

Office of Inspector General



Office of Material Loss Reviews
Report No. MLR-11-004

**Material Loss Review of Broadway Bank,
Chicago, Illinois**

November 2010



Why We Did The Audit

On April 23, 2010, the Illinois Department of Financial and Professional Regulation (IDFPR) closed Broadway Bank (Broadway), Chicago, Illinois and named the FDIC as receiver. On May 14, 2010, the FDIC notified the Office of Inspector General (OIG) that Broadway's total assets at closing were \$1.1 billion and the estimated loss to the Deposit Insurance Fund (DIF) was \$390.2 million. As required by section 38(k) of the Federal Deposit Insurance Act (FDI Act), as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Financial Reform Act), the OIG conducted a material loss review of the failure of Broadway. The estimated loss exceeds the \$200 million MLR threshold for losses occurring between January 1, 2010 and December 31, 2011, as established by the Financial Reform Act.

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

Background

Broadway was chartered as an insured state nonmember bank on May 7, 1979 and was controlled by one or more members of the Giannoulis family. In 1997, members of the Giannoulis family acquired 100 percent of the issued and outstanding voting stock of the bank. In June 2007, Broadway Bancorp, Inc., Chicago, Illinois, acquired 100 percent of the bank's stock, becoming a one-bank holding company. To effect the acquisition, the previous shareholders of the bank exchanged all their bank shares for an equal number of shares of Broadway Bancorp. Accordingly, Broadway's holding company was controlled by the same stockholders that formerly controlled the bank. Broadway Bancorp provided capital contributions to, and received dividends from, Broadway resulting in a net outflow of \$1.6 million from the bank to the holding company.

Broadway specialized in commercial real estate (CRE) loans, with a particular focus on commercial acquisition, development, and construction (ADC) lending and relied heavily on brokered deposits to fund its loan growth. In addition to its main location, Broadway operated three branches in the Chicago metropolitan area. More than 50 percent of the bank's lending was outside of its local market area, primarily in Florida and the New York metropolitan area, and a major portion of the bank's lending was focused on large borrower relationships. Broadway had numerous affiliates through common ownership and established various subsidiaries to hold title to selected real estate properties acquired through foreclosure. In addition, Broadway had a chain banking organization relationship with CheckSpring Bank, Bronx, New York.

Audit Results

Causes of Failure and Material Loss

Broadway's failure is attributed to its Board and management pursuing an aggressive growth strategy concentrated in CRE and ADC loans, without establishing sound credit risk management practices to manage those loans, and the bank's inability to absorb significant loan-related losses during a severe economic downturn. Broadway's CRE and ADC concentrations were exacerbated by the bank's significant emphasis on out-of-territory lending and large borrower relationships. Although not a primary

cause of failure, Broadway's investments in higher-risk collateralized debt obligation (CDO) securities also increased the bank's risk exposure. Further, bank management increasingly relied on noncore funding sources, particularly brokered deposits, to fund CRE and ADC loan growth, which exposed the bank to additional risks. Ultimately, increases in adverse classifications, including substantial loan charge-offs and other loan- and securities-related losses, contributed to the depletion of earnings and the erosion of capital.

The FDIC's Supervision of Broadway

The FDIC, in conjunction with the IDFP, provided ongoing supervision of Broadway through onsite risk management examinations, visitations, and offsite monitoring activities. Through its supervisory efforts, the FDIC identified risks in Broadway's operations and brought these risks to the attention of the bank's Board and management through examination reports and other correspondence. Such risks included significant concentrations in CRE and ADC lending, weaknesses in credit risk management practices, inadequate management and monitoring of investments, and heavy reliance on brokered deposits. Examiners also reported apparent violations of regulations and contraventions of interagency policy guidance associated with the institution's lending practices. In addition, examiners performed procedures to determine whether the bank had taken appropriate corrective action to address examiner recommendations and made additional recommendations when the bank's corrective actions were not adequate.

The FDIC and the IDFP downgraded certain supervisory CAMELS component and composite ratings at the March 2008 and April 2009 examinations. The FDIC and the IDFP also pursued informal and formal enforcement actions to address problems identified at the March 2008 and April 2009 examinations, respectively. Further, the FDIC is continuing to review the causes of Broadway's failure to determine whether additional regulatory action might be warranted.

In retrospect, considering the risks related to the bank's CRE and ADC loan concentrations, CDO investments, and brokered deposits in a declining economic environment, greater supervisory attention to the bank's controls in those areas may have been warranted at the time of the 2008 examination. Such attention could have taken the form of additional provisions in a September 2008 Memorandum of Understanding (MOU) that was executed. The provisions may have influenced Broadway's Board and management to improve the bank's policies and practices and more effectively monitor and manage the risks that resulted in loan and investment losses for the bank. In addition, the FDIC and the IDFP could have issued the April 2009 examination report and imposed the related enforcement action more timely, although both were impacted by the deteriorated condition of Broadway, the review of various complex issues, and the need for close coordination between the two regulators.

The FDIC has taken a number of actions to address issues discussed in this report based on lessons it has learned from failures during the financial crisis. For example, the FDIC completed a training initiative in March 2010 for its entire supervisory workforce that emphasized the need to assess a bank's risk profile using forward-looking supervision and addressed the need for examiners to consider management practices as well as the financial institution's current financial performance or trends in assigning ratings as allowable under existing examination guidance. In addition, the FDIC has updated or issued new examiner and/or financial institution guidance related to CRE and ADC concentrations, brokered deposits, loan underwriting and credit administration, and investment securities. Further, the training and

guidance covered methods for communicating weak management practices to the Board and management and addressed the need for timely examiner follow-up and issuance of enforcement actions.

With respect to PCA, based on supervisory actions taken, the FDIC generally implemented applicable provisions of section 38, although notifications to Broadway regarding the adequacy of its capital restoration plan could have been improved.

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 November 12, 2010, the Director, Division of Supervision and Consumer Protection (DSC), provided a written response to the draft report. That response is provided in its entirety as Appendix 4 of this report.

DSC reiterated the OIG's conclusions regarding the causes of Broadway's failure. With regard to our assessment of the FDIC's supervision of Broadway, DSC stated that from 2005 through February 2010, the IDFPR and the FDIC jointly and separately conducted five examinations and three visitations, along with offsite monitoring activities. In addition, DSC stated that the 2008 FDIC examination found significant loan portfolio deterioration and identified the heightened risk profile of the bank. As a result, the FDIC and IDFPR downgraded Broadway to a composite "3" rating and issued a joint MOU. Further, DSC stated that the 2009 examination concluded that significant concentrations in CRE, specifically out-of-territory lending in areas where the real estate markets had severely deteriorated, led to rapid and material asset quality deterioration. Consequently, the FDIC and IDFPR downgraded Broadway to a composite "5" rating and issued a joint Consent Order. In addition, DSC stated that it has issued guidance to enhance supervision of institutions, such as Broadway, with concentrated CRE and ADC lending and reliance on volatile noncore funding.

Contents

	Page
Background	2
Causes of Failure and Material Loss	3
CRE and ADC Loan Concentrations and Related Risk Management Controls	3
Other Credit Risk Management Practices	9
Investment Securities	11
Reliance on Brokered Deposits	13
The FDIC's Supervision of Broadway	15
Supervisory History	16
Supervisory Response to Key Risks	18
Timeliness of the April 2009 Examination Report and Related Enforcement Action	26
Supervisory Lessons Learned	28
Implementation of PCA	29
Corporation Comments	32
Appendices	
1. Objectives, Scope, and Methodology	33
2. Glossary of Terms	37
3. Acronyms	42
4. Corporation Comments	43
Tables	
1. Selected Financial Information for Broadway, 2005 to 2010	3
2. Broadway's ADC Loans as a Percent of Average Gross Loans Compared to Peers	5
3: Broadway's CRE and ADC Loan Concentrations as a Percent of Total Capital	6
4. Broadway's Collateralized Debt Obligations Sold at a Loss	12
5. Broadway's Brokered Deposit and Short-Term Brokered Deposit Ratios Compared to Peers	14
6. Broadway's Net Noncore and Net Short-Term Noncore Funding Dependence Ratios Compared to Peers	14
7. Broadway's Examination and Enforcement Action History, 2005 to 2010	16
8. Broadway's Concentration Risk Exposure	21
9. Supervisory Timeline for the April 2009 Examination of Broadway	27
10. Broadway's Capital Ratios, 2005 to 2009	29
Figure	
Composition and Growth of Broadway's Loan Portfolio, 2004 to 2010	4



Federal Deposit Insurance Corporation

3501 Fairfax Drive, Arlington, Virginia 22226

Office of Material Loss Reviews
Office of Inspector General

DATE: November 12, 2010

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

FROM: */Signed/*
Stephen M. Beard
Assistant Inspector General for Material Loss Reviews

SUBJECT: *Material Loss Review of Broadway Bank, Chicago, Illinois*
(Report No. MLR-11-004)

As required by section 38(k) of the Federal Deposit Insurance (FDI) Act, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Financial Reform Act), the Office of Inspector General (OIG) conducted a material loss review of the failure of Broadway Bank (Broadway), Chicago, Illinois. The Illinois Department of Financial and Professional Regulation (IDFPR) closed the institution on April 23, 2010, and named the FDIC as receiver. On May 14, 2010, the FDIC notified the OIG that Broadway's total assets at closing were \$1.1 billion and the estimated loss to the Deposit Insurance Fund (DIF) was \$390.2 million. The estimated loss exceeds the \$200 million MLR threshold for losses occurring between January 1, 2010 and December 31, 2011, as established by the Financial Reform Act.

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

The objectives of this material loss review were to (1) determine the causes of Broadway's failure and the resulting material loss to the DIF and (2) evaluate the FDIC's supervision of Broadway, including the FDIC's implementation of the PCA provisions of section 38 of the FDI Act. In addition, the OIG engaged KPMG LLP (KPMG) to review certain issues related to this bank's failure.

This report presents our analysis of Broadway's failure and the FDIC's efforts to ensure that the Board of Directors (Board) and management operated the institution in a safe and sound manner. The report does not contain formal recommendations. Instead, as major causes, trends, and common characteristics of institution failures are identified in our material loss reviews, we will communicate those to FDIC management for its consideration. As resources allow, we may also conduct more comprehensive reviews of

specific aspects of the FDIC's supervision program and make recommendations as warranted.¹

Appendix 1 contains details on our objectives, scope, and methodology, including a description of the work performed by KPMG. 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 and Appendix 4 contains the Corporation's comments on this report.

Background

Broadway was chartered as an insured state nonmember bank on May 7, 1979 and was controlled by one or more members of the Giannoulis family. In 1997, members of the Giannoulis family acquired 100 percent of the issued and outstanding voting stock of the bank. In June 2007, Broadway Bancorp, Inc., Chicago, Illinois, acquired 100 percent of the bank's stock, becoming a one-bank holding company. To effect the acquisition, the previous shareholders of the bank exchanged all their bank shares for an equal number of shares of Broadway Bancorp. Accordingly, Broadway's holding company was controlled by the same stockholders that formerly controlled the bank. Broadway Bancorp provided capital contributions to, and received dividends from, Broadway resulting in a net outflow of \$1.6 million from the bank to the holding company.

Broadway specialized in commercial real estate (CRE) loans, with a particular focus on commercial acquisition, development, and construction (ADC) lending and relied heavily on brokered deposits to fund its loan growth. In addition to its main location, Broadway operated three branches in the Chicago metropolitan area. More than 50 percent of the bank's lending was outside of its local market area, primarily in Florida and the New York metropolitan area, and a major portion of the bank's lending was focused on large borrower relationships. Broadway had numerous affiliates through common ownership and established various subsidiaries to hold title to selected real estate properties acquired through foreclosure. In addition, Broadway had a chain banking organization relationship with CheckSpring Bank, Bronx, New York.²

During 2006, the bank experienced several personnel changes, including the departure in May 2006 of a lending officer of the bank. Shortly thereafter, in June 2006, one of the

¹ A further discussion of OIG-related coverage of financial institution failures can be found in the *Objectives, Scope, and Methodology* section of our report.

² According to the FDIC *Case Manager Procedures Manual*, a chain banking organization is a group of insured institutions that are controlled, directly or indirectly, by an individual acting alone, through, or in concert with any other individual(s). The individual(s) must own or control 25 percent or more of the institutions' voting securities; the power to control in any manner the election of a majority of the directors of the institutions; or the power to exercise a controlling influence over the management or policies of the institutions. Although related, the FDIC determined that there was no cross-guarantee liability under section 5(e) of the FDI Act between Broadway Bank and CheckSpring Bank.

bank's founders, who was also the Board Chairman, bank President, and Chief Executive Officer, passed away and his roles and responsibilities were divided among two of his sons, both of whom had been involved with the bank for many years. In addition, two new outside members were subsequently added to the Board. Table 1 provides selected financial information for Broadway.

