition was satisfactory. A follow-up visitation in December 2008 found that UCB had made progress in addressing these

issues. However, other FDIC examinations and documentation identified a number of management-related findings at UCB as discussed in the following sections. These issues are indicative of a less than satisfactory Board and management.

Dominant Management Official

One individual, who held the titles of UCB's President, CEO, and Chairman of the Board, exercised a considerable amount of influence over UCB's operations. In an effort to increase UCB's assets, this individual was ultimately responsible for (1) fostering a culture that led to the bank's approval of a large number of exceptions to the bank's loan policy so UCB could make more loans, (2) fostering a combative culture where management failed to downgrade non-performing loans in a timely manner, and (3) over-paying to acquire financial institutions.

The August 2009 targeted review draft report noted that the President's desire over time to grow the bank ultimately imperiled it by fostering a culture that deterred the identification and correction of problems by staff.

Board and Management Weaknesses

Examiners cited the following weaknesses with UCB's Board and management:

- The March 2007 examination stated that examiners could not determine if the Board was apprised of UCB's significant leverage strategy to grow its assets to $10 billion. UCB's executive management stated that the Board was apprised of the strategy; however, UCB's legal counsel directed management to not document the discussions due to liability concerns.

- The February 2008 examination reported Matters Requiring Board Attention, including an organizational assessment that would address, among other things, the management structure of the bank. The examination also recommended increased oversight by UCB's Board to ensure that reported weaknesses were addressed in a timely manner.

Internal Loan Review and Management Controls

The April 2009 targeted review noted that UCB's Board and management had not supplied IARD with the necessary support to fulfill its mandate. IARD's efforts were frustrated, in part, due to a lack of stature and influence, which impeded its ability to effectively downgrade credits. The review noted: "After roughly four years of existence, IARD cannot fully quantify credit risk to a degree that provides senior management and the Board with sufficient and accurate information to manage the institution's risks."

UCB's President also delayed the issuance of an IARD loan review report to UCB's Board and examiners because it contained negative performance information about the loans that were reviewed, according to UCB and examination staff interviewed.

Finally, as discussed previously, management controls were not sufficient to prevent apparent violations of federal securities laws by UCB officials and the issuance of inaccurate financial statements.

Risk Management and Infrastructure

FDIC examination reports documented UCB's difficulty in managing the risks associated with its aggressive growth and implementing an adequate supportive infrastructure. For example:

- The February 2008 examination noted that, after several years of existence, UCB's Enterprise Risk Management function was unable to quantify or report risks to UCB's Board and the bank's management had not developed an overarching assessment of its enterprise-wide risks.

- The December 2008 visitation noted that UCB's management needed to revisit its risk appetite and decide if its continued business prospects were vibrant enough to accept the risks associated with management's asset growth and market share expectations.

- The 2007, 2008, and 2009 examination reports and reviews noted UCB's high levels of senior management staff turnover, inexperienced staff, insufficient staffing levels, indeterminate job roles, and unclear responsibilities and authority. Similarly, the June 2009 UCBC targeted review noted that UCBC experienced elevated staff departures.

- The April 2009 targeted review noted that management's failure to strengthen UCB's risk management infrastructure was attributed, in part, to the bank's strategy to reach $10 billion in assets, so it could meet an eligibility standard to purchase a bank in the People's Republic of China. During UCB's growth period, its assets nearly doubled in 4 years and the bank continued to rely on manual processes rather than employ adequate technology and appropriate staff to effectively manage the institution. While manual processes served the bank when it was smaller, these methods became unreliable as it grew. The review further stated that the lack of a fully developed risk management infrastructure hampered management's efforts to control the bank's deterioration and that its loan risk rating system was ineffective.

Integration of Foreign and Domestic Operations

Examiners noted the following with respect to UCB's oversight of UCBC and the Hong Kong branch:

- The March 2007 examination report noted that UCB had not adequately integrated the Hong Kong branch into its risk management framework due to

weaknesses in its credit underwriting and administration and BSA and IT operations.

- While the February 2008 examination found that the bank was managed in a satisfactory manner, it noted that UCB's Board and management needed to develop and approve a comprehensive strategic plan that provided a vision for the future of the bank, including the integration of the Greater China strategy.

As discussed earlier, examination reports rated UCB management a "1" or a "2" until the April 2009 targeted review. Given the examination findings detailed above, a "3" management rating may have been more appropriate for the February 2008 examination. A stronger and earlier supervisory response may have influenced UCB's Board and management to take corrective actions sooner in response to examiners' findings and enhance its risk management and infrastructure in support of the institution's rapid growth.

Supervisory Response to UCB's Asset Quality

Asset quality is one of the most critical areas in determining the overall condition of a bank. As discussed below, examiners sampled a reasonable number of loans and successively downgraded UCB's Asset Quality component rating. However, examiners did not report significant concerns with UCB's ADC and CRE loan concentrations and the extent of UCB's weak underwriting issues until the 2009 targeted reviews.

Examination Coverage of ADC and CRE Concentrations

Examination reports issued from 2005 through February 2008 generally noted UCB's elevated ADC and CRE concentrations and that UCB management was adequately monitoring and mitigating the risks associated with these concentrations. The December 2008 visitation report noted deterioration in UCB's construction and commercial loan portfolios but reported that UCB's overall CRE concentrations had declined and bank management continued to monitor its CRE concentrations against capital and provided the Board with reports that sufficiently disclosed the bank's risk exposures.

Examiners first criticized UCB's CRE concentrations in the April 2009 targeted review. This review noted that the CRE concentrations were problematic because they accounted for a substantial increase in adversely classified assets, and UCB underestimated the risk associated with, and did not properly manage, its CRE portfolio. The August 2009 targeted review draft report noted several deficiencies with UCB's lending practices, which adversely impacted its CRE portfolio, and criticized UCB for cancelling planned audits of its CRE portfolio, despite the fact that this portfolio had been identified as having a high level of inherent risk.

Examination Coverage of Underwriting and Credit Administration Practices

A discussion of the FDIC's examination coverage of UCB's underwriting and credit administration follows, with an emphasis on examiners' reviews of the bank's loan files and relevant findings in examination reports.