Table 1: Selected Financial Information for Broadway, 2005 to 2010

Financial Measure	Mar-10	Dec-09	Dec-08	Dec-07	Dec-06	Dec-05
	(Dollars in Thousands)					
Total Assets	1,059,194	1,151,451	1,170,826	1,094,432	946,818	749,920
Gross Loans	871,658	923,574	986,363	904,681	779,895	597,994
Allowance for Loan and Lease Losses (ALLL)	20,866	20,580	23,665	11,777	9,763	7,732
Total Investments	113,130	171,437	144,956	168,062	148,072	136,574
Total Deposits	1,023,421	1,113,959	1,065,256	914,054	795,584	629,751
Brokered Deposits	763,424	835,913	881,051	748,900	639,534	491,741
Net Interest Margin	1.58%	2.13%	4.60%	6.15%	6.30%	5.91%
Net Income (Loss)	(2,553)	(75,336)	(13,397)	49,809	45,341	31,315
Net Loan Growth Rate	(12.06)%	(6.20)%	7.82%	15.94%	30.47%	35.98%

Source: Uniform Bank Performance Reports (UBPRs) for Broadway.

Causes of Failure and Material Loss

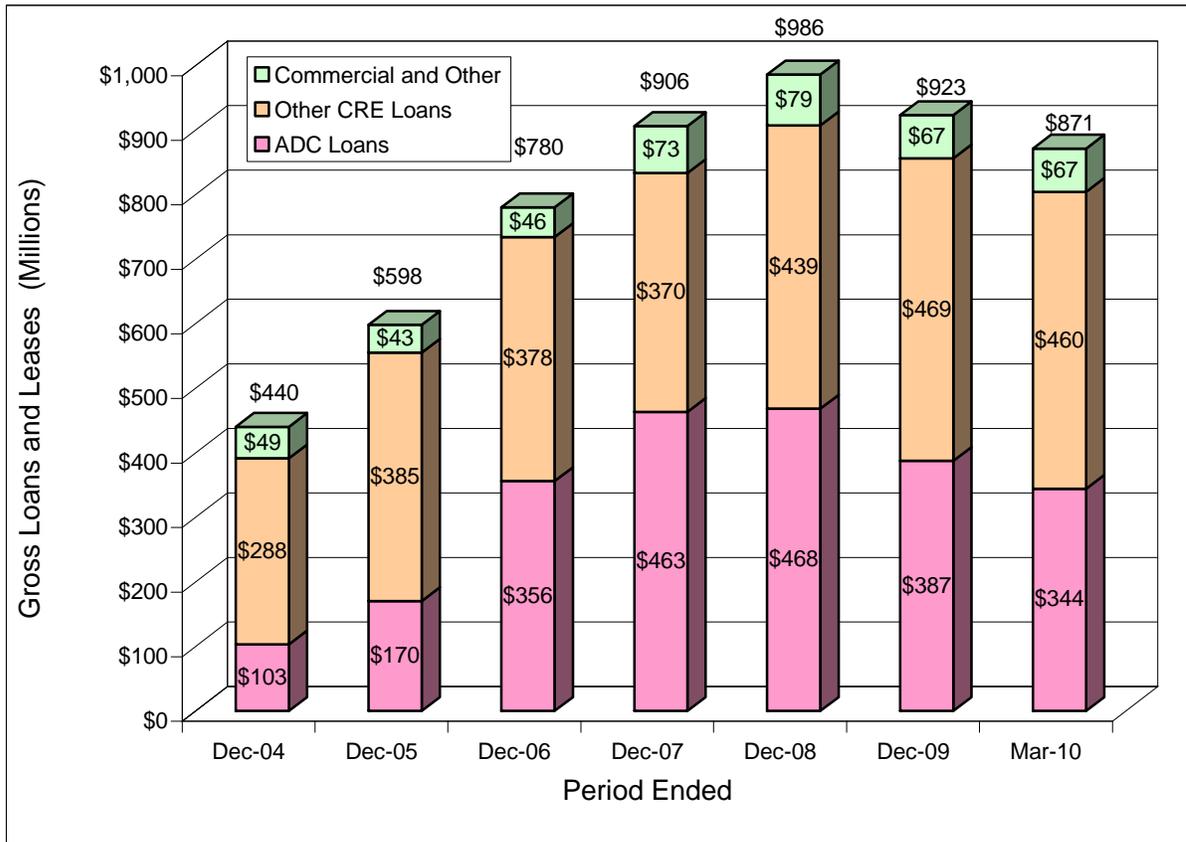
Broadway's failure is attributed to its Board and management pursuing an aggressive growth strategy concentrated in CRE and ADC loans, without establishing sound credit risk management practices to manage those loans, and the bank's inability to absorb significant loan-related losses during a severe economic downturn. Broadway's CRE and ADC concentrations were exacerbated by the bank's significant emphasis on out-of-territory lending and large borrower relationships. Although not a primary cause of failure, Broadway's investments in higher-risk collateralized debt obligation (CDO) securities also increased the bank's risk exposure. Further, bank management increasingly relied on noncore funding sources, particularly brokered deposits, to fund CRE and ADC loan growth, which exposed the bank to additional risks. Ultimately, increases in adverse classifications, including substantial loan charge-offs and other loan- and securities-related losses, contributed to the depletion of earnings and the erosion of capital.

CRE and ADC Loan Concentrations and Related Risk Management Controls

Broadway's loan concentrations magnified the impact of a severe downturn in the economy and real estate markets, ultimately resulting in a rapid and material deterioration in the bank's loan portfolio. The lending strategy implemented by Broadway's Board and management was initially profitable, and the bank's return on assets was significantly higher than its peers for the years 2004 to 2007. However, during 2007, real estate markets in the bank's lending areas began to decline, which led to substantial asset quality deterioration and net losses in 2008 and 2009.

As illustrated in the Figure below, Broadway rapidly increased its CRE and ADC lending between December 2004 and December 2007. During that same period, Broadway's total CRE loans more than doubled, while the bank's ADC loans, alone, quadrupled to become the largest segment of the loan portfolio. Loans originated during this growth period would culminate in substantial losses for the bank. Management continued to increase the bank's total CRE concentration in 2008, although growth in the ADC concentration was minimal. As of March 2009, total CRE concentrations represented almost 92 percent of Broadway's total loans. In 2009, significant increases in loan losses and adversely classified assets led management to curtail lending and focus on problem loan management.

Figure: Composition and Growth of Broadway's Loan Portfolio, 2004 to 2010



Source: OIG Analysis of Consolidated Reports of Condition and Income (Call Reports) for Broadway.

As previously discussed, Broadway's ADC portfolio grew significantly prior to 2008, with ADC loans more than doubling between 2005 and 2006. By December 31, 2007, approximately 50 percent of the bank's loans were ADC and, as shown in Table 2, from December 2004 through March 2010, Broadway's loan growth strategy resulted in the

bank having a significantly higher percent of its loan portfolio in ADC loans compared to its peers.³

Table 2: Broadway's ADC Loans as a Percent of Average Gross Loans Compared to Peers

	Dec-04	Dec-05	Dec-06	Dec-07	Dec-08	Dec-09	Mar-10
	(Percent of Average Gross Loans)						
Broadway	22	23	40	49	49	45	41
Peers	10	13	15	19	18	15	12

Source: UBPRs for Broadway.

Broadway also developed two large industry concentrations that were subsets of the CRE and ADC concentrations, which proved to further increase the risk to the institution. Those concentrations were related to loans secured by:

- **Hotel or Motel Properties.** These loans represented 430 percent of the bank's Total Capital by December 31, 2009.⁴ In addition, as of December 31, 2009, 71 percent of these loans was secured by properties outside of Illinois, with 40 percent of those loans in the New York metropolitan area. Two hotel/motel-related construction loans, representing two large borrower relationships, resulted in \$20.8 million in loan-related losses for the bank.
- **Condominium or 1-4 Family Construction Projects.** These loans represented 362 percent of the bank's Total Capital by December 31, 2009. As of that date, two-thirds (67 percent) of these loans was secured by properties outside of Illinois, primarily in the New York metropolitan area. Four condominium/1-4 family construction loans, representing three large borrower relationships, resulted in \$30 million in loan-related losses for the bank.

The FDIC's concern with ADC lending dates as far back as October 1998 when the FDIC issued FIL-110-98, *Internal and Regulatory Guidelines for Managing Risks Associated with Acquisition, Development, and Construction Lending*, which states that ADC lending is a highly specialized field with inherent risks that must be managed and controlled to ensure that this activity remains profitable. Regulatory concerns with ADC lending were reinforced in December 2006 when the FDIC, the Office of the Comptroller of the Currency, and the Board of Governors of the Federal Reserve System issued guidance, entitled, *Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices* (Joint Guidance). The guidance reinforces existing regulations and guidelines for real estate lending and safety and soundness for institutions with high

³ Institutions are assigned to 1 of 15 peer groups based on asset size, number of branches, and whether the institution is located in a metropolitan or non-metropolitan area. Broadway's peer group from December 31, 2004 until June 30, 2007 included all insured commercial banks having assets between \$300 million and \$1 billion. In the quarter ended September 30, 2007, Broadway's peer group became all insured commercial banks having assets between \$1 billion and \$3 billion.

⁴ Total Capital is defined in the Joint Guidance as a bank's total risk-based capital as reported in an institution's Call Report. Significant increases in Broadway's loan concentration ratios, including the hotel or motel properties and the condominium or 1-4 family construction projects, during 2009 resulted from a substantial decrease in Broadway's Total Capital rather than an increase in the bank's lending.

and increasing levels of ADC and CRE loans. According to the Joint Guidance, a bank that has experienced rapid growth in CRE lending, has notable exposure to a specific type of CRE, or is approaching or exceeds the following supervisory criteria⁵ may be identified for further supervisory analysis of the level and nature of its CRE concentration risk:

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

As shown in Table 3, from December 2004 through March 2010, Broadway's CRE and ADC concentration ratios consistently and significantly exceeded the ratios of its peers and beginning in 2007 also exceeded thresholds in the Joint Guidance.⁶

Table 3: Broadway's CRE and ADC Loan Concentrations as a Percent of Total Capital

Period Ended	CRE Loans as a Percent of Total Capital*		ADC Loans as a Percent of Total Capital	
	Broadway	Peers	Broadway	Peers
Dec-04	519	331	136	81
Dec-05	586	358	179	104
Dec-06	580	372	281	117
Dec-07	409	309	307	147
Dec-08**	574	307	390	139
Dec-09**	1157	267	793	97
Mar-10	1140	252	750	89

Source: UBPRs for Broadway.

* Amounts after 2006 indicate non-owner occupied CRE. Amounts shown for 2006 and before indicate total CRE loans, as non-owner occupied CRE balances were not captured in the UBPR at that time.

** Increased ratios for these periods are primarily a result of significant declines in capital rather than an increase in loans.

According to the Joint Guidance, CRE loan concentrations can pose substantial potential risks, including unanticipated earnings and capital volatility during a downturn in the real estate market, and can inflict large losses on institutions. Therefore, risk management practices and capital levels should be commensurate with the level and nature of the CRE loan concentration risk. Recognizing the risk that the bank's concentrations presented to the institution, the FDIC proactively encouraged Broadway to maintain capital above the minimum levels required for *Well Capitalized* banks as early as 2002. Consistent with the FDIC's guidance, the bank established a policy to maintain a minimum Total Capital

⁵ The Joint Guidance does not establish specific CRE lending limits, but defines criteria to identify institutions potentially exposed to significant CRE concentration risk.

⁶ Although Broadway's CRE and ADC concentration levels exceeded the December 12, 2006 Joint Guidance, that guidance would only have been in effect a short period before the December 31, 2006 concentration levels were reported by Broadway. Accordingly, we compared the concentration levels beginning in 2007 to the Joint Guidance instead to determine whether Broadway's concentrations exceeded regulatory guidance.

Ratio of 12.5 percent, which was higher than the 10 percent minimum required to remain *Well Capitalized* for PCA purposes. Through 2008, the bank maintained capital ratios that were above those required for *Well Capitalized* banks and often in excess of its peers.

Out-of-Territory Lending

Broadway's Board and management pursued a lending strategy that included significant loan originations outside of its local market area, with an emphasis on New York and Florida. The bank believed a nationwide focus on loan growth through geographic diversification would decrease loan portfolio risk. However, such a focus resulted in a large out-of-territory loan concentration in some states that experienced significant economic declines, substantial risk, and significant losses for Broadway. As of December 31, 2007, out-of-territory loans represented 60 percent of the loan portfolio. Broadway's risk exposure to out-of-territory loans continued through 2009 with the majority of the out-of-territory portfolio consisting of CRE and ADC loans in the following two geographic locations:

- **Florida.** Lending in Florida was generally focused on waterfront properties. By the March 2008 examination,⁷ \$86.9 million of the Florida CRE and ADC loans were adversely classified, representing 80.5 percent of total adverse classifications for that examination. Four loans representing three borrower relationships accounted for most of the adversely classified amount. By the April 2009 examination, the bank had recognized significant losses on these loans. Although Broadway subsequently reduced the level of the Florida loans, and hired a third-party firm to help manage the Florida credits, the Florida loan concentration accounted for 15 percent of loan amounts adversely classified during the April 2009 examination. Ultimately, seven loans in the bank's Florida loan concentration, representing six large borrower relationships, accounted for \$58 million in loan-related losses for the bank. Five of the loans were speculative ADC-related credits, of which four were collateralized primarily by land.
- **New York.** Lending in the state of New York was focused on properties in the New York City metropolitan area. As of December 31, 2007, the bank's New York loan concentration represented 160 percent of Total Capital. Between the March 2008 and April 2009 examinations, as Broadway decreased its lending in Florida, the New York loan concentration increased by \$34 million. The April 2009 examination report noted that collateral located in New York deteriorated in the latter part of 2008, leading to an increased level of problem assets. The bank's New York loan concentration accounted for \$126 million or 44 percent of the dollar amount of loans adversely classified during the April 2009 examination. Ultimately, six loans in the bank's New York's loan concentration, representing three large borrower relationships, accounted for \$23 million in loan-related losses for the bank.

⁷ Unless otherwise noted in this report, examinations and visitations of Broadway were performed jointly by the FDIC and the IDFP.

Large Borrower Relationships

Adding to Broadway's risks was the decision by the Board and management to further concentrate the bank's loan portfolio in large borrower relationships. Examination reports for Broadway from 2005 to 2009 also identified borrower relationship concentrations that represented 25 percent or more of the bank's Tier 1 Capital. Several of these large borrower relationships/individual concentrations⁸ were tied to the real estate development and construction industry in higher-risk out-of-territory locations and depended on the borrower's ability to refinance a loan or sell collateral as the primary source of repayment. Consequently, the decline in the economy and real estate markets negatively affected the borrower's capacity to service the debt and resulted in substantial losses as discussed previously.

Broadway's strategic plan indicated that the bank was comfortable with, and had the ability to manage, large loans. In addition, the bank's loan policy allowed an individual borrower relationship concentration of up to 75 percent of Total Capital. The April 2009 examination report identified 12 individual borrower relationships that exceeded 25 percent of Tier 1 Capital, and highlighted that 6 of the 12 borrower relationship concentrations had at least one loan adversely classified or listed for special mention in the examination report. Losses associated with Broadway's larger borrowers continued, and by March 31, 2010, 15 loans, representing 10 borrower relationships, accounted for \$93.5 million in losses.

Concentration-Related Risk Management Controls

Broadway's Board and management failed to implement adequate risk management controls to mitigate the risks associated with its various concentrations. Although Broadway created monthly reports to monitor concentrations by loan portfolio type, industry, geographic distribution, and borrower, and provided these reports to the Board for review, such reporting and monitoring would prove to be ineffective to mitigate the bank's risk exposure. In addition, bank management established concentration limits in its loan policy that allowed significant levels of loan concentrations in relationship to the bank's Total Capital. Specifically, Broadway failed to implement adequate controls related to the concentrations that fully addressed the risk management framework suggested by the Joint Guidance, as discussed below.

- **Aggregate CRE and ADC Concentration Limits.** Broadway did not establish aggregate limits for its CRE and ADC loan concentrations, allowing the institution's overall CRE and ADC concentrations to grow to levels significantly in excess of the supervisory thresholds identified in the Joint Guidance.⁹ While Broadway did establish concentration limits based on loan portfolio type,

⁸ The FDIC defines an individual concentration of credit as one in which there are obligations totaling 25 percent or more of Tier 1 Capital to an individual borrower, small interrelated group of individuals, single repayment source, or individual project.

⁹ The supervisory thresholds in the Joint Guidance do not constitute required limits on an institution's lending activity, but they are intended to serve as high-level indicators to identify institutions potentially exposed to CRE concentration risk.

geographic distribution, industry, and borrower relationship, the bank's ADC limit was established as the greater of 300 percent of Total Capital, or 40 percent of the loan portfolio, for each state or metropolitan area. Accordingly, the ADC concentrations in Florida and New York could each represent 300 percent of Total Capital for a combined 600 percent of Total Capital, far in excess of the 100 percent of Total Capital threshold for ADC loans in the Joint Guidance.

- **Portfolio Level Stress Testing.** Broadway did not conduct thorough stress testing of its loan portfolio to determine the impact that various economic scenarios might have on the bank's asset quality, capital, and earnings. While the bank did evaluate the impact of interest rate changes on the portfolio as part of its interest rate risk management, the bank did not assess the impact that real estate market change might have on its portfolio. Such an assessment might consider stressed loss rates on collateral as a result of declines in real estate market values, lower absorption rates, or increased vacancy rates. The Joint Guidance notes that an institution with CRE concentrations should perform stress testing on vulnerable segments of its CRE portfolio, taking into consideration the prevailing market environment and the bank's business strategy.
- **Formalized Concentration Contingency Planning.** Broadway did not develop an effective, written contingency plan to mitigate risks associated with its loan concentrations in a declining economic environment. As a result, the bank did not effectively respond to the rapid deterioration in the real estate markets in which it lent. The Joint Guidance recommends that institutions develop appropriate strategies for managing CRE concentration levels, including a contingency plan to reduce or mitigate concentrations in the event of adverse market conditions. Such strategies could include, among others, loan participations, loan sales, and securitizations to mitigate concentration risk.

Other Credit Risk Management Practices

By the March 2008 examination, regulators concluded that the bank's asset quality had significantly weakened, as evidenced by substantially elevated adverse classifications attributable to the economic downturn, as well as inadequate credit risk management practices. Examiners identified weaknesses in the bank's loan policy and practices related to loan underwriting and credit administration, including, but not limited to, global cash flow analysis; appraisals; loan grading and review; and the methodology for and funding of the Allowance for Loan and Lease Losses (ALLL).

Global Cash Flow Analysis

The February 2007 IDFPR examination concluded that the bank needed to improve efforts to obtain current borrower financial statements and to ensure global cash flows were performed for applicable borrowers with multiple loans. The March 2008 examination identified a repeat concern in this area, noting that loan underwriters had not calculated global cash flow analysis on borrowers with multiple real estate projects or income producing properties. The April 2009 examination noted some improvement in

this area but also identified additional loans for which global cash flow analyses had not been performed or were calculated incorrectly. In addition, although the collection of borrower financial data had also improved, additional weaknesses were identified, such as failing to obtain current tax returns for borrowers and guarantors and current financial statements, which can make it difficult to perform accurate debt service assessments.

Appraisals

Accurate, timely appraisals are an important component of a bank's lending practices and support loan underwriting decisions, loan grading and review programs, and the determination of the bank's ALLL. Examinations conducted in 2005 through 2007 did not identify any weaknesses in the bank's appraisal practices. The March 2008 examination, however, identified appraisal-related weaknesses, noting that the bank did not always obtain current appraisals to support the fair market value of real estate assets acquired through foreclosure or to support loan underwriting decisions for two loans in accordance with FDIC Rules and Regulations Part 323 and minimum appraisal standards. The bank eventually charged off \$1.4 million on one of the loans. The April 2009 examination report noted continued concern with the bank's appraisal-related practices, identifying nine loans for which Broadway had not obtained current appraisals in accordance with FDIC Rules and Regulation Part 323 and minimum appraisal standards to support loan underwriting decisions. The bank eventually charged off \$1.1 million on one of these loans. As a result of the apparent violations, examiners concluded that the bank's appraisal review program needed improvement, including training for officers responsible for reviewing appraisals.

Loan Grading and Review

Most of the examinations and visitations performed from 2005 to 2010 identified weaknesses in the bank's loan grading and review practices and inadequate attention by bank management to address examiner concerns and recommendations related to this issue. According to the Joint Guidance, a strong credit risk review function is critical for an institution's self-assessment of emerging risks. Further, an effective, accurate, and timely risk-rating system provides a foundation for an institution's credit risk review function to assess credit quality, and ultimately, identify problem loans in a timely manner.

At the March 2008 examination, examiners noted significant concerns regarding the bank's loan grading and review, and downgraded a number of loans from the loan grades that Broadway had assigned, resulting in a substantial increase in adversely classified items from the prior examination. The examination report noted that bank management appeared to be hesitant to place loans on the watch list or to downgrade loans lower than watch status. In addition, examiners identified problems with the bank's external loan review program and concluded that it had not identified the heightened risk of some individual loans and the overall exposure in the loan portfolio.

Examiner concern regarding the bank's ability to correctly risk-rate loans continued at the April 2009 examination. Specifically, examiners determined that of the 65 loans that

they reviewed and criticized, 59 loans needed further downgrades, indicating again that Broadway was not properly rating problem loans in an effective, timely manner. In addition, the examination report noted that bank management had not adequately identified and properly risk-graded many large relationships that had portrayed a high-risk profile for an extended period of time, in a timely manner. Examiners cited an apparent contravention of Appendix A to Part 364 of the FDIC Rules and Regulations due to the failure to adequately implement a sound risk-rating process.

Broadway's failure to effectively address deficiencies in its loan grading and review process was also evident at the January 2010 visitation, during which examiners determined that a number of loans adversely classified at the April 2009 examination were not listed on the bank's watch list, apparently because bank management had failed to inform responsible departmental personnel of reported deficiencies so that appropriate action could be taken.

Allowance for Loan and Lease Losses

According to the *Interagency Policy Statement on the Allowance for Loan and Lease Losses* (Policy Statement on ALLL), the ALLL represents one of the most significant estimates in an institution's financial statements and regulatory reports. As a result, each institution is responsible for developing, maintaining, and documenting a comprehensive, systematic, and consistently applied process for determining the ALLL. Broadway's Board and bank management recognized the risk in their loan portfolio as early as 2002, by establishing a minimum reserve level of 1.25 percent of the bank's loans. However, the January 2005 examination concluded that while the ALLL funding was adequate, the ALLL methodology did not comply with regulatory guidance outlined in FIL 63-2001, *Interagency Policy Statement on ALLL Methodologies and Documentation for Banks and Savings Associations*, dated July 25, 2001, or generally accepted accounting practices, and was not documented in written policies and procedures.

Broadway's total adversely classified items increased from \$2.2 million at the January 2005 examination to \$108 million at the March 2008 examination. By the April 2009 examination, the adversely classified items had increased to \$411 million and represented 335 percent of Tier 1 Capital plus ALLL. Regulatory concern regarding the ALLL methodology was again identified during the March 2008 and April 2009 examinations. In each case, examiners concluded that the bank's ALLL methodology was not fully compliant with interagency policy and that the ALLL balance was significantly underfunded, requiring increases to the ALLL of \$5.1 million and \$19 million, respectively.

Investment Securities

Although not a primary cause of failure, Broadway's investment in higher-risk, non-U.S. government agency securities, in particular Collateralized Debt Obligations (CDOs), substantively contributed to the bank's losses. The CDOs, when purchased, were rated investment grade by nationally-recognized credit rating agencies. However, they declined to sub-investment grade and were therefore adversely classified by examiners,

as of March 31, 2009. Subsequently, the bank realized approximately \$18 million in investment losses on the sale of two CDO securities during 2009, representing 24 percent of the \$75 million net loss recorded by the bank that year. Details of the CDOs are identified in Table 4.

Table 4: Broadway's Collateralized Debt Obligations Sold at a Loss

Security	Date Purchased	Tranche	Credit Rating at Purchase*	Purchase Amount (000s)	Date Sold	Loss on Sale (000s)
1	12/15/2005	C-1	A3	\$8,500	12/28/2009	\$8,258
2	6/28/2007	B-1	A3	\$9,925	12/28/2009	\$9,695

Source: OIG analysis of Broadway investment records.

* Rating by Moody's Investors Service.

Both CDOs were collateralized predominately by trust preferred securities,¹⁰ with Broadway's interest in each security at the mezzanine tranche level.¹¹ Management's decision to purchase the CDOs represented a departure from the bank's investment policy guideline of purchasing triple-A-rated investment securities.¹² Broadway's management, therefore, assumed more risk by purchasing CDOs rated A3,¹³ in return for the potential of higher income.

The Federal Financial Institutions Examination Council's publication, entitled, *Supervisory Policy Statement on Investment Securities and End-User Derivatives Activities*, effective May 26, 1998, states that the institution's Board is responsible for approving major policies for conducting investment activities and establishing associated risk limits. Board oversight is particularly important for products that have unusual, leveraged, or highly variable cash flows, such as CDOs. Institutions should ensure that they identify and measure the risks associated with individual transactions prior to acquisition and periodically after purchase. However, Broadway Board minutes contained limited information pertaining to the acquisition and monitoring of the CDOs and did not indicate that the Board was periodically provided current, independent market value or credit rating information for these securities.