Loan File Reviews. Between 2002 and 2009, FDIC examiners reviewed from 9 percent to 27 percent of UCB's non-homogenous loans,[17] representing between $237 million and $2.2 billion of UCB's loan portfolio. In comparison, UCB's loan portfolio ranged from $3 billion to $8 billion during this period. The percentage of non-homogenous loans and total number of loans reviewed generally increased each year, with the largest loan sample review conducted during the April 2009 targeted review. In this review, the loans examined represented 26 percent of UCB's total loan portfolio and 27 percent of its non-homogenous loans. Examiners reviewed a commensurate cross-section of loans that were representative of the concentrations in UCB's major loan categories. The number of loans reviewed appeared reasonable, based on informal guidance contained in a DSC pre-examination planning memo, suggesting that examiners should generally review between 15 percent and 30 percent of an institution's loan portfolio during a full-scope examination.[18]

From 2002 through 2009, examiners selected their loan samples during the pre-examination planning process and derived their loan samples by reviewing UCB's delinquent loan reports, list of non-accrual loans, debt reports, performing credits, and new loan originations since the last examination to see if there were changes in UCB's underwriting standards. In selecting loans for review, examiners paid particular attention to loans that UCB management had concerns with, such as those on watch lists. Examiners also considered the impact the economy had on UCB's loan portfolio and selected loans accordingly, using an FDIC database to help generate their loan samples, which generated summary information on the loans, known as line sheets.

Examiners reviewed loan files and recorded instances where the files lacked sufficient documentation to determine whether UCB used sound practices to originate and service the loans. Exceptions included instances when UCB did not (1) demonstrate that the loans had sufficient collateral; (2) perform adequate financial statement analyses; or (3) obtain current appraisals.

In 2009, examiners also reviewed certain loans that were later believed to have been originated as a result of illegal activities. During their review, examiners prompted UCB

[17] Non-homogenous loans have distinctive characteristics and are usually of larger dollar amounts than homogenous loans. Construction, CRE, and commercial and industrial loans are non-homogenous loans, while single family 1-4 loans are homogenous loans. The vast majority of UCB's loans were non-homogenous.

[18] The DSC Examination Documentation module provides guidance for examiners to follow when conducting loan file reviews, including assessing underwriting and file documentation sufficiency, but does not specify suggested sample sizes.

to downgrade these loans due to performance issues.[19] These loans and approximately 150 others, as well as senior UCB management, are being investigated by other units within and outside of the FDIC.

Examination Report Findings. The March 2007 examination noted underwriting and credit administration weaknesses in UCB's construction lending portfolio and UCB's Hong Kong branch and criticized approximately $15 million in credits. UCB initiated corrective action during the examination and received a "1" Asset Quality rating, in part because adverse classifications were low and had decreased by $10 million from the prior examination. Findings from this examination were as follows:

- Guarantor financial statements were not consistently analyzed and were presented on an "as is" basis without adjustments. The statements reviewed were self-prepared by the guarantors, were not in accepted accounting format, and reflected substantial gains in real estate and other values that were not adequately supported.

- For the majority of loans sampled by examiners, UCB's analysis of financial data was overly simplistic, listing only major assets and liabilities, the current assets ratio,[20] and working capital.

- There were significant deficiencies with the Hong Kong branch's underwriting standards because (1) the branch staff did not verify borrowers' financial conditions or obtain tax returns from borrowers and guarantors, (2) the debt service coverage ratio calculation was not standardized, and (3) the branch's underwriting standards did not meet those prescribed by UCB.

The February 2008 examination noted that almost all of UCB's adversely classified construction loans had collateral dependent exposures to borrowing entities and guarantors that did not provide additional support or an alternative source of repayment. The February 2008 examination also noted that UCB had not adequately monitored participation loans purchased from other lenders and loans classified as "special mention."[21] The December 2008 visitation noted that UCB needed to improve the stress testing of its loan portfolio in order to better quantify the potential impact that changing economic conditions could have had on its asset quality, earnings, and capital. Examiners downgraded UCB's Asset Quality component rating to a "2" at the February 2008 examination and a "3" at the December 2008 visitation.

[19] We did not evaluate whether the FDIC should have been cognizant of UCB's alleged violations of securities laws at an earlier time and note that the alleged violations involved several of UCB's senior officers.

[20] The current assets ratio is a measure of an institution's ability to pay debts that are due within one year and is calculated by dividing current assets by current liabilities. Current assets are assets that could be converted into cash or cash equivalents within one year; current liabilities are debts or obligations that are due within one year.

[21] Special mention loans denote assets with potential weaknesses warranting management's close attention.

The April 2009 targeted review noted UCB's failure to downgrade loans in a timely manner and maximize recoveries on its increased volume of distressed assets and identified certain concerns with asset quality, some of which were new and others that were similar to those noted in prior examinations.[22] Examiners again downgraded UCB's Asset Quality component rating to a "4." Further, this review noted that several deficient lending practices heavily contributed to UCB's excessive level of adversely classified assets. According to examination staff, the deficient lending practices related primarily to construction and commercial loans that were originated in 2006 and 2007, when UCB approved numerous exceptions to its loan policy in an effort to increase lending and its assets to $10 billion so it could purchase UCBC. DSC officials stated that prior to 2009, examinations did not identify the extent of the underwriting deficiencies because, in part, UCB's loans were performing, the market was strong, and appraisals generally supported the loans.

To the FDIC's credit, examiners downgraded UCB's Asset Quality ratings at consecutive examinations. However, examiners did not pursue supervisory action related to risks in this area until 2009. In that regard, the *Formal and Informal Action Procedures Manual* states that the FDIC may consider BBRs for institutions that receive a composite CAMELS or compliance rating of "2;" however, these resolutions are rare in such instances. Nevertheless, BBRs could be used to address concerns noted in areas where component "3" ratings were assigned, or to address high-risk areas in a particular lending segment. Given the risks associated with UCB's loan portfolio, a BBR may have been warranted based on the December 2008 visitation to establish a stronger supervisory tenor and elevated sense of concern.