In the April 2009 examination report, examiners identified significant concerns regarding the bank's management and monitoring of its investment securities and the bank's investment policy and practices. In particular, the report noted that Broadway had not (1) adequately analyzed or monitored the risks associated with the CDOs; (2) established concentration limits; (3) obtained, reviewed, and evaluated independent credit, market, and pricing data on a regular and consistent basis; and (4) established an on-going

¹⁰ Trust preferred securities are hybrid instruments possessing characteristics typically associated with debt obligations.

¹¹ The risk of loss on a CDO portfolio is generally divided among three types of tranches – senior, mezzanine, and equity. Losses on the CDO will first affect the equity tranche, next the mezzanine tranches, and finally the senior tranche. Each tranche receives a periodic payment, with the junior tranches offering higher premiums.

¹² Obligations rated Aaa by Moody's are judged to be of the highest quality, with minimal credit risk.

¹³ Obligations rated A by Moody's are considered upper-medium grade and are subject to low credit risk. A3 is the lowest A tier rating on Moody's rating scale.

program to assess or determine whether impairment existed in the bank's investments securities.

In addition, the April 2009 examination concluded that (1) the CDOs' actual market values were below book value and had been for an extended period of time, (2) the CDOs had declined to sub-investment grade, with market values significantly below par as of March 31, 2009, (3) the substantial deterioration was due to underlying issuer defaults and payment deferrals, and (4) the bank was unable to adequately determine the level of Other Than Temporary Impairment on its sub-investment grade securities in accordance with relevant accounting guidance. Therefore, examiners adversely classified all six of the bank's sub-investment grade securities, including the two CDOs and four Collateralized Mortgage Obligations.¹⁴ As discussed later in the *Implementation of PCA* section of the report, the adverse classification of the securities impacted the bank's capital position and helped cause Broadway to fall from *Well Capitalized* to *Undercapitalized* for PCA purposes. As noted previously, Broadway's sale of the CDOs at the end of 2009 resulted in a substantial loss for the bank.

Reliance on Brokered Deposits

Broadway's access to brokered deposits helped fuel the bank's rapid asset growth and, therefore, was integral to the bank's ability to obtain and sustain its excessive CRE and ADC concentrations.¹⁵ By March 2009, Broadway's brokered deposits represented 84 percent of total deposits and had consistently ranged between 75 percent and 83 percent between 2005 and March 2010. However, examiners generally concluded that the risk associated with this reliance was, historically, mitigated by bank management's practice of laddering maturities of brokered deposits to limit the amount that matured in any given month. Broadway's declining financial condition negatively impacted the bank's ability to continue the use of such deposits. Specifically, by July 2009, as a result of a decline in the bank's capital position to *Undercapitalized*, the bank could no longer accept, renew, or roll over any brokered deposit,¹⁶ which essentially cut off the main funding source for the bank. Broadway was unable to improve its capital position, and the bank's liquidity sources remained constrained until it was closed.

As indicated previously in Table 1, Broadway's level of brokered deposits grew from \$491 million, as of December 2005, to a high of \$881 million, as of December 2008, an increase of 79 percent, before a gradual decline starting in 2009. As noted in Table 5, Broadway's ratio of brokered deposits to total deposits continued to increase through the end of 2008 and was significantly higher than its peer group. For the periods shown, Broadway was generally in the 98th or 99th percentile for this ratio. However, as also noted in Table 5, Broadway's ratio of brokered deposits maturing in one year or less (i.e.

¹⁴ Broadway had recorded \$4.2 million in Other Than Temporary Impairment on the bank's Collateralized Mortgage Obligations as of December 31, 2009.

¹⁵ Broadway also used Federal Home Loan Bank borrowings and the Federal Reserve Bank's discount window as noncore funding sources although to a much lesser extent than brokered deposits.

¹⁶ FDIC Rules and Regulations Part 337.6(b)(3)(i), which implements section 29 of the FDI Act.

short-term brokered deposits) compared to total brokered deposits was significantly less than the bank's peers.

Table 5: Broadway's Brokered Deposit and Short-Term Brokered Deposit Ratios Compared to Peers

Period Ended	Brokered to Total Deposits		Short-Term Brokered to Total Brokered Deposits	
	Broadway	Peers	Broadway	Peers
	(Percent)			
Dec-05	78.09	3.27	29.34	48.25
Dec-06	80.39	4.18	15.54	54.85
Dec-07	81.93	5.74	15.41	57.92
Dec-08	82.71	10.26	26.41	75.92
Dec-09	75.04	6.62	28.36	71.28
Mar-10	74.60	6.18	28.81	70.78

Source: UBPRs for Broadway.

Broadway's reliance on brokered deposits was also reflected in the bank's high net noncore funding dependence ratio. A bank's net noncore funding dependence ratio indicates the degree to which the bank is relying on noncore and potentially volatile liabilities to fund long-term earning assets. Generally, higher ratios indicate greater risk exposure and a reliance on funding sources that may not be available in times of financial stress or adverse changes in market conditions.

Broadway's net noncore dependence ratio was consistently and significantly higher than its peers, ranging from 75 percent in December 2005 to a high of 85 percent in March 2010. In contrast, Broadway's peers' net noncore dependence ratios ranged from 22 to a high of 35 percent. For the periods shown, Broadway was consistently in the 99th percentile for this ratio. However, the bank's practice of laddering brokered deposit maturities generally helped the institution maintain the net short-term noncore dependence ratios from 14 percent to 27 percent, which were more in line with its peers' ratios of 13 percent to 23 percent, as shown in Table 6.

Table 6: Broadway's Net Noncore and Net Short-Term Noncore Funding Dependence Ratios Compared to Peers

Period Ended	Noncore Funding Dependence		Short-Term Noncore Funding Dependence	
	Broadway	Peers	Broadway	Peers
	(Percent)			
Dec-05	75	22	21	13
Dec-06	76	24	15	16
Dec-07	77	30	14	20
Dec-08	83	35	25	23
Dec-09	82	27	21	16
Mar-10	85	24	27	13

Source: UBPRs for Broadway.

As a result of its focus on brokered deposits, Broadway's cost of funds consistently and, in some years, significantly exceeded the average for its peer group and other banks in

the state of Illinois from 2005 to March 2010, with the bank's cost of interest-bearing deposits ranging from 4.81 percent as of December 2007 to a low of 3.35 percent as of December 2005. In contrast, Broadway's peer group's averages ranged from a high of 3.70 percent as of December 2007 to a low of 1.35 percent as of March 2010.

Financial institution guidance has stressed the importance of contingency funding plans (CFP) in liquidity management practices, especially when a bank relies heavily on noncore funding sources. Broadway developed a CFP, and the March 2008 examination report concluded that the plan was adequate and included sufficient off-balance sheet sources of funds, as well as monthly monitoring, reporting, and testing. The April 2009 examination indicated the plan focused on various options to obtain liquidity, including, among others, initiating a local advertising campaign to solicit above-market-rate deposits and selling unencumbered investments.

The FDIC's Supervision of Broadway

The FDIC, in conjunction with the IDFPR, provided ongoing supervision of Broadway through onsite risk management examinations, visitations, and offsite monitoring activities. Through its supervisory efforts, the FDIC identified risks in Broadway's operations and brought these risks to the attention of the bank's Board and management through examination reports and other correspondence. Such risks included significant concentrations in CRE and ADC lending, weaknesses in credit risk management practices, inadequate management and monitoring of investments, and heavy reliance on brokered deposits. Examiners also reported apparent violations of regulations and contraventions of interagency policy guidance associated with the institution's lending practices. In addition, examiners performed procedures to determine whether the bank had taken appropriate corrective action to address examiner recommendations and made additional recommendations when the bank's corrective actions were not adequate.

The FDIC and the IDFPR downgraded certain supervisory CAMELS component and composite ratings at the March 2008 and April 2009 examinations. The FDIC and the IDFPR also pursued informal and formal enforcement actions to address problems identified at the March 2008 and April 2009 examinations, respectively. In retrospect, considering the risks related to the bank's CRE and ADC loan concentrations, CDO investments, and brokered deposits in a declining economic environment, greater supervisory attention to the bank's controls in those areas may have been warranted at the time of the 2008 examination. Such attention and any resulting informal action may have influenced Broadway's Board and management to improve the bank's policies and practices and more effectively monitor and manage the risks that resulted in loan and investment losses for the bank. In addition, the FDIC and the IDFPR could have issued the April 2009 examination report and imposed the related enforcement action more timely, although both were impacted by the deteriorated condition of Broadway, the review of various complex issues, and the need for close coordination between the two regulators.

Supervisory History

Between 2005 and 2010, the FDIC and the IDFPR conducted five onsite examinations and three visitations of Broadway. Table 7 summarizes key supervisory information pertaining to these activities.

Table 7: Broadway’s Examination and Enforcement Action History, 2005 to 2010

Start Date	As of Date	Agency	Supervisory Ratings (UFIRS)	Enforcement Action
01/03/2005	09/30/2004	Joint	122122/2	Bank Board Resolution (BBR)—effective April 2004 and terminated March 2005.
02/13/2006	12/31/2005	FDIC	121121/1	None.
02/13/2007	09/30/2006	IDFPR	121121/1	None.
03/24/2008	12/31/2007	Joint	243121/3	Memorandum of Understanding (MOU)—effective September 2008.
12/16/2008 Visitation	Not Applicable (NA)	Joint	NA	MOU remained in effect.
04/20/2009	03/31/2009	Joint	555554/5	Consent Order—effective January 2010.
01/25/2010 Visitation	NA	Joint	NA	Section 51 Notice (IDFPR)—effective February 2010 and Consent Order remained in effect.
04/05/2010 Visitation	NA	Joint	NA	Supervisory PCA Directive—effective April 2010 and Consent Order and Section 51 Notice remained in effect.

Source: Examination and visitation reports and enforcement action documents for Broadway.

In addition to onsite supervisory activities, the FDIC monitored Broadway’s condition through its offsite review processes, periodically contacted the institution’s management to discuss current and emerging business issues, and used automated tools¹⁷ and reports to help identify potential supervisory concerns. In 2005 and 2006, the bank was included on the FDIC’s Offsite Review List, as a result of rapid growth and a Real Estate Stress Test (REST)¹⁸ score of “5”. The 2008 Pre-examination Planning Memorandum noted that for the prior 4 calendar years, Broadway had a REST score of “5”.

Broadway consistently received CAMELS composite ratings of “1” or “2” for the 2005 through 2007 examinations. Such ratings typically indicate that a bank gives no cause for

¹⁷ The FDIC uses various offsite monitoring tools to help assess the financial condition of institutions including, but not limited to, the Statistical CAMELS Offsite Rating (SCOR) system, Growth Monitoring System (GMS), and REST. SCOR and GMS use statistical techniques and Call Report data to identify potential risks, such as institutions likely to receive a supervisory downgrade at the next examination or institutions experiencing rapid growth and/or a funding structure highly dependent on noncore funding sources.

¹⁸ REST uses the ratio of ADC loans to total assets as the primary risk factor. Other risk factors include the percentage of CRE loans, percentage of multifamily loans, percentage of commercial and industrial loans, and high noncore funding and rapid asset growth. A bank with a high concentration in ADC loans, coupled with rapid asset growth, would appear to be riskier than a bank with similar concentrations but low asset growth. REST provides a single rating from 1 to 5 in descending order of performance quality.

supervisory concern, and that weaknesses identified are considered minor and correctable in the normal course of business. In the case of Broadway, however, the bank was still subject to offsite monitoring and increased capital levels due to examiner concerns about the bank's high level of CRE loans. The March 2008 examination found that the overall condition of the bank had deteriorated to less than satisfactory, resulting in a CAMELS composite "3" rating. Of particular concern was the sharp increase in adversely classified assets, largely concentrated in the institution's ADC portfolio, as well as weaknesses in credit risk management practices, which resulted in a downgrade of the bank's asset quality component rating from "2" to "4" and the management component rating from "1" to "3". As a result, the FDIC and the IDFPF jointly issued an MOU, effective September 17, 2008, which contained 13 provisions designed to, among other things:

- improve the management of problem assets and implement appropriate loan underwriting, loan grading and review, other real estate owned, and ALLL practices;
- develop a formal management succession plan and assess the adequacy of staffing in the loan department; and
- correct and prevent violations of laws, rules, and regulations.

The FDIC's offsite monitoring activities identified continued deterioration in the bank's asset quality, as evidenced by an increase in delinquent and non-accrual credits, as well as charge-offs, reflected in the bank's September 30, 2008 financial data. These concerns prompted the December 2008 visitation of the bank. The subsequent April 2009 examination determined that Broadway had experienced rapid and material asset quality deterioration, which severely depleted earnings, reduced capital levels, and exposed the bank to unwarranted and excessive amounts of risk. In addition, the examination acknowledged the bank's efforts to address the MOU but identified additional corrective actions needed for some provisions. The April 2009 examination downgraded all of the bank's CAMELS component ratings, except Sensitivity to Market Risk, to "5" and the composite rating to a "5," which indicated extremely unsafe and unsound practices or conditions; critically deficient performance; inadequate risk management practices relative to the institution's size, complexity, and risk profile; and great supervisory concern. Institutions in this group pose a significant risk to the DIF and a high probability of failure. After this examination, regulators implemented a number of follow-up supervisory actions. For example:

- The FDIC and the IDFPF jointly issued a Consent Order, effective January 26, 2010, which included 24 provisions designed to, among other things:
 - increase and maintain adequate capital levels;
 - assess management and correct staffing levels;
 - improve the management of problem assets; reduce loan concentration levels; and implement appropriate loan approval, credit administration and loan underwriting, loan grading and review, and ALLL practices;
 - improve investment and asset/liability management policies and practices; and

- o identify and report conflicts of interest, and correct and prevent violations of laws, rules, and regulations.
- The FDIC and the IDFPR conducted a January 2010 visitation to assess the bank's financial condition and found continued deterioration. The visitation determined that Broadway's capital levels had dropped to *Significantly Undercapitalized* and concluded that the bank's CAMELS composite rating of "5" was still appropriate.
- On February 19, 2010, the IDFPR issued a Section 51 Notice¹⁹ requiring Broadway to take action to become *Well Capitalized* and correct other unsafe and unsound conditions not later than 60 days from the date of the notice or face closure by the IDFPR and liquidation through receivership.

The April 2010 visitation concluded that Broadway was not a viable entity based on its capital position. Therefore, on April 19, 2010, the FDIC issued a Supervisory PCA Directive to Broadway requiring the bank to sell enough voting shares or obligations of the bank to become *Adequately Capitalized* and/or accept an offer to be acquired by a another depository institution or holding company. Despite Broadway's efforts to comply with the various enforcement actions issued by the FDIC and the IDFPR, the bank's condition continued to deteriorate, and Broadway was closed on April 23, 2010.

Supervisory Response to Key Risks

In general, examinations from January 2005 through April 2009 identified key risks at Broadway. In addition, various forms of informal and formal supervisory action were taken to address the key risks at Broadway as a result of the 2008 and 2009 examinations and 2010 visitations.²⁰ In retrospect, considering the declining economy and Broadway's lending markets, greater supervisory attention at the March 2008 examination may have been warranted for the bank's:

- substantial CRE and ADC concentrations, including the impact that the economic decline had and could have on the bank's out-of-territory loans and large borrower relationships. Greater emphasis could have been placed on the bank's need to diversify risk and its lack of formalized concentration contingency planning.
- investments in CDOs, and the potential impact of a declining economy and real estate markets on the value of those securities. Additional supervisory attention

¹⁹ Pursuant to Section 51 of the Illinois Banking Act, 205 ILCS 5/51. Section 51 provides that, among other things, if a state bank's capital is impaired or it is otherwise in an unsound condition, the IDFPR may give the bank at least 60, but no more than 180 days, to correct the situation or face liquidation through receivership.

²⁰ In addition, a BBR was executed as a result of the 2004 examination that focused on various issues, including the bank's asset growth, concentrations of credit, capital, loan administration, ALLL, and apparent violations of laws and regulations. The capital provision required Broadway to maintain Total Risk-Based Capital at 12.50 percent. The BBR was terminated at the 2005 examination.

may have resulted in Broadway improving its investment policy and practices to more effectively monitor and manage the risks associated with its CDOs.

- heavy reliance on brokered deposits. For example, examiners could have required Broadway's Board to implement a plan to stabilize or reduce risk exposure associated with its loan funding strategy.

Such attention could have taken the form of additional provisions to address each of these areas in the September 2008 MOU.

Supervisory Response to Broadway's Board and Management

Prior to the March 2008 examination, examiners generally concluded that Broadway's management demonstrated the ability to manage the bank and was satisfactory.²¹ Examiner concerns with Broadway's Board and management were reported beginning with the March 2008 examination, when examiners rated bank management a "3" and deemed it to be less than satisfactory. Examiners reported concerns regarding asset quality deterioration and made repeat recommendations, most notably related to the ALLL; other credit risk management controls; apparent violations; and the need for a management succession plan. Examiners also identified the need to hire a Chief Credit Officer and expressed concern regarding transactions with affiliates. In particular, the March 2008 examination report noted that management had sold a loan to an affiliate of the bank at a \$3.75 million loss without obtaining an appraisal of the loan collateral to ensure that the transaction did not benefit the affiliate at the expense of the bank.

After the March 2008 examination, Broadway was designated as a problem institution. The July 2008 problem bank memorandum concluded that, despite the high volume of classified assets and the significant concentrations of credit, the risk to the DIF was only moderate given the bank's overall condition and the family that was supporting the bank.

However, by Broadway's April 2009 examination, examiners concluded that management's performance was deficient and the Board and senior management had failed to recognize risk exposures and take action to limit those risks. Accordingly, examiners rated Broadway's management "5". However, examiners also acknowledged the negative impact that the severe economic downturn had on the institution. The April 2009 examination report identified a number of concerns, in addition to those already discussed in prior sections of this report, which Broadway's Board and management needed to address, including:

- apparent conflicts of interest related to transactions between the bank and an affiliate, including, but not limited to, transactions related to certain loans and the adequacy of documentation in Board minutes related to these transactions;

²¹ References to Broadway's CAMELS ratings are related to examinations and visitations conducted between January 2005 and April 2010.

- apparent violations of laws and regulations and contraventions of policy, including those related to Part 323 and Appendix A to Part 364 of the FDIC Rules and Regulations;
- the lack of formal loan committee minutes that included pertinent information about each loan discussed by the committee and material reasons for approving the loan, as well as the decision to approve exceptions;
- the need for more detailed Board minutes, including the need to document material Board discussions and decisions and for the bank to focus on staffing, with emphasis on the loan department's staffing needs.

The FDIC is continuing to review the causes of Broadway's failure, including the Board and management's implementation of strategies and risk management practices, and the extent to which the causes might result in additional regulatory action.

Supervisory Response to Loan Concentrations

Broadway's earnings performance was strong, and the level of adverse classifications was low until 2008. As such, examiners generally concluded that Broadway's overall financial condition and operations were satisfactory and assigned "1" or "2" component and composite ratings. However, as shown in Table 8, FDIC and IDFP examination reports identified Broadway's multi-layered concentration risk exposure, which was significant and consistent for multiple examinations.

Table 8: Broadway's Concentration Risk Exposure

Type of Concentration	Examination Dates				
	Jan-05	Feb-06	Feb-07	Mar-08	Apr-09 ^a
	(Percent of Tier 1 Capital)				
CRE	317	638	628	623	964
ADC	133	195	304	347	654
Hotel/Motel Loans ^b	138	186	195	185	311
Total Out-of-Territory	NA ^c	354	405	408	NA
Florida	NA	NA	142	118	148
New York	NA	119	162	181	385
Large Borrower Relationships ^d	27-29	29-46	26-65	25-51	31-93
Number of Large Borrower Relationships	3	4	4	5	12
Assigned Asset Quality Rating	2	2	2	4	5

Source: Examination reports for Broadway.

^a Increased ratios for the April 2009 examination were primarily the result of significant declines in capital rather than an increase in loans.

^b Broadway's condominium/1-4 family construction concentration did not develop until after the March 2008 examination and, accordingly, would only have been applicable to the April 2009 examination results.

^c "NA" indicates information regarding this data element was not provided in the examination reports.

^d Percentages indicate the range of ratios as a percent of Tier 1 Capital applicable to the large borrower relationships identified in the examination report.

The exposure associated with Broadway's multi-layered concentrations, which had been established at least as far back as the January 2005 examination, did not impact the bank's asset quality ratings until 2008, as noted in Table 8, when examiners downgraded the bank's asset quality from "2" to "4" and January 2010 when examiners required Broadway to take action to address the concentration exposure. A synopsis of the examiner comments and recommendations follows.

- March 2008 Examination.** Examiners determined that Broadway's asset quality had significantly deteriorated and concluded that the deterioration was caused by a downturn in the economy and CRE markets. This deterioration was exacerbated by significant CRE and ADC concentrations, in particular loan concentrations in Florida. At that time, real estate loans in Florida accounted for 80 percent of the total classified asset amount. Examiners concluded that while Broadway was monitoring concentrations through various reports and providing that information to the Board, the bank remained vulnerable to economic risks impacting CRE and ADC loans.

The transmittal letter for the examination report expressed significant concern regarding the (1) level of adverse classifications and (2) level of risk associated with the large volume of problem assets, which was further elevated by the CRE and ADC concentrations and the out-of-territory loans. Examiners concluded that

the bank's serious loan problems presented a substantial challenge to the bank's staff and senior management, as well as to its Board and were impacting the bank's overall operation. Although the bank had relatively high capital ratios, examiners concluded that the level of capital was no longer considered strong because of the high volume of problem assets.

In addition, the examination report emphasized that a material downturn in the Florida economy and real estate markets had directly translated into problem credits for the bank, and while management was attempting to reduce the bank's reliance on the Florida real estate market, the bank's progress in this effort had been slow. The examination report warned that bank management's ability to maintain adequate oversight of the out-of-territory loans might require extensive cost, time, and travel. The report also noted that, while a slowdown in the New York real estate market had not translated into asset quality problems, the bank's vulnerability to the New York real estate market remained high because of the large loan concentration in that state.

Examiners, did not, however, recommend that bank management develop a formalized concentration contingency plan with effective strategies for mitigating these risks. Further, although examiners concluded that the bank's loan portfolio was not adequately diversified for risk reduction, they did not recommend that Broadway reduce its concentration levels.

As the bank's condition deteriorated, examiner concern regarding Broadway's CRE and ADC concentrations continued and increased during the subsequent 2009 and 2010 examination and visitation, respectively. However, it was not until January 2010 that examiners required Broadway to take action to develop written plans to reduce concentration levels. Specifically:

- **December 2008 Visitation.** Examiners conducted a visitation that identified significant concern regarding Broadway's vulnerability to economic risks impacting CRE and ADC loans and further noted that while the geographic concentration in Florida had decreased, the concentration in New York had slightly increased.
- **April 2009 Examination.** At this examination, CRE and ADC concentrations represented 964 percent and 654 percent of Tier 1 Capital, respectively. The initial examination loan review scope focused on large borrower relationships and out-of-territory loans, and was expanded during the examination, in part to address concerns related to a group of large borrowers. The examination report noted that (1) severe deterioration of real estate markets in which the bank had significant CRE and ADC concentrations, such as Florida and New York, had led to a rapid and material decline in asset quality and an increase in the level of problem assets and (2) loan portfolio deterioration had been magnified by the bank's significant CRE and ADC concentrations. In addition, examiners identified a significant increase in the number and dollar amount of borrower

relationship concentrations from the prior examination as a result of a decline in capital. Further, examiners (1) emphasized that Broadway's willingness to lend to a select group of individuals, several of whose relationships were adversely classified or criticized, substantially increased the overall risk to capital and (2) concluded that the bank needed to diversify risk—a repeat concern from the March 2008 examination.

- **January 2010 Visitation.** Examiners noted that although the bank had closely monitored and measured the bank's CRE loan concentration, which had decreased since the prior examination, the CRE loan concentration ratio had soared as a result of a significant drop in the bank's capital. Regulatory concern regarding the bank's ADC loan concentration, out-of-territory loan concentrations, and certain large borrower relationships was significant.

As a result of the weaknesses identified in the April 2009 examination, the FDIC and the IDFPR issued the January 2010 Consent Order that required the bank to develop and implement a plan to reduce loan concentrations to no more than 300 percent of the bank's Tier 1 Capital and individual borrower relationships to no more than 50 percent of Tier 1 Capital. The Consent Order also required monthly reports to the Board regarding progress to achieve those goals. Pursuant to the Consent Order, bank management provided the FDIC with a *Concentrations Reduction Plan* on March 12, 2010.

Supervisory Response to Credit Risk Management Practices

As mentioned previously, Broadway did not establish risk limits for its aggregate CRE and ADC loan concentrations. In addition, while Broadway's loan policy established risk limits based on loan portfolio type, geographic distribution, industry, and borrower relationship, the bank's ADC limit was established as the greater of 300 percent of Total Capital or 40 percent of the loan portfolio for each state or metropolitan area. Accordingly, the ADC concentrations in out-of-territory areas could each represent 300 percent of Total Capital, far in excess of the 100 percent of Total Capital threshold for ADC loans in the Joint Guidance. In addition, the bank's loan policy allowed an individual borrower relationship concentration of up to 75 percent of Total Capital, which exceeded the 25 percent of Tier 1 Capital supervisory parameter included in FDIC examiner guidance.