Use of Targeted Reviews

In 2009, the FDIC switched from conducting point-in-time examinations to targeted reviews of UCB. Targeted reviews are usually performed at large institutions, typically focus on specific areas of risk, and are conducted approximately 3 to 4 times per year. Point-in-time examinations are done annually and include an evaluation of all of the CAMELS components. The FDIC has not issued formal guidance prescribing when an institution should switch to targeted reviews, but according to FDIC management, targeted reviews are triggered by certain changes, such as deterioration in a bank's financial condition. The decision to switch a bank from a point-in-time examination schedule to targeted reviews is based on the judgment of FDIC regional office staff and examiners.

The FDIC's SFRO considered placing UCB on a targeted review schedule in 2008, as recommended by examiners. However, the SFRO conducted point-in-time examinations of UCB through 2008 because regional management concluded that these examinations were sufficient, UCB's risk profile was satisfactory, and this approach enabled the

[22] An examination official noted that the targeted review identified new loan administration issues related to troubled debt restructuring and loss impairment analyses for problem loans that surfaced once asset quality deteriorated.

FRBSF to meet statutory timeframes for examining UCBH in mid-2008 while avoiding overlapping regulatory oversight.

The SFRO thoroughly considered its decision to delay placing UCB on a targeted review schedule and documented its reasons for the delay. Even though UCB remained on the point-in-time examination schedule until 2009, SFRO officials indicated that they closely monitored the bank, obtained current information regarding UCB's financial performance and interim developments, identified deterioration in UCB's asset quality and earnings in the latter half of 2008 through the FDIC's offsite monitoring efforts, and kept apprised of the FRBSF's 2008 examination findings. Nevertheless, in our view, UCB's size, rapid growth, and increased risk profile constituted triggering events for switching UCB to targeted reviews at an earlier date. Switching to targeted reviews earlier would have enabled examiners to be onsite more frequently and further focus their efforts on key risks at an earlier date. Conducting targeted reviews during 2008 also may have provided the FDIC with additional information upon which to base its October 2008 CPP funding recommendation.

LIDI Program

The FDIC develops LIDI reports and associated rankings as an additional means to measure the financial health of large institutions and risks to the DIF. Based on their review, case managers assign an institution a rating from A (best) to E (worst) and an "outlook" rating of positive, stable, or negative, which reflects an institution's forward-looking risks. According to DSC officials, given the forward-looking nature of the LIDI Program, the LIDI ratings do not always match the CAMELS ratings because of their timing and the point-in-time nature of the examinations. Table 8 presents the FDIC LIDI rating definitions.

Table 8: LIDI Rating Descriptions

A	Low risk of concern regarding ultimate risk to the insurance funds.
B	Ordinary level of concern regarding the ultimate risk for the insurance funds.
C	More than ordinary level of concern regarding the ultimate risk to the insurance funds.
D	High level of concern regarding the risk to the insurance funds.
E	Serious concerns regarding the ultimate risk to the insurance funds.

Source: FDIC Case Managers' Manual.

UCB became subject to the LIDI program in the fourth quarter of 2006, when its assets reached $10 billion. The FDIC conducted quarterly LIDI reviews and issued 10 related reports, as required, beginning in the first quarter of 2007 and through the second quarter of 2009. Each of the 10 reports identified UCB's ability to manage its rapid growth and high ADC and CRE concentrations as key risks and regulatory concerns. The six reports issued in 2008 and 2009 identified risks related to rises in UCB's problem loans. UCB's

LIDI outlook rating was "stable" through the second quarter of 2008; however, the rating dropped to "negative" in the third quarter of 2008.

UCB's LIDI ratings for each quarter in 2008 were "C" compared to composite CAMELS "2" ratings for the two 2008 examinations of UCB. The "C" LIDI ratings resulted from increased loan classifications and declined earnings. DSC officials noted that the lower LIDI ratings were indicative of the 12-month forward-looking orientation of that program versus the more point-in-time focus of the CAMELS ratings, as discussed earlier.

Implementation of PCA

Section 38, *Prompt Corrective Action*, of the FDI Act establishes a framework of mandatory and discretionary supervisory actions pertaining to all insured depository institutions. The section requires that regulators take progressively more severe actions, known as "prompt corrective actions," as an institution's capital level deteriorates. The purpose of section 38 is to resolve problems of insured depository institutions at the least possible long-term cost to the DIF. Part 325, *Capital Maintenance*, of the FDIC Rules and Regulations, defines the capital measures used in determining the supervisory actions that will be taken pursuant to section 38 for FDIC-supervised institutions. Part 325 also establishes procedures for the submission and review of capital restoration plans and for the issuance of directives and orders pursuant to section 38. Table 9 provides UCB's capital ratios from 2002 through September 2009.

Table 9: UCB's Capital Levels

Period Ended	Tier 1 Leverage Capital	Tier 1 Risk Based Capital	Total Risk Based Capital	PCA Capital Category
PCA Threshold	5% or more	6% or more	10% or more	
Dec-02	7.57%	10.26%	11.52%	*Well Capitalized*
Dec-03	7.86%	10.92%	12.18%	*Well Capitalized*
Dec-04	8.49%	11.42%	12.67%	*Well Capitalized*
Dec-05	8.26%	9.91%	10.98%	*Well Capitalized*
Dec-06	9.30%	9.67%	10.53%	*Well Capitalized*
Dec-07	7.42%	8.55%	10.80%	*Well Capitalized*
Dec-08	9.06%	11.72%	14.24%	*Well Capitalized*
June-09	4.02%	5.32%	7.92%	*Undercapitalized* PCA letter sent August 11, 2009.
Sept-09	2.20%	3.16%	5.91%	*Significantly Undercapitalized* PCA letter sent October 29, 2009.

Source: UBPRs for UCB.