Until the March 2008 examination, examiners had generally concluded that Broadway's credit risk management practices were adequate but made recommendations to enhance some procedures. However, examiner concern regarding Broadway's risk management practices became more significant during and after the 2008 examination. Specifically, the March 2008 and April 2009 examination reports included a number of recommendations to address weaknesses related to appraisals, loan underwriting, loan grading and review, and the ALLL. As a result, the FDIC and the IDFPR incorporated provisions into the September 2008 MOU and the 2010 Consent Order that generally addressed those significant credit risk management weaknesses identified during the examinations.

The April 2009 examination report noted that while management had taken action to address each provision of the September 2008 MOU, several provisions had not been fully addressed. Many of those provisions that still needed Broadway's attention related to controls necessary to assist the bank in managing risks associated with its concentrations. Meanwhile, Broadway's concentration levels had substantially increased due to significant decreases in the bank's capital position. Consequently, the April 2009 examination report included recommendations for Broadway to implement actions to address inadequacies related, but not limited, to (1) current borrower financial data, loan file documentation, and global cash flow analysis for large borrowers; (2) the adequacy of the bank's appraisal review program and apparent violations of Part 323 regarding appraisals; (3) apparent contraventions of Part 364, Appendix A, regarding loan grading and review; and (4) the ALLL methodology and/or funding levels. As a result of concerns identified in the April 2009 examination and untimely or inadequate attention by Broadway to address previous concerns, the January 2010 Consent Order included provisions to address these issues.

Supervisory Response to Investment Securities

Although examiners repeatedly identified deficiencies in Broadway's investment policy, those deficiencies were not always included in examination reports and were not fully addressed until the April 2009 examination report.

Specifically, examiners reported the need for Broadway to update its investment policy to include guidelines and limits for CDO securities in the February 2006 FDIC examination report. Examiners identified this deficiency again in work papers for the February 2007 IDFP and March 2008 examinations. However, examiner concerns about the repeat deficiency were not included in those examination reports, and instead, examiners concluded that Broadway's investment policy was adequate. In addition, information in the March 2008 examination work papers indicated that bank management was not periodically obtaining and documenting current credit rating and market value information for the CDOs subsequent to purchase; however, the March 2008 examination report did not identify this weakness.

The DSC *Capital Markets Handbook* dated June 2007 states that the pre-purchase analysis for CDOs should (1) document how the investment in the CDO is appropriate for the investment portfolio and (2) incorporate stress testing, concentration, and exposure analyses. However, our review of the pre-purchase analysis for the CDO that Broadway purchased in 2007 indicated that the analysis did not comply with the DSC guidance. Specifically, Broadway's analysis did not discuss the appropriateness of the security in relation to the bank's investment policy guidelines, or document the results of any stress testing or concentration and exposure analyses that might have been prepared by bank management. Despite these deficiencies, examiners' review of Broadway's pre-purchase analysis for this CDO during the March 2008 examination did not identify any weaknesses. As of December 31, 2007, the as of date for the March 2008 examination, the \$18.4 million outstanding balance of the two CDOs represented only 11 percent of the bank's total investments of \$169.7 million.

In recognition of the risks associated with CDOs, the FDIC issued Financial Institution Letter (FIL)-20-2009, entitled, *Risk Management of Investments in Structured Credit Products* on April 30, 2009. The FIL reiterated and clarified existing supervisory guidance²² to FDIC-supervised institutions regarding the purchase and holding of complex structured credit products, such as CDOs and, according to DSC personnel, focused additional examiner attention on the bank's investment practices during the April 2009 examination. As a result, the April 2009 examination report noted significant concerns about the management and monitoring of the bank's securities and recommended that the bank expand the investment policy to address issues including, but not limited to, investment concentration limits, rating guidelines and procedures for sub-investment grade securities, and due diligence and monitoring.

The January 2010 Consent Order required the bank to review and update its investment policy and procedures to correct weaknesses, including the need for reasonable risk limits and well-defined requirements for documented pre-purchase analysis for CDOs.

Supervisory Response to Brokered Deposits

Examinations from 2005 through 2009 consistently identified the bank's high reliance on brokered deposits as an asset funding source. Access to those funds contributed to the bank's ability to develop and maintain excessive CRE and ADC concentrations and increased the risks to the bank. However, examination reports issued through 2008 generally concluded that Broadway was adequately managing these liabilities. Broadway exhibited potential "red flags" that, according to the Examination Manual, may indicate the need for action to ensure that the risks associated with brokered deposits are managed appropriately. Specifically, examiners at the March 2008 examination identified the following potential red flags.

Deterioration in the general financial condition of the institution. Examiners concluded that the overall condition of the bank was less than satisfactory, with asset quality significantly weakened due to substantial elevated adverse classifications and a need to improve credit risk management practices.

Deterioration in other asset quality indicators. Adversely classified items had increased from \$6.3 million to \$107.9 million, representing a 1,605 percent increase since the 2007 examination. Likewise, the adversely classified coverage ratio increased from 5.6 percent to 71.7 percent of Tier 1 Capital and reserves.

However, despite the bank's significant reliance on noncore funding—with a net-noncore funding dependence ratio of 77 percent and brokered deposits representing 82 percent of total deposits—and the potential red flags listed above, examiners concluded that Broadway's liquidity was adequate at the March 2008 examination. In reaching this conclusion, examiners focused on what they considered to be Broadway's adequate liquidity levels and funds management practices, including the practice of laddering the

²² Primarily the 1998 "Supervisory Policy Statement on Investment Securities and End-User Derivatives Activities" and the "Uniform Agreement on the Classification of Assets and Appraisal of Securities."

maturity dates for the brokered deposits and the bank's CFP. As a result, the September 2008 MOU did not include a provision to address the bank's reliance on brokered deposits. When Broadway became *Undercapitalized* for PCA purposes as a result of the April 2009 examination and could no longer access the brokered deposits market, examiners concluded that the bank's existing funds management practices were in need of immediate attention, and downgraded the Liquidity component rating from "2" to "5".

We noted that between March 2008 and March 2009, brokered deposits increased \$161 million, or 21 percent. Half of this growth occurred in the third quarter of 2008. Examiner concerns regarding the bank's alternative funding sources and liquidity were elevated in the April 2009 examination report. At that time, examiners reported that Broadway's net noncore funding dependence ratio for the prior 3 years had been 77.09 percent, 75.91 percent, and 75.04 percent, respectively. Examiners also concluded that the bank's (1) dependence on noncore liabilities had resulted from Broadway's funding loan growth through increases in brokered deposits and FHLB borrowings and (2) liquidity was inadequate and funds management practices needed improvement. Further, examiners expressed concern regarding Broadway's ability to meet future funding needs, particularly given the extremely high dependence on noncore funding, the substantial decline in alternative funding sources over the prior year, and the weakened financial condition of the bank. In addition, examiners noted that Broadway was subject to restrictions on brokered deposits and the interest rates it could pay on deposits, which eliminated certain funding sources and critically impacted the viability of the institution. In June 2009, the FDIC requested that Broadway provide weekly liquidity monitoring reports due to the decline in Broadway's liquidity position.

Supervisory action to address the bank's brokered deposits was not taken until the bank's capital level became severely impaired and access to brokered deposits was restricted based on Section 337.6 of the FDIC Rules and Regulations. Such a restriction was included in the FDIC's PCA Notice issued in July 2009. In addition, it was determined at that time that Broadway had placed an order for additional brokered deposits. However, at the insistence of the FDIC, the bank canceled the order for those deposits.

The January 2010 visitation determined that although Broadway's liquidity ratio had improved, concern regarding Broadway's ability to raise deposits from local sources was evident. This concern was exacerbated by a decline in the bank's alternate funding sources. Additional supervisory action to address the bank's reliance on brokered deposits was taken in the January 2010 Consent Order, which required Broadway to develop a written plan addressing liquidity, including volatile liabilities and temporary investments.

Timeliness of the April 2009 Examination Report and Related Enforcement Action

The FDIC and the IDFPR could have reviewed, processed, and delivered the IDFPR-led April 2009 examination report and related January 2010 Consent Order to Broadway in a more timely manner. As indicated in Table 9, substantial time elapsed between the completion of the April 2009 examination and the issuance of the examination report and related enforcement action.

Table 9: Supervisory Timeline for the April 2009 Examination of Broadway

Examination Completion Date	Examination Report Issuance Date	Supervisory Rating	Enforcement Action and Effective Date
08/19/2009	12/07/2009	555554/5	Consent Order—effective January 26, 2010

Source: FDIC Virtual Supervisory Information on the Net System and Chicago Regional Office correspondence files.

The FDIC and the IDFPR jointly conducted the April 2009 examination of Broadway and jointly issued the January 2010 Consent Order. The IDFPR was the lead agency for the April 2009 examination and January 2010 Consent Order and, as such, was responsible for the initial drafting and quality control review of the examination report and recommendations as well as the initial draft and review of the Consent Order provisions. The FDIC was responsible for reviewing, and adjusting where necessary, the language of the IDFPR draft examination report and the Consent Order.

According to DSC officials, the deteriorated condition and complexity of Broadway at the April 2009 examination necessitated extensive review of various issues related to: the bank's ALLL methodology; its level of classified assets; the investment portfolio, which required close coordination with FDIC Capital Markets personnel; and transactions for one of Broadway's affiliates. In addition, the timeframes for processing the examination report and issuing the Consent Order were impacted by the complexity of the bank and the identified problems, as well as the need for coordination between the FDIC and the IDFPR.

April 2009 Examination Report. On August 5, 2009, the examination team met with bank management, providing preliminary examination results, and indicated they were recommending a formal enforcement action against Broadway. The examination was completed shortly thereafter, on August 19, 2009 and the examination report was issued December 7, 2009. Therefore, it took the FDIC and the IDFPR 110 days to review, process, and deliver the examination report to Broadway. DSC Chicago officials noted that the examination timeframe was reasonable for a complex bank like Broadway with a composite rating of "5", signifying an extremely high, immediate, or near-term probability of failure, and that problem banks, by nature, take longer to examine.

January 2010 Consent Order. The FDIC and the IDFPR took 160 days from the completion of the examination to issue the Consent Order. Throughout this process, the FDIC maintained close coordination with the regional office's Legal Division and the IDFPR. For example, the FDIC Chicago Legal Division officials received the first draft of the enforcement action on October 6, 2009. On October 27, 2009, the FDIC Legal Division sent a draft recommending changes, including changing the action from a Cease and Desist Order to a Consent Order, to the Counsel for the IDFPR. The IDFPR and the FDIC determined that there was a need to add a provision related to the bank's investment policy portion. The IDFPR provided the proposed provision to the FDIC Legal Division officials on November 17, 2009. The IDFPR had provided a draft of the Consent Order to Broadway for review on December 7, 2009. The FDIC Legal Division

revised the Consent Order to include proper citations for the Financial Accounting Standards Board's recent codification of accounting standards and provided a draft of the revised Consent Order to the IDFPFR on December 11, 2009. The IDFPFR received comments on the draft Consent Order from the bank on January 6, 2010.²³ On January 25, 2010, the IDFPFR and the FDIC presented the Consent Order to Broadway's Board, which signed it on the same day. The Consent Order became effective on January 26, 2010.

Supervisory Lessons Learned

The FDIC has taken a number of actions to address issues discussed in this report based on lessons it has learned from failures during the financial crisis. For example, the FDIC completed a training initiative in March 2010 for its entire supervisory workforce that emphasized the need to assess a bank's risk profile using forward-looking supervision and addressed the need for examiners to consider management practices as well as the financial institution's current financial performance or trends in assigning ratings as allowable under existing examination guidance. In addition, the FDIC has updated or issued new examiner and/or financial institution guidance related to CRE and ADC concentrations, brokered deposits, loan underwriting and credit administration, and investment securities. Further, the training and guidance covered methods for communicating weak management practices to the Board and management and addressed the need for timely examiner follow-up and issuance of enforcement actions.

In addition, the FDIC has established a 2010 annual performance goal to (1) promptly implement appropriate corrective programs for financial institutions rated "3", "4", and "5" or (2) otherwise ensure that significant examiner concerns are presented to a bank's Board and management after examinations are completed. Further, in September 2009, the FDIC issued additional guidance entitled, *Issuing Examination Letters to Troubled Institutions*, to assist in ensuring timely and effective supervisory action for financial institutions newly-rated "3," "4," and "5" and revised the applicable procedures to include banks rated "3" because previous guidance only related to banks rated "4" and "5". The purpose of the guidance is to control new risk at the banks, such as asset growth and changes in funding strategies to increase reliance on noncore funding or high-rate deposits, temporarily insured deposits, or other government-guaranteed debt.

The FDIC also issued guidance related to the use of volatile funding sources by financial institutions that are in a weakened condition. The guidance states that FDIC-supervised institutions, regardless of rating, that engage in aggressive growth strategies or rely excessively on a volatile funding mix are subject to heightened off-site monitoring and onsite examinations that are more extensive than those applicable to other institutions.

²³ FDIC Legal Division officials indicated it is common practice to share a draft enforcement action with the institution.

Implementation of PCA

Section 38, *Prompt Corrective Action*, (PCA) of the FDI Act establishes a framework of mandatory and discretionary supervisory actions pertaining to all institutions. The section requires regulators to take progressively more severe actions, known as “prompt corrective actions,” as an institution’s capital level deteriorates. The purpose of PCA is to resolve problems of insured depository institutions at the least possible long-term cost to the DIF. Part 325, *Capital Maintenance*, (Part 325) of the FDIC Rules and Regulations defines the capital measures used in determining the supervisory actions applicable to FDIC-supervised institutions that are not adequately capitalized. Part 325 establishes procedures for the submission and review of capital restoration plans and for the issuance of directives and orders pursuant to section 38. The FDIC is required to closely monitor the institution’s compliance with its capital restoration plan, mandatory restrictions defined under section 38(e), and discretionary safeguards imposed by the FDIC (if any) to determine if the purposes of PCA are being achieved.

Based on supervisory actions taken, we determined that the FDIC generally implemented applicable provisions of section 38, although the FDIC’s notifications to Broadway regarding the adequacy of its capital restoration plan (CRP) could have been improved. Table 10 illustrates Broadway’s capital ratios relative to PCA capital category thresholds for selected dates from December 2005 through December 2009.

Table 10: Broadway’s Capital Ratios, 2005 to 2009

Period Ended	Tier 1 Leverage Capital	Tier 1 Risk Based Capital	Total Risk Based Capital	PCA Capital Category
Well Capitalized Thresholds				
	5% or more	6% or more	10% or more	
Broadway’s Capital Ratios				
Dec-05	12.20%	13.07%	14.23%	<i>Well Capitalized</i>
Dec-06	12.50%	13.56%	14.70%	<i>Well Capitalized</i>
Dec-07	12.94%	13.87%	15.04%	<i>Well Capitalized</i>
Dec-08	8.70%	9.87%	11.13%	<i>Well Capitalized</i>
Mar-09	5.94%	5.78%	7.06%	<i>Undercapitalized</i>
Dec-09	2.86%	3.27%	4.53%	<i>Significantly Undercapitalized</i>

Source: July 2009 PCA Notification, Broadway Call Reports, and Part 325 of the FDIC Rules and Regulations.

The FDIC’s implementation of PCA resulted in actions by Broadway’s Board and management to pursue options to increase capital. By the time Broadway’s capital levels fell below the required thresholds necessary to implement PCA, the bank’s condition had deteriorated to a point at which the institution was unable to raise additional capital from external parties or to find a suitable acquirer prior to the bank’s failure on April 23, 2010.

On January 30, 2009, Broadway submitted an application for the Troubled Asset Relief Program (TARP) requesting \$33.7 million in funding but did not receive any TARP funds. With respect to PCA provisions, the FDIC determined, as a result of adjustments identified during the April 2009 examination, that Broadway’s capital category had declined and, therefore, the bank was subject to the PCA requirements and restrictions for

institutions that are less than *Adequately Capitalized*. As a result, the following are some of the PCA-related actions taken by the FDIC and Broadway.

July 20, 2009. The FDIC notified Broadway that its capital category had fallen to *Undercapitalized* based on the results of the April 2009 examination. The notice required Broadway to submit a CRP by August 16, 2009 and communicated the mandatory restrictions of section 38 related to restricting asset growth; acquisitions, new activities, and branches; and payment of dividends or any other capital distribution or management fees.

The April 2009 examination adversely classified six Broadway investments, including the CDOs previously discussed in this report. As there was no established market price, the FDIC estimated the decline in value for these securities and reflected 50 percent, or \$11.7 million of this decline as a reduction to Broadway's Tier 1 Capital. Broadway disagreed with the FDIC's valuation adjustment and continued to report higher capital levels in its June 30, 2009 and September 30, 2009 Call Reports. Accordingly, while the FDIC had notified Broadway, and Broadway's Board acknowledged that the bank was *Undercapitalized*, Broadway's Call Reports continued to show capital ratios in the *Adequately Capitalized* range until December 31, 2009.

August 14, 2009. The bank provided a draft proposed strategy for raising capital through the creation of a Limited Liability Company subsidiary to purchase selected loans and other assets of the bank to the FDIC, which the Corporation accepted as a CRP. However, the FDIC concluded it did not constitute a viable plan for improving capital. Part 325.104(c) requires the FDIC to provide written notice within 60 days of receiving a CRP as to whether the plan has been approved. Although a DSC official stated that he orally communicated to Broadway on several occasions that the CRP was unacceptable, he did not provide written notification within 60 days in accordance with Part 325.104(c). However, on or about August 14, 2009, the FDIC notified the bank that the revised due date for the CRP was September 3, 2009. Broadway Board minutes state that a CRP was filed with the FDIC on September 3, 2009. However, FDIC personnel indicated that the FDIC never received that plan.

November 18, 2009. The FDIC drafted a letter, which was never issued, to inform Broadway that because of its failure to submit an acceptable CRP on September 3, 2009, the bank was subject to the restrictions applicable to *Significantly Undercapitalized* institutions.²⁴ The draft letter also noted that Broadway had not submitted documentation regarding specific steps taken to comply with the mandatory restrictions under section 38, as requested in the July 20, 2009 letter notifying the bank of its *Undercapitalized* position. Further, the draft letter (1) explained the additional restrictions related to executive compensation, affiliate transactions, interest rates paid on deposits, and the

²⁴ Per FDIC Rules and Regulations § 325.104(e) *Failure to submit capital restoration plan*, a bank that is *Undercapitalized* (as defined in § 325.103(b)) and that fails to submit a written capital restoration plan within the period provided in this section shall, upon the expiration of that period, be subject to all of the provisions of section 38 and § 325.104 applicable to *Significantly Undercapitalized* institutions.

requirement to recapitalize or sell Broadway and (2) discussed Call Reporting inaccuracies and the FDIC's authority to assess civil money penalties for the bank's failure to provide an acceptable CRP and to file accurate Call Reports.

DSC officials stated that the FDIC was already monitoring Broadway as if it were *Significantly Undercapitalized*. For example, the FDIC had already placed limits on the bank's use of brokered deposits and was monitoring Broadway's executive compensation practice, and Broadway had no transactions with affiliates. In addition, according to DSC officials, the draft letter was not sent to Broadway because (1) the examination report used to justify the bank's *Undercapitalized* PCA category was still in draft and the region was working with the FDIC Capital Markets group to determine the value of the bank's classified investments; and (2) the formal enforcement action that would broadly address all of the issues at Broadway, including capital requirements, was still being drafted.

Although not required, it would have been prudent for the FDIC to issue this letter to Broadway because, at that time, as noted in the draft letter, Broadway had neither (1) submitted an acceptable CRP nor (2) provided documentation regarding the bank's compliance with the mandatory restrictions associated with its *Undercapitalized* position.

February 4, 2010. The FDIC notified Broadway that it was *Significantly Undercapitalized*, as of December 31, 2009. The bank provided a PCA compliance summary on February 19, 2010, as required by the notification.

March 17, 2010. The bank submitted a CRP. However, the FDIC informed Broadway on March 31, 2010 that the CRP was not acceptable because it did not meet regulatory requirements and was too vague. The FDIC requested a revised plan by April 16, 2010. Although Broadway provided additional details regarding its efforts to increase capital, the bank did not provide a revised CRP.

April 19, 2010. The FDIC issued a Supervisory PCA Directive due to the need for an immediate capital infusion and the lack of a viable CRP. Although the need for a PCA Directive was mitigated by the capital-related provisions in the Consent Order, DSC management indicated that the directive was prepared to emphasize the severity of the bank's condition and the importance of increasing capital.

Ultimately, Broadway was unsuccessful in efforts to raise capital and was closed by the IDFP on April 23, 2010.

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 November 12, 2010, the Director, Division of Supervision and Consumer Protection (DSC), provided a written response to the draft report. That response is provided in its entirety as Appendix 4 of this report.

DSC reiterated the OIG's conclusions regarding the causes of Broadway's failure. With regard to our assessment of the FDIC's supervision of Broadway, DSC stated that from 2005 through February 2010, the IDFP and the FDIC jointly and separately conducted five examinations and three visitations, along with offsite monitoring activities. In addition, DSC stated that the 2008 FDIC examination found significant loan portfolio deterioration and identified the heightened risk profile of the bank. As a result, the FDIC and IDFP downgraded Broadway to a composite "3" rating and issued a joint MOU. Further, DSC stated that the 2009 examination concluded that significant concentrations in CRE, specifically out-of-territory lending in areas where the real estate markets had severely deteriorated, led to rapid and material asset quality deterioration. Consequently, the FDIC and IDFP downgraded Broadway to a composite "5" rating and issued a joint Consent Order. In addition, DSC stated that it has issued guidance to enhance supervision of institutions, such as Broadway, with concentrated CRE and ADC lending and reliance on volatile noncore funding.

Objectives, Scope, and Methodology

Objectives

We performed this audit in accordance with section 38(k) of the FDI Act, as amended by the Financial Reform Act, which provides, in general, that if the Deposit Insurance Fund incurs a material loss with respect to an insured depository institution, the Inspector General of the appropriate federal banking agency shall prepare a report to that agency reviewing the agency's supervision of the institution. The Financial Reform Act amends section 38(k) by increasing the MLR threshold from \$25 million to \$200 million for losses that occur for the period January 1, 2010 through December 31, 2011. The FDI Act requires that the report be completed within 6 months after it becomes apparent that a material loss has been incurred.

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

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

Scope and Methodology

The scope of this audit included an analysis of Broadway's operations from December 2004 until its failure on April 23, 2010. Our review also entailed an evaluation of the regulatory supervision of the institution over the same period.

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

- Analyzed examination and visitation reports prepared by the FDIC and the IDFPR examiners from January 2005 to April 2010.
- Reviewed the following:
 - Documentation related to Broadway's acquisition by Broadway Bancorp, Inc. in June 2007.
 - Available FDIC examination work papers and correspondence maintained at DSC's Chicago Regional Office and Chicago Field Office in Illinois.

Objectives, Scope, and Methodology

- Available IDFPR examination work papers maintained at the IDFPR office in Chicago, Illinois.
- Reports prepared by the Division of Resolutions and Receiverships (DRR) and DSC relating to the bank's closure.
- Selected bank records maintained by DRR in Irvine, California for information that would provide insight into the bank's failure.
- Audit reports prepared by the bank's external auditors.
- Pertinent DSC policies and procedures and various banking laws and regulations.
- Actions that DSC implemented to comply with (1) provisions of section 29 of the FDI Act and FDIC Rules and Regulations, Part 337, *Unsafe and Unsound Banking Practices* restricting Broadway's use of brokered deposits; and (2) section 38 of the FDI Act, including, but not limited to, issuing PCA notification letters restricting Broadway's growth and payment of dividends, when applicable, based on the bank's capital category.
- Interviewed the following FDIC officials:
 - DSC management in the Chicago Regional Office.
 - FDIC examiners from the DSC Chicago Field Office who participated in examinations or reviews of examinations of Broadway.
 - DRR officials at the FDIC Dallas Regional Office and Irvine, California Service Center.
- Met with officials from the IDFPR to discuss the historical perspective of the institution, its examinations, and other activities regarding the state's supervision of the bank.
- We engaged KPMG to perform audit procedures designed to assess the bank's credit risk management practices and use of brokered deposits, as well as to assess the FDIC's supervisory response to risks in those areas. As a part of its audit work, KPMG reviewed a non-statistical sample of 10 borrower relationships to determine if the FDIC had reviewed and classified borrower loans as appropriate. Specifically, KPMG reviewed the examination report loan write-up, loan line sheet, and other loan-related documentation and any relevant loan records that may have been retained by DRR and determined for the sampled loans whether:

Objectives, Scope, and Methodology

- o the examiners adequately assessed their collectability and assigned a classification to the loans, when appropriate;
- o any impairment calculated by the examiners was properly reflected in the examiners' ALLL analysis;
- o any loan underwriting or credit administration weaknesses identified were consistent with the credit risk management weaknesses and conclusions documented in the examination report; and
- o Broadway management identified losses for each loan within the sample (and related Other Real Estate) and reflected those losses in the bank's ALLL analysis in a timely manner.

KPMG conducted its work in accordance with GAGAS.

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 FDIC systems, examination and other reports, and interviews of examiners to understand Broadway's management controls pertaining to causes of failure and material loss as discussed in the body of this report.

We obtained data from various FDIC systems but determined that information system controls were not significant to the audit objectives and, therefore, did not evaluate the effectiveness of information system controls. We relied on our analysis of information from various sources, including examination and other reports, correspondence files, and testimonial evidence to corroborate data obtained from systems that were used to support our audit conclusions.