Based on the supervisory actions taken with respect to UCB, the FDIC properly implemented applicable PCA provisions of section 38 of the FDI Act. The FDIC timely notified UCB of its *Undercapitalized* and *Significantly Undercapitalized* status, required UCB to file a capital restoration plan with the FDIC, and required UCB to comply with mandatory restrictions of section 38 of the FDI Act. These restrictions related to UCB's

asset growth, acquisitions, new activities, new branches, dividend payments, management fees, capital distributions, and senior executive compensation.

Specifically, the FDIC's supervisory actions related to PCA were as follows:

- On August 11, 2009, the FDIC sent a PCA notification letter to UCB informing it of its *Undercapitalized* status and required UCB to develop a capital restoration plan.
- On October 29, 2009, the FDIC sent a PCA notification letter to UCB informing it of its *Significantly Undercapitalized* status.
- On November 2, 2009, a PCA Directive noted that UCB submitted to the FDIC an unacceptable capital restoration plan on September 15, 2009. The FDIC concluded the plan contained unrealistic and unobtainable goals. The Directive required UCB to submit an acceptable revised capital restoration plan, which UCB never did.

Capital Purchase Program

On November 14, 2008, UCBH received $298.7 million in TARP CPP funds and subsequently down-streamed the money to UCB. Treasury lost this investment when UCB was closed on November 6, 2009. UCB was the first depository institution to lose TARP funds. Nevertheless, we determined that (1) the FDIC followed applicable procedures in recommending UCBH for CPP funding and (2) examiners evaluated UCB's compliance with the CPP Securities Purchase Agreement in accordance with DSC guidance.

CPP Criteria

On October 20, 2008, the Treasury issued final viability criteria for the federal banking agencies to use in reviewing CPP applications. The DSC regional offices reviewed the CPP applications from state nonmember banks and relied upon the Treasury's guidance in determining whether the institutions qualified for CPP funding. The criteria indicated that the CPP eligibility recommendation was to be based on an assessment of the overall strength and viability of the applicant without considering potential funds received under the CPP. The viability criteria included an institution's examination ratings and selected performance and capital ratios. The Treasury also provided the federal banking agencies with a *TARP Capital Purchase Program Case Decision Memo*. The FDIC used this document to record its findings related to: UCB's CAMELS and Community Reinvestment Act ratings and selected performance ratios; UCB's viability; the FDIC's supervisory strategy; and relevant actions. The FDIC also included narrative comments in the document in support of its recommendation.

In general, if an institution met the Treasury's viability criteria for CPP participation, the appropriate federal banking agency recommended that the Treasury approve it for CPP funding.[23] In turn, the Treasury made the final CPP funding decision. In exchange for CPP funds, the Treasury received preferred shares and warrants or future rights to purchase shares. Banks were required to pay the Treasury a 5-percent dividend for 5 years and a 9-percent dividend thereafter. Banks had the right to suspend the dividend payments, which UCBH did, to preserve capital.

The FDIC's Recommendation of UCBH for CPP Funding

On October 21, 2008, UCBH filed its CPP application with the FRBSF, its primary regulator, and the FDIC. The FDIC, UCB's primary regulator, reviewed the application and recommended Treasury approval of UCBH for CPP funding. At the time of its application, UCB met all of the Treasury's eligibility criteria and the FDIC considered UCB to be a "viable" institution. The FDIC was not aware of UCB's serious financial reporting matters when it assessed UCB's TARP application in October 2008; these matters became apparent in 2009, after the investigation by UCBH's audit committee. UCB's capital and leverage ratios qualified it as a *Well Capitalized* institution and the bank met the Treasury's viability criteria associated with classified and nonperforming asset levels, and construction and development loan concentrations. UCB's most recent CAMELS composite rating was a "2" (based on the February 2008 examination) and its most recent Community Reinvestment Act rating was "Outstanding." Further, the FRBSF assigned a satisfactory rating to UCBH and UCB received acceptable external debt ratings.

UCBH's CPP Application Timeline

Treasury had requested the FDIC and other banking regulators to quickly recommend viable community banks for CPP funding. In response, SFRO representatives contacted UCB and other banks to solicit their interest in the program and UCB was one of the first institutions that the FDIC recommended for CPP funding. UCB expressed an interest in CPP funding on October 17, 2008, and 4 days later, UCBH submitted its CPP application. UCBH requested $298.7 million, the maximum allowable funding amount.[24] The FDIC forwarded the application and its case decision memo to the Treasury on October 22, 2008. The Treasury reviewed the FDIC's recommendation on October 23, 2008, and requested additional information about UCB concerning deficiencies with its BSA program and a potential purchase of UCB by a foreign bank. The FDIC provided this information, and on October 24, 2008, the Treasury unanimously recommended preliminary approval of UCBH's CPP application. On November 14, 2008, the Treasury disbursed $298.7 million in CPP funds to UCBH. UCBH down-streamed the funds to UCB, which used the TARP proceeds to make consumer and commercial loans, according to examiners' documentation.

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[23] Institutions that did not meet the Treasury's criteria were reviewed by the CPP Interagency Council, which was comprised of senior representatives from the federal banking agencies. Because UCB met the Treasury's eligibility criteria, it was not subject to CPP Interagency Council review.

[24] The maximum amount of capital eligible for purchase by the Treasury under the CPP is the lesser of (i) an amount equal to 3 percent of the Total Risk-Weighted Assets of the applicant or (ii) $25 billion.

On October 27, 2008, 5 days after the FDIC had recommended UCBH for CPP funding, a Treasury staff member forwarded an e-mail from an anonymous source to DSC headquarters and senior Treasury officials. The e-mail questioned the Treasury's decision to provide CPP funding to UCB and the integrity of UCB's CEO. The FDIC and the Treasury considered the e-mail but because the e-mail was from an anonymous source, its allegations were unsubstantiated, and UCBH met the Treasury's eligibility criteria, DSC did not change its recommendation decision.

The FDIC's Review of UCBH's CPP Funding Request

We confirmed that the FDIC relied upon the Treasury's viability criteria and case decision memo to assess UCBH's request for CPP funding. We also found that the Total Risk-Weighted Assets figure provided by UCB in its CPP application substantially matched the figure in UCB's Call Report.[25]

We interviewed the FDIC's Case Manager for UCB to understand what actions were taken in reviewing the CPP application and preparing the case decision memo. The Case Manager indicated that he relied on UCB's most recent FDIC risk management examination, which commenced in February 2008; the most recent Call Report data, which was as of June 30, 2008; and pro forma Call Report data, as of September 30, 2008.[26] The Case Manager stated that he also contacted the CDFI and the FRB regarding UCB's application. Neither institution objected to UCB's receipt of CPP funding. The Case Manager indicated that he was not aware of any accounting issues at UCB at the time of his review of the bank's CPP application. As discussed earlier, had the FDIC transitioned UCB to targeted reviews during 2008, the FDIC may have had additional information upon which to make a CPP funding recommendation.

In recommending UCBH for CPP funding, DSC was aware of certain negative information about UCB, but these issues were not considered significant enough to recommend against CPP funding. At the time of UCB's application, the most recent LIDI report identified concerns about UCB's CRE concentrations and rapid growth, and contained a "negative" outlook rating and a "C" overall rating, due to a decline in UCB's asset quality and earnings. The report also stated, however, that UCB's capital appeared adequate and UCB was well managed. The Case Manager was aware that UCB was subject to a July 2008 BBR regarding deficiencies in its BSA program and found that UCB had made progress in addressing these issues.

We concluded that the FDIC followed applicable procedures in recommending UCBH for CPP funding. We also note that the financial ratios that the FDIC used to determine that UCBH met the eligibility criteria may have been erroneous because these ratios were computed according to UCB's 2008 financial statements, which were later found to be in

[25] The CPP application requested only one financial figure from UCB, its Total Risk-Weighted Assets. The figure that UCB reported on its application was $9,957,908,000, compared to $9,947,144,000 on UCB's June 30, 2008 Call Report. We determined that this difference of 0.11 percent was not material.
[26] UCB had not finalized its September 30, 2008 financial data at the time of its CPP application.

need of restatement. Since UCB is now closed and its 2008 financial statements are not likely to be restated, we cannot conclude on whether UCB would have failed any of the eligibility criteria had the ratios been based on accurate financial data. For the same reason, we cannot opine on whether UCBH's Total Risk-Weighted Assets figure reported in its CPP application was accurate, despite the fact that it substantially matched the figure in UCB's June 30, 2008 Call Report. Finally, we did not find any reason to believe that the FDIC should have been aware of the problems with UCB's financial statements at the time of UCBH's CPP application.

Examiners' Evaluation of UCB's Compliance with the CPP Securities Purchase Agreement

The CPP Securities Purchase Agreement (Agreement) describes the CPP recipient's responsibility for issuing shares and fulfilling other requirements in exchange for the Treasury's investment. FDIC examiners evaluated UCB's compliance with the

Agreement in accordance with DSC guidance issued in February 2009.[27] The August 2009 targeted review draft report identified one instance where UCB was in apparent violation of the CPP provisions and one instance where UCB apparently violated excessive compensation standards imposed by regulation.

To evaluate UCB's compliance with the Agreement, FDIC examiners reviewed applicable statutes and regulations, FDIC guidance, UCB's compensation committee minutes, compensation and employment agreements, and related amendments for UCB's five highest paid executives and UCBH's dividend payments. Examiners prepared memoranda detailing their assessment of UCB's compliance with the Agreement. These memoranda identified areas of UCB compliance and apparent non-compliance with the Agreement and contained recommendations for improvement. The FDIC examiners reviewed and documented UCB's compliance with the CPP rules and regulations in April 2009 and as a part of the fieldwork performed in support of the August 2009 targeted review.

The August 2009 targeted review draft report identified the following apparent violations:

- UCB was in apparent violation of the CPP standards for compensation and corporate governance because UCB's Board had not established an excessive or luxury expenditures policy, filed the policy with the Treasury, and posted the policy on its Internet Web site.[28]

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[27] CPP compliance provisions were established through the EESA and the Treasury's rules codified under section 31 of the Code of Federal Regulations (CFR), Part 30. DSC issued implementing guidance through regional director memorandum, classification number 6300: *Examination Guidance for Financial Institutions Receiving Subscriptions from the U.S. Department of the Treasury's TARP CPP Program*, dated February 9, 2009.

[28] This requirement is found at 31 CFR Part 30, Section 111(d), *TARP Standards for Compensation and Corporate Governance*; Interim Final Rule.

- UCB's former President/CEO claimed and was reimbursed for travel and other business expenses, in contravention of Appendix A to Part 364 of the Interagency Guidelines Establishing Standards for Safety and Soundness.[29] These expenses included expensive dinners where UCB had not maintained branch offices and corporate gifts that were considered to be unreasonable and disproportionate to services performed by the CEO. Further, the draft targeted review reported that there was no evidence that UCB's Board had reviewed or approved the expenses for which the President/CEO had been reimbursed.

The following summarizes areas where examiners found UCB to be in compliance with the CPP. According to their documentation, examiners:

- Found that UCB management amended the compensation and employment agreements of its five highest paid executives to comply with executive compensation restrictions imposed by the CPP. However, examiner documentation noted that UCB's CEO had not certified that the compensation and employment agreements complied with executive compensation standards imposed by the TARP CPP interim final rule.[30]

- Determined, in conjunction with an FDIC legal counsel's opinion, that a $150,000 signing bonus, paid in April 2009 to UCB's incoming President, was allowed under the CPP and that UCB was compliant with Section 111(b) of the EESA, which placed restrictions on executive compensation.

- Concluded that UCB was in general compliance with the CPP provisions covering "Golden Parachute" payments, based on their review of related documentation. Examiners found that two former UCB Presidents signed agreements that they would not receive golden parachute payments while the bank participated in the CPP, nor would they accept other bonuses or incentive compensation based on certain criteria.

- Recommended that the salary provisions of the employment contracts of two executives (the President/CEO and the Director of Community Banking) be amended to conform with CPP regulations; UCB subsequently amended these contracts.

- Concluded that as of August 3, 2009, UCB's maintenance of records related to the CPP was satisfactory.