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

Regarding compliance with laws and regulations, we performed tests to determine whether the FDIC had complied with provisions of PCA and limited tests to determine compliance with certain aspects of the FDI Act. The results of our tests were discussed, where appropriate, in the report. In that regard, although not consequential to the overall supervision of the institution, we note on page 30 that the FDIC did not meet the

Objectives, Scope, and Methodology

requirement of FDIC Rules and Regulations Part 325 Subpart B §325.104(c) *Review of capital restoration plans*, which states “Within 60 days after receiving a capital restoration plan under this subpart, the FDIC shall provide written notice to the bank of whether the plan has been approved.”

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 comprehensive 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 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 comprehensive 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.

In August 2010, the OIG issued a report entitled *Evaluation of the Timeliness and Factors Considered in Closing Broadway Bank, Chicago, Illinois*. The overall objective of the evaluation was to review the timeliness and factors considered in closing Broadway. Specifically, the evaluation reviewed:

- the timeline of events leading to the closing of the bank and the factors that the FDIC considered in scheduling the bank closing,
- whether the timing of the closing of Broadway was consistent with PCA provisions, and
- whether there was any indication of political or inappropriate influence associated with the closing.

Glossary of Terms

Term	Definition
Acquisition, Development, and Construction (ADC) Loans	ADC loans are a component of Commercial Real Estate loans that provide funding for acquiring and developing land for future construction, and providing interim construction 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.
Affiliate	Under section 23A of the Federal Reserve Act (12 U.S.C. section 371c), an affiliate generally includes, among other things, a bank subsidiary, or a company that (1) controls the bank and any other company that is controlled by the company that controls the bank, (2) is sponsored and advised on a contractual basis by the bank, or (3) is controlled by or for the benefit of shareholders who control the bank or in which a majority of directors hold similar positions in the bank.
Allowance for Loan and Lease Losses (ALLL)	The ALLL is an estimate of uncollectible amounts that is used to reduce the book value of loans and leases to the amount that is expected to be collected. It is established in recognition that some loans in the institution's overall loan and lease portfolio will not be repaid. Boards of directors are responsible for ensuring that their institutions have controls in place to consistently determine the allowance in accordance with the institutions' stated policies and procedures, generally accepted accounting principles, and supervisory guidance.
Bank Board Resolution (BBR)	A Bank Board Resolution is an informal commitment adopted by a financial institution's Board of Directors (often at the request of the FDIC) directing the institution's personnel to take corrective action regarding specific noted deficiencies. A BBR may also be used as a tool to strengthen and monitor the institution's progress with regard to a particular component rating or activity.
Call Report	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.

Glossary of Terms

Term	Definition
Collateralized Debt Obligation (CDO)	General terminology for a broad range of structured finance products. CDOs are similar to collateralized mortgage obligations and asset-backed securities in that they are securitized investments that are subdivided into tiers or tranches, and are backed by an underlying collateral pool. Unlike collateralized mortgage obligations and asset-backed securities, the CDO collateral pool can contain a wide variety of less than homogeneous assets. Essentially, CDOs reallocate the risk of the underlying collateral pool to investors based on their risk tolerance levels and investment return objectives. CDOs are most commonly issued by commercial banks, insurance companies, money managers, and investment banks.
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.
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.
Consent Order	A Consent Order is a cease and desist order that is entered into and becomes final through the board of directors' execution, on behalf of the bank, of a stipulation and consent document. Its provisions are set out in article-by-article form, and it prescribes restrictions and remedial measures necessary to correct deficiencies or violations in the bank in order to return it to a safe and sound condition.
Contingency Funding (or Liquidity) Plan (CFP)	A written plan that defines strategies for addressing liquidity shortfalls in emergency situations. Such plans delineate policies to manage a range of stress environments, establish clear lines of responsibility, and articulate clear implementation and escalation procedures. Contingency funding plans should be regularly tested and updated to ensure that they are operationally sound. DSC uses the term contingency funding plan and contingency liquidity plan interchangeably.
Credit Rating	An indicator of the credit risk of one or more securities assigned by a nationally recognized statistical rating organization, such as Moody's Investors Service, Standard & Poor's Corporation, or Fitch Investors Service. In general, a credit rating of AA indicates that the underlying obligator has a very strong capacity to meet its financial commitments, but not as strong as the highest rating of AAA.

Glossary of Terms

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Credit Ratings Agency	A credit ratings agency is any person engaged in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee by employing either a quantitative or qualitative model, or both, to determine credit ratings; and receiving fees from either issuers, investors, or other market participants, or a combination thereof. These include nationally recognized rating organizations such as AM Best Company, DBRS Ltd., Fitch, Inc., Moody's Investors Service, Inc., Ratings and Investment Information, Inc. and Standard and Poor's Rating Services.
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.
Global Cash Flow Analysis	A global cash flow analysis is a comprehensive evaluation of borrower capacity to perform on a loan. During underwriting, proper global cash flow must thoroughly analyze projected cash flow and guarantor support. Beyond the individual loan, global cash flow must consider all other relevant factors, including: guarantor's related debt at other financial institutions, future economic conditions, as well as obtaining current and complete operating statements of all related entities. In addition, global cash flow analysis should be routinely conducted as a part of credit administration. The extent and frequency of global cash flow analysis should be commensurate to the amount of risk associated with the particular loan.
Growth Monitoring System (GMS)	GMS is an offsite rating tool that identifies institutions experiencing rapid growth or having a funding structure highly dependent on non-core funding sources.
Investment Grade	Investment grade generally means a security that is rated in one of the four highest rating categories by (1) two or more nationally recognized statistical rating organizations (NRSRO) or (2) one NRSRO if the security has been rated by only one NRSRO. In many instances, a security must be "investment grade" to be a permissible investment for a national bank.
Material Loss	As defined by section 38(k)(2)(B) of the FDI Act, as amended by the Financial Reform Act, a material loss is any estimated loss in excess of \$200 million, if the loss occurs during the period beginning on January 1, 2010, and ending on December 31, 2011.

Glossary of Terms

Term	Definition
Memorandum of Understanding (MOU)	A Memorandum of Understanding is an informal agreement between the institution and the FDIC, which is signed by both parties. The State Authority may also be a party to the agreement. MOUs are designed to address and correct identified weaknesses in an institution's condition.
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.
Other Than Temporary Impairment (OTTI)	An impairment of a debt instrument occurs when the fair value of the security is less than its amortized cost basis. According to accounting standards, when the impairment is judged to be other than temporary, the cost basis of the individual security must be written down to fair value, thereby establishing a new cost basis for the security and the amount of the write-down must be included in earnings as a realized loss.
Prompt Corrective Action (PCA)	<p>The purpose of PCA is to resolve the problems of insured depository institutions at the least possible long-term cost to the Deposit Insurance Fund. Part 325, subpart B, of the FDIC Rules and Regulations, 12 Code of Federal Regulations, section 325.101, et. seq., implements section 38, <i>Prompt Corrective Action</i>, 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.</p> <p>A PCA Directive is a formal enforcement action seeking corrective action or compliance with the PCA statute with respect to an institution that falls within any of the three categories of undercapitalized institutions.</p>
Statistical CAMELS Offsite Rating (SCOR) System	SCOR is a financial model that uses statistical techniques, offsite data, and historical examination results to measure the likelihood that an institution will receive a CAMELS downgrade at the next examination.

Glossary of Terms

Term	Definition
Tier 1 (Core) Capital	<p>Defined in Part 325 of the FDIC Rules and Regulations, 12 C.F.R. section 325.2(v), as</p> <p>The sum of:</p> <ul style="list-style-type: none"> • Common stockholder’s equity (common stock and related surplus, undivided profits, disclosed capital reserves, foreign currency translation adjustments, less net unrealized losses on available-for-sale securities with readily determinable market values); • Non-cumulative perpetual preferred stock; and • Minority interest in consolidated subsidiaries; <p>Minus:</p> <ul style="list-style-type: none"> • Certain intangible assets; • Identified losses; • Investments in securities subsidiaries subject to section 337.4; and • Deferred tax assets in excess of the limit set forth in section 325.5(g).
Tranches	<p>Multiple classes of equity and debt that are set in a senior or subordinate position to one another based upon seniority in bankruptcy and timing of repayment. The tranches are divided into three general categories: (1) Senior tranche; (2) Mezzanine tranche; and (3) Equity tranche.</p>
Troubled Asset Relief Program (TARP)	<p>TARP was established under the Emergency Economic Stabilization Act of 2008, which established the Office of Financial Stability within the Department of the Treasury. Under TARP, Treasury will purchase up to \$250 billion of preferred shares from qualifying institutions as part of the Capital Purchase Program.</p>
Uniform Bank Performance Report (UBPR)	<p>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.</p>
Uniform Financial Institutions Rating System (UFIRS)	<p>Financial institution regulators and examiners use the Uniform Financial Institutions Rating System (UFIRS) to evaluate a bank’s performance in six components represented by the CAMELS acronym: Capital adequacy, Asset quality, Management practices, Earnings performance, Liquidity position, and Sensitivity to market risk. Each component, and an overall composite score, is assigned a rating of 1 through 5, with 1 having the least regulatory concern and 5 having the greatest concern.</p>

Acronyms

ADC	Acquisition, Development, and Construction
ALLL	Allowance for Loan and Lease Losses
BBR	Bank Board Resolution
CAMELS	<u>C</u> apital, <u>A</u> sset Quality, <u>M</u> anagement, <u>E</u> arnings, <u>L</u> iquidity and <u>S</u> ensitivity to Market Risk
CDO	Collateralized Debt Obligation
CFP	Contingency Funding Plan
CRE	Commercial Real Estate
CRP	Capital Restoration Plan
DIF	Deposit Insurance Fund
DRR	Division of Resolutions and Receiverships
DSC	Division of Supervision and Consumer Protection
FDI	Federal Deposit Insurance
FFIEC	Federal Financial Institutions Examination Council
FIL	Financial Institution Letter
GAGAS	Generally Accepted Government Auditing Standards
GMS	Growth Monitoring System
IDFPR	Illinois Department of Financial and Professional Regulation
MOU	Memorandum of Understanding
OIG	Office of Inspector General
PCA	Prompt Corrective Action
REST	Real Estate Stress Test
SCOR	Statistical CAMELS Offsite Rating
TARP	Troubled Asset Relief Program
UBPR	Uniform Bank Performance Report
UFIRS	Uniform Financial Institutions Rating System

Corporation Comments



Federal Deposit Insurance Corporation

550 17th Street NW, Washington, D.C. 20429-9990

Division of Supervision and Consumer Protection

November 12, 2010

TO: Stephen Beard
Assistant Inspector General for Material Loss Reviews

FROM: /Signed/
Sandra L. Thompson [signed by Victor J. Valdez for Sandra L. Thompson]
Director

SUBJECT: FDIC Response to the Draft Audit Report Entitled, Material Loss Review of Broadway Bank, Chicago, Illinois (Assignment No. 2010-060)

Pursuant to Section 38(k) of the Federal Deposit Insurance Act, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Federal Deposit Insurance Corporation's Office of Inspector General (OIG) conducted a material loss review of the failure of Broadway Bank (Broadway), Chicago, Illinois, which failed on April 23, 2010. This memorandum is the response of the Division of Supervision and Consumer Protection (DSC) to the OIG's Draft Report (Report) received on October 22, 2010.

Broadway failed primarily because the Board and management pursued an aggressive growth strategy focused on commercial real estate (CRE) and acquisition, development, and construction (ADC) lending without implementing adequate credit risk management practices. Broadway's CRE and ADC concentrations were exacerbated by the bank's significant emphasis on out-of-territory lending in Florida and New York. Furthermore, bank management increasingly relied on brokered deposits to fund loan growth. Significant losses ultimately depleted earnings and eroded capital.

From 2005 through February 2010, the Illinois Department of Financial and Profession Regulations (IDFPR) and the FDIC jointly and separately conducted five examinations and three visitations, along with offsite monitoring activities. The 2008 FDIC examination found significant loan portfolio deterioration and identified the heightened risk profile of the bank. As a result, Broadway was downgraded to a composite "3" rating and a joint Memorandum of Understanding (MOU) was issued. The 2009 examination concluded that significant concentrations in CRE, specifically out-of-territory lending in areas where the real estate markets had severely deteriorated, led to rapid and material asset quality deterioration. Broadway was downgraded to a composite "5" rating and a joint Consent Order was issued.

DSC has issued guidance to enhance our supervision of institutions, such as Broadway, with concentrated CRE/ADC lending and reliance on volatile non-core funding. A Financial Institution Letter (FIL) on *Managing Commercial Real Estate Concentrations in a Challenging Environment* was issued in 2008 that re-emphasizes the importance of robust credit risk-management practices and sets forth broad supervisory expectations. Additionally, DSC issued a FIL in 2009 on *The Use of Volatile or Special Funding Sources by Financial Institutions That are in a Weakened Condition*.

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