- Recalculated UCB's capital ratios without including the $298.7 million in CPP funds and found that, as of April 2009, UCB would still have been considered *Well Capitalized*. Under this scenario, UCB's leverage, Tier I Risk-based Capital and Total Risk-based Capital levels would have been 6.74 percent, 8.71 percent,

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[29] 12 CFR, Part 364 appendix A III, *Prohibition of Compensation that Constitutes an Unsafe and Unsound Practice,* A. – *Excessive Compensation.*
[30] 31 CFR § 30.12(a)(3)(i).

and 11.23 percent, respectively. These capital figures, however, were likely based on erroneous financial data, based on the findings of the investigation initiated by UCBH, which concluded in September 2009.

- Reviewed UCBH's dividend payments to shareholders and found that UCBH appeared to be in compliance with restrictions on paying dividends. However, examiners criticized UCBH's dividend payments during periods when UCB reported a loss, due to the bank's negative earnings and low levels of capital. UCBH eventually stopped paying dividends to the Treasury for the CPP funds, as allowed under the Agreement.

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 July 20, 2010, the Director, DSC, provided a written response to the draft report. That response is provided in its entirety as Appendix 5 of this report.

DSC reiterated the OIG's conclusions regarding the causes of UCB's failure. With regard to our assessment of the FDIC's supervision of UCB, DSC stated that from 2005 through 2009, the FDIC and the CDFI jointly and separately completed several examinations, visitations, reviews and other oversight activities of UCB. Through these activities, examiners identified key risks and brought them to the attention of UCB's Board and management in examination reports, and other correspondence. DSC pointed out that in December 2008, the FDIC and the CDFI downgraded UCB's Asset Quality and Earnings component ratings to "3" and identified further deterioration during an April 2009 joint targeted review. DSC also stated that UCBH's external auditor found that UCB's management had begun to conceal serious financial reporting issues around October 2008.

Finally, DSC stated that it has issued guidance from 2006 through 2009 that re-emphasizes the importance of monitoring institutions that have concentrated ADC and CRE exposures and rely on volatile non-core funding sources.

Objectives, Scope, and Methodology

Objectives

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

Our primary 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 UCB, including the FDIC's implementation of the PCA provisions of section 38 of the FDI Act. In November 2008, UCB received $298.7 million through the Treasury's TARP CPP. As a result, the third objective of this review was to determine whether the FDIC followed applicable procedures in recommending UCBH for CPP funding and in monitoring UCB's compliance with the CPP Securities Purchase Agreement.

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

Scope and Methodology

The scope of this audit focused on UCB's business operations from 2002 until its failure on November 6, 2009. Our work also included an evaluation of the regulatory supervision of the institution during this same time period.

To accomplish our objectives, we performed the following procedures and techniques:

- Analyzed examination reports prepared by the FDIC and the CDFI from 2002 through 2009 as well as FRBSF examination reports prepared between 2005 and 2008.

- Reviewed the following:

    - Pertinent regulations, policies, procedures, and guidance.

    - UBPR and Call Report data.

    - Bank data and correspondence maintained in DSC's SFRO.

Objectives, Scope, and Methodology

- Reports prepared by the Division of Resolutions and Receiverships (DRR) and DSC's Washington, D.C. office staff related to the institution's failure.
- Documentation pertaining to offsite monitoring activities performed by the FDIC.
- Relevant records maintained by the institution's external auditors, KPMG and PwC.
- Form 10-K and Form 8-K SEC filings.
- Treasury's viability criteria for recommending institutions for CPP funding.

- Interviewed the following officials:
  - DSC officials and examination staff in Washington, D.C. and the SFRO.
  - DRR officials and contractors in the Irvine, California field office.
  - KPMG and PwC officials responsible for auditing UCB's financial statements and their legal counsels.
  - The CDFI examiner-in-charge who worked on the FDIC examinations of UCB.
  - SEC and FRBSF officials.

Coordination with the Special Inspector General for the Troubled Asset Relief Program (SIGTARP)

We coordinated with SIGTARP in completing the TARP CPP objective.

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, examination reports, and interviews of examiners to understand UCB'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 reports of examination, correspondence files, and

Objectives, Scope, and Methodology

testimonial evidence to corroborate data obtained from systems that were used to support our audit conclusions.

The Government Performance and Results Act of 1993 (GPRA) 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 GPRA because such an assessment is not part of the audit objectives. DSC's compliance with the GPRA 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 PCA provisions by timely issuing PCA letters to UCB, notifying it of its *Undercapitalized* and *Significantly Undercapitalized* status. We also analyzed the restrictions that were imposed through PCA letters and Directives and assessed the FDIC's monitoring of UCB's compliance with CPP provisions.

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.

Related Coverage of Financial Institution Failures

On May 1, 2009, the OIG issued an internal memorandum that outlined major causes, trends, and common characteristics of FDIC-supervised financial institution failures that had resulted in a material loss to the DIF. The memorandum also indicated that the OIG planned to provide more in-depth coverage of those issues and make related recommendations, when appropriate. Since May 1, 2009, the OIG has issued additional MLR reports related to failures of FDIC-supervised institutions and these reports can be found at http://www.fdicig.gov. In June 2010, the OIG initiated an audit, the objectives of which are to (1) determine the actions that the FDIC has taken to enhance its supervision program since May 2009, including those specifically in response to the May 2009 memorandum, and (2) identify trends and issues that have emerged from subsequent MLRs.

In addition, with respect to more in-depth coverage of specific issues, in May 2010, the OIG initiated an evaluation of the role and federal regulators' use of the Prompt Regulatory Action provisions of the FDI Act (section 38, *PCA* and section 39, *Standards for Safety and Soundness*) in the banking crisis.

Glossary of Terms

Term	Definition
Acquisition, Development, and Construction (ADC) Loans	ADC loans are a component of Commercial Real Estate that provide funding for acquiring and developing land for future construction, and providing interim financing for residential or commercial structures.
Adversely Classified Assets	Assets subject to criticism and/or comment in an examination report. Adversely classified assets are allocated on the basis of risk (lowest to highest) into three categories: Substandard, Doubtful, and Loss.
Allowance for Loan and Lease Losses (ALLL)	The ALLL is an estimate of uncollectible amounts that is used to reduce the book value of loans and leases to the amount that is expected to be collected. It is established in recognition that some loans in the institution's overall loan and lease portfolio will not be repaid. Boards of directors are responsible for ensuring that their institutions have controls in place to consistently determine the allowance in accordance with the institutions' stated policies and procedures, generally accepted accounting principles, and supervisory guidance.
Bank Secrecy Act (BSA)	Congress enacted the BSA of 1970 to prevent banks and other financial service providers from being used as intermediaries for, or to hide the transfer or deposit of money derived from, criminal activity. The BSA requires financial institutions to maintain appropriate records and to file certain reports, including cash transactions over $10,000 via the Currency Transactions Reports (CTR). These reports are used in criminal, tax, or regulatory investigations or proceedings.
Call Report	Reports of Condition and Income, often referred to as Call Reports, include basic financial data for insured commercial banks in the form of a balance sheet, an income statement, and supporting schedules. According to the Federal Financial Institutions Examination Council's (FFIEC) instructions for preparing Call Reports, national banks, state member banks, and insured nonmember banks are required to submit a Call Report to the FFIEC's Central Data Repository (an Internet-based system used for data collection) as of the close of business on the last day of each calendar quarter.
Commercial Real Estate (CRE) Loans	CRE loans are land development and construction loans (including 1-to-4 family residential and commercial construction loans), and other land loans. CRE loans also include loans secured by multifamily property and nonfarm nonresidential property, where the primary source of repayment is derived from rental income associated with the property, or the proceeds of the sale, refinancing, or permanent financing of the property.

Glossary of Terms

Term	Definition
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.
FDIC's Supervision Program	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 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.
Federal Home Loan Bank (FHLB)	FHLBs provide long- and short-term advances (loans) to their members. Advances are primarily collateralized by residential mortgage loans, and government and agency securities. Community financial institutions may pledge small business, small farm, and small agribusiness loans as collateral for advances. Advances are priced at a small spread over comparable U.S. Department of the Treasury obligations.
Form 8-K	A form that the Securities and Exchange Commission (SEC) requires publicly-traded companies to file whenever a significant event happens. These events may affect the company's financial state and, therefore, the SEC believes that they should be known to the public. Examples of these events include an acquisition, merger, bankruptcy, or change in the composition of the board of directors. Publicly-traded companies must file a Form 8-K within 4 days of the event.
Form 10-K	An annual report required by the SEC that provides a comprehensive summary of a public company's performance. The report includes information such as company history, organizational structure, executive compensation, equity, subsidiaries, and audited financial statements, among other information.
Formal Actions	Notices or orders issued by the FDIC against insured financial institutions and/or individual respondents. The purpose of formal actions is to correct noted safety and soundness deficiencies, ensure compliance with federal and state banking laws, assess civil money penalties, and/or pursue removal or prohibition proceedings. Formal actions are legally enforceable. Final orders are available to the public after issuance.

Glossary of Terms

Term	Definition
Informal Actions	Voluntary commitments made by an insured financial institution's board of directors. Such actions are designed to correct noted safety and soundness deficiencies or ensure compliance with federal and state laws. Informal actions are not legally enforceable and are not available to the public.
Large Insured Depository Institution (LIDI) Program	The FDIC established the LIDI program to assess and report on emerging risks at all institutions with total assets of $10 billion or more as well as other selected institutions. Under this program, regional case managers perform ongoing analyses of emerging risks within each insured institution and assign a quarterly risk rating. Case managers also maintain contact with the primary federal regulator for each institution in the LIDI program. Data obtained through this program are analyzed and key issues are reported to corporate executives regularly for use in policy and operational discussions. In addition, senior financial institution analysts with the Complex Financial Institutions Branch complete offsite analyses in order to meet the Corporation's risk information needs and form appropriate supervisory strategies.
Material Loss	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 as the receiver.
Offsite Review Program	The FDIC's Offsite Review Program is designed to identify emerging supervisory concerns and potential problems so that supervisory strategies can be adjusted appropriately. Offsite reviews are performed quarterly for each bank that appears on the Offsite Review List. Regional management is responsible for implementing procedures to ensure that Offsite Review findings are factored into examination schedules and other supervisory activities.
Prompt Corrective Action (PCA)	The purpose of PCA is to resolve the problems of insured depository institutions at the least possible long-term cost to the Deposit Insurance Fund. Part 325, subpart B, of the FDIC Rules and Regulations, 12 CFR, section 325.101, et. seq., implements section 38, *Prompt Corrective Action*, of the FDI Act, 12 United States Code section 1831(o), by establishing a framework for determining capital adequacy and taking supervisory actions against depository institutions that are in an unsafe or unsound condition. The following terms are used to describe capital adequacy: (1) *Well Capitalized*, (2) *Adequately Capitalized*, (3) *Undercapitalized*, (4) *Significantly Undercapitalized*, and (5) *Critically Undercapitalized*. A PCA Directive is a formal 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.

Appendix 2

Glossary of Terms

Term	Definition
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 Call Report data submitted by banks.
Uniform Financial Institutions Rating System (UFIRS)	Financial institution regulators and examiners use the Uniform Financial Institutions Rating System 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.

Acronyms

ADC	Acquisition, Development, and Construction
ALLL	Allowance for Loan and Lease Losses
BBR	Bank Board Resolution
BSA	Bank Secrecy Act
CAMELS	**C**apital, **A**sset Quality, **M**anagement, **E**arnings, **L**iquidity, and **S**ensitivity to Market Risk
CDFI	California Department of Financial Institutions
CEO	Chief Executive Officer
CFR	Code of Federal Regulations
CPP	Capital Purchase Program
CRE	Commercial Real Estate
DIF	Deposit Insurance Fund
DRR	Division of Resolutions and Receiverships
DSC	Division of Supervision and Consumer Protection
EESA	Emergency Economic Stabilization Act of 2008
FDI	Federal Deposit Insurance
FHLB	Federal Home Loan Bank
FRB	Board of Governors of the Federal Reserve System
FRBSF	Federal Reserve Bank of San Francisco
GPRA	Government Performance and Results Act of 1993
IARD	Independent Asset Review Division
IT	Information Technology
LIDI	Large Insured Depository Institution
OCC	Office of the Comptroller of the Currency
OIG	Office of Inspector General
ORL	Offsite Review List
OTS	Office of Thrift Supervision

Acronyms

PCA	Prompt Corrective Action
PwC	PricewaterhouseCoopers LLC
REO	Real Estate Owned
SFRO	San Francisco Regional Office
SIGTARP	Special Inspector General for the Troubled Asset Relief Program
TARP	Troubled Asset Relief Program
UBPR	Uniform Bank Performance Report
UCB	United Commercial Bank
UCBC	United Commercial Bank (China) Limited
UCBH	United Commercial Bank Holdings, Inc.

Organizational Chart

UCBH Holdings, Inc. and Subsidiaries

UCBH Holdings, Inc.
A Delaware corporation
A bank holding company

- 100% **UCBH Capital Trust I** — A statutory business trust organized under the Delaware Business Trust Act
- 100% **UCBH Capital Trust II** — A statutory business trust organized under the Delaware Business Trust Act
- 100% **UCBH Capital Trust III** — A statutory business trust organized under the Delaware Business Trust Act
- 100% **UCBH Capital Trust IV** — A statutory business trust organized under the Delaware Business Trust Act
- 100% **UCBH Capital Trust V** — A statutory business trust organized under the laws of the State of Delaware
- 100% **UCBH Capital Trust VI** — A statutory business trust organized under the Delaware Statutory Trust Act
- 100% **UCBH Capital Trust VII** — A statutory business trust organized under the Delaware Business Trust Act
- 100% **UCBH Capital Trust VIII** — A statutory business trust organized under the Delaware Business Trust Act

- 100% **UCBH Holdings Statutory Trust I** — A statutory business trust organized under the Connecticut Statutory Trust Act
- 100% **UCBH Holdings Statutory Trust II** — A statutory business trust organized under the Connecticut Business Trust Act

- 100% **UCB Merger, LLC** — A Delaware limited liability company. Formed to facilitate the Summit National Bank merger and to insulate UCBH from any unknown liabilities resulting from that merger
  - 100% **Summit Bank Corporation Capital Trust I** — A business trust. Trust Preferred Stock Entity
  - 100% **Summit Merchant Banking Corporation** — A Georgia corporation. Inactive; formed for the purpose of merchant banking, but holds no assets
  - 100% **SBC Properties, LLC** — A Georgia LLC. Inactive; formed for the purpose of holding bank branch real estate in Georgia, but holds no assets
- 100% **UCB Merger II, LLC** — A Delaware limited liability company. Formed to facilitate the Chinese American Bank merger and to insulate UCBH from any unknown liabilities resulting from that merger
- 100% **UCBH Merger Sub, Inc.** — A California corporation. Formed to facilitate the Pacifica Bank merger and to insulate UCBH from any unknown liabilities resulting from that merger

- 100% **United Commercial Bank** — A California corporation. California state-chartered commercial bank
  - 100% **California Canton International Bank (Cayman) Ltd.** — A Cayman Islands corporation. Provides banking services
  - 100% **Newston Investments, Inc.** — A Texas corporation. Holds bank branch real estate in Texas
  - 100% **U. F. Service Corporation** — A California corporation. Trustee under deeds of trust securing promissory notes
  - 100% **UCB Asset Management, Inc.** — A Delaware corporation. Investment management (Formerly known as UCB Investment Management Services, Inc.)
  - 100% **UCB Community Development Enterprise, Inc.** — A California corporation. Functions as a Qualified Community Development Entity by serving or providing investment capital for low-income communities or low-income persons
  - 100% **UCB Insurance Services, Inc.** — A California corporation. Inactive; insurance
  - 100% **UCB Investment Services, Inc.** — A California corporation. Retail securities broker/dealer
  - 100% **United Commercial Bank (China) Limited** — A wholly owned subsidiary licensed in China (Formerly known as Business Development Bank)
  - 100% **United Commercial Mortgage Securities, LLC** — A Delaware limited liability company. Organized for the purpose of serving as a private secondary mortgage market conduit

June 2009

Corporation Comments

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

July 20, 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 United Commercial Bank, San Francisco, California (Assignment No. 2010-019)

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 United Commercial Bank (UCB), San Francisco, California, which failed on November 6, 2009. This memorandum is the response of the Division of Supervision and Consumer Protection (DSC) to the OIG's Draft Report (Report) received on June 25, 2010.

UCB failed due to inadequate oversight by the Board of Directors (Board) and management during the institution's rapid expansion. Management controls were insufficient to prevent the occurrence of inaccuracies, omissions, and misrepresentations by UCB management and staff and ultimately masked the true condition of the institution. Further contributing to UCB's failure were the high concentrations in acquisition, development, and construction (ADC) and commercial real estate (CRE) loans supported by heavy reliance on non-core funding sources. UCB was closed due to overall deterioration in its loan portfolio, poor earnings, and inadequate capital.

From 2005 through 2009, the FDIC and the California Department of Financial Institutions (CDFI) jointly and separately completed four examinations, one targeted review, two visitations, three offsite reviews, two relationship manager contacts, and quarterly Large Insured Depository Institution (LIDI) reviews. Examiners identified key risks and brought them to the attention of UCB's Board and management in examination reports and other correspondence. In December 2008, FDIC and CDFI downgraded both asset quality and earnings to component ratings of "3," and further deterioration was discovered during the April 2009 joint targeted review. Subsequently, the holding company's external auditor revealed that UCB's management had begun around October 2008, to conceal serious financial reporting issues. The deterioration noted in the April 2009 targeted review coupled with the reporting irregularities resulted in substantially higher than projected provision expenses, further rating downgrades, and the issuance of a formal enforcement action. UCB was unable to resolve the mounting problems and raise capital to remain viable.

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

